CHICOPEE BANCORP, INC.
Form 10-K
March 14, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2013

OR

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

Commission File Number: 000-51996

CHICOPEE BANCORP, INC.
(Exact name of registrant as specified in its charter)

Massachusetts (State or other jurisdiction of incorporation or organization)	20-4840562 (I.R.S. Employer Identification No.)
70 Center Street, Chicopee, Massachusetts (Address of principal executive offices)	01013 (Zip Code)

Registrant's telephone number: (413) 594-6692

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, no par value	NASDAQ Global Market

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark whether the registrant is a well known seasoned issuer, as defined in Rule 405 of the Securities Act. YES___ NO X

Indicate by check mark whether the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES NO X

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES X NO ___

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ___

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “accelerated filer,” “large accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer [ ] Accelerated filer [X]
Non-accelerated filer [ ] Smaller reporting company [ ]
(Do not check if a smaller reporting company)

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

On June 30, 2013, the aggregate market value of the voting and non-voting common equity held by non-affiliates was $87,248,261.

The number of shares of Common Stock outstanding as of March 3, 2014 was 5,438,085.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for our Annual Meeting of Stockholders, to be held on May 28, 2014, are incorporated by reference in Part III of this Annual Report on Form 10-K.

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PART I

Item 1. Business.

General

Chicopee Bancorp, Inc. (the "Company" or "Chicopee Bancorp"), a Massachusetts corporation, was formed on March 14, 2006 by Chicopee Savings Bank (the "Bank" or "Chicopee Savings Bank") to become the holding company for the Bank upon completion of the Bank's conversion from a mutual savings bank to a stock savings bank. The conversion and the offering were completed on July 19, 2006.

The Bank, a Massachusetts stock savings bank, was organized in 1845 under the name Cabot Savings Bank and adopted its present name in 1854. The Bank is a full-service, community oriented financial institution offering products and services to individuals and businesses through nine offices located in Western Massachusetts. The Bank's deposits are insured by the Federal Deposit Insurance Corporation ("FDIC") and Depositor's Insurance Fund ("DIF") of Massachusetts. The Bank is also a member of the Federal Home Loan Bank of Boston ("FHLB") and is regulated by the FDIC and the Massachusetts Division of Banks. Chicopee Savings Bank's business consists primarily of making loans to its customers, including residential mortgages, commercial real estate loans, commercial loans and consumer loans, including home equity loans, and investing in a variety of investment securities. The Bank funds these lending and investment activities with deposits from the general public, funds generated from operations and borrowings. The Bank also sells residential one-to-four family real estate loans to the secondary market to reduce interest rate risk. The Bank's revenues are derived from the generation of interest and fees on loans, interest and dividends on investment securities, fees from its retail banking operation, and investment management. The Bank's primary sources of funds are deposits, principal and interest payments on loans and investments, advances from the FHLB and proceeds from loan sales. The Bank also provides access to insurance and investment products through its Financial Services Division.

Available Information

The Company's website is www.chicopeesavings.com. The Company makes available free of charge, on or through its website, its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after the Company electronically files such material with, or furnishes it to, the Securities and Exchange Commission. Information on the Company's website shall not be considered part of this Form 10-K.

Market Area

Chicopee Savings Bank is headquartered in Chicopee, Massachusetts. The Bank's primary lending and deposit market areas include Hampden and Hampshire Counties in Western Massachusetts. Chicopee is located at the "Crossroads of New England", the intersection of Interstate 91 and the Massachusetts Turnpike. Interstate 91 is the major north-south highway and Interstate 90 is the major east-west highway that crosses Massachusetts. The city is also bisected by several secondary highways, which include Routes 391, 116, 33 and 141. These roadways provide good access to major highways and centers of employment. Chicopee is located approximately 90 miles west of Boston, Massachusetts, 80 miles southeast of Albany, New York and 30 miles north of Hartford, Connecticut.

Chicopee is an urban community, which serves as the home of the Westover Air Force Base, which is the nation's largest Air Force Reserve Base and is a key part of the local economy. More than 2,700 military and civilian workers are assigned to Westover's 439th Military Airlift Wing. A diversified mix of industry groups also operate within

Hampden and Hampshire County, including manufacturing, health care, higher education, whole sale retail trade and service. The economy of our primary market area has benefited from the presence of large employers such as Baystate Health, Big Y Supermarkets, University of Massachusetts, Mass Mutual Financial Group, Hasbro Games, Peter Pan Bus Lines, Friendly's Ice Cream Corporation, Sisters of Providence Health Systems, Westover Air Force Base, Smith and Wesson, Yankee Candle and Verizon. Other employment and economic activity is provided by financial institutions, nine other colleges and universities, eight other hospitals, and a variety of wholesale and retail trade business. Our market also enjoys a strong tourism business with attractions such as the Eastern States Exposition called the Big E, the largest fair in the northeast, the Basketball Hall of Fame and Six Flags New England.

Competition

We face significant competition in attracting deposits and loans. Our most direct competition for deposits has historically come from the several financial institutions and credit unions operating in our market area and, to a lesser extent, from other financial service companies such as brokerage firms and insurance companies. We also face competition for depositors' funds from money market funds, mutual funds and other corporate and government securities. At June 30, 2013, which is the most recent date for which data is available from the FDIC, we held approximately 4.89% of the deposits in Hampden County, which was the 8th largest market share out of the 20 banks and thrifts with offices in Hampden County. This data does not include deposits held by one of our primary competitors, credit unions, which, as tax-exempt organizations, are able to offer higher rates on deposits than banks. There are 16 credit unions headquartered in Hampden County, some of the larger of which are headquartered in Chicopee, Massachusetts. In addition, banks owned by large super-regional bank holding companies such as Bank of America Corporation, Santander Bank, N.A., Citizens Financial Group, First Niagara Financial Group, Inc., and TD Bank, Inc. also operate in our market area. These institutions are significantly larger than us and, therefore, have greater resources.

Our competition for loans comes primarily from financial institutions in our market areas, and, to a lesser extent, from other financial service providers such as mortgage companies and mortgage brokers. Competition for loans also comes from the increasing number of non-depository financial service companies entering the mortgage market such as insurance companies, securities companies and specialty finance companies.

We expect competition to increase in the future as a result of legislative, regulatory and technological changes and the continuing trend of consolidation in the financial services industry. Technological advances, for example, have lowered the barriers to market entry, allowed banks and other lenders to expand their geographic reach by providing services over the Internet and made it possible for non-depository institutions to offer products and services that traditionally have been provided by banks. Changes in federal laws permit affiliation among banks, securities firms and insurance companies, which promotes a competitive environment in the financial services industry. Competition for deposits and the origination of loans could limit our future growth.

Lending Activities

General. The Company's loan portfolio totaled $489.3 million at December 31, 2013 compared to $468.7 million at December 31, 2012, representing 83.3% and 78.1% of total assets, respectively. In its lending activity, the Company originates one-to-four family real estate loans, commercial real estate loans, residential and commercial construction loans, commercial and industrial loans, home equity lines-of-credit, fixed rate home equity loans and other consumer loans. The Company does not originate loans that generally target borrowers with weakened credit histories typically characterized by payment delinquencies, previous charge-offs, judgments, bankruptcies, or borrowers with questionable repayment capacity as evidenced by low credit scores or high debt-burden ratios. While the Company makes loans throughout Massachusetts, most of its lending activities are concentrated in Hampden and Hampshire counties. Loans originated totaled $187.6 million in fiscal year 2013 and $164.7 million in 2012, including residential mortgage loans sold to the secondary market of $26.3 million and $24.4 million, respectively. Servicing rights are retained on all loans originated and sold into the secondary market.

Residential Real Estate Loans. At December 31, 2013 and 2012, the residential real estate loan portfolio totaled $112.5 million and $120.3 million, or 23.0% and 25.7% of the total loan portfolio, with an average yield of 5.06% and 5.48%, respectively. Residential real estate loans originated totaled $53.0 million and $48.8 million in 2013 and 2012, respectively, including loans sold to the secondary market. Of the residential real estate loans outstanding at December 31, 2013, $98.3 million, or 87.4%, were adjustable rate loans. Total loans serviced for others as of December 31, 2013 and 2012 were $97.6 million and $87.1 million, respectively. Residential real estate loans enable

borrowers to purchase or refinance existing homes, most of which serve as the primary residence of the owner. We offer fixed-rate and adjustable-rate loans with terms up to 30 years. Borrower demand for adjustable-rate loans versus fixed-rate loans is a function of the level of interest rates, the expectations of changes in the level of interest rates, and the difference between the interest rates and loan fees offered for fixed-rate mortgage loans and the initial period interest rates and loan fees for adjustable-rate loans. The relative amount of fixed-rate mortgage loans and adjustable-rate mortgage loans that can be originated at any time is largely determined by the demand for each in a competitive environment. The loan fees, interest rates and other provisions of mortgage loans are determined by the demand for each in a competitive environment.

We offer fixed-rate residential real estate loans secured by one-to-four family residences with terms between 10 and 30 years. Management establishes the loan interest rates based on market conditions. Interest rates and payments on our adjustable-rate mortgage loans generally adjust annually after an initial fixed period that ranges from one to ten years. Interest rates and payments on our adjustable-rate loans generally are adjusted to a rate typically equal to 3.50 percentage points above the one-year constant maturity Treasury index. The maximum amount by which the interest rate on our adjustable-rate mortgage loans may be increased or decreased is generally 2 percentage points per adjustment period and the lifetime interest rate cap is generally 6 percentage points over the initial interest rate of the loan. We also offer adjustable-rate mortgage loans that adjust every three years after an initial three-year fixed period and adjustable-rate mortgage loans that adjust every five years after an initial six-year fixed period. Interest rates and payments on these adjustable-rate loans generally are adjusted to a rate typically equal to 3.50 percentage points above the three- and five-year constant maturity Treasury index.

The largest owner-occupied residential real estate loan was $1.5 million and was performing according to its original terms as of December 31, 2013.

All adjustable-rate mortgage loans are underwritten taking the indexed rate into consideration at each adjustment period until the full cap is reached. A Mass Attorney General Important Disclosure (MA Chapter 93A-Determining Affordability of ARM Loans) is completed for each adjustable rate mortgage request, which calculates the overall debt to income based on the initial principal and interest payment along with real estate taxes, insurance, and other monthly payments due from the borrower and also includes the repricing of these payments at each adjustment up to the maximum caps allowed under the note. This process minimizes the risk of qualification at the time the loan reaches the maximum rate for that product.

Adjustable rate mortgage loans help decrease the risk associated with changes in market interest rates by periodically repricing. However, upward adjustment of interest rates is limited by the maximum periodic and lifetime interest rate adjustments permitted by our loan documents. In addition, adjustable rate mortgage loans may increase credit risk because, as interest rates increase, interest payments on adjustable rate loans increase, which increases the potential for defaults by our borrowers. See “Loan Underwriting Risks” below.

While one-to-four-family residential real estate loans are normally originated with up to 30-year terms, such loans typically remain outstanding for substantially shorter periods because borrowers often prepay their loans in full upon sale of the property pledged as security or upon refinancing the original loan. Therefore, average loan maturity is a function of, among other factors, the level of purchase and sale activity in the real estate market, prevailing interest rates and the interest rates payable on outstanding loans.
We generally do not make conventional loans with loan-to-value ratios exceeding 95% at the time the loan is originated. Conventional loans with loan-to-value ratios in excess of 80% generally require private mortgage insurance or additional collateral. We require all properties securing mortgage loans to be appraised by a board-approved independent appraiser. We generally require title insurance on all first mortgage loans. Borrowers must obtain hazard insurance, and flood insurance for loans on properties located in a flood zone, before closing the loan.

In an effort to provide financing for first-time home buyers, we offer 30-year fixed-rate residential mortgage loans and 10/1 adjustable rate mortgage loans with loan-to-value ratios up to 97%. We offer mortgage loans through this program to qualified individuals and originate the loans using underwriting guidelines as set forth by the Company.

Commercial Real Estate Loans. At December 31, 2013 and 2012, commercial real estate loans totaled $211.2 million and $189.5 million, or 43.1% and 40.4% of the total loan portfolio, with an average yield of 4.64% and 4.97%, respectively. This yield calculation includes commercial construction and residential investment loan balances and interest income. Our commercial real estate and residential investment loans are generally secured by apartment

buildings and properties used for business purposes such as office buildings, industrial facilities and retail facilities. In addition to originating these loans, we also participate in loans with other financial institutions located primarily in Massachusetts.

We originate a variety of fixed- and adjustable-rate commercial real estate and residential investment loans for terms up to 20 years. Interest rates and payments on our adjustable-rate loans adjust every one to ten years and generally are adjusted to a rate equal to 2.0% to 3.0% above the corresponding U.S. Treasury rate or FHLB rate. Most of our adjustable-rate commercial real estate and residential investment loans adjust every five years. There are no adjustment period or lifetime interest rate caps. Loan amounts generally do not exceed 80% of the property's appraised value at the time the loan is originated.

At December 31, 2013, our largest commercial real estate loan was $8.5 million and was secured by a retail building in Uxbridge, Massachusetts. This loan was performing according to the original terms at December 31, 2013.

At December 31, 2013, our exposure to commercial real estate and commercial business loan participations purchased and sold totaled $18.9 million and $19.3 million, respectively. The properties securing these loans are located primarily in Massachusetts.

We also originate land loans primarily to local contractors and developers for making improvements on approved building lots. Such loans are generally written with a maximum 75% loan-to-value ratio based upon the appraised value or purchase price, whichever is less, for a term of up to three years. Interest rates on our land loans are fixed for three years. At December 31, 2013, we had eight land loans totaling $358,000.

Construction Loans. At December 31, 2013 and 2012, the Company had $44.6 million and $40.1 million of construction loans outstanding, representing 9.2% and 8.5% of the total loan portfolio, with an average yield of 4.47% and 4.85%, respectively. We originate fixed-rate and adjustable-rate loans to individuals and builders to finance the construction of residential dwellings. We also make construction loans for commercial development projects, including apartment buildings, condominiums, small industrial buildings and retail and office buildings. Our construction loans generally provide for the payment of interest only during the construction phase, which is usually 12 to 36 months. At the end of the construction phase, the loan generally converts to a permanent mortgage loan. Loans generally can be made with a maximum loan to value ratio of 80% at the time the loan is originated. Before making a commitment to fund a construction loan, we require an appraisal of the property by an independent licensed appraiser. We also will require an inspection of the property before disbursement of funds during the term of the construction loan.

At December 31, 2013, our largest outstanding residential construction loan was $1.1 million, of which $530,000 was outstanding. At December 31, 2013, our largest outstanding commercial construction loan was $8.8 million, of which $7.7 million was outstanding for the development of an office building. These loans were performing in accordance with their original terms at December 31, 2013.

Commercial and Industrial Loans. The Company originated $38.2 million and $41.0 million in commercial and industrial loans in 2013 and 2012, respectively. As of December 31, 2013 and 2012, the Company had $86.5 million and $84.6 million in commercial and industrial loans, representing 17.7% and 18.0% of the total loan portfolio, with an average yield of 4.23% and 4.31%, respectively. We make commercial business loans primarily in our market area to a variety of professionals, sole proprietorships and small businesses. Commercial lending products include term loans, revolving lines of credit and letters of credit loans. Commercial loans and lines of credit are made with either variable or fixed rates of interest. Variable rates are based on the prime rate as published in The Wall Street Journal, plus a margin. Fixed-rate business loans are generally indexed to a corresponding U.S. Treasury rate, plus margin, or FHLB, plus margin. The Company generally does not make unsecured commercial and industrial loans.

When making commercial and industrial loans, we consider the financial statements of the borrower, our lending history with the borrower, the debt service capabilities of the borrower, the projected cash flows of the business and the value of the collateral, primarily accounts receivable, inventory and equipment, and are supported by personal guarantees. Depending on the collateral used to secure the loans, commercial loans are made in amounts of up to 80% of the value of the collateral securing the loan. The collateral securing commercial and industrial loans may depreciate over time, may be difficult to appraise and may fluctuate in value. See “Loan Underwriting Risks” below.

At December 31, 2013, our largest commercial term loan was a $2.0 million loan secured by real estate located in East Longmeadow, Massachusetts, including all assets of the borrower. The loan was performing according to its original terms at December 31, 2013. Our largest lending exposure was a $14.7 million commercial lending relationship, of which $13.7 million was outstanding at December 31, 2013. The relationship consists of three separate entities each providing independent cash flow and were secured by the assets of the borrower, including all assets and commercial real estate. The loans were performing in accordance with their original terms at December 31, 2013.

Consumer Loans. The Company originated $8.9 million and $12.9 million of consumer loans in 2013 and 2012, respectively. At December 31, 2013 and 2012, consumer loans outstanding totaled $34.5 million and $34.2 million, or 7.1% and 7.3% of the total loan portfolio, with an average yield of 3.82% and 4.09%, respectively. We offer a variety of consumer loans, primarily home equity loans and lines of credit, and, to a much lesser extent, loans secured by automobiles and recreational vehicles and pools and spas and home improvement loans.

The procedures for underwriting consumer loans include an assessment of the applicant's payment history on other debts and ability to meet existing obligations and payments on the proposed loan. Although the applicant's creditworthiness is a primary consideration, the underwriting process also includes a comparison of the value of the collateral, if any, to the proposed loan amount.

We generally offer home equity loans with a maximum combined loan to value ratio of 80% and home equity lines of credit with a maximum combined loan to value ratio of 80%. Home equity lines of credit have adjustable rates of interest that are indexed to the prime rate as reported in The Wall Street Journal. Home equity loans have fixed interest rates and terms that range from five to twenty years.

We offer automobile and recreational vehicle loans secured by new and used vehicles. These loans have fixed interest rates and generally have terms up to six years for new automobiles, five years for used automobiles and four years for recreational vehicles. We also offer fixed-rate pool and spa loans up to $10,000 for terms up to five years.

Loan Underwriting Risks

Adjustable-Rate Loans. While we anticipate adjustable-rate loans will better offset the potential adverse effects of an increase in interest rates as compared to fixed-rate mortgages, the increased mortgage payments required of adjustable-rate loan borrowers in a rising interest rate environment could cause an increase in delinquencies and defaults. The marketability of the underlying property also may be adversely affected in a high interest rate environment. In addition, although adjustable-rate mortgage loans help make our loan portfolio more responsive to changes in interest rates, the extent of this interest sensitivity is limited by the annual and lifetime interest rate adjustment limits.

Commercial Real Estate. Loans secured by commercial real estate and residential investment real estate generally have larger balances and involve a greater degree of risk than one-to four-family residential mortgage loans. Of primary concern in commercial real estate and residential investment lending is the borrower’s creditworthiness and the feasibility and cash flow potential of the project. Payments on loans secured by income properties often depend on successful operation and management of the properties. As a result, repayment of such loans may be subject to a greater extent than residential real estate loans to adverse conditions in the real estate market or the economy. To monitor cash flows on income properties, we generally require borrowers and loan guarantors, if any, to provide annual financial statements and/or tax returns on commercial real estate and residential investment loans. In reaching a decision on whether to make a commercial real estate and residential investment loan, we consider the net operating income of the property, the borrower’s expertise, credit history and profitability and the value of the underlying property. We have generally required that the properties securing these real estate loans have debt service coverage ratios (the ratio of earnings before debt service to debt service) of at least 1.20x; however, this ratio can be lower depending on the amount and type of collateral. Environmental surveys and inspections are obtained when circumstances suggest the possibility of the presence of hazardous materials.

We underwrite all loan participations to our own underwriting standards. In addition, we also consider the financial strength and reputation of the lead lender. To monitor cash flows on loan participations, we require the lead lender to provide annual financial statements for the borrower. Generally, we also conduct an annual internal loan review for loan participations.

Construction Loans. Construction financing is generally considered to involve a higher degree of risk of loss than long-term financing on improved, occupied real estate. Risk of loss on a construction loan depends largely upon the accuracy of the initial estimate of the property’s value at completion of construction and the estimated cost (including interest) of construction. During the construction phase, a number of factors could result in delays and cost overruns. If the estimate of construction costs proves to be inaccurate, we may be required to advance funds beyond the amount originally committed to permit completion of the building. If the estimate of value proves to be inaccurate, we may be confronted, at or before the maturity of the loan, with a building having a value which is insufficient to assure full repayment. If we are forced to foreclose on a building before or at completion due to a default, there can be no assurance that we will be able to recover all of the unpaid balance of, and accrued interest on, the loan as well as

related foreclosure and holding costs.

Commercial and Industrial Loans. Unlike residential mortgage loans, which generally are made on the basis of the borrower's ability to make repayment from his or her employment or other income, and which are secured by real property the value of which tends to be more easily ascertainable, commercial and industrial loans are of higher risk and typically are made on the basis of the borrower's ability to make repayment from the cash flow of the borrower's business. As a result, the availability of funds for the repayment of commercial and industrial loans may depend substantially on the success of the business itself. Further, any collateral securing such loans may depreciate over time, may be difficult to appraise and may fluctuate in value.

Consumer Loans. Consumer loans may entail greater risk than do residential mortgage loans, particularly in the case of consumer loans that are unsecured or secured by assets that depreciate rapidly. In such cases, repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment for the outstanding loan and the remaining deficiency often does not warrant further substantial collection efforts against the borrower. In addition, 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. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount that can be recovered on such loans.

Loan Originations, Purchases, and Sales. Loan originations come from a number of sources. The primary sources of loan originations are existing customers, walk-in traffic, advertising and referrals from customers. We advertise on television, on the radio and in newspapers that are widely circulated in Hampden and Hampshire Counties, both in Massachusetts. Accordingly, because our rates are competitive, we attract loans from throughout Hampden and Hampshire Counties. We occasionally purchase participation interests in loans to supplement our origination efforts.

We generally originate loans for our portfolio; however, we generally sell, prior to funding, to the secondary market all newly originated conforming fixed-rate, 10- to 30-year one-to-four-family residential real estate loans. Our decision to sell loans is based on prevailing market interest rate conditions and interest rate risk management. Generally, loans are sold to Freddie Mac with loan servicing retained. In addition, we sell participation interests in commercial real estate loans to local financial institutions, primarily on the portion of loans that exceed our borrowing limits.

Loan Approval Procedures and Authority. Our lending activities follow written, non-discriminatory, underwriting standards and loan origination procedures established by our board of directors and management. Our Board of Directors has granted loan approval authority to certain officers up to prescribed limits, depending on the officer’s experience, the type of loan and whether the loan is secured or unsecured. Loans in excess of the Senior Lending Officer limits ($500,000 for real estate loans, secured consumer loans, and secured and unsecured commercial loans; and $100,000 for unsecured consumer loans.) must be authorized by the President and the Executive Vice President of Lending up to 1.5 times the Senior Lending Officer lending limits. All other extensions of credit exceeding such limitations require the approval of the executive committee, a committee of the Board of Directors of the Bank.

Loans to One Borrower. The maximum amount that we may lend to one borrower and the borrower’s related entities generally is limited, by statute, to 20% of our stated capital and reserves. At December 31, 2013, our general regulatory limit on loans to one borrower was $17.0 million. At December 31, 2013, our internal lending limit to one borrower was $8.0 million, unless approved in excess of this amount by the executive committee of the Board of Directors. Our largest lending exposure was a $14.7 million commercial lending relationship, of which $13.7 million was outstanding at December 31, 2013. The relationship consists of three separate entities each providing independent cash flow and were secured by the assets of the borrower, including all assets and commercial real estate. The loans were performing in accordance with their original terms at December 31, 2013.

Loan Commitments. We issue commitments for fixed- and adjustable-rate mortgage loans conditioned upon the occurrence of certain events. Commitments to originate mortgage loans are legally binding agreements to lend to our customers. Generally, our mortgage loan commitments expire after 30 days.

Investment Activities

We have legal authority to invest in various types of liquid assets, including U.S. Treasury obligations, securities of various government sponsored enterprises and municipal governments, deposits at the FHLB and certificates of deposit of federally insured institutions. We are also required to maintain an investment in FHLB stock. While we have the authority under applicable law to invest in derivative securities, our investment policy does not permit us to do so and we had no investments in derivative securities at December 31, 2013.

At December 31, 2013, our investment portfolio consisted primarily of short-term U.S Treasury securities, investment-grade tax-exempt industrial revenue bonds, certificates of deposit, collateralized mortgage obligations, and investment-grade marketable equity securities.

Our investment objectives are to provide and maintain liquidity, to establish an acceptable level of interest rate and credit risk, to provide an alternate source of low-risk investments when demand for loans is weak and to generate a favorable return. The Board of Directors of the Bank has the overall responsibility for approval of our investment policy. The Treasurer is responsible for the implementation of the investment policy. Individual investment transactions are reviewed and approved by our executive committee monthly while portfolio composition and performance are reviewed at least annually by the Board of Directors of the Bank.
Our Chief Financial Officer and Treasurer is responsible for ensuring that the investment policy is followed and that all securities are considered prudent for investment.

Deposit Activities and Other Sources of Funds

General. Deposits, borrowings and loan repayments are the major sources of our funds for lending and other investment purposes. Loan repayments are a relatively stable source of funds, while deposit inflows and outflows and loan prepayments are significantly influenced by general interest rates and money market conditions.

Deposits. Substantially all of our depositors are residents of the Commonwealth of Massachusetts. Deposits are attracted, by advertising and through our website, from within our market areas through the offering of a broad selection of deposit instruments, including non-interest-bearing demand accounts (such as checking accounts), interest-bearing accounts (such as NOW and money market deposit accounts), regular savings accounts (such as passbook accounts) and certificates of deposit. At December 31, 2013, $18.2 million, or 4.1% of our total deposits were municipal deposits, consisting of five individual municipalities, with an average life of 14.9 years. At December 31, 2013, we did not utilize brokered deposits. Deposit account terms vary according to the minimum balance required, the time periods the funds must remain on deposit and the interest rate, among other factors. In determining the terms of our deposit accounts, we consider the rates offered by our competition, our liquidity needs, profitability to us, matching deposit and loan products and customer preferences and concerns. We generally review our deposit mix and pricing weekly. Our current strategy is to offer competitive rates and price the deposit products depending on our needs for funds and rates on borrowings. Deposit accounts at the Bank are insured by the Deposit Insurance Fund of the FDIC, generally up to a maximum of $250,000 for each separately insured depositor and up to a maximum of $250,000 for self-directed retirement accounts. In addition, as a Massachusetts-chartered savings bank, Chicopee Savings Bank is required to be a member of the Massachusetts Depositors Insurance Fund (“DIF”), a corporation that insures savings bank deposits in excess of federal deposit insurance coverage. The combination of FDIC and DIF insurance provides customers of Massachusetts-chartered savings banks with full deposit insurance on all their deposits.

Borrowed Funds. We may utilize advances from the FHLB to supplement our supply of investable funds. The FHLB functions as a central reserve bank providing credit for its member financial institutions. As a member, we are required to own capital stock in the FHLB and are authorized to apply for advances on the security of such stock and certain of our whole first real estate loans and other assets (principally securities which are obligations of, or guaranteed by, the United States), provided certain standards related to creditworthiness have been met. Advances are made under several different programs, each having its own interest rate and range of maturities. Depending on the program, limitations on the amount of advances are based either on a fixed percentage of an institution’s net worth or on the FHLB’s assessment of the institution’s creditworthiness.

Securities sold under agreements to repurchase are customer deposits that are invested overnight in U.S. Treasury securities. The customers, predominantly commercial customers, set a predetermined balance and deposits in excess of that amount are transferred into the repurchase account from each customer’s checking account. These types of accounts are often referred to as sweep accounts.

Financial Services

We have a partnership with a third-party registered broker-dealer, Linsco/Private Ledger ("LPL"). Through LPL, we offer customers a range of non-deposit investment products, including mutual funds, debt, equity and government securities, retirement accounts, insurance products and fixed and variable annuities. We receive a portion of the commissions generated by LPL from sales to customers. For the years ended December 31, 2013, 2012 and 2011, we received fees of $320,000, $312,000 and $232,000, respectively, through our relationship with LPL.

Subsidiary Activities

Chicopee Bancorp, Inc. conducts its principal business activities through its two wholly-owned subsidiaries: Chicopee Savings Bank and Chicopee Funding Corporation.

Chicopee Funding Corporation. Chicopee Funding Corporation was incorporated in Massachusetts in 2006. Chicopee Bancorp, Inc. contributed funds to Chicopee Funding Corporation to enable it to make a 20-year loan to the employee stock ownership plan to allow it to purchase shares of the Company's common stock as part of the initial public offering. The Employee Stock Ownership Plan purchased 595,149 shares in the initial public offering, or 8% of the 7,439,368 shares issued in connection with the Bank's mutual-to-stock conversion.

The following are descriptions of Chicopee Savings Bank's wholly-owned subsidiaries:

CSB Colts, Inc. CSB Colts, Inc. was formed in 2003 as a Massachusetts corporation to engage in buying, selling and holding securities on its own behalf. At December 31, 2013, CSB Colts had total assets of $37.6 million consisting primarily of tax-exempt industrial revenue bonds. CSB Colts' net income for the year ended December 31, 2013 was $1.5 million. As a Massachusetts securities corporation, the income earned on CSB Colts' investment securities is subject to a lower state tax rate than that assessed on income earned on investment securities maintained at Chicopee Savings Bank.

CSB Investment Corp. CSB Investment Corp. was formed in 2003 as a Massachusetts corporation to engage in buying, selling and holding securities on its own behalf. At December 31, 2013, CSB Investment had total assets of $1.0 million consisting primarily of certificates of deposit, U.S. Treasury securities, collateralized mortgage obligations, and marketable equity securities. CSB Investment's net income for the year ended December 31, 2013 was $86,000. As a Massachusetts securities corporation, the income earned on CSB Investment's investment securities is subject to a lower state tax rate than that assessed on income earned on investment securities maintained at Chicopee Savings Bank.

Cabot Realty L.L.C. Cabot Realty L.L.C. was formed as a Massachusetts limited liability company to hold other real estate owned ("OREO"). At December 31, 2013, Cabot Realty had total assets of $459,000 consisting primarily of cash and cash equivalents of $46,000 and OREO of $407,000. Cabot Realty's net loss for the year ended December 31, 2013 was $248,000. Cabot Management Corporation, a wholly owned subsidiary of Chicopee Savings Bank, has a 1% membership interest in, and Chicopee Savings Bank has a 99% membership interest in, Cabot Realty.

Cabot Management Corporation. Cabot Management Corporation was formed in 1979 as a Massachusetts corporation to acquire and manage interests in real property and to acquire, construct, rehabilitate, lease, finance and dispose of housing facilities. Cabot Management is currently inactive and at December 31, 2013 had total assets of $17,000.

Personnel

As of December 31, 2013, we had approximately 115 full-time employees and 24 part-time employees, none of whom is represented by a collective bargaining unit. We believe we have a good relationship with our employees.

Regulation and Supervision

General

Chicopee Savings Bank is a Massachusetts-chartered savings bank and the wholly-owned subsidiary of Chicopee Bancorp, Inc. ("Chicopee Bancorp"), a Maryland corporation. Chicopee Savings Bank's deposits are insured up to applicable limits by the Federal Deposit Insurance Corporation, or "FDIC", and by the Depositors Insurance Fund of Massachusetts for amounts in excess of the FDIC insurance limits. Chicopee Savings Bank is subject to extensive regulation by the Massachusetts Commissioner of Banks, as its chartering agency, and by the FDIC, its primary federal regulator and deposit insurer. Chicopee Savings Bank is required to file reports with, and is periodically examined by, the FDIC and the Massachusetts Commissioner of Banks concerning its activities and financial condition and must obtain regulatory approvals prior to entering into certain transactions, including, but not limited to, mergers with or acquisitions of other financial institutions. As a registered bank holding company, Chicopee Bancorp is regulated by the Board of Governors of the Federal Reserve System, or the "Federal Reserve Board."

The regulatory and supervisory structure establishes a comprehensive framework of activities in which an institution can engage and is intended primarily for the protection of depositors and the deposit insurance funds, rather than for

the protection of stockholders and creditors. The regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies concerning the establishment of deposit insurance assessment fees, classification of assets and establishment of adequate loan loss reserves for regulatory purposes. Any change in such regulatory requirements and policies, whether by the Massachusetts legislature, the Massachusetts Commissioner of Banks, the FDIC, the Federal Reserve Board or Congress, could have a material adverse impact on the financial condition and results of operations of Chicopee Bancorp and Chicopee Savings Bank. As is further described below, the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), has significantly changed the bank regulatory structure and may affect the lending, investment and general operating activities of depository institutions and their holding companies.

Set forth below is a summary of certain material statutory and regulatory requirements that are applicable to Chicopee Savings Bank and Chicopee Bancorp. This description of statutes and regulations is not intended to be a complete description of such statutes and regulations and their effects on Chicopee Savings Bank and Chicopee Bancorp.

The Dodd-Frank Act

The Dodd-Frank Act has significantly changed the bank regulatory structure and is affecting the lending and investment activities and general operations of depository institutions and their holding companies.

The Dodd-Frank Act required the Federal Reserve Board to establish minimum consolidated capital requirements for bank holding companies that are as stringent as those required for insured depository institutions; the components of Tier 1 capital would be restricted to capital instruments that are currently considered to be Tier 1 capital for insured depository institutions. In addition, the proceeds of trust preferred securities are excluded from Tier 1 capital unless such securities were issued prior to May 19, 2010 by bank or savings and loan holding companies with less than $15 billion of assets. The legislation also established a floor for capital of insured depository institutions that cannot be lower than the standards in effect on July 21, 2010, and directed the federal banking regulators to implement new leverage and capital requirements within 18 months of that date. The revised capital regulations are effective January 1, 2015.

The Dodd-Frank Act also created a new Consumer Financial Protection Bureau with extensive powers to implement and enforce consumer protection laws. The Consumer Financial Protection Bureau has broad rulemaking authority for a wide range of consumer protection laws that apply to all banks and savings associations, among other things, including the authority to prohibit “unfair, deceptive or abusive” acts and practices. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks and savings associations with more than $10 billion in assets. Banks and savings associations with $10 billion or less in assets will continue to be examined for compliance with federal consumer protection and fair lending laws by their applicable primary federal bank regulators. The new legislation also weakens the federal preemption available for national banks and federal savings associations and gives state attorneys general certain authority to enforce applicable federal consumer protection laws.

The Dodd Frank Act also broadened the base for FDIC insurance assessments. The FDIC was required to promulgate rules revising its assessment system so that it is based on the average consolidated total assets less tangible equity capital of an insured institution instead of deposits. That rule took effect April 1, 2011. The Dodd-Frank Act also permanently increased the maximum amount of deposit insurance for banks, savings institutions and credit unions to $250,000 per depositor, retroactive to January 1, 2008, and provided non-interest bearing transaction accounts with unlimited deposit insurance through December 31, 2012.

The Dodd-Frank Act requires companies to give stockholders a non-binding vote on executive compensation and so-called “golden parachute” payments. The legislation also directed the Federal Reserve Board to promulgate rules prohibiting excessive compensation paid to bank holding company executives, regardless of whether the company is publicly traded.

The Dodd-Frank Act made many other changes in banking regulation. These include authorizing depository institutions, for the first time, to pay interest on business checking accounts, mandating that regulation be issued requiring originators of securitized loans to retain a percentage of the risk for transferred loans and establishing regulatory rate-setting for certain debit card interchange fees and establishing a number of reforms for mortgage originations.

The Dodd-Frank Act contained the so-called “Volcker Rule,” which generally prohibits banking organizations from engaging in proprietary trading and from investing in, sponsoring or having certain relationships with hedge or private equity funds (“covered funds”). On December 13, 2013, federal agencies issued a final rule implementing the Volcker Rule which, among other things, requires banking organizations to restructure and limit certain of their investments in

and relationships with covered funds. The final rule unexpectedly included within the interests subject to its restrictions collateralized debt obligations backed by trust-preferred securities (“TRUPs CDOs”). Many banking organizations had purchased such instruments because of their favorable tax, accounting and regulatory treatment and would have been subject to unexpected write-downs. In response to concerns expressed by community banking organizations, the federal agencies subsequently issued an interim final rule which grandfathers TRUPS CDOs issued before May 19, 2010 if (i) acquired by a banking organization on or before December 10, 2013 and (ii) the organization reasonably believed the proceeds from the TRUPS CDOs were invested primarily in any trust preferred security or subordinated debt instrument issued by a depository institution holding company with less than $15 billion in assets or by a mutual holding company. In addition, the Consumer Financial Protection Bureau has finalized the rule implementing the “Ability to Pay” requirements of the Dodd-Frank Act. The regulations generally require lenders to make a reasonable, good faith determination as to a potential borrower’s ability to repay a residential mortgage loan. The final rule establishes a safe harbor for certain “Qualified Mortgages,” which contain certain features and terms deemed to make the loan less risky. The Ability to Repay final rules were effective January 10, 2014.

Many of the provisions of the Dodd-Frank Act were subject to delayed effective dates and the legislation required various federal agencies to promulgate numerous and extensive implementing regulations over a period over years. It is therefore difficult to predict at this time what the full impact the new legislation and implementing regulations will have on community banks such as Chicopee Savings Bank. Although the substance and scope of many of these regulations cannot be determined at this time, it is expected that the legislation and implementing regulations, particularly those provisions relating to the new Consumer Financial Protection Bureau, may increase operating and compliance costs.

Massachusetts Banking Laws and Supervision

General. As a Massachusetts-chartered stock savings bank, Chicopee Savings Bank is subject to supervision, regulation and examination by the Massachusetts Commissioner of Banks and to various Massachusetts statutes and regulations which govern, among other things, investment powers, lending and deposit-taking activities, borrowings, maintenance of surplus and reserve accounts, distribution of earnings and payment of dividends. In addition, Chicopee Savings Bank is subject to Massachusetts consumer protection and civil rights laws and regulations. The approval of the Massachusetts Commissioner of Banks or the Massachusetts Board of Bank Incorporation is required for a Massachusetts-chartered bank to establish or close branches, merge with other financial institutions, issue stock and undertake certain other activities.

Massachusetts regulations generally allow Massachusetts banks to, with appropriate regulatory approvals, engage in activities permissible for federally chartered banks or banks chartered by another state. The Commissioner also has adopted procedures reducing regulatory burdens and expense and expediting branching by well-capitalized and well-managed banks.

Dividends. A Massachusetts stock bank may declare cash dividends from net profits not more frequently than quarterly. Non-cash dividends may be declared at any time. No dividends may be declared, credited or paid if the bank’s capital stock is impaired. The approval of the Massachusetts Commissioner of Banks is required if the total of all dividends declared in any calendar year exceeds the total of its net profits for that year combined with its retained net profits of the preceding two years. Dividends from The Company may depend, in part, upon receipt of dividends from Chicopee Savings Bank. The payment of dividends from Chicopee Savings Bank would be restricted by federal law if the payment of such dividends resulted in Chicopee Savings Bank failing to meet regulatory capital requirements.

During 2013, a total of $2.5 million in dividends were declared from the Bank to the Company. The Bank paid the dividends in January 2013. During 2012, a total of $1.6 million in dividends were declared from the Bank to the Company. The Bank paid the dividends in June and December 2012. During 2013 and 2012, a total of $660,000 and $2.0 million, respectively, in dividends were declared from Chicopee Funding Corporation ("CFC") to the Company, respectively. CFC paid the dividends in December 2013 and June and December 2012.

During 2013, a total of $1.0 million in cash dividends was paid to the Company's stockholders. No other dividends have been paid by the Company during 2013. There were no cash dividends paid to the Company's stockholders during 2012.

Loans to One Borrower Limitations. Massachusetts banking law grants broad lending authority. However, with certain limited exceptions, total obligations to one borrower may not exceed 20 percent of the total of the bank’s capital, surplus and undivided profits.

Loans to a Bank’s Insiders. Massachusetts banking laws prohibit any executive officer or director of a savings bank from borrowing or guaranteeing extensions of credit by such savings bank except for any of the following loans or extensions of credit with the approval of a majority of the Board of Directors: (i) loans or extensions of credit, secured or unsecured, to an officer of the savings bank in an amount not exceeding $100,000; (ii) loans or extensions of credit intended or secured for educational purposes to an officer of the bank in an amount not exceeding $200,000; (iii) loans or extensions of credit secured by a mortgage on residential real estate to be occupied in whole or in part by the officer

to whom the loan or extension of credit is made, in an amount not exceeding $750,000; and (iv) loans or extensions of credit to a director of the savings bank who is not also an officer of the savings bank in an amount permissible under the savings bank's loan to one borrower limit. No such loan or extension of credit may be granted with an interest rate or other terms that are preferential in comparison to loans granted to persons not affiliated with the savings bank.

Investment Activities. In general, Massachusetts-chartered savings banks may invest in preferred and common stock of any corporation organized under the laws of the United States or any state provided such investments do not involve control of any corporation and do not, in the aggregate, exceed 4% of the bank's deposits. Federal law imposes additional restrictions on Chicopee Savings Bank's investment activities. See "-Federal Regulations-Business and Investment Activities".

Regulatory Enforcement Authority. Any Massachusetts savings bank that does not operate in accordance with the regulations, policies and directives of the Massachusetts Commissioner of Banks may be subject to sanctions for non-compliance, including revocation of its charter. The Massachusetts Commissioner of Banks may, under certain circumstances, suspend or remove officers or directors who have violated the law, conducted the bank's business in an unsafe or unsound manner or contrary to the depositors interests or been negligent in the performance of their duties. Upon finding that a bank has engaged in an unfair or deceptive act or practice, the Massachusetts Commissioner of Banks may issue an order to cease and desist and impose a fine on the bank concerned. The Commissioner also has authority to take possession of a bank and appoint a liquidating agent under certain conditions such as an unsafe and unsound condition to transact business, the conduct of business in an unsafe or unauthorized manner of impaired capital. In addition, Massachusetts consumer protection and civil rights statutes applicable to Chicopee Savings Bank permit private individual and class action law suits and provide for the rescission of consumer transactions, including loans, and the recovery of statutory and punitive damage and attorney's fees in the case of certain violations of those statutes.

Depositors Insurance Fund. All Massachusetts-chartered savings banks are required to be members of the Depositors Insurance Fund, a corporation that insures savings bank deposits in excess of federal deposit insurance coverage. The Depositors Insurance Fund is authorized to charge savings banks an annual assessment fee on deposit balances in excess of amounts insured by the FDIC. Assessment rates are based on the institution's risk category, similar to the method currently used to determine assessments by the FDIC discussed below under "-Federal Regulations-Insurance of Deposit Accounts."

Protection of Personal Information. Massachusetts has adopted regulatory requirements intended to protect personal information. These requirements, which became effective March 1, 2010, are similar to existing federal laws such as the Gramm-Leach-Bliley Act, discussed below under "-Federal Regulations-Privacy Regulations", that require organizations to establish written information security programs to prevent identity theft. The Massachusetts regulation also contains technology system requirements, especially for the encryption of personal information sent over wireless or public networks or stored on portable devices.

Massachusetts has other statutes or regulations that are similar to certain of the federal provisions discussed below.

Federal Regulations

Capital Requirements. Under the FDIC's regulations, federally insured state-chartered banks that are not members of the Federal Reserve System ("state non-member banks"), such as Chicopee Savings Bank, are required to comply with minimum leverage capital requirements. For an institution not anticipating or experiencing significant growth and deemed by the FDIC to be, in general, a strong banking organization rated composite 1 under Uniform Financial Institutions Ranking System, the minimum capital leverage requirement is a ratio of Tier 1 capital to total assets of 3.0%. For all other institutions, the minimum leverage capital ratio is not less than 4.0%. Tier 1 capital is the sum of common stockholder's equity, noncumulative perpetual preferred stock (including any related surplus) and minority investments in certain subsidiaries, less intangible assets (except for certain servicing rights and credit card relationships) and certain other specified items.

FDIC regulations also require state non-member banks to maintain certain ratios of regulatory capital to regulatory risk-weighted assets, or "risk-based capital ratios." Risk-based capital ratios are determined by allocating assets and specified off-balance sheet items to four risk-weighted categories ranging from 0.0% to 100.0%. State non-member banks must maintain a minimum ratio of total capital to risk-weighted assets of at least 8.0%, of which at least one-half must be Tier 1 capital. Total capital consists of Tier 1 capital plus Tier 2 or supplementary capital items, which include allowances for loan losses in an amount of up to 1.25% of risk-weighted assets, cumulative preferred stock, subordinated debentures and certain other capital instruments, and a portion of the net unrealized gain on equity securities. The includable amount of Tier 2 capital cannot exceed the amount of the institution's Tier 1 capital.

In July 2013, the FDIC and the other federal bank regulatory agencies issued a final rule that will revise their leverage and risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with agreements that were reached by the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act. Among other things, the rule establishes a uniform leverage ratio requirement of 4% of total assets,

provides for a new common equity Tier 1 minimum capital requirement (4.5% of risk-weighted assets), increases the minimum Tier 1 capital to risk-based assets requirement (from 4% to 6% of risk-weighted assets) and assigns a higher risk weight (150%) to exposures that are more than 90 days past due or are on nonaccrual status and to certain commercial real estate facilities that finance the acquisition, development or construction of real property. The final rule also requires unrealized gains and losses on certain "available-for-sale" securities holdings to be included for purposes of calculating regulatory capital requirements unless a one-time opt-in or opt-out is exercised. The rule limits a banking organization's capital distributions and certain discretionary bonus payments to executive officers if the banking organization does not hold a "capital conservation buffer" consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements. The final rule also implements the Dodd-Frank Act's directive to apply to savings and loan holding companies consolidated capital requirements that

are not less stringent than those applicable to their subsidiary institutions. The final rule is effective January 1, 2015. The "capital conservation buffer" will be phased in from January 1, 2016 to January 1, 2019, when the full capital conservation buffer will be effective.

Standards for Safety and Soundness. As required by statute, the federal banking agencies adopted final regulations and Interagency Guidelines Establishing Standards for Safety and Soundness to implement safety and soundness standards. The guidelines set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. The guidelines address internal controls and information systems, internal audit systems, credit underwriting, loan documentation, interest rate exposure, asset growth, asset quality, earnings, compensation, fees and benefits and, more recently, safeguarding customer information. If the appropriate federal banking agency determines that an institution fails to meet any standard prescribed by the guidelines, the agency may require the institution to submit to the agency an acceptable plan to achieve compliance with the standard.

Business and Investment Activities. Under federal law, all state-chartered FDIC-insured banks, including savings banks, have been limited in their activities as principal and in their equity investments to the type and the amount authorized for national banks, notwithstanding state law. Federal law permits exceptions to these limitations. For example, certain state-chartered savings banks may, with FDIC approval, continue to exercise state authority to invest in common or preferred stocks listed on a national securities exchange and in the shares of an investment company registered under the Investment Company Act of 1940, as amended. The maximum permissible investment is the lesser of 100.0% of Tier 1 capital or the maximum amount permitted by Massachusetts law. Chicopee Savings Bank received approval from the FDIC to retain and acquire such equity instruments up to the specified limits. However, at December 31, 2013, Chicopee Savings Bank held no such investments. Any such grandfathered authority may be terminated upon the FDIC's determination that such investments pose a safety and soundness risk or upon the occurrence of certain events such as the savings bank's conversion to a different charter.

The FDIC is also authorized to permit state banks to engage in state authorized activities or investments not permissible for national banks (other than non-subsidiary equity investments) if they meet all applicable capital requirements and it is determined that such activities or investments do not pose a significant risk to the FDIC insurance fund. The FDIC has adopted regulations governing the procedures for institutions seeking approval to engage in such activities or investments. The Gramm-Leach-Bliley Act of 1999 specified that a state bank may control a subsidiary that engages in activities as principal that would only be permitted for a national bank to conduct in a "financial subsidiary," if a bank meets specified conditions and deducts its investment in the subsidiary for regulatory capital purposes.

Prompt Corrective Regulatory Action. Federal law requires, among other things, that federal bank regulatory authorities take "prompt corrective action" with respect to banks that do not meet minimum capital requirements. For these purposes, the law establishes five capital categories: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized.

The FDIC has adopted regulations to implement the prompt corrective action legislation. An institution is deemed to be "well capitalized" if it has a total risk-based capital ratio of 10.0% or greater, a Tier 1 risk-based capital ratio of 6.0% or greater and a leverage ratio of 5.0% or greater. An institution is "adequately capitalized" if it has a total risk-based capital ratio of 8.0% or greater, a Tier 1 risk-based capital ratio of 4.0% or greater, and a leverage ratio of 4.0% or greater. An institution is "undercapitalized" if it has a total risk-based capital ratio of less than 8.0%, a Tier 1 risk-based capital ratio of less than 4.0%, or a leverage ratio of less than 4.0%. An institution is deemed to be "significantly undercapitalized" if it has a total risk-based capital ratio of less than 6.0%, a Tier 1 risk-based capital ratio of less than 3.0%, or a leverage ratio of less than 3.0%. An institution is considered to be "critically undercapitalized" if it has a ratio of tangible equity (as defined in the regulations) to total assets that is equal to or less than 2.0%.

"Undercapitalized" banks must adhere to growth, capital distribution (including dividend) and other limitations and are required to submit a capital restoration plan. A bank's compliance with such a plan must be guaranteed by any company that controls the undercapitalized institution in an amount equal to the lesser of 5% of the institution's total assets when deemed undercapitalized or the amount necessary to achieve the status of adequately capitalized. If an "undercapitalized" bank fails to submit an acceptable plan, it is treated as if it is "significantly undercapitalized."

“Significantly undercapitalized” banks must comply with one or more of a number of additional measures, including, but not limited to, a required sale of sufficient voting stock to become adequately capitalized, a requirement to reduce total assets, cessation of taking deposits from correspondent banks, the dismissal of directors or officers and restrictions on interest rates paid on deposits, compensation of executive officers and capital distributions by the parent holding company. “Critically undercapitalized” institutions are subject to additional measures including, subject to a narrow exception, the appointment of a receiver or conservator within 270 days after it obtains such status.

In connection with the final capital rule described earlier, the federal banking agencies have adopted revisions to the prompt corrective action framework, effective January 1, 2015. Under the revised prompt corrective action requirements, insured depository institutions would be required to meet the following in order to qualify as “well capitalized:” (1) a common equity Tier 1 risk-based capital ratio of at least 6.5%; (2) a Tier 1 risk-based capital ratio of at least 8% (increased from 6%); (3) a total risk-based capital ratio of at least 10% (unchanged from current rules) and (4) a Tier 1 leverage ratio of 5% or greater (unchanged from the current rules).

Transactions with Affiliates. Transactions between a bank (and, generally, its subsidiaries) and its related parties or affiliates are limited by Sections 23A and 23B of the Federal Reserve Act. An affiliate of a bank is any company or entity that controls, is controlled by or is under common control with the bank. In a holding company context, the parent bank holding company and any companies which are controlled by such parent holding company are affiliates of the bank. Generally, Sections 23A and 23B of the Federal Reserve Act limit the extent to which the bank or its subsidiaries may engage in “covered transactions” with any one affiliate to 10% of such institution’s capital stock and surplus and contain an aggregate limit on all such transactions with all affiliates to an amount equal to 20% of such institution’s capital stock and surplus. The term “covered transaction” includes the making of loans, purchase of assets, issuance of a guarantee and similar transactions. In addition, loans or other extensions of credit by the institution to the affiliate are required to be collateralized in accordance with specified requirements. The law also requires that affiliate transactions be on terms and conditions that are substantially the same, or at least as favorable to the institution, as those provided to non-affiliates.

The Sarbanes-Oxley Act of 2002 generally prohibits loans by a company to its executive officers and directors. The law contains a specific exception for loans by a depository institution to its executive officers and directors in compliance with federal banking laws, assuming such loans are also permitted under the law of the institution’s chartering state. Under such laws, a bank’s authority to extend credit to executive officers, directors and 10% shareholders (“insiders”), as well as entities such persons control, is restricted. The law limits both the individual and aggregate amount of loans that may be made to insiders based, in part, on the bank’s capital position and requires certain board approval procedures to be followed. Such loans are required to be made on terms substantially the same as those offered to unaffiliated individuals and not involve more than the normal risk of repayment. There is an exception for loans made pursuant to a benefit or compensation program that is widely available to all employees of the institution and does not give preference to insiders over other employees. Loans to executive officers are further limited to loans of specific types and amounts.

Enforcement. The FDIC has extensive enforcement authority over insured state savings banks, including Chicopee Savings Bank. That enforcement authority includes, among other things, the ability to assess civil money penalties, issue cease and desist orders and remove directors and officers. In general, enforcement actions may be initiated in response to violations of laws and regulations and unsafe or unsound practices. The FDIC also has authority under federal law to appoint a conservator or receiver for an insured bank under certain circumstances. The FDIC is required, with certain exceptions, to appoint a receiver or conservator for an insured state non-member bank if that bank was “critically undercapitalized” on average during the calendar quarter beginning 270 days after the date on which the institution became “critically undercapitalized.”

Federal Insurance of Deposit Accounts. Deposit accounts in Chicopee Savings Bank are insured by the FDIC’s Deposit Insurance Fund, generally up to a maximum of $250,000 per separately insured depositor, pursuant to changes made permanent by the Dodd-Frank Act. The FDIC assesses insured depository institutions to maintain the Deposit Insurance Fund. No institution may pay a dividend if in default of its deposit insurance assessment.

Under the FDIC’s risk-based assessment system, insured institutions are assigned to a risk category based on supervisory evaluations, regulatory capital levels and other risk-based factors. An institution’s assessment rate depends upon the category to which it is assigned and certain adjustments specified by the FDIC, with less risky institutions paying lower assessments. On February 7, 2011, as required by the Dodd-Frank Act, the FDIC published a final rule to revise the deposit insurance assessment system. The rule, which took effect April 1, 2011, changes the assessment base used for calculating deposit insurance assessments from deposits to total assets less tangible (Tier 1) capital. Since the new base is larger than the previous base, the FDIC also lowered assessment rates so that the rule would not significantly alter the total amount of revenue collected from the industry. The range of adjusted assessment rates is

now 2.5 to 45 basis points of the new assessment base.

In addition to FDIC assessments, the Financing Corporation (“FICO”) is authorized to impose and collect, through the FDIC, assessments for costs related to bonds issued by the FICO in the 1980s to recapitalize the former Federal Savings and Loan Insurance Corporation. The bonds issued by the FICO are due to mature in 2017 through 2019. During the calendar year ended December 31, 2013, Chicopee Savings Bank paid $41,000 in fees related to the FICO.

The Dodd-Frank Act increased the minimum target Deposit Insurance Fund ratio from 1.15% of estimated insured deposits to 1.35% of estimated insured deposits. The FDIC must seek to achieve the 1.35% ratio by September 30, 2020. Insured institutions with assets of $10 billion or more are supposed to fund the increase. The Dodd-Frank Act eliminated the 1.5% maximum fund ratio, instead leaving it to the discretion of the FDIC. The FDIC has exercised that discretion by establishing a long range fund ratio of 2%.

A material increase in insurance premiums would likely have an adverse effect on the operating expenses and results of operations of Chicopee Savings Bank. Management cannot predict what insurance assessment rates will be in the future.

Insurance of deposits may be terminated by the FDIC upon a finding that an institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC. We do not know of any practice, condition or violation that might lead to termination of Chicopee Savings Bank's deposit insurance.

As a Massachusetts-chartered savings bank, Chicopee Savings Bank is also required to be a member of the Depositors Insurance Fund, a corporation that insures savings bank deposits in excess of federal deposit insurance coverage. See "-Massachusetts Banking Laws and Supervision-Depositors Insurance Fund," above.

Community Reinvestment Act. Under the Community Reinvestment Act ("CRA"), a bank has a continuing and affirmative obligation, consistent with its safe and sound operation, to help meet the credit needs of its entire community, including low and moderate income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution's discretion to develop the types of products and services that it believes are best suited to its particular community. The CRA does require the FDIC, in connection with its examination of a bank, to assess the institution's record of meeting the credit needs of its community and to take such record into account in its evaluation of certain applications by such institution, including applications to establish or acquire branches and merger with other depository institutions. The CRA requires the FDIC to provide a written evaluation of an institution's CRA performance utilizing a four-tiered descriptive rating system. Chicopee Savings Bank's latest FDIC CRA rating was "outstanding."

Massachusetts has its own statutory counterpart to the CRA which is also applicable to Chicopee Savings Bank. The Massachusetts version is generally similar to the CRA but utilizes a five-tiered descriptive rating system. The Massachusetts Commissioner of Banks is required to consider a bank's record of performance under the Massachusetts law in considering any application by the bank to establish a branch or other deposit-taking facility, relocate an office or to merge or consolidate with or acquire the assets and assume the liabilities of any other banking institution. Chicopee Savings Bank's most recent rating under Massachusetts law was "outstanding."

Federal Reserve System. The Federal Reserve Board regulations require savings institutions to maintain non-interest earning reserves against their transaction accounts (primarily Negotiable Order of Withdrawal (NOW) and regular checking accounts). The regulations currently provide that reserves be maintained against aggregate transaction accounts as follows: a 3% reserve ratio is assessed on net transaction accounts up to and including $89.0 million; a 10% reserve ratio is applied above $89.0 million. The first $13.3 million of otherwise reservable balances are exempted from the reserve requirements. The amounts are adjusted annually. Chicopee Savings Bank complies with the foregoing requirements.

Federal Home Loan Bank System. Chicopee Savings Bank is a member of the Federal Home Loan Bank System, which consists of 12 regional Federal Home Loan Banks. The Federal Home Loan Bank System provides a central credit facility primarily for member institutions as well as other entities involved in home mortgage lending. As a member of the Federal Home Loan Bank of Boston, Chicopee Savings Bank is required to acquire and hold shares of capital stock in the Federal Home Loan Bank. As of December 31, 2013, Chicopee Savings Bank was in compliance with this requirement with an investment in stock of the FHLB at December 31, 2013 of $3.9 million.

The Federal Home Loan Bank of Boston suspended its dividend payment for the first quarter of 2009 until the first quarter of 2011. For the years ended December 31, 2013 and 2012, the Company received $15,000, and $22,000 in dividend income from its FHLB stock investment, respectively.

Other Regulations

Some interest and other charges collected or contracted for by Chicopee Savings Bank are subject to state usury laws and federal laws concerning interest rates. Chicopee Savings Bank’s operations are also subject to state and federal laws applicable to credit transactions and other operations, including but not limited to, the:

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- Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;
- Real Estate Settlement Procedures Act, requiring that borrowers for mortgage loans for one-to-four-family residential real estate receive various disclosures, including good faith estimates of settlement costs, lender servicing and escrow account practices, and prohibiting certain practices that increase the cost of settlement services;
- Home Mortgage Disclosure Act, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;
- Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed, or other prohibited factors in extending credit;
- Fair Credit Reporting Act, governing the use and provision of information to credit reporting agencies; and
- Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies.

The operations of Chicopee Savings Bank also are subject to the:

- Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records;
- Electronic Funds Transfer Act and Regulation E promulgated thereunder, that govern automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services;
- Gramm-Leach-Bliley Act privacy statute which requires each depository institution to disclose its privacy policy, identify parties with whom certain nonpublic customer information is shared and provide customers with certain rights to "opt out" of disclosure to certain third parties; and
- Title III of The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (referred to as the "USA PATRIOT Act"), which significantly expanded the responsibilities of financial institutions, in preventing the use of the United States financial system to fund terrorist activities. Among other things, the USA PATRIOT Act and the related regulations required banks operating in the United States to develop anti-money laundering compliance programs, due diligence policies and controls to facilitate the detection and reporting of money laundering.

Holding Company Regulation

Chicopee Bancorp, as a bank holding company, is subject to examination, regulation, and periodic reporting under the Bank Holding Company Act of 1956, as amended, as administered by the Federal Reserve Board. Chicopee Bancorp is required to obtain the prior approval of the Federal Reserve Board to acquire all, or substantially all, of the assets of any bank or bank holding company. Prior Federal Reserve Board approval would be required for Chicopee Bancorp to acquire direct or indirect ownership or control of any voting securities of any bank or bank holding company if it would, directly or indirectly, own or control more than 5% of any class of voting shares of the bank or bank holding company.

A bank holding company is generally prohibited from engaging in, or acquiring, direct or indirect control of more than 5% of the voting securities of any company engaged in non-banking activities. One of the principal exceptions to this prohibition is for activities found by the Federal Reserve Board to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. Some of the principal activities that the Federal Reserve Board has determined by regulation to be closely related to banking are: (i) making or servicing loans; (ii) performing certain data processing services; (iii) providing securities brokerage services; (iv) acting as fiduciary, investment or financial advisor; (v) leasing personal or real property under certain conditions; (vi) making investments in corporations or projects designed primarily to promote community welfare; and (vii) acquiring a savings association.

The Gramm-Leach-Bliley Act of 1999 authorizes a bank holding company that meets specified conditions, including depository institutions subsidiaries that are “well capitalized” and “well managed,” to opt to become a “financial holding company.” A “financial holding company” may engage in a broader array of financial activities than permitted a typical bank holding company. Such activities can include insurance underwriting and investment banking. Chicopee Bancorp does not anticipate opting for “financial holding company” status at this time.

Chicopee Bancorp is subject to the Federal Reserve Board’s consolidated capital adequacy guidelines for bank holding companies. Traditionally, those guidelines have been structured similarly to the regulatory capital requirements for the subsidiary depository institutions, but were somewhat more lenient. For example, the holding company capital requirements allowed inclusion of certain instruments in Tier 1 capital that are not includable at the institution level. As previously noted, the Dodd-Frank Act directs the Federal Reserve Board to issue consolidated capital requirements for depository institution holding companies that are not less stringent, both quantitatively and in terms of components of capital, than those applicable to institutions themselves. The previously discussed final rule regarding regulatory capital requirements implements the Dodd-Frank Act as to bank holding company capital standards. Consolidated regulatory capital requirements identical to those applicable to the subsidiary banks will apply to bank holding companies (with greater than $500 million of assets) as of January 1, 2015. As is the case with institutions themselves, the capital conservation buffer will be phased in between 2016 and 2019.

A bank holding company is generally required to give the Federal Reserve Board prior written notice of any purchase or redemption of then outstanding equity securities if the gross consideration for the purchase or redemption, when combined with the net consideration paid for all such purchases or redemptions during the preceding 12 months, is equal to 10% or more of the company’s consolidated net worth. The Federal Reserve Board may disapprove such a purchase or redemption if it determines that the proposal would constitute an unsafe and unsound practice, or would violate any law, regulation, Federal Reserve Board order or directive, or any condition imposed by, or written agreement with, the Federal Reserve Board. The Federal Reserve Board has adopted an exception to that approval requirement for well-capitalized bank holding companies that meet certain other conditions.

The Federal Reserve Board has issued a policy statement regarding the payment of dividends and the repurchase of shares of common stock by bank holding companies. In general, the policy provides that dividends should be paid only out of current earnings and only if the prospective rate of earnings retention by the holding company appears consistent with the organization’s capital needs, asset quality and overall financial condition. Regulatory guidance provides for prior regulatory consultation with respect to dividends in certain circumstances such as where the company’s net income for the past four quarters, net of dividends’ previously paid over that period, is insufficient to fully fund the dividend or the company’s overall rate of earnings retention is inconsistent with the company’s capital needs and overall financial condition. The ability of a holding company to pay dividends may be restricted if a subsidiary bank becomes undercapitalized. The policy statement also provides for regulatory consultation prior to a holding company redeeming or repurchasing regulatory capital instruments when the holding company is experiencing financial weaknesses or redeeming or repurchasing common stock or perpetual preferred stock that would result in a net reduction as of the end of a quarter in the amount of such equity instruments outstanding compared with the beginning of the quarter in which the redemption or repurchase occurred. These regulatory policies could affect the ability of the Chicopee Bancorp, Inc. to pay dividends, repurchase shares of its stock or otherwise engage in capital distributions.

The Federal Deposit Insurance Act, makes depository institutions liable to the FDIC for losses suffered or anticipated by the insurance fund in connection with the default of a commonly controlled depository institution or any assistance provided by the FDIC to such an institution in danger of default. That law would have potential applicability if Chicopee Bancorp ever held as a separate subsidiary a depository institution in addition to Chicopee Savings Bank.

Chicopee Bancorp and Chicopee Savings Bank will be affected by the monetary and fiscal policies of various agencies of the United States Government, including the Federal Reserve System. In view of changing conditions in the national economy and in the money markets, it is impossible for management to accurately predict future changes in monetary policy or the effect of such changes on the business or financial condition of Chicopee Bancorp or Chicopee Savings Bank.

The status of Chicopee Bancorp as a registered bank holding company under the Bank Holding Company Act will not exempt it from certain federal and state laws and regulations applicable to corporations generally, including, without limitation, certain provisions of the federal securities laws.

Change in Control Regulations. Under the Change in Bank Control Act, no person may acquire control of a bank holding company such as Chicopee Bancorp, Inc. unless the Federal Reserve Board has been given 60 days' prior written notice and has not issued a notice disapproving the proposed acquisition, taking into consideration certain factors, including the financial and managerial resources of the acquirer and the competitive effects of the acquisition. Control, as defined under federal law, means ownership, control of or holding irrevocable proxies representing more than 25% of any class of voting stock, control in any manner of the election of a majority of the institution's directors, or a determination by the regulator that the acquiror has the power to direct, or directly or indirectly to exercise a controlling influence over, the management or policies of the institution. Acquisition of more than 10% of any class of a savings and loan holding company's voting stock constitutes a rebuttable determination of control under the regulations under certain circumstances including where, as will be the case with Chicopee Bancorp, Inc., the issuer has registered securities under Section 12 of the Securities Exchange Act of 1934.
Massachusetts Holding Company Regulation. Under Massachusetts banking laws, a company owning or controlling two or more banking institutions, including a savings bank, is regulated as a bank holding company. Each Massachusetts bank holding company: (i) must obtain the approval of the Massachusetts Board of Bank Incorporation before engaging in certain transactions, such as the acquisition of more than 5% of the voting stock of another banking institution; (ii) must register, and file reports, with the Massachusetts Division of Banks; and (iii) is subject to examination by the Division of Banks. Chicopee Bancorp would become a Massachusetts bank holding company if it acquires a second banking institution and holds and operates it separately from Chicopee Savings Bank.
Federal Securities Laws
Chicopee Bancorp's common stock is registered with the Securities and Exchange Commission. Chicopee Bancorp is subject to the information, proxy solicitation, insider trading restrictions and other requirements under the Securities Exchange Act of 1934.
Executive Officers of the Registrant

Name	Principal Position
William J. Wagner	President and Chief Executive Officer of Chicopee Bancorp and Chicopee Savings Bank
Guida R. Sajdak	Senior Vice President, Chief Financial Officer and Treasurer of Chicopee Bancorp and Senior Vice President and Treasurer of Chicopee Savings Bank
Russell J. Omer	Executive Vice President of Chicopee Bancorp and Executive Vice President, Lending, of Chicopee Savings Bank

Below is information regarding our executive officers who are not also Directors. Unless otherwise stated, each executive officer has held his or her position for at least the last five years. Ages presented are as of December 31, 2013.

Russell J. Omer has served as Executive Vice President of Chicopee Bancorp since December 2008, and Senior Vice President of Chicopee Bancorp since 2006, and Senior Vice President, Lending, since 1998. Age 63.

Guida R. Sajdak was appointed Senior Vice President, Chief Financial Officer and Treasurer of the Company and Bank effective July 1, 2010. Ms. Sajdak has been employed by the Bank since 1989. Prior to her most recent appointment, Ms. Sajdak held the title of Senior Vice President of Finance. Age 40.

Item 1A. Risk Factors.

Our increased emphasis on commercial real estate and commercial business lending may expose us to increased lending risks. At December 31, 2013, our loan portfolio included $211.2 million of commercial real estate loans, equaling 43.1% of total loans, and $86.5 million of commercial business loans, equaling 17.7% of total loans. We have grown the commercial loan portfolio in recent years and intend to continue to grow commercial real estate and commercial loans. These types of loans generally expose a lender to greater risk of non-payment and loss than

one-to-four-family residential real estate loans because repayment of the loans often depends on the successful operation of the property and the income stream of the borrowers. Such loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to one-to-four-family residential real estate loans. Commercial business loans expose us to additional risks since they typically are made on the basis of the borrower's ability to make repayments from the cash flow of the borrower's business and are secured by non-real estate collateral that may depreciate over time. In addition, since such loans generally entail greater risk than one-to-four-family residential real estate loans, we may need to increase our allowance for loan losses in the future to account for the likely increase in probable

credit losses associated with the growth of such loans. Also, many of our commercial borrowers have more than one loan outstanding with us. Consequently, an adverse development with respect to one loan or one credit relationship can expose us to a significantly greater risk of loss compared to an adverse development with respect to a one-to-four-family residential mortgage loan.

Negative developments in the financial industry and the domestic and international credit markets may adversely affect our operations and results. Since the latter half of 2007, negative developments in the global credit and securitization markets have resulted in uncertainty in the financial markets and a general economic downturn which has continued into 2013. The economic downturn was accompanied by deteriorated loan portfolio quality at many institutions, including Chicopee Savings Bank. In addition, the value of real estate collateral supporting many home mortgages has declined and may continue to decline. Bank and bank holding company stock prices have been negatively affected, as has the ability of banks and bank holding companies to raise capital or borrow in the debt markets. These negative developments along with the turmoil and uncertainties that have accompanied them have heavily influenced the formulation and enactment of the Dodd-Frank Act, along with its implications as described elsewhere in this “Risk Factors” section. In addition to the many future implementing rules and regulations of the Dodd-Frank Act, the potential exists for other new federal or state laws and regulations regarding lending and funding practices and liquidity standards to be enacted. Bank regulatory agencies are expected to continue to be active in responding to concerns and trends identified in examinations. Negative developments in the financial industry and the domestic and international credit markets, and the impact of new legislation in response to those developments, may negatively impact our operations by increasing our costs, restricting our business operations, including our ability to originate or sell loans, and adversely impact our financial performance. In addition, these risks could affect the value of our loan portfolio as well as the value of our investment portfolio, which would also negatively affect our financial performance.

A downturn in the local economy or a decline in real estate values could decrease our profits. Nearly all of our real estate loans are secured by real estate in Hampden County. As a result of this concentration, a downturn in the local economy could cause significant increases in non-performing loans, which would decrease our profits. Additionally, a decrease in asset quality could require additions to our allowance for loan losses through increased provisions for loan losses, which would hurt our profits. A continued decline in real estate values could cause some of our real estate loans to become inadequately collateralized, which would expose us to a greater risk of loss. In addition, because we have a significant amount of commercial real estate loans, decreases in tenant occupancy may also have a negative effect on the ability of many of our borrowers to make timely repayments on their loans, which would have an adverse impact on our earnings.

Changes in interest rates could adversely affect our results of operations and financial condition. Our results of operations and financial condition are significantly affected by changes in interest rates. Our results of operations depend substantially on our net interest income, which is the difference between the interest income we earn on our interest-earning assets, such as loans and securities, and the interest expense we pay on our interest-bearing liabilities, such as deposits and borrowings. Because our interest-earning assets generally reprice or mature more quickly than our interest-bearing liabilities, an increase in interest rates generally would tend to result in an increase in net interest income.

Changes in interest rates may also affect the average life of loans and mortgage-related securities. Decreases in interest rates can result in increased prepayments of loans and mortgage-related securities, as borrowers refinance to reduce their borrowing costs. Under these circumstances, we are subject to reinvestment risk to the extent that we are unable to reinvest the cash received from such prepayments at rates that are comparable to the rates on existing loans and securities. Additionally, increases in interest rates may decrease loan demand and make it more difficult for borrowers to repay adjustable rate loans. Also, increases in interest rates may extend the life of fixed-rate assets, which would restrict our ability to reinvest in higher yielding alternatives, and may result in customers withdrawing

certificates of deposit early so long as the early withdrawal penalty is less than the interest they could receive as a result of the higher interest rates.

Changes in interest rates also affect the current fair value of our interest-earning securities portfolio. Generally, the value of securities moves inversely with changes in interest rates.

Additionally, a majority of our single-family real estate loans held for investment are adjustable-rate loans. Any rise in market interest rates may result in increased payments for borrowers who have adjustable rate loans, increasing the possibility of default.

For further discussion of how changes in interest rates could impact us, see “Management's Discussion and Analysis of Financial Condition and Results of Operations-Risk Management-Interest Rate Risk Management.”

Historically low interest rates may adversely affect our net interest income and profitability. During the past four years it has been the policy of the Board of Governors of the Federal Reserve System (“Federal Reserve Board”) to maintain interest rates at historically low levels through its targeted federal funds rate and the purchase of mortgage-backed securities. As a result, market rates on the loans we have originated and the yields on securities we have purchased have been at lower levels than available

prior to 2008. As a general matter, our interest-bearing liabilities reprice or mature more quickly than our interest-earning assets, which has resulted in increases in net interest income as interest rates decreased. However, our ability to lower our interest expense is limited at these interest rate levels while the average yield on our interest-earning assets may continue to decrease. The Board of Governors of the Federal Reserve System has recently indicated to maintain low interest rates. Accordingly, our net interest income (the difference between interest income earned on assets and interest expense paid on liabilities) may be adversely affected and may even decrease, which may have an adverse effect on our profitability.

If our allowance for loan losses is not sufficient to cover actual loan losses, our earnings will decrease. We make various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. In determining the amount of the allowance for loan losses, we review our loans and our loss and delinquency experience, and we evaluate economic conditions. If our assumptions are incorrect, our allowance for loan losses may not be sufficient to cover probable losses in our loan portfolio, resulting in additions to our allowance. Our allowance for loan losses was 0.94% of total loans at December 31, 2013. Material additions to our allowance could materially decrease our net income. In addition, bank regulators periodically review our allowance for loan losses and may require us to increase our allowance for loan losses or recognize further loan charge-offs. Any increase in our allowance for loan losses or loan charge-offs as required by these regulatory authorities might have a material adverse effect on our financial condition and results of operations.

We are subject to extensive regulatory oversight. We are subject to extensive supervision, regulation, and examination by the Federal Reserve Board, the Federal Deposit Insurance Corporation and the Massachusetts Division of Banks. As a result, we are limited in the manner in which we conduct our business, undertake new investments and activities, and obtain financing. This regulatory structure is designed primarily for the protection of the Deposit Insurance Fund of the Federal Deposit Insurance Corporation, the Depositor's Insurance Fund of Massachusetts, and our depositors, and not to benefit our stockholders. This regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement actions and examination policies, including policies with respect to capital levels, the timing and amount of dividend payments, the classification of assets, the establishment of adequate loan loss reserves for regulatory purposes and the timing and amounts of assessments and fees.

In addition, we must comply with significant anti-money laundering and anti-terrorism laws and regulations, Community Reinvestment Act laws and regulations, and fair lending laws and regulations. Government agencies have the authority to impose monetary penalties and other sanctions on institutions that fail to comply with these laws and regulations, which could significantly affect our business activities, including our ability to acquire other financial institutions or expand our branch network.

Financial reform legislation recently enacted will, among other things, tighten capital standards and result in new laws and regulations that are expected to increase our costs of operations. The Dodd-Frank Wall Street Reform and Consumer Protection Act was enacted in 2010. This new law is significantly changing the current bank regulatory structure and affects the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act requires various federal agencies to adopt a broad range of new implementing rules and regulations, and to prepare numerous studies and reports for Congress. The federal agencies are given significant discretion in drafting the implementing rules and regulations, and consequently, many of the details and much of the impacts of the Dodd-Frank Act may not be known for many months or years.

The Dodd-Frank Act created a new Consumer Financial Protection Bureau with broad powers to supervise and enforce consumer protection laws. The Consumer Financial Protection Bureau has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit “unfair, deceptive or abusive” acts and practices. The Consumer Financial Protection Bureau has examination

and enforcement authority over all banks with more than $10 billion in assets. Banks with $10 billion or less in assets will continue to be examined for compliance with the consumer laws by their primary bank regulators. The Dodd-Frank Act also weakened the federal preemption rules that have been applicable for national banks and federal savings associations, and gives state attorneys general the ability to enforce federal consumer protection laws.

The Dodd-Frank Act required minimum leverage (Tier 1) and risk based capital requirements for bank and savings and loan holding companies that are no less than those applicable to banks, which will exclude certain instruments that previously have been eligible for inclusion by bank holding companies as Tier 1 capital, such as trust preferred securities and certain collateralized debt obligations.

A provision of the Dodd-Frank Act eliminated, as of July 21, 2011, the federal prohibitions on paying interest on demand deposits, thus allowing businesses to have interest bearing checking accounts. Depending on competitive responses, this significant change to existing law could have an adverse impact on our interest expense.

The Dodd-Frank Act also broadened the base for Federal Deposit Insurance Corporation deposit insurance assessments. Assessments are now based on the average consolidated total assets less tangible equity capital of a financial institution, rather than deposits. The Dodd-Frank Act also permanently increased the maximum amount of deposit insurance for banks, savings institutions and credit unions to $250,000 per depositor, retroactive to January 1, 2009. The legislation also increased the required minimum reserve ratio for the Deposit Insurance Fund, from 1.15% to 1.35% of insured deposits, and directs the Federal Deposit Insurance Corporation to offset the effects of increased assessments on depository institutions with less than $10 billion in assets.
The Dodd-Frank Act requires publicly traded companies to give stockholders a non-binding vote on executive compensation and so-called “golden parachute” payments. It also provides that the listing standards of the national securities exchanges shall require listed companies to implement and disclose “clawback” policies mandating the recovery of incentive compensation paid to executive officers in connection with accounting restatements. The legislation also directs the Federal Reserve Board to promulgate rules prohibiting excessive compensation paid to bank holding company executives.
We expect that current and future rules and regulations promulgated pursuant to the Dodd-Frank Act will increase our operating and compliance costs and could increase our interest expense.
Legislative or regulatory responses to perceived financial and market problems could impair our rights against borrowers. Federal, state and local laws and policies could reduce the amount distressed borrowers are otherwise contractually obligated to pay under their mortgage loans, and may limit the ability of lenders to foreclose on mortgage collateral. Restrictions on Chicopee Savings Bank's rights as creditor could result in increased credit losses on our loans and mortgage-backed securities, or increased expense in pursuing our remedies as a creditor.

Strong competition within our market area could hurt our profits and slow growth. We face intense competition both in making loans and attracting deposits. This competition has made it more difficult for us to make new loans and attract deposits. Price competition for loans and deposits might result in us earning less on our loans and paying more on our deposits, which reduces net interest income. As of June 30, 2013, we held 4.89% of the deposits in Hampden County, which was the 8th largest market share of deposits out of the 20 financial institutions in the county. This data does not include deposits held by one of our primary competitors, credit unions, which, as tax-exempt organizations, are able to offer higher rates on retail deposits than banks. There are 16 credit unions headquartered in Hampden County, some of the larger of which are headquartered in Chicopee, Massachusetts. Some of the institutions with which we compete have substantially greater resources and lending limits than we have and may offer services that we do not provide. We expect competition to increase in the future as a result of legislative, regulatory and technological changes and the continuing trend of consolidation in the financial services industry. Our profitability depends upon our continued ability to compete successfully in our market area.

The building of market share through our branching strategy could cause our expenses to increase faster than revenues. We intend to continue to build market share in Hampden County, Massachusetts and surrounding areas through our branching strategy. Our business plan currently contemplates that we will establish additional branches, if market conditions are favorable. There are considerable costs involved in opening branches and new branches generally require a period of time to generate the necessary revenues to offset their costs, especially in areas in which we do not have an established presence. Accordingly, any new branch can be expected to negatively impact our earnings for some period of time until the branch reaches certain economies of scale. Our expenses could be further increased if we encounter delays in the opening of any of our new branches. Finally, we have no assurance our new branches will be successful even after they have been established.

Our low return on equity may negatively affect our stock price. Net income divided by average equity, known as “return on equity,” is a ratio many investors use to compare the performance of a financial institution to its peers. Our return on equity was reduced due to the large amount of capital that we raised in our 2006 stock offering and to expenses we will incur in pursuing our growth strategies, the costs of being a public company and added expenses associated with our employee stock ownership plan and equity incentive plan. Until we can increase our net interest

income and non-interest income, we expect our return on equity to be below that of our peers, which may negatively affect the value of our common stock. For the twelve months ended December 31, 2013, our return on average equity was 2.79%.

Our information systems may experience an interruption or breach in security. We rely heavily on communications and information systems to conduct our business. Any failure, interruption, or breach in security or operational integrity of these systems could result in failures or disruptions in our customer relationship management, general ledger, deposit, loan, and other systems. While we have policies and procedures designed to prevent or limit the effect of the failure, interruption, or security breach of our information systems, we cannot assure you that any such failures, interruptions, or security breaches will not occur or, if they do occur, that they will be adequately addressed. The occurrence of any failures, interruptions, or security breaches of our information systems could damage our reputation, result in a loss of customer business, subject us to additional regulatory scrutiny, or expose us to civil litigation and possible financial liability, any of which could have a material adverse effect on our financial condition and results of operations.

Our earnings have been negatively affected by the reduction in dividends paid by the Federal Home Loan Bank of Boston. The FHLB of Boston did not pay any dividends during the years 2009 and 2010. Although the FHLB of Boston began paying a dividend again in 2011, the dividends paid for 2013 were equal to annualized rate of 30 basis points per share, far below the dividend paid by the FHLB of Boston prior to 2009. The failure of the FHLB of Boston to pay full dividends for any quarter will reduce our earnings during that quarter.

Item 1B. Unresolved Staff Comments.

Not applicable.

Item 2. Properties.

We conduct our business through our main office in Chicopee, Massachusetts, eight full service branch offices and our lending and operation center. Of our nine locations, we own six and lease three of the buildings. We also own the land for five of the six buildings we own. For one of our branches we own the building and lease the land. The net book value of our land, buildings, and improvements was $8.3 million at December 31, 2013. The following table sets forth ownership and lease information for the Company’s offices as of December 31, 2013:

		Location	Year Opened	Lease Expires
Owned				
	Main Office:			
		70 Center Street Chicopee, MA 01013	1973	
	Branch Offices:			
		39 Morgan Road West Springfield, MA 01089	2005	
		569 East Street Chicopee, MA 01020	1976	
		435 Burnett Road Chicopee, MA 01020	1990	
		219/229 Exchange Street Chicopee, MA 01013	2009/1998	
Leased				
		599 Memorial Drive Chicopee, MA 01020	1977	2017
		477A Center Street Ludlow, MA 01056	2002	2022
		350 Palmer Road Ware, MA 01082	2009	2027
		32 Willimansett Street South Hadley, MA 01075	2008	2027 (1)

(1) The lease is for the land only, the building is owned by Chicopee Savings Bank.

Item 3. Legal Proceedings.

Periodically, we are involved in routine litigation incidental to our business, such as claims to enforce liens and contracts, condemnation proceedings on properties in which we hold security interests, claims involving the making and servicing of real property loans and other issues incident to our business. We are not a party to any pending legal

proceedings that we believe would have a material adverse effect on our financial condition, results of operations or cash flows.

Item 4. Mine Safety Disclosures.

Not applicable.

PART II

Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

The Company's common stock is traded on the NASDAQ Global Market (“NASDAQ”) under the symbol “CBNK.” The following table sets forth the high and low closing prices of the common stock and dividends declared for the years ended December 31, 2013 and 2012, as reported by NASDAQ. The Company did not pay any dividend to shareholders during the year ended December 31, 2012. The first quarterly dividend declared by the Company was announced on January 24, 2013. The Company currently anticipates that comparable cash dividends will continue to be paid in the future.

	High	Low	Dividends Declared		High	Low	Dividends Declared
2013				2012			
First Quarter	$17.05	$15.43	$0.05	First Quarter	$14.67	$13.18	$—
Second Quarter	18.27	16.73	0.05	Second Quarter	14.85	13.30	—
Third Quarter	19.72	17.10	0.05	Third Quarter	15.11	14.01	—
Fourth Quarter	18.19	17.31	0.05	Fourth Quarter	15.89	13.70	—

The Company’s ability to pay dividends is dependent on dividends received from Chicopee Savings Bank and its other subsidiaries. For a discussion of restrictions on the payment of cash dividends by Chicopee Savings Bank, see “Business—Regulation and Supervision—Massachusetts Banking Laws and Supervision—Dividends” in this Annual Report o Form 10-K.

Stock Performance Graph

The following graph compares the cumulative total shareholder return on Chicopee Bancorp common stock with the cumulative total return on the NASDAQ Index (U.S. Companies) and with the SNL Thrift <$500M Index. The graph assumes $100 was invested at the close of business on December 31, 2008.

Shareholders and Issuer Purchases of Equity Securities

As of March 3, 2014, the Company had approximately 605 registered holders of record of the Company's common stock.

The following table provides information regarding the Company's purchase of its equity securities during the three months ended December 31, 2013.

Period	(a) Total Number of Shares (or Units) Purchased	(b) Average Price Paid Per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs (1)	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
October 1-31, 2013	—	$—	36,354	235,646
November 1-30, 2013	—	—	36,354	235,646
December 1-31, 2013	—	—	36,354	235,646
Total	—	$—		

(1) On June 1, 2012, the Company announced that the Board of Directors authorized a Seventh Stock Repurchase Program for the purchase of up to 272,000 shares, or 5%, of the Company's common stock outstanding upon the completion of the Sixth Stock Repurchase Program. On October 11, 2012, the Company announced that it had completed its Sixth Stock Repurchase Program for the purchase of 287,000 shares, at an average price per share of $14.26. During the fourth quarter of 2013, the Company did not repurchase any shares of Company stock. The Company intends to repurchase its shares from time to time at prevailing prices in the open market, in block transactions or in privately negotiated transactions. Repurchases will be made under rule 10b-5(1) repurchase plans. The repurchased shares will be held by the Company as treasury stock and will be available for general corporate purposes. A total of 235,646 shares are authorized to be repurchased under the current stock repurchase program.

Item 6. Selected Financial Data.

We have derived the following selected consolidated financial and other data of the Company in part from our consolidated financial statements and notes appearing elsewhere in this Form 10-K.

	At December 31,				
	2013	2012	2011	2010	2009
	(In Thousands)				
Selected Financial Data:					
Total assets	$587,727	$599,982	$616,306	$573,704	$544,150
Cash and cash equivalents	18,915	39,608	61,122	35,873	20,075
Loans, net	485,619	465,211	443,471	430,307	424,655
Available-for-sale securities	602	621	613	362	503
Held-to-maturity securities	48,606	59,568	73,852	69,713	62,983
Deposits	449,766	466,177	453,377	391,937	365,498
Advances from the Federal Home Loan Bank	44,992	33,332	59,265	71,915	63,675
Total stockholders' equity	92,230	89,969	90,782	91,882	94,172
Nonperforming assets	7,241	4,559	5,624	6,756	4,924
Selected Operating Data:					
Interest and dividend income	$23,069	$24,397	$24,850	$24,857	$24,514
Interest expense	4,349	5,627	6,902	8,016	9,107
Net interest and dividend income	18,720	18,770	17,948	16,841	15,407
Provision for loan losses	425	442	842	1,223	897
Net interest income after provision for loan losses	18,295	18,328	17,106	15,618	14,510
Non-interest income	3,100	3,023	2,650	2,626	1,312
Non-interest expense	18,155	18,305	18,734	18,009	18,045
Income (loss) before provision for income taxes	3,240	3,046	1,022	235	(2,223)
Income tax expense (benefit)	687	581	(78)	(230)	(627)
Net income (loss)	$2,553	$2,465	$1,100	$465	$(1,596)
Earnings (loss) per share					
Basic	$0.51	$0.49	$0.21	$0.08	$(0.28)
Diluted	$0.50	$0.48	$0.21	$0.08	$(0.28)

	At or For the Years Ended December 31,				
	2013	2012	2011	2010	2009
Selected Operating Ratios and Other Data:					
Performance Ratios:					
Average yield on interest-earning assets (1)	4.39 %	4.55 %	4.73 %	4.96 %	5.03 %
Average rate paid on interest-bearing liabilities	1.04 %	1.27 %	1.57 %	1.91 %	2.26 %
Average interest rate spread (2)	3.35 %	3.28 %	3.16 %	3.05 %	2.77 %
Net interest margin (3)	3.60 %	3.54 %	3.47 %	3.40 %	3.18 %
Ratio of interest-earning assets to interest-bearing liabilities	132.02 %	126.51 %	124.18 %	122.61 %	121.58 %
Non-interest expenses as a percent of average assets	3.10 %	3.06 %	3.21 %	3.24 %	3.39 %
Return on average assets	0.44 %	0.41 %	0.19 %	0.08 %	(0.30)%
Return on average equity	2.79 %	2.75 %	1.20 %	0.49 %	(1.69)%
Ratio of average equity to average assets	15.58 %	15.02 %	15.72 %	17.04 %	17.76 %
Efficiency ratio (4)	78.87 %	79.43 %	88.06 %	91.59 %	102.74 %
Regulatory Capital Ratios:					
Total capital to risk-weighted assets	19.6 %	19.3 %	19.6 %	20.7 %	23.4 %
Tier 1 capital to risk-weighted assets	18.6 %	18.4 %	18.7 %	19.7 %	22.4 %
Tier 1 capital to average assets	15.8 %	15.0 %	14.8 %	16.1 %	17.4 %
Asset Quality Ratios:					
Nonperforming loans as a percent of total loans	1.40 %	0.85 %	1.05 %	1.49 %	1.13 %
Nonperforming assets as a percent of total assets	1.23 %	0.76 %	0.91 %	1.18 %	0.90 %
Allowance for loan losses as a percent of total loans	0.94 %	0.93 %	1.02 %	1.02 %	0.95 %
Allowance for loan losses as a percent of nonperforming loans and troubled debt restructurings	67.25 %	109.46 %	97.13 %	68.49 %	84.17 %
Net loans charged-off to average interest-earning loans	0.04 %	0.14 %	0.16 %	0.20 %	0.04 %
Other Data:					
Banking offices at end of year	9	9	9	9	8

(1) Municipal securities income and net interest income are presented on a tax equivalent basis using a tax rate of 41%. The tax equivalent adjustment is deducted from the tax equivalent net interest income to agree to the amount reported on the income statement.

(2) Tax equivalent net interest rate spread represents the difference between the weighted average yield on interest-earning assets and the weighted average cost of interest-bearing liabilities.

(3) Tax equivalent net interest margin represents tax equivalent net interest income divided by total average interest-earning assets.

(4) The efficiency ratio represents the ratio of non-interest expenses divided by the sum of tax equivalent net interest income and non-interest income. This ratio excludes gains (losses) on sales of investment securities, property, loans and other, net. At December 31, 2013 the ratio is calculated as follows (in thousands):

Non-interest expenses	$18,155
Tax equivalent net interest income	$19,784

Non-interest income	3,100	
Add back:		
Other non-interest income	(24	)
Loss on sale of other real estate owned	158	
Total income included in calculation	$23,018	
Non-interest expenses divided by total income	78.87	%

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion should be read in conjunction with the “Selected Financial Data” and the Company’s Consolidated Financial Statements and notes thereto, each appearing elsewhere in this Annual Report on Form 10-K.

Forward-Looking Statements

This Annual Report on Form 10-K contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The Company intends such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and is including this statement for purposes of these safe harbor provisions. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies and expectations of the Company, are generally identified by use of the words “believe,” “expect,” “intend,” “anticipate,” “estimate,” “project,” or similar expressions. The Company’s ability to predict results or the actual effect of future plans or strategies is inherently uncertain.

By identifying these forward-looking statements for you in this manner, we are alerting you to the possibility that our actual results and financial condition may differ, possibly materially, from the anticipated results and financial condition indicated in these forward-looking statements. Important factors that could cause our actual results and financial condition to differ from those indicated in the forward-looking statements include, among others, those discussed under “Risk Factors” in Part I, Item 1A of this Annual Report on Form 10-K. In addition to these risk factors, there are other factors that may impact any public company, including ours, which could have a material adverse effect on the operations and future prospects of the Company and its subsidiaries. These additional factors include, but are not limited to: (1) changes in consumer spending, borrowing and savings habits; (2) the financial health of certain entities, including government sponsored enterprises, the securities of which are owned or acquired by the Company; (3) adverse changes in the securities market; and (4) the costs, effects and outcomes of existing of future litigation. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements.

Overview

Income. The Company's primary source of pre-tax income is net interest income. Net interest income is the difference between interest income, which is the income that we earn on our loans and securities, and interest expense, which is the interest that we pay on our deposits and borrowings. Other significant sources of pre-tax income are service charges fees and commissions, which include service charges on deposit accounts, brokerage fee income and other loan fees (including loan brokerage fees and late charges), income from bank-owned life insurance and income from loan sales and servicing. In addition, we recognize income or losses from the sale of available-for-sale securities in years that we have such sales.

Allowance for Loan Losses. The allowance for loan losses is a valuation allowance to cover the inherent probable losses in the loan portfolio. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, information about specific borrower situations, estimated collateral values, economic conditions, and other factors. Allocation of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management’s judgment, should be charged off.

Expenses. The non-interest expenses we incur in operating our business consist of salaries and employee benefits expenses, occupancy expenses, furniture and equipment expenses, data processing expenses and various other

miscellaneous expenses.

Critical Accounting Policies

We consider 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. We consider the following to be our critical accounting policies:

Allowance for Loan Losses. The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

Management believes the allowance for loan losses requires the most significant estimates and assumptions used in the preparation of the consolidated financial statements. The allowance for loan losses is based on management's evaluation of the level of the allowance required in relation to the probable loss exposure in the loan portfolio. The allowance for loan losses is evaluated on a regular basis by management. Qualitative factors, or risks considered in evaluating the adequacy of the allowance
for loan losses for all loan classes include historical loss experience; levels and trends in delinquencies, nonaccrual loans, impaired loans and net charge-offs; the character and size of the loan portfolio; effects of any changes in underwriting policies; experience of management and staff; current economic conditions and their effect on borrowers; effects of changes in credit concentrations, and management's estimation of probable losses. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific and general components. The specific component relates to loans that are classified as doubtful, substandard, special mention, or loss. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors.

Loans individually considered for impairment include all loans included in the class of commercial and residential, as well as home equity loans. Theses are considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Impairment is measured on a loan-by-loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer loans for impairment evaluation, except for home equity loans.

Although we believe that we use the best information available to establish the allowance for loan losses, future adjustments to the allowance may be necessary if economic conditions differ substantially from the assumptions used in making the evaluation. In addition, our banking regulators, as an integral part of their examination process, periodically review our allowance for loan losses. Such agencies may require us to recognize adjustments to the allowance based on its judgments about information available to it at the time of its examination. A large loss could deplete the allowance and require increased provisions to replenish the allowance, which would negatively affect earnings.

Deferred Income Taxes. We use the asset and liability method of accounting for income taxes as prescribed in "Accounting for Income Taxes". Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. If current available information raises doubt as to the realization of the deferred tax assets, a valuation allowance is established. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. We exercise significant judgment in evaluating the amount and timing of recognition of the resulting tax liabilities and assets. These judgments require us to make projections of future taxable income. The judgments and estimates we make in determining our deferred tax assets, which are inherently subjective, are reviewed on a continual basis as regulatory and business factors change. Any reduction in estimated future taxable income may require us to record a valuation allowance against our deferred tax assets. A valuation allowance would result in additional income tax expense in the period, which would negatively affect earnings.

Mortgage Servicing Rights. Mortgage servicing rights associated with loans originated and sold, where servicing is retained, are capitalized and included in other assets in the consolidated balance sheet. Mortgage servicing rights are amortized into non-interest income in proportion to, and over the period of, estimated future net servicing income of the underlying financial assets. Mortgage servicing rights are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. The value of the capitalized servicing rights represents the present value of the future servicing fees arising from the right to service loans in the portfolio. Critical accounting policies for mortgage servicing rights relate to the initial valuation and subsequent impairment tests. The methodology used to determine the valuation of mortgage servicing rights requires the development and use of a number of estimates, including anticipated principal amortization and prepayments of that principal balance. Events that may significantly affect the estimates used are changes in interest rates, mortgage loan prepayment speeds and the payment performance of the underlying loans. The carrying value of the mortgage servicing rights is periodically reviewed for impairment based on a determination of fair value. Impairment, if any, is recognized through a valuation allowance and is recorded as a component of non-interest expense.

Other-Than-Temporary Impairment. “Accounting for Certain Investments in Debt and Equity Securities,” “The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Benefits,” and “Noncurrent Marketable Equity Securities,” require companies to perform periodic reviews of individual securities in their investment portfolios to determine whether decline in the value of a security is other than temporary. A review of other-than-temporary impairment requires companies to make certain judgments regarding the materiality of the decline, its effect on the financial statements and the probability, extent and timing of a valuation recovery and the company’s intent and ability to hold the security. Pursuant to these requirements, we assess valuation declines to determine the extent to which such changes are attributable to (1) fundamental factors specific to the issuer, such as financial condition, business prospects or other factors or (2) market-related factors, such as interest rates or equity market declines. Declines in the fair value of securities below their costs that are deemed to be other than temporary are recorded in earnings as realized losses. For declines in the fair value of individual debt available-for-sale securities below their cost that are deemed to be other-than-temporary, where the Company does not intend to sell the security and it is more likely than not that the Company will not be required to sell the security before recovery of its amortized cost basis, the other-than-temporary decline in the fair value of the debt security related to 1) credit loss is recognized in earnings and 2) other factors is recognized in other comprehensive income or loss. Credit loss is determined to exist if the present value of expected future cash flows using the effective rate at acquisition is less than the amortized cost basis of the debt security. For individual debt securities where the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost, the other-than-temporary impairment is recognized in earnings equal to the difference between the security’s cost basis and its fair value at the balance sheet date. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Operating Strategy

Our mission is to operate and grow a profitable community-oriented financial institution serving primarily retail customers and businesses in our market areas. We plan to continue our strategy of:

- increasing our overall commercial relationships, as well as broadening individual commercial relationships, in our expanding market area;
- increasing our deposit market share in our expanding market area;
- increasing our sale of non-deposit investment products;
- improving operating efficiency and cost control; and
- applying disciplined underwriting practices to maintain the high quality of our loan portfolio.

Continuing to increase our commercial relationships in our expanding market area. We have diversified our loan portfolio beyond residential loans by increasing our commercial relationships. Our goal is to increase the number of our commercial customers, while also broadening individual relationships. Our commercial real estate, commercial construction and commercial and industrial loan portfolio has increased $91.2 million, or 37.2%, from $244.9 million, or 58.5% of the total loan portfolio, at December 31, 2009 to $336.1 million, or 68.7% of the total loan portfolio, at December 31, 2013. Business deposit accounts have increased $36.9 million, or 107.6%, from $34.3 million at December 31, 2009 to $71.2 million at December 31, 2013. In order to support the growth in the commercial loan portfolio, we have also increased the number of commercial lenders and commercial underwriting and support staff.

Increasing our deposit market share in our expanding market area. Retail deposits are our primary source of funds for investing and lending. By offering a variety of deposit products, special and tiered pricing, and superior customer

service, we intend to retain and expand existing customer relationships as well as attract new deposit customers. Personalized service and flexibility with regard to customer needs will continue to be augmented with a full array of delivery channels to maximize customer convenience. These include drive-up banking, ATMs, internet banking, automated bill payment, remote capture, and telephone banking. Through our continued focus on these deposit-gathering efforts in existing branch locations, couple with our plans for geographic expansion, we expect to increase the overall level of deposits and our market share in the markets we serve.

In addition, historically, one of our primary competitors for retail deposits in the Chicopee market area has been credit unions. Credit unions are formidable competitors since, as tax-exempt organizations, they are able to offer higher rates on retail deposits than banks. By expanding our market area beyond the immediate Chicopee market area, and beyond the market areas of our larger credit union competitors, we intend to increase our overall deposit market share of Hampden County.

Increasing our sale of non-deposit investment products. Our profits rely heavily on the spread between the interest earned on loans and securities and interest paid on deposits and borrowings. In order to decrease our reliance on interest rate spread income we have pursued initiatives to increase non-interest income. We offer non-deposit investment products, including mutual funds, annuities, pension plans, life insurance, long-term care and 529 college savings plans through a third party registered broker-dealer, Linsco/Private Ledger. This initiative generated $320,000, $312,000 and $232,000 of non-interest income during the years ended December 31, 2013, 2012, and 2011, respectively. In connection with our expanding branch network, we intend to continue to increase our sale of non-deposit investment products by engaging one additional retail investment employee to serve customers of our anticipated branch expansion.

Improving operating efficiency and cost control. Non-interest expense decreased $150,000, or 0.8%, from $18.3 million, or 3.06% of average total assets, at December 31, 2012 to $18.2 million, or 3.10% of average total assets, at December 31, 2013. The decrease in expenses was largely due to the decrease in salaries and benefits of $264,000, or 2.5%, and a decrease in FDIC insurance premium fees of $126,000, or 35.3%. We recognize that our growth strategies have required greater investments in personnel, marketing, premises and equipment which have had a negative impact on our expense ratio over the short term. Our non-interest expenses are also impacted as a result of the financial, accounting, legal and compliance and other additional expenses usually associated with operating as a public company. We will also recognize additional annual employee compensation and benefit expenses stemming from our employee stock ownership plan and stock options. These additional expenses adversely affect our profitability. We recognize expenses for our employee stock ownership plan when shares are committed to be released to participants' accounts and recognize expenses for stock options over the vesting period of awards made to recipients pursuant to our 2007 Equity Incentive Plan.

Applying disciplined underwriting practices to maintain the high quality of our loan portfolio. We believe that high asset quality is a key to long-term financial success. We have sought to grow and diversify the loan portfolio, while maintaining a high level of asset quality and moderate credit risk, using underwriting standards that we believe are conservative and diligent monitoring and collection efforts. At December 31, 2013, our ratio of nonperforming loans (loans which are 90 or more days delinquent) to total loans was 1.40% of our total loan portfolio. Although we intend to continue our efforts to originate commercial real estate, commercial business and construction loans, we intend to continue our philosophy of managing large loan exposures through our conservative approach to lending.

Balance Sheet Analysis

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

Total Assets. Total assets decreased $12.3 million, or 2.0%, from $600.0 million at December 31, 2012 to $587.7 million at December 31, 2013. The decrease in total assets at December 31, 2013 was primarily due to the decrease in cash and cash equivalents of $20.7 million, or 52.2%, and a decrease in investments of $11.0 million or 18.2%. These decreases were partially offset by the increase in net loans of $20.4 million, or 4.4%, from $465.2 million, or 77.5% of total assets, at December 31, 2012 to $485.6 million, or 82.6% of total assets, at December 31, 2013.

Cash and Cash Equivalents. Cash, including correspondent bank balances and federal funds sold, decreased $20.7 million, or 52.2%, from $39.6 million at December 31, 2012 to $18.9 million at December 31, 2013.

Investments. The investment securities portfolio, including held-to-maturity and available-for-sale securities, decreased $11.0 million, or 18.2%, from $60.2 million at December 31, 2012 to $49.2 million at December 31, 2013. The decrease in investments was primarily due to the $8.7 million, or 63.5%, decrease in the U.S. Treasury portfolio, a decrease of $668,000, or 7.4%, in certificates of deposit, a decrease of $535,000, or 45.3%, in collateralized mortgage obligations, and a decrease of $1.1 million, or 3.0%, in tax-exempt industrial revenue bonds.

Net Loans. Net loans increased $20.4 million, or 4.4%, from $465.2 million at December 31, 2012 to $485.6 million at December 31, 2013. Commercial real estate loans increased $21.7 million, or 11.4%, commercial and industrial loans increased $2.0 million, or 2.3%, commercial construction loans increased $2.7 million, or 7.4%, residential construction loans increased $1.8 million, or 41.4%, and home equity loans increased $360,000, or 1.1%. These increases were partially offset by a decrease in one-to four-family residential loans of $7.7 million, or 6.4%, and a decrease of $87,000, or 3.5%, in consumer loans. The decrease in residential real estate loans was primarily due to prepayments and refinancing activity attributed to the decline in interest rates to historically low levels. In accordance with the Company's asset/liability management strategy and in an effort to reduce interest rate risk, the Company sold $26.3 million fixed rate, low coupon residential real estate loans originated in 2013 to the secondary market. The Company currently services $97.6 million in loans sold to the secondary market. Servicing rights will continue to be retained on all loans originated and sold in the secondary market.

Deposits and Borrowed Funds. Total deposits decreased $16.4 million, or 3.5%, from $466.2 million at December 31, 2012 to $449.8 million at December 31, 2013. Core deposits, which we consider to be savings accounts, money market accounts, demand deposit accounts and NOW accounts increased $3.8 million, or 1.3%, from $288.7 million at December 31, 2012 to $292.5 million at December 31, 2013. NOW accounts increased $4.1 million, or 11.1%, to $40.8 million, money market deposit accounts decreased $16.6 million, or 13.0%, to $111.1 million, demand accounts increased $15.5 million, or 20.5%, to $90.9 million and regular savings accounts increased $873,000, or 1.8%, to $49.8 million. These changes were offset by a decrease in certificates of deposit of $20.2 million, or 11.4%, to $157.2 million. The decrease in certificates of deposit was mainly attributed to the strategic run-off of high cost accounts as a result of management's focus to lower the cost of deposits and allow higher cost, short-term certificates of deposit to mature without renewals.

Total borrowings, including securities sold under agreement to repurchase and Federal Home Loan Bank (“FHLB”) advances increased $1.9 million, or 4.4%, to $45.0 million at December 31, 2013. FHLB advances increased $11.7 million, or 35.0%. Repurchase agreements were terminated during 2013 and balances were transferred to the corresponding demand deposit account. From time to time, management may use borrowed money to engage in various leverage strategies to increase income as opportunities arise. In an effort to decrease the Bank’s interest rate risk from rising interest rates, the Bank took advantage of the Federal Home Loan Bank of Boston’s program to restructure outstanding advances and restructured $6.7 million of FHLB advances. Prior to this restructuring, these advances had a weighted average cost of 2.40% and a weighted average maturity term of 16.1 months. After this restructuring, the weighted average cost was reduced to 1.76% and the weighted average maturity term was extended to 47.4 months.

Total Stockholders’ Equity. Total stockholders’ equity at December 31, 2013 was $92.2 million, or 15.7% of total assets, compared to $90.0 million, or 15.0% of total assets, at December 31, 2012. The Company's stockholders' equity increased primarily as a result of $2.6 million in net income, a $303,000, or 7.8%, increase in stock-based compensation, and an increase of $255,000, or 8.4%, in additional paid-in-capital, partially offset by the $1.0 million cash dividend paid to stockholders. In 2013, the Company repurchased 13,000 shares of the Company’s common stock at an average per share price of $17.60 and released 21,000 shares to fund employee stock option exercises at an average share price of $17.55. Our capital management strategies allowed us to increase our book value per share by $0.40, or 2.4%, to $16.97 at December 31, 2013 compared to $16.57 at December 31, 2012.

Loans. Our primary lending activity is the origination of loans secured by real estate. We originate one-to-four-family residential loans, commercial real estate loans and commercial business loans. To a lesser extent, we originate residential investment, construction and consumer loans.

Our residential real estate loan portfolio has decreased from $120.3 million at December 31, 2012 to $112.5 million at December 31, 2013, primarily due to prepayments and refinancing activity attributed to the decline in interest rates to historically low levels. In accordance with the Company’s asset/liability management strategy and in an effort to reduce interest rate risk, the Company sold $26.3 million of fixed rate, low coupon residential real estate loans originated in 2013 to the secondary market. Servicing rights will continue to be retained on all loans originated and sold in the secondary market.

The commercial real estate portfolio increased $21.7 million, or 11.4%, from $189.5 million at December 31, 2012 to $211.2 million at December 31, 2013 as a result of new commercial loan relationships.

Commercial and industrial loans increased from $84.6 million at December 31, 2012 to $86.5 million at December 31, 2013 as a result of new commercial relationships due to increased marketing efforts and offering a wider variety of services to commercial borrowers, including cash management products.

The construction loan portfolio increased from $40.1 million at December 31, 2012 to $44.6 million at December 31, 2013. Commercial construction increased $2.7 million, or 7.4%, from $35.8 million at December 31, 2012 to $38.4 million at December 31, 2013 and residential construction increased $1.8 million, or 41.4% to $6.1 million.

The consumer and home equity loan portfolio increased $273,000, or 0.8%, from $34.2 million at December 31, 2012 to $34.5 million at December 31, 2013, primarily due to refinancing activity attributed to the decline in interest rates to historically low levels.

Loan Portfolio Composition. The following table sets forth the composition of the Company's loan portfolio in dollar amounts and as a percentage of the respective portfolio at the dates indicated.

	At December 31,									
	2013		2012		2011		2010		2009	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
	(Dollars In Thousands)									
Real estate loans:										
Residential real estate	$112,524	23.0 %	$120,265	25.7 %	$123,294	27.6 %	$132,670	30.6 %	$139,937	32.7 %
Home equity	32,091	6.6 %	31,731	6.8 %	29,790	6.7 %	29,933	6.9 %	29,320	6.9 %
Commercial	211,161	43.1 %	189,472	40.4 %	174,761	39.0 %	162,107	37.4 %	147,255	34.4 %
Total real estate loans	355,776	72.7 %	341,468	72.9 %	327,845	73.3 %	324,710	74.9 %	316,512	74.0 %
Construction loans:										
Residential	6,130	1.3 %	4,334	0.9 %	5,597	1.3 %	6,428	1.5 %	9,192	2.1 %
Commercial	38,441	7.9 %	35,781	7.6 %	31,706	7.0 %	26,643	6.1 %	29,121	6.9 %
Total construction loans	44,571	9.2 %	40,115	8.5 %	37,303	8.3 %	33,071	7.6 %	38,313	9.0 %
Total real estate and construction loans	400,347	81.9 %	381,583	81.4 %	365,148	81.6 %	357,781	82.5 %	354,825	83.0 %
Consumer	2,405	0.4 %	2,492	0.6 %	2,566	0.6 %	3,165	0.7 %	4,390	1.0 %
Commercial and industrial	86,540	17.7 %	84,583	18.0 %	79,412	17.8 %	72,847	16.8 %	68,552	16.0 %
Total loans	489,292	100.0 %	468,658	100.0 %	447,126	100.0 %	433,793	100.0 %	427,767	100.0 %
Deferred loan origination costs, net	923		917		921		945		965	
Allowance for loan losses	(4,596)		(4,364)		(4,576)		(4,431)		(4,077)	
Loans, net	$485,619		$465,211		$443,471		$430,307		$424,655	

Loan Maturity. The following table sets forth certain information at December 31, 2013 regarding the dollar amount of loan principal repayments becoming due during the periods indicated. The table does not include any estimate of prepayments which significantly shorten the average life of all loans and may cause our actual repayment experience to differ from that shown. Demand loans having no stated schedule of repayments and no stated maturity are reported as due in one year or less. Real estate mortgage loans include residential and commercial real estate loans and home equity loans.

	Real Estate Mortgage	Construction	Commercial	Consumer	Total Loans
	(In Thousands)				

Amounts due:					
One year or less	$1,215	$10,470	$57,036	$201	$68,922
More than one year to five years	7,940	17,557	22,063	1,611	49,171
More than five years	346,621	16,544	7,441	593	371,199
Total amount due	$355,776	$44,571	$86,540	$2,405	$489,292

The following table sets forth the dollar amount of all loans at December 31, 2013 that are due after December 31, 2014 that have either fixed interest rates or adjustable interest rates. The amounts shown below exclude unearned interest on consumer loans and deferred loan origination costs. Real estate loans include residential and commercial real estate loans. Consumer loans include home equity loans.

	Due After December 31, 2014		
	Fixed	Adjustable	Total
	(In Thousands)		
Real estate loans	$38,273	$316,288	$354,561
Construction	7,943	26,158	34,101
Commercial	21,234	8,270	29,504
Consumer	2,115	89	2,204
Total loans	$69,565	$350,805	$420,370

Securities. The securities portfolio consists primarily of tax-exempt industrial revenue bonds, U.S. Treasury securities, collateralized mortgage obligations and certificates of deposit. Total securities decreased $11.0 million, or 18.2%, from $60.1 million million at December 31, 2013 to $49.1 million at December 31, 2013. The decrease was primarily due to maturities of U.S. Treasury securities of $20.2 million, paydowns of tax-exempt industrial revenue bonds of $1.1 million, $16.2 million of maturities in certificates of deposit, and maturities of collateralized mortgage obligations of $535,000. These decreases were partially offset by purchases of U.S. Treasury securities of $11.5 million and $15.5 million in certificates of deposit.

Total securities decreased $14.3 million, or 19.2%, from $74.5 million at December 31, 2011 to $60.1 million at December 31, 2012. The decrease was primarily due to maturities of U.S. Treasury securities of $36.0 million, maturities of tax-exempt industrial revenue bonds of $2.7 million, $23.4 million of maturities in certificates of deposit, and maturities of collateralized mortgage obligations of $892,000. These decreases were partially offset by purchases of U.S. Treasury securities of $22.7 million, $7.9 million in tax-exempt industrial revenue bonds, and $19.3 million in certificates of deposit.

Total securities increased $4.4 million, or 6.3%, from $70.1 million at December 31, 2010 to $74.5 million at December 31, 2011. The increase was primarily due to purchases of U.S. Treasury securities of $58.0 million, tax-exempt industrial revenue bonds of $8.9 million and $32.0 million in certificates of deposit. These increases were partially offset by maturities of U.S. Treasury securities of $61.8 million, maturities of certificates of deposit of $30.5 million, and maturities of collateralized mortgage obligations of $1.8 million.

All of our collateralized mortgage obligations were issued by Fannie Mae or Freddie Mac.

The following table sets forth, at the dates indicated, information regarding the amortized cost and market values of the Company's investment securities.

	At December 31,					
	2013		2012		2011	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In Thousands)					
Available-for-sale securities						
Marketable equity securities [1]	$522	$602	$581	$621	$618	$613
Total available-for-sale securities	$522	$602	$581	$621	$618	$613
Held-to-maturity securities						
U.S. Treasury securities	$5,000	$5,000	$13,691	$13,693	$26,998	$26,998
Corporate and industrial revenue bonds	34,588	35,269	35,656	43,137	31,576	38,219
Certificates of deposit	8,373	8,388	9,041	9,045	13,206	13,213
Collateralized mortgage obligations	645	681	1,180	1,233	2,072	2,177
Total held-to-maturity securities	$48,606	$49,338	$59,568	$67,108	$73,852	$80,607
Total securities	$49,128	$49,940	$60,149	$67,729	$74,470	$81,220

[1] Does not include investments in FHLB stock or Banker's Bank Northeast stock totaling $3.9 million and $183,000, respectively, at December 31, 2013, and totaling $4.3 million and $183,000, respectively, at December 31, 2012 and totaling $4.5 million and $183,000, respectively, at December 31, 2011.

The amortized cost of available-for-sale securities decreased $59,000, or 10.2%, from $581,000 at December 31, 2012 to $522,000 at December 31, 2013, due to the sale of 6,000 shares of a security issued by one company in the financial industry. The fair value of available-for-sale securities decreased $19,000, or 3.1%, from $621,000 at December 31,

2012 to $602,000 at December 31, 2013. The fair value of the remaining securities decreased due to the sale of the 6,000 shares in 2013.

The amortized cost of available-for-sale securities decreased $37,000, or 59.9%, from $618,000 at December 31, 2011 to $581,000 at December 31, 2012, primarily due to an OTTI charge of $37,000 relating to three securities issued by one company in the financial industry. The fair value of securities available-for-sale increased $8,000, or 13.1%, from $613,000 at December 31, 2011 to $621,000 at December 31, 2012.

The amortized cost of available-for-sale securities increased $299,000, or 93.7%, from $319,000 at December 31, 2010 to $618,000 at December 31, 2011, primarily due to a purchase of securities in the financial industry. The fair value of available-for-sale securities increased $251,000, or 69.3%, from $362,000 at December 31, 2010 to $613,000 at December 31, 2011 primarily due to the aforementioned purchases of securities and by increases in market values of the remaining equity portfolio.

The amortized cost of held-to-maturity securities decreased $11.0 million, or 18.4%, to $48.6 million at December 31, 2013, compared to $59.6 million at December 31, 2012, primarily due to maturities of U.S. Treasury securities of $8.7 million, or 63.5%, a $668,000, or 7.4%, decrease in certificates of deposit, a decrease of $535,000, or 45.3%, in collateralized mortgage obligations, partially and a decrease in tax-exempt industrial revenue bonds of $1.1 million, or 3.0%.

The amortized cost of held-to-maturity securities decreased $14.3 million, or 19.3%, to $59.6 million at December 31, 2012, compared to $73.9 million at December 31, 2011, primarily due to maturities of U.S. Treasury securities of $13.3 million, or 49.2%, a $4.2 million, or 31.5%, decrease in certificates of deposit, and a decrease of $892,000, or 43.1%, in collateralized mortgage obligations, partially offset by the increase in tax-exempt industrial revenue bonds of $4.1 million, or 12.9%.

The amortized cost of held-to-maturity securities increased $4.1 million, or 5.9%, to $73.9 million at December 31, 2011, compared to $69.7 million at December 31, 2010, primarily due to purchases of U.S. Treasury securities of $58.0 million, tax-exempt industrial revenue bonds of $8.9 million and certificates of deposit of $32.0 million, partially offset by maturities of U.S. Treasury securities of $61.8 million, maturities of certificates of deposit of $30.5 million and maturities of collateralized mortgage obligations and tax-exempt industrial revenue bonds of $2.4 million.

At December 31, 2013, our marketable equity securities had a net unrealized gain of $80,000 and no unrealized losses. At December 31, 2013, the Company sold 6,000 shares of a security issued by one company in the financial industry. The Company recorded a realized gain of $37,000.

At December 31, 2012, our marketable equity securities had a net unrealized gain of $40,000 and no unrealized losses. During the year ended December 31, 2012, the Company recorded an OTTI charge of $37,000. Management evaluated the security according to the Company’s OTTI policy and determined the decline in value to be other-than-temporary. There were no sales of available-for sale securities during 2012.

At December 31, 2011, our marketable equity securities had an unrealized gain of $28,000 offset by an unrealized loss of $33,000. The unrealized losses within the marketable equity securities category at December 31, 2011 related to three securities issued by one company in the financial industry. During the year ended December 31, 2011, none of the three securities with unrealized losses had losses for more than 12 months. Management evaluated the securities according to the Company’s OTTI policy and determined there was no other-than-temporary impairment write-downs required. At December 31, 2011, the Company sold 1,133 shares of a security issued by one company in the financial industry. The Company recorded a realized gain of $12,000.

At December 31, 2013 and 2012, there were no investments in a single company or entity (other than the U.S. Government) that had an aggregate book value in excess of 10% of our equity.

The table below sets forth the stated maturities and weighted average yields of debt securities at December 31, 2013. Weighted average yields on tax-exempt securities are not presented on a tax equivalent basis because the impact would be insignificant.

Less than One Year		More than One Year to Five Years		More than Five Years to Ten Years		More than Ten Years		Total	
Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield
(Dollars in Thousands)									

Held-to-maturity securities														
U.S. Treasury securities	$5,000	0.10	%	$—	—		$—	—		$—	—		$5,000	0.10	%
Industrial revenue bonds	—	—		—	—		8,029	4.47	%	26,559	4.22	%	34,588	4.28	%
Certificates of deposit	8,373	0.60	%	—	—		—	—		—	—		8,373	0.60	%
Collateralized mortgage obligations	—	—		615	4.49	%	30	5.00	%	—	—		645	4.51	%
Total held-to-maturity securities	$13,373	0.41	%	$615	4.49	%	$8,059	4.47	%	$26,559	4.22	%	$48,606	3.22	%

Restricted Equity Securities. At December 31, 2013, the Company held $3.9 million of FHLB stock. This stock is restricted and must be held as a condition of membership in the FHLB and as a condition for the Bank to borrow from the FHLB. On February 26, 2009, the FHLB's board of directors (i) announced that they were suspending dividends and (ii) issued a moratorium on the redemption of FHLB stock. The FHLB's board of directors declared dividends in 2013 at a rate of 0.38%. The Company periodically evaluates its investment in FHLB stock for impairment based on, among other factors, the capital adequacy of the FHLB and its overall financial condition. No impairment losses have been recorded through December 31, 2013. The Company will continue to monitor its investment in FHLB stock. For additional information regarding our FHLB stock, see Note 3 to the notes to the consolidated financial statements.

Deposits. Our primary source of funds are deposits, which are comprised of certificates of deposit, money market deposit accounts, demand deposits, passbook accounts, and NOW accounts. These deposits are provided primarily by individuals and businesses within our market areas. At December 31, 2013, 2012 and 2011, we did not use brokered deposits as a source of funding.

Total deposits decreased $16.4 million, or 3.5%, from $466.2 million at December 31, 2012 to $449.8 million at December 31, 2013. Core deposits increased $3.8 million, or 1.3%, from $288.7 million at December 31, 2012 to $292.5 million at December 31, 2013. NOW accounts increased $4.1 million, or 11.1%, to $40.8 million, money market deposit accounts decreased $16.6 million, or 13.0%, to $111.1 million, demand accounts increased $15.5 million, or 20.5%, to $90.9 million and regular savings accounts increased $873,000, or 1.8%, to $49.8 million. These changes were offset by a decrease in certificates of deposit of $20.2 million, or 11.4%, to $157.2 million. The decrease in certificates of deposit was mainly attributed to the strategic run-off of high cost accounts as a result of management's focus to lower the cost of deposits and allow higher cost, short-term certificates of deposit to mature without renewals.

At December 31, 2012, deposits increased $12.8 million, or 2.8%, to $466.2 million from $453.4 million at December 31, 2011. The increase was primarily due to increases in NOW accounts of $10.0 million, or 37.3%, money market accounts of $30.1 million, or 30.9%, demand accounts of $6.6 million, or 9.6% and savings accounts of $1.8 million, or 3.7%. These increases were partially offset by a decrease in certificates of deposit of $35.7 million, or 16.7%. The decrease in certificates of deposits was mainly attributed to the strategic run-off of high cost accounts as a result of management's focus to lower the cost of deposits and allow higher cost, short-term time deposits to mature without renewals. Money market and demand accounts increased due to increases in municipal and commercial accounts as well as an increase in low cost relationship focused transaction and savings accounts.

The following table sets forth the distribution of the Company's deposit accounts for the periods indicated.

	December 31,		
	2013	2012	2011
	(In Thousands)		
Demand deposits	$90,869	$75,407	$68,799
NOW accounts	40,774	36,711	26,747
Savings accounts	49,755	48,882	47,122
Money market deposit accounts	111,126	127,730	97,606
Certificates of deposit	157,242	177,447	213,103
Total deposits	$449,766	$466,177	$453,377

The following table indicates the amount of jumbo certificates of deposit by time remaining until maturity as of December 31, 2013. Jumbo certificates of deposit require minimum deposits of $100,000.

Weighted
Average

Maturity Period	Amount	Rate	
	(Dollars in Thousands)		
Three months or less	$19,881	2.08	%
Over three months through six months	10,392	1.45	%
Over six months through 12 months	18,293	1.70	%
Over 12 months	28,847	2.04	%
Total	$77,413	1.89	%

Borrowings. The Company utilizes borrowings from a variety of sources to supplement our supply of funds for loans and investments.

	Years Ended December 31,		
	2013	2012	2011
	(Dollars in Thousands)		
Maximum amount of advances outstanding at any month-end during the year:			
FHLB advances	$44,992	$58,308	$70,564
Securities sold under agreements to repurchase	15,312	12,982	24,560
Average advances outstanding during the year:			
FHLB advances	$29,202	$46,907	$64,777
Securities sold under agreements to repurchase	7,243	9,027	17,554
Weighted average interest rate during the year:			
FHLB advances	2.41 %	2.56 %	2.57 %
Securities sold under agreements to repurchase	0.12 %	0.14 %	0.21 %
Balance outstanding at end of year:			
FHLB advances	$44,992	$33,332	$59,265
Securities sold under agreements to repurchase	—	9,763	12,340
Weighted average interest rate at end of year:			
FHLB advances	1.93 %	2.39 %	2.51 %
Securities sold under agreements to repurchase	— %	0.12 %	0.18 %

FHLB advances increased $11.7 million, or 35.0%, to $45.0 million at December 31, 2013 from $33.3 million at December 31, 2012. The increase was due to long-term advances of $21.0 million to fund loan growth and minimize interest rate risk.

FHLB advances decreased $25.9 million, or 43.8%, to $33.3 million at December 31, 2012 from $59.3 million at December 31, 2011. The decrease was due to pay downs of $12.4 million and maturities on long-term advances of $16.8 million. During 2011, the Company relied primarily on the increase in deposits of $12.8 million to fund loan growth and minimize interest rate risk.

At December 31, 2013, securities sold under agreements to repurchase decreased to zero from $9.8 million at December 31, 2012. At December 31, 2012, securities sold under agreements to repurchase decreased $2.6 million, or 20.9%, to $9.8 million from $12.3 million at December 31, 2011.

At December 31, 2013, the Company had an Ideal Way Line of Credit with the FHLB of $2.0 million and the ability to borrow a total of $47.4 million with the Federal Reserve Bank of Boston's discount window. In addition, we had the ability to borrow a total of $4.0 million from Banker's Bank Northeast. As of December 31, 2013, the Company did not utilize any of these contingency funding sources.

Analysis of Net Interest Income

Net interest income represents the difference between income on interest-earning assets and expense on interest-bearing liabilities. Net interest income depends on the relative amounts of interest-earning assets and interest-bearing liabilities and the interest rate earned or paid on them.

Average Balance Sheet. The following table sets forth information relating to the Company for the years ended December 31, 2013, 2012 and 2011. The average yields and costs are derived by dividing interest income or interest

expense by the average balance of interest-earning assets or interest-bearing liabilities, respectively, for the periods shown. Average balances are derived from average daily balances. The yields include fees which are considered adjustments to yields. Loan interest and yield data does not include any accrued interest from non-accruing loans.

	2013				2012				2011			
	Average Balance	Interest	Average Yield/ Rate		Average Balance	Interest	Average Yield/ Rate		Average Balance	Interest	Average Yield/ Rate	
	(Dollars in Thousands)											
Interest-earning assets:												
Investments (1)	$64,405	$2,754	4.28	%	$68,257	$2,721	3.99	%	$72,774	$2,551	3.51	%
Loans:												
Residential real estate loans	115,402	5,845	5.06	%	123,102	6,743	5.48	%	129,924	7,487	5.76	%
Home equity loans	31,840	1,178	3.70	%	30,744	1,216	3.96	%	29,678	1,281	4.32	%
Commercial real estate loans	187,751	8,711	4.64	%	179,564	8,926	4.97	%	170,702	8,944	5.24	%
Residential construction loans	4,778	198	4.14	%	5,208	226	4.34	%	5,548	295	5.32	%
Commercial construction loans	34,824	1,574	4.52	%	38,089	1,874	4.92	%	26,984	1,418	5.25	%
Consumer loans	2,376	130	5.47	%	2,553	146	5.72	%	2,735	185	6.76	%
Commercial and industrial loans	87,190	3,688	4.23	%	81,566	3,518	4.31	%	81,480	3,576	4.39	%
Loans, net (2)	464,161	21,324	4.59	%	460,826	22,649	4.91	%	447,051	23,186	5.19	%
Other	21,069	55	0.26	%	29,664	64	0.22	%	25,068	49	0.20	%
Total interest-earning assets	549,635	24,133	4.39	%	558,747	25,434	4.55	%	544,893	25,786	4.73	%
Noninterest-earning assets	36,945				40,164				38,351			
Total assets	$586,580				$598,911				$583,244			
Interest-bearing liabilities:												
Deposits:												
Money market deposit accounts	$120,405	$378	0.31	%	$109,168	$358	0.33	%	$78,719	$274	0.35	%
Savings accounts (3)	49,851	52	0.10	%	48,679	51	0.10	%	46,711	49	0.10	%
NOW accounts	39,435	371	0.94	%	31,401	322	1.03	%	18,861	86	0.46	%
Certificates of deposit	170,195	2,834	1.67	%	196,491	3,681	1.87	%	212,184	4,789	2.26	%
Total interest-bearing deposits	379,886	3,635	0.96	%	385,739	4,412	1.14	%	356,475	5,198	1.46	%
FHLB advances	29,202	705	2.41	%	46,907	1,202	2.56	%	64,777	1,668	2.57	%
Securities sold under agreement to												
repurchase	7,243	9	0.12	%	9,027	13	0.14	%	17,554	36	0.21	%
	36,445	714	1.96	%	55,934	1,215	2.17	%	82,331	1,704	2.07	%

Total interest-bearing borrowings									
Total interest-bearing liabilities	416,331	4,349	1.04 %	441,673	5,627	1.27 %	438,806	6,902	1.57 %
Demand deposits	77,949			66,840			52,403		
Other noninterest-bearing liabilities	887			464			365		
Total liabilities	495,167			508,977			491,574		
Total stockholders' equity	91,413			89,934			91,670		
Total liabilities and stockholders' equity	$586,580			$598,911			$583,244		
Net interest-earning assets	$133,304			$117,074			$106,087		
Tax equivalent net interest income/ interest rate spread (4)		19,784	3.35 %		19,807	3.28 %		18,884	3.16 %
Tax equivalent net interest margin (net interest income as a percentage of interest-earning assets)			3.60 %			3.54 %			3.47 %
Ratio of interest-earning assets to interest-bearing liabilities			132.02 %			126.51 %			124.18 %
Less: tax equivalent adjustment (1)		(1,064)			(1,037)			(936)	
Net interest income as reported on income statement					$18,770			$17,948	

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(1) Municipal securities income and net interest income are presented on a tax equivalent basis using a tax rate of 41%.
The tax equivalent adjustment is deducted from the tax equivalent net interest income to agree to the amount reported
on the statement of operations. See 'Explanation of Use of Non-GAAP Financial Measurements'.
(2) Loans, net excludes loans held for sale and the allowance for loan losses and includes nonperforming loans.
(3) Savings accounts include mortgagors' escrow deposits.
(4) Tax equivalent interest rate spread represents the difference between the weighted average yield on interest-earning
assets and the weighted average cost of interest-bearing liabilities

Rate/Volume Analysis. The following table presents the extent to which changes in interest rates and changes in the volume of interest-earning assets and interest-bearing liabilities have affected the Company's tax equivalent interest income and interest expense during the periods indicated. Information is provided in each category with respect to: (i) changes attributable to changes in volume (changes in volume multiplied by prior rate); (ii) changes attributable to changes in rate (changes in rate multiplied by prior volume); and (iii) the net change. The changes attributable to the combined impact of volume and rate have been allocated proportionately to the changes due to volume and the changes due to rate.

	Year Ended December 31, 2013 Compared to December 31, 2012 Increase (Decrease) Due to			Year Ended December 31, 2012 Compared to December 31, 2011 Increase (Decrease) Due to		
	Volume	Rate	Net	Volume	Rate	Net
	(Dollars in Thousands)					
Interest-earning assets:						
Investment securities	$(159)	$192	$33	$(165)	$335	$170
Loans:						
Residential real estate	(407)	(491)	(898)	(383)	(361)	(744)
Home equity	42	(80)	(38)	45	(110)	(65)
Commercial real estate	396	(611)	(215)	452	(470)	(18)
Residential construction	(18)	(10)	(28)	(17)	(52)	(69)
Commercial construction	(154)	(146)	(300)	551	(95)	456
Consumer	(10)	(6)	(16)	(11)	(28)	(39)
Commercial and industrial	239	(69)	170	4	(62)	(58)
Total loans	88	(1,413)	(1,325)	641	(1,178)	(537)
Other	(21)	12	(9)	10	5	15
Total interest-earning assets	$(92)	$(1,209)	$(1,301)	$486	$(838)	$(352)
Interest-bearing liabilities:						
Deposits:						
Money market deposit accounts	$36	$(16)	$20	$101	$(17)	$84
Savings accounts (1)	1	—	1	2	—	2
NOW accounts	77	(28)	49	82	154	236
Certificates of deposit	(463)	(384)	(847)	(336)	(772)	(1,108)
Total interest-bearing deposits	(349)	(428)	(777)	(151)	(635)	(786)
FHLB advances	(431)	(66)	(497)	(458)	(8)	(466)
Securities sold under agreement to repurchase	(2)	(2)	(4)	(14)	(9)	(23)
Total interest-bearing borrowings	(433)	(68)	(501)	(472)	(17)	(489)
Total interest-bearing liabilities	(782)	(496)	(1,278)	(623)	(652)	(1,275)
Increase in net interest income	$690	$(713)	$(23)	$1,109	$(186)	$923

(1) Includes interest on mortgagors' escrow deposits.

Results of Operations.

Comparison of Operating Results for the Years Ended December 31, 2013 and December 31, 2012

Net Income. The Company had net income of $2.6 million, or $0.51 basic earnings per share, for the year ended December 31, 2013 as compared to net income of $2.5 million, or $0.49 basic earnings per share, for the year ended December 31, 2012. The $88,000, or 3.6%, increase in net income for the year ended December 31, 2013 compared to the year ended December 31, 2012, was primarily due to the decrease of $50,000, or 0.3%, in net interest income and a $106,000, or 18.2%, increase in income tax expense, partially offset by a decrease in non-interest expense of $150,000, or 0.8%, a decrease in provision for loan losses of $17,000, or 3.8%, and an increase of $77,000, or 2.5%, in non-interest income.

Net Interest Income. The tables on the preceding pages set forth the components of the Company's net interest income, yields on interest-earning assets and interest-bearing liabilities, and the effect on net interest income arising from changes in volume and rate. There was a decrease in tax equivalent net interest income for the year ended December 31, 2013 of $23,000, or 0.1%, to $19.8 million for the same period in 2012. The decrease in the volume of interest-earning assets decreased interest and dividend income $92,000. The increase in the volume of interest bearing deposits, specially, money market accounts, NOW accounts and savings accounts increased interest expense $114,000, partially offset by the decrease in the volume of certificates of deposit which decreased interest expense $463,000, for an overall decrease of $349,000. In addition, the volume of interest-bearing borrowings decreased interest expense $433,000. The changes in volume had the effect of increasing net interest income $690,000. The changes in the rates of interest-earning assets decreased interest income $1.2 million, partially offset by changes in the rates of interest-bearing liabilities which decreased interest expense $496,000. The changes in the rates of interest-earning assets and interest-bearing liabilities had the effect of decreasing net interest income $713,000. Net interest margin, on a tax equivalent basis, increased from 3.54% for the year ended December 31, 2012 to 3.60% for the year ended December 31, 2013.

Interest and Dividend Income. Interest and dividend income, on a tax equivalent basis, decreased $1.3 million, or 5.1%, to $24.1 million for the year ended December 31, 2013 compared to $25.4 million for the year ended December 31, 2012, largely reflecting the decrease in income from loans. Average interest-earning assets totaled $549.6 million for the year ended December 31, 2013 compared to $558.7 million for the same period 2012, representing an decrease of $9.1 million, or 1.6%. Average loans increased $3.3 million, or 0.7%, primarily due to commercial lending and partially offset by the sale of low-coupon fixed rate residential real estate loans originated in 2013 to the secondary market. Average investment securities decreased $3.9 million, or 5.7%, primarily due to maturities of U.S. Treasury securities and certificates of deposit and pay downs of collateralized mortgage obligations and tax-exempt industrial revenue bonds. The tax equivalent yield on interest-earning assets decreased 16 basis points to 4.39% for the year ended December 31, 2013 from 4.55% for the year ended December 31, 2012, largely attributable to lower market rates of interest for 2013.

Interest Expense. Total interest expense decreased $1.3 million, or 22.7%, to $4.3 million for the year ended December 31, 2013 from $5.6 million for the year ended December 31, 2012. The decrease was primarily due to the decrease in deposit interest rates to manage interest rate risk, as well as decreased market rates of interest. Average interest-bearing liabilities totaled $416.3 million for the year ended December 31, 2013, representing a decrease of $25.4 million, or 5.8%, from $441.7 million for the same period in 2012, primarily due to the decrease in average interest-bearing deposits of $5.9 million, or 1.5%, and a decrease in average interest-bearing borrowings of $19.5 million, or 34.8%. The rate paid on interest-bearing liabilities decreased 23 basis points to 1.04% for the year ended December 31, 2013 from 1.27% in 2012, reflecting the lower interest rate environment.

Provision for Loan Losses. For the year ended December 31, 2013, the provision for loan losses decreased $17,000, or 3.8%, to $425,000 from $442,000 for the same period in 2012. Charge-offs for year ended December 31, 2013 and 2012 were $493,000 and $678,000, respectively, partially offset by recoveries of $300,000 and $24,000 for the year ended December 31, 2013 and December 31, 2012, respectively.

The allowance for loan losses of $4.6 million at December 31, 2013 represented 0.94% of total loans, as compared to an allowance for loan losses of $4.4 million, representing 0.93% of total loans at December 31, 2012. An analysis of the changes in the allowance for loan losses is presented under “Risk Management – Analysis and Determination of the Allowance for Loan Losses” and in Note 4 of the financial statements.

Non-interest Income. Non-interest income increased $77,000, or 2.5%, to $3.1 million for the year ended December 31, 2013. Income from customer service charges, fees and commissions decreased $18,000, or 0.8%, income from bank owned life insurance decreased $15,000, or 3.9%, and income from net loan sales and servicing decreased $45,000, or 6.7%. These decreases were partially offset by the decrease on the loss on sale of OREO of $91,000, or 36.5%.

Non-interest Expenses. Non-interest expense decreased $150,000, or 0.8%, from $18.3 million for the year ended December 31, 2012 to $18.2 million for the year ended December 31, 2013. The decrease was primarily due to a decrease in salaries and employee benefits of $264,000, or 2.5%. The decrease in salaries and employee benefits was directly attributed to the decrease in the expense related to the 2007 Equity Incentive Plan. The restricted stock awards and stock options granted in 2007 were fully expensed on July 27, 2012. FDIC insurance expense decreased $126,000, or 35.3%, stationery, supplies and postage decreased $46,000, or 13.6%, advertising expense decreased $21,000, or 3.5%, furniture and equipment expense decreased $15,000, or 1.9%, and other non-interest expense decreased $4,000, or 0.2%. These decreases were partially offset by an increase in occupancy expense of $99,000, or 6.7%, an increase in data processing of $125,000, or 11.2%, and an increase in professional fees of $102,000, or 18.5%.

Income Taxes. Income tax expense increased $106,000, or 18.2% from $581,000 for the year ended December 31, 2012 to $687,000 for the year ended December 31, 2013 mainly due to the increase in income before income taxes of $194,000, or 6.4%, which resulted in an increase in current tax expense of $465,000, and a decrease of $13,000 in the valuation reserve. As of December 31, 2013, a valuation allowance of $54,000 has been established against deferred tax assets related to the uncertain utilization of the charitable contribution carry forward created primarily by the donation to the Foundation as part of the conversion, as well as to a capital loss carry forward. The decrease in the valuation reserve is due to an increase in expected future capital gains. The judgment applied by management considers the likelihood that sufficient taxable income will be realized within the carry forward period in light of our tax planning strategies and changes in market conditions. See Note 10 for additional income tax disclosures.

Comparison of Operating Results for the Years Ended December 31, 2012 and December 31, 2011

Net Income. The Company had net income of $2.5 million, or $0.49 basic earnings per share, for the year ended December 31, 2012 as compared to net income of $1.1 million, or $0.21 basic earnings per share, for the year ended December 31, 2011. The primary reason for the increase in net income of $1.4 million, or 124.1%, was the increase in net interest income of $822,000, or 4.6%.

Net Interest Income. The tables on the preceding pages set forth the components of the Company's net interest income, yields on interest-earning assets and interest-bearing liabilities, and the effect on net interest income arising from changes in volume and rate. There was an increase in tax equivalent net interest income for the year ended December 31, 2012 of $923,000, or 4.8%, to $19.8 million from $18.9 million for the same period in 2011. The increase in the volume of interest-earning assets increased interest income $629,000. Money market accounts, NOW accounts and savings accounts increased interest expense $185,000, which was offset by the decrease in the volume of certificates of deposit which decreased interest expense $336,000, for an overall decrease of $151,000. In addition, the volume of interest-bearing borrowings decreased interest expense $472,000. The changes in volume had the effect of increasing net interest income $1.3 million. The changes in the rates of interest-earning assets decreased interest income $981,000, partially offset by changes in the rates of interest-bearing liabilities which decreased interest expense $652,000. The changes in the rates of interest-earning assets and interest-bearing liabilities had the effect of decreasing net interest income $329,000. Net interest margin, on a tax equivalent basis, increased from 3.47% for the year ended December 31, 2011 to 3.54% for the year ended December 31, 2012.

Interest and Dividend Income. Interest and dividend income, on a tax equivalent basis, decreased $352,000, or 1.4%, to $25.4 million for the year ended December 31, 2012 compared to $25.8 million for the year ended December 31, 2011, largely reflecting the decrease in income from loans. Average interest-earning assets totaled $558.7 million for the year ended December 31, 2012 compared to $544.9 million for the same period 2011, representing an increase of $13.9 million, or 2.5%. Average loans increased $13.8 million, or 3.1%, primarily due to strong originations partially offset by the sale of low-coupon fixed rate residential real estate loans originated in 2012 to the secondary market. Average investment securities decreased $4.5 million, or 6.2%, primarily due to maturities of U.S. Treasury securities and pay downs of collateralized mortgage obligations. These decreases were partially offset by purchase of a $5.3

million tax-exempt industrial revenue bond. The tax equivalent yield on interest-earning assets decreased 18 basis points to 4.55% for the year ended December 31, 2012 from 4.73% for the year ended December 31, 2011, largely attributable to lower market rates of interest for 2012.

Interest Expense. Total interest expense decreased $1.3 million, or 18.5%, to $5.6 million for the year ended December 31, 2012 from $6.9 million in 2011, resulting primarily from the Company reducing deposit interest rates to manage interest rate risk, and also reflecting decreased market rates of interest. Average interest-bearing liabilities totaled $441.7 million for the year ended December 31, 2012, representing an increase of $2.9 million, or 0.7%, from $438.8 million for the same period in 2011, mainly due to an increase in average interest-bearing deposits of $29.3 million, or 8.2%. This increase was partially offset by a decrease in average interest-bearing borrowings of $26.4 million, or 32.1%. The rate paid on interest-bearing liabilities decreased 30 basis points to 1.27% for the year ended December 31, 2012 from 1.57% in 2011, reflecting the lower interest rate environment.

Provision for Loan Losses. For the year ended December 31, 2012, the provision for loan losses decreased $400,000, or 47.5%, to $442,000 from $842,000 for the same period in 2011. Net loan charge-offs for year ended December 31, 2012 and 2011 were $654,000 and $697,000, respectively.

The allowance for loan losses of $4.4 million at December 31, 2012 represented 0.93% of total loans, as compared to an allowance of $4.6 million, representing 1.02% of total loans at December 31, 2011. An analysis of the changes in the allowance for loan losses is presented under “Risk Management - Analysis and Determination of the Allowance for Loan Losses” and in Note 4 of the financial statements.

Non-interest Income. Non-interest income, excluding gains on the sale of securities, increased $385,000, or 14.6%, to $3.0 million for the year ended December 31, 2012. Income from customer service charges, fees and commissions increased $264,000, or 13.4%, due to the increase in transaction accounts and an increase in income from net loan sales and servicing of $294,000, or 78.8%. These increases were partially offset by a loss on sale of OREO of $249,000 and a decrease in income from bank owned life insurance of $15,000, or 3.8%.

Non-interest Expenses. Non-interest expense decreased $429,000, or 2.3%, from $18.7 million for the year ended December 31, 2011 to $18.3 million for the year ended December 31, 2012. The decrease was primarily due to a decrease in salaries and employee benefits of $466,000, or 4.3%. The decrease in salaries and employee benefits was directly attributed to the decrease in the expense related to the 2007 Equity Incentive Plan. The restricted stock awards and stock options granted in 2007 were fully expensed on July 27, 2012. FDIC insurance expense decreased $180,000, or 33.5%, occupancy expense decreased $58,000, or 3.8%, data processing decreased $47,000, or 4.0%, and stationery, supplies and postage decreased $25,000, or 6.9%. These decreases were partially offset by a $70,000, or 9.6%, increase in furniture and equipment, an increase of $23,000, or 4.0%, in advertising, and a $251,000, or 10.5%, increase in other non-interest expense. The increase in other non-interest expense was primarily due to a $71,000, or 46.7%, increase in foreclosure related expenses, a $39,000, or 22.3%, increase in armored car expense, and a $51,000 non-recurring expense for the termination of a contract with a third party vendor.

Income Taxes. The Company’s income tax expense increased $659,000, or 844.9% from a benefit of $78,000 for the year ended December 31, 2011 to an expense of $581,000 for the year ended December 31, 2012 mainly attributable to the increase in income before income taxes of $2.0 million, or 198.0%, which resulted in an increase in current tax expense of $626,000, and a decrease of $20,000 in the valuation reserve. As of December 31, 2012, a valuation allowance of $67,000 has been established against deferred tax assets related to the uncertain utilization of the charitable contribution carry forward created primarily by the donation to the Foundation as part of the conversion, as well as to a capital loss carry forward. The decrease in the valuation reserve is due to an increase in expected future capital gains. The judgment applied by management considers the likelihood that sufficient taxable income will be realized within the carry forward period in light of our tax planning strategies and changes in market conditions. See Note 10 for additional income tax disclosures.

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Explanation of Use of Non-GAAP Financial Measurements. We believe that it is common practice in the banking industry to present interest income and related yield information on tax-exempt securities on a tax-equivalent basis and that such information is useful to investors because it facilitates comparisons among financial institutions. However, the adjustment of interest income and yields on tax-exempt securities to a tax-equivalent amount may be considered to include non-GAAP financial information. A reconciliation to GAAP is provided below.

	For the Years Ended December 31,								
	2013			2012			2011		
	(Dollars in Thousands)								
	Interest	Average Yield		Interest	Average Yield		Interest	Average Yield	
Investment securities (non-tax adjustment)	$1,690	2.62	%	$1,684	2.47	%	$1,615	2.22	%
Tax equivalent adjustment (1)	1,064			1,037			936		
Investment securities (tax equivalent basis)	$2,754	4.28	%	$2,721	3.99	%	$2,551	3.51	%
Net interest income (non-tax adjustment)	$18,720			$18,770			$17,948		
Tax equivalent adjustment (1)	1,064			1,037			936		
Net interest income (tax equivalent basis)	$19,784			$19,807			$18,884		
Interest rate spread (no tax adjustment)		3.16	%		3.10	%		2.99	%
Net interest margin (no tax adjustment)		3.41	%		3.36	%		3.29	%

(1) The tax equivalent adjustment is based on a tax rate of 41% for all periods presented.

Risk Management

Overview. Managing risk is an essential part of successfully managing a financial institution. Our most prominent risk exposures are credit risk, interest rate risk and market risk. Credit risk is the risk of not collecting the interest and/or the principal balance of a loan or investment when due. Interest rate risk is the potential reduction of net interest income as a result of changes in interest rates. Market risk arises from fluctuations in interest rates that may result in changes in the values of financial instruments, such as available-for-sale securities, that are accounted for on a mark-to-market basis. Other risks that we face are operational risks, liquidity risks and reputation risk. Operational risks include risks related to fraud, regulatory compliance, processing errors, and technology and disaster recovery. Liquidity risk is the possible inability to fund obligations to depositors, lenders or borrowers. Reputation risk is the risk that negative publicity or press, whether true or not, could cause a decline in our customer base or revenue.

Credit Risk Management. Our strategy for credit risk management focuses on having well-defined credit policies and uniform underwriting criteria and providing prompt attention to potential problem loans.

Management performs a monthly review of all delinquent loans. The actions taken with respect to delinquency vary depending upon the nature of the delinquent loans and the period of delinquency. A late charge is normally assessed on loans where the scheduled payment remains unpaid after a 15 day grace period. After mailing delinquency notices, the Company’s collection department calls the borrower to determine the reason for the delinquency and the repayment status. Through continued heightened account monitoring, collection, and workout efforts, the Company attempts to work out a payment schedule with the borrower in order to avoid foreclosure. If these actions do not result in a satisfactory resolution, the Company refers the loan to legal counsel and counsel initiates foreclosure proceedings. The Company is committed to assist the homeowners to remain in their homes.

Management reports to the executive committee monthly regarding the amount of loans delinquent. All loans that are delinquent greater than 90 days, loans that are in foreclosure, and all foreclosed and repossessed property that we own

are reported in greater detail to the executive committee monthly.

Analysis of Nonperforming and Classified Assets. We consider repossessed assets, loans that are 90 days or more past due, and other loans which have been identified by the Company as presenting uncertainty with respect to the collectability of interest or principal to be nonperforming assets. Loans are placed on nonaccrual status when they become 90 days delinquent, at which time the accrual of interest ceases and the allowance for any uncollectible accrued interest is established and charged against operations. Typically, payments received on a nonaccrual loan are applied to the outstanding principal and interest as determined at the time of collection of the loan.

Real estate that we acquire as a result of foreclosure or by deed-in-lieu of foreclosure is classified as OREO until it is sold. When property is acquired and placed in OREO, it is recorded at the fair value, less estimated selling expenses. Holding costs and declines in fair value after acquisition of the property result in charges against income. As of December 31, 2013 and 2012, the Company had $407,000 and $572,000 classified as OREO, respectively.

The following table provides information with respect to our nonperforming assets at the dates indicated. We did not have any accruing loans past due 90 days or more at the dates presented.

	At December 31,				
	2013	2012	2011	2010	2009
		(Dollars in Thousands)			
Nonaccrual loans:					
Residential real estate	$2,415	$2,587	$2,222	$3,329	$2,740
Residential construction	—	331	—	316	184
Commercial real estate	3,362	902	798	2,158	982
Commercial	806	47	1,306	391	664
Home equity	243	96	306	204	182
Consumer	8	24	79	72	92
Total	6,834	3,987	4,711	6,470	4,844
Real estate owned	407	572	913	286	80
Total nonperforming assets	$7,241	$4,559	$5,624	$6,756	$4,924
Total nonperforming loans as a percentage of total loans (1)	1.40 %	0.85 %	1.05 %	1.49 %	1.13 %
Total nonperforming assets as a percentage of total assets (2)	1.23 %	0.76 %	0.91 %	1.18 %	0.90 %

(1) Total loans equals net loans plus the allowance for loan losses.

(2) Nonperforming assets consist of nonperforming loans and other real estate owned. Nonperforming loans consist of all loans 90 days or more past due and other loans which have been identified by the Company as presenting uncertainty with respect to the collectability of interest or principal. The Company had one troubled debt restructuring included in nonperforming loans of $249,000 at December 31, 2013. This TDR was granted during the year ended December 31, 2013.

As of December 31, 2013, the following loan classes were not accruing interest: there were 17 residential real estate loans, with total principal balances of $2.4 million and total collateral values of $2.6 million, seven commercial real estate loans, with total principal balances of $3.4 million and total collateral values of $2.4 million; there were 24 commercial and industrial loans, with total principal balances of $806,000 and total collateral values of $1.3 million; there were 7 consumer loans, with principal balances of $8,000 and there were four home equity loans, with principal balances of $243,000 and total collateral values of $432,000. We do not separately identify consumer loans for impairment. Any shortfalls of collateral were charged against the allowance for loan losses. At December 31, 2013, the Company’s total nonperforming loans as a percentage of total loans of 1.40% was below the peer average of 1.59%. This statistical data was obtained from the December 31, 2013 UBPR Peer Group Average Report and included average data for 933 insured savings banks.

As of December 31, 2012, the following loan classes were not accruing interest: there were 20 residential real estate loans, with total principal balances of $2.6 million and total collateral values of $3.0 million, one residential construction loan, with a total principal balance $331,000 and total collateral value of $316,000, five commercial real estate loans, with total principal balances of $902,000 and total collateral values of $1.3 million; there were five

commercial and industrial loans, with total principal balances of $47,000 and total collateral values of $47,000, and there were two home equity loans, with principal balances of $96,000 and total collateral values of $289,000. We do not separately identify consumer loans for impairment. Any shortfalls of collateral were charged against the allowance for loan losses. At December 31, 2012, the Company’s total nonperforming loans as a percentage of total loans of 0.85% was below the peer average of 2.00%. This statistical data was obtained from the December 31, 2012 UBPR Peer Group Average Report and included average data for 982 insured savings banks.

As of December 31, 2011, the following loan classes were not accruing interest: there were 20 residential real estate loans, with total principal balances of $2.2 million and total collateral values of $3.2 million, and four commercial real estate loans, with total principal balances of $798,000 and total collateral values of $1.3 million; there were 20 commercial and industrial loans, with total principal balances of $1.3 million and total collateral values of $1.8 million, and there were four home equity loans, with principal balances of $306,000 and total collateral values of $418,000. We do not separately identify consumer loans for impairment. Any shortfalls of collateral were charged against the allowance for loan losses. At December 31, 2011, the Company’s total nonperforming loans as a percentage of total loans of 1.05% was below the peer average of 2.02%. This statistical data was obtained from the December 31, 2011 UBPR Peer Group Average Report and included average data for 427 insured savings banks.

As of December 31, 2010, the following loan classes were not accruing interest: there were 26 residential real estate loans, with total principal balances of $3.3 million and total collateral values of $4.3 million, and 8 commercial real estate loans, with total principal balances of $2.2 million and total collateral values of $2.3 million; there was 3 residential construction loans, with total principal balances of $316,000 and total collateral values of $295,000; there were 11 commercial and industrial loans, with total principal balances of $391,000 and total collateral values of $629,000; and there were seven home equity loans, with principal balances of $204,000 and total collateral values of $702,000. We do not separately identify consumer loans for impairment. Any shortfalls of collateral were charged against the allowance for loan losses. At December 31, 2010, the Company’s total nonperforming loans as a percentage of total loans of 1.49% was below the peer average of 2.05%. This statistical data was obtained from the December 31, 2010 UBPR Peer Group Average Report and included average data for 398 insured savings banks.

There were 21 residential real estate loans, with total principal balances of $2.7 million and total collateral values of $3.6 million, and five commercial real estate loans, with total principal balances of $982,000 and total collateral values of $2.0 million that were not accruing interest as of December 31, 2009. There was one residential construction loan with a principal balance of $184,000 not accruing interest as of December 31, 2009, with a collateral value of $250,000. There were no commercial construction loans that were not accruing interest as of December 31, 2009. There were 11 commercial and industrial loans not accruing interest as of December 31, 2009, with total principal balances of $664,000 and total collateral values of $1.2 million. Of the 11 commercial and industrial loans, six loans were applied specific reserves of $53,000 to compensate for 100% of the collateral shortfalls. Only one commercial loan has exposure to loss of $9,000 due to a collateral shortfall. The remaining four commercial and industrial loans are adequately collateralized. There were 6 home equity loans not accruing interest as of December 31, 2009 with total principal balances of $182,000 with a combined collateral value of $776,000. Collateral values were sufficient to cover the loan balances of nonaccrual loans. At December 31, 2009, the Company’s total nonperforming loans as a percentage of total loans of 1.13% was below the peer average of 1.77%. This statistical data was obtained from the December 31, 2009 UBPR Peer Group Average Report and included average data for 408 insured savings banks.

Interest income that would have been recorded for the years ended December 31, 2013 and 2012 had nonperforming loans and troubled debt restructurings been current according to their original terms amounted to $527,000 and $92,000, respectively. Interest income recognized on impaired loans and troubled debt restructurings for the years ended December 31, 2013 and 2012 was $542,000 and $423,000, respectively.

Regulators have adopted various regulations and practices regarding problem assets of financial institutions. Under such regulations, federal and state examiners have authority to identify problem assets during examinations and, if appropriate, require them to be classified. We perform an internal analysis of our loan portfolio and assets to classify such loans and assets similar to the manner in which such loans and assets are classified by the federal banking regulators. In addition, we regularly analyze the probable losses inherent in our loan portfolio and our nonperforming loans to determine the appropriate level of the allowance for loan losses. There are four classifications for problem assets: special mention, substandard, doubtful, and loss. Assets that do not currently expose the insured institution to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses are designated

“special mention”. “Substandard” assets have one or more defined weaknesses and are characterized by the distinct possibility that the insured institution will sustain some loss if the deficiencies are not corrected. Non-accruing loans are normally classified as substandard. “Doubtful” assets have the weaknesses of substandard assets with the additional characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions and values questionable, and there is a high possibility of loss. An asset classified as “loss” is normally fully charged-off.

The following table shows the aggregate amounts of our classified loans at the dates indicated.

	December 31,		
	2013	2012	2011
	(Dollars in Thousands)		
Special mention loans	$14,228	$23,699	$20,063
Substandard loans	19,025	11,801	8,267
Doubtful loans	—	47	—
Loss loans	—	—	—
Total classified loans	$33,253	$35,547	$28,330

At December 31, 2013, special mention loans consisted of $4.1 million in commercial and industrial loans, $6.6 million in commercial construction loans, and $3.6 million in commercial real estate loans. Substandard loans consisted of $5.0 million in commercial and industrial loans, $3.9 million in commercial constructions loans, $7.5 million in commercial real estate loans and $2.7 million in residential real estate loans. The decrease in classified loans was due to an decrease in additions of special mention loan partially offset by the increase in additions to substandard loans. At December 31, 2013, 78.2% of our classified loans were current with payments. Other than disclosed in the above tables, there are no other loans at December 31, 2013 that management had serious doubts about the ability of the borrowers to comply with the present loan repayment terms.

At December 31, 2012, special mention loans consisted of $8.0 million in commercial and industrial loans, $8.2 million in commercial construction loans, and $7.5 million in commercial real estate loans. Substandard loans consisted of $874,000 in commercial and industrial loans, $4.4 million in commercial constructions loans, $3.6 million in commercial real estate loans and $2.9 million in residential real estate loans. The increase in classified loans was due to an increase in additions of special mention and substandard loans. At December 31, 2012, 95.3% of our classified loans were current with payments. Other than disclosed in the above tables, there are no other loans at December 31, 2012 that management had serious doubts about the ability of the borrowers to comply with the present loan repayment terms.

At December 31, 2011, special mention loans consisted of $2.9 million in commercial and industrial loans, $11.6 million in commercial construction loans, and $5.6 million in commercial real estate loans. Substandard loans consisted of $1.9 million in commercial and industrial loans, $216,000 in commercial constructions loans, $4.0 million in commercial real estate loans and $2.2 million in residential real estate loans. The decrease in classified loans was due to a decrease in nonperforming loans. At December 31, 2011, 91.5% of our classified loans were current with payments. Other than disclosed in the above tables, there are no other loans at December 31, 2011 that management has serious doubts about the ability of the borrowers to comply with the present loan repayment terms.

Analysis and Determination of the Allowance for Loan Losses. The allowance for loan losses is a valuation allowance for probable credit losses inherent in the loan portfolio. We evaluate the need to establish allowances against losses on loans on a monthly basis. When additional allowances are necessary, a provision for loan losses is charged to earnings. The allowance for loan losses is maintained at an amount that management considers appropriate to cover inherent probable losses in the loan portfolio.

Our methodology for assessing the appropriateness of the allowance for loan losses consists of: (1) a specific allowance on identified problem loans; and (2) a general valuation allowance on the remainder of the loan portfolio. Although we determine the amount of each element of the allowance separately, the entire allowance for loan losses is available for the entire portfolio.

Specific Allowance Required for Identified Problem Loans. We establish an allowance on certain identified problem loans based on such factors as: (1) the strength of the customer's personal or business cash flows; (2) the availability of

other sources of repayment; (3) the amount due or past due; (4) the type and value of collateral; (5) the strength of our collateral position; (6) the estimated cost to sell the collateral; and (7) the borrower's effort to cure the delinquency.

General Valuation Allowance on the Remainder of the Loan Portfolio. We establish a general allowance for loans that are not delinquent to recognize the probable losses associated with lending activities. This general valuation allowance is determined by segregating the loans by loan category and assigning percentages to each category. The percentages are adjusted for significant factors that, in management's judgment, affect the collectability of the portfolio as of the evaluation date. These significant factors include: levels and historical trends in delinquencies, impaired loans, nonaccrual loans, charge-offs, recoveries, and classified assets; trends in the volume and terms of loans; effects of any change in underwriting, policies, procedures, and practices; experience, ability, and depth of management and staff; national and local economic trends and conditions; trends and conditions in the industries in which borrowers operate; effects of changes in credit concentrations. The applied loss factors are reevaluated quarterly to ensure their relevance in the current economic environment.

We identify loans that may need to be charged off as a loss by reviewing all delinquent loans, classified loans and other loans that management may have concerns about collectability. For individually reviewed loans, the borrower's inability to make payments under the terms of the loan or a shortfall in collateral value would result in our allocating a portion of the allowance to the loan that was impaired.

At December 31, 2013, our allowance for loan losses represented 0.94% of total loans and 67.25% of nonperforming loans. The allowance for loan losses increased $232,000, or 5.3%, from $4.4 million at December 31, 2012 to $4.6 million at December 31, 2013, due to a provision for loan losses of $425,000, partially offset by net charge-offs of $193,000, or 0.4%, of total average loans. Net charge-offs decreased $461,000, or 70.5%, from $654,000, or 0.14% of total average loans, for the same period in December 31, 2012. In the fourth quarter of 2013, a recovery of $235,000 on a previous charge-off was recognized.

Management is in the process of evaluating a $4.6 million commercial relationship consisting of four commercial real estate loans totaling $2.1 million secured by commercial real estate and a commercial line of credit totaling $2.5 million secured by the assets of the borrower, including, equipment, accounts receivable and inventory. The loans totaling $4.6 million are cross-collateralized and cross-guaranteed by the borrower and guarantor. Based on adverse events with this relationship in the first quarter of 2014, the relationship was placed on nonaccrual. Although we are very early in the process, Management is taking steps to protect the Company's position and minimize any loss exposure that may result. In estimating the loss exposure, we believe a range of possible loss could be as low as $1.0 million to a maximum of $2.0 million. The Company is committed to employing every legal remedy available to us in recovering losses related to this commercial relationship.

The provision for loan losses in the year ended December 31, 2013 reflects management's assessment of several factors. In particular, nonaccrual loans increased $2.8 million to $6.8 million at December 31, 2013 from $4.0 million at December 31, 2012.
At December 31, 2012, our allowance for loan losses represented 0.93% of total loans and 109.46% of nonperforming loans. The allowance for loan losses decreased slightly from $4.6 million at December 31, 2011 to $4.4 million at December 31, 2012, due to a provision for loan losses of $442,000, partially offset by net charge-offs of $654,000. The provision for loan losses in the year ended December 31, 2012 reflects management's assessment of several factors. In particular, nonaccrual loans decreased $700,000 to $4.0 million at December 31, 2011 from $4.0 million at December 31, 2012. Also, net charge-offs decreased $43,000 from December 31, 2011. In addition, management assessed the continued growth of the loan portfolio, particularly the increases in commercial real estate loans, construction loans and commercial business loans, as well as the weakening of the local and national economy.

At December 31, 2011, our allowance for loan losses represented 1.02% of total loans and 97.1% of nonperforming loans. The allowance for loan losses increased slightly from $4.4 million at December 31, 2010 to $4.6 million at December 31, 2011, due to a provision for loan losses of $842,000, partially offset by net charge-offs of $697,000. The provision for loan losses in the year ended December 31, 2011 reflected management's assessment of several factors. In particular, nonaccrual loans decreased $1.8 million to $4.7 million at December 31, 2011 from $6.5 million at December 31, 2010. Also, net charge-offs decreased $172,000 from December 31, 2010. In addition, management assessed the continued growth of the loan portfolio, particularly the increases in commercial real estate loans, construction loans and commercial business loans, as well as the weakening of the local and national economy.

At December 31, 2010, our allowance for loan losses represented 1.02% of total loans and 68.5% of nonperforming loans. The allowance for loan losses increased slightly from $4.1 million at December 31, 2009 to $4.4 million at December 31, 2010, due to a provision for loan losses of $1.2 million, partially offset by net charge-offs of $869,000. The provision for loan losses in the year ended December 31, 2010 reflected management's assessment of several factors. In particular, nonaccrual loans increased $1.6 million to $6.5 million at December 31, 2010 from $4.8 million at December 31, 2009. Also, net charge-offs increased $716,000 from December 31, 2009. In addition, management

assessed the continued growth of the loan portfolio, particularly the increases in commercial real estate loans, construction loans and commercial business loans, as well as the weakening of the local and national economy.

At December 31, 2009, our allowance for loan losses represented 0.95% of total loans and 84.2% of nonperforming loans. The allowance for loan losses increased slightly from $3.3 million at December 31, 2008 to $4.1 million at December 31, 2009, due to a provision for loan losses of $897,000, partially offset by net charge-offs of $153,000. The provision for loan losses in the year ended December 31, 2009 reflected management's assessment of several factors. In particular, nonaccrual loans increased $1.9 million to $4.8 million at December 31, 2009 from $2.9 million at December 31, 2008. Also, net charge-offs increased $95,000 from December 31, 2008. In addition, management assessed the continued growth of the loan portfolio, particularly the increases in commercial real estate loans, construction loans and commercial business loans, as well as the weakening of the local and national economy.

The following table sets forth the Company's percent of allowance for loan losses to total allowances and the percent of loans to total loans in each of the categories listed at the dates indicated. Real estate includes residential, commercial and home equity loans.

	For Years Ended December 31,								
	2013			2012			2011		
	Amount	% of Allowance in each Category to Total Allowance	Percent of Loans in each Category to Total Loans	Amount	% of Allowance in each Category to Total Allowance	Percent of Loans in each Category to Total Loans	Amount	% of Allowance in each Category to Total Allowance	Percent of Loans in each Category to Total Loans
	(Dollars in Thousands)								
Real estate	$2,922	63.6 %	72.7 %	$2,626	60.2 %	72.9 %	$2,571	56.2 %	73.3 %
Construction	529	11.5 %	9.2 %	595	13.6 %	8.5 %	615	13.4 %	8.3 %
Commercial and industrial	1,110	24.2 %	17.7 %	1,099	25.2 %	18.0 %	1,343	29.4 %	17.8 %
Consumer	35	0.7 %	0.4 %	44	1.0 %	0.6 %	47	1.0 %	0.6 %
Unallocated	—	—	—	—	—	—	—	—	—
Total allowance for loan ====losses	$4,596	100.0 %	100.0 %	$4,364	100.0 %	100.0 %	$4,576	100.0 %	100.0 %

	For Years Ended December 31,					
	2010			2009		
	Amount	% of Allowance in each Category to Total Allowance	Percent of Loans in each Category to Total Loans	Amount	% of Allowance in each Category to Total Allowance	Percent of Loans in each Category to Total Loans
	(Dollars in Thousands)					
Real estate	$2,424	54.7 %	74.9 %	$2,105	51.6 %	74.0 %
Construction	550	12.4 %	7.6 %	811	19.9 %	9.0 %
Commercial and industrial	1,429	32.3 %	16.8 %	1,124	27.6 %	16.0 %
Consumer	28	0.6 %	0.7 %	37	0.9 %	1.0 %
Unallocated	—	—	—	—	—	—
Total allowance for loan losses	$4,431	100.0 %	100.0 %	$4,077	100.0 %	100.0 %

Although we believe that we use the best information available to establish the allowance for loan losses, future adjustments to the allowance for loan losses may be necessary and our results of operations could be adversely affected if circumstances differ substantially from the assumptions used in making the determinations. Furthermore, while we believe we have established our allowance for loan losses in conformity with U.S. generally accepted accounting principles, there can be no assurance that our banking regulators, in reviewing our loan portfolio, will not request us to increase our allowance for loan losses. Our banking regulators may require 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, there can be no assurance that increases will not 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 may adversely affect our financial condition and results of operations.

Analysis of Loan Loss Experience. The following table sets forth an analysis of the allowance for loan losses for the periods indicated. Real estate includes residential and commercial real estate loans.

	At or for the Years Ended December 31,				
	2013	2012	2011	2010	2009
	(Dollars in Thousands)				
Allowance for loan losses, beginning of period	$4,364	$4,576	$4,431	$4,077	$3,333
Charged-off loans:					
Residential real estate	(183)	(98)	(87)	(118)	(93)
Residential construction	(62)	—	(76)	(107)	—
Commercial real estate	(68)	(65)	(164)	(332)	—
Commercial and industrial	(117)	(406)	(317)	(266)	(9)
Home equity	(10)	(35)	(6)	—	—
Consumer	(53)	(74)	(65)	(109)	(69)
Total charged off loans	(493)	(678)	(715)	(932)	(171)
Recoveries on loans previously charged-off:					
Residential real estate	1	1	—	—	—
Residential construction	—	—	—	—	—
Commercial real estate	247	—	—	—	—
Commercial and industrial	38	4	—	38	—
Home equity	—	—	—	—	—
Consumer	14	19	18	25	18
Total recoveries	300	24	18	63	18
Net loans charged off	(193)	(654)	(697)	(869)	(153)
Provision for loan losses	425	442	842	1,223	897
Allowance for loan losses, end of period	$4,596	$4,364	$4,576	$4,431	$4,077
Net loans charged-off to average loans, net	0.04%	0.14%	0.16%	0.20%	0.04%
Allowance for loan losses to total loans (1)	0.94%	0.93%	1.02%	1.02%	0.95%
Allowance for loan losses to nonperforming loans ==(2)	67.25%	109.46%	97.13%	68.49%	84.17%
Net loans charged-off to allowance for loan losses	4.20%	14.99%	15.23%	19.61%	3.75%
Recoveries to charge-offs	60.85%	3.54%	2.52		