SALISBURY BANCORP INC
Form 10-Q
November 14, 2012

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 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 0-24751

SALISBURY BANCORP, INC.

(Exact name of registrant as specified in its charter)

Connecticut	06-1514263
(State of other jurisdiction of incorporation)	(IRS Employer Identification No.)

5 Bissell Street, Lakeville, Connecticut	**06039**
(Address of principal executive offices)	**(Zip Code)**

Registrant's telephone number, including area code: (860) 435-9801

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes [X] No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, 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). (Check one):

Large accelerated filer   Accelerated filer   Non-accelerated filer   Smaller reporting company [X]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes . No [X]

The number of shares of Common Stock outstanding as of November 14, 2012 is 1,689,691.

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PART I - FINANCIAL INFORMATION

Salisbury Bancorp, Inc. and Subsidiary

CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)	September 30, 2012 (unaudited)	December 31, 2011
ASSETS		
Cash and due from banks	$ 6,061	$ 4,829
Interest bearing demand deposits with other banks	59,355	32,057
Total cash and cash equivalents	65,416	36,886
Securities		
Available-for-sale at fair value	125,665	155,794
Held-to-maturity at amortized cost (fair value: $ - and $52)	-	50
Federal Home Loan Bank of Boston stock at cost	5,747	6,032
Loans held-for-sale	1,595	948
Loans receivable, net (allowance for loan losses: $4,179 and $4,076)	377,377	370,766
Other real estate owned	641	2,744
Bank premises and equipment, net	11,619	12,023
Goodwill	9,829	9,829
Intangible assets (net of accumulated amortization: $1,690 and $1,523)	853	1,020
Accrued interest receivable	1,966	2,126
Cash surrender value of life insurance policies	7,239	7,037
Deferred taxes	57	829
Other assets	3,033	3,200
Total Assets	$ 611,037	$ 609,284
LIABILITIES and SHAREHOLDERS' EQUITY		
Deposits		
Demand (non-interest bearing)	$ 90,064	$ 82,202
Demand (interest bearing)	66,535	66,332
Money market	136,512	124,566
Savings and other	100,462	94,503
Certificates of deposit	96,633	103,703
Total deposits	490,206	471,306
Repurchase agreements	2,941	12,148
Federal Home Loan Bank of Boston advances	42,392	54,615
Accrued interest and other liabilities	5,124	4,353
Total Liabilities	540,663	542,422
Commitments and contingencies	-	-
Shareholders' Equity		
Preferred stock - $.01 per share par value		
Authorized: 25,000; Issued: 16,000 (Series B);		
Liquidation preference: $1,000 per share	16,000	16,000
Common stock - $.10 per share par value		
Authorized: 3,000,000;		
Issued: 1,689,691 and 1,688,731	169	169

Paid-in capital	13,158	13,134
Retained earnings	40,175	38,264
Accumulated other comprehensive income (loss), net	872	(705)
Total Shareholders' Equity	70,374	66,862
Total Liabilities and Shareholders' Equity	$ 611,037	$ 609,284

Salisbury Bancorp, Inc. and Subsidiary

CONSOLIDATED STATEMENTS OF INCOME (unaudited)

	Three months ended		Nine months ended	
Periods ended September 30, (in thousands except per share amounts) unaudited	2012	2011	2012	2011
Interest and dividend income				
Interest and fees on loans	$ 4,500	$ 4,630	$ 13,678	$ 13,989
Interest on debt securities				
Taxable	579	739	1,939	2,255
Tax exempt	495	553	1,539	1,661
Other interest and dividends	33	34	75	109
Total interest and dividend income	5,607	5,956	17,231	18,014
Interest expense				
Deposits	580	748	1,870	2,449
Repurchase agreements	3	19	21	46
Federal Home Loan Bank of Boston advances	452	565	1,398	1,772
Total interest expense	1,035	1,332	3,289	4,267
Net interest and dividend income	4,572	4,624	13,942	13,747
Provision for loan losses	330	180	690	860
Net interest and dividend income after provision for loan losses	4,242	4,444	13,252	12,887
Non-interest income				
Trust and wealth advisory	683	599	2,173	1,861
Service charges and fees	559	534	1,628	1,555
Gains on sales of mortgage loans, net	568	178	1,203	370
Mortgage servicing, net	(9)	(35)	(98)	(8)
Gains on securities, net	-	-	279	11
Other	86	58	252	176
Total non-interest income	1,887	1,334	5,437	3,965
Non-interest expense				
Salaries	1,810	1,816	5,268	5,202
Employee benefits	597	636	2,244	1,919
Premises and equipment	603	582	1,799	1,733
Data processing	369	366	1,190	1,028
Professional fees	299	307	915	887
Collections and OREO	301	152	767	519
FDIC insurance	116	137	363	541
Marketing and community support	92	85	267	245
Amortization of intangibles	56	56	167	167
Other	450	398	1,240	1,149
Total non-interest expense	4,693	4,535	14,220	13,390
Income before income taxes	1,436	1,243	4,469	3,462
Income tax provision	296	204	963	598
Net income	$ 1,140	$ 1,039	$ 3,506	$ 2,864
Net income available to common shareholders	$ 1,094	$ 865	$ 3,328	$ 2,459

Basic and diluted earnings per common share	$ 0.65	$ 0.51	$ 1.97	$ 1.46
Common dividends per share	0.28	0.28	0.84	0.84

Salisbury Bancorp, Inc. and Subsidiary

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (unaudited)

	Three months ended		Nine months ended	
Periods ended September 30, (in thousands)	2012	2011	2012	2011
Net income	$ 1,140	$ 1,039	$ 3,506	$ 2,864
Other comprehensive income				
Net unrealized gains on securities available-for-sale	921	2,544	2,140	6,144
Reclassification of net realized gains in net income	-	-	279	11
Unrealized gains on securities available-for-sale	921	2,544	2,419	6,155
Income tax expense	(313)	(865)	(822)	(2,093)
Unrealized gains on securities available-for-sale, net of tax	608	1,679	1,597	4,062
Pension plan income (loss)	27	17	(31)	50
Income tax (expense) benefit	(9)	(6)	11	(17)
Pension plan income (loss), net of tax	18	11	(20)	33
Other comprehensive income, net of tax	626	1,690	1,577	4,095
Comprehensive income	$ 1,766	$ 2,729	$ 5,083	$ 6,959

Salisbury Bancorp, Inc. and Subsidiary

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (unaudited)

(dollars in thousands) unaudited	Common Stock Shares	Common Stock Amount	Preferred Stock	Warrants	Paid-in capital	Retained earnings	Accumulated other com-prehensive income (loss)	Total share-holders' equity
Balances at December 31, 2010	1,687,661	$ 168	$ 8,738	$ 112	$13,200	$ 36,567	$ (3,769)	$ 55,016
Net income for period	-	-	-	-	-	2,864	-	2,864
Other comprehensive income, net of tax	-	-	-	-	-	-	4,095	4,095
Amortization (accretion) of preferred stock	-	-	78	-	-	(78)	-	-
Common stock dividends paid	-	-	-	-	-	(1,418)	-	(1,418)
Issuance of Series B preferred stock	-	-	16,000	-	-	-	-	16,000
Redemption of Series A preferred stock	-	-	(8,816)	-	-	-	-	(8,816)
Preferred stock dividends declared	-	-	-	-	-	(382)	-	(382)
Issuance of common stock for director fees	1,070	1	-	-	27	-	-	28
Balances September 30, 2011	1,688,731	$ 169	$ 16,000	$ 112	$13,227	$ 37,553	$ 326	$ 67,387
Balances at December 31, 2011	1,688,731	$ 169	$ 16,000	$ -	$13,134	$ 38,264	$ (705)	$ 66,862
Net income for period	-	-	-	-	-	3,506	-	3,506
Other comprehensive income, net of tax	-	-	-	-	-	-	1,577	1,577
Common stock dividends paid	-	-	-	-	-	(1,419)	-	(1,419)
Preferred stock dividends declared	-	-	-	-	-	(176)	-	(176)
Issuance of common stock for director fees	960	-	-	-	24	-	-	24
Balances at September 30, 2012	1,689,691	$ 169	$ 16,000	$ -	$13,158	$ 40,175	$ 872	$ 70,374

Salisbury Bancorp, Inc. and Subsidiary

CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

Nine months ended September 30, (in thousands) unaudited	2012	2011
Operating Activities		
Net income	$ 3,506	$ 2,864
Adjustments to reconcile net income to net cash provided by operating activities:		
(Accretion), amortization and depreciation		
Securities	464	222
Bank premises and equipment	666	631
Core deposit intangible	167	167
Mortgage servicing rights	278	165
Fair value adjustment on loans	25	33
Gains on calls of securities available-for-sale	(12)	(11)
Gains on sales of securities available-for-sale	(267)	-
Loss on sale/disposals of premises and equipment	24	-
Loss recognized on other real estate owned	24	-
Write down of other real estate owned	-	231
Provision for loan losses	690	860
(Increase) decrease in loans held-for-sale	(647)	127
Increase in deferred loan origination fees and costs, net	(44)	(122)
Mortgage servicing rights originated	(504)	(181)
Decrease in mortgage servicing rights impairment reserve	89	80
Decrease in interest receivable	160	90
Deferred tax benefit	(39)	(41)
(Increase) decrease in prepaid expenses	(87)	371
Increase in cash surrender value of life insurance policies	(202)	(120)
Decrease in income tax receivable	420	728
(Increase) decrease in other assets	(29)	10
Increase (decrease) in accrued expenses	766	(235)
Decrease in interest payable	(53)	(152)
Increase (decrease) in other liabilities	47	(607)
Issuance of shares for directors' fee	24	28
Net cash provided by operating activities	5,466	5,138
Investing Activities		
Proceeds from maturities of interest-bearing time deposits	-	5,000
Purchases of securities available-for-sale	-	(35,729)
Redemption of Federal Home Loan Bank stock	285	-
Proceeds from calls of securities available-for-sale	12,668	27,560
Proceeds from maturities of securities available-for-sale	16,928	10,457
Proceeds from sale of securities available-for-sale	2,767	-
Proceeds from maturities of securities held-to-maturity	50	4
Loan originations and principle collections, net	(6,986)	(11,569)
Recoveries of loans previously charged-off	37	55
Proceeds from sale of other real estate owned	1,745	655
Capital expenditures	(286)	(504)
Net cash provided (used) by investing activities	27,208	(4,071)
Financing Activities		

Increase in deposit transaction accounts, net	25,970	68,081
Decrease in time deposits, net	(7,070)	(19,779)
(Decrease) increase in securities sold under agreements to repurchase, net	(9,207)	1,596
Principal payments on Federal Home Loan Bank of Boston advances	(12,223)	(17,779)
Redemption of Series A preferred stock	-	(8,816)
Proceeds from issuance of Series B preferred stock	-	16,000
Common stock dividends paid	(1,419)	(1,418)
Preferred stock dividends paid	(195)	(343)
Net cash (used) provided by financing activities	(4,144)	37,542
Net increase in cash and cash equivalents	28,530	38,609
Cash and cash equivalents, beginning of period	36,886	26,908
Cash and cash equivalents, end of period	$ 65,416	$ 65,517
Cash paid during period		
Interest	$ 3,342	$ 4,419
Income taxes	582	(89)
Non-cash transfers		
Transfer from loans to other real estate owned	666	314
Loans originated to finance the sale of other real estate owned	(1,000)	-

Salisbury Bancorp, Inc. and Subsidiary

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTATION

The interim (unaudited) consolidated financial statements of Salisbury Bancorp, Inc. ("Salisbury") include those of Salisbury and its wholly owned subsidiary, Salisbury Bank and Trust Company (the "Bank"). In the opinion of management, the interim unaudited consolidated financial statements include all adjustments (consisting of normal recurring adjustments) necessary to present fairly the financial position of Salisbury and the statements of income, comprehensive income, shareholders' equity and cash flows for the interim periods presented.

The financial statements have been prepared in accordance with generally accepted accounting principles. In preparing the financial statements, management is required to make extensive use of estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet, and revenues and expenses for the period. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans. In connection with the determination of the allowance for loan losses and valuation of real estate, management obtains independent appraisals for significant properties.

Certain financial information, which is normally included in financial statements prepared in accordance with generally accepted accounting principles, but which is not required for interim reporting purposes, has been condensed or omitted. Operating results for the interim period ended September 30, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. The accompanying condensed financial statements should be read in conjunction with the financial statements and notes thereto included in Salisbury's 2011 Annual Report on Form 10-K for the period ended December 31, 2011.

The allowance for loan losses is a significant accounting policy and is presented in the Notes to Consolidated Financial Statements and in Management's Discussion and Analysis, which provide information on how significant assets are valued in the financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions and estimates underlying those amounts, management has identified the determination of the allowance for loan losses to be the accounting area that requires the most subjective judgments, and as such could be most subject to revision as new information becomes available.

Impact of New Accounting Pronouncements Issued

In December 2011, the FASB issued ASU 2011-12, "Comprehensive Income (Topic 220): 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. The amendments in this update defer those changes in ASU 2011-05 that relate to the presentation of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. All other requirements in ASU 2011-05 are not affected by this update. The amendments are effective during interim and annual periods beginning after December 15, 2011. The adoption of ASU 2011-12 did not have a material impact on Salisbury's consolidated financial position, results of operations or cash flows.

In December 2011, the FASB issued ASU 2011-11, “Disclosures about Offsetting Assets and Liabilities.” This ASU is to enhance current disclosures. Entities are required to disclose both gross information and net information about both instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting arrangement. The amendments in this ASU are effective for annual periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented. The adoption of ASU 2011-11 is not expected to have a material impact on Salisbury’s consolidated financial position, results of operations or cash flows.

In September 2011, the FASB issued ASU 2011-08, “Intangibles – Goodwill and Other”, an update to ASC 350, “Intangibles – Goodwill and Other.” ASU 2011-08 simplifies how entities, both public and nonpublic, test goodwill for impairment. The amendments in this update permit an entity to first assess qualitative factors to determine whether it is more likely than not the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in ASC 350. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. For public and nonpublic entities, the amendments in this ASU are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted. The adoption of ASU 2011-08 did not have a material impact on Salisbury’s consolidated financial position, results of operations or cash flows.

In June 2011, the FASB issued ASU 2011-05, “Presentation of Comprehensive Income.” The objective of this ASU is to improve the comparability, consistency, and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. Under this ASU, 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. An entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. An entity is required to present on the face of the financial statements reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement(s) where the components of net income and the components of other comprehensive income are presented. The amendments in this ASU should be applied retrospectively. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The adoption of ASU 2011-05 did not have a material impact on Salisbury’s consolidated financial position, results of operations or cash flows.

In May 2011, the FASB issued ASU 2011-04, “Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards.” The amendments in this ASU explain how to measure fair value. They do not require additional fair value measurements and are not intended to establish valuation standards or affect valuation practices outside of financial reporting. The amendments in this ASU are to be applied prospectively. For public entities, the amendments are effective during interim and annual periods beginning after December 15, 2011. The adoption of ASU 2011-04 did not have a material impact on Salisbury’s consolidated financial position, results of operations or cash flows.

In April 2011, the FASB issued ASU 2011-03, “Reconsideration of Effective Control for Repurchase Agreements.” The objective of this ASU is to improve the accounting for repurchase agreements and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. This ASU prescribes when an entity may or may not recognize a sale upon the transfer of financial assets subject to repurchase agreements. The guidance in this ASU is effective for the first interim or annual period beginning on or after December 15, 2011. Early adoption is not permitted. The adoption of ASU 2011-03 did not have a material impact on Salisbury’s consolidated financial position, results of operations or cash flows.

In April 2011, the FASB issued ASU 2011-02, “A Creditor’s Determination of Whether a Restructuring Is a Troubled Debt Restructuring.” This ASU provides additional guidance or clarification to help creditors determine whether a restructuring constitutes a troubled debt restructuring. For public entities, the amendments in this ASU are effective for the first interim or annual period beginning on or after June 15, 2011, and were applied retrospectively to the beginning of the 2011 annual period. The adoption of ASU 2011-02 did not have a material impact on Salisbury's consolidated financial position, results of operations or cash flows.

NOTE 2 - SECURITIES

The composition of securities is as follows:

(in thousands)	Amortized cost (1)	Gross un-realized gains	Gross un-realized losses	Fair value
September 30, 2012				
Available-for-sale				
U.S. Treasury notes	$ 2,495	$ 250	$ -	$ 2,745
U.S. Government Agency notes	7,517	238	-	7,755
Municipal bonds	45,363	2,107	(286)	47,184
Mortgage backed securities				
U.S. Government Agencies	45,214	1,547	(1)	46,760
Collateralized mortgage obligations				
U.S. Government Agencies	5,671	79	-	5,750
Non-agency	11,969	534	(119)	12,384
SBA bonds	2,946	87	-	3,033
Preferred Stock	20	34	-	54
Total securities available-for-sale	$ 121,195	$ 4,876	$ (406)	$ 125,665
Non-marketable securities				
Federal Home Loan Bank of Boston stock	$ 5,747	$ -	$ -	$ 5,747

(in thousands)	Amortized cost (1)	Gross un-realized gains	Gross un-realized losses	Fair value
December 31, 2011				
Available-for-sale				
U.S. Treasury notes	$ 5,000	$ 528	$ -	$ 5,528
U.S. Government Agency notes	14,544	380	-	14,924
Municipal bonds	50,881	1,067	(1,152)	50,796
Mortgage backed securities				
U.S. Government Agencies	57,193	1,126	(19)	58,300
Collateralized mortgage obligations				
U.S. Government Agencies	7,077	76	-	7,153
Non-agency	14,300	355	(488)	14,167
SBA bonds	3,629	77	-	3,706
Corporate bonds	1,100	4	-	1,104
Preferred Stock	20	96	-	116
Total securities available-for-sale	$ 153,744	$ 3,709	$ (1,659)	$ 155,794
Held-to-maturity				
Mortgage backed security	$ 50	$ 2	$ -	$ 52
Non-marketable securities				
Federal Home Loan Bank of Boston stock	$ 6,032	$ -	$ -	$ 6,032

(1) Net of other-than-temporary impairment write-down recognized in earnings.

Salisbury sold a $2,500,000 Treasury bond available-for-sale during the nine month period ended September 30, 2012. The gain recognized on this sale was $267,000. Salisbury did not sell any securities available-for-sale in the nine months ended September 30, 2011.

The following table summarizes, for all securities in an unrealized loss position, including debt securities for which a portion of other-than-temporary impairment has been recognized in other comprehensive income, the aggregate fair value and gross unrealized loss of securities that have been in a continuous unrealized loss position as of the date presented:

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized losses	Fair value	Unrealized losses	Fair Value	Unrealized losses

(in thousands)						
September 30, 2012						
Available-for-sale						
Municipal bonds	$ 592	$ 5	$2,892	$ 280	$3,484	$ 285
Mortgage backed securities	-	-	53	1	53	1
Collateralized mortgage obligations						
Non-agency	-	-	1,612	27	1,612	27
Total temporarily impaired securities	592	5	4,557	308	5,149	313
Other-than-temporarily impaired securities						
Collateralized mortgage obligations						
Non-agency	-	-	2,053	93	2,053	93
Total temporarily and other-than-temporarily impaired securities	$ 592	$ 5	$6,610	$ 401	$7,202	$ 406

Salisbury evaluates securities for Other Than Temporary Impairment ("OTTI") where the fair value of a security is less than its amortized cost basis at the balance sheet date. As part of this process, Salisbury considers its intent to sell each debt security and whether it is more likely than not that it will be required to sell the security before its anticipated recovery. If either of these conditions is met, Salisbury recognizes an OTTI charge to earnings equal to the entire difference between the security's amortized cost basis and its fair value at the balance sheet date. For securities that meet neither of these conditions, an analysis is performed to determine if any of these securities are at risk for OTTI.

The following summarizes, by security type, the basis for evaluating if the applicable securities were OTTI at September 30, 2012.

U.S Government Agency notes, U.S. Government Agency mortgage-backed securities and U.S. Government Agency CMOs: The contractual cash flows are guaranteed by U.S. government agencies and U.S. government-sponsored enterprises. Changes in fair values are a function of changes in investment spreads and interest rate movements and not changes in credit quality. Management expects to recover the entire amortized cost basis of these securities. Furthermore, Salisbury does not intend to sell these securities and it is not more likely than not that Salisbury will be required to sell these securities before recovery of their cost basis, which may be maturity. Therefore, management does not consider these securities to be OTTI at September 30, 2012.

Municipal bonds: Contractual cash flows are performing as expected. Salisbury purchased substantially all of these securities during 2006-to-2008 as bank qualified, insured, AAA rated general obligation or revenue bonds. Salisbury's portfolio is mostly comprised of tax-exempt general obligation bonds or public-purpose revenue bonds for schools, municipal offices, sewer infrastructure and fire houses, for small towns and municipalities across the United States. In the wake of the financial crisis, most monoline bond insurers had their ratings downgraded or withdrawn because of excessive exposure to insurance for collateralized debt obligations. Where appropriate, Salisbury performs credit underwriting reviews of issuers, including some that have had their ratings withdrawn or are insured by insurers that have had their ratings withdrawn, to assess default risk. Management expects to recover the entire amortized cost basis of these securities. Salisbury does not intend to sell these securities and it is not more likely than not that Salisbury will be required to sell these securities before recovery of their cost basis, which may be maturity. Management does not consider these securities to be OTTI at September 30, 2012.

Non-agency CMOs: Salisbury performed a detailed cash flow analysis of its non-agency CMOs at September 30, 2012 to assess whether any of the securities were OTTI. Salisbury uses third party provided cash flow forecasts of each security based on a variety of market driven assumptions and securitization terms, including prepayment speed, default or delinquency rate, and default severity for losses including interest, legal fees, property repairs, expenses and realtor fees, that, together with the loan amount are subtracted from collateral sales proceeds to determine severity. In

2009 Salisbury determined that five non-agency CMO securities reflected OTTI and recognized losses for deterioration in credit quality of $1,128,000. Salisbury judged the four remaining securities not to have additional OTTI and all other CMO securities not to be OTTI as of September 30, 2012. It is possible that future loss assumptions could change, necessitating Salisbury to recognize future OTTI for further deterioration in credit quality. Salisbury does not intend to sell these securities and it is not more likely than not that Salisbury will be required to sell these securities before recovery of their cost basis.

The following table presents activity related to credit losses recognized into earnings on the non-agency CMOs held by Salisbury for which a portion of an OTTI charge was recognized in accumulated other comprehensive income:

Nine months ended September 30 (in thousands)	2012	2011
Balance, beginning of period	$ 1,128	$ 1,128
Credit component on debt securities in which OTTI was not previously recognized	-	-
Balance, end of period	$ 1,128	$ 1,128

Federal Home Loan Bank of Boston (“FHLBB”): The Bank is a member of the FHLBB. The FHLBB is a cooperative that provides services, including funding in the form of advances, to its member banking institutions. As a requirement of membership, the Bank must own a minimum amount of FHLBB stock, calculated periodically based primarily on its level of borrowings from the FHLBB. No market exists for shares of the FHLBB and therefore, they are carried at par value. FHLBB stock may be redeemed at par value five years following termination of FHLBB membership, subject to limitations which may be imposed by the FHLBB or its regulator, the Federal Housing Finance Board, to maintain capital adequacy of the FHLBB. While the Bank currently has no intentions to terminate its FHLBB membership, the ability to redeem its investment in FHLBB stock would be subject to the conditions imposed by the FHLBB. In 2008, the FHLBB announced to its members that it is focusing on preserving capital in response to ongoing market volatility including the extension of a moratorium on excess stock repurchases, and in 2009 announced the suspension of its quarterly dividends. In 2011, the FHLBB resumed modest quarterly cash dividends to its members and in early 2012 the FHLBB repurchased its excess stock pool. Based on the capital adequacy and the liquidity position of the FHLBB, management believes there is no impairment related to the carrying amount of the Bank’s FHLBB stock as of September 30, 2012. Further deterioration of the FHLBB’s capital levels may require the Bank to deem its restricted investment in FHLBB stock to be OTTI. If evidence of impairment exists in the future, the FHLBB stock would reflect fair value using either observable or unobservable inputs. The Bank will continue to monitor its investment in FHLBB stock.

NOTE 3 - LOANS

The composition of loans receivable and loans held-for-sale is as follows:

(in thousands)	September 30, 2012	December 31, 2011
Residential 1-4 family	$ 196,976	$ 187,676
Residential 5+ multifamily	3,604	3,187
Construction of residential 1-4 family	4,044	5,305
Home equity credit	35,263	34,621
Residential real estate	239,887	230,789
Commercial	83,219	81,958
Construction of commercial	5,416	7,069
Commercial real estate	88,635	89,027
Farm land	4,364	4,925
Vacant land	11,172	12,828
Real estate secured	344,058	337,569
Commercial and industrial	28,893	29,358
Municipal	3,083	2,415
Consumer	4,474	4,496
Loans receivable, gross	380,508	373,838
Deferred loan origination fees and costs, net	1,048	1,004
Allowance for loan losses	(4,179)	(4,076)
Loans receivable, net	$ 377,377	$ 370,766
Loans held-for-sale		
Residential 1-4 family	$ 1,595	$ 948

Concentrations of Credit Risk

Salisbury's loans consist primarily of residential and commercial real estate loans located principally in northwestern Connecticut and nearby New York and Massachusetts towns, which constitute Salisbury's service area. Salisbury offers a broad range of loan and credit facilities to borrowers in its service area, including residential mortgage loans, commercial real estate loans, construction loans, working capital loans, equipment loans, and a variety of consumer loans, including home equity lines of credit, and installment and collateral loans. All residential and commercial mortgage loans are collateralized by first or second mortgages on real estate. The ability of single family residential and consumer borrowers to honor their repayment commitments is generally dependent on the level of overall economic activity within the market area and real estate values. The ability of commercial borrowers to honor their repayment commitments is dependent on the general economy as well as the health of the real estate economic sector in Salisbury’s market area.

Credit Quality

The composition of loans receivable by credit risk rating is as follows:

(in thousands)	Pass	Special mention	Substandard	Doubtful	Loss	Total
September 30, 2012						
Residential 1-4 family	$ 179,426	$ 13,568	$ 3,982	$ -	$ -	$ 196,976
Residential 5+ multifamily	2,823	781	-	-	-	3,604
Construction of residential 1-4 family	3,249	-	795	-	-	4,044
Home equity credit	31,986	1,920	1,357	-	-	35,263
Residential real estate	217,484	16,269	6,134	-	-	239,887

Commercial	61,680	10,704	10,294	541	-	83,219
Construction of commercial	4,646	299	471	-	-	5,416
Commercial real estate	66,326	11,003	10,765	541	-	88,635
Farm land	2,828	344	1,192	-	-	4,364
Vacant land	5,725	868	4,579	-	-	11,172
Real estate secured	292,363	28,484	22,670	541	-	344,058
Commercial and industrial	20,237	6,464	2,192	-	-	28,893
Municipal	3,083	-	-	-	-	3,083
Consumer	4,270	171	33	-	-	4,474
Loans receivable, gross	$ 319,953	$ 35,119	$ 24,895	$ 541	$ -	$ 380,508

(in thousands)	Pass	Special mention	Substandard	Doubtful	Loss	Total
December 31, 2011						
Residential 1-4 family	$ 168,326	$ 15,517	$ 3,833	$ -	$ -	$ 187,676
Residential 5+ multifamily	2,752	435	-	-	-	3,187
Construction of residential 1-4 family	4,116	415	774	-	-	5,305
Home equity credit	31,843	1,451	1,327	-	-	34,621
Residential real estate	207,037	17,818	5,934	-	-	230,789
Commercial	64,458	6,187	11,313	-	-	81,958
Construction of commercial	6,296	302	471	-	-	7,069
Commercial real estate	70,754	6,489	11,784	-	-	89,027
Farm land	2,327	1,768	830	-	-	4,925
Vacant land	8,039	883	3,906	-	-	12,828
Real estate secured	288,157	26,958	22,454	-	-	337,569
Commercial and industrial	21,104	6,847	1,407	-	-	29,358
Municipal	2,415	-	-	-	-	2,415
Consumer	4,254	178	64	-	-	4,496
Loans receivable, gross	$ 315,930	$ 33,983	$ 23,925	$ -	$ -	$ 373,838

Credit quality segments of loans receivable by credit risk rating are as follows:

(in thousands)	Pass	Special mention	Substandard	Doubtful	Loss	Total
September 30, 2012						
Performing loans	$ 318,822	$ 33,540	$ -	$ -	$ -	$ 352,362
Potential problem loans	-	-	12,110	-	-	12,110
Troubled debt restructurings: accruing	1,131	1,579	4,097	-	-	6,807
Troubled debt restructurings: non-accrual	-	-	1,962	-	-	1,962
Other non-accrual loans	-	-	6,726	541	-	7,267
Impaired loans	1,131	1,579	12,785	541	-	16,036
Loans receivable, gross	$ 319,953	$ 35,119	$ 24,895	$ 541	$ -	$ 380,508
December 31, 2011						
Performing loans	$ 314,551	$ 32,570	$ -	$ -	$ -	$ 347,121
Potential problem loans	-	-	14,039	-	-	14,039
Troubled debt restructurings: accruing	1,379	1,413	1,810	-	-	4,602
Troubled debt restructurings: non-accrual	-	-	1,753	-	-	1,753
Other non-accrual loans	-	-	6,323	-	-	6,323
Impaired loans	1,379	1,413	9,886	-	-	12,678
Loans receivable, gross	$ 315,930	$ 33,983	$ 23,925	$ -	$ -	$ 373,838

Potential problem loans are performing loans risk rated substandard that are not classified as impaired. Impaired loans are loans for which it is probable that Salisbury will not be able to collect all principal and interest amounts due according to the contractual terms of the loan agreements.

The composition of loans receivable delinquency status by credit risk rating is as follows:

(in thousands)	Pass	Special mention	Substandard	Doubtful	Loss	Total
September 30, 2012						
Current	$ 315,252	$ 30,883	$ 14,043	$ -	$ -	$ 360,178
Past due 001-029	4,116	2,954	1,447	-	-	8,517
Past due 030-059	543	362	1,458	-	-	2,363
Past due 060-089	42	920	1,551	-	-	2,513
Past due 090-179	-	-	634	-	-	634
Past due 180+	-	-	5,762	541	-	6,303
Loans receivable, gross	$ 319,953	$ 35,119	$ 24,895	$ 541	$ -	$ 380,508
December 31, 2011						
Current	$ 311,741	$ 31,407	$ 12,618	$ -	$ -	$ 355,766
Past due 001-029	3,696	1,195	3,517	-	-	8,408
Past due 030-059	435	1,024	674	-	-	2,133
Past due 060-089	58	357	46	-	-	461
Past due 090-179	-	-	1,095	-	-	1,095
Past due 180+	-	-	5,975	-	-	5,975
Loans receivable, gross	$ 315,930	$ 33,983	$ 23,925	$ -	$ -	$ 373,838

The composition of loans receivable by delinquency status is as follows:

(in thousands)	Current	Past due 1-29 days	30-59 days	60-89 days	90-179 days	180 days and over	30 days and over	Accruing 90 days and over	Non-accrual
September 30, 2012									
Residential 1-4 family	$ 190,863	$ 4,174	$ 745	$ 488	$ 498	$ 208	$ 1,939	$ -	$ 1,157
Residential 5+ multifamily	3,363	134	-	107	-	-	107	-	-
Residential 1-4 family construction	4,044	-	-	-	-	-	-	-	-
Home equity credit	34,059	420	58	428	92	206	784	-	299
Residential real estate	232,329	4,728	803	1,023	590	414	2,830	-	1,456
Commercial	77,516	2,365	1,146	313	-	1,879	3,338	-	2,739
Construction of commercial	5,272	-	144	-	-	-	144	-	21
Commercial real estate	82,788	2,365	1,290	313	-	1,879	3,482	-	2,760
Farm land	3,974	14	-	376	-	-	376	-	-
Vacant land	5,619	933	229	789	44	3,558	4,620	-	4,391
Real estate secured	324,710	8,040	2,322	2,501	634	5,851	11,308	-	8,607
Commercial and industrial	28,024	417	-	-	-	452	452	-	622
Municipal	3,083	-	-	-	-	-	-	-	-
Consumer	4,361	60	41	12	-	-	53	-	-
	$360,178	$ 8,517	$ 2,363	$ 2,513	$ 634	$ 6,303	$11,813	$ -	$ 9,229

Loans receivable, gross									
December 31, 2011									
Residential 1-4 family	$ 182,263	$ 3,772	$ 811	$ 121	$ -	$ 709	$ 1,641	$ -	$ 1,240
Residential 5+ multifamily	2,918	-	112	157	-	-	269	-	-
Residential 1-4 family construction	5,305	-	-	-	-	-	-	-	-
Home equity credit	34,124	298	50	-	83	66	199		173
Residential real estate	224,610	4,070	973	278	83	775	2,109	-	1,413
Commercial	75,486	3,887	483	180	930	992	2,585	-	2,317
Construction of commercial	6,796	108	145	-	20	-	165	-	20
Commercial real estate	82,282	3,995	628	180	950	992	2,750	-	2,337
Farm land	4,499	46	380	-	-	-	380	-	-
Vacant land	9,047	73	50	-	-	3,658	3,708	-	3,658
Real estate secured	320,438	8,184	2,031	458	1,033	5,425	8,947	-	7,408
Commercial and industrial	28,542	152	51	1	62	550	664	-	668
Municipal	2,415	-	-	-	-	-	-	-	-
Consumer	4,371	72	51	2	-	-	53	-	-
Loans receivable, gross	$355,766	$ 8,408	$ 2,133	$ 461	$1,095	$ 5,975	$ 9,664	$ -	$ 8,076

Troubled Debt Restructurings

Troubled debt restructurings occurring during the periods are as follows:

(in thousands)	Three months ended September 30, 2012			Nine months ended September 30, 2012		
	Quantity	Pre-modification balance	Post-modification balance	Quantity	Pre-modification balance	Post-modification balance
Commercial real estate	6	$ 554	$ 554	7	$ 2,124	$ 2,124
Commercial and industrial	-	-	-	5	779	779
Residential real estate	-	-	-	1	326	326
Troubled debt restructurings	6	$ 554	$ 554	13	$ 3,229	$ 3,229
Debt consolidation and term extension	-	$ -	$ -	4	$ 2,276	$ 2,276
Rate reduction and term extension	1	140	140	3	513	513
Rate reduction	2	280	280	2	280	280
Refinance	1	80	80	1	80	80
Modification pursuant to bankruptcy	1	33	33	1	33	33
	-	-	-	1	26	26

Seasonal interest only concession						
Term extension and amortization	1	21	21	1	21	21
Troubled debt restructurings	6	$ 554	$ 554	13	$ 3,229	$ 3,229

Thirteen loans were restructured during the first nine months of 2012. At September 30, 2012 two loans totaling $280,000 were past due 30-59 days and eleven loans were current.

Allowance for Loan Losses

Changes in the allowance for loan losses are as follows:

	Three months ended September 30					Nine months ended September 30				
(in thousands)	Beginning balance	Provision (benefit)	Charge-offs	Recoveries	Ending balance	Beginning balance	Provision (benefit)	Charge-offs	Recoveries	Ending balance
2012 Periods										
Residential	$ 1,475	$ 92	$ (88)	$ -	$ 1,479	$ 1,478	$ 226	$ (225)	$ -	$1,479
Commercial	1,277	(206)	(41)	3	1,033	1,139	(72)	(41)	7	1,033
Land	219	318	(224)	-	313	410	169	(266)	-	313
Real estate	2,971	204	(353)	3	2,825	3,027	323	(532)	7	2,825
Commercial & industrial	820	(23)	-	1	798	704	114	(29)	9	798
Municipal	27	6	-	-	33	24	9	-	-	33
Consumer	66	74	(14)	5	131	79	92	(63)	22	130
Unallocated	323	69	-	-	392	242	152	-	(1)	393
Totals	$ 4,207	$ 330	$ (367)	$ 9	$ 4,179	$ 4,076	$ 690	$ (624)	$ 37	$ 4,179
2011 Periods										
Residential	$ 1,583	$ 73	$ (50)	$ -	$ 1,606	$ 1,504	$ 269	$ (170)	$ 3	$ 1,606
Commercial	1,239	(145)	(30)	1	1,065	1,132	138	(206)	1	1,065
Land	271	179	(75)	-	375	392	137	(154)	-	375
Real estate	3,093	107	(155)	1	3,046	3,028	544	(530)	4	3,046
Commercial & industrial	521	(92)	-	29	458	541	(22)	(89)	29	459
Municipal	28	(3)	-	-	25	51	(26)	-	-	25
Consumer	90	8	(10)	3	91	164	94	(189)	22	91
Unallocated	247	160	-	-	407	136	270	-	0	406
Totals	$ 3,979	$ 180	$ (165)	$ 33	$ 4,027	$ 3,920	$ 860	$ (808)	$ 55	$ 4,027

The composition of loans receivable and the allowance for loan losses is as follows:

(in thousands)	Collectively evaluated		Individually evaluated		Total portfolio	
	Loans	Allowance	Loans	Allowance	Loans	Allowance
September 30, 2012						
Residential 1-4 family	$ 192,610	$ 774	$ 4,366	$ 252	$ 196,976	$ 1,026
Residential 5+ multifamily	2,867	22	737	-	3,604	22
Construction of residential 1-4 family	4,044	19	-	-	4,044	19
Home equity credit	34,941	391	322	22	35,263	413
Residential real estate	234,462	1,206	5,425	274	239,887	1,480
Commercial	76,686	879	6,533	93	83,219	972
Construction of commercial	5,395	60	21	-	5,416	60
Commercial real estate	82,081	939	6,554	93	88,635	1,032
Farm land	4,364	67	-	-	4,364	67
Vacant land	6,641	78	4,531	167	11,172	245
Real estate secured	327,548	2,290	16,510	534	344,058	2,824
Commercial and industrial	26,887	352	2,006	447	28,893	799
Municipal	3,083	34	-	-	3,083	34
Consumer	4,083	40	391	90	4,474	130
Unallocated allowance	-	392	-	-	-	392
Totals	$ 361,601	$ 3,108	$ 18,907	$ 1,071	$ 380,508	$ 4,179

(in thousands)	Collectively evaluated		Individually evaluated		Total portfolio	
	Loans	Allowance	Loans	Allowance	Loans	Allowance
December 31, 2011						
Residential 1-4 family	$ 182,695	$ 762	$ 4,981	$ 297	$ 187,676	$ 1,059
Residential 5+ multifamily	2,437	17	750	4	3,187	21
Construction of residential 1-4 family	4,606	17	699	-	5,305	17
Home equity credit	34,333	382	288	-	34,621	382
Residential real estate	224,071	1,178	6,718	301	230,789	1,479
Commercial	74,419	840	7,539	202	81,958	1,042
Construction of commercial	7,049	77	20	20	7,069	97
Commercial real estate	81,468	917	7,559	222	89,027	1,139
Farm land	4,095	35	830	150	4,925	185
Vacant land	9,021	104	3,807	120	12,828	224
Real estate secured	318,655	2,234	18,914	793	337,569	3,027
Commercial and industrial	28,091	368	1,267	336	29,358	704
Municipal	2,415	24	-	-	2,415	24
Consumer	4,431	44	65	35	4,496	79
Unallocated allowance	-	-	-	-	-	242
Totals	$ 353,592	$ 2,670	$ 20,246	$ 1,164	$ 373,838	$ 4,076

The credit quality segments of loans receivable and the allowance for