Cornerstone Financial Corp
Form 10-Q
May 11, 2012

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2012

-OR-

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

For the transition period from ___________ to _____________.

CORNERSTONE FINANCIAL CORPORATION

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

New Jersey	80-0282551
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

6000 Midlantic Drive, Suite 120 S, Mount Laurel, New Jersey	08054
(Address of principal executive offices)	Zip Code

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

Securities registered pursuant to Section 12(b) of the Act: None

(Title of Class)

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

Common stock, no par value

(Title of Class)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer", and "smaller reporting company" in rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer [ ] Accelerated filer [ ]

Non-accelerated filer [ ] Smaller reporting company [X]

(Do not check if a smaller reporting company)

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

As of May 11, 2012, there were 1,954,302 outstanding shares of the registrant's Common stock.

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CORNERSTONE FINANCIAL CORPORATION

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CORNERSTONE FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(In thousands, except share data)	31-Mar-12	31-Dec-11
	(Unaudited)	
Assets:		
Cash and due from banks	$5,736	$5,039
Federal funds sold	36,500	32,800
Cash and cash equivalents	42,236	37,839
Investment securities:		
Available for sale (amortized cost 2012- $87,008; 2011 - $83,232)	86,608	83,727
Loans receivable	234,316	241,917
Less allowance for loan losses	6,425	4,995
Loans receivable, net	$227,891	$236,922
Federal Home Loan Bank stock	763	1,438
Premises and equipment, net	7,912	7,710
Accrued interest receivable	1,768	1,577
Bank owned life insurance	6,257	6,206
Deferred taxes	2,128	1,233
Other real estate owned	6,062	5,262
Other assets	1,559	1,871
Total Assets	$383,184	$383,785
Liabilities:		
Non-interest bearing deposits	38,001	29,963
Interest bearing deposits	204,238	201,066
Certificates of deposit	99,634	99,279
Total deposits	341,873	330,308
Advances from the Federal Home Loan Bank	10,000	25,000
Line of credit	5,000	5,000
Subordinated debt	3,000	3,000
Other liabilities	1,178	1,410
Unsettled Investment Security payable	4,000	-
Total Liabilities	365,051	364,718
Stockholders’ Equity:		

Preferred Stock Series A: $0 par value; $1,000 per share stated value, authorized 1,000,000 shares; issued and outstanding 1,900 at March 31, 2012 and December 31, 2011, respectively.	1,900	1,900
Preferred Stock Series B: $0 par value; $20 per share stated value, authorized 10,000 shares; issued and outstanding 10,000 at March31, 2012 and December 31, 2011, respectively.	200	200
Common stock:		
$0 par value: authorized 10,000,000 shares; issued and outstanding 1,954,302 at March,31, 2012 and December 31, 2011, respectively	-	-
Additional paid-in capital	17,770	17,735
Accumulated other comprehensive (loss) income	(240)	297
Retained deficit	(1,497)	(1,065)
Total Shareholders’ Equity	18,133	19,067
Total Liabilities and Shareholders’ Equity	$383,184	$383,785

See accompanying notes to consolidate financial statements

CORNERSTONE FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

Three Months Ended

(In thousands, except per share data)	March 31, 2012 (Unaudited)	March 31, 2011 (Unaudited)
Interest Income		
Interest and fees on loans	$ 3,183	$ 3,385
Interest on investment securities	784	886
Interest on federal funds	4	3
Total interest income	3,971	4,274
Interest Expense		
Interest on deposits	717	905
Interest on borrowings	121	176
Total interest expense	838	1,081
Net interest income	3,133	3,193
Provision for loan losses	1,403	953
Net interest income after loan loss provision	1,730	2,240
Non-Interest Income		
Service charges on deposit accounts	36	43
Bank owned life insurance income	51	40
Gain on sale of loans	82	156
Miscellaneous fee income	94	54
Total non-interest income	263	293
Non-Interest Expense		
Salaries and employee benefits	1,503	1,377
Net occupancy	388	367
Data processing and other service costs	129	119
Professional services	219	158
Advertising and promotion	43	37
Other real estate owned expense	49	29
FDIC expense	115	133
Other operating expenses	219	148
Total non-interest expense	2,665	2,368
(Loss) income before income taxes	(672)	165
Income tax (benefit) expense	(277)	56

Net (Loss) income	(395)	109
Preferred stock dividends	37	33
Net (loss) income available to common shareholders		
	$ (432)	$ 76
Earnings (loss) per share		
Basic	$ (0.22)	$ 0.04
Diluted	$ (0.22)	$ 0.04
Weighted average shares outstanding		
Basic	1,954	1,954
Diluted	1,954	1,962

See accompanying notes to consolidate financial statements

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CORNERSTONE FINANCIAL CORPORATION

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Three Months Ended		
(In thousands, except per share data)	March 31, 2012 (Unaudited)	March 31, 2011 (Unaudited)
Net (loss) income	$ (395)	$ 109
Other Comprehensive (loss) income, net of tax		
unrealized loss arising from available for sale securities during period	$ (537)	$ 87
Comprehensive (loss) income	$ (932)	$ 196

See accompanying notes to consolidate financial statements

Weighted average shares outstanding

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CORNERSTONE FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(Unaudited)

(In thousands, except per share data)

	Preferred Stock Series A	Preferred Stock Series B	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive (Loss) income	Accumulated Earnings (Deficit)	Total
Balance at Januray1, 2012	$ 1,900	$ 200	$ -	$ 17,735	$ 297	$ (1,065)	$ 19,067
Net loss	-	-	-	-	-	(395)	(395)
Unrealized loss on securities available for sale, net of tax	-	-	-	-	(537)	-	(537)
Stock based compensation	-	-	-	35	-	-	35
Preferred stock dividend payment	-	-	-	-	-	(37)	(37)
Balance at March 31, 2012	$ 1,900	$ 200	$ -	$ 17,770	$ (240)	$ (1,497)	$ 18,133

	Preferred Stock Series A	Preferred Stock Series B	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive (Loss)	Accumulated Earnings	Total

Balance at							
January 1, 2011	$ 1,900 $	-$	- $	16,727	$ (1,988) $	1,109	$ 17,748
Net income	-	-	-	-	-	109	109
Unrealized gain on securities available for sale, net of tax	-	-	-	-	87	-	87
Stock based compensation	-	-	-	35	-	-	35
Declaration of 8% Common Stock Dividend (1)	-	-	-	869	-	(869)	-
Preferred stock dividend payment	-	-	-	-	-	(33)	(33)
Balance at							
March 31, 2011	$ 1,900 $	-$	- $	17,631	$ (1,901) $	316	$ 17,946

(1) An 8.0% common stock dividend, declared on March 17, 2011 and payable on May 16, 2011 to common shareholders of record as of April 15, 2011 resulted in the issuance of 144,772

additional shares and resulted in $869 thousand being transferred from retained earnings to additional paid in capital.

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CORNERSTONE FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

Three Months Ended

(In thousands)	March 31, 2012 (Unaudited)	March 31, 2011 (Unaudited)
Cash flows from operating activities:		
Net (loss) Income	$ (395)	$ 109
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,403	953
Depreciation	113	108
Amortization of premiums and discounts, net	7	9
Stock option expense	35	35
Gain on sale of loans	(82)	(156)
Deferred tax (benefit) expense	(537)	394
(Increase) in other real estate owned	(800)	-
Income on bank owned life Insurance	(51)	(40)
Decrease, net in accrued interest receivable and other assets	121	11
(Decrease) increase in other liabilities	(232)	25
Net cash (used) provided by operating activities	(418)	1,448
Cash flows from investing activities:		
Purchases of securities available for sale	(18,500)	-
Repayment of investments available for sale	18,717	-
Repayment of investments held to maturity	-	267
Redemption of FHLB stock	675	-
Net decrease in loans	7,710	3,193
Purchases of premises and equipment	(315)	(75)
Net cash provided in investing activities	8,287	3,385
Cash flows from financing activities:		
Net increase in deposits	11,565	1,903
Proceeds from borrowings	-	52
Principal payments on advance from the FHLB	(15,000)	-
Cash dividend paid on preferred stock	(37)	(33)
Net cash (used) provided by financing activities	(3,472)	1,922

Net increase in cash and cash equivalents		4,397		6,755
Cash and cash equivalents at the beginning of the period		37,839		9,031
Cash and cash equivalents at the end of the period		$ 42,236	$ 15,786	
Supplemental disclosures of cash flow information:				
Cash paid during the period for interest	$ 870		$ 1,066	
Cash paid during the period for income taxes		2		96
Net change in unrealized (loss) gain on securities, net of tax		(537)		87
Supplemental non-cash investing and financing activities:				
Unsettled securities payable	$ 4,000		-	$

See accompanying notes to consolidated financial statements.

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CORNERSTONE FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

NOTE 1 - BASIS OF PRESENTATION AND BUSINESS UPDATE

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

Cornerstone Financial Corporation was formed in 2008 at the direction of the Board of Directors of Cornerstone Bank to serve as a holding company for the Bank. The holding company reorganization was completed in January 2009. The statement of financial condition as of December 31, 2011 has been derived from audited financial statements. For further information, refer to the consolidated financial statements and footnotes thereto included in Cornerstone Financial Corporation’s Annual Report on Form 10-K for the year ended December 31, 2011 as filed with the United States Securities and Exchange Commission.

During the past two years, many of our borrowers have been adversely affected by the recession of 2008 and the subsequent slow economic recovery. As a result, we have experienced elevated levels of non-performing assets, which have continued to increase through the first quarter of 2012. Our primary focus has turned toward managing our credit quality and capital levels while continuing to meet the credit needs of the communities served by our branches. We expect that we will not continue our historical rate of growth until the economy strengthens and our non-performing assets have returned to more normalized levels.

The Company has certain cash requirements that are independent of the Bank, such as paying certain operating expenses and dividends on outstanding preferred stock. Historically, the Company has obtained funds through dividends paid by the Bank. At March 31, 2012, the Company had unconsolidated assets of $112 thousand (exclusive of its investment in the Bank), consisting of $101 thousand in cash and $11 thousand in prepaid assets. If the Bank is unable to pay dividends to the Company, this may result in the Company’s inability to meet certain of its cash obligations.

NOTE 2 – USE OF ESTIMATES

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near-term relate to the allowance for loan losses and the evaluation of deferred taxes.

NOTE 3 - CONTINGENCIES

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

NOTE 4 - EARNINGS PER SHARE

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

NOTE 5 – STOCK OPTIONS

The Company accounts for stock options in accordance with FASB Accounting Standards Codification (ASC) 718 *Stock Compensation*. The Company recognizes the grant-date fair-value of stock options and other equity-based compensation issued to employees in the statement of operations. The Company had $89 thousand in unrecognized compensation costs relating to non-vested stock based compensation awards at March 31, 2012.

No stock options were granted during 2011 or during the three month period ended March 31, 2012.

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NOTE 6 - INVESTMENT SECURITIES

A comparison of amortized cost and approximate fair value of investment securities held to maturity at March 31, 2012 and December 31, 2011 is as follows (in thousands):

	March 31, 2012			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Investments available for sale:				
Government agency obligations	$ 87,008	$ 137	$ (537)	$ 86,608
Total	$ 87,008	$ 137	$ (537)	$ 86,608

	December 31, 2011			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Investments available for sale:				
Government agency obligations	$ 83,232	$ 495	$ -	$ 83,727
Total	$ 83,232	$ 495	$ -	$ 83,727

The following table sets forth information regarding the fair value and unrealized losses on the Company's temporarily impaired investment securities at March 31, 2012 and December 31, 2011 for the time periods shown (in thousands):

	March 31, 2012					
	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses

	Losses					
Investments available for sale:						
Government agency obligations	$ 50,716	$ (537)	$ -	$ -	$ 50,716	$ (537)
Total temporarily impaired investment securities	$ 50,716	$ (537)	$ -	$ -	$ 50,716	$ (537)

The Company had no unrealized losses on temporarily impaired investment securities at December 31, 2011.

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

Other Comprehensive Income (Loss)

The change in other comprehensive income (loss) components and related tax benefit are as follows for the three months ended March 31, 2012 and March 31, 2011 (In thousands):

	March 31,		
		2012	
Unrealized (loss) on securities available for sale:	Before-Tax Amount	Tax Benefit	Net-of-Tax Amount
Unrealized holding (loss) arising during the year	$ (895)	$ 358	$ (537)
Other comprehensive (loss)	$ (895)	$ 358	$ (537)

	March 31,		
		2011	
Unrealized gain on securities available for sale:	Before-Tax Amount	Tax Benefit	Net-of-Tax Amount
Unrealized holding gain arising during the year	$ 144	$ (57)	$ 87
Other comprehensive income	$ 144	$ (57)	$ 87

NOTE 7 – LOANS RECEIVABLE

The Company monitors and assesses the credit risk of its loan portfolio using the classes set forth below. These classes also represent the segments by which the Company estimates its allowance for loan losses.

Commercial loans include short and long-term business loans and commercial lines of credit for the purposes of providing working capital, supporting accounts receivable, purchasing inventory and acquiring fixed assets. The loans generally are secured by these types of assets as collateral and/or by personal guarantees provided by principals of the borrowers.

Commercial real estate loans are generally originated in amounts up to the lower of 75% of the appraised value or cost of the property and are secured by improved property such as multi-family dwelling units, office buildings, retail stores, ware–houses, church buildings and other non-residential buildings, most of which are located in the Company’s market area. Commercial real estate loans are generally made with fixed interest rates which mature or reprice in five to seven years with principal amortization of up to 25 years.

Residential real estate loans consist of loans secured by one- to four-family residences located in the Company’s market area. The Bank has originated one- to four-family residential mortgage loans in amounts up to 80% of the lesser of the appraised value or selling price of the mortgaged property without requiring mortgage insurance. A mortgage loan originated by the Bank, for owner occupied property, whether fixed rate or adjustable rate, can have a term of up to 30 years.

Loans secured by non-owner occupied property, whether fixed rate or adjustable rate, can have a term of up to 25 years. Adjustable rate loan terms limit the periodic interest rate adjustment and the minimum and maximum rates that may be charged over the term of the loan based on the type of loan.

Construction loans will be made only if there is a permanent mortgage commitment in place. Interest rates on commercial construction loans are typically in line with normal commercial mortgage loan rates, while interest rates on residential construction loans are slightly higher than normal residential mortgage loan rates. These loans usually are adjustable rate loans and generally have terms of up to one year.

Consumer loans include installment loans and home equity loans, secured by first or second mortgages on homes owned or being purchased by the loan applicant. Home equity term loans and credit lines are credit accommodations secured by either a first or second mortgage on the borrower's residential property.

Interest rates charged on home equity term loans are generally fixed; interest on credit lines is usually a floating rate related to the prime rate. The Bank generally requires a loan to value ratio of less than or equal to 80% of the appraised value, including any outstanding prior mortgage balance.

Loans receivable consist of the following (in thousands):

	March 31, 2012	December 31, 2011
Commercial	$ 94,128	$ 97,783
Real estate, Commercial	115,289	116,079
Real estate, Residential	7,247	8,976
Construction	10,952	12,108
Consumer	6,985	7,245
Net deferred loan fees	(285)	(274)
	234,316	241,917
Allowance for loan losses	(6,425)	(4,995)
Loans receivable, net	$ 227,891	$ 236,922

Under New Jersey banking laws, the Bank is subject to a loans-to-one-borrower limitation of 15% of capital funds for most loans. At March 31, 2012, the loans-to-one-borrower limitation was approximately $4.9 million; this excludes an additional 10% of capital funds, or approximately $3.2 million which may be loaned if collateralized by readily marketable securities. At March 31, 2012, there were no loans outstanding or committed to any one borrower which individually or in the aggregate exceeded the Bank's loans-to-one-borrower limitation of 15% of capital funds.

A summary of the Company's credit quality indicators is as follow:

Pass - A credit which is assigned a rating of Pass shall exhibit some or all of the following characteristics:

a. Loans that present an acceptable degree of risk associated with the financing being considered as measured against earnings and balance sheet trends, industry averages, etc. Actual and projected indicators and market conditions provide satisfactory evidence that the credit will perform as agreed.

b. Loans to borrowers that display acceptable financial conditions and operating results. Debt service capacity is demonstrated and future prospects are considered good.

c. Loans to borrowers where a comfort level is achieved by the strength of the cash flows from the business or project and the strength and quantity of the collateral or security position (i.e.: receivables, inventory and other readily marketable securities) as supported by a current valuation and/or the strong capabilities of a guarantor.

Special Mention **-** Loans on which the credit risk requires more than ordinary attention by the Loan Officer. This may be the result of some erosion in the borrower's financial condition, the economics of the industry, the capability of management, or changes in the original transaction. Loans which are currently sound yet exhibit potentially unacceptable credit risk or deteriorating long term prospects, will receive this classification. Loans which deviate from loan policy or regulations will not generally be classified in this category, but will be separately reported as an area of concern.

Classified – Classified loans include those considered by the Company to be substandard, doubtful or loss.

An asset is considered “substandard” if it involves more than an acceptable level of risk due to a deteriorating financial condition, unfavorable history of the borrower, inadequate payment capacity, insufficient security or other negative factors within the industry, market or management. Substandard loans have clearly defined weaknesses which can jeopardize the timely payment of the loan.

Assets classified as “doubtful” exhibit all of the weaknesses defined under the substandard category but with enough risk to present a high probability of some principal loss on the loan, although not yet fully ascertainable in amount.

Assets classified as “loss” are those considered uncollectible or of little value, even though a collection effort may continue after the classification and potential charge-off.

Non-Performing Loans

Non-performing loans consist of non-accrual loans (loans on which the accrual of interest has ceased), loans over ninety days delinquent and still accruing interest, troubled debt restructurings loans and impaired loans. Loans are generally placed on non-accrual status if, in the opinion of management, collection is doubtful, or when principal or interest is past due 90 days or more, unless the collateral is considered sufficient to cover principal and interest and the loan is in the process of collection. At March 31, 2012 the Company had thirty seven loan relationships totaling $23.9 million in non-accrual loans compared to twenty one relationships totaling $8.9 million in non-accrual loans at December 31, 2011. The Company recognized no interest income on non-accrual loans during the three month period ended March 31, 2012 and March 31, 2011.

The following table represents loans by credit quality indicator at March 31, 2012.

(In thousands)	Pass	Special Mention Loans	Accruing Classified Loans	Non Accrual Loans	Total
Commercial	$ 76,130	$ 7,627	$ 5,031	$ 5,198	$ 93,986
Real Estate, Commercial	100,713	6,914	198	7,311	115,136
Real Estate, Residential	6,366	-	-	875	7,241
Construction	1,040	-	-	9,900	10,940
Consumer	6,353	-	-	660	7,013
Total loans	$ 190,602	$ 14,541	$ 5,229	$ 23,944	$ 234,316

The following table represents loans by credit quality indicator at December 31, 2011.

(In thousands)	Pass	Special Mention Loans	Accruing Classified Loans	Non Accrual Loans	Total

Commercial	$ 80,872	$ 13,956	$ 882	$ 1,935	$ 97,645
Real Estate, Commercial	103,804	3,104	3,548	5,479	115,935
Real Estate, Residential	8,095	-	-	875	8,970
Construction	7,523	-	4,569	-	12,092
Consumer	6,694	-	-	581	7,275
Total loans	$ 206,988	$ 17,060	$ 8,999	$ 8,870	$ 241,917

The following table represents past-due loans as of March 31, 2012.

(In thousands)	30-89 Days Past Due and Still Accruing	90 Days or more Past Due and Still Accruing	Total Past Due and Still Accruing	Accruing Current Balances	Non-Accrual Balances	Total Loan Balances
Commercial	$ 3,878	$ -	$ 3,878	$ 84,910	$ 5,198	$ 93,986
Real Estate, Commercial	275	-	275	107,550	7,311	115,136
Real Estate, Residential	323	-	323	6,043	875	7,241
Construction	-	-	-	1,040	9,900	10,940
Consumer	-	-	-	6,353	660	7,013
Total loans	$ 4,476	$ -	$ 4,476	$ 205,896	$ 23,944	$ 234,316
Percentage of total loans	1.91%	0.00%	1.91%	87.87%	10.22%	

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The following table represents past-due loans as of December 31, 2011.

(In thousands)	30-89 Days Past Due and Still Accruing	90 Days or more Past Due and Still Accruing	Total Past Due and Still Accruing	Accruing Current Balances	Non-Accrual Balances	Total Loan Balances
Commercial	$ 495	$ -	$ 495	$ 95,215	$ 1,935	$ 97,645
Real Estate, Commercial	1,201	-	1,201	109,255	5,479	115,935
Real Estate, Residential	1	-	1	8,094	875	8,970
Construction	-	-	-	12,092	-	12,092
Consumer	81	-	81	6,613	581	7,275
Total loans	$ 1,778	$ -	$ 1,778	$ 231,269	$ 8,870	$ 241,917
Percentage of total loans	0.73%	0.00%	0.73%	95.60%	3.67%	

Impaired loans are measured based on the present value of expected future discounted cash flows, the fair value of the loan or the fair value of the underlying collateral if the loan is collateral dependent. The recognition of interest income on impaired loans is the same as for non-accrual loans discussed above. At March 31, 2012, the Company had forty impaired loan relationships totaling $29.4 million (included within the non-accrual loans discussed above) in which $21.1 million in impaired loans had a related allowance for credit losses of $4.0 million and $8.3 million in impaired loans in which there is no related allowance for credit losses. The average balance of impaired loans totaled $20.6 million for the period ending March 31, 2012, and interest income recorded on impaired loans during the three months ended March 31, 2012 totaled $2 thousand, as compared to $13 thousand for the three months ended March 31, 2011.

At March 31, 2012 and December 31, 2011 respectively, the Company had no loan relationships delinquent ninety days or more and still accruing interest.

The following table represents data on impaired loans at March 31, 2012 and March 31, 2011.

(In thousands)	2012	2011
Impaired loans for which a valuation allowance has been provided	$ 21,106	$ 3,781
Impaired loans for which no valuation allowance has been provided	8,278	7,212
Total loans determined to be impaired	29,384	10,993

Allowance for loan losses related to impaired loans	3,957	1,096
Average recorded investment in impaired loans	20,635	11,391
Cash basis interest income recognized on impaired loans	$ 2	$ 13

The following table presents impaired loans by portfolio class at March 31, 2012.

(In thousands)	Recorded Investment	Unpaid Principal Balance	Related Valuation Allowance	Average Annual Recorded Investment	Interest Income Recognized While Impaired
Impaired loans with a valuation allowance:					
Commercial	$ 8,291	$ 8,386	$ 2,130	$ 5,609	$ -
Real Estate, Commercial	6,759	7,718	1,329	6,429	-
Real Estate, Residential	875	1,245	64	875	-
Construction	4,908	4,908	335	2,454	-
Consumer	273	273	99	254	-
Subtotal	$ 21,106	$ 22,530	$ 3,957	$ 15,621	$ -

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Impaired loans with no valuation allowance:					
Commercial	$ 2,149	$ 2,149	$ -	$ 1,267	2
Real Estate, Commercial	750	750	-	864	-
Real Estate, Residential	-	-	-	-	-
Construction	4,992	4,992	-	2,496	-
Consumer	387	387	-	387	-
Subtotal	$ 8,278	$ 8,278	$ -	$ 5,014	$ 2
Total Impaired loans:					
Commercial	$ 10,440	$ 10,535	$ 2,130	$ 6,876	$ 2
Real Estate, Commercial	7,509	8,468	1,329	7,293	-
Real Estate, Residential	875	1,245	64	875	-
Construction	9,900	9,900	335	4,950	-
Consumer	660	660	99	641	-
Total	$ 29,384	$ 30,808	$ 3,957	$ 20,635	$ 2

The following table presents impaired loans by portfolio class at December 31, 2011.

(In thousands)	Recorded Investment	Unpaid Principal Balance	Related Valuation Allowance	Average Annual Recorded Investment	Interest Income Recognized While Impaired
Impaired loans with a valuation allowance**:**					
Commercial	$ 2,649	$ 2,649	$ 705	$ 2,635	$ 12
Real Estate, Commercial	5,880	5,880	1,291	8,390	-
Real Estate, Residential	875	875	64	824	-
Construction	-	-	-	-	-
Consumer	194	194	97	196	-
Subtotal	$ 9,598	$ 9,598	$ 2,157	$ 12,045	$ 12
Impaired loans with no valuation allowance:					
Commercial	$ 569	$ 569	$ -	$ 343	$ 10
Real Estate, Commercial	1,571	1,571	-	540	4
Real Estate, Residential	-	-	-	-	-
Construction	-	-	-	-	-
Consumer	387	387	-	385	-
Subtotal	$ 2,527	$ 2,527	$ -	$ 1,268	$ 14
Total Impaired loans:					
Commercial	$ 3,218	$ 3,218	$ 705	$ 2,978	$ 22
Real Estate, Commercial	7,451	7,451	1,291	8,930	4
Real Estate, Residential	875	875	64	824	-

Construction	-	-	-	-	-
Consumer	581	581	97	581	-
Total	$ 12,125	$ 12,125	$ 2,157	$ 13,313	$ 26

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

Subsequent to quarter end, the Company reached a settlement agreement with the lead/originating bank under which the parties have agreed to mutually release and forever discharge each other from any and all claims that have been asserted in the suit. The Company will record a $484 thousand charge-off, related to this credit, in the second quarter of 2012. This charge-off will also be considered by the Company in the analysis of historical loss rates within the respective portfolios and may result in an increased provision in the second quarter of 2012.

The following table provides information regarding risk elements in the loan portfolio as of March 31, 2012 and December 31, 2011

(In thousands)	**March 31, 2012**	**December 31, 2011**
Non-performing assets:		
Loans past due 90 days or more and accruing		
Commercial	$ -	$ -
Construction	-	-
Consumer	-	-
Total loans past due 90 days or more and accruing	-	-
Non-accrual loans:		
Commercial	5,198	1,935
Real Estate, Commercial	7,311	5,479
Real Estate, Residential	875	875
Construction	9,900	-
Consumer	660	581
Total non-accrual loans(1)	23,944	8,870
Loans less than 90 days and still accruing	5,229	1,451
Restructured loans	211	1,804
Total non-performing loans	29,384	12,125
Real estate owned	6,062	5,262
Total non-performing assets	$ 35,446	17,387
Non-performing loans as a percentage of loans	12.54%	5.01%
Non-performing assets as a percentage of loans and real estate owned	14.75%	7.03%
Non-performing assets as a percentage of total assets	9.25%	4.53%

(1) Nonaccrual loans in the table above include TDR’S totaling $ 11.6 million at March 31, 2012 and $0 at December 31, 2011.

During the three month period ended March 31, 2012 the Company experienced a $15.0 million increase in non-accrual loans. This change reflects the downgrade of seventeen credit relationships to non-accrual status totaling $15.9 million, partially offset by total charge offs of two credit relationships in the amount of $1 thousand, principal reductions on non-accrual loans of $6 thousand and one loan relationship taken into other real estate owned for $800 thousand during the three month period ended March 31, 2012. The downgraded loans consisted of eight commercial loan relationships totaling $3.3 million, four commercial real estate relationships totaling $2.6 million, six construction loan relationships totaling $9.9 million and one consumer loan relationship totaling $80 thousand.

The following tables set forth activity within the Bank's allowance for losses by portfolio class during the three and periods ended March 31, 2012 and March 31, 2011:

Three months ended March 31, 2012 and March 31, 2011:

Allowance for Loan Losses	Commercial	Commercial Real Estate	Residential Real Estate	Construction	Consumer	Total
Beginning Balance January 1, 2012	$ 2,930	$ 1,788	$ 173	$ -	$ 104	$ 4,995
Charge-off	-	-	-	-	(1)	(1)
Provision	992	95	(22)	335	3	1,403
Recoveries	28	-	-	-	-	28
Ending Balance March 31, 2012	$ 3,950	$ 1,883	$ 151	$ 335	$ 106	$ 6,425

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Allowance for Loan Losses	Commercial	Commercial Real Estate	Residential Real Estate	Construction	Consumer	Total
Beginning Balance January 1, 2011	$ 1,743	$ 1,527	$ 417	$ -	$ 139	$ 3,826
Charge-off	(1,536)	-	(281)	-	-	(1,817)
Provision	943	(344)	323	-	31	953
Recoveries	-	-	-	-	-	-
Ending Balance March 31,2011	$ 1,150	$ 1,183	$ 459	$ -	$ 170	$ 2,962

	March 31, 2012	March 31, 2011
Period-end loans outstanding	$234,316	$238,002
Average loans outstanding	$237,957	$239,449
Allowance as a percentage of period-end loans	2.74%	1.24%
Net charge-offs as a percentage of average loans	0.00%	0.76%

Allowance for Loan Losses	Commercial	Commercial Real Estate	Residential Real Estate	Construction	Consumer	Total
Ending balance individually evaluated for impairment	$ 2,130	$ 1,329	$ 64	$ 335	$ 99	$3,957
Ending balance collectively evaluated for impairment	1,820	554	87	-	7	2,468
Ending Balance, March 31, 2012	$ 3,950	$ 1,883	$ 151	$ 335	$ 106	$6,425

Financing receivable:	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	Construction	Total
Ending balance	$ 93,986	$ 115,136	$ 7,241	$ 7,013		

NOTE 6 - INVESTMENT SECURITIES

					$ 10,940	$234,316
Ending balance individually evaluated for impairment	10,440	7,509	875	660	9,900	29,384
Ending balance collectively evaluated for impairment	83,546	107,627	6,366	6,353	1,040	204,932

Management considers a variety of factors when establishing the allowance, such as the impact of current economic conditions, diversification of the loan portfolio, delinquency statistics, results of independent loan review and related classifications. Historic loss rates and the loss rates of peer financial institutions are also considered. In evaluating the Company's allowance for loan losses, the Company maintains a Criticized Asset Committee ("CAC") consisting of senior management that monitors problem loans and formulates collection efforts and resolution plans for each borrower. On a monthly basis the CAC meets to review each problem loan and determines if there has been any change in collateral value due to changes in market conditions. Each quarter, when calculating the allowance for loan losses, the CAC reviews an updated loan impairment analysis on each problem loan to determine if a specific provision for loan loss is warranted. Management reviews the most recent appraisal on each loan adjusted for holding and selling costs. In the event there is no recent appraisal on file, the Company will use the aged appraisal and apply a discount factor to the appraisal then deduct the holding and selling costs from the discounted appraisal value.

Management considers a variety of factors when establishing the allowance, such as the impact of current economi

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At March 31, 2012, the Company maintained an allowance for loan loss ratio of 2.74% to period end loans outstanding, compared to 2.06% to period end loans at year end 2011. On a linked basis, our non-performing assets have increased by $18.0 million over their levels at December 31, 2011 representing a non-performing asset to total asset ratio of 9.25% at March 31, 2012 as compared to a non-performing asset to total asset ratio 4.56% at December 31, 2011.

The Company's charge-off policy states that any asset classified loss shall be charged-off within thirty days of such classification unless the asset has already been eliminated from the books by collection or other appropriate entry. On a quarterly basis the Board Loan Committee ("BLC") reviews past due, classified, non-performing and other loans, as it deems appropriate, to determine the collectability of such loans. If the BLC determines a loan to be uncollectible, the loan is charged to the allowance for loan loss. In addition, upon reviewing the collectability of a loan, the BLC may determine a portion of the loan to be uncollectible; in which case that portion of the loan deemed uncollectable will be partially charged-off against the allowance for loan loss.

For the three month period ending March 31, 2012 the Company experienced two total charge offs relating to two loan relationships totaling $1 thousand as compared to total charge-offs of eighteen loans representing ten relationship totaling $4.3 million and ten partial charge-offs relating to seven loan relationships totaling $1.3 million for the period ended December 31, 2011.

The Company modifies loans by offering a restructuring in loan terms that may include, but is not limited to, principal moratoriums and interest rate reductions. There was one loan modification classified as a troubled debt restructure during the three months ended March 31, 2012.

The following tables present loans by class which were modified as trouble debt restructurings during the three period ended March 31, 2012, (in thousands);

Three Months ended March 31, 2012:

Trouble Debt Restructuring	Number of Loans	Pre Modification Outstanding Recorded Investment	Post Modification Outstanding Recorded Investment
Construction	8	$ 9,900	$ 9,900
Total	8	$ 9,900	$ 9,900

Trouble Debt Restructuring That Subsequently Defaulted	Number of loans	Recorded Investment
	-	$ -
Total	-	$ -

There were no troubled debt restructurings during the three month period ended March 31, 2011.

NOTE 8 – Bank Owned Life Insurance

Bank owned life insurance (“BOLI”) is carried at its aggregate cash surrender value less surrender charges and totaled $6.3 million at March 31, 2012. Income of $51 thousand was recognized on BOLI during the three month period ended March 31, 2012 as compared to $40 thousand for the three month period ended March 31, 2011. The Bank is the sole owner and beneficiary of the BOLI.

NOTE 9 – Deferred Compensation Plans

Effective January 1, 2006, the Bank adopted a Nonqualified Deferred Compensation Plan (The “Executive Plan”) and the Directors’ Fee Deferral and Death Benefit Plan (the “Directors’ Plan”). Both plans provide for payments of deferred compensation to participants. The Company recorded $85 thousand in deferred compensation expense during the three month period ended March 31, 2012 as compared to $79 thousand for the three month period ended March 31, 2011.

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NOTE 10 – Income Taxes

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

Federal tax years 2008 through 2010 remain subject to examination as of March 31, 2012, while tax years 2007 through 2010 remain subject to examination by state taxing jurisdictions. In the event the Company is assessed for interest and/or penalties by taxing authorities, such assessed amounts will be classified in the financial statements as income tax expense.

The ability to realize deferred tax assets is dependent upon a variety of factors, including the generation of future taxable income, the existence of taxes paid and recoverable, the reversal of deferred tax liabilities, and tax planning strategies. Based upon these and other factors, the Company determined that it is more likely than not that our deferred tax asset will be realized. As such, no valuation allowance was established for the deferred tax asset as of March 31, 2012 or December 31, 2011. The Company will continue to reassess the realizability of the deferred tax asset in future periods. If, in the future, it is determined that the Company's deferred tax asset is not realizable, a valuation allowance may be established against the deferred tax asset, which may have a material impact on the Company's net income in the period in which it is recorded.

NOTE 11 – Fair Value of Financial Instruments

ASC 820 *Fair Value Measurements and Disclosures* establishes a framework for measuring fair value under U.S. generally accepted accounting principles, and expands disclosure requirements for fair value measurements.

ASC 820 does not require any new fair value measurements.

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

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

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

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

Assets and Liabilities Measured on a Recurring Basis

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

	Fair Value Measurements at March 31, 2012			Fair Value Measurements at De	
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant other Observable Inputs Level (2)	Significant other Unobservable Inputs Level (3)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant other Observable Inputs Level (2)
Assets :					
Investment Securities					
US Government Obligations	$ -	$ 86,608	$ -	$ -	$ 83,727
Total assets on a recurring basis at fair value	$ -	$ 86,608	$ -	$ -	$ 83,727

Assets and Liabilities Measured on a Non-Recurring Basis

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

	Fair Value Measurements at March 31, 2012			Fair Value Measurements 2011	
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant other Observable Inputs Level (2)	Significant other Unobservable Inputs Level (3)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Signific other Observa Input Level (
Assets :					
Impaired loans	$ -	$ 29,384	$ -	$ -	$ 12,
Other real estate owned	-	6,062	-	-	5,
Total assets on a non-recurring basis at fair value	$ -	$ 35,446	$ -	$ -	$ 17,

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

including comparable sales and the income approach.

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

NOTE 8 – Bank Owned Life Insurance

As required by ASC 825-10-65, the estimated fair value of financial instruments at March 31, 2012 and December 31, 2011 was as follows:

(In thousands)	Level in fair value hierarchy	March 31, 2012 Carrying amount	March 31, 2012 Estimated fair value	December 31, 2011 Carrying amount	December 31, 2011 Estimated fair value
Financial assets:					
Cash and cash equivalents	Level 1	$ 42,236	$ 42,236	$ 37,839	$ 37,839
Investments available for sale					
Federal Agency Securities	Level 2	86,608	86,608	83,727	83,727
Loans receivable	Level 3	234,316	246,393	241,917	272,384
FHLB stock	Level 3	763	763	1,438	1,438
Bank owned life insurance	Level 3	6,257	6,257	6,206	6,206
Accrued interest receivable	Level 2	1,768	1,768	1,577	1,577
Total financial assets		$371,948	$384,025	$372,704	$403,171
Financial Liabilities:					
Non-interest bearing deposits	Level 1	$ 38,001	$ 38,001	$ 29,963	$ 29,963
Interest bearing deposits	Level 2	204,238	204,238	201,066	201,066
	Level 2	99,634	97,449	99,279	97,069

Certificates of deposit					
FHLB advances	Level 2	10,000	10,000	25,000	25,000
Line of credit	Level 2	5,000	5,000	5,000	5,000
Subordinated debt	Level 2	3,000	3,000	3,000	3,000
Accrued interest payable	Level 2	135	135	167	167
Total financial liabilities		$360,008	$357,823	$363,475	$361,265

	Contract Value	Estimated Fair Value	Contract Value	Estimated Fair Value
Off-balance sheet instruments:				
Commitments to extend credit	$ 57,559	$ -	$ 49,568	$ -

The forgoing fair values are presented pursuant to the requirements of GAAP and ASC topic 825-10-65 for disclosure purposes only, and should not be considered to represent the value of the Company as a whole.

NOTE 12 – Recent Accounting Pronouncements

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

In May 2011, the FASB issued ASU 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*, to provide largely identical guidance about fair value measurement and disclosure requirements with the IASB's new IFRS 13, *Fair Value Measurement*. Issuing this standard completed a major project of the Boards' joint work to improve and converge IFRS and U.S. GAAP. The new standard does not extend the use of fair value but, rather, provides guidance about how fair value should be applied where it already is required or permitted under U.S. GAAP. ASU 2011-04 is effective for interim and annual periods beginning after December 15, 2011. The Company adopted ASU 2011-04 and did not have a material impact to the financial statements.

In June 2011, the FASB issued ASU No. 2011-05, *Presentation of Comprehensive Income*. This ASU increases the prominence of other comprehensive income in financial statements. Under this ASU, an entity will have the option to present the components of net income and comprehensive income in either one or two consecutive financial statements. The ASU eliminates the option in U.S. GAAP to present other comprehensive income in the statement of changes in equity.

NOTE 8 – Bank Owned Life Insurance

ASU 2011-05 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The adoption of ASU 2011-05 impacted the Company's presentation of comprehensive income within the financial statements. However, it did not impact the financial statements amounts.

NOTE 13– Private Placement Common Stock Offering and Preferred Stock Issuance

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

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

In December 2011, the Company authorized the establishment of 10 thousand shares of no par, $20 stated value, Series B Perpetual Non-Cumulative Convertible Preferred Stock. The preferred stock is entitled to receive, as and when declared by the Company's Board of Directors, non-cumulative cash dividends at an annual rate of 7% of the stated value. In December 2011, the Company sold 10,000 preferred shares. The preferred stock is redeemable at the Company's option at any time after six months from the issue date at the stated value plus any dividends declared but unpaid. The preferred shares have priority with regards to dividends such that, no dividends or distributions shall be declared or paid to common shareholders for any quarter unless full dividends on all outstanding preferred shares have been declared and paid for the most recently completed calendar quarter.

NOTE 14 – Subsequent Events

The Company has evaluated subsequent events through the filing date of this report, and has determined that, except for the following, there were no subsequent events to report in the March 31, 2012 financial statements.

Subsequent to quarter end, the Company reached a settlement agreement with the lead/originating bank under which the parties have agreed to mutually release and forever discharge each other from any and all claims that have been asserted in the suit. The Company will record a $484 thousand charge-off, related to this credit, in the second quarter of 2012. This charge-off will also be considered by the Company in the analysis of historical loss rates within the respective portfolios and may result in an increased provision in the second quarter of 2012.

Item 2. Management's Discussion and Analysis

Forward-Looking Statements

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

These forward-looking statements involve risks and uncertainties, such as statements of the Company's plans, objectives, expectations, estimates and intentions that are subject to change based on various important factors (many of which are beyond the Company's control). Forward-looking statements may be identified by the use of words such as “expects,” “subject,” “believe,” “will,” “intends,” “will be,” or “would.”

The factors which could cause the Company's financial performance to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements include those items listed under “Item 1A-Risk Factors” in both our Annual Report on Form 10-K for the year ended December 31, 2011 and in this Quarterly Report on Form 10-Q and include the following factors, among others: the strength of the United States economy in general and the strength of the local economies in which the Company conducts operations; the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System (“Federal Reserve”); inflation; interest rates; market and monetary fluctuations; the timely development of new products and services by the Company and the perceived overall value of these products and services by users, including the features, pricing and quality compared to competitors' products and services; the success of the Company in gaining regulatory approval of its products, services, dividends and of new branches, when required; the impact of changes in financial services laws and regulations (including laws concerning taxes, banking, securities and insurance); technological changes; the ability to continue to effectively manage costs, changes in consumer spending and saving habits; the Company’s ability to access the capital markets to maintain its regulatory capital standing and the success of the Company at managing the risks resulting from these factors.

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

Overview

Cornerstone Financial Corporation

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

At March 31, 2012, we had total assets of $383.2 million, total loans, gross of $234.3 million, total investment securities of $86.6 million and total deposits of $341.9 million compared to total assets of $383.8 million, total loans, gross of $241.9 million, total investment securities of $83.7 million and total deposits of $330.3 million at December 31, 2011. During the past two years, many of our borrowers have been adversely affected by the recession of 2008 and the subsequent slow economic recovery. As a result, we have experienced elevated levels of nonperforming assets, which have continued to increase through the first quarter of 2012. Our primary focus has turned toward managing our credit quality and capital levels while continuing to meet the credit needs of the communities served by our branches. We expect that we will not continue our historical rate of growth until the economy strengthens and our non-performing assets have returned to more normalized levels. Because of the growth in our non-performing assets, it is possible that our Federal and state regulators may decide to take a formal or informal enforcement action against the Bank. In the event of any such action, our growth may be further limited, and we may incur substantial expense in complying with any such action.

Interest Rate Risk

Our primary objective in managing interest rate risk is to minimize the adverse impact of changes in interest rates on our net interest income while creating an asset/liability structure that maximizes earnings.

Our Asset Liability Management Committee actively monitors and manages our interest rate exposure using gap analysis and interest rate simulation models.

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

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

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

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

The following table sets forth the amount of our interest-earning assets and interest-bearing liabilities at March 31, 2012, which are expected to mature or reprice in each of the time periods shown:

Non-Rate

Sensitive

(In thousands)	One Year or Less	One-Five Years	Over Five Years	Assets/ Liabilities	Total
Interest-earning assets:					
Short term investments	$ 36,500	$ -	$ -	$ -	$ 36,500
Investment securities available for sale		-	86,608	-	86,608
Loans receivable	112,782	68,356	53,178	-	234,316
Total interest-earning assets	149,282	68,356	139,786	-	357,424
Non-rate sensitive assets:					
Other assets	-	-	-	25,760	25,760
Total assets	$ 149,282	$ 68,356	$ 139,786	$ 25,760	$ 383,184
Interest-bearing liabilities:					
Interest-bearing demand	$ 40,478	$ -	$ -	$ -	$ 40,478
Statement savings	3,663	-	-	-	3,663
Money market	160,097	-	-	-	160.097
Certificates of deposit	36,153	63,481	-	-	99,634
Subordinated debt	-	3,000	-	-	3,000
Borrowings	5,000	10,000	-	-	15,000
Total interest-bearing liabilities	245,391	76,481	-	-	321,872
Non-rate sensitive liabilities:					
Non-interest bearing deposits	-	-	-	38,001	38,001
Other liabilities	-	-	-	5,178	5,178
Capital	-	-	-	18,133	18,133
Total liabilities and capital	$ 245,391	$ 76,481	$ -	$ 61,312	$ 383,184
Period GAP	$ (96,109)	$ (8,125)	$ 139,786	$ (35,552)	
Cumulative interest-earning assets	$ 149,282	$ 217,638	$ 357,424		
Cumulative interest-bearing liabilities	$ 245,391	$ 321,872	$ 321,872		
Cumulative GAP	$ (96,109)	$ (104,234)	$ 35,552		
Cumulative RSA/RSL (1)	60.83%	67.62%	111.05%		

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

At March 31, 2012, our interest rate sensitivity gap was within Board approved guidelines.

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

The following discussion focuses on the major components of our operations and presents an overview of the significant changes in our financial condition at March 31, 2012 as compared to December 31, 2011 and our results of operations for the three month periods ended March 31, 2012 as compared to the same period in 2011.

Comparison of Financial Condition at March 31, 2012 and December 31, 2011

Total assets at March 31, 2012 were $383.2 million, a decrease of $601 thousand or .2% over December 31, 2011. This change was due to increases in cash and cash equivalents of $4.4 million, bank owned life insurance of $51 thousand, investment securities available for sale of $2.9 million, accrued interest receivable of $191 thousand, deferred taxes of $895 thousand, other real estate owned of $800 thousand and premises and equipment of $202 thousand, offset by decreases in loans receivable, net, of $9.0 million, other assets of $312 thousand and FHLB stock of $675 thousand. Management has elected to keep excess cash flow in short term, liquid assets to maintain a strong liquidity base while managing our level of capital.

Gross loans receivable at March 31, 2012, totaled $234.3 million, a decrease of $7.6 million or 3.1% from December 31, 2011. This change was attributable to decreases of $3.7 million in commercial loans, $1.7 million in residential real estate loans, $790 thousand in commercial real estate loans, $1.2 million in construction loans, and $260 thousand in consumer loans. The decline in gross loans represents payoffs received during the three months ended March 31, 2012 coupled with $800 thousand in other real estate owned.

See Footnote 7 to our Consolidated Financial Statements for a breakdown of the components of our loan portfolio.

Non-performing assets consist of non-accrual loans (loans on which the accrual of interest has ceased), loans over ninety days delinquent and still accruing interest, renegotiated loans, impaired loans, and real estate owned. Loans are generally placed on non-accrual status if, in the opinion of management, collection is doubtful, or when principal

or interest is past due 90 days or more unless the collateral is considered sufficient to cover principal and interest and the loan is in the process of collection. The Company recognized no interest income on non-accrual loans during the three month periods ended March 31, 2012 and March 31, 2011.

Impaired loans are measured based on the present value of expected future discounted cash flows, the fair value of the loan or the fair value of the underlying collateral if the loan is collateral dependent. The recognition of interest income on impaired loans is the same as for non-accrual loans discussed above.

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At March 31, 2012 the Company had thirty seven loan relationships totaling $23.9 million on non-accrual status compared to twenty one relationships totaling $8.9 million on non-accrual status at December 31, 2011. During the three month period ended March 31, 2012 the Company experienced a $15.0 million increase in non-accrual loans. This change reflects the downgrade of seventeen credit relationships to non-accrual status totaling $15.9 million partially offset by total charge offs of two credit relationships in the amount of $1 thousand, principal reductions on non-accrual loans of $6 thousand and one loan relationship taken into other real estate owned for $800 thousand during the three month period ended March 31, 2012. The downgraded loans consisted of eight commercial loan relationships totaling $3.3 million, four commercial real estate relationships totaling $2.6 million, six construction loan relationships totaling $9.9 million and one consumer loan relationship totaling $80 thousand. These downgrades reflect further evidence that our borrowers continue to be adversely affected by the recession of 2008 and the subsequent slow economic recovery.

At March 31, 2012, the Company had forty impaired loan relationships totaling $29.4 million (included within the non-accrual loans discussed above) in which $21.1 million in impaired loans had a related allowance for credit losses of $4.0 million and $8.3 million in impaired loans in which there is no related allowance for credit losses. The average balance of impaired loans totaled $20.6 million as of March 31, 2012, and interest income recorded on impaired loans during the three months ended March 31, 2012 totaled $2 thousand, as compared to $13 thousand for the three months ended March 30, 2011.

There was no balance in loans 90-days past due and still accruing at March 31, 2012 and December 31 2011, respectively.

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

Subsequent to quarter end, the Company reached a settlement agreement with the lead/originating bank under which the parties have agreed to mutually release and forever discharge each other from any and all claims that have been asserted in the suit. The Company will record a $484 thousand charge-off, related to this credit, in the second quarter of 2012. This charge-off will also be considered by the Company in the analysis of historical loss rates within the respective portfolios and may result in an increased provision in the second quarter of 2012.

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Management considers a variety of factors when establishing the allowance, such as the impact of current economic conditions, diversification of the loan portfolio, delinquency statistics, results of independent loan review and related classifications. Historic loss rates and the loss rates of peer financial institutions are also considered. In evaluating the Company's allowance for loan loss the Company maintains a Criticized Asset Committee ("CAC") consisting of senior management that monitors problem loans and formulates collection efforts and resolution plans for each borrower. On a monthly basis the CAC meets to review each problem loan and determines if there has been any change in collateral value due to changes in market conditions. Each quarter, when calculating the allowance for loan losses, the CAC reviews an updated loan impairment analysis on each problem credit to determine if a specific provision for loan loss is warranted. Management reviews the most recent appraisal on each loan, adjusted for holding and selling costs. In the event there is no recent appraisal on file, the Company will use the aged appraisal and apply a discount factor to the appraisal then adjust the holding and selling costs from the discounted appraisal value. At March 31, 2012, the Company maintained an allowance for loan loss ratio of 2.74% to period end loans outstanding.

Any asset classified as loss is charged-off within thirty days of such classification unless the asset has already been eliminated from the books by collection or other appropriate entry. On a quarterly basis the Board Loan Committee ("BLC") will review past due, classified, non-performing and other loans, as it deems appropriate, to determine the collectability of such loans. If the BLC determines a loan to be uncollectible, the loan is charged to the allowance for loan loss. In addition, upon reviewing the collectability of a loan, the BLC may determine a portion of the loan to be uncollectible; in which case that portion of the loan deemed uncollectable will be partially charged-off against the allowance for loan loss.

For the three month period ending March 31, 2012, the Company experienced two total charge offs relating to two loan relationships totaling $1 thousand as compared to total charge-offs of eighteen loans representing ten relationship totaling $4.3 million and ten partial charge-offs relating to seven loan relationships totaling $1.3 million for the period ended December 31, 2011.

Real estate acquired by foreclosure or by deed in lieu of foreclosure is classified as real estate owned until it is sold. At March 31, 2012 the Company had $6.1 million in real estate owned as compared to $5.3 million at December 31, 2011.

Our investment securities are classified as available for sale. Our investment portfolio increased by $2.9 million or 3.5% to $86.6 million at March 31, 2012, from $83.7 million at December 31, 2011. The change in our investment portfolio is related to purchases of $18.5 million offset by $18.7 million in calls within our available for sale investment portfolio. See Footnote 6 to our Consolidated Financial statements for more information regarding our investment securities portfolio.

Our cash and cash equivalents increased by $4.4 million to $42.2 million at March 31, 2012 from $37.8 million at December 31, 2011. The increase reflects cash inflows from an increase in deposits, repayments of higher yielding investment securities in a lower rate environment and loan repayment and prepayments exceeding current loan funding demands. The increase in deposits reflects, in part, the Bank benefiting from merger activity involving competing institutions and resulting customer dislocation. Management has elected to keep excess cash flow in short term, liquid assets to maintain a strong liquidity base while managing our level of capital.

Total liabilities at March 31, 2012 amounted to $365.1 million, an increase of $333 thousand or .1% from December 31, 2011. This change was primarily due to increases in total deposits of $11.6 million and unsettled securities payable of $4.0 million, representing an investment security purchased in March with an April settlement, offset by decreases in other liabilities of $232 thousand and the payoff of $15 million in FHLB advances.

Total deposits at March 31, 2012 were $341.9 million, an increase of $11.6 million or 3.5% from December 31, 2011. The increase in deposits was attributable to an increase of $3.2 million in interest bearing deposit accounts, $8.0 million in non-interest bearing deposit accounts and $355 thousand from certificates of deposit.

The increase represents new funds deposited with the Bank, as a result of competitive pricing of deposit products coupled with the continued development of relationships with local small businesses along with the high level of individualized service provided by our team of retail branch managers.

At March 31, 2012 we had advances from the FHLB in the amount of $10.0 million as compared to FHLB advances of $25 million at December 31, 2011. The weighted average interest rate on these borrowings from the FHLB was 0.72% at March 31, 2012 and 1.14% at December 31, 2011.

On February 28, 2012, the Company renewed its non-revolving line of credit loan agreement with Atlantic Central Bankers Bank in the amount of $5.0 million. The term of the debt is for a six month period with a maturity date of August 17, 2012. The interest rate adjusts at a variable rate at the greater of prime plus 100 basis points with a floor of 5.00%. The loan agreement contains representations, warranties and covenants typical of agreements of this type, including a provision making it an event of default for the Bank to enter into any formal or informal enforcement agreement with its primary regulators.

As previously discussed, due to the increase in our non-performing assets, it is possible our Federal or state regulators may decide to take a formal or informal enforcement action against the Bank. The Company has an outstanding balance on the line of credit of $5.0 million at March 31, 2012 and at December 31, 2011 respectively, and has contributed $4.4 million as additional capital to the Bank.

On November 1, 2010, the Bank modified the terms of the hybrid capital instrument originally issued on October 31, 2008, in the aggregate amount of $3.0 million in the form of subordinated debt. This instrument qualifies as Tier II capital. The new term of the debt is for a ten year period with a maturity date of November 1, 2020. The interest rate is at a variable rate equal to the prime rate plus 100 basis points for the entire ten year term. The debt security is redeemable, at the Bank's option, at par on any January 31st, April 30th, July 31st, or October 31st that the debt security remains outstanding.

Stockholders' equity at March 31, 2012 amounted to $18.1 million, a decrease of $934 thousand or 4.9% over December 31, 2011. This increase reflects a net loss of $395 thousand and other comprehensive loss of $537 thousand and $37 thousand in cash paid for the declaration of dividends on preferred stock for the three month period ended March 31, 2012.

Results of Operations

Net Income. We recorded a net loss for the three month period ended March 31, 2012 of $432 thousand or $0.22 per common and diluted share, (after preferred stock dividend) as compared to net income of $76 thousand or $0.04 per common and diluted share, for the same period in 2011. The change in net income for the three-month period compared to the prior period was attributable to a $450 thousand increase in provision for loan loss, a decrease of $60 thousand in net interest income, a $30 thousand decrease in non-interest income, and an increase of $297 thousand in non-interest expense, offset by a decrease in income tax expense of $333 thousand. The net interest margin for the three-month period ended March 31, 2012 decreased by 25 basis points to 3.61% as compared to 3.86% for the same period in 2011.

Interest Income. Total interest income amounted to $4.0 million for the three-month period ended March 31, 2012, a decrease of $303 thousand or 7.1% when compared to the same period in 2011. The decrease in interest income was due to a reduction in the average yield, partially offset by volume increases in our interest-earning assets. The average yield on our interest-earning assets was 4.51% for the three month period ended March 31, 2012 compared to 5.14% during the same period in 2011.The reduction in yield in the quarterly period reflects the sustained low interest rate environment as long-term, higher yielding assets mature and are replaced with lower yielding assets.

Interest Expense. Total interest expense amounted to $838 thousand for the three-month period ended March 31, 2012, a decrease of $243 thousand or 22.5 % when compared to the same period in 2011. The decrease in interest expense resulted from lower rates paid on deposit and borrowing products when compared to the same period in 2011. The average cost of interest-bearing liabilities was 0.98% for the three-month period ended March 31, 2012 compared to 1.38% during the same period in 2011. The reduction in rate was partially offset by the increased volume of interest bearing liabilities.

Allowance for Loan Losses. We recorded a provision for loan losses for the three month period ended March 31, 2012 of $1.4 million compared to a provision of $953 thousand for the same period in 2011. The increased provision reflects our elevated level of non-performing and classified assets. At March 31, 2012, our allowance for loan losses represented 2.74% of total loans outstanding and 21.87% of non-performing loans.

Non-Interest Income. For the three-months ended March 31, 2012, non-interest income, which is comprised principally of service charges on deposit accounts, gain on sale of loans, origination fees on residential mortgage loans sold, bank owned life insurance income, ATM fees and other miscellaneous fee income totaled $263 thousand. This represents a decrease of $30 thousand or 10.2% when compared to the same period in 2011.This decrease resulted from decreases in services charges on deposits accounts of $7 thousand and gain on sale of loans of $74 thousand, partially offset by increases in miscellaneous fee income of $40 and $11 thousand in Bank owned life insurance. The decrease in gain on sale of loans is the result of fewer loan originations reducing income earned on the sale of Small Business loans at March 31, 2012 as compared to March 31, 2011. The increase in miscellaneous fee income resulted from an increase in loan prepayment penalties and other loan fees.

Non-Interest Expense. Non-interest expense, which is comprised principally of salaries and employee benefits, net occupancy costs, FDIC insurance premium expense, advertising costs, data processing costs and professional services and other operating costs, totaled $2.7 million for the three months ended March 31, 2012. This represents an increase of $297 thousand or 12.5% when compared to the same period in 2011. The increase in non-interest expense was primarily the result of increased salary and benefit costs of $126 thousand, net occupancy costs of $21 thousand, data processing costs of $10 thousand, advertising and promotion of $6 thousand, other real estate owned expense of $20 thousand, other operating expenses of $71 thousand, and professional services of $61 thousand, partially offset by decrease FDIC expense of $18 thousand. The increase in salary and benefit costs of $126 thousand resulted from the hiring of a marketing president in August of 2011 and additional staff added in connection with our Woodbury branch opening in March 2012. The increase in professional services of $61 thousand is related to expenses incurred for audit and tax preparation services, consulting fees, and legal fees in connection with general matters as well as matters relating to our loan portfolio.

Income Taxes. We recorded a federal and state income tax benefit of $277 thousand during the three month period ended March 31, 2012 compared to an income tax expense of $56 thousand for the same period in 2011. The effective tax rate for the three month period ended March 31, 2012 was 41.2% compared to 33.9% for the three month period ended March 31, 2011.

Liquidity and Capital Resources

***Liquidity*.** Liquidity represents our ability to meet our normal cash flow requirements for the funding of loans, repayment of deposits and payment of operating costs. Our primary sources of liquidity include growth in deposits, amortization and prepayment of loans, maturities of investment securities, and our borrowing capability. Management

monitors liquidity daily, and on a monthly basis incorporates liquidity analysis into its asset/liability management program.

In addition to using growth in deposits, loan repayments and the investment portfolio as a source of liquidity, we also have access to unsecured, overnight lines of credit aggregating $30.3 million, consisting of $3.0 million, on an uncommitted basis, through ACBB and $27.3 million through the FHLB of New York. The Bank has $10 million in outstanding FHLB advances which would reduce the availability of borrowing potential to $20.3 million. The arrangements with ACBB are for the sale of federal funds to the Bank, subject to the availability of such funds. Pursuant to a collateral agreement with the FHLB, advances under this line of credit are secured by a blanket lien on our residential mortgage and commercial loan portfolios.

At March 31, 2012, we had no outstanding balance against the overnight line of credit at ACBB. In addition, the Company has a non-revolving line of credit with ACBB for up to $5.0 million and as of March 31, 2012 and December 31, 2011 there is an outstanding balance of $5.0 million under this line.

In addition, the Bank's membership in the FHLB provides the Bank with additional secured borrowing capacity of up to a maximum of 50% of the Bank's total assets, subject to certain conditions.

We had cash and cash equivalents of $42.2 million at March 31, 2012 in the form of cash and due from banks. At March 31, 2012, unused lines of credit available to our customers, committed undisbursed loan proceeds and standby letters of credit totaled $57.6 million. Certificates of deposit scheduled to mature in one year or less totaled $36.2 million at March 31, 2012. We anticipate that we will continue to have sufficient funds available to meet the needs of our customers for deposit repayments and loan fundings.

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

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

The Bank is subject to risk-based capital guidelines promulgated by the FDIC that are designed to make regulatory capital requirements more sensitive to differences in risk profile among banks, to account for off-balance sheet exposure, and to minimize disincentives for holding liquid assets. Under the guidelines, assets and off-balance sheet items are assigned to broad risk categories, each with appropriate weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance sheet items. The minimum ratio of total capital to risk-weighted assets (including certain off-balance sheet activities, such as standby letters of credit) is 8%. At least 4% of total risk-weighted capital must consist of "Tier I Capital," consisting of common stockholders' equity and qualifying hybrid instruments, less certain goodwill items and other intangible assets.

The remainder ("Tier II Capital") may consist of (a) the allowance for loan losses of up to 1.25% of risk-weighted assets, (b) excess of qualifying hybrid instruments, (c) perpetual debt (d) mandatory convertible securities, and (e) qualifying subordinated debt and intermediate-term preferred stock up to 50% of Tier I capital. Total capital is the sum of Tier I and Tier II capital less reciprocal holdings of other banking organizations, capital instruments, investments in unconsolidated subsidiaries and any other deductions as determined by the FDIC (determined on a case-by-case basis or as a matter of policy after formal rule-making.

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

expansion. All other banks are expected to maintain a leverage ratio of at least 1% to 2% above the stated minimum.

The Bank was in compliance with all applicable minimum capital requirements for all periods presented. At March 31, 2012 the Bank maintained a Tier I leverage ratio of 6.02%, a Tier I risk-based capital ratio of 8.02% and a total risk-based capital ratio of 10.33%.

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

On February 28, 2012, the Company renewed its non-revolving line of credit loan agreement with Atlantic Central Bankers Bank in the amount of $5.0 million. The term of the debt is for a six month period with a maturity date of August 17, 2012. The interest rate adjusts at a variable rate at the greater of prime plus 100 basis points with a floor of 5.00%.

The loan agreement contains representations, warranties and covenants typical of agreements of this type, including a provision making it an event of default for the Bank to enter into any formal or informal enforcement agreement with its primary regulators. As previously discussed, due to the increase in our non-performing assets, it is possible our Federal or state regulators may decide to take a formal or informal enforcement action against the Bank. The Company has an outstanding balance on the line of credit of $5.0 million at March 31, 2012 and at December 31, 2011 respectively, and has contributed $4.4 million as additional capital to the Bank.

On November 1, 2010, the Bank modified the terms of the hybrid capital instrument originally issued on October 31, 2008, in the aggregate amount of $3.0 million in the form of subordinated debt. This instrument qualifies as Tier II capital. The new term of the debt is for a ten year period with a maturity date of November 1, 2020. The interest rate is at a variable rate equal to the prime rate plus 100 basis points for the entire ten year term. The debt security is redeemable, at the Bank's option, at par on any January 31st, April 30th, July 31st, or October 31st that the debt security remains outstanding.

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

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

In December 2011, the Company authorized the establishment of 10 thousand shares of no par, $20 stated value, Series B Perpetual Non-Cumulative Convertible Preferred Stock. The preferred stock is entitled to receive, as and when declared by the Company's Board of Directors, non-cumulative cash dividends at an annual rate of 7% of the stated value. In December 2011, the Company sold 10,000 preferred shares. The preferred stock is redeemable at the Company's option at any time after six months from the issue date at the stated value plus any dividends declared but unpaid. The preferred shares have priority with regards to dividends such that, no dividends or distributions shall be declared or paid to common shareholders for any quarter unless full dividends on all outstanding preferred shares have been declared and paid for the most recently completed calendar quarter.

The Bank's capital ratios at March 31, 2012 and December 31, 2011 are presented in the following table

	March 2012	December 2011
Shareholders’ equity to total assets	4.7%	5.0%
Leverage ratio	6.0%	5.9%
Risk-based capital ratios:		
Tier 1	8.0%	8.0%
Total Capital	10.3%	10.3%

The Company has certain cash requirements that are independent of the Bank, such as paying certain operating expenses and dividends on outstanding preferred stock. Historically, the Company has obtained funds through dividends paid by the Bank. At March 31, 2012, the Company had unconsolidated assets of $112 thousand (exclusive of its investment in the Bank), consisting of $101 thousand in cash and $11 thousand in prepaid assets. Due to its recent losses and elevated levels of classified and non-performing assets, the Bank may not currently pay dividends to the Company without the prior approval of its regulators. If the Bank is unable to pay dividends to the Company, this may result in the Company’s inability to meet certain of its cash obligations.

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

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the agreement. Commitments generally have fixed dates or other termination clauses and may require the payment of a fee. Some of the commitments are expected to expire without being drawn upon, and the total commitments do not necessarily represent future cash requirements. Total commitments to extend credit at March 31, 2012 were $57.6 million. We evaluate each customer's creditworthiness on a case by case basis. Collateral obtained, if deemed necessary, is based on management's credit evaluation of the customer. Collateral varies but may include accounts receivable, marketable securities, inventory, property, plant and equipment, residential and commercial real estate.

Standby letters of credit are conditional commitments issued to a third party for a customer. The credit risk involved in issuing standby letters of credit is similar to that involved in extending credit to customers. We evaluate each customer's creditworthiness on a case by case basis. Collateral obtained, if deemed necessary, is based on management's credit evaluation of the customer. Collateral varies, but may include accounts receivable, marketable securities, inventory, property, plant and equipment, and residential and commercial real estate. At March 31, 2012, our obligations under standby letters of credit totaled $2.0 million.

Critical Accounting Policies

Allowance for Losses on Loans

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

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

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

The Company utilizes its own loss experience to estimate inherent losses on loans. Internal risk ratings are assigned to each commercial, real estate commercial, real estate construction and land development loan.

A portion of the allowance is allocated to the remaining loans by applying projected loss ratios, based on numerous factors such as recent charge-off experience, trends with respect to adversely risk rated commercial, real estate commercial, real estate construction and land development loans, trends with respect to past due and nonaccrual loans, changes in economic conditions and trends, changes in the value of underlying collateral and other credit risk factors.

Historical loss rates are calculated using the last nine quarters of a variable factor analysis. The analysis consists of economic conditions, concentrations of industry, quality of management and systems, general collateral quality, delinquency trends over the last four quarters, loan grade trends over the past four quarters, annual portfolio growth and credit/borrower concentration.

The loans are grouped into the following categories: Commercial loans and Letters of Credit, Commercial Mortgage Loans, Residential Mortgage Loans, Installment Loans, Home Equity and Credit Lines, and Lease Backed Term Loans.

Income Taxes

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, as well as operating loss carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is established against deferred tax assets when, in the judgment of management, it is more likely than not that such deferred tax assets will not become available. Because the judgment about the level of future taxable income is dependent to a great extent on matters that may, at least in part, be beyond the our control, it is at least reasonably possible that management's judgment about the need for a valuation allowance for deferred taxes could change in the near term.

Impact of Inflation and Changing Prices

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

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not applicable to smaller reporting companies.

Item 4. Controls and Procedures

The Registrant's chief executive officer and chief financial officer, after evaluating the effectiveness of the Registrant's "disclosure controls and procedures" (as defined in the Securities Exchange Act of 1934 Rules13a-15(e) and 15d-15(e)) as of the end of the period covered by this quarterly report, have concluded that as of such date, the Registrant's disclosure controls and procedures were effective to ensure at a reasonable assurance level that material information relating to the Registrant is recorded, processed, summarized and reported in a timely manner.

There were no changes in the Registrant's internal control over financial reporting that occurred during the Registrant's first fiscal quarter of 2012 that have materially affected, or are reasonably likely to materially affect, the Registrant's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1.   Legal Proceedings

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

Item 1A. Risk Factors

In addition to those risk factors included under Item 1A of our Annual Report on Form 10-K, investors should consider the following information prior to making any investment decisions regarding the Company's securities:

Our elevated level of classified and non-performing assets and recent losses may cause our regulators to take formal or informal enforcement actions against us.

Our level of non-performing assets has continued to increase through the first quarter of 2012. At March 31, 2012 our non-performing assets totaled $35.4 million, or 9.25% of our total assets. As a result, we have incurred losses for 2011 and the first quarter of 2012. This deterioration in our operations and financial condition may result in our regulators taking a formal or informal enforcement action against the Bank. Any such action may restrict our ability to grow, and result in our incurring significant additional expense to comply with the requirements of such an action. In addition, the Bank has been informed that it may not pay dividends to the Company, nor engage in transactions that would materially change the composition of the Bank's balance sheet (including increasing assets by 5% or more), without in each case the prior approval of the Bank's regulators. Any additional regulatory actions may adversely effect our future results of operations.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Not applicable.

Item 3. **Defaults Upon Senior Securities**

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable

Item 5. Other Information

Not applicable.

Item 6. Exhibits

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

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

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

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

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

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SIGNATURES

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

CORNERSTONE FINANCIAL CORPORATION

Date: May 11, 2012 By: /s/ George W. Matteo, Jr.

George W. Matteo, Jr.

President and Chief Executive Officer

(Principal Executive Officer)

Date: May 11, 2012 By: /s/ Keith Winchester

Keith Winchester

Executive Vice President and

Chief Financial Officer

(Principal Financial and Accounting Officer)

Item 4. Controls and Procedures

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