First Bancorp, Inc /ME/
Form 10-Q
August 09, 2012
UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

[X] Quarterly Report Pursuant to Section 13 or 15(d) of The Securities Exchange Act of 1934
For the quarterly period ended June 30, 2012

Commission File Number 0-26589

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

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

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

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

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

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

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

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

Indicate the number of shares outstanding of each of the registrant's classes of common stock as of August 1, 2012
Common Stock: 9,851,246 shares

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Part I. Financial Information

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

Dollars in thousands, except for per share amounts	For the six months ended June 30, 2012	2011	For the quarters ended June 30, 2012	2011
Summary of Operations				
Interest Income	$26,239	$28,251	$13,133	$13,997
Interest Expense	6,515	7,523	3,215	3,774
Net Interest Income	19,724	20,728	9,918	10,223
Provision for Loan Losses	4,900	4,100	2,800	2,000
Non-Interest Income	6,064	4,511	3,896	2,234
Non-Interest Expense	12,908	12,738	6,730	6,250
Net Income	6,236	6,336	3,323	3,193
Per Common Share Data				
Basic Earnings per Share	$0.60	$0.58	$0.32	$0.29
Diluted Earnings per Share	0.60	0.58	0.32	0.29
Cash Dividends Declared	0.390	0.390	0.195	0.195
Book Value per Common Share	14.32	13.42	14.32	13.42
Tangible Book Value per Common Share	11.51	10.60	11.51	10.60
Market Value	17.00	14.86	17.00	14.86
Financial Ratios				
Return on Average Equity[1]	8.84 %	9.90 %	9.38 %	9.78 %
Return on Average Tangible Equity[1,2]	10.35 %	11.26 %	11.01 %	11.09 %
Return on Average Assets[1]	0.88 %	0.90 %	0.93 %	0.89 %
Average Equity to Average Assets	10.84 %	10.78 %	10.73 %	10.80 %
Average Tangible Equity to Average Assets[2]	8.89 %	8.84 %	8.81 %	8.88 %
Net Interest Margin Tax-Equivalent[1,2]	3.19 %	3.31 %	3.16 %	3.22 %
Dividend Payout Ratio	65.00 %	67.24 %	60.94 %	67.24 %
Allowance for Loan Losses/Total Loans	1.63 %	1.70 %	1.63 %	1.70 %
Non-Performing Loans to Total Loans	2.49 %	2.49 %	2.49 %	2.49 %
Non-Performing Assets to Total Assets	1.91 %	2.10 %	1.91 %	2.10 %
Efficiency Ratio[2]	50.74 %	48.29 %	51.06 %	48.30 %
At Period End				
Total Assets	$1,424,757	$1,417,690	$1,424,757	$1,417,690
Total Loans	881,814	886,929	881,814	886,929
Total Investment Securities	457,570	442,691	457,570	442,691
Total Deposits	1,005,274	998,838	1,005,274	998,838
Total Shareholders' Equity	153,405	156,210	153,405	156,210

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

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 June 30, 2012 and 2011 and for the three-month and six-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
August 9, 2012

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

	June 30, 2012	December 31, 2011	June 30, 2011
Assets			
Cash and cash equivalents	$14,192,000	$14,115,000	$14,322,000
Interest bearing deposits in other banks	-	-	100,000
Securities available for sale	307,347,000	286,202,000	304,278,000
Securities to be held to maturity (fair value of $143,628,000 at June 30, 2012, $130,677,000 at December 31, 2011 and $128,426,000 at June 30, 2011)	135,775,000	122,661,000	122,970,000
Restricted equity securities, at cost	14,448,000	15,443,000	15,443,000
Loans held for sale	378,000	-	419,000
Loans	881,814,000	864,988,000	886,929,000
Less allowance for loan losses	14,384,000	13,000,000	15,034,000
Net loans	867,430,000	851,988,000	871,895,000
Accrued interest receivable	6,024,000	4,835,000	6,511,000
Premises and equipment, net	18,500,000	18,842,000	18,351,000
Other real estate owned	5,188,000	4,094,000	7,723,000
Goodwill	27,684,000	27,684,000	27,684,000
Other assets	27,791,000	27,003,000	27,994,000
Total assets	$1,424,757,000	$1,372,867,000	$1,417,690,000
Liabilities			
Demand deposits	$77,019,000	$75,750,000	$71,517,000
NOW deposits	123,897,000	122,775,000	117,064,000
Money market deposits	71,009,000	79,015,000	69,681,000
Savings deposits	119,471,000	114,617,000	107,278,000
Certificates of deposit	613,878,000	549,176,000	633,298,000
Total deposits	1,005,274,000	941,333,000	998,838,000
Borrowed funds - short term	118,767,000	135,500,000	119,170,000
Borrowed funds - long term	130,159,000	130,163,000	130,166,000
Other liabilities	17,152,000	15,013,000	13,306,000
Total liabilities	1,271,352,000	1,222,009,000	1,261,480,000
Shareholders' equity			
Preferred stock, $1,000 preference value per share	12,352,000	12,303,000	24,754,000
Common stock, one cent par value per share	98,000	98,000	98,000
Additional paid-in capital	46,110,000	45,829,000	45,629,000
Retained earnings	87,396,000	85,314,000	83,594,000
Accumulated other comprehensive income (loss)			
Net unrealized gain on securities available-for-sale	7,526,000	7,401,000	2,198,000
Net unrealized loss on postretirement benefit costs	(77,000)	(87,000)	(63,000)
Total shareholders' equity	153,405,000	150,858,000	156,210,000
Total liabilities & shareholders' equity	$1,424,757,000	$1,372,867,000	$1,417,690,000
Common Stock			
Number of shares authorized	18,000,000	18,000,000	18,000,000
Number of shares issued and outstanding	9,847,159	9,812,180	9,793,706
Book value per common share	$14.32	$14.12	$13.42
Tangible book value per common share	$11.51	$11.30	$10.60

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

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

	For the six months ended June 30,		For the quarters ended June 30,	
	2012	2011	2012	2011
Interest income				
Interest and fees on loans	$18,759,000	$20,128,000	$9,367,000	$9,955,000
Interest on deposits with other banks	1,000	-	1,000	-
Interest and dividends on investments	7,479,000	8,123,000	3,765,000	4,042,000
Total interest income	26,239,000	28,251,000	13,133,000	13,997,000
Interest expense				
Interest on deposits	4,297,000	5,081,000	2,104,000	2,518,000
Interest on borrowed funds	2,218,000	2,442,000	1,111,000	1,256,000
Total interest expense	6,515,000	7,523,000	3,215,000	3,774,000
Net interest income	19,724,000	20,728,000	9,918,000	10,223,000
Provision for loan losses	4,900,000	4,100,000	2,800,000	2,000,000
Net interest income after provision for loan losses	14,824,000	16,628,000	7,118,000	8,223,000
Non-interest income				
Investment management and fiduciary income	844,000	782,000	448,000	358,000
Service charges on deposit accounts	1,351,000	1,351,000	713,000	711,000
Net securities gains	1,967,000	229,000	1,444,000	229,000
Mortgage origination and servicing income	304,000	652,000	460,000	193,000
Other operating income	1,598,000	1,497,000	831,000	743,000
Total non-interest income	6,064,000	4,511,000	3,896,000	2,234,000
Non-interest expense				
Salaries and employee benefits	6,202,000	6,005,000	3,118,000	2,928,000
Occupancy expense	819,000	827,000	405,000	378,000
Furniture and equipment expense	1,123,000	1,111,000	550,000	561,000
FDIC insurance premiums	606,000	806,000	305,000	405,000
Amortization of identified intangibles	141,000	141,000	70,000	70,000
Other operating expense	4,017,000	3,848,000	2,282,000	1,908,000
Total non-interest expense	12,908,000	12,738,000	6,730,000	6,250,000
Income before income taxes	7,980,000	8,401,000	4,284,000	4,207,000
Applicable income taxes	1,744,000	2,065,000	961,000	1,014,000
NET INCOME	$6,236,000	$6,336,000	$3,323,000	$3,193,000
Basic earnings per common share	$0.60	$0.58	$0.32	$0.29
Diluted earnings per common share	$0.60	$0.58	$0.32	$0.29
Other comprehensive income, net of tax				
Net unrealized gain on securities available for sale	$125,000	$4,255,000	$438,000	$3,587,000
Unrecognized postretirement benefits transition obligation	10,000	10,000	5,000	5,000
Other comprehensive income	$135,000	$4,265,000	$443,000	$3,592,000
Comprehensive income	$6,371,000	$10,601,000	$3,766,000	$6,785,000

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

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

	Preferred stock	Common stock and additional paid-in capital Shares	Amount	Retained earnings	Accumulated other comprehensive income (loss)	Total shareholders' equity
Balance at December 31, 2010	$24,705,000	9,773,025	$45,572,000	$81,701,000	$(2,130,000)	$149,848,000
Net income	-	-	-	6,336,000	-	6,336,000
Net unrealized gain on securities available for sale, net of taxes of $2,291,000	-	-	-	-	4,255,000	4,255,000
Unrecognized transition obligation for postretirement benefits, net of taxes of $4,000	-	-	-	-	10,000	10,000
Comprehensive income	-	-	-	6,336,000	4,265,000	10,601,000
Cash dividends declared	-	-	-	(4,443,000)	-	(4,443,000)
Equity compensation expense	-	-	11,000	-	-	11,000
Amortization of premium for preferred stock issuance	49,000	-	(49,000)	-	-	-
Proceeds from sale of common stock	-	20,681	193,000	-	-	193,000
Balance at June 30, 2011	$24,754,000	9,793,706	$45,727,000	$83,594,000	$2,135,000	$156,210,000
Balance at December 31, 2011	$12,303,000	9,812,180	$45,927,000	$85,314,000	$7,314,000	$150,858,000
Net income	-	-	-	6,236,000	-	6,236,000
Net unrealized gain on securities available for sale, net of taxes of $67,000	-	-	-	-	125,000	125,000
Unrecognized transition obligation for postretirement benefits, net of taxes of $4,000	-	-	-	-	10,000	10,000
Comprehensive income	-	-	-	6,236,000	135,000	6,371,000
Cash dividends declared	-	-	-	(4,154,000)	-	(4,154,000)
Equity compensation expense	-	-	40,000	-	-	40,000
Amortization of premium for preferred stock issuance	49,000	-	(49,000)	-	-	-
Proceeds from sale of common stock	-	34,979	290,000	-	-	290,000
Balance at June 30, 2012	$12,352,000	9,847,159	$46,208,000	$87,396,000	$7,449,000	$153,405,000

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

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

	For the six months ended June 30, 2012	June 30, 2011
Cash flows from operating activities		
Net income	$6,236,000	$6,336,000
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	663,000	681,000
Change in deferred taxes	(688,000)	(374,000)
Provision for loan losses	4,900,000	4,100,000
Loans originated for resale	(13,273,000)	(20,502,000)
Proceeds from sales and transfers of loans	13,089,000	22,889,000
Net gain on sale or call of securities	(1,967,000)	(229,000)
Net loss on sale of other real estate owned	39,000	47,000
Provision for losses on other real estate owned	198,000	145,000
Equity compensation expense	40,000	11,000
Net increase in other assets and accrued interest	(1,831,000)	(482,000)
Net increase in other liabilities	2,243,000	66,000
Net loss on disposal of premises and equipment	-	5,000
Net amortization of premiums on investments	1,482,000	2,048,000
Amortization of investment in limited partnership	238,000	195,000
Net acquisition amortization	103,000	103,000
Net cash provided by operating activities	11,472,000	15,039,000
Cash flows from investing activities		
Proceeds from maturities, payments and calls of securities available for sale	26,024,000	26,723,000
Proceeds from sales of securities available for sale	25,137,000	75,176,000
Proceeds from maturities, payments and calls of securities to be held to maturity	21,871,000	10,441,000
Proceeds from sales of other real estate owned	667,000	992,000
Purchases of securities available for sale	(71,706,000)	(107,910,000)
Purchases of securities to be held to maturity	(35,101,000)	(26,342,000)
Redemption of restricted equity securities	995,000	-
Net increase in loans	(22,340,000)	(5,693,000)
Capital expenditures	(321,000)	(57,000)
Net cash used in investing activities	(54,774,000)	(26,670,000)
Cash flows from financing activities		
Net decrease in demand, savings, and money market accounts	(761,000)	(789,000)
Net increase in certificates of deposit	64,734,000	25,141,000
Net decrease in short-term borrowings	(16,730,000)	(7,987,000)
Proceeds from sale of common stock	290,000	193,000
Dividends paid	(4,154,000)	(4,443,000)
Net cash provided by financing activities	43,379,000	12,115,000
Net increase in cash and cash equivalents	77,000	484,000
Cash and cash equivalents at beginning of period	14,115,000	13,838,000
Cash and cash equivalents at end of period	$14,192,000	$14,322,000
Interest paid	$6,640,000	$7,594,000
Income taxes paid	869,000	1,297,000
Non-cash transactions		
Net transfer from loans to other real estate owned	1,998,000	3,978,000

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

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

Note 1 - Basis of Presentation

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

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

Note 2 - Investment Securities

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

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value (Estimated)
Securities available for sale				
U.S. Treasury and agency	$-	$-	$-	$-
Mortgage-backed securities	201,552,000	5,677,000	(250,000)	206,979,000
State and political subdivisions	92,353,000	6,291,000	(51,000)	98,593,000
Corporate securities	-	-	-	-
Other equity securities	1,863,000	47,000	(135,000)	1,775,000
	$295,768,000	$12,015,000	$(436,000)	$307,347,000
Securities to be held to maturity				
U.S. Treasury and agency	$41,197,000	$282,000	$(33,000)	$41,446,000
Mortgage-backed securities	49,992,000	3,524,000	(8,000)	53,508,000
State and political subdivisions	44,286,000	4,088,000	-	48,374,000
Corporate securities	300,000	-	-	300,000
	$135,775,000	$7,894,000	$(41,000)	$143,628,000
Restricted equity securities				
Federal Home Loan Bank Stock	$13,412,000	$-	$-	$13,412,000
Federal Reserve Bank Stock	1,036,000	-	-	1,036,000
	$14,448,000	$-	$-	$14,448,000

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

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

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

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value (Estimated)
Securities available for sale				
U.S. Treasury and agency	$15,324,000	$799,000	$-	$16,123,000
Mortgage-backed securities	220,245,000	2,548,000	(1,269,000)	221,524,000
State and political subdivisions	63,696,000	1,573,000	(107,000)	65,162,000
Corporate securities	1,105,000	-	(169,000)	936,000
Other equity securities	527,000	26,000	(20,000)	533,000
	$300,897,000	$4,946,000	$(1,565,000)	$304,278,000
Securities to be held to maturity				
U.S. Treasury and agency	$12,970,000	$-	$(186,000)	$12,784,000
Mortgage-backed securities	60,836,000	3,626,000	(37,000)	64,425,000
State and political subdivisions	48,864,000	2,399,000	(346,000)	50,917,000
Corporate securities	300,000	-	-	300,000
	$122,970,000	$6,025,000	$(569,000)	$128,426,000
Restricted equity securities				
Federal Home Loan Bank Stock	$14,031,000	$-	$-	$14,031,000
Federal Reserve Bank Stock	1,412,000	-	-	1,412,000
	$15,443,000	$-	$-	$15,443,000

The following table summarizes the contractual maturities of investment securities at June 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	$4,296,000	$4,328,000	$1,382,000	$1,399,000
Due in 1 to 5 years	55,317,000	56,358,000	13,556,000	14,134,000
Due in 5 to 10 years	23,143,000	24,034,000	21,137,000	22,958,000
Due after 10 years	211,149,000	220,852,000	99,700,000	105,137,000
Equity securities	1,863,000	1,775,000	-	-
	$295,768,000	$307,347,000	$135,775,000	$143,628,000

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

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

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

	Securities available for sale		Securities to be held to maturity	
	Amortized Cost	Fair Value (Estimated)	Amortized Cost	Fair Value (Estimated)
Due in 1 year or less	$5,032,000	$4,941,000	$227,000	$227,000
Due in 1 to 5 years	7,623,000	7,904,000	10,633,000	11,147,000
Due in 5 to 10 years	25,845,000	26,099,000	23,562,000	24,623,000
Due after 10 years	261,870,000	264,801,000	88,548,000	92,429,000
Equity securities	527,000	533,000	-	-
	$300,897,000	$304,278,000	$122,970,000	$128,426,000

At June 30, 2012, securities with a fair value of $140,384,000 were pledged to secure public deposits, repurchase agreements, and for other purposes as required by law. This compares to securities with a fair value of $141,506,000 as of December 31, 2011 and $132,827,000 at June 30, 2011, pledged for the same purposes.

Gains and losses on the sale of securities available for sale are computed by subtracting the amortized cost at the time of sale from the security's selling price, net of accrued interest to be received. The following table shows securities gains and losses for the six months and quarters ended June 30, 2012 and 2011:

	For the six months ended June 30,		For the quarters ended June 30,	
	2012	2011	2012	2011
Proceeds from sales of securities	$25,137,000	$75,176,000	$14,194,000	$75,176,000

Gross realized gains	2,256,000	957,000	1,444,000	957,000
Gross realized losses	(289,000)	(728,000)	-	(728,000)
Net gain	$1,967,000	$229,000	$1,444,000	$229,000
Related income taxes	$688,000	$80,000	$505,000	$80,000

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

	For the six months ended June 30,		For the quarters ended June 30,	
	2012	2011	2012	2011
Balance at beginning of period	$7,401,000	$(2,057,000)	$7,088,000	$(1,389,000)
Unrealized gains arising during the period	2,159,000	6,775,000	2,118,000	5,747,000
Realized gains during the period	(1,967,000)	(229,000)	(1,444,000)	(229,000)
Related deferred taxes	(67,000)	(2,291,000)	(236,000)	(1,931,000)
Net change	125,000	4,255,000	438,000	3,587,000
Balance at end of period	$7,526,000	$2,198,000	$7,526,000	$2,198,000

Management reviews securities with unrealized losses for other than temporary impairment. As of June 30, 2012, there were 30 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 eight 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 June 30, 2012 is summarized below:

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury and agency	$7,942,000	$(33,000)	$-	$-	$7,942,000	$(33,000)
Mortgage-backed securities	9,822,000	(110,000)	5,137,000	(148,000)	14,959,000	(258,000)
State and political subdivisions	3,719,000	(51,000)	-	-	3,719,000	(51,000)
Corporate securities	-	-	-	-	-	-
Other equity securities	-	-	191,000	(135,000)	191,000	(135,000)
	$21,483,000	$(194,000)	$5,328,000	$(283,000)	$26,811,000	$(477,000)

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

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

As of June 30, 2011, there were 65 securities with unrealized losses held in the Company's portfolio. These securities were temporarily impaired as a result of changes in interest rates reducing their fair value, of which 11 had been temporarily impaired for 12 months or more. Information regarding securities temporarily impaired as of June 30, 2011 is summarized below:

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury and agency	$12,784,000	$(186,000)	$-	$-	$12,784,000	$(186,000)
Mortgage-backed securities	71,157,000	(1,044,000)	3,681,000	(262,000)	74,838,000	(1,306,000)
State and political subdivisions	12,050,000	(142,000)	1,489,000	(311,000)	13,539,000	(453,000)
Corporate securities	-	-	936,000	(169,000)	936,000	(169,000)
Other equity securities	247,000	(15,000)	48,000	(5,000)	295,000	(20,000)
	$96,238,000	$(1,387,000)	$6,154,000	$(747,000)	$102,392,000	$(2,134,000)

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 June 30, 2012 and 2011, and December 31, 2011, the Bank's investment in FHLB stock totaled $13,412,000, $14,031,000 and $14,031,000 respectively. FHLB stock is a non-marketable equity security and therefore is reported at cost, which equals par value.

Note 3 - Loans

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

	June 30, 2012		December 31, 2011		June 30, 2011	
Commercial						
Real estate	$253,193,000	28.7 %	$255,424,000	29.5 %	$263,337,000	29.7 %
Construction	33,072,000	3.8 %	32,574,000	3.8 %	29,386,000	3.3 %
Other	87,833,000	10.0 %	86,982,000	10.1 %	102,499,000	11.6 %
Municipal	16,089,000	1.8 %	16,221,000	1.9 %	19,974,000	2.3 %
Residential						
Term	368,876,000	41.8 %	341,286,000	39.5 %	335,807,000	37.9 %
Construction	6,449,000	0.7 %	10,469,000	1.2 %	11,063,000	1.2 %
Home equity line of credit	100,689,000	11.4 %	105,244,000	12.1 %	107,224,000	12.0 %
Consumer	15,613,000	1.8 %	16,788,000	1.9 %	17,639,000	2.0 %
Total	$881,814,000	100.0%	$864,988,000	100.0%	$886,929,000	100.0%

Loan balances include net deferred loan costs of $1,664,000 as of June 30, 2012, $1,386,000 as of December 31, 2011, and $1,365,000 as of June 30, 2011. Pursuant to collateral agreements, qualifying first mortgage loans, which totaled $243,196,000 at June 30, 2012, $211,597,000 at December 31, 2011, and $180,839,000 at June 30, 2011, were used to collateralize borrowings from the Federal Home Loan Bank of Boston. In addition, commercial, construction and home equity loans totaling $232,598,000 at June 30, 2012, $218,417,000 at December 31, 2011, and $329,677,000 at June 30, 2011, were used to collateralize a standby line of credit at the Federal Reserve Bank of Boston that is currently unused.

Loans on non-accrual status totaled $21,958,000 at June 30, 2012, $27,806,000 at December 31, 2011 and $22,049,000 at June 30, 2011. Loans past due 90 days or greater which are accruing interest totaled $164,000 at June 30, 2012, $1,170,000 at December 31, 2011 and $355,000 at June 30, 2011. The Company continues to accrue interest on these loans because it believes collection of principal and interest is reasonably assured.

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

	30-89 Days Past Due	90+ Days Past Due	All Past Due	Current	Total	90+ Days & Accruing
Commercial						
Real estate	$13,000	$1,858,000	$1,871,000	$251,322,000	$253,193,000	$-
Construction	119,000	34,000	153,000	32,919,000	33,072,000	-
Other	443,000	1,398,000	1,841,000	85,992,000	87,833,000	-
Municipal	1,560,000	-	1,560,000	14,529,000	16,089,000	-
Residential						
Term	3,191,000	7,878,000	11,069,000	357,807,000	368,876,000	-
Construction	-	1,336,000	1,336,000	5,113,000	6,449,000	-
Home equity line of credit	530,000	1,311,000	1,841,000	98,848,000	100,689,000	-
Consumer	189,000	180,000	369,000	15,244,000	15,613,000	164,000
Total	$6,045,000	$13,995,000	$20,040,000	$861,774,000	$881,814,000	$164,000

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

	30-89 Days Past Due	90+ Days Past Due	All Past Due	Current	Total	90+ Days & Accruing
Commercial						
Real estate	$2,872,000	$3,992,000	$6,864,000	$248,560,000	$255,424,000	$-
Construction	174,000	1,603,000	1,777,000	30,797,000	32,574,000	-
Other	1,431,000	1,192,000	2,623,000	84,359,000	86,982,000	52,000
Municipal	-	-	-	16,221,000	16,221,000	-
Residential						
Term	3,331,000	8,843,000	12,174,000	329,112,000	341,286,000	1,118,000
Construction	-	1,198,000	1,198,000	9,271,000	10,469,000	-
Home equity line of credit	480,000	1,134,000	1,614,000	103,630,000	105,244,000	-
Consumer	331,000	16,000	347,000	16,441,000	16,788,000	-
Total	$8,619,000	$17,978,000	$26,597,000	$838,391,000	$864,988,000	$1,170,000

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

	30-89 Days Past Due	90+ Days Past Due	All Past Due	Current	Total	90+ Days & Accruing
Commercial						
Real estate	$2,227,000	$4,051,000	$6,278,000	$257,059,000	$263,337,000	$-
Construction	117,000	-	117,000	29,269,000	29,386,000	-
Other	544,000	997,000	1,541,000	100,958,000	102,499,000	38,000
Municipal	-	-	-	19,974,000	19,974,000	-
Residential						
Term	6,093,000	9,916,000	16,009,000	319,798,000	335,807,000	309,000
Construction	-	334,000	334,000	10,729,000	11,063,000	-

Home equity line of credit	868,000	740,000	1,608,000	105,616,000	107,224,000	-
Consumer	258,000	8,000	266,000	17,373,000	17,639,000	8,000
Total	$10,107,000	$16,046,000	$26,153,000	$860,776,000	$886,929,000	$355,000

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

	June 30, 2012	December 31, 2011	June 30, 2011
Commercial			
Real estate	$5,545,000	$7,064,000	$6,746,000
Construction	521,000	2,350,000	771,000
Other	2,361,000	5,784,000	2,095,000
Municipal	-	-	-
Residential			
Term	10,723,000	10,194,000	11,260,000
Construction	1,336,000	1,198,000	334,000
Home equity line of credit	1,456,000	1,163,000	740,000
Consumer	16,000	53,000	103,000
Total	$21,958,000	$27,806,000	$22,049,000

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

A breakdown of impaired loans by class of financing receivable as of June 30, 2012, is presented in the following table:

				For six months ended June 30, 2012		For the quarter ended June 30, 2012	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Recognized Interest Income	Average Recorded Investment	Recognized Interest Income
With No Related Allowance							
Commercial							
Real estate	$10,313,000	$10,313,000	$-	$9,729,000	$111,000	$11,013,000	$71,000
Construction	1,464,000	1,464,000	-	2,189,000	26,000	1,395,000	13,000
Other	2,249,000	2,249,000	-	2,710,000	16,000	2,439,000	21,000
Municipal	-	-	-	-	-	-	-
Residential					-		
Term	8,695,000	8,695,000	-	9,662,000	71,000	9,322,000	41,000
Construction	1,002,000	1,002,000	-	880,000	-	1,042,000	-
Home equity line of credit	740,000	740,000	-	758,000	-	740,000	-
Consumer	-	-	-	6,000	-	-	-
	$24,463,000	$24,463,000	$-	$25,934,000	$224,000	$25,951,000	$146,000
With an Allowance Recorded							
Commercial							
Real estate	$3,482,000	$3,482,000	$1,133,000	$4,026,000	$16,000	$3,775,000	$6,000
Construction	2,155,000	2,155,000	787,000	1,376,000	37,000	2,155,000	37,000
Other	1,851,000	1,851,000	932,000	2,013,000	18,000	1,802,000	13,000
Municipal	-	-	-	-	-	-	-
Residential							
Term	10,357,000	10,357,000	966,000	8,487,000	127,000	9,525,000	68,000
Construction	334,000	334,000	48,000	466,000	-	334,000	-
Home equity line of credit	716,000	716,000	300,000	566,000	-	613,000	-
Consumer	16,000	16,000	11,000	15,000	-	15,000	-
	$18,911,000	$18,911,000	$4,177,000	$16,949,000	$198,000	$18,219,000	$124,000
Total							
Commercial							
Real estate	$13,795,000	$13,795,000	$1,133,000	$13,755,000	$127,000	$14,788,000	$77,000
Construction	3,619,000	3,619,000	787,000	3,565,000	63,000	3,550,000	50,000
Other	4,100,000	4,100,000	932,000	4,723,000	34,000	4,241,000	34,000
Municipal	-	-	-	-	-	-	-
Residential							
Term	19,052,000	19,052,000	966,000	18,149,000	198,000	18,847,000	109,000
Construction	1,336,000	1,336,000	48,000	1,346,000	-	1,376,000	-
Home equity line of credit	1,456,000	1,456,000	300,000	1,324,000	-	1,353,000	-
Consumer	16,000	16,000	11,000	21,000	-	15,000	-
	$43,374,000	$43,374,000	$4,177,000	$42,883,000	$422,000	$44,170,000	$270,000

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 December 31, 2011, is presented in the following table:

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

A breakdown of impaired loans by class of financing receivable as of June 30, 2011, is presented in the following table:

				For six months ended June 30, 2011		For the quarter ended June 30, 2011	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Recognized Interest Income	Average Recorded Investment	Recognized Interest Income
<u>With No Related Allowance</u>							
Commercial							
Real estate	$5,841,000	$5,841,000	$-	$5,151,000	$12,000	$5,738,000	$6,000
Construction	772,000	772,000	-	617,000	72,000	790,000	36,000
Other	1,056,000	1,056,000	-	1,118,000	14,000	1,064,000	7,000
Municipal	-	-	-	-	-	-	-
Residential							-
Term	10,818,000	10,818,000	-	8,957,000	27,000	9,785,000	13,000
Construction	334,000	334,000	-	1,641,000	-	348,000	-
Home equity line of credit	509,000	509,000	-	417,000	-	516,000	-
Consumer	38,000	38,000	-	40,000	-	38,000	-
	$19,368,000	$19,368,000	$-	$17,941,000	$125,000	$18,279,000	$62,000
<u>With an Allowance Recorded</u>							
Commercial							
Real estate	$905,000	$905,000	$613,000	$2,021,000	$52,000	$1,785,000	$26,000
Construction	-	-	-	227,000	-	3,000	-
Other	1,039,000	1,039,000	857,000	652,000	10,000	754,000	5,000
Municipal	-	-	-	-	-	-	-
Residential							-
Term	5,373,000	5,373,000	265,000	5,254,000	114,000	4,978,000	57,000
Construction	-	-	-	192,000	-	192,000	-
Home equity line of credit	231,000	231,000	165,000	256,000	-	281,000	-
Consumer	65,000	65,000	65,000	69,000	-	65,000	-
	$7,613,000	$7,613,000	$1,965,000	$8,671,000	$176,000	$8,058,000	$88,000
<u>Total</u>							
Commercial							
Real estate	$6,746,000	$6,746,000	$613,000	$7,172,000	$64,000	$7,521,000	$32,000
Construction	772,000	772,000	-	844,000	72,000	793,000	36,000
Other	2,095,000	2,095,000	857,000	1,770,000	24,000	1,816,000	12,000
Municipal	-	-	-	-	-	-	-
Residential					-		-
Term	16,191,000	16,191,000	265,000	14,211,000	141,000	14,761,000	70,000
Construction	334,000	334,000	-	1,833,000	-	539,000	-
Home equity line of credit	740,000	740,000	165,000	673,000	-	797,000	-
Consumer	103,000	103,000	65,000	109,000	-	103,000	-
	$26,981,000	$26,981,000	$1,965,000	$26,612,000	$301,000	$26,330,000	$150,000

Note 4. Allowance for Loan Losses

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

A breakdown of the allowance for loan losses as of June 30, 2012, December 31, 2011, and June 30, 2011, by class of financing receivable and allowance element, is presented in the following tables:

As of June 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	$ 1,133,000	$ 2,685,000	$ 1,746,000	$ -	$ 5,564,000
Construction	787,000	355,000	231,000	-	1,373,000
Other	932,000	935,000	609,000	-	2,476,000
Municipal	-	-	19,000	-	19,000
Residential					
Term	966,000	165,000	456,000	-	1,587,000
Construction	48,000	2,000	8,000	-	58,000
Home equity line of credit	300,000	155,000	354,000	-	809,000
Consumer	11,000	351,000	241,000	-	603,000
Unallocated	-	-	-	1,895,000	1,895,000
	$ 4,177,000	$ 4,648,000	$ 3,664,000	$ 1,895,000	$ 14,384,000

As of December 31, 2011	Specific Reserves on Loans Evaluated Individually for Impairment	General Reserves on Loans Based on Historical Loss Experience	Reserves for Qualitative Factors	Unallocated Reserves	Total Reserves
Commercial					
Real estate	$ 808,000	$ 2,578,000	$ 2,273,000	$ -	$ 5,659,000
Construction	33,000	332,000	293,000	-	658,000

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

As of June 30, 2011	Specific Reserves on Loans Evaluated Individually for Impairment	General Reserves on Loans Based on Historical Loss Experience	Reserves for Qualitative Factors	Unallocated Reserves	Total Reserves
Commercial					
Real estate	$ 613,000	$ 2,463,000	$ 3,851,000	$ -	$ 6,927,000
Construction	-	274,000	428,000	-	702,000
Other	857,000	962,000	1,504,000	-	3,323,000
Municipal	-	-	19,000	-	19,000
Residential					
Term	265,000	505,000	586,000	-	1,356,000
Construction	-	16,000	19,000	-	35,000
Home equity line of credit	165,000	85,000	402,000	-	652,000
Consumer	65,000	264,000	335,000	-	664,000
Unallocated	-	-	-	1,356,000	1,356,000
	$ 1,965,000	$ 4,569,000	$ 7,144,000	$ 1,356,000	$ 15,034,000

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 30.3% of capital are well under the regulatory guidance of 100.0% of capital at June 30, 2012. Construction loans and non-owner-occupied commercial real estate loans are at 90.4% of total capital, well under regulatory guidance of 300.0% of capital at June 30, 2012.

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

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

	Commercial Real Estate	Commercial Construction	Commercial Other	Municipal Loans	All Risk-Rated Loans
1 Strong	$21,000	$-	$284,000	$1,822,000	$2,127,000
2 Above Average	19,319,000	170,000	4,601,000	7,933,000	32,023,000
3 Satisfactory	36,207,000	1,751,000	13,541,000	3,770,000	55,269,000
4 Average	99,855,000	20,932,000	32,700,000	2,564,000	156,051,000
5 Watch	41,089,000	1,969,000	21,147,000	-	64,205,000
6 OAEM	21,135,000	1,649,000	4,357,000	-	27,141,000
7 Substandard	34,931,000	6,601,000	11,111,000	-	52,643,000
8 Doubtful	636,000	-	92,000	-	728,000
Total	$253,193,000	$33,072,000	$87,833,000	$16,089,000	$390,187,000

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

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

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

	Commercial Real Estate	Commercial Construction	Commercial Other	Municipal Loans	All Risk-Rated Loans
1 Strong	$29,000	$-	$467,000	$2,341,000	$2,837,000
2 Above Average	21,021,000	10,000	3,657,000	10,772,000	35,460,000
3 Satisfactory	40,346,000	1,616,000	15,714,000	3,985,000	61,661,000
4 Average	114,124,000	12,894,000	41,208,000	2,876,000	171,102,000
5 Watch	38,095,000	6,293,000	15,042,000	-	59,430,000
6 OAEM	19,572,000	4,015,000	6,338,000	-	29,925,000
7 Substandard	30,150,000	4,558,000	20,067,000	-	54,775,000
8 Doubtful	-	-	6,000	-	6,000
Total	$263,337,000	$29,386,000	$102,499,000	$19,974,000	$415,196,000

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

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

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

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

The following table presents allowance for loan losses transactions by class for the six-months and quarters ended June 30, 2012, and allowance for loan loss balances by class and related loan balances by class as of June 30, 2012:

	Commercial Real Estate	Construction	Other	Municipal	Residential Term	Construction	Home Equity Line of Credit	Consum
For the six months ended June 30, 2012								
Beginning balance	$5,659,000	$658,000	$2,063,000	$19,000	$1,159,000	$255,000	$595,000	$584,00
Charge offs	915,000	-	2,162,000	-	375,000	118,000	49,000	276,00
Recoveries	1,000	246,000	11,000	-	2,000	-	-	119,00
Provision	819,000	469,000	2,564,000	-	801,000	(79,000)	263,000	176,00
Ending balance	$5,564,000	$1,373,000	$2,476,000	$19,000	$1,587,000	$58,000	$809,000	$603,00
For the three months ended June 30, 2012								
Beginning balance	$5,862,000	$704,000	$2,125,000	$19,000	$1,236,000	$59,000	$682,000	$568,00
Charge offs	915,000	-	160,000	-	136,000	118,000	-	96,000
Recoveries	1,000	-	9,000	-	1,000	-	-	44,000
Provision	616,000	669,000	502,000	-	486,000	117,000	127,000	87,000
Ending balance	$5,564,000	$1,373,000	$2,476,000	$19,000	$1,587,000	$58,000	$809,000	$603,00
Allowance for loan losses as of June 30, 2012								
Ending balance specifically evaluated for impairment	$1,133,000	$787,000	$932,000	$-	$966,000	$48,000	$300,000	$11,000
Ending balance collectively evaluated for impairment	$4,431,000	$586,000	$1,544,000	$19,000	$621,000	$10,000	$509,000	$592,00
Related loan balances as of June 30, 2012								
Ending balance	$253,193,000	$33,072,000	$87,833,000	$16,089,000	$368,876,000	$6,449,000	$100,689,000	$15,613
Ending balance specifically evaluated for impairment	$13,795,000	$3,619,000	$4,100,000	$-	$19,052,000	$1,336,000	$1,456,000	$16,000
Ending balance collectively evaluated for impairment	$239,398,000	$29,453,000	$83,733,000	$16,089,000	$349,824,000	$5,113,000	$99,233,000	$15,597

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

	Commercial			Municipal	Residential		Home Equity Line of Credit	Consumer	Unallocated	Total
	Real Estate	Construction	Other		Term	Construction				
Allowance for loan losses as of December 31, 2011										
Ending balance specifically evaluated for impairment	$808,000	$ 33,000	$402,000	$ -	$					