SI Financial Group, Inc.
Form 10-Q
May 09, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

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

For the Quarterly Period Ended March 31, 2013
OR

o	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: 0-54241

SI FINANCIAL GROUP, INC.
(Exact name of registrant as specified in its charter)

Maryland	80-0643149
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
803 Main Street, Willimantic, Connecticut	06226
(Address of principal executive offices)	(Zip Code)

(860) 423-4581
(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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 o

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 (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

Large Accelerated Filer o	Accelerated Filer x
Non-Accelerated Filer o	Smaller Reporting Company o

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

As of May 3, 2013, there were 10,111,757 shares of the registrant’s common stock outstanding.

SI FINANCIAL GROUP, INC.
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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements.
SI FINANCIAL GROUP, INC.
CONSOLIDATED BALANCE SHEETS
(In Thousands, Except Share Amounts / Unaudited)

	March 31, 2013	December 31, 2012
ASSETS:		
Cash and due from banks:		
Noninterest-bearing	$11,710	$16,364
Interest-bearing	23,541	21,325
Total cash and cash equivalents	35,251	37,689
Available for sale securities, at fair value	196,101	176,513
Loans held for sale	4,911	5,069
Loans receivable (net of allowance for loan losses of $6,328 at March 31, 2013 and $6,387 at December 31, 2012)	671,770	685,163
Federal Home Loan Bank stock, at cost	7,753	8,078
Bank-owned life insurance	9,128	9,060
Premises and equipment, net	11,660	11,216
Goodwill	3,451	3,451
Accrued interest receivable	3,147	3,215
Deferred tax asset, net	4,619	4,639
Other real estate owned, net	999	1,293
Prepaid FDIC deposit insurance assessment	1,149	1,312
Other assets	7,239	6,552
Total assets	$957,178	$953,250
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Liabilities:		
Deposits:		
Noninterest-bearing	$83,539	$89,834
Interest-bearing	629,639	615,314
Total deposits	713,178	705,148
Mortgagors' and investors' escrow accounts	1,717	3,207
Federal Home Loan Bank advances	96,069	98,069
Junior subordinated debt owed to unconsolidated trust	8,248	8,248
Accrued expenses and other liabilities	12,251	12,819
Total liabilities	831,463	827,491
Shareholders' Equity:		
Preferred stock ($.01 par value; 1,000,000 shares authorized; none issued)	—	—
Common stock ($.01 par value; 35,000,000 shares authorized; 10,111,757 shares issued and outstanding at March 31, 2013; 10,112,310 shares issued and outstanding at December 31, 2012)	101	101
Additional paid-in-capital	94,910	94,810
Unallocated common shares held by ESOP	(4,968)	(5,088)
Unearned restricted shares	(2,091)	(2,210)

Retained earnings	36,363	36,733
Accumulated other comprehensive income	1,400	1,413
Total shareholders' equity	125,715	125,759
Total liabilities and shareholders' equity	$957,178	$953,250

See accompanying notes to unaudited interim consolidated financial statements.

SI FINANCIAL GROUP, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(In Thousands, Except Per Share Amounts / Unaudited)

	Three Months Ended March 31,	
	2013	2012
Interest and dividend income:		
Loans, including fees	$7,523	$7,635
Securities:		
Taxable interest	1,022	1,557
Tax-exempt interest	—	1
Dividends	—	16
Other	10	12
Total interest and dividend income	8,555	9,221
Interest expense:		
Deposits	1,352	1,595
Federal Home Loan Bank advances	775	849
Subordinated debt	83	107
Total interest expense	2,210	2,551
Net interest income	6,345	6,670
Provision for loan losses	135	484
Net interest income after provision for loan losses	6,210	6,186
Noninterest income:		
Total other-than-temporary impairment losses on securities	—	(409)
Portion of losses recognized in other comprehensive income	—	373
Net impairment losses recognized in earnings	—	(36)
Service fees	1,216	1,210
Wealth management fees	257	1,067
Increase in cash surrender value of bank-owned life insurance	68	72
Net gain on sales of securities	3	317
Mortgage banking	579	279
Net gain (loss) on fair value of derivatives	47	(49)
Net loss on disposal of SI Trust Servicing operations	—	(486)
Other	270	387
Total noninterest income	2,440	2,761
Noninterest expenses:		
Salaries and employee benefits	4,408	4,238
Occupancy and equipment	1,383	1,486
Computer and electronic banking services	868	993
Outside professional services	952	364
Marketing and advertising	130	152
Supplies	100	137
FDIC deposit insurance and regulatory assessments	233	272

Other	507	708
Total noninterest expenses	8,581	8,350
Income before income tax provision	69	597
Income tax provision	146	194
Net (loss) income	$(77)	$403
(Loss) earnings per share:		
Basic	$(0.01)	$0.04
Diluted	$(0.01)	$0.04

See accompanying notes to unaudited interim consolidated financial statements.

SI FINANCIAL GROUP, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME
(In Thousands / Unaudited)

	Three Months Ended March 31, 2013	2012
Net (loss) income	$(77)	$403
Other comprehensive (loss) income, net of tax:		
Net unrealized (loss) gain on available for sale securities:		
Net unrealized holding (loss) gain on available for sale securities	(4)	627
Reclassification adjustment for gains recognized in net (loss) income [1]	(2)	(209)
Plus: credit portion of OTTI losses recognized in net (loss) income [2]	—	24
Plus: noncredit portion of OTTI (loss) gain on available for sale securities	(35)	360
Net unrealized holding (losses) gains on available for sale securities	(41)	802
Net unrealized gain on interest-rate swap derivative	28	5
Other comprehensive (loss) income	(13)	807
Comprehensive (loss) income	$(90)	$1,210

(1) Amounts are included in net gain on the sales of securities in noninterest income on the consolidated statements of operations. Income tax expense associated with the reclassification adjustment for the three months ended March 31, 2013 and 2012 was $1,000 and $108,000, respectively.
(2) Amounts are included in net impairment losses recognized in (loss) earnings in noninterest income on the consolidated statements of operations. Income tax expense associated with the reclassification adjustment for the three months ended March 31, 2012 was $12,000. There were no impairment losses recognized in net loss for the three months ended March 31, 2013.

See accompanying notes to unaudited interim consolidated financial statements.

SI FINANCIAL GROUP, INC.
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE THREE MONTHS ENDED MARCH 31, 2013
(In Thousands, Except Share Data / Unaudited)

	Common Stock			Unallocated				
	Shares	Dollars	Additional Paid-in Capital	Common Shares Held by ESOP	Unearned Restricted Shares	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Balance at December 31, 2012	10,112,310	$ 101	$ 94,810	$ (5,088)	$ (2,210)	$ 36,733	$ 1,413	$ 125,759
Comprehensive loss	—	—	—	—	—	(77)	(13)	(90)
Cash dividends declared ($0.03 per share)	—	—	—	—	—	(287)	—	(287)
Equity incentive plan compensation	—	—	73	—	119	—	—	192
Allocation of 12,159 ESOP shares	—	—	24	120	—	—	—	144
Tax benefit from share-based compensation	—	—	3	—	—	—	—	3
Common shares repurchased	(553)	—	—	—	—	(6)	—	(6)
Balance at March 31, 2013	10,111,757	$ 101	$ 94,910	$ (4,968)	$ (2,091)	$ 36,363	$ 1,400	$ 125,715

See accompanying notes to unaudited interim consolidated financial statements.

SI FINANCIAL GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands / Unaudited)

	Three Months Ended March 31, 2013	2012
Cash flows from operating activities:		
Net (loss) income	$(77)	$403
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Provision for loan losses	135	484
Employee stock ownership plan expense	144	128
Equity incentive plan expense	192	29
Excess tax benefit from share-based compensation	(3)	(3)
Amortization of investment premiums and discounts, net	307	325
Amortization of loan premiums and discounts, net	346	206
Depreciation and amortization of premises and equipment	424	501
Amortization of core deposit intangible	—	3
Net gain on sales of securities	(3)	(317)
Net (gain) loss on fair value of derivatives	(47)	49
Deferred income tax provision	26	—
Loans originated for sale	(13,136)	(7,002)
Proceeds from sale of loans held for sale	13,520	11,049
Net loss on disposal of SI Trust Servicing operations	—	486
Net gain on sales of loans held for sale	(522)	(218)
Net gain on sales of loans held for investment	(201)	—
Net loss on sales or write-downs of other real estate owned	25	11
Increase in cash surrender value of bank-owned life insurance	(68)	(72)
Other-than-temporary impairment losses on securities	—	36
Change in operating assets and liabilities:		
Accrued interest receivable	60	66
Other assets	(211)	(99)
Accrued expenses and other liabilities	(493)	136
Net cash provided by operating activities	418	6,201
Cash flows from investing activities:		
Purchases of available for sale securities	(31,359)	(27,712)
Proceeds from sales of available for sale securities	1,000	9,336
Proceeds from maturities of and principal repayments on available for sale securities	10,406	18,150
Redemption of Federal Home Loan Bank stock	325	—
Net decrease (increase) in loans	13,190	(14,381)
Purchases of loans	(3,549)	—
Proceeds from sales of loans held for investment	3,197	—
Proceeds from sales of other real estate owned	552	700
Purchases of premises and equipment	(868)	(335)
Net cash used in investing activities	(7,106)	(14,242)

SI FINANCIAL GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (Concluded)
(In Thousands / Unaudited)

	Three Months Ended March 31, 2013	2012
Cash flows from financing activities:		
Net increase in deposits	8,030	19,261
Net decrease in mortgagors' and investors' escrow accounts	(1,490)	(1,541)
Proceeds from Federal Home Loan Bank advances	4,000	—
Repayments of Federal Home Loan Bank advances	(6,000)	—
Excess tax benefit from share-based compensation	3	3
Cash dividends on common stock	(287)	(300)
Common shares repurchased	(6)	(6)
Net cash provided by financing activities	4,250	17,417
Net change in cash and cash equivalents	(2,438)	9,376
Cash and cash equivalents at beginning of period	37,689	48,412
Cash and cash equivalents at end of period	$35,251	$57,788
Supplemental cash flow information:		
Interest paid	$2,184	$2,513
Income taxes paid, net	862	13
Transfer of loans to other real estate owned	283	119

See accompanying notes to unaudited interim consolidated financial statements.

SI FINANCIAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2013 AND 2012 AND DECEMBER 31, 2012

NOTE 1. NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business
SI Financial Group, Inc. (the “Company”) is the holding company for Savings Institute Bank and Trust Company (the “Bank”). Established in 1842, the Bank is a community-oriented financial institution headquartered in Willimantic, Connecticut. The Bank provides a variety of financial services to individuals, businesses and municipalities through its twenty offices in eastern Connecticut. Its primary products include savings, checking and certificate of deposit accounts, residential and commercial mortgage loans, commercial business loans and consumer loans. In addition, wealth management services, which include trust, financial planning, life insurance and investment services, are offered to individuals and businesses through the Bank’s offices. The Company does not conduct any material business other than owning all of the stock of the Bank and making payments on the subordinated debentures held by the Company.

Principles of Consolidation
The accompanying consolidated financial statements include the accounts of the Company, its wholly-owned subsidiary, the Bank, and the Bank’s wholly-owned subsidiaries, 803 Financial Corp., SI Mortgage Company and SI Realty Company, Inc. All significant intercompany accounts and transactions have been eliminated.

Basis of Financial Statement Presentation
The interim consolidated financial statements and related notes have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information, with the instructions to Form 10-Q and Rule 10.01 of Regulation S-X of the Securities and Exchange Commission (“SEC”) and general practices within the banking industry. Accordingly, certain information and footnote disclosures required by GAAP for complete financial statements have been omitted. Information in the accompanying interim consolidated financial statements and notes to the financial statements of the Company as of March 31, 2013 and for the three months ended March 31, 2013 and 2012 is unaudited. These unaudited interim consolidated financial statements and related notes should be read in conjunction with the audited financial statements of the Company and the accompanying notes for the year ended December 31, 2012 contained in the Company’s Form 10-K.

In the opinion of management, the accompanying unaudited interim consolidated financial statements reflect all of the adjustments, consisting only of normal and recurring adjustments, necessary for a fair presentation of the financial condition, results of operations and cash flows as of and for the period covered herein. The results of operations for the three months ended March 31, 2013 are not necessarily indicative of the operating results for the year ending December 31, 2013 or for any other period.

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosures of contingent assets and liabilities, as of the date of the balance sheets and reported amounts of revenues and expenses for the periods presented. Actual results could differ 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, other-than-temporary impairment (“OTTI”) of securities, deferred income taxes and the impairment of long-lived assets.

Reclassifications

Certain amounts in the Company's 2012 consolidated financial statements have been reclassified to conform to the 2013 presentation. Such reclassifications had no effect on net income.

Loans Receivable
Loans receivable are stated at current unpaid principal balances, net of the allowance for loan losses and deferred loan origination fees and costs. Management has the ability and intent to hold its loans receivable for the foreseeable future or until maturity or pay-off.

A loan is impaired when, based on current information and events, it is probable the Company will be unable to collect all contractual principal and interest payments due in accordance with the terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Impairment is measured on a loan by loan basis for residential and commercial mortgage loans and commercial business loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical expedient, at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not typically identify individual consumer loans for impairment disclosures, unless such loans are subject to a troubled debt restructuring ("TDR") agreement.

The Company periodically may agree to modify the contractual terms of loans. When a loan is modified and concessions have been made to the original contractual terms, such as reductions of interest rates or deferral of interest or principal payments due to the borrower’s financial condition, the modification is considered a TDR.

Management considers all nonaccrual loans, with the exception of certain consumer loans, to be impaired. Also, all TDRs are initially classified as impaired. In most cases, loan payments less than 90 days past due are considered minor collection delays and the related loans are generally not considered impaired.

Allowance for Loan Losses
The allowance for loan losses, a material estimate which could change significantly in the near-term, is established through a provision for loan losses charged to earnings to account for losses that are inherent in the loan portfolio and estimated to occur, and is maintained at a level that management considers adequate to absorb losses in the loan portfolio. Loan losses are charged against the allowance for loan losses when management believes that the uncollectibility of the principal loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance for loan losses when received. In the determination of the allowance for loan losses, management may obtain independent appraisals for significant properties, if necessary.

Management's judgment in determining the adequacy of the allowance is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. The allowance for loan losses is evaluated on a monthly basis by management and is based on the evaluation of the known and inherent risk characteristics and size and composition of the loan portfolio, the assessment of current economic and real estate market conditions, adverse situations that may affect the borrower’s ability to repay, estimated value of any underlying collateral, historical loan loss experience, the level of nonperforming loans, delinquencies, classified assets and loan charge-offs and evaluations of loans and other relevant factors.

The allowance for loan losses consists of the following key elements:

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Specific allowance for identified impaired loans. For loans that are identified as impaired, an allowance is established when the present value of expected cash flows (or observable market price of the loan or fair value of the collateral if the loan is collateral dependent) of the impaired loan is lower than the carrying value of that loan.

- General valuation allowance. The general component represents a valuation allowance on the remainder of the loan portfolio, after excluding impaired loans. For this portion of the allowance, loans are segregated by category and assigned an allowance percentage based on historical loan loss experience adjusted for qualitative factors stratified by the following loan segments: residential one- to four-family, multi-family and commercial real estate, construction, commercial business and consumer. Management uses a rolling average of historical losses based on the time frame appropriate to capture relevant loss data for each loan segment. This historical loss factor is adjusted for the following qualitative factors: levels/trends in delinquencies, classified loans and nonaccrual loans; level of loan charge-offs; trends in volume, nature and terms of loans; existence and effect of/or changes in the level of credit concentrations; effects of changes in risk selection, underwriting standards and other changes in lending policies, procedures and practices; experience/ability and depth of lending management and staff, national and local economic trends and conditions and impact on value of underlying collateral for collateral dependent loans.

The qualitative factors are determined based on the following various risk characteristics for each loan segment. Risk characteristics relevant to each portfolio segment are as follows:

Residential – One- to Four-Family – The Bank primarily originates conventional loans with loan-to-value ratios less than 95% and generally originates loans with loan-to-value ratios in excess of 80% only when secured by first liens on owner-occupied one- to four-family residences. Loans with loan-to-value ratios in excess of 80% generally require private mortgage insurance or additional collateral. All loans in this segment are collateralized by 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, will have an effect on the credit quality of this segment.

Multi-family and Commercial – Loans in this segment are originated for the purpose of acquiring, developing, improving or refinancing multi-family and commercial real estate where the property is the primary collateral securing the loan, and the income generated from the property is the primary repayment source. The underlying cash flows generated by the properties are adversely impacted by a downturn in the economy as evidenced by increased vacancy rates, which in turn, will have an effect on the credit quality in this segment. Payments on loans secured by income-producing properties often depend on the successful operation and management of the properties. Management continually monitors the cash flows of these loans.

Construction – This segment includes loans to individuals, and to a lesser extent builders, to finance the construction of residential dwellings. The Bank also originates construction loans for commercial development projects. Upon the completion of construction, the loan generally converts to a permanent mortgage loan. Credit risk is affected by cost overruns, time to sell at an adequate price and market conditions.

Commercial Business – Loans in this segment are made to businesses and are generally secured by assets of the business. Repayment is expected from the cash flows of the business. A weakened economy and reduced viability of the industry in which the customer operates will have a negative impact on the credit quality in this segment. To a lesser but increasing extent, the Bank provides financing for investors in the time share industry, which are secured by consumer receivables, and finances capital improvements for condominium associations, which are secured by the assigned rights to levy special assessments to condominium owners.

Consumer – Loans in this segment primarily include home equity lines of credit (representing both first and second liens) and indirect automobile loans and, to a lesser extent, loans secured by marketable securities, passbook or certificate accounts, motorcycles, automobiles and recreational vehicles, as well as unsecured loans. Consumer loan collections depend on the borrower’s continuing financial stability, and therefore, are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy.

In computing the allowance for loan losses, we do not assign a general valuation allowance to the Small Business Administration ("SBA") and United States Department of Agriculture ("USDA") loans that we purchase as such loans are fully guaranteed. These loans are included in commercial business loans. See Note 4 for details.

The majority of the Company's loans are collateralized by real estate located in eastern Connecticut. To a lesser extent, certain commercial real estate loans are secured by collateral located outside of our primary market area. Accordingly, the collateral value of a substantial portion of the Company's loan portfolio and real estate acquired through foreclosure is susceptible to changes in market conditions.

Although management believes that it uses the best information available to establish the allowance for loan losses, future adjustments to the allowance for loan losses may be necessary and the Company's results of operations could be adversely affected if circumstances differ substantially from the assumptions used in making the determinations. Furthermore, while management believes it has established the allowance for loan losses in conformity with GAAP, the regulatory agencies, in reviewing the loan portfolio, may request us to increase our allowance for loan losses based on judgments different from ours. In addition, because future events affecting borrowers and collateral cannot be predicted with certainty, the existing allowance for loan losses may not be adequate or increases may be necessary should the quality of any loans deteriorate as a result of the factors discussed above. Any material increase in the allowance for loan losses would adversely affect the Company's financial condition and results of operations.

Interest and Fees on Loans

Interest on loans is accrued and included in net interest income based on contractual rates applied to principal amounts outstanding. Accrual of interest is discontinued when loan payments are 90 days or more past due, based on contractual terms, or when, in the judgment of management, collectibility of the loan or loan interest becomes uncertain. Subsequent recognition of income occurs only to the extent payment is received subject to management's assessment of the collectibility of the remaining interest and principal. A nonaccrual loan is restored to accrual status when it is no longer delinquent and collectibility of interest and principal is no longer in doubt and the borrower has made regular payments in accordance with the terms of the loan over a period of at least six months. Interest collected on nonaccrual loans is recognized only to the extent cash payments are received, and may be recorded as a reduction to principal if the collectibility of the principal balance of the loan is unlikely.

Loan origination fees and direct loan origination costs are deferred, and the net amount is recognized as an adjustment of the related loan's yield utilizing the interest method over the contractual life of the loan.

Common Share Repurchases

The Company is chartered in the state of Maryland. Maryland law does not provide for treasury shares, rather shares repurchased by the Company constitute authorized but unissued shares. Accounting principles generally accepted in the United States of America state that accounting for treasury stock shall conform to state law. Therefore, the cost of shares repurchased by the Company has been allocated to common stock and retained earnings balances.

Recent Accounting Pronouncements

Disclosures about Offsetting Assets and Liabilities – In December 2011, the Financial Accounting Standards Board ("FASB") amended its standard related to disclosure requirements for offsetting assets and liabilities. Under this amendment, an entity will be required to disclose both gross 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. This scope would include derivatives, sale and repurchase agreements and reverse sale and repurchase agreements, and securities borrowing and securities lending arrangements. The amendments in this update were effective for annual reporting periods beginning on or after

January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by these amendments retrospectively for all comparative periods presented. The adoption of this amendment had no impact on the Company's consolidated financial statements.

Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities - In January 2013, the FASB issued amendments to clarify that the scope of Disclosures about Offsetting Assets and Liabilities applies to derivatives accounted for in accordance with Derivatives and Hedging, including bifurcated embedded derivatives, repurchase agreements, reverse repurchase agreements, securities borrowing and securities lending transactions that are either offset in accordance with applicable guidance or subject to an enforceable master netting arrangement or similar agreement. The amendments in this update were effective for fiscal years beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the required disclosures retrospectively for all comparative periods presented. The adoption of this amendment had no impact on the Company's consolidated financial statements.

Comprehensive Income - Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income - In February 2012, the FASB issued an amendment to improve the transparency of reporting these reclassifications by requiring an organization to 1) present the effects on the line items of net income of significant amounts reclassified out of accumulated other comprehensive income and 2) cross-reference to other disclosures currently required under GAAP for other reclassification items to be reclassified directly to net income in their entirety in the same reporting period. The amendments were effective for reporting periods beginning after December 15, 2012. The adoption of this amendment did not have a material impact on the Company's consolidated financial statements. See Consolidated Statements of Comprehensive (Loss) Income.

NOTE 2. EARNINGS (LOSS) PER SHARE

Basic earnings (loss) per share is calculated by dividing the net income (loss) available to common shareholders by the weighted average number of common shares outstanding during the period. Unvested restricted shares are considered outstanding in the computation of basic earnings (loss) per share since the shares participate in dividends and the rights to the dividends are non-forfeitable. Diluted earnings (loss) per share is computed in a manner similar to basic earnings (loss) per share except that the weighted average number of common shares outstanding is increased to include the incremental common shares (as computed using the treasury stock method) that would have been outstanding if all potentially dilutive common stock equivalents were issued during the period. The Company’s common stock equivalents relate solely to stock options. Repurchased common shares and unallocated common shares held by the Bank’s ESOP are not deemed outstanding for earnings (loss) per share calculations.

Anti-dilutive shares are common stock equivalents with weighted average exercise prices in excess of the weighted average market value for the periods presented, and are not considered in diluted earnings (loss) per share calculations. The Company had anti-dilutive common shares outstanding of 481,254 and 343,807 for the three months ended March 31, 2013 and 2012, respectively. For the quarter ended March 31, 2013, all common stock equivalents were anti-dilutive and were not included in the computation of loss per share.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2013 AND 2012 AND DECEMBER 31, 2012

The computation of (loss) earnings per share is as follows:

	Three Months Ended March 31, 2013	2012
	(In Thousands, Except Share Data)	
Net (loss) income	$(77)	$403
Weighted average common shares outstanding:		
Basic	9,555,940	9,971,292
Effect of dilutive stock options	—	27,023
Diluted	9,555,940	9,998,315
(Loss) earnings per share:		
Basic	$(0.01)	$0.04
Diluted	$(0.01)	$0.04

NOTE 3. SECURITIES

Available for sale securities:
The amortized cost, gross unrealized gains and losses and approximate fair values of available for sale securities at March 31, 2013 and December 31, 2012 are as follows:

	March 31, 2013			
	Amortized Cost [1]	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
Debt securities:				
U.S. Government and agency obligations	$52,732	$1,333	$(23)	$54,042
Government-sponsored enterprises	26,116	536	—	26,652
Mortgage-backed securities:[2]				
Agency - residential	89,473	1,993	(56)	91,410
Non-agency - residential	4,409	40	(110)	4,339
Non-agency - HELOC	2,402	—	(69)	2,333
Corporate debt securities	7,537	218	—	7,755
Collateralized debt obligations	5,882	—	(1,557)	4,325
Obligations of state and political subdivisions	4,976	244	—	5,220
Foreign government securities	25	—	—	25
Total available for sale securities	$193,552	$4,364	$(1,815)	$196,101

[1] Net of OTTI write-downs recognized in earnings.
[2] Agency securities refer to debt obligations issued or guaranteed by government corporations or government-sponsored enterprises (“GSEs”). Non-agency securities, or private-label securities, are the sole obligation of their issuer and are not guaranteed by one of the GSEs or the U.S. Government.

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MARCH 31, 2013 AND 2012 AND DECEMBER 31, 2012

	December 31, 2012			
	Amortized Cost [(1)]	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
Debt securities:				
U.S. Government and agency obligations	$55,027	$1,255	$(23)	$56,259
Government-sponsored enterprises	23,388	579	—	23,967
Mortgage-backed securities:[(2)]				
Agency - residential	69,399	2,211	(66)	71,544
Non-agency - residential	4,784	52	(124)	4,712
Non-agency - HELOC	2,555	—	(78)	2,477
Corporate debt securities	7,555	188	(49)	7,694
Collateralized debt obligations	5,993	—	(1,597)	4,396
Obligations of state and political subdivisions	5,152	262	—	5,414
Foreign government securities	50	—	—	50
Total available for sale securities	$173,903	$4,547	$(1,937)	$176,513

(1) Net of OTTI write-downs recognized in earnings.
(2) Agency securities refer to debt obligations issued or guaranteed by government corporations or government-sponsored enterprises (“GSEs”). Non-agency securities, or private-label securities, are the sole obligation of their issuer and are not guaranteed by one of the GSEs or the U.S. Government.

The amortized cost and fair value of debt securities by contractual maturities at March 31, 2013 are presented below. Actual maturities of mortgage-backed securities ("MBS") may differ from contractual maturities because the mortgages underlying the securities may be called or repaid without any penalties. Because MBSs are not due at a single maturity date, they are not included in the maturity categories in the following maturity summary.

	Amortized Cost	Fair Value
	(In Thousands)	
Within 1 year	$8,950	$9,032
After 1 but within 5 years	24,773	25,470
After 5 but within 10 years	19,177	19,487
After 10 years	44,368	44,030
	97,268	98,019
Mortgage-backed securities	96,284	98,082
Total debt securities	$193,552	$196,101

The following is a summary of realized gains and losses on the sales of securities for the three months ended March 31, 2013 and 2012:

	Three Months Ended March 31,	
	2013	2012

	(In Thousands)	
Gross gains on sales	$3	$370
Gross losses on sales	—	(53)
Net gain on sale of securities	$3	$317

Proceeds from the sales of available for sales securities totaled $1.0 million and $9.3 million for the three months ended March 31, 2013 and 2012, respectively.

The following tables present information pertaining to securities with gross unrealized losses at March 31, 2013 and December 31, 2012, aggregated by investment category and length of time the individual securities have been in a continuous unrealized loss position.

March 31, 2013:	Less Than 12 Months		12 Months Or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In Thousands)					
U.S. Government and agency obligations	$—	$—	$1,232	$23	$1,232	$23
Mortgage-backed securities:						
Agency - residential	16,848	38	932	18	17,780	56
Non-agency - residential	2,283	16	1,356	94	3,639	110
Non-agency - HELOC	—	—	2,333	69	2,333	69
Collateralized debt obligations	—	—	4,325	1,557	4,325	1,557
Total	$19,131	$54	$10,178	$1,761	$29,309	$1,815

December 31, 2012:	Less Than 12 Months		12 Months Or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In Thousands)					
U.S. Government and agency obligations	$—	$—	$1,367	$23	$1,367	$23
Mortgage-backed securities:						
Agency - residential	6,923	37	1,404	29	8,327	66
Non-agency - residential	1,926	8	1,417	116	3,343	124
Non-agency - HELOC	—	—	2,477	78	2,477	78
Corporate debt securities	—	—	946	49	946	49
Collateralized debt obligations	—	—	4,396	1,597	4,396	1,597
Total	$8,849	$45	$12,007	$1,892	$20,856	$1,937

For debt securities with OTTI losses, the Company estimated the portion of loss attributable to credit using a discounted cash flow model in accordance with applicable guidance. Significant inputs for the non-agency mortgage-backed securities included the estimated cash flows of the underlying collateral based on key assumptions, such as default rate, loss severity and prepayment rate. Assumptions used can vary widely from loan to loan, and are influenced by such factors as loan interest rate, geographical location of the borrower, borrower characteristics and collateral type. Significant inputs for the collateralized debt obligations included estimated cash flows and prospective deferrals, defaults and recoveries based on the underlying seniority status and subordination structure of the pooled trust preferred debt tranche at the time of measurement. Prospective deferral, default and recovery estimates affecting projected cash flows were based on an analysis of the underlying financial condition of the individual issuers, with consideration of the account’s capital adequacy, credit quality, lending concentrations and other factors. All cash flow estimates were based on the securities' tranche structure and contractual rate and maturity terms. The Company utilized the services of an independent third-party valuation firm to obtain information about the structure in order to determine how the underlying collateral cash flows will be distributed to each security issued from the structure. The present value of the expected cash flows was compared to the Company's holdings to determine the credit-related impairment loss, if any.

To the extent that continued changes in interest rates, credit movements and other factors that influence fair value of investments occur, the Company may be required to record impairment charges for OTTI in future periods.

At March 31, 2013, sixteen debt securities with gross unrealized losses had aggregate depreciation of approximately 5.83% of the Company's amortized cost basis. The majority of the unrealized losses related to the Company's collateralized debt obligations and non-agency mortgage-backed securities. No impairment charges on investments deemed other-than-temporarily impaired were recognized for the three months ended March 31, 2013 compared to $36,000 of net impairment charges recognized by the Company for the three months ended March 31, 2012. The following summarizes, by security type, the basis for management's determination during the preparation of the financial statements of whether the applicable investments within the Company's securities portfolio were other-than-temporarily impaired at March 31, 2013.

U.S. Government and Agency Obligations. The unrealized losses on the Company's U.S. Government and agency obligations related primarily to a widening of the rate spread to comparable treasury securities. The contractual terms of these investments do not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell these securities and it is not more likely than not that the Company will be required to sell the securities before their anticipated recovery, which may be at maturity, the Company did not consider these securities to be other-than-temporarily impaired at March 31, 2013.

Mortgage-backed Securities - Agency - Residential. The unrealized losses on the Company's agency–residential mortgage-backed securities were caused by increases in the rate spread to comparable treasury securities. The Company does not expect these securities to settle at a price less than the amortized cost basis of the investments. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before the recovery of their amortized cost basis, which may be at maturity, the Company did not consider these investments to be other-than-temporarily impaired at March 31, 2013.

Mortgage-backed Securities - Non-agency - Residential. Despite significant improvement in the market, these securities continue to trade well below historic levels, particularly those backed by jumbo or hybrid loan collateral. At March 31, 2013, management evaluated credit rating details for the tranche, as well as credit information on subordinate tranches, potential future credit losses and loss analyses. Additionally, management reviewed reports prepared by an independent third party for certain non-agency mortgage-backed securities. The Company has not recorded any further impairment losses as of March 31, 2013 because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be at maturity.

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The following table details the Company's non-agency residential mortgage-backed securities that were rated below investment grade at March 31, 2013:

Security	Class (1)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Lowest Credit Rating (2)	Total Credit-Related OTTI (3)	Credit Support Coverage Ratios (4)
(Dollars in Thousands)								
MBS 1	SSNR, AS	$1,450	$—	$(94)	$1,356	D	$197	0.00
MBS 2	PT, AS	178	3	—	181	C	—	0.15
		$1,628	$3	$(94)	$1,537		$197	

(1) Class definitions: PT – Pass Through, AS – Accelerated, and SSNR – Super Senior.
(2) The Company utilized credit ratings provided by Moody’s, S&P and Fitch in its evaluation of issuers.
(3) The OTTI amounts provided in the table represent cumulative credit loss amounts through March 31, 2013.
(4) The credit support coverage ratio, which is the ratio that determines the multiple of credit support, is based on assumptions for the performance of loans within the delinquency pipeline. The assumptions used are: current collateral support/((60 day delinquencies x .60) + (90 day delinquencies x .70) + (foreclosures x 1.00) + (other real estate x 1.00)) x .40 for loss severity.

Mortgage-backed Securities - Non-agency - HELOC. The unrealized loss on the Company’s non-agency - HELOC mortgage-backed security is related to one investment grade security whose market has been illiquid. This security is collateralized by home equity lines of credit secured by first and second liens and insured by Financial Security Assurance. At March 31, 2013, management evaluated credit rating details, collateral support and loss analyses. All of the unrealized losses on this security relate to factors other than credit. Because the Company does not intend to sell this security and it is not more likely than not that the Company will be required to sell this security before the recovery of its amortized cost basis, which may be at maturity, the Company did not record an impairment loss at March 31, 2013.

Collateralized Debt Obligations. The unrealized losses on the Company’s collateralized debt obligations relate to investments in pooled trust preferred securities (“PTPS”). The PTPS market has stabilized at depressed market values as a result of market saturation. Transactions for PTPS have been limited and have occurred primarily as a result of distressed or forced liquidation sales. The securities were widely held by hedge funds and European banks and used to offset interest rate exposure tied to LIBOR. As the positions have unwound, an excess supply of these securities have saturated the market.

Management evaluated current credit ratings, credit support and stress testing for future defaults related to the Company’s PTPS. Management also reviewed analytics provided by the trustee and independent OTTI reviews and associated cash flow analyses performed by an independent third party. The unrealized losses on the Company’s PTPS investments were caused by a lack of liquidity, credit downgrades and decreasing credit support. The increased number of bank and insurance company failures has decreased the level of credit support for these investments. A number of lower tranches have foregone payments or have received payment in kind through increased principal allocations. However, the number of deferring securities has been decreasing and a number of reinstatements have occurred recently. Based on the existing credit profile of the remainder of the Company's PTPS investments, management does not believe that these investments will suffer from any further credit-related losses. Because the

Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be at maturity, the Company did not record additional impairment losses at March 31, 2013.

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The following table details the Company's collateralized debt obligations that are rated below investment grade at March 31, 2013:

Security	Class	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Lowest Credit Rating (1)	Total Credit-Related OTTI (2)	% of Current Performing Collateral Coverage
(Dollars in Thousands)								
CDO 1	B1	$1,000	$—	$(558)	$442	CCC-	$—	107.0
CDO 2	B3	1,000	—	(539)	461	CCC-	—	107.0
CDO 3	A2	2,578	—	(226)	2,352	B-	62	125.0
CDO 4	A1	1,304	—	(234)	1,070	BB-	—	166.9
		$5,882	$—	$(1,557)	$4,325		$62	

(1) The Company utilized credit ratings provided by Moody's, S&P and Fitch in its evaluation of issuers.
(2) The OTTI amounts provided in the table represent cumulative credit loss amounts through March 31, 2013.

The following table presents a roll-forward of the balance of credit losses on the Company's debt securities for which a portion of OTTI was recognized in other comprehensive (loss) income for the three months ended March 31, 2013 and 2012.

	Three Months Ended March 31,	
	2013	2012
	(In Thousands)	
Balance at beginning of period	$259	$1,207
Additional credit losses for which OTTI losses were previously recognized	—	36
Balance at end of period	$259	$1,243

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NOTE 4. LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

Loan Portfolio
The composition of the Company's loan portfolio at March 31, 2013 and December 31, 2012 is as follows:

	March 31, 2013	December 31, 2012
	(In Thousands)	
Real estate loans:		
Residential - 1 to 4 family	$226,949	$230,664
Multi-family and commercial	193,848	201,951
Construction	3,216	3,284
Total real estate loans	424,013	435,899
Commercial business loans:		
SBA and USDA guaranteed	141,897	148,385
Other [1]	72,004	65,142
Total commercial business loans	213,901	213,527
Consumer loans:		
Home equity	27,594	28,375
Indirect automobile	8,732	9,652
Other	2,176	2,353
Total consumer loans	38,502	40,380
Total loans	676,416	689,806
Deferred loan origination costs, net of fees	1,682	1,744
Allowance for loan losses	(6,328)	(6,387)
Loans receivable, net	$671,770	$685,163

[1] Includes $28.7 million and $23.3 million in time share loans and $15.8 million and $15.5 million in condominium association loans at March 31, 2013 and December 31, 2012, respectively.

The Company purchased commercial business loans totaling $3.5 million for the three months ended March 31, 2013. For the twelve months ended December 31, 2012, the Company purchased commercial business loans and consumer loans totaling $42.9 million and $6.9 million, respectively.

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Allowance for Loan Losses
Changes in the allowance for loan losses for the three months ended March 31, 2013 and 2012 are as follows:

Three Months Ended March 31, 2013	Residential - 1 to 4 Family	Multi-family and Commercial	Construction	Commercial Business	Consumer	Total
	(In Thousands)					
Balance at beginning of period	$1,125	$3,028	$22	$1,735	$477	$6,387
Provision (credit) for loan losses	242	71	5	(201)	18	135
Loans charged-off	(266)	—	—	—	(40)	(306)
Recoveries of loans previously charged-off	—	69	—	—	43	112
Balance at end of period	$1,101	$3,168	$27	$1,534	$498	$6,328

Three Months Ended March 31, 2012	Residential - 1 to 4 Family	Multi-family and Commercial	Construction	Commercial Business	Consumer	Total
	(In Thousands)					
Balance at beginning of period	$759	$2,337	$280	$1,148	$446	$4,970
Provision (credit) for loan losses	37	340	88	(22)	41	484
Loans charged-off	(63)	—	—	—	(19)	(82)
Recoveries of loans previously charged-off	2	1	—	1	2	6
Balance at end of period	$735	$2,678	$368	$1,127	$470	$5,378

Further information pertaining to the allowance for loan losses at March 31, 2013 and December 31, 2012 is as follows:

March 31, 2013	Residential - 1 to 4 Family	Multi-family and Commercial	Construction	Commercial Business	Consumer	Total
	(In Thousands)					
Allowance for loans individually evaluated and deemed to be impaired	$430	$307	$—	$—	$—	$737
Allowance for loans individually or collectively evaluated and not deemed to be impaired	671	2,861	27	1,534	498	5,591
Total allowance for loan losses	$1,101	$3,168	$27	$1,534	$498	$6,328

Loans individually evaluated and deemed to be impaired	$7,714	$3,322	$—	$423	$290	$11,749
Loans individually or collectively evaluated and not deemed to be impaired	219,235	190,526	3,216	213,478	38,212	664,667
Total loans	$226,949	$193,848	$3,216	$213,901	$38,502	$676,416

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December 31, 2012	Residential - 1 to 4 Family	Multi-family and Commercial	Construction	Commercial Business	Consumer	Total
	(In Thousands)					
Allowance for loans individually evaluated and deemed to be impaired	$454	$88	$—	$39	$—	$581
Allowance for loans individually or collectively evaluated and not deemed to be impaired	671	2,940	22	1,696	477	5,806
Total allowance for loan losses	$1,125	$3,028	$22	$1,735	$477	$6,387
Loans individually evaluated and deemed to be impaired	$6,991	$5,873	$—	$618	$361	$13,843
Loans individually or collectively evaluated and not deemed to be impaired	223,673	196,078	3,284	212,909	40,019	675,963
Total loans	$230,664	$201,951	$3,284	$213,527	$40,380	$689,806

Past Due Loans
The following represents an aging of loans at March 31, 2013 and December 31, 2012:

March 31, 2013	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total 30 Days or More Past Due	Current	Total Loans
	(In Thousands)					
Real Estate:						
Residential - 1 to 4 family	$2,451	$365	$3,125	$5,941	$221,008	$226,949
Multi-family and commercial	—	—	1,836	1,836	192,012	193,848
Construction	—	—	—	—	3,216	3,216
Commercial Business:						
SBA and USDA guaranteed	3,248	447	—	3,695	138,202	141,897
Other	—	243	423	666	71,338	72,004
Consumer:						
Home equity	—	—	233	233	27,361	27,594
Indirect automobile	48	—	—	48	8,684	8,732
Other	2	—	—	2	2,174	2,176
Total	$5,749	$1,055	$5,617	$12,421	$663,995	$676,416

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December 31, 2012	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total 30 Days or More Past Due	Current	Total Loans
	(In Thousands)					
Real Estate:						
Residential - 1 to 4 family	$3,245	$1,725	$3,285	$8,255	$222,409	$230,664
Multi-family and commercial	4,149	—	1,266	5,415	196,536	201,951
Construction	—	—	—	—	3,284	3,284
Commercial Business:						
SBA and USDA guaranteed	5,014	1,087	—	6,101	142,284	148,385
Other	—	—	541	541	64,601	65,142
Consumer:						
Home equity	216	—	361	577	27,798	28,375
Indirect automobile	19	—	—	19	9,633	9,652
Other	21	—	—	21	2,332	2,353
Total	$12,664	$2,812	$5,453	$20,929	$668,877	$689,806

The Company did not have any loans that were past due 90 days or more and still accruing interest at March 31, 2013 or December 31, 2012 .

Impaired and Nonaccrual Loans
The following is a summary of impaired loans and nonaccrual loans at March 31, 2013 and December 31, 2012:

	Impaired Loans			
March 31, 2013	Recorded Investment	Unpaid Principal Balance	Related Allowance	Nonaccrual Loans
	(In Thousands)			
Impaired loans without valuation allowance:				
Real Estate:				
Residential - 1 to 4 family	$5,026	$5,293	$—	$4,955
Multi-family and commercial	1,930	1,930	—	1,497
Commercial business - Other	423	423	—	423
Consumer - Home equity	290	340	—	295
Total impaired loans without valuation allowance	7,669	7,986	—	7,170
Impaired loans with valuation allowance:				
Real Estate:				
Residential - 1 to 4 family	2,688	2,695	430	947
Multi-family and commercial	1,392	1,482	307	817
Total impaired loans with valuation allowance	4,080	4,177	737	1,764
Total impaired loans	$11,749	$12,163	$737	$8,934

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December 31, 2012	Impaired Loans Recorded Investment	Unpaid Principal Balance	Related Allowance	Nonaccrual Loans
	(In Thousands)			
Impaired loans without valuation allowance:				
Real Estate:				
Residential - 1 to 4 family	$3,866	$4,013	$—	$3,855
Multi-family and commercial	4,407	4,407	—	1,522
Commercial business - Other	546	546	—	470
Consumer - Home equity	361	435	—	366
Total impaired loans without valuation allowance	9,180	9,401	—	6,213
Impaired loans with valuation allowance:				
Real Estate:				
Residential - 1 to 4 family	3,125	3,125	454	1,133
Multi-family and commercial	1,466	1,556	88	236
Commercial business - Other	72	72	39	72
Total impaired loans with valuation allowance	4,663	4,753	581	1,441
Total impaired loans	$13,843	$14,154	$581	$7,654

The Company reviews and establishes, if necessary, an allowance for certain impaired loans for the amount by which the present value of expected cash flows (or observable market price of loan or fair value of the collateral if the loan is collateral dependent) are lower than the carrying value of the loan. For the periods presented, the Company concluded that certain impaired loans required no valuation allowance as a result of management's measurement of impairment. No additional funds are committed to be advanced to those borrowers whose loans are deemed impaired.

Additional information related to impaired loans is as follows:

	Three Months Ended March 31, 2013			2012		
	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized on Cash Basis	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized on Cash Basis
	(In Thousands)					
Real Estate:						
Residential - 1 to 4 family	$7,353	$31	$15	$5,478	$66	$66
Multi-family and commercial	4,597	45	—	9,164	64	—
Commercial business - Other	454	6	4	640	—	—
Consumer - Home equity	392	16	15	316	—	—
Total	$12,796	$98	$34	$15,598	$130	$66

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Credit Quality Information
The Company utilizes an eight-grade internal loan rating system for all loans in the portfolio, with the exception of its purchased SBA and USDA commercial business loans that are fully guaranteed by the U.S. government, as follows:

- Pass (Ratings 1-4): Loans in these categories are considered low to average risk.
- Special Mention (Rating 5): Loans in this category are starting to show signs of potential weakness and are being closely monitored by management.
- Substandard (Rating 6): Generally, a loan is considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligors and/or the collateral pledged. There is a distinct possibility that the Company will sustain some loss if the weakness is not corrected.
- Doubtful (Rating 7): Loans classified as doubtful have all the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, highly questionable and improbable.
- Loss (Rating 8): Loans in this category are considered uncollectible and of such little value that their continuance as assets, without establishment of a specific valuation allowance or charge-off, is not warranted.

Management periodically reviews the ratings described above and the Company's internal audit function reviews components of the credit files, including the assigned risk ratings, of certain commercial loans as part of its loan review.

The following tables present the Company's loans by risk rating at March 31, 2013 and December 31, 2012:

March 31, 2013	Not Rated	Pass	Special Mention	Substandard	Doubtful	Loss	Total
	(In Thousands)						
Real Estate:							
Residential - 1 to 4 family	$—	$217,929	$681	$8,339	$—	$—	$226,949
Multi-family and commercial	—	175,203	7,034	11,611	—	—	193,848
Construction	—	3,216	—	—	—	—	3,216
Total real estate loans	—	396,348	7,715	19,950	—	—	424,013
Commercial Business:							
SBA and USDA guaranteed	141,897	—	—	—	—	—	141,897
Other	—	67,967	3,033	1,004	—	—	72,004
Total commercial business loans	141,897	67,967	3,033	1,004	—	—	213,901
Consumer:							
Home equity	—	27,250	—	344	—	—	27,594
Indirect automobile	—	8,732	—	—	—	—	8,732
Other	—	2,176	—	—	—	—	2,176
Total consumer loans	—	38,158	—	344	—	—	38,502
Total loans	$141,897	$502,473	$10,748	$21,298	$—	$—	$676,416

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	(In Thousands)						
Real Estate:							
Residential - 1 to 4 family	$—	$222,262	$723	$7,679	$—	$—	$230,664
Multi-family and commercial	—	185,141	5,321	11,489	—	—	201,951
Construction	—	3,284	—	—	—	—	3,284
Total real estate loans	—	410,687	6,044	19,168	—	—	435,899
Commercial Business:							
SBA and USDA guaranteed	148,385	—	—	—	—	—	148,385
Other	—	61,047	3,399	696	—	—	65,142
Total commercial business loans	148,385	61,047	3,399	696	—	—	213,527
Consumer:							
Home equity	—	27,960	—	415	—	—	28,375
Indirect automobile	—	9,652	—	—	—	—	9,652
Other	—	2,353	—	—	—	—	2,353
Total consumer loans	—	39,965	—	415	—	—	40,380
Total loans	$148,385	$511,699	$9,443	$20,279	$—	$—	$689,806

Troubled Debt Restructurings
A modified loan is considered a TDR when two conditions are met: 1) the borrower is experiencing documented financial difficulty and 2) concessions are made by the Company that would not otherwise be considered for a borrower with similar risk characteristics. The most common types of modifications include below market interest rate reductions, deferrals of principal and maturity extensions. Modified terms are dependent upon the financial position and needs of the individual borrower. If the modification agreement is violated, the loan is handled by the Company's Collections Department for resolution, which may result in foreclosure. The Company's determination of whether a loan modification is a TDR considers the individual facts and circumstances surrounding each modification.

The Company's nonaccrual policy is followed for TDRs. If the loan was current prior to modification, nonaccrual status would not be required. If the loan was on nonaccrual prior to modification or if the payment amount significantly increases, the loan will remain on nonaccrual for a period of at least six months. Loans qualify for return to accrual status once the borrower has demonstrated the willingness and the ability to perform in accordance with the restructured terms of the loan agreement for a period of not less than six consecutive months.

All TDRs are initially reported as impaired. Impaired classification may be removed after the year of restructure if the borrower demonstrates compliance with the modified terms and the restructuring agreement specifies an interest rate equal to that which would be provided to a borrower with similar risk characteristics at the time of restructuring.

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The following table provides information on loans modified as TDRs during the three months ended March 31, 2013. There were no loans modified as TDRs during the three months ended March 31, 2012.

	Number of Loans	Recorded Investment	Allowance for Loan Losses (End of Period)
	(Dollars in Thousands)		
Residential - 1 to 4 family	1	$413	$72
Total	1	$413	$72

During the modification process, there was no loan charge-off or principal reduction for the loan included in the above table.

The following table provides the recorded investment, by type of modification for loans identified as TDRs and modified during the three months ended March 31, 2013 (in thousands). There were no loans modified as TDRs during the three months ended March 31, 2012.

Interest rate adjustments	$—
Principal deferrals	—
Combination of rate and payment	—
Combination of rate and maturity [1]	413
Total	$413

[1] Terms include combination of interest rate adjustments and extensions of maturity.

For the three months ended March 31, 2013, there were no TDRs that were in payment default (defined as 90 days or more past due).

NOTE 5. PREMISES AND EQUIPMENT

Premises and equipment at March 31, 2013 and December 31, 2012 are summarized as follows:

	March 31, 2013	December 31, 2012
	(In Thousands)	
Land	$2,890	$2,098
Buildings	6,992	7,052
Leasehold improvements	7,565	7,563
Furniture and equipment	11,067	10,867
Construction in process	18	84
	28,532	27,664
Accumulated depreciation and amortization	(16,872)	(16,448)
Premises and equipment, net	$11,660	$11,216

At March 31, 2013 and December 31, 2012, construction in process related to design and site costs associated with a new branch location. At December 31, 2012, the Company had an outstanding commitment for the purchase of land totaling $450,000, which was subsequently purchased during the quarter ended March 31, 2013.

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NOTE 6. OTHER COMPREHENSIVE (LOSS) INCOME

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net (loss) income. Although certain changes in assets and liabilities are reported as a separate component of shareholders' equity on the balance sheet, such items, along with net (loss) income are components of comprehensive (loss) income.

Components of other comprehensive (loss) income and related tax effects are as follows:

	Three Months Ended March 31, 2013		
	Before Tax Amount	Tax Effects	Net of Tax Amount
	(In Thousands)		
Securities:			
Unrealized holding losses on available for sale securities	$(5)	$1	$(4)
Reclassification adjustment for gains recognized in net loss	(3)	1	(2)
Noncredit portion of OTTI losses on available for sale securities	(53)	18	(35)
Unrealized holding losses on available for sale securities, net of taxes	(61)	20	(41)
Derivative instrument:			
Change in fair value of effective cash flow hedging derivative	43	(15)	28
Other comprehensive loss	$(18)	$5	$(13)

The components of accumulated other comprehensive income included in shareholders' equity are as follows:

	March 31, 2013		
	Before Tax Amount	Tax Effects	Net of Tax Amount
	(In Thousands)		
Net unrealized gains on available for sale securities	$2,868	$(975)	$1,893
Noncredit portion of OTTI losses on available for sale securities	(319)	108	(211)
Net unrealized loss on effective cash flow hedging derivative	(427)	145	(282)
Accumulated other comprehensive income	$2,122	$(722)	$1,400

	December 31, 2012		
	Before Tax Amount	Tax Effects	Net of Tax Amount
	(In Thousands)		
Net unrealized gains on available for sale securities	$2,876	$(977)	$1,899
Noncredit portion of OTTI losses on available for sale securities	(266)	90	(176)
Net unrealized loss on effective cash flow hedging derivative	(470)	160	(310)
Accumulated other comprehensive income	$2,140	$(727)	$1,413

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NOTE 7. REGULATORY CAPITAL

The Bank is 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 consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank’s assets, liabilities and certain off-balance sheet items, as calculated under regulatory accounting practices. The Bank’s capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier I capital (as defined) to total assets (as defined). As of March 31, 2013 and December 31, 2012, the Bank met the conditions to be classified as “well capitalized” under the regulatory framework for prompt corrective action. There are no conditions or events since then that management believes have changed the Bank’s regulatory category. As a savings and loan holding company regulated by the Federal Reserve Board (the “FRB”), the Company is not currently subject to any separate regulatory capital requirements. The Dodd-Frank Act, however, requires the FRB to promulgate consolidated capital requirements for depository institution holding companies that are no less stringent, quantitatively in terms of components of capital, than those applicable to institutions themselves. There is a five-year transition period before the capital requirements will apply to savings and loan holding companies.

The Bank’s actual capital amounts and ratios as of March 31, 2013 and December 31, 2012 were as follows:

	Actual			For Capital Adequacy Purposes			To Be Well Capitalized Under Prompt Corrective Action Provisions		
March 31, 2013	Amount	Ratio		Amount	Ratio		Amount	Ratio	
	(Dollars in Thousands)								
Tier I Capital Ratio	$104,374	11.10	%	$37,600	4.00	%	$47,000	5.00	%
Tier I Risk-based Capital Ratio	104,374	19.90		20,985	4.00		31,477	6.00	
Total Risk-based Capital Ratio	110,933	21.15		41,970	8.00		52,462	10.00	
Tangible Equity Ratio	104,374	11.10		14,100	1.50		N/A	N/A	

	Actual			For Capital Adequacy Purposes			To Be Well Capitalized Under Prompt Corrective Action Provisions		
December 31, 2012	Amount	Ratio		Amount	Ratio		Amount	Ratio	
	(Dollars in Thousands)								
Tier I Capital Ratio	$103,547	11.08	%	$37,382	4.00	%	$46,727	5.00	%
Tier I Risk-based Capital Ratio	103,547	20.20		20,504	4.00		30,757	6.00	
Total Risk-based Capital Ratio	109,751	21.41		41,009	8.00		51,262	10.00	

Tangible Equity Ratio	103,547	11.08	14,018	1.50	N/A	N/A

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NOTE 8. FAIR VALUE OF ASSETS AND LIABILITIES

Fair Value Hierarchy
The Company groups its assets and liabilities 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.

Level 1:	Valuation is based on quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities generally include debt and equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.
Level 2:	Valuation is based on observable inputs other than Level 1 prices, such as quoted prices for similar assets or 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 3:	Valuation is based on 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 unobservable inputs to 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. Transfers between levels are recognized at the end of a reporting period, if applicable.

Determination of Fair Value
The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. 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. 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.

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

- Cash and cash equivalents. The carrying amounts of cash and short-term instruments approximate the fair values based on the short-term nature of the assets.

- Securities available for sale. Included in the available for sale category are both debt and equity securities. The securities measured at fair value in Level 1 are based on quoted market prices in an active exchange market. Securities measured at fair value in Level 2 are based on pricing models that consider standard input factors such as observable market data, benchmark yields, interest rate volatilities, broker/dealer quotes, credit spreads and new issue data. The Company utilizes a nationally-recognized, third-party pricing service to estimate fair value measurements for the majority of its portfolio. The pricing service evaluates each asset class based on relevant market information considering observable data, but these prices do not represent binding quotes. The fair value prices on all investments are reviewed for reasonableness by management. Securities measured at fair value in Level 3 include collateralized debt obligations that are backed by trust preferred securities issued by banks, thrifts and insurance companies. Management determined that an orderly and active market for these securities and similar securities did not exist based on a significant reduction in trading volume and widening spreads relative to historical levels. The Company estimates future cash flows discounted using a rate management believes is representative of current market conditions. Factors in determining the discount rate include the current level of deferrals and/or defaults, changes in credit rating and the financial condition of the debtors within the underlying securities, broker quotes for securities with similar structure and credit risk, interest rate movements and pricing for new issuances.

- Federal Home Loan Bank stock. The carrying value of Federal Home Loan Bank ("FHLB") stock approximates fair value based on the redemption provisions of the FHLB.

- Loans held for sale. The fair value of loans held for sale is estimated using quoted market prices.

- Loans receivable. For variable rate loans that reprice frequently and have no significant change in credit risk, fair values are based on carrying values. The fair value of fixed-rate loans are estimated by discounting the future cash flows using the rates at the end of the period in which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

- Accrued interest receivable. The carrying amount of accrued interest approximates fair value.

- Deposits. The fair value of demand deposits, negotiable orders of withdrawal, regular savings, certain money market deposits and mortgagors' and investors' escrow accounts is the amount payable on demand at the reporting date. The fair value of certificates of deposit and other time deposits is estimated using a discounted cash flow calculation that applies interest rates currently being offered for deposits of similar remaining maturities to a schedule of aggregated expected maturities on such deposits.

- Federal Home Loan Bank advances. The fair value of the advances is estimated using a discounted cash flow calculation that applies current FHLB interest rates for advances of similar maturity to a schedule of maturities of such advances.

- Junior subordinated debt owed to unconsolidated trust. Rates currently available for debt with similar terms and remaining maturities are used to estimate fair value of existing debt.

- Interest rate swap agreements. The fair values of the Company's interest rate swaps are obtained from a third-party pricing service and are determined using a discounted cash flow analysis on the expected cash flows of the derivative. The pricing analysis is based on observable inputs for the contractual term of the derivative, including the period to maturity and interest rate curves.

- Forward loan sale commitments and derivative loan commitments. Forward loan sale commitments and derivative loan commitments are based on the fair values of the underlying mortgage loans, including the servicing rights for derivative loan commitments, and the probability of such commitments being exercised. Significant management judgment and estimation is required in determining these fair value measurements.

- Off-balance sheet instruments. Fair values for off-balance sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standings.

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Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following tables present assets and liabilities measured at fair value on a recurring basis as of March 31, 2013 and December 31, 2012. The Company had no significant transfers into or out of Levels 1, 2 or 3 during the three months ended March 31, 2013.

	March 31, 2013			
	Level 1	Level 2	Level 3	Total
	(In Thousands)			
Assets:				
U.S. Government and agency obligations	$1,031	$53,011	$—	$54,042
Government-sponsored enterprises	—	26,652	—	26,652
Mortgage-backed securities	—	98,082	—	98,082
Corporate debt securities	—	7,755	—	7,755
Collateralized debt obligations	—	—	4,325	4,325
Obligations of state and political subdivisions	—	5,220	—	5,220
Foreign government securities	—	25	—	25
Forward loan sale commitments and derivative loan commitments	—	—	228	228
Total assets	$1,031	$190,745	$4,553	$196,329
Liabilities:				
Forward loan sale commitments and derivative loan commitments	$—	$—	$19	$19
Interest rate swap agreements	—	762	—	762
Total liabilities	$—	$762	$19	$781

	December 31, 2012			
	Level 1	Level 2	Level 3	Total
	(In Thousands)			
Assets:				
U.S. Government and agency obligations	$1,035	$55,224	$—	$56,259
Government-sponsored enterprises	—	23,967	—	23,967
Mortgage-backed securities	—	78,733	—	78,733
Corporate debt securities	—	7,694	—	7,694
Collateralized debt obligations	—	—	4,396	4,396
Obligations of state and political subdivisions	—	5,414	—	5,414
Foreign government securities	—	50	—	50
Forward loan sale commitments and derivative loan commitments	—	—	17	17
Total assets	$1,035	$171,082	$4,413	$176,530
Liabilities:				
Forward loan sale commitments and derivative loan commitments	$—	$—	$4	$4
Interest rate swap agreements	—	849	—	849

Total liabilities	$—	$849	$4	$853

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The following table shows a reconciliation of the beginning and ending balances for Level 3 assets (liabilities):

	Collateralized Debt Obligations	Derivative Loan and Forward Loan Sale Commitments, Net
	(In Thousands)	
Balance at December 31, 2012	$4,396	$13
Total realized and unrealized gains included in net loss	—	196
Total unrealized losses included in other comprehensive loss	(71)	—
Balance at March 31, 2013	$4,325	$209

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis
The Company may also be required, from time to time, to measure certain other financial assets on a nonrecurring basis in accordance with generally accepted accounting principles. These adjustments to fair value usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets. The following table summarizes the fair value hierarchy used to determine each adjustment and the carrying value of the related individual assets for the periods presented. There were no liabilities measured at fair value on a nonrecurring basis for the periods presented.

	At March 31, 2013			At December 31, 2012		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
	(In Thousands)					
Impaired loans	$—	$—	$1,636	$—	$—	$1,616
Other real estate owned	—	—	999	—	—	1,293
Total assets	$—	$—	$2,635	$—	$—	$2,909

The following table summarizes losses resulting from fair value adjustments for assets measured at fair value on a nonrecurring basis.

	Three Months Ended March 31,	
	2013	2012
	(In Thousands)	
Impaired loans	$316	$144
Other real estate owned	12	—
Total assets	$328	$144

The Company measures the impairment of loans that are collateral dependent based on the fair value of the collateral (Level 3). The fair value of collateral used by the Company represents the amount expected to be received from the sale of the property, net of selling costs, as determined by an independent, licensed or certified appraiser using observable market data. This data includes information such as selling price of similar properties, expected future cash flows or earnings of the subject property based on current market expectations, and relevant legal, physical and economic factors. The appraised values of collateral are adjusted as necessary by management based on observable inputs for specific properties. Losses applicable to write-downs of impaired loans are based on the appraised market value of the underlying collateral, assuming foreclosure of these loans is imminent.

The amount of other real estate owned represents the carrying value of the collateral based on the appraised value of the underlying collateral less estimated selling costs. The loss on foreclosed assets represents adjustments in the valuation recorded during the time period indicated and not for losses incurred on sales.

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Summary of Fair Values of Financial Instruments
The estimated fair values, and related carrying or notional amounts, of the Company’s financial instruments are presented in the following table. Certain financial instruments and all nonfinancial instruments are exempt from disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

Management uses its best judgment in estimating the fair value of the Company's financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates presented herein are not necessarily indicative of the amounts the Company could have realized in a sales transaction at March 31, 2013 and December 31, 2012. The estimated fair value amounts at March 31, 2013 and December 31, 2012 have been measured as of each respective date, and have not been re-evaluated or updated for purposes of the consolidated financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each period-end. The information presented should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only required for a limited portion of the Company's assets. Due to the wide range of valuation techniques and the degree of subjectivity used in making the estimate, comparisons between the Company's disclosures and those of other banks may not be meaningful.

As of March 31, 2013 and December 31, 2012, the recorded carrying amounts and estimated fair values of the Company's financial instruments are as follows:

	March 31, 2013				
	Carrying Amount	Level 1	Level 2	Level 3	Total
Financial Assets:	(In Thousands)				
Cash and cash equivalents	$35,251	$35,251	$—	$—	$35,251
Available for sale securities	196,101	1,031	190,745	4,325	196,101
Loans held for sale	4,911	—	—	4,997	4,997
Loans receivable, net	671,770	—	—	691,560	691,560
Federal Home Loan Bank stock	7,753	—	—	7,753	7,753
Accrued interest receivable	3,147	—	—	3,147	3,147
Financial Liabilities:					
Deposits	713,178	—	—	716,920	716,920
Mortgagors' and investors' escrow accounts	1,717	—	—	1,717	1,717
Federal Home Loan Bank advances	96,069	—	100,200	—	100,200
Junior subordinated debt owed to unconsolidated trust	8,248	—	5,672	—	5,672
On-balance Sheet Derivative Financial Instruments:					
Assets:					
Derivative loan commitments	131	—	—	131	131
Forward loan sale commitments	97	—	—	97	97
Liabilities:					
Derivative loan commitments	4	—	—	4	4
Forward loan sale commitments	15	—	—	15	15
Interest rate swap agreements	762	—	762	—	762

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	December 31, 2012				
	Carrying Amount	Level 1	Level 2	Level 3	Total
Financial Assets:	(In Thousands)				
Cash and cash equivalents	$37,689	$37,689	$—	$—	$37,689
Available for sale securities	176,513	1,035	171,082	4,396	176,513
Loans held for sale	5,069	—	—	5,232	5,232
Loans receivable, net	685,163	—	—	703,925	703,925
Federal Home Loan Bank stock	8,078	—	—	8,078	8,078
Accrued interest receivable	3,215	—	—	3,215	3,215
Financial Liabilities:					
Deposits	705,148	—	—	709,357	709,357
Mortgagors' and investors' escrow accounts	3,207	—	—	3,207	3,207
Federal Home Loan Bank advances	98,069	—	102,919	—	102,919
Junior subordinated debt owed to unconsolidated trust	8,248	—	5,268	—	5,268
On-balance Sheet Derivative Financial Instruments:					
Assets:					
Derivative loan commitments	13	—	—	13	13
Forward loan sale commitments	4	—	—	4	4
Liabilities:					
Derivative loan commitments	3	—	—	3	3
Forward loan sale commitments	1	—	—	1	1
Interest rate swap agreements	849	—	849	—	849

NOTE 9. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

Derivative Financial Instruments

The Company has stand-alone derivative financial instruments in the form of interest rate swap agreements, which derive their value from underlying interest rates. These transactions involve both credit and market risk. The notional amounts are amounts on which calculations, payments and the value of the derivatives are based. Notional amounts do not represent direct credit exposures. Direct credit exposure is limited to the net difference between the calculated amounts to be received and paid, if any. Such difference, which represents the fair value of the derivative instruments, is reflected on the Company's balance sheets as other assets and other liabilities. The Company is exposed to credit-related losses in the event of nonperformance by the counterparties to these agreements. The Company controls the credit risk of its financial contracts through credit approvals, limits and monitoring procedures and does not expect any counterparties to fail their obligations.

Derivative instruments are generally either negotiated over-the-counter contracts or standardized contracts executed on a recognized exchange. Negotiated over-the-counter derivative contracts are generally entered into between two counterparties that negotiate specific agreement terms, including the underlying instrument, amount, exercise prices and maturity.

Derivative Instruments Designated As Hedging Instruments

The Company uses long-term variable rate debt as a source of funds for use in the Company’s lending and investment activities and other general business purposes. These debt obligations expose the Company to variability in interest payments due to changes in interest rates. If interest rates increase, interest expense increases. Conversely, if interest rates decrease, interest expense decreases. Management believes it is prudent to limit the variability of a portion of its interest payments and, therefore, generally hedges a portion of its variable-rate interest payments. To meet this objective, management entered into an interest rate swap agreement, characterized as a cash flow hedge, whereby the Company receives variable interest rate payments determined by three-month LIBOR in exchange for making payments at a fixed interest rate.

At March 31, 2013 and December 31, 2012, information pertaining to the outstanding interest rate swap agreement used to hedge variable rate debt is as follows:

	March 31, 2013		December 31, 2012	
	(Dollars in Thousands)			
Notional amount	$8,000		$8,000	
Weighted average fixed pay rate	2.44	%	2.44	%
Weighted average variable receive rate	0.28	%	0.31	%
Weighted average maturity in years	2.7		3.0	
Unrealized loss relating to interest rate swap	$427		$470	

At March 31, 2013 and December 31, 2012, the unrealized loss related to the above mentioned interest rate swap was recorded as a derivative liability. Changes in the fair value of an interest rate swap designated as a hedging instrument of the variability of cash flows associated with long-term debt are reported in other comprehensive income. These amounts are subsequently reclassified into interest expense as a yield adjustment in the same period in which the related interest on the long-term debt affects earnings.

Risk management results for the periods ended March 31, 2013 and December 31, 2012, related to the balance sheet hedging of long-term debt indicate that the hedge was 100% effective and that there was no component of the derivative instrument’s loss which was excluded from the assessment of hedge effectiveness.

The Company’s derivative contract contains a provision establishing a collateral requirement (subject to minimum collateral posting thresholds) based on the Company’s external credit rating. If the Company’s junior subordinated debt rating was to fall below the level generally recognized as investment grade, the counterparty to such derivative contract could require additional collateral on the derivative transaction in a net liability position (after considering the effect of bilateral netting arrangements and posted collateral). The Company had previously posted collateral of $600,000 in the normal course of business for a derivative instrument, with a credit-related contingent feature, that was in a net liability position at March 31, 2013 and December 31, 2012.

Derivative Instruments Not Designated As Hedging Instruments
Certain derivative instruments do not meet the requirements to be accounted for as hedging instruments. These undesignated derivative instruments are recognized on the consolidated balance sheets at fair value, with changes in fair value recorded in other noninterest income.

Interest Rate Swap Agreement - During the first quarter of 2012, management entered into an interest rate swap agreement, that does not meet the strict hedge accounting requirements of FASB's "Derivatives and Hedging" standard, to manage the Company's exposure to interest rate movements and other identified risks. Changes in fair value of this instrument are recorded as a component of noninterest income.

At March 31, 2013 and December 31, 2012, information pertaining to the Company's interest rate swap agreement not designated as a hedge is as follows:

	March 31, 2013	December 31, 2012
	(Dollars in Thousands)	

Notional amount	$15,000	$15,000
Weighted average fixed pay rate	1.26 %	1.26 %
Weighted average variable receive rate	0.31 %	0.35 %
Weighted average maturity in years	3.8	4.0

The Company reported a loss in fair value on the interest rate swap not designated as a hedge of $335,000 and $53,000 in noninterest income for three months ended March 31, 2013 and 2012, respectively.

Derivative Loan Commitments - Mortgage loan commitments are referred to as derivative loan commitments if the loan that will result from exercise of the commitment will be held for sale upon funding. The Company enters into commitments to fund residential mortgage loans at specified times in the future, with the intention that these loans will subsequently be sold in the secondary market. A mortgage loan commitment binds the Company to lend funds to a potential borrower at a specified interest rate and within a specified period of time, generally up to 60 days after inception of the rate lock.

Outstanding derivative loan commitments expose the Company to the risk that the price of the loans arising from exercise of the loan commitment might decline from inception of the rate lock to funding of the loan due to increases in mortgage interest rates. If interest rates increase, the value of these loan commitments decrease. Conversely, if interest rates decrease, the value of these loan commitments increase. The notional amount of undesignated mortgage loan commitment was $9.0 million at March 31, 2013. At March 31, 2013, the fair values of such commitments were a net asset of $127,000.

Forward Loan Sale Commitments - To protect against the price risk inherent in derivative loan commitments, the Company utilizes “mandatory delivery” forward loan sale commitments to mitigate the risk of potential decreases in the value of loans that would result from the exercise of the derivative loan commitments.

With a “mandatory delivery” contract, the Company commits to deliver a certain principal amount of mortgage loans to an investor at a specified price on or before a specified date. If the Company fails to deliver the amount of mortgages necessary to fulfill the commitment by the specified date, it is obligated to pay a “pair-off” fee, based on then-current market prices, to the investor to compensate the investor for the shortfall.

The Company expects that these forward loan sale commitments will experience changes in fair value opposite to the change in fair value of derivative loan commitments. The notional amount of undesiginated forward loan sale commitments was $6.2 million at March 31, 2013. The fair value of such commitments was a net asset of $82,000 at March 31, 2013.

Interest Rate Risk Management - Derivative Instruments
The following table presents the fair values of derivative instruments as well as their classification on the consolidated balance sheets at March 31, 2013 and December 31, 2012.

	Balance Sheet Location	March 31, 2013		December 31, 2012	
		Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
		(In Thousands)			
Derivative designated as hedging instrument:					
Interest rate swap	Other Liabilities	$8,000	$(427)	$8,000	$(470)

Derivatives not designated as hedging instruments:					
Interest rate swap	Other Liabilities	15,000	(335)	15,000	(379)
Derivative loan commitments	Other Assets	8,991	127	7,844	10
Forward loan sale commitments	Other Assets	6,210	82	5,919	3

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NOTE 10. ACQUISITION OF NEWPORT BANCORP, INC.

On March 5, 2013, the Company entered into a definitive merger agreement to acquire Newport Bancorp, Inc. Under the terms of the merger agreement, the shareholders of Newport Bancorp will have the right to elect to receive either $17.55 in cash or 1.5129 shares of SI Financial Group's common stock in exchange for each share of Newport Bancorp held by them, subject to proration and allocation procedures so that 50% of the outstanding shares of Newport Bancorp common stock is converted into Company common stock and the balance is converted into the cash consideration. The acquisition will add approximately $430.6 million in assets, $356.1 million in loans and $281.5 million in deposits before acquisition accounting adjustments, as well as six full-service banking offices. The Company incurred merger-related costs totaling $684,000 (pre-tax) during the quarter ended March 31, 2013. The Company anticipates the transaction will close in the third quarter of 2013, subject to shareholder and regulatory approvals.

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 is intended to assist in understanding changes in the Company's financial condition as of March 31, 2013 and December 31, 2012 and the results of operations for the three months ended March 31, 2013 and 2012. The information contained in this section should be read in conjunction with the consolidated financial statements and notes thereto appearing in Part I, Item 1 of this document as well as with management's discussion and analysis of financial condition and results of operations and consolidated financial statements included in the Company's 2012 Annual Report on Form 10-K.

This report may contain certain "forward-looking statements" within the meaning of the federal securities laws, which are made in good faith pursuant to the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are generally preceded by terms such as "expects," "believes," "anticipates," "intends," "estimates "projects" and similar expressions. These statements are not historical facts; rather, they are statements based on management's current expectations regarding our business strategies, intended results and future performance.

Management's ability to predict results or the effect of future plans or strategies is inherently uncertain. Factors that could have a material adverse effect on the operations of the Company and its subsidiaries include, but are not limited to, changes in interest rates, national and regional economic conditions, legislative and regulatory changes, monetary and fiscal policies of the United States government, including policies of the United States Treasury and the Federal Reserve Board, the quality and composition of the loan and investment portfolios, demand for loan products, deposit flows, competition, demand for financial services in the Company's market area, changes in real estate market values in the Company's market area and changes in relevant accounting principles and guidelines. Additional factors that may affect the Company's results are discussed in the Company's Annual Report on Form 10-K and in other reports filed with the Securities and Exchange Commission. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Except as required by applicable law or regulation, the Company does not undertake, and specifically disclaims any obligation, to release publicly the result of any revisions that may be made to any forward-looking statements to reflect events or circumstances after the date of the statements or to reflect the occurrence of anticipated or unanticipated events.

Critical Accounting Policies

The Company considers accounting policies involving significant judgments and assumptions by management that have, or could have, a material impact on the carrying value of certain assets or on income to be critical accounting policies. The Company considers the determination of allowance for loan losses, OTTI of securities, deferred income taxes and the impairment of long-lived assets to be its critical accounting policies. Additional information about the Company's accounting policies is included in the notes to the Company's consolidated financial statements contained in Part I, Item 1 of this document and in the Company's 2012 Annual Report on Form 10-K.

Impact of New Accounting Standards

Refer to Note 1 of the consolidated financial statements in this report for a discussion of recent accounting pronouncements.

Comparison of Financial Condition at March 31, 2013 and December 31, 2012

Assets:
Summary. Assets increased $3.9 million, or 0.4%, to $957.2 million at March 31, 2013 from $953.3 million at December 31, 2012, principally due to increases of $19.6 million in available for sale securities, offset by decreases of $13.4 million in net loans receivable and $2.4 million in cash and cash equivalents. Securities increased with the purchase of primarily mortgage-backed securities and government-sponsored enterprise securities.

Loans Receivable, Net. Net loans receivable decreased $13.4 million for the period ended March 31, 2013. Loan originations decreased $464,000 during the first quarter of 2013 compared to 2012 mainly due to declines in commercial mortgage loan originations of $22.5 million, offset by increases in commercial business and residential mortgage loan originations of $18.0 million and $3.3 million, respectively. Changes in the loan portfolio consisted of the following:

- Residential Real Estate. Residential mortgage loans comprised 33.6% of the total loan portfolio at March 31, 2013. The residential mortgage portfolio decreased $3.7 million, or 1.6%, primarily due to the sale of $13.3 million of fixed-rate residential mortgage loans, offset by the increase of $3.3 million in residential mortgage loan originations during the first quarter of 2013 over the comparable period in 2012.

- Multi-family and Commercial Real Estate. Multi-family and commercial real estate loans represented 28.7% of total loans at March 31, 2013 and decreased $8.1 million, or 4.0%, during the first quarter of 2013. Loan originations for multi-family and commercial real estate loans decreased $22.5 million during the first three months of 2013 compared to the same period in 2012.

- Construction. Construction loans, which include both residential and commercial construction loans, decreased $68,000 as a result of loans converting to permanent mortgage loans.

- Commercial Business. Commercial business loans represented 31.6% of total loans at March 31, 2013. Commercial business loans increased $374,000, or 0.2%, primarily due to an increase of $18.0 million in commercial business loan originations, which includes unfunded lines of credit, and the purchase of $3.5 million in SBA and USDA guaranteed loans, partially offset by the sale of $3.0 million of SBA and USDA guaranteed loans during the first quarter of 2013. Commercial business loans included growth in specialized products such as time share and condominium lending of $5.4 million and $318,000, respectively. At March 31, 2013, time share loans outstanding totaled $28.7 million and unfunded lines of credit related to time share lending totaled $14.3 million as a result of an experienced lender dedicated to identifying new opportunities for growth within the time share industry.

- Consumer. Consumer loans represented 5.7% of the Company's total loan portfolio at March 31, 2013. Consumer loans decreased $1.9 million during the first quarter of 2013. Indirect automobile loans, home equity loans and other consumer loans decreased $920,000, $781,000 and $177,000, respectively. Loan originations for consumer loans totaled $2.8 million, representing an increase of $695,000 for the three months ended March 31, 2013 from the comparable period in 2012.

The allowance for loan losses totaled $6.3 million at March 31, 2013 compared to $6.4 million at December 31, 2012. The ratio of the allowance for loan losses to total loans increased from 0.93% at December 31, 2012 to 0.94% at March 31, 2013.

The following table provides information with respect to nonperforming assets and troubled debt restructurings as of the dates indicated.

	March 31, 2013	December 31, 2012
	(Dollars in Thousands)	
Nonaccrual loans:		
Real estate loans:		
Residential - 1 to 4 family	$5,902	$4,988
Multi-family and commercial	2,314	1,758
Total real estate loans	8,216	6,746
Commercial business loans	423	542
Consumer loans:		
Home equity	295	366
Total nonaccrual loans	8,934	7,654
Accruing loans past due 90 days or more	—	—
Total nonperforming loans (1)	8,934	7,654
Other real estate owned, net (2)	999	1,293
Total nonperforming assets	9,933	8,947
Accruing troubled debt restructurings	2,245	3,826
Total nonperforming assets and troubled debt restructurings	$12,178	$12,773