First Bancorp, Inc /ME/
Form 10-Q
November 09, 2012
UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 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 September 30, 2012

Commission File Number 0-26589

THE FIRST BANCORP, INC.
(Exact name of Registrant as specified in its charter)

MAINE	01-0404322
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

MAIN STREET, DAMARISCOTTA, MAINE	04543
(Address of principal executive offices)	(Zip code)

(207) 563-3195
Registrant's telephone number, including area code

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer [_] Accelerated filer [X] Non-accelerated filer [_]

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

Indicate the number of shares outstanding of each of the registrant's classes of common stock as of November 1, 2012
Common Stock: 9,853,396 shares

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Part I. Financial Information

Selected Financial Data (Unaudited)
The First Bancorp, Inc. and Subsidiary

Dollars in thousands, except for per share amounts	For the nine months ended September 30, 2012	2011	For the quarters ended September 30, 2012	2011
Summary of Operations				
Interest Income	$39,131	$42,146	$12,892	$13,898
Interest Expense	9,737	11,193	3,222	3,670
Net Interest Income	29,394	30,953	9,670	10,228
Provision for Loan Losses	6,300	5,600	1,400	1,500
Non-Interest Income	8,556	6,591	2,492	2,080
Non-Interest Expense	19,503	19,669	6,595	6,934
Net Income	9,459	9,341	3,223	3,006
Per Common Share Data				
Basic Earnings per Share	$0.91	$0.85	$0.31	$0.27
Diluted Earnings per Share	0.91	0.85	0.31	0.27
Cash Dividends Declared	0.585	0.585	0.195	0.195
Book Value per Common Share	14.64	14.11	14.64	14.11
Tangible Book Value per Common Share	11.83	11.28	11.83	11.28
Market Value	17.55	12.59	17.55	12.59
Financial Ratios				
Return on Average Equity[1]	8.86 %	9.64 %	8.90 %	9.15 %
Return on Average Tangible Equity[1,2]	10.36 %	10.92 %	10.39 %	10.25 %
Return on Average Assets[1]	0.89 %	0.87 %	0.90 %	0.83 %
Average Equity to Average Assets	10.90 %	10.67 %	11.02 %	10.46 %
Average Tangible Equity to Average Assets[2]	8.95 %	8.74 %	9.07 %	8.53 %
Net Interest Margin Tax-Equivalent[1,2]	3.16 %	3.29 %	3.12 %	3.24 %
Dividend Payout Ratio	64.29 %	68.82 %	62.90 %	72.22 %
Allowance for Loan Losses/Total Loans	1.69 %	1.76 %	1.69 %	1.76 %
Non-Performing Loans to Total Loans	2.71 %	2.42 %	2.71 %	2.42 %
Non-Performing Assets to Total Assets	2.04 %	1.91 %	2.04 %	1.91 %
Efficiency Ratio[2]	50.74 %	49.89 %	50.73 %	53.15 %
At Period End				
Total Assets	$1,423,316	$1,427,038	$1,423,316	$1,427,038
Total Loans	869,871	868,573	869,871	868,573
Total Investment Securities	468,604	471,924	468,604	471,924
Total Deposits	944,547	1,004,894	944,547	1,004,894
Total Shareholders' Equity	156,637	150,538	156,637	150,538

[1]Annualized using a 366-day basis in 2012 and 365-day basis in 2011
[2]These ratios use non-GAAP financial measures. See Management's Discussion and Analysis of Financial Condition and Results of Operations for additional disclosures and information.

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Item 1 – Financial Statements

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
The First Bancorp, Inc.

We have reviewed the accompanying interim consolidated financial information of The First Bancorp, Inc. and Subsidiary as of September 30, 2012 and 2011 and for the three- and nine-month periods then ended. These financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit in accordance with standards of the Public Company Accounting Oversight Board (United States), the objective of which is to express an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying interim consolidated financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

/s/ Berry Dunn McNeil & Parker, LLC

Portland, Maine
November 9, 2012

Consolidated Balance Sheets (Unaudited)
The First Bancorp, Inc. and Subsidiary

	September 30, 2012	December 31, 2011	September 30, 2011
Assets			
Cash and cash equivalents	$14,904,000	$14,115,000	$16,563,000
Interest bearing deposits in other banks	681,000	-	100,000
Securities available for sale	299,900,000	286,202,000	326,782,000
Securities to be held to maturity (fair value of $162,382,000 at September 30, 2012, $130,677,000 at December 31, 2011 and $137,227,000 at September 30, 2011)	154,256,000	122,661,000	129,699,000
Restricted equity securities, at cost	14,448,000	15,443,000	15,443,000
Loans held for sale	-	-	230,000
Loans	869,871,000	864,988,000	868,573,000
Less allowance for loan losses	14,739,000	13,000,000	15,319,000
Net loans	855,132,000	851,988,000	853,254,000
Accrued interest receivable	5,425,000	4,835,000	5,018,000
Premises and equipment, net	18,376,000	18,842,000	18,872,000
Other real estate owned	5,471,000	4,094,000	6,310,000
Goodwill	27,684,000	27,684,000	27,684,000
Other assets	27,039,000	27,003,000	27,083,000
Total assets	$1,423,316,000	$1,372,867,000	$1,427,038,000
Liabilities			
Demand deposits	$89,500,000	$75,750,000	$88,472,000
NOW deposits	136,472,000	122,775,000	130,522,000
Money market deposits	74,805,000	79,015,000	77,736,000
Savings deposits	130,354,000	114,617,000	114,079,000
Certificates of deposit	513,416,000	549,176,000	594,085,000
Total deposits	944,547,000	941,333,000	1,004,894,000
Borrowed funds – short term	164,592,000	135,500,000	135,452,000
Borrowed funds – long term	140,157,000	130,163,000	120,164,000
Other liabilities	17,383,000	15,013,000	15,990,000
Total liabilities	1,266,679,000	1,222,009,000	1,276,500,000
Shareholders' equity			
Preferred stock, $1,000 preference value per share	12,377,000	12,303,000	12,278,000
Common stock, one cent par value per share	98,000	98,000	98,000
Additional paid-in capital	46,205,000	45,829,000	45,706,000
Retained earnings	88,541,000	85,314,000	84,360,000
Accumulated other comprehensive income (loss)			
Net unrealized gain on securities available-for-sale	9,488,000	7,401,000	8,155,000
Net unrealized loss on postretirement benefit costs	(72,000)	(87,000)	(59,000)
Total shareholders' equity	156,637,000	150,858,000	150,538,000
Total liabilities & shareholders' equity	$1,423,316,000	$1,372,867,000	$1,427,038,000
Common Stock			
Number of shares authorized	18,000,000	18,000,000	18,000,000
Number of shares issued and outstanding	9,853,396	9,812,180	9,800,507
Book value per common share	$14.64	$14.12	$14.11
Tangible book value per common share	$11.83	$11.30	$11.28

See Report of Independent Registered Public Accounting Firm.
The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Income and Comprehensive Income (Unaudited)
The First Bancorp, Inc. and Subsidiary

	For the nine months ended September 30,		For the quarters ended September 30,	
	2012	2011	2012	2011
Interest income				
Interest and fees on loans	$28,006,000	$30,088,000	$9,247,000	$9,960,000
Interest on deposits with other banks	3,000	11,000	2,000	7,000
Interest and dividends on investments	11,122,000	12,047,000	3,643,000	3,931,000
Total interest income	39,131,000	42,146,000	12,892,000	13,898,000
Interest expense				
Interest on deposits	6,370,000	7,478,000	2,073,000	2,397,000
Interest on borrowed funds	3,367,000	3,715,000	1,149,000	1,273,000
Total interest expense	9,737,000	11,193,000	3,222,000	3,670,000
Net interest income	29,394,000	30,953,000	9,670,000	10,228,000
Provision for loan losses	6,300,000	5,600,000	1,400,000	1,500,000
Net interest income after provision for loan losses	23,094,000	25,353,000	8,270,000	8,728,000
Non-interest income				
Investment management and fiduciary income	1,230,000	1,140,000	386,000	358,000
Service charges on deposit accounts	1,995,000	2,032,000	644,000	681,000
Net securities gains	1,967,000	237,000	-	8,000
Mortgage origination and servicing income	854,000	845,000	550,000	193,000
Other operating income	2,510,000	2,337,000	912,000	840,000
Total non-interest income	8,556,000	6,591,000	2,492,000	2,080,000
Non-interest expense				
Salaries and employee benefits	9,485,000	9,255,000	3,283,000	3,250,000
Occupancy expense	1,247,000	1,194,000	428,000	367,000
Furniture and equipment expense	1,650,000	1,665,000	527,000	554,000
FDIC insurance premiums	909,000	1,104,000	303,000	298,000
Amortization of identified intangibles	212,000	212,000	71,000	71,000
Other operating expense	6,000,000	6,239,000	1,983,000	2,394,000
Total non-interest expense	19,503,000	19,669,000	6,595,000	6,934,000
Income before income taxes	12,147,000	12,275,000	4,167,000	3,874,000
Applicable income taxes	2,688,000	2,934,000	944,000	868,000
NET INCOME	$9,459,000	$9,341,000	$3,223,000	$3,006,000
Basic earnings per common share	$0.91	$0.85	$0.31	$0.27
Diluted earnings per common share	$0.91	$0.85	$0.31	$0.27
Other comprehensive income, net of tax				
Net unrealized gain on securities available for sale	2,087,000	10,212,000	1,962,000	5,957,000
Unrecognized postretirement benefits transition obligation	15,000	14,000	5,000	4,000
Other comprehensive income	2,102,000	10,226,000	1,967,000	5,961,000
Comprehensive income	$11,561,000	$19,567,000	$5,190,000	$8,967,000

See Report of Independent Registered Public Accounting Firm.
The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Changes in Shareholders' Equity (Unaudited)
The First Bancorp, Inc. and Subsidiary

	Preferred stock	Common stock and additional paid-in capital Shares	Amount	Retained earnings	Accumulated other comprehensive income (loss)	Total shareholders' equity
Balance at December 31, 2010	$ 24,705,000	9,773,025	$ 45,572,000	$ 81,701,000	$ (2,130,000)	$ 149,848,000
Net income	-	-	-	9,341,000	-	9,341,000
Net unrealized gain on securities available for sale, net of taxes of $5,500,000	-	-	-	-	10,212,000	10,212,000
Unrecognized transition obligation for postretirement benefits, net of taxes of $8,000	-	-	-	-	14,000	14,000
Comprehensive income	-	-	-	9,341,000	10,226,000	19,567,000
Cash dividends declared	-	-	-	(6,682,000)	-	(6,682,000)
Equity compensation expense	-	-	17,000	-	-	17,000
Amortization of premium for preferred stock issuance	73,000	-	(73,000)	-	-	-
Payment to repurchase preferred stock	(12,500,000)	-	-	-	-	(12,500,000)
Proceeds from sale of common stock	-	27,482	288,000	-	-	288,000
Balance at September 30, 2011	$ 12,278,000	9,800,507	$ 45,804,000	$ 84,360,000	$ 8,096,000	$ 150,538,000
Balance at December 31, 2011	$ 12,303,000	9,812,180	$ 45,927,000	$ 85,314,000	$ 7,314,000	$ 150,858,000
Net income	-	-	-	9,459,000	-	9,459,000
Net unrealized gain on securities available for sale, net of taxes of $1,124,000	-	-	-	-	2,087,000	2,087,000
Unrecognized transition obligation for postretirement benefits, net of taxes of $8,000	-	-	-	-	15,000	15,000
Comprehensive income	-	-	-	9,459,000	2,102,000	11,561,000
Cash dividends declared	-	-	-	(6,232,000)	-	(6,232,000)
Equity compensation expense	-	-	57,000	-	-	57,000
Amortization of premium for preferred stock issuance	74,000	-	(74,000)	-	-	-

Proceeds from sale of common stock	-	41,216	393,000	-	-	393,000
Balance at September 30, 2012	$12,377,000	9,853,396	$46,303,000	$88,541,000	$9,416,000	$156,637,000

See Report of Independent Registered Public Accounting Firm.

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

Consolidated Statements of Cash Flows (Unaudited)
The First Bancorp, Inc. and Subsidiary

	For the nine months ended September 30, 2012	September 30, 2011
Cash flows from operating activities		
Net income	$9,459,000	$9,341,000
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	992,000	1,018,000
Change in deferred taxes	(929,000)	(644,000)
Provision for loan losses	6,300,000	5,600,000
Loans originated for resale	(29,137,762)	(33,416,000)
Proceeds from sales and transfers of loans	29,331,762	35,992,000
Net gain on sale or call of securities	(1,967,000)	(237,000)
Net (gain)/loss on sale of other real estate owned	29,000	(13,000)
Provision for losses on other real estate owned	291,000	800,000
Equity compensation expense	57,000	17,000
Net (increase) decrease in other assets and accrued interest	(483,000)	2,043,000
Net increase (decrease) in other liabilities	1,478,000	(473,000)
Net (gain)/loss on disposal of premises and equipment	(30,000)	5,000
Net amortization of premiums on investments	2,125,000	2,908,000
Amortization of investment in limited partnership	357,000	292,000
Net acquisition amortization	173,000	173,000
Net cash provided by operating activities	18,046,000	23,406,000
Cash flows from investing activities		
Purchase of Fed Funds sold	(681,000)	-
Proceeds from sales of securities available for sale	25,437,000	75,182,000
Proceeds from maturities, payments and calls of securities available for sale	43,803,000	34,209,000
Proceeds from maturities, payments and calls of securities to be held to maturity	42,497,000	16,031,000
Proceeds from sales of other real estate owned	2,077,000	2,875,000
Purchases of securities available for sale	(79,941,000)	(129,488,000)
Purchases of securities to be held to maturity	(74,230,000)	(38,765,000)
Redemption of restricted equity securities	995,000	-
Net (increase) decrease in loans	(13,218,000)	10,383,000
Capital expenditures	(554,000)	(915,000)
Proceeds from sale of equipment	58,000	-
Net cash used in investing activities	(53,757,000)	(30,488,000)
Cash flows from financing activities		
Net increase in demand, savings, and money market accounts	38,974,000	44,480,000
Net decrease in certificates of deposit	(35,728,000)	(14,072,000)
Net increase (decrease) in short-term borrowings	39,093,000	(1,707,000)
Repurchase of preferred stock	-	(12,500,000)
Proceeds from sale of common stock	393,000	288,000
Dividends paid	(6,232,000)	(6,682,000)
Net cash provided by financing activities	36,500,000	9,807,000
Net increase in cash and cash equivalents	789,000	2,725,000
Cash and cash equivalents at beginning of period	14,115,000	13,838,000
Cash and cash equivalents at end of period	$14,904,000	$16,563,000
Interest paid	$9,853,000	$11,418,000
Income taxes paid	$2,060,000	$2,557,000

Non-cash transactions		
Net transfer from loans to other real estate owned	$3,774,000	$5,043,000

See Report of Independent Registered Public Accounting Firm.

Notes to Consolidated Financial Statements
The First Bancorp, Inc. and Subsidiary

Note 1 – Basis of Presentation

The First Bancorp, Inc. (the Company) is a financial holding company that owns all of the common stock of The First, N.A. (the Bank). The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of Management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. All significant intercompany transactions and balances are eliminated in consolidation. The income reported for the 2012 period is not necessarily indicative of the results that may be expected for the year ending December 31, 2012. For further information, refer to the consolidated financial statements and notes included in the Company's annual report on Form 10-K for the year ended December 31, 2011.

Subsequent Events
Events occurring subsequent to September 30, 2012, have been evaluated as to their potential impact to the financial statements.

Note 2 – Investment Securities

The following table summarizes the amortized cost and estimated fair value of investment securities at September 30, 2012:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value (Estimated)
Securities available for sale				
U.S. Treasury and agency	$-	$-	$-	$-
Mortgage-backed securities	183,126,000	6,408,000	(97,000)	189,437,000
State and political subdivisions	100,614,000	8,363,000	(22,000)	108,955,000
Corporate securities	-	-	-	-
Other equity securities	1,563,000	49,000	(104,000)	1,508,000
	$285,303,000	$14,820,000	$(223,000)	$299,900,000
Securities to be held to maturity				
U.S. Treasury and agency	$65,859,000	$390,000	$(21,000)	$66,228,000
Mortgage-backed securities	44,236,000	3,400,000	(10,000)	47,626,000
State and political subdivisions	43,861,000	4,367,000	-	48,228,000
Corporate securities	300,000	-	-	300,000
	$154,256,000	$8,157,000	$(31,000)	$162,382,000
Restricted equity securities				
Federal Home Loan Bank Stock	$13,412,000	$-	$-	$13,412,000
Federal Reserve Bank Stock	1,036,000	-	-	1,036,000
	$14,448,000	$-	$-	$14,448,000

The following table summarizes the amortized cost and estimated fair value of investment securities at December 31, 2011:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value (Estimated)
Securities available for sale				
U.S. Treasury and agency	$-	$-	$-	$-
Mortgage-backed securities	191,924,000	6,486,000	(178,000)	198,232,000
State and political subdivisions	80,259,000	5,484,000	(17,000)	85,726,000
Corporate securities	1,098,000	-	(287,000)	811,000
Other equity securities	1,535,000	37,000	(139,000)	1,433,000
	$274,816,000	$12,007,000	$(621,000)	$286,202,000
Securities to be held to maturity				
U.S. Treasury and agency	$19,390,000	$132,000	$-	$19,522,000
Mortgage-backed securities	56,800,000	3,900,000	(3,000)	60,697,000
State and political subdivisions	46,171,000	4,159,000	(172,000)	50,158,000
Corporate securities	300,000	-	-	300,000
	$122,661,000	$8,191,000	$(175,000)	$130,677,000
Restricted equity securities				
Federal Home Loan Bank Stock	$14,031,000	$-	$-	$14,031,000
Federal Reserve Bank Stock	1,412,000	-	-	1,412,000
	$15,443,000	$-	$-	$15,443,000

The following table summarizes the amortized cost and estimated fair value of investment securities at September 30, 2011:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value (Estimated)
Securities available for sale				
U.S. Treasury and agency	$15,295,000	$1,199,000	$-	$16,494,000
Mortgage-backed securities	227,180,000	8,173,000	(315,000)	235,038,000
State and political subdivisions	70,124,000	3,936,000	(21,000)	74,039,000
Corporate securities	1,103,000	-	(324,000)	779,000
Other equity securities	534,000	33,000	(135,000)	432,000
	$314,236,000	$13,341,000	$(795,000)	$326,782,000
Securities to be held to maturity				
U.S. Treasury and agency	$20,998,000	$180,000	$-	$21,178,000
Mortgage-backed securities	61,048,000	4,221,000	(19,000)	65,250,000
State and political subdivisions	47,353,000	3,397,000	(251,000)	50,499,000
Corporate securities	300,000	-	-	300,000
	$129,699,000	$7,798,000	$(270,000)	$137,227,000
Restricted equity securities				
Federal Home Loan Bank Stock	$14,031,000	$-	$-	$14,031,000
Federal Reserve Bank Stock	1,412,000	-	-	1,412,000
	$15,443,000	$-	$-	$15,443,000

The following table summarizes the contractual maturities of investment securities at September 30, 2012:

	Securities available for sale		Securities to be held to maturity	
	Amortized Cost	Fair Value (Estimated)	Amortized Cost	Fair Value (Estimated)
Due in 1 year or less	$4,592,000	$4,652,000	$1,376,000	$1,380,000
Due in 1 to 5 years	50,173,000	51,286,000	11,046,000	11,569,000
Due in 5 to 10 years	16,908,000	17,965,000	20,519,000	22,376,000
Due after 10 years	212,067,000	224,489,000	121,315,000	127,057,000
Equity securities	1,563,000	1,508,000	-	-
	$285,303,000	$299,900,000	$154,256,000	$162,382,000

The following table summarizes the contractual maturities of investment securities at December 31, 2011:

	Securities available for sale		Securities to be held to maturity	
	Amortized Cost	Fair Value (Estimated)	Amortized Cost	Fair Value (Estimated)
Due in 1 year or less	$6,617,000	$6,773,000	$5,179,000	$5,227,000
Due in 1 to 5 years	18,792,000	19,473,000	10,085,000	10,654,000
Due in 5 to 10 years	23,219,000	24,065,000	23,027,000	24,694,000
Due after 10 years	224,653,000	234,458,000	84,370,000	90,102,000
Equity securities	1,535,000	1,433,000	-	-
	$274,816,000	$286,202,000	$122,661,000	$130,677,000

The following table summarizes the contractual maturities of investment securities at September 30, 2011:

	Securities available for sale		Securities to be held to maturity	
	Amortized Cost	Fair Value (Estimated)	Amortized Cost	Fair Value (Estimated)
Due in 1 year or less	$4,394,000	$4,450,000	$152,000	$153,000
Due in 1 to 5 years	11,188,000	11,748,000	14,848,000	15,415,000
Due in 5 to 10 years	34,872,000	36,698,000	22,158,000	23,608,000
Due after 10 years	263,248,000	273,454,000	92,541,000	98,051,000
Equity securities	534,000	432,000	-	-
	$314,236,000	$326,782,000	$129,699,000	$137,227,000

At September 30, 2012, securities with a fair value of $171,004,000 were pledged to secure public deposits, repurchase agreements, and for other purposes as required by law. This compares to securities with a fair value of $141,506,000 as of December 31, 2011 and $171,436,000 at September 30, 2011, pledged for the same purposes. Gains and losses on the sale of securities available for sale are computed by subtracting the amortized cost at the time of sale from the security's selling price, net of accrued interest to be received. The following table shows securities gains and losses for the nine months and quarters ended September 30, 2012 and 2011:

For the nine months ended September 30,	For the quarters ended September 30,

	2012	2011	2012	2011
Proceeds from sales of securities	$25,437,000	$75,182,000	$300,000	$6,000
Gross realized gains	2,256,000	964,000	-	7,000
Gross realized losses	(289,000)	(727,000)	-	1,000
Net gain	$1,967,000	$237,000	-	$8,000
Related income taxes	$688,000	$83,000	$-	$3,000

The following table summarizes activity in the unrealized gain or loss on available for sale securities included in other comprehensive income for the nine months and quarters ended September 30, 2012 and 2011.

	For the nine months ended September 30,		For the quarters ended September 30,	
	2012	2011	2012	2011
Balance at beginning of period	$7,401,000	$(2,057,000)	$7,526,000	$2,198,000
Unrealized gains arising during the period	5,178,000	15,949,000	3,019,000	9,174,000
Realized gains during the period	(1,967,000)	(237,000)	-	(8,000)
Related deferred taxes	(1,124,000)	(5,500,000)	(1,057,000)	(3,209,000)
Net change	2,087,000	10,212,000	1,962,000	5,957,000
Balance at end of period	$9,488,000	$8,155,000	$9,488,000	$8,155,000

Management reviews securities with unrealized losses for other than temporary impairment. As of September 30, 2012, there were 20 securities with unrealized losses held in the Company's portfolio. These securities were temporarily impaired as a result of changes in interest rates reducing their fair value, of which seven had been temporarily impaired for 12 months or more. At the present time, there have been no material changes in the credit quality of these securities resulting in other than temporary impairment, and in Management's opinion, no additional write-down for other-than-temporary impairment is warranted. Information regarding securities temporarily impaired as of September 30, 2012 is summarized below:

	Less than 12 months		12 months or more		Total	
	Fair Value (Estimated)	Unrealized Losses	Fair Value (Estimated)	Unrealized Losses	Fair Value (Estimated)	Unrealized Losses
U.S. Treasury and agency	$1,199,000	$(21,000)	$-	$-	$1,199,000	$(21,000)
Mortgage-backed securities	12,990,000	(76,000)	3,104,000	(31,000)	16,094,000	(107,000)
State and political subdivisions	1,123,000	(22,000)	-	-	1,123,000	(22,000)
Corporate securities	-	-	-	-	-	-
Other equity securities	3,000	-	191,000	(104,000)	194,000	(104,000)
	$15,315,000	$(119,000)	$3,295,000	$(135,000)	$18,610,000	$(254,000)

As of December 31, 2011, there were 29 securities with unrealized losses held in the Company's portfolio. These securities were temporarily impaired as a result of changes in interest rates reducing their fair value, of which 11 had been temporarily impaired for 12 months or more. Information regarding securities temporarily impaired as of December 31, 2011 is summarized below:

	Less than 12 months		12 months or more		Total	
	Fair Value (Estimated)	Unrealized Losses	Fair Value (Estimated)	Unrealized Losses	Fair Value (Estimated)	Unrealized Losses
U.S. Treasury and agency	$-	$-	$-	$-	$-	$-
Mortgage-backed securities	12,489,000	(25,000)	6,780,000	(156,000)	19,269,000	(181,000)
State and political subdivisions	1,984,000	(17,000)	1,667,000	(172,000)	3,651,000	(189,000)
Corporate securities	-	-	811,000	(287,000)	811,000	(287,000)
Other equity securities	154,000	(120,000)	34,000	(19,000)	188,000	(139,000)
	$14,627,000	$(162,000)	$9,292,000	$(634,000)	$23,919,000	$(796,000)

As of September 30, 2011, there were 29 securities with unrealized losses held in the Company's portfolio. These securities were temporarily impaired as a result of changes in interest rates reducing their fair value, of which 12 had been temporarily impaired for 12 months or more. Information regarding securities temporarily impaired as of September 30, 2011 is summarized below:

	Less than 12 months		12 months or more		Total	
	Fair Value (Estimated)	Unrealized Losses	Fair Value (Estimated)	Unrealized Losses	Fair Value (Estimated)	Unrealized Losses
U.S. Treasury and agency	$-	$-	$-	$-	$-	$-
Mortgage-backed securities	11,669,000	(46,000)	6,984,000	(288,000)	18,653,000	(334,000)
State and political subdivisions	1,748,000	(21,000)	1,569,000	(251,000)	3,317,000	(272,000)
Corporate securities	-	-	779,000	(324,000)	779,000	(324,000)
Other equity securities	151,000	(119,000)	36,000	(16,000)	187,000	(135,000)
	$13,568,000	$(186,000)	$9,368,000	$(879,000)	$22,936,000	$(1,065,000)

The Bank is a member of the Federal Home Loan Bank ("FHLB") of Boston, a cooperatively owned wholesale bank for housing and finance in the six New England States. As a requirement of membership in the FHLB, the Bank must own a minimum required amount of FHLB stock, calculated periodically based primarily on its level of borrowings from the FHLB. The Bank uses the FHLB for much of its wholesale funding needs. As of September 30, 2012 and 2011, and December 31, 2011, the Bank's investment in FHLB stock totaled $13,412,000, $14,031,000 and $14,031,000 respectively. FHLB stock is a non-marketable equity security and therefore is reported at cost, which equals par value.

Note 3 – Loans

The following table shows the composition of the Company's loan portfolio as of September 30, 2012 and 2011 and at December 31, 2011:

	September 30, 2012		December 31, 2011		September 30, 2011	
Commercial						
Real estate	$256,531,000	29.5 %	$255,424,000	29.5 %	$257,910,000	29.7 %
Construction	21,905,000	2.5 %	32,574,000	3.8 %	30,345,000	3.5 %
Other	83,703,000	9.6 %	86,982,000	10.1 %	96,045,000	11.1 %
Municipal	16,448,000	1.9 %	16,221,000	1.9 %	19,853,000	2.3 %
Residential						
Term	369,949,000	42.5 %	341,286,000	39.5 %	329,730,000	38.0 %
Construction	6,528,000	0.8 %	10,469,000	1.2 %	12,061,000	1.4 %
Home equity line of credit	100,099,000	11.5 %	105,244,000	12.1 %	105,891,000	12.1 %
Consumer	14,708,000	1.7 %	16,788,000	1.9 %	16,738,000	1.9 %
Total	$869,871,000	100.0%	$864,988,000	100.0%	$868,573,000	100.0%

Loan balances include net deferred loan costs of $1,694,000 as of September 30, 2012, $1,386,000 as of December 31, 2011, and $1,336,000 as of September 30, 2011. Pursuant to collateral agreements, qualifying first mortgage loans, which totaled $244,794,000 at September 30, 2012, $211,597,000 at December 31, 2011, and $190,890,000 at September 30, 2011, were used to collateralize borrowings from the Federal Home Loan Bank of Boston. In addition, commercial, construction and home equity loans totaling $234,200,000 at September 30, 2012, $218,417,000 at December 31, 2011, and $310,230,000 at September 30, 2011, were used to collateralize a standby line of credit at the Federal Reserve Bank of Boston that is currently unused.

Loans on non-accrual status totaled $23,573,000 at September 30, 2012, $27,806,000 at December 31, 2011 and $20,980,000 at September 30, 2011. Loans past due 90 days or greater which are accruing interest totaled $1,787,000 at September 30, 2012, $1,170,000 at December 31, 2011 and $1,291,000 at September 30, 2011. The Company continues to accrue interest on these loans because it believes collection of principal and interest is reasonably assured.

Information on the past-due status of loans by class of financing receivable as of September 30, 2012, is presented in the following table:

	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	All Past Due	Current	Total	90+ Days & Accruing
Commercial							
Real estate	$190,000	$102,000	$2,105,000	$2,397,000	$254,134,000	$256,531,000	$283,000
Construction	31,000	-	154,000	185,000	21,720,000	21,905,000	-
Other	448,000	248,000	1,790,000	2,486,000	81,217,000	83,703,000	-
Municipal	-	-	-	-	16,448,000	16,448,000	-
Residential							
Term	1,436,000	2,536,000	9,047,000	13,019,000	356,930,000	369,949,000	1,442,000
Construction	-	-	23,000	23,000	6,505,000	6,528,000	-
Home equity line of credit	358,000	-	1,000,000	1,358,000	98,741,000	100,099,000	-
Consumer	169,000	19,000	63,000	251,000	14,457,000	14,708,000	62,000
Total	$2,632,000	$2,905,000	$14,182,000	$19,719,000	$850,152,000	$869,871,000	$1,787,000

Information on the past-due status of loans by class of financing receivable as of December 31, 2011, is presented in the following table:

	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	All Past Due	Current	Total	90+ Days & Accruing
Commercial							
Real estate	$1,367,000	$1,505,000	$3,992,000	$6,864,000	$248,560,000	$255,424,000	$-
Construction	-	174,000	1,603,000	1,777,000	30,797,000	32,574,000	-
Other	665,000	766,000	1,192,000	2,623,000	84,359,000	86,982,000	52,000
Municipal	-		-	-	16,221,000	16,221,000	-
Residential							
Term	1,933,000	1,398,000	8,843,000	12,174,000	329,112,000	341,286,000	1,118,000
Construction	-	-	1,198,000	1,198,000	9,271,000	10,469,000	-
Home equity line of credit	480,000	-	1,134,000	1,614,000	103,630,000	105,244,000	-
Consumer	230,000	101,000	16,000	347,000	16,441,000	16,788,000	-
Total	$4,675,000	$3,944,000	$17,978,000	$26,597,000	$838,391,000	$864,988,000	$1,170,000

Information on the past-due status of loans by class of financing receivable as of September 30, 2011, is presented in the following table:

	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	All Past Due	Current	Total	90+ Days & Accruing
Commercial							
Real estate	$1,337,000	$341,000	$3,437,000	$5,115,000	$252,795,000	$257,910,000	$-
Construction	-	-	35,000	35,000	30,310,000	30,345,000	-
Other	820,000	155,000	802,000	1,777,000	94,268,000	96,045,000	71,000
Municipal	-	-	-	-	19,853,000	19,853,000	-
Residential							
Term	1,274,000	954,000	7,945,000	10,173,000	319,557,000	329,730,000	1,213,000
Construction	-	-	396,000	396,000	11,665,000	12,061,000	-
Home equity line of credit	232,000	13,000	1,234,000	1,479,000	104,412,000	105,891,000	-
Consumer	115,000	25,000	7,000	147,000	16,591,000	16,738,000	7,000
Total	$3,778,000	$1,488,000	$13,856,000	$19,122,000	$849,451,000	$868,573,000	$1,291,000

For all classes, loans are placed on non-accrual status when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement or when principal and interest is 90 days or more past due unless the loan is both well secured and in the process of collection (in which case the loan may continue to accrue interest in spite of its past due status). A loan is "well secured" if it is secured (1) by collateral in the form of liens on or pledges of real or personal property, including securities, that have a realizable value sufficient to discharge the debt (including accrued interest) in full, or (2) by the guarantee of a financially responsible party. A loan is "in the process of collection" if collection of the loan is proceeding in due course either (1) through legal action, including judgment enforcement procedures, or, (2) in appropriate circumstances, through collection efforts not involving legal action which are reasonably expected to result in repayment of the debt or in its restoration to a current status in the near future.
Information on nonaccrual loans as of September 30, 2012 and 2011 and at December 31, 2011 is presented in the following table:

	September 30, 2012	December 31, 2011	September 30, 2011
Commercial			
Real estate	$5,200,000	$7,064,000	$6,056,000
Construction	3,546,000	2,350,000	792,000
Other	3,030,000	5,784,000	1,327,000
Municipal	-	-	-
Residential			
Term	10,745,000	10,194,000	11,073,000
Construction	23,000	1,198,000	396,000
Home equity line of credit	1,028,000	1,163,000	1,234,000
Consumer	1,000	53,000	102,000
Total	$23,573,000	$27,806,000	$20,980,000

Impaired loans include restructured loans and loans placed on non-accrual. These loans are measured at the present value of expected future cash flows discounted at the loan's effective interest rate or at the fair value of the collateral if the loan is collateral dependent. If the measure of an impaired loan is lower than the recorded investment in the loan and estimated selling costs, a specific reserve is established for the difference.

A breakdown of impaired loans by class of financing receivable as of and for the period ended September 30, 2012, is presented in the following table:

				For the nine months ended September 30, 2012		For the quarter ended September 30, 2012	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Recognized Interest Income	Average Recorded Investment	Recognized Interest Income
With No Related Allowance							
Commercial							
Real estate	$10,142,000	$10,858,000	$-	$10,238,000	$134,000	$11,257,000	$23,000
Construction	4,694,000	4,694,000	-	2,319,000	34,000	2,578,000	8,000
Other	2,362,000	2,543,000	-	2,548,000	22,000	2,223,000	6,000
Municipal	-	-	-	-	-	-	-
Residential							
Term	8,414,000	8,870,000	-	9,267,000	102,000	8,477,000	31,000
Construction	23,000	272,000	-	747,000	-	481,000	-
Home equity line of credit	957,000	1,076,000	-	868,000	14,000	1,089,000	14,000
Consumer	-	-	-	4,000	-	-	-
	$26,592,000	$28,313,000	$-	$25,991,000	$306,000	$26,105,000	$82,000
With an Allowance Recorded							
Commercial							
Real estate	$6,179,000	$6,416,000	$1,416,000	$4,058,000	$113,000	$4,119,000	$97,000
Construction	1,951,000	1,951,000	696,000	1,613,000	61,000	2,086,000	24,000
Other	2,543,000	2,573,000	1,240,000	2,105,000	28,000	2,290,000	10,000
Municipal	-	-	-	-	-	-	-
Residential							
Term	10,891,000	11,066,000	1,494,000	9,215,000	202,000	10,672,000	75,000
Construction	-	-	-	348,000	-	111,000	-
Home equity line of credit	488,000	488,000	215,000	563,000	-	558,000	-
Consumer	1,000	1,000	1,000	12,000	-	6,000	-
	$22,053,000	$22,495,000	$5,062,000	$17,914,000	$404,000	$19,842,000	$206,000
Total							
Commercial							
Real estate	$16,321,000	$17,274,000	$1,416,000	$14,296,000	$247,000	$15,376,000	$120,000
Construction	6,645,000	6,645,000	696,000	3,931,000	95,000	4,664,000	32,000
Other	4,905,000	5,116,000	1,240,000	4,653,000	50,000	4,513,000	16,000
Municipal	-	-	-	-	-	-	-
Residential							
Term	19,305,000	19,936,000	1,494,000	18,482,000	304,000	19,149,000	106,000
Construction	23,000	272,000	-	1,095,000	-	592,000	-
Home equity line of credit	1,445,000	1,564,000	215,000	1,432,000	14,000	1,647,000	14,000
Consumer	1,000	1,000	1,000	16,000	-	6,000	-
	$48,645,000	$50,808,000	$5,062,000	$43,905,000	$710,000	$45,947,000	$288,000

Substantially all interest income recognized on impaired loans for all classes of financing receivables was recognized on a cash basis as received.

A breakdown of impaired loans by class of financing receivable as of and for the year ended December 31, 2011, is presented in the following table:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Recognized Interest Income
With No Related Allowance					
Commercial					
Real estate	$5,584,000	$5,584,000	$-	$5,212,000	$ 23,000
Construction	5,172,000	5,172,000	-	1,072,000	143,000
Other	6,022,000	6,022,000	-	1,918,000	28,000
Municipal	-	-	-	-	-
Residential					
Term	9,875,000	9,875,000	-	9,493,000	54,000
Construction	468,000	468,000	-	961,000	-
Home equity line of credit	739,000	739,000	-	646,000	-
Consumer	37,000	37,000	-	39,000	-
	$27,897,000	$27,897,000	$-	$19,341,000	$ 248,000
With an Allowance Recorded					
Commercial					
Real estate	$4,557,000	$4,557,000	$808,000	$2,307,000	$ 103,000
Construction	530,000	530,000	33,000	247,000	-
Other	1,020,000	1,020,000	402,000	681,000	19,000
Municipal	-	-	-	-	-
Residential					
Term	6,946,000	6,946,000	478,000	5,628,000	228,000
Construction	730,000	730,000	235,000	244,000	-
Home equity line of credit	424,000	424,000	91,000	272,000	-
Consumer	16,000	16,000	11,000	57,000	-
	$14,223,000	$14,223,000	$2,058,000	$9,436,000	$ 350,000
Total					
Commercial					
Real estate	$10,141,000	$10,141,000	$808,000	$7,519,000	$ 126,000
Construction	5,702,000	5,702,000	33,000	1,318,000	143,000
Other	7,042,000	7,042,000	402,000	2,600,000	47,000
Municipal	-	-	-	-	-
Residential					
Term	16,821,000	16,821,000	478,000	15,121,000	282,000
Construction	1,198,000	1,198,000	235,000	1,205,000	-
Home equity line of credit	1,163,000	1,163,000	91,000	918,000	-
Consumer	53,000	53,000	11,000	96,000	-
	$42,120,000	$42,120,000	$2,058,000	$28,777,000	$ 598,000

A breakdown of impaired loans by class of financing receivable as of and for the period ended September 30, 2011, is presented in the following table:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	For the nine months ended September 30, 2011 Average Recorded Investment	Recognized Interest Income	For the quarter ended September 30, 2011 Average Recorded Investment	Recognized Interest Income
With No Related Allowance							
Commercial							
Real estate	$5,008,000	$5,008,000	$-	$5,268,000	$-	$5,384,000	$ -
Construction	792,000	792,000	-	670,000	-	775,000	-
Other	1,295,000	1,295,000	-	1,150,000	-	1,215,000	-
Municipal	-	-	-	-	-	-	-
Residential							
Term	10,104,000	10,104,000	-	9,482,000	-	10,650,000	-
Construction	314,000	314,000	-	1,203,000	-	328,000	-
Home equity line of credit	886,000	886,000	-	618,000	-	1,018,000	-
Consumer	38,000	38,000	-	40,000	-	38,000	-
	$18,437,000	$18,437,000	$-	$18,431,000	$-	$19,408,000	$ -
With an Allowance Recorded							
Commercial							
Real estate	$2,731,000	$2,731,000	$636,000	$1,858,000	$43,000	$1,532,000	$ 15,000
Construction	-	-	-	151,000	-	-	-
Other	645,000	645,000	352,000	651,000	16,000	648,000	6,000
Municipal	-	-	-	-	-	-	-
Residential							
Term	5,963,000	5,963,000	398,000	5,370,000	187,000	5,602,000	63,000
Construction	82,000	82,000	82,000	155,000	-	82,000	-
Home equity line of credit	348,000	348,000	95,000	247,000	-	230,000	-
Consumer	64,000	64,000	64,000	67,000	-	64,000	-
	$9,833,000	$9,833,000	$1,627,000	$8,499,000	$246,000	$8,158,000	$ 84,000
Total							
Commercial							
Real estate	$7,739,000	$7,739,000	$636,000	$7,126,000	$43,000	$6,917,000	$ 15,000
Construction	792,000	792,000	-	821,000	-	775,000	-
Other	1,940,000	1,940,000	352,000	1,801,000	16,000	1,863,000	6,000
Municipal	-	-	-	-	-	-	-
Residential							
Term	16,067,000	16,067,000	398,000	14,852,000	187,000	16,252,000	63,000
Construction	396,000	396,000	82,000	1,358,000	-	410,000	-
Home equity line of credit	1,234,000	1,234,000	95,000	865,000	-	1,248,000	-
Consumer	102,000	102,000	64,000	107,000	-	102,000	-
	$28,270,000	$28,270,000	$1,627,000	$26,930,000	$246,000	$27,567,000	$ 84,000

Note 4. Allowance for Loan Losses

The Company provides for loan losses through the establishment of an allowance for loan losses which represents an estimated reserve for existing losses in the loan portfolio. A systematic methodology is used for determining the allowance that includes a quarterly review process, risk rating changes, and adjustments to the allowance. The loan portfolio is classified in eight segments and credit risk is evaluated separately in each segment. The appropriate level of the allowance is evaluated continually based on a review of significant loans, with a particular emphasis on nonaccruing, past due, and other loans that may require special attention. Other factors include general conditions in local and national economies; loan portfolio composition and asset quality indicators; and internal factors such as changes in underwriting policies, credit administration practices, experience, ability and depth of lending management, among others. The allowance consists of four elements: (1) specific reserves for loans evaluated individually for impairment; (2) general reserves for each portfolio segment based on historical loan loss experience, (3) qualitative reserves judgmentally adjusted for local and national economic conditions, concentrations, portfolio composition, volume and severity of delinquencies and nonaccrual loans, trends of criticized and classified loans, changes in credit policies, and underwriting standards, credit administration practices, and other factors as applicable for each portfolio segment; and (4) unallocated reserves. All outstanding loans are considered in evaluating the appropriateness of the allowance. A breakdown of the allowance for loan losses as of September 30, 2012, December 31, 2011, and September 30, 2011, by class of financing receivable and allowance element, is presented in the following tables:

As of September 30, 2012	Specific Reserves on Loans Evaluated Individually for Impairment	General Reserves on Loans Based on Historical Loss Experience	Reserves for Qualitative Factors	Unallocated Reserves	Total Reserves
Commercial					
Real estate	$ 1,416,000	$ 2,479,000	$ 1,800,000	$ -	$ 5,695,000
Construction	696,000	210,000	153,000	-	1,059,000
Other	1,240,000	807,000	585,000	-	2,632,000
Municipal	-	-	18,000	-	18,000
Residential					
Term	1,494,000	293,000	436,000	-	2,223,000
Construction	-	5,000	9,000	-	14,000
Home equity line of credit	215,000	238,000	337,000	-	790,000
Consumer	1,000	317,000	230,000	-	548,000
Unallocated	-	-	-	1,760,000	1,760,000
	$ 5,062,000	$ 4,349,000	$ 3,568,000	$ 1,760,000	$ 14,739,000

As of December 31, 2011	Specific Reserves on Loans Evaluated Individually for Impairment	General Reserves on Loans Based on Historical Loss Experience	Reserves for Qualitative Factors	Unallocated Reserves	Total Reserves
Commercial					
Real estate	$ 808,000	$ 2,578,000	$ 2,273,000	$ -	$ 5,659,000

Construction	33,000	332,000	293,000	-	658,000
Other	402,000	883,000	778,000	-	2,063,000
Municipal	-	-	19,000	-	19,000
Residential					
Term	478,000	222,000	459,000	-	1,159,000
Construction	235,000	6,000	14,000	-	255,000
Home equity line of credit	91,000	149,000	355,000	-	595,000
Consumer	11,000	331,000	242,000	-	584,000
Unallocated	-	-	-	2,008,000	2,008,000
	$ 2,058,000	$ 4,501,000	$ 4,433,000	$ 2,008,000	$ 13,000,000

As of September 30, 2011	Specific Reserves on Loans Evaluated Individually for Impairment	General Reserves on Loans Based on Historical Loss Experience	Reserves for Qualitative Factors	Unallocated Reserves	Total Reserves
Commercial					
Real estate	$ 636,000	$ 2,547,000	$ 4,273,000	$ -	$ 7,456,000
Construction	-	300,000	504,000	-	804,000
Other	352,000	952,000	1,597,000	-	2,901,000
Municipal	-	-	19,000	-	19,000
Residential					
Term	398,000	553,000	493,000	-	1,444,000
Construction	82,000	20,000	18,000	-	120,000
Home equity line of credit	95,000	130,000	349,000	-	574,000
Consumer	64,000	313,000	238,000	-	615,000
Unallocated	-	-	-	1,386,000	1,386,000
	$ 1,627,000	$ 4,815,000	$ 7,491,000	$ 1,386,000	$ 15,319,000

Qualitative adjustment factors are taken into consideration when determining reserve estimates. These adjustment factors are based upon our evaluation of various current conditions, including those listed below.

- General economic conditions.
- Credit quality trends with emphasis on loan delinquencies, nonaccrual levels and classified loans.
- Recent loss experience in particular segments of the portfolio.
- Loan volumes and concentrations, including changes in mix.
- Other factors, including changes in quality of the loan origination; loan policy changes; changes in credit risk management processes; Bank regulatory and external loan review examination results.

The qualitative amount assigned to the substandard commercial loan segments was reduced at September 30, 2012 from June 30, 2012 to adjust historical loss averages for the impact of recent write downs taken on a large, atypical credit. Changes to qualitative adjustments for other major portfolio segments were not material at September 30, 2012.
The unallocated component of the Allowance for Loan Losses totaled $1.8 million at September 30, 2012. This compares to $1.9 million as of June 30, 2012 and $2.0 million as of December 31, 2011. Management views these fluctuations in the unallocated portion of the Allowance for Loan Losses to be immaterial. The unallocated amount was deemed appropriate due to the following:

- In general, the unallocated component is available to cover imprecision or uncertainties to incorporate the range of probable outcomes inherent in estimates used for the allowance, which may change from period to period. An example of this could be a delay in receiving an updated appraisal on a troubled credit.
- An internal analysis completed on foreclosed property found that when these properties are sold, on average, the selling price is approximately 22% below the appraised value of the property at the time of take in. The unallocated provides for uncertainty in the value of properties when in impaired loan status.
- Watch-rated commercial loans have increased after bottoming out in late 2009 and early 2010. Additional losses may exist in this portfolio segment, yet are not identifiable at present. The unallocated portion provides some level of support for this.

Commercial loans are comprised of three major classes, commercial real estate loans, commercial construction loans and other commercial loans. Commercial real estate is primarily comprised of loans to small businesses collateralized by owner-occupied real estate, while other commercial is primarily comprised of loans to small businesses collateralized by plant and equipment, commercial fishing vessels and gear, and limited inventory-based lending. Commercial real estate loans typically have a maximum loan-to-value of 75% based upon current appraisal information at the time the loan is made. Municipal loans are comprised of loans to municipalities in Maine for capitalized expenditures, construction projects or tax-anticipation notes. All municipal loans are considered general obligations of the municipality and as such are collateralized by the taxing ability of the municipality for repayment of debt.

Construction loans, both commercial and residential, comprise a very small portion of the portfolio, and at 21.7% of capital are well under the regulatory guidance of 100.0% of capital at September 30, 2012. Construction loans and non-owner-occupied commercial real estate loans are at 79.0% of total capital, well under regulatory guidance of 300.0% of capital at September 30, 2012.

The process of establishing the allowance with respect to the commercial loan portfolio begins when a loan officer initially assigns each loan a risk rating, using established credit criteria. Approximately 50% of the outstanding loans and commitments are subject to review and validation annually by an independent consulting firm, as well as periodically by the Company's internal credit review function. The methodology employs Management's judgment as to the level of losses on existing loans based on internal review of the loan portfolio, including an analysis of a borrower's current financial position, and the consideration of current and anticipated economic conditions and their potential effects on specific borrowers and or lines of business. In determining the Company's ability to collect certain loans, Management also considers the fair value of underlying collateral. The risk rating system has eight levels, defined as follows:

1 Strong
Credits rated "1" are characterized by borrowers fully responsible for the credit with excellent capacity to pay principal and interest. Loans rated "1" may be secured with acceptable forms of liquid collateral.
2 Above Average
Credits rated "2" are characterized by borrowers that have better than average liquidity, capitalization, earnings and/or cash flow with a consistent record of solid financial performance.
3 Satisfactory
Credits rated "3" are characterized by borrowers with favorable liquidity, profitability and financial condition with adequate cash flow to pay debt service.
4 Average
Credits rated "4" are characterized by borrowers that present risk more than 1, 2 and 3 rated loans and merit an ordinary level of ongoing monitoring. Financial condition is on par or somewhat below industry averages while cash flow is generally adequate to meet debt service requirements.
5 Watch
Credits rated "5" are characterized by borrowers that warrant greater monitoring due to financial condition or unresolved and identified risk factors.
6 Other Assets Especially Mentioned (OAEM)
Loans in this category are currently protected but are potentially weak and constitute an undue and unwarranted credit risk, but not to the point of justifying a classification of substandard. OAEM have potential weaknesses which may, if not checked or corrected, weaken the asset or inadequately protect the Bank's credit position at some future date.
7 Substandard
Loans in this category are inadequately protected by the current sound worth and paying capacity of the borrower or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Substandard loans are characterized by the distinct possibility that the Bank may sustain some loss if the deficiencies are not corrected.
8 Doubtful
Loans classified "Doubtful" have the same weaknesses as those classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, based on currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is high, but because of certain important and reasonably specific pending factors which may work to the advantage and strengthening of the asset, its classification as an estimated loss is deferred until its more exact status may be determined.
The following table summarizes the risk ratings for the Company's commercial real estate, commercial construction, commercial other, and municipal loans as of September 30, 2012:

	Commercial Real Estate	Commercial Construction	Commercial Other	Municipal Loans	All Risk-Rated Loans
1 Strong	$20,000	$-	$279,000	$1,775,000	$2,074,000
2 Above Average	18,918,000	699,000	5,426,000	8,651,000	33,694,000
3 Satisfactory	36,580,000	643,000	13,497,000	3,523,000	54,243,000
4 Average	105,150,000	10,670,000	30,688,000	2,499,000	149,007,000
5 Watch	39,494,000	1,812,000	19,100,000	-	60,406,000

6 OAEM	21,530,000	1,227,000	3,731,000	-	26,488,000
7 Substandard	34,359,000	6,854,000	10,916,000	-	52,129,000
8 Doubtful	480,000	-	66,000	-	546,000
Total	$256,531,000	$21,905,000	$83,703,000	$16,448,000	$378,587,000

The following table summarizes the risk ratings for the Company's commercial real estate, commercial construction, commercial other, and municipal loans as of December 31, 2011:

	Commercial Real Estate	Commercial Construction	Commercial Other	Municipal Loans	All Risk-Rated Loans
1 Strong	$23,000	$-	$465,000	$2,158,000	$2,646,000
2 Above Average	21,334,000	-	4,229,000	7,509,000	33,072,000
3 Satisfactory	33,119,000	1,365,000	10,981,000	3,861,000	49,326,000
4 Average	106,171,000	17,125,000	31,600,000	2,693,000	157,589,000
5 Watch	44,215,000	3,287,000	17,893,000	-	65,395,000
6 OAEM	18,309,000	2,320,000	5,303,000	-	25,932,000
7 Substandard	31,575,000	7,323,000	16,362,000	-	55,260,000
8 Doubtful	678,000	1,154,000	149,000	-	1,981,000
Total	$255,424,000	$32,574,000	$86,982,000	$16,221,000	$391,201,000

The following table summarizes the risk ratings for the Company's commercial real estate, commercial construction, commercial other, and municipal loans as of September 30, 2011:

	Commercial Real Estate	Commercial Construction	Commercial Other	Municipal Loans	All Risk-Rated Loans
1 Strong	$28,000	$-	$351,000	$2,214,000	$2,593,000
2 Above Average	20,546,000	10,000	3,444,000	10,930,000	34,930,000
3 Satisfactory	36,693,000	1,665,000	14,408,000	3,896,000	56,662,000
4 Average	113,350,000	14,564,000	35,808,000	2,813,000	166,535,000
5 Watch	40,518,000	5,222,000	15,235,000	-	60,975,000
6 OAEM	14,964,000	4,007,000	4,522,000	-	23,493,000
7 Substandard	31,811,000	4,877,000	22,271,000	-	58,959,000
8 Doubtful	-	-	6,000	-	6,000
Total	$257,910,000	$30,345,000	$96,045,000	$19,853,000	$404,153,000

Commercial loans are generally charged off when all or a portion of the principal amount is determined to be uncollectible. This determination is based on circumstances specific to a borrower including repayment ability, analysis of collateral and other factors as applicable.

Residential loans are comprised of two classes: term loans, which include traditional amortizing home mortgages, and construction loans, which include loans for owner-occupied residential construction. Residential loans typically have a 75% to 80% loan to value based upon current appraisal information at the time the loan is made. Home equity loans and lines of credit are typically written to the same underwriting standards. Consumer loans are primarily amortizing loans to individuals collateralized by automobiles, pleasure craft and recreation vehicles, typically with a maximum loan to value of 80% to 90% of the purchase price of the collateral. Consumer loans also include a small amount of unsecured short-term time notes to individuals.

Residential loans, consumer loans and home equity lines of credit are segregated into homogeneous pools with similar risk characteristics. Trends and current conditions are analyzed and historical loss experience is adjusted accordingly. Quantitative and qualitative adjustment factors for these segments are consistent with those for the commercial and municipal classes. Certain loans in the residential, home equity lines of credit and consumer classes identified as having the potential for further deterioration are analyzed individually to confirm impairment status, and to determine the need for a specific reserve, however there is no formal rating system used for these classes. Consumer loans greater than 120 days past due are generally charged off. Residential loans 90 days or more past due are placed on non-accrual status unless the loans are both well secured and in the process of collection.

There were no changes to the Company's accounting policies or methodology used to estimate the allowance for loan losses during the nine months ended September 30, 2012.

The following table presents allowance for loan losses activity by class for the nine-months and quarter ended September 30, 2012, and allowance for loan loss balances by class and related loan balances by class as of September 30, 2012:

	Commercial Real Estate	Construction	Other	Municipal	Residential Term	Construction	Home Equity Line of Credit	Consum
For the nine months ended September 30, 2012								
Beginning balance	$5,659,000	$658,000	$2,063,000	$19,000	$1,159,000	$255,000	$595,000	$584,00
Charge offs	1,101,000	87,000	2,168,000	-	554,000	381,000	391,000	382,00
Recoveries	4,000	247,000	50,000	-	3,000	42,000	-	157,00
Provision	1,133,000	241,000	2,687,000	(1,000)	1,615,000	98,000	586,000	189,00
Ending balance	$5,695,000	$1,059,000	$2,632,000	$18,000	$2,223,000	$14,000	$790,000	$548,00
For the three months ended September 30, 2012								
Beginning balance	$5,564,000	$1,373,000	$2,476,000	$19,000	$1,587,000	$58,000	$809,000	$603,00
Charge offs	186,000	87,000	6,000	-	179,000	263,000	342,000	106,00
Recoveries	3,000	1,000	39,000	-	1,000	42,000	-	38,000
Provision	314,000	(228,000)	123,000	(1,000)	814,000	177,000	323,000	13,000
Ending balance	$5,695,000	$1,059,000	$2,632,000	$18,000	$2,223,000	$14,000	$790,000	$548,00
Allowance for loan losses as of September 30, 2012								
Ending balance specifically evaluated for impairment	$1,416,000	$696,000	$1,240,000	$-	$1,494,000	$-	$215,000	$1,000
Ending balance collectively evaluated for impairment	$4,279,000	$363,000	$1,392,000	$18,000	$729,000	$14,000	$575,000	$547,00
Related loan balances as of September 30, 2012								
Ending balance	$256,531,000	$21,905,000	$83,703,000	$16,448,000	$369,949,000	$6,528,000	$100,099,000	$14,708
Ending balance specifically evaluated for impairment	$16,321,000	$6,645,000	$4,905,000	$-	$19,305,000	$23,000	$1,445,000	$1,000
Ending balance collectively evaluated for impairment	$240,210,000	$15,260,000	$78,798,000	$16,448,000	$350,644,000	$6,505,000	$98,654,000	$14,707

The following table presents allowance for loan loss balances by class and related loan balances by class as of December 31, 2011:

	Commercial Real Estate	Construction	Other	Municipal	Residential Term	Construction	Home Equity Line of Credit	Consun
Allowance for loan losses as of December 31, 2011								
Ending balance specifically evaluated for impairment	$808,000	$33,000	$402,000	$-	$478,000	$235,000	$91,000	$11,00
Ending balance collectively evaluated for impairment	$4,851,000	$625,000	$1,661,000	$19,000	$681,000	$20,000	$504,000	$573,0
Related loan balances as of December 31, 2011								
Ending balance	$255,424,000	$32,574,000	$86,982,000	$16,221,000	$341,286,000	$10,469,000	$105,244,000	$16,78
Ending balance specifically evaluated for impairment	$10,141,000	$5,702,000	$7,042,000	$-	$16,821,000	$1,198,000	$1,163,000	$53,00
Ending balance collectively evaluated for impairment	$245,283,000	$26,872,000	$79,940,000	$16,221,000	$324,465,000	$9,271,000	$104,081,000	$16,73

The following table presents allowance for loan losses activity by class for the nine-months and quarter ended September 30, 2011, and allowance for loan loss balances by class and related loan balances by class as of September 30, 2011:

	Commercial Real Estate	Construction	Other	Municipal	Residential Term	Construction	Home Equity Line of Credit	Consur
For the nine months ended September 30, 2011								
Beginning balance	$5,260,000	$1,012,000	$2,377,000	$19,000	$1,408,000	$44,000	$670,000	$646,0
Charge offs	835,000	-	942,000	-	1,013,000	505,000	240,000	298,0
Recoveries	8,000	-	33,000	-	5,000	-	1,000	189,0
Provision	3,023,000	(208,000)	1,433,000	-	1,044,000	581,000	143,000	78,00
Ending balance	$7,456,000	$804,000	$2,901,000	$19,000	$1,444,000	$120,000	$574,000	$615,0
For the three months ended September 30, 2011								
Beginning balance	$6,927,000	$702,000	$3,323,000	$19,000	$1,356,000	$35,000	$652,000	$664,0
Charge offs	-	-	623,000	-	316,000	-	195,000	142,0
Recoveries	3,000	-	12,000	-	1,000	-	-	43,00
Provision	526,000	102,000	189,000	-	403,000	85,000	117,000	50,00
Ending balance	$7,456,000	$804,000	$2,901,000	$19,000	$1,444,000	$120,000	$574,000	$615,0
Allowance for loan losses as of September 30, 2011								
Ending balance specifically evaluated for impairment	$636,000	$-	$352,000	$-	$398,000	$82,000	$95,000	$64,00
Ending balance collectively evaluated for impairment	$6,820,000	$804,000	$2,549,000	$19,000	$1,046,000	$38,000	$479,000	$551,0
Related loan balances as of September 30, 2011								
Ending balance	$257,910,000	$30,345,000	$96,045,000	$19,853,000	$329,730,000	$12,061,000	$105,891,000	$16,73
Ending balance specifically evaluated for impairment	$7,739,000	$792,000	$1,940,000	$-	$16,067,000	$396,000	$1,234,000	$102,0
Ending balance collectively evaluated for	$250,171,000	$29,553,000	$94,105,000	$19,853,000	$313,663,000	$11,665,000	$104,657,000	$16,63

impairment
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Troubled Debt Restructured

A troubled debt restructured ("TDR") constitutes a restructuring of debt if the Company, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower that it would not otherwise consider. To determine whether or not a loan should be classified as a TDR, Management evaluates a loan based upon the following criteria:

- The borrower demonstrates financial difficulty; common indicators include past due status with bank obligations, substandard credit bureau reports, or an inability to refinance with another lender, and
- The Company has granted a concession; common concession types include maturity date extension, interest rate adjustments to below market pricing, and deferment of payments.

As of September 30, 2012, the Company had 91 loans with a value of $29,349,000 that have been classified as TDRs. This compares to 59 loans with a value of $22,858,000 and 45 loans with a value of $10,467,000 classified as TDRs as of December 31, 2011 and September 30, 2011, respectively. The impairment carried as a specific reserve in the allowance for loan losses is calculated by present valuing the cashflow modification on the loan, or, for collateral-dependent loans, using the fair value of the collateral less costs to sell. The following table shows TDRs by class and the specific reserve as of September 30, 2012:

	Number of Loans	Balance	Specific Reserves
Commercial			
Real estate	18	$12,329,000	$823,000
Construction	2	3,099,000	696,000
Other	20	2,614,000	594,000
Municipal	-	-	-
Residential			
Term	50	10,890,000	371,000
Construction	-	-	-
Home equity line of credit	1	417,000	-
Consumer	-	-	-
	91	$29,349,000	$2,484,000

As of September 30, 2012, 15 of the loans classified as TDRs with a total balance of $2,820,000 were more than 30 days past due. Of these loans, six loans with an outstanding balance of $970,000 had been placed on TDR status in the previous 12 months. The following table shows these TDRs by class and the associated specific reserves included in the allowance for loan losses as of September 30, 2012:

	Number of Loans	Balance	Specific Reserves
Commercial			
Real estate	1	$263,000	$-
Construction	-	-	-
Other	2	55,000	22,000
Municipal	-	-	-
Residential			
Term	12	2,502,000	148,000
Construction	-	-	-
Home equity line of credit	-	-	-
Consumer	-	-	-

15	$2,820,000	$170,000

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For the nine months ended September 30, 2012, 38 loans were placed on TDR status with an outstanding balance of $12,369,000. These were considered TDRs because concessions had been granted to borrowers experiencing financial difficulties. Concessions include reductions in interest rates, principal and/or interest forbearance, payment extensions, or combinations thereof.
The following table shows loans placed on TDR status in the nine months ended September 30, 2012, by class of loan and the associated specific reserve included in the allowance for loan losses as of September 30, 2012:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Specific Reserves
Commercial				
Real estate	13	$ 6,962,000	$ 7,171,000	$ 175,000
Construction	1	1,951,000	1,951,000	696,000
Other	14	1,369,000	1,380,000	546,000
Municipal	-	-	-	-
Residential				
Term	9	1,670,000	1,672,000	84,000
Construction	-	-	-	-
Home equity line of credit	1	417,000	417,000	-
Consumer	-	-	-	-
	38	$ 12,369,000	$ 12,591,000	$ 1,501,000

For the quarter ended September 30, 2012, 11 loans were placed on TDR status with an outstanding balance of $4,512,000. These were considered to be TDRs because concessions had been granted to borrowers experiencing financial difficulties. Concessions include reductions in interest rates, principal and/or interest forbearance, payment extensions, or combinations thereof. The following table shows loans placed on TDR status in the quarter ended September 30, 2012, by class of loan and the associated specific reserve included in the allowance for loan losses as of September 30, 2012:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Specific Reserves
Commercial				
Real estate	2	$ 3,150,000	$ 3,150,000	$ 29,000
Construction	-	-	-	-
Other	6	682,000	682,000	2,000
Municipal	-	-	-	-
Residential				
Term	2	263,000	264,000	15,000
Construction	-	-	-	-
Home equity line of credit	1	417,000	417,000	-
Consumer	-	-	-	-
	11	$ 4,512,000	$ 4,513,000	$ 46,000

As of September 30, 2012, Management is aware of four loans classified as TDRs that are involved in bankruptcy with an outstanding balance of $712,000. There were also 29 loans with an outstanding balance of $4,276,000 that were classified as TDRs and on non-accrual status, four of which, with an outstanding balance of $574,000, were in the process of foreclosure.

Note 5 – Stock Options and Stock-Based Compensation

At the 2010 Annual Meeting, shareholders approved the 2010 Equity Incentive Plan (the "2010 Plan"). This reserves 400,000 shares of common stock for issuance in connection with stock options, restricted stock awards and other equity based awards to attract and retain the best available personnel, provide additional incentive to officers, employees and non-employee Directors and promote the success of our business. Such grants and awards will be structured in a manner that does not encourage the recipients to expose the Company to undue or inappropriate risk. Options issued under the 2010 Plan will qualify for treatment as incentive stock options for purposes of Section 422 of the Internal Revenue Code. Other compensation under the 2010 Plan will qualify as performance-based for purposes of Section 162(m) of the Internal Revenue Code, and will satisfy NASDAQ guidelines relating to equity compensation.
As of September 30, 2012, 19,727 shares of restricted stock had been granted under the 2010 Plan, as detailed in the following table:

Year Granted	Vesting Term (In Years)	Shares	Remaining Term (In Years)
2011	4.0	1,500	2.3
2011	5.0	5,500	3.3
2012	3.0	2,027	2.4
2012	4.0	2,704	3.4
2012	5.0	7,996	4.4
		19,727	3.6

The compensation cost related to these restricted stock grants was $302,000 and will be recognized over the vesting terms of each grant. In the first nine months of 2012, $57,000 of expense was recognized for these restricted shares, leaving $223,000 in unrecognized expense as of September 30, 2012. In the first nine months of 2011, $17,000 of expense was recognized for restricted shares, leaving $94,000 in unrecognized expense as of September 30, 2011.
The Company established a shareholder-approved stock option plan in 1995 (the "1995 Plan"), under which the Company granted options to employees for 600,000 shares of common stock. Only incentive stock options were granted under the 1995 Plan. The option price of each option grant was determined by the Options Committee of the Board of Directors, and in no instance was less than the fair market value on the date of the grant. An option's maximum term was ten years from the date of grant, with 50% of the options granted vesting two years from the date of grant and the remaining 50% vesting five years from the date of grant. As of January 16, 2005, all options under the 1995 Plan had been granted.
The Company applies the fair value recognition provisions of the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 718 "Compensation – Stock Compensation", to stock-based employee compensation. As of September 30, 2012, all outstanding options were fully vested and all compensation cost for options had been recognized. A summary of the status of outstanding stock options as of September 30, 2012 and changes during the nine-month period then ended, is presented below.

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value (In thousands)
Outstanding at December 31, 2011	51,000	$ 16.47		
Granted in 2012	-	-		

Exercised in 2012	(9,000)	$ 9.33		$ 59,000
Forfeited in 2012	-	-		
Outstanding at September 30, 2012	42,000	$ 18.00	2.3	-
Exercisable at September 30, 2012	42,000	$ 18.00	2.3	-

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Note 6 – Preferred and Common Stock

Preferred Stock
On January 9, 2009, the Company issued $25 million in Fixed Rate Cumulative Perpetual Preferred Stock, Series A, having a liquidation preference of $1,000 per share, to the U.S. Treasury under the Capital Purchase Program ("the CPP Shares"). The CPP Shares call for cumulative dividends at a rate of 5.0% per year for the first five years, and at a rate of 9.0% per year in following years, payable quarterly in arrears on February 15, May 15, August 15 and November 15 of each year.
On August 24, 2011, the Company repurchased $12.5 million of the CPP Shares. The repurchase transaction was approved by the Federal Reserve Bank of Boston, the Company's primary regulator, as well as the Bank's primary regulator, the Office of the Comptroller of the Currency, based on continued strong capital ratios after the repayment. Almost all of the repayment was made from retained earnings accumulated since the preferred stock was issued in 2009. After the repurchase, $12.5 million of the CPP shares remains outstanding. The Company may redeem the remaining CPP Shares at any time using any funds available, subject to the prior approval of the Federal Reserve Bank of Boston. The CPP Shares are "perpetual" preferred stock, which means that neither Treasury nor any subsequent holder would have a right to require that the Company redeem any of the shares.
Incident to such issuance, the Company issued to the U.S. Treasury warrants (the "Warrants") to purchase up to 225,904 shares of the Company's common stock at a price per share of $16.60 (subject to adjustment). The CPP Shares and the related Warrants (and any shares of common stock issuable pursuant to the Warrants) are freely transferable by Treasury to third parties and the Company has filed a registration statement with the Securities and Exchange Commission to allow for possible resale of such securities. The CPP Shares qualify as Tier 1 capital on the Company's books for regulatory purposes and rank senior to the Company's common stock and senior or at an equal level in the Company's capital structure to any other shares of preferred stock the Company may issue in the future. The Warrants issued in conjunction with the sale of the CPP Shares have a term of ten years and could be exercised by Treasury or a subsequent holder at any time or from time to time during their term. To the extent they had not previously been exercised, the Warrants would expire after ten years. Treasury will not vote any shares of common stock it receives upon exercise of the Warrants, but that restriction would not apply to third parties to whom Treasury transferred the Warrants. The Warrants (and any common stock issued upon exercise of the Warrants) could be transferred to third parties separately from the CPP Shares. The proceeds from the sale of the CPP Shares were allocated between the CPP Shares and Warrants based on their relative fair values on the issue date. The fair value of the Warrants was determined using the Black-Scholes model which includes the following assumptions: common stock price of $16.60 per share, dividend yield of 4.70%, stock price volatility of 24.43%, and a risk-free interest rate of 2.01%. The discount on the CPP Shares was based on the value that was allocated to the Warrants upon issuance, and is being accreted back to the value of the CPP Shares over a five-year period (the expected life of the shares upon issuance) on a straight-line basis. The Warrants were unchanged as a result of the CPP Shares repurchase transaction and remain outstanding.
As a condition to Treasury's purchase of the CPP Shares, during the time that Treasury holds any equity or debt instrument the Company issued, the Company is required to comply with certain restrictions and other requirements relating to the compensation of the Company's chief executive officer, chief financial officer and three other most highly compensated executive officers. These restrictions include a prohibition on severance payments to those executive officers upon termination of their employment and a $500,000 limit on the tax deductions the Company can take for compensation expense for each of those executive officers in a single year as well as a prohibition on bonus compensation to such officers other than limited amounts of long-term restricted stock.

Common Stock
As a consequence of the Company's issuance of securities under the U.S. Treasury's Capital Purchase Program, its ability to repurchase stock while such securities remain outstanding is restricted to purchases from employee benefit plans. In the first nine months of 2012, the Company repurchased no common stock.

Note 7 – Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share (EPS) for the nine months ended September 30, 2012 and 2011:

	Income (Numerator)	Shares (Denominator)	Per-Share Amount
For the nine months ended September 30, 2012			
Net income as reported	$9,459,000		
Less dividends and amortization of premium on preferred stock	543,000		
Basic EPS: Income available to common shareholders	8,916,000	9,825,719	$ 0.91
Effect of dilutive securities: restricted stock		16,894	
Diluted EPS: Income available to common shareholders plus assumed conversions	$8,916,000	9,842,613	$ 0.91
For the nine months ended September 30, 2011			
Net income as reported	$9,341,000		
Less dividends and amortization of premium on preferred stock	1,027,000		
Basic EPS: Income available to common shareholders	8,314,000	9,785,063	$ 0.85
Effect of dilutive securities: incentive stock options and restricted stock		10,888	
Diluted EPS: Income available to common shareholders plus assumed conversions	$8,314,000	9,795,951	$ 0.85

The following table sets forth the computation of basic and diluted EPS for the quarters ended September 30, 2012 and 2011:

	Income (Numerator)	Shares (Denominator)	Per-Share Amount
For the quarter ended September 30, 2012			
Net income as reported	$3,223,000		
Less dividends and amortization of premium on preferred stock	181,000		
Basic EPS: Income available to common shareholders	3,042,000	9,824,568	$ 0.31
Effect of dilutive securities: restricted stock and warrants		22,814	
Diluted EPS: Income available to common shareholders plus assumed conversions	$3,042,000	9,847,382	$ 0.31
For the quarter ended September 30, 2011			
Net income as reported	$3,006,000		
Less dividends and amortization of premium on preferred stock	353,000		
Basic EPS: Income available to common shareholders	2,653,000	9,791,550	$ 0.27
Effect of dilutive securities: incentive stock options and restricted stock		11,843	
Diluted EPS: Income available to common shareholders plus assumed conversions	$2,653,000	9,803,393	$ 0.27

All earnings per share calculations have been made using the weighted average number of shares outstanding during the period. The potentially dilutive securities are incentive stock options and unvested shares of restricted stock granted to certain key members of Management and warrants granted to the U.S. Treasury under the CPP. The number of dilutive shares is calculated using the treasury method, assuming that all options and warrants were exercisable at the end of each period. Options and warrants that are out-of-the-money are not considered in the calculation of dilutive earnings per share as the effect would be anti-dilutive.

The following table presents the number of options and warrants outstanding as of September 30, 2012 and 2011 and the amount for which the market price at period end is above or below the strike price:

	Outstanding	In-the-Money	Out-of-the-Money
As of September 30, 2012			
Incentive stock options	42,000	-	42,000
Warrants issued to U.S. Treasury	225,904	225,904	-
Total dilutive securities	267,904	225,904	42,000
As of September 30, 2011			
Incentive stock options	55,500	13,500	42,000
Warrants issued to U.S. Treasury	225,904	-	225,904
Total dilutive securities	281,404	13,500	267,904

Note 8 – Employee Benefit Plans

401(k) Plan
The Bank has a defined contribution plan available to substantially all employees who have completed 3 months of service. Employees may contribute up to IRS determined limits and the Bank may match employee contributions not to exceed 3.0% of compensation depending on contribution level. Subject to a vote of the Board of Directors, the Bank may also make a profit-sharing contribution to the Plan. Such contribution equaled 2.0% of each eligible employee's compensation in 2011. The amount for 2012 has not been established. The expense related to the 401(k) plan was $272,000 and $302,000 for the nine months ended September 30, 2012 and 2011, respectively.

Supplemental Retirement Benefits
The Bank also provides unfunded, non-qualified supplemental retirement benefits for certain officers, payable in installments over 20 years upon retirement or death. The agreements consist of individual contracts with differing characteristics that, when taken together, do not constitute a postretirement plan. The costs for these benefits are recognized over the service periods of the participating officers in accordance with FASB ASC Topic 712 "Compensation – Nonretirement Postemployment Benefits". The expense of these supplemental retirement benefits was $217,000 and $232,000 for the nine months ended September 30, 2012 and 2011, respectively. As of September 30, 2012, the associated accrued liability included in other liabilities in the balance sheet was $2,022,000 compared to $1,847,000 and $1,787,000 at December 31, 2011 and September 30, 2011, respectively.

Post-Retirement Benefit Plans
The Bank sponsors two post-retirement benefit plans. One plan currently provides a subsidy for health insurance premiums to certain retired employees and a future subsidy for seven active employees who were age 50 and over in 1996. These subsidies are based on years of service and range between $40 and $1,200 per month per person. The other plan provides life insurance coverage to certain retired employees and health insurance for retired directors. None of these plans are pre-funded. The Company utilizes FASB ASC Topic 712 "Compensation – Nonretirement Postemployment Benefits" to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its balance sheet and to recognize changes in the funded status in the year in which the changes occur through comprehensive income. The following table sets forth the accumulated postretirement benefit obligation and funded status:

	At or for the nine months ended September 30, 2012	2011
Change in benefit obligation		
Benefit obligation at beginning of year	$1,848,000	$1,796,000
Service cost	51,000	12,000
Interest cost	84,000	87,000
Benefits paid	(102,000)	(117,000)
Benefit obligation at end of period	1,881,000	1,778,000
Funded status		
Benefit obligation at end of period	(1,881,000)	(1,778,000)
Accrued benefit cost at end of period	$(1,881,000)	$(1,778,000)

The following table sets forth the net periodic pension cost:

	For the nine months ended September 30, 2012	2011	For the quarters ended September 30, 2012	2011
Components of net periodic benefit cost				
Service cost	$51,000	$12,000	$17,000	$4,000
Interest cost	84,000	87,000	28,000	29,000
Amortization of unrecognized transition obligation	21,000	21,000	7,000	7,000
Amortization of accumulated losses	8,000	15,000	2,000	5,000
Net periodic benefit cost	$164,000	$135,000	$54,000	$45,000

Amounts not yet reflected in net periodic benefit cost and included in accumulated other comprehensive income are as follows:

	September 30, 2012	December 31, 2011	September 30, 2011
Unamortized net actuarial loss	$(100,000)	$(100,000)	$(49,000)
Unrecognized transition obligation	(13,000)	(34,000)	(42,000)
	(113,000)	(134,000)	(91,000)
Deferred tax benefit at 35%	41,000	47,000	32,000
Net unrecognized postretirement benefits included in accumulated other comprehensive income (loss)	$(72,000)	$(87,000)	$(59,000)

The following table summarizes activity in the unrealized gain or loss on postretirement benefits included in other comprehensive income for the nine months and quarters ended September 30, 2012 and 2011.

	For the nine months ended September 30, 2012	2011	For the quarters ended September 30, 2012	2011
Unrecognized transition obligation at beginning of period	$(87,000)	$(73,000)	$(77,000)	$(63,000)
Amortization of unrecognized transition obligation	21,000	21,000	7,000	7,000

Related deferred taxes	(6,000)	(7,000)	(2,000)	(3,000)
Unrecognized transition obligation at end of period	$(72,000)	$(59,000)	$(72,000)	$(59,000)

A weighted average discount rate of 7.0% was used in determining the accumulated benefit obligation and the net periodic benefit cost. The assumed health care cost trend rate is 7.0%. The measurement date for benefit obligations was as of year-end for prior years presented. The expected benefit payments for the fourth quarter of 2012 are $34,000 and the expected benefit payments for all of 2012 are $136,000. Plan expense for 2012 is estimated to be $190,000. A 1% change in trend assumptions would create an approximate change in the same direction of $100,000 in the accumulated benefit obligation, $7,000 in the interest cost and $1,000 in the service cost.

Note 9 – Goodwill and Other Intangible Assets

As of December 31, 2011, in accordance FASB ASC Topic 350 "Intangibles – Goodwill and Other," the Company completed its annual review of goodwill and determined there has been no impairment.

Note 10 – Mortgage Servicing Rights

FASB ASC Topic 940 "Financial Services – Mortgage Banking," requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable. The Company's servicing assets and servicing liabilities are reported using the amortization method and carried at the lower of amortized cost or fair value by strata. In evaluating the carrying values of mortgage servicing rights, the Company obtains third party valuations based on loan level data including note rate, type and term of the underlying loans. The model utilizes several assumptions, the most significant of which is loan prepayments, calculated using a three-month moving average of weekly prepayment data published by the Public Securities Association (PSA) and modeled against the serviced loan portfolio, and the discount rate to discount future cash flows. As of September 30, 2012, the prepayment assumption using the PSA model was 430, which translates into an anticipated prepayment rate of 25.80%. The discount rate is the quarterly average 10 year U.S. Treasury plus 4.89%. Other assumptions include delinquency rates, foreclosure rates, servicing cost inflation, and annual unit loan cost. All assumptions are adjusted periodically to reflect current circumstances. Amortization of mortgage servicing rights, as well as write-offs due to prepayments of the related mortgage loans, are recorded as a charge against mortgage servicing fee income.
For the nine months ended September 30, 2012 and 2011, servicing rights capitalized totaled $250,000 and $343,000, respectively. Servicing rights capitalized for the three-month periods ended September 30, 2012 and 2011, were $169,000 and $80,000 respectively. Servicing rights amortized for the nine-month periods ended September 30, 2012 and 2011, were $487,000 and $399,000, respectively. The fair value of servicing rights was $1,129,000, $1,581,000 and $1,541,000 at September 30, 2012, December 31, 2011 and September 30, 2011, respectively. The Bank serviced loans for others totaling $215,741,000, $238,221,000 and $255,384,000 at September 30, 2012, December 31, 2011, and September 30, 2011, respectively. Mortgage servicing rights are included in other assets and detailed in the following table:

	September 30, 2012	December 31, 2011	September 30, 2011
Mortgage servicing rights	$6,346,000	$6,099,000	$6,067,000
Accumulated amortization	(5,324,000)	(4,837,000)	(4,661,000)
Impairment reserve	(154,000)	(61,000)	(211,000)
	$868,000	$1,201,000	$1,195,000

Note 11 – Income Taxes

FASB ASC Topic 740 "Income Taxes," defines the criteria that an individual tax position must satisfy for some or all of the benefits of that position to be recognized in a company's financial statements. Topic 740 prescribes a recog-nition threshold of more-likely-than-not, and a measurement attribute for all tax positions taken or expected to be taken on a tax return, in order for those tax positions to be recognized in the financial statements. The Company is currently open to audit under the statute of limitations by the IRS for the years ended December 31, 2009 through

2011.

Note 12- Certificates of Deposit

The following table represents the breakdown of Certificates of Deposit at September 30, 2012 and 2011, and at December 31, 2011:

	September 30, 2012	December 31, 2011	September 30, 2011
Certificates of deposit < $100,000	$210,963,000	$216,836,000	$231,351,000
Certificates $100,000 to $250,000	247,095,000	309,841,000	336,147,000
Certificates $250,000 and over	55,358,000	22,499,000	26,587,000
	$513,416,000	$549,176,000	$594,085,000

Note 13 – Reclassifications

Certain items from the prior year were reclassified in the financial statements to conform with the current year presentation. These do not have a material impact on the balance sheet or statement of income and comprehensive income presentations.

Note 14 – Fair Value

Certain assets and liabilities are recorded at fair value to provide additional insight into the Company's quality of earnings. Some of these assets and liabilities are measured on a recurring basis while others are measured on a nonrecurring basis, with the determination based upon applicable existing accounting pronouncements. For example, securities available for sale are recorded at fair value on a recurring basis. Other assets, such as, mortgage servicing rights, loans held for sale, and impaired loans, are recorded at fair value on a nonrecurring basis using the lower of cost or market methodology to determine impairment of individual assets. The Company groups assets and liabilities which are recorded at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement (with level 1 considered highest and level 3 considered lowest). A brief description of each level follows.
Level 1 – Valuation is based upon quoted prices for identical instruments in active markets.
Level 2 – Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.
Level 3 – Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates that market participants would use in pricing the asset or liability. Valuation includes use of discounted cash flow models and similar techniques.

The most significant instruments that the Company records at fair value include securities which fall into Level 2 in the fair value hierarchy. The securities in the available for sale portfolio are priced by independent providers. In obtaining such valuation information from third parties, the Company has evaluated their valuation methodologies used to develop the fair values in order to determine whether the valuations are representative of an exit price in the Company's principal markets. The Company's principal markets for its securities portfolios are the secondary institutional markets, with an exit price that is predominantly reflective of bid level pricing in those markets.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

Securities Available for Sale. Investment securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices for similar assets, if available. If quoted prices are not available, fair values are measured using matrix pricing models, or other model-based valuation techniques requiring observable inputs other than quoted prices such as yield curves, prepayment speeds, and default rates. Recurring Level 1 securities would include U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets. Recurring Level 2 securities include federal agency securities, mortgage-backed securities, collateralized mortgage obligations, municipal bonds and corporate debt securities.
The following table presents the balances of assets and liabilities that were measured at fair value on a recurring basis as of September 30, 2012, December 31, 2011 and September 30, 2011.

	At September 30, 2012			
	Level 1	Level 2	Level 3	Total
Securities available for sale				
Mortgage-backed securities	$-	$189,437,000	$ -	$189,437,000
State and political subdivisions	-	108,955,000	-	108,955,000
Corporate securities	-	-	-	-
Other equity securities	-	1,508,000	-	1,508,000
Total assets	$-	$299,900,000	$ -	$299,900,000

	At December 31, 2011			
	Level 1	Level 2	Level 3	Total
Securities available for sale				
Mortgage-backed securities	$-	$198,232,000	$ -	$198,232,000
State and political subdivisions	-	85,726,000	-	85,726,000
Corporate securities	-	811,000	-	811,000
Other equity securities	-	1,433,000	-	1,433,000
Total assets	$-	$286,202,000	$ -	$286,202,000

	At September 30, 2011			
	Level 1	Level 2	Level 3	Total
Securities available for sale				
U.S. Treasury and agency	$-	$16,494,000	$ -	$16,494,000
Mortgage-backed securities	-	235,038,000	-	235,038,000
State and political subdivisions	-	74,039,000	-	74,039,000
Corporate securities	-	779,000	-	779,000
Other equity securities	-	432,000	-	432,000
Total assets	$-	$326,782,000	$ -	$326,782,000

Assets and Liabilities Recorded at Fair Value on a Non-Recurring Basis

Mortgage Servicing Rights. Mortgage servicing rights represent the value associated with servicing residential mortgage loans. Servicing assets and servicing liabilities are rep