

COMMUNITY BANCORP /VT
Form 10-Q
August 13, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 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, 2012

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number 000-16435

Vermont
(State of Incorporation)

03-0284070
(IRS Employer Identification
Number)

4811 US Route 5, Derby, Vermont
(Address of Principal Executive
Offices)

05829
(zip code)

Registrant's Telephone Number: (802) 334-7915

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 for 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 the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated
filer

Accelerated filer

Edgar Filing: COMMUNITY BANCORP /VT - Form 10-Q

Non-accelerated filer (Do not check if a smaller reporting company) 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

At August 6, 2012, there were 4,774,561 shares outstanding of the Corporation's common stock.

FORM 10-Q

| Index | | Page |
|---------|---|------|
| PART I | FINANCIAL INFORMATION | |
| Item 1 | Financial Statements | 3 |
| Item 2 | Management's Discussion and Analysis of Financial Condition and Results of Operations | 29 |
| Item 3 | Quantitative and Qualitative Disclosures About Market Risk | 45 |
| Item 4 | Controls and Procedures | 45 |
| PART II | OTHER INFORMATION | |
| Item 1 | Legal Proceedings | 46 |
| Item 2 | Unregistered Sales of Equity Securities and Use of Proceeds | 46 |
| Item 6 | Exhibits | 46 |
| | Signatures | 47 |

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

The following are the unaudited consolidated financial statements for Community Bancorp. and Subsidiary, "the Company".

Edgar Filing: COMMUNITY BANCORP /VT - Form 10-Q

| Community Bancorp. and Subsidiary Consolidated Balance Sheets | June 30 2012 (Unaudited) | December 31 2011 | June 30 2011 (Unaudited) |
|--|--------------------------------|---------------------|--------------------------------|
| Assets | | | |
| Cash and due from banks | \$15,092,924 | \$23,459,776 | \$26,403,787 |
| Federal funds sold and overnight deposits | 4,000 | 5,000 | 1,000 |
| Total cash and cash equivalents | 15,096,924 | 23,464,776 | 26,404,787 |
| Securities held-to-maturity (fair value \$24,625,000 at 06/30/12, \$30,289,000 at 12/31/11 and \$22,624,000 at 06/30/11) | 24,026,422 | 29,702,159 | 21,939,781 |
| Securities available-for-sale | 60,101,855 | 66,098,917 | 27,570,328 |
| Restricted equity securities, at cost | 4,021,350 | 4,308,550 | 4,308,550 |
| Loans held-for-sale | 2,984,024 | 2,285,567 | 1,555,288 |
| Loans | 405,197,659 | 386,386,472 | 391,966,557 |
| Allowance for loan losses | (3,926,119) | (3,886,502) | (3,851,369) |
| Unearned net loan fees | 76,703 | 7,251 | (38,803) |
| Net loans | 401,348,243 | 382,507,221 | 388,076,385 |
| Bank premises and equipment, net | 12,404,860 | 12,715,226 | 12,612,777 |
| Accrued interest receivable | 1,755,832 | 1,700,600 | 1,565,196 |
| Bank owned life insurance | 4,125,066 | 4,063,246 | 3,997,996 |
| Core deposit intangible | 1,533,911 | 1,704,346 | 1,917,389 |
| Goodwill | 11,574,269 | 11,574,269 | 11,574,269 |
| Other real estate owned (OREO) | 1,010,198 | 90,000 | 131,000 |
| Prepaid expense - Federal Deposit Insurance Corporation (FDIC) | 939,425 | 1,131,861 | 1,296,684 |
| Other assets | 12,455,196 | 11,558,779 | 10,337,162 |
| Total assets | \$553,377,575 | \$552,905,517 | \$513,287,592 |
| Liabilities and Shareholders' Equity | | | |
| Liabilities | | | |
| Deposits: | | | |
| Demand, non-interest bearing | \$65,966,687 | \$62,745,782 | \$56,759,900 |
| NOW | 99,227,534 | 123,493,475 | 98,805,676 |
| Money market funds | 65,650,865 | 71,408,069 | 58,755,721 |
| Savings | 67,184,458 | 59,284,631 | 62,043,869 |
| Time deposits, \$100,000 and over | 52,189,543 | 51,372,782 | 50,591,697 |
| Other time deposits | 81,934,668 | 86,088,570 | 89,983,451 |
| Total deposits | 432,153,755 | 454,393,309 | 416,940,314 |
| Federal funds purchased and other borrowed funds | 37,835,000 | 18,010,000 | 18,010,000 |
| Repurchase agreements | 24,042,704 | 21,645,446 | 20,858,746 |
| Capital lease obligations | 804,671 | 833,467 | 812,714 |
| Junior subordinated debentures | 12,887,000 | 12,887,000 | 12,887,000 |
| Accrued interest and other liabilities | 3,523,766 | 4,217,886 | 3,624,094 |
| Total liabilities | 511,246,896 | 511,987,108 | 473,132,868 |
| Shareholders' Equity | | | |
| Preferred stock, 1,000,000 shares authorized, 25 shares issued and outstanding (\$100,000 liquidation value) | 2,500,000 | 2,500,000 | 2,500,000 |
| Common stock - \$2.50 par value; 10,000,000 shares authorized, 4,986,628 shares issued at 06/30/12, 4,938,262 shares issued at 12/31/11, and 4,891,194 shares issued at 06/30/11 | 12,466,570 | 12,345,655 | 12,227,985 |

Edgar Filing: COMMUNITY BANCORP /VT - Form 10-Q

| | | | |
|---|---------------|---------------|---------------|
| Additional paid-in capital | 27,750,038 | 27,410,049 | 27,048,147 |
| Retained earnings | 1,716,864 | 1,151,751 | 791,811 |
| Accumulated other comprehensive income | 319,984 | 133,731 | 209,558 |
| Less: treasury stock, at cost; 210,101 shares at 06/30/12, 12/31/11 and 06/30/11 | (2,622,777) | (2,622,777) | (2,622,777) |
| Total shareholders' equity | 42,130,679 | 40,918,409 | 40,154,724 |
| Total liabilities and shareholders' equity | \$553,377,575 | \$552,905,517 | \$513,287,592 |

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

Community Bancorp. and Subsidiary
Consolidated Statements of Income
(Unaudited)

| For The Quarter Ended June 30, | 2012 | 2011 |
|--|-------------|-------------|
| Interest income | | |
| Interest and fees on loans | \$5,250,077 | \$5,359,227 |
| Interest on debt securities | | |
| Taxable | 147,215 | 83,960 |
| Tax-exempt | 214,709 | 264,841 |
| Dividends | 20,854 | 18,981 |
| Interest on federal funds sold and overnight deposits | 7 | 13,788 |
| Total interest income | 5,632,862 | 5,740,797 |
| Interest expense | | |
| Interest on deposits | 866,863 | 1,042,510 |
| Interest on federal funds purchased and other borrowed funds | 94,983 | 99,123 |
| Interest on repurchase agreements | 33,746 | 36,310 |
| Interest on junior subordinated debentures | 243,564 | 243,564 |
| Total interest expense | 1,239,156 | 1,421,507 |
| Net interest income | 4,393,706 | 4,319,290 |
| Provision for loan losses | 249,999 | 237,500 |
| Net interest income after provision for loan losses | 4,143,707 | 4,081,790 |
| Non-interest income | | |
| Service fees | 587,729 | 599,270 |
| Income from sold loans | 450,958 | 205,324 |
| Other income from loans | 250,620 | 188,430 |
| Net realized gains on sale of securities available-for-sale | 41,295 | 0 |
| Other income | 202,430 | 286,171 |
| Total non-interest income | 1,533,032 | 1,279,195 |
| Non-interest expense | | |
| Salaries and wages | 1,542,878 | 1,468,875 |
| Employee benefits | 593,617 | 577,903 |
| Occupancy expenses, net | 812,580 | 784,605 |
| FDIC insurance | 99,101 | 90,314 |
| Amortization of core deposit intangible | 85,217 | 106,521 |
| Other expenses | 1,584,820 | 1,358,441 |
| Total non-interest expense | 4,718,213 | 4,386,659 |
| Income before income taxes | 958,526 | 974,326 |
| Income tax (benefit) expense | (62,666) | 103,008 |
| Net income | \$1,021,192 | \$871,318 |
| Earnings per common share | \$0.20 | \$0.18 |
| Weighted average number of common shares used in computing earnings per share | 4,760,169 | 4,663,166 |

Edgar Filing: COMMUNITY BANCORP /VT - Form 10-Q

| | | |
|---|--------|--------|
| Dividends declared per common share | \$0.14 | \$0.14 |
| Book value per share on common shares outstanding at June 30, | \$8.30 | \$8.04 |

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

5

Community Bancorp. and Subsidiary
Consolidated Statements of Income
(Unaudited)

For the Six Months Ended June 30,

2012

2011

Interest income

| | | |
|---|---------------|---------------|
| Interest and fees on loans | \$ 10,429,811 | \$ 10,663,093 |
| Interest on debt securities | | |
| Taxable | 320,056 | 154,770 |
| Tax-exempt | 427,982 | 526,730 |
| Dividends | 41,587 | 37,878 |
| Interest on federal funds sold and overnight deposits | 3,323 | 35,440 |
| Total interest income | 11,222,759 | 11,417,911 |

Interest expense

| | | |
|--|-----------|-----------|
| Interest on deposits | 1,770,154 | 2,155,293 |
| Interest on federal funds purchased and other borrowed funds | 186,152 | 216,332 |
| Interest on repurchase agreements | 66,649 | 74,224 |
| Interest on junior subordinated debentures | 487,129 | 487,129 |
| Total interest expense | 2,510,084 | 2,932,978 |

| | | |
|---|-----------|-----------|
| Net interest income | 8,712,675 | 8,484,933 |
| Provision for loan losses | 500,002 | 425,000 |
| Net interest income after provision for loan losses | 8,212,673 | 8,059,933 |

Non-interest income

| | | |
|---|-----------|-----------|
| Service fees | 1,154,345 | 1,149,788 |
| Income from sold loans | 838,169 | 708,059 |
| Other income from loans | 421,067 | 343,495 |
| Net realized gains on sale of securities available-for-sale | 41,295 | 0 |
| Other income | 433,133 | 537,322 |
| Total non-interest income | 2,888,009 | 2,738,664 |

Non-interest expense

| | | |
|---|-----------|-----------|
| Salaries and wages | 2,976,598 | 2,935,691 |
| Employee benefits | 1,187,224 | 1,118,340 |
| Occupancy expenses, net | 1,685,892 | 1,592,217 |
| FDIC insurance | 209,582 | 260,611 |
| Amortization of core deposit intangible | 170,435 | 213,043 |
| Other expenses | 3,038,413 | 2,616,271 |
| Total non-interest expense | 9,268,144 | 8,736,173 |

| | | |
|------------------------------|--------------|--------------|
| Income before income taxes | 1,832,538 | 2,062,424 |
| Income tax (benefit) expense | (153,504) | 246,237 |
| Net income | \$ 1,986,042 | \$ 1,816,187 |

| | | |
|--|-----------|-----------|
| Earnings per common share | \$0.40 | \$0.37 |
| Weighted average number of common shares used in computing earnings per share | 4,748,013 | 4,649,322 |

Edgar Filing: COMMUNITY BANCORP /VT - Form 10-Q

| | | |
|---|--------|--------|
| Dividends declared per common share | \$0.28 | \$0.28 |
| Book value per share on common shares outstanding at June 30, | \$8.30 | \$8.04 |

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

6

Community Bancorp. and Subsidiary
Consolidated Statements of Comprehensive Income
(Unaudited)

| For The Quarter Ended June 30, | 2012 | 2011 |
|--|-------------|-------------|
| Net income | \$1,021,192 | \$871,318 |
| Other comprehensive income, net of tax: | | |
| Change in unrealized holding gain on available-for-sale securities arising during the period | 187,135 | 203,720 |
| Reclassification adjustment for gains realized in income | 41,295 | 0 |
| Net change in unrealized gain | 228,430 | 203,720 |
| Tax effect | (77,666) | (69,265) |
| Other comprehensive income, net of tax | 150,764 | 134,455 |
| Total comprehensive income | \$1,171,956 | \$1,005,773 |

Community Bancorp. and Subsidiary
Consolidated Statements of Comprehensive Income
(Unaudited)

| For the Six Months Ended June 30, | 2012 | 2011 |
|--|-------------|-------------|
| Net income | \$1,986,042 | \$1,816,187 |
| Other comprehensive income, net of tax: | | |
| Change in unrealized holding gain on available-for-sale securities arising during the period | 240,906 | 201,364 |
| Reclassification adjustment for gains realized in income | 41,295 | 0 |
| Net change in unrealized gain | 282,201 | 201,364 |
| Tax effect | (95,948) | (68,463) |
| Other comprehensive income, net of tax | 186,253 | 132,901 |
| Total comprehensive income | \$2,172,295 | \$1,949,088 |

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

Community Bancorp. and Subsidiary
Consolidated Statements of Cash Flows
(Unaudited)

For the Six Months Ended June 30,

2012

2011

Cash Flows from Operating Activities:

| | | |
|---|--------------|--------------|
| Net income | \$1,986,042 | \$1,816,187 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization, bank premises and equipment | 560,662 | 499,082 |
| Provision for loan losses | 500,002 | 425,000 |
| Deferred income tax | (2,122,290) | (33,055) |
| Net gain on sale of securities available-for-sale | (41,295) | 0 |
| Net gain on sale of loans | (616,431) | (324,726) |
| Loss on sale of OREO | 0 | 7,212 |
| Gain on Trust LLC | (82,873) | (90,809) |
| Amortization of bond premium, net | 290,856 | 181,748 |
| Write down of OREO | 0 | 10,000 |
| Proceeds from sales of loans held for sale | 24,080,214 | 19,164,732 |
| Originations of loans held for sale | (24,162,240) | (18,031,356) |
| Increase (decrease) in taxes payable | 1,498,949 | (312,257) |
| (Increase) decrease in interest receivable | (55,232) | 224,425 |
| Amortization of FDIC insurance assessment | 192,436 | 236,473 |
| Decrease (increase) in mortgage servicing rights | 45,249 | (127,103) |
| Increase in other assets | (728,040) | (290,624) |
| Increase in cash surrender value of bank owned life insurance | (61,820) | (64,665) |
| Amortization of core deposit intangible | 170,435 | 213,043 |
| Amortization of limited partnerships | 610,470 | 244,293 |
| Decrease in unamortized loan fees | (69,452) | (35,548) |
| Decrease in interest payable | (22,164) | (36,691) |
| Increase (decrease) in accrued expenses | 46,170 | (161,825) |
| Increase (decrease) in other liabilities | 12,466 | (76,394) |
| Net cash provided by operating activities | 2,032,114 | 3,437,142 |

Cash Flows from Investing Activities:

| | | |
|---|--------------|--------------|
| Investments - held-to-maturity | | |
| Maturities and pay downs | 13,784,002 | 26,597,110 |
| Purchases | (8,108,265) | (11,096,177) |
| Investments - available-for-sale | | |
| Maturities, calls, pay downs and sales | 16,061,945 | 7,000,000 |
| Purchases | (10,032,243) | (13,120,276) |
| Proceeds from redemption of restricted equity securities | 287,200 | 0 |
| (Decrease) increase in limited partnership contributions payable | (740,000) | 1,084,000 |
| Investments in limited partnerships | (213,830) | (1,085,000) |
| Increase in loans, net | (20,215,537) | (3,367,384) |
| Proceeds from sales of bank premises and equipment, net of capital expenditures | (250,296) | (319,888) |
| Proceeds from sales of OREO | 0 | 1,193,088 |
| Recoveries of loans charged off | 23,767 | 37,120 |

| | | |
|---|--------------|-----------|
| Net cash (used in) provided by investing activities | (9,403,257) | 6,922,593 |
|---|--------------|-----------|

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

| | 2012 | 2011 |
|---|---------------|----------------|
| Cash Flows from Financing Activities: | | |
| Net decrease in demand and NOW accounts | (21,045,036) | (8,962,491) |
| Net increase (decrease) in money market and savings accounts | 2,142,623 | (9,132,508) |
| Net decrease in time deposits | (3,337,141) | (3,156,950) |
| Net increase in repurchase agreements | 2,397,258 | 1,750,931 |
| Net increase in short-term borrowings | 25,825,000 | 0 |
| Repayments on long-term borrowings | (6,000,000) | (15,000,000) |
| Decrease in capital lease obligations | (28,796) | (22,125) |
| Dividends paid on preferred stock | (93,750) | (93,750) |
| Dividends paid on common stock | (856,867) | (786,342) |
| Net cash used in financing activities | (996,709) | (35,403,235) |
| Net decrease in cash and cash equivalents | (8,367,852) | (25,043,500) |
| Cash and cash equivalents: | | |
| Beginning | 23,464,776 | 51,448,287 |
| Ending | \$ 15,096,924 | \$ 26,404,787 |
| Supplemental Schedule of Cash Paid During the Period | | |
| Interest | \$ 2,532,248 | \$ 2,969,669 |
| Income taxes | \$ 450,000 | \$ 591,550 |
| Supplemental Schedule of Noncash Investing and Financing Activities: | | |
| Change in unrealized gain on securities available-for-sale | \$ 282,201 | \$ 201,364 |
| Loans transferred to OREO | \$ 920,198 | \$ 131,000 |
| Investments in limited partnerships | | |
| Investments in limited partnerships | \$(213,830) | \$(1,085,000) |
| (Decrease) increase in limited partnership contributions payable | (740,000) | 1,084,000 |
| | \$(953,830) | \$(1,000) |
| Common Shares Dividends Paid | | |
| Dividends declared | \$ 1,327,179 | \$ 1,299,474 |
| Increase in dividends payable attributable to dividends declared | (9,408) | (41,941) |
| Dividends reinvested | (460,904) | (471,191) |
| | \$ 856,867 | \$ 786,342 |

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

Notes to Consolidated Financial Statements

Note 1. Basis of Presentation and Consolidation

The interim consolidated financial statements of Community Bancorp. and Subsidiary are unaudited. All significant intercompany balances and transactions have been eliminated in consolidation. In the opinion of management, all adjustments necessary for fair presentation of the financial condition and results of operations of the Company contained herein have been made. The unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2011 contained in the Company's Annual Report on Form 10-K. The results of operations for the interim period are not necessarily indicative of the results of operations to be expected for the full annual period ending December 31, 2012, or for any other interim period.

Note 2. Recent Accounting Developments

In April 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-03, "Reconsideration of Effective Control for Repurchase Agreements," amending the criteria under Accounting Standards Codification (ASC) Topic 860 for determining whether the transferor under a repurchase agreement involving a financial asset has retained effective control over the financial asset and therefore must account for the transaction as a secured borrowing rather than a sale. The guidance removes from the effective control criteria the consideration of whether the transferor has the ability to repurchase or redeem the financial asset on substantially the agreed terms. The guidance applies prospectively and is effective for new transactions and for existing transactions that are modified as of the beginning of the first interim or annual period beginning on or after December 15, 2011. Adoption of ASU 2011-03 did not have a material impact on the Company's consolidated financial statements.

In May 2011, the FASB issued ASU 2011-04, "Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in United States Generally Accepted Accounting Principles (US GAAP) and IFRS," amending ASC Topic 820. Although ASU 2011-04 deals primarily with development of a single fair value framework for US GAAP and International Financial Reporting Standards, the ASU also contains additional guidance on fair value measurements. Among other things, ASU 2011-04: clarifies how a principal market is determined; addresses the fair value measurement or counterparty credit risks and the concept of valuation premise and highest and best use of nonfinancial assets; prescribes a model for measuring the fair value of an instrument classified in shareholders' equity; limits the use of premiums or discounts based on the size of a holding; and requires certain new disclosures, including disclosures of all transfers between Levels 1 and 2 of the fair value hierarchy, whether or not significant, and additional disclosures regarding unobservable inputs and valuation processes for Level 3 measurements. The guidance in ASU 2011-04 is to be applied prospectively, and is effective for the Company for interim and annual periods beginning on or after December 15, 2011. Adoption of ASU 2011-04 did not have a material impact on the Company's consolidated financial statements.

In June 2011, the FASB issued ASU 2011-05, "Presentation of Comprehensive Income," amending Topic 220. The amendments provide that an entity has the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The Company has chosen the latter option. This ASU eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. The ASU does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income, nor does it require any transition disclosures. The amendments in this ASU are to be applied retrospectively, and are effective for fiscal years and interim periods beginning after December 15, 2011. In December 2011, the FASB issued ASU No. 2011-12, "Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other

Comprehensive Income in Accounting Standards Update No. 2011-05”, which defers the effective date of a requirement in ASU 2011-05 related to reclassifications of items out of accumulated other comprehensive income. The deferral of the effective date was made to allow the FASB time to consider whether to require presentation on the face of the financial statements of the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. Adoption of ASU 2011-05 did not have a material impact on the Company’s consolidated financial statements.

In September 2011, the FASB issued ASU 2011-08, “Testing Goodwill for Impairment,” amending Topic 350. The guidance changes the manner of testing of goodwill for impairment by providing an entity with the option of first assessing qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not (more than 50%) that the fair value of a reporting unit is less than its carrying amount. Such qualitative factors may include the following: macroeconomic conditions; industry and market considerations; cost factors; overall financial performance; and other relevant entity-specific events. If an entity elects to perform a qualitative assessment and determines that an impairment is more likely than not, the entity is then required to perform the existing two-step quantitative impairment test; otherwise, no further analysis is required. An entity also may elect not to perform the qualitative assessment and instead go directly to the two-step quantitative impairment test. These changes are effective for fiscal years beginning on or after December 15, 2011. The Company does not expect that adoption of the ASU will have a material impact on the Company’s consolidated financial statements.

In December 2011, the FASB issued ASU 2011-11, “Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities,” amending Topic 210. The amendments require an entity to disclose both gross and net information about both instruments and transactions that are eligible for offset on the balance sheet and instruments and transactions that are subject to an agreement similar to a master netting arrangement. This guidance is effective for annual periods beginning on or after January 1, 2013 and interim periods within those annual periods, with retrospective disclosure for all comparative periods presented. The Company is evaluating the impact of ASU 2011-11 but does not expect that adoption of the ASU will have a material impact on the Company’s consolidated financial statements.

In July 2012, the FASB issued ASU 2012-02, “Intangibles-Goodwill and Other (Topic 35): Testing Indefinite-Lived Intangible Assets for Impairment,” amending Topic 350. The guidance allows entities to first perform an optional qualitative assessment to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired in order to determine whether the asset should be further evaluated under quantitative impairment testing. The guidance does not revise the requirement that indefinite-lived intangible assets be tested for impairment at least annually, or more frequently if circumstances warrant, although it does revise the examples of events and circumstances that an entity should consider during interim periods. The ASU is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, although early adoption is permitted. The Company is evaluating the impact of ASU 2012-02 but does not expect its adoption will have a material impact on the Company’s consolidated financial statements.

Note 3. Earnings per Common Share

Earnings per common share amounts are computed based on the weighted average number of shares of common stock issued during the period (retroactively adjusted for stock splits and stock dividends), including Dividend Reinvestment Plan shares issuable upon reinvestment of dividends declared, and reduced for shares held in treasury.

The following table illustrates the calculation for the periods ended June 30, as adjusted for the cash dividends declared on the preferred stock:

| For The Quarter Ended June 30, | 2012 | 2011 |
|---|-------------|-------------|
| Net income, as reported | \$1,021,192 | \$871,318 |
| Less: dividends to preferred shareholders | 46,875 | 46,875 |
| Net income available to common shareholders | \$974,317 | \$824,443 |
| Weighted average number of common shares used in calculating earnings per share | 4,760,169 | 4,663,166 |
| Earnings per common share | \$0.20 | \$0.18 |
| | | |
| For the Six Months Ended June 30, | 2012 | 2011 |
| Net income, as reported | \$1,986,042 | \$1,816,187 |
| Less: dividends to preferred shareholders | 93,750 | 93,750 |
| Net income available to common shareholders | \$1,892,292 | \$1,722,437 |
| Weighted average number of common shares used in calculating earnings per share | 4,748,013 | 4,649,322 |
| Earnings per common share | \$0.40 | \$0.37 |

Note 4. Investment Securities

Securities available-for-sale (AFS) and held-to-maturity (HTM) as of the balance sheet dates consisted of the following:

| Securities AFS | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|--|-------------------|------------------------------|-------------------------------|----------------|
| June 30, 2012 | | | | |
| U.S. Government sponsored enterprise (GSE) debt securities | \$52,544,543 | \$390,057 | \$4,979 | \$52,929,621 |
| U.S. Government securities | 7,030,128 | 30,232 | 1,451 | 7,058,909 |
| U.S. GSE preferred stock | 42,360 | 70,965 | 0 | 113,325 |
| | \$59,617,031 | \$491,254 | \$6,430 | \$60,101,855 |
| December 31, 2011 | | | | |
| U.S. GSE debt securities | \$60,846,954 | \$215,595 | \$99,310 | \$60,963,239 |
| U.S. Government securities | 5,006,979 | 37,424 | 848 | 5,043,555 |
| U.S. GSE preferred stock | 42,360 | 49,763 | 0 | 92,123 |
| | \$65,896,293 | \$302,782 | \$100,158 | \$66,098,917 |
| June 30, 2011 | | | | |
| U.S. GSE debt securities | \$22,191,612 | \$129,836 | \$0 | \$22,321,448 |
| U.S. Government securities | 5,018,844 | 38,868 | 0 | 5,057,712 |
| U.S. GSE preferred stock | 42,360 | 148,808 | 0 | 191,168 |
| | \$27,252,816 | \$317,512 | \$0 | \$27,570,328 |
| Securities HTM | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value* |
| June 30, 2012 | | | | |
| States and political subdivisions | \$ 24,026,422 | \$ 598,578 | \$ 0 | \$ 24,625,000 |
| December 31, 2011 | | | | |
| States and political subdivisions | \$ 29,702,159 | \$ 586,841 | \$ 0 | \$ 30,289,000 |
| June 30, 2011 | | | | |
| States and political subdivisions | \$ 21,939,781 | \$ 684,219 | \$ 0 | \$ 22,624,000 |

The scheduled maturities of debt securities AFS were as follows:

| | Amortized Cost | Fair Value |
|----------------------------|-------------------|---------------|
| June 30, 2012 | | |
| Due in one year or less | \$3,007,965 | \$3,015,864 |
| Due from one to five years | 56,566,706 | 56,972,666 |
| | \$59,574,671 | \$59,988,530 |
| December 31, 2011 | | |
| Due in one year or less | \$5,018,549 | \$5,035,711 |
| Due from one to five years | 58,835,384 | 58,970,925 |
| Due from five to ten years | 2,000,000 | 2,000,158 |
| | \$65,853,933 | \$66,006,794 |
| June 30, 2011 | | |
| Due in one year or less | \$10,075,075 | \$10,117,753 |
| Due from one to five years | 17,135,381 | 17,261,407 |
| | \$27,210,456 | \$27,379,160 |

The scheduled maturities of debt securities HTM were as follows:

| | Amortized Cost | Fair Value* |
|----------------------------|-------------------|----------------|
| June 30, 2012 | | |
| Due in one year or less | \$14,724,739 | \$14,725,000 |
| Due from one to five years | 4,082,893 | 4,232,000 |
| Due from five to ten years | 2,016,088 | 2,166,000 |
| Due after ten years | 3,202,702 | 3,502,000 |
| | \$24,026,422 | \$24,625,000 |
| December 31, 2011 | | |
| Due in one year or less | \$20,589,247 | \$20,589,000 |
| Due from one to five years | 4,534,944 | 4,682,000 |
| Due from five to ten years | 822,735 | 969,000 |
| Due after ten years | 3,755,233 | 4,049,000 |
| | \$29,702,159 | \$30,289,000 |
| June 30, 2011 | | |
| Due in one year or less | \$12,747,547 | \$12,747,000 |
| Due from one to five years | 3,955,564 | 4,127,000 |
| Due from five to ten years | 1,375,793 | 1,547,000 |
| Due after ten years | 3,860,877 | 4,203,000 |
| | \$21,939,781 | \$22,624,000 |

*Method used to determine fair value on HTM securities rounds values to nearest thousand.

Debt securities with unrealized losses are presented in the table below. At June 30, 2011 the Company had no debt securities with an unrealized loss. There were no debt securities in an unrealized loss position of 12 months or more as of the dates presented.

| | Less than 12 months Fair Value | Unrealized Loss |
|----------------------------|--------------------------------------|--------------------|
| June 30, 2012 | | |
| U.S. GSE debt securities | \$3,533,963 | \$4,979 |
| U.S. Government securities | 2,010,281 | 1,451 |
| | \$5,544,244 | \$6,430 |
| December 31, 2011 | | |
| U.S. GSE debt securities | \$29,940,644 | \$99,310 |
| U.S. Government securities | 999,766 | 848 |
| | \$30,940,410 | \$100,158 |

Debt securities represented consisted of three U.S. GSE debt securities and two U.S. Government securities at June 30, 2012 and 21 U.S. GSE debt securities and one U.S. Government security at December 31, 2011 in an unrealized loss position. These unrealized losses were principally attributable to changes in prevailing interest rates for similar types of securities and not deterioration in the creditworthiness of the issuer.

At June 30, 2012 and 2011 and December 31, 2011, the Company's AFS portfolio included two classes of Fannie Mae preferred stock with an aggregate cost basis of \$42,360, which reflects cumulative other-than-temporary impairment write downs in prior periods of \$833,778.

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market conditions, or adverse developments relating to the issuer, warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than the carrying value, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment for a period of time sufficient to allow for any anticipated recovery in fair value. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies or other adverse developments in the status of the securities have occurred, and the results of reviews of the issuer's financial condition.

Note 5. Loans, Allowance for Loan Losses and Credit Quality

The composition of net loans follows:

| | June 30, 2012 | December 31, 2011 | June 30, 2011 |
|------------------------------------|------------------|----------------------|------------------|
| Commercial | \$52,696,811 | \$39,514,607 | \$36,860,487 |
| Commercial real estate | 131,239,549 | 132,269,368 | 137,273,305 |
| Residential real estate - 1st lien | 166,621,140 | 159,535,958 | 161,038,426 |
| Residential real estate - Jr. lien | 46,253,285 | 45,886,967 | 46,289,717 |
| Consumer | 11,370,898 | 11,465,139 | 12,059,910 |
| | 408,181,683 | 388,672,039 | 393,521,845 |
| Deduct (add): | | | |

Edgar Filing: COMMUNITY BANCORP /VT - Form 10-Q

| | | | |
|---------------------------|---------------|---------------|---------------|
| Allowance for loan losses | 3,926,119 | 3,886,502 | 3,851,369 |
| Unearned net loan fees | (76,703) | (7,251) | 38,803 |
| Loans held-for-sale | 2,984,024 | 2,285,567 | 1,555,288 |
| | 6,833,440 | 6,164,818 | 5,445,460 |
| Net Loans | \$401,348,243 | \$382,507,221 | \$388,076,385 |

14

Edgar Filing: COMMUNITY BANCORP /VT - Form 10-Q

The following is an age analysis of past due loans (including non-accrual) by segment:

| June 30, 2012 | 30-89 Days | 90 Days or More | Total Past Due | Current | Total Loans | Non-Accrual Loans | Over 90 Days and Accruing |
|--|-------------|--------------------|-------------------|---------------|---------------|----------------------|------------------------------------|
| Commercial | \$690,163 | \$608,100 | \$1,298,263 | \$51,398,548 | \$52,696,811 | \$1,159,782 | \$31,517 |
| Commercial real estate | 403,082 | 2,609,864 | 3,012,946 | 128,226,603 | 131,239,549 | 3,571,542 | 96,622 |
| Residential real estate - 1st lien | 1,148,563 | 1,263,035 | 2,411,598 | 161,225,518 | 163,637,116 | 1,629,611 | 704,780 |
| Residential real estate - Jr lien | 315,398 | 80,602 | 396,000 | 45,857,285 | 46,253,285 | 340,427 | 71,155 |
| Consumer | 157,491 | 17,131 | 174,622 | 11,196,276 | 11,370,898 | 0 | 17,131 |
| Total | \$2,714,697 | \$4,578,732 | \$7,293,429 | \$397,904,230 | \$405,197,659 | \$6,701,362 | \$921,205 |

| December 31, 2011 | 30-89 Days | 90 Days or More | Total Past Due | Current | Total Loans | Non-Accrual Loans | Over 90 Days and Accruing |
|--|-------------|--------------------|-------------------|---------------|---------------|----------------------|------------------------------------|
| Commercial | \$655,168 | \$265,668 | \$920,836 | \$38,593,771 | \$39,514,607 | \$1,066,945 | \$59,618 |
| Commercial real estate | 2,266,412 | 1,288,616 | 3,555,028 | 128,714,340 | 132,269,368 | 3,714,146 | 98,554 |
| Residential real estate - 1st lien | 5,614,513 | 2,517,282 | 8,131,795 | 149,118,596 | 157,250,391 | 2,703,920 | 969,078 |
| Residential real estate - Jr lien | 431,885 | 2,754,129 | 3,186,014 | 42,700,953 | 45,886,967 | 464,308 | 111,061 |
| Consumer | 152,151 | 1,498 | 153,649 | 11,311,490 | 11,465,139 | 0 | 1,498 |
| Total | \$9,120,129 | \$6,827,193 | \$15,947,322 | \$370,439,150 | \$386,386,472 | \$7,949,319 | \$1,239,809 |

| June 30, 2011 | 30-89 Days | 90 Days or More | Total Past Due | Current | Total Loans | Non-Accrual Loans | Over 90 Days and Accruing |
|--|------------|--------------------|-------------------|--------------|--------------|----------------------|------------------------------------|
| Commercial | \$563,870 | \$107,318 | \$671,188 | \$36,189,299 | \$36,860,487 | \$350,498 | \$4,838 |
| Commercial real estate | 1,003,076 | 817,168 | 1,820,244 | 135,453,061 | 137,273,305 | 1,517,465 | 393,707 |
| Residential real estate - 1st lien | 1,473,327 | 1,959,554 | 3,432,881 | 156,050,257 | 159,483,138 | 2,514,155 | 571,001 |
| Residential real estate - Jr | 280,423 | 297,726 | 578,149 | 45,711,568 | 46,289,717 | 459,626 | 207,758 |

| | | | | | | | |
|----------|-------------|-------------|-------------|---------------|---------------|-------------|-------------|
| lien | | | | | | | |
| Consumer | 107,179 | 1,228 | 108,407 | 11,951,503 | 12,059,910 | 0 | 1,228 |
| Total | \$3,427,875 | \$3,182,994 | \$6,610,869 | \$385,355,688 | \$391,966,557 | \$4,841,744 | \$1,178,532 |

Allowance for loan losses

The allowance for loan losses is established through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is probable. Subsequent recoveries, if any, are credited to the allowance.

As described below, the allowance consists of general, specific and unallocated components. However, the entire allowance is available to absorb losses in the loan portfolio, regardless of specific, general and unallocated components considered in determining the amount of the allowance.

General component

The general component of the allowance for loan losses is based on historical loss experience, adjusted for qualitative factors and stratified by the following loan segments: commercial, commercial real estate, residential real estate first lien, residential real estate junior lien, and consumer loans. The Company does not disaggregate its portfolio segments further into classes. Loss ratios are calculated for one year, two year and five year look back periods. The highest loss ratio among these look-back periods is then applied against the respective segment. Management uses an average of historical losses based on a time frame appropriate to capture relevant loss data for each loan segment. This historical loss factor is adjusted for the following qualitative factors: levels of and trends in delinquencies and non-performing loans, levels of and trends in loan risk groups, trends in volumes and terms of loans, effects of any changes in loan related policies, experience, ability and the depth of management, documentation and credit data exception levels, national and local economic trends, external factors such as competition and regulation and lastly, concentrations of credit risk in a variety of areas, including portfolio product mix, the level of loans to individual borrowers and their related interests, loans to industry segments, and the geographic distribution of commercial real estate loans. This evaluation is inherently subjective as it requires estimates that are susceptible to revision as more information becomes available.

During the fourth quarter of 2011 the Company modified its allowance methodology by further segmenting the residential real estate portfolio into first lien residential mortgages and junior lien residential mortgages, also known as home equity loans. The change was made to allow the Company to more closely monitor and appropriately reserve for the risk inherent with home equity lending, given the modest repayment requirements, relaxed documentation characteristic of home equity lending, higher loan to value ratios, subordinate lien position, and recent decline of home property values. The residential real estate junior lien portfolio accounted for 22 percent of the total residential real estate portfolio as of June 30, 2012, December 31, 2011, and June 30, 2011. No changes in the Company's policies or methodology pertaining to the general component for loan losses were made during the first six months of 2012.

The qualitative factors are determined based on the various risk characteristics of each loan segment. The Company has policies, procedures and internal controls that management believes are commensurate with the risk profile of each of these segments. Risk characteristics relevant to each portfolio segment are as follows:

Commercial – Loans in this segment include commercial and industrial loans and to a lesser extent loans to finance agricultural production. Commercial loans are made to businesses and are generally secured by assets of the business, including trade assets and equipment. While not the primary collateral, in many cases these loans may also be secured by the real estate of the business. Repayment is expected from the cash flows of the business. A weakened economy, soft consumer spending, unfavorable foreign trade conditions and the rising cost of labor or raw materials are examples of issues that can impact the credit quality in this segment.

Commercial Real Estate – Loans in this segment are principally made to businesses and are generally secured by either owner-occupied, or non-owner occupied commercial real estate. A relatively small portion of this segment includes farm loans secured by farm land and buildings. As with commercial loans, repayment of owner-occupied commercial real estate loans is expected from the cash flows of the business and the segment would be impacted by similar risk factors. The non-owner occupied commercial real estate portion includes both residential and commercial construction loans, vacant land and real estate development loans, multi-family dwelling loans and commercial rental property loans. Repayment of construction loans is expected from permanent financing takeout; the Company generally requires a commitment or eligibility for the take-out financing prior to construction loan origination. Real estate development loans are generally repaid from the sale of the subject real property as the project progresses. Construction and development lending entail additional risks, including the project exceeding budget, not being constructed according to plans, not receiving permits, or the pre-leasing or occupancy rate not meeting expectations. Repayment of multi-family loans and commercial rental property loans is expected from the cash flow generated by rental payments received from the individuals or businesses occupying the real estate. Commercial real estate loans are impacted by factors such as competitive market forces, vacancy rates, cap rates, net operating incomes, lease renewals and overall economic demand. In addition, loans in the recreational and tourism sector can be affected by weather conditions, such as unseasonably low winter snowfalls. Commercial real estate lending also carries a higher degree of environmental risk than other real estate lending.

Residential Real Estate - 1st Lien – All loans in this segment are collateralized by first mortgages on 1 – 4 family owner-occupied residential real estate and repayment is dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, has an impact on the credit quality of this segment.

Residential Real Estate – Jr. Lien – All loans in this segment are collateralized by junior lien mortgages on 1 – 4 family residential real estate and repayment is primarily dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, has an impact on the credit quality of this segment.

Consumer – Loans in this segment are made to individuals for consumer and household purposes. This segment includes both loans secured by automobiles and other consumer goods, as well as loans that are unsecured. This segment also includes overdrafts, which are extensions of credit made to both individuals and businesses to cover temporary shortages in their deposit accounts and are generally unsecured. The Company maintains policies restricting the size and length of these extensions of credit. The overall health of the economy, including unemployment rates, has an impact on the credit quality of this segment.

Specific component

The specific component relates to loans that are impaired. A specific allowance is established when a loan's impaired basis is less than the carrying value of the loan. For all loan segments, except consumer loans, a loan is considered impaired when, based on current information and events, in management's estimation it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Impaired loans are loan(s) to a borrower that in aggregate are greater than \$100,000 and that are in non-accrual status or are troubled debt restructurings (TDR). Factors considered by management in determining impairment include payment status, collateral value and probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant or temporary payment delays and payment shortfalls generally are not classified as impaired. Management evaluates the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length and frequency of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis, by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Impaired loans also include troubled loans that are restructured. A TDR occurs when the Company, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower that would otherwise not be granted. TDRs may include the transfer of assets to the Company in partial satisfaction of a troubled loan, a modification of a loan's terms, or a combination of the two.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer loans for impairment evaluation, unless such loans are subject to a restructuring agreement.

Unallocated component

An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

The following summarizes changes in the allowance for loan losses and select loan information, by portfolio segment.

For the quarter ended June 30, 2012

| | Commercial | Commercial Real Estate | Residential Real Estate 1st Lien | Residential Real Estate Jr Lien | Consumer | Unallocated | Total |
|---------------------------|------------|---------------------------|--|---------------------------------------|------------|-------------|--------------|
| Allowance for loan losses | | | | | | | |
| Beginning balance | \$ 388,576 | \$ 1,389,368 | \$ 1,595,453 | \$ 318,075 | \$ 124,022 | \$ 136,995 | \$ 3,952,489 |
| Charge-offs | (115,100) | (8,259) | (125,000) | 0 | (36,714) | 0 | (285,073) |
| Recoveries | 1,268 | 108 | 366 | 62 | 6,900 | 0 | 8,704 |
| Provision | 108,779 | 4,966 | 2,842 | 50,802 | 32,706 | 49,904 | 249,999 |
| Ending balance | \$ 383,523 | \$ 1,386,183 | \$ 1,473,661 | \$ 368,939 | \$ 126,914 | \$ 186,899 | \$ 3,926,119 |

For the six months ended June 30, 2012

| | Commercial | Commercial Real Estate | Residential Real Estate 1st Lien | Residential Real Estate Jr Lien | Consumer | Unallocated | Total |
|---------------------------|------------|---------------------------|--|---------------------------------------|------------|-------------|--------------|
| Allowance for loan losses | | | | | | | |
| Beginning balance | \$ 342,314 | \$ 1,385,939 | \$ 1,578,493 | \$ 331,684 | \$ 124,779 | \$ 123,293 | \$ 3,886,502 |
| Charge-offs | (124,934) | (55,057) | (183,474) | (60,287) | (60,373) | 0 | (484,125) |
| Recoveries | 2,520 | 863 | 1,823 | 1,418 | 17,116 | 0 | 23,740 |
| Provision | 163,623 | 54,438 | 76,819 | 96,124 | 45,392 | 63,606 | 500,002 |
| Ending balance | \$ 383,523 | \$ 1,386,183 | \$ 1,473,661 | \$ 368,939 | \$ 126,914 | \$ 186,899 | \$ 3,926,119 |

Allowance for loan losses

Evaluated for
impairment

| | | | | | | | |
|--------------|------------|--------------|--------------|------------|------------|------------|--------------|
| Individually | \$ 0 | \$ 15,100 | \$ 144,300 | \$ 21,000 | \$ 0 | \$ 0 | \$ 180,400 |
| Collectively | 383,523 | 1,371,083 | 1,329,361 | 347,939 | 126,914 | 186,899 | 3,745,719 |
| Total | \$ 383,523 | \$ 1,386,183 | \$ 1,473,661 | \$ 368,939 | \$ 126,914 | \$ 186,899 | \$ 3,926,119 |

Loans evaluated for impairment

| | | | | | | |
|--------------|--------------|---------------|---------------|--------------|--------------|---------------|
| Individually | \$985,350 | \$3,459,215 | \$1,345,724 | \$301,796 | \$0 | \$6,092,085 |
| Collectively | 51,711,461 | 127,780,334 | 165,275,416 | 45,951,489 | 11,370,898 | 402,089,598 |
| Total | \$52,696,811 | \$131,239,549 | \$166,621,140 | \$46,253,285 | \$11,370,898 | \$408,181,683 |

Edgar Filing: COMMUNITY BANCORP /VT - Form 10-Q

For the year ended December 31, 2011

| | Commercial Real Estate | Commercial Real Estate | Residential Real Estate 1st Lien | Residential Real Estate Jr Lien | Consumer | Unallocated | Total |
|---------------------------|---------------------------|---------------------------|--|---------------------------------------|------------|-------------|-------------|
| Allowance for loan losses | | | | | | | |
| Beginning | | | | | | | |
| balance | \$302,421 | \$1,391,898 | \$1,830,816 | \$0 | \$151,948 | \$50,852 | \$3,727,935 |
| Charge-offs | (22,050) | (197,367) | (521,608) | (96,961) | (103,687) | 0 | (941,673) |
| Recoveries | 13,225 | 8,479 | 42,593 | 20 | 35,923 | 0 | 100,240 |
| Provision | 48,718 | 182,929 | 226,692 | 428,625 | 40,595 | 72,441 | 1,000,000 |
| Ending | | | | | | | |
| balance | \$342,314 | \$1,385,939 | \$1,578,493 | \$331,684 | \$124,779 | \$123,293 | \$3,886,502 |

Allowance for loan losses

Evaluated for
impairment

| | | | | | | | |
|--------------|-----------|-------------|-------------|-----------|-----------|-----------|-------------|
| Individually | \$70,600 | \$57,500 | \$283,200 | \$47,200 | \$0 | \$0 | \$458,500 |
| Collectively | 271,714 | 1,328,439 | 1,295,293 | 284,484 | 124,779 | 123,293 | 3,428,002 |
| Total | \$342,314 | \$1,385,939 | \$1,578,493 | \$331,684 | \$124,779 | \$123,293 | \$3,886,502 |

Loans evaluated for impairment

| | | | | | | | |
|--------------|--------------|---------------|---------------|--------------|--------------|--|---------------|
| Individually | \$1,000,120 | \$3,669,260 | \$2,366,326 | \$434,664 | \$0 | | \$7,470,370 |
| Collectively | 38,514,487 | 128,600,108 | 157,169,632 | 45,452,303 | 11,465,139 | | 381,201,669 |
| Total | \$39,514,607 | \$132,269,368 | \$159,535,958 | \$45,886,967 | \$11,465,139 | | \$388,672,039 |

For the quarter ended June 30, 2011

| | Commercial | Commercial Real Estate | Residential Real Estate | Consumer | Unallocated | Total | |
|---------------------------|------------|---------------------------|----------------------------|-------------|-------------|-----------|-------------|
| Allowance for loan losses | | | | | | | |
| Beginning balance | | \$256,448 | \$1,396,946 | \$1,756,119 | \$151,865 | \$148,540 | \$3,709,918 |
| Charge-offs | | (2,427) | 0 | (82,646) | (26,523) | 0 | (111,596) |
| Recoveries | | 3,416 | 1,091 | 600 | 10,440 | 0 | 15,547 |
| Provision (reduction) | | (10,870) | (2,687) | 291,867 | (3,250) | (37,560) | 237,500 |
| Ending balance | | \$246,567 | \$1,395,350 | \$1,965,940 | \$132,532 | \$110,980 | \$3,851,369 |

For the six months ended June 30, 2011

| | Commercial | Commercial Real Estate | Residential Real Estate | Consumer | Unallocated | Total |
|---------------------------|------------|---------------------------|----------------------------|-----------|-------------|-------------|
| Allowance for loan losses | | | | | | |
| Beginning balance | \$302,421 | \$1,391,898 | \$1,830,816 | \$151,948 | \$50,852 | \$3,727,935 |
| Charge-offs | (3,127) | 0 | (271,446) | (64,113) | 0 | (338,686) |
| Recoveries | 11,522 | 2,181 | 600 | 22,817 | 0 | 37,120 |
| Provision (reduction) | (64,249) | 1,271 | 405,970 | 21,880 | 60,128 | 425,000 |
| Ending balance | \$246,567 | \$1,395,350 | \$1,965,940 | \$132,532 | \$110,980 | \$3,851,369 |
| | \$0 | \$6,100 | \$366,300 | \$0 | \$0 | \$372,400 |

| | | | | | | |
|--|-----------|-------------|-------------|-----------|-----------|-------------|
| Individually evaluated for impairment | | | | | | |
| Collectively evaluated for impairment | 246,567 | 1,389,250 | 1,599,640 | 132,532 | 110,980 | 3,478,969 |
| Total | \$246,567 | \$1,395,350 | \$1,965,940 | \$132,532 | \$110,980 | \$3,851,369 |

| | | | | | | |
|--|--------------|---------------|---------------|--------------|--|---------------|
| Loans | | | | | | |
| Individually evaluated for impairment | \$856,643 | \$1,471,703 | \$2,644,713 | \$0 | | \$4,973,059 |
| Collectively evaluated for impairment | 36,003,844 | 135,801,602 | 204,683,430 | 12,059,910 | | \$388,548,786 |
| Total | \$36,860,487 | \$137,273,305 | \$207,328,143 | \$12,059,910 | | \$393,521,845 |

Impaired loans by segments were as follows:

For the six months ended June 30, 2012

| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized * |
|------------------------------------|------------------------|--------------------------------|----------------------|-----------------------------------|---------------------------------------|
| With no related allowance recorded | | | | | |
| Commercial | \$985,350 | \$1,098,373 | \$0 | \$601,073 | \$0 |
| Commercial real estate | 2,307,560 | 2,658,965 | 0 | 2,112,726 | 0 |
| Residential real estate 1st lien | 701,424 | 924,758 | 0 | 847,776 | 0 |
| Residential real estate Jr lien | 31,532 | 36,024 | 0 | 52,439 | 0 |
| With an allowance recorded | | | | | |
| Commercial | 0 | 0 | 0 | 387,905 | 0 |
| Commercial real estate | 1,151,655 | 1,167,055 | 15,100 | 1,471,201 | 0 |
| Residential real estate 1st lien | 644,300 | 683,961 | 144,300 | 1,161,093 | 0 |
| Residential real estate Jr lien | 270,264 | 284,776 | 21,000 | 295,016 | 0 |
| Total | | | | | |
| Commercial | \$985,350 | \$1,098,373 | \$0 | \$988,978 | \$0 |
| Commercial real estate | \$3,459,215 | \$3,826,020 | \$15,100 | \$3,583,927 | \$0 |
| Residential real estate 1st lien | \$1,345,724 | \$1,608,719 | \$144,300 | \$2,008,869 | \$0 |
| Residential real estate Jr lien | \$301,796 | \$320,800 | \$21,000 | \$347,455 | \$0 |
| Total | \$6,092,085 | \$6,853,912 | \$180,400 | \$6,929,229 | \$0 |

For the year ended December 31, 2011

| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized* |
|------------------------------------|------------------------|--------------------------------|----------------------|-----------------------------------|-----------------------------------|
| With no related allowance recorded | | | | | |
| Commercial | \$380,624 | \$391,800 | \$0 | \$332,523 | \$0 |
| Commercial real estate | 2,041,101 | 2,246,905 | 0 | 960,407 | 0 |
| Residential real estate 1st lien | 1,000,819 | 1,191,437 | 0 | 1,210,137 | 0 |
| Residential real estate Jr lien | 125,786 | 185,142 | 0 | 25,157 | 0 |
| With an allowance recorded | | | | | |
| Commercial | 619,496 | 637,729 | 70,600 | 237,724 | 0 |
| Commercial real estate | 1,628,159 | 1,653,646 | 57,500 | 1,128,795 | 0 |
| Residential real estate 1st lien | 1,365,507 | 1,869,338 | 283,200 | 1,629,151 | 0 |
| Residential real estate Jr lien | 308,878 | 321,475 | 47,200 | 61,776 | 0 |
| Total | | | | | |
| Commercial | \$1,000,120 | \$1,029,529 | \$70,600 | \$570,247 | \$0 |
| Commercial real estate | \$3,669,260 | \$3,900,551 | \$57,500 | \$2,089,202 | \$0 |
| Residential real estate 1st lien | \$2,366,326 | \$3,060,775 | \$283,200 | \$2,839,288 | \$0 |

Edgar Filing: COMMUNITY BANCORP /VT - Form 10-Q

| | | | | | |
|---------------------------------|-------------|-------------|-----------|-------------|------|
| Residential real estate Jr lien | \$434,664 | \$506,617 | \$47,200 | \$86,933 | \$ 0 |
| Total | \$7,470,370 | \$8,497,472 | \$458,500 | \$5,585,670 | \$ 0 |

For the six months ended June 30, 2011

| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized* |
|------------------------------------|------------------------|--------------------------------|----------------------|-----------------------------------|-----------------------------------|
| With no related allowance recorded | | | | | |
| Commercial | \$856,643 | \$859,175 | | \$294,667 | \$ 0 |
| Commercial real estate | 1,260,762 | 1,276,902 | | 480,280 | 0 |
| Residential real estate | 865,299 | 1,058,921 | | 1,323,348 | 0 |
| With an allowance recorded | | | | | |
| Commercial | 0 | 0 | 0 | 42,028 | 0 |
| Commercial real estate | 210,941 | 210,941 | 6,100 | 833,777 | 0 |
| Residential real estate | 1,779,414 | 2,176,749 | 366,300 | 1,655,730 | 0 |
| Total | | | | | |
| Commercial | \$856,643 | \$859,175 | \$0 | \$336,695 | \$ 0 |
| Commercial real estate | \$1,471,703 | \$1,487,843 | \$6,100 | \$1,314,057 | \$ 0 |
| Residential real estate | \$2,644,713 | \$3,235,670 | \$366,300 | \$2,979,078 | \$ 0 |
| Total | \$4,973,059 | \$5,582,688 | \$372,400 | \$4,629,830 | \$ 0 |

*Interest income recognized on impaired loans is immaterial for all periods presented.

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

The Company is not contractually committed to lend additional funds to debtors with impaired, non-accrual or restructured loans.

Credit Quality Grouping

In developing the allowance for loan losses, management uses credit quality grouping to help evaluate trends in credit quality. The Company groups credit risk into Groups A, B and C. The manner the Company utilizes to assign risk grouping is driven by loan purpose. Commercial purpose loans are individually risk graded while the retail portion of the portfolio is generally grouped by delinquency pool.

Group A loans - Acceptable Risk – are loans that are expected to perform as agreed under their respective terms. Such loans carry a normal level of risk that does not require management attention beyond that warranted by the loan or loan relationship characteristics, such as loan size or relationship size. Group A loans include commercial loans that are individually risk rated and retail loans that are rated by pool. Group A retail loans include both performing consumer and residential real estate loans. Residential real estate loans are loans to individuals secured by 1-4 family homes, including first mortgages, home equity and home improvement loans. Loan balances fully secured by deposit accounts or that are fully guaranteed by the Federal Government are considered acceptable risk.

Group B loans – Management Involved - are loans that require greater attention than the acceptable loans in Group A. Characteristics of such loans may include, but are not limited to, borrowers that are experiencing negative operating trends such as reduced sales or margins, borrowers that have exposure to adverse market conditions such as increased

competition or regulatory burden, or that have had unexpected or adverse changes in management. These loans have a greater likelihood of migrating to an unacceptable risk level if these characteristics are left unchecked. Group B is limited to commercial loans that are individually risk rated.

Group C loans – Unacceptable Risk – are loans that have distinct shortcomings that require a greater degree of management attention. Examples of these shortcomings include a borrower's inadequate capacity to service debt, poor operating performance, or insolvency. These loans are more likely to result in repayment through collateral liquidation. Group C loans range from those that are likely to sustain some loss if the shortcomings are not corrected, to those for which loss is imminent and non-accrual treatment is warranted. Group C loans include individually rated commercial purpose loans, and retail loans adversely rated in accordance with the Federal Financial Institutions Examination Council's Uniform Retail Credit Classification Policy. Group C retail loans include 1-4 family residential real estate loans and home equity loans past due 90 days or more with loan-to-value ratios greater than 60%, home equity loans 90 days or more past due where the bank does not hold first mortgage, irrespective of loan-to-value, loans in bankruptcy where repayment is likely but not yet established, and lastly consumer loans that are 90 days or more past due.

Commercial purpose loan ratings are assigned by the commercial account officer; for larger and more complex commercial loans, the credit rating is a collaborative assignment by the lender and the credit analyst. The credit risk rating is based on the borrower's expected performance, i.e., the likelihood that the borrower will be able to service its obligations in accordance with the loan terms. Credit risk ratings are meant to measure risk versus simply record history. Assessment of expected future payment performance requires consideration of numerous factors. While past performance is part of the overall evaluation, expected performance is based on an analysis of the borrower's financial strength, and historical and projected factors such as size and financing alternatives, capacity and cash flow, balance sheet and income statement trends, the quality and timeliness of financial reporting, and the quality of the borrower's management. Other factors influencing the credit risk rating to a lesser degree include collateral coverage and control, guarantor strength and commitment, documentation, structure and covenants and industry conditions. There are uncertainties inherent in this process.

Credit risk ratings are dynamic and require updating whenever relevant information is received. The risk ratings of larger or more complex loans, and Group B and C rated loans, are assessed at the time of their respective annual reviews, during quarterly updates, in action plans or at any other time that relevant information warrants update. Lenders are required to make immediate disclosure to the Chief Credit Officer of any known increase in loan risk, even if considered temporary in nature.

The risk ratings within the loan portfolio by segments as of the balance sheet dates were as follows:

| June 30, 2012 | Total Loans | | | | | |
|---------------|--------------|------------------------|----------------------------------|---------------------------------|--------------|---------------|
| | Commercial | Commercial Real Estate | Residential Real Estate 1st Lien | Residential Real Estate Jr Lien | Consumer | Total |
| Group A | \$50,347,984 | \$119,388,434 | \$162,033,504 | \$45,302,653 | \$11,350,308 | \$388,422,883 |
| Group B | 400,125 | 4,660,012 | 412,798 | 321,946 | 0 | 5,794,881 |
| Group C | 1,948,702 | 7,191,103 | 4,174,838 | 628,686 | 20,590 | 13,963,919 |
| Total | \$52,696,811 | \$131,239,549 | \$166,621,140 | \$46,253,285 | \$11,370,898 | \$408,181,683 |

| December 31, 2011 | Total Loans | | | | | |
|-------------------|--------------|------------------------|----------------------------------|---------------------------------|--------------|---------------|
| | Commercial | Commercial Real Estate | Residential Real Estate 1st Lien | Residential Real Estate Jr Lien | Consumer | Total |
| Group A | \$36,971,880 | \$119,410,381 | \$153,954,604 | \$44,943,200 | \$11,459,371 | \$366,739,436 |
| Group B | 530,523 | 4,037,860 | 98,603 | 322,022 | 0 | 4,989,008 |
| Group C | 2,012,204 | 8,821,127 | 5,482,751 | 621,745 | 5,768 | 16,943,595 |
| Total | \$39,514,607 | \$132,269,368 | \$159,535,958 | \$45,886,967 | \$11,465,139 | \$388,672,039 |

| June 30, 2011 | Total Loans | | | | | |
|---------------|-------------|------------------------|-------------------------|-------------------------|--------------|---------------|
| | Commercial | Commercial Real Estate | Residential Real Estate | Residential Real Estate | Consumer | Total |
| Group A | | \$33,713,261 | \$121,191,043 | \$201,366,558 | \$12,045,442 | \$368,316,305 |
| Group B | | 990,727 | 7,129,125 | 594,832 | 0 | 8,714,684 |
| Group C | | 2,156,499 | 8,953,137 | 5,366,753 | 14,468 | 16,490,856 |
| Total | | \$36,860,487 | \$137,273,305 | \$207,328,143 | \$12,059,910 | \$393,521,845 |

Modifications of Loans and TDRs

A loan is classified as a TDR if, for economic or legal reasons related to a borrower's financial difficulties, the Company grants a concession to the borrower that it would not otherwise consider.

21

The Company has granted such a concession if it has modified a troubled loan in any of the following ways:

Reduced accrued interest

- Reduced the original contractual interest rate to a rate that is below the current market rate for the borrower;
- Converted a variable-rate loan to a fixed-rate loan;
- Extended the term of the loan beyond an insignificant delay;
- Deferred or forgiven principal in an amount greater than three months of payments; or,
- Performed a refinancing and deferred or forgiven principal on the original loan.

An insignificant delay or insignificant shortfall in the amount of payments typically would not require the loan to be accounted for as a TDR. However, pursuant to regulatory guidance, any delay longer than three months is generally not considered insignificant. The assessment of whether a concession has been granted also takes into account payments expected to be received from third parties, including third-party guarantors, provided that the third party has the ability to perform on the guarantee.

The Company's TDRs are principally a result of extending loan repayment terms to relieve cash flow difficulties. The Company has only, on a limited basis, reduced interest rates for borrowers below the current market rate for the borrower. The Company has not forgiven principal or reduced accrued interest within the terms of original restructurings, nor has it converted variable rate terms to fixed rate terms.

The following table presents loans modified as TDRs by segment during the six months ended June 30, 2012:

| | Number of Contracts | Pre- Modification Outstanding Recorded Investment | Post- Modification Outstanding Recorded Investment |
|----------------------------------|------------------------|---|--|
| Residential real estate 1st lien | 1 | \$ 23,944 | \$ 26,493 |

The following table presents TDRs for the twelve month period ended June 30, 2012 for which there was a payment default under the restructured terms during the period:

| | Number of Contracts | Recorded Investment |
|----------------------------------|---------------------------|------------------------|
| Commercial | 3 | \$ 283,363 |
| Commercial real estate | 1 | 398,002 |
| Residential real estate 1st lien | 1 | 107,584 |
| Total | 5 | \$ 788,949 |

With respect to the calculation of the allowance for loan losses, TDRs are treated as other impaired loans and carry specific reserves. These loans are categorized as non-performing, may be past due, and are generally adversely risk rated. TDRs that have defaulted under their restructured terms are generally in collection status and the specific reserve is typically calculated using the fair value of collateral method.

Note 6. Goodwill and Other Intangible Assets

As a result of the merger with LyndonBank on December 31, 2007, the Company recorded goodwill amounting to \$11,574,269. The goodwill is not amortizable and is not deductible for tax purposes.

The Company also recorded \$4,161,000 of acquired identified intangible assets representing the core deposit intangible which is subject to amortization as a non-interest expense over a ten year period.

Amortization expense for the core deposit intangible for the first six months of 2012 was \$170,435. As of June 30, 2012, the remaining annual amortization expense related to the core deposit intangible, absent any future impairment, is expected to be as follows:

| | |
|---|-------------|
| 2012 | \$ 170,435 |
| 2013 | 272,695 |
| 2014 | 272,695 |
| 2015 | 272,695 |
| 2016 | 272,695 |
| 2017 | 272,696 |
| Total remaining core deposit intangible | \$1,533,911 |

Management evaluates goodwill for impairment annually and the core deposit intangible for impairment if conditions warrant. As of the date of the most recent evaluation (December 31, 2011), management concluded that no impairment existed.

Note 7. 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, mortgage servicing rights, loans held for sale, 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 Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as U.S. Treasury, other U.S. Government and agency mortgage-backed debt securities that are highly liquid and are actively traded in over-the-counter markets.

Level 2 Observable inputs other than Level 1 prices such as quoted prices for similar assets and liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments and derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes mortgage servicing rights, impaired loans, and OREO.

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

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

Securities Available-for-Sale. Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices for similar assets, if available. If quoted prices are not available, fair values are measured using matrix pricing models, or other model-based valuation techniques requiring observable inputs other than quoted prices such as yield curves, prepayment speeds, and default rates. Recurring Level 1 securities would include U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets. Recurring Level 2 securities include federal agency securities.

Assets measured at fair value on a recurring basis and reflected in the balance sheet at the dates presented are summarized below:

| June 30, 2012 | Level 1 | Level 2 | Total |
|----------------------------|-----------|--------------|--------------|
| Assets: (market approach) | | | |
| U.S. GSE debt securities | \$0 | \$52,929,621 | \$52,929,621 |
| U.S. Government securities | 7,058,909 | 0 | 7,058,909 |
| U.S. GSE preferred stock | 113,325 | 0 | 113,325 |
| December 31, 2011 | | | |
| Assets: (market approach) | | | |
| U.S. GSE debt securities | \$0 | \$60,963,239 | \$60,963,239 |
| U.S. Government securities | 5,043,555 | 0 | 5,043,555 |
| U.S. GSE preferred stock | 92,123 | 0 | 92,123 |
| June 30, 2011 | | | |
| Assets: (market approach) | | | |
| U.S. GSE debt securities | \$0 | \$22,321,448 | \$22,321,448 |
| U.S. Government securities | 4,042,594 | 1,015,118 | 5,057,712 |
| U.S. GSE preferred stock | 191,168 | 0 | 191,168 |

There were no transfers between Levels 1 and 2 for the periods presented. There were no Level 3 financial instruments at June 30, 2012, December 31, 2011, or June 30, 2011.

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

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. 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. As such, the Company classifies mortgage servicing rights as nonrecurring Level 2.

OREO. Real estate acquired through foreclosure is initially recorded at market 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.

Impaired loans. A loan is considered to be impaired when it is probable that all of the principal and interest due under the original underwriting terms of the loan may not be collected. Impairment is measured based on the fair value of the underlying collateral or present value of expected cash flows. As such, the Company records impaired loans as nonrecurring Level 2.

The following table includes assets measured at fair value on a nonrecurring basis that have had a fair value adjustment since their initial recognition. 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 as disclosed in Note 5.

Assets measured at fair value on a nonrecurring basis and reflected in the balance sheet at the dates presented are summarized below:

| June 30, 2012 | Level 2 |
|--|--------------|
| Assets: (market approach) | |
| Residential mortgage servicing rights | \$ 1,052,235 |
| Impaired loans, net of related allowance | 1,885,819 |
| OREO | 1,010,198 |
| December 31, 2011 | |
| Assets: (market approach) | |
| Residential mortgage servicing rights | \$ 1,167,808 |
| Impaired loans, net of related allowance | 3,463,540 |
| OREO | 90,000 |
| June 30, 2011 | |
| Assets: (market approach) | |
| Residential mortgage servicing rights | \$ 1,203,811 |
| Impaired loans, net of related allowance | 1,617,955 |
| OREO | 131,000 |

There were no Level 1 or Level 3 financial instruments measured on a non-recurring basis at June 30, 2012, December 31, 2011, or June 30, 2011.

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.

Fair values of financial instruments

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

Cash and cash equivalents: The carrying amounts reported in the balance sheet for cash and cash equivalents approximate their fair values.

Investment securities: The fair value of securities available for sale equals quoted market prices, if available. If quoted market prices are not available, fair value is determined using quoted market prices for similar securities. Level 1 securities include certain U.S. Government securities and U.S. GSE preferred stock. Level 2 securities include asset-backed securities, including obligations of U.S. GSEs and certain U.S. Government securities.

Restricted equity securities: Restricted equity securities are comprised of FRBB stock and FHLBB stock. These securities are carried at cost, which is believed to approximate fair value, based on the redemption provisions of the FRBB and the FHLBB. The stock is nonmarketable, and redeemable at par value, subject to certain conditions, and, in the case of FHLBB stock, a moratorium on redemptions.

Loans and loans held-for-sale: For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying amounts. The fair values for other loans (for example, fixed rate residential, commercial real estate, and rental property mortgage loans, and commercial and industrial loans) are estimated using discounted cash flow analyses, based on interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Loan fair value estimates include judgments regarding future expected loss experience and risk characteristics. Loan impairment is deemed to exist when full repayment of principal and interest according to the contractual terms of the loan is no longer probable. Impaired loans are reported based on one of three measures: the present value of expected future cash flows discounted at the loan's effective interest rate; the loan's observable market price; or the fair value of the collateral if the loan is collateral dependent. If the fair value is less than an impaired loan's recorded investment, an impairment loss is recognized as part of the allowance for loan losses. Accordingly, certain impaired loans may be subject to measurement at fair value on a non-recurring basis. Management has estimated the fair values of these assets using Level 2 inputs, such as the fair value of collateral based on independent third-party appraisals for collateral-dependent loans.

The fair value of loans held-for-sale is based upon an actual purchase and sale agreement between the Company and an independent market participant. The sale is executed within a reasonable period following quarter end at the stated fair value.

Mortgage servicing rights: Mortgage servicing rights are evaluated regularly for impairment based upon the fair value of the servicing rights as compared to their amortized cost. The fair value of mortgage servicing rights is based on a valuation model that calculates the present value of estimated net servicing income, with loans divided into strata for valuation purposes based on their rates, terms and other features. The Company obtains a third party valuation based upon loan level data, including note rate, type and term. The model utilizes a variety of observable inputs for its assumptions, the most significant of which are loan prepayment assumptions and the discount rate used to discount future cash flows. Mortgage servicing rights are subject to measurement at fair value on a nonrecurring basis and are classified as Level 2 assets.

Deposits, federal funds purchased and borrowed funds: The fair values disclosed for demand deposits (for example, checking and savings accounts) are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The fair values for certificates of deposit and borrowed funds are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates and indebtedness to a schedule of aggregated contractual maturities on such time deposits and indebtedness.

Junior subordinated debentures: Fair value is estimated using current rates for debentures of similar maturity.

Capital lease obligations: Fair value is determined using a discounted cash flow calculation using current rates. Based on current rates, carrying value approximates fair value.

Accrued interest: The carrying amounts of accrued interest approximate their fair values.

Off-balance-sheet credit related instruments: Commitments to extend credit were evaluated and fair value was estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present credit-worthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates.

The estimated fair values of the Company's financial instruments were as follows:

| June 30, 2012 | Carrying Amount | Fair Value | Fair Value | Fair Value | Fair Value |
|--|-----------------|------------------------|------------|------------|------------|
| | | (Dollars in Thousands) | | | |
| | | Level 1 | Level 2 | Level 3 | Total |
| Financial assets: | | | | | |
| Cash and cash equivalents | \$ 15,097 | \$ 15,097 | \$ 0 | \$ 0 | \$ 15,097 |
| Securities held-to-maturity | 24,026 | 0 | 24,625 | 0 | 24,625 |
| Securities available-for-sale | 60,102 | 7,135 | 65,901 | 0 | 73,036 |
| Restricted equity securities | 4,021 | 0 | 4,021 | 0 | 4,021 |
| Loans and loans held-for-sale | | | | | |
| Commercial | 52,697 | 0 | 0 | 53,404 | 53,404 |
| Commercial real estate | 131,240 | 0 | 0 | 132,750 | 132,750 |
| Residential real estate - 1st lien | 166,621 | 0 | 0 | 173,833 | 173,833 |
| Residential real estate - Jr lien | 46,253 | 0 | 0 | 47,162 | 47,162 |
| Consumer | 11,371 | 0 | 0 | 11,814 | 11,814 |
| Mortgage servicing rights | 1,052 | 0 | 1,052 | 0 | 1,052 |
| Accrued interest receivable | 1,756 | 0 | 1,756 | 0 | 1,756 |
| Financial liabilities: | | | | | |
| Deposits | | | | | |
| Other deposits | 413,719 | 0 | 416,120 | 0 | 416,120 |
| Brokered deposits | 18,435 | 0 | 18,449 | 0 | 18,449 |
| Federal funds purchased and short term-borrowings | | | | | |
| Long-term borrowings | 25,825 | 0 | 25,825 | 0 | 25,825 |
| Repurchase agreements | 12,010 | 0 | 12,351 | 0 | 12,351 |
| Capital lease obligations | 24,043 | 0 | 24,043 | 0 | 24,043 |
| Subordinated debentures | 805 | 0 | 805 | 0 | 805 |
| Accrued interest payable | 12,887 | 0 | 12,207 | 0 | 12,207 |
| | 128 | 0 | 128 | 0 | 128 |

| | December 31, 2011 | | June 30, 2011 | |
|---|-------------------|------------|-----------------|------------|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Financial assets: | | | | |
| Cash and cash equivalents | \$ 23,465 | \$ 23,465 | \$ 26,405 | \$ 26,405 |
| Securities held-to-maturity | 29,702 | 30,289 | 21,940 | 22,624 |
| Securities available-for-sale | 66,099 | 66,099 | 27,570 | 27,570 |
| Restricted equity securities | 4,309 | 4,309 | 4,309 | 4,309 |
| Loans and loans held-for-sale, net | 384,793 | 395,386 | 389,632 | 400,174 |
| Mortgage servicing rights | 1,097 | 1,168 | 1,204 | 1,207 |
| Accrued interest receivable | 1,701 | 1,701 | 1,565 | 1,565 |
| Financial liabilities: | | | | |
| Deposits | 454,393 | 457,347 | 416,940 | 419,768 |
| Federal funds purchased and other borrowed funds | | | | |
| Repurchase agreements | 18,010 | 18,404 | 18,010 | 18,370 |
| | 21,645 | 21,645 | 20,859 | 20,859 |

Edgar Filing: COMMUNITY BANCORP /VT - Form 10-Q

| | | | | |
|---------------------------|--------|--------|--------|--------|
| Capital lease obligations | 833 | 833 | 813 | 813 |
| Subordinated debentures | 12,887 | 11,691 | 12,887 | 13,592 |
| Accrued interest payable | 150 | 150 | 155 | 155 |

The estimated fair values of commitments to extend credit and letters of credit were immaterial as of the dates presented in the above table.

Note 8. Loan Servicing

The following table shows the changes in the carrying amount of the mortgage servicing rights for the periods indicated:

| | June 30, 2012 | December 31, 2011 | June 30, 2011 |
|---------------------------------------|------------------|-------------------------|------------------|
| Balance at beginning of year | \$1,097,442 | \$1,076,708 | \$1,076,708 |
| Mortgage servicing rights capitalized | 204,042 | 355,730 | 176,014 |
| Mortgage servicing rights amortized | (202,455) | (346,165) | (161,413) |
| Change in valuation allowance | (46,836) | 11,169 | 112,502 |
| Balance at end of period | \$1,052,193 | \$1,097,442 | \$1,203,811 |

Note 9. Legal Proceedings

In the normal course of business the Company and its subsidiary are involved in litigation that is considered incidental to their business. Management does not expect that any such litigation will be material to the Company's consolidated financial condition or results of operations.

Note 10. Subsequent Event

The Company has evaluated events and transactions through the date that the financial statements were issued for potential recognition or disclosure in these financial statements, as required by GAAP. On June 12, 2012, the Company declared a cash dividend of \$0.14 per common share payable August 1, 2012 to shareholders of record as of July 15, 2012. This dividend, amounting to \$665,297, was accrued at June 30, 2012.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS for the Period Ended June 30, 2012

The following discussion analyzes the consolidated financial condition of Community Bancorp. (the Company) and its wholly-owned subsidiary, Community National Bank, as of June 30, 2012, December 31, 2011 and June 30, 2011, and its consolidated results of operations for the periods then ended. The Company is considered a "smaller reporting company" under applicable regulations of the Securities and Exchange Commission (SEC) and is therefore eligible for relief from certain disclosure requirements.

The following discussion should be read in conjunction with the Company's audited consolidated financial statements and related notes contained in its 2011 Annual Report on form 10-K filed with the SEC.

FORWARD-LOOKING STATEMENTS

The following Management's Discussion and Analysis of Financial Condition and Results of Operations contains certain forward-looking statements about the results of operations, financial condition and business of the Company and its subsidiary. When used therein, the words "believes," "expects," "anticipates," "intends," "estimates," "plans," "predicts," or similar expressions, indicate that management of the Company is making forward-looking statements.

Forward-looking statements are not guarantees of future performance. They necessarily involve risks, uncertainties and assumptions. Future results of the Company may differ materially from those expressed in these forward-looking statements. Examples of forward looking statements included in this discussion include, but are not limited to, estimated contingent liability related to assumptions made within the asset/liability management process, management's expectations as to the future interest rate environment and the Company's related liquidity level, credit risk expectations relating to the Company's loan portfolio and its participation in the Federal Home Loan Bank of Boston (FHLBB) Mortgage Partnership Finance (MPF) program, and management's general outlook for the future performance of the Company, summarized below under "Overview". Although forward-looking statements are based on management's current expectations and estimates, many of the factors that could influence or determine actual results are unpredictable and not within the Company's control. Readers are cautioned not to place undue reliance on such statements as they speak only as of the date they are made. The Company does not undertake, and disclaims any obligation, to revise or update any forward-looking statements to reflect the occurrence or anticipated occurrence of events or circumstances after the date of this Report, except as required by applicable law. The Company claims the protection of the safe harbor for forward-looking statements provided in the Private Securities Litigation Reform Act of 1995.

Factors that may cause actual results to differ materially from those contemplated by these forward-looking statements include, among others, the following possibilities: (1) general economic conditions, either nationally, regionally or locally continue to deteriorate, resulting in a decline in credit quality or a diminished demand for the Company's products and services; (2) competitive pressures increase among financial service providers in the Company's northern New England market area or in the financial service industry generally, including competitive pressures from non-bank financial service providers, from increasing consolidation and integration of financial service providers, and from changes in technology and delivery systems; (3) interest rates change in such a way as to reduce the Company's margins; (4) changes in laws or government rules, or the way in which courts and government agencies interpret or implement those laws or rules, increase our costs of doing business or otherwise adversely affect the Company's business; (5) changes in federal or state tax policy; (6) changes in the level of nonperforming assets and charge-offs;

(7) changes in estimates of future reserve requirements based upon relevant regulatory and accounting requirements; (8) changes in consumer and business spending, borrowing and savings habits; and (9) the effect of and changes in the United States monetary and fiscal policies, including the interest rate policies, regulation of the money supply by the Federal Reserve Board, and adverse changes in the credit rating of U.S. government debt.

NON-GAAP FINANCIAL MEASURES

Under SEC Regulation G, public companies making disclosures containing financial measures that are not in accordance with generally accepted accounting principles in the United States (US GAAP or GAAP) must also disclose, along with each non-GAAP financial measure, certain additional information, including a reconciliation of the non-GAAP financial measure to the closest comparable GAAP financial measure, as well as a statement of the company's reasons for utilizing the non-GAAP financial measure. The SEC has exempted from the definition of non-GAAP financial measures certain commonly used financial measures that are not based on GAAP. However, two non-GAAP financial measures commonly used by financial institutions, namely tax-equivalent net interest income and tax-equivalent net interest margin, have not been specifically exempted by the SEC, and may therefore constitute non-GAAP financial measures under Regulation G. We are unable to state with certainty whether the SEC would regard those measures as subject to Regulation G.

Management believes that these non-GAAP financial measures are useful in evaluating the Company's financial performance and facilitate comparisons with the performance of other financial institutions. However, that information should be considered supplemental in nature and not as a substitute for related financial information prepared in accordance with GAAP.

OVERVIEW

The Company's consolidated assets on June 30, 2012 were \$553,377,575, an increase of \$472,058, or .09% from December 31, 2011, and an increase of \$40,089,983, or 7.8% from June 30, 2011. Although there was no significant change in total assets since year end, a shift occurred within earning assets. The most significant change in assets in both comparison periods was a decrease in cash and an increase in investments and loans as the Company shifted cash into higher yielding assets. Demand for commercial loans increased since year end and demand for 1-4 family residential loans has remained steady. The Company has retained in the loan portfolio some 10 – 15 year mortgages to help maintain the level of the 1-4 family loans, while continuing to sell 30 year mortgage loans in the secondary market to manage interest rate risk. Cash decreased \$8,366,852 from year end and \$11,310,863 year over year. Cash was used to purchase available-for-sale securities during the later part of 2011 and continuing into the first quarter of 2012, which increased \$32,531,527 year over year. As loan demand increased in 2012, cash was used to fund loans, which increased \$19,509,644 from year end and \$14,659,838 from June 30, 2011. The decrease in the securities held-to-maturity portfolio from year-end to June 30, 2012 reflects the annual municipal finance cycle, as short-term municipal loans, recorded as held-to-maturity securities, generally mature at the end of the second quarter and are not replaced until after the start of the third quarter. Municipal loans totaling \$14.0 million matured on June 30, 2012, with renewals and new municipal loans of approximately \$24.0 million recorded in July, 2012. Deposits on June 30, 2012 were \$432,153,755, an increase of \$15,213,441, or 3.7% from June 30, 2011 and a decrease of \$22,239,554, or 4.9% from December 31, 2011. Contributing to the increase in deposits year over year, was an increase in demand deposit accounts of \$9,206,787, or 16.2%, representing accounts the Company considers core deposits. While an increase is noted in money market and savings accounts, management believes, to a certain extent, that this may reflect a shift of funds from maturing time deposits parked in non maturing deposit accounts, thus partially accounting for the decrease in time deposits of \$8,048,783, or 8.9% year over year. The most significant variance in deposit balances from December 31, 2011 to June 30, 2012 is a decrease in NOW accounts of \$24,265,941, or 19.7%. Most of the decrease is due to a decrease in Government Agency accounts of \$22,220,920, due to cyclical fluctuations in the balances of municipal customer accounts, as account balances typically increase during the third and fourth quarters of the year and then run off during the first half of the following year. The decrease in deposits from year end combined with continued loan demand resulted in an increase of \$19,825,000 in borrowed funds.

Net income for the second quarter of 2012 was \$1,021,192 or \$0.20 per common share compared to \$871,318 or \$0.18 per common share for the second quarter of 2011. Net interest income increased in the first quarter of 2012 compared to the first quarter of 2011, despite a decline in interest income, due to a decrease in interest expense. The lower interest expense was attributed to a combination of the decrease in other time deposits and a decrease in rates paid on interest bearing deposits and borrowed funds. Non-interest income increased during the second quarter of 2012 compared to the second quarter 2011, due mostly to an increase in fee income from the sale of residential loans in the secondary market. Operating expenses increased \$331,554, of which \$173,170 was attributed to an increase in the amortization of the Company's investment in tax credit projects. The investment in tax credit projects has a corresponding tax benefit in the amount of \$639,714 for the first six months of 2012 compared to \$267,036 for the first six months of 2011.

On June 13, 2012, the Company's Board of Directors declared a quarterly cash dividend of \$0.14 per common share, payable on August 1, 2012 to shareholders of record on July 15, 2012. The Company is focused on increasing the profitability of the balance sheet, improving expense efficiency, and prudently managing risk, particularly credit risk, in order to remain a well-capitalized bank in this challenging economic environment.

CRITICAL ACCOUNTING POLICIES

The Company's significant accounting policies, which are described in Note 1 (Significant Accounting Policies) to the Company's consolidated financial statements in the December 31, 2011 Annual Report on Form 10-K, are fundamental to understanding the Company's results of operations and financial condition because they require management to use estimates and assumptions that may affect the value of the Company's assets or liabilities and financial results. These policies are considered by management to be critical because they require subjective and complex judgments about matters that are inherently uncertain and because it is likely that materially different amounts would be reported under different conditions or using different assumptions. The critical accounting policies govern:

- the allowance for loan losses;
- other real estate owned (OREO);
- valuation of residential mortgage servicing rights (MSRs);
- other than temporary impairment of investment securities; and
- the carrying value of goodwill.

These policies are described further in the Company's December 31, 2011 Annual Report on Form 10-K in the section titled "Management's Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies" and in Note 1 (Significant Accounting Policies) to the consolidated financial statements. There have been no material changes in the critical accounting policies described in the 2011 Annual Report on Form 10-K.

RESULTS OF OPERATIONS

The Company's net income for the second quarter of 2012 was \$1,021,192, representing an increase of \$149,874 or 17.2% over net income of \$871,318 for the second quarter of 2011. This resulted in earnings per common share of \$0.20 for the second quarter of 2012 and \$0.18 for the second quarter of 2011. Net income for the first six months of 2012 was \$1,986,042 compared to \$1,816,187 for the same period in 2011, representing an increase of \$169,855 or 9.4%. This resulted in earnings per common share for the six months ended June 30, of \$0.40 for 2012 and \$0.37 for 2011. Core earnings (net interest income) for the second quarter of 2012 increased \$74,416 or 1.7%, compared to the second quarter of 2011, despite continued pressure on the net interest margin and spread in this persistent low interest rate environment. Although second quarter interest income decreased \$107,936 or 1.9% compared to the same period last year, this decrease was more than offset by a decrease in interest expense of \$182,351 or 12.8% year over year. Despite a \$14,659,838 or 3.7% increase in loans between the second quarters of 2011 and 2012, interest and fees on loans, the major component of interest income, decreased \$109,150 or 2.0%, due to a decrease in interest rates between periods. Although total deposits increased \$15.2 million year over year, interest expense on deposits, the major component of total interest expense, decreased \$175,647 or 16.8% between quarterly periods, partly attributable to a decrease in the rates paid on interest-bearing deposit accounts, as certificates of deposits matured and were renewed into products at lower rates. Furthermore, it appears that some customers may be parking funds in more liquid, non maturing products such as savings or money market accounts while rates remain at historical lows. These same trends affected net interest income for the first six months of 2012, resulting in net income of \$8,712,675, an increase of \$227,742 or 2.7% over the first six months of 2011. The Company recorded a provision for loan losses of \$249,999 for the second quarter of 2012 compared to \$237,500 for the second quarter of 2011, an increase of 5.3% and the provision for the six months ended June 30, 2012 was \$500,002 compared to 425,000 for the same period in 2011, an increase of 17.6%.

Non-interest income increased \$253,837 or 19.8%, when compared to the second quarter of 2011. Strong mortgage activity and commercial loan demand had a positive impact on non-interest income. Fees related to the sales and servicing of loans sold on the secondary market was the major component of the increase in total non-interest income between the two quarters. Point fees and premiums collected on sold mortgages were \$326,814 for the second quarter of 2012 compared to \$128,411 for the same period in 2011, an increase of 154.5%. The increase in non-interest income for the six months ended June 30, 2012 was \$149,346 or 5.5% from the same period in 2011, with similar trends causing the variance.

Total non-interest expenses increased \$331,554 or 7.6% for the second quarter 2012 compared to the same quarter in 2011. The most significant increase was the amortization of the Company's investments in tax credit projects which were \$295,317 for the second quarter of 2012 compared to \$122,146 for the second quarter of 2011; an increase of \$173,170, or 141.8%. The amortization for the six months ended June 30, 2012 was \$590,634 compared to \$244,293; an increase of \$346,341 or 141.8% over the first six months of 2011. The tax credit investments provided tax benefits of \$639,714 for the first six months of 2012 compared to \$267,036 for the first six months of 2011. Otherwise, operating expenses remained relatively stable compared to the same period last year.

Return on average assets, which is net income divided by average total assets, measures how effectively a corporation uses its assets to produce earnings. Return on average equity, which is net income divided by average shareholders' equity, measures how effectively a corporation uses its equity capital to produce earnings. The following table shows these ratios annualized for the comparison periods.

Edgar Filing: COMMUNITY BANCORP /VT - Form 10-Q

| For the second quarter ended June 30, | 2012 | | 2011 | |
|---------------------------------------|------|---|------|---|
| Return on Average Assets | 0.77 | % | 0.64 | % |
| Return on Average Equity | 9.74 | % | 8.69 | % |

| For the six months ended June 30, | 2012 | | 2011 | |
|-----------------------------------|------|---|------|---|
| Return on Average Assets | 0.74 | % | 0.67 | % |
| Return on Average Equity | 9.58 | % | 9.18 | % |

The following table summarizes the earnings performance and certain balance sheet data of the Company for the 2012 and 2011 comparison periods.

SELECTED FINANCIAL DATA

| Balance Sheet Data | June 30, 2012 (Unaudited) | December 31, 2011 (Unaudited) |
|--|---------------------------------|-------------------------------------|
| Net loans | \$404,332,267 | \$384,792,788 |
| Total assets | 553,377,575 | 552,905,517 |
| Total deposits | 432,153,755 | 454,393,309 |
| Borrowed funds | 37,835,000 | 18,010,000 |
| Total liabilities | 511,246,896 | 511,987,108 |
| Total shareholders' equity | 42,130,679 | 40,918,409 |
| | | |
| Six Months Ended June 30, | 2012 | 2011 |
| | | |
| Total interest income | \$11,222,759 | \$11,417,911 |
| Less: | | |
| Total interest expense | 2,510,084 | 2,932,978 |
| Net interest income | 8,712,675 | 8,484,933 |
| Less: | | |
| Provision for loan losses | 500,002 | 425,000 |
| | | |
| Non-interest income | 2,888,009 | 2,738,664 |
| Less: | | |
| Non-interest expense | 9,268,144 | 8,736,173 |
| Income before income taxes | 1,832,538 | 2,062,424 |
| Less: | | |
| Applicable income tax expense | (153,504) | 246,237 |
| | | |
| Net Income | \$1,986,042 | \$1,816,187 |
| | | |
| Per Share Data | | |
| | | |
| Earnings per common share | \$0.40 | \$0.37 |
| Dividends declared per common share | \$0.28 | \$0.28 |
| Book value per common shares outstanding | \$8.30 | \$8.04 |
| Weighted average number of common shares outstanding | 4,748,013 | 4,649,322 |
| Number of common shares outstanding | 4,776,527 | 4,681,093 |

INTEREST INCOME VERSUS INTEREST EXPENSE (NET INTEREST INCOME)

The largest component of the Company's operating income is net interest income, which is the difference between interest earned on loans and investments versus the interest paid on deposits and other sources of funds (i.e. other borrowings). The Company's level of net interest income can fluctuate over time due to changes in the level and mix of earning assets, and sources of funds (volume) and from changes in the yield earned and costs of funds (rate). A portion of the Company's income from municipal investments is not subject to income taxes. Because the proportion of tax-exempt items in the Company's portfolio varies from year-to-year, to improve comparability of information, the non-taxable income shown in the tables below has been converted to a tax equivalent basis. Because the Company's corporate tax rate is 34%, to equalize tax-free and taxable income in the comparison, we divide the tax-free income by 66%, with the result that every tax-free dollar is equivalent to \$1.52 in taxable income.

The Company's tax-exempt income is derived from its municipal investments, which comprised the entire held-to-maturity portfolio of \$24,026,422 at June 30, 2012, and \$21,939,781 at June 30, 2011.

The following table shows the reconciliation between reported net interest income and tax equivalent, net interest income for the comparison periods of 2012 and 2011.

| For the Six Months Ended June 30, | 2012 | 2011 |
|-------------------------------------|--------------|--------------|
| Net interest income as presented | \$ 8,712,675 | \$ 8,484,933 |
| Effect of tax-exempt income | 220,476 | 271,346 |
| Net interest income, tax equivalent | \$ 8,933,151 | \$ 8,756,279 |

The following table presents average earning assets and average interest-bearing liabilities supporting earning assets. Interest income (excluding interest on non-accrual loans) and interest expense are both expressed on a tax equivalent basis, both in dollars and as a rate/yield for the 2012 and 2011 comparison periods.

| | For the Six Months Ended June 30, | | | | | | |
|--|-----------------------------------|----------------|--------------------|------|-----------------|----------------|--------------------|
| | 2012 | | | 2011 | | | |
| | Average Balance | Income/Expense | Average Rate/Yield | | Average Balance | Income/Expense | Average Rate/Yield |
| Interest-Earning Assets | | | | | | | |
| Loans (1) | \$396,786,437 | \$10,429,811 | 5.29 % | | \$390,762,880 | \$10,663,093 | 5.50 % |
| Taxable investment securities | 67,568,304 | 320,056 | 0.95 % | | 26,098,615 | 154,770 | 1.20 % |
| Tax-exempt investment securities | 32,981,207 | 648,458 | 3.95 % | | 36,754,166 | 798,076 | 4.38 % |
| Sweep and interest earning accounts | 6,371,556 | 3,323 | 0.10 % | | 30,690,819 | 35,440 | 0.23 % |
| Other investments (4) | 4,520,390 | 41,587 | 1.85 % | | 4,695,550 | 37,878 | 1.63 % |
| Total | \$508,227,894 | \$11,443,235 | 4.53 % | | \$489,002,030 | \$11,689,257 | 4.82 % |
| Interest-Bearing Liabilities | | | | | | | |
| NOW | \$108,083,964 | \$170,726 | 0.32 % | | \$102,958,600 | \$239,158 | 0.47 % |
| Money market accounts | 74,969,730 | 345,905 | 0.93 % | | 73,572,543 | 428,539 | 1.17 % |
| Savings deposits | 63,695,053 | 50,561 | 0.16 % | | 59,430,872 | 60,256 | 0.20 % |
| Time deposits | 137,516,778 | 1,202,962 | 1.76 % | | 143,396,869 | 1,427,340 | 2.01 % |
| Federal funds purchased and other borrowed funds | 22,221,489 | 153,070 | 1.39 % | | 20,197,845 | 182,965 | 1.83 % |
| Repurchase agreements | 24,862,350 | 66,649 | 0.54 % | | 20,754,859 | 74,224 | 0.72 % |
| Capital lease obligations | 816,437 | 33,082 | 8.10 % | | 822,038 | 33,367 | 8.12 % |
| Junior subordinated debentures | 12,887,000 | 487,129 | 7.60 % | | 12,887,000 | 487,129 | 7.62 % |
| Total | \$445,052,801 | \$2,510,084 | 1.13 % | | \$434,020,626 | \$2,932,978 | 1.36 % |
| Net interest income | | \$8,933,151 | | | | \$8,756,279 | |

| | | | | |
|-------------------------|------|---|------|---|
| Net interest spread (2) | 3.40 | % | 3.46 | % |
| Net interest margin (3) | 3.53 | % | 3.61 | % |

- (1) Included in gross loans are non-accrual loans with an average balance of \$7,571,881 and \$4,620,930 for the six months ended June 30, 2012 and 2011, respectively. Loans are stated before deduction of unearned discount and allowance for loan losses.
- (2) Net interest spread is the difference between the average yield on average earning assets and the average rate paid on average interest-bearing liabilities.
- (3) Net interest margin is net interest income divided by average earning assets.
- (4) Included in other investments is the Company's FHLBB Stock with an average balance of \$3,545,240 and an annualized dividend payout rate of approximately 0.53%.

The average volume of earning assets for the first six months of 2012 increased \$19,225,864 or 3.9% compared to the same period of 2011, while the average yield decreased 29 basis points. The average volume of loans increased \$6,023,557 or 1.5%, while the average yield decreased 21 basis points. Interest earned on the loan portfolio equaled 91.1% of total interest income for the first six months of 2012 and 91.2% for the 2011 comparison period. The average volume of sweep and interest earning accounts decreased \$24,319,263 or 79.2%, as the Company shifted cash into higher yielding assets. The average volume of the taxable investment portfolio (classified as available-for-sale) increased \$41,469,689 or 158.9% for the same period, while the average yield decreased 25 basis points. The Company increased its taxable investment portfolio with U.S. government sponsored enterprise securities, as deposit funding increased in 2011, yet loan demand was weak. The Company has now seen an increase in loan demand beginning in the first quarter of 2012 and throughout the second quarter of 2012. The average volume of the tax exempt investment portfolio (classified as held-to-maturity) decreased \$3,772,959 or 10.27% between periods, while the average tax equivalent yield decreased 43 basis points. Interest earned on tax exempt investments (which is presented on a tax equivalent basis) comprised 5.7% of total interest income for the first six months of 2012 compared to 6.8% for the same period in 2011. The Company has experienced additional competition from other local financial institutions in our municipal market, which is reflected in the decrease in the average volume of our tax exempt investment portfolio.

In comparison, the average volume of interest bearing liabilities for the first six months of 2012 increased \$11,032,175 or 2.5% over the 2011 comparison period, while the average rate paid on these liabilities decreased 23 basis points. The average volume of NOW accounts increased \$5,125,364 or 5.0% and money market funds increased \$1,397,187 or 1.9% and the average rate paid decreased 15 basis points and 24 basis points, respectively. The average volume carried in the Company's money market product, an insured cash sweep account (ICS) offered through Promontory Interfinancial Network, increased \$3,626,351 year over year from \$8,758,986 in 2011 to \$12,385,337 in 2012. Although this product has brought in some new funds, most of the interest has come from the Company's Certificate of Deposit Account Registry Service (CDARS) of Promontory Interfinancial Network customers looking for alternatives to placing their money in time deposit accounts that are not as liquid. The average volume of time deposits decreased \$5,880,091 or 4.1%, and the average rate paid on time deposits decreased 25 basis points. On June 30, 2012, the Company held \$3,976,000 in one-way funds through CDARS. The average volume of federal funds purchased and other borrowed funds increased \$2,023,644 or 10.0% from an average volume of \$20,197,845 for the six months of 2011 to \$22,221,489 for the same period in 2012.

The prolonged low interest rate environment has resulted in continued pressure on the Company's net interest spread and margin. The Company's earning assets are being replaced and repricing to lower interest rates, while the opportunity to reduce rates further on non-maturing interest-bearing deposits is more limited, given the already low rates paid on deposits. During the first six months of 2012, the average yield on interest earning assets decreased 29 basis points while the average rate paid on interest bearing liabilities decreased only 23 basis points compared to the average yields and rates for the same period last year. Most of the decrease in interest expense during the first six months of 2012 was attributable to the decrease in time deposits due to both volume and the rate paid on these deposits. As long-term time deposits matured, they either repriced to lower rates or were not renewed. The cumulative result of all these changes was a decrease of six basis points in the net interest spread and a decrease of eight basis points in the net interest margin.

The following table summarizes the variances in interest income and interest expense on a fully tax-equivalent basis for the first six months of 2012 and 2011 resulting from volume changes in average assets and average liabilities and fluctuations in average rates earned and paid.

Changes in Interest Income and Interest Expense

| | Variance Due to Rate (1) | Variance Due to Volume (1) | Total Variance |
|--|--------------------------------|----------------------------------|-------------------|
| Average Interest-Earning Assets | | | |
| Loans | \$(397,568) | \$164,286 | \$(233,282) |
| Taxable investment securities | (81,487) | 246,773 | 165,286 |
| Tax-exempt investment securities | (75,509) | (74,109) | (149,618) |
| Sweep and interest earning accounts | (20,024) | (12,093) | (32,117) |
| Other investments | 5,320 | (1,611) | 3,709 |
| Total | \$(569,268) | \$323,246 | \$(246,022) |
| Average Interest-Bearing Liabilities | | | |
| NOW | \$(80,378) | \$11,946 | \$(68,432) |
| Money market accounts | (90,740) | 8,106 | (82,634) |
| Savings deposits | (13,924) | 4,229 | (9,695) |
| Time deposits | (172,916) | (51,462) | (224,378) |
| Federal funds purchased and other borrowed funds | (48,259) | 18,364 | (29,895) |
| Repurchase agreements | (22,240) | 14,665 | (7,575) |
| Capital lease obligations | (59) | (226) | (285) |
| Total | \$(428,516) | \$5,622 | \$(422,894) |
| Changes in net interest income | \$(140,752) | \$317,624 | \$176,872 |

(1) Items which have shown a year-to-year increase in volume have variances allocated as follows:

Variance due to rate = Change in rate x new volume

Variance due to volume = Change in volume x old rate

Items which have shown a year-to-year decrease in volume have variances allocated as follows:

Variance due to rate = Change in rate x old volume

Variances due to volume = Change in volume x new rate

NON-INTEREST INCOME AND NON-INTEREST EXPENSE

Non-interest Income: The Company's non-interest income increased \$253,837 or 19.8% to 1,533,032 for the second quarter of 2012 compared to the first quarter of 2011, while in the year-to-date comparison the increase was \$149,346 or 5.5% to \$2,888,010. Income from sold loans of \$450,958 during the second quarter was the major contributor to this increase. Also contributing to the increase in non-interest income was an increase in documentation fees collected on both commercial and in-house residential loans, for a total increase of \$71,071, or 35.0%. During the quarter, the Company sold \$12,000,000 in securities available for sale to support loan growth which created realized gains of \$41,295 compared to no securities gains during the second quarter in 2011. Other income, a subtotal within total non-interest income, decreased in the second quarter by \$83,740 or 29.3%, compared to the same quarter last year, with a portion of the variance coming from a decrease in exchange income of \$34,452 or 65.7%. Another component of other income is the fair value adjustment to the Company's Supplemental Employee Retirement Plan (SERP) which was a negative adjustment of \$20,169 at the end of the second quarter of 2012, while the adjustment at the end of the second quarter of 2011 was a positive adjustment of \$22,218, resulting in a negative variance of \$42,387 or 190.8% quarter over quarter. These same trends resulted in an increase in non-interest income for the six months ended June 30, 2012 of \$149,346 or 5.5%.

Non-interest Expense: The Company's non-interest expense was \$4,718,213 compared to \$4,386,659 for the second quarter of 2012 and 2011 respectively and \$9,268,144 and \$8,736,173 for the six months ended June 30, 2012 and 2011 respectively, an increase of 7.6% for the quarter comparison and an increase of 6.09% for the year-to-date comparison. Salaries, wages and employee benefits increased 4.4% and 2.7% for the quarter and six months ended June 30, 2012, respectively when compared to the same periods in 2011, primarily a result of normal salary increases. Occupancy expenses were \$812,581 and \$1,685,892 for the quarter and six months ended June 30, 2012 respectively, compared to \$784,605 and \$1,592,217 for the same periods in 2011. This increase is primarily a result of depreciation and service contracts related to significant bank-wide investments in new technology, including among others, digital imaging, requiring more sophisticated software which entails new service contracts. FDIC insurance for the second quarter of 2012 was \$99,101 compared to \$90,314 for the same period in 2011 while the total for the six months ended June 30, 2012 and 2011 was \$209,582 and \$260,611 respectively. A new deposit insurance assessment rule that went into effect on April 1, 2011 resulted in lower premiums for the Company initially, however the combination of an increase in assets and an increase in the factor used to calculate the premiums resulted in the increase in the second quarter of 2012. The Company continues to benefit from the amortization of the core deposit intangible associated with the LyndonBank acquisition which was \$85,217 and \$170,435 for the quarter and six months ended June 30, 2012 respectively, compared to \$106,521 and \$213,043 for the same periods in 2011.

Losses relating to various limited partnership investments for affordable housing in our market area constitute the largest portion of other expenses and account for the largest portion of the increase in non-interest expense. These losses for the second quarter of 2012 and 2011 amounted to \$295,317 and \$122,146, respectively, representing an increase of \$173,171 or 141.8%. Losses for the first six months of 2012 and 2011 amounted to \$590,634 and \$244,293, respectively, representing an increase of \$346,341 or 141.8%. These investments provide tax benefits, including tax credits, and are designed to provide an effective yield between 8% and 10%. Losses relating to the Company's New Market Tax Credit (NMTC) investment for the second quarter 2012 were recorded as \$19,836, with tax credits amounting to \$56,348. The Company amortizes these investments under the effective yield method.

APPLICABLE INCOME TAXES

The provision for income taxes decreased from a tax expense of \$103,008 for the second quarter of 2011 to a tax benefit of \$62,666 for the second quarter of 2012, a decrease of \$165,675 or 160.8%. The provision for income taxes decreased from a tax expense of \$246,237 for the first six months of 2011 to a tax benefit of \$153,504 for the first six months of 2012, a decrease of \$399,741 or 162.3%. The change from expense to benefit is due primarily to the increase in tax credits year over year. Total tax credits for the first six months of 2012 were \$639,714 compared to total tax credits of \$267,036 for the first six months of 2011.

CHANGES IN FINANCIAL CONDITION

The following table reflects the composition of the Company's major categories of assets and liabilities as a percent of total assets or liabilities and shareholders' equity, as the case may be, as of the dates indicated:

| | June 30, 2012 | | | December 31, 2011 | | | June 30, 2011 | | |
|-------------------------------|---------------|-------|---|-------------------|-------|---|---------------|-------|---|
| Assets | | | | | | | | | |
| Loans (gross)* | \$408,181,683 | 73.76 | % | \$388,672,039 | 70.30 | % | \$393,521,845 | 76.67 | % |
| Securities available-for-sale | 60,101,855 | 10.86 | % | 66,098,917 | 11.95 | % | 27,570,328 | 5.37 | % |
| Securities held-to-maturity | 24,026,422 | 4.34 | % | 29,702,159 | 5.37 | % | 21,939,781 | 4.27 | % |
| *includes loans held for sale | | | | | | | | | |
| | June 30, 2012 | | | December 31, 2011 | | | June 30, 2011 | | |
| Liabilities | | | | | | | | | |
| Time deposits | \$134,124,211 | 24.24 | % | \$137,461,352 | 24.86 | % | \$140,575,148 | 27.39 | % |

Edgar Filing: COMMUNITY BANCORP /VT - Form 10-Q

| | | | | | | | | | |
|-------------------------|------------|-------|---|-------------|-------|---|------------|-------|---|
| Savings deposits | 67,184,458 | 12.14 | % | 59,284,631 | 10.72 | % | 62,043,869 | 12.09 | % |
| Demand deposits | 65,966,687 | 11.92 | % | 62,745,782 | 11.35 | % | 56,759,900 | 11.06 | % |
| Now | 99,227,534 | 17.93 | % | 123,493,475 | 22.34 | % | 98,805,676 | 19.25 | % |
| Money market accounts | 65,650,865 | 11.86 | % | 71,408,069 | 12.92 | % | 58,755,721 | 11.45 | % |
| Federal funds purchased | 25,825,000 | 4.67 | % | 0 | 0.00 | % | 0 | 0.00 | % |
| Long-term borrowings | 12,010,000 | 2.17 | % | 18,010,000 | 3.26 | % | 18,010,000 | 3.51 | % |

The Company's loan portfolio increased \$19,509,644 or 5.0%, from December 31, 2011 to June 30, 2012, and increased \$14,659,838 or 3.7%, from June 30, 2011 to June 30, 2012. This increase is due in part to strong commercial loan growth during the first six months of 2012 and to the Company's decision to begin holding some 10-15 year fixed rate residential mortgages in-house, rather than selling them into the secondary market. Securities available-for-sale decreased \$5,997,062 or 9.07% from December 31, 2011 to June 30, 2012, and increased \$32,531,527 or 118.0% year over year. During 2011 and early in 2012, excess cash was invested into the available-for-sale portfolio while loan demand was weak. Subsequently, during the second quarter of 2012 as loan demand increased, securities available-for-sale in the amount of \$12,000,000 were sold to fund loan growth. Securities held-to-maturity decreased \$5,675,737 or 19.1% during the first six months of 2012, and increased \$2,086,641 or 9.5% year over year. The decrease at June 30, 2012 reflects municipal investments that mature at the end of the annual municipal finance cycle.

Total deposits decreased \$22,239,554 or 4.9% from December 31, 2011 to June 30, 2012 and increased \$15,213,441 or 3.7% from June 30, 2011 to June 30, 2012. Time deposits decreased \$3,337,141 or 2.4% from December 31, 2011 to June 30, 2012 and \$6,450,937 or 4.6% from June 30, 2011 to June 30, 2012. Management believes this decrease in time deposits is attributable to the low rate environment as customers park their funds in non-maturing deposit accounts while searching for higher paying investments. Savings deposits increased \$7,899,827 or 13.3% during the first six months of 2012 and \$5,140,589 or 8.3% year to year. Demand deposits increased \$3,220,905 or 5.1% during the first six months of 2012, compared to an increase of \$9,206,787 or 16.2% year to year. NOW accounts reported a decrease during the first six months of 2012 of \$24,265,941 or 19.7% and an increase of \$421,858 or .4% year over year. The government agency accounts, which are a component of the NOW accounts, decreased \$22,220,920 from \$15,576,914 at June 30, 2012 compared to \$37,697,835 at December 31, 2011. The account held by the Company's affiliate, CFSG, had a balance of \$22,411,064 at June 30, 2012 compared to \$26,005,366 at December 31, 2011, also contributing to the decrease in NOW accounts in 2012. Money market accounts decreased \$5,757,204 or 8.1% for the first six months of 2012 and increased \$6,895,144 or 11.7% year over year. Contributing to the decrease during the first six months is a decrease in municipal accounts, related to the annual finance cycle of the municipal customers and the increase year over year is attributable partly to an increase in the ICS accounts. Long-term borrowings at June 30, 2012 decreased \$6,000,000 or 33.3%, through the maturity of a long-term borrowing, compared to both December 31, and June 30, 2011.

RISK MANAGEMENT

Interest Rate Risk and Asset and Liability Management - Management actively monitors and manages the Company's interest rate risk exposure and attempts to structure the balance sheet to maximize net interest income while controlling its exposure to interest rate risk. The Company's Asset/Liability Management Committee (ALCO) is made up of the Executive Officers and all the Vice Presidents of the Bank. The ALCO formulates strategies to manage interest rate risk by evaluating the impact on earnings and capital of such factors as current interest rate forecasts and economic indicators, potential changes in such forecasts and indicators, liquidity and various business strategies. The ALCO meets monthly to review financial statements, liquidity levels, yields and spreads to better understand, measure, monitor and control the Company's interest rate risk. In the ALCO process, the committee members apply policy limits set forth in the Asset Liability, Liquidity and Investment policies approved and periodically reviewed by the Company's Board of Directors. The ALCO's methods for evaluating interest rate risk include an analysis of the effects of interest rate changes on net interest income and an analysis of the Company's interest rate sensitivity "gap", which provides a static analysis of the maturity and repricing characteristics of the entire balance sheet.

Interest rate risk represents the sensitivity of earnings to changes in market interest rates. As interest rates change, the interest income and expense streams associated with the Company's financial instruments also change, thereby impacting net interest income (NII), the primary component of the Company's earnings. Fluctuations in interest rates can also have an impact on liquidity. The ALCO uses an outside consultant to perform rate shock simulations to the Company's net interest income, as well as a variety of other analyses. It is the ALCO's function to provide the assumptions used in the modeling process. The ALCO utilizes the results of this simulation model to quantify the estimated exposure of NII and liquidity to sustained interest rate changes. The simulation model captures the impact of changing interest rates on the interest income received and interest expense paid on all interest-earning assets and interest-bearing liabilities reflected on the Company's balance sheet. Furthermore, the model simulates the balance sheet's sensitivity to a prolonged flat rate environment. All rate scenarios are simulated assuming a parallel shift of the yield curve; however further simulations are performed utilizing a flattening yield curve as well. This sensitivity analysis is compared to the ALCO policy limits which specify a maximum tolerance level for NII exposure over a 1-year horizon, assuming no balance sheet growth, given a 200 basis point (bp) shift upward and a 100 bp shift downward in interest rates. The analysis also provides a summary of the Company's liquidity position. Furthermore, the analysis provides testing of the assumptions used in previous simulation models by comparing the projected NII with actual NII. The asset/liability simulation model provides management with an important tool for making sound

economic decisions regarding the balance sheet.

The Company's Asset/Liability Policy has been enhanced with a contingency funding plan to help management prepare for unforeseen liquidity restrictions to include hypothetical severe liquidity crises.

While assumptions are developed based upon current economic and local market conditions, the Company cannot provide any assurances as to the predictive nature of these assumptions, including how customer preferences or competitor influences might change.

Credit Risk - A primary challenge of management is to reduce the exposure to credit loss within the loan portfolio. Management follows established underwriting guidelines, and exceptions to the policy must be approved in accordance with limits prescribed by the Board of Directors. The adequacy of the loan loss reserve is reviewed quarterly by the risk management committee of the Board of Directors and then presented to the full Board of Directors for approval. This committee meets to discuss, among other matters, potential exposures, historical loss experience, and overall economic conditions. Existing or potential problems are noted and addressed by senior management in order to assess the risk of probable loss or delinquency. A sample of loans are reviewed periodically by an independent loan review firm in order to assure accuracy of the Company's internal risk ratings and compliance with various internal policies and procedures and regulatory guidance. The Company maintains a Credit Administration department whose function includes credit analysis and monitoring and reporting on the status of the loan portfolio including delinquent and non-performing loans. The Company also monitors concentration of credit risk in a variety of areas, including portfolio product mix, the level of loans to individual borrowers and their related interest, loans to industry segments, and the geographic distribution of commercial real estate loans. The Company's strategy is to continue growing the commercial and commercial real estate portfolios and it is committed to adding additional resources to the commercial credit function to manage the risk as this growth materializes. Consistent with management's increased strategic focus on commercial lending, the Company has seen an increase in commercial and industrial loans as a percent of the total loan portfolio over the past year. However, achieving significant increases in commercial loans remains a challenge in light of the prolonged weak economy and slow recovery. Some growth has also been realized in the residential mortgage first lien portfolio during 2012 with the Company now holding rather than selling some of its 10 and 15 year fixed rate residential mortgages.

The following table reflects the composition of the Company's loan portfolio as of the dates indicated:

| | June 30, 2012 | | | December 31, 2011 | | |
|--|---------------|------------|---|-------------------|------------|---|
| | Total Loans | % of Total | | Total Loans | % of Total | |
| Construction & land development | \$11,938,303 | 2.93 | % | \$ 12,588,715 | 3.24 | % |
| Secured by farm land | 10,183,987 | 2.49 | % | 10,223,277 | 2.63 | % |
| 1 - 4 family residential - 1st lien | 166,621,140 | 40.82 | % | 159,535,958 | 41.05 | % |
| 1 - 4 family residential - Jr lien | 46,253,285 | 11.33 | % | 45,886,967 | 11.80 | % |
| Commercial real estate | 109,117,259 | 26.73 | % | 109,457,376 | 28.16 | % |
| Loans to finance agricultural production | 1,290,983 | 0.32 | % | 1,282,339 | 0.33 | % |
| Commercial & industrial loans | 51,405,828 | 12.59 | % | 38,232,268 | 9.84 | % |
| Consumer loans | 11,370,898 | 2.79 | % | 11,465,139 | 2.95 | % |
| Total gross loans | 408,181,683 | 100.00 | % | 388,672,039 | 100.00 | % |
| Deduct: | | | | | | |
| Allowance for loan losses | 3,926,119 | | | 3,886,502 | | |
| Unearned loan fees | (76,703) | | | (7,251) | | |
| Loans held-for-sale | 2,984,024 | | | 2,285,567 | | |
| | 6,833,440 | | | 6,164,818 | | |
| Net loans | \$401,348,243 | | | \$ 382,507,221 | | |

Allowance for loan losses and provisions - The Company maintains an allowance for loan losses at a level that management believes is appropriate to absorb losses inherent in the loan portfolio (See Critical Accounting Policies). Although the Company, in establishing the allowance, considers the inherent losses in individual loans and pools of loans, the allowance is a general reserve available to absorb all credit losses in the loan portfolio. No part of the allowance is segregated for, or allocated to, any particular loan or class.

When establishing the allowance each quarter the Company applies a combination of historical loss factors and qualitative factors to loan classes including residential first and junior lien mortgages, commercial real estate, commercial and industrial, and consumer loan portfolios. During the fourth quarter of 2011 the Company changed its allowance methodology by segmenting the classes of the residential real estate portfolio into first lien residential mortgages and junior lien residential mortgages, also known as home equity loans. The change was made to allow the Company to closely monitor and appropriately reserve for the risk inherent with home equity lending, given the modest repayment requirements, relaxed documentation, higher loan to value ratios characteristic of home equity lending, subordinate lien position, and recent decline of home property values. No changes in the Company's policies or methodology pertaining to the general component for loan losses were made during the first six months of 2012. The Company will shorten or lengthen its look back period for determining average portfolio historical loss rates as the economy either contracts or expands; during a period of economic contraction a shortening of the look back period may more conservatively reflect the current economic climate. The highest loss rates experienced for the look back period are applied to the various segments in establishing the allowance.

The Company then applies numerous qualitative factors to each of these segments of the loan portfolio. Those factors include the levels of and trends in delinquencies and non-accrual loans, criticized and classified assets, volumes and terms of loans, and the impact of any loan policy changes. Experience, ability and depth of lending personnel, levels of policy and documentation exceptions, national and local economic trends, the competitive environment, and concentrations of credit are also factors considered.

The following table summarizes the Company's loan loss experience for the six months ended June 30,

| | 2012 | 2011 | | |
|---|----------------|----------------|--------|---|
| Loans outstanding, end of period | \$ 408,181,683 | \$ 393,521,845 | | |
| Average loans outstanding during period | \$ 396,786,437 | \$ 390,762,880 | | |
| Non-accruing loans, end of period | \$ 6,701,362 | \$ 4,841,744 | | |
| Loan loss reserve, beginning of period | \$ 3,886,502 | \$ 3,727,935 | | |
| Loans charged off: | | | | |
| Residential real estate - 1st lien | (183,474) | (271,446) | | |
| Residential real estate - Jr lien | (60,287) | 0 | | |
| Commercial real estate | (55,057) | 0 | | |
| Commercial loans not secured by real estate | (124,934) | (3,127) | | |
| Consumer loans | (60,373) | (64,113) | | |
| Total loans charged off | (484,125) | (338,686) | | |
| Recoveries: | | | | |
| Residential real estate - 1st lien | 1,823 | 600 | | |
| Residential real estate - Jr lien | 1,418 | 0 | | |
| Commercial real estate | 863 | 2,181 | | |
| Commercial loans not secured by real estate | 2,520 | 11,522 | | |
| Consumer loans | 17,116 | 22,817 | | |
| Total recoveries | 23,740 | 37,120 | | |
| Net loans charged off | (460,385) | (301,566) | | |
| Provision charged to income | 500,002 | 425,000 | | |
| Loan loss reserve, end of period | \$ 3,926,119 | \$ 3,851,369 | | |
| Net charge offs to average loans outstanding | 0.116 | % | 0.077 | % |
| Provision charged to income as a percent of average loans | 0.126 | % | 0.109 | % |
| Loan loss reserve to average loans outstanding | 0.989 | % | 0.986 | % |
| Loan loss reserve to non-accruing loans * | 58.587 | % | 79.545 | % |

*The percentages include loans that carry federal government guarantees. If the guaranteed portions were deducted, the reserve coverage of non-accruing loans would increase to 93.5% as of June 30, 2012 and 108.9% as of June 30, 2011.

Specific allocations to the reserve are made for certain impaired loans. Impaired loans are loans to a borrower that in aggregate are greater than \$100,000 and that are in non-accrual status, including troubled debt restructurings (TDR). A loan is considered impaired when it is probable that the Company will be unable to collect all amounts due, including interest and principal, according to the contractual terms of the loan agreement. The Company will review all the facts and circumstances surrounding non-accrual and TDR loans and on a case-by-case basis may consider loans below the threshold as impaired when such treatment is material to the financial statements. Commercial and commercial real estate loans are generally placed on non-accrual status when there is deterioration in the financial

position of the borrower, payment in full of principal and interest is not expected, and/or principal or interest has been in default for 90 days or more. However, such a loan need not be placed in non-accrual status if it is both well secured and in the process of collection. Residential mortgages and home equity loans are considered for non-accrual status at 90 days past due and are evaluated on a case-by-case basis. The Company obtains current property appraisals or market value analyses and considers the cost to carry and sell collateral in order to assess the level of specific allocations required. Consumer loans are generally not placed in non-accrual but are charged off by the time they reach 120 days past due.

The portion of the allowance termed "unallocated" is established to absorb inherent losses that exist as of the valuation date although not specifically identified through management's process for estimating credit losses. While the allowance is described as consisting of separate allocated portions, the entire allowance is available to support loan losses, regardless of category.

The Company began experiencing increasing delinquencies and collection activity in 2008 when the most recent recession began. The slow recovery has resulted in prolonged work through of some of these delinquencies and problem loans. The Company works actively with customers early in the delinquency process to help them to avoid default and foreclosure. During the same period the Company experienced increasing trends in the levels of non-performing loans and criticized and classified assets, which is consistent with the length and depth of the economic recession and the current slow recovery. During 2009 the Company had carried the maximum qualitative factor adjustment for weak economic conditions and is now slowly decreasing that factor as the recovery progresses. The factors for trends in delinquency and non-accrual loans and criticized and classified assets were similarly increased. With the economic recovery continuing, the levels of both Group B and C loans (as defined in Note 5 of the Company's notes to consolidated financial statements) have shown gradual improvement. The sluggish pace of the economic recovery and the lack of national economic stimulus funding in 2011 translated into slow and measured improvement of the negative trends experienced in the loan portfolio since the onset of the 2008 recession.

The Company's non-performing assets decreased \$646,363 or 6.9% during the first six months of 2012 from \$9,279,128 at December 31, 2011 to \$8,632,765 as of June 30, 2012. The improvement in non-performing loans is due to several factors, including the transfer into OREO of real estate securing four loans, completion of an auction liquidation of another loan, payment in full of two non-performing loans, and charge offs taken on other non-performing loans. Foreclosure actions are in process on loan relationships with balances totaling approximately \$4.3 million; those foreclosures and claims on related government guarantees are expected to further reduce non-performing loans during 2012. The \$8.6 million of non-performing loans at June 30, 2012 include \$2.7 million in federal government guarantees, making the non-performing loans, net of guarantees, \$5.9 million. At June 30, 2011, of the \$6.0 million in non-performing loans, \$1.5 million included federal government guarantees, resulting in non-performing loans net of guarantee of \$4.5 million.

When a loan is placed in non-accrual status, the Company's policy is to reverse the accrued interest against current period income and to discontinue the accrual of interest until the borrower clearly demonstrates the ability and intention to resume normal payments, typically demonstrated by regular timely payments for a period of not less than six months. Interest payments received on non-accrual or impaired loans are generally applied as a reduction of the loan principal balance. Deferred taxes are calculated monthly, based on interest amounts that would have accrued through the normal accrual process.

Non-performing assets for the comparison periods were as follows:

| | June 30, 2012 | | December 31, 2011 | | | |
|--|---------------|------------------|-------------------|------------------|---|--|
| | Balance | Percent of Total | Balance | Percent of Total | | |
| Loans past due 90 days or more and still accruing: | | | | | | |
| Commercial loans | \$31,517 | 0.37 | % \$59,618 | 0.64 | % | |
| Commercial real estate | 96,622 | 1.12 | % 98,554 | 1.06 | % | |
| Residential real estate - 1st lien | 704,780 | 8.17 | % 969,078 | 10.44 | % | |
| Residential real estate - Jr lien | 71,155 | 0.82 | % 111,061 | 1.20 | % | |
| Consumer | 17,131 | 0.20 | % 1,498 | 0.02 | % | |
| Total | 921,205 | 10.68 | % 1,239,809 | 13.36 | % | |

Non-accrual loans:

| | | | | | |
|------------------------------------|-----------|-------|-------------|-------|---|
| Commercial loans | 1,159,782 | 13.43 | % 1,066,945 | 11.50 | % |
| Commercial real estate | 3,571,542 | 41.37 | % 3,714,146 | 40.03 | % |
| Residential real estate - 1st lien | 1,629,611 | 18.88 | % 2,703,920 | 29.14 | % |

Edgar Filing: COMMUNITY BANCORP /VT - Form 10-Q

| | | | | | | |
|-----------------------------------|-------------|--------|---|-------------|--------|---|
| Residential real estate - Jr lien | 340,427 | 3.94 | % | 464,308 | 5.00 | % |
| Total | 6,701,362 | 77.62 | % | 7,949,319 | 85.67 | % |
| Other real estate owned | 1,010,198 | 11.70 | % | 90,000 | 0.97 | % |
| Total | \$8,632,765 | 100.00 | % | \$9,279,128 | 100.00 | % |

40

The Company's non-accrual loans decreased \$1,247,957 or 15.7% during the first six months of 2012 from \$7,949,319 at December 31, 2011 to \$6,701,362 as of June 30, 2012. The Company's impaired loans decreased \$1,378,285 during the first six months of 2012 from \$7,470,370 to \$6,092,085. Specific allocations to the reserve decreased for the same period, from \$458,500 to \$180,400. Two other federally guaranteed loans to one borrower totaling \$1.3 million at December 31, 2009 were rewritten through a TDR in 2010 and as of June 30, 2012 the book balance remains at just over \$1.1 million, of which \$951,050 is guaranteed; the subject loans are now in the foreclosure process. A \$1.3 million residential mortgage loan modified in June 2010 with an \$800,000 carrying balance was liquidated during the second quarter through a combination of charge off and transfer to OREO. Two other non-performing loans with balances of approximately \$1.0 million at December 31, 2011 were restructured in January 2012 to allow for tropical storm Irene flood related remediation and are performing under the terms of the modification. The impaired portfolio as of June 30, 2012 includes approximately 22% residential first mortgages, 5% junior lien home equity loans, 57% commercial real estate, with the balance of 16% in commercial or installment loans not secured by real estate. This compares to the impaired portfolio as of December 31, 2011 that included approximately 32% residential first mortgages, 6% junior lien home equity loans, 49% commercial real estate, with the balance of 13% in commercial or installment loans not secured by real estate.

The Company is not contractually committed to lend additional funds to debtors with impaired, non-accrual or modified loans.

As of June 30, 2012 and December 31, 2011, the OREO portfolio totaled \$1,010,198 and \$90,000 respectively. The Company's OREO portfolio at June 30, 2012 consisted of five properties acquired through the normal foreclosure process; four residential properties were added to OREO during the first six months of 2012. Upon court confirmation of foreclosures all properties are promptly listed for sale.

The residential mortgage portfolio makes up the largest segment of the loan portfolio and as a result of the severity and depth of the recent recession it has recently seen the greatest degree of collection and foreclosure activity and losses. The Company however, has not experienced delinquencies and losses to the extent of national peers as the Company maintains a mortgage loan portfolio of traditional mortgage products and has not engaged in higher risk loans such as option adjustable rate mortgage products, high loan-to-value products, interest only mortgages, subprime loans and products with deeply discounted teaser rates. In areas of the country where such risky products were originated, borrowers with little or no equity in their property defaulted on mortgages they could longer afford, and walked away from those properties as real estate values had fallen precipitously. While real estate values have declined in the Company's market area, the sound underwriting standards historically employed by the Company have mitigated the trends in defaults and property surrenders experienced elsewhere. Residential mortgages with loan-to-values exceeding 80% are generally covered by private mortgage insurance (PMI). A 90% loan-to-value residential mortgage product without PMI is only available to borrowers with excellent credit and low debt-to-income ratios and has not been widely originated. Junior lien home equity products make up 22% of the residential mortgage portfolio with maximum loan-to-value ratios (including prior liens) of 80%. The residential mortgage portfolio has had satisfactory performance in light of the depth of the recent recession and the slow recovery.

Risk in the Company's commercial and commercial real estate loan portfolios is mitigated in part by government guarantees issued by federal agencies such as the U.S. Small Business Administration and USDA Rural Development. At June 30, 2012, the Company had \$27,031,163 in guaranteed loans with guaranteed balances of 21,833,781, compared to \$28,077,575 in guaranteed loans with guaranteed balances of \$22,885,794 at December 31, 2011.

The Company made provisions to the allowance for loan losses of \$500,002 during the first six months of 2012, comparable to the level of the provision made during the same periods over the last two years and sufficient, in management's view, to cover charge offs, net of recoveries of \$460,385 during the first six months of 2012, and to provide for growth in the loan portfolio. Net loan losses began increasing in 2007 and 2008 as a result of the recession

and, given the increasing trend, the depth of the recession and the long and shallow recovery, management increased its provision for loan losses to \$1.0 million for 2011 and just under \$1.1 million for 2010, compared to \$625,004 for 2009. Management believes that the level of the provision for loan losses for the first six months of 2012 and prior recent periods is directionally consistent with the trends and risk in the loan portfolio and with the growth of the loan portfolio. Management will continue to monitor the activity of non-performing loans, carefully assess the reserve requirement and adjust the provision in future periods as circumstances warrant. The Company has an experienced collections department that continues to work actively with borrowers to resolve problem loans, and management continues to monitor the loan portfolio closely.

Market Risk - In addition to credit risk in the Company's loan portfolio and liquidity risk in its loan and deposit-taking operations, the Company's business activities also generate market risk. Market risk is the risk of loss in a financial instrument arising from adverse changes in market prices and rates, foreign currency exchange rates, commodity prices and equity prices. Declining capital markets can result in fair value adjustments necessary to record decreases in the value of the investment portfolio for other-than-temporary-impairment. The Company does not have any market risk sensitive instruments acquired for trading purposes. The Company's market risk arises primarily from interest rate risk inherent in its lending and deposit taking activities. During times of recessionary periods, a declining housing market can result in an increase in loan loss reserves or ultimately an increase in foreclosures. Interest rate risk is directly related to the different maturities and repricing characteristics of interest-bearing assets and liabilities, as well as to loan prepayment risks, early withdrawal of time deposits, and the fact that the speed and magnitude of responses to interest rate changes vary by product. The prolonged weak economy and disruption in the financial markets in recent years may heighten the Company's market risk. As discussed above under "Interest Rate Risk and Asset and Liability Management", the Company actively monitors and manages its interest rate risk through the ALCO process.

COMMITMENTS, CONTINGENCIES AND OFF-BALANCE-SHEET ARRANGEMENTS

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit and risk-sharing commitments on certain sold loans. Such instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The contract or notional amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments. During the first six months of 2012, the Company did not engage in any activity that created any additional types of off-balance sheet risk.

The Company generally requires collateral or other security to support financial instruments with credit risk. The Company's financial instruments whose contract amount represents credit risk were as follows:

| | -Contract or Notional Amount- | |
|---|----------------------------------|-------------------------|
| | June 30, 2012 | December 31, 2011 |
| Unused portions of home equity lines of credit | \$20,947,215 | \$20,161,629 |
| Other commitments to extend credit | 39,161,764 | 38,106,476 |
| Residential construction lines of credit | 2,002,859 | 588,290 |
| Commercial real estate and other construction lines of credit | 3,018,841 | 2,126,558 |
| Standby letters of credit and commercial letters of credit | 1,485,425 | 1,954,885 |
| Recourse on sale of credit card portfolio | 364,650 | 398,200 |
| MPF credit enhancement obligation, net of liability recorded | 2,009,358 | 1,979,684 |

Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company sold its credit card portfolio during the third quarter of 2007, but retained a partial recourse obligation under the terms of the sale, based on total lines, not balances outstanding. Based on historical losses, the Company does not expect any significant losses from this commitment.

In connection with its trust preferred securities financing completed on October 31, 2007, the Company guaranteed the payment obligations under the \$12,500,000 of capital securities of its subsidiary, CMTV Statutory Trust I. The source of funds for payments by the Trust on its capital securities is payments made by the Company on its debentures issued to the Trust. The Company's obligation under those debentures is fully reflected in the Company's balance sheet, in the gross amount of \$12,887,000 for each of the comparison periods, of which \$12,500,000 represents external financing.

During 2011, an audit conducted by the Vermont Tax Department resulted in a sales and use tax assessment, including interest and penalties of \$171,563. The Company appealed the assessment, which was subsequently adjusted and settled in full for \$65,846 during the second quarter of 2012. The Company had accrued a liability in the amount of \$65,000 relating to this matter as of December 31, 2011.

LIQUIDITY AND CAPITAL RESOURCES

Managing liquidity risk is essential to maintaining both depositor confidence and stability in earnings. Liquidity management refers to the ability of the Company to adequately cover fluctuations in assets and liabilities. Meeting loan demand (assets) and covering the withdrawal of deposit funds (liabilities) are two key components of the

liquidity management process. The Company's principal sources of funds are deposits, amortization and prepayment of loans and securities, maturities of investment securities, sales of loans available-for-sale, and earnings and funds provided from operations. Maintaining a relatively stable funding base, which is achieved by diversifying funding sources, competitively pricing deposit products, and extending the contractual maturity of liabilities, reduces the Company's exposure to roll over risk on deposits and limits reliance on volatile short-term borrowed funds. Short-term funding needs arise from declines in deposits or other funding sources and funding requirements for loan commitments. The Company's strategy is to fund assets to the maximum extent possible with core deposits that provide a sizable source of relatively stable and low-cost funds.

In order to attract deposits, the Company from time to time offers deposit specials at competitive rates, in varying terms that fit within the balance sheet mix. The strategy of offering specials is meant to provide a means to retain deposits while not having to reprice the entire deposit portfolio. The Company recognizes that, at times, when loan demand exceeds deposit growth it may be desirable to utilize alternative sources of deposit funding to augment retail deposits and borrowings. One-way deposits purchased through the CDARS provide an alternative funding source when needed. Such deposits are generally considered a form of brokered deposits. The Company had \$3,976,000 and \$0 in one-way funds on June 30, 2012 and December 31, 2011, respectively. In addition, two-way CDARS deposits allow the Company to provide FDIC deposit insurance to its customers in excess of account coverage limits by exchanging deposits with other CDARS members. At June 30, 2012, the Company reported \$1,019,541 in CDARS deposits representing exchanged deposits with other CDARS participating banks compared to \$1,121,632 at December 31, 2011. The balance in ICS deposits was \$13,437,965 at June 30, 2012, compared to \$10,872,204 at December 31, 2011.

The Company has a Borrower-in-Custody arrangement with the Federal Reserve Bank of Boston (FRBB) secured by eligible commercial loans, commercial real estate loans and home equity loans, resulting in an available line of \$70,208,987 and \$69,222,549, respectively at June 30, 2012 and December 31, 2011. Credit advances in the FRBB lending program are overnight advances with interest chargeable at the primary credit rate (generally referred to as the discount rate), currently 75 basis points. At June 30, 2012 and December 31, 2011, the Company had no outstanding advances against this line.

The Company has an unsecured IDEAL Way line with the FHLBB with an available balance of \$500,000 at June 30, 2012 and December 31, 2011. Interest is determined daily and is approximately 25 basis points higher than the rate paid on federal funds sold. In addition, at June 30, 2012 and December 31, 2011, additional borrowing capacity of \$67,723,797 and \$77,902,569, respectively, was available through the FHLBB secured by the Company's qualifying loan portfolio (generally residential mortgages). Under a separate agreement, the Company has the authority to collateralize public unit deposits up to its available FHLBB borrowing capacity with letters of credit issued by the FHLBB. The Company offers a Government Agency Account to the municipalities collateralized with these FHLBB letters of credit. At June 30, 2012 and December 31, 2011, approximately \$12,450,000 and \$15,950,000, respectively, of qualifying residential real estate loans was pledged as collateral to the FHLBB for these collateralized governmental unit deposits. Early in 2012, a \$6,000,000 long-term advance matured and was replaced with lower cost overnight borrowings. As of June 30, 2012, the balance of overnight borrowings was \$25,825,000, compared to a zero balance on both June 30, 2011 and December 31, 2011. The Company utilized this low cost funding source as loan demand increased but deposits decreased.

The following table reflects the Company's outstanding FHLBB advances against the respective lines as of the dates indicated:

| | June 30, 2012 | December 31, 2011 | June 30, 2011 |
|---|------------------|-------------------------|------------------|
| Long-Term Advances | | | |
| FHLBB Community Investment Program borrowing, 7.67% fixed rate, due November 16, 2012 | \$10,000 | \$10,000 | \$10,000 |
| FHLBB term borrowing, 1.00% fixed rate, due January 27, 2012 | 0 | 6,000,000 | 6,000,000 |
| FHLBB term borrowing, 1.71% fixed rate, due January 28, 2013 | 6,000,000 | 6,000,000 | 6,000,000 |
| FHLBB term borrowing, 2.72% fixed rate, due January 27, 2015 | 6,000,000 | 6,000,000 | 6,000,000 |
| | 12,010,000 | 18,010,000 | 18,010,000 |
| Overnight Borrowings | | | |

Edgar Filing: COMMUNITY BANCORP /VT - Form 10-Q

| | | | |
|--|--------------|--------------|--------------|
| Federal funds purchased (FHLBB), 0.3125% | 25,825,000 | 0 | 0 |
| Total Borrowings | \$37,835,000 | \$18,010,000 | \$18,010,000 |

On June 12, 2012, the Company declared a cash dividend of \$0.14 on common stock payable on August 1, 2012, to shareholders of record as of July 15, 2012, which was accrued in the financial statements at June 30, 2012.

The following table illustrates the changes in shareholders' equity from December 31, 2011 to June 30, 2012:

| | |
|--|--------------|
| Balance at December 31, 2011 (book value \$8.13 per common share) | \$40,918,409 |
| Net income | 1,986,042 |
| Issuance of stock through the Dividend Reinvestment Plan | 460,904 |
| Dividends declared on common stock | (1,327,179) |
| Dividends declared on preferred stock | (93,750) |
| Change in unrealized gain on available-for-sale securities, net of tax | 186,253 |
| Balance at June 30, 2012 (book value \$8.30 per common share) | \$42,130,679 |

The primary source of funds for the Company's payment of dividends to its shareholders is dividends paid to the Company by the Bank. The Bank, as a national bank, is subject to the dividend restrictions set forth by the Comptroller of the Currency (OCC). Under such restrictions, the Bank may not, without the prior approval of the OCC, declare dividends in excess of the sum of the current year's earnings (as defined) plus the retained earnings (as defined) from the prior two years.

The Company (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory - and possibly additional discretionary - actions by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance-sheet items, as calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action capital requirements are applicable to banks, but not bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). The Company's Series A preferred stock (\$2.5 million liquidation preference) is includable without limitation in its Tier 1 capital. In accordance with changes in the regulatory requirements for calculating capital ratios, beginning with the quarter ended March 31, 2011, the Company deducts the amount of goodwill, net of deferred tax liability (\$2,061,772 at June 30, 2012 and December 31, 2011), for purposes of calculating the amount of trust preferred junior subordinated debentures includable in Tier 1 capital. Management believes, as of June 30, 2012, that the Company and the Bank met all capital adequacy requirements to which they are subject.

As of June 30, 2012 the Bank was considered well capitalized under the regulatory capital framework for Prompt Corrective Action and the Company exceeded applicable consolidated regulatory capital guidelines.

The regulatory capital ratios of the Company and its subsidiary as of June 30, 2012 and December 31, 2011 exceeded regulatory guidelines and are presented in the following table.

| | Actual | | Minimum For Capital Adequacy Purposes: | | Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions: | |
|--|----------|-------|--|-------|---|---------|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| (Dollars in Thousands) | | | | | | |
| As of June 30, 2012: | | | | | | |
| Total capital (to risk-weighted assets) | | | | | | |
| Company | \$47,538 | 12.74 | % \$29,853 | 8.00 | % N/A | N/A |
| Bank | \$46,780 | 12.56 | % \$29,804 | 8.00 | % \$37,255 | 10.00 % |
| Tier I capital (to risk-weighted assets) | | | | | | |
| Company | \$41,521 | 11.13 | % \$14,927 | 4.00 | % N/A | N/A |
| Bank | \$42,788 | 11.47 | % \$14,902 | 4.00 | % \$22,353 | 6.00 % |
| Tier I capital (to average assets) | | | | | | |

Edgar Filing: COMMUNITY BANCORP /VT - Form 10-Q

| | | | | | | | | | |
|---------|----------|------|---|----------|------|---|----------|------|---|
| Company | \$41,521 | 7.66 | % | \$21,685 | 4.00 | % | N/A | N/A | |
| Bank | \$42,788 | 7.90 | % | \$21,665 | 4.00 | % | \$27,081 | 5.00 | % |

| | Actual | | Minimum For Capital Adequacy Purposes: | | Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions: | | |
|--|----------|-------|--|-------|---|---------|--|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio | |
| (Dollars in Thousands) | | | | | | | |
| As of December 31, 2011: | | | | | | | |
| Total capital (to risk-weighted assets) | | | | | | | |
| Company | \$46,351 | 12.50 | % \$29,660 | 8.00 | % N/A | N/A | |
| Bank | \$45,772 | 12.37 | % \$29,596 | 8.00 | % \$36,995 | 10.00 % | |
| Tier I capital (to risk-weighted assets) | | | | | | | |
| Company | \$39,980 | 10.78 | % \$14,830 | 4.00 | % N/A | N/A | |
| Bank | \$41,830 | 11.31 | % \$14,798 | 4.00 | % \$22,197 | 6.00 % | |
| Tier I capital (to average assets) | | | | | | | |
| Company | \$39,980 | 7.28 | % \$21,965 | 4.00 | % N/A | N/A | |
| Bank | \$41,830 | 7.63 | % \$21,935 | 4.00 | % \$27,419 | 5.00 % | |

The Company intends to continue the past policy of maintaining a strong capital resource position to support its asset size and level of operations. Consistent with that policy, management will continue to anticipate the Company's future capital needs and will adjust its dividend payment practices consistent with those needs.

From time to time the Company may make contributions to the capital of Community National Bank. At present, regulatory authorities have made no demand on the Company to make additional capital contributions.

In June 2012, the Federal Reserve Board proposed new rules implementing the Basel III capital standards, which if adopted as proposed would significantly revise the regulatory capital standards for U.S. financial institutions, including community banks. Among other things, the proposed rules would revise the definition of various regulatory capital components and related calculation methods, add a new regulatory capital component (common equity tier 1 capital), increase the minimum required tier 1 capital, implement a new capital conservation buffer and restrict dividends and certain discretionary bonus payments when the buffer is not maintained. Management is evaluating the potential impact of the proposed capital rules on the Company.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's management of the credit, liquidity and market risk inherent in its business operations is discussed in Part 1, Item 2 of this report under the captions "RISK MANAGEMENT" and "COMMITMENTS, CONTINGENCIES AND OFF-BALANCE-SHEET ARRANGEMENTS", which are incorporated herein by reference. Management does not believe that there have been any material changes in the nature or categories of the Company's risk exposures from those disclosed in the Company's 2011 Annual Report on form 10-K.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Management is responsible for establishing and maintaining effective disclosure controls and procedures, as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act"). As of June 30, 2012, an evaluation

was performed under the supervision and with the participation of management, including the principal executive officer and principal financial officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on that evaluation, management concluded that its disclosure controls and procedures as of June 30, 2012 were effective in ensuring that material information required to be disclosed in the reports it files with the Commission under the Exchange Act was recorded, processed, summarized, and reported on a timely basis.

For this purpose, the term "disclosure controls and procedures" means controls and other procedures of the Company that are designed to ensure that information required to be disclosed by it in the reports that it files or submits under the Exchange Act (15 U.S.C. 78a et seq.) is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There were no changes in the Company's internal control over financial reporting that occurred during the quarter ended June 30, 2012 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In the normal course of business the Company and its subsidiary are involved in litigation that is considered incidental to their business. Management does not expect that any such litigation will be material to the Company's consolidated financial condition or results of operations.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table provides information as to purchases of the Company's common stock during the quarter ended June 30, 2012, by the Company and by any affiliated purchaser (as defined in SEC Rule 10b-18):

| For the period: | Total Number of Shares Purchased(1)(2) | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plan | Maximum Number of Shares That May Yet Be Purchased Under the Plan at the End of the Period |
|--------------------|--|------------------------------------|--|---|
| April 1 - April 30 | 0 | \$0.00 | N/A | N/A |
| May 1 - May 31 | 2,548 | 9.95 | N/A | N/A |
| June 1 - June 30 | 4,477 | 10.08 | N/A | N/A |
| Total | 7,025 | \$10.03 | N/A | N/A |

(1) All 7,025 shares were purchased for the account of participants invested in the Company Stock Fund under the Company's Retirement Savings Plan by or on behalf of the Plan Trustee, the Human Resources Committee of Community National Bank. Such share purchases were facilitated through CFSG, which provides certain investment advisory services to the Plan. Both the Plan Trustee and CFSG may be considered affiliates of the Company under Rule 10b-18.

(2) Shares purchased during the period do not include fractional shares repurchased from time to time in connection with the participant's election to discontinue participation in the Company's Dividend Reinvestment Plan.

ITEM 6. EXHIBIT

The following exhibits are filed with this report:

- Exhibit 31 Certification from the Chief Executive Officer of the Company pursuant to section 302 of the Sarbanes-Oxley Act of 2002
-
- Exhibit 31 Certification from the Chief Financial Officer of the Company pursuant to section 302 of the Sarbanes-Oxley Act of 2002
-

Exhibit 32 Certification from the Chief Executive Officer of the Company pursuant to 18 U.S.C., Section 1350, as
- adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002*

Exhibit 32 Certification from the Chief Financial Officer of the Company pursuant to 18 U.S.C., Section 1350, as
- adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002*

Exhibit 101 - The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 formatted in eXtensible Business Reporting Language (XBRL): (i) the unaudited consolidated balance sheets, (ii) the unaudited consolidated statements of income for the second quarters and six months ended June 30, 2012 and 2011, (iii) the unaudited consolidated statements of comprehensive income, (iv) the unaudited consolidated statements of cash flows and (v) related notes, tagged as detail tagging.* **

* This exhibit shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to the liability of that section, and shall not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934.

** As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

SIGNATURES

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

COMMUNITY BANCORP.

DATED: August 13, 2012

By: /s/ Stephen P. Marsh
Stephen P. Marsh, Chairman, President
& Chief Executive Officer

DATED: August 13, 2012

By: /s/ Louise M. Bonvechio
Louise M. Bonvechio, Treasurer
(Principal Financial Officer)