

UNITED STATES FEDERAL DEPOSIT INSURANCE CORPORATION

WASHINGTON, D.C. 20429

FORM 10 - Q

(Mark one)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended June 30, 2013

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period \_\_\_\_\_ to \_\_\_\_\_.

Commission File Number: FDIC Certificate No. 90211-0

HINGHAM INSTITUTION FOR SAVINGS  
(Exact name of registrant as specified in its charter)

Massachusetts  
(State of incorporation)

04-1442480  
(I.R.S. Employer Identification Number)

55 Main Street, Hingham, MA 02043  
(Address of Principal Executive Offices)

(781) 749-2200  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

(1) 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  
Yes \_\_\_ No  [Not Applicable]

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 definitions 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 \_\_\_\_\_  
(Do not check if a 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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

At July 31, 2013, there were 2,128,750 shares of the registrant's common stock outstanding.

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#### Exhibit No.

31.1	Certifications – Chief Executive Officer
31.2	Certifications – Chief Financial Officer
32.1	Certification Pursuant to 18 U.S.C. §1350 – Chief Executive Officer
32.2	Certification Pursuant to 18 U.S.C. §1350 – Chief Financial Officer

PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

HINGHAM INSTITUTION FOR SAVINGS AND SUBSIDIARIES

Consolidated Balance Sheets

(Unaudited)	June 30, 2013	December 31, 2012
	(In Thousands)	
<b>ASSETS</b>		
Cash and due from banks	\$ 8,570	\$ 7,961
Short-term investments	87,195	79,373
Cash and cash equivalents	95,765	87,334
Certificates of deposit	13,055	13,737
Securities available for sale, at fair value	103,580	102,866
Federal Home Loan Bank stock, at cost	14,043	14,105
Loans, net of allowance for loan losses of \$8,330,000 at June 30, 2013 and \$7,999,000 at December 31, 2012	990,831	949,662
Foreclosed assets	471	471
Bank-owned life insurance	15,160	14,945
Premises and equipment, net	15,101	14,180
Accrued interest receivable	3,119	2,667
Deferred income tax asset, net	2,676	2,556
Other assets	1,848	3,361
Total assets	\$ 1,255,649	\$ 1,205,884
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Deposits	\$ 891,772	\$ 869,886
Federal Home Loan Bank advances	257,795	234,355
Mortgage payable	1,043	1,065
Mortgagors' escrow accounts	3,092	3,231
Accrued interest payable	448	478
Other liabilities	3,473	4,070
Total liabilities	1,157,623	1,113,085
Stockholders' equity:		
Preferred stock, \$1.00 par value, 2,500,000 shares authorized; none issued	—	—
Common stock, \$1.00 par value, 5,000,000 shares authorized: 2,127,250 shares issued and outstanding at June 30, 2013 and 2,125,750 issued and outstanding at December 31, 2012	2,127	2,126
Additional paid-in capital	10,587	10,519
Undivided profits	85,303	79,930
Accumulated other comprehensive income	9	224
Total stockholders' equity	98,026	92,799
Total liabilities and stockholders' equity	\$ 1,255,649	\$ 1,205,884

See accompanying Notes to Unaudited Consolidated Financial Statements.

## ITEM 1 - FINANCIAL STATEMENTS (continued)

## HINGHAM INSTITUTION FOR SAVINGS AND SUBSIDIARIES

## Consolidated Statements of Net Income

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2013	2012	2013	2012
(Unaudited)	(In Thousands, except per share amounts)			
Interest and dividend income:				
Loans	\$ 11,991	\$ 11,926	\$ 23,779	\$ 23,769
Debt securities	104	139	213	288
Equity securities	38	44	76	86
Short-term investments and certificates of deposit	66	92	134	181
Total interest and dividend income	<u>12,199</u>	<u>12,201</u>	<u>24,202</u>	<u>24,324</u>
Interest expense:				
Deposits	1,405	1,436	2,834	2,942
Federal Home Loan Bank advances	1,209	1,235	2,417	2,475
Mortgage payable	15	17	31	33
Total interest expense	<u>2,629</u>	<u>2,688</u>	<u>5,282</u>	<u>5,450</u>
Net interest income	9,570	9,513	18,920	18,874
Provision for loan losses	100	200	200	425
Net interest income, after provision for loan losses	<u>9,470</u>	<u>9,313</u>	<u>18,720</u>	<u>18,449</u>
Other income:				
Customer service fees on deposits	256	253	494	506
Increase in bank-owned life insurance	106	113	215	210
Miscellaneous	57	58	107	115
Total other income	<u>419</u>	<u>424</u>	<u>816</u>	<u>831</u>
Operating expenses:				
Salaries and employee benefits	2,604	2,368	5,158	4,703
Data processing	240	213	479	444
Occupancy and equipment	459	428	940	847
Deposit insurance	168	156	335	289
Foreclosure	119	44	199	244
Marketing	130	215	208	349
Other general and administrative	637	645	1,256	1,270
Total operating expenses	<u>4,357</u>	<u>4,069</u>	<u>8,575</u>	<u>8,146</u>
Income before income taxes	5,532	5,668	10,961	11,134
Income tax provision	2,257	2,300	4,481	4,525
Net income	<u>\$ 3,275</u>	<u>\$ 3,368</u>	<u>\$ 6,480</u>	<u>\$ 6,609</u>
Weighted average common shares outstanding:				
Basic	<u>2,127</u>	<u>2,126</u>	<u>2,127</u>	<u>2,126</u>
Diluted	<u>2,129</u>	<u>2,127</u>	<u>2,129</u>	<u>2,127</u>
Earnings per common share:				
Basic	<u>\$ 1.54</u>	<u>\$ 1.58</u>	<u>\$ 3.05</u>	<u>\$ 3.11</u>
Diluted	<u>\$ 1.54</u>	<u>\$ 1.58</u>	<u>\$ 3.04</u>	<u>\$ 3.11</u>

See accompanying Notes to Unaudited Consolidated Financial Statements.

## ITEM 1 - FINANCIAL STATEMENTS (continued)

## HINGHAM INSTITUTION FOR SAVINGS AND SUBSIDIARIES

## Consolidated Statements of Comprehensive Income

	Three Months Ended June 30,		Six Months Ended June 30,	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
(Unaudited)	(In Thousands)			
Net income	\$ <u>3,275</u>	\$ <u>3,368</u>	\$ <u>6,480</u>	\$ <u>6,609</u>
Other comprehensive income (loss):				
Net unrealized gain (loss) on securities available for sale	269	32	(336)	(71)
Tax effect	<u>(97)</u>	<u>(11)</u>	<u>121</u>	<u>26</u>
	<u>(172)</u>	<u>21</u>	<u>(215)</u>	<u>(45)</u>
Comprehensive income	\$ <u>3,103</u>	\$ <u>3,389</u>	\$ <u>6,265</u>	\$ <u>6,564</u>

See accompanying Notes to Unaudited Consolidated Financial Statements.

ITEM 1 - FINANCIAL STATEMENTS (continued)

HINGHAM INSTITUTION FOR SAVINGS AND SUBSIDIARIES

Consolidated Statements of Changes in Stockholders' Equity  
 For the Six Months Ended  
 June 30, 2013 and 2012

(Unaudited)	Common Stock	Additional Paid-In Capital	Undivided Profits	Accumulated Other Comprehensive Income	Total Stockholders' Equity
	(In Thousands)				
Balance at December 31, 2011	\$ 2,126	\$ 10,500	\$ 69,404	\$ 235	\$ 82,265
Net income	—	—	6,609	—	6,609
Other comprehensive loss	—	—	—	(45)	(45)
Share-based compensation	—	19	—	—	19
Cash dividends declared – common (\$0.49 per share)	—	—	(1,084)	—	(1,084)
Balance at June 30, 2012	<u>\$ 2,126</u>	<u>\$ 10,519</u>	<u>\$ 74,929</u>	<u>\$ 190</u>	<u>\$ 87,764</u>
Balance at December 31, 2012	\$ 2,126	\$ 10,519	\$ 79,930	\$ 224	\$ 92,799
Net income	—	—	6,480	—	6,480
Other comprehensive loss	—	—	—	(215)	(215)
Stock option exercise, including tax effect of \$24	1	68	—	—	69
Cash dividends declared – common (\$0.52 per share)	—	—	(1,107)	—	(1,107)
Balance at June 30, 2013	<u>\$ 2,127</u>	<u>\$ 10,587</u>	<u>\$ 85,303</u>	<u>\$ 9</u>	<u>\$ 98,026</u>

See accompanying Notes to Unaudited Consolidated Financial Statements.

## ITEM 1 - FINANCIAL STATEMENTS (continued)

## HINGHAM INSTITUTION FOR SAVINGS AND SUBSIDIARIES

## Consolidated Statements of Cash Flows

(Unaudited)	Six Months Ended	
	June 30,	
	2013	2012
	(In Thousands)	
Cash flows from operating activities:		
Net income	\$ 6,480	\$ 6,609
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	200	425
Amortization of securities, net	447	368
Amortization of deferred loan origination costs, net	55	115
Excess tax benefits from share-based compensation	(24)	—
Share-based compensation expense	—	19
Depreciation and amortization of premises and equipment	329	304
Increase in bank-owned life insurance	(215)	(210)
Deferred income tax benefit	—	(8)
Loss on sale of foreclosed assets, net of write-downs	—	6
Changes in operating assets and liabilities:		
Accrued interest receivable and other assets	1,066	(85)
Accrued interest payable and other liabilities	(35)	(1,615)
Net cash provided by operating activities	<u>8,303</u>	<u>5,928</u>
Cash flows from investing activities:		
Activity in certificates of deposit:		
Maturities	3,512	3,365
Purchases	(2,831)	(3,764)
Activity in available-for-sale securities:		
Maturities, prepayments and calls	19,136	37,533
Purchases	(20,631)	(44,350)
Redemption of Federal Home Loan Bank stock	62	214
Purchase of Federal Home Loan Bank stock	—	(247)
Loans originated, net of payments received	(41,424)	(34,963)
Proceeds from sale of foreclosed assets	—	1,440
Additions to premises and equipment	(1,250)	(163)
Net cash used in investing activities	<u>(43,426)</u>	<u>(40,935)</u>

(continued)

See accompanying Notes to Unaudited Consolidated Financial Statements.

ITEM 1 – FINANCIAL STATEMENTS (concluded)

Consolidated Statements of Cash Flows (concluded)

(Unaudited)	Six Months Ended	
	June 30,	
	<u>2013</u>	<u>2012</u>
	(In Thousands)	
Cash flows from financing activities:		
Increase in deposits	21,886	39,272
Increase (decrease) in mortgagors' escrow accounts	(139)	183
Cash dividends paid on common stock	(1,680)	(1,616)
Proceeds from stock options exercised	45	—
Excess tax benefits from share-based compensation	24	—
Proceeds from Federal Home Loan Bank advances with maturities of three months or more	95,000	100,000
Repayment of Federal Home Loan Bank advances with maturities of three months or more	(71,560)	(111,057)
Repayment of mortgage payable	<u>(22)</u>	<u>(21)</u>
Net cash provided by financing activities	<u>43,554</u>	<u>26,761</u>
Net change in cash and cash equivalents	<u>8,431</u>	<u>(8,246)</u>
Cash and cash equivalents at beginning of period	<u>87,334</u>	<u>116,340</u>
Cash and cash equivalents at end of period	<u>\$ 95,765</u>	<u>\$ 108,094</u>
Supplementary information:		
Interest paid on deposit accounts	\$ 2,835	\$ 2,944
Interest paid on Federal Home Loan Bank advances and mortgage payable	2,478	2,526
Income taxes paid	4,360	4,557
Non-cash investing and financing activities:		
Transfer from loans to foreclosed assets	\$ —	\$ 978

See accompanying Notes to Unaudited Consolidated Financial Statements.



# HINGHAM INSTITUTION FOR SAVINGS AND SUBSIDIARIES

## Notes to Unaudited Consolidated Financial Statements

June 30, 2013 and 2012

### NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The consolidated interim financial statements of Hingham Institution for Savings (the “Bank”) have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial statements and with the instructions to SEC Form 10-Q and Article 10 of Regulation S-X. Accordingly they do not include all of the information and footnotes required by GAAP for complete financial statements.

Financial information as of June 30, 2013 and for the three and six months ended June 30, 2013 is unaudited, and in the opinion of management, reflect all adjustments necessary for a fair presentation of such information. Such adjustments were of a normal recurring nature. Interim results are not necessarily indicative of results to be expected for the entire year. The unaudited interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements of the Bank for the year ended December 31, 2012 filed on Form 10-K.

### Earnings per common share

Basic earnings per common share represent income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Bank relate solely to outstanding stock options and are determined using the treasury stock method.

Earnings per common share have been computed based on the following:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in Thousands)			
Average number of common shares outstanding used to calculate basic earnings per share	2,127	2,126	2,127	2,126
Effect of dilutive options	2	1	2	1
Average number of common shares outstanding used to calculate diluted earnings per common share	<u>2,129</u>	<u>2,127</u>	<u>2,129</u>	<u>2,127</u>

Options for 3,000 shares were not included in the computation of diluted earnings per share because to do so would have been antidilutive for the quarter and six months ended June 30, 2012. There were no antidilutive options for the quarter and six months ended June 30, 2013.

## Notes to Unaudited Consolidated Financial Statements (continued)

### Loans

The Bank's loan portfolio includes residential real estate, commercial real estate, construction, home equity, commercial and consumer segments. A substantial portion of the loan portfolio is secured by real estate in the southeastern Massachusetts area. The ability of the Bank's debtors to honor their contracts is dependent upon the real estate, construction, and general economic conditions.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding unpaid principal balances adjusted for charge-offs, the allowance for loan losses, and net deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method.

The accrual of interest on mortgage and commercial loans is discontinued at the time a loan is 90 days past due (the loan is in default) unless the credit is well-secured and in process of collection. Personal loans are typically charged off no later than becoming 180 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on non-accrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

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

### 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. The allowance consists of general and allocated loss components, as further discussed below.

#### 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 loan segments: residential real estate, commercial real estate, construction, home equity (equity lines of credit and second mortgages), commercial and consumer. Management uses a rolling average of historical losses based on a time frame (currently two years) appropriate to capture relevant loss data for each loan segment. This historical loss factor is adjusted for the following qualitative factors: levels/trends in delinquencies; trends in volume and terms of loans; effects of changes in risk selection and underwriting standards and other changes in lending policies, procedures and practices; experience/ability/depth of lending management and staff; and national and local economic trends and conditions. There were no changes in the Bank's policies or methodology pertaining to the general component of the allowance for loan losses during the six months ended June 30, 2013.

## Notes to Unaudited Consolidated Financial Statements (continued)

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

*Residential real estate* – The Bank generally does not originate loans with a loan-to-value ratio greater than 80 percent (without private mortgage insurance) and does not grant sub-prime loans. All loans in this segment are collateralized by owner-occupied residential real estate and repayment is dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality in this segment.

*Commercial real estate* – Loans in this segment are primarily secured by income-producing properties throughout Massachusetts. Generally, loan amounts do not exceed 75% of the appraised value of the collateral nor are the loan amounts in excess of \$4.5 million to any one borrower. The underlying cash flows generated by the properties are adversely impacted by a downturn in the economy as evidenced by increased vacancy rates which, in turn, will have an effect on the credit quality in this segment. Management obtains rent rolls annually and continually monitors the cash flows of these loans.

*Construction* – Loans in this segment include both owner-occupied and speculative real estate development loans for which payment is derived from sale of the property. Credit risk is affected by cost overruns, time to sell at an adequate price, the overall health of the economy and market conditions.

*Home equity* – Loans in this segment are generally collateralized by residential real estate and repayment is dependent on the credit quality of the individual borrower. The Bank generally does not originate loans with combined loan-to-values greater than 70% when taking into account both the balance of the home equity loans and first mortgage loan. Similar to residential real estate, the overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality in this segment.

*Commercial* – Loans in this segment are made to businesses and are generally secured by assets of the business. Repayment is expected from the cash flows of the business. A weakened economy, and resultant decreased consumer spending, will have an effect on the credit quality in this segment.

*Consumer* – Loans in this segment are generally unsecured and repayment is dependent on the credit quality of the individual borrower.

### 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, commercial real estate, construction, home equity and commercial loans.

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

## Notes to Unaudited Consolidated Financial Statements (continued)

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. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment.

The Bank periodically may 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 initially classified as impaired.

### NOTE 2: COMMITMENTS

At June 30, 2013 and December 31, 2012, there were \$134.8 million and \$125.8 million, respectively, in outstanding loan commitments as follows:

	June 30, 2013	December 31, 2012
	(In Thousands)	
Mortgage origination	\$ 56,743	\$ 47,360
Unused lines of credit	64,185	60,668
Unadvanced construction funds	13,788	17,733
Letters of credit	35	35
Total	<u>\$ 134,751</u>	<u>\$ 125,796</u>

At June 30, 2013, the Bank had the following contractual obligations outstanding:

	Payments Due by Year				
	Total	Less Than One Year	One to Three Years	Three to Five Years	More than Five Years
Contractual Obligations:	(In Thousands)				
Federal Home Loan Bank advances	\$ 257,795	\$ 147,000	\$ 40,000	\$ 66,000	\$ 4,795
Certificates of deposit	365,115	278,044	70,350	16,721	—
Data processing agreements*	3,434	771	1,424	1,190	49
Lease agreements**	1,161	284	402	198	277
Mortgage payable	1,043	46	101	114	782
Construction contract***	722	722	—	—	—

\* Estimated payments subject to change based on transaction volume.

\*\* Leases contain provisions to pay certain operating expenses, the cost of which is not included above. Lease commitments are based on the initial contract term, or longer, when in the opinion of management it is more likely than not that the lease will be renewed.

\*\*\* In February 2013, the Bank entered into a contract to renovate a property on Nantucket Island to serve as a branch location. Construction is expected to be complete in the 3<sup>rd</sup> quarter of 2013.

### NOTE 3: DIVIDEND DECLARATION

On June 26, 2013, the Board of Directors declared a cash dividend of \$0.26 per share to all stockholders of record as of July 10, 2013, payable July 22, 2013.

## Notes to Unaudited Consolidated Financial Statements (continued)

### NOTE 4: FAIR VALUES OF ASSETS AND LIABILITIES

#### Determination of Fair Value

The Bank uses fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures of certain assets and liabilities. The fair value of a financial instrument is the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Bank's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

#### Notes to Unaudited Consolidated Financial Statements (continued)

The Bank groups its assets measured or disclosed at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value, as follows:

Level 1 – Valuation is based on quoted prices in active exchange markets for identical assets or liabilities. Valuations are obtained from readily available pricing sources for market transactions involving identical assets.

Level 2 – Valuation is based on observable inputs other than Level 1 prices, such as quoted prices for similar assets; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 – Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using unobservable inputs to pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

Transfers between levels are recognized at the end of a reporting period, if applicable.

The following methods and assumptions were used by the Bank in estimating fair value disclosures:

Cash and cash equivalents: The carrying amounts of cash, due from banks, interest-bearing deposits and short-term investments approximate fair values based on the short-term nature of the assets.

Certificates of deposit: Fair values for certificates of deposit are based upon quoted market prices.

Securities available for sale: The securities measured at fair value in Level 1 are based on quoted market prices in an active exchange market and generally include marketable equity securities. Securities measured at fair value in Level 2 are based on pricing models that consider standard input factors such as observable market data, benchmark yields, interest rate volatilities, broker/dealer quotes, credit spreads and new issue data. These securities include U.S. Treasuries, government-sponsored enterprise obligations, FHLMC and FNMA bonds, corporate bonds and other securities. All fair value measurements are obtained from a third-party pricing service and are not adjusted by management.

Federal Home Loan Bank stock: The carrying value of Federal Home Loan Bank stock is deemed to approximate fair value based on the redemption provisions of the Federal Home Loan Bank of Boston.

## Notes to Unaudited Consolidated Financial Statements (continued)

**Loans:** For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for other loans are estimated using discounted cash flow analysis, using market interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for non-performing loans are estimated using discounted cash flow analysis or underlying collateral values, where applicable.

**Deposits:** The fair values of non-certificate accounts are, by definition, equal to the amount payable on demand at the reporting date which is their carrying amount. Fair values for certificates of deposit are estimated using a discounted cash flow calculation that applies market interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

**Federal Home Loan Bank advances:** The fair values of the advances are estimated using discounted cash flow analysis based on the Bank's current incremental borrowing rates for similar types of borrowing arrangements.

**Mortgage payable:** The fair value of the Bank's mortgage payable is estimated using discounted cash flow analysis based on the current incremental borrowing rates in the market for similar types of borrowing arrangements.

**Mortgagors' escrow accounts:** The carrying amounts of mortgagors' escrow accounts approximate fair value.

**Accrued interest:** The carrying amounts of accrued interest approximate fair value.

**Off-balance-sheet instruments:** Fair values for off-balance-sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. At June 30, 2013 and December 31, 2012, the fair value of commitments outstanding is not significant since fees charged are not material.

### Assets Measured at Fair Value on a Recurring Basis

Assets measured at fair value on a recurring basis are summarized below. There are no liabilities measured at fair value on a recurring basis.

	June 30, 2013			Total Fair Value
	Level 1	Level 2	Level 3	
	(In Thousands)			
Securities available for sale:				
Debt securities	\$ —	\$ 98,604	\$ —	\$ 98,604
Equity securities	4,976	—	—	4,976
Total securities available for sale	<u>\$ 4,976</u>	<u>\$ 98,604</u>	<u>\$ —</u>	<u>\$ 103,580</u>
	December 31, 2012			
	Level 1	Level 2	Level 3	Total Fair Value
	(In Thousands)			
Securities available for sale:				
Debt securities	\$ —	\$ 98,205	\$ —	\$ 98,205
Equity securities	4,661	—	—	4,661
Total securities available for sale	<u>\$ 4,661</u>	<u>\$ 98,205</u>	<u>\$ —</u>	<u>\$ 102,866</u>

## Notes to Unaudited Consolidated Financial Statements (continued)

### Assets Measured at Fair Value on a Non-recurring Basis

The Bank may also be required, from time to time, to measure certain other assets on a non-recurring basis in accordance with generally accepted accounting principles. These adjustments to fair value usually result from application of lower-of-cost-or-market accounting, or write-downs of individual assets. The following table summarizes the fair value hierarchy used to determine each adjustment and the carrying value of the related individual assets as of June 30, 2013, December 31, 2012 and June 30, 2012. There are no liabilities measured at fair value on a non-recurring basis at June 30, 2013, December 31, 2012 or June 30, 2012.

	June 30, 2013			Six Months Ended June 30, 2013	Three Months Ended June 30, 2013
	Level 1	Level 2	Level 3	Total Losses	Total Losses
	(In Thousands)			(In Thousands)	
Impaired loans	\$ —	\$ —	\$ 939	\$ 3	\$ —
Foreclosed assets	—	—	471	—	—
	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 1,410</u>	<u>\$ 3</u>	<u>\$ —</u>

	December 31, 2012		
	Level 1	Level 2	Level 3
	(In Thousands)		
Impaired loans	\$ —	\$ —	\$ 212
Foreclosed assets	—	—	471
	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 683</u>

	June 30, 2012			Six Months Ended June 30, 2012	Three Months Ended June 30, 2012
	Level 1	Level 2	Level 3	Total Losses	Total Losses
	(In Thousands)			(In Thousands)	
Impaired loans	\$ —	\$ —	\$ 1,035	\$ 50	\$ —
Foreclosed assets	—	—	3,161	75	18
	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 4,196</u>	<u>\$ 125</u>	<u>\$ 18</u>

Losses applicable to impaired loans and foreclosed assets are estimated using the appraised value of the underlying collateral, discounting factors and other factors. The losses applicable to impaired loans are not recorded directly as an adjustment to current earnings or comprehensive income, but rather as a component in determining the overall adequacy of the allowance for loan losses. Adjustments to the estimated fair value of impaired loans may result in increases or decreases to the provision for loan losses. Management will consider the circumstances of the individual loan or foreclosed asset when determining any estimated losses. This may include a review of an independent appraisal and if deemed necessary, an updated appraisal will be performed.

## Notes to Unaudited Consolidated Financial Statements (continued)

### Summary of Fair Values of Financial Instruments

The estimated fair values, and related carrying amounts, of the Bank's financial instruments are as follows. Certain financial instruments and all nonfinancial instruments are exempt from disclosure requirements. Accordingly, the aggregate fair value amounts presented herein do not represent the underlying fair value of the Bank.

	June 30, 2013			
	Carrying Amount	Fair Value		
		Level 1	Level 2	Level 3
	(in Thousands)			
<b>Financial assets:</b>				
Cash and cash equivalents	\$ 95,765	\$ 95,765	\$ —	\$ —
Certificates of deposit	13,055	13,066	—	—
Securities available for sale	103,580	4,976	98,604	—
Federal Home Loan Bank stock	14,043	—	—	14,043
Loans, net	990,831	—	—	996,415
Accrued interest receivable	3,119	—	—	3,119
<b>Financial liabilities:</b>				
Deposits	\$ 891,772	\$ —	\$ —	\$ 895,018
Federal Home Loan Bank advances	257,795	—	258,747	—
Mortgage payable	1,043	—	—	1,565
Mortgagors' escrow accounts	3,092	—	—	3,092
Accrued interest payable	448	—	—	448
<b>December 31, 2012</b>				
	Carrying Amount	Fair Value		
		Level 1	Level 2	Level 3
	(in Thousands)			
<b>Financial assets:</b>				
Cash and cash equivalents	\$ 87,334	\$ 87,334	\$ —	\$ —
Certificates of deposit	13,737	13,760	—	—
Securities available for sale	102,866	4,661	98,205	—
Federal Home Loan Bank stock	14,105	—	—	14,105
Loans, net	949,662	—	—	977,290
Accrued interest receivable	2,667	—	—	2,667
<b>Financial liabilities:</b>				
Deposits	\$ 869,886	\$ —	\$ —	\$ 873,833
Federal Home Loan Bank advances	234,355	—	243,009	—
Mortgage payable	1,065	—	—	1,489
Mortgagors' escrow accounts	3,231	—	—	3,231
Accrued interest payable	478	—	—	478



## Notes to Unaudited Consolidated Financial Statements (continued)

### NOTE 5: SECURITIES AVAILABLE FOR SALE

The amortized cost and estimated fair value of securities available for sale, with gross unrealized gains and losses, follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
<u>June 30, 2013</u>				
Debt securities:				
U.S. Treasury notes	\$ 10,025	\$ 16	\$ —	\$ 10,041
Government-sponsored enterprises –FHLMC	33,217	28	(26)	33,219
Government-sponsored enterprises - FNMA	41,600	22	(32)	41,590
Government-sponsored enterprises - Other	13,588	27	(1)	13,614
Residential mortgage-backed securities	137	3	—	140
Total debt securities	<u>98,567</u>	<u>96</u>	<u>(59)</u>	<u>98,604</u>
Equity securities	5,000	—	(24)	4,976
Total securities available for sale	<u>\$ 103,567</u>	<u>\$ 96</u>	<u>\$ (83)</u>	<u>\$ 103,580</u>

#### December 31, 2012

Debt securities:				
U.S. Treasury notes	\$ 10,039	\$ 20	\$ —	\$ 10,059
Government-sponsored enterprises –FHLMC	37,371	63	—	37,434
Government-sponsored enterprises – FNMA	29,629	51	(3)	29,677
Government-sponsored enterprises - Other	20,821	53	—	20,874
Residential mortgage-backed securities	157	4	—	161
Total debt securities	<u>98,017</u>	<u>191</u>	<u>(3)</u>	<u>98,205</u>
Equity securities	4,500	161	—	4,661
Total securities available for sale	<u>\$ 102,517</u>	<u>\$ 352</u>	<u>\$ (3)</u>	<u>\$ 102,866</u>

At June 30, 2013 and December 31, 2012, debt securities with a fair value of \$98,604,000 and \$98,205,000, respectively, were pledged to secure Federal Home Loan Bank advances.

The amortized cost and estimated fair value of debt securities by contractual maturity at June 30, 2013 are shown below. Expected maturities will differ from contractual maturities because of prepayments and scheduled payments on mortgage-backed securities. Further, certain obligors have the right to call bonds and obligations without prepayment penalties.

	Amortized Cost	Fair Value
	(In Thousands)	
Bonds and obligations:		
Within 1 year	\$ 45,591	\$ 46,310
Over 1 year to 5 years	52,839	52,154
Government-sponsored residential mortgage- backed securities:		
Over 5 to 10 years	73	75
Over 10 years	64	65
Total debt securities	<u>\$ 98,567</u>	<u>\$ 98,604</u>

## Notes to Unaudited Consolidated Financial Statements (continued)

Information pertaining to securities with gross unrealized losses at June 30, 2013 and December 31, 2012, aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

Less Than Twelve Months		Over Twelve Months	
Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value

(In Thousands)

### **June 30, 2013**

Debt securities:

Government-sponsored enterprises	\$ 59	\$ 33,552	\$ —	\$ —
Equity securities	24	4,976	—	—
Total temporarily impaired securities	\$ 83	\$ 38,528	\$ —	\$ —

Less Than Twelve Months		Over Twelve Months	
Gross Unrealized Losses	Fair Values	Gross Unrealized Losses	Fair Values

(In Thousands)

### **December 31, 2012**

Debt Securities:

Government-sponsored enterprises	\$ 3	\$ 5,339	\$ —	\$ —
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At June 30, 2013, \$33.6 million in debt securities had unrealized losses with aggregate depreciation of less than 1% from the Bank's amortized cost basis. These unrealized losses relate to debt securities issued by government-sponsored enterprises, and result from changes in the bond markets since their purchase. Because the declines in market value are attributable to changes in interest rates and not to credit quality, and because the Bank does not intend to sell the securities and it is not "more likely than not" that the Bank will be required to sell the securities before recovery of their amortized cost basis, which may be maturity, no declines are deemed to be other than temporary.

At June 30, 2013, \$5.0 million in equity securities had unrealized losses with aggregate depreciation of less than 1% from the Bank's cost basis. No credit issues have been identified that cause management to believe the decline in market value is other than temporary, and the Bank has the ability and intent to hold these investments until a recovery of fair value.

## Notes to Unaudited Consolidated Financial Statements (continued)

### NOTE 6: LOANS

A summary of the balances of loans is as follows:

	Loan Balances by Type	
	June 30, 2013	December 31, 2012
	(In Thousands)	
Mortgage loans:		
Residential	\$ 455,373	\$ 432,162
Commercial	463,654	438,037
Construction	53,989	60,390
Home equity	21,345	21,499
Second mortgages	2,830	3,556
Total mortgage loans	<u>997,191</u>	<u>955,644</u>
Other loans:		
Commercial	262	371
Consumer	434	498
Total other loans	<u>696</u>	<u>869</u>
 Total loans	 997,887	 956,513
Allowance for loan losses	(8,330)	(7,999)
Net deferred loan origination costs	<u>1,274</u>	<u>1,148</u>
 Loans, net	 <u>\$ 990,831</u>	 <u>\$ 949,662</u>

The Bank has sold mortgage loans in the secondary mortgage market and has retained the servicing responsibility and receives fees for the services provided. Loans sold and serviced for others amounted to \$5,990,000 and \$6,775,000 at June 30, 2013 and December 31, 2012, respectively. All loans serviced for others were sold without recourse provisions and are not included in the accompanying consolidated balance sheets.

The Bank has transferred a portion of its originated commercial real estate loans to participating lenders. The amounts transferred have been accounted for as sales and are therefore not included in the Bank's accompanying consolidated balance sheets. The Bank and participating lenders share ratably in any gains or losses that may result from a borrower's lack of compliance with contractual terms of the loan. The Bank continues to service the loans on behalf of the participating lenders and, as such, collects cash payments from the borrowers, remits payments to participating lenders and disburses required escrow funds to relevant parties. At June 30, 2013 and December 31, 2012, the Bank was servicing loans for participants aggregating \$3,490,000 and \$3,520,000, respectively.

A blanket lien on "qualified collateral", defined principally as 60-75% of the carrying value of first mortgage loans on certain owner-occupied residential property, 50% of the carrying value of first mortgage loans on certain non-owner-occupied residential property, 65% of the carrying value of first mortgage loans on certain multi-family residential property and 50% of the carrying value of loans on certain commercial property, is used to secure borrowings from the Federal Home Loan Bank of Boston.

## Notes to Unaudited Consolidated Financial Statements (continued)

An analysis of the activity in the allowance for loan losses, by segment, for the three- and six-month periods ended June 30, 2013 and 2012 follows:

	Residential Real Estate	Commercial Real Estate	Construction	Home Equity	Commercial	Consumer	Total
	(In Thousands)						
<b>Six months ended June 30, 2013</b>							
Balance December 31, 2012	\$ 2,959	\$ 4,368	\$ 568	\$ 102	\$ 1	\$ 1	\$ 7,999
Provision for loan losses	172	112	(81)	(3)	—	—	200
Loans charged off	(3)	—	—	—	—	—	(3)
Recoveries of loans previously charged off	14	120	—	—	—	—	134
Balance June 30, 2013	<u>\$ 3,142</u>	<u>\$ 4,600</u>	<u>\$ 487</u>	<u>\$ 99</u>	<u>\$ 1</u>	<u>\$ 1</u>	<u>\$ 8,330</u>
<b>Three months ended June 30, 2013</b>							
Balance March 31, 2013	\$ 3,209	\$ 4,352	\$ 553	\$ 100	\$ 1	\$ 1	\$ 8,216
Provision for loan losses	(81)	248	(66)	(1)	—	—	100
Loans charged off	—	—	—	—	—	—	—
Recoveries of loans previously charged off	14	—	—	—	—	—	14
Balance June 30, 2013	<u>\$ 3,142</u>	<u>\$ 4,600</u>	<u>\$ 487</u>	<u>\$ 99</u>	<u>\$ 1</u>	<u>\$ 1</u>	<u>\$ 8,330</u>
<b>Six months ended June 30, 2012</b>							
Balance December 31, 2011	\$ 2,569	\$ 4,337	\$ 475	\$ 127	\$ 1	\$ 7	\$ 7,516
Provision for loan losses	389	20	34	(12)	—	(6)	425
Loans charged off	(120)	—	—	—	—	—	(120)
Recoveries of loans previously charged off	—	—	—	—	—	—	—
Balance June 30, 2012	<u>\$ 2,838</u>	<u>\$ 4,357</u>	<u>\$ 509</u>	<u>\$ 115</u>	<u>\$ 1</u>	<u>\$ 1</u>	<u>\$ 7,821</u>
<b>Three months ended June 30, 2012</b>							
Balance March 31, 2011	\$ 2,668	\$ 4,355	\$ 490	\$ 123	\$ 1	\$ 2	\$ 7,639
Provision for loan losses	188	2	19	(8)	—	(1)	200
Loans charged off	(18)	—	—	—	—	—	(18)
Recoveries of loans previously charged off	—	—	—	—	—	—	—
Balance June 30, 2012	<u>\$ 2,838</u>	<u>\$ 4,357</u>	<u>\$ 509</u>	<u>\$ 115</u>	<u>\$ 1</u>	<u>\$ 1</u>	<u>\$ 7,821</u>

## Notes to Unaudited Consolidated Financial Statements (continued)

An analysis of the allowance for loan losses, by segment, as of June 30, 2013 and December 31, 2012 follows:

	Residential Real Estate	Commercial Real Estate	Construction	Home Equity (In Thousands)	Commercial	Consumer	Total
<b>June 30, 2013</b>							
Allowance for loans individually evaluated and deemed to be impaired	\$ 277	\$ 67	\$ —	\$ —	\$ —	\$ —	\$ 344
Allowance for loans collectively or individually evaluated and not deemed to be impaired	<u>2,865</u>	<u>4,533</u>	<u>487</u>	<u>99</u>	<u>1</u>	<u>1</u>	<u>7,986</u>
	<u>\$ 3,142</u>	<u>\$ 4,600</u>	<u>\$ 487</u>	<u>\$ 99</u>	<u>\$ 1</u>	<u>\$ 1</u>	<u>\$ 8,330</u>
Loans deemed to be impaired	\$ 3,373	\$ 3,905	\$ —	\$ 136	\$ —	\$ —	\$ 7,414
Loans not deemed to be impaired	<u>42</u>	<u>459,749</u>	<u>53,989</u>	<u>24,039</u>	<u>262</u>	<u>434</u>	<u>990,473</u>
Total loans	<u>\$ 455,373</u>	<u>\$ 463,654</u>	<u>\$ 53,989</u>	<u>\$ 24,175</u>	<u>\$ 262</u>	<u>\$ 434</u>	<u>\$ 997,887</u>
<b>December 31, 2012</b>							
Allowance for loans individually evaluated and deemed to be impaired	\$ 334	\$ 55	\$ —	\$ —	\$ —	\$ —	\$ 389
Allowance for loans collectively or individually evaluated and not deemed to be impaired	<u>2,625</u>	<u>4,313</u>	<u>568</u>	<u>102</u>	<u>1</u>	<u>1</u>	<u>7,610</u>
	<u>\$ 2,959</u>	<u>\$ 4,368</u>	<u>\$ 568</u>	<u>\$ 102</u>	<u>\$ 1</u>	<u>\$ 1</u>	<u>\$ 7,999</u>
Loans deemed to be impaired	\$ 2,850	\$ 3,038	\$ —	\$ 115	\$ —	\$ —	\$ 6,003
Loans not deemed to be impaired	<u>429,312</u>	<u>434,999</u>	<u>60,390</u>	<u>24,940</u>	<u>371</u>	<u>498</u>	<u>950,510</u>
	<u>\$ 432,162</u>	<u>\$ 438,037</u>	<u>\$ 60,390</u>	<u>\$ 25,055</u>	<u>\$ 371</u>	<u>\$ 498</u>	<u>\$ 956,513</u>

The following is a summary of past due and non-accrual loans at June 30, 2013 and December 31, 2012:

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due (In Thousands)	Total Past Due	Loans on Non-accrual
<b>June 30, 2013</b>					
Residential real estate	\$ 209	\$ 597	\$ 1,044	\$ 1,850	\$ 2,327
Commercial real estate	5,502	555	561	6,618	1,891
Home equity	1,312	—	39	1,351	136
Consumer	<u>1</u>	<u>—</u>	<u>—</u>	<u>1</u>	<u>—</u>
Total loans	<u>\$ 7,024</u>	<u>\$ 1,152</u>	<u>\$ 1,644</u>	<u>\$ 9,820</u>	<u>\$ 4,354</u>
<b>December 31, 2012</b>					
Residential real estate	\$ 4,027	\$ 1,592	\$ 726	\$ 6,345	\$ 1,471
Commercial real estate	1,388	—	959	2,347	1,337
Home equity	<u>934</u>	<u>—</u>	<u>115</u>	<u>1,049</u>	<u>115</u>
Total loans	<u>\$ 6,349</u>	<u>\$ 1,592</u>	<u>\$ 1,800</u>	<u>\$ 9,741</u>	<u>\$ 2,923</u>

At June 30, 2013 and December 31, 2012 there were no loans past due 90 days or more and still accruing interest.

## Notes to Unaudited Consolidated Financial Statements (continued)

The following is a summary of impaired loans at June 30, 2013 and December 31, 2012:

	June 30, 2013			December 31, 2012		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(In Thousands)					
Impaired loans without a valuation allowance:						
Residential real estate	\$ 1,730	\$ 1,730	\$ —	\$ 484	\$ 484	\$ —
Commercial real estate	1,681	1,681	—	1,125	1,125	—
Home equity	136	136	—	115	115	—
Total	<u>3,547</u>	<u>3,547</u>	<u>—</u>	<u>1,724</u>	<u>1,724</u>	<u>—</u>
Impaired loans with a valuation allowance:						
Residential real estate	1,642	1,642	277	2,366	2,366	334
Commercial real estate	2,225	2,399	67	1,913	2,089	55
Total	<u>3,867</u>	<u>4,041</u>	<u>344</u>	<u>4,279</u>	<u>4,455</u>	<u>389</u>
Total impaired loans	<u>\$ 7,414</u>	<u>\$ 7,588</u>	<u>\$ 344</u>	<u>\$ 6,003</u>	<u>\$ 6,179</u>	<u>\$ 389</u>

The following is information pertaining to impaired loans for the three and six months ended June 30, 2013 and 2012:

	Three Months June 30, 2013			Six Months Ended June 30, 2013		
	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized on Cash Basis	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized on Cash Basis
	(In Thousands)					
Impaired loans:						
Residential real estate	\$ 3,238	\$ 41	\$ 19	\$ 3,005	\$ 82	\$ 23
Commercial real estate	3,909	64	33	3,728	118	61
Home equity	137	1	1	129	5	2
Total impaired loans	<u>\$ 7,284</u>	<u>\$ 106</u>	<u>\$ 53</u>	<u>\$ 6,862</u>	<u>\$ 205</u>	<u>\$ 86</u>

	Three Months June 30, 2012			Six Months Ended June 30, 2012		
	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized on Cash Basis	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized on Cash Basis
	(In Thousands)					
Impaired loans:						
Residential real estate	\$ 3,126	\$ 64	\$ 40	\$ 3,251	\$ 146	\$ 101
Commercial real estate	3,511	82	34	3,234	164	84
Home equity	209	3	—	308	10	8
Total impaired loans	<u>\$ 6,846</u>	<u>\$ 149</u>	<u>\$ 74</u>	<u>\$ 6,793</u>	<u>\$ 320</u>	<u>\$ 193</u>

No additional funds are committed to be advanced in connection with impaired loans

## Notes to Unaudited Consolidated Financial Statements (continued)

In the course of resolving non-performing loans, the Bank may choose to restructure the contractual terms of certain loans, with terms modified to fit the ability of the borrower to repay in line with its current financial status. A loan is considered a troubled debt restructure if, for reasons related to the debtor's financial difficulties, a concession is granted to the debtor that would not otherwise be considered.

The following table summarizes the Bank's troubled debt restructurings ("TDRs") for the three and six months ended June 30, 2013 and 2012.

	Three Months Ended June 30, 2013			Six Months Ended June 30, 2013		
	Number of Contracts	Pre- Modification Unpaid Principal Balance	Post- Modification Unpaid Principal Balance	Number of Contracts	Pre- Modificati on Unpaid Principal Balance	Post- Modification Unpaid Principal Balance
		(In Thousands)			(In Thousands)	
TDRs on accrual status:						
Residential real estate	<u>—</u>	\$ <u>—</u>	\$ <u>—</u>	<u>1</u>	\$ <u>170</u>	\$ <u>170</u>
	Three Months Ended June 30, 2012			Six Months Ended June 30, 2012		
	Number of Contracts	Pre- Modification Unpaid Principal Balance	Post- Modification Unpaid Principal Balance	Number of Contracts	Pre- Modificati on Unpaid Principal Balance	Post- Modification Unpaid Principal Balance
		(In Thousands)			(In Thousands)	
TDRs on non-accrual status:						
Residential real estate	<u>1</u>	\$ <u>212</u>	\$ <u>212</u>	<u>2</u>	\$ <u>598</u>	\$ <u>598</u>
Commercial real estate	<u>1</u>	<u>176</u>	<u>176</u>	<u>1</u>	<u>176</u>	<u>176</u>
	<u>2</u>	<u>388</u>	<u>388</u>	<u>3</u>	<u>774</u>	<u>774</u>
TDRs on accrual status:						
Residential real estate	<u>1</u>	<u>328</u>	<u>328</u>	<u>2</u>	<u>646</u>	<u>646</u>
Commercial real estate	<u>2</u>	<u>1,290</u>	<u>1,290</u>	<u>2</u>	<u>1,290</u>	<u>1,290</u>
	<u>3</u>	<u>1,618</u>	<u>1,618</u>	<u>4</u>	<u>1,936</u>	<u>1,936</u>
	<u>5</u>	\$ <u>2,006</u>	\$ <u>2,006</u>	<u>7</u>	\$ <u>2,710</u>	\$ <u>2,710</u>

During the six months ended June 30, 2013, the Bank restructured one residential real estate loan that was delinquent by giving a rate concession. Subsequently, the Bank approved a short-sale and wrote the loan down to the anticipated net proceeds from the sale of underlying collateral. During the second quarter 2013, the property was sold without the Bank taking any principal loss.

## Notes to Unaudited Consolidated Financial Statements (continued)

During the six months ended June 30, 2012, the Bank restructured two residential real estate loans (one during the first quarter and one in the second quarter 2012) that were on non-accrual by giving rate concessions once the borrowers brought the loan fully current. Additionally there were two residential real estate troubled debt restructures (one during the first quarter and one in the second quarter) that were kept on accrual because the customers were granted rate concessions without being delinquent. There was one commercial real estate loan relationship consisting of three loans that were restructured as part of a bankruptcy settlement. One of the loans was a deficiency note that was reaffirmed and had the rate and term adjusted. The loan had previously been charged off and the payments are being applied as recoveries against the original charge-off. The other two loans consisted of adjusting the rate and maturity dates. These loans were kept on accrual because the concessions were granted without being delinquent.

On all loans, management performed a discounted cash flow calculation to determine the amount of impairment reserve required on each of the troubled debt restructurings. Any reserve required is recorded through the provision for loan losses.

### Credit Quality Information

The Bank uses a seven grade internal rating system for residential real estate, commercial real estate, construction and commercial loans as follows:

*Loans rated 1-3B:* Loans in this category are considered “pass” rated with low to average risk.

*Loans rated 4:* Loans in this category are considered “special mention.” These loans are currently protected, but exhibit conditions that have the potential for weakness. The borrower may be affected by unfavorable economic, market or other external conditions that may affect their ability to repay the debt. These may also include credits where there is deterioration of the collateral or have deficiencies which may affect the Bank’s ability to collect on the collateral. This rating is consistent with the “Other Assets Especially Mentioned” category used by the FDIC regulatory agency.

*Loans rated 5:* Loans in this category are considered “substandard.” Generally, a loan is considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligors and/or the collateral pledged. There is a distinct possibility that the Bank will sustain some loss if the weakness is not corrected.

*Loans rated 6:* Loans in this category are considered “doubtful.” Loans classified as doubtful have all the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, highly questionable and improbable.

*Loans rated 7:* Loans in this category are considered uncollectible (“loss”) and of such little value that their continuance as loans is not warranted.

Loans are assigned an initial grade at the origination of the loan. After origination, the Bank has a quality control program performed by an independent third-party. On a quarterly basis, all commercial and residential real estate loan relationships with individual loans \$500,000 or more are assigned a risk rating. An in-depth review is performed on all relationships totaling \$850,000 or greater along with loans on the Bank’s Watchlist. Watchlist loans are those loans that are more than two payments past due at the end of the quarter, loans rated four or higher in a previous review, loans that are determined to be troubled debt restructurings or loans past contractual maturity. Results of the review are reported to the Bank’s Audit Committee on a quarterly basis and become the mechanism for monitoring the overall credit quality of the portfolio. Any loan not reviewed under the quality control program retains the initial grade assigned at the origination of the loan.



## Notes to Unaudited Consolidated Financial Statements (concluded)

The following table presents the Bank's loans by risk ratings as of June 30, 2013 and December 31, 2012:

Rating	Residential Real Estate	Commercial Real Estate	Construction	Commercial
	(In Thousands)			
<u>June 30, 2013</u>				
1- 3B	\$ 451,042	\$ 459,921	\$ 53,989	\$ 262
4	3,075	2,551	—	—
5	1,256	1,182	—	—
	\$ 455,373	\$ 463,654	\$ 53,989	\$ 262
<u>December 31, 2012</u>				
1- 3B	\$ 428,199	\$ 433,550	\$ 60,390	\$ 371
4	3,170	4,275	—	—
5	793	212	—	—
	\$ 432,162	\$ 438,037	\$ 60,390	\$ 371

### NOTE 7: NEW ACCOUNTING PRONOUNCEMENTS

In February 2013, the Financial Accounting Standards Board issued Accounting Standards Update No. 2013-02, *Comprehensive Income (Topic 220), Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income*. The update generally requires the Bank to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income, effective prospectively for reporting periods beginning after December 15, 2012. The update had no material impact on the Bank's consolidated financial statements for the three and six months ended June 30, 2013.

## **ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.**

### **FORWARD-LOOKING STATEMENTS**

The following discussion of the financial condition and results of operations of the Bank should be read in conjunction with the Consolidated Financial Statements and Notes thereto included elsewhere in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K for the year ended December 31, 2012. Matters discussed in this Quarterly Report on Form 10-Q and in our public disclosures, whether written or oral, relating to future events or our future performance, including any discussion, express or implied, of our anticipated growth, operating results, future earnings per share, plans and objectives, contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements are often identified by the words "believe", "plan", "estimate", "project", "target", "continue", "intend", "expect", "future", "anticipate", and similar expressions that are not statements of historical fact. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict, including changes in political and economic climate, interest rate fluctuations and competitive product and pricing pressures within the Bank's market, bond market fluctuations, personal and corporate customers' bankruptcies and inflation. Our actual results and timing of certain events could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including, but not limited to, those set forth under "Risk Factors" and elsewhere in this Quarterly Report on Form 10-Q and in our other public filings with the FDIC. It is routine for internal projections and expectations to change as the year or each quarter in the year progresses, and therefore, it should be clearly understood that all forward-looking statements and the internal projections and beliefs upon which we base our expectations included in this Quarterly Report on Form 10-Q are made only as of the date of this Quarterly Report on Form 10-Q and may change. While we may elect to update forward-looking statements at some point in the future, we do not undertake any obligation to update any forward-looking statements whether as a result of new information, future events or otherwise.

### **INTRODUCTION**

The earnings of the Bank are driven primarily by its net interest income, which is influenced by market interest rates as well as the Bank's ability to generate loans and gather deposits. To a significantly lesser degree, the Bank also generates fee income from its deposit and loan customers. Earnings can also be affected by the creditworthiness of its borrowers, and as such, management monitors the portfolio and analyzes trends, both internal and external, which could impact the borrowers' ability to repay their loans. The Bank operates ten banking offices which provide services to its deposit and loan customers. The Bank competes with other local, regional and national banks, credit unions and mutual funds to attract new depositors. The Bank is regulated by various agencies, primarily the Federal Deposit Insurance Corporation ("FDIC") and the Massachusetts Commissioner of Banks, which among other things require minimum capital levels.

Net income decreased \$93,000, or 3%, for the second quarter of 2013 as compared to the same quarter of 2012. A \$57,000, or 1%, improvement in net interest income combined with a decrease of \$100,000 in the provision for loan losses and a decrease of \$43,000 in income tax provision were more than offset by a decline of \$5,000 in other income and a \$288,000, or 7%, increase in operating expenses.

Net income decreased \$129,000, or 2%, for the six months of 2013 as compared to the same period in 2012. The \$46,000 improvement in net interest income combined with a reduction of \$225,000 in the provision for loan losses and a \$44,000 decrease in income tax provision were more than offset by a \$15,000 decline in other income and a \$429,000, or 5%, increase in operating expenses.

During the first six months of 2013, the Bank originated \$161.9 million in loans, resulting in net loan growth of \$41.2 million after giving effect to continued loan prepayments. At June 30, 2013, loans continue to be the Bank's largest component of total assets at 79%. Non-performing assets were 0.38% of total assets at

June 30, 2013 as compared to 0.28% at December 31, 2012. Management believes that these assets are significantly collateralized, pose minimal risk of loss to the Bank, and that the allowance for loan losses is sufficient to absorb such losses, if any.

During the first six months of 2013, \$19.1 million of the Bank's securities matured, paid down or were called and the proceeds were reinvested in the securities portfolio.

During the first six months of 2013, the Bank received \$21.9 million in net new deposits. Management believes that the increase in deposit balances is attributable to the Bank's full insurance coverage and the current trend to move towards community banks. These funds were used to purchase securities, fund loans, maintain a reduced level of borrowed funds and maintain higher levels of liquidity.

The Bank continues to exceed all of the minimum regulatory capital requirements.

## **RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED JUNE 30, 2013 AND 2012**

### **GENERAL**

The Bank reported net income of \$3.3 million for the quarter ended June 30, 2013 as compared to \$3.4 million for the quarter ended June 30, 2012. Net income was \$1.54 per share (basic and diluted) for the quarter ended June 30, 2013 as compared with \$1.58 per share (basic and diluted) for the same period in 2012. Earnings for the quarter ended June 30, 2013 were positively impacted by an increase of \$57,000, or 1%, in net interest income along with a decrease of \$100,000 in the provision for loan losses. This was more than offset by a \$288,000, or 7%, increase in operating costs, primarily attributable to an increase in salaries and employee benefits and foreclosure expenses.

### **NET INTEREST INCOME**

Net interest income is impacted by growth in balances combined with market interest rates. As short-term market rates fall, rates paid to depositors decrease and maturing borrowings may be refinanced at lower rates. New loans and securities may earn lower rates. Adjustable rate loans may also re-set at lower rates.

During the last several years, interest rates have been at historical lows as the Federal Reserve Bank has lowered the Federal Funds rate to near zero and has implemented a security purchase program geared towards keeping longer-term rates at historical lows in an effort to stabilize financial markets and stimulate the overall economy. Due to the extended period of lower rates, a large portion of interest-bearing liabilities have fully repriced to lower rates but yields on longer-term interest earning assets have been slower to decline. During the last year the Bank has seen the yield on earning assets decline at a faster pace than the cost of interest-bearing liabilities; producing lower average interest rate spreads and lower net interest margins.

For the quarter ended June 30, 2013 the Bank's weighted average rate spread was 3.11%, a decrease from 3.31% for the same period in 2012. The net interest margin for the quarter ended June 30, 2013 was 3.23%, a decline from the 3.43% for the same period in 2012. When comparing the two quarters, the yield on total earning assets decreased 28 basis points and the rate on interest-bearing liabilities decreased by 8 basis points.

Net interest income was \$9.6 million for the second quarter of 2013 and \$9.5 million for the second quarter of 2012. The \$57,000 improvement was due to an increase in average earning assets in the second quarter of 2013 compared to the second quarter 2012 and was largely offset by a 20 basis point decrease in the weighted average rate spread.

The following table details components of net interest income and yields/rates on average earning assets/liabilities.

	Three Months Ended June 30,					
	2013			2012		
	AVERAGE BALANCE	INTEREST	YIELD/ RATE	AVERAGE BALANCE	INTEREST	YIELD/ RATE
	(Dollars in Thousands)					
Loans (1) (2)	\$ 984,444	\$ 11,991	4.87 %	882,684	\$ 11,926	5.40 %
Securities (3) (4)	113,924	142	0.50	108,318	183	0.68
Short-term investments and certificates of deposit	85,227	66	0.31	117,639	92	0.31
Total earning assets	1,183,595	12,199	4.12	1,108,641	12,201	4.40
Other assets	36,535			37,467		
Total assets	<u>\$ 1,220,130</u>			<u>\$ 1,146,108</u>		
Interest-bearing deposits (5)	\$ 793,668	1,405	0.71	\$ 742,847	1,436	0.77
Borrowed funds	243,374	1,224	2.01	242,903	1,252	2.06
Total interest-bearing liabilities	1,037,042	2,629	1.01	985,750	2,688	1.09
Demand deposits	82,166			68,750		
Other liabilities	3,559			4,581		
Total liabilities	1,122,767			1,059,081		
Stockholders' equity	97,363			87,027		
Total liabilities and stockholders' equity	<u>\$ 1,220,130</u>			<u>\$ 1,146,108</u>		
Net interest income		<u>\$ 9,570</u>			<u>\$ 9,513</u>	
Weighted average rate spread			<u>3.11 %</u>			<u>3.31 %</u>
Net interest margin (6)			<u>3.23 %</u>			<u>3.43 %</u>
Average interest-earning assets to average interest-bearing liabilities (7)			<u>114.13 %</u>			<u>112.47 %</u>

(1) Before allowance for loan losses.

(2) Includes non-accrual loans.

(3) Excludes the impact of the average net unrealized gain or loss on securities available for sale.

(4) Includes Federal Home Loan Bank stock.

(5) Includes mortgagors' escrow accounts.

(6) Net interest income divided by average total earning assets.

(7) Total earning assets divided by total interest-bearing liabilities.

The following table presents information regarding changes in interest and dividend income and interest expense of the Bank for the periods indicated. For each category, information is provided with respect to the change attributable to volume (change in volume multiplied by old rate) and the change in rate (change in rate multiplied by old volume). The change attributable to both volume and rate is allocated proportionately to the change due to volume and rate.

	Three Months Ended June 30, 2013 Compared to the Three Months Ended June 30, 2012 Increase (Decrease)		
	Due to		Total
	Volume	Rate (in Thousands)	
Interest and dividend income:			
Loans	\$ 1,302	\$ (1,237)	\$ 65
Securities and FHLB stock	9	(50)	(41)
Short-term investments and certificates of deposit	(25)	(1)	(26)
Total interest and dividend income	<u>1,286</u>	<u>(1,288)</u>	<u>(2)</u>
Interest expense:			
Deposits	95	(126)	(31)
Borrowed funds	2	(30)	(28)
Total interest expense	<u>97</u>	<u>(156)</u>	<u>(59)</u>
Net interest income	<u>\$ 1,189</u>	<u>\$ (1,132)</u>	<u>\$ 57</u>

Interest and dividend income declined by \$2,000 for the second quarter of 2013 as compared to the second quarter of 2012. The yield on total interest-earning assets was 4.12% for the quarter ended June 30, 2013 as compared to 4.40% for the quarter ended June 30, 2012.

Interest income on loans increased \$65,000 when comparing the two periods, primarily resulting from a 12% increase in average loans, offset, in part, by a 53 basis point decrease in overall yield. Although short-term market rates remained at historic lows during the last year, longer-term rates were more volatile, fluctuating between 50-100 basis points during the period. Loans that reset to market rates, such as prime-based home equity loans and commercial lines remained relatively stable. Adjustable rate residential and commercial mortgages with reset dates in 2012 and through the first six months of 2013 were impacted by lower market rates.

Securities, Federal Home Loan Bank stock and short-term investments accounted for 17% of the total average earning assets for the quarter ended June 30, 2013 and 20% for the same period in 2012. Income for these categories combined decreased \$67,000 when comparing the two periods primarily due to decreases in interest rates combined with a \$26.8 million decrease in average balances. Over the last three years, shorter-term rates have remained at historic lows affecting short-term overnight investments and matured/called securities when the funds are reinvested.

The average rate on interest-bearing liabilities decreased to 1.01% for the second quarter of 2013 from 1.09% for the comparable quarter of 2012. Total interest expense decreased by \$59,000 when comparing the quarters ended June 30, 2013 and 2012. During the prior 12 months, there has been an increase of \$50.8 million in average interest bearing deposits. Most of this growth has come from money market balances. Additionally, there was growth of \$13.4 million in demand deposit balances in which no interest is paid. These have served as the primary funding source, however, the average balance of borrowed funds increased by \$471,000 during the last 12 months.

Interest expense on deposits decreased by \$31,000, primarily as a result of a 6 basis point decrease in the weighted average rate, offset, in part, by a \$50.8 million increase in average interest-bearing deposit balances. The rates paid on deposit accounts were lowered during the last six months of 2012 and through the first six months of 2013 and reflect market conditions. The Bank has benefitted from the lower interest rate environment as certificates roll into lower rate products and rates paid on savings and transaction account products are

lowered. Certificate balances decreased by \$12.8 million during the last six months and non-certificate accounts increased by \$34.7 million and represents 60% of total deposits at June 30, 2013 compared to 57% at December 31, 2012. Generally, most mutual fund and broker related money market products are indexed to short term rates. A combination of more attractive rates on bank money market accounts, along with deposit insurance coverage, has produced strong growth in our money market and short-term certificate products. The significant increase in deposit balances has allowed the Bank to fund lending activity and maintain an elevated level of liquidity.

Interest expense on borrowed funds for the second quarter of 2013 decreased \$28,000 as compared to the same quarter in 2012, due primarily to a 5 basis point decrease in the weighted average rate offset, in part, by a \$471,000 increase in average outstanding balance. Strong growth in loans was funded by a combination of deposits and borrowed funds.

### PROVISION FOR LOAN LOSSES

At June 30, 2013, management's review of the allowance for loan losses concluded that a balance of \$8.3 million was adequate to provide for losses based upon evaluation of risk in the loan portfolio. During the second quarter of 2013, management provided \$100,000 to achieve such a loan loss allowance balance at June 30, 2013. The Bank did not record any charge-offs and posted \$14,000 in recoveries for the second quarter of 2013. Comparably, at June 30, 2012, management's evaluation of the balance of the allowance for loan losses indicated the need for a quarterly provision of \$200,000.

At June 30, 2013, the allowance for loan losses represented 0.83% of gross loans as compared to 0.84% at December 31, 2012 and 0.88% at June 30, 2012. Management considers many factors when evaluating the balance in the loan loss allowance. Beginning with historical charge-offs, adjustments are made to assess trends in portfolio volume, maturity and composition, trends in delinquencies and the national and local economic condition. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. In particular, at June 30, 2013, management considered the growth and composition of the loan portfolio and the continued volatility in the financial markets as key factors. Management believes that its loans classified as non-accrual are significantly collateralized, pose minimal risk of loss to the Bank and the allowance for loan losses is sufficient to absorb such losses. However, management continues to monitor the loan portfolio and additional reserves will be taken if necessary.

See Note 6 to interim consolidated financial statements and "Loans and Foreclosed Real Estate" included in this Management's Discussion and Analysis for additional information pertaining to the allowance for loan losses.

### OTHER INCOME

Other income is comprised of customer service fees, increases in the cash surrender value of life insurance policies and miscellaneous income. Total other income was \$419,000 for the quarter ended June 30, 2013 compared to \$424,000 for the same period in 2012. Customer service fees increased by \$3,000; primarily the result of an increased volume of fee-based customer transactions along with ATM interchange income from higher transaction volume. This was partially offset by a decrease in bank-owned life insurance income of \$7,000 based on a decline in interest rates.

### OPERATING EXPENSES

Total operating expenses were \$4.4 million, or an annualized 1.43% of average total assets, for the quarter ended June 30, 2013 as compared to \$4.1 million, or 1.42%, for the same quarter of 2012. Operating expenses include salaries and employee benefits, data processing, occupancy and equipment, deposit insurance, foreclosure, marketing and other general and administrative expenses.

Salaries and employee benefits expenses rose 10% primarily due to increases in staffing including staffing associated with the new branch being opened on Nantucket, annual merit-based salary increases and rising

medical insurance costs.

Data processing expenses increased by 13% primarily due to investments in new systems and products as well as a general increase in processing volume.

Occupancy and equipment expenditures increased by \$31,000, or 7%, due to added depreciation expense associated renovations made to bank facilities, increases in maintenance expense, increases in real estate taxes and increases in utility costs.

Deposit insurance expense increased \$12,000, or 8%, from \$156,000 for the second quarter of 2012 to \$168,000 in the second quarter of 2013. The increase in expense is due to the higher level of insured deposit balances.

Foreclosure related expenses increased by \$75,000 to \$119,000 for the second quarter 2013. The increase is primarily related to increased legal costs associated with processing foreclosures and bankruptcy proceedings. Additionally, the Bank sold two properties in the second quarter of 2012 for a net gain of \$47,000. There were no properties sold during the second quarter 2013. At June 30, 2013 and December 31, 2012, the Bank held two properties with a carrying value of \$471,000. This compares to five properties totaling \$3.2 million at June 30, 2012. During the second quarter of 2013, there were no additions or disposals of any properties.

Marketing expenses decreased by \$85,000 to \$130,000 for the second quarter 2013. The decrease was due to a reduction in print advertising in the second quarter of 2013. Additionally, 2012 was higher in comparison to the current year due to additional marketing initiatives for both lending and deposits.

Other expenses, which include director fees, supplies, deposit related losses and audit-related expenses, among others, decreased \$8,000, or 1%, when comparing the two periods primarily due to lower corporate legal fees, partially offset by general increases in operating expenses.

#### INCOME TAXES

The Bank recognizes income taxes under the asset and liability method in which deferred tax assets and liabilities are established for the temporary difference between the accounting basis and the tax basis of the Bank's assets and liabilities at enacted tax rates expected to be in effect when the amounts related to such temporary differences are realized or settled. The Bank's deferred tax asset is reviewed quarterly and adjustments to such asset are recognized as deferred income tax expense or benefit based on management's judgment relating to the realizability of such asset. For the quarter ended June 30, 2013 the only adjustment to the deferred tax asset represents the change in the tax impact of the unrealized gain on securities held as available-for-sale.

During the second quarter of 2013, the Bank recorded \$2.3 million, or 40.8% of pre-tax income, in tax expense as compared to \$2.3 million, or 40.6%, for the same quarter in 2012, a decrease of \$43,000. The decrease in income tax expense is due to the decrease in pre-tax earnings. Changes in the Bank's tax rate are due primarily to changes in the yields earned on assets subject to preferential tax treatment.

## **RESULTS OF OPERATIONS FOR THE SIX MONTHS ENDED JUNE 30, 2013 AND 2012**

### **GENERAL**

The Bank reported net income of \$6.5 million for the six months ended June 30, 2013 as compared to \$6.6 million for the six months ended June 30, 2012. Net income was \$3.05 per share basic and \$3.04 per share diluted for the six months ended June 30, 2013 as compared with \$3.11 per share (basic and diluted) for the same period in 2012. Earnings for the six months ended June 30, 2013 were positively impacted by a 1% improvement in net interest income and a reduction of \$225,000 in the provision for loan losses. This was offset by a decline of \$15,000 in other income and a \$429,000, or 5%, increase in operating costs, primarily attributable to an increase in salaries and employee benefits, increased occupancy and equipment expenses and increased data processing expenses.

### **NET INTEREST INCOME**

Net interest income is impacted by portfolio growth and market interest rates. As short-term market rates fall, rates paid to depositors decrease and maturing borrowings may be refinanced at lower rates. New loans and securities may earn lower rates. Adjustable rate loans may also re-set at lower rates.

During the last three years, interest rates have been at historical lows as the Federal Reserve Bank has lowered the Federal Funds rate to near zero and has implemented a security purchase program geared towards keeping longer-term rates at historical lows in an effort to stabilize financial markets and stimulate the overall economy. Additionally, volatility in the equity markets has caused an increase in deposit balances as customers seek the safe haven of a fully-insured depository institution.

However, due to the extended period of lower rates, a large portion of interest-bearing liabilities have fully repriced to lower rates but yields on longer-term interest earning assets have been slower to decline. In the last year the Bank has seen the yield on earning assets decline at a faster pace than the cost of interest-bearing liabilities and the Bank is starting to see flatter average interest rate spreads and lower net interest margins. The net effect of these low interest rates and growth in deposit balances was reflected in the decline in the Bank's weighted average rate spread and net interest margin which were 3.10% and 3.22%, respectively, for the six months ended June 30, 2013 as compared to 3.32% and 3.44%, respectively, for the six months ended June 30, 2012. When comparing the two periods, the yield on total earning assets decreased 31 basis points and the rate on interest-bearing liabilities decreased by 9 basis points.

Net interest income was \$18.9 million for the first six months of 2013 and also \$18.9 million for the first six months of 2012. The \$46,000 improvement was due to a 7% increase in average earning assets in the first six months of 2013 compared to the same period in 2012, partially offset by a decrease in the weighted average rate spread of 22 basis points.



The following table details components of net interest income and yields/rates on average earning assets/liabilities.

	Six Months Ended June 30,					
	2013			2012		
	AVERAGE BALANCE	INTEREST	YIELD/ RATE	AVERAGE BALANCE	INTEREST	YIELD/ RATE
	(Dollars in Thousands)					
Loans (1) (2)	\$ 971,146	\$ 23,779	4.90 %	\$ 873,408	\$ 23,769	5.44 %
Securities (3) (4)	114,812	289	0.50	107,884	374	0.69
Short-term investments and certificates of deposit	89,444	134	0.30	116,672	181	0.31
Total earning assets	1,175,402	24,202	4.12	1,097,964	24,324	4.43
Other assets	36,234			37,152		
Total assets	<u>\$ 1,211,636</u>			<u>\$ 1,135,116</u>		
Interest-bearing deposits (5)	\$ 793,801	2,834	0.71	\$ 739,249	2,942	0.80
Borrowed funds	239,102	2,448	2.05	239,860	2,508	2.09
Total interest-bearing liabilities	1,032,903	5,282	1.02	979,109	5,450	1.11
Demand deposits	79,188			66,051		
Other liabilities	3,102			4,330		
Total liabilities	1,115,193			1,049,490		
Stockholders' equity	96,443			85,626		
Total liabilities and stockholders' equity	<u>\$ 1,211,636</u>			<u>\$ 1,135,116</u>		
Net interest income		<u>\$ 18,920</u>			<u>\$ 18,874</u>	
Weighted average rate spread			<u>3.10 %</u>			<u>3.32 %</u>
Net interest margin (6)			<u>3.22 %</u>			<u>3.44 %</u>
Average interest-earning assets to average interest-bearing liabilities (7)			<u>113.80 %</u>			<u>112.14 %</u>

(1) Before allowance for loan losses.

(2) Includes non-accrual loans.

(3) Excludes the impact of the average net unrealized gain or loss on securities available for sale.

(4) Includes Federal Home Loan Bank stock.

(5) Includes mortgagors' escrow accounts.

(6) Net interest income divided by average total earning assets.

(7) Total earning assets divided by total interest-bearing liabilities.

The following table presents information regarding changes in interest and dividend income and interest expense of the Bank for the periods indicated. For each category, information is provided with respect to the change attributable to volume (change in volume multiplied by old rate) and the change in rate (change in rate multiplied by old volume). The change attributable to both volume and rate is allocated proportionately to the change due to volume and rate.

	Six Months Ended June 30, 2013 Compared to the Six Months Ended June 30, 2012 Increase (Decrease)		
	Due to		Total
	Volume	Rate	
		(In Thousands)	
Interest and dividend income:			
Loans	\$ 2,519	\$ (2,509)	\$ 10
Securities and FHLB stock	23	(108)	(85)
Short-term investments and certificates of deposit	(41)	(6)	(47)
Total interest and dividend income	<u>2,501</u>	<u>(2,623)</u>	<u>(122)</u>
Interest expense:			
Deposits	208	(316)	(108)
Borrowed funds	(8)	(52)	(60)
Total interest expense	<u>200</u>	<u>(368)</u>	<u>(168)</u>
Net interest income	<u>\$ 2,301</u>	<u>\$ (2,255)</u>	<u>\$ 46</u>

Interest and dividend income decreased by \$122,000 to \$24.2 million for the first six months of 2013 as compared to \$24.3 million for the first six months of 2012. The yield on total interest-earning assets was 4.12% for the first six months ended June 30, 2013 as compared to 4.43% for the first six months ended June 30, 2012.

Interest income on loans increased \$10,000 when comparing the two periods, primarily resulting from an 11% increase in average loans, offset, in part, by a 54 basis point decrease in overall yield. Although short-term market rates remained at historic lows during the last year, longer-term rates were more volatile, fluctuating between 50-100 basis points during the period. Loans that reset to market rates, such as prime-based home equity loans and commercial lines remained relatively stable. Adjustable rate residential and commercial mortgages, with reset dates in late 2012 and through the first six months of 2013, were impacted by lower market rates.

Securities, Federal Home Loan Bank stock and short-term investments accounted for 17% of the total average earning assets for the six months ended June 30, 2013 and 20% for the same period in 2012. Income for these categories combined decreased \$132,000 when comparing the two periods primarily due to decreases in interest rates combined with a \$20.3 million decrease in average balances. Over the last several years, shorter-term rates have remained at historic lows affecting short-term overnight investments and matured/called securities when the funds are reinvested.

The average rate on interest-bearing liabilities decreased to 1.02% for the first six months of 2013 from 1.11% for the comparable period in 2012. Total interest expense decreased by \$168,000 when comparing the six months ended June 30, 2013 and 2012. During the prior 12 months, there has been an increase of \$54.6 million in average interest bearing deposits. Most of this growth has come from lower-cost money market balances. This has served as the primary funding source for asset growth.

Interest expense on deposits decreased by \$108,000, primarily as a result of a 9 basis point decrease in the weighted average rate, offset, in part, by a \$54.6 million increase in average interest-bearing deposit balances. The rates paid on savings accounts, money market deposit accounts and certificates of deposit were lowered during the last six months of 2012 and through the first six months of 2013 and reflect market conditions. The Bank has benefitted from the lower interest rate environment as certificates roll into lower rate products and rates paid on savings and transaction accounts are lowered. Certificate balances decreased by \$12.8 million during the last six months, non-certificate accounts increased by \$34.7 million and represents 59% of total

deposits at June 30, 2013 compared to 57% at December 31, 2012. Generally, most mutual fund and broker related money market products are indexed to short term rates. A combination of more attractive rates on bank money market accounts, along with deposit insurance coverage, has produced strong growth in our money market products. Additionally, during the first six month of 2013 the Bank has seen growth in demand deposit accounts totaling \$11.2 million. These deposits do not pay interest and is considered a low cost source of funds. The significant increase in deposit balances has allowed the Bank to fund lending activity and maintain an elevated level of liquidity.

Interest expense on borrowed funds for the first six months of 2013 decreased \$60,000 as compared to the same period in 2012, due primarily to a 4 basis point decrease in the weighted average rate and combined with a \$758,000 decrease in average outstanding balance.

### PROVISION FOR LOAN LOSSES

At June 30, 2013, management's review of the allowance for loan losses concluded that a balance of \$8.3 million was adequate to provide for losses based upon evaluation of risk in the loan portfolio. During the first six months of 2013, management provided \$200,000 to achieve such a loan loss allowance balance at June 30, 2013. The Bank recorded charge-offs of \$3,000 during the first six months of 2013 and recoveries totaling \$134,000. The growth and composition of the loan portfolio warranted additional provisions to the Bank's allowance for loan losses. Comparably, at June 30, 2012, management's evaluation of the balance of the allowance for loan losses indicated the need for a provision of \$425,000.

At June 30, 2013, the allowance for loan losses represented 0.83% of gross loans as compared to 0.84% at December 31, 2012 and 0.88% at June 30, 2012. Management considers many factors when evaluating the balance in the loan loss allowance. Beginning with historical charge-offs, adjustments are made to assess trends in portfolio volume, maturity and composition, trends in delinquencies and the national and local economic condition. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. In particular, at June 30, 2013, management considered the growth and composition of the loan portfolio and the continued volatility in the financial markets as key factors. Management believes that its loans classified as non-accrual are significantly collateralized, pose minimal risk of loss to the Bank and the allowance for loan losses is sufficient to absorb such losses. However, management continues to monitor the loan portfolio and additional reserves will be taken if necessary.

See Note 6 to interim consolidated financial statements and "Loans and Foreclosed Real Estate" included in this Management's Discussion and Analysis for additional information pertaining to the allowance for loan losses.

### OTHER INCOME

Other income is comprised of customer service fees, increases in the cash surrender value of life insurance policies and miscellaneous income. Total other income was \$816,000 for the six months ended June 30, 2013 compared to \$831,000 for the same period in 2012. Customer service fees decreased by \$12,000 over the two periods, primarily the result of a decreased volume of fee-based customer transactions along with ATM interchange income from lower transaction volume. This was partially offset by an increase of \$5,000 life insurance income.

### OPERATING EXPENSES

Total operating expenses were \$8.6 million, or an annualized 1.42% of average total assets, for the six months ended June 30, 2013 as compared to \$8.1 million, or 1.44%, for the same period of 2012. Operating expenses include salaries and employee benefits, data processing, occupancy and equipment, deposit insurance, foreclosure, marketing and other general and administrative expenses.

Salaries and employee benefits expenses rose 10% primarily due to the staffing of the new branch on Nantucket which is scheduled to open later in the summer of 2013 combined with staff additions at our

administration offices, annual merit-based salary increases and rising medical insurance costs.

Data processing expenses increased by 8% primarily due to increased data processing charges associated with growth in the number of loan and deposit accounts along with the implementation of several new deposit products.

Occupancy and equipment expenditures increased by \$93,000, or 11%, due to increases in real estate taxes, depreciation and costs associated renovations to the main office branch and increased utility costs. During 2013, the Bank was fully assessed for the addition and renovations to the Bank's administration building.

Deposit insurance expense increased \$46,000, or 16%, from \$289,000 for the first six months of 2012 to \$335,000 in the first six months of 2013. The increase in expense due to an increase in insured balances.

Foreclosure related expenses decreased by \$45,000 to \$199,000 for the first six months of 2013. The decrease is primarily related to reduced costs associated with managing foreclosed property due to fewer properties being held during 2013. At June 30, 2013, the Bank held two properties with a carrying value of \$471,000. This compares to the same two properties totaling \$471,000 at December 31, 2012 and five properties totaling \$3.2 million at June 30, 2012. During the first six months of 2013, the Bank did not add or sell any properties. During the first half of 2012, the Bank added 3 properties and sold five properties. Three properties were written down by \$60,000 to reflect the anticipated proceeds from the sales of the properties. This was partially offset by net cash gains of \$47,000 on the sale of the five properties. Also included in this category are expenses associated with the foreclosure process which include legal expenses, appraisal expenses, insurance expenses and other related foreclosure expenses.

Marketing expenses decreased by \$141,000 to \$208,000 for the first half of 2013. The decrease was due to the Bank shifting a portion of its print advertising to more direct marketing. In comparison, during the same period in 2012, the Bank had higher marketing expense due to the rollout of its new internet banking product and the new branch on Charles Street in Boston.

Other expenses, which include director fees, supplies, deposit related losses and audit-related expenses, among others, decreased \$14,000, or 1%, when comparing the two periods primarily due to lower corporate legal fees partially offset by general increases in operating expenses.

### INCOME TAXES

The Bank recognizes income taxes under the asset and liability method in which deferred tax assets and liabilities are established for the temporary difference between the accounting basis and the tax basis of the Bank's assets and liabilities at enacted tax rates expected to be in effect when the amounts related to such temporary differences are realized or settled. The Bank's deferred tax asset is reviewed quarterly and adjustments to such asset are recognized as deferred income tax expense or benefit based on management's judgment relating to the realizability of such asset. For the quarter ended June 30, 2013 the only adjustment to the deferred tax asset represents the change in the tax impact of the unrealized gain on securities held as available-for-sale.

During the first six months of 2013, the Bank recorded \$4.5 million, or 40.9% of pre-tax income, in tax expense as compared to \$4.5 million, or 40.6%, for the same period in 2012, a decrease of \$44,000. The decrease in expense is attributable to the lower pre-tax earnings. Changes in the Bank's tax rate are due primarily to changes in the yields earned on assets subject to preferential tax treatment.

## **BALANCE SHEET ANALYSIS - COMPARISON AT JUNE 30, 2013 TO DECEMBER 31, 2012**

Assets totaled \$1,256 million at June 30, 2013, as compared to \$1,206 million at December 31, 2012, an increase of \$49.8 million.

### **SECURITIES, SHORT-TERM INVESTMENTS, CERTIFICATES OF DEPOSITS AND FHLB STOCK**

Securities were \$103.6 million at June 30, 2013, an increase of \$714,000 when compared to the \$102.9 million at December 31, 2012. During the first six months of 2013, there were \$20.6 million in securities purchased offset by \$19.1 million in maturities, calls and principal paydowns. Net proceeds from securities transactions were reinvested in new securities.

During 2012 and continuing through June 30, 2013, the Bank continues to see strong deposit growth. These funds along with additional Federal Home Loan Bank advances have been used to fund loan growth.

At June 30, 2013 and December 31, 2012, the Bank's entire securities portfolio was classified as available for sale and reflected on the balance sheet at fair value with unrealized gains and losses, net of tax effect, excluded from earnings and reported in accumulated other comprehensive income. The net unrealized gain on securities available for sale, net of tax, was \$9,000 at June 30, 2013. This compares to \$224,000, net of tax, at December 31, 2012 and \$190,000, net of tax, at June 30, 2012. The fair value of securities fluctuates with the movement of interest rates. Generally, during periods of falling interest rates, the fair values increase whereas the opposite may hold true during a rising interest rate environment. During the first six months of 2013, mid- to long-term interest rates began to rise resulting in a decline in market values on the outstanding securities.

The securities portfolio is comprised primarily of bonds issued by the U.S. Treasury and government-sponsored enterprises. At June 30, 2013, approximately 10% is represented by U.S. Treasury issues. Another 85% of the portfolio consisted of fixed-rate agency bond issues. In September 2008, the U.S. government placed FNMA and FHLMC in conservatorship under the Federal Housing Financing Agency ("FHFA"). While equity investors in these two entities were negatively impacted, bond holders have, thus far, been unaffected. Residential mortgage-backed issues, which are guaranteed by FNMA and FHLMC, comprised less than 1% of the portfolio. Repayment of these issues is anticipated from payments made on the underlying mortgages. The majority of the bond and mortgage-backed holdings are short-term in nature with nearly the entire portfolio maturing in three years or less.

At June 30, 2013, the Bank held \$5.0 million, or 5% of the portfolio, in the CRA Fund, an equity security which invests in local community-related projects.

The Bank held an investment of \$13.1 million in FDIC-insured certificates of deposit issued by other financial institutions at June 30, 2013. Generally, the Bank invests in such certificates due to the increase in yield over comparably-termed bonds issued by government-sponsored enterprises at time of purchase.

As a member of the Federal Home Loan Bank of Boston ("FHLBB"), the Bank is required to hold a Membership Stock Investment plus an Activity-based Stock Investment in the FHLBB, which is based primarily on the amount of FHLBB borrowings. The Bank received dividends totaling \$27,000 for the six months ended June 30, 2013 compared to \$34,000 for the same period in 2012. At June 30, 2013 the Bank held \$14.0 million in FHLBB stock compared to \$14.1 million at December 31, 2012 and \$13.4 million at June 30, 2012.

### **LOANS AND FORECLOSED REAL ESTATE**

During the first six months of 2013, net loans outstanding increased by \$41.2 million to \$990.8 million, from \$949.7 million at December 31, 2012, attributable primarily to originated loans of \$161.9 million offset by payoffs and amortization. Comparably, loan originations for the same period in 2012 were \$154.9 million. On June 30, 2013 and December 31, 2012, net loans outstanding represented 79% of assets. Mortgage loans continue to account for more than 99% of the loan portfolio.

Loans are carried net of the allowance for loan losses. The allowance is maintained at a level to absorb estimated losses within the loan portfolio. At June 30, 2013, the allowance had a balance of \$8.3 million as compared to \$8.0 million at December 31, 2012. At June 30, 2013, the Bank allocated \$344,000 to loans

classified as impaired. At December 31, 2012, \$389,000 was allocated to impaired loans.

The Bank works closely with delinquent mortgagors to bring their loans current and foreclosure proceedings commence if the mortgagor is unable to satisfy their outstanding obligation. In 2008, the Commonwealth of Massachusetts enacted a law which grants a mortgagor a 90-day right to cure a default on residential real property mortgages. In 2010, this was increased to 150 days to cure a default. Land court filings, which are part of the foreclosure process in Massachusetts, experienced a 90-day backlog due to the volume of foreclosure filings in the state. This resulted in a delay in the Bank's collection process. These delays have been experienced over the last several years and are expected to continue until foreclosure trends decline.

At June 30, 2013, there were 13 loans classified as non-accrual totaling \$4.4 million as compared to 10 non-accrual loans totaling \$2.9 million at December 31, 2012. At June 30, 2013 and December 31, 2012, the Bank held \$471,000 in foreclosed assets consisting of 2 residential properties. At June 30, 2013, non-performing assets were 0.38% of total assets as compared to 0.28% at December 31, 2012. Management believes that its loans classified as non-accrual are significantly collateralized, pose minimal risk of loss to the Bank, and the allowance for loan losses is sufficient to absorb such losses, if any. However, management continues to monitor the loan portfolio and additional reserves will be taken if necessary.

### Non-Performing Assets

	June 30, 2013	December 31, 2012
	(Dollars in Thousands)	
Non-accrual loans:		
Residential mortgages	\$ 2,327	\$ 1,471
Commercial mortgages	1,891	1,337
Home equity	136	115
Total non-accrual loans	<u>4,354</u>	<u>2,923</u>
Foreclosed real estate	<u>471</u>	<u>471</u>
Total non-performing assets	<u>\$ 4,825</u>	<u>\$ 3,394</u>
Percent of non-accrual loans to:		
Total loans	0.44 %	0.31 %
Total assets	0.35 %	0.24 %
Percent of non-performing assets to:		
Total loans and foreclosed real estate	0.48 %	0.35 %
Total assets	0.38 %	0.28 %
Allowance for loan losses to total loans	0.83 %	0.84 %

### DEPOSITS

Deposits increased by \$21.9 million to \$891.8 million at June 30, 2013 from \$869.9 million at December 31, 2012. Core deposits, which include regular, money market, NOW and demand deposits, increased \$34.7 million over the December 31, 2012 balance. Certificate accounts were \$365.1 million, or 41% of total deposits, at June 30, 2013, as compared to \$377.9 million, or 43% of total deposits, at December 31, 2012.

Beginning in late 2008, national and international financial markets became increasingly volatile. The New York Stock Exchange ("NYSE") reported large declines in the trading prices of equity securities and several financial services companies were in severe distress. Combined, these events concerned consumers and small business owners, a number of whom ultimately transferred their funds from affected markets into premium money market and certificate of deposit accounts at the Bank. The Bank offers FDIC insurance, which generally provides protection for up to \$250,000 in separately insured deposit accounts, and Deposit Insurance Fund of Massachusetts ("DIF") insurance for all deposits in excess of this amount. Although the national and international markets have stabilized, the Bank continues to experience growth in deposits.

Deposit growth over the first six months of 2013 was used to fund growth in the loan portfolio and has allowed the Bank to fund a large portion of balance sheet growth.

	Deposit Balances by Type			
	June 30, 2013	% of Total	December 31, 2012	% of Total
	(Dollars in Thousands)			
Non-certificate accounts				
Regular	\$ 75,951	8.5 %	\$ 71,316	8.2 %
Money market deposits	330,600	37.1	310,715	35.7
NOW	29,928	3.4	30,905	3.6
Demand	90,179	10.1	79,005	9.1
Total non-certificate accounts	<u>526,658</u>	<u>59.1</u>	<u>491,941</u>	<u>56.6</u>
Term certificates less than \$100,000	160,811	18.0	168,287	19.3
Term certificates \$100,000 or more	204,303	22.9	209,658	24.1
Total certificate accounts	<u>365,114</u>	<u>40.9</u>	<u>377,945</u>	<u>43.4</u>
Total deposits	<u>\$ 891,772</u>	<u>100.0 %</u>	<u>\$ 869,886</u>	<u>100.0 %</u>

## BORROWINGS

FHLBB advances were \$257.8 million or 21% of total assets at June 30, 2013 as compared to \$234.4 million or 19% of total assets at December 31, 2012. These advances are predominately fixed rate in nature with 57% scheduled to mature in the next twelve months. During the first six months of 2013, total borrowings increased by \$23.4 million and has been used to fund loan production.

## LIQUIDITY AND CAPITAL RESOURCES

The Bank continually assesses its liquidity position by forecasting incoming and outgoing cash flows. In some cases, contractual maturity dates are used to anticipate cash flows. However, when an asset or liability is subject to early repayment or redemption at the discretion of the issuer or customer, cash flows can be difficult to predict. Generally, these prepayment rights are exercised when it is most financially favorable to the issuer or customer.

The majority of the Bank's investment portfolio was fixed with respect to rate and maturity date. The remaining securities can be called at the discretion of the issuer. Mortgage-backed securities, which comprised less than 1% of the portfolio, are subject to repayment at the discretion of the underlying borrower.

Residential loans are susceptible to principal repayment at the discretion of the borrower. Commercial mortgages, while subject to significant penalties for early repayment in most cases, can also prepay at the borrower's discretion.

Core deposit balances can generally be withdrawn from the Bank at any time. Certificates of deposit, with predefined maturity dates and subject to early redemption penalties, can also be withdrawn. The Bank estimates the volatility of its deposits in light of the general economic climate and recent actual experience.

Approximately 89% of the Bank's borrowings were fixed in term of rate and maturity. Approximately 11% or \$29.0 million can be called for earlier repayment at the discretion of the issuer. It is considered unlikely that these borrowings will be called by the issuer in the near term.

The Bank also monitors its off-balance sheet items. See "Commitments" appearing in Note 2 within the "Notes to Unaudited Consolidated Financial Statements" section of this document. At June 30, 2013, the Bank had \$134.8 million in commitments to extend credit as compared to \$125.8 million at December 31, 2012.

The Bank considers the above information when measuring its liquidity position. Specific measurements include the Bank's cash flow position at the 30 day, 60 day and 90 day horizon, the level of volatile liabilities

on earning assets and loan to deposit ratios. These estimates anticipate the possibility of deposit outflows. At June 30, 2013, each measurement was within pre-defined Bank guidelines.

To supplement its liquidity position, should the need arise, the Bank maintains its membership in the Federal Home Loan Bank of Boston where it is eligible to obtain both short and long-term credit advances. The Bank can borrow up to \$376.7 million to meet its borrowing needs, based on the Bank's available qualified collateral which consists primarily of 1-4 family residential mortgages, five or more family residential mortgages, the majority of the Bank's investment in securities issued by government-sponsored enterprises and certain commercial mortgages. The Bank can pledge other mortgages and assets as collateral to secure as much as \$206.7 million in additional borrowings. At June 30, 2013, the Bank had \$257.8 million in advances outstanding.

At June 30, 2013, the Bank had capital of \$98.0 million, or 7.81% of total assets, as compared to \$92.8 million, or 7.70%, at December 31, 2012. During the six months ended June 30, 2013, stockholders' equity increased by \$5.2 million due primarily to net income for the period of \$6.5 million, partially offset by the declaration of dividends of \$0.52 per share, which reduced capital by \$1.1 million.

Total capital is adjusted by the unrealized gains or losses in the Bank's available-for-sale securities portfolio and, as such, it is subject to fluctuations resulting from changes in the market values of its securities. At June 30, 2013, the Bank's entire securities portfolio was classified as available for sale which had the effect of decreasing capital over the six-month period by \$215,000.

Massachusetts-chartered savings banks that are insured by the FDIC are subject to minimum capital maintenance requirements. Regulatory guidelines define the minimum amount of qualifying capital an institution must maintain as a percentage of risk-weighted assets and average total assets.

The following table details the Bank's actual capital ratios and minimum regulatory ratios.

	<u>Actual Regulatory Capital Ratios</u>		Minimum Capital Requirement Ratios	Minimum To Be Well Capitalized Under Prompt Corrective Action Provision Ratios
	<u>June 30, 2013</u>	<u>December 31, 2012</u>		
	(Dollars in Thousands)			
Tier 1 Capital as a Percent of Risk-Weighted Assets	12.91 %	12.68 %	4.0 %	6.0 %
Total Capital as a Percentage of Risk-Weighted Assets	14.01 %	13.79 %	8.0 %	10.0 %
Tier 1 Capital to Average Assets	8.03 %	7.65 %	4.0 %	5.0 %
Total Risk-Weighted Assets	\$ 758,960	\$ 730,106		

At June 30, 2013 and December 31, 2012, the Bank exceeded all of the minimum regulatory capital ratio requirements.

In July 2013, the federal banking agencies approved a final rule to set minimum requirements for both the quantity and quality of capital held by banking organizations. Consistent with the international Basel framework, the rule includes a new minimum ratio of common equity tier 1 capital to risk-weighted assets of 4.5 percent and a common equity tier 1 capital conservation buffer of 2.5 percent of risk-weighted assets that will apply to all supervised financial institutions. The rule also raises the minimum ratio of tier 1 capital to risk-weighted assets from 4 percent to 6 percent and includes a minimum leverage ratio of 4 percent for all banking organizations. The rules will be phased in beginning in January 2015. The Bank is currently evaluating the new rules but believes that it will continue to exceed all the minimum capital ratio requirements.



### **ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK**

The earnings of most banking institutions are exposed to interest rate risk because their balance sheets, both assets and liabilities, are predominantly interest bearing. It is the Bank's objective to minimize, to the degree prudently possible, its exposure to interest rate risk, and bearing in mind that the Bank, by its very nature, will always be in the business of taking on interest rate risk. Interest rate risk is monitored on a quarterly basis by the Asset Liability Committee of the Bank. The primary tool used by the Bank in managing interest rate risk is income simulation modeling. Income simulation modeling measures changes in net interest income by projecting the future composition of the Bank's balance sheet and applying different interest rate scenarios. Management incorporates numerous assumptions into the simulation model, such as prepayment speeds, interest rate environments, balance sheet growth and deposit elasticity. To a significantly lesser degree, the Bank also utilizes "GAP" analysis which involves comparing the difference between interest-rate sensitive assets and liabilities that mature or reprice during a given period of time. Management believes that there has been no material changes in the interest rate risk reported in the Bank's Annual Report on Form 10-K for the fiscal year ended December 31, 2012, filed with the Federal Deposit Insurance Corporation. The information is contained in the Form 10-K within the Market Risk and Asset Liability Management section of Management's Discussion and Analysis of Results of Operations and Financial Condition.

### **ITEM 4 – CONTROLS AND PROCEDURES**

#### **(a) (a) Disclosure Controls and Procedures**

An evaluation was carried out under the supervision and with the participation of the Bank's management, including the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), of the effectiveness, as of June 30, 2013, of the Bank's disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Securities and Exchange Act of 1934, as amended. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of the Bank's disclosure controls and procedures as of June 30, 2013, the CEO and CFO concluded that, as of such date, the Bank's disclosure controls and procedures were effective at the reasonable assurance level.

#### **(b) Changes in Internal Control**

There were no significant changes in the Bank's internal control over financial reporting, as defined in Rules 13a-15(e) and 15d-15(e), during the fiscal quarter ended June 30, 2013 that have materially affected, or are reasonably likely to materially affect, the Bank's internal control over financial reporting.

## **PART II - OTHER INFORMATION**

### **ITEM 1 - LEGAL PROCEEDINGS**

None.

### **ITEM 1A – RISK FACTORS**

There have been no material changes to the risk factors previously disclosed in the Bank's most recently filed Form 10K.

### **ITEM 2 – UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None.

### **ITEM 3 - DEFAULTS UPON SENIOR SECURITIES**

None.

### **ITEM 4 – MINE SAFETY DISCLOSURES**

Not applicable.

### **ITEM 5 - OTHER INFORMATION**

None.

### **ITEM 6 – EXHIBITS**

#### Exhibit No.

31.1	Certifications – Chief Executive Officer
31.2	Certifications – Chief Financial Officer
32.1	Certification Pursuant to 18 U.S.C. §1350 – Chief Executive Officer
32.2	Certification Pursuant to 18 U.S.C. §1350 – Chief Financial Officer

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

HINGHAM INSTITUTION FOR SAVINGS

Date: August 2, 2013

/s/  
Robert H. Gaughen, Jr.  
President & Chief Executive Officer

Date: August 2, 2013

/s/  
Robert A. Bogart  
Vice President & Treasurer







CERTIFICATION PURSUANT TO  
18 U.S.C. §1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of Hingham Institution for Savings (the “Bank”) for the fiscal quarter ended June 30, 2013, as filed with the Federal Deposit Insurance Corporation on the date hereof (the “Report”), the undersigned Robert A. Bogart, Chief Financial Officer of the Bank, hereby certifies pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly represents, in all material respects, the financial condition and results of operations of the Bank.

\_\_\_\_\_/s/\_\_\_\_\_  
Robert A. Bogart  
Vice President and Treasurer  
Chief Financial Officer

Date: August 2, 2013