

CHICOPEE BANCORP, INC.  
Form 10-Q  
May 09, 2014

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

FORM 10-Q

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934

For the quarterly period ended March 31, 2014

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 000-51996

CHICOPEE BANCORP, INC.  
(Exact name of registrant as specified in its charter)

Massachusetts  
(State or other jurisdiction of incorporation or  
organization)

20-4840562  
(I.R.S. Employer Identification No.)

70 Center Street, Chicopee, Massachusetts  
(Address of principal executive offices)  
(413) 594-6692  
(Registrant's telephone number, including area code)

01013  
(Zip 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 ☒ 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  
Yes ☒ No ☐

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

Large Accelerated Filer ☐ Accelerated Filer ☒  
Non-Accelerated Filer ☐ Smaller Reporting Company ☐

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

As of May 8, 2014, there were 5,438,085 shares of the Registrant's Common Stock outstanding.

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

## CHICOPEE BANCORP, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(Dollars In Thousands)

(Unaudited)

	March 31, 2014	December 31, 2013
<b>ASSETS</b>		
Cash and due from banks	\$ 13,142	\$ 9,100
Federal funds sold	1,036	426
Interest-bearing deposits with the Federal Reserve Bank of Boston	22,256	9,389
Total cash and cash equivalents	36,434	18,915
Available-for-sale securities, at fair value	407	602
Held-to-maturity securities, at cost (fair value of \$41,606 at March 31, 2014 and \$49,338 at December 31, 2013)	40,993	48,606
Federal Home Loan Bank stock, at cost	3,914	3,914
Loans, net of allowance for loan losses of (\$4,462 at March 31, 2014 and \$4,596 at December 31, 2013)	488,170	485,619
Loans held for sale	396	70
Other real estate owned	135	407
Mortgage servicing rights	352	381
Bank owned life insurance	14,261	14,173
Premises and equipment, net	9,043	9,181
Accrued interest and dividends receivable	1,528	1,609
Deferred income tax asset	3,057	3,042
Other assets	1,167	1,208
Total assets	\$ 599,857	\$ 587,727
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Deposits</b>		
Demand deposits	\$ 94,590	\$ 90,869
NOW accounts	42,181	40,774
Savings accounts	50,546	49,755
Money market deposit accounts	111,688	111,126
Certificates of deposit	157,680	157,242
Total deposits	456,685	449,766
Federal Home Loan Bank advances	52,187	44,992
Accrued expenses and other liabilities	327	739
Total liabilities	509,199	495,497
<b>Stockholders' equity</b>		
Common stock (no par value, 20,000,000 shares authorized, 7,439,368 shares issued; 5,438,085 and 5,435,885 shares outstanding at March 31, 2014 and December 31, 2013, respectively)	72,479	72,479

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Treasury stock, at cost (2,001,283 and 2,003,483 shares at March 31, 2014 and December 31, 2013, respectively)	(26,394	) (26,435	)
Additional paid-in-capital	3,377	3,299	
Unearned compensation (restricted stock awards)	(11	) (12	)
Unearned compensation (Employee Stock Ownership Plan)	(3,496	) (3,571	)
Retained earnings	44,678	46,418	
Accumulated other comprehensive income	25	52	
Total stockholders' equity	90,658	92,230	
Total liabilities and stockholders' equity	\$599,857	\$587,727	

See accompanying notes to unaudited consolidated financial statements.

CHICOPEE BANCORP, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS

(In Thousands, Except for Number of Shares and Per Share Amounts)  
(Unaudited)

	Three Months Ended March 31,	
	2014	2013
Interest and dividend income:		
Loans, including fees	\$5,204	\$5,456
Interest and dividends on securities	411	424
Interest on other interest-earning assets	8	14
Total interest and dividend income	5,623	5,894
Interest expense:		
Deposits	714	958
Securities sold under agreements to repurchase	—	3
Federal Home Loan Bank advances	213	189
Total interest expense	927	1,150
Net interest income	4,696	4,744
Provision for (reduction of) loan losses	2,201	(70 )
Net interest income, after provision for (reduction of) loan losses	2,495	4,814
Non-interest income:		
Service charges, fees and commissions	496	502
Net loan sales and servicing	53	264
Net gain on sales of available-for-sale securities	34	—
Net loss on sale of other real estate owned	(82 )	(40 )
Income from bank owned life insurance	88	92
Other non-interest income	—	24
Total non-interest income	589	842
Non-interest expenses:		
Salaries and employee benefits	2,516	2,533
Occupancy expenses	448	425
Furniture and equipment	183	204
FDIC insurance assessment	84	68
Data processing services	346	312
Professional fees	180	217
Advertising expense	169	147
Stationery, supplies and postage	60	76
Other non-interest expense	632	652
Total non-interest expenses	4,618	4,634
Income (loss) before income taxes	(1,534 )	1,022
Income tax expense (benefit)	(175 )	225
Net income (loss)	\$(1,359 )	\$797
Earnings (loss) per share:		

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Basic	\$ (0.27	)	\$ 0.16
Diluted	\$ (0.27	)	\$ 0.16

Adjusted weighted average shares outstanding:

Basic	5,079,063	5,040,230
Diluted	5,176,226	5,104,810

See accompanying notes to unaudited consolidated financial statements.

CHICOPEE BANCORP, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)  
(In Thousands)  
(Unaudited)

	Three Months Ended March 31,		
	2014	2013	
Net income (loss)	\$(1,359	) \$797	
Other comprehensive income (loss), net of tax			
Unrealized holding gains (losses) arising during period on investment securities available-for-sale	(8	) 12	
Reclassification adjustment for gains realized in net income (1)	(34	) —	
Tax effect	15	(4	)
Other comprehensive income (loss), net of tax	(27	) 8	
Comprehensive income (loss)	\$(1,386	) \$805	

(1) Reclassified into the consolidated statements of operations in net gain on sales of available-for-sale securities.

See accompanying notes to unaudited consolidated financial statements.



## CHICOPEE BANCORP, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

Three Months Ended March 31, 2014 and 2013

(Dollars In Thousands)

(Unaudited)

	Common Stock	Treasury Stock	Additional Paid-in Capital	Unearned Compensation (restricted stock awards)	Unearned Compensation (Employee Stock Ownership Plan)	Retained Earnings	Accumulated Other Comprehensive Income	Total
Balance at December 31, 2013	\$72,479	\$(26,435)	\$3,299	\$ (12 )	\$ (3,571 )	\$46,418	\$ 52	\$92,230
Comprehensive income (loss):								
Net loss	—	—	—	—	—	(1,359 )	—	(1,359 )
Change in net unrealized gain on available-for-sale securities (net of deferred income taxes of \$15)	—	—	—	—	—	—	(27 )	(27 )
Total comprehensive loss								(1,386 )
Stock options exercised (2,200 shares)	—	41	(8 )	—	—	—	—	33
Stock option expense	—	—	30	—	—	—	—	30
Change in unearned compensation:								
Restricted stock award expense	—	—	—	1	—	—	—	1
Common stock held by ESOP committed to be released	—	—	56	—	75	—	—	131
Cash dividends declared (\$0.07 per share)	—	—	—	—	—	(381 )	—	(381 )
Balance at March 31, 2014	\$72,479	\$(26,394)	\$3,377	\$ (11 )	\$ (3,496 )	\$44,678	\$ 25	\$90,658
Balance at December 31, 2012	\$72,479	\$(26,567)	\$3,044	\$ (18 )	\$ (3,868 )	\$44,873	\$ 26	\$89,969
Comprehensive income:								
Net income	—	—	—	—	—	797	—	797
Change in net unrealized gain on available-for-sale	—	—	—	—	—	—	8	8

securities (net of deferred income taxes of \$4)								
Total comprehensive income								805
Stock option expense	—	—	28	—	—	—	—	28
Change in unearned compensation:								
Restricted stock award expense	—	—	—	1	—	—	—	1
Common stock held by ESOP committed to be released	—	—	47	—	74	—	—	121
Cash dividends declared (\$0.05 per share)	—	—	—	—	—	(271 )	—	(271 )
Balance at March 31, 2013	\$72,479	\$(26,567)	\$3,119	\$ (17 )	\$ (3,794 )	\$45,399	\$ 34	\$90,653

See accompanying notes to unaudited consolidated financial statements.

CHICOPEE BANCORP, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

	Three Months Ended March 31,	
	2014	2013
	(In Thousands)	
Cash flows from operating activities:		
Net income (loss)	\$(1,359	) \$797
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:		
Depreciation and amortization	172	230
Provision for (reduction of) loan losses	2,201	(70 )
Increase in cash surrender value of life insurance	(88 )	(92 )
Net realized gain on sales of securities available-for-sale	(34 )	—
Realized gains on sales of mortgage loans	(7 )	(90 )
Decrease (increase) in other assets	78	(17 )
Decrease (increase) in accrued interest and dividends receivable	81	(128 )
Decrease in FDIC prepaid insurance	—	(9 )
Net change in loans originated for resale	(326 )	(2,224 )
Write-down of other real estate owned	82	40
(Decrease) increase in other liabilities	(412 )	62
Change in unearned compensation	132	122
Stock option expense	30	28
Net cash provided (used) by operating activities	550	(1,351 )
Cash flows from investing activities:		
Purchase of premises and equipment	(35 )	(82 )
Loan originations, net of principal payments	(4,752 )	8,637
Proceeds from sales of other real estate owned	190	48
Proceeds from sales of securities available-for-sale	187	—
Purchases of held-to-maturity securities	—	(9,444 )
Maturities of held-to-maturity securities	7,325	8,711
Proceeds from principal paydowns of held-to-maturity securities	288	406
Proceeds from sale of Federal Home Loan Bank, stock	—	362
Net cash provided by investing activities	3,203	8,638
Cash flows from financing activities:		
Net increase (decrease) in deposits	6,919	(15,095 )
Net change in repurchase agreements	—	2,958
Payments on long-term FHLB advances	(2,805 )	(2,319 )
Proceeds from long-term FHLB advances	5,000	—
Proceeds from short-term FHLB advances	5,000	—
Cash dividends paid on common stock	(381 )	(271 )
Stock options exercised	33	—
Net cash provided (used) by financing activities	13,766	(14,727 )
Net increase (decrease) in cash and cash equivalents	17,519	(7,440 )
Cash and cash equivalents at beginning of year	18,915	39,608

Cash and cash equivalents at end of period	\$36,434	\$32,168
Supplemental cash flow information:		
Interest paid on deposits	\$714	\$958
Interest paid on borrowings	200	242
Income taxes paid	7	7
See accompanying notes to unaudited consolidated financial statements.		

CHICOPEE BANCORP, INC. AND SUBSIDIARIES  
Notes to Unaudited Consolidated Financial Statements  
March 31, 2014 and 2013

1. Basis of Presentation

Chicopee Bancorp, Inc. (the “Corporation”) has no significant assets other than all of the outstanding shares of its wholly-owned subsidiaries, Chicopee Savings Bank (the “Bank”) and Chicopee Funding Corporation (collectively, the “Company”). The Corporation was formed on March 14, 2006 and became the holding company for the Bank upon completion of the Bank’s conversion from a mutual savings bank to a stock savings bank. The conversion of the Bank was completed on July 19, 2006. The accounts of the Bank include its wholly-owned subsidiaries and a 99% owned subsidiary. The consolidated financial statements of the Company as of March 31, 2014 and for the periods ended March 31, 2014 and 2013 included herein are unaudited. In the opinion of management, all adjustments, consisting only of normal recurring adjustments necessary for a fair presentation of the financial condition, results of operations, changes in stockholders’ equity and cash flows, as of and for the periods covered herein, have been made. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2013 included in the Company’s Annual Report on Form 10-K.

The results for the three month interim period ended March 31, 2014 are not necessarily indicative of the operating results for a full year.

2. Earnings (Loss) Per Share

Basic earnings per share represents income available to common stockholders divided by the adjusted weighted-average number of common shares outstanding during the period. The adjusted outstanding common shares equals the gross number of common shares issued less average treasury shares, unallocated shares of the Chicopee Savings Bank Employee Stock Ownership Plan (“ESOP”), and average dilutive restricted stock awards under the 2007 Equity Incentive Plan. Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may be issued by the Company relate to outstanding stock options and certain stock awards and are determined using the treasury stock method.

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

(\$ in thousands, except share data )	Three Months Ended March 31,	
	2014	2013
Net income (loss)	\$ (1,359 )	\$ 797
Average number of shares issued	7,439,368	7,439,368
Less: average number of treasury shares	(2,002,114 )	(2,010,783 )
Less: average number of unallocated ESOP shares	(357,089 )	(386,848 )
Less: average number of dilutive restricted stock awards	(1,102 )	(1,507 )
Adjusted weighted average number of common shares outstanding	5,079,063	5,040,230
Plus: dilutive outstanding restricted stock awards	435	446
Plus: dilutive outstanding stock options	96,728	64,134
Weighted average number of diluted shares outstanding	5,176,226	5,104,810

Earnings (loss) per share:

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Basic-common stock	\$ (0.27	) \$0.16
Basic-unvested share-based payment awards	\$ (0.27	) \$0.16
Diluted-common stock	\$ (0.27	) \$0.16
Diluted-unvested share-based payment awards	\$ (0.27	) \$0.16

Given the loss for the three months ended March 31, 2014, diluted loss per share did not differ from basic loss per share as all dilutive-potential shares were anti-dilutive. There were 695,198 stock options that were not included in the calculation of diluted earnings per share for the three months ended March 31, 2013 because the effect was anti-dilutive.

### 3. Equity Incentive Plan

#### Stock Options

The Company's 2007 Equity Incentive Plan (the "Plan") was approved by the Company's stockholders at the annual meeting of the Company's stockholders on May 30, 2007. The Plan provides that the Company may grant options to directors, officers and employees for up to 743,936 shares of common stock. Both incentive stock options and non-qualified stock options may be granted under the Plan. The exercise price for each option is equal to the market price of the Company's stock on the date of grant and the maximum term of each option is ten years. The stock options vest over five years in five equal installments on each anniversary of the date of grant.

The Company recognizes compensation expense over the vesting period, based on the grant-date fair value of the options granted. The fair value of each option granted is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions for options granted during the year ended December 31, 2013.

	Year Ended December 31, 2013	
Expected dividend yield	1.39	%
Weighted average expected term	6.5 years	
Weighted average expected volatility	24.06	%
Weighted average risk-free interest rate	1.25	%

Expected volatility is based on the historical volatility of the Company's stock and other factors. The risk-free interest rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. The Company uses historical data, such as option exercise and employee termination rates, to calculate the expected option life.

A summary of options under the Plan as of March 31, 2014 and changes during the three months ended March 31, 2014, is as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (000's)
Outstanding at December 31, 2013	668,598	\$14.58	4.86	\$1,894
Granted	—	—	—	—
Exercised	(2,200)	15.27	8.28	—
Forfeited or expired	(5,800)	15.82	8.51	—
Outstanding at March 31, 2014	660,598	\$14.56	4.57	\$2,071
Exercisable at March 31, 2014	546,897	\$14.33	3.77	\$1,842
Exercisable at March 31, 2013	534,598	\$14.26	4.50	\$1,411

There were no options granted during the three months ended March 31, 2014. The weighted-average grant-date fair value of options granted during 2013 was \$3.59. The weighted-average grant-date fair value of the options outstanding and exercisable at March 31, 2014 was \$3.81 and \$3.87, respectively. For the three months ended March

31, 2014, share based compensation expense applicable to options granted under the Plan was \$30,000 and the related tax benefit was \$1,000. For the three months ended March 31, 2013, share based compensation expense applicable to options granted under the Plan was \$28,000 and the related tax benefit was \$1,000. As of March 31, 2014, unrecognized stock-based compensation expense related to non-vested options amounted to \$375,000. This amount is expected to be recognized over a period of 3.32 years.



## Stock Awards

The Plan provides that the Company may grant stock awards to its directors, officers and employees for up to 297,574 shares of common stock. The stock awards vest 20% per year beginning on the first anniversary of the date of grant. The fair market value of the stock awards, based on the market price at the date of grant, is recorded as unearned compensation. Unearned compensation is amortized over the applicable vesting period. The weighted-average grant-date fair value of stock awards as of March 31, 2014 is \$14.08. The Company recorded compensation cost related to stock awards of approximately \$1,000 for the three months ended March 31, 2014 and for the three months ended March 31, 2013. There were no stock awards granted prior to July 1, 2007. There were no stock awards granted by the Company during the three months ended March 31, 2014. The Company granted 2,000 stock awards during the year ended December 31, 2011 with a grant price of \$14.08. As of March 31, 2014, unrecognized stock-based compensation expense related to non-vested restricted stock awards amounted to \$11,000. This amount is expected to be recognized over a period of 1.94 years.

A summary of the status of the Company's stock awards as of March 31, 2014, and changes during the three months ended March 31, 2014, is as follows:

Nonvested Shares	Number of Shares	Weighted Average Grant-Date Fair Value
Outstanding at December 31, 2013	1,200	\$ 14.08
Granted	—	—
Vested	400	14.08
Forfeited	—	—
Outstanding at March 31, 2014	800	\$ 14.08

## 4. Long-term Incentive Plan

On March 13, 2012, the Company adopted the Chicopee Bancorp, Inc. 2012 Phantom Stock Unit Award and Long-Term Incentive Plan (the "Phantom Stock Plan"), effective January 1, 2012, to promote the long-term financial success of the Company and its subsidiaries by providing a means to attract, retain and reward individuals who contribute to such success and to further align their interest with those of the Company's stockholders.

A total of 150,000 phantom stock units will be available for awards under the Phantom Stock Plan. The only awards that may be granted under the Phantom Stock Plan are Phantom Stock Units. A Phantom Stock Unit represents the right to receive a cash payment on the determination date equal to the book value of a share of the Company's stock on the determination date. The settlement of a Phantom Stock Unit on the determination date shall be in cash. Unless the Compensation Committee of the Board of Directors of the Company determines otherwise, the required period of service for full vesting will be three years. The Company's total expense under the Phantom Stock Plan for the three months ended March 31, 2014, and 2013, was \$8,000 and \$4,000, respectively.

## 5. Recent Accounting Pronouncements (Applicable to the Company)

In January 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-04, Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure. The ASU was issued to clarify that an in substance repossession or foreclosure occurs, and a credit is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the credit obtaining legal

title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the ASU amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The ASU is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2014, and the ASU is to be adopted using either a modified retrospective transition method or a prospective transition method. The Company does not believe such ASU will have a material effect on the Company's consolidated financial statements for the interim and annual periods in 2014, other than the additional disclosures required.

## 6. Investment Securities

The following tables set forth, at the dates indicated, information regarding the amortized cost and fair value, with gross unrealized gains and losses of the Company's investment securities:

	March 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
Available-for-sale securities				
Marketable equity securities	\$369	\$38	\$—	\$407
Total available-for-sale securities	\$369	\$38	\$—	\$407
Held-to-maturity securities				
U.S. Treasury securities	\$—	\$—	\$—	\$—
Corporate and industrial revenue bonds	34,358	576	—	34,934
Certificates of deposit	6,048	7	—	6,055
Collateralized mortgage obligations	587	30	—	617
Total held-to-maturity securities	\$40,993	\$613	\$—	\$41,606
Non-marketable securities				
Federal Home Loan Bank stock	\$3,914	\$—	\$—	\$3,914
Banker's Bank Northeast stock	183	—	—	183
Total non-marketable securities	\$4,097	\$—	\$—	\$4,097
	December 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
Available-for-sale securities				
Marketable equity securities	\$522	\$80	\$—	\$602
Total available-for-sale securities	\$522	\$80	\$—	\$602
Held-to-maturity securities				
U.S. Treasury securities	\$5,000	\$—	\$—	\$5,000
Corporate and industrial revenue bonds	34,588	681	—	35,269
Certificates of deposit	8,373	15	—	8,388
Collateralized mortgage obligations	645	36	—	681
Total held-to-maturity securities	\$48,606	\$732	\$—	\$49,338
Non-marketable securities				
Federal Home Loan Bank stock	\$3,914	\$—	\$—	\$3,914
Banker's Bank Northeast stock	183	—	—	183
Total non-marketable securities	\$4,097	\$—	\$—	\$4,097



The amortized cost and estimated fair value of debt securities by contractual maturity at March 31, 2014 are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without prepayment penalties. The collateralized mortgage obligations are allocated to maturity categories according to final maturity date.

	Held-to-maturity Amortized Cost (In Thousands)	Fair Value
Due in one year or less	\$6,048	\$6,055
Due after one year through five years	560	588
Due after five years through ten years	8,021	8,200
Due after ten years	26,364	26,763
	\$40,993	\$41,606

During the three months ended March 31, 2014 proceeds from sales of available-for-sale securities amounted to \$187,000 with gross realized gains of \$34,000. The tax provision applicable to the net realized gain for the three months ended March 31, 2014 was \$8,000. There were no sales of available-for-sale securities during the three months ended March 31, 2013.

#### Unrealized Losses on Investment Securities

Management conducts, at least on a monthly basis, a review of its investment portfolio including available-for-sale and held-to-maturity securities to determine if the fair value of any security has declined below its cost or amortized cost and whether such security is other-than-temporarily impaired. Securities are evaluated individually based on guidelines established by the FASB and the internal policy of the Company and include but are not limited to: (1) intent and ability of the Company to retain the investment for a period of time sufficient to allow for the anticipated recovery in fair value; (2) percentage and length of time which an issue is below book value; (3) financial condition and near-term prospects of the issuer; (4) whether the debtor is current on contractually obligated interest and principal payments; (5) the volatility of the market price of the security; and (6) any other information and observable data considered relevant in determining whether other-than-temporary impairment has occurred, including the expectation of receipt of all principal and interest due.

There were no unrealized losses as of March 31, 2014 and December 31, 2013.

#### U.S. Treasury Securities

The Company did not hold U.S. Treasury securities at March 31, 2014. There were no unrealized losses within the U.S. Treasury securities portfolio at December 31, 2013.

#### Collateralized Mortgage Obligations (“CMO”)

As of March 31, 2014 and December 31, 2013, there were no unrealized losses within the CMO portfolio. The portfolio ended with an unrealized gain of \$30,000 and \$36,000 as of March 31, 2014 and December 31, 2013, respectively. As of March 31, 2014, the Company had six CMO bonds, or eight individual issues, with an aggregate book value of \$587,000. Since the purchase of these bonds, interest payments have been current and the Company expects to receive all principal and interest due.

As of December 31, 2013, the Company had eight CMO bonds, or six individual issues, with an aggregate book value of \$645,000. Since the purchase of these bonds, interest payments have been current and the Company expects to receive all principal and interest due.

#### Corporate and Industrial Revenue Bonds

As of March 31, 2014 and December 31, 2013, there were no unrealized losses within the corporate industrial revenue bond category. The Company had six tax-exempt industrial revenue bonds ("IRB"), with an aggregate book value of \$34.4 million and \$34.6 million at March 31, 2014 and December 31, 2013, respectively. The portfolio ended with unrealized gains of \$576,000 and \$681,000 as of March 31, 2014 and December 31, 2013, respectively.

#### Marketable Equity Securities

As of March 31, 2014 and December 31, 2013 there were no unrealized losses within the marketable equity securities portfolio, and the portfolio ended the period with a net unrealized gain of \$38,000 and \$80,000, respectively.

#### Non-Marketable Securities

The Company is a member of the Federal Home Loan Bank of Boston ("FHLB"). The FHLB is a cooperatively owned wholesale bank for housing and finance in the six New England States. Its mission is to support the residential mortgage and community development lending activities of its members, which include over 450 financial institutions across New England. As a requirement of membership in the FHLB, the Company must own a minimum required amount of FHLB stock, calculated periodically based primarily on the Company's level of borrowings from the FHLB. The Company uses the FHLB for much of its wholesale funding needs. The Company's investment in FHLB stock totaled \$3.9 million as of March 31, 2014 and December 31, 2013.

FHLB stock is a non-marketable equity security and therefore is reported at cost, which equals par value. Shares held in excess of the minimum required amount are generally redeemable at par value. For the three months ended March 31, 2014 and for the year ended December 31, 2013, the Company received \$15,000 and \$15,000, respectively, in dividend income from its FHLB stock investment.

The Company periodically evaluates its investment in FHLB stock for impairment based on, among other factors, the capital adequacy of the FHLB and its overall financial condition. There have not been any impairment losses recorded through March 31, 2014 and the Company will continue to monitor its FHLB stock investment.

Banker's Bank Northeast (BBN) stock is reported under other assets on the Statement of Financial Condition and is carried at cost. The BBN stock investment is evaluated for impairment based on an estimate of the ultimate recovery to par value. As of March 31, 2014 and December 31, 2013, the Company's investment in BBN totaled \$183,000. There have not been any impairment losses recorded through March 31, 2014 and the Company will continue to monitor its BBN stock investment.

## 7. Loans and Allowance for Loan Losses

The following table sets forth the composition of the Company's loan portfolio in dollar amounts and as a percentage of the total loan portfolio at the dates indicated.

	March 31, 2014		December 31, 2013		
	Amount	Percent of Total	Amount	Percent of Total	
	(Dollars In Thousands)				
Real estate loans:					
Residential(1)	\$ 113,257	23.0	% \$ 112,524	23.0	%
Home equity	31,436	6.4	% 32,091	6.6	%
Commercial	215,203	43.8	% 211,161	43.1	%
Total	359,896	73.2	% 355,776	72.7	%
Construction-residential	7,109	1.4	% 6,130	1.3	%
Construction-commercial	43,439	8.8	% 38,441	7.9	%
Total	50,548	10.3	% 44,571	9.2	%
Total real estate loans	410,444	83.5	% 400,347	81.9	%
Consumer loans	2,358	0.5	% 2,405	0.4	%
Commercial and industrial loans	78,912	16.0	% 86,540	17.7	%
Total loans	491,714	100.0	% 489,292	100.0	%
Deferred loan origination costs, net	918		923		
Allowance for loan losses	(4,462)	)	(4,596)	)	
Loans, net	\$488,170		\$485,619		

(1) Excludes loans held for sale of \$396,000 and \$70,000 at March 31, 2014 and December 31, 2013, respectively.

The Company has transferred a portion of its originated commercial real estate and commercial loans to participating lenders. The amounts transferred have been accounted for as sales and therefore not included in the Company's consolidated statements of financial condition. The Company and participating lenders share proportionally, based on participating agreements, any gains or losses that may result from the borrowers lack of compliance with the terms of the loan. The Company continues to service the loans on behalf of the participating lenders. At March 31, 2014 and December 31, 2013, the Company was servicing loans for participating lenders totaling \$15.0 million and \$13.7 million, respectively.

In accordance with the Company's asset/liability management strategy and in an effort to reduce interest rate risk, the Company continues to sell fixed rate, low coupon residential real estate loans to the secondary market. The Company sold \$1.6 million and \$12.0 million in residential real estate loans to the secondary market, during the three month period ended March 31, 2014 and 2013, respectively. The unpaid principal balance of residential real estate loans serviced for others was \$97.0 million at March 31, 2014 and \$97.6 million at December 31, 2013. Servicing rights will continue to be retained on all loans written and sold in the secondary market.

## Credit Quality



To evaluate the risk in the loan portfolio, internal credit risk ratings are used for the following loan segments: commercial real estate, commercial construction and commercial. The risks evaluated in determining an adequate credit risk rating include the financial strength of the borrower and the collateral securing the loan. All commercial real estate, commercial construction and commercial loans are rated from one through nine. Credit risk ratings one through five are considered pass ratings. Classified assets include credit risk ratings of special mention, substandard, doubtful and loss. At least quarterly, classified assets are reviewed by management. Credit risk ratings are updated as soon as information is obtained that indicates a change in the credit risk rating may be warranted.

The following describes the classified credit risk ratings:

Special mention. Assets that do not currently expose the Company to sufficient risk to warrant classification in one of the following categories but possess potential weaknesses.

Substandard. Assets that have one or more defined weaknesses and are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Non-accruing loans are typically classified as substandard.

Residential real estate and residential construction loans are categorized into pass and substandard risk ratings. Substandard residential loans are loans that are on nonaccrual status and are individually evaluated for impairment.

Consumer loans are considered nonperforming when they are 90 days past due or have not returned to accrual status. Consumer loans are not individually evaluated for impairment.

Home equity loans are considered nonperforming when they are 90 days past due or have not returned to accrual status. Each nonperforming home equity loan is individually evaluated for impairment.

The following table presents an analysis of total loans segregated by risk rating and segment as of March 31, 2014:

Commercial Credit Risk Exposure				
	Commercial and Industrial (In Thousands)	Commercial Construction	Commercial Real Estate	Total
Pass	\$70,995	\$32,854	\$203,844	\$307,693
Special mention	5,034	6,487	4,155	15,676
Substandard	2,883	4,098	7,204	14,185
Total commercial loans	\$78,912	\$43,439	\$215,203	\$337,554
Residential Credit Risk Exposure				
	Residential Real Estate (In Thousands)	Residential Construction		Total
Performing	\$110,335	\$7,109		\$117,444
Substandard (nonaccrual)	2,922	—		2,922
Total residential loans	\$113,257	\$7,109		\$120,366
Consumer Credit Risk Exposure				
	Consumer (In Thousands)	Home Equity		Total
Performing	\$2,333	\$31,196		\$33,529
Nonperforming (nonaccrual)	25	240		265
Total consumer loans	\$2,358	\$31,436		\$33,794



The following table presents an analysis of total loans segregated by risk rating and segment as of December 31, 2013:

	Commercial Credit Risk Exposure			
	Commercial and Industrial (In Thousands)	Commercial Construction	Commercial Real Estate	Total
Pass	\$77,483	\$27,969	\$200,096	\$305,548
Special mention	4,050	6,584	3,594	14,228
Substandard	5,007	3,888	7,471	16,366
Total commercial loans	\$86,540	\$38,441	\$211,161	\$336,142
	Residential Credit Risk Exposure			
	Residential Real Estate (In Thousands)	Residential Construction		Total
Performing	\$110,109	\$6,130		\$116,239
Substandard (nonaccrual)	2,415	—		2,415
Total residential loans	\$112,524	\$6,130		\$118,654
	Consumer Credit Risk Exposure			
	Consumer (In Thousands)	Home Equity		Total
Performing	\$2,397	\$31,798		\$34,195
Substandard (nonaccrual)	8	293		301
Total consumer loans	\$2,405	\$32,091		\$34,496

#### Allowance for Loan Losses

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

This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

Net charge-offs of \$2.3 million for the three months ended March 31, 2014 were primarily due to losses taken on a \$4.6 million commercial relationship consisting of four commercial real estate loans totaling \$2.1 million and a commercial line of credit totaling \$2.5 million. Management is investigating potential fraudulent activity with one relationship and taking the necessary steps to protect the Company's position and to mitigate additional losses related to this relationship.

The allowance consists of general and allocated components, as further described below.

#### Loans charged off

Commercial and industrial loans. Loans past due more than 120 days are considered for one of three options: charge off the balance of the loan, charge off any excess balance over the fair value of the collateral securing the loan, or continue collection efforts subject to a monthly review until either the balance is collected or a charge-off recommendation can be reasonably made.

Residential loans. In general, a charge-off will not be recommended until a potential shortfall can be determined upon receipt of an updated appraisal and/or title to the property. However, any outstanding loan balance in excess of the fair value of the property, less cost to sell, is classified as a loss in the allocation of loan loss reserves and charged off when the property is acquired before being transferred to OREO.

Consumer loans. Generally all loans are automatically considered for charge-off at 90 to 120 days from the contractual due date, unless there is liquid collateral in hand sufficient to repay principal and interest in full.

## General Component

The general component of the allowance for loan losses is based on historical loss experience adjusted for qualitative factors stratified by the following portfolio segments: residential real estate, residential construction, commercial real estate, commercial, commercial construction, consumer and home equity. Management uses an average of historical losses based on a time frame appropriate to capture relevant loss data for each portfolio segment. Management deems 36 months to be an appropriate time frame on which to base historical losses for each portfolio segment. This historical loss factor is adjusted for qualitative factors for each portfolio segment including, but not limited to: levels/trends in delinquencies; trends in volume and terms of loans; effects of changes in risk selection and changes in lending policies, experience, ability, depth of lending management and staff; and national and local economic conditions. Management follows a similar process to estimate its liability for off-balance-sheet commitments to extend credit.

The qualitative factors are determined based on the various risk characteristics of each portfolio segment. Risk characteristics relevant to each portfolio segment are as follows:

Residential real estate loans enable the borrower to purchase or refinance existing homes, most of which serve as the primary residence of the owner. Repayment is dependent on the credit quality of the borrower. Factors attributable to failure of repayment may include a weakened economy and/or unemployment, as well as possible personal considerations. While the Company anticipates adjustable-rate mortgages will better offset the potential adverse effects of an increase in interest rates as compared to fixed-rate mortgages, the increased mortgage payments required of adjustable-rate loan borrowers in a rising interest rate environment could cause an increase in delinquencies and defaults. The marketability of the underlying property also may be adversely affected in a high interest rate environment.

Commercial real estate loans are secured by commercial real estate and residential investment real estate and generally have larger balances and involve a greater degree of risk than one- to four-family residential mortgage loans. Risks in commercial real estate and residential investment lending are borrower's creditworthiness and the feasibility and cash flow potential of the project. Payments on loans secured by income properties often depend on successful operation and management of the properties. As a result, repayment of such loans may be subject to a greater extent than residential real estate loans to adverse conditions in the real estate market or the economy.

Commercial and residential construction loans are generally considered to involve a higher degree of risk of loss than long-term financing on improved, occupied real estate. Risk of loss on a construction loan depends largely upon the accuracy of the initial estimate of the property's value at completion of construction and the estimated cost (including interest) of construction.

Commercial and industrial loans are of higher risk and typically are made on the basis of the borrower's ability to make repayment from the cash flow of the borrower's business. As a result, the availability of funds for the repayment of commercial loans may depend substantially on the success of the business itself. Further, any collateral securing such loans may depreciate over time, may be difficult to appraise and may fluctuate in value.

Consumer and home equity loans may entail greater risk than do residential mortgage loans, particularly in the case of consumer loans that are unsecured or secured by assets that depreciate rapidly. In such cases, repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment for the outstanding loan and the remaining deficiency often does not warrant further substantial collection efforts against the borrower. In addition, consumer loan collections depend on the borrower's continuing financial stability, and therefore are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount that can be recovered on such loans.

The Company does not disaggregate its portfolio segments into loan classes.

#### Allocated Component

The allocated component relates to loans that are classified as impaired. Impairment is measured on a loan by loan basis for residential real estate, home equity loans, commercial real estate and commercial loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. An allowance is established when the discounted cash flows or collateral value of the impaired loan is lower than the carrying value of that loan. The Company recognizes the change in present value attributable to the passage of time as provision for loan losses. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment, and the resulting allowance is reported as the general component, as described above.

Loans are considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered

by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

The Company may periodically agree to modify the contractual terms of loans. When a loan is modified and a concession is made to a borrower experiencing financial difficulty, the modification is considered a troubled debt restructuring ("TDR"). All TDRs are classified as impaired.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer loans for impairment evaluation, except for home equity loans.

During the three months ended March 31, 2014, there were no changes in the Company's allowance methodology related to the qualitative or quantitative factors.

The following table presents the allowance for loan losses and select loan information as of and for the three months ended March 31, 2014:

	Residential Real Estate	Residential Construction	Commercial Real Estate	Commercial Construction	Commercial and Industrial	Consumer Loans	Home Equity	Total
Allowance for loan losses	(In Thousands)							
Balance as of December 31, 2013	\$650	\$ 94	\$ 2,121	\$ 435	\$ 1,110	\$ 35	\$ 151	\$4,596
Provision for (reduction of) loan losses	(6	) 16	148	61	1,929	13	40	2,201
Recoveries	—	—	—	—	1	5	—	6
Loans charged off	(233	) —	—	—	(2,033	) (19	) (56	) (2,341
Balance as of March 31, 2014	\$411	\$ 110	\$ 2,269	\$ 496	\$ 1,007	\$ 34	\$ 135	\$4,462
Allowance for loan losses ending balance								
Collectively evaluated for impairment	\$407	\$ 110	\$ 2,129	\$ 496	\$ 997	\$ 34	\$ 135	\$4,308
Individually evaluated for impairment	4	—	140	—	10	—	—	154
	\$411	\$ 110	\$ 2,269	\$ 496	\$ 1,007	\$ 34	\$ 135	\$4,462
Total loans ending balance								
Collectively evaluated for impairment	\$110,092	\$ 7,109	\$ 208,845	\$ 39,341	\$ 77,238	\$ 2,358	\$ 31,196	\$476,179
Individually evaluated for impairment	3,165	—	6,358	4,098	1,674	—	240	15,535
	\$113,257	\$ 7,109	\$ 215,203	\$ 43,439	\$ 78,912	\$ 2,358	\$ 31,436	