First Bancorp, Inc /ME/
Form 10-Q
November 08, 2013

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

[X] Quarterly Report Pursuant to Section 13 or 15(d) of The Securities Exchange Act of 1934
For the quarterly period ended September 30, 2013

Commission File Number 0-26589

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

MAINE (State or other jurisdiction of incorporation or organization)	01-0404322 (I.R.S. Employer Identification No.)
MAIN STREET, DAMARISCOTTA, MAINE (Address of principal executive offices)	04543 (Zip code)

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

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

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

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

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

Indicate the number of shares outstanding of each of the registrant's classes of common stock as of November 1, 2013
Common Stock: 10,668,891 shares

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Part I. Financial Information

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

Dollars in thousands, except for per share amounts	As of and for the nine months ended September 30, 2013	2012	As of and for the quarters ended September 30, 2013	2012
Summary of Operations				
Interest Income	$37,169	$39,131	$12,655	$12,892
Interest Expense	9,390	9,737	3,150	3,222
Net Interest Income	27,779	29,394	9,505	9,670
Provision for Loan Losses	3,500	6,300	800	1,400
Non-Interest Income	9,488	8,556	2,621	2,492
Non-Interest Expense	21,818	19,503	7,006	6,595
Net Income	9,463	9,459	3,365	3,223
Per Common Share Data				
Basic Earnings per Share	$0.87	$0.91	$0.31	$0.31
Diluted Earnings per Share	0.87	0.91	0.31	0.31
Cash Dividends Declared	0.585	0.585	0.195	0.195
Book Value per Common Share	13.75	14.64	13.75	14.64
Tangible Book Value per Common Share[2]	10.88	11.83	10.88	11.83
Market Value	16.65	17.55	16.65	17.55
Financial Ratios				
Return on Average Equity[1]	8.51 %	8.86 %	9.19 %	8.90 %
Return on Average Tangible Common Equity[1,2]	10.29 %	10.36 %	11.51 %	10.39 %
Return on Average Assets[1]	0.88 %	0.89 %	0.92 %	0.90 %
Average Equity to Average Assets	10.77 %	10.90 %	9.99 %	11.02 %
Average Tangible Equity to Average Assets[2]	8.63 %	8.95 %	7.88 %	9.07 %
Net Interest Margin Tax-Equivalent[1,2]	3.04 %	3.16 %	3.04 %	3.12 %
Dividend Payout Ratio	67.24 %	64.29 %	62.90 %	62.90 %
Allowance for Loan Losses/Total Loans	1.45 %	1.69 %	1.45 %	1.69 %
Non-Performing Loans to Total Loans	2.08 %	2.71 %	2.08 %	2.71 %
Non-Performing Assets to Total Assets	1.48 %	2.04 %	1.48 %	2.04 %
Efficiency Ratio[2]	56.00 %	50.74 %	53.51 %	50.73 %
At Period End				
Total Assets	$1,464,749	$1,423,316	$1,464,749	$1,423,316
Total Loans	862,073	869,871	862,073	869,871
Total Investment Securities	504,063	468,604	504,063	468,604
Total Deposits	1,037,466	944,547	1,037,466	944,547
Total Shareholders' Equity	146,653	156,637	146,653	156,637

[1]Annualized using a 365-day basis in 2013 and 366-day basis in 2012

[2]These ratios use non-GAAP financial measures. See Management's Discussion and Analysis of Financial Condition and Results of Operations for additional disclosures and information.

Item 1 – Financial Statements

Report of Independent Registered Public Accounting Firm

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

We have reviewed the accompanying interim consolidated financial information of The First Bancorp, Inc. and Subsidiary as of September 30, 2013 and 2012 and for the three-month and nine-month periods then ended. These financial statements are the responsibility of the Company's management.
We conducted our reviews in accordance with standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit in accordance with standards of the Public Company Accounting Oversight Board (United States), the objective of which is to express an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.
Based on our reviews, we are not aware of any material modifications that should be made to the accompanying interim consolidated financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

/s/ Berry Dunn McNeil & Parker, LLC

Portland, Maine
November 8, 2013

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

	September 30, 2013	December 31, 2012	September 30, 2012
Assets			
Cash and cash equivalents	$20,117,000	$14,958,000	$14,904,000
Interest bearing deposits in other banks	787,000	1,638,000	681,000
Securities available for sale	317,900,000	291,614,000	299,900,000
Securities to be held to maturity (fair value of $166,269,000 at September 30, 2013, $150,247,000 at December 31, 2012 and $162,382,000 at September 30, 2012)	172,251,000	143,320,000	154,256,000
Restricted equity securities, at cost	13,912,000	14,448,000	14,448,000
Loans held for sale	1,555,000	1,035,000	—
Loans	862,073,000	869,284,000	869,871,000
Less allowance for loan losses	12,457,000	12,500,000	14,739,000
Net loans	849,616,000	856,784,000	855,132,000
Accrued interest receivable	5,353,000	4,912,000	5,425,000
Premises and equipment, net	23,667,000	22,988,000	18,376,000
Other real estate owned	3,760,000	7,593,000	5,471,000
Goodwill	29,805,000	29,805,000	27,684,000
Other assets	26,026,000	25,904,000	27,039,000
Total assets	$1,464,749,000	$1,414,999,000	$1,423,316,000
Liabilities			
Demand deposits	$110,007,000	$90,252,000	$89,500,000
NOW deposits	151,126,000	147,309,000	136,472,000
Money market deposits	96,313,000	80,983,000	74,805,000
Savings deposits	147,560,000	135,250,000	130,354,000
Certificates of deposit	532,460,000	505,056,000	513,416,000
Total deposits	1,037,466,000	958,850,000	944,547,000
Borrowed funds – short term	131,627,000	142,750,000	164,592,000
Borrowed funds – long term	135,150,000	140,155,000	140,157,000
Other liabilities	13,853,000	16,921,000	17,383,000
Total liabilities	1,318,096,000	1,258,676,000	1,266,679,000
Shareholders' equity			
Preferred stock, $1,000 preference value per share	—	12,402,000	12,377,000
Common stock, one cent par value per share	106,000	98,000	98,000
Additional paid-in capital	58,241,000	46,314,000	46,205,000
Retained earnings	92,633,000	89,692,000	88,541,000
Accumulated other comprehensive income (loss)			
Net unrealized gain (loss) on securities available for sale	(4,212,000)	7,940,000	9,488,000
Net unrealized loss on postretirement benefit costs	(115,000)	(123,000)	(72,000)
Total shareholders' equity	146,653,000	156,323,000	156,637,000
Total liabilities & shareholders' equity	$1,464,749,000	$1,414,999,000	$1,423,316,000
Common Stock			
Number of shares authorized	18,000,000	18,000,000	18,000,000
Number of shares issued and outstanding	10,665,378	9,859,914	9,853,396
Book value per common share	$13.75	$14.60	$14.64
Tangible book value per common share	$10.88	$11.47	$11.83

See Report of Independent Registered Public Accounting Firm.

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

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

	For the nine months ended September 30,		For the quarters ended September 30,	
	2013	2012	2013	2012
Interest income				
Interest and fees on loans	$26,240,000	$28,006,000	$8,710,000	$9,247,000
Interest on deposits with other banks	6,000	3,000	2,000	2,000
Interest and dividends on investments	10,923,000	11,122,000	3,943,000	3,643,000
Total interest income	37,169,000	39,131,000	12,655,000	12,892,000
Interest expense				
Interest on deposits	6,035,000	6,370,000	2,023,000	2,073,000
Interest on borrowed funds	3,355,000	3,367,000	1,127,000	1,149,000
Total interest expense	9,390,000	9,737,000	3,150,000	3,222,000
Net interest income	27,779,000	29,394,000	9,505,000	9,670,000
Provision for loan losses	3,500,000	6,300,000	800,000	1,400,000
Net interest income after provision for loan losses	24,279,000	23,094,000	8,705,000	8,270,000
Non-interest income				
Investment management and fiduciary income	1,438,000	1,230,000	470,000	386,000
Service charges on deposit accounts	2,099,000	1,995,000	676,000	644,000
Net securities gains	1,087,000	1,967,000	—	—
Mortgage origination and servicing income, net of amortization	1,735,000	854,000	348,000	550,000
Other operating income	3,129,000	2,510,000	1,127,000	912,000
Total non-interest income	9,488,000	8,556,000	2,621,000	2,492,000
Non-interest expense				
Salaries and employee benefits	10,607,000	9,485,000	3,613,000	3,283,000
Occupancy expense	1,557,000	1,247,000	488,000	428,000
Furniture and equipment expense	1,992,000	1,650,000	682,000	527,000
FDIC insurance premiums	864,000	909,000	280,000	303,000
Amortization of identified intangibles	245,000	212,000	82,000	71,000
Other operating expense	6,553,000	6,000,000	1,861,000	1,983,000
Total non-interest expense	21,818,000	19,503,000	7,006,000	6,595,000
Income before income taxes	11,949,000	12,147,000	4,320,000	4,167,000
Income tax expense	2,486,000	2,688,000	955,000	944,000
NET INCOME	$9,463,000	$9,459,000	$3,365,000	$3,223,000
Basic earnings per common share	$0.87	$0.91	$0.31	$0.31
Diluted earnings per common share	$0.87	$0.91	$0.31	$0.31
Other comprehensive income (loss), net of tax				
Net unrealized gain (loss) on securities available for sale	(12,152,000)	2,087,000	(779,000)	1,962,000
Amortization of unrecognized postretirement benefits	8,000	15,000	—	5,000
Other comprehensive income (loss)	(12,144,000)	2,102,000	(779,000)	1,967,000
Comprehensive income (loss)	$(2,681,000)	$11,561,000	$2,586,000	$5,190,000

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

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

	Preferred stock	Common stock and additional paid-in capital		Retained earnings	Accumulated other comprehensive income (loss)	Total shareholders' equity
		Shares	Amount			
Balance at December 31, 2011	$12,303,000	9,812,180	$45,927,000	$85,314,000	$7,314,000	$150,858,000
Net income	—	—	—	9,459,000	—	9,459,000
Net unrealized gain on securities available for sale, net of tax	—	—	—	—	2,087,000	2,087,000
Amortization of unrecognized postretirement benefits, net of tax	—	—	—	—	15,000	15,000
Comprehensive income	—	—	—	9,459,000	2,102,000	11,561,000
Cash dividends declared on preferred stock	—	—	—	(469,000)	—	(469,000)
Cash dividends declared on common stock ($0.585 per share)	—	—	—	(5,763,000)	—	(5,763,000)
Equity compensation expense	—	—	57,000	—	—	57,000
Amortization of premium for preferred stock issuance	74,000	—	(74,000)	—	—	—
Proceeds from sale of common stock	—	41,216	393,000	—	—	393,000
Balance at September 30, 2012	$12,377,000	9,853,396	$46,303,000	$88,541,000	$9,416,000	$156,637,000
Balance at December 31, 2012	$12,402,000	9,859,914	$46,412,000	$89,692,000	$7,817,000	$156,323,000
Net income	—	—	—	9,463,000	—	9,463,000
Net unrealized loss on securities available for sale, net of tax	—	—	—	—	(12,152,000)	(12,152,000)
Amortization of unrecognized postretirement benefits, net of tax	—	—	—	—	8,000	8,000
Comprehensive loss	—	—	—	9,463,000	(12,144,000)	(2,681,000)
Cash dividends declared on preferred stock	—	—	—	(286,000)	—	(286,000)
Cash dividends declared on common stock ($0.585 per share)	—	—	—	(6,236,000)	—	(6,236,000)
	—	—	161,000	—	—	161,000

Equity compensation expense						
Amortization of premium for preferred stock issuance	98,000	—	(98,000)	—	—	—
Payment to repurchase preferred stock	(12,500,000)	—	—	—	—	(12,500,000)
Proceeds from sale of common stock	—	805,464	11,872,000	—	—	11,872,000
Balance at September 30, 2013	$—	10,665,378	$58,347,000	$92,633,000	$(4,327,000)	$146,653,000

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

Consolidated Statements of Cash Flows (Unaudited)

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The First Bancorp, Inc. and Subsidiary

	For the nine months ended September 30, 2013	September 30, 2012
Cash flows from operating activities		
Net income	$9,463,000	$9,459,000
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	1,282,000	992,000
Change in deferred taxes	176,000	(929,000)
Provision for loan losses	3,500,000	6,300,000
Loans originated for resale	(48,833,000)	(29,138,000)
Proceeds from sales and transfers of loans	49,389,000	29,889,000
Net gain on sales of loans	(1,076,000)	(751,000)
Net gain on sale or call of securities	(1,087,000)	(1,967,000)
Net amortization of premiums on investments	1,566,000	2,125,000
Net loss on sale of other real estate owned	11,000	29,000
Provision for losses on other real estate owned	390,000	291,000
Equity compensation expense	161,000	57,000
Net (increase) decrease in other assets and accrued interest	3,260,000	(483,000)
Net increase (decrease) in other liabilities	(1,150,000)	1,478,000
Net (gain) loss on disposal of premises and equipment	4,000	(30,000)
Amortization of investment in limited partnership	390,000	357,000
Net acquisition amortization	245,000	212,000
Net cash provided by operating activities	17,691,000	17,891,000
Cash flows from investing activities		
(Increase) decrease in interest-bearing deposits in other banks	851,000	(681,000)
Proceeds from sales of securities available for sale	10,563,000	25,437,000
Proceeds from maturities, payments and calls of securities available for sale	47,223,000	43,997,000
Proceeds from maturities, payments and calls of securities to be held to maturity	33,857,000	42,497,000
Proceeds from sales of other real estate owned	5,074,000	2,077,000
Purchases of securities available for sale	(103,307,000)	(79,941,000)
Purchases of securities to be held to maturity	(62,728,000)	(74,230,000)
Redemption of restricted equity securities	536,000	995,000
Net (increase) decrease in loans	2,026,000	(13,218,000)
Capital expenditures	(1,965,000)	(554,000)
Proceeds from sale of equipment	—	58,000
Net cash used in investing activities	(67,870,000)	(53,563,000)
Cash flows from financing activities		
Net increase in demand, savings, and money market accounts	51,212,000	38,974,000
Net increase (decrease) in certificates of deposit	27,404,000	(35,760,000)
Net increase in short-term borrowings	—	39,086,000
Repayments of long-term borrowings	(16,128,000)	—
Repurchase of preferred stock	(12,500,000)	—
Proceeds from sale of common stock	11,872,000	393,000
Dividends paid	(6,522,000)	(6,232,000)
Net cash provided by financing activities	55,338,000	36,461,000
Net increase in cash and cash equivalents	5,159,000	789,000

Cash and cash equivalents at beginning of period	14,958,000	14,115,000
Cash and cash equivalents at end of period	$20,117,000	$14,904,000
Interest paid	$9,530,000	$9,853,000
Income taxes paid	1,310,000	2,060,000
Non-cash transactions		
Net transfer from loans to other real estate owned	$1,642,000	$3,774,000

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

Note 1 – Basis of Presentation
The First Bancorp, Inc. ("the Company") is a financial holding company that owns all of the common stock of The First, N.A. ("the Bank"). The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of Management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. All significant intercompany transactions and balances are eliminated in consolidation. The income reported for the 2013 period is not necessarily indicative of the results that may be expected for the year ending December 31, 2013. For further information, refer to the consolidated financial statements and notes included in the Company's annual report on Form 10-K for the year ended December 31, 2012.
Subsequent Events
Events occurring subsequent to September 30, 2013, have been evaluated as to their potential impact to the financial statements.

Note 2 – Investment Securities
The following table summarizes the amortized cost and estimated fair value of investment securities at September 30, 2013:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value (Estimated)
Securities available for sale				
Mortgage-backed securities	$187,789,000	$2,117,000	$(1,650,000)	$188,256,000
State and political subdivisions	134,978,000	1,703,000	(8,710,000)	127,971,000
Other equity securities	1,614,000	62,000	(3,000)	1,673,000
	$324,381,000	$3,882,000	$(10,363,000)	$317,900,000
Securities to be held to maturity				
U.S. Government-sponsored agencies	$92,226,000	$11,000	$(8,684,000)	$83,553,000
Mortgage-backed securities	37,915,000	1,701,000	(997,000)	38,619,000
State and political subdivisions	41,810,000	2,067,000	(80,000)	43,797,000
Corporate securities	300,000	—	—	300,000
	$172,251,000	$3,779,000	$(9,761,000)	$166,269,000
Restricted equity securities				
Federal Home Loan Bank Stock	$12,875,000	$—	$—	$12,875,000
Federal Reserve Bank Stock	1,037,000	—	—	1,037,000
	$13,912,000	$—	$—	$13,912,000

The following table summarizes the amortized cost and estimated fair value of investment securities at December 31, 2012:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value (Estimated)
Securities available for sale				
Mortgage-backed securities	$164,752,000	$4,636,000	$(295,000)	$169,093,000
State and political subdivisions	113,069,000	8,074,000	(199,000)	120,944,000
Other equity securities	1,578,000	43,000	(44,000)	1,577,000
	$279,399,000	$12,753,000	$(538,000)	$291,614,000
Securities to be held to maturity				
U.S. Government-sponsored agencies	$60,919,000	$242,000	$(182,000)	$60,979,000
Mortgage-backed securities	39,193,000	2,850,000	(19,000)	42,024,000
State and political subdivisions	42,908,000	4,036,000	—	46,944,000
Corporate securities	300,000	—	—	300,000
	$143,320,000	$7,128,000	$(201,000)	$150,247,000
Restricted equity securities				
Federal Home Loan Bank Stock	$13,412,000	$—	$—	$13,412,000
Federal Reserve Bank Stock	1,036,000	—	—	1,036,000
	$14,448,000	$—	$—	$14,448,000

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

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

The following table summarizes the contractual maturities of investment securities at September 30, 2013:

	Securities available for sale		Securities to be held to maturity	
	Amortized Cost	Fair Value (Estimated)	Amortized Cost	Fair Value (Estimated)
Due in 1 year or less	$1,755,000	$1,775,000	$717,000	$726,000
Due in 1 to 5 years	14,249,000	14,473,000	6,559,000	6,955,000
Due in 5 to 10 years	18,808,000	19,199,000	33,863,000	34,692,000
Due after 10 years	287,955,000	280,780,000	131,112,000	123,896,000
Equity securities	1,614,000	1,673,000	—	—
	$324,381,000	$317,900,000	$172,251,000	$166,269,000

The following table summarizes the contractual maturities of investment securities at December 31, 2012:

	Securities available for sale		Securities to be held to maturity	
	Amortized Cost	Fair Value (Estimated)	Amortized Cost	Fair Value (Estimated)
Due in 1 year or less	$18,761,000	$18,926,000	$3,754,000	$3,785,000
Due in 1 to 5 years	27,243,000	27,816,000	11,950,000	12,701,000
Due in 5 to 10 years	16,686,000	17,666,000	27,461,000	29,986,000
Due after 10 years	215,131,000	225,629,000	100,155,000	103,775,000
Equity securities	1,578,000	1,577,000	—	—
	$279,399,000	$291,614,000	$143,320,000	$150,247,000

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

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

At September 30, 2013, securities with a fair value of $156,727,000 were pledged to secure public deposits, repurchase agreements, and for other purposes as required by law. This compares to securities with a fair value of $154,817,000 as of December 31, 2012 and $171,004,000 at September 30, 2012, pledged for the same purposes.

Gains and losses on the sale of securities available for sale are computed by subtracting the amortized cost at the time of sale from the security's selling price, net of accrued interest to be received. The following table shows securities gains and losses for the nine months and quarters ended September 30, 2013 and 2012:

	For the nine months ended September 30,		For the quarters ended September 30,	
	2013	2012	2013	2012
Proceeds from sales of securities	$10,563,000	$25,437,000	$—	$300,000
Gross realized gains	1,087,000	2,256,000	—	—
Gross realized losses	—	(289,000)	—	—
Net gain	$1,087,000	$1,967,000	$—	$—
Related income taxes	$380,000	$688,000	$—	$—

Management reviews securities with unrealized losses for other than temporary impairment. As of September 30, 2013, there were 297 securities with unrealized losses held in the Company's portfolio. These securities were temporarily impaired as a result of changes in interest rates reducing their fair value, of which seven had been temporarily impaired for 12 months or more. At the present time, there have been no material changes in the credit quality of these securities resulting in other than temporary impairment, and in Management's opinion, no additional write-down for other-than-temporary impairment is warranted. Information regarding securities temporarily impaired as of September 30, 2013 is summarized below:

	Less than 12 months		12 months or more		Total	
	Fair Value (Estimated)	Unrealized Losses	Fair Value (Estimated)	Unrealized Losses	Fair Value (Estimated)	Unrealized Losses
U.S. Government-sponsored agencies	$82,752,000	$(8,684,000)	$—	$—	$82,752,000	$(8,684,000)
Mortgage-backed securities	84,609,000	(2,514,000)	3,086,000	(133,000)	87,695,000	(2,647,000)
State and political subdivisions	73,244,000	(8,760,000)	334,000	(30,000)	73,578,000	(8,790,000)
Other equity securities	—	—	50,000	(3,000)	50,000	(3,000)
	$240,605,000	$(19,958,000)	$3,470,000	$(166,000)	$244,075,000	$(20,124,000)

As of December 31, 2012, there were 42 securities with unrealized losses held in the Company's portfolio. These securities were temporarily impaired as a result of changes in interest rates reducing their fair value, of which seven had been temporarily impaired for 12 months or more. Information regarding securities temporarily impaired as of December 31, 2012 is summarized below:

	Less than 12 months		12 months or more		Total	
	Fair Value (Estimated)	Unrealized Losses	Fair Value (Estimated)	Unrealized Losses	Fair Value (Estimated)	Unrealized Losses
U.S. Government-sponsored agencies	$15,817,000	$(182,000)	$—	$—	$15,817,000	$(182,000)
Mortgage-backed securities	9,982,000	(231,000)	2,534,000	(83,000)	12,516,000	(314,000)
State and political subdivisions	8,621,000	(199,000)	—	—	8,621,000	(199,000)

Other equity securities	—	—	222,000	(44,000)	222,000	(44,000)
	$34,420,000	$(612,000)	$2,756,000	$(127,000)	$37,176,000	$(739,000)

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As of September 30, 2012, there were 20 securities with unrealized losses held in the Company's portfolio. These securities were temporarily impaired as a result of changes in interest rates reducing their fair value, of which seven had been temporarily impaired for 12 months or more. Information regarding securities temporarily impaired as of September 30, 2012 is summarized below:

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

The Bank is a member of the Federal Home Loan Bank ("FHLB") of Boston, a cooperatively owned wholesale bank for housing and finance in the six New England States. As a requirement of membership in the FHLB, the Bank must own a minimum required amount of FHLB stock, calculated periodically based primarily on its level of borrowings from the FHLB. The Bank uses the FHLB for much of its wholesale funding needs. As of September 30, 2013 and 2012, and December 31, 2012, the Bank's investment in FHLB stock totaled $12,875,000, $13,412,000 and $13,412,000, respectively. FHLB stock is a non-marketable equity security and therefore is reported at cost, which equals par value.

Note 3 – Loans

The following table shows the composition of the Company's loan portfolio as of September 30, 2013 and 2012 and at December 31, 2012:

	September 30, 2013		December 31, 2012		September 30, 2012	
Commercial						
Real estate	$248,889,000	28.9%	$251,335,000	28.9%	$256,531,000	29.5%
Construction	19,409,000	2.3%	22,417,000	2.6%	21,905,000	2.5%
Other	85,130,000	9.9%	81,183,000	9.3%	83,703,000	9.6%
Municipal	18,218,000	2.1%	14,704,000	1.7%	16,448,000	1.9%
Residential						
Term	375,387,000	43.5%	379,447,000	43.7%	369,949,000	42.5%
Construction	7,617,000	0.9%	6,459,000	0.7%	6,528,000	0.8%
Home equity line of credit	92,374,000	10.7%	99,082,000	11.4%	100,099,000	11.5%
Consumer	15,049,000	1.7%	14,657,000	1.7%	14,708,000	1.7%
Total	$862,073,000	100.0%	$869,284,000	100.0%	$869,871,000	100.0%

Loan balances include net deferred loan costs of $2,007,000 as of September 30, 2013, $1,783,000 as of December 31, 2012, and $1,694,000 as of September 30, 2012. Pursuant to collateral agreements, qualifying first mortgage loans, which totaled $260,084,000 at September 30, 2013, $256,378,000 at December 31, 2012, and $244,794,000 at September 30, 2012, were used to collateralize borrowings from the FHLB. In addition, commercial, construction and home equity loans totaling $195,687,000 at September 30, 2013, $220,520,000 at December 31, 2012, and $234,200,000 at September 30, 2012, were used to collateralize a standby line of credit at the Federal Reserve Bank of Boston that is currently unused.

For all loan classes, loans over 30 days past due are considered delinquent. Information on the past-due status of loans by class of financing receivable as of September 30, 2013, is presented in the following table:

	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	All Past Due	Current	Total	90+ Days & Accruing
Commercial							
Real estate	$1,537,000	$—	$2,085,000	$3,622,000	$245,267,000	$248,889,000	$—
Construction	—	—	62,000	62,000	19,347,000	19,409,000	—
Other	3,970,000	291,000	1,783,000	6,044,000	79,086,000	85,130,000	—
Municipal	—	—	—	—	18,218,000	18,218,000	—
Residential							
Term	1,553,000	1,649,000	8,281,000	11,483,000	363,904,000	375,387,000	264,000
Construction	—	—	—	—	7,617,000	7,617,000	—
Home equity line of credit	666,000	—	1,045,000	1,711,000	90,663,000	92,374,000	40,000
Consumer	89,000	12,000	51,000	152,000	14,897,000	15,049,000	51,000
Total	$7,815,000	$1,952,000	$13,307,000	$23,074,000	$838,999,000	$862,073,000	$355,000

Information on the past-due status of loans by class of financing receivable as of December 31, 2012, is presented in the following table:

	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	All Past Due	Current	Total	90+ Days & Accruing
Commercial							
Real estate	$2,172,000	$346,000	$2,380,000	$4,898,000	$246,437,000	$251,335,000	$102,000
Construction	—	29,000	35,000	64,000	22,353,000	22,417,000	—
Other	658,000	218,000	2,306,000	3,182,000	78,001,000	81,183,000	2,000
Municipal	136,000	—	—	136,000	14,568,000	14,704,000	—
Residential							
Term	2,404,000	1,082,000	9,298,000	12,784,000	366,663,000	379,447,000	363,000
Construction	188,000	—	—	188,000	6,271,000	6,459,000	—
Home equity line of credit	430,000	133,000	1,136,000	1,699,000	97,383,000	99,082,000	539,000
Consumer	101,000	70,000	45,000	216,000	14,441,000	14,657,000	45,000
Total	$6,089,000	$1,878,000	$15,200,000	$23,167,000	$846,117,000	$869,284,000	$1,051,000

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

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

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

Cash payments received on non-accrual loans, which are included in impaired loans, are applied to reduce the loan's principal balance until the remaining principal balance is deemed collectible, after which interest is recognized when collected. As a general rule, a loan may be restored to accrual status when payments are current for a substantial period of time, generally six months, and repayment of the remaining contractual amounts is expected or when it otherwise becomes well secured and in the process of collection. Information on nonaccrual loans as of September 30, 2013 and 2012 and at December 31, 2012 is presented in the following table:

	September 30, 2013	December 31, 2012	September 30, 2012
Commercial			
Real estate	$3,996,000	$4,603,000	$5,200,000
Construction	62,000	101,000	3,546,000
Other	2,542,000	3,459,000	3,030,000
Municipal	—	—	—
Residential			
Term	10,279,000	10,333,000	10,745,000
Construction	—	—	23,000
Home equity line of credit	1,033,000	654,000	1,028,000
Consumer	—	—	1,000
Total	$17,912,000	$19,150,000	$23,573,000

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

A breakdown of impaired loans by class of financing receivable as of and for the period ended September 30, 2013, is presented in the following table:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	For the nine months ended September 30, 2013 Average Recorded Investment	For the nine months ended September 30, 2013 Recognized Interest Income	For the quarter ended September 30, 2013 Average Recorded Investment	For the quarter ended September 30, 2013 Recognized Interest Income
With No Related Allowance							
Commercial							
Real estate	$11,848,000	$12,509,000	$—	$10,913,000	$351,000	$11,487,000	$151,000
Construction	62,000	79,000	—	262,000	4,000	364,000	1,000
Other	3,939,000	4,282,000	—	3,793,000	168,000	3,923,000	109,000
Municipal	—	—	—	—	—	—	—
Residential							
Term	15,787,000	17,888,000	—	14,435,000	385,000	15,564,000	137,000
Construction	—	—	—	—	—	—	—
Home equity line of credit	1,638,000	1,854,000	—	1,601,000	24,000	1,644,000	9,000
Consumer	—	—	—	—	—	—	—
	$33,274,000	$36,612,000	$—	$31,004,000	$932,000	$32,982,000	$407,000
With an Allowance Recorded							
Commercial							
Real estate	$5,122,000	$5,644,000	$1,535,000	$6,327,000	$154,000	$5,617,000	$44,000
Construction	1,302,000	1,302,000	269,000	1,965,000	32,000	1,312,000	13,000
Other	987,000	1,097,000	807,000	1,843,000	11,000	1,518,000	—
Municipal	—	—	—	—	—	—	—
Residential							
Term	3,351,000	3,493,000	228,000	5,261,000	105,000	3,884,000	12,000
Construction	—	—	—	—	—	—	—
Home equity line of credit	40,000	40,000	6,000	76,000	1,000	41,000	—
Consumer	—	—	—	—	—	—	—
	$10,802,000	$11,576,000	$2,845,000	$15,472,000	$303,000	$12,372,000	$69,000
Total							
Commercial							
Real estate	$16,970,000	$18,153,000	$1,535,000	$17,240,000	$505,000	$17,104,000	$195,000
Construction	1,364,000	1,381,000	269,000	2,227,000	36,000	1,676,000	14,000
Other	4,926,000	5,379,000	807,000	5,636,000	179,000	5,441,000	109,000
Municipal	—	—	—	—	—	—	—
Residential							
Term	19,138,000	21,381,000	228,000	19,696,000	490,000	19,448,000	149,000
Construction	—	—	—	—	—	—	—
Home equity line of credit	1,678,000	1,894,000	6,000	1,677,000	25,000	1,685,000	9,000
Consumer	—	—	—	—	—	—	—
	$44,076,000	$48,188,000	$2,845,000	$46,476,000	$1,235,000	$45,354,000	$476,000

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

A breakdown of impaired loans by class of financing receivable as of and for the year ended December 31, 2012, is presented in the following table:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Recognized Interest Income
With No Related Allowance					
Commercial					
Real estate	$9,386,000	$9,963,000	$—	$10,102,000	$199,000
Construction	101,000	115,000	—	2,533,000	—
Other	4,737,000	5,345,000	—	2,877,000	53,000
Municipal	—	—	—	—	—
Residential					
Term	12,747,000	14,440,000	—	9,801,000	189,000
Construction	—	—	—	560,000	—
Home equity line of credit	1,311,000	1,440,000	—	961,000	27,000
Consumer	—	—	—	3,000	—
	$28,282,000	$31,303,000	$—	$26,837,000	$468,000
With an Allowance Recorded					
Commercial					
Real estate	$6,388,000	$7,018,000	$1,523,000	$4,614,000	$211,000
Construction	3,253,000	3,253,000	969,000	1,816,000	85,000
Other	1,124,000	1,126,000	652,000	1,974,000	38,000
Municipal	—	—	—	—	—
Residential					
Term	6,697,000	6,842,000	395,000	9,066,000	237,000
Construction	—	—	—	261,000	—
Home equity line of credit	—	—	—	442,000	—
Consumer	—	—	—	9,000	—
	$17,462,000	$18,239,000	$3,539,000	$18,182,000	$571,000
Total					
Commercial					
Real estate	$15,774,000	$16,981,000	$1,523,000	$14,716,000	$410,000
Construction	3,354,000	3,368,000	969,000	4,349,000	85,000
Other	5,861,000	6,471,000	652,000	4,851,000	91,000
Municipal	—	—	—	—	—
Residential					
Term	19,444,000	21,282,000	395,000	18,867,000	426,000
Construction	—	—	—	821,000	—
Home equity line of credit	1,311,000	1,440,000	—	1,403,000	27,000
Consumer	—	—	—	12,000	—
	$45,744,000	$49,542,000	$3,539,000	$45,019,000	$1,039,000

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

	Recorded Investment	Unpaid Principal Balance	Related Allowance	For the nine months ended September 30, 2012 Average Recorded Investment	For the nine months ended September 30, 2012 Recognized Interest Income	For the quarter ended September 30, 2012 Average Recorded Investment	For the quarter ended September 30, 2012 Recognized Interest Income
With No Related Allowance							
Commercial							
Real estate	$10,142,000	$10,858,000	$—	$10,238,000	$134,000	$11,257,000	$23,000
Construction	4,694,000	4,694,000	—	2,319,000	34,000	2,578,000	8,000
Other	2,362,000	2,543,000	—	2,548,000	22,000	2,223,000	6,000
Municipal	—	—	—	—	—	—	—
Residential							
Term	8,414,000	8,870,000	—	9,267,000	102,000	8,477,000	31,000
Construction	23,000	272,000	—	747,000	—	481,000	—
Home equity line of credit	957,000	1,076,000	—	868,000	14,000	1,089,000	14,000
Consumer	—	—	—	4,000	—	—	—
	$26,592,000	$28,313,000	$—	$25,991,000	$306,000	$26,105,000	$82,000
With an Allowance Recorded							
Commercial							
Real estate	$6,179,000	$6,416,000	$1,416,000	$4,058,000	$113,000	$4,119,000	$97,000
Construction	1,951,000	1,951,000	696,000	1,613,000	61,000	2,086,000	24,000
Other	2,543,000	2,573,000	1,240,000	2,105,000	28,000	2,290,000	10,000
Municipal	—	—	—	—	—	—	—
Residential							
Term	10,891,000	11,066,000	1,494,000	9,215,000	202,000	10,672,000	75,000
Construction	—	—	—	348,000	—	111,000	—
Home equity line of credit	488,000	488,000	215,000	563,000	—	558,000	—
Consumer	1,000	1,000	1,000	12,000	—	6,000	—
	$22,053,000	$22,495,000	$5,062,000	$17,914,000	$404,000	$19,842,000	$206,000
Total							
Commercial							
Real estate	$16,321,000	$17,274,000	$1,416,000	$14,296,000	$247,000	$15,376,000	$120,000
Construction	6,645,000	6,645,000	696,000	3,932,000	95,000	4,664,000	32,000
Other	4,905,000	5,116,000	1,240,000	4,653,000	50,000	4,513,000	16,000
Municipal	—	—	—	—	—	—	—
Residential							
Term	19,305,000	19,936,000	1,494,000	18,482,000	304,000	19,149,000	106,000
Construction	23,000	272,000	—	1,095,000	—	592,000	—
Home equity line of credit	1,445,000	1,564,000	215,000	1,431,000	14,000	1,647,000	14,000
Consumer	1,000	1,000	1,000	16,000	—	6,000	—
	$48,645,000	$50,808,000	$5,062,000	$43,905,000	$710,000	$45,947,000	$288,000

Note 4. Allowance for Loan Losses

The Company provides for loan losses through the establishment of an allowance for loan losses which represents an estimated reserve for existing losses in the loan portfolio. A systematic methodology is used for determining the allowance that includes a quarterly review process, risk rating changes, and adjustments to the allowance. The loan portfolio is classified in eight classes and credit risk is evaluated separately in each class. The appropriate level of the allowance is evaluated continually based on a review of significant loans, with a particular emphasis on nonaccruing, past due, and other loans that may require special attention. Other factors include general conditions in local and national economies; loan portfolio composition and asset quality indicators; and internal factors such as changes in underwriting policies, credit administration practices, experience, ability and depth of lending management, among others. The allowance consists of four elements: (1) specific reserves for loans evaluated individually for impairment; (2) general reserves for each portfolio segment based on historical loan loss experience, (3) qualitative reserves judgmentally adjusted for local and national economic conditions, concentrations, portfolio composition, volume and severity of delinquencies and nonaccrual loans, trends of criticized and classified loans, changes in credit policies and underwriting standards, credit administration practices, and other factors as applicable for each portfolio segment; and (4) unallocated reserves. All outstanding loans are considered in evaluating the appropriateness of the allowance. A breakdown of the allowance for loan losses as of September 30, 2013, December 31, 2012, and September 30, 2012, by class of financing receivable and allowance element, is presented in the following tables:

As of September 30, 2013	Specific Reserves on Loans Evaluated Individually for Impairment	General Reserves on Loans Based on Historical Loss Experience	Reserves for Qualitative Factors	Unallocated Reserves	Total Reserves
Commercial					
Real estate	$1,535,000	$2,231,000	$2,037,000	$—	$5,803,000
Construction	269,000	178,000	162,000	—	609,000
Other	807,000	764,000	698,000	—	2,269,000
Municipal	—	—	16,000	—	16,000
Residential					
Term	228,000	360,000	394,000	—	982,000
Construction	—	7,000	8,000	—	15,000
Home equity line of credit	6,000	352,000	308,000	—	666,000
Consumer	—	342,000	211,000	—	553,000
Unallocated	—	—	—	1,544,000	1,544,000
	$2,845,000	$4,234,000	$3,834,000	$1,544,000	$12,457,000

As of December 31, 2012	Specific Reserves on Loans Evaluated Individually for Impairment	General Reserves on Loans Based on Historical Loss Experience	Reserves for Qualitative Factors	Unallocated Reserves	Total Reserves
Commercial					
Real estate	$1,523,000	$2,369,000	$1,973,000	$—	$5,865,000
Construction	969,000	213,000	177,000	—	1,359,000
Other	652,000	763,000	635,000	—	2,050,000
Municipal	—	—	18,000	—	18,000
Residential					
Term	395,000	278,000	436,000	—	1,109,000
Construction	—	4,000	7,000	—	11,000
Home equity line of credit	—	315,000	339,000	—	654,000
Consumer	—	362,000	230,000	—	592,000

Unallocated	—	—	—	842,000	842,000
	$3,539,000	$4,304,000	$3,815,000	$842,000	$12,500,000

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

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

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

The qualitative portion of the allowance for loan losses was 0.47% of related loans as of September 30, 2013, compared to 0.46% of related loans as of December 31, 2012. The qualitative portion increased $19,000 between December 31, 2012 and September 30, 2013 as a result of a higher level of pooled substandard commercial loans. Changes to qualitative adjustments for other major portfolio segments were not material in this period.

The unallocated portion of the allowance totaled $1,544,000 at September 30, 2013, or 12% of the total reserve. This compares to $842,000 as of December 31, 2012. The fluctuation in the unallocated component is supported by the following:

- A portion of the increase in the unallocated amount was attributable to uncertainties of the economic impact related to the Government shutdown and federeal debt ceiling issues looming over the country at September 30, 2013.
- Losses in the commercial loan portfolio have been influenced by classified levels and exacerbated by declines in real estate values, reflected in appraisal updates on collateral that secure troubled loans. Certain valuation declines have been more than expected. The unallocated portion allows some coverage for unexpected and specifically unidentified losses in pooled portfolios.
- An internal analysis completed on sales of other real estate owned found these properties sold, on average, approximately 20% below the appraised value of the property at the time of take in. Based on the analysis, Management applies a 20% additional discount factor to arrive at OREO take in amounts. This will impact the allowance as these potential additional write downs would be taken against the allowance, and the unallocated portion provides additional reserves for these adjustments.
- Watch-rated commercial loans have remained elevated after bottoming out in the third quarter of 2009. Additional losses may exist in this portfolio segment, yet are not identifiable at present. The unallocated portion provides some level of support for this.

- The present view of the economic recovery is one moving at a slow to moderate pace; consequently, caution remains appropriate at the evaluation date regarding the direction of the economy and its impact on Bank loan portfolio quality. The spike in interest rates during the second and third quarter increases uncertainty in the existing loan portfolio and warrants an increase in the unallocated reserve over the nine months ended September 30, 2013. Until conditions show consistent improvement, particularly with employment levels, and until the real estate markets return to some form of normalcy, losses may be higher than normal.
- The unallocated portion is also available to cover imprecision or uncertainties to incorporate the range of probable outcomes inherent in estimates used for the allowance, which may change from period to period.

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

Construction loans, both commercial and residential, comprise a very small portion of the portfolio, and at 21.0% of capital are well under the regulatory guidance of 100.0% of capital at September 30, 2013. Construction loans and non-owner-occupied commercial real estate loans are at 75.1% of total capital, well under regulatory guidance of 300.0% of capital at September 30, 2013.

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

1 Strong

Credits rated "1" are characterized by borrowers fully responsible for the credit with excellent capacity to pay principal and interest. Loans rated "1" may be secured with acceptable forms of liquid collateral.

2 Above Average

Credits rated "2" are characterized by borrowers that have better than average liquidity, capitalization, earnings and/or cash flow with a consistent record of solid financial performance.

3 Satisfactory

Credits rated "3" are characterized by borrowers with favorable liquidity, profitability and financial condition with adequate cash flow to pay debt service.

4 Average

Credits rated "4" are characterized by borrowers that present risk more than 1, 2 and 3 rated loans and merit an ordinary level of ongoing monitoring. Financial condition is on par or somewhat below industry averages while cash flow is generally adequate to meet debt service requirements.

5 Watch

Credits rated "5" are characterized by borrowers that warrant greater monitoring due to financial condition or unresolved and identified risk factors.

6 Other Assets Especially Mentioned (OAEM)

Loans in this category are currently protected but are potentially weak and constitute an undue and unwarranted credit risk, but not to the point of justifying a classification of substandard. OAEM have potential weaknesses which may, if not checked or corrected, weaken the asset or inadequately protect the Bank's credit position at some future date.

7 Substandard

Loans in this category are inadequately protected by the current sound worth and paying capacity of the borrower or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Substandard loans are characterized by the distinct possibility that the Bank may sustain some loss if the deficiencies are not corrected.

8 Doubtful

Loans classified "Doubtful" have the same weaknesses as those classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, based on currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is high, but because of certain important and reasonably specific pending factors which may work to the advantage and strengthening of the asset, its classification as an estimated loss is deferred until its more exact status may be determined.

The following table summarizes the risk ratings for the Company's commercial real estate, commercial construction, commercial other, and municipal loans as of September 30, 2013:

	Commercial Real Estate	Commercial Construction	Commercial Other	Municipal Loans	All Risk-Rated Loans
1 Strong	$18,000	$—	$268,000	$—	$286,000
2 Above Average	14,964,000	667,000	6,789,000	16,124,000	38,544,000
3 Satisfactory	36,696,000	2,219,000	16,368,000	2,094,000	57,377,000
4 Average	110,665,000	12,640,000	31,035,000	—	154,340,000
5 Watch	30,568,000	21,000	11,382,000	—	41,971,000
6 OAEM	25,314,000	3,001,000	3,194,000	—	31,509,000
7 Substandard	30,273,000	861,000	16,094,000	—	47,228,000
8 Doubtful	391,000	—	—	—	391,000
Total	$248,889,000	$19,409,000	$85,130,000	$18,218,000	$371,646,000

The following table summarizes the risk ratings for the Company's commercial real estate, commercial construction, commercial other, and municipal loans as of December 31, 2012:

	Commercial Real Estate	Commercial Construction	Commercial Other	Municipal Loans	All Risk-Rated Loans
1 Strong	$19,000	$—	$271,000	$1,731,000	$2,021,000
2 Above Average	13,871,000	1,274,000	4,084,000	7,061,000	26,290,000
3 Satisfactory	34,454,000	2,312,000	14,578,000	3,487,000	54,831,000
4 Average	99,712,000	12,322,000	28,618,000	2,425,000	143,077,000
5 Watch	43,369,000	1,721,000	19,524,000	—	64,614,000
6 OAEM	26,302,000	79,000	5,300,000	—	31,681,000
7 Substandard	33,153,000	4,709,000	8,806,000	—	46,668,000
8 Doubtful	455,000	—	2,000	—	457,000
Total	$251,335,000	$22,417,000	$81,183,000	$14,704,000	$369,639,000

The following table summarizes the risk ratings for the Company's commercial real estate, commercial construction, commercial other, and municipal loans as of September 30, 2012:

	Commercial Real Estate	Commercial Construction	Commercial Other	Municipal Loans	All Risk-Rated Loans
1 Strong	$20,000	$—	$279,000	$1,775,000	$2,074,000
2 Above Average	18,918,000	699,000	5,426,000	8,651,000	33,694,000
3 Satisfactory	36,580,000	643,000	13,497,000	3,523,000	54,243,000
4 Average	105,150,000	10,670,000	30,688,000	2,499,000	149,007,000
5 Watch	39,494,000	1,812,000	19,100,000	—	60,406,000
6 OAEM	21,530,000	1,227,000	3,731,000	—	26,488,000
7 Substandard	34,359,000	6,854,000	10,916,000	—	52,129,000
8 Doubtful	480,000	—	66,000	—	546,000
Total	$256,531,000	$21,905,000	$83,703,000	$16,448,000	$378,587,000

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

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

Residential loans, consumer loans and home equity lines of credit are segregated into homogeneous pools with similar risk characteristics. Trends and current conditions are analyzed and historical loss experience is adjusted accordingly. Quantitative and qualitative adjustment factors for these segments are consistent with those for the commercial and municipal classes. Certain loans in the residential, home equity lines of credit and consumer classes identified as having the potential for further deterioration are analyzed individually to confirm impairment status, and to determine the need for a specific reserve; however there is no formal rating system used for these classes. Consumer loans greater than 120 days past due are generally charged off. Residential loans 90 days or more past due are placed on non-accrual status unless the loans are both well secured and in the process of collection. One- to four-family residential real estate loans and home equity loans are written down or charged-off no later than 180 days past due, or for residential real estate secured loans having a borrower in bankruptcy, within 60 days of receipt of notification of filing from the bankruptcy court, whichever is sooner. This is subject to completion of a current assessment of the value of the collateral with any outstanding loan balance in excess of the fair value of the property, less costs to sell, written down or charged-off.

There were no changes to the Company's accounting policies or methodology used to estimate the allowance for loan losses during the nine months ended September 30, 2013.

The following table presents allowance for loan losses activity by class for the nine months and quarter ended September 30, 2013, and allowance for loan loss balances by class and related loan balances by class as of September 30, 2013:

	Commercial			Municipal	Residential		Home Equity Line of Credit	Consumer	Un
	Real Estate	Construction	Other		Term	Construction			
For the nine months ended September 30, 2013									
Beginning balance	$5,865,000	$1,359,000	$2,050,000	$18,000	$1,109,000	$11,000	$654,000	$592,000	$84
Charge offs	150,000	963,000	1,053,000	—	909,000	—	485,000	333,000	—
Recoveries	—	—	157,000	—	38,000	—	5,000	150,000	—
Provision (credit)	88,000	213,000	1,115,000	(2,000)	744,000	4,000	492,000	144,000	702
Ending balance	$5,803,000	$609,000	$2,269,000	$16,000	$982,000	$15,000	$666,000	$553,000	$1,
For the three months ended September 30, 2013									
Beginning balance	$5,811,000	$591,000	$2,572,000	$18,000	$1,026,000	$9,000	$737,000	$631,000	$1,
Charge offs	89,000	33,000	532,000	—	302,000	—	54,000	81,000	—
Recoveries	—	—	13,000	—	2,000	—	3,000	60,000	—
Provision (credit)	81,000	51,000	216,000	(2,000)	256,000	6,000	(20,000)	(57,000)	269
Ending balance	$5,803,000	$609,000	$2,269,000	$16,000	$982,000	$15,000	$666,000	$553,000	$1,
Allowance for loan losses as of September 30, 2013									
Ending balance specifically evaluated for impairment	$1,535,000	$269,000	$807,000	$—	$228,000	$—	$6,000	$—	$—
Ending balance collectively evaluated for impairment	$4,268,000	$340,000	$1,462,000	$16,000	$754,000	$15,000	$660,000	$553,000	$1,
Related loan balances as of September 30, 2013									
Ending balance	$248,889,000	$19,409,000	$85,130,000	$18,218,000	$375,387,000	$7,617,000	$92,374,000	$15,049,000	$—
Ending balance specifically evaluated for impairment	$16,970,000	$1,364,000	$4,926,000	$—	$19,138,000	$—	$1,678,000	$—	$—
Ending balance	$231,919,000	$18,045,000	$80,204,000	$18,218,000	$356,249,000	$7,617,000	$90,696,000	$15,049,000	$—

collectively
evaluated
for
impairment

The following table presents allowance for loan losses activity by class for the year-ended December 31, 2012 and allowance for loan loss balances by class and related loan balances by class as of December 31, 2012:

	Commercial			Municipal	Residential		Home Equity Line of Credit	Consumer	Unall
	Real Estate	Construction	Other		Term	Construction			
For the year ended December 31, 2012									
Beginning balance	$5,659,000	$658,000	$2,063,000	$19,000	$1,159,000	$255,000	$595,000	$584,000	$2,00
Charge offs	1,394,000	928,000	3,215,000	—	1,911,000	389,000	688,000	555,000	—
Recoveries	13,000	246,000	113,000	—	110,000	54,000	1,000	208,000	—
Provision (credit)	1,587,000	1,383,000	3,089,000	(1,000)	1,751,000	91,000	746,000	355,000	(1,16
Ending balance	$5,865,000	$1,359,000	$2,050,000	$18,000	$1,109,000	$11,000	$654,000	$592,000	$842
Allowance for loan losses as of December 31, 2012									
Ending balance specifically evaluated for impairment	$1,523,000	$969,000	$652,000	$—	$395,000	$—	$—	$—	$—
Ending balance collectively evaluated for impairment	$4,342,000	$390,000	$1,398,000	$18,000	$714,000	$11,000	$654,000	$592,000	$842
Related loan balances as of December 31, 2012									
Ending balance	$251,335,000	$22,417,000	$81,183,000	$14,704,000	$379,447,000	$6,459,000	$99,082,000	$14,657,000	$—
Ending balance specifically evaluated for impairment	$15,774,000	$3,354,000	$5,861,000	$—	$19,444,000	$—	$1,311,000	$—	$—
Ending balance collectively evaluated for impairment	$235,561,000	$19,063,000	$75,322,000	$14,704,000	$360,003,000	$6,459,000	$97,771,000	$14,657,000	$—

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

	Commercial			Municipal	Residential		Home Equity Line of Credit	Consumer	Unallocated	Total
	Real Estate	Construction	Other		Term	Construction				
For the nine months ended September 30, 2012										
Beginning balance	$5,659,000	$658,000	$2,063,000	$19,000	$1,159,000	$255,000	$595,000	$584,000	$2,008,000	$13,000,000
Charge offs	1,101,000	87,000	2,168,000	—	554,000	381,000	391,000	382,000	—	5,064,000
Recoveries	4,000	247,000	50,000	—	3,000	42,000	—	157,000	—	503,000
Provision (credit)	1,133,000	241,000	2,687,000	(1,000)	1,615,000	98,000	586,000	189,000	(248,000)	6,300,000
Ending balance	$5,695,000	$1,059,000	$2,632,000	$18,000	$2,223,000	$14,000	$790,000	$548,000	$1,760,000	$14,739,000
For the three months ended September 30, 2012										
Beginning balance	$5,564,000	$1,373,000	$2,476,000	$19,000	$1,587,000	$58,000	$809,000	$603,000	$1,895,000	$14,384,000
Charge offs	186,000	87,000	6,000	—	179,000	263,000	342,000	106,000	—	1,169,000
Recoveries	3,000	1,000	39,000	—	1,000	42,000	—	38,000	—	124,000
Provision (credit)	314,000	(228,000)	123,000	(1,000)	814,000	177,000	323,000	13,000	(135,000)	1,400,000
Ending balance	$5,695,000	$1,059,000	$2,632,000	$18,000	$2,223,000	$14,000	$790,000	$		