# 1991 ANNUAL REPORT

The majestic view at World's End, Hingham

Hingham Institution for Savings

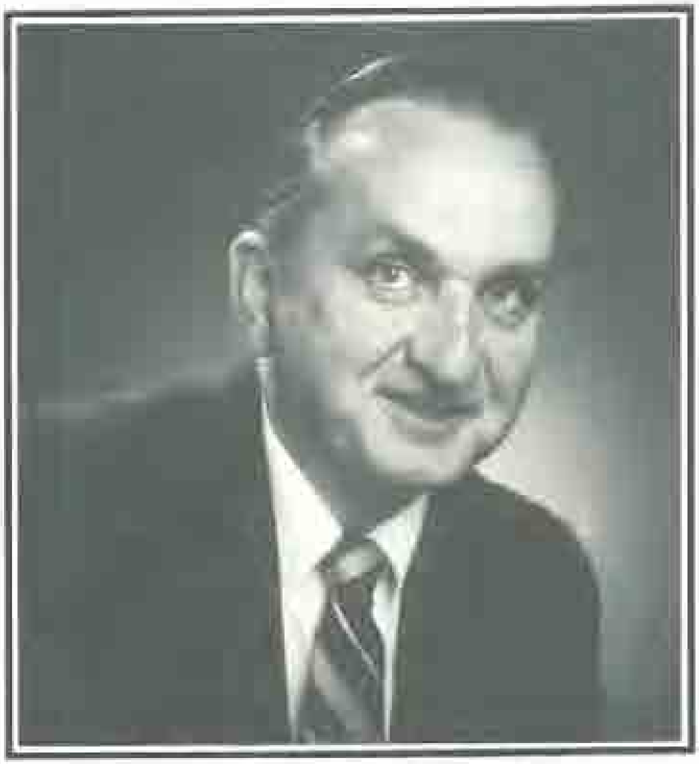
# Selected Consolidated Financial Data

The following information does not purport to be complete and is qualified in its entirety by the more detailed information contained elsewhere herein.

| | At December 31, | | | | |
|---|---|---|---|---|---|
| | 1991 | 1990 | 1989 (In Thousands) | 1988 | 1987 |
| Balance Sheet Data: | | | | | |
| Total assets | $ 148,760 | 149,262 | 150,633 | 157,040 | 134,418 |
| Investment securities | 49,343 | 33,434 | 20,506 | 20,147 | 21,748 |
| Loans: | | | | | |
| Mortgage | 81,085 | 90,224 | 110,132 | 113,667 | 100,341 |
| Commercial | 1,047 | 1,045 | 947 | 987 | 693 |
| Consumer | 3,117 | 4,277 | 5,555 | 4,598 | 5,689 |
| Total loans | 85,249 | 95,546 | 116,634 | 119,252 | 106,723 |
| Allowance for possible loan losses | 1,628 | 1,414 | 3,381 | 924 | 525 |
| Loans, net | 83,440 | 93,953 | 113,138 | 118,141 | 106,198 |
| Real estate owned or substantively repossessed | 4,772 | 9,637 | 1,093 | 634 | — |
| Deposits | 120,721 | 119,211 | 116,345 | 124,221 | 122,788 |
| Federal Home Loan Bank advances | 15,000 | 15,000 | 15,000 | 10,000 | — |
| Stockholders' equity | 11,988 | 13,751 | 17,999 | 20,764 | 10,291 |

| | Years Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 1991 | 1990 | 1989 (Dollars in Thousands, Except Per Share Amounts) | 1988 | 1987 |
| Operating Data: | | | | | |
| Total interest income | $ 12,631 | 13,212 | 13,018 | 13,618 | 12,528 |
| Total interest expense | 8,850 | 9,928 | 9,455 | 8,935 | 8,228 |
| Net interest income | 3,781 | 3,284 | 3,563 | 4,683 | 4,300 |
| Provision for possible loan losses | 1,690 | 2,770 | 3,500 | 621 | 1,038 |
| Non-interest income | 785 | 346 | 388 | 339 | 737 |
| Non-interest expense | 4,734 | 5,279 | 3,302 | 2,603 | 2,677 |
| Income (loss) before income taxes | (1,858) | (4,419) | (2,851) | 1,798 | 1,322 |
| Income tax expense (benefit) | 1 | (607) | (512) | 965 | 407 |
| Net income (loss) | $ (1,859) | (3,812) | (2,339) | 833 | 915 |
| Loss per share | $ (1.49) | (3.05) | (1.87) | | |
| Financial Ratios: | | | | | |
| Return (loss) on average assets | (1.23)% | (2.50)% | (1.58)% | 0.58% | 0.69% |
| Return (loss) on average equity | (13.74) | (22.14) | (11.60) | 7.23 | 9.46 |
| Average equity to average assets | 8.92 | 11.31 | 13.61 | 8.07 | 7.26 |
| Interest rate spread | 2.86 | 2.04 | 1.77 | 3.08 | 3.16 |
| Net yield on average earning assets | 2.78 | 2.34 | 2.52 | 3.43 | 3.39 |

# *President's Message*



*Paul E. Bulman, President, C.E.O.*

Dear Stockholder,

For the year ended December 31, 1991, Hingham Institution for Savings recorded a net loss of $1,859,000 or $1.49 per common share, as compared to a net loss of $3,812,000 or $3.05 per share in 1990. The loss resulted from management's decision to increase the allowance for possible loan losses through provisions that totaled $1,690,000 for the year, and additional provisions for possible losses totaling $870,000 relating to properties held as real estate owned or substantively repossessed. These additions are directly attributed to the declining collateral value of properties sold during the year.

Non-accrual loans decreased from $5,263,000 reported as of December 31, 1990 to $3,591,000 as of December 31, 1991. Real estate owned or substantively repossessed decreased from $9,637,000 reported as of December 31, 1990 to $4,772,000 reported as of December 31, 1991. It includes $956,000 in residential homes, $2,360,000 in land development, $708,000 in residential condominiums, $852,000 in commercial real estate, less an allowance for possible losses of $104,000. All of these properties are being actively marketed.

We are currently responding to a proposed Memorandum of Understanding with the FDIC and The Massachusetts Commissioner of Banks. This memorandum will set forth our existing plans for reducing classified assets; improving the earnings of the Bank and revising our funds management policy to address our ongoing liquidity needs as well as monitor interest rate sensitivity. We will coordinate our loan, investment and budget policies into a comprehensive business plan. Specific goals are to be established under this memorandum for reducing the ratio of non-performing loans to total loans.

The Bank is required by FDIC regulations to maintain certain capital requirements. At December 31, 1991, the Bank's actual capital ratios significantly exceeded the minimum capital requirements as follows:

| | Required | | Actual | |
|---|---|---|---|---|
| | Percentage | Amount | Percentage | Amount |
| | (Dollars in Thousands) | | | |
| Leveraged Capital: | | | | |
| Tier 1 or Core Capital | 4.00% | $6,043 | 7.94% | $11,988 |
| Risk Based: | | | | |
| Tier 1: | 3.625 | 3,007 | 14.45 | 11,988 |
| Total: (Tiers 1 and 2) | 7.25 | 6,013 | 15.95 | 13,232 |

We are confident that we can continue our progress in reducing non-performing assets and return to profitability. However, evidence that the recession continues to plague the northeast can be read in any newspaper, and as a noted economist said recently, "Since there is virtually no possibility for a regional economic recovery, the question, 'Where now, New England' requires an answer to, 'Where now, The Nation' ". Let all of us hope that our national leaders will hear the people and do what is necessary to produce jobs for those without them, and incentives to jumpstart this prolonged recessionary economy.

Investment securities increased from $33,434,000 at December 31, 1990 to $49,343,000 as of December 31, 1991 and consist primarily of U.S. Treasury, Government agency, and mortgage-backed securities. The funds were obtained from loan amortization as well as the proceeds from properties sold out of other real estate owned. At December 31, 1991, the portfolio had a market value of $51,015,000 which exceeded book value by $1,672,000.

I am pleased to announce the election by the Board of Directors on March 18, 1992 of Mrs. Stacey M. Page of Hingham as a Director of the Bank, and to nominate as new Directors of the Bank, Mr. Robert H. Gaughen of Weymouth and Miss Marion J. Fahey of Hingham. We believe that each will make substantial contributions and are very capable of providing the leadership that will be required of this industry throughout the nineties. Mr. Jon Davis decided not to stand for re-election in order to afford him the opportunity to pursue other interests. We thank Mr. Davis for his many contributions and wish him well.

I thank you for your continued support, expressed by many of you, during these difficult times and be assured that the staff of this Bank is committed to representing the best interest of all of you.

Sincerely,

Paul E. Bulman

Paul E. Bulman
President and Chief Executive Officer

# Retail Banking

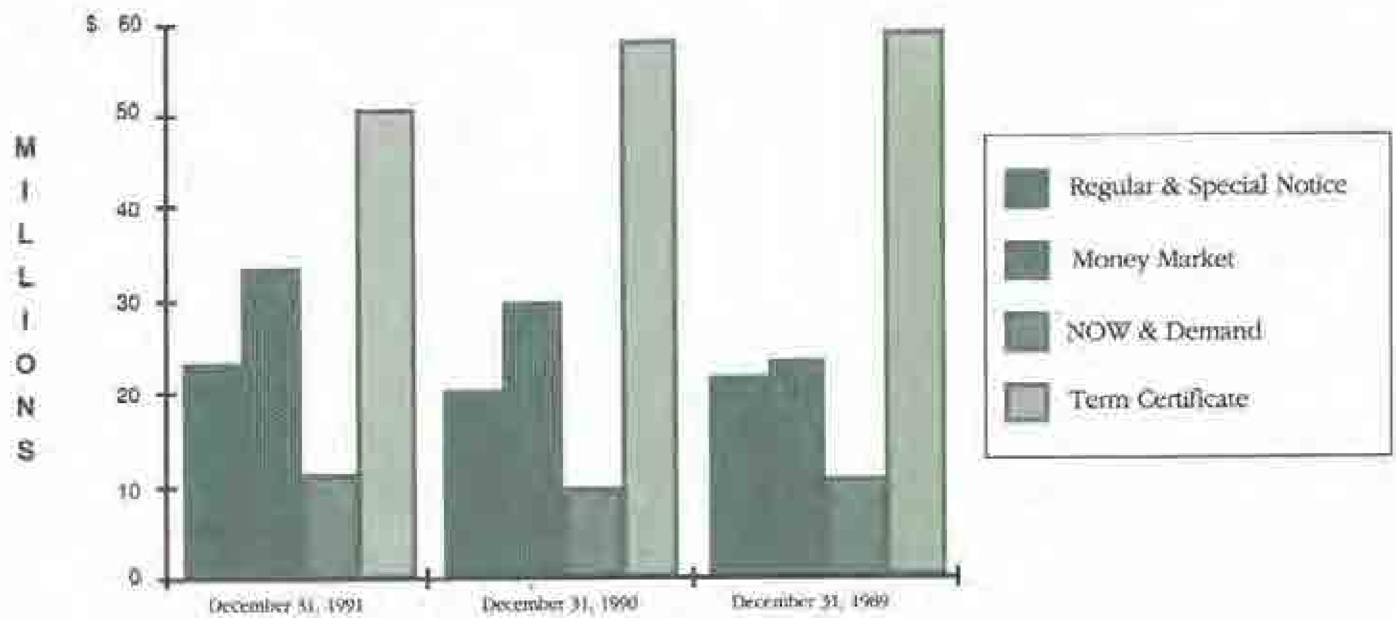
Attracting and retaining deposits with an emphasis on controlled and carefully monitored growth continues to be one of our foremost objectives at Hingham Institution for Savings. The Bank must compete in an extremely competitive market place. Economic conditions, competition and decreasing interest rates can cause the general market for deposits to be extremely volatile. Deposits as of December 31, 1991 were $120.7 million representing an increase of $1.5 million or 1.3% over December 31, 1990. During 1991, interest rates plummeted resulting in a shift from term certificates to non-certificate accounts. Term certificates decreased by $7.0 million or 12.1% while non-certificate accounts increased by $8.5 million or 14.0% compared to the prior year. In our industry, many depositors traditionally loyal to certificate of deposits have made new decisions about where to invest their money helping to drive the stock market to new highs and spurring a phenomenal increase in mutual fund assets. In prior years, getting a solid return on a certificate of deposit was both simple and safe, not providing much motivation for depositors to look elsewhere. We believe our depositors aren't moving into riskier investments just because interest rates are low at the moment. Rather our depositors are choosing the safety and soundness of our non-certificate accounts with the expectation that this period of low interest rates will pass.

Management believes that by offering competitive rates, combined with friendly, efficient service, we will achieve our deposit objective in a cost effective way that contributes to increasing our net interest margin. The Bank offers a wide range of deposit accounts including, regular savings accounts, NOW accounts, demand deposit accounts, commercial checking, term certificates, club accounts and retirement accounts plus the convenience of Automated Teller Machines at all our offices.

The Bank currently enjoys a substantial market share in its retail branch system which is greatly attributable to our commitment in community banking; a cornerstone of our approach to customer service. As a community oriented bank we have a special relationship with the communities we serve. We have both a responsibility and an opportunity to contribute to the communities we serve, helping to make them better places in which to live and work. This approach has distinguished the Bank with a reputation for offering personalized service on products designed to meet the needs of our customers.

A natural concern to all depositors, in a continually changing and volatile financial environment, is the security of their deposit funds. Deposits at Hingham Institution for Savings are insured in full through the Federal Deposit Insurance Corporation, and the Deposit Insurance Fund of Massachusetts. This insurance, combined with a strong capital position, should alleviate any customer concerns regarding the safety of their deposits in the Bank.

As we grow and cautiously anticipate an economic recovery we will continue to foster close ties with our customers and the communities we serve while striving to enhance the value of our stockholders. In the current economic environment the Bank must, and will, face the challenge of working harder to achieve these goals.



# *Lending Department*

Lending at Hingham Institution for Savings consists primarily of residential first mortgage loans. Residential loans are originated on both a fixed rate and variable rate basis and generally have amortization periods from 15 to 30 years.

Variable rate mortgage loans have interest rates that are periodically adjusted to reflect market conditions. During 1991 the Bank continued to originate variable rate residential mortgage loans for its portfolio. Fixed rate loans are originated with the intention of being sold in the secondary market. On December 31, 1991, residential variable rate mortgage loans totaled $31.3 million or 36.8% of total loan portfolio and residential fixed rate mortgage loans totaled $23.4 million or 27.4% of the total loan portfolio.

The largest portion of the loan portfolio consists of loans made to homeowners on one to four family residences. At December 31, 1991, the residential portion of the loan portfolio totaled $54.7 million or 64.2% of the total loan portfolio, commercial mortgages totaled $15.0 million, representing 17.6% of the total loan portfolio. Home equity and second mortgage totaled $8.0 million, representing 9.4% of the total loan portfolio. Commercial and consumer loans represented 4.9% of the total loan portfolio.

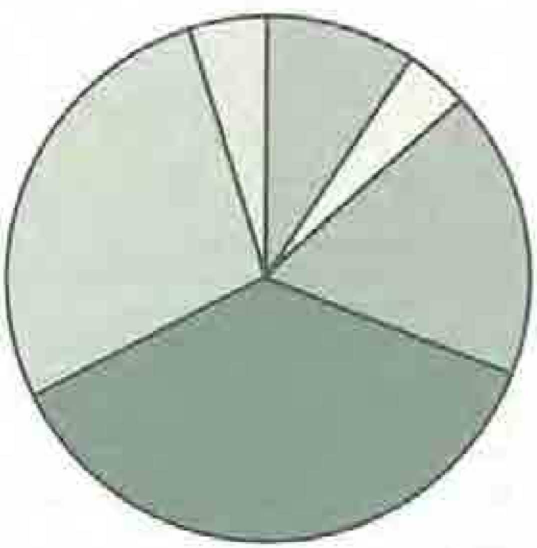
All real estate loans originated by the Bank are located in Bank's primary lending area reflecting the Bank's commitment to serve the credit needs of the local community.

Loan applications come from a number of sources, including depositors, existing borrowers, walk-in customers and others responding to the Bank's advertising program. For the year ended December 31, 1991, mortgage loan originations amounted to $17.3 million as compared to $14.4 million for the year ended December 31, 1990. Although the sales of existing housing were slow throughout 1991 the increase in loan originations was primarily due to refinancings at lower interest rates.

During 1992, the Bank intends to strengthen and expand its commitment to residential mortgage lending by emphasizing lending in the one to four family residential market. Issues related to affordable housing and the strength of the economy will influence the level of originations during the coming year. Hingham Institution for Savings expects to maintain it's position as the leading residential lender in the Hingham area. The Bank's strategy will be to continue to originate loans with shorter term variable rates to be held in the Bank's portfolio and to generally sell fixed rate loan originations.

Commercial mortgage lending activities are assuming greater importance in our plans for the future. Working with customers who have existing relationships with the Bank and by focusing on the needs of small to mid size businesses we can build a commercial mortgage portfolio.

The Bank has historically been active in the secondary market as conditions warrant. The Bank anticipates that by both originating variable rate loans, to be held in its own portfolio and fixed rate loans written under guidelines of the secondary market we will reduce our exposure to interest rate risk.



**Total Loans at December 31, 1991**

- Home Equity & Second Mortgages (9.4%)
- Residential Construction (3.9%)
- Residential Fixed Rate (27.4%)*
- Residential Variable Rate (36.8%)*
- Commercial Mortgage (17.6%)
- Commercial & Consumer Loans (4.9%)

*As shown in above chart, residential loans totaled 64.2% of the total loan portfolio. Of these loans, 42.7% are fixed rate loans and 57.3% are variable rate loans.

# *Management's Discussion & Analysis*

The operating results of the Bank depend on its net interest income. Net interest income is the difference between interest and dividend income on interest-earning assets (primarily consisting of loans and investment securities) and interest expense on interest-bearing liabilities (consisting of deposits and borrowings). Additional components that affect the operating income include the provision for loan losses, non-interest income, and non-interest expense. All aspects of the Bank's operations are significantly affected by the economy, competition and by policies of regulatory authorities.

The Bank's net loss for the year ended December 31, 1991 was $1,859,000 or $1.49 per share. In 1989 and 1990 the Bank had net losses of $2,339,000 or $1.87 per share and $3,812,000, or $3.05 per share respectively. The reduction in the net loss for 1991 was reflective of both lower interest rates paid on deposits and Federal Home Loan Bank advances, and a reduced provision for possible loan losses. Since 1988, the Bank's results have been affected significantly by the levels of the provision for possible loan losses associated with non-performing real estate loans. In addition to the provision for possible loan losses, the Bank incurred substantial increases in costs and write-downs associated with foreclosed properties.

Assets totaled $148.8 million on December 31, 1991, and $149.3 million on December 31, 1990; a decrease of 0.3%. During this period, stockholders' equity decreased to $12.0 million from $13.8 million.

**Interest and Dividend Income.** Total interest and dividend income decreased by $581,000, or 4.4% in 1991 as compared to an increase of $194,000, or 1.5% in 1990. The 1991 decrease was mainly attributed to a decrease in average earning assets offset by a decrease in non-accrual loans from $5,263,000 on December 31, 1990 to $3,591,000 on December 31, 1991. The 1990 increase in interest income was attributed to an increased yield on earning assets. The yield on average earning assets was as follows: 1989, 9.21%; 1990, 9.41%; and 1991, 9.28%.

**Interest Expense.** The general decline in market rates of interest resulted in a decrease in the average rates paid on the Bank's deposits over the period. Costs were 6.31%, 7.19%, and 7.28% for 1991, 1990 and 1989, respectively. Deposit balances increased by $1.5 million during 1991 and $2.9 million during 1990.

The decrease in the interest expense of $1,078,000 for 1991 consisted of a decrease of $860,000 or 10.0% in interest on deposits, and a decrease of $218,000 or 16.2% in interest on Federal Home Loan Bank advances due to a reduction in the weighted average rates paid.

**Provision for Possible Loan Losses.** The provision for possible loan losses was $1,690,000 for the year ended December 31, 1991; $2,770,000 for the year ended December 31, 1990, and $3,500,000 for the year ended December 31, 1989. The balance of the allowance for possible loan losses as of December 31, 1991 was $1,628,000 compared to $1,414,000 in 1990. Management believes that the decrease in the loan loss provisions between December 31, 1991 and December 31, 1990 reflects a possible leveling off of non-performing loans. The 1990 provision was affected by an unanticipated continuing deterioration of the regional real estate market and the increased financial difficulties among certain of the Bank's most significant borrowers. Management reviews the loan portfolio quarterly and, subject to approval of the Board of Directors, adjusts allowances for possible losses to an adequate level based on the composition of the loan portfolio, economic conditions, and potential charge-offs based on management's assessment of risk. Provisions for possible loan losses are charged to earnings as required. Loan balances are charged to the allowance when collection of the principal is considered to be unlikely.

Actual loan losses for the past three years have been as follows: $1,081,000 in 1989; $4,816,000 in 1990; $1,495,000 in 1991. Recoveries on loans previously charged off amounted to $38,000 in 1989, $79,000 in 1990, and $19,000 in 1991. Net charge-offs of $1,476,000 in 1991 reflect the realization, at the time properties were foreclosed, of losses previously provided. The amount reflects the deterioration in the value of collateral securing the Bank's loans which occurred during the year.

**Non-Interest Income.** Total non-interest income increased in 1991 by $439,000 attributed to the net gain on sales of investment securities of $457,000. The net gain on sales of investments mainly resulted from sales associated with restructuring the risk profile of the Bank's bond portfolio by reducing corporate bonds and increasing holdings of U.S. Government Agency securities. The decrease of non-interest income of $42,000 or 10.8% in 1990 is attributed in part to lower fees collected on deposit accounts and other fees collected.

**Non-Interest Expense.** Total non-interest expense as a percentage of average assets was 3.12% for 1991,

# *Management's Discussion & Analysis*

3.47% for 1990, and 2.23% for 1989. The decrease in 1991 is due primarily to the $516,000 reduction in costs associated with acquiring and maintaining real estate owned and substantively repossessed.

Total non-interest expense decreased by $545,000 or 10.3% during 1991, and increased by $1,977,000 or 59.9% during 1990. Salaries and employee benefits remained relatively constant during 1991 due to a new policy of officer and employee contributions toward health insurance premiums. During 1990 salaries and employee benefits increased by $61,000 or 4.2% mostly due to increased health and life insurance costs.

Foreclosed properties expenses decreased by $516,000 or 28.6% in 1991 after having increased by $1,744,000 in 1990. The decrease for 1991 is attributed to a reduction in real estate owned or substantively repossessed from $9,637,000 on December 31, 1990 to $4,772,000 on December 31, 1991. During 1991 and 1990 properties valued at $15,236,000 and improvement costs of $1,023,000 were added to this problem asset category. During the same period $9,989,000 of sales were completed, write-downs of $2,111,000 were incurred and $376,000 was rented and transferred to real estate held for investment. Expenses for real estate held for investment, net of rental income, amounted to $94,000 in 1991 and is associated with the $3,128,000 of properties held and operated by the Bank.

During 1991 the Bank increased properties held for investment by adding residential condominiums which are being operated as rental units. Legal expenses decreased by $165,000 or 60.7% in 1991 due to the settlement of certain litigation which existed in 1990 (as discussed in Note 13 of Notes to the Consolidated Financial Statements). Deposit insurance costs increased by $119,000 or 83.8% in 1991 after having increased by $41,000 or 40.6% in 1990 due to higher insurance rates established by the FDIC and an increase in average deposits.

**Effective Income Tax Rates.** The following table sets forth the effective federal, state, and combined income tax rates on pre-tax accounting income of the Bank for the years indicated. See also Note 11 of Notes to the Consolidated Financial Statements.

| Years Ended December 31: | Federal | State | Combined |
|---|---|---|---|
| 1991 | — % | 0.1% | 0.1 % |
| 1990 | (13.8) | 0.1 | (13.7) |
| 1989 | (16.6) | (1.4) | (18.0) |

The combined effective income tax benefit rate of (13.7)% in 1990 reflects an income tax benefit of $607,000 in 1990. Refunds of Federal income taxes of approximately $850,000 were received in 1991.

On December 31, 1991, the Bank had a book net operating loss carryforward of approximately $4.6 million, and a tax net operating loss carryforward of approximately $1.1 million. These carryforwards are available to offset future Federal taxable income through the years 2005 and 2006.

## LIQUIDITY AND CAPITAL RESOURCES

The Bank's principal sources of liquidity are customer deposits, amortization and payoff of principal and interest payments on loans, and its ability to sell or pledge its loan and investment portfolios. As a member of the Federal Home Loan Bank of Boston (FHLBB), the Bank may borrow through advances. The Bank also has the ability to borrow from the Federal Reserve Bank of Boston and the Mutual Savings Central Fund, Inc. for short-term needs by pledging certain assets. At December 31, 1991, the Bank had outstanding commitments to originate loans of $1,130,000, unused lines of credit of $2,714,000, unadvanced portions of construction loans of $744,000, and standby letters of credit of $34,000. The Bank believes it has adequate sources of liquidity to fund these commitments.

Deposits as of December 31, 1991 were $120.7 million representing an increase of $1.5 million or 1.3% over December 31, 1990. During 1991 decreasing interest rates resulted in a reduction of $7.0 million or 12.1% in term certificates with an offsetting increase offset in non-certificate accounts. The net reduction in total loans during the year ended December 31, 1991 amounted to $10,297,000, combined with the reduction of $4,865,000 in real estate owned or substantively repossessed, amounted to $15,162,000. These funds were redeployed primarily into intermediate term U. S. Government Agency obligations and Mortgage-backed securities.

Massachusetts-chartered savings banks, that are insured by the Federal Deposit Insurance Corporation are subject to certain capital requirements. At December 31, 1991, the Bank's Tier 1 leverage capital ratio was equal to 7.94%, exceeding the 4.00% to 5.00% minimum capital requirement. In a proposed Memorandum of Understanding with the FDIC and the Massachusetts Commissioner of Banks, to which the Bank is presently responding, the regulatory authorities have proposed a minimum Tier 1 leverage capital ratio for the Bank of 6.00%. See

# Management's Discussion & Analysis

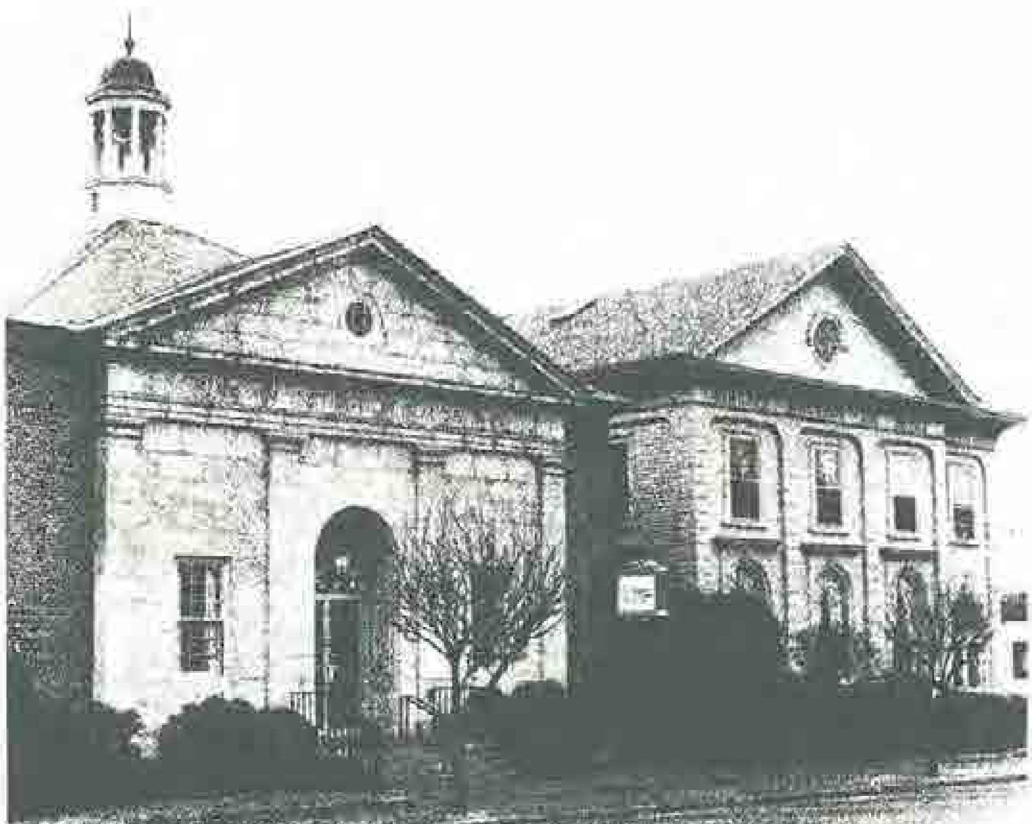
"GENERAL" below. Risk based tier 1 capital of 14.45% exceeded the minimum requirement of 3.625%. Risk based total tier 1 and 2 capital equaled 15.95% which exceeded the required percentage of 7.25%.

## IMPACT ON INFLATION AND CHANGING PRICES

The consolidated financial statements and related consolidated financial data presented herein have been prepared in accordance with generally accepted accounting principles which require the measurement of financial position and operating results in terms of historical dollars without considering the changes in the relative purchasing power of money over time due to inflation. The primary impact of inflation on operations of the Bank is reflected in increased operating costs. Unlike most industrial companies, virtually all the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a more significant impact on a financial institution's performance than the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the price of goods and services.

## GENERAL

We are currently responding to a proposed Memorandum of Understanding with the FDIC and the Massachusetts Commissioner of Banks. The Memorandum is based on the results and findings of a joint examination as of September 30, 1991. It is expected that this Memorandum, when agreed to by the parties, will require the Bank to prepare and submit to the FDIC and the Commissioner of Banks several plans and policies, the purpose of which is to ensure the adequacy of the Bank's policies and procedures in certain fundamental areas. We expect to submit our existing plans for reducing classified assets, improving the earnings of the Bank, and to revise our Fund's Management Policy to address our ongoing liquidity needs as well as monitoring interest rate sensitivity in this regard. We also expect to coordinate our lending, investment and budget policies into a comprehensive business plan, which would likewise be submitted to the FDIC and the Commissioner of Banks under the Memorandum. Specific goals are to be established under this Memorandum for reducing the ratio of non-performing loans to total loans.



# *Independent Auditors' Report*

**KPMG** Peat Marwick

The Board of Directors and Stockholders
Hingham Institution for Savings:

We have audited the accompanying consolidated balance sheets of Hingham Institution for Savings and subsidiaries as of December 31, 1991 and 1990, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. The statements of operations, changes in stockholders' equity, and cash flows of Hingham Institution for Savings for the year ended December 31, 1989 were audited by other auditors whose report dated January 19, 1990 included an explanatory paragraph that described certain litigation discussed in note 13 to those financial statements.

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

In our opinion, the 1991 and 1990 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Hingham Institution for Savings and subsidiaries as of December 31, 1991 and 1990, and the results of their operations and their cash flows for the years then ended in conformity with generally accepted accounting principles.

KPMG Peat Marwick

Boston, Massachusetts
January 23, 1992

# Consolidated Balance Sheets

**December 31, 1991 and 1990**

**Assets**

| | 1991 | 1990 |
|---|---|---|
| | (In Thousands) | |
| Cash and due from banks (note 2) | $ 2,463 | 2,603 |
| Interest-bearing deposits in banks | 1,037 | 958 |
| Total cash and cash equivalents | 3,500 | 3,561 |
| Investment securities - market value of $51,015,000 in 1991 and $33,376,000 in 1990 (notes 3 and 10) | 49,343 | 33,434 |
| Loans, net of allowance for possible loan losses of $1,628,000 in 1991 and $1,414,000 in 1990 (notes 4, 5, 10 and 12) | 83,440 | 93,953 |
| Real estate owned or substantively repossessed (note 6) | 4,772 | 9,637 |
| Real estate held for investment (note 7) | 3,128 | 2,951 |
| Income taxes receivable (note 11) | — | 850 |
| Accrued interest receivable | 1,393 | 1,542 |
| Federal Home Loan Bank stock, at cost (note 10) | 1,000 | 949 |
| Banking premises and equipment, net (note 8) | 1,825 | 1,946 |
| Other assets | 359 | 439 |
| | $ 148,760 | 149,262 |

**Liabilities and Stockholders' Equity**

| | 1991 | 1990 |
|---|---|---|
| Deposits (note 9) | $ 120,721 | 119,211 |
| Federal Home Loan Bank advances (note 10) | 15,000 | 15,000 |
| Accrued interest payable | 585 | 754 |
| Mortgagors' escrow | 166 | 285 |
| Other liabilities | 300 | 261 |
| Total liabilities | 136,772 | 135,511 |
| Commitments and contingencies (notes 12 and 13) | | |
| Stockholders' equity (note 14): | | |
| Preferred stock, $1.00 par value, 2,500,000 shares authorized; none issued | — | — |
| Common stock, $1.00 par value, 5,000,000 shares authorized; 1,250,000 shares issued and outstanding | 1,250 | 1,250 |
| Additional paid-in capital | 8,371 | 8,371 |
| Retained earnings (substantially restricted) | 2,547 | 4,406 |
| | 12,168 | 14,027 |
| Net unrealized loss on marketable equity securities (note 3) | (180) | (276) |
| Total stockholders' equity | 11,988 | 13,751 |
| | $ 148,760 | 149,262 |

See accompanying notes to consolidated financial statements.

# Consolidated Statements of Operations

**Years ended December 31, 1991, 1990 and 1989**

| | 1991 | 1990 | 1989 |
|---|---|---|---|
| | (In Thousands, Except Per Share Amounts) | | |
| Interest and dividend income: | | | |
| Loans | $ 8,757 | 10,458 | 11,134 |
| Investment securities | 3,679 | 2,335 | 1,234 |
| Interest bearing deposits | 195 | 419 | 650 |
| Total interest income | 12,631 | 13,212 | 13,018 |
| Interest expense: | | | |
| Deposits (note 9) | 7,723 | 8,583 | 8,446 |
| Federal Home Loan Bank advances | 1,127 | 1,345 | 1,009 |
| Total interest expense | 8,850 | 9,928 | 9,455 |
| Net interest income | 3,781 | 3,284 | 3,563 |
| Provision for possible loan losses (note 5) | 1,690 | 2,770 | 3,500 |
| Net interest income after provision for possible loan losses | 2,091 | 514 | 63 |
| Non-interest income: | | | |
| Fees on deposit accounts | 217 | 226 | 245 |
| Gain (loss) on sales of investments, net (note 3) | 457 | (1) | (1) |
| Other | 111 | 121 | 144 |
| Total non-interest income | 785 | 346 | 388 |
| Non-interest expense: | | | |
| Salaries and employee benefits (note 15) | 1,512 | 1,515 | 1,454 |
| Data processing | 311 | 344 | 307 |
| Occupancy and equipment | 321 | 335 | 349 |
| Foreclosed properties, net (note 6) | 1,286 | 1,802 | 56 |
| Real estate held for investment, net | 94 | 88 | (1) |
| Legal (note 13) | 107 | 272 | 274 |
| Deposit insurance | 261 | 142 | 101 |
| Other | 842 | 781 | 760 |
| Total non-interest expense | 4,734 | 5,279 | 3,302 |
| Loss before income tax expense (benefit) | (1,858) | (4,419) | (2,851) |
| Income tax expense (benefit) (note 11) | 1 | (607) | (512) |
| Net loss | $ (1,859) | (3,812) | (2,339) |
| Loss per share | $ (1.49) | (3.05) | (1.87) |

See accompanying notes to consolidated financial statements.

# Consolidated Statements of Changes in Stockholders' Equity

**Years ended December 31, 1991, 1990 and 1989**

| | Common stock | Additional paid-in capital | Retained earnings (in Thousands) | Net unrealized loss on marketable equity securities (note 3) | Total stock-holders' equity |
|---|---|---|---|---|---|
| Balance at December 31, 1988 | $ 1,250 | 8,371 | 11,194 | (51) | 20,764 |
| Net loss | — | — | (2,339) | — | (2,339) |
| Cash dividends paid ($.23 per share) | — | — | (287) | — | (287) |
| Increase in net unrealized loss on marketable securities | — | — | — | (139) | (139) |
| Balance at December 31, 1989 | 1,250 | 8,371 | 8,568 | (190) | 17,999 |
| Net loss | — | — | (3,812) | — | (3,812) |
| Cash dividends paid ($.28 per share) | — | — | (350) | — | (350) |
| Increase in net unrealized loss on marketable equity securities | — | — | — | (86) | (86) |
| Balance at December 31, 1990 | 1,250 | 8,371 | 4,406 | (276) | 13,751 |
| Net loss | — | — | (1,859) | — | (1,859) |
| Decrease in net unrealized loss on marketable equity securities | — | — | — | 96 | 96 |
| Balance at December 31, 1991 | $ 1,250 | 8,371 | 2,547 | (180) | 11,988 |

See accompanying notes to consolidated financial statements.

# Consolidated Statements of Cash Flows

**Years ended December 31, 1991, 1990 and 1989**

| | 1991 | 1990 | 1989 |
|---|---|---|---|
| | | (In Thousands) | |
| Cash flows from operating activities: | | | |
| Net loss | $ (1,859) | (3,812) | (2,339) |
| Adjustments to reconcile net loss to net cash provided by operating activities: | | | |
| Provision for possible loan losses | 1,690 | 2,770 | 3,500 |
| Provision for loss and write-downs on real estate owned and real estate held for investment | 870 | 1,402 | — |
| Amortization of discount on investment securities, net of accretion | 51 | (10) | 73 |
| Increase (decrease) deferred loan fees, net | 2 | 64 | (129) |
| Deferred income taxes | — | 25 | (53) |
| Depreciation | 304 | 260 | 193 |
| Loss (gain) on sale of investments, net | (457) | 1 | 1 |
| (Increase) decrease in income taxes receivable | 850 | (81) | (1,338) |
| (Increase) decrease in accrued interest receivable | 149 | 10 | (182) |
| (Increase) decrease in other assets | 80 | (75) | 648 |
| Increase (decrease) in mortgagors' escrow | (119) | (55) | 65 |
| Increase (decrease) in accrued interest payable and other liabilities | (130) | 66 | (234) |
| Net cash provided by operating activities | 1,431 | 565 | 205 |
| Cash flows from investing activities: | | | |
| Decrease in short-term investments, net | — | 2,000 | 4,000 |
| Proceeds from maturities of investment securities | 1,000 | 8,315 | 6,712 |
| Proceeds from sales of investment securities | 48,918 | 12 | 8 |
| Principal payments received on mortgage-backed securities | 231 | 50 | 56 |
| Purchase of investment securities | (65,556) | (21,382) | (13,348) |
| Proceeds from sale of loans | 277 | 2,907 | 284 |
| (Increase) decrease in loans, net | 8,860 | (21) | (1,700) |
| Additions to real estate owned | (501) | (522) | (79) |
| Proceeds from sales of real estate owned | 3,861 | 2,278 | 1,373 |
| Additions to real estate held for investment | (16) | — | — |
| Increase in FHLB stock | (51) | — | (149) |
| Additions to banking premises and equipment | (25) | (43) | (1,206) |
| Net cash used in investing activities | (3,002) | (6,406) | (4,049) |

(Continued)

# *Consolidated Statements of Cash Flows*

**Years ended December 31, 1991, 1990 and 1989**

| | 1991 | 1990 (In Thousands) | 1989 |
|---|---|---|---|
| Cash flows from financing activities: | | | |
| Increase (decrease) in deposits, net | $ 1,510 | 2,866 | (7,876) |
| Proceeds from Federal Home Loan Bank advances | 8,000 | — | 15,000 |
| Repayment of Federal Home Loan Bank advances | (8,000) | — | (10,000) |
| Cash dividends paid | — | (350) | (287) |
| Net cash provided by (used in) financing activities | 1,510 | 2,516 | (3,163) |
| Net decrease in cash and cash equivalents | (61) | (3,325) | (7,007) |
| Cash and cash equivalents: | | | |
| Beginning of year | 3,561 | 6,886 | 13,893 |
| End of year | $ 3,500 | 3,561 | 6,886 |
| Supplemental cash flow information: | | | |
| Cash paid (received) during the year for: | | | |
| Interest | $ 9,019 | 9,952 | 9,436 |
| Income taxes | (850) | (551) | 878 |
| Supplemental disclosure of non-cash investing activities: | | | |
| Loans transferred to real estate owned or substantively repossessed | 3,534 | 11,702 | 1,753 |
| Loans transferred to real estate held for investment | — | 1,763 | 1,295 |
| Loans charged-off, net of recoveries | 1,476 | 4,737 | 1,043 |
| Real estate owned or substantively repossessed transferred to real estate held for investment | 376 | — | — |
| Financed sales of real estate owned | 3,850 | — | — |

See accompanying notes to consolidated financial statements.

# *Notes to Consolidated Financial Statements*

**December 31, 1991,1990 and 1989**

## (1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Basis of Presentation

The consolidated financial statements include the accounts of the Bank and its wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation. The accounting and reporting policies of the Bank conform to generally accepted accounting principles and prevailing practices within the banking industry.

In preparing these financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the dates of the balance sheets, and income and expense for the periods. Actual results could differ from those estimates. Material estimates that are particularly susceptible to change in the near-term relate to the determination of the allowance for possible loan losses and valuation of other real estate owned or substantively repossessed.

The Bank's loans are secured by real estate in the depressed market of Massachusetts. In addition, real estate owned or substantively repossessed is located in that same market. Accordingly, the ultimate collectibility of a substantial portion of the Bank's loan portfolio and the recovery of real estate owned or substantively repossessed properties are susceptible to changing conditions in this market.

### Interest-Bearing Deposits in Banks

Interest-bearing deposits in banks generally mature daily and are stated at cost, which approximates market value.

### Investment Securities

Investment securities are stated at cost, adjusted for amortization of premiums and accretion of discounts, which are calculated on a straight-line basis over the remaining life of the securities.

Mortgage-backed securities are stated at cost, adjusted for amortization of premiums, which are calculated on a level-yield basis over the estimated average life of the securities, and are reduced by principal payments.

Debt securities are carried at amortized cost based upon management's intention and ability to carry these securities until maturity. There were no securities held for sale or trading at December 31, 1991 or 1990.

Marketable equity securities are stated at the lower of aggregate cost or market value.

Gains and losses on disposition of investment securities are computed using the specific identification method.

### Loans

Interest is not accrued on loans past-due more than 90 days or when, in the opinion of management, the collectibility of interest becomes doubtful.

Loan origination fees, net of direct loan origination costs, are deferred and are recognized as adjustments to loan income over the contractual life of the related loans using the level-yield method.

### Allowance for Possible Loan Losses

The allowance for possible loan losses is maintained at a level which management considers adequate to provide for potential losses based upon an evaluation of risks in the loan portfolio. Such evaluation includes a review of overall portfolio size, quality, composition, and an assessment of existing economic conditions. While management uses available information in establishing the allowance for possible loan losses, future adjustments to the allowance may be necessary if economic conditions differ substantially from the assumptions used in making the evaluations. Additions to the allowance are charged to operations; realized losses, net of recoveries, are charged to the allowance. Management believes that the allowance for possible loan losses is adequate.

# Notes to Consolidated Financial Statements

Various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for possible loan losses. Such agencies may require the Bank to recognize additions to the allowance based on their judgments of information available to them at their examination date.

### Real Estate Owned or Substantively Repossessed

Real estate owned or substantively repossessed includes those properties acquired through foreclosure or deed in lieu of foreclosure and properties considered to be repossessed in substance ("in substance foreclosure"). A property is considered to be an in substance foreclosure when there is indication that the borrower no longer has equity in the property collateralizing the loan and it is doubtful that the borrower's equity will be restored in the foreseeable future. Such loans are carried at the lower of fair value or the balance of the loan on the property at the date of acquisition.

Costs relating to the development and improvement of property are capitalized, whereas those relating to holding the property are charged to operations. During the year ended December 31, 1990, losses realized subsequent to foreclosure were charged to operations as incurred or when it was determined that the investment in the property was greater than its estimated net realizable value.

At December 31, 1990, an allowance for possible losses was established. This allowance is maintained for real estate owned or substantively repossessed properties which management believes to be adequate to provide for potential losses. Additions to the allowance are charged to operations; realized losses, net of recoveries, are charged to the allowance.

### Real Estate Held for Investment

Real estate held for investment is carried at the lower of cost or estimated net realizable value. Net realizable value is reviewed quarterly and, when necessary, provisions for loss are charged to operations. Profit or loss from operations of real estate held for investment is included in the consolidated statements of operations as non-interest expense - real estate held for investment, net.

### Banking Premises and Equipment

Land is carried at cost. Buildings and equipment are carried at cost less accumulated depreciation. Depreciation expense is computed using the straight-line method over the estimated useful lives of the related assets: from 25 to 65 years for buildings and 3 to 20 years for equipment.

Maintenance and repairs are charged to expense. Major improvements are capitalized and depreciated.

### Income Taxes

Certain items of income and expense are recognized in different periods for financial statement and income tax purposes. Deferred income taxes are provided in the financial statements for such timing differences.

### Loss Per Share

Loss per share is computed based on the weighted average number of shares outstanding during the year.

### Statements of Cash Flows

Cash and cash equivalents include amounts due from banks and interest bearing deposits.

## (2) Cash and Due from Banks

The Bank is required to maintain cash reserve balances with the Federal Reserve Bank based upon a percentage of certain deposits. At December 31, 1991 and 1990, cash and due from banks included $295,000 and $193,000, respectively to satisfy such reserve requirements.

## *Notes to Consolidated Financial Statements*

### (3) Investment Securities

Investment securities at December 31 follow:

| | 1991 | | | |
|---|---|---|---|---|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Market Value |
| | | (In Thousands) | | |
| Bonds and obligations: | | | | |
| U.S. Treasury | $ 5,044 | 215 | — | 5,259 |
| U.S. Government agencies | 17,051 | 912 | — | 17,963 |
| Corporate | 2,502 | 1 | (6) | 2,497 |
| | 24,597 | 1,128 | (6) | 25,719 |
| Mortgage-backed securities: | | | | |
| FHLMC | 14,552 | 389 | — | 14,941 |
| FNMA | 9,700 | 151 | — | 9,851 |
| GNMA | 239 | 10 | — | 249 |
| | 24,491 | 550 | — | 25,041 |
| Total debt securities | 49,088 | 1,678 | (6) | 50,760 |
| Marketable equity securities | 435 | | | |
| Less net unrealized loss on marketable equity securities | (180) | | | |
| Marketable equity securities, net | 255 | | | 255 |
| Total investment securities | $ 49,343 | | | 51,015 |

| | 1990 | | | |
|---|---|---|---|---|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Market Value |
| | | (In Thousands) | | |
| Bonds and obligations: | | | | |
| U.S. Treasury | $ 5,970 | 93 | — | 6,063 |
| U.S. Government agencies | 9,000 | 102 | — | 9,102 |
| Corporate | 17,548 | 44 | (251) | 17,341 |
| | 32,518 | 239 | (251) | 32,506 |
| Mortgage-backed securities (GNMA) | 524 | — | (46) | 478 |
| Total debt securities | 33,042 | 239 | (297) | 32,984 |
| Marketable equity securities | 668 | | | |
| Less net unrealized loss on marketable equity securities | (276) | | | |
| Marketable equity securities, net | 392 | | | 392 |
| Total investment securities | $ 33,434 | | | 33,376 |

# Notes to Consolidated Financial Statements

Realized gains on debt securities were $640,000 and realized losses on debt securities were $80,000 for the year ended December 31, 1991. Proceeds from sales of debt securities were $48,787,000 for the year ended December 31, 1991. No debt securities were sold during the years ended December 31, 1990 and 1989.

Net realized losses on marketable equity securities were $103,000, $1,000 and $1,000 for the years ended December 31, 1991, 1990 and 1989, respectively. Included in the realized losses for the year ended December 31, 1991 is a write-down of $100,000 in the carrying value of marketable equity securities reflecting the depreciation in value of a common stock which was considered other than temporary.

Net unrealized losses on marketable equity securities at December 31 consisted of the following:

| | 1991 | 1990 |
|---|---|---|
| | (In Thousands) | |
| Gross unrealized gains | $ — | — |
| Gross unrealized losses | (180) | (276) |
| | $ (180) | (276) |

The maturity distribution of debt securities at December 31 follows:

| | 1991 | | 1990 | |
|---|---|---|---|---|
| | Amortized Cost | Market Value | Amortized Cost | Market Value |
| | | (In Thousands) | | |
| Bonds and obligations: | | | | |
| Within one year | $ 3,488 | 3,560 | 4,473 | 4,487 |
| Over 1 year to 5 years | 13,520 | 14,189 | 23,805 | 23,944 |
| Over 5 years to 10 years | 7,589 | 7,970 | 4,240 | 4,075 |
| | 24,597 | 25,719 | 32,518 | 32,506 |
| Mortgage-backed securities: | | | | |
| Over 1 year to 5 years | 5,042 | 5,205 | — | — |
| Over 5 years to 10 years | 4,669 | 4,805 | — | — |
| Over 10 years | 14,780 | 15,031 | 524 | 478 |
| | 24,491 | 25,041 | 524 | 478 |
| Total debt securities | $ 49,088 | 50,760 | 33,042 | 32,984 |

# Notes to Consolidated Financial Statements

## (4) Loans

Loans at December 31 follow:

| | 1991 | 1990 |
|---|---|---|
| | (In Thousands) | |
| Mortgage loans: | | |
| Residential | $ 54,746 | 57,733 |
| Commercial | 15,032 | 16,964 |
| Residential construction | 4,018 | 6,814 |
| Home equity | 7,134 | 8,735 |
| Second mortgages | 899 | 1,070 |
| | 81,829 | 91,316 |
| Less unadvanced funds | (744) | (1,092) |
| Total mortgage loans, net | 81,085 | 90,224 |
| Commercial loans: | | |
| Secured | 1,004 | 1,017 |
| Unsecured | 43 | 28 |
| Total commercial loans | 1,047 | 1,045 |
| Consumer loans: | | |
| Personal installment | 2,270 | 3,383 |
| Education | 725 | 758 |
| Revolving credit | 122 | 136 |
| Total consumer loans | 3,117 | 4,277 |
| Total loans | 85,249 | 95,546 |
| Less: | | |
| Allowance for possible loan losses (note 5) | (1,628) | (1,414) |
| Deferred loan origiation fees, net | (181) | (179) |
| Loans, net | $ 83,440 | 93,953 |

Loans totaling $3,591,000 and $5,263,000 were on non-accrual at December 31, 1991 and 1990, respectively. Interest income not recognized on such loans amounted to $192,000 and $356,000 for the years ended December 31, 1991 and 1990, respectively. Prior to cessation of accrual, interest income recognized on such loans was $107,000 and $224,000 for the years ended December 31, 1991 and 1990, respectively.

Restructured loans totaled $1,990,000 at December 31, 1991. The modified terms of these loans resulted in a $28,000 reduction in interest income for the year ended December 31, 1991. There were no restructured loans at December 31, 1990.

Loans serviced for others amounted to $9,089,000 and $11,063,000 at December 31, 1991 and 1990, respectively.

The Bank's lending activities are conducted principally in communities on the South Shore of Massachusetts. The Bank grants single family residential loans, commercial real estate loans, commercial loans and a variety of consumer loans. In addition, the Bank grants loans for the construction of residential homes, commercial real estate properties, and for land development. Substantially all loans granted by the Bank are secured by real estate collateral. The ability and willingness of residential mortgage and consumer loan borrowers to honor their repayment commitments is generally dependent on the level of overall economic activity within the borrowers' geographic areas and real estate

# Notes to Consolidated Financial Statements

values. The ability and willingness of commercial real estate, construction loan and commercial borrowers to honor their repayment commitments is generally dependent on the health of the real estate market in the borrowers' geographic areas and the general economy. The Bank is limited by statute from lending to any one borrower amounts in excess of 20% of stockholders' equity. The Bank had no such lending relationships with borrowers at December 31, 1991.

In the ordinary course of business, the Bank has granted loans to its officers, directors and their affiliates. Activity in these loans for the years ended December 31 follows:

| | 1991 | 1990 |
|---|---|---|
| | (In Thousands) | |
| Balance at beginning of year | $ 951 | 911 |
| New loans | 276 | 288 |
| Repayments | (280) | (248) |
| Balance at end of year | $ 947 | 951 |

## (5) Allowance for Possible Loan Losses

The analysis of the allowance for possible loan losses for the years ended December 31 follows:

| | 1991 | 1990 | 1989 |
|---|---|---|---|
| | | (In Thousands) | |
| Balance at beginning of year | $ 1,414 | 3,381 | 924 |
| Provision for possible loan losses | 1,690 | 2,770 | 3,500 |
| Loans charged-off | (1,495) | (4,816) | (1,081) |
| Recoveries on loans previously charged-off | 19 | 79 | 38 |
| Balance at end of year | $ 1,628 | 1,414 | 3,381 |

## (6) Real Estate Owned or Substantively Repossessed

Real estate owned or substantively repossessed at December 31 follows:

| | 1991 | 1990 |
|---|---|---|
| | (In Thousands) | |
| Residential homes | $ 956 | 7,135 |
| Land | 2,360 | 2,152 |
| Residential condominiums | 708 | 460 |
| Commercial real estate | 852 | 320 |
| | 4,876 | 10,067 |
| Less allowance for possible losses | (104) | (430) |
| | $ 4,772 | 9,637 |

# Notes to Consolidated Financial Statements

At December 31, 1991 and 1990, real estate owned included $1,808,000 and $3,315,000 respectively, of properties that were substantively repossessed.

Real estate owned or substantively repossessed properties are required to be recorded at the lower of cost or fair value of the collateral at the time of foreclosure. Under existing generally accepted accounting principles, net realizable value is required to be used to value foreclosed real estate collateral in periods following foreclosure. As indicated in note 1 to the consolidated financial statements, the Bank's accounting policies with respect to foreclosed real estate are consistent with existing generally accepted accounting principles. The AICPA has issued a draft Statement of Position, expected to become effective during 1992, which would require that foreclosed real estate be carried at the lower of cost or fair value in periods following foreclosure. In periods of declining real estate values, this accounting treatment would result in additional charges to non-interest expense - foreclosed properties, net.

An analysis of the allowance for possible losses for the years ended December 31 follows:

| | 1991 | 1990 |
|---|---|---|
| | (In Thousands) | |
| Balance at beginning of year | $ 430 | — |
| Provision for possible losses | 870 | 430 |
| Write-downs: | | |
| Real estate owned | (1,139) | — |
| Real estate held for investment | (57) | — |
| Balance at end of year | $ 104 | 430 |

An analysis of real estate owned or substantively repossessed for the years ended December 31 follows:

| | 1991 | 1990 |
|---|---|---|
| | (In Thousands) | |
| Balance at beginning of year | $ 10,067 | 1,093 |
| Foreclosures and properties substantively repossessed | 3,534 | 11,702 |
| Improvements | 501 | 522 |
| Sales | (7,711) | (2,278) |
| Write-downs | (1,139) | (972) |
| Transferred to real estate held for investment | (376) | — |
| Balance at end of year | $ 4,876 | 10,067 |

An analysis of foreclosed properties expense for the years ended December 31 follows:

| | 1991 | 1990 | 1989 |
|---|---|---|---|
| | | (In Thousands) | |
| Provision for possible losses | $ 870 | 430 | — |
| Write-downs, net | — | 972 | — |
| Foreclosure and holding costs, net | 416 | 400 | 58 |
| | $ 1,286 | 1,802 | 58 |

# *Notes to Consolidated Financial Statements*

## (7) Real Estate Held for Investment

Real estate held for investment represents properties acquired by foreclosure or deed-in-lieu of foreclosure which are operated by the Bank for income-producing purposes. The properties held at December 31 are as follows:

| | 1991 | 1990 |
|---|---|---|
| | (In Thousands) | |
| Residential condominiums | $ 2,000 | 1,637 |
| Motel | 1,372 | 1,400 |
| | 3,372 | 3,037 |
| Less accumulated depreciation | (244) | (86) |
| | $ 3,128 | 2,951 |

## (8) Banking Premises and Equipment

Banking premises and equipment at December 31 follows:

| | 1991 | 1990 |
|---|---|---|
| | (In Thousands) | |
| Land | $ 473 | 473 |
| Buildings | 1,622 | 1,622 |
| Equipment | 1,074 | 1,057 |
| | 3,169 | 3,152 |
| Less accumulated depreciation | (1,344) | (1,206) |
| | $ 1,825 | 1,946 |

## (9) Deposits

Deposits at December 31 follows:

| | 1991 | 1990 |
|---|---|---|
| | (In Thousands) | |
| Non-certificate accounts: | | |
| Regular and special notice | $ 23,905 | 20,637 |
| Money market deposits | 33,846 | 30,264 |
| NOW | 7,554 | 7,385 |
| Demand | 4,240 | 2,712 |
| Total non-certificate accounts | 69,545 | 60,998 |
| Term certificates: | | |
| Less than $100,000 | 47,023 | 51,513 |
| $100,000 and over | 4,153 | 6,700 |
| Total term certificates | 51,176 | 58,213 |
| Total deposits | $ 120,721 | 119,211 |
| Weighted average interest rate at December 31 | 6.31% | 7.19% |

## *Notes to Consolidated Financial Statements*

The maturity distribution of term certificates at December 31 follows:

| | 1991 | | 1990 | |
|---|---|---|---|---|
| | Amount | Weighted Average Interest Rate | Amount | Weighted Average Interest Rate |
| | (Dollars In Thousands) | | | |
| Within 1 year | $ 42,216 | 6.50% | $ 44,151 | 8.08% |
| Over 1 year to 2 years | 6,244 | 8.07 | 9,419 | 8.51 |
| Over 2 years to 3 years | 2,716 | 6.76 | 4,643 | 8.49 |
| | $ 51,176 | 6.71% | $ 58,213 | 8.18% |

A summary of interest expense on deposits for the years ended December 31 follows:

| | 1991 | 1990 | 1989 |
|---|---|---|---|
| | (In Thousands) | | |
| Regular and special notice | $ 1,217 | 1,211 | 1,308 |
| Money market deposits | 1,947 | 2,162 | 1,600 |
| NOW | 358 | 367 | 361 |
| Term certificates | 4,201 | 4,843 | 5,177 |
| | $ 7,723 | $ 8,583 | $ 8,446 |

### (10) Federal Home Loan Bank Advances

A summary of advances from the Federal Home Loan Bank of Boston at December 31 follows:

| | | 1991 | | 1990 | |
|---|---|---|---|---|---|
| Maturity Date | Type | Amount | Interest Rate | Amount | Interest Rate |
| | | (Dollars In Thousands) | | | |
| February 15, 1994 | Variable Rate | $ 7,000 | 6.73% | $ 7,000 | 8.63% |
| May 15, 1994 | Variable Rate | 5,000 | 6.56 | 5,000 | 8.86 |
| September 15, 1994 | Variable Rate | — | — | 3,000 | 8.25 |
| September 20, 1994 | Fixed Rate | 3,000 | 6.66 | — | — |
| | | $ 15,000 | 6.66% | $ 15,000 | 8.63% |

All borrowings from the Federal Home Loan Bank of Boston are secured by all stock in the Federal Home Loan Bank of Boston and a blanket lien on "qualified collateral" defined principally as 80% of the market value of U.S. Government and federal agency obligations and 70% of the carrying values of residential mortgage loans.

# *Notes to Consolidated Financial Statements*

## (11) Income Taxes

The components of income tax expense (benefit) at December 31 follows:

| | 1991 | 1990 (In Thousands) | 1989 |
|---|---|---|---|
| Current: | | | |
| Federal | $ — | (632) | (387) |
| State | 1 | — | (72) |
| | 1 | (632) | (459) |
| Deferred: | | | |
| Federal | — | — | (53) |
| State | — | 25 | — |
| | — | 25 | (53) |
| | $ 1 | (607) | (512) |

Deferred income taxes result from timing differences in the recognition of revenue and expense for tax and financial statement purposes. The tax effects of these timing differences for the years ended December 31 are as follows:

| | 1991 | 1990 (In Thousands) | 1989 |
|---|---|---|---|
| Cash basis accounting for tax purposes | $ (66) | (79) | (78) |
| Deferred loan origination fees | 1 | 8 | (25) |
| Accrued interest payable | (49) | — | — |
| Other | (8) | (3) | — |
| Non-recognition of net operating loss carryover | 122 | 99 | — |
| | $ — | 25 | (53) |

The effective income tax rates for the years ended December 31 differ from the Federal "expected" statutory income tax rate for the following reasons:

| | 1991 | 1990 | 1989 |
|---|---|---|---|
| Federal "expected" statutory rate | (34.0)% | (34.0)% | (34.0)% |
| Increase (decrease) resulting from: | | | |
| Bad debt deduction | 5.8 | (16.5) | 15.8 |
| Dividends received deduction | (0.2) | (1.9) | (.2) |
| State taxes, net of federal income tax benefit | 0.1 | .1 | (1.4) |
| Investment write-down | 1.8 | — | — |
| Other, net | (0.3) | — | 1.8 |
| Net operating loss for which no benefit is currently available | 26.9 | 38.6 | — |
| Effective income tax rate | 0.1% | (13.7)% | (18.0)% |

## Notes to Consolidated Financial Statements

At December 31, 1991, the Bank had a book net operating loss carryforward of approximately $4,600,000 and a tax net operating loss carryforward of approximately $1,100,000 which are available to offset future federal taxable income. Net operating loss carryforwards are subject to a fifteen-year carryforward and will expire from 2005-2006. The income tax benefits of net operating loss carryforwards are recognized when realized.

A new income tax accounting standard, which will be effective for the Bank on January 1, 1993, requires that a liability be recognized for the amount of temporary differences anticipated to be included in taxable income in future years at income tax rates in effect at each reporting date. The impact of adopting this new accounting standard on the Bank's financial condition or results of operations has not been determined.

### (12) Financial Instruments with Off-Balance Sheet Risk

The Bank is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include unused lines of credit, unadvanced portions of construction loans, commitments to originate loans, and standby letters of credit. The instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the balance sheets. The amounts of those instruments reflect the extent of the Bank's involvement in particular classes of financial instruments.

The Bank's exposure to credit loss in the event of nonperformance by the other party to its financial instruments (for unused lines of credit, unadvanced portions of construction loans, commitments to originate loans, and standby letters of credit) is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Financial instruments with off-balance sheet risk at December 31, 1991 follow:

| | |
|---|---|
| Unused lines of credit | $ 2,714,000 |
| Unadvanced portions of construction loans | 744,000 |
| Commitments to originate loans: | |
| Fixed interest rates | 167,000 |
| Variable interest rates | 963,000 |
| Standby letters of credit | 34,000 |

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

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance by a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers.

### (13) Litigation

On April 11, 1990, a lawsuit against the Bank by its former president was dismissed by the court without liability to the Bank. The Bank's claims against its former president will continue to be vigorously pursued as the Bank contends that a substantial amount of the cumulative loan losses it has sustained result from the former president's alleged conduct. The

# Notes to Consolidated Financial Statements

Bank is pursuing recovery of damages with its insurance carrier as such losses are believed to be covered under the Bank's insurance policy, subject to the deductible amount. No determination can be made at this time as to the extent to which the Bank will recover damages, if any, if it is successful in pursuing its claim.

In connection with the alleged conduct of the Bank's former president, several individuals have threatened claims against the Bank. The Bank will vigorously defend itself against any and all such claims if or when they are filed.

The Bank is currently a defendant in two lawsuits relating to lender liability. One of these lawsuits was brought by a borrower who has subsequently initiated two additional suits. The Bank has obtained partial summary judgment in the initial suit. The additional lawsuits were dismissed in March 1991 on the basis that they were duplicative of the borrower's original complaint. The Bank has recently amended its counterclaim against this borrower to reach and apply proceeds of mortgages payable to him. The second lawsuit was brought by a separate borrower of the Bank. The borrower has alleged that the Bank committed various torts and breached its contract with respect to the borrower's application for funds. The Bank denied these claims and counterclaimed against the borrower for breach of contract. In August 1991, the judge non-suited the borrower. The Bank will continue to vigorously assert its counterclaims.

The outcome of and the ultimate liability of the Bank, if any, from these actions cannot be predicted at this time and, accordingly, the Bank has made no provision for these matters in its financial statements. The Bank believes that it has meritorious defenses to the claims and intends to pursue them through the appropriate legal process.

## (14) Stockholders' Equity

At the time of the Bank's conversion to stock form, the Bank established a liquidation account for the benefit of eligible deposit account holders. According to the Bank's transfer agent, the balance of the liquidation account at December 31, 1991 was approximately $2,498,000 (unaudited).

The Bank may not declare or pay cash dividends on its shares of common stock if the effects thereof would cause stockholders' equity to be reduced below applicable capital maintenance requirements or below the balance of the liquidation account, or if such declaration and payments would otherwise violate regulatory requirements.

Retained earnings at December 31, 1991 includes approximately $384,000 of additions to the bad debt reserve for income tax purposes which may be subject to tax if not used to absorb loan losses or if the Bank's "qualifying" assets (primarily cash, U.S. Treasury securities and residential mortgage loans) fall below 60% of total assets. At December 31, 1991, qualifying assets were in excess of 70% (unaudited) of total assets.

Under the Bank's stock option plan, options may be granted to directors and officers and other employees as the Board may determine. A total of 125,000 shares of common stock are reserved for issuance pursuant to options granted under the plan. Both "incentive options" and "non-qualified options" may be granted under the plan. All options granted under the plan will have an exercise price per share equal to or in excess of the fair market value of a share of common stock at the date the option is granted and will have a maximum option term of 10 years. Non-qualified stock options vest over a five year period. No option is exercisable until three years from the date of the completion of the conversion of the Bank to stock form (December 20, 1991).

# Notes to Consolidated Financial Statements

Stock option activity for the years ended December 31 follows:

| | 1991 | 1990 | 1989 |
|---|---|---|---|
| Options outstanding at beginning of year | 95,500 | 53,600 | — |
| Granted | — | 54,600 | 53,600 |
| Forfeited | (5,000) | (12,700) | — |
| Options outstanding at end of year | 90,500 | 95,500 | 53,600 |
| Weighted average exercise price per share | $ 6.16 | $ 6.05 | $ 8.50 |
| Options currently exercisable | 26,780 | 8,680 | — |

## (15) Pension and Employee Incentive Plans

The Bank provides pension benefits for substantially all of its eligible officers and employees through membership in a defined benefit plan of the Savings Banks Employees' Retirement Association ("SBERA"). Under the plan, retirement benefits are based on years of credited service, the highest average compensation (as defined), and the primary social security benefit. In addition, employees may make optional, voluntary contributions to the plan under several methods. These optional contributions provide retirement benefits to the employee in addition to those otherwise available under the Bank's plan. Annual contributions by the Bank to the plan are based on assessments from SBERA.

Pension expense under the plan for the years ended December 31, 1991, 1990 and 1989 follows:

| | 1991 | 1990 (In Thousands) | 1989 |
|---|---|---|---|
| Service cost - benefits earned during period | $ 105 | 96 | 69 |
| Interest cost on projected benefit obligation | 94 | 84 | 115 |
| Actual return on plan assets | (219) | 29 | (163) |
| Net amortization and deferral | 3 | 3 | 3 |
| Amortization of net (gain) loss | 134 | (115) | 65 |
| Net pension expense | $ 117 | 97 | 89 |

## Notes to Consolidated Financial Statements

The funded status of the plan at October 31, the plan's valuation date, follows:

| | 1991 | 1990 |
|---|---|---|
| | (In Thousands) | |
| Actuarial present value of: | | |
| Vested benefit obligations | $ 746 | 829 |
| Non-vested benefit obligations | 15 | 12 |
| | $ 761 | 841 |
| Actuarial present value of projected benefit obligation | $ 1,305 | 1,209 |
| Plan assets at fair value | 1,105 | 1,069 |
| Plan assets less than projected benefit obligation | (200) | (140) |
| Unrecognized net gain | (23) | (38) |
| Unrecognized net obligation at inception | 42 | 46 |
| Accrued pension cost at end of year | $ (181) | (132) |

For the plan years ended October 31, 1991 and 1990, actuarial assumptions include an assumed discount rate of 8.75% and 7.75%, respectively, and an expected long-term rate of return on plan assets of 7.75% and 7.50%, respectively, and an assumed 6.00% rate of increase in compensation for both years.

The Bank had maintained an incentive plan whereby employees were eligible to receive a bonus based on their respective salaries and years of service dependent on the Bank's earnings. The incentive plan was terminated in 1990. Incentive plan expense for the year ended December 31, 1989 amounted to $96,000.

In December 1990, the FASB issued a statement of entitled "Employers' Accounting for Postretirement Benefits Other Than Pensions." Under the statement, the Bank will be required to use accrual accounting for postretirement benefits beginning in fiscal 1993. The projected benefit obligation for postretirement benefits, calculated as if the Bank had adopted the statement at December 31, 1991, is not expected to be material.

# Notes to Consolidated Financial Statements

### (16) Quarterly Financial Data (unaudited)

Quarterly results of operations for the years ended December 31, 1991 and 1990 are as follows:

| | 1991 | | | | 1990 | | | |
|---|---|---|---|---|---|---|---|---|
| | 1st | 2nd | 3rd | 4th | 1st | 2nd | 3rd | 4th |
| | (In Thousands, Except Per Share Amounts) | | | | | | | |
| Interest income | $ 3,178 | 3,178 | 3,181 | 3,094 | 3,282 | 3,274 | 3,384 | 3,272 |
| Interest expense | 2,328 | 2,310 | 2,214 | 1,998 | 2,467 | 2,446 | 2,508 | 2,507 |
| Net interest income | 850 | 868 | 967 | 1,096 | 815 | 828 | 876 | 765 |
| Provision for possible loan losses | 100 | 500 | 160 | 930 | 1,100 | 100 | 680 | 890 |
| Net interest income (expense) after provision for possible loan losses | 750 | 368 | 807 | 166 | (285) | 728 | 196 | (125) |
| Non-interest income | 83 | 157 | 272 | 273 | 80 | 98 | 79 | 89 |
| Non-interest expense | (1,043) | (1,278) | (1,026) | (1,387) | (1,036) | (1,086) | (1,290) | (1,867) |
| Income (loss) before income taxes | (210) | (753) | 53 | (948) | (1,241) | (260) | (1,015) | (1,903) |
| Income tax expense(benefit) | — | 1 | — | — | (498) | (25) | (96) | 12 |
| Net income (loss) | $ (210) | (754) | 53 | (948) | (743) | (235) | (919) | (1,915) |
| Earnings (loss) per share | $ (.17) | (.60) | .04 | (.76) | (.59) | (.19) | (.74) | (1.53) |

In the fourth quarter of 1991 and 1990, the Bank reevaluated all non-performing loans and foreclosed properties in light of the continuing decline of real estate values. These evaluations resulted in an increased provision for possible loan losses and additional writedowns and provision for loss on foreclosed properties (included in non-interest expense). In the first quarter of 1990, the provision for possible loan losses of $1,100,000 reflects the effects of a regulatory examination which was completed during that period.

## *Board of Directors*

Paul E. Bulman
President and C.E.O.
Hingham Institution for Savings

James V. Consentino
Retired, Founder
J. V. Consentino
Plastering & Construction Co.

J. Robert Crowley
Clerk of the Bank
Hingham Institution for Savings

Jon S. Davis
Partner
Driscoll & Davis

John J. Flatley
President
John J. Flatley Company

Robert H. Gaughen, Jr.
Attorney
Gaughen, Gaughen & Gaughen

Richard B. Lane
Partner
Lane, Lane & Kelly

John R. Lombardo
Consultant;
Process Systems
International, Inc.

Vito A. Nardo
President
BLT Spirits, Inc.

Warren B. Noble
Treasurer
Noble's Camera Shop

Gerard W. Pyne
Chairman
Hingham Institution for
Savings

Russell G. Sears
President and C.E.O.
Developmental Expeditions, Inc.

Herbert E. Soini
Senior Mechanical Engineer
Thermo Electron Corporation
Retired

David L. Wightman
Vice President
W. R. Grace & Co.
Alewife Boston Ltd.
Alewife Land Corporation

Thomas H. Youngworth, Sr.
President and C.E.O.
Bay State Metal Products, Inc.
Hi-Tech Filter Corp. of America

## *Officers and Managers*

Gerard W. Pyne
Chairman

Paul E. Bulman
President and C.E.O.

Robert F. Cass
Vice President and Treasurer

Michael Donahue
Vice President/Lending

William M. Donovan, Jr.
Assistant Vice President

Edward P. Zec
Assistant Vice President

Deborah A. Bearde
Assistant Treasurer

Elizabeth A. Cossette
Assistant Treasurer

Helen Fuda
Assistant Treasurer

Rose Leibfarth
Assistant Treasurer

Sally A. Paulson
Assistant Treasurer

Lois F. Vanasse
Asssistant Treasurer

J. Robert Crowley
Clerk of the Bank

# Stockholder Information

**Hingham Institution for Savings**
**55 Main Street**
**Hingham, MA 02043**
**(617) 749-2200**

Paul E. Bulman
**President and Chief Executive Officer**

Robert F. Cass
**Vice President and Treasurer**

**Transfer Agent and Registrar**
Mellon Securities Trust Co.
c/o Mellon Securities Transfer Services
111 Founders Plaza, Suite 1100
East Hartford, CT 06108

**Stockholder Inquiries and Dividend Reinvestment**
Mellon Securities Transfer Services
P.O. Box 444
Pittsburgh, PA 15230
1-800-288-9541

**Independent Auditors**
KPMG Peat Marwick
One Boston Place
Boston, MA 02108

**General Counsel**
Bingham, Dana & Gould
150 Federal Street
Boston, MA 02110

**Form F-2**
A copy of the Bank's Annual Report on Form F-2 for the fiscal year ended December 31,1991 as filed with the Federal Deposit Insurance Corporation, may be obtained without charge, by any stockholder of the Bank upon written request addressed to the Investor Relations Department.

**STOCK DATA**

Hingham Institution for Savings common shares are listed and traded on the NASDAQ National Market System under the symbol HIFS.

As of December 31,1991 there were approximately 688 stockholders of record, holding 829,978 outstanding shares of common stock. These shares do not include the number of persons who hold their shares in nominee or street name through various brokerage firms.

The following table presents the quarterly high and low bid prices for the Bank's common stock reported by NASDAQ.

| | High | Low |
|---|---|---|
| **1991** | | |
| First Quarter | $ 3 | $ 1 3/4 |
| Second Quarter | 5 3/4 | 3 1/4 |
| Third Quarter | 4 5/8 | 3 |
| Fourth Quarter | 3 3/4 | 2 3/4 |
| **1990** | | |
| First Quarter | $ 5 1/2 | $ 3 3/4 |
| Second Quarter | 5 1/8 | 3 1/2 |
| Third Quarter | 4 1/4 | 2 3/8 |
| Fourth Quarter | 3 1/4 | 1 5/8 |

The closing sale price of the Bank's common stock at December 31, 1991 was $ 3 3/8 per share.

Hingham Institution
FOR Savings
55 MAIN STREET, HINGHAM, MA 02043 • (617) 749-2200