

ENTERPRISE BANCORP INC /MA/
Form 10-Q
August 09, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

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: 001-33912
Enterprise Bancorp, Inc.
(Exact name of registrant as specified in its charter)

Massachusetts
(State or other jurisdiction of
incorporation or organization)

04-3308902
(I.R.S. Employer Identification No.)

222 Merrimack Street, Lowell, Massachusetts
(Address of principal executive offices)
(978) 459-9000
(Registrant's telephone number, including area code)

01852
(Zip 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 No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition for "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company

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

As of August 5, 2013, there were 9,943,786 shares of the issuer's common stock outstanding- Par Value \$0.01 per share

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PART I-FINANCIAL INFORMATION

Item 1 - Financial Statements

ENTERPRISE BANCORP, INC.

Consolidated Balance Sheets

(Dollars in thousands)	June 30, 2013 (unaudited)	December 31, 2012
Assets		
Cash and cash equivalents:		
Cash and due from banks	\$40,795	\$38,007
Interest-earning deposits	6,878	12,218
Fed funds sold	4,055	2,510
Total cash and cash equivalents	51,728	52,735
Investment securities at fair value	190,459	184,464
Federal Home Loan Bank Stock	4,324	4,260
Loans held for sale	3,917	8,557
Loans, less allowance for loan losses of \$25,671 at June 30, 2013 and \$24,254 at December 31, 2012, respectively	1,421,675	1,335,401
Premises and equipment	28,602	27,206
Accrued interest receivable	6,092	5,828
Deferred income taxes, net	13,771	12,548
Bank-owned life insurance	15,678	15,443
Prepaid income taxes	1,387	174
Prepaid expenses and other assets	10,047	13,454
Goodwill	5,656	5,656
Total assets	\$1,753,336	\$1,665,726
Liabilities and Stockholders' Equity		
Liabilities		
Deposits	\$1,579,293	\$1,475,027
Borrowed funds	1,880	26,540
Junior subordinated debentures	10,825	10,825
Accrued expenses and other liabilities	16,766	13,182
Accrued interest payable	579	603
Total liabilities	\$1,609,343	\$1,526,177
Commitments and Contingencies		
Stockholders' Equity		
Preferred stock, \$0.01 par value per share; 1,000,000 shares authorized; no shares issued	—	—
Common stock, \$0.01 par value per share; 20,000,000 shares authorized; 9,872,735 issued and outstanding at June 30, 2013 (including 171,481 shares of unvested participating restricted awards) and 9,676,477 shares issued and outstanding at December 31, 2012 (including 154,186 shares of unvested participating restricted awards)	99	97
Additional paid-in-capital	50,479	48,194
Retained earnings	91,427	87,159
Accumulated other comprehensive income	1,988	4,099
Total stockholders' equity	\$143,993	\$139,549
Total liabilities and stockholders' equity	\$1,753,336	\$1,665,726

See the accompanying notes to the unaudited consolidated financial statements.

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ENTERPRISE BANCORP, INC.
 Consolidated Statements of Income
 (unaudited)

(Dollars in thousands, except per share data)	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Interest and dividend income:				
Loans and loans held for sale	\$16,653	\$16,228	\$33,026	\$32,186
Investment securities	794	835	1,604	1,634
Other interest-earning assets	11	24	21	43
Total interest and dividend income	17,458	17,087	34,651	33,863
Interest expense:				
Deposits	996	1,368	2,030	2,905
Borrowed funds	40	13	86	29
Junior subordinated debentures	295	295	589	589
Total interest expense	1,331	1,676	2,705	3,523
Net interest income	16,127	15,411	31,946	30,340
Provision for loan losses	534	1,050	1,317	1,350
Net interest income after provision for loan losses	15,593	14,361	30,629	28,990
Non-interest income:				
Investment advisory fees	1,045	934	2,061	1,955
Deposit and interchange fees	1,181	1,107	2,289	2,128
Income on bank-owned life insurance, net	119	128	235	262
Net gains on sales of investment securities	468	112	948	159
Gains on sales of loans	222	218	557	458
Other income	518	453	1,102	964
Total non-interest income	3,553	2,952	7,192	5,926
Non-interest expense:				
Salaries and employee benefits	8,651	7,841	16,699	15,344
Occupancy and equipment expenses	1,488	1,430	3,059	2,844
Technology and telecommunications expenses	1,203	1,077	2,356	2,076
Advertising and public relations expenses	946	497	1,566	1,286
Audit, legal and other professional fees	411	487	825	970
Deposit insurance premiums	284	283	533	560
Supplies and postage expenses	250	196	487	427
Investment advisory and custodial expenses	134	112	260	209
Other operating expenses	1,094	1,049	2,130	2,074
Total non-interest expense	14,461	12,972	27,915	25,790
Income before income taxes	4,685	4,341	9,906	9,126
Provision for income taxes	1,606	1,436	3,394	3,048
Net income	\$3,079	\$2,905	\$6,512	\$6,078
Basic earnings per share	\$0.31	\$0.30	\$0.67	\$0.64
Diluted earnings per share	\$0.31	\$0.30	\$0.66	\$0.63
Basic weighted average common shares outstanding	9,825,335	9,588,420	9,770,559	9,543,994
Diluted weighted average common shares outstanding	9,889,639	9,655,728	9,840,016	9,612,187

See the accompanying notes to the unaudited consolidated financial statements.

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ENTERPRISE BANCORP, INC.
 Consolidated Statements of Comprehensive Income
 (Unaudited)

(Dollars in thousands)	Three months ended June 30,		Six months ended June 30,		
	2013	2012	2013	2012	
Net income	\$3,079	\$2,905	\$6,512	\$6,078	
Other comprehensive (loss) income, net of taxes:					
Gross unrealized holding (losses) gains on investments arising during the period	(2,744	) 312	(2,386	) 816
Income tax benefit (expense)	999	(117) 884	(287)
Net unrealized holding (losses) gains, net of tax	(1,745	) 195	(1,502	) 529
Less: Reclassification adjustment for net gains included in net income					
Net realized gains on sales of securities during the period	468	112	948	159	
Income tax expense	(163) (40) (339) (56)
Reclassification adjustment for gains realized, net of tax	305	72	609	103	
Total other comprehensive (loss) income	(2,050	) 123	(2,111	) 426
Comprehensive income	\$1,029	\$3,028	\$4,401	\$6,504	

See the accompanying notes to the unaudited consolidated financial statements.

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ENTERPRISE BANCORP, INC.

Consolidated Statement of Changes in Stockholders' Equity
(Unaudited)

(Dollars in thousands)	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
Balance at December 31, 2012	\$97	\$48,194	\$87,159	\$ 4,099	\$139,549
Net income			6,512		6,512
Other comprehensive loss, net				(2,111)	(2,111)
Tax benefit from exercise of stock options		7			7
Common stock dividend paid (\$0.23 per share)			(2,244)		(2,244)
Common stock issued under dividend reinvestment plan	—	630			630
Stock-based compensation	1	933			934
Stock options exercised, net	1	715			716
Balance at June 30, 2013	\$99	\$50,479	\$91,427	\$ 1,988	\$143,993

See the accompanying notes to the unaudited consolidated financial statements.

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ENTERPRISE BANCORP, INC.
 Consolidated Statements of Cash Flows
 (Unaudited)

	Six months ended June 30,	
(Dollars in thousands)	2013	2012
Cash flows from operating activities:		
Net income	\$6,512	\$6,078
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,317	1,350
Depreciation and amortization	2,458	2,133
Stock-based compensation expense	859	652
Mortgage loans originated for sale	(25,274	) (21,388
Proceeds from mortgage loans sold	30,471	24,644
Net gains on sales of loans	(557	) (458
Net gains on sales of OREO	(121	) (45
Net gains on sales of investments	(948	) (159
Income on bank-owned life insurance, net	(235	) (262
Changes in:		
Accrued interest receivable	(264	) 191
Prepaid expenses and other assets	1,802	683
Accrued expenses and other liabilities	(1,319	) 1,391
Accrued interest payable	(24	) (169
Net cash provided by operating activities	14,677	14,641
Cash flows from investing activities:		
Proceeds from sales of investment securities available for sale	7,361	2,921
Net proceeds (purchase) from FHLB capital stock	(64	) 480
Proceeds from maturities, calls and pay-downs of investment securities	8,040	9,689
Purchase of investment securities	(19,297	) (36,874
Net increase in loans	(87,759	) (46,522
Additions to premises and equipment, net	(3,332	) (962
Proceeds from OREO sales and payments	652	885
Net cash used in investing activities	(94,399	) (70,383
Cash flows from financing activities:		
Net increase in deposits	104,266	120,454
Net decrease in borrowed funds	(24,660	) (1,625
Cash dividends paid	(2,244	) (2,098
Proceeds from issuance of common stock	630	635
Proceeds from the exercise of stock options	716	100
Tax benefit from the exercise of stock options	7	1
Net cash provided by financing activities	78,715	117,467
Net (decrease) increase in cash and cash equivalents	(1,007	) 61,725
Cash and cash equivalents at beginning of period	52,735	39,131
Cash and cash equivalents at end of period	\$51,728	\$100,856
Supplemental financial data:		
Cash Paid For: Interest	\$2,729	\$3,692
Cash Paid For: Income Taxes	4,583	4,134

Supplemental schedule of non-cash investing activity:

Purchase of investment securities not yet settled	4,978	—
Transfer from loans to other real estate owned	167	400
Capital expenditures incurred not yet paid	—	74

See accompanying notes to the unaudited consolidated financial statements.

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ENTERPRISE BANCORP, INC.

Notes to the Unaudited Consolidated Financial Statements

(1) Organization of Holding Company and Basis of Presentation

The accompanying unaudited consolidated financial statements and these notes should be read in conjunction with the December 31, 2012 audited consolidated financial statements and notes thereto contained in the 2012 Annual Report on Form 10-K of Enterprise Bancorp, Inc. (the "Company" or "Enterprise"), a Massachusetts corporation, as filed with the Securities and Exchange Commission (the "SEC") on March 15, 2013. The Company has not changed its reporting policies from those disclosed in its 2012 Annual Report on Form 10-K.

The accompanying unaudited consolidated interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information and the instructions for Form 10-Q through the rules and interpretive releases of the SEC under federal securities law. In the opinion of management, the accompanying unaudited consolidated interim financial statements reflect all necessary adjustments consisting of normal recurring accruals for a fair presentation. All significant intercompany balances and transactions have been eliminated in the accompanying unaudited consolidated interim financial statements. Certain previous year amounts in the unaudited consolidated interim financial statements and accompanying footnotes have been reclassified to conform to the current year's presentation. Interim results are not necessarily indicative of results to be expected for the entire year.

The Company's consolidated unaudited interim financial statements include the accounts of the Company and its wholly owned subsidiary, Enterprise Bank and Trust Company (the "Bank"). The Bank is a Massachusetts trust company organized in 1989. Substantially all of the Company's operations are conducted through the Bank.

The Bank's subsidiaries include Enterprise Insurance Services, LLC and Enterprise Investment Services, LLC, organized under the laws of the State of Delaware for the purposes of engaging in insurance sales activities and offering non-deposit investment products and services, respectively. In addition, the Bank has the following subsidiaries that are incorporated in the Commonwealth of Massachusetts and classified as security corporations in accordance with applicable Massachusetts General Laws: Enterprise Security Corporation; Enterprise Security Corporation II; and Enterprise Security Corporation III, which hold various types of qualifying securities. The security corporations are limited to conducting securities investment activities that the Bank itself would be allowed to conduct under applicable laws.

Pursuant to the Accounting Standards Codification ("ASC") Topic 810 "Consolidation of Variable Interest Entities," issued by the Financial Accounting Standards Board (originally issued as Financial Interpretation No. 46R) in December 2003, the Company carries Junior Subordinated Debentures as a liability on its consolidated financial statements, along with the related interest expense. The debentures were issued by a statutory business trust (the "Trust") created by the Company in March 2000 under the laws of the State of Delaware, and the trust preferred securities issued by the Trust, and the related non-interest expense, are excluded from the Company's consolidated financial statements.

Comprehensive income is defined as all changes to equity except investments by and distributions to stockholders. Net income is one component of comprehensive income, with other components referred to in the aggregate as other comprehensive income. The Company's only other comprehensive income component is the net unrealized holding gains or losses on investments available-for-sale. Pursuant to Accounting Standards Update ("ASU") No. 2013-02, Comprehensive Income (Topic 220): Reporting Amounts Reclassified Out of Accumulated Comprehensive Income, the Company initially excludes these unrealized holding gains and losses from net income; however they are later reported as reclassifications out of accumulated other comprehensive income into net income when the securities are

sold. When securities are sold, the reclassification of realized gains and losses on available-for-sale securities are included on the Consolidated Statements of Income under the "non-interest income" subheading on the line item "net gains on sales of investment securities" and the related income tax expense is included in the line item "provision for income taxes," both of which are also detailed on the Consolidated Statements of Comprehensive Income under the subheading "reclassification adjustment for net gains included in net income."

The Company has 21 full service branches serving the Merrimack Valley and North Central regions of Massachusetts and Southern New Hampshire. The Company is currently constructing a branch office in Nashua, NH with an anticipated opening in the fourth quarter of 2013. Through the Bank and its subsidiaries, the Company offers a range of commercial and consumer loan products, deposit and cash management products, investment advisory and wealth management, and insurance services. The services offered through the Bank and subsidiaries are managed as one strategic unit and represent the Company's only reportable operating segment.

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ENTERPRISE BANCORP, INC.

Notes to the Unaudited Consolidated Financial Statements (continued)

The Federal Deposit Insurance Corporation (the "FDIC") and the Massachusetts Commissioner of Banks (the "Commissioner") have regulatory authority over the Bank. The Bank is also subject to certain regulatory requirements of the Board of Governors of the Federal Reserve System (the "Federal Reserve Board") and, with respect to its New Hampshire branch operations, the New Hampshire Banking Department. The business and operations of the Company are subject to the regulatory oversight of the Federal Reserve Board. The Commissioner also retains supervisory jurisdiction over the Company.

(2)Critical Accounting Estimates

As discussed in the Company's 2012 Annual Report on Form 10-K, the three most significant areas in which management applies critical assumptions and estimates that are particularly susceptible to change relate to the determination of the allowance for loan losses, impairment review of investment securities and the impairment review of goodwill. Refer to Note 1, "Summary of Significant Accounting Policies," to the Company's consolidated financial statements included in the Company's 2012 Annual Report on Form 10-K for significant accounting policies. The Company has not changed its significant accounting policies from those disclosed in its 2012 Annual Report filed on Form 10-K.

In preparing the consolidated financial statements in conformity with GAAP, management is required to exercise judgment in determining many of the methodologies, assumptions and estimates to be utilized. These estimates and assumptions affect the reported values of assets and liabilities as of the balance sheet date and income and expenses for the period then ended. As future events and their effects cannot be determined with precision, actual results could differ significantly from these estimates should the assumptions and estimates used change over time due to changes in circumstances. Changes in those estimates resulting from continuing change in the economic environment and other factors will be reflected in the financial statements and results of operations in future periods.

(3)Recent Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board ("FASB") issued ASU No. 2013-02, Comprehensive Income (Topic 220): Reporting Amounts Reclassified out of Accumulated Other Comprehensive Income. The new amendments require an organization to present the effects on the income statement of significant amounts reclassified out of accumulated other comprehensive income or cross-reference to other disclosures currently required under GAAP for certain items. The new amended standard is effective for annual periods beginning after December 15, 2012, and interim periods within those annual periods. As this ASU addresses only disclosure requirements, the adoption in the first quarter of 2013 did not have a material impact on the Company's financial statements. See Note 1, "Organization of Holding Company and Basis of Presentation," for the disclosure of the effects of amounts reclassified out of accumulated other comprehensive income.

In December 2011, the FASB issued ASU No. 2011-11, Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities, which was subsequently clarified in January 2013 by ASU 2013-01. The new amended standard was effective for annual periods beginning January 1, 2013, and interim periods within those annual periods. As this ASU primarily deals with disclosure requirements and the Company has no netting arrangements, the adoption in January 2013 did not have an impact on the Company's financial statements.

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ENTERPRISE BANCORP, INC.

Notes to the Unaudited Consolidated Financial Statements (continued)

(4) Investments

The amortized cost and carrying values of investment securities at the dates specified are summarized as follows:

(Dollars in thousands)	June 30, 2013			Fair Value
	Amortized cost	Unrealized gains	Unrealized losses	
Federal agency obligations ⁽¹⁾	\$65,111	\$191	\$50	\$65,252
Federal agency mortgage backed securities (MBS) ⁽¹⁾	52,563	570	976	52,157
Municipal securities	56,222	1,847	391	57,678
Corporate bonds	3,786	4	54	3,736
Certificates of deposit	858	—	3	855
Total fixed income securities	178,540	2,612	1,474	179,678
Equity investments	8,886	2,020	125	10,781
Total available for sale securities, at fair value	\$187,426	\$4,632	\$1,599	\$190,459

(Dollars in thousands)	December 31, 2012			Fair Value
	Amortized cost	Unrealized gains	Unrealized losses	
Federal agency obligations ⁽¹⁾	\$65,247	\$438	\$—	\$65,685
Federal agency mortgage backed securities (MBS) ⁽¹⁾	48,429	1,287	42	49,674
Municipal securities	53,437	3,103	17	56,523
Corporate bonds	1,905	15	6	1,914
Total fixed income securities	169,018	4,843	65	173,796
Equity investments	9,080	1,622	34	10,668
Total available for sale securities, at fair value	\$178,098	\$6,465	\$99	\$184,464

These categories may include investments issued or guaranteed by government sponsored enterprises such as Fannie Mae (FNMA), Freddie Mac (FHLMC), Ginnie Mae (GNMA), Federal Farm Credit Bank, or one of several Federal Home Loan Banks. All agency MBS/Collateralized Mortgage Obligations ("CMOs") investments owned by the Company are backed by residential mortgages.

Included in the carrying amount of the federal agency MBS category were CMOs totaling \$20.6 million and \$23.6 million at June 30, 2013 and December 31, 2012, respectively.

Certificates of Deposit (CDs) represent term deposits issued by banks that are subject to FDIC insurance and purchased on the open market. The Company utilizes these CDs as an alternative investment option to holding short-term excess cash in lower yielding overnight deposit accounts. These securities have maturities of less than a year and the market value approximates the carrying value.

At June 30, 2013, the equity portfolio consisted primarily of investments in a diversified group of mutual funds, with a small portion of the portfolio (approximately 17%) invested in exchange traded funds or individual common stock of entities in the financial services industry.

The net unrealized gain or loss in the Company's fixed income portfolio fluctuates as market interest rates rise and fall. Due to the fixed rate nature of this portfolio, as market rates fall, the value of the portfolio rises, and as market rates rise, the value of the portfolio declines. The unrealized gains or losses on fixed income investments will also decline as the securities approach maturity, or if the issuer is credit impaired. Unrealized gains or losses will be recognized in the statements of

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ENTERPRISE BANCORP, INC.

Notes to the Unaudited Consolidated Financial Statements (continued)

income if the securities are sold. However, if an unrealized loss on the fixed income portfolio is deemed to be other than temporary, the credit loss portion is charged to earnings and the noncredit portion is recognized in accumulated other comprehensive income. Net unrealized appreciation and depreciation on investments available for sale, net of applicable income taxes, are reflected as a component of accumulated other comprehensive income.

The net unrealized gain or loss on equity securities will fluctuate based on changes in the market value of the mutual funds and individual securities held in the portfolio. Unrealized gains or losses will be recognized in the statements of income if the securities are sold. However, if an unrealized loss on an equity security is deemed to be other than temporary prior to a sale, the loss is charged to earnings.

Management regularly reviews the portfolio for securities with unrealized losses that are other-than-temporarily impaired. During the six months ended June 30, 2013 and 2012, the Company did not record any fair value impairment charges on its investments. As of June 30, 2013, there were a total of 64 investments (fixed income and equity, excluding CDs), with a fair market value of \$71.6 million, in an unrealized loss position totaling \$1.6 million. The Company attributes these unrealized losses to increases in current market yields since the date the underlying securities were purchased and does not consider these investments to be other-than-temporarily impaired at June 30, 2013, because the decline in market value is not attributable to credit quality for fixed income securities, or a fundamental deterioration in the equity fund or issuers, and because the Company does not intend to, and it is more likely than not that it will not be required to, sell those investments prior to a market price recovery or maturity.

In assessing MBS investments and Federal Agency obligations, the contractual cash flows of these investments are guaranteed by an agency of the U.S. Government, and the agency that issued these securities is sponsored by the U.S. Government. Accordingly, it is expected that the securities would not be settled at a price less than the par value of the Company's investments. Management's assessment of other fixed income investments within the portfolio includes reviews of market pricing, ongoing credit quality evaluations, assessment of the investment's materiality, and duration of the unrealized loss position. In addition, the Company utilizes an outside registered investment adviser to manage the corporate and municipal bond portfolios, within prescribed guidelines set by management. At June 30, 2013 the Company's corporate and municipal bond portfolios did not contain any securities below investment grade, as reported by major credit rating agencies. For equities and funds, management's assessment includes the severity of the declines, whether it is unlikely that the security or fund will completely recover its unrealized loss within a reasonable time period and if the equity security or fund exhibits fundamental deterioration.

The small portion of the portfolio invested in short-term CDs was also in an unrealized loss position at June 30, 2013 due to market rates. The unrealized loss was not considered to be material and the securities are expected to be settled at par value at maturity.

The contractual maturity distribution at June 30, 2013 of total fixed income investments, excluding CDs which mature in less than one year, is as follows:

	Within One Year		After One, But Within Five Years		After Five, But within Ten Years		After Ten Years	
	Amortized Cost	Yields	Amortized Cost	Yields	Amortized Cost	Yields	Amortized Cost	Yields
At amortized cost:								
Federal agency obligations	\$15,502	0.76 %	\$49,609	0.92 %	\$—	— %	\$—	— %
MBS	—	— %	49	1.54 %	11,150	3.00 %	41,364	1.80 %
Municipal securities	2,226	2.53 %	15,250	2.83 %	31,841	4.32 %	6,905	6.78 %

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Corporate bonds	—	—	% 2,389	1.87	% 1,397	2.47	% —	—	%
Total fixed income securities	\$17,728	0.98	% \$67,297	1.39	% \$44,388	3.93	% \$48,269	2.51	%
At fair value:									
Total fixed income securities	\$17,794		\$67,696		\$45,488		\$47,845		

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ENTERPRISE BANCORP, INC.

Notes to the Unaudited Consolidated Financial Statements (continued)

Scheduled contractual maturities may not reflect the actual maturities of the investments. MBS/CMOs are shown at their final maturity. However, due to prepayments and amortization the actual MBS/CMO cash flows may be faster than presented above. Similarly, included in the carrying value of fixed income investments above are callable securities, comprised of municipal securities, federal agency obligations and corporate bonds totaling \$46.0 million, which can be redeemed by the issuer prior to the maturity presented above. Management considers these factors when evaluating the net interest margin in the Company's asset-liability management program.

See Note 12, "Fair Value Measurements" below for further information regarding the Company's fair value measurements for available-for-sale securities.

From time to time the Company may pledge securities as collateral against deposit account balances of municipal deposit customers, for Federal Home Loan Bank of Boston ("FHLB") borrowing capacity and as collateral for borrowing from the Federal Reserve Bank of Boston ("FRB"). The fair value of securities pledged as collateral for these purposes was \$173.8 million at June 30, 2013.

(5) Restricted Investments

As a member of the FHLB, the Company is required to purchase certain levels of FHLB capital stock in association with the Company's borrowing relationship from the FHLB. This stock is classified as a restricted investment and carried at cost, which management believes approximates fair value. FHLB stock represents the only restricted investment held by the Company.

Based on management's ongoing review, the Company has not recorded any other-than-temporary impairment charges on this investment to date. However, if negative events or deterioration in the FHLB financial condition or capital levels occurs, the Company's investment in FHLB capital stock may become other-than-temporarily impaired to some degree.

(6) Loans

Major classifications of loans at the periods indicated, are as follows:

(Dollars in thousands)	June 30, 2013	December 31, 2012
Real estate:		
Commercial real estate	\$785,994	\$710,265
Commercial construction	116,348	121,367
Residential mortgages	122,704	120,278
Total real estate	1,025,046	951,910
Commercial and industrial	343,509	328,579
Home equity	74,639	75,648
Consumer	5,649	4,911
Gross loans	1,448,843	1,361,048
Deferred loan origination fees, net	(1,497)	(1,393)
Total loans	1,447,346	1,359,655
Allowance for loan losses	(25,671)	(24,254)
Net loans	\$1,421,675	\$1,335,401

The Company specializes in lending to business entities, non-profit organizations, professionals and individuals. The Company's primary lending focus is on the development of high quality commercial relationships achieved through active business development efforts, long-term relationships with established commercial developers, strong community involvement and focused marketing strategies. Loans made to businesses include commercial mortgage loans, construction and land development loans, secured and unsecured commercial loans and lines of credit, and standby letters of credit. The Company also originates equipment lease financing for businesses. Loans made to individuals include conventional residential mortgage loans, home equity loans and lines, residential construction loans on primary and secondary residences, and secured and

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ENTERPRISE BANCORP, INC.

Notes to the Unaudited Consolidated Financial Statements (continued)

unsecured personal loans and lines of credit (see Note 7, "Allowance for Loan Losses," for additional information on the Company's credit risk management).

Loan Categories

- Commercial loans:

Commercial real estate loans include loans secured by both owner-use and non-owner occupied real estate. These loans are typically secured by a variety of commercial and industrial property types including one-to-four and multi-family apartment buildings, office or mixed-use facilities, strip shopping centers, or other commercial property and are generally guaranteed by the principals of the borrower. Commercial real estate loans generally have repayment periods of approximately fifteen to twenty-five years. Variable interest rate loans have a variety of adjustment terms and indices, and are generally fixed for an initial period before periodic rate adjustments begin.

Commercial and industrial loans include seasonal revolving lines of credit, working capital loans, equipment financing (including equipment leases), and term loans. Also included in commercial and industrial loans are loans partially guaranteed by the Small Business Administration (SBA), loans under various programs issued in conjunction with the Massachusetts Development Finance Agency and other agencies. Commercial and industrial credits may be unsecured loans and lines to financially strong borrowers, secured in whole or in part by real estate unrelated to the principal purpose of the loan or secured by inventories, equipment, or receivables, and are generally guaranteed by the principals of the borrower. Variable rate loans and lines in this portfolio have interest rates that are periodically adjusted, with loans generally having fixed initial periods. Commercial and industrial loans have average repayment periods of one to seven years.

Commercial construction loans include the development of residential housing and condominium projects, the development of commercial and industrial use property, and loans for the purchase and improvement of raw land. These loans are secured in whole or in part by the underlying real estate collateral and are generally guaranteed by the principals of the borrowers. The Company limits the amount of financing provided to any single developer for the construction of properties built on a speculative basis. Funds for construction projects are disbursed as pre-specified stages of construction are completed. Regular site inspections are performed, either by experienced construction lenders on staff or by independent outside inspection companies, at each construction phase, prior to advancing additional funds. Commercial construction loans generally are variable rate loans and lines with interest rates that are periodically adjusted and generally have terms of one to three years.

From time to time, the Company participates with other banks in the financing of certain commercial projects. In some cases, the Company may act as the lead lender, originating and servicing the loans, but participating out a portion of the funding to other banks. In other cases, the Company may participate in loans originated by other institutions. In each case, the participating bank funds a percentage of the loan commitment and takes on the related risk. In each case in which the Company participates in a loan, the rights and obligations of each participating bank are divided proportionately among the participating banks in an amount equal to their share of ownership and with equal priority among all banks. The balances participated out to other institutions are not carried as assets on the Company's financial statements. Loans originated by other banks in which the Company is the participating institution are carried in the loan portfolio at the Company's pro rata share of ownership. The Company performs an independent credit analysis of each commitment and a review of the participating institution prior to participation in the loan. Loans originated by other banks in which the Company is the participating institution amounted to \$35.5 million at June 30, 2013 and \$28.6 million at December 31, 2012.

Standby letters of credit are conditional commitments issued by the Company to guarantee the financial obligation or performance by a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. If the letter of credit is drawn upon, a loan is created for the customer, generally a commercial loan, with the same criteria associated with similar commercial loans.

- Residential loans:

Enterprise originates conventional mortgage loans on one-to-four family residential properties. These properties may serve as the borrower's primary residence, vacation homes, or investment properties. Loan to value limits vary, generally from 80% for adjustable rate and multi-family, owner occupied properties, up to 97% for fixed rate loans on single family, owner occupied properties, with mortgage insurance coverage required for loan-to-value ratios greater than 80% based on program parameters. In addition, financing is provided for the construction of owner occupied primary and secondary residences. Residential

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Notes to the Unaudited Consolidated Financial Statements (continued)

mortgage loans may have terms of up to 30 years at either fixed or adjustable rates of interest. Fixed and adjustable rate residential mortgage loans are generally originated using secondary market underwriting and documentation standards.

Depending on the current interest rate environment, management projections of future interest rates and the overall asset-liability management program of the Company, management may elect to sell those fixed and adjustable rate residential mortgage loans which are eligible for sale in the secondary market, or hold some or all of this residential loan production for the Company's portfolio. Mortgage loans are generally not pooled for sale, but instead sold on an individual basis. The Company may retain or sell the servicing when selling the loans. All loans sold are currently sold without recourse, but are typically subject to standard secondary market underwriting and eligibility representations and warranties and are subject to an early payment default period covering the first four payments for certain loan sales. Loans classified as held for sale are carried as a separate line item on the balance sheet.

- Home equity loans and lines of credit:

Home equity term loans are originated for one-to-four family residential properties with maximum original loan to value ratios generally up to 80% of the assessed or appraised value of the property securing the loan. Home equity loan payments consist of monthly principal and interest based on amortization ranging from three to fifteen years. The rates may also be fixed for three to fifteen years, before periodic rate adjustments begin.

The Company originates home equity revolving lines of credit for one-to-four family residential properties with maximum original loan to value ratios generally up to 80% of the appraised value of the property securing the loan. Home equity lines generally have interest rates that adjust monthly based on changes in the Prime Rate, although minimum rates may be applicable. Some home equity line rates may be fixed for a period of time and then adjusted monthly thereafter. The payment schedule for home equity lines requires interest only payments for the first ten years of the lines. Generally at the end of ten years, the line may be frozen to future advances, and principal plus interest payments are collected over a fifteen-year amortization schedule or, for eligible borrowers meeting certain requirements, the line availability may be extended for an additional interest only period.

- Consumer loans:

Consumer loans primarily consist of secured or unsecured personal loans and overdraft protection lines on checking accounts extended to individual customers. The aggregate amount of overdrawn deposit accounts are reclassified as loan balances.

Loans serviced for others

At June 30, 2013 and December 31, 2012, the Company was servicing residential mortgage loans owned by investors amounting to \$21.5 million and \$22.2 million, respectively. Additionally, the Company was servicing commercial loans participated out to various other institutions amounting to \$53.9 million and \$53.6 million at June 30, 2013 and December 31, 2012, respectively. See the discussion above for further information regarding commercial participations.

Loans serving as collateral

Loans designated as qualified collateral and pledged to the FHLB for borrowing capacity are summarized below:

(Dollars in thousands)	June 30, 2013	December 31, 2012
Commercial real estate	\$205,210	\$216,080
Residential mortgages	88,836	94,552
Home equity	18,009	18,907
Total loans pledged to FHLB	\$312,055	\$329,539

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Notes to the Unaudited Consolidated Financial Statements (continued)

(7) Allowance for Loan Loss

The Company manages its loan portfolio to avoid concentration by industry and loan size to minimize its credit risk exposure. In addition, the Company does not have a “sub-prime” mortgage program. However, inherent in the lending process is the risk of loss due to customer non-payment, or “credit risk.” While the Company endeavors to minimize this risk through the credit risk management function, management recognizes that loan losses will occur and that the amount of these losses will fluctuate depending on the risk characteristics of the loan portfolio and economic conditions.

Credit Quality Indicators

The level of adversely classified loans, delinquent and non-performing assets is largely a function of economic conditions, the overall banking environment, and the Company's underwriting, and credit risk management standards. The Company's commercial lending focus may entail significant additional risks compared to long term financing on existing, owner-occupied residential real estate. The Company endeavors to minimize this risk through sound underwriting practices and the risk management function. The credit risk management function focuses on a wide variety of factors, including, among others, current and expected economic conditions, the real estate market, the financial condition of borrowers, the ability of borrowers to adapt to changing conditions or circumstances affecting their business and the continuity of borrowers' management teams. Early detection of credit issues is critical to minimize credit losses. Accordingly, management regularly monitors these factors, among others, through ongoing credit reviews by the Credit Department, an external loan review service, reviews by members of senior management and the Loan Committee of the Board of Directors. This review includes the assessment of internal credit quality indicators such as the risk classification of individual loans, adversely classified loans, past due and non-accrual loans, impaired and restructured loans, and the level of foreclosure activity. However, despite prudent loan underwriting and ongoing credit risk management, adverse changes within the Company's market area or deterioration in the local, regional or national economic conditions could negatively impact the portfolio's credit risk profile and the Company's asset quality in the future.

The loan portfolio continued to show improving statistics related to migration of adversely classified, non-accrual, impaired loans and the level of Other Real Estate Owned (“OREO”) properties held during the quarter ended June 30, 2013. However, management believes that the credit profile of the portfolio will continue to be affected by lagging effects that the economic environment has had on the regional and local commercial markets.

- Adversely Classified Loans

The Company's loan risk rating system classifies loans depending on risk of loss characteristics. The classifications range from “substantially risk free” for the highest quality loans and loans that are secured by cash collateral, to the more severe adverse classifications of “substandard,” “doubtful” and “loss” based on criteria established under banking regulations.

Loans classified as substandard include those loans characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. These loans are inadequately protected by the sound net worth and paying capacity of the borrower; repayment has become increasingly reliant on collateral liquidation or reliance on guaranties; credit weaknesses are well-defined; borrower cash flow is insufficient to meet required debt service specified in loan terms and to meet other obligations, such as trade debt and tax payments.

Loans classified as doubtful have all the weaknesses inherent in a substandard rated loan with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The probability of loss is extremely high, but because of certain important and reasonably specific pending factors which may work to the advantage and strengthening of the loan, its classification as an estimated loss is deferred until more exact status may be determined.

Loans classified as loss are generally considered uncollectible at present, although long term recovery of part or all of loan proceeds may be possible. These "loss" loans would require a specific loss reserve or charge-off.

Adversely classified loans may be accruing or in non-accrual status and may be additionally designated as impaired or restructured, or some combination thereof. Loans which are evaluated to be of weaker credit quality are reviewed on a more frequent basis by management.

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Notes to the Unaudited Consolidated Financial Statements (continued)

The following tables present the credit risk profile by internally assigned risk rating category at the periods indicated.

(Dollars in thousands)	June 30, 2013				
	Adversely Classified			Not Adversely	
	Substandard	Doubtful	Loss	Classified	Gross Loans
Commercial real estate	\$15,253	\$—	\$—	\$770,741	\$785,994
Commercial and industrial	6,012	500	—	336,997	343,509
Commercial construction	3,685	—	—	112,663	116,348
Residential	1,380	—	—	121,324	122,704
Home equity	696	—	—	73,943	74,639
Consumer	40	—	—	5,609	5,649
Total gross loans	\$27,066	\$500	\$—	\$1,421,277	\$1,448,843

(Dollars in thousands)	December 31, 2012				
	Adversely Classified			Not Adversely	
	Substandard	Doubtful	Loss	Classified	Gross Loans
Commercial real estate	\$21,999	\$—	\$—	\$688,266	\$710,265
Commercial and industrial	5,993	1,460	48	321,078	328,579
Commercial construction	2,986	—	—	118,381	121,367
Residential	1,254	—	—	119,024	120,278
Home equity	661	—	—	74,987	75,648
Consumer	34	—	—	4,877	4,911
Total gross loans	\$32,927	\$1,460	\$48	\$1,326,613	\$1,361,048

The decrease in adversely classified loans since the prior period was due primarily to paydowns on several commercial relationships, and upgraded commercial loans, in particular one larger commercial real estate relationship of approximately \$6.0 million classified as accruing/impaired/Troubled Debt Restructure (or "TDR") at December 31, 2012 which was upgraded during the period, due to the borrower's improved financial condition and sustained performance over time, partially offset by additional credit downgrades during the period.

- Past Due and Non-Accrual Loans

Loans on which the accrual of interest has been discontinued are designated as non-accrual loans. Accrual of interest on loans is generally discontinued when a loan becomes contractually past due, with respect to interest or principal, by 90 days, or when reasonable doubt exists as to the full and timely collection of interest or principal. When a loan is placed on non-accrual status, all interest previously accrued but not collected is reversed against current period interest income. Interest accruals are resumed on such loans only when payments are brought current and have remained current for a period of 180 days and when, in the judgment of management, the collectability of both principal and interest is reasonably assured. Interest payments received on loans in a non-accrual status are generally applied to principal on the books of the Company. Additionally, deposit accounts overdrawn for 90 or more days are included in the consumer non-accrual numbers below.

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Notes to the Unaudited Consolidated Financial Statements (continued)

The following tables present age analysis of past due loans as of the dates indicated.

Balance at June 30, 2013

(Dollars in thousands)	Loans 30-59 Days Past Due	Loans 60-89 Days Past Due	Loans 90 or More Days Past Due (non- accrual)	Total Past Due Loans	Current Loans	Gross Loans
Commercial real estate	\$1,921	\$183	\$12,645	\$14,749	\$771,245	\$785,994
Commercial and industrial	449	34	5,997	6,480	337,029	343,509
Commercial construction	727	—	1,442	2,169	114,179	116,348
Residential	1,500	—	995	2,495	120,209	122,704
Home equity	85	—	477	562	74,077	74,639
Consumer	10	9	14	33	5,616	5,649
Total gross loans	\$4,692	\$226	\$21,570	\$26,488	\$1,422,355	\$1,448,843

Balance at December 31, 2012

(Dollars in thousands)	Loans 30-59 Days Past Due	Loans 60-89 Days Past Due	Loans 90 or More Days Past Due (non- accrual)	Total Past Due Loans	Current Loans	Gross Loans
Commercial real estate	\$1,560	\$551	\$12,608	\$14,719	\$695,546	\$710,265
Commercial and industrial	472	55	6,993	7,520	321,059	328,579
Commercial construction	—	—	743	743	120,624	121,367
Residential	42	558	862	1,462	118,816	120,278
Home equity	73	9	390	472	75,176	75,648
Consumer	42	11	5	58	4,853	4,911
Total gross loans	\$2,189	\$1,184	\$21,601	\$24,974	\$1,336,074	\$1,361,048

At June 30, 2013 and December 31, 2012, all loans 90 or more days past due were carried as non-accruing. Included in the consumer non-accrual numbers in the table above were \$8 thousand and \$5 thousand of overdraft deposit account balances 90 days or more past due at June 30, 2013 and December 31, 2012, respectively. Total non-performing loans amounted to \$21.6 million at both June 30, 2013 and December 31, 2012. Non-accrual loans which were not adversely classified amounted to \$1.1 million at June 30, 2013 and \$1.2 million at December 31, 2012. These balances primarily represented the guaranteed portions of non-performing Small Business Administration loans. The majority of the non-accrual loan balances were also carried as impaired loans during the periods noted, and are discussed further below. The increase in loans 30-59 days past due occurred primarily within the residential portfolio, due to a single large balance mortgage which was subsequently brought current, and in the commercial real estate and construction portfolios, with the majority of these loans just 30 days overdue at June 30, 2013.

The ratio of non-accrual loans to total loans amounted to 1.49% at June 30, 2013, 1.59% at December 31, 2012, and 1.93% at June 30, 2012.

At June 30, 2013, additional funding commitments for loans on non-accrual status totaled \$592 thousand. The Company's obligation to fulfill the additional funding commitments on non-accrual loans is generally contingent on the borrower's compliance with the terms of the credit agreement. If the borrower is not in compliance, additional funding commitments may be made at the Company's discretion.

- Impaired Loans

Impaired loans are individually significant loans for which management considers it probable that not all amounts due (principal and interest) in accordance with the original contractual terms will be collected. The majority of impaired loans are included within the non-accrual balances; however, not every loan in non-accrual status has been designated as impaired.

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Impaired loans include loans that have been modified in a troubled debt restructuring (see below). Impaired loans exclude large groups of smaller-balance homogeneous loans, such as residential mortgage loans and consumer loans, which are collectively evaluated for impairment and loans that are measured at fair value, unless the loan is amended in a TDR.

Management does not set any minimum delay of payments as a factor in reviewing for impaired classification. Management considers the individual payment status, net worth and earnings potential of the borrower, and the value and cash flow of the collateral as factors to determine if a loan will be paid in accordance with its contractual terms.

Impaired loans are individually evaluated for credit loss and a specific reserve is assigned for the amount of the estimated credit loss. Refer to heading "Allowance for probable loan losses methodology" contained in Note 5 "Allowance For Loan Losses," to the Company's consolidated financial statements contained in the Company's 2012 Annual Report on Form 10-K for further discussion of management's methodology used to estimate specific reserves for impaired loans.

Total impaired loans amounted to \$29.3 million and \$37.4 million, at June 30, 2013 and December 31, 2012, respectively. Total accruing impaired loans amounted to \$8.6 million and \$16.6 million at June 30, 2013 and December 31, 2012, respectively, while non-accrual impaired loans amounted to \$20.7 million and \$20.8 million as of June 30, 2013 and December 31, 2012, respectively. The decrease was primarily due to the changes discussed above under the heading "Adversely Classified Loans."

The following tables set forth the recorded investment in impaired loans and the related specific allowance allocated as of the dated indicated.

Balance at June 30, 2013

(Dollars in thousands)	Unpaid contractual principal balance	Total recorded investment in impaired loans	Recorded investment with no allowance	Recorded investment with allowance	Related allowance
Commercial real estate	\$ 18,212	\$16,245	\$11,873	\$4,372	\$915
Commercial and industrial	10,534	9,235	4,293	4,942	2,302
Commercial construction	3,034	2,916	986	1,930	739
Residential	846	799	377	422	163
Home equity	110	109	—	109	36
Consumer	19	19	—	19	19
Total	\$ 32,755	\$29,323	\$17,529	\$11,794	\$4,174

Balance at December 31, 2012

(Dollars in thousands)	Unpaid contractual principal balance	Total recorded investment in impaired loans	Recorded investment with no allowance	Recorded investment with allowance	Related allowance
Commercial real estate	\$ 24,760	\$22,859	\$18,735	\$4,124	\$1,041
Commercial and industrial	12,184	10,831	6,016	4,815	2,186
Commercial construction	3,091	2,932	995	1,937	753
Residential	687	648	390	258	65

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Home equity	110	109	—	109	87
Consumer	14	14	—	14	14
Total	\$40,846	\$37,393	\$26,136	\$11,257	\$4,146

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The following table presents the average recorded investment in impaired loans and the related interest recognized during the three month periods indicated.

(Dollars in thousands)	Three Months Ended June 30, 2013		Three Months Ended June 30, 2012	
	Average recorded investment	Interest income recognized	Average recorded investment	Interest income recognized
Commercial real estate	\$17,868	\$ 51	\$24,378	\$186
Commercial and industrial	9,252	24	9,806	68
Commercial construction	2,906	9	2,092	(4)
Residential	804	3	722	5
Home equity	109	—	50	(1)
Consumer	19	—	17	—
Total	\$30,958	\$ 87	\$37,065	\$254

The following table presents the average recorded investment in impaired loans and the related interest recognized during the six month periods indicated.

(Dollars in thousands)	Six Months Ended June 30, 2013		Six Months Ended June 30, 2012	
	Average recorded investment	Interest income recognized	Average recorded investment	Interest income recognized
Commercial real estate	\$20,155	\$149	\$24,281	\$310
Commercial and industrial	9,427	54	10,213	86
Commercial construction	2,902	33	2,054	17
Residential	807	4	698	5
Home equity	124	—	50	—
Consumer	16	—	17	1
Total	\$33,431	\$240	\$37,313	\$419

At June 30, 2013, additional funding commitments for impaired loans totaled \$592 thousand. The Company's obligation to fulfill the additional funding commitments on impaired loans is generally contingent on the borrower's compliance with the terms of the credit agreement. If the borrower is not in compliance, additional funding commitments may be made at the Company's discretion.

- Troubled Debt Restructures

Loans are designated as a TDR when, as part of an agreement to modify the original contractual terms of the loan, the Bank grants a concession on the terms, that would not otherwise be considered, as a result of financial difficulties of the borrower. Typically, such concessions may consist of a reduction in interest rate to a below market rate, taking into account the credit quality of the note, or a deferment or reduction of payments (principal or interest) which materially alters the Bank's position or significantly extends the note's maturity date, such that the present value of cash flows to be received is materially less than those contractually established at the loan's origination. All loans that are modified are reviewed by the Company to identify if a TDR has occurred. TDR loans are included in the impaired

loan category and, as such, these loans are individually evaluated and a specific reserve is assigned for the amount of the estimated credit loss.

Total TDR loans, included in the impaired loan figures above as of June 30, 2013 and December 31, 2012 were \$18.9 million and \$26.6 million, respectively.

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Notes to the Unaudited Consolidated Financial Statements (continued)

TDR loans on accrual status amounted to \$8.1 million and \$16.0 million at June 30, 2013 and December 31, 2012, respectively. During the current quarter, an accruing TDR commercial real estate relationship of approximately \$6.0 million was upgraded and removed from impaired/TDR status, due to the borrower's improved financial condition and sustained performance over time. TDR loans included in non-performing loans amounted to \$10.8 million and \$10.5 million at June 30, 2013 and December 31, 2012, respectively. The Company continues to work with commercial relationships and enters into loan modifications to the extent deemed to be necessary or appropriate to ensure the best mutual outcome given the current economic environment.

Troubled debt restructure agreements entered into during the three month period ended June 30, 2013

(Dollars in thousands)	Three months ended June 30, 2013		
	Number of restructurings	Pre-modification outstanding recorded investment	Post-modification outstanding recorded investment
Commercial real estate	—	\$ —	\$ —
Commercial and industrial	1	100	62
Commercial construction	—	—	—
Residential	—	—	—
Home equity	—	—	—
Consumer	—	—	—
Total	1	\$ 100	\$ 62

Loans modified as troubled debt restructuring within the previous twelve months for which there was a subsequent payment default during the period noted are detailed below.

(Dollars in thousands)	Three months ended June 30, 2013	
	Number of TDR's that defaulted	Post-modification outstanding recorded investment
Commercial real estate	—	\$ —
Commercial and industrial	—	—
Commercial construction	2	715
Residential	—	—
Home equity	—	—
Consumer	—	—
Total	2	\$ 715

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Notes to the Unaudited Consolidated Financial Statements (continued)

Troubled debt restructure agreements entered into during the six month period ended June 30, 2013.

(Dollars in thousands)	Six months ended June 30, 2013		
	Number of restructurings	Pre-modification outstanding recorded investment	Post-modification outstanding recorded investment
Commercial real estate	—	\$ —	\$ —
Commercial and industrial	1	100	62
Commercial construction	—	—	—
Residential	—	—	—
Home equity	—	—	—
Consumer	—	—	—
Total	1	\$ 100	\$ 62

Loans modified as troubled debt restructuring within the previous twelve months for which there was a subsequent payment default during the period noted are detailed below.

(Dollars in thousands)	Six months ended June 30, 2013	
	Number of TDR's that defaulted	Post-modification recorded investment outstanding
Commercial real estate	1	\$ 137
Commercial and industrial	—	—
Commercial construction	3	746
Residential	—	—
Home equity	—	—
Consumer	—	—
Total	4	\$ 883

There were \$38 thousand in charge-offs associated with the TDRs, noted in the table above, during the six months ended June 30, 2013. Included in the table above were two TDR's modified during the previous twelve months which defaulted and were subsequently transferred to OREO during the current period with a total post modification outstanding balance of \$167 thousand. At June 30, 2013, specific reserves allocated to the TDRs entered into during the 2013 period amounted to \$1 thousand, as management considered it likely the principal would ultimately be collected.

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Troubled debt restructure agreements entered into during the three month period ended June 30, 2012.

(Dollars in thousands)	Three months ended June 30, 2012		
	Number of restructurings	Pre-modification outstanding recorded investment	Post-modification outstanding recorded investment
Commercial real estate	—	\$ —	\$ —
Commercial and industrial	2	16	12
Commercial construction	—	—	—
Residential	—	—	—
Home equity	—	—	—
Consumer	—	—	—
Total	2	\$ 16	\$ 12

Loans modified as troubled debt restructuring within the previous twelve months for which there was a subsequent payment default during the period noted are detailed below.

(Dollars in thousands)	Three months ended June 30, 2012	
	Number of TDR's that defaulted	Post-modification outstanding recorded investment
Commercial real estate	—	\$—
Commercial and industrial	2	12
Commercial construction	—	—
Residential	—	—
Home Equity	—	—
Consumer	—	—
Total	2	\$12

Troubled debt restructure agreements entered into during six month the period ended June 30, 2012.

(Dollars in thousands)	Six months ended June 30, 2012		
	Number of restructurings	Pre-modification outstanding recorded investment	Post-modification outstanding recorded investment
Commercial real estate	—	\$ —	\$ —
Commercial and industrial	5	126	123
Commercial construction	—	—	—
Residential	1	130	128
Home equity	—	—	—
Consumer	—	—	—
Total	6	\$ 256	\$ 251

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Notes to the Unaudited Consolidated Financial Statements (continued)

Loans modified as troubled debt restructuring within the previous twelve months for which there was a subsequent payment default during the period noted are detailed below.

(Dollars in thousands)	Six months ended June 30, 2012	
	Number of TDR's that defaulted	Post-modification outstanding recorded investment
Commercial real estate	—	\$—
Commercial and industrial	3	17
Commercial construction	—	—
Residential	1	128
Home Equity	—	—
Consumer	—	—
Total	4	\$145

There were no charge-offs associated with the TDRs noted in the tables above during the six months ended June 30, 2012. At June 30, 2012, specific reserves allocated to the TDRs entered into during the 2012 period amounted to \$31 thousand, as management considered it likely the principal would ultimately be collected. Interest payments received on non-accruing new 2012 TDR loans which were applied to principal and not recognized as interest income amounted to \$3 thousand for the six months ended June 30, 2012.

Other Real Estate Owned

Real estate acquired by the Company through foreclosure proceedings or the acceptance of a deed in lieu of foreclosure is classified as OREO. When property is acquired, it is generally recorded at the lesser of the loan's remaining principal balance, net of any unamortized deferred fees, or the estimated fair value of the property acquired, less estimated costs to sell. Any loan balance in excess of the estimated realizable fair value on the date of transfer is charged to the allowance for loan losses on that date. All costs incurred thereafter in maintaining the property, as well as subsequent declines in fair value are charged to non-interest expense.

The carrying value of OREO at June 30, 2013 was \$136 thousand and consisted of 1 property, compared to \$500 thousand comprised of 1 property at December 31, 2012. During the six months ended June 30, 2013, 2 properties were sold, 1 of which was held at December 31, 2012, and 2 properties were added to OREO. There was \$121 thousand of gains realized on the sale of OREO in 2013. There were \$45 thousand gains on OREO sales during the six months ended June 30, 2012.

Allowance for probable loan losses methodology

On a quarterly basis, management prepares an estimate of the allowance necessary to cover estimated credit losses. The Company maintains the allowance at a level that it deems adequate to absorb all reasonably anticipated losses from specifically known and other credit risks associated with the portfolio. The Company uses a systematic methodology to measure the amount of estimated loan loss exposure inherent in the portfolio for purposes of establishing a sufficient allowance for loan losses. The methodology makes use of specific reserves, for loans individually evaluated and deemed impaired and general reserves, for larger groups of homogeneous loans, which rely on a combination of qualitative and quantitative factors that could have an impact on the credit quality of the portfolio.

There have been no material changes in the Company's underwriting practices, credit risk management system, or to the allowance assessment methodology used to estimate loan loss exposure as reported in the Company's most recent Annual Report on Form 10-K. Refer to heading "Allowance for probable loan losses methodology" contained in Note 5 "Allowance For Loan Losses," to the Company's consolidated financial statements contained in the Company's 2012 Annual Report on Form 10-K for further discussion of management's methodology used to estimate the loan loss exposure inherent in the portfolio for purposes of establishing a sufficient allowance.

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Notes to the Unaudited Consolidated Financial Statements (continued)

Allowance for loan loss activity

The allowance for loan losses is established through a provision for loan losses, a direct charge to 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.

During the fourth quarter of 2012, the Company purchased a group of residential mortgage loans with a June 30, 2013 carrying value of \$17.2 million. These purchased loans are initially booked at fair market value and, in accordance with accounting guidance, do not carry an initial allowance for loan losses. Management will continue to closely monitor this portfolio of non classified loans for estimated credit loss under general loss allocations taking into account the loss experience as well as the quantitative and qualitative factors identified above.

The allowance for loan losses amounted to \$25.7 million at June 30, 2013 compared to \$24.3 million at December 31, 2012. The allowance for loan losses to total loans ratio was 1.77% at June 30, 2013 and 1.78% at December 31, 2012 compared to 1.79% at June 30, 2012.

Based on management's judgment as to the existing credit risks inherent in the loan portfolio, as discussed above under the heading "Credit Quality Indicators," management believes that the Company's allowance for loan losses is adequate to absorb probable losses from specifically known and other credit risks associated with the portfolio as of June 30, 2013.

Changes in the allowance for loan losses by segment for the three months ended June 30, 2013, are presented below:

(Dollars in thousands)	Cmml Real Estate	Cmml and Industrial	Cmml Constr	Resid. Mortgage	Home Equity	Consumer	Total
Beginning Balance at March 31, 2013	\$ 12,359	\$ 7,396	\$ 3,486	\$ 975	\$ 672	\$ 128	\$ 25,016
Provision	614	207	(382)	58	10	27	534
Recoveries	61	31	50	—	—	3	145
Less: Charge offs	14	1	—	—	—	9	24
Ending Balance at June 30, 2013	\$ 13,020	\$ 7,633	\$ 3,154	\$ 1,033	\$ 682	\$ 149	\$ 25,671

Changes in the allowance for loan losses by segment for the six months ended June 30, 2013, are presented below:

(Dollars in thousands)	Cmml Real Estate	Cmml and Industrial	Cmml Constr	Resid. Mortgage	Home Equity	Consumer	Total
Beginning Balance at December 31, 2012	\$ 11,793	\$ 7,297	\$ 3,456	\$ 854	\$ 728	\$ 126	\$ 24,254
Provision	1,180	428	(352)	51	(23)	33	1,317
Recoveries	61	41	50	128	21	6	307
Less: Charge offs	14	133	—	—	44	16	207
Ending Balance at June 30, 2013	\$ 13,020	\$ 7,633	\$ 3,154	\$ 1,033	\$ 682	\$ 149	\$ 25,671
Ending allowance balance:							
Allotted to loans individually evaluated for impairment	\$ 915	\$ 2,302	\$ 739	\$ 163	\$ 36	\$ 19	\$ 4,174
Allotted to loans collectively evaluated for impairment	\$ 12,105	\$ 5,331	\$ 2,415	\$ 870	\$ 646	\$ 130	\$ 21,497

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Notes to the Unaudited Consolidated Financial Statements (continued)

Changes in the allowance for loan losses by segment for the three months ended June 30, 2012, are presented below:

(Dollars in thousands)	Cmml Real Estate	Cmml and Industrial	Cmml Constr	Resid. Mortgage	Home Equity	Consumer	Total
Beginning Balance at March 31, 2012	\$ 10,598	\$ 7,142	\$ 3,196	\$ 827	\$ 764	\$ 80	\$ 22,607
Provision	622	185	133	129	(43)	24	1,050
Recoveries	—	146	—	—	—	2	148
Less: Charge offs	223	268	—	182	—	6	679
Ending Balance at June 30, 2012	\$ 10,997	\$ 7,205	\$ 3,329	\$ 774	\$ 721	\$ 100	\$ 23,126

Changes in the allowance for loan losses by segment for the six months ended June 30, 2012, are presented below:

(Dollars in thousands)	Cmml Real Estate	Cmml and Industrial	Cmml Constr	Resid. Mortgage	Home Equity	Consumer	Total
Beginning Balance at December 31, 2011	\$ 10,855	\$ 7,568	\$ 3,013	\$ 995	\$ 615	\$ 114	\$ 23,160
Provision	365	510	414	(39)	105	(5)	1,350
Recoveries	—	192	2	—	1	3	198
Less: Charge offs	223	1,065	100	182	—	12	1,582
Ending Balance at June 30, 2012	\$ 10,997	\$ 7,205	\$ 3,329	\$ 774	\$ 721	\$ 100	\$ 23,126
Ending allowance balance:							
Allotted to loans individually evaluated for impairment	\$ 819	\$ 2,001	\$ 670	\$ 27	\$ 50	\$ 16	\$ 3,583
Allotted to loans collectively evaluated for impairment	\$ 10,178	\$ 5,204	\$ 2,659	\$ 747	\$ 671	\$ 84	\$ 19,543

The balances of loans as of June 30, 2013 by segment and evaluation method are summarized as follows:

(Dollars in thousands)	Loans individually evaluated for impairment	Loans collectively evaluated for impairment	Total Loans
Commercial real estate	\$ 16,245	\$ 769,749	\$ 785,994
Commercial and industrial	9,235	334,274	343,509
Commercial construction	2,916	113,432	116,348
Residential	799	121,905	122,704
Home equity	109	74,530	74,639
Consumer	19	5,630	5,649
Deferred Fees	—	(1,497)	(1,497)
Total loans	\$ 29,323	\$ 1,418,023	\$ 1,447,346

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Notes to the Unaudited Consolidated Financial Statements (continued)

The balances of loans as of December 31, 2012 by segment and evaluation method are summarized as follows:

(Dollars in thousands)	Loans individually	Loans collectively	Total Loans
	evaluated for impairment	evaluated for impairment	
Commercial real estate	\$ 22,859	\$ 687,406	\$ 710,265
Commercial and industrial	10,831	317,748	328,579
Commercial construction	2,932	118,435	121,367
Residential	648	119,630	120,278
Home equity	109	75,539	75,648
Consumer	14	4,897	4,911
Deferred Fees	—	(1,393	) (1,393
Total loans	\$ 37,393	\$ 1,322,262	\$ 1,359,655

(8) Supplemental Retirement Plan and Other Postretirement Benefit Obligations

Supplemental Retirement Plan (SERPs)

The Company has salary continuation agreements with two of its active executive officers, and one former executive officer who currently works on a part time basis. These agreements provide for predetermined fixed-cash supplemental retirement benefits to be provided for a period of 20 years after each individual reaches a defined "benefit age." The Company has not recognized service cost in the current or prior year as each officer had previously attained their individually defined benefit age and was fully vested under the plan.

This non-qualified plan represents a direct liability of the Company, and as such has no specific assets set aside to settle the benefit obligation. The funded status is the aggregate amount accrued, or the "Accumulated Benefit Obligation," which is equal to the present value of the benefits to be provided to the employee or any beneficiary in exchange for the employee's service rendered to that date. Because the Company's benefit obligations provide for predetermined fixed-cash payments, the Company does not have any unrecognized costs to be included as a component of accumulated other comprehensive income.

Total net periodic benefit cost, which was comprised of interest cost only, was \$34 thousand for the three months ended June 30, 2013 compared to \$38 thousand for the three months ended June 30, 2012, and \$67 thousand for the six months ended June 30, 2013 compared to \$76 thousand for the six months ended June 30, 2012.

Benefits paid amounted to \$69 thousand and \$138 thousand for both the three and six months ended June 30, 2013 and June 30, 2012, respectively. The Company anticipates accruing an additional \$67 thousand to the plan during the remainder of 2013.

Supplemental Life Insurance

For certain senior and executive officers on whom the Bank owns bank owned life insurance ("BOLI"), the Company has provided supplemental life insurance which provides a death benefit to the officer's designated beneficiaries.

The Company has recognized a liability for future benefits associated with an endorsement split-dollar life insurance arrangement that provides a benefit to an employee that extends to postretirement periods.

This non-qualified plan represents a direct liability of the Company, and as such has no specific assets set aside to settle the benefit obligation. The funded status is the aggregate amount accrued, or the “Accumulated Postretirement Benefit Obligation,” which is the present value of the post retirement benefits associated with this arrangement.

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The following table illustrates the net periodic post retirement benefit cost for the supplemental life insurance plans for the periods indicated:

(Dollars in thousands)	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Service Cost	\$1	\$1	\$1	\$3
Interest Cost	17	17	35	34
Net periodic post retirement benefit cost	\$18	\$18	\$36	\$37

(9) Stock-Based Compensation

The Company has individual stock incentive plans and has not changed the general terms and conditions of these plans from those disclosed in the Company's 2012 Annual Report on Form 10-K.

The Company's stock-based compensation expense includes stock option awards and restricted stock awards to officers, other employees and directors, and stock compensation in lieu of cash fees to directors. Total stock-based compensation expense was \$520 thousand and \$859 thousand for the three and six months ended June 30, 2013, respectively, compared to \$334 thousand and \$652 thousand for the three and six months ended June 30, 2012, respectively.

Stock Option Awards

The Company recognized stock-based compensation expense related to stock option awards of \$202 thousand and \$269 thousand for the three and six months ended June 30, 2013, respectively, compared to \$65 thousand and \$125 thousand for the three and six months ended June 30, 2012, respectively.

There were a total of 44,175 and 67,750 stock option awards granted to employees during the six months ended June 30, 2013 and 2012, respectively. Options granted in 2013 will vest 50% in year two and 50% in year four, on the anniversary date of the award. Options granted in 2012 generally vest equally over four years, on the anniversary date of the awards. Vested options are only exercisable while the employee remains employed with the Bank and for a limited time thereafter. The 2013 options expire ten years from the date of grant and the 2012 options expire seven years from the date of grant.

If a grantee's employment or other service relationship, such as service as a director, is terminated for any reason, then any stock options granted that have not vested as of the time of such termination generally must be forfeited, unless the Compensation Committee or the Board of Directors, as the case may be, waives such forfeiture requirement. In the case of retirement, under current Company guidelines, unvested stock options may be accelerated if the employee meets certain retirement criteria.

The Company utilizes the Black-Scholes option valuation model in order to determine the per share grant date fair value of option grants.

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The table below provides a summary of the options granted, fair value, the fair value as a percentage of the market value of the stock at the date of grant and the average assumptions used in the model for the options granted in 2013 and 2012.

	Six months ended June 30,		
	2013	2012	
Options granted	44,175	67,750	
Average assumptions used in the model:			
Expected volatility	48	% 50	%
Expected dividend yield	2.99	% 2.88	%
Expected life in years	7.0	5.5	
Risk-free interest rate	1.29	% 1.38	%
Market price on date of grant	\$16.43	\$16.25	
Per share weighted average fair value	\$6.56	\$6.33	
Fair value as a percentage of market value at grant date	40	% 39	%

Refer to Note 12 “Stock-Based Compensation Plans” in the Company’s 2012 Annual Report on Form 10-K for a further description of the assumptions used in the valuation model.

Restricted Stock Awards

Stock-based compensation expense recognized in association with restricted stock awards amounted to \$264 thousand and \$481 thousand for the three and six months ended June 30, 2013, respectively, compared to \$211 thousand and \$416 thousand for the three and six months ended June 30, 2012, respectively.

During the six months ended June 30, 2013, the Company granted 78,806 shares of common stock in the form of restricted stock awards. The awards were comprised of 24,925 shares awarded to employees generally vesting over four years in equal portions beginning on or about the first anniversary date of the award, 47,735 shares awarded to certain individuals that are performance based awards which vest upon Enterprise achieving certain predefined performance objectives and 6,146 shares awarded to directors vesting over two years in equal portions beginning on or about the first anniversary date of the award. The weighted average grant date fair value of the restricted stock awarded was \$16.43 per share, the market value of the common stock on the grant dates.

During the six months ended June 30, 2012, the Company granted 71,376 shares of common stock in the form of restricted stock awards comprised of 62,160 shares awarded to employees, generally vesting over four years, 3,000 shares awarded to an executive officer vesting immediately and 6,216 shares awarded to directors vesting over two years. The weighted average grant date fair value of the restricted stock awarded was \$16.25 per share, which reflects the market value of the common stock on the grant dates. The unvested 2012 awards generally vest, in each case, in equal portions beginning on or about the first anniversary date of the award.

The restricted stock awards allow for the receipt of dividends, and the voting of all shares, whether or not vested, throughout the vesting periods at the same proportional level as common shares outstanding.

If a grantee’s employment or other service relationship, such as service as a director, is terminated for any reason, then any shares of restricted stock granted that have not vested as of the time of such termination generally must be forfeited, unless the Compensation Committee or the Board of Directors, as the case may be, waives such forfeiture requirement. In the case of retirement, under current Company guidelines, a portion of the unvested restricted shares

may be accelerated if the employee meets certain retirement criteria.

Stock in Lieu of Directors' Fees

In addition to restricted stock awards discussed above, the members of the Company's Board of Directors may opt to receive newly issued shares of the Company's common stock in lieu of cash compensation for attendance at Board and Board Committee meetings. Stock-based compensation expense related to Directors' election to receive shares of common stock in lieu of cash fees for attendance at Board and Board committee meetings amounted to \$54 thousand and \$109 thousand for the

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Notes to the Unaudited Consolidated Financial Statements (continued)

three and six months ended June 30, 2013, respectively, compared to \$58 thousand and \$111 thousand for the three and six months ended June 30, 2012, respectively. In January 2013, directors were issued 12,592 shares of common stock in lieu of cash fees related to the 2012 annual directors' stock-based compensation expense of \$184 thousand and a market value price of \$14.63 per share, the market value of the common stock on the opt-in measurement date, January 3, 2012.

(10) Income Taxes

The Company uses the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax attributable to differences between the financial statement carrying amounts and the tax basis of assets and liabilities. The deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities will be adjusted accordingly through the provision for income taxes.

The Company's policy is to classify interest resulting from underpayment of income taxes as income tax expense in the first period the interest would begin accruing according to the provisions of the relevant tax law. The Company classifies penalties resulting from underpayment of income taxes as income tax expense in the period for which the Company claims or expects to claim an uncertain tax position or in the period in which the Company's judgment changes regarding an uncertain tax position.

The income tax provisions will differ from the expense that would result from applying the federal statutory rate to income before taxes, primarily due to the impact of tax exempt interest from certain investment securities, loans and bank owned life insurance.

The Company did not have any unrecognized tax benefits accrued as income tax liabilities or receivables or as deferred tax items at June 30, 2013. The Company is subject to U.S. federal and state income tax examinations by taxing authorities for the 2006 through 2012 tax years.

(11) Earnings per share

Basic earnings per share are calculated by dividing net income by the weighted average number of common shares outstanding (including participating securities) during the year. The Company's only participating securities are unvested restricted stock awards that contain non-forfeitable rights to dividends. Diluted earnings per share reflects the effect on weighted average shares outstanding of the number of additional shares outstanding if dilutive stock options were converted into common stock using the treasury stock method.

The table below presents the increase in average shares outstanding, using the treasury stock method, for the diluted earnings per share calculation for the periods indicated:

	Three months ended		Six months ended June	
	June 30, 2013	2012	30, 2013	2012
Basic weighted average common shares outstanding	9,825,335	9,588,420	9,770,559	9,543,994
Dilutive shares	64,304	67,308	69,457	68,193
Diluted weighted average common shares outstanding	9,889,639	9,655,728	9,840,016	9,612,187

For the six months ended June 30, 2013, there were an additional 6,000 average stock options outstanding, which were excluded from the year-to-date calculation of diluted earnings per share due to the exercise price of these options exceeding the average market price of the Company's common stock for the period. These options, which were not dilutive at that date, may potentially dilute earnings per share in the future.

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(12) Fair Value Measurements

The FASB defines the fair value of an asset or liability to be the price which a seller would receive in an orderly transaction between market participants (an exit price) and also establishes a fair value hierarchy segregating fair value measurements using three levels of inputs: (Level 1) quoted market prices in active markets for identical assets or liabilities; (Level 2) significant other observable inputs, including quoted prices for similar items in active markets, quoted prices for identical or similar items in markets that are not active, inputs such as interest rates and yield curves, volatilities, prepayment speeds, credit risks and default rates which provide a reasonable basis for fair value determination or inputs derived principally from observed market data; (Level 3) significant unobservable inputs for situations in which there is little, if any, market activity for the asset or liability. Unobservable inputs must reflect reasonable assumptions that market participants would use in pricing the asset or liability, which are developed on the basis of the best information available under the circumstances.

The following tables summarize significant assets and liabilities carried at fair value and placement in the fair value hierarchy at the dates specified:

(Dollars in thousands)	June 30, 2013	Fair Value Measurements using:		
	Fair Value	(level 1)	(level 2)	(level 3)
Assets measured on a recurring basis:				
Fixed income securities	\$179,678	\$—	\$179,678	\$—
Equity securities	10,781	10,781	—	—
FHLB Stock	4,324	—	—	4,324
Assets measured on a non-recurring basis:				
Impaired loans (collateral dependent)	7,540	—	—	7,540
Other real estate owned	136	—	—	136

(Dollars in thousands)	December 31, 2012	Fair Value Measurements using:		
	Fair Value	(level 1)	(level 2)	(level 3)
Assets measured on a recurring basis:				
Fixed income securities	\$173,796	\$—	\$173,796	\$—
Equity securities	10,668	10,668	—	—
FHLB Stock	4,260	—	—	4,260
Assets measured on a non-recurring basis:				
Impaired loans (collateral dependent)	7,110	—	—	7,110
Other real estate owned	500	—	—	500

The Company did not have cause to transfer any assets between the fair value measurement levels during the six months ended June 30, 2013 or the year ended December 31, 2012. There were no liabilities measured at fair value on a recurring or non-recurring basis as of June 30, 2013 or December 31, 2012. There were no gains or losses due to changes in fair value, recorded in earnings for level 3 assets for the six months ended June 30, 2013, or the year ended December 31, 2012.

All of the Company's fixed income investments and equity securities that are considered "available for sale" are carried at fair value. The fixed income category above includes federal agency obligations, federal agency MBS, municipal securities, corporate bonds and certificates of deposits as held at those dates. Certificates of deposit are investment

securities issued by financial institutions. They are subject to FDIC insurance and trade in the open market. The Company utilizes third-party pricing vendors to provide valuations on its fixed income securities. Fair values provided by the vendors were generally determined based upon pricing matrices utilizing observable market data inputs for similar or benchmark securities in active markets and/or based on a matrix pricing methodology which employs The Bond Market Association's standard calculations for cash flow and price/yield analysis, live benchmark bond pricing and terms/condition data available from major pricing sources. Therefore, management regards the inputs and methods used by third party pricing vendors to be "Level 2 inputs and methods" as defined

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in the “fair value hierarchy.” The Company periodically obtains a second price from an impartial third party on fixed income securities to assess the reasonableness of prices provided by the primary independent pricing vendor.

The Company’s equity portfolio fair value is measured based on quoted market prices for the shares; therefore, these securities are categorized as Level 1 within the fair value hierarchy.

Net unrealized appreciation and depreciation on investments available for sale, net of applicable income taxes, are reflected as a component of accumulated other comprehensive income.

The Bank is required to purchase FHLB stock at par value in association with advances from the FHLB; this stock is classified as a restricted investment and carried at cost which management believes approximates fair value; therefore, these securities are categorized as Level 3 measures.

Impaired loan balances in the table above represent those collateral dependent impaired commercial loans where management has estimated the credit loss by comparing the loan’s carrying value against the expected realizable fair value of the collateral (appraised value or internal analysis less estimated cost to sell, adjusted as necessary for changes in relevant valuation factors subsequent to the measurement date). Certain inputs used in these assessments, and possible subsequent adjustments, are not always observable, and therefore, collateral dependent impaired loans are categorized as Level 3 within the fair value hierarchy. A specific allowance is assigned to the collateral dependent impaired loan for the amount of management’s estimated credit loss. The specific allowances assigned to the collateral dependent impaired loans at June 30, 2013 amounted to \$2.7 million compared to \$3.3 million at December 31, 2012, a net decrease of \$592 thousand.

Real estate acquired by the Company through foreclosure proceedings or the acceptance of a deed in lieu of foreclosure is classified as OREO. When property is acquired, it is generally recorded at the lesser of the loan’s remaining principal balance, net of unamortized deferred fees, or the estimated fair value of the property acquired, less estimated costs to sell. The estimated fair value is based on market appraisals and the Company’s internal analysis. Certain inputs used in appraisals or the Company’s internal analysis, are not always observable, and therefore, OREO may be categorized as Level 3 within the fair value hierarchy. The carrying values of OREO at both June 30, 2013 and December 31, 2012 consisted of one property, respectively, at the end of each period. Two properties were added and two properties were sold during 2013; net gains realized on the sale of the OREO properties were \$121 thousand.

The following table presents additional quantitative information about assets measured at fair value on a recurring and non-recurring basis for which the Company utilized Level 3 inputs (significant unobservable inputs for situations in which there is little, if any, market activity for the asset or liability) to determine fair value as of June 30, 2013.

(Dollars in thousands)

Fair Value Valuation Technique