First Bancorp, Inc /ME/
Form 10-Q
August 09, 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 June 30, 2013

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, 2013
Common Stock: 10,663,193 shares

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Part I. Financial Information

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

Dollars in thousands,	As of and for the six months ended June 30,		For the quarters ended June 30,	
except for per share amounts	2013	2012	2013	2012
Summary of Operations				
Interest Income	$24,514	$26,239	$12,249	$13,133
Interest Expense	6,240	6,515	3,138	3,215
Net Interest Income	18,274	19,724	9,111	9,918
Provision for Loan Losses	2,700	4,900	1,200	2,800
Non-Interest Income	6,867	6,064	3,579	3,896
Non-Interest Expense	14,812	12,908	7,423	6,730
Net Income	6,098	6,236	3,242	3,323
Per Common Share Data				
Basic Earnings per Share	$0.56	$0.60	$0.29	$0.32
Diluted Earnings per Share	0.56	0.60	0.29	0.32
Cash Dividends Declared	0.390	0.390	0.195	0.195
Book Value per Common Share	13.69	14.32	13.69	14.32
Tangible Book Value per Common Share[2]	10.82	11.51	10.82	11.51
Market Value	17.48	17.00	17.48	17.00
Financial Ratios				
Return on Average Equity[1]	8.18 %	8.84 %	8.38 %	9.38 %
Return on Average Tangible Common Equity[1,2]	9.70 %	10.35 %	9.93 %	11.01 %
Return on Average Assets[1]	0.87 %	0.88 %	0.92 %	0.93 %
Average Equity to Average Assets	11.18 %	10.84 %	11.23 %	10.73 %
Average Tangible Equity to Average Assets[2]	9.01 %	8.89 %	9.06 %	8.81 %
Net Interest Margin Tax-Equivalent[1,2]	3.04 %	3.19 %	3.02 %	3.16 %
Dividend Payout Ratio	69.64 %	65.00 %	67.24 %	60.94 %
Allowance for Loan Losses/Total Loans	1.46 %	1.63 %	1.46 %	1.63 %
Non-Performing Loans to Total Loans	2.25 %	2.49 %	2.25 %	2.49 %
Non-Performing Assets to Total Assets	1.75 %	1.91 %	1.75 %	1.91 %
Efficiency Ratio[2]	57.26 %	50.74 %	57.90 %	51.06 %
At Period End				
Total Assets	$1,444,496	$1,424,757	$1,444,496	$1,424,757
Total Loans	866,071	881,814	866,071	881,814
Total Investment Securities	478,911	457,570	478,911	457,570
Total Deposits	1,027,682	1,005,274	1,027,682	1,005,274
Total Shareholders' Equity	145,972	153,405	145,972	153,405

[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 June 30, 2013 and 2012 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, 2013

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

	June 30, 2013	December 31, 2012	June 30, 2012
Assets			
Cash and cash equivalents	$18,683,000	$14,958,000	$14,192,000
Interest bearing deposits in other banks	334,000	1,638,000	—
Securities available for sale	287,735,000	291,614,000	307,347,000
Securities to be held to maturity (fair value of $174,790,000 at June 30, 2013, $150,247,000 at December 31, 2012 and $143,628,000 at June 30, 2012)	177,264,000	143,320,000	135,775,000
Restricted equity securities, at cost	13,912,000	14,448,000	14,448,000
Loans held for sale	1,047,000	1,035,000	378,000
Loans	866,071,000	869,284,000	881,814,000
Less allowance for loan losses	12,670,000	12,500,000	14,384,000
Net loans	853,401,000	856,784,000	867,430,000
Accrued interest receivable	6,443,000	4,912,000	6,024,000
Premises and equipment, net	23,913,000	22,988,000	18,500,000
Other real estate owned	5,826,000	7,593,000	5,188,000
Goodwill	29,805,000	29,805,000	27,684,000
Other assets	26,133,000	25,904,000	27,791,000
Total assets	$1,444,496,000	$1,414,999,000	$1,424,757,000
Liabilities			
Demand deposits	$88,540,000	$90,252,000	$77,019,000
NOW deposits	139,022,000	147,309,000	123,897,000
Money market deposits	87,993,000	80,983,000	71,009,000
Savings deposits	142,718,000	135,250,000	119,471,000
Certificates of deposit	569,409,000	505,056,000	613,878,000
Total deposits	1,027,682,000	958,850,000	1,005,274,000
Borrowed funds – short term	116,956,000	142,750,000	118,767,000
Borrowed funds – long term	140,152,000	140,155,000	130,159,000
Other liabilities	13,734,000	16,921,000	17,152,000
Total liabilities	1,298,524,000	1,258,676,000	1,271,352,000
Shareholders' equity			
Preferred stock, $1,000 preference value per share	—	12,402,000	12,352,000
Common stock, one cent par value per share	106,000	98,000	98,000
Additional paid-in capital	58,066,000	46,314,000	46,110,000
Retained earnings	91,348,000	89,692,000	87,396,000
Accumulated other comprehensive income (loss)			
Net unrealized gain (loss) on securities available for sale	(3,433,000)	7,940,000	7,526,000
Net unrealized loss on postretirement benefit costs	(115,000)	(123,000)	(77,000)
Total shareholders' equity	145,972,000	156,323,000	153,405,000
Total liabilities & shareholders' equity	$1,444,496,000	$1,414,999,000	$1,424,757,000
Common Stock			
Number of shares authorized	18,000,000	18,000,000	18,000,000
Number of shares issued and outstanding	10,659,764	9,859,914	9,847,159
Book value per common share	$13.69	$14.60	$14.32
Tangible book value per common share	$10.82	$11.47	$11.51

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 six months ended June 30,		For the quarters ended June 30,	
	2013	2012	2013	2012
Interest income				
Interest and fees on loans	$17,530,000	$18,759,000	$8,738,000	$9,367,000
Interest on deposits with other banks	4,000	1,000	2,000	1,000
Interest and dividends on investments	6,980,000	7,479,000	3,509,000	3,765,000
Total interest income	24,514,000	26,239,000	12,249,000	13,133,000
Interest expense				
Interest on deposits	4,012,000	4,297,000	2,025,000	2,104,000
Interest on borrowed funds	2,228,000	2,218,000	1,113,000	1,111,000
Total interest expense	6,240,000	6,515,000	3,138,000	3,215,000
Net interest income	18,274,000	19,724,000	9,111,000	9,918,000
Provision for loan losses	2,700,000	4,900,000	1,200,000	2,800,000
Net interest income after provision for loan losses	15,574,000	14,824,000	7,911,000	7,118,000
Non-interest income				
Investment management and fiduciary income	968,000	844,000	519,000	448,000
Service charges on deposit accounts	1,423,000	1,351,000	775,000	713,000
Net securities gains	1,087,000	1,967,000	788,000	1,444,000
Mortgage origination and servicing income, net of amortization	1,387,000	304,000	491,000	460,000
Other operating income	2,002,000	1,598,000	1,006,000	831,000
Total non-interest income	6,867,000	6,064,000	3,579,000	3,896,000
Non-interest expense				
Salaries and employee benefits	6,994,000	6,202,000	3,520,000	3,118,000
Occupancy expense	1,069,000	819,000	522,000	405,000
Furniture and equipment expense	1,310,000	1,123,000	688,000	550,000
FDIC insurance premiums	584,000	606,000	294,000	305,000
Amortization of identified intangibles	163,000	141,000	81,000	70,000
Other operating expense	4,692,000	4,017,000	2,318,000	2,282,000
Total non-interest expense	14,812,000	12,908,000	7,423,000	6,730,000
Income before income taxes	7,629,000	7,980,000	4,067,000	4,284,000
Income tax expense	1,531,000	1,744,000	825,000	961,000
NET INCOME	$6,098,000	$6,236,000	$3,242,000	$3,323,000
Basic earnings per common share	$0.56	$0.60	$0.29	$0.32
Diluted earnings per common share	$0.56	$0.60	$0.29	$0.32
Other comprehensive income (loss), net of tax				
Net unrealized gain (loss) on securities available for sale	(11,373,000)	125,000	(8,907,000)	438,000
Amortization of unrecognized postretirement benefits	8,000	10,000	4,000	5,000
Other comprehensive income (loss)	(11,365,000)	135,000	(8,903,000)	443,000
Comprehensive income (loss)	$(5,267,000)	$6,371,000	$(5,661,000)	$3,766,000

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	—	—	—	6,236,000	—	6,236,000
Net unrealized gain on securities available for sale, net of tax	—	—	—	—	125,000	125,000
Amortization of unrecognized postretirement benefits, net of tax	—	—	—	—	10,000	10,000
Comprehensive income	—	—	—	6,236,000	135,000	6,371,000
Cash dividends declared ($0.195 per share)	—	—	—	(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
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	—	—	—	6,098,000	—	6,098,000
Net unrealized loss on securities available for sale, net of tax	—	—	—	—	(11,373,000)	(11,373,000)
Amortization of unrecognized postretirement benefits, net of tax	—	—	—	—	8,000	8,000
Comprehensive loss	—	—	—	6,098,000	(11,365,000)	(5,267,000)
Cash dividends declared ($0.195 per share)	—	—	—	(4,442,000)	—	(4,442,000)
Equity compensation expense	—	—	107,000	—	—	107,000
Amortization of premium for preferred stock issuance	98,000	—	(98,000)	—	—	—
Payment to repurchase preferred stock	(12,500,000)	—	—	—	—	(12,500,000)
	—	799,850	11,751,000	—	—	11,751,000

Proceeds from sale of common stock						
Balance at June 30, 2013	—	10,659,764	$58,172,000	$91,348,000	$(3,548,000)	$145,972,000

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, 2013	June 30, 2012
Cash flows from operating activities		
Net income	$6,098,000	$6,236,000
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	838,000	663,000
Change in deferred taxes	(13,000)	(688,000)
Provision for loan losses	2,700,000	4,900,000
Loans originated for resale	(34,725,000)	(12,535,000)
Proceeds from sales and transfers of loans	35,549,000	12,720,000
Net gain on sales of loans	(836,000)	(369,000)
Net gain on sale or call of securities	(1,087,000)	(1,967,000)
Net amortization of premiums on investments	1,152,000	1,482,000
Net loss on sale of other real estate owned	24,000	39,000
Provision for losses on other real estate owned	332,000	198,000
Equity compensation expense	107,000	40,000
Net increase in other assets and accrued interest	(125,000)	(1,831,000)
Net increase in other liabilities	900,000	2,243,000
Net loss on disposal of premises and equipment	4,000	—
Amortization of investment in limited partnership	260,000	238,000
Net acquisition amortization	163,000	103,000
Net cash provided by operating activities	11,341,000	11,472,000
Cash flows from investing activities		
Decrease in interest-bearing deposits in other banks	1,304,000	—
Proceeds from sales of securities available for sale	10,563,000	25,137,000
Proceeds from maturities, payments and calls of securities available for sale	35,593,000	26,024,000
Proceeds from maturities, payments and calls of securities to be held to maturity	28,818,000	21,871,000
Proceeds from sales of other real estate owned	2,062,000	667,000
Purchases of securities available for sale	(59,873,000)	(71,706,000)
Purchases of securities to be held to maturity	(62,728,000)	(35,101,000)
Redemption of restricted equity securities	536,000	995,000
Net (increase) decrease in loans	32,000	(22,340,000)
Capital expenditures	(1,767,000)	(321,000)
Net cash used in investing activities	(45,460,000)	(54,774,000)
Cash flows from financing activities		
Net increase (decrease) in demand, savings, and money market accounts	4,479,000	(761,000)
Net increase in certificates of deposit	64,353,000	64,734,000
Net decrease in short-term borrowings	(25,797,000)	(16,730,000)
Repurchase of preferred stock	(12,500,000)	—
Proceeds from sale of common stock	11,751,000	290,000
Dividends paid	(4,442,000)	(4,154,000)
Net cash provided by financing activities	37,844,000	43,379,000
Net increase in cash and cash equivalents	3,725,000	77,000
Cash and cash equivalents at beginning of period	14,958,000	14,115,000

Cash and cash equivalents at end of period	$18,683,000	$14,192,000
Interest paid	$6,368,000	$6,640,000
Income taxes paid	950,000	869,000
Non-cash transactions		
Net transfer from loans to other real estate owned	$651,000	$1,998,000

See Report of Independent Registered Public Accounting Firm.

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 June 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 June 30, 2013:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value (Estimated)
Securities available for sale				
Mortgage-backed securities	$157,023,000	$2,014,000	$(1,513,000)	$157,524,000
State and political subdivisions	134,376,000	1,955,000	(7,792,000)	128,539,000
Other equity securities	1,617,000	63,000	(8,000)	1,672,000
	$293,016,000	$4,032,000	$(9,313,000)	$287,735,000
Securities to be held to maturity				
U.S. Government-sponsored agencies	$92,179,000	$10,000	$(5,944,000)	$86,245,000
Mortgage-backed securities	42,389,000	1,883,000	(625,000)	43,647,000
State and political subdivisions	42,396,000	2,268,000	(66,000)	44,598,000
Corporate securities	300,000	—	—	300,000
	$177,264,000	$4,161,000	$(6,635,000)	$174,790,000
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 June 30, 2012:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value (Estimated)
Securities available for sale				
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
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. Government-sponsored agencies	$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 contractual maturities of investment securities at June 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	$1,345,000	$1,368,000	$766,000	$773,000
Due in 1 to 5 years	139,000	140,000	6,081,000	6,462,000
Due in 5 to 10 years	2,426,000	2,563,000	24,873,000	26,299,000
Due after 10 years	287,489,000	281,992,000	145,544,000	141,256,000
Equity securities	1,617,000	1,672,000	—	—
	$293,016,000	$287,735,000	$177,264,000	$174,790,000

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 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

At June 30, 2013, securities with a fair value of $123,571,000 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 $140,384,000 at June 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 six months and quarters ended June 30, 2013 and 2012:

	For the six months ended June 30,		For the quarters ended June 30,	
	2013	2012	2013	2012
Proceeds from sales of securities	$10,563,000	$25,137,000	$5,598,000	$14,194,000
Gross realized gains	1,087,000	2,256,000	788,000	1,444,000
Gross realized losses	—	(289,000)	—	—
Net gain	$1,087,000	$1,967,000	$788,000	$1,444,000
Related income taxes	$380,000	$688,000	$275,000	$505,000

Management reviews securities with unrealized losses for other than temporary impairment. As of June 30, 2013, there were 280 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 six 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, 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	$85,453,000	$(5,944,000)	$—	$—	$85,453,000	$(5,944,000)
Mortgage-backed securities	58,706,000	(2,039,000)	1,585,000	(99,000)	60,291,000	(2,138,000)
State and political subdivisions	71,738,000	(7,858,000)	—	—	71,738,000	(7,858,000)
Other equity securities	—	—	110,000	(8,000)	110,000	(8,000)
	$215,897,000	$(15,841,000)	$1,695,000	$(107,000)	$217,592,000	$(15,948,000)

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)

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. Information regarding securities temporarily impaired as of June 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	$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)
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)

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, 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 June 30, 2013 and 2012 and at December 31, 2012:

	June 30, 2013		December 31, 2012		June 30, 2012	
Commercial						
Real estate	$251,799,000	29.1%	$251,335,000	28.9%	$253,193,000	28.7%
Construction	18,641,000	2.2%	22,417,000	2.6%	33,072,000	3.8%
Other	91,393,000	10.6%	81,183,000	9.3%	87,833,000	10.0%
Municipal	14,885,000	1.7%	14,704,000	1.7%	16,089,000	1.8%
Residential						
Term	374,522,000	43.2%	379,447,000	43.7%	368,876,000	41.8%
Construction	4,759,000	0.5%	6,459,000	0.7%	6,449,000	0.7%
Home equity line of credit	95,013,000	11.0%	99,082,000	11.4%	100,689,000	11.4%
Consumer	15,059,000	1.7%	14,657,000	1.7%	15,613,000	1.8%
Total	$866,071,000	100.0%	$869,284,000	100.0%	$881,814,000	100.0%

Loan balances include net deferred loan costs of $2,001,000 as of June 30, 2013, $1,783,000 as of December 31, 2012, and $1,664,000 as of June 30, 2012. Pursuant to collateral agreements, qualifying first mortgage loans, which totaled $254,417,000 at June 30, 2013, $256,378,000 at December 31, 2012, and $243,196,000 at June 30, 2012, were used to collateralize borrowings from the Federal Home Loan Bank of Boston. In addition, commercial, construction and home equity loans totaling $221,953,000 at June 30, 2013, $220,520,000 at December 31, 2012, and $232,598,000 at June 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 June 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	$717,000	$—	$2,347,000	$3,064,000	$248,735,000	$251,799,000	$—
Construction	—	—	456,000	456,000	18,185,000	18,641,000	—
Other	244,000	3,482,000	2,547,000	6,273,000	85,120,000	91,393,000	503,000
Municipal	—	—	—	—	14,885,000	14,885,000	—
Residential							
Term	636,000	3,955,000	7,933,000	12,524,000	361,998,000	374,522,000	395,000
Construction	82,000	—	—	82,000	4,677,000	4,759,000	—
Home equity line of credit	652,000	62,000	816,000	1,530,000	93,483,000	95,013,000	—
Consumer	104,000	63,000	121,000	288,000	14,771,000	15,059,000	121,000
Total	$2,435,000	$7,562,000	$14,220,000	$24,217,000	$841,854,000	$866,071,000	$1,019,000

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 June 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	$—	$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	177,000	266,000	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	2,191,000	1,000,000	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	140,000	49,000	180,000	369,000	15,244,000	15,613,000	164,000
Total	$4,717,000	1,328,000	$13,995,000	$20,040,000	$861,774,000	$881,814,000	$164,000

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 June 30, 2013 and 2012 and at December 31, 2012 is presented in the following table:

	June 30, 2013	December 31, 2012	June 30, 2012
Commercial			
Real estate	$4,424,000	$4,603,000	$5,545,000
Construction	519,000	101,000	521,000
Other	2,856,000	3,459,000	2,361,000
Municipal	—	—	—
Residential			
Term	10,640,000	10,333,000	10,723,000
Construction	—	—	1,336,000
Home equity line of credit	1,046,000	654,000	1,456,000
Consumer	—	—	16,000
Total	$19,485,000	$19,150,000	$21,958,000

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 June 30, 2013, is presented in the following table:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	For the six months ended June 30, 2013 Average Recorded Investment	For the six months ended June 30, 2013 Recognized Interest Income	For the quarter ended June 30, 2013 Average Recorded Investment	For the quarter ended June 30, 2013 Recognized Interest Income
With No Related Allowance							
Commercial							
Real estate	$11,452,000	$11,851,000	$—	$10,621,000	$200,000	$11,083,000	$99,000
Construction	517,000	1,065,000	—	210,000	28,000	376,000	27,000
Other	4,017,000	4,325,000	—	3,726,000	59,000	3,759,000	32,000
Municipal	—	—	—	—	—	—	—
Residential							
Term	15,399,000	17,441,000	—	13,862,000	248,000	14,636,000	150,000
Construction	—	—	—	—	—	—	—
Home equity line of credit	1,655,000	1,892,000	—	1,579,000	15,000	1,665,000	7,000
Consumer	—	—	—	—	—	—	—
	$33,040,000	$36,574,000	$—	$29,998,000	$550,000	$31,519,000	$315,000
With an Allowance Recorded							
Commercial							
Real estate	$5,880,000	$6,619,000	$1,510,000	$6,688,000	$110,000	$6,577,000	$48,000
Construction	1,302,000	1,302,000	266,000	2,297,000	19,000	1,626,000	(7,000)
Other	1,773,000	1,893,000	1,005,000	2,008,000	11,000	1,920,000	2,000
Municipal	—	—	—	—	—	—	—
Residential							
Term	4,296,000	4,520,000	218,000	5,961,000	93,000	5,117,000	29,000
Construction	—	—	—	—	—	—	—
Home equity line of credit	40,000	40,000	7,000	94,000	1,000	15,000	1,000
Consumer	—	—	—	—	—	—	—
	$13,291,000	$14,374,000	$3,006,000	$17,048,000	$234,000	$15,255,000	$73,000
Total							
Commercial							
Real estate	$17,332,000	$18,470,000	$1,510,000	$17,309,000	$310,000	$17,660,000	$147,000
Construction	1,819,000	2,367,000	266,000	2,507,000	47,000	2,002,000	20,000
Other	5,790,000	6,218,000	1,005,000	5,735,000	70,000	5,679,000	34,000
Municipal	—	—	—	—	—	—	—
Residential							
Term	19,695,000	21,961,000	218,000	19,822,000	341,000	19,753,000	179,000
Construction	—	—	—	—	—	—	—
Home equity line of credit	1,695,000	1,932,000	7,000	1,673,000	16,000	1,680,000	8,000
Consumer	—	—	—	—	—	—	—
	$46,331,000	$50,948,000	$3,006,000	$47,046,000	$784,000	$46,774,000	$388,000

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 June 30, 2012, is presented in the following table:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	For the six months ended June 30, 2012 Average Recorded Investment	For the six months ended June 30, 2012 Recognized Interest Income	For the quarter ended June 30, 2012 Average Recorded Investment	For the quarter ended June 30, 2012 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

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 June 30, 2013, December 31, 2012, and June 30, 2012, by class of financing receivable and allowance element, is presented in the following tables:

As of June 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	$1,510,000	$2,148,000	$2,153,000	$—	$5,811,000
Construction	266,000	162,000	163,000	—	591,000
Other	1,005,000	783,000	784,000	—	2,572,000
Municipal	—	—	18,000	—	18,000
Residential					
Term	218,000	380,000	428,000	—	1,026,000
Construction	—	4,000	5,000	—	9,000
Home equity line of credit	7,000	402,000	328,000	—	737,000
Consumer	—	408,000	223,000	—	631,000
Unallocated	—	—	—	1,275,000	1,275,000
	$3,006,000	$4,287,000	$4,102,000	$1,275,000	$12,670,000

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 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

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 0.50% of related loans as of June 30, 2013, compared to 0.46% of related loans as of December 31, 2012. The qualitative portion increased $287,000 between December 31, 2012 and June 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 $1,275,000 at June 30, 2013, or 10% 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:

- 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 quarter increases uncertainty in the existing loan portfolio and warrants an increase in the unallocated reserve over the six months ended June 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 18.4% of capital are well under the regulatory guidance of 100.0% of capital at June 30, 2013. Construction loans and non-owner-occupied commercial real estate loans are at 74.1% of total capital, well under regulatory guidance of 300.0% of capital at June 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 June 30, 2013:

	Commercial Real Estate	Commercial Construction	Commercial Other	Municipal Loans	All Risk-Rated Loans
1 Strong	$18,000	$—	$255,000	$1,590,000	$1,863,000
2 Above Average	12,914,000	569,000	6,135,000	7,775,000	27,393,000
3 Satisfactory	39,155,000	2,716,000	17,439,000	4,183,000	63,493,000
4 Average	102,063,000	10,963,000	33,117,000	1,337,000	147,480,000
5 Watch	39,466,000	42,000	15,716,000	—	55,224,000
6 OAEM	24,265,000	3,001,000	4,196,000	—	31,462,000
7 Substandard	33,503,000	1,350,000	14,535,000	—	49,388,000
8 Doubtful	415,000	—	—	—	415,000
Total	$251,799,000	$18,641,000	$91,393,000	$14,885,000	$376,718,000

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 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

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 six months ended June 30, 2013.

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

	Commercial			Municipal	Residential		Home Equity Line of Credit	Consumer	Un
	Real Estate	Construction	Other		Term	Construction			
For the six months ended June 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	61,000	930,000	521,000	—	607,000	—	431,000	252,000	—
Recoveries	—	—	144,000	—	36,000	—	2,000	90,000	—
Provision	7,000	162,000	899,000	—	488,000	(2,000)	512,000	201,000	433
Ending balance	$5,811,000	$591,000	$2,572,000	$18,000	$1,026,000	$9,000	$737,000	$631,000	$1,
For the three months ended June 30, 2013									
Beginning balance	$5,879,000	$1,064,000	$2,115,000	$18,000	$1,113,000	$9,000	$859,000	$574,000	$1,
Charge offs	7,000	527,000	233,000	—	407,000	—	69,000	125,000	—
Recoveries	—	—	41,000	—	34,000	—	1,000	42,000	—
Provision	(61,000)	54,000	649,000	—	286,000	—	(54,000)	140,000	186
Ending balance	$5,811,000	$591,000	$2,572,000	$18,000	$1,026,000	$9,000	$737,000	$631,000	$1,
Allowance for loan losses as of June 30, 2013									
Ending balance specifically evaluated for impairment	$1,510,000	$266,000	$1,005,000	$—	$218,000	$—	$7,000	$—	$—
Ending balance collectively evaluated for impairment	$4,301,000	$325,000	$1,567,000	$18,000	$808,000	$9,000	$730,000	$631,000	$1,
Related loan balances as of June 30, 2013									
Ending balance	$251,799,000	$18,641,000	$91,393,000	$14,885,000	$374,522,000	$4,759,000	$95,013,000	$15,059,000	$—
Ending balance specifically evaluated for impairment	$17,332,000	$1,819,000	$5,790,000	$—	$19,695,000	$—	$1,695,000	$—	$—
Ending balance collectively evaluated for	$234,467,000	$16,822,000	$85,603,000	$14,885,000	$354,827,000	$4,759,000	$93,318,000	$15,059,000	$—

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	$2,0(
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	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 six-months and quarter ended June 30, 2012, and allowance for loan loss balances by class and related loan balances by class as of June 30, 2012:

	Commercial			Municipal	Residential		Home Equity Line of Credit	Consumer	Una
	Real Estate	Construction	Other		Term	Construction			
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	$584,000	$2,0
Charge offs	915,000	—	2,162,000	—	375,000	118,000	49,000	276,000	—
Recoveries	1,000	246,000	11,000	—	2,000	—	—	119,000	—
Provision	819,000	469,000	2,564,000	—	801,000	(79,000)	263,000	176,000	(113
Ending balance	$5,564,000	$1,373,000	$2,476,000	$19,000	$1,587,000	$58,000	$809,000	$603,000	$1,8
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	$568,000	$1,6
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	196
Ending balance	$5,564,000	$1,373,000	$2,476,000	$19,000	$1,587,000	$58,000	$809,000	$603,000	$1,8
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	$592,000	$1,8
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	$15,613,000	$—
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	$239,398,000	$29,453,000	$83,733,000	$16,089,000	$349,824,000	$5,113,000	$99,233,000	$15,597,000	$—

impairment

Troubled Debt Restructured

A troubled debt restructured ("TDR") constitutes a restructuring of debt if the Company, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower that it would not otherwise consider. To determine whether or not a loan should be classified as a TDR, Management evaluates a loan based upon the following criteria:

- The borrower demonstrates financial difficulty; common indicators include past due status with bank obligations, substandard credit bureau reports, or an inability to refinance with another lender, and
- The Company has granted a concession; common concession types include maturity date extension, interest rate adjustments to below market pricing, and deferment of payments.

As of June 30, 2013, the Company had 105 loans with a value of $30,874,000 that have been classified as TDRs. This compares to 101 loans with a value of $29,955,000 and 82 loans with a value of $24,980,000 classified as TDRs as of December 31, 2012 and June 30, 2012, respectively. The impairment carried as a specific reserve in the allowance for loan losses is calculated by present valuing the expected cash flows on the loan at the original interest rate, or, for collateral-dependent loans, using the fair value of the collateral less costs to sell.

The following table shows TDRs by class and the specific reserve as of June 30, 2013:

	Number of Loans	Balance	Specific Reserves
Commercial			
Real estate	20	$13,593,000	$868,000
Construction	3	1,789,000	267,000
Other	23	3,491,000	607,000
Municipal	—	—	—
Residential			
Term	54	11,149,000	167,000
Construction	—	—	—
Home equity line of credit	5	852,000	7,000
Consumer	—	—	—
	105	$30,874,000	$1,916,000

The following table shows TDRs by class and the specific reserve as of December 31, 2012:

	Number of Loans	Balance	Specific Reserves
Commercial			
Real estate	18	$11,961,000	$823,000
Construction	3	3,319,000	969,000
Other	23	3,074,000	574,000
Municipal	—	—	—
Residential			
Term	53	10,945,000	224,000
Construction	—	—	—
Home equity line of credit	4	656,000	—
Consumer	—	—	—
	101	$29,955,000	$2,590,000

The following table shows TDRs by class and the specific reserve as of June 30, 2012:

	Number of Loans	Balance	Specific Reserves
Commercial			
Real estate	17	$9,216,000	$496,000
Construction	2	3,099,000	696,000
Other	15	1,984,000	590,000
Municipal	—	—	—
Residential			
Term	48	10,681,000	327,000
Construction	—	—	—
Home equity line of credit	—	—	—
Consumer	—	—	—
	82	$24,980,000	$2,109,000

As of June 30, 2013, 12 of the loans classified as TDRs with a total balance of $2,197,000 were more than 30 days past due. Of these loans, two loans with an outstanding balance of $524,000 had been placed on TDR status in the previous 12 months. The following table shows these TDRs by class and the associated specific reserves included in the allowance for loan losses as of June 30, 2013:

	Number of Loans	Balance	Specific Reserves
Commercial			
Real estate	2	$319,000	$5,000
Construction	1	423,000	—
Other	2	370,000	9,000
Municipal	—	—	—
Residential			
Term	7	1,085,000	6,000
Construction	—	—	—
Home equity line of credit	—	—	—
Consumer	—	—	—
	12	$2,197,000	$20,000

As of June 30, 2012, 13 of the loans classified as TDRs with a total balance of $2,487,000 were more than 30 days past due. Of these loans, six loans with an outstanding balance of $864,000 had been placed on TDR status in the previous 12 months. The following table shows these TDRs by class and the associated specific reserves included in the allowance for loan losses as of June 30, 2012:

	Number of Loans	Balance	Specific Reserves
Commercial			
Real estate	1	$269,000	$111,000
Construction	—	—	—
Other	3	180,000	—
Municipal	—	—	—
Residential			
Term	9	2,038,000	92,000
Construction	—	—	—
Home equity line of credit	—	—	—
Consumer	—	—	—
	13	$2,487,000	$203,000

For the six months ended June 30, 2013, ten loans were placed on TDR status with an outstanding balance of $3,890,000. This compares to 29 loans placed on TDR status with an outstanding balance of $8,107,000 for the six months ended June 30, 2012. These were considered TDRs because concessions had been granted to borrowers experiencing financial difficulties. Concessions include reductions in interest rates, principal and/or interest forbearance, payment extensions, or combinations thereof.

The following tables show loans placed on TDR status in the six months ended June 30, 2013 and 2012, by class of loan and the associated specific reserve included in the allowance for loan losses as of June 30, 2013 and 2012:

For the six months ended June 30, 2013	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Specific Reserves
Commercial				
Real estate	2	$ 1,897,000	$ 1,897,000	$—
Construction	—	—	—	—
Other	5	1,164,000	1,150,000	$—
Municipal	—	—	—	—
Residential				
Term	2	625,000	475,000	—
Construction	—	—	—	—
Home equity line of credit	1	204,000	202,000	—
Consumer	—	—	—	—
	10	$ 3,890,000	$ 3,724,000	—

For the six months ended June 30, 2012	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Specific Reserves
Commercial				
Real estate	12	$ 4,032,000	$ 3,845,000	$152,000
Construction	1	1,951,000	1,951,000	696,000
Other	9	713,000	712,000	544,000
Municipal	—	—	—	—
Residential				
Term	7	1,411,000	1,411,000	76,000
Construction	—	—	—	—
Home equity line of credit	—	—	—	—
Consumer	—	—	—	—
	29	$ 8,107,000	$ 7,919,000	$1,468,000

For the quarter ended June 30, 2013, three loans were placed on TDR status with an outstanding balance of $936,000. This compares to 15 loans placed on TDR status with an outstanding balance of $5,105,000 for the quarter ended June 30, 2012. These were considered TDRs because concessions had been granted to borrowers experiencing financial difficulties. Concessions include reductions in interest rates, principal and/or interest forbearance, payment extensions, or combinations thereof.

The following tables show loans placed on TDR status in the three months ended June 30, 2013 and 2012, by class of loan and the associated specific reserve included in the allowance for loan losses as of June 30, 2013 and 2012:

For the quarter ended June 30, 2013	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Specific Reserves
Commercial				
Real estate	—	$ —	$ —	$—
Construction	—	—	—	—
Other	2	623,000	620,000	—
Municipal	—	—	—	—
Residential				
Term	1	313,000	163,000	$—
Construction	—	—	—	—
Home equity line of credit	—	—	—	—
Consumer	—	—	—	—
	3	$ 936,000	$ 783,000	$—

For the quarter ended June 30, 2012	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Specific Reserves
Commercial				
Real estate	5	$ 1,598,000	$ 1,449,000	$152,000
Construction	1	1,951,000	1,951,000	696,000
Other	6	701,000	700,000	545,000
Municipal	—	—	—	—
Residential				
Term	3	855,000	855,000	61,000
Construction	—	—	—	—
Home equity line of credit	—	—	—	—
Consumer	—	—	—	—
	15	$ 5,105,000	$ 4,955,000	$1,454,000

As of June 30, 2013, Management is aware of ten loans classified as TDRs that are involved in bankruptcy with an outstanding balance of $970,000. There were also 23 loans with an outstanding balance of $4,027,000 that were classified as TDRs and on non-accrual status. Five loans with an outstanding balance of $450,000, that were classified as TDRs, were in the process of foreclosure.

Note 5 – Stock Options and Stock-Based Compensation

At the 2010 Annual Meeting, shareholders approved the 2010 Equity Incentive Plan (the "2010 Plan"). This reserves 400,000 shares of common stock for issuance in connection with stock options, restricted stock awards and other equity based awards to attract and retain the best available personnel, provide additional incentive to officers, employees and non-employee Directors and promote the success of our business. Such grants and awards will be structured in a manner that does not encourage the recipients to expose the Company to undue or inappropriate risk. Options issued under the 2010 Plan will qualify for treatment as incentive stock options for purposes of Section 422 of the Internal Revenue Code. Other compensation under the 2010 Plan will qualify as performance-based for purposes of Section 162(m) of the Internal Revenue Code, and will satisfy NASDAQ guidelines relating to equity compensation.

As of June 30, 2013, 46,841 shares of restricted stock had been granted under the 2010 Plan, as detailed in the following table:

Year Granted	Vesting Term (In Years)	Shares	Remaining Term (In Years)
2011	4.0	1,500	1.6
2011	5.0	5,500	2.6
2012	3.0	2,027	1.7
2012	4.0	2,704	2.7
2012	5.0	7,996	3.7
2013	2.0	8,529	1.7
2013	3.0	8,886	2.7
2013	5.0	9,699	4.7
		46,841	3.0

The compensation cost related to these restricted stock grants was $756,000 and will be recognized over the vesting terms of each grant. In the six months ended June 30, 2013, $107,000 of expense was recognized for these restricted shares, leaving $540,000 in unrecognized expense as of June 30, 2013. In the six months ended June 30, 2012, $40,000 of expense was recognized for restricted shares, leaving $240,000 in unrecognized expense as of June 30, 2012.

The Company established a shareholder-approved stock option plan in 1995 (the "1995 Plan"), under which the Company granted options to employees for 600,000 shares of common stock. Only incentive stock options were granted under the 1995 Plan. The option price of each option grant was determined by the Options Committee of the Board of Directors, and in no instance was less than the fair market value on the date of the grant. An option's maximum term was ten years from the date of grant, with 50% of the options granted vesting two years from the date of grant and the remaining 50% vesting five years from the date of grant. As of January 16, 2005, all options under the 1995 Plan had been granted. The Company applies the fair value recognition provisions of the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 718 "Compensation – Stock Compensation", to stock-based employee compensation. As of June 30, 2013, all outstanding options were fully vested and all compensation cost for options had been recognized. A summary of the status of outstanding stock options as of June 30, 2013 and changes during the six-month period then ended, is presented below.

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value (In thousands)
Outstanding at December 31, 2012	42,000	$18.00		
Granted in 2013	—	—		
Exercised in 2013	—	—		—
Forfeited in 2013	—	—		
Outstanding at June 30, 2013	42,000	$18.00	1.6	—
Exercisable at June 30, 2013	42,000	$18.00	1.6	—

Note 6 – Preferred and Common Stock

Preferred Stock

On January 9, 2009, the Company issued $25,000,000 in Fixed Rate Cumulative Perpetual Preferred Stock, Series A, having a liquidation preference of $1,000 per share, to the U.S. Treasury ("Treasury') under the Capital Purchase Program ("the CPP Shares"). The CPP Shares called for cumulative dividends at a rate of 5.0% per year for the first five years, and at a rate of 9.0% per year in following years, payable quarterly in arrears on February 15, May 15, August 15 and November 15 of each year.

On August 24, 2011, the Company repurchased $12,500,000 of the CPP Shares. Almost all of the repayment was made from retained earnings accumulated since the preferred stock was issued in 2009. On March 27, 2013, the Company repurchased $2,500,000 of the CPP Shares with funds from it's operating account. On May 8, 2013, the Company repurchased the remaining $10,000,000 CPP Shares using proceeds from the Company's common stock offering in the first quarter of 2013, All the repurchase transactions were approved by the Federal Reserve Bank of Boston, the Company's primary regulator.

Incident to such issuance of the CPP shares, the Company issued to the Treasury warrants (the "Warrants") to purchase up to 225,904 shares of the Company's common stock at a price per share of $16.60 (subject to adjustment). The Warrants (and any shares of common stock issuable pursuant to the Warrants) are freely transferable by Treasury to third parties and the Company has filed a registration statement with the Securities and Exchange Commission to allow for possible resale of such securities.

The Warrants have a term of ten years and could be exercised by Treasury or a subsequent holder at any time or from time to time during their term. To the extent they had not previously been exercised, the Warrants will expire after ten years. Treasury will not vote any shares of common stock it receives upon exercise of the Warrants, but that restriction would not apply to third parties to whom Treasury transferred the Warrants. The proceeds from the sale of the CPP Shares were allocated between the CPP Shares and Warrants based on their relative fair values on the issue date. The fair value of the Warrants was determined using the Black-Scholes model which includes the following assumptions: common stock price of $16.60 per share, dividend yield of 4.70%, stock price volatility of 24.43%, and a risk-free interest rate of 2.01%. The discount on the CPP Shares was based on the value that was allocated to the Warrants upon issuance, and is being accreted back to the value of the CPP Shares over a five-year period (the expected life of the shares upon issuance) on a straight-line basis. The Warrants were unchanged as a result of the CPP Shares repurchase transactions and remain outstanding.

Common Stock

On March 28, 2013, the Company consummated a fully underwritten offering for 760,771 shares of the Company's common stock, with net proceeds of $11,649,000. The Company used these proceeds to repurchase the remaining $10,000,000 of CPP Shares on May 8, 2013.

Note 7 – Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share (EPS) for the six months ended June 30, 2013 and 2012:

	Income (Numerator)	Shares (Denominator)	Per-Share Amount
For the six months ended June 30, 2013			
Net income as reported	$6,098,000		
Less dividends and amortization of premium on preferred stock	345,000		
Basic EPS: Income available to common shareholders	5,753,000	10,316,177	$0.56
Effect of dilutive securities: warrants and restricted stock		47,799	
Diluted EPS: Income available to common shareholders plus assumed conversions	$5,753,000	10,363,976	$0.56
For the six months ended June 30, 2012			
Net income as reported	$6,236,000		
Less dividends and amortization of premium on preferred stock	362,000		
Basic EPS: Income available to common shareholders	5,874,000	9,822,437	$0.60
Effect of dilutive securities: restricted stock		15,461	
Diluted EPS: Income available to common shareholders plus assumed conversions	$5,874,000	9,837,898	$0.60

The following table sets forth the computation of basic and diluted EPS for the quarters ended June 30, 2013 and 2012.

	Income (Numerator)	Shares (Denominator)	Per-Share Amount
For the quarter ended June 30, 2013			
Net income as reported	$3,242,000		
Less dividends and amortization of premium on preferred stock	164,000		
Basic EPS: Income available to common shareholders	3,078,000	10,610,615	$0.29
Effect of dilutive securities: warrants and restricted stock		47,249	
Diluted EPS: Income available to common shareholders plus assumed conversions	$3,078,000	10,657,864	$0.29
For the quarter ended June 30, 2012			
Net income as reported	$3,323,000		
Less dividends and amortization of premium on preferred stock	181,000		
Basic EPS: Income available to common shareholders	3,142,000	9,824,568	$0.32
Effect of dilutive securities: restricted stock		19,727	
Diluted EPS: Income available to common shareholders plus assumed conversions	$3,142,000	9,844,295	$0.32

All earnings per share calculations have been made using the weighted average number of shares outstanding during the period. The potentially dilutive securities are incentive stock options and unvested shares of restricted stock granted to certain key members of Management and the warrants. The number of dilutive shares is calculated using the treasury method, assuming that all options and warrants were exercisable at the end of each period. Options and warrants that are out-of-the-money are not considered in the calculation of dilutive earnings per share as the effect would be anti-dilutive.

The following table presents the number of options and warrants outstanding as of June 30, 2013 and 2012 and the amount for which the market price at period end is above or below the strike price:

	Outstanding	In-the-Money	Out-of-the-Money
As of June 30, 2013			
Incentive stock options	42,000	—	42,000
Warrants issued to Treasury	225,904	225,904	—
Total dilutive securities	267,904	225,904	42,000
As of June 30, 2012			
Incentive stock options	42,000	—	42,000
Warrants issued to Treasury	225,904	—	225,904
Total dilutive securities	267,904	—	267,904

Note 8 – Employee Benefit Plans

401(k) Plan

The Bank has a defined contribution plan available to substantially all employees who have completed 3 months of service. Employees may contribute up to Internal Revenue Service ("IRS") determined limits and the Bank may match employee contributions not to exceed 3.0% of compensation depending on contribution level. Subject to a vote of the Board of Directors, the Bank may also make a profit-sharing contribution to the Plan. Such contribution equaled 2.0% of each eligible employee's compensation in 2012. The amount for 2013 has not been established. The expense related to the 401(k) plan was $199,000 and $186,000 for the six months ended June 30, 2013 and 2012, respectively.

Supplemental Retirement Benefits

The Bank also provides unfunded, non-qualified supplemental retirement benefits for certain officers, payable in installments over 20 years upon retirement or death. The agreements consist of individual contracts with differing characteristics that, when taken together, do not constitute a postretirement plan. The costs for these benefits are recognized over the service periods of the participating officers in accordance with FASB ASC Topic 712 "Compensation – Nonretirement Postemployment Benefits". The expense of these supplemental retirement benefits was $155,000 for the six months ended June 30, 2013 and $145,000 for the same period in 2012. As of June 30, 2013, the associated accrued liability included in other liabilities in the balance sheet was $2,207,000 compared to $2,080,000 and $1,964,000 at December 31, 2012 and June 30, 2012, respectively.

Post-Retirement Benefit Plans

The Bank sponsors two post-retirement benefit plans. One plan currently provides a subsidy for health insurance premiums to certain retired employees and a future subsidy for seven active employees who were age 50 and over in 1996. These subsidies are based on years of service and range between $40 and $1,200 per month per person. The other plan provides life insurance coverage to certain retired employees and health insurance for retired directors. None of these plans are pre-funded. The Company utilizes FASB ASC Topic 712 "Compensation – Nonretirement Postemployment Benefits" to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its balance sheet and to recognize changes in the funded status in the year in which the changes occur through comprehensive income. The following table sets forth the accumulated postretirement benefit obligation and funded status:

	At or for the six months ended June 30,	
	2013	2012
Change in benefit obligation		
Benefit obligation at beginning of year	$1,954,000	$1,848,000
Service cost	8,000	34,000
Interest cost	52,000	56,000
Benefits paid	(68,000)	(68,000)
Benefit obligation at end of period	1,946,000	1,870,000
Funded status		
Benefit obligation at end of period	(1,946,000)	(1,870,000)
Accrued benefit cost at end of period	$(1,946,000)	$(1,870,000)

The following table sets forth the net periodic pension cost:

	For the six months ended June 30,		For the quarters ended June 30,	
	2013	2012	2013	2012
Components of net periodic benefit cost				
Service cost	$8,000	$34,000	$4,000	$17,000
Interest cost	52,000	56,000	26,000	28,000
Amortization of unrecognized transition obligation	5,000	14,000	—	7,000
Amortization of accumulated losses	4,000	6,000	4,000	3,000
Net periodic benefit cost	$69,000	$110,000	$34,000	$55,000

Amounts not yet reflected in net periodic benefit cost and included in accumulated other comprehensive income (loss) are as follows:

	June 30, 2013	December 31, 2012	June 30, 2012
Unamortized net actuarial loss	$(182,000)	$(186,000)	$(100,000)
Unrecognized transition obligation	—	(5,000)	(20,000)
	(182,000)	(191,000)	(120,000)
Deferred tax benefit at 35%	67,000	68,000	43,000
Net unrecognized postretirement benefits included in accumulated other comprehensive income (loss)	$(115,000)	$(123,000)	$(77,000)

A weighted average discount rate of 4.5% was used in determining the accumulated benefit obligation and the net periodic benefit cost. The assumed health care cost trend rate is 7.0%. The measurement date for benefit obligations was as of year-end for prior years presented. The expected benefit payments for the third quarter of 2013 are $26,000 and the expected benefit payments for all of 2013 are $102,000. Plan expense for 2013 is estimated to be $112,000. A 1% change in trend assumptions would create an approximate change in the same direction of $100,000 in the accumulated benefit obligation, $7,000 in the interest cost and $1,000 in the service cost.

Note 9 - Other Comprehensive Income (Loss)

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, 2013 and 2012.

	For the six months ended June 30,		For the quarters ended June 30,	
	2013	2012	2013	2012
Balance at beginning of period	$7,940,000	$7,401,000	$5,474,000	$7,088,000
Unrealized gains (losses) arising during the period	(16,410,000)	2,159,000	(12,915,000)	2,118,000
Reclassification of realized gains during the period	(1,087,000)	(1,967,000)	(788,000)	(1,444,000)
Related deferred taxes	6,124,000	(67,000)	4,796,000	(236,000)
Net change	(11,373,000)	125,000	(8,907,000)	438,000
Balance at end of period	$(3,433,000)	$7,526,000	$(3,433,000)	$7,526,000

The reclassification of realized gains is included in the net securities gain line of the consolidated statements of income and comprehensive income and the tax effect is included in the income tax expense line of the same statement. The following table summarizes activity in the unrealized gain or loss on postretirement benefits included in other comprehensive income for the six-months and quarters ended June 30, 2013 and 2012.

	For the six months ended June 30,		For the quarters ended June 30,	
	2013	2012	2013	2012
Unrecognized postretirement benefits at beginning of period	$(123,000)	$(87,000)	$(119,000)	$(82,000)
Amortization of unrecognized transition obligation	5,000	14,000	—	7,000
Change in accumulated losses	4,000	—	6,000	—
Related deferred taxes	(1,000)	(4,000)	(2,000)	(2,000)
Unrecognized postretirement benefits at end of period	$(115,000)	$(77,000)	$(115,000)	$(77,000)

The reclassification of unrecognized transition obligation is a component of net periodic benefit cost (see Note 8) and the income tax effect is included in the income tax expense line of the consolidated statements of income and comprehensive income.

Note 10 - Acquisitions and Intangible Assets

On October 26, 2012, the Bank completed the purchase of a branch at 63 Union Street in Rockland, Maine, from Camden National Bank that was formerly operated by Bank of America. As part of the transaction, the Bank acquired approximately $32,300,000 in deposits as well as a small volume of loans. On the same date, the Bank completed the purchase of a full-service bank building at 145 Exchange Street in Bangor, Maine, also from Camden National Bank, and opened a full-service branch in this building in the first quarter of 2013. The acquisition allows the Bank to expand its community banking franchise into eastern Maine and expand its presence in Rockland, Maine. The acquisition-date estimated fair values of assets acquired and liabilities assumed in Rockland and Bangor were as follows:

Assets	
Cash	$25,297,000
Loans	224,000
Bank premises and equipment	3,776,000
Accrued interest receivable and other assets	24,000
Core deposit intangible	432,000
Goodwill	2,121,000
Liabilities	
Deposits	$31,858,000
Accrued interest and other liabilities	16,000

The purchase premium of $2,600,000 was allocated to assets acquired and liabilities assumed based on estimates of fair value at the date of acquisition. The fair value of the deposit accounts assumed was compared to the carrying amounts received and the difference of $432,000 was recorded as core deposit intangible. The core deposit intangible is subject to amortization over the estimated ten-year average life of the acquired core deposit base and will be evaluated for impairment periodically. The amortization expense is included in noninterest expense in the consolidated statements of income and comprehensive income (loss) and is deductible for tax purposes. As of December 31, 2012, the amortization expense related to the core deposit intangible, absent any future impairment, is expected to be as follows:

2013	$43,000
2014	43,000
2015	43,000
2016	43,000
2017	43,000
Thereafter	217,000
Total	$432,000

The banking facilities were valued at the most recent tax assessed value, which approximates fair value. The loans acquired were recorded at fair value at the time of acquisition. The estimated fair value of the loans acquired is equal to the carrying value. The excess of the purchase price over the fair value of the assets acquired, liabilities assumed, and the amount allocated for core deposit intangible totaled $2,121,000 and was recorded as goodwill. The goodwill is not amortizable for GAAP but is amortizable for tax purposes. Management periodically assesses qualitative factors to determine whether goodwill is impaired. Management is not aware of any such events or circumstances that would cause it to conclude that the goodwill is impaired.

On January 14, 2005, the Company acquired FNB Bankshares (“FNB”) of Bar Harbor, Maine, and its subsidiary, The First National Bank of Bar Harbor. The total value of the transaction was $47,955,000, and all of the voting equity interest of FNB was acquired in the transaction. The transaction was accounted for as a purchase and the excess of purchase price over the fair value of net identifiable assets acquired equaled $27,559,000 and was recorded as goodwill, none of which was deductible for tax purposes. The portion of the purchase price related to the core deposit intangible is being amortized over its expected economic life, and goodwill is evaluated annually for possible impairment under the provisions of FASB ASC Topic 350, “Intangibles – Goodwill and Other”. As of December 31, 2012, in accordance with Topic 350, the Company completed its annual review of goodwill and determined there has been no impairment. The Bank also carries $125,000 in goodwill for a de minimus transaction in 2001.

Note 11 – Mortgage Servicing Rights

FASB ASC Topic 940 "Financial Services – Mortgage Banking" requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable. The Company's servicing assets and servicing liabilities are reported using the amortization method and carried at the lower of amortized cost or fair value by strata. In evaluating the carrying values of mortgage servicing rights, the Company obtains third party valuations based on loan level data including note rate, type and term of the underlying loans. The model utilizes several assumptions, the most significant of which is loan prepayments, calculated using a three-month moving average of weekly prepayment data published by the Public Securities

Association (PSA) and modeled against the serviced loan portfolio, and the discount rate to discount future cash flows. As of June 30, 2013, the prepayment assumption using the PSA model was 268, which translates into an anticipated prepayment rate of 16.06%. The discount rate is the quarterly average 10 year U.S. Treasury plus 5.09%. Other assumptions include delinquency rates, foreclosure rates, servicing cost inflation, and annual unit loan cost. All assumptions are adjusted periodically to reflect current circumstances. Amortization of mortgage servicing rights, as well as write-offs due to prepayments of the related mortgage loans, are recorded as a charge against mortgage servicing fee income.

For the six months ended June 30, 2013 and 2012, servicing rights capitalized totaled $479,000 and $81,000, respectively. Servicing rights capitalized for the three-month periods ended June 30, 2013 and 2012, were $224,000 and $70,000 respectively. Servicing rights amortized for the six-month periods ended June 30, 2013 and 2012, were $265,000 and $334,000, respectively. The fair value of servicing rights was $1,757,000, $1,228,000 and $1,075,000 at June 30, 2013, December 31, 2012 and June 30, 2012, respectively. The Bank serviced loans for others totaling $212,106,000, $205,859,000 and $213,035,000 at June 30, 2013, December 31, 2012, and June 30, 2012, respectively.

Mortgage servicing rights are included in other assets and detailed in the following table:

	June 30, 2013	December 31, 2012	June 30, 2012
Mortgage servicing rights	$6,909,000	$6,430,000	$6,177,000
Accumulated amortization	(5,738,000)	(5,473,000)	(5,170,000)
Impairment reserve	(18,000)	(90,000)	(177,000)
	$1,153,000	$867,000	$830,000

Note 12 – Income Taxes

FASB ASC Topic 740 "Income Taxes," defines the criteria that an individual tax position must satisfy for some or all of the benefits of that position to be recognized in a company's financial statements. Topic 740 prescribes a recognition threshold of more-likely-than-not, and a measurement attribute for all tax positions taken or expected to be taken on a tax return, in order for those tax positions to be recognized in the financial statements. The Company is currently open to audit under the statute of limitations by the IRS for the years ended December 31, 2010 through 2012.

Note 13 - Certificates of Deposit

The following table represents the breakdown of certificates of deposit at June 30, 2013 and 2012, and at December 31, 2012:

	June 30, 2013	December 31, 2012	June 30, 2012
Certificates of deposit < $100,000	$197,888,000	$199,265,000	$239,635,000
Certificates $100,000 to $250,000	334,361,000	277,571,000	313,742,000
Certificates $250,000 and over	37,160,000	28,220,000	60,501,000
	$569,409,000	$505,056,000	$613,878,000

Note 14 – Reclassifications

Certain items from the prior year were reclassified in the financial statements to conform with the current year presentation. These do not have a material impact on the consolidated balance sheet or statement of income and comprehensive income (loss) presentations.

Note 15 – Fair Value

Certain assets and liabilities are recorded at fair value to provide additional insight into the Company's quality of earnings. Some of these assets and liabilities are measured on a recurring basis while others are measured on a nonrecurring basis, with the determination based upon applicable existing accounting pronouncements. For example, securities available for sale are recorded at fair value on a recurring basis. Other assets, such as, other real estate owned and impaired loans, are recorded at fair value on a nonrecurring basis using the lower of cost or market methodology to determine impairment of individual assets. The Company groups assets and liabilities which are recorded at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement (with level 1 considered highest and level 3 considered lowest). A brief description of each level follows.

Level 1 - Valuation is based upon quoted prices for identical instruments in active markets.
Level 2 - Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.
Level 3 - Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates that market participants would use in pricing the asset or liability. Valuation includes use of discounted cash flow models and similar techniques.

The fair value methods and assumptions for the Company's financial instruments and other assets measured at fair value are set forth below.

Cash, Cash Equivalents and Interest-Bearing Deposits in Other Banks
The carrying values of cash equivalents, due from banks and federal funds sold approximate their relative fair values. As such, the Company classifies these financial instruments as Level 1.

Investment Securities
The fair values of investment securities are estimated by independent providers using a market approach with observable inputs. In obtaining such valuation information from third parties, the Company has evaluated their valuation methodologies used to develop the fair values in order to determine whether the valuations are representative of an exit price in the Company's principal markets. The Company's principal markets for its securities portfolios are the secondary institutional markets, with an exit price that is predominantly reflective of bid level pricing in those markets. Fair values are calculated based on the value of one unit without regard to any premium or discount that may result from concentrations of ownership of a financial instrument, possible tax ramifications, or estimated transaction costs. If these considerations had been incorporated into the fair value estimates, the aggregate fair value could have been changed. The carrying values of restricted equity securities approximate fair values. As such, the Company classifies investment securities as Level 2.

Loans Held for Sale
Loans held for sale are recorded at the lower of carrying value or market value. The fair value of mortgage loans held for sale is based on what secondary markets are currently offering for portfolios with similar characteristics. As such, the Company classifies mortgage loans held for sale as Level 2.

Loans
Fair values are estimated for portfolios of loans with similar financial characteristics. The fair values of performing loans are calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest risk inherent in the loan. The estimates of maturity are based on the Company's historical experience with repayments for each loan classification, modified, as required, by an estimate of the effect of current economic and lending conditions, and the effects of estimated prepayments. Assumptions regarding credit risk, cash flows, and discount rates are judgmentally determined using available market information and specific borrower information. Management has made estimates of fair value using discount rates that it believes to be reasonable. However, because there is no market for many of these financial instruments, Management has no basis to determine whether the fair value presented above would be indicative of the value negotiated in an actual sale. As such, the Company classifies loans as Level 3, except for collateral dependent impaired loans. Fair values of impaired loans are based on estimated cash flows and are discounted using a rate commensurate with the risk associated with the estimated cash flows, or if collateral dependent, discounted to the appraised value of the collateral, less costs to sell. As such, the Company classifies collateral dependent impaired loans as Level 2 and all other impaired loans as level 3.

Other Real Estate Owned
Real estate acquired through foreclosure is initially recorded at fair value. The fair value of other real estate owned is based on property appraisals and an analysis of similar properties currently available. As such, the Company records other real estate owned as nonrecurring Level 2.

Mortgage Servicing Rights
Mortgage servicing rights represent the value associated with servicing residential mortgage loans. Servicing assets and servicing liabilities are reported using the amortization method and compared to fair value for impairment. In evaluating the fair values of mortgage servicing rights, the Company obtains third party valuations based on loan level data including note rate, type and term of the underlying loans. As such, the Company classifies mortgage servicing rights as Level 2.

Accrued Interest Receivable
The fair value estimate of this financial instrument approximates the carrying value as this financial instrument has a short maturity. It is the Company's policy to stop accruing interest on loans for which it is probable that the interest is not collectible. Therefore, this financial instrument has been adjusted for estimated credit loss. As such, the Company classifies accrued interest receivable as Level 2.

Deposits
The fair value of deposits is based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar remaining maturities. The fair value estimates do not include the benefit that results from the low-cost funding provided by the deposits compared to the cost of borrowing funds in the market. If that value were considered, the fair value of the Company's net assets could increase. As such, the Company classifies deposits as Level 2.

Borrowed Funds
The fair value of borrowed funds is based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently available for borrowings of similar remaining maturities. As such, the Company classifies borrowed funds as Level 2.

Accrued Interest Payable
The fair value estimate approximates the carrying amount as this financial instrument has a short maturity. As such, the Company classifies accrued interest payable as Level 2.

Off-Balance-Sheet Instruments
Off-balance-sheet instruments include loan commitments. Fair values for loan commitments have not been presented as the future revenue derived from such financial instruments is not significant.

Limitations
Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These values do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on Management's judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates. Fair value estimates are based on existing on- and off-balance-sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Other significant assets and liabilities that are not considered financial instruments include the deferred tax asset, premises and equipment, and other real estate owned. In addition, tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of the estimates.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis
The following tables present the balances of assets and liabilities that were measured at fair value on a recurring basis as of June 30, 2013, December 31, 2012 and June 30, 2012.

	At June 30, 2013			
	Level 1	Level 2	Level 3	Total
Securities available for sale				
Mortgage-backed securities	$—	$157,524,000	$—	$157,524,000

State and political subdivisions	—	128,539,000	—	128,539,000
Other equity securities	—	1,672,000	—	1,672,000
Total assets	$—	$287,735,000	$—	$287,735,000

	At December 31, 2012			
	Level 1	Level 2	Level 3	Total
Securities available for sale				
Mortgage-backed securities	$—	$169,093,000	$—	$169,093,000
State and political subdivisions	—	120,944,000	—	120,944,000
Other equity securities	—	1,577,000	—	1,577,000
Total assets	$—	$291,614,000	$—	$291,614,000

	At June 30, 2012			
	Level 1	Level 2	Level 3	Total
Securities available for sale				
Mortgage-backed securities	$—	$206,979,000	$—	$206,979,000
State and political subdivisions	—	98,593,000	—	98,593,000
Other equity securities	—	1,775,000	—	1,775,000
Total assets	$—	$307,347,000	$—	$307,347,000

Assets and Liabilities Recorded at Fair Value on a Non-Recurring Basis

The following tables include assets measured at fair value on a nonrecurring basis that have had a fair value adjustment since their initial recognition. Other real estate owned is presented net of an allowance of $547,000, $373,000 and $385,000 at June 30, 2013, December 31, 2012, and June 30, 2012, respectively. Impaired loans measured at fair value only include impaired loans with a related specific allowance for loan losses and are presented net of specific allowances of $877,000, $3,539,000 and $4,177,000 at June 30, 2013, December 31, 2012, and June 30, 2012, respectively. The December 31, 2012 and June 30, 2012 non-recurring fair value table includes all impaired loans with a related allowance. The Company refined its process for identifying impaired loans for purposes of fair value disclosures; accordingly the June 30, 2013 fair value table only includes those impaired loans for which the related allowance results in a fair value measure, as described above.

	At June 30, 2013			
	Level 1	Level 2	Level 3	Total
Other real estate owned	$—	$5,826,000	$—	$5,826,000
Impaired loans	—	3,911,000	—	3,911,000
Total assets	$—	$9,737,000	$—	$9,737,000

	At December 31, 2012			
	Level 1	Level 2	Level 3	Total
Other real estate owned	$—	$7,593,000	$—	$7,593,000
Impaired loans	—	13,923,000	—	13,923,000
Total assets	$—	$21,516,000	$—	$21,516,000

	At June 30, 2012			
	Level 1	Level 2	Level 3	Total
Other real estate owned	$—	$5,188,000	$—	$5,188,000
Impaired loans	—	14,734,000	—	14,734,000
Total assets	$—	$19,922,000	$—	$19,922,000

Fair Value of Financial Instruments

FASB ASC Topic 825 "Financial Instruments" requires disclosures of fair value information about financial instruments, whether or not recognized in the balance sheet, if the fair values can be reasonably determined. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques using observable inputs when available. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. Topic 825 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company.

The carrying amount and estimated fair values for financial instruments as of June 30, 2013 were as follows:

	Carrying value	Estimated fair value	Level 1	Level 2	Level 3
Financial assets					
Cash and cash equivalents	$18,683,000	$18,683,000	$18,683,000	$—	$—
Interest bearing deposits in other banks	334,000	334,000	334,000	—	—
Securities available for sale	287,735,000	287,735,000	—	287,735,000	—
Securities to be held to maturity	177,264,000	174,790,000	—	174,790,000	—
Restricted equity securities	13,912,000	13,912,000	—	13,912,000	—
Loans held for sale	1,047,000	1,047,000	—	1,047,000	—
Loans (net of allowance for loan losses)					
Commercial					
Real estate	245,338,000	243,846,000	—	2,334,000	241,512,000
Construction	17,984,000	17,875,000	—	0	17,875,000
Other	88,533,000	88,601,000	—	755,000	87,846,000
Municipal	14,865,000	15,599,000	—	—	15,599,000
Residential					
Term	373,381,000	379,161,000	—	789,000	378,372,000
Construction	4,749,000	4,736,000	—	—	4,736,000
Home equity line of credit	94,194,000	93,904,000	—	33,000	93,871,000
Consumer	14,357,000	14,714,000	—	—	14,714,000
Total loans	853,401,000	858,436,000	—	3,911,000	854,525,000
Mortgage servicing rights	1,153,000	1,757,000	—	1,757,000	—
Accrued interest receivable	6,443,000	6,443,000	—	6,443,000	—
Financial liabilities					
Demand deposits	$88,540,000	$82,280,000	$—	$82,280,000	$—
NOW deposits	139,022,000	122,048,000	—	122,048,000	—
Money market deposits	87,993,000	71,120,000	—	71,120,000	—
Savings deposits	142,718,000	121,525,000	—	121,525,000	—
Local certificates of deposit	224,472,000	227,421,000	—	227,421,000	—
National certificates of deposit	344,937,000	347,693,000	—	347,693,000	—
Total deposits	1,027,682,000	972,087,000	—	972,087,000	—
Repurchase agreements	85,731,000	85,731,000	—	85,731,000	—
Federal Home Loan Bank advances	171,377,000	176,813,000	—	176,813,000	—
Total borrowed funds	257,108,000	262,544,000	—	262,544,000	—

Accrued interest payable	607,000	607,000	—	607,000	—

The carrying amounts and estimated fair values for financial instruments as of December 31, 2012 were as follows:

	Carrying value	Estimated fair value	Level 1	Level 2	Level 3
Financial assets					
Cash and cash equivalents	$14,958,000	$14,958,000	$14,958,000	$—	$—
Interest bearing deposits in other banks	1,638,000	1,638,000	1,638,000	—	—
Securities available for sale	291,614,000	291,614,000	—	291,614,000	—
Securities to be held to maturity	143,320,000	150,247,000	—	150,247,000	—
Restricted equity securities	14,448,000	14,448,000	—	14,448,000	—
Loans held for sale	1,035,000	1,035,000	—	1,035,000	—
Loans (net of allowance for loan losses)					
Commercial					
Real estate	245,046,000	244,365,000	—	4,865,000	239,500,000
Construction	20,960,000	20,902,000	—	2,284,000	18,618,000
Other	78,985,000	79,312,000	—	472,000	78,840,000
Municipal	14,685,000	16,058,000	—	—	16,058,000
Residential					
Term	378,258,000	390,223,000	—	6,302,000	383,921,000
Construction	6,447,000	6,430,000	—	—	6,430,000
Home equity line of credit	98,381,000	99,038,000	—	—	99,038,000
Consumer	14,022,000	14,392,000	—	—	14,392,000
Total loans	856,784,000	870,720,000	—	13,923,000	856,797,000
Mortgage servicing rights	867,000	1,228,000	—	1,228,000	—
Accrued interest receivable	4,912,000	4,912,000	—	4,912,000	—
Financial liabilities					
Demand deposits	$90,252,000	$91,544,000	$—	$91,544,000	$—
NOW deposits	147,309,000	141,436,000	—	141,436,000	—
Money market deposits	80,983,000	71,799,000	—	71,799,000	—
Savings deposits	135,250,000	126,142,000	—	126,142,000	—
Local certificates of deposit	218,571,000	223,748,000	—	223,748,000	—
National certificates of deposit	286,485,000	290,457,000	—	290,457,000	—
Total deposits	958,850,000	945,126,000	—	945,126,000	—
Repurchase agreements	101,504,000	101,504,000	—	101,504,000	—
Federal Home Loan Bank advances	181,401,000	189,321,000	—	189,321,000	—
Total borrowed funds	282,905,000	290,825,000	—	290,825,000	—
Accrued interest payable	619,000	619,000	—	619,000	—

The carrying amount and estimated fair values for financial instruments as of June 30, 2012 were as follows:

	Carrying value	Estimated fair value	Level 1	Level 2	Level 3
Financial assets					
Cash and cash equivalents	$14,192,000	$14,192,000	$14,192,000	$—	$—
Interest bearing deposits in other banks	—	—	—	—	—
Securities available for sale	307,347,000	307,347,000	—	307,347,000	—
Securities to be held to maturity	135,775,000	143,628,000	—	143,628,000	—
Restricted equity securities	14,448,000	14,448,000	—	14,448,000	—
Loans held for sale	378,000	378,000	—	378,000	—
Loans (net of allowance for loan losses)					
Commercial					
Real estate	246,597,000	247,044,000	—	2,349,000	244,695,000
Construction	31,507,000	31,564,000	—	1,368,000	30,196,000
Other	84,952,000	85,322,000	—	919,000	84,403,000
Municipal	16,068,000	17,640,000	—	—	17,640,000
Residential					
Term	367,152,000	380,115,000	—	9,391,000	370,724,000
Construction	6,386,000	6,380,000	—	286,000	6,094,000
Home equity line of credit	99,810,000	100,546,000	—	416,000	100,130,000
Consumer	14,958,000	15,868,000	—	5,000	15,863,000
Total loans	867,430,000	884,479,000	—	14,734,000	869,745,000
Mortgage servicing rights	830,000	1,075,000	—	1,075,000	—
Accrued interest receivable	6,024,000	6,024,000	—	6,024,000	—
Financial liabilities					
Demand deposits	$77,019,000	$77,250,000	$—	$77,250,000	$—
NOW deposits	123,897,000	117,571,000	—	117,571,000	—
Money market deposits	71,009,000	62,251,000	—	62,251,000	—
Savings deposits	119,471,000	110,169,000	—	110,169,000	—
Local certificates of deposit	212,845,000	218,300,000	—	218,300,000	—
National certificates of deposit	401,033,000	405,539,000	—	405,539,000	—
Total deposits	1,005,274,000	991,080,000	—	991,080,000	—
Repurchase agreements	90,537,000	90,537,000	—	90,537,000	—
Federal Home Loan Bank advances	158,389,000	166,535,000	—	166,535,000	—
Total borrowed funds	248,926,000	257,072,000	—	257,072,000	—
Accrued interest payable	608,000	608,000	—	608,000	—

Note 16 – Impact of Recently Issued Accounting Standards

In February 2013, the FASB issued Accounting Standards Update ("ASU") No. 2013-02, Reporting of Amounts Reclassified out of Accumulated Comprehensive Income. The ASU adds new disclosure requirements for items reclassified out of accumulated other comprehensive income (AOCI) and is intended to help entities improve the transparency of changes in other comprehensive income and items reclassified out of AOCI in their financial statements. The guidance is effective prospectively for reporting periods beginning after December 15, 2012, with early adoption permitted. Adoption of this new guidance did not have a material effect on the Company's consolidated financial statements.

Item 2 – Management's Discussion and Analysis of Financial Condition
and Results of Operations
The First Bancorp, Inc. and Subsidiary
Forward-Looking Statements
This report contains statements that are "forward-looking statements." We may also make written or oral forward-looking statements in other documents we file with the Securities and Exchange Commission ("SEC"), in our annual reports to shareholders, in press releases and other written materials, and in oral statements made by our officers, directors or employees. You can identify forward-looking statements by the use of the words "believe," "expect," "anticipate," "intend," "estimate," "assume," "outlook," "will," "should," and other expressions that predict or indicate future events and trends and which do not relate to historical matters. You should not rely on forward-looking statements, because they involve known and unknown risks, uncertainties and other factors, some of which are beyond the control of the Company. These risks, uncertainties and other factors may cause the actual results, performance or achievements of the Company to be materially different from the anticipated future results, performance or achievements expressed or implied by the forward-looking statements.
Some of the factors that might cause these differences include the following: changes in general national, regional or international economic conditions or conditions affecting the banking or financial services industries or financial capital markets, volatility and disruption in national and international financial markets, government intervention in the U.S. financial system, reductions in net interest income resulting from interest rate volatility as well as changes in the balance and mix of loans and deposits, reductions in the market value of wealth management assets under administration, changes in the value of securities and other assets, reductions in loan demand, changes in loan collectability, default and charge-off rates, changes in the size and nature of the Company's competition, changes in legislation or regulation and accounting principles, policies and guidelines, and changes in the assumptions used in making such forward-looking statements. In addition, the factors described under "Risk Factors" in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2012, as filed with the SEC, may result in these differences. You should carefully review all of these factors, and you should be aware that there may be other factors that could cause these differences. These forward-looking statements were based on information, plans and estimates at the date of this quarterly report, and we assume no obligation to update any forward-looking statements to reflect changes in underlying assumptions or factors, new information, future events or other changes.
Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, actual results may differ materially from the results discussed in these forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. The Company undertakes no obligation to republish revised forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. Readers are also urged to carefully review and consider the various disclosures made by the Company, which attempt to advise interested parties of the facts that affect the Company's business.
Critical Accounting Policies
Management's discussion and analysis of the Company's financial condition is based on the consolidated financial statements which are prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of such financial statements requires Management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On an ongoing basis, Management evaluates its estimates, including those related to the allowance for loan losses, goodwill, the valuation of mortgage servicing rights, and other-than-temporary impairment on securities. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis in making judgments about the carrying values of assets that are not readily apparent from other sources. Actual results could differ from the amount derived from Management's estimates and assumptions under different assumptions or conditions.
Allowance for Loan Losses. Management believes the allowance for loan losses requires the most significant estimates and assumptions used in the preparation of the consolidated financial statements. The allowance for loan losses is based on Management's evaluation of the level of the allowance required in relation to the estimated loss

exposure in the loan portfolio. Management believes the allowance for loan losses is a significant estimate and therefore regularly evaluates it to determine the appropriate level by taking into consideration factors such as prior loan loss experience, the character and size of the loan portfolio, business and economic conditions and Management's estimation of potential losses. The use of different estimates or assumptions could produce different provisions for loan losses.

Goodwill. Management utilizes numerous techniques to estimate the value of various assets held by the Company, including methods to determine the appropriate carrying value of goodwill as required under Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 350 "Intangibles – Goodwill and Other." In addition, goodwill from a purchase acquisition is subject to ongoing periodic impairment tests, which include an evaluation of the ongoing assets, liabilities and revenues from the acquisition and an estimation of the impact of business conditions.

Mortgage Servicing Rights. The valuation of mortgage servicing rights is a critical accounting policy which requires significant estimates and assumptions. The Bank often sells mortgage loans it originates and retains the ongoing servicing of such loans, receiving a fee for these services, generally 0.25% of the outstanding balance of the loan per annum. Mortgage servicing rights are recognized at fair value when they are acquired through the sale of loans, and are reported in other assets. They are amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. The rights are subsequently carried at the lower of amortized cost or fair value. Management uses an independent firm which specializes in the valuation of mortgage servicing rights to determine the fair value which is recorded on the balance sheet. The most important assumption is the anticipated loan prepayment rate, and increases in prepayment speed results in lower valuations of mortgage servicing rights. The valuation also includes an evaluation for impairment based upon the fair value of the rights, which can vary depending upon current interest rates and prepayment expectations, as compared to amortized cost. Impairment is determined by stratifying rights by predominant characteristics, such as interest rates and terms. The use of different assumptions could produce a different valuation. All of the assumptions are based on standards the Company believes would be utilized by market participants in valuing mortgage servicing rights and are consistently derived and/or benchmarked against independent public sources.

Other-Than-Temporary Impairment on Securities. One of the significant estimates related to investment securities is the evaluation of other-than-temporary impairments. The evaluation of securities for other-than-temporary impairments is a quantitative and qualitative process, which is subject to risks and uncertainties and is intended to determine whether declines in the fair value of investments should be recognized in current period earnings. The risks and uncertainties include changes in general economic conditions, the issuer's financial condition and/or future prospects, the effects of changes in interest rates or credit spreads and the expected recovery period of unrealized losses. Securities that are in an unrealized loss position are reviewed at least quarterly to determine if other-than-temporary impairment is present based on certain quantitative and qualitative factors and measures. The primary factors considered in evaluating whether a decline in value of securities is other-than-temporary include: (a) the length of time and extent to which the fair value has been less than cost or amortized cost and the expected recovery period of the security, (b) the financial condition, credit rating and future prospects of the issuer, (c) whether the debtor is current on contractually obligated interest and principal payments, (d) the volatility of the securities' market price, (e) the intent and ability of the Company to retain the investment for a period of time sufficient to allow for recovery, which may be at maturity and (f) any other information and observable data considered relevant in determining whether other-than-temporary impairment has occurred, including the expectation of receipt of all principal and interest when due.

Use of Non-GAAP Financial Measures

Certain information in Management's Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this Report contains financial information determined by methods other than in accordance with accounting principles generally accepted in the United States of America ("GAAP"). Management uses these "non-GAAP" measures in its analysis of the Company's performance and believes that these non-GAAP financial measures provide a greater understanding of ongoing operations and enhance comparability of results with prior periods as well as demonstrating the effects of significant gains and charges in the current period. The Company believes that a meaningful analysis of its financial performance requires an understanding of the factors underlying that performance. Management believes that investors may use these non-GAAP financial measures to analyze financial performance without the impact of unusual items that may obscure trends in the Company's underlying performance. These disclosures should not be viewed as a substitute for operating results determined in accordance with GAAP, nor are they necessarily comparable to non-GAAP performance measures that may be presented by other companies.

In several places net interest income is presented on a fully taxable-equivalent basis. Specifically included in interest income was tax-exempt interest income from certain investment securities and loans. An amount equal to the tax benefit derived from this tax exempt income has been added back to the interest income total, which adjustments increased net interest income accordingly. Management believes the disclosure of tax-equivalent net interest income information improves the clarity of financial analysis, and is particularly useful to investors in understanding and evaluating the changes and trends in the Company's results of operations. Other financial institutions commonly present net interest income on a tax-equivalent basis. This adjustment is considered helpful in the comparison of one financial institution's net interest income to that of another, as each will have a different proportion of tax-exempt interest from its earning assets. Moreover, net interest income is a component of a second financial measure commonly used by financial institutions, net interest margin, which is the ratio of net interest income to average earning assets. For purposes of this measure as well, other financial institutions generally use tax-equivalent net interest income to provide a better basis of comparison from institution to institution. The Company follows these practices. The following table provides a reconciliation of tax-equivalent financial information to the Company's consolidated financial statements prepared in accordance with GAAP. A 35.0% tax rate was used in both 2013 and 2012.

Dollars in thousands	For the six months ended June 30, 2013	2012	For the quarters ended June 30, 2013	2012
Net interest income as presented	$18,274	$19,724	$9,111	$9,918
Effect of tax-exempt income	1,726	1,527	875	763
Net interest income, tax equivalent	$20,000	$21,251	$9,986	$10,681

The Company presents its efficiency ratio using non-GAAP information. The GAAP-based efficiency ratio is noninterest expenses divided by net interest income plus noninterest income from the Consolidated Statements of Income and Comprehensive Income (Loss). The non-GAAP efficiency ratio excludes securities losses and other-than-temporary impairment charges from noninterest expenses, excludes securities gains from noninterest income, and adds the tax-equivalent adjustment to net interest income. The following table provides a reconciliation between the GAAP and non-GAAP efficiency ratio:

Dollars in thousands	For the six months ended June 30, 2013	2012	For the quarters ended June 30, 2013	2012
Non-interest expense, as presented	$14,812	$12,908	$7,423	$6,730
Net interest income, as presented	18,274	19,724	9,111	9,918
Effect of tax-exempt income	1,726	1,527	875	763
Non-interest income, as presented	6,867	6,064	3,579	3,896
Effect of non-interest tax-exempt income	89	91	44	48
Net securities gains	(1,087)	(1,967)	(788)	(1,444)
Adjusted net interest income plus non-interest income	$25,869	$25,439	$12,821	$13,181
Non-GAAP efficiency ratio	57.26 %	50.74 %	57.90 %	51.06 %
GAAP efficiency ratio	58.92 %	50.05 %	58.49 %	48.72 %

The Company presents certain information based upon average tangible shareholders' common equity instead of total average shareholders' equity. The difference between these measures is the Company's intangible assets, specifically goodwill from prior acquisitions. Management, banking regulators and many stock analysts use the tangible common equity ratio and the tangible book value per common share in conjunction with more traditional bank capital ratios to compare the capital adequacy of banking organizations with significant amounts of goodwill or other intangible assets, typically stemming from the use of the purchase accounting method in accounting for mergers and acquisitions. The following table provides a reconciliation of average tangible shareholders' common equity to the Company's consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles:

Dollars in thousands	For the six months ended June 30, 2013	2012	For the quarters ended June 30, 2013	2012
Average shareholders' equity as presented	$158,472	$154,187	159,092	154,831
Less preferred stock	(8,106)	(12,317)	(3,994)	(12,329)
Less intangible assets	(30,746)	(28,522)	(30,746)	(28,522)
Average tangible shareholders' common equity	119,620	113,348	124,352	113,980

Executive Summary

Net income for the six months ended June 30, 2013 was $6.1 million, down $138,000 or 2.2% from the same period in 2012. Earnings per common share on a fully diluted basis were $0.56 for the six months ended June 30, 2013, down $0.04 or 6.7% from the $0.60 posted for the same period in 2012. For the quarter ended June 30, 2013, net income was $3.2 million, down $81,000 or 2.4% from the same period in 2012. Earnings per common share on a fully diluted basis were $0.29 for the quarter ended June 30, 2013, down $0.03 or 9.4% from the $0.32 posted in 2012. Compared to the previous quarter, net income was up $386,000 or 13.5% and earnings per common share on a fully diluted basis were up $0.02 or 7.4%.

Net interest income on a tax-equivalent basis was down $1.3 million or 5.9% in the six months ended June 30, 2013 compared to the same period in 2012. Margin compression, which is the result of the low interest rate environment, with a higher volume of assets continuing to reprice downward without the opportunity to reprice a comparable volume of liabilities, can be seen in our net interest margin, which dropped from 3.19% for the six months ended June 30, 2012 to 3.04% for same period in 2013. Compression was responsible for $978,000 of the decline in net interest income, while lower volumes of earning assets were responsible for $284,000. This decline was offset by a lower provision for loan losses during the six months ended June 20, 2013 compared to the same period in 2012.

For the quarter ended June 30, 2013, net interest income on a tax-equivalent basis declined $695,000 or 6.5% compared to the same period in 2012. Compared to the previous quarter, net interest income on a tax-equivalent basis was down $27,000 or 0.3%. As stated above, this decline in net interest income was offset by lower provision for loan losses for the second quarter 2013 compared to the second quarter 2012.

Non-interest income in the six months ended June 30, 2013 was $803,000 or 13.2% higher than in the six months ended June 30, 2012. This was attributable primarily to an increase in origination income from the sale of refinanced mortgage loans into the secondary market. Non-interest expense was $1.9 million or 14.8% higher than in the same period in 2012, due to higher operating costs related to the opening of the de novo Bangor office, as well as from the Union Street Branch in Rockland that we acquired in the fourth quarter 2012. The $1.9 million increase in non-interest expense was offset by the lower provision for loan losses as well as the increase in non-interest income.

The lower provision for loan losses for the six months ended June 30, 2013 compared to the six months ended June 30, 2012 is attributable to the improving trend in credit quality seen over the past several quarters. Net loan chargeoffs for the six months ended June 30, 2013, were $2.5 million or 0.59% of average loans on an annualized basis. This was down $1.0 million from net chargeoffs of $3.5 million or 0.81% of average loans on an annualized basis for the first six months ended June 30, 2012. We provisioned $2.7 million for loan losses in the six months ended June 30, 2013, down $2.2 million from the amount provisioned in the six months ended June 30, 2012. The allowance for loan losses increased $170,000 between December 31, 2012 and June 30, 2013, and is 1.46% of loans outstanding compared to 1.44% at year end and 1.63% a year ago. Total past-due loans were 2.80% of total loans as of June 30, 2013, compared to 2.67% of total loans as of December 31, 2012, and 2.27% of total loans as of June 30, 2012. Non-performing assets stood at 1.75% of total assets as of June 30, 2013, below 1.87% of total assets at December 31, 2012 and well below 1.91% a year ago.

Total assets have increased $29.5 million or 2.1% year-to-date. The loan portfolio decreased $3.2 million in the six months ended June 30, 2013 and decreased $15.7 million from a year ago. The investment portfolio has increased $29.5 million or 6.6% year-to-date and $21.3 million or 4.7% from a year ago. On the liability side of the balance sheet, low-cost deposits have decreased $2.5 million or 0.7% year-to-date, and increased $49.9 million or 15.6% over the past year. This year-over-year increase is the result of healthy deposit inflows added in October 2012 with the purchase of the Union Street branch in Rockland. Local certificates of deposit (CDs) increased $11.6 million and wholesale CDs decreased $56.0 million year-to-date.

Remaining well capitalized remains a top priority for The First Bancorp, Inc. Since December 31, 2008, the Company's total risk-based capital ratio has increased from 11.13% to 16.34%, well above the well-capitalized threshold of 10.0% set by the Federal Deposit Insurance Corporation . In Management's view, participating in the U.S. Treasury Capital Purchase Program (the "CPP") was the right decision for The First Bancorp, Inc. The Company obtained additional capital at a relatively low cost and it provides us with greater ability to ride out the current economic storm and allows us more flexibility to work with individuals and businesses as they too struggle through these adverse economic conditions. As of June 30, 2013, the Company had fully repaid the $12.5 million preferred stock issued by the Treasury under the CPP. When the Company received the $25.0 million CPP investment in 2009, it was Management's intent to fully repay the Treasury before the annual rate on the investment increased from 5.0% to 9.0% in 2014.

The Company's operating ratios remain good, with a return on average tangible common equity of 9.70% for the six months ended June 30, 2013 compared to 10.35% for the same period in 2012. Based upon March 31, 2013 data, our return on average tangible common equity was in the top 50% of all banks in the UBPR peer group, which had an average return on equity of 8.91%. Our efficiency ratio continues to be an important component in our overall performance, and while up to 57.26% for the first six months of 2013, compared to 50.74% for the same period in 2012, due to the previously noted increased operating costs, it remains well below the UBPR peer group average of 67.81% as of March 31, 2013.

On February 25, 2013, the Bank opened its sixteenth branch at 145 Exchange Street in Bangor, Maine in the building purchased in the fourth quarter of 2012. This Bangor location offers an excellent opportunity to enter the expanding Northern Maine market.

Net Interest Income

Total interest income of $24.5 million for the six months ended June 30, 2013, was a decrease of $1.7 million or 6.6% compared to total interest income of $26.2 million for the same period of 2012. Total interest expense of $6.2 million for the six months ended June 30, 2013 is a $275,000 or 4.2% decrease from total interest expense of $6.5 million for the six months ended June 30, 2012. As a result, net interest income decreased 7.4% or $1.5 million to $18.3 million for the six months ended

June 30, 2013, from the $19.7 million reported for the same period in 2012. The Company's net interest margin on a tax-equivalent basis decreased from 3.19% in the six months ended June 30, 2012 to 3.04% for the six months ended June 30, 2013. This is the result of the low interest rate environment with a higher volume of assets continuing to reprice downward without the opportunity to reprice a comparable volume of liabilities. Tax-exempt interest income amounted to $3.2 million and $2.8 million for the six months ended June 30, 2013 and 2012, respectively.

Total interest income of $12.2 million for the quarter ended June 30, 2013 is a 6.7% decrease from total interest income of $13.1 million in the comparable period of 2012. Total interest expense of $3.1 million for the quarter ended June 30, 2013 is a 2.4% decrease from total interest expense of $3.2 million for the comparable period of 2012. As a result, net interest income decreased 8.1% or $807,000 to $9.1 million for the quarter ended June 30, 2013, from the $9.9 million reported for the same period in 2012. The Company's net interest margin on a tax-equivalent basis decreased from 3.16% for the quarter ended June 30, 2012 to 3.02% for the quarter ended June 30, 2013. Tax-exempt interest income amounted to $1.6 million and $1.4 million for the quarters ended June 30, 2013 and 2012, respectively.

The following tables present the amount of interest earned or paid, as well as the average yield or rate on an annualized basis, for each major category of assets or liabilities for the six months and quarters ended June 30, 2013 and 2012. Tax-exempt income is calculated on a tax-equivalent basis, using a 35.0% tax rate in 2013 and 2012.

	For the six months ended					
	June 30, 2013			June 30, 2012		
Dollars in thousands	Amount of interest	Average Yield/Rate		Amount of interest	Average Yield/Rate	
Interest on earning assets						
Interest-bearing deposits	$4	0.25	%	$1	0.16	%
Investments	8,562	3.79	%	8,829	3.83	%
Loans held for sale	11	3.21	%	4	3.41	%
Loans	17,663	4.11	%	18,932	4.35	%
Total interest-earning assets	26,240	3.99	%	27,766	4.17	%
Interest-bearing liabilities						
Deposits	4,012	0.90	%	4,297	0.93	%
Other borrowings	2,228	1.71	%	2,218	1.77	%
Total interest-bearing liabilities	6,240	1.08	%	6,515	1.11	%
Net interest income	$20,000			$21,251		
Interest rate spread		2.91	%		3.06	%
Net interest margin		3.04	%		3.19	%

Dollars in thousands	For the quarters ended June 30, 2013 Amount of interest	Average Yield/Rate		June 30, 2012 Amount of interest	Average Yield/Rate	
Interest on earning assets						
Interest-bearing deposits	$2	0.37	%	$1	0.68	%
Investments	4,315	3.79	%	4,444	3.74	%
Loans held for sale	5	3.27	%	4	3.97	%
Loans	8,802	4.08	%	9,447	4.31	%
Total interest-earning assets	13,124	3.98	%	13,896	4.11	%
Interest-bearing liabilities						
Deposits	2,025	0.90	%	2,104	0.90	%
Other borrowings	1,113	1.75	%	1,111	1.71	%
Total interest-bearing liabilities	3,138	1.08	%	3,215	1.08	%
Net interest income	$9,986			$10,681		
Interest rate spread		2.90	%		3.03	%
Net interest margin		3.02	%		3.16	%

The following tables present changes in interest income and expense attributable to changes in interest rates and volume for interest-earning assets and liabilities for the six months and quarters ended June 30, 2013 compared to 2012. Tax-exempt income is calculated on a tax-equivalent basis, using a 35.0% tax rate in 2013 and 2012.

For the six months ended June 30, 2013 compared to 2012

Dollars in thousands	Volume		Rate		Rate/Volume[1]		Total	
Interest on earning assets								
Interest-bearing deposits	$2		$—		$1		$3	
Investment securities	(155	)	(115	)	2		(268	)
Loans held for sale	8		—		(1	)	7	
Loans	(199	)	(1,080	)	11		(1,268	)
Total interest income	(344	)	(1,195	)	$13		(1,526	)
Interest expense								
Deposits	(148	)	(142	)	5		(285	)
Other borrowings	88		(75	)	(3	)	10	
Total interest expense	(60	)	(217	)	2		(275	)
Change in net interest income	$(284	)	$(978	)	$11		$(1,251	)

[1] Represents the change attributable to a combination of change in rate and change in volume.

For the quarter ended June 30, 2013 compared to 2012

Dollars in thousands	Volume	Rate	Rate/Volume[1]	Total
Interest on earning assets				
Interest-bearing deposits	$2	$—	$(1)	$1
Investment securities	(199)	73	(3)	(129)
Loans held for sale	3	(1)	(1)	1
Loans	(180)	(475)	10	(645)
Total interest income	(374)	(403)	5	(772)
Interest expense				
Deposits	(80)	1	0	(79)
Other borrowings	(25)	28	(1)	2
Total interest expense	(105)	29	(1)	(77)
Change in net interest income	$(269)	$(432)	$6	$(695)

Average Daily Balance Sheets

The following table shows the Company's average daily balance sheets for the six-month periods and quarters ended June 30, 2013 and 2012.

Dollars in thousands	For the six months ended June 30, 2013	For the six months ended June 30, 2012	For the quarters ended June 30, 2013	For the quarters ended June 30, 2012
Assets				
Cash and cash equivalents	$13,706	$12,725	$14,414	$13,103
Interest-bearing deposits in other banks	3,287	1,219	2,145	590
Securities available for sale	287,546	312,113	285,372	319,358
Securities to be held to maturity	153,421	136,169	156,990	143,686
Restricted equity securities, at cost	14,116	14,948	13,912	14,609
Loans held for sale	690	236	613	405
Loans	866,281	875,496	865,084	881,767
Allowance for loan losses	(12,801)	(13,154)	(12,757)	(13,399)
Net loans	853,480	862,342	852,327	868,368
Accrued interest receivable	5,106	5,220	5,228	5,549
Premises and equipment	23,168	18,760	23,295	18,650
Other real estate owned	7,242	4,429	6,826	4,640
Goodwill	29,805	27,684	29,805	27,684
Other assets	25,613	26,493	25,734	26,210
Total Assets	$1,417,180	$1,422,338	$1,416,661	$1,442,852
Liabilities & Shareholders' Equity				
Demand deposits	$83,520	$71,140	$82,764	$70,739
NOW deposits	139,633	121,356	138,489	122,165
Money market deposits	87,322	76,178	90,273	73,880
Savings deposits	140,250	117,716	141,227	119,085
Certificates of deposit	530,636	614,538	534,908	625,593
Total deposits	981,361	1,000,928	987,661	1,011,462
Borrowed funds – short term	122,160	118,767	116,956	118,767
Borrowed funds – long term	140,152	133,556	138,285	142,436
Dividends payable	936	948	941	871
Other liabilities	14,099	13,952	13,726	14,485
Total Liabilities	1,258,708	1,268,151	1,257,569	1,288,021
Shareholders' Equity:				
Preferred stock	8,106	12,317	3,994	12,329
Common stock	102	98	106	98
Additional paid-in capital	52,502	46,023	58,049	46,077
Retained earnings	91,674	87,403	92,100	88,149
Net unrealized gain on securities available-for-sale	6,207	8,428	4,959	8,257
Net unrealized loss on postretirement benefit costs	(119)	(82)	(116)	(79)
Total Shareholders' Equity	158,472	154,187	159,092	154,831
Total Liabilities & Shareholders' Equity	$1,417,180	$1,422,338	$1,416,661	$1,442,852

Non-Interest Income
Non-interest income of $6.9 million for the six months ended June 30, 2013, is an increase of $803,000 compared to the same period in 2012. This increase was primarily attributable to origination income from the sale of refinanced mortgage loans into the secondary market. Non-interest income was $3.6 million for the quarter ended June 30, 2013, a decrease of 8.1% from the $3.9 million reported for the quarter ended June 30, 2012. This decrease was attributable to a decrease in net securities gains.

Non-Interest Expense
Non-interest expense of $14.8 million for the six months ended June 30, 2013 is an increase of 14.8% or $1.9 million compared to non-interest expense of $12.9 million for the same period in 2012. Much of this increase was attributable to higher operating costs due to the opening of the Company's sixteenth branch in Bangor, Maine on February 25, 2013. This increase was offset by the lower provision for loan losses as well as the increase in non-interest income. Non-interest expense of $7.4 million million for the quarter ended June 30, 2013 is an increase of 10.3% compared to non-interest expense of $6.7 million for the same period in 2012. With higher operating expenses attributable to the new Bangor office and the aquired branch at Union Street in Rockland, the Company's efficiency ratio has increased to 57.26% for the six months ended June 30, 2013 compared to 50.74% for the same period in 2012.

Income Taxes
Income taxes on operating earnings were $1.5 million for the six months ended June 30, 2013, down $213,000 from the same period in 2012. This is in line with the decrease in the Company's level of income before taxes and a higher level of tax-exempt income.
FASB ASC Topic 740 "Income Taxes" defines the criteria that an individual tax position must satisfy for some or all of the benefits of that position to be recognized in a company's financial statements. Topic 740 prescribes a recognition threshold of more-likely-than-not, and a measurement attribute for all tax positions taken or expected to be taken, in order for those tax positions to be recognized in the financial statements. The Company is currently open to audit under the statute of limitations by the IRS for the years ended December 31, 2010 through 2012.

Investments
The Company's investment portfolio increased by $29.5 million or 6.6% between December 31, 2012, and June 30, 2013. As of June 30, 2013, mortgage-backed securities had a carrying value of $199.9 million and a fair value of $201.2 million. Of this total, securities with a fair value of $157.3 million or 78.2% of the mortgage-backed portfolio were issued by the Government National Mortgage Association and securities with a fair value of $43.9 million or 21.8% of the mortgage-backed portfolio were issued by the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association.
The Company's investment securities are classified into two categories: securities available for sale and securities to be held to maturity. Securities available for sale consist primarily of debt securities which Management intends to hold for indefinite periods of time. They may be used as part of the Company's funds management strategy, and may be sold in response to changes in interest rates, prepayment risk and liquidity needs, to increase capital ratios, or for other similar reasons. Securities to be held to maturity consist primarily of debt securities that the Company has acquired solely for long-term investment purposes, rather than for trading or future sale. For securities to be categorized as held to maturity Management must have the intent and the Company must have the ability to hold such investments until their respective maturity dates. The Company does not hold trading account securities.
All investment securities are managed in accordance with a written investment policy adopted by the Board of Directors. It is the Company's general policy that investments for either portfolio be limited to government debt obligations, time deposits, and corporate bonds or commercial paper with one of the three highest ratings given by a nationally recognized rating agency. The portfolio is currently invested primarily in U.S. Government agency securities and tax-exempt obligations of states and political subdivisions. The individual securities have been selected to enhance the portfolio's overall yield while not materially adding to the Company's level of interest rate risk.

The following table sets forth the Company's investment securities at their carrying amounts as of June 30, 2013 and 2012 and December 31, 2012.

Dollars in thousands	June 30, 2013	December 31, 2012	June 30, 2012
Securities available for sale			
Mortgage-backed securities	$157,524	$169,093	$206,979
State and political subdivisions	128,539	120,944	98,593
Other equity securities	1,672	1,577	1,775
	$287,735	$291,614	$307,347
Securities to be held to maturity			
U.S. government-sponsored agencies	$92,179	$60,919	$41,197
Mortgage-backed securities	42,389	39,193	49,992
State and political subdivisions	42,396	42,908	44,286
Corporate securities	300	300	300
	$177,264	$143,320	$135,775
Restricted equity securities			
Federal Home Loan Bank Stock	$12,875	$13,412	$13,412
Federal Reserve Bank Stock	1,037	1,036	1,036
	$13,912	$14,448	$14,448
Total securities	$478,911	$449,382	$457,570

The following table sets forth yields and expected maturities of the Company's investment securities as of June 30, 2013. Yields on tax-exempt securities have been computed on a tax-equivalent basis using a tax rate of 35%. Mortgage-backed securities are presented according to their final contractual maturity date, while the calculated yield takes into effect the intermediate cash flows from repayment of principal which results in a much shorter average life.

Dollars in thousands	Available For Sale Fair Value	Yield to maturity		Held to Maturity Amortized Cost	Yield to maturity	
U.S. Government-Sponsored Agencies						
Due in 1 year or less	$—	0.00	%	$—	0.00	%
Due in 1 to 5 years	—	0.00	%	—	0.00	%
Due in 5 to 10 years	—	0.00	%	—	0.00	%
Due after 10 years	—	0.00	%	92,179	3.32	%
Total	—	0.00	%	92,179	3.32	%
Mortgage-Backed Securities						
Due in 1 year or less	—	0.00	%	16	2.44	%
Due in 1 to 5 years	35	8.50	%	154	4.78	%
Due in 5 to 10 years	973	0.68	%	767	6.60	%
Due after 10 years	156,516	2.50	%	41,452	3.81	%
Total	157,524	2.49	%	42,389	3.87	%
State & Political Subdivisions						
Due in 1 year or less	1,368	6.95	%	750	5.95	%
Due in 1 to 5 years	105	7.05	%	5,627	6.62	%
Due in 5 to 10 years	1,590	6.20	%	24,106	6.25	%
Due after 10 years	125,476	5.38	%	11,913	6.20	%
Total	128,539	5.40	%	42,396	6.28	%
Corporate Securities						
Due in 1 year or less	—	0.00	%	—	0.00	%
Due in 1 to 5 years	—	0.00	%	300	1.00	%
Due in 5 to 10 years	—	0.00	%	—	0.00	%
Due after 10 years	—	0.00	%	—	0.00	%
Total	—	0.00	%	300	1.00	%
Equity Securities	1,672	2.00	%	—	0.00	%
	$287,735	3.79	%	$177,264	4.16	%

Impaired Securities

The securities portfolio contains certain securities that the amortized cost of which exceeds fair value, which at June 30, 2013 amounted to $15.9 million, or 3.45% of the amortized cost of the total securities portfolio. At December 31, 2012 this amount was $739,000, or 0.17% of the total securities portfolio. As a part of the Company's ongoing security monitoring process, the Company identifies securities in an unrealized loss position that could potentially be other-than-temporarily impaired. If a decline in the fair value of a debt security is judged to be other-than-temporary, the decline related to credit loss is recorded in net realized securities losses while the decline attributable to other factors is recorded in other comprehensive income or loss.

The Company's evaluation of securities for impairment is a quantitative and qualitative process intended to determine whether declines in the fair value of investment securities should be recognized in current period earnings. The primary factors considered in evaluating whether a decline in the fair value of securities is other-than-temporary include: (a) the length of time and extent to which the fair value has been less than cost or amortized cost and the expected recovery period of the security, (b) the financial condition, credit rating and future prospects of the issuer, (c) whether the debtor is current on contractually obligated interest and principal payments, (d) the volatility of the securities market price, (e) the intent and ability of the Company to retain the investment for a period of time sufficient to allow for recovery, which may be at maturity, and (f) any other information and observable data considered relevant in determining whether other-than-temporary impairment has occurred.

The Company's best estimate of cash flows uses severe economic recession assumptions due to market uncertainty. The Company's assumptions include but are not limited to delinquencies, foreclosure levels and constant default rates on the underlying collateral, loss severity ratios, and constant prepayment rates. If the Company does not expect to receive 100% of future contractual principal and interest, an other-than-temporary impairment charge is recognized. Estimating future cash flows is a quantitative and qualitative process that incorporates information received from third party sources along with certain internal assumptions and judgments regarding the future performance of the underlying collateral.

As of June 30, 2013, the Company had temporarily impaired securities with a fair value of $217.6 million and unrealized losses of $15.9 million, as identified in the table below. This was up from December 31, 2012 as a result of a shift in the yield curve and a corresponding decrease in value of investment securities. Securities in a continuous unrealized loss position more than twelve-months amounted to $1.7 million as of June 30, 2013, compared with $2.8 million at December 31, 2012. The Company has concluded that these securities were not other-than-temporarily impaired. This conclusion was based on the issuer's continued satisfaction of the securities obligations in accordance with their contractual terms and the expectation that the issuer will continue to do so, Management's intent and ability to hold these securities for a period of time sufficient to allow for any anticipated recovery in fair value which may be at maturity, the expectation that the Company will receive 100% of future contractual cash flows, as well as the evaluation of the fundamentals of the issuer's financial condition and other objective evidence. The following table summarizes temporarily impaired securities and their approximate fair values at June 30, 2013:

Dollars in thousands	Less than 12 months Fair Value	Less than 12 months Unrealized Losses	12 months or more Fair Value	12 months or more Unrealized Losses	Total Fair Value	Total Unrealized Losses
U.S. government-sponsored agencies	$85,453	$(5,944)	$—	$—	$85,453	$(5,944)
Mortgage-backed securities	58,706	(2,039)	1,585	(99)	60,291	(2,138)
State and political subdivisions	71,738	(7,858)	—	—	71,738	(7,858)
Other equity securities	—	—	110	(8)	110	(8)
	$215,897	$(15,841)	$1,695	$(107)	$217,592	$(15,948)

For securities with unrealized losses, the following information was considered in determining that the securities were not other-than-temporarily impaired:

Securities issued by U.S. Government-sponsored agencies and enterprises. As of June 30, 2013, there were $5.9 million of unrealized losses on these securities compared to $182,000 unrealized losses as of December 31, 2012. All of these securities were credit rated "AAA" or "AA+" by the major credit rating agencies. Management believes that securities issued by the U.S. Treasury bear no credit risk because they are backed by the full faith and credit of the United States and that securities issued by U.S. Government-sponsored agencies and enterprises have minimal credit risk, as these agencies and enterprises play a vital role in the nation's financial markets.

Mortgage-backed securities issued by U.S. Government agencies and U.S. Government-sponsored enterprises. As of June 30, 2013, there were $2.1 million of unrealized losses on these securities compared with $314,000 at December 31, 2012. All of these securities were credit rated "AAA" or "AA+" by the major credit rating agencies. Management believes that securities issued by U.S. Government agencies bear no credit risk because they are backed by the full faith and credit of the United States and that securities issued by U.S. Government-sponsored enterprises have minimal credit risk, as these agencies and enterprises play a vital role in the nation's financial markets. Management believes that the unrealized losses at June 30, 2013 were attributable to changes in current market yields and spreads since the date the underlying securities were purchased, and does not consider these securities to be other-than-temporarily impaired at June 30, 2013. The Company also has the ability and intent to hold these securities until a recovery of their amortized cost, which may be at maturity.

Obligations of state and political subdivisions. As of June 30, 2013, the total unrealized losses on municipal securities amounted to $7.9 million, compared with $199,000 at December 31, 2012. Municipal securities are supported by the general taxing authority of the municipality and, in the cases of school districts, are generally supported by state aid. At June 30, 2013, all municipal bond issuers were current on contractually obligated interest and principal payments. The Company attributes the unrealized losses at June 30, 2013 to changes in prevailing market yields and pricing spreads since the date the underlying securities were purchased, combined with current market liquidity conditions and the disruption in the financial markets in general. Accordingly, the Company does not consider these municipal securities to be other-than-temporarily impaired at June 30, 2013. The Company also has the ability and intent to hold these securities until a recovery of their amortized cost, which may be at maturity.

Corporate securities. There were no unrealized losses on corporate securities as of June 30, 2013, or at December 31, 2012. Corporate securities are dependent on the operating performance of the issuers. At June 30, 2013, all corporate bond issuers were current on contractually obligated interest and principal payments.

Other Equity Securities. As of June 30, 2013, the total unrealized losses on other equity securities amounted to $8,000, compared with $44,000 at December 31, 2012. Other equity securities is comprised of common and preferred stock holdings. The unrealized losses were the result of normal market fluctuations for equity securities. Accordingly, the Company does not consider other equity securities to be other-than-temporarily impaired at June 30, 2013.

Federal Home Loan Bank Stock

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, 2013 and December 31, 2012, the Bank's investment in FHLB stock totaled $12.9 million and $13.4 million, respectively. FHLB stock is a non-marketable equity security and therefore is reported at cost, which equals par value.

Loans Held for Sale

Loans held for sale are carried at the lower of cost or market value. As of June 30, 2013, the Bank had $1,047,000 in loans held for sale. This compares to $1,035,000 at December 31, 2012 and $378,000 at June 30, 2012. No recourse obligations have been incurred in connection with the sale of loans.

Loans

The loan portfolio decreased during the first six months of 2013, with total loans at $866.1 million at June 30, 2013, down $3.2 million or 0.4% from total loans of $869.3 million at December 31, 2012. Commercial loans increased $6.9 million or 1.9% between December 31, 2012 and June 30, 2013, municipal loans increased by $181,000 or 1.2% and residential term loans decreased $4.9 million or 1.3%.

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. Land and land development loans typically have a maximum loan-to-value of 65% to 75% based upon current appraisal information at the time the loan is made. Construction loans, both commercial and residential, comprise a very small portion of the portfolio, and at 18.4% of capital are well under the regulatory guidance of 100.0% of capital. Construction loans and non-owner-occupied commercial real estate loans are at 74.1% of total capital, well under the regulatory guidance of 300.0% of capital. Municipal loans are comprised of loans to municipalities in the State of 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.

Residential loans are also 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. 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.

The following table summarizes the loan portfolio, by class, at June 30, 2013 and 2012 and December 31, 2012.

Dollars in thousands	June 30, 2013			December 31, 2012			June 30, 2012		
Commercial									
Real estate	$251,799	29.1	%	$251,335	28.9	%	$253,193	28.7	%
Construction	18,641	2.2	%	22,417	2.6	%	33,072	3.8	%
Other	91,393	10.6	%	81,183	9.3	%	87,833	10.0	%
Municipal	14,885	1.7	%	14,704	1.7	%	16,089	1.8	%
Residential									
Term	374,522	43.2	%	379,447	43.7	%	368,876	41.8	%

Construction	4,759	0.5	%	6,459	0.7	%	6,449	0.7	%
Home equity line of credit	95,013	11.0	%	99,082	11.4	%	100,689	11.4	%
Consumer	15,059	1.7	%	14,657	1.7	%	15,613	1.8	%
Total loans	$866,071	100.0	%	$869,284	100.0	%	$881,814	100.0	%

The following table sets forth certain information regarding the contractual maturities of the Bank's loan portfolio as of June 30, 2013.

Dollars in thousands	< 1 Year	1 - 5 Years	5 - 10 Years	> 10 Years	Total
Commercial					
Real estate	$6,918	$23,716	$18,346	$202,819	$251,799
Construction	1,948	2,028	748	13,917	18,641
Other	14,570	22,990	18,862	34,971	91,393
Municipal	599	3,874	4,690	5,722	14,885
Residential					
Term	2,448	11,438	18,723	341,913	374,522
Construction	922	—	—	3,837	4,759
Home equity line of credit	915	219	1,242	92,637	95,013
Consumer	7,159	4,566	855	2,479	15,059
Total loans	$35,479	$68,831	$63,466	$698,295	$866,071

The following table provides a listing of loans by class, between variable and fixed rates as of June 30, 2013.

	Fixed-Rate			Adjustable-Rate			Total		
Dollars in thousands	Amount	% of total		Amount	% of total		Amount	% of total	
Commercial									
Real estate	$35,264	4.1	%	$216,535	25.0	%	$251,799	29.1	%
Construction	1,646	0.2	%	16,995	2.0	%	18,641	2.2	%
Other	34,442	4.0	%	56,951	6.6	%	91,393	10.6	%
Municipal	12,105	1.4	%	2,780	0.3	%	14,885	1.7	%
Residential									
Term	201,345	23.2	%	173,177	20.0	%	374,522	43.2	%
Construction	4,646	0.5	%	113	0.0	%	4,759	0.5	%
Home equity line of credit	1,391	0.2	%	93,622	10.8	%	95,013	11.0	%
Consumer	11,184	1.3	%	3,875	0.4	%	15,059	1.7	%
Total loans	$302,023	34.9	%	$564,048	65.1	%	$866,071	100.0	%

Loan Concentrations

As of June 30, 2013, the Bank did not have any concentration of loans in one particular industry that exceeded 10% of its total loan portfolio.

Credit Risk Management and Allowance for Loan Losses

Credit risk is the risk of loss arising from the inability of a borrower to meet its obligations. We manage credit risk by evaluating the risk profile of the borrower, repayment sources, the nature of the underlying collateral, and other support given current events, conditions, and expectations. We attempt to manage the risk characteristics of our loan portfolio through various control processes, such as credit evaluation of borrowers, establishment of lending limits, and application of lending procedures, including the holding of adequate collateral and the maintenance of compensating balances. However, we seek to rely primarily on the cash flow of our borrowers as the principal source of repayment. Although credit policies and evaluation processes are designed to minimize our risk, Management recognizes that loan losses will occur and the amount of these losses will fluctuate depending on the risk characteristics of our loan portfolio, as well as general and regional economic conditions.

We provide for loan losses through the establishment of an allowance for loan losses which represents an estimated reserve for existing losses in the loan portfolio. We deploy a systematic methodology for determining our allowance that includes a quarterly review process, risk rating, and adjustment to our allowance. We classify our portfolios as either commercial or residential and consumer and monitor credit risk separately as discussed below. We evaluate the appropriateness of our allowance continually based on a review of all significant loans, with a particular emphasis on nonaccruing, past due, and other loans that we believe require special attention.

The allowance consists of four elements: (1) specific reserves for loans evaluated individually for impairment; (2) general reserves for types or portfolios of loans 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; and (4) unallocated reserves. All outstanding loans are considered in evaluating the appropriateness of the allowance.

Appropriateness of the allowance for loan losses is determined using a consistent, systematic methodology, which analyzes the risk inherent in the loan portfolio. In addition to evaluating the collectability of specific loans when determining the appropriateness of the allowance for loan losses, Management also takes into consideration other factors such as changes in the mix and size of the loan portfolio, historic loss experience, the amount of delinquencies and loans adversely classified, economic trends, changes in credit policies, and experience, ability and depth of lending management. The appropriateness of the allowance for loan losses is assessed by an allocation process whereby specific reserve allocations are made against certain adversely classified loans, and general reserve allocations are made against segments of the loan portfolio which have similar attributes. The Company's historical loss experience, industry trends, and the impact of the local and regional economy on the Company's borrowers, are considered by Management in determining the appropriateness of the allowance for loan losses.

The allowance for loan losses is increased by provisions charged against current earnings. Loan losses are charged against the allowance when Management believes that the collectability of the loan principal is unlikely. Recoveries on loans previously charged off are credited to the allowance. While Management uses available information to assess possible losses on loans, future additions to the allowance may be necessary based on increases in non-performing loans, changes in economic conditions, growth in loan portfolios, or for other reasons. Any future additions to the allowance would be recognized in the period in which they were determined to be necessary. In addition, various regulatory agencies periodically review the Company's allowance for loan losses as an integral part of their examination process. Such agencies may require the Company to record additions to the allowance based on judgments different from those of Management.

Commercial

Our commercial portfolio includes all secured and unsecured loans to borrowers for commercial purposes, including commercial lines of credit and commercial real estate. Our process for evaluating commercial loans includes performing updates on loans that we have rated for risk. Our non-performing commercial loans are generally reviewed individually to determine impairment, accrual status, and the need for specific reserves. Our methodology incorporates a variety of risk considerations, both qualitative and quantitative. Quantitative factors include our historical loss experience by loan type, collateral values, financial condition of borrowers, and other factors. Qualitative factors include judgments concerning general economic conditions that may affect credit quality, credit concentrations, the pace of portfolio growth, and delinquency levels; these qualitative factors are also considered in connection with our unallocated portion of our allowance for loan losses.

The process of establishing the allowance with respect to our commercial loan portfolio begins when a loan officer initially assigns each loan a risk rating, using established credit criteria. Approximately 50% of our outstanding loans and commitments are subject to review and validation annually by an independent consulting firm, as well as periodically by our internal credit review function. Our methodology employs Management's judgment as to the level of losses on existing loans based on our internal review of the loan portfolio, including an analysis of the borrowers' 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 our ability to collect certain loans, we also consider the fair value of any underlying collateral. We also evaluate credit risk concentrations, including trends in large dollar exposures to related borrowers, industry and geographic concentrations, and economic and environmental factors.

Residential, Home Equity and Consumer

Consumer, home equity and residential mortgage loans are generally segregated into homogeneous pools with similar risk characteristics. Trends and current conditions in these pools are analyzed and historical loss experience is adjusted accordingly. Quantitative and qualitative adjustment factors for the consumer, home equity and residential mortgage portfolios are consistent with those for the commercial portfolios. Certain loans in the consumer and residential portfolios identified as having the potential for further deterioration are analyzed individually to confirm the appropriate risk status and accrual status, and to determine the need for a specific reserve. Consumer loans that are greater than 120 days past due are generally charged off. Residential loans and home equity lines of credit that are greater than 90 days past due are evaluated for collateral adequacy and if deficient are placed on non-accrual status.

Unallocated

The unallocated portion of the allowance is intended to provide for losses that are not identified when establishing the specific and general portions of the allowance and is based upon Management's evaluation of various conditions that are not directly measured in the determination of the portfolio and loan specific allowances. Such conditions include general economic and business conditions affecting our lending area, credit quality trends (including trends in delinquencies and nonperforming loans expected to result from existing conditions), loan volumes and concentrations, duration of the current business cycle, bank regulatory examination results, findings of external loan review examiners, and Management's judgment with respect to various other conditions including loan administration and management and the quality of risk identification systems. Management reviews these conditions quarterly. We have risk management practices designed to ensure timely identification of changes in loan risk profiles; however, undetected losses may exist inherently within the loan portfolio. The judgmental aspects involved in applying the risk grading criteria, analyzing the quality of individual loans, and assessing collateral values can also contribute to undetected, but probable, losses.

The allowance for loan losses includes reserve amounts assigned to individual loans on the basis of loan impairment. Certain loans are evaluated individually and are judged to be impaired when Management believes it is probable that the Company will not collect all of the contractual interest and principal payments as scheduled in the loan agreement. Under this method, loans are selected for evaluation based on internal risk ratings or non-accrual status. A specific reserve is allocated to an individual loan when that loan has been deemed impaired and when the amount of a probable loss is estimable on the basis of its collateral value, the present value of anticipated future cash flows, or its net realizable value. At June 30, 2013, impaired loans with specific reserves totaled $13.3 million and the amount of such reserves was $3.0 million. This compares to impaired loans with specific reserves of $17.5 million at December 31, 2012 and the amount of such reserves was $3.5 million.

All of these analyses are reviewed and discussed by the Directors' Loan Committee, and recommendations from these processes provide Management and the Board of Directors with independent information on loan portfolio condition. Our total allowance at June 30, 2013 is considered by Management to be appropriate to address the credit losses inherent in the loan portfolio at that date. Management views the level of the allowance for loan losses as appropriate. However, our determination of the appropriate allowance level is based upon a number of assumptions we make about future events, which we believe are reasonable, but which may or may not prove valid. Thus, there can be no assurance that our charge-offs in future periods will not exceed our allowance for loan losses or that we will not need to make additional increases in our allowance for loan losses.

The following table summarizes our allocation of allowance by loan class as of June 30, 2013 and 2012 and December 31, 2012. The percentages are the portion of each loan class to total loans.

Dollars in thousands	June 30, 2013			December 31, 2012			June 30, 2012		
Commercial									
Real estate	$5,811	29.1	%	$5,865	28.9	%	$5,564	28.7	%
Construction	591	2.2	%	1,359	2.6	%	1,373	3.8	%
Other	2,572	10.6	%	2,050	9.3	%	2,476	10.0	%
Municipal	18	1.7	%	18	1.7	%	19	1.8	%
Residential									
Term	1,026	43.2	%	1,109	43.7	%	1,587	41.8	%
Construction	9	0.5	%	11	0.7	%	58	0.7	%
Home equity line of credit	737	11.0	%	654	11.4	%	809	11.4	%
Consumer	631	1.7	%	592	1.7	%	603	1.8	%
Unallocated	1,275	0.0	%	842	0.0	%	1,895	0.0	%
Total	$12,670	100.0	%	$12,500	100.0	%	$14,384	100.0	%

The allowance for loan losses totaled $12.7 million at June 30, 2013, compared to $12.5 million and $14.4 million as of December 31, 2012 and June 30, 2012, respectively. Management's ongoing application of methodologies to establish the allowance include an evaluation of impaired loans for specific reserves. These specific reserves decreased $533,000 in the first six months of 2013 from $3.5 million at December 31, 2012 to $3.0 million at June 30, 2013. The specific loans that make up those categories change from period to period. Impairment on those loans, which would be reflected in the allowance for loan losses, might or might not exist, depending on the specific circumstances of each loan. The portion of the reserve based upon homogeneous pools of loans decreased by $17,000 in the first six months of 2013. This small decline was due to lower loss averages for both the commercial classified loan and home equity line of credit pools. Outstandings in these pools declined in the recent quarter, which, in combination with the drop in related loss rates, helped lessen the effect of a rise in other pooled loss rates particularly in the retail portfolios. The portio