PATRIOT NATIONAL BANCORP INC
Form 10-Q
August 12, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarter Ended June 30, 2013

Commission file number 000-29599

PATRIOT NATIONAL BANCORP, INC.

(Exact name of registrant as specified in its charter)

Connecticut	**06-1559137**
(State of incorporation)	**(I.R.S. Employer Identification Number)**

900 Bedford Street, Stamford, Connecticut 06901

(Address of principal executive offices)

(203) 324-7500

(Registrant s telephone number)

Check whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company in Rule 12b-2 of the Exchange Act:

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

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

State the number of shares outstanding of each of the registrant s classes of common equity, as of the latest practicable date.

Common stock, $0.01 par value per share, 38,445,326 shares outstanding as of the close of business July 31, 2013.

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PART I - FINANCIAL INFORMATION

Item 1: Consolidated Financial Statements

PATRIOT NATIONAL BANCORP, INC.

CONSOLIDATED BALANCE SHEETS

	June 30, 2013 (Unaudited)	December 31, 2012
ASSETS		
Cash and due from banks:		
Noninterest bearing deposits and cash	**$ 3,866,156**	$ 2,736,486
Interest bearing deposits	**20,509,127**	67,567,155
Short-term investments	**711,213**	710,766
Total cash and cash equivalents	**25,086,496**	71,014,407
Securities:		
Available for sale securities, at fair value (Note 2)	**39,543,075**	41,719,320
Other Investments	**3,500,000**	3,500,000
Federal Reserve Bank stock, at cost	**1,634,100**	1,730,200
Federal Home Loan Bank stock, at cost	**4,142,600**	4,343,800
Total securities	**48,819,775**	51,293,320
Loans receivable (net of allowance for loan losses: 2013: $5,322,070 2012: $6,015,636) (Note 3)	**447,813,433**	458,793,536
Loans held for sale	**11,551,869**	1,527,299
Accrued interest and dividends receivable	**1,710,690**	1,894,292
Premises and equipment, net	**6,420,178**	4,288,372
Cash surrender value of life insurance	**21,770,880**	21,501,703
Other real estate owned	**3,845,041**	4,873,844
Deferred tax asset (Note 6)		
Other assets	**1,785,598**	2,580,118
Other branch related assets held for sale		88,244
Total assets	**$ 568,803,960**	$ 617,855,135
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities		
Deposits (Note 4):		
Noninterest bearing deposits	**$ 63,869,164**	$ 61,459,959
Interest bearing deposits	**413,773,710**	411,117,558
Deposits held for sale		24,705,381
Total deposits	**477,642,874**	497,282,898
Borrowings:		
Repurchase agreements		7,000,000
Federal Home Loan Bank borrowings	**35,000,000**	50,000,000
Total borrowings	**35,000,000**	57,000,000
Junior subordinated debt owed to unconsolidated trust	**8,248,000**	8,248,000
Accrued expenses and other liabilities	**4,773,320**	5,756,439
Total liabilities	**525,664,194**	568,287,337

Commitments and Contingencies (Note 9)		
Shareholders equity		
Preferred stock, no par value; 1,000,000 shares authorized, no shares issued and outstanding		
Common stock, $.01 par value, 100,000,000 shares authorized; 2013 & 2012: 38,491,819 shares issued; 38,445,326 shares outstanding	**384,570**	384,918
Additional paid-in capital	**105,371,239**	105,355,680
Accumulated deficit	**(61,263,793)**	(55,394,995)
Less: Treasury stock, at cost: 2013 and 2012 11,705 shares	**(160,025)**	(160,025)
Accumulated other comprehensive loss	**(1,192,225)**	(617,780)
Total shareholders equity	**43,139,766**	49,567,798
Total liabilities and shareholders equity	**$ 568,803,960**	$ 617,855,135

See Accompanying Notes to Consolidated Financial Statements.

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PATRIOT NATIONAL BANCORP, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
Interest and Dividend Income				
Interest and fees on loans	$ 5,045,335	$ 5,811,733	$ 10,241,227	$ 12,477,525
Interest on investment securities	225,829	426,658	473,565	903,688
Dividends on investment securities	29,205	31,879	58,063	65,160
Other interest income	9,252	40,160	37,612	50,638
Total interest and dividend income	**5,309,621**	**6,310,430**	**10,810,467**	**13,497,011**
Interest Expense				
Interest on deposits	1,032,813	1,421,170	2,161,527	2,938,014
Interest on Federal Home Loan Bank borrowings	167,183	354,591	518,203	711,428
Interest on subordinated debt	70,926	74,677	141,555	151,244
Interest on other borrowings	5,918	76,927	81,999	153,853
Total interest expense	**1,276,840**	**1,927,365**	**2,903,284**	**3,954,539**
Net interest income	**4,032,781**	**4,383,065**	**7,907,183**	**9,542,472**
Provision for Loan Losses		(1,713,425)	(29,786)	(2,558,827)
Net interest income after provision for loan losses	**4,032,781**	**6,096,490**	**7,936,969**	**12,101,299**
Non-interest Income				
Mortgage banking activity	118,738	22,117	164,972	34,537
Loan application, inspection & processing fees	115,890	15,986	153,920	30,713
Fees and service charges	211,100	227,064	382,611	455,732
Gain on sale of loans	28,310		28,310	263,646
Loss on sale of investment securities				(8,042)
Gain on sale of branch assets and deposits	50,643		50,643	
Earnings on cash surrender value of life insurance	142,068	120,294	269,177	262,963
Other income	101,753	69,639	206,350	165,548
Total non-interest income	**768,502**	**455,100**	**1,255,983**	**1,205,097**
Non-interest Expense				
Salaries and benefits	2,576,453	2,725,721	5,581,767	5,616,445
Occupancy and equipment expense	935,947	1,135,113	1,974,755	2,258,697
Data processing	288,170	345,704	659,616	691,725
Advertising and promotional expense	75,541	8,234	118,022	25,963
Professional and other outside services	770,296	854,268	1,658,886	1,469,350
Loan administration and processing expense	73,590	45,624	151,076	53,904
Regulatory assessments	304,803	462,153	678,305	872,154
Insurance expense	83,161	108,775	161,919	278,020
Other real estate operations	55,089	16,351	56,935	(133,896)
Material and communications	102,351	132,734	208,430	263,912
Restructuring charges and asset disposals (Note 12)	394,458	126,730	394,458	495,207

Prepayment penalty on borrowings		2,710,757				2,710,757		
Other operating expense		342,498		244,901		727,904		524,103
Total non-interest expense		**8,713,114**		**6,206,308**		**15,082,830**		**12,415,584**
(Loss) income before income taxes		**(3,911,831)**		**345,282**		**(5,889,878)**		**890,812**
Benefit for Income Taxes						(21,080)		
Net (loss) income	**$**	**(3,911,831)**	**$**	**345,282**	**$**	**(5,868,798)**	**$**	**890,812**
Basic and diluted (loss) income per share (Note 7)	**$**	**(0.10)**	**$**	**0.01**	**$**	**(0.15)**	**$**	**0.02**

See Accompanying Notes to Consolidated Financial Statements.

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PATRIOT NATIONAL BANCORP, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net (loss) income	$ (3,911,831)	$ 345,282	$ (5,868,798)	$ 890,812
Other comprehensive income:				
Unrealized holding (losses) gains on securities, net of taxes:				
Unrealized holding (losses) gains arising during the period	(629,406)	122,856	(574,445)	190,241
Less reclassification adjustment for net gains included in net income				(4,986)
Total	(629,406)	122,856	(574,445)	185,255
Comprehensive (loss) income	**$ (4,541,237)**	**$ 468,138**	**$ (6,443,243)**	**$ 1,076,067**

See Accompanying Notes to Consolidated Financial Statements.

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PATRIOT NATIONAL BANCORP, INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

(Unaudited)

	Number of Shares	Common Stock	Additional Paid-In Capital	Accumulated Deficit	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total
Six months ended June 30, 2012							
Balance at December 31, 2011	38,362,727	$ 383,744	$ 105,050,433	$ (54,858,831)	$ (160,025)	$ 134,339	$ 50,549,660
Comprehensive income							
Net income				890,812			890,812
Unrealized holding gain on available for sale securities, net of taxes						185,255	185,255
Total comprehensive income							1,076,067
Share-based compensation expense			133,128				133,128
Issuance of restricted stock	104,346	1,043	(1,043)				
Balance, June 30, 2012	38,467,073	$ 384,787	$ 105,182,518	$ (53,968,019)	$ (160,025)	$ 319,594	$ 51,758,855
Six months ended June 30, 2013							
Balance at December 31, 2012	38,480,114	$ 384,918	$ 105,355,680	$ (55,394,995)	$ (160,025)	$ (617,780)	$ 49,567,798
Comprehensive loss							
Net loss				(5,868,798)			(5,868,798)
Unrealized holding loss on available for sale securities, net of taxes						(574,445)	(574,445)
Total comprehensive loss							(6,443,243)
Share-based compensation expense			15,211				15,211
Redemption of restricted stock	(34,788)	(348)	348				
Balance, June 30, 2013	**38,445,326**	**$ 384,570**	**$ 105,371,239**	**$ (61,263,793)**	**$ (160,025)**	**$ (1,192,225)**	**$ 43,139,766**

See Accompanying Notes to Consolidated Financial Statements.

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PATRIOT NATIONAL BANCORP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
Cash Flows from Operating Activities:		
Net (loss) income:	$ (5,868,798)	$ 890,812
Adjustments to reconcile net (loss) income to net cash used in operating activities:		
Restructuring charges and asset disposals	302,617	(5,049)
Amortization and accretion of investment premiums and discounts, net	87,510	213,178
Amortization and accretion of purchase loan premiums and discounts, net	15,848	7,272
Provision for loan losses	(29,786)	(2,558,827)
Gain on sale of loans	(28,310)	(263,646)
Gain on sale of mortgage loans	(160,488)	
Originations of mortgage loans held for sale	(28,975,427)	
Proceeds from sales of mortgage loans held for sale	19,111,345	
Loss on sale of investment securities		8,042
Earnings on cash surrender value of life insurance	(269,177)	(262,964)
Depreciation and amortization	587,765	606,350
Gain on sale of other real estate owned	(200,383)	(201,355)
Proceeds from sale of branch assets and deposits	126,875	
Gain on sale of branch assets and deposits	(50,643)	
Share-based compensation	15,211	133,128
Changes in assets and liabilities:		
(Increase) decrease in net deferred loan costs	(109,655)	36,089
Decrease in accrued interest and dividends receivable	183,602	163,833
Decrease in other assets	794,520	571,248
Decrease in accrued expenses and other liabilities	(1,285,736)	(61,423)
Net cash used in operating activities	**(15,753,110)**	**(723,312)**
Cash Flows from Investing Activities:		
Principal repayments on available for sale securities	1,514,290	5,039,296
Proceeds from the sale of available for sale securities		5,165,626
Purchases of Federal Reserve Bank stock		(12,550)
Proceeds from repurchase of excess stock by Federal Reserve Bank	96,100	
Proceeds from repurchase of excess stock by Federal Home Loan Bank	201,200	164,500
Proceeds from sale of loans	10,655,482	67,126,928
Net decrease (increase) in loans	476,524	(47,966,735)
Proceeds from sale of other real estate owned	1,309,587	1,823,435
Capital improvements of other real estate owned	(80,401)	(89,051)
Purchase of bank premises and equipment, net	(2,707,559)	(252,341)
Net cash provided by investing activities	**11,465,223**	**30,999,108**
Cash Flows from Financing Activities:		
Net increase in demand, savings and money market deposits	17,102,802	7,813,928
Net decrease in time certificates of deposits	(22,204,621)	(30,627,566)
Decrease in deposits held for sale	(14,538,205)	
Decrease in FHLB borrowings	(15,000,000)	
Decrease in repurchase agreements	(7,000,000)	

Net cash used in financing activities	**(41,640,024)**	**(22,813,638)**
Net (decrease) increase in cash and cash equivalents	**(45,927,911)**	**7,462,158**
Cash and Cash Equivalents:		
Beginning	71,014,407	55,425,376
Ending	**$ 25,086,496**	**$ 62,887,534**

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PATRIOT NATIONAL BANCORP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS, Continued

(Unaudited)

	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
Supplemental disclosures of cash flow information		
Interest paid	$ 2,866,328	$ 3,807,140
Income taxes paid	$ 2,750	$
Supplemental disclosures of noncash operating, investing and financing activities:		
Unrealized holding (loss) gain on available for sale securities arising during the period	$ (574,445)	$ 306,842
Transfer of loans to other real estate owned	$	$ 1,238,144
Transfer of other real estate owned to premises and equipment	$	$ 950,000
Reduction in deposits held for sale	$ 10,167,176	$
Reduction in branch assets held for sale	$ 12,012	$

See Accompanying Notes to Consolidated Financial Statements.

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PATRIOT NATIONAL BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Note 1: Basis of Financial Statement Presentation

The Consolidated Balance Sheet at December 31, 2012 has been derived from the audited financial statements of Patriot National Bancorp, Inc. (Bancorp or the Company) at that date, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements.

The accompanying unaudited financial statements and related notes have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted. The accompanying consolidated financial statements and related notes should be read in conjunction with the audited financial statements of Bancorp and notes thereto for the year ended December 31, 2012.

The information furnished reflects, in the opinion of management, all normal recurring adjustments necessary for a fair presentation of the results for the interim periods presented. The results of operations for the six months ended June 30, 2013 are not necessarily indicative of the results of operations that may be expected for the remainder of 2013.

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Note 2: Investment Securities

The amortized cost, gross unrealized gains, gross unrealized losses and approximate fair values of available-for-sale securities at June 30, 2013 and December 31, 2012 are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2013:				
U. S. Government agency bonds	$ 7,500,000	$	$ (311,397)	$ 7,188,603
U. S. Government agency mortgage-backed securities	24,235,300		(490,921)	23,744,379
Corporate bonds	9,000,000		(389,907)	8,610,093
	$ 40,735,300	$	$ (1,192,225)	$ 39,543,075
December 31, 2012:				
U. S. Government agency bonds	$ 7,500,000	$ 26,170	$	$ 7,526,170
U. S. Government agency mortgage-backed securities	25,837,100		(130,209)	25,706,891
Corporate bonds	9,000,000		(513,741)	8,486,259
	$ 42,337,100	$ 26,170	$ (643,950)	$ 41,719,320

The following table presents the gross unrealized loss and fair value of Bancorp s available-for-sale securities, aggregated by the length of time the individual securities have been in a continuous loss position, at June 30, 2013 and December 31, 2012:

	Less Than 12 Months		**12 Months or More**		**Total**	
	Fair Value	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**
June 30, 2013:						
U. S. Government agency bonds	$ 7,188,603	$ (311,397)	$	$	$ 7,188,603	$ (311,397)
U. S. Government agency mortgage - backed securities	23,690,508	(490,921)			23,690,508	(490,921)
Corporate bonds			8,610,093	(389,907)	8,610,093	(389,907)
Totals	$ 30,879,111	$ (802,318)	$ 8,610,093	$ (389,907)	$ 39,489,204	$ (1,192,225)
December 31, 2012:						
U. S. Government agency mortgage - backed securities	$ 25,670,832	$ (130,209)	$	$	$ 25,670,832	$ (130,209)
Corporate bonds	2,842,368	(157,632)	5,643,891	(356,109)	8,486,259	(513,741)
Totals	$ 28,513,200	$ (287,841)	$ 5,643,891	$ (356,109)	$ 34,157,091	$ (643,950)

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At June 30, 2013, eleven securities had unrealized holding losses with aggregate depreciation of 2.9% from the amortized cost. At December 31, 2012, nine securities had unrealized losses with aggregate depreciation of 1.9% from the amortized cost.

Bancorp performs a quarterly analysis of those securities that are in an unrealized loss position to determine if those losses qualify as other-than-temporary impairments. This analysis considers the following criteria in its determination: the ability of the issuer to meet its obligations, when the loss position is due to a deterioration in credit quality, management s plans and ability to maintain its investment in the security, the length of time and the amount by which the security has been in a loss position, the interest rate environment, the general economic environment and prospects or projections for improvement or deterioration.

Management believes that none of the unrealized losses on available-for-sale securities noted above are other than temporary due to the fact that they relate to market interest rate changes on corporate debt and bonds issued by U.S. Government agencies. Management considers the issuers of the securities to be financially sound. The corporate bonds are investment grade and the Company expects to receive all contractual principal and interest related to these investments. The Company does not intend to sell the investments, and it is not more-likely-than-not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be at maturity. The Company therefore does not consider those investments to be other-than-temporarily impaired at June 30, 2013.

The amortized cost and fair value of available-for-sale debt securities at June 30, 2013 by contractual maturity are presented below. Actual maturities of mortgage-backed securities may differ from contractual maturities because the mortgages underlying the securities may be prepaid without any penalties. Because mortgage-backed securities are not due at a single maturity date, they are not included in the maturity categories in the following summary:

	Amortized Cost	Fair Value
Maturity:		
Corporate bonds 5 to 10 years	$ 9,000,000	$ 8,610,093
U.S. Government agency bonds 5 to 10 years	7,500,000	7,188,603
U.S. Government agency mortgage-backed securities	24,235,300	23,744,379
Total	$ 40,735,300	$ 39,543,075

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Note 3: Loans Receivable and Allowance for Loan Losses

A summary of the Company s loan portfolio at June 30, 2013 and December 31, 2012 is as follows:

	June 30, 2013	December 31, 2012
Real Estate		
Commercial	$ 236,223,829	$ 247,495,321
Residential	117,416,181	119,033,025
Construction	3,470,518	4,997,991
Construction to permanent	9,904,369	4,851,768
Commercial	36,278,299	36,428,751
Consumer home equity	47,097,674	49,180,908
Consumer installment	1,992,136	2,162,718
Total Loans	452,383,006	464,150,482
Premiums on purchased loans	203,801	219,649
Net deferred costs	548,696	439,041
Allowance for loan losses	(5,322,070)	(6,015,636)
Loans receivable, net	$ 447,813,433	$ 458,793,536

The changes in the allowance for loan losses for the periods shown are as follows:

	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Balance, beginning of period	$ 5,717,148	$ 8,460,943	$ 6,015,636	$ 9,384,672
Provision for loan losses		(1,713,425)	(29,786)	(2,558,827)
Loans charged-off	(411,790)	(90,739)	(717,174)	(193,223)
Recoveries of loans previously charged-off	16,712	16,869	53,394	41,026
Balance, end of period	$ 5,322,070	$ 6,673,648	$ 5,322,070	$ 6,673,648

At June 30, 2013 and December 31, 2012, the unpaid balances of loans 90 days or more past maturity, and still accruing interest were $1.7 million and $2.2 million, respectively. All of the 4 loans at June 30, 2013, totaling $1.7 million, were continuing to make interest payments, were past maturity and are in the process of being renewed.

The unpaid principal balances of loans on nonaccrual status and considered impaired were $26.6 million at June 30, 2013 and $23.8 million at December 31, 2012. If non-accrual loans had been performing in accordance with their contractual terms, the Company would have recorded approximately $373,000 of additional income during the quarter ended June 30, 2013 and $274,000 during the quarter ended June 30, 2012. If non-accrual loans had been performing in accordance with their contractual terms, the Company would have recorded approximately $679,000 of additional income for the six months ended June 30, 2013 and $584,000 for the six months ended June 30, 2012.

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For the three months ended June 30, 2013 and 2012, the interest collected and recognized as income on impaired loans, which includes non-accrual loans, TDRs and loans that were previously classified as TDRs that have been upgraded, was approximately $96,000 and $0 respectively. For the six months ended June 30, 2013 and 2012, the interest income collected and recognized on impaired loans was approximately $220,000 and $180,000 respectively. The average recorded investment in impaired loans for the three and six months ended June 30, 2013 was $31.7 million and $32.4 million respectively.

At June 30, 2013, there were 7 loans totaling $10.7 million that were considered troubled debt restructurings, as compared to December 31, 2012 when there were 8 loans totaling $11.6 million, all of which were included in impaired loans. At June 30, 2013, 2 of the 7 loans aggregating $4.7 million were accruing loans and 5 loans aggregating $6.0 million were non-accruing loans.

The Company s lending activities are conducted principally in Fairfield and New Haven Counties in Connecticut and Westchester County, New York City and Long Island, New York. The Company originates commercial real estate loans, commercial business loans, residential real estate loans and a variety of other consumer loans. In addition, the Company had originated loans for the construction of residential homes, residential developments and for land development projects. A moratorium on all new speculative construction loans was instituted by management in July 2008. All residential and commercial mortgage loans are collateralized primarily by first or second mortgages on real estate. The ability and willingness of borrowers to satisfy their loan obligations is dependent to some degree on the status of the regional economy as well as upon the regional real estate market. Accordingly, the ultimate collectability of a substantial portion of the loan portfolio and the recovery of a substantial portion of any resulting real estate acquired is susceptible to changes in market conditions.

The Company has established credit policies applicable to each type of lending activity in which it engages, evaluates the creditworthiness of each customer and, in most cases, extends credit of up to 75% of the market value of the collateral for commercial real estate at the date of the credit extension depending on the Company s evaluation of the borrowers creditworthiness and type of collateral and up to 80% for residential 1-4 family real estate. In the case of construction loans, the maximum loan-to-value was 65% of the as completed market value. The market value of collateral is monitored on an ongoing basis and additional collateral is obtained when warranted. Real estate is the primary form of collateral. Other important forms of collateral are accounts receivable, inventory, other business assets, marketable securities and time deposits. While collateral provides assurance as a secondary source of repayment, the Company ordinarily requires the primary source of repayment to be based on the borrower s ability to generate continuing cash flows on all loans not related to construction.

Risk characteristics of the Company s portfolio classes include the following:

Commercial Real Estate Loans In underwriting commercial real estate loans, the Company evaluates both the prospective borrower s ability to make timely payments on the loan and the value of the property securing the loans. Repayment of such loans may be negatively impacted should the borrower default or should there be a substantial decline in the value of the property securing the loan or a decline in the general economic conditions. Where the owner occupies the property, the Company also evaluates the business s ability to repay the loan on a timely basis. In addition, the Company may require personal guarantees, lease assignments and/or the guarantee of the operating company when the property is owner occupied. These types of loans may involve some additional risks because payments on such loans are dependent upon the successful operation of the business involved, therefore, repayment of such loans may be negatively impacted by adverse changes in economic conditions affecting the borrowers businesses.

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Commercial and Industrial Loans The Company s commercial and industrial loan portfolio consists primarily of commercial business loans and lines of credit to businesses and professionals. These loans are usually made to finance the purchase of inventory or new or used equipment and for other short or long-term working capital purposes. These loans are generally secured by corporate assets, often with real estate as secondary collateral, but are also occasionally offered on an unsecured basis. In granting this type of loan, the Company primarily looks to the borrower s cash flow as the source of repayment with collateral and personal guarantees, where obtained, as a secondary source. Commercial loans are often larger and may involve greater risks than other types of loans offered by the Company. Payments on such loans are often dependent upon the successful operation of the underlying business involved. Repayment of such loans may therefore be negatively impacted by adverse changes in economic conditions, management s inability to effectively manage the business, claims of others against the borrower s assets which may take priority over the Company s claims against assets, death or disability of the borrower or loss of market for the borrower s products or services.

Residential Real Estate Loans Various loans secured by residential real estate properties are offered by the Company, including 1-4 family residential mortgages, multi-family residential loans and a variety of home equity line of credit products. Repayment of such loans may be negatively impacted should the borrower default, should there be a significant decline in the value of the property securing the loan or should there be decline in general economic conditions.

Construction Loans Construction loans are short-term loans (generally up to 18 months) secured by land for both residential and commercial development. The loans are generally made for acquisition and improvements. Funds are disbursed as phases of construction are completed. In the past, the Company funded construction of single family homes, when no contract of sale existed, based upon the experience and the financial strength of the builder, the type and location of the property and other factors. Construction loans are generally personally guaranteed by the principal(s). Repayment of such loans may be negatively impacted by the builders inability to complete construction, by a downturn in the new construction market, by a significant increase in interest rates or by a decline in general economic conditions. The Company has had a moratorium in place since mid-2008 on new speculative construction loans.

Other Loans The Company also offers installment loans and reserve lines of credit to individuals. Repayments of such loans are often dependent on the personal income of the borrower which may be negatively impacted by adverse changes in economic conditions. The Company does not place an emphasis on originating these types of loans.

The Company does not have any lending programs commonly referred to as subprime lending. Subprime lending generally targets 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-burdened ratios.

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The following table sets forth activity in our allowance for loan losses, by loan type, for the three months ended June 30, 2013. The following table also details the amount of loans receivable, net, that are evaluated individually, and collectively, for impairment, and the related portion of the allowance for loan losses that is allocated to each loan portfolio segment.

Three months ended June 30, 2013	Commercial	Commercial Real Estate	Construction	Construction to Permanent	Residential	Consumer	Unallocated	Total
Allowance for loan losses:								
Beginning Balance	$ 1,846,315	$ 2,492,111	$ 307,198	$ 31,114	$ 746,399	$ 118,348	$ 175,663	$ 5,717,148
Charge-offs		(275,000)	(23,104)		(94,733)	(18,953)		(411,790)
Recoveries	1,000	14,988			612	112		16,712
Provision	(125,627)	(279,015)	(47,610)	(7,520)	281,683	144,442	33,647	
Ending Balance	$ 1,721,688	$ 1,953,084	$ 236,484	$ 23,594	$ 933,961	$ 243,949	$ 209,310	$ 5,322,070
Ending balance: individually evaluated for impairment	$ 1,250,663	$ 538,714	$ 236,484	$	$ 158,247	$ 1,936	$	$ 2,186,044
Ending balance: collectively evaluated for impairment	471,025	1,414,370		23,594	775,714	242,013	209,310	3,136,026
Total Allowance for Loan Losses	$ 1,721,688	$ 1,953,084	$ 236,484	$ 23,594	$ 933,961	$ 243,949	$ 209,310	$ 5,322,070
Total Loans ending balance	$ 36,278,299	$ 236,223,829	$ 3,470,518	$ 9,904,369	$ 117,416,181	$ 49,089,810	$	$ 452,383,006
Ending balance: individually evaluated for impairment	$ 6,348,925	$ 15,614,812	$ 3,470,518	$ 1,228,429	$ 8,754,261	$ 599,822	$	$ 36,016,767
Ending balance : collectively evaluated for impairment	$ 29,929,374	$ 220,609,017	$	$ 8,675,940	$ 108,661,920	$ 48,489,988	$	$ 416,366,239

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The following table sets forth activity in our allowance for loan losses, by loan type, for the six months ended June 30, 2013. The following table also details the amount of loans receivable, net, that are evaluated individually, and collectively, for impairment, and the related portion of the allowance for loan losses that is allocated to each loan portfolio segment.

Six months ended June 30, 2013	Commercial	Commercial Real Estate	Construction	Construction to Permanent	Residential	Consumer	Unallocated	Total
Allowance for loan losses:								
Beginning Balance	$ 941,456	$ 3,509,395	$ 311,297	$ 18,720	$ 897,368	$ 216,698	$ 120,702	$ 6,015,636
Charge-offs		(290,000)	(23,104)		(385,117)	(18,953)		(717,174)
Recoveries	2,000	29,976	20,000		612	806		53,394
Provision	778,232	(1,296,287)	(71,709)	4,874	421,098	45,398	88,608	(29,786)
Ending Balance	$ 1,721,688	$ 1,953,084	$ 236,484	$ 23,594	$ 933,961	$ 243,949	$ 209,310	$ 5,322,070
Ending balance: individually evaluated for impairment	$ 1,250,663	$ 538,714	$ 236,484	$	$ 158,247	$ 1,936	$	$ 2,186,044
Ending balance: collectively evaluated for impairment	471,025	1,414,370		23,594	775,714	242,013	209,310	3,136,026
Total Allowance for Loan Losses	$ 1,721,688	$ 1,953,084	$ 236,484	$ 23,594	$ 933,961	$ 243,949	$ 209,310	$ 5,322,070
Total Loans ending balance	$ 36,278,299	$ 236,223,829	$ 3,470,518	$ 9,904,369	$ 117,416,181	$ 49,089,810	$	$ 452,383,006
Ending balance: individually evaluated for impairment	$ 6,348,925	$ 15,614,812	$ 3,470,518	$ 1,228,429	$ 8,754,261	$ 599,822	$	$ 36,016,767
Ending balance : collectively evaluated for impairment	$ 29,929,374	$ 220,609,017	$	$ 8,675,940	$ 108,661,920	$ 48,489,988	$	$ 416,366,239

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The following table sets forth activity in our allowance for loan losses, by loan type, for the year ended December 31, 2012. The following table also details the amount of loans receivable, net, that are evaluated individually, and collectively, for impairment, and the related portion of the allowance for loan losses that is allocated to each loan portfolio segment.

2012	Commercial	Commercial Real Estate	Construction	Construction to Permanent	Residential	Consumer	Unallocated	Total
Allowance for loan losses:								
Beginning Balance	$ 882,062	$ 4,018,746	$ 867,159	$ 547,333	$ 2,550,588	$ 458,762	$ 60,022	$ 9,384,672
Charge-offs	(48,414)	(49,922)	(101,391)		(84,711)	(785,918)		(1,070,356)
Recoveries	10,861	66,951				2,731		80,543
Provision	96,947	(526,380)	(454,471)	(528,613)	(1,568,509)	541,123	60,680	(2,379,223)
Ending Balance	$ 941,456	$ 3,509,395	$ 311,297	$ 18,720	$ 897,368	$ 216,698	$ 120,702	$ 6,015,636
Ending balance: individually evaluated for impairment	$ 33,280	$ 728,607	$ 120,616	$	$ 83,543	$ 2,368	$	$ 968,414
Ending balance: collectively evaluated for impairment	908,176	2,780,788	190,681	18,720	813,825	214,330	120,702	5,047,222
Total Allowance for Loan Losses	$ 941,456	$ 3,509,395	$ 311,297	$ 18,720	$ 897,368	$ 216,698	$ 120,702	$ 6,015,636
Total Loans ending balance	$ 36,428,751	$ 247,495,321	$ 4,997,991	$ 4,851,768	$ 119,033,025	$ 51,343,626	$	$ 464,150,482
Ending balance: individually evaluated for impairment	$ 219,509	$ 15,909,103	$ 1,862,038	$ 1,258,710	$ 13,567,175	$ 566,543	$	$ 33,383,078
Ending balance : collectively evaluated for impairment	$ 36,209,242	$ 231,586,218	$ 3,135,953	$ 3,593,058	$ 105,465,850	$ 50,777,083	$	$ 430,767,404

The Company monitors the credit quality of its loans receivable on an ongoing manner. Credit quality is monitored by reviewing certain credit quality indicators. Management has determined that internally assigned risk ratings and loan-to-value ratios (LTVs), at period end, are the key credit quality indicators that best help management monitor the credit quality of the Company s loans receivable. Loan-to-value ratios used by management in monitoring credit quality are based on current period loan balances and the most recent appraisal, which may be the original appraisal.

Appraisals on properties securing impaired loans and Other Real Estate Owned (OREO) are updated annually. Additionally, appraisals on construction loans are updated four months in advance of scheduled maturity dates. We update our impairment analysis monthly based on the most recent appraisal as well as other factors (such as senior lien positions, e.g. property taxes). We are subscribers to a national real estate valuation database service and use published information regarding home sales prices in the towns/counties where our collateral is located in CT and NY.

The majority of the Company s impaired loans have been resolved through courses of action other than via bank liquidations of real estate collateral through OREO. These include normal loan payoffs, the traditional workout process, triggering personal guarantee obligations, and troubled debt restructurings. However, as loan workout efforts progress to a point where the bank s liquidation of real estate collateral is the likely outcome, the impairment analysis is updated to reflect actual recent experience with bank sales of OREO properties.

A disposition discount is built into our impairment analysis and reflected in our allowance once a property is determined to be a likely OREO (e.g. foreclosure is probable). To determine the discount we compare the average sales prices of our prior OREO properties to the appraised value that was obtained as of the date when we took title to the property. The difference is the bank-owned disposition discount.

The Company has a risk rating system as part of the risk assessment of its loan portfolio. The Company s lending officers are required to assign an Obligor and a Facility risk rating to each loan in their portfolio at origination, which is ratified or modified by the Committee to which the loan is submitted for approval. When the lender learns of important financial developments, the risk rating is reviewed accordingly, and adjusted if necessary. All loans are reviewed annually. Similarly, the Loan Committee can adjust a risk rating.

In addition, the Company engages a third party independent loan reviewer that performs quarterly reviews of a sample of loans, validating the Bank s risk ratings assigned to such loans. The risk ratings play an important role in the establishment of the loan loss provision and to confirm the adequacy of the allowance for loan losses. Any upgrades to classified loans must be approved by the Board Loan Committee.

When assigning a risk rating to a loan, management utilizes the Bank s internal eleven-point risk rating system. An asset is considered special mention when it has a potential weakness based on objective evidence, but does not currently expose the Company to sufficient risk to warrant classification in one of the following categories: An asset is considered substandard if it is not adequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets have well defined weaknesses based on objective evidence, and are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have all of the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

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During the quarter ended June 30, 2012, the Bank implemented enhancements to the allowance methodology, resulting in a reduction of the allowance for loan losses of $1.1 million for that period. In making this transition, the changes served to update and enhance the methodology to better reflect the direction of the current loan portfolio. The changes were threefold:

First, the Bank adopted a two year, instead of a three year, weighted average historical loss factor as the basis for the calculation of its historical loss experience. This is used to calculate expected losses in the pools identified in the Accounting Standards Codification (ASC) (Topic 450-20), Loss Contingencies pools prior to the application of qualitative risk adjustment factors. This change was made to be more responsive to the changing credit environment. This shorter average historical loss period will produce results more indicative of the current and expected behavior of the portfolio.

Second, the Bank adopted an Internal Risk Ratings Based (IRB) approach to calculating historical loss rates. This approach calibrates expected losses with actual risk assessment and equates the likelihood of loss to the level of risk in a credit facility rating. Previously, loss history was applied to categories of loans and qualitative adjustments were apportioned by risk rating within the categories.

Third, the Bank increased the detail of analysis within the segments, particularly within Commercial Real Estate lending, which is currently the Bank s largest concentration overall, by expanding the number of ASC 450-20 pools. In all, ten sub-concentrations have been added to the analysis. The greater level of detail enables the Bank to better apply qualitative risk adjustment factors to the segments affected and to monitor changes in credit risk within the portfolio.

Charge-off generally commences in the month that the loan is classified doubtful and is fully charged off within six months of such classification. If the account is classified loss the full balance is charged off immediately. The full balance is charged off regardless of the potential recovery from the sale of the collateral. This amount is recognized as a recovery once the collateral is sold.

In accordance with FFIEC (Federal Financial Institutions Examination Council) published policies establishing uniform criteria for the classification of retail credit based on delinquency status, Open-end credits are charged-off when 180 days delinquent and Closed-end credits are charged-off when 120 days delinquent. Typically, consumer installment loans are charged off no later than 90 days past due.

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The following table details the credit risk exposure of loans receivable, by loan type and credit quality indicator at June 30, 2013:

CREDIT RISK PROFILE BY CREDITWORTHINESS CATEGORY

Commercial		Commercial Real Estate		Construction		Construction to Permanent		Residential Real Estate		Consumer		
75%	>= 75%	< 75%	>= 75%	< 75%	>= 75%	< 75%	>= 75%	< 75%	>= 75%	< 75%	>= 75%	Other
79,503	$ 2,506,139	$ 196,311,404	$ 6,837,773	$	$	$ 8,675,940	$	$ 86,632,838	$ 24,827,976	$ 43,847,982	$ 4,478,031	$ 657,208
946,488		12,619,340	5,272,043							934		
206,295	6,339,874	4,106,228	11,077,041	3,135,518	335,000		1,228,429	2,011,433	3,943,934	47,655	58,000	
32,286	$ 8,846,013	$ 213,036,972	$ 23,186,857	$ 3,135,518	$ 335,000	$ 8,675,940	$ 1,228,429	$ 88,644,271	$ 28,771,910	$ 43,896,571	$ 4,536,031	$ 657,208

CREDIT RISK PROFILE

	Commercial	Commercial Real Estate	Construction	Construction to Permanent	Residential Real Estate	Consumer	Totals
Performing	$ 29,929,374	$ 226,700,322	$	$ 8,675,940	$ 111,460,814	$ 49,051,340	$ 425,817,790
Non Performing	6,348,925	9,523,507	3,470,518	1,228,429	5,955,367	38,470	26,565,216
Total	$ 36,278,299	$ 236,223,829	$ 3,470,518	$ 9,904,369	$ 117,416,181	$ 49,089,810	$ 452,383,006

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The following table details the credit risk exposure of loans receivable, by loan type and credit quality indicator at December 31, 2012:

CREDIT RISK PROFILE BY CREDITWORTHINESS CATEGORY

	nmercial	Commercial Real Estate		Construction		Construction to Permanent		Residential Real Estate		Consumer		C
	>= 75%	< 75%	>= 75%	< 75%	>= 75%	< 75%	>= 75%	< 75%	>= 75%	< 75%	>= 75%	
7	$ 1,241,109	$ 203,149,356	$ 9,182,622	$	$	$ 3,593,058	$	$ 77,368,459	$ 25,617,355	$ 46,102,332	$ 3,752,752	$ 7
4	164,191	11,554,971	5,374,265	3,135,953				5,310,178		98,530	564,175	
01	210,459	8,503,630	9,730,477		1,862,038		1,258,710	2,524,186	8,212,847	2,368	58,000	
92	$ 1,615,759	$ 223,207,957	$ 24,287,364	$ 3,135,953	$ 1,862,038	$ 3,593,058	$ 1,258,710	$ 85,202,823	$ 33,830,202	$ 46,203,230	$ 4,374,927	$ 7

CREDIT RISK PROFILE

	Commercial	Commercial Real Estate	Construction	Construction to Permanent	Residential Real Estate	Consumer	Totals
Performing	$ 36,209,242	$ 237,764,844	$ 3,135,953	$ 3,593,058	$ 108,295,992	$ 51,341,258	$ 440,340,347
Non Performing	219,509	9,730,477	1,862,038	1,258,710	10,737,033	2,368	23,810,135
Total	$ 36,428,751	$ 247,495,321	$ 4,997,991	$ 4,851,768	$ 119,033,025	$ 51,343,626	$ 464,150,482

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The following table sets forth the detail, and delinquency status, of non-accrual loans and past due loans at June 30, 2013:

	Non-Accrual and Past Due Loans						
	Non-Accrual Loans						
2013	**31-60 Days Past Due**	**61-90 Days Past Due**	**Greater Than 90 Days**	**Total Past Due**	**Current**	**>90 Days Past Due and Accruing**	**Total Non-Accrual and Past Due Loans**
Commercial							
Pass	$	$	$	$	$	$ 49,765	$ 49,765
Substandard			6,348,925	6,348,925		750,000	7,098,925
Total Commercial	$	$	$ 6,348,925	$ 6,348,925	$	$ 799,765	$ 7,148,690
Commercial Real Estate							
Pass	$	$	$	$	$	$	$
Special Mention							
Substandard	$	$	$ 7,482,251	$ 7,482,251	$ 2,041,256	$ 854,162	$ 10,377,669
Total Commercial Real Estate	$	$	$ 7,482,251	$ 7,482,251	$ 2,041,256	$ 854,162	$ 10,377,669
Construction							
Substandard	$	$	$ 3,470,518	$ 3,470,518	$	$	$ 3,470,518
Total Construction	$	$	$ 3,470,518	$ 3,470,518	$	$	$ 3,470,518
Construction to Permanent							
Substandard	$	$	$	$	$ 1,228,429	$	$ 1,228,429
Total Construction to Permanent	$	$	$	$	$ 1,228,429	$	$ 1,228,429
Residential Real Estate							
Special Mention	$	$	$	$	$	$	$
Substandard			5,217,476	5,217,476	737,891		5,955,367
Total Residential Real Estate	$	$	$ 5,217,476	$ 5,217,476	$ 737,891	$	$ 5,955,367
Consumer							
Substandard	$ 1,936	$	$ 36,534	$ 38,470	$	$	$ 38,470
Total Consumer	$ 1,936	$	$ 36,534	$ 38,470	$	$	$ 38,470
Total	$ 1,936	$	$ 22,555,704	$ 22,557,640	$ 4,007,576	$ 1,653,927	$ 28,219,143

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The following table sets forth the detail, and delinquency status, of non-accrual loans and past due loans at December 31, 2012:

2012	Non-Accrual and Past Due Loans — Non-Accrual Loans — 31-60 Days Past Due	61-90 Days Past Due	Greater Than 90 Days	Total Past Due	Current	>90 Days Past Due and Accruing	Total Non-Accrual and Past Due Loans
Commercial							
Special Mention	$	$	$	$	$	$ 300,000	$ 300,000
Substandard			182,258	182,258	37,251	500,000	719,509
Total Commercial	$	$	$ 182,258	$ 182,258	$ 37,251	$ 800,000	$ 1,019,509
Commercial Real Estate							
Pass	$	$	$	$	$	$ 566,936	$ 566,936
Special Mention							
Substandard	$	$	$ 7,629,819	$ 7,629,819	$ 2,100,658	$ 867,361	$ 10,597,838
Total Commercial Real Estate	$	$	$ 7,629,819	$ 7,629,819	$ 2,100,658	$ 1,434,297	$ 11,164,774
Construction							
Substandard	$	$	$ 1,862,038	$ 1,862,038	$	$	$ 1,862,038
Total Construction	$	$	$ 1,862,038	$ 1,862,038	$	$	$ 1,862,038
Construction to Permanent							
Substandard	$	$	$	$	$ 1,258,710	$	$ 1,258,710
Total Construction to Permanent	$	$	$	$	$ 1,258,710	$	$ 1,258,710
Residential Real Estate							
Substandard	$	$ 358,123	$ 10,231,542	$ 10,589,665	$ 147,368	$	$ 10,737,033
Total Residential Real Estate	$	$ 358,123	$ 10,231,542	$ 10,589,665	$ 147,368	$	$ 10,737,033
Consumer							
Substandard	$	$	$	$	$ 2,368	$	$ 2,368
Total Consumer	$	$	$	$	$ 2,368	$	$ 2,368
Total	$	$ 358,123	$ 19,905,657	$ 20,263,780	$ 3,546,355	$ 2,234,297	$ 26,044,432

Included in loans receivable are loans for which the accrual of interest income has been discontinued due to deterioration in the financial condition of the borrowers. The recorded balance of these non-accrual loans was $26.6 million and $23.8 million at June 30, 2013, and December 31, 2012 respectively. Generally, loans are placed on non-accruing status when they become 90 days or more delinquent, and remain on non-accrual status until they are brought current, have six months of performance under the loan terms, and factors indicating reasonable doubt about the timely collection of payments no longer exist. Therefore, loans may be current in accordance with their loan terms, or may be less than 90 days delinquent and still be on a non-accruing status. Additionally, certain loans that cannot demonstrate sufficient global cash flow to continue loan payments in the future and certain troubled debt restructures (TDRs) are placed on non-accrual status.

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Loans past due ninety days or more, and still accruing interest were $1.7 million and $2.2 million at June 30, 2013, and December 31, 2012 respectively, and consisted of 4 loans at June 30, 2013. All of the 4 loans at June 30, 2013, totaling $1.7 million, were continuing to make interest payments, were past maturity and are in the process of being renewed.

The following table sets forth the detail and delinquency status of loans receivable, by performing and non-performing loans at June 30, 2013.

	Performing (Accruing) Loans						
2013	**31-60 Days Past Due**	**61-90 Days Past Due**	**Total Past Due**	**Current**	**Total Performing Loans**	**Total Non-Accrual and Past Due Loans**	**Total Loans**
Commercial							
Pass	$ 14,455	$ 9,365	$ 23,820	$ 26,712,057	$ 26,735,877	$ 49,765	$ 26,785,642
Special Mention	23,025		23,025	923,463	946,488		946,488
Substandard				1,447,244	1,447,244	7,098,925	8,546,169
Total Commercial	$ 37,480	$ 9,365	$ 46,845	$ 29,082,764	$ 29,129,609	$ 7,148,690	$ 36,278,299
Commercial Real Estate							
Pass	$	$	$	$ 203,149,177	$ 203,149,177	$	$ 203,149,177
Special Mention				17,891,383	17,891,383		17,891,383
Substandard				4,805,600	4,805,600	10,377,669	15,183,269
Total Commercial Real Estate	$	$	$	$ 225,846,160	$ 225,846,160	$ 10,377,669	$ 236,223,829
Construction							
Pass	$	$	$	$	$	$	$
Special Mention							
Substandard						3,470,518	3,470,518
Total Construction	$	$	$	$	$	$ 3,470,518	$ 3,470,518
Construction to Permanent							
Pass	$	$	$	$ 8,675,940	$ 8,675,940	$	$ 8,675,940
Special Mention							
Substandard						1,228,429	1,228,429
Total Construction to Permanent	$	$	$	$ 8,675,940	$ 8,675,940	$ 1,228,429	$ 9,904,369
Residential Real Estate							
Pass	$ 30,313	$	$ 30,313	$ 111,430,501	$ 111,460,814	$	$ 111,460,814
Special Mention							
Substandard						5,955,367	5,955,367
Total Residential Real Estate	$ 30,313	$	$ 30,313	$ 111,430,501	$ 111,460,814	$ 5,955,367	$ 117,416,181
Consumer							
Pass	$ 87,081	$	$ 87,081	$ 48,896,140	$ 48,983,221	$	$ 48,983,221
Special Mention		934	934		934		934
Substandard	58,000		58,000	9,185	67,185	38,470	105,655
Total Consumer	$ 145,081	$ 934	$ 146,015	$ 48,905,325	$ 49,051,340	$ 38,470	$ 49,089,810
Total	$ 212,874	$ 10,299	$ 223,173	$ 423,940,690	$ 424,163,863	$ 28,219,143	$ 452,383,006

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The following table sets forth the detail and delinquency status of loans receivable, net, by performing and non-performing loans at December 31, 2012.

	Performing (Accruing) Loans						
2012	31-60 Days Past Due	Greater Than 60 Days	Total Past Due	Current	Total Perfoming Loans	Total Non-Accrual and Past Due Loans	Total Loans
Commercial							
Pass	$ 10,171	$	$ 10,171	$ 26,494,715	$ 26,504,886	$ 300,000	$ 26,804,886
Special Mention				7,399,006	7,399,006		7,399,006
Substandard				1,505,350	1,505,350	719,509	2,224,859
Total Commercial	$ 10,171	$	$ 10,171	$ 35,399,071	$ 35,409,242	$ 1,019,509	$ 36,428,751
Commercial Real Estate							
Pass	$	$	$	$ 211,765,042	$ 211,765,042	$ 566,936	$ 212,331,978
Special Mention				16,929,236	16,929,236		16,929,236
Substandard				7,636,269	7,636,269	10,597,838	18,234,107
Total Commercial Real Estate	$	$	$	$ 236,330,547	$ 236,330,547	$ 11,164,774	$ 247,495,321
Construction							
Special Mention	$	$	$	$ 3,135,953	$ 3,135,953	$	$ 3,135,953
Substandard						1,862,038	1,862,038
Total Construction	$	$	$	$ 3,135,953	$ 3,135,953	$ 1,862,038	$ 4,997,991
Construction to Permanent							
Pass	$	$	$	$ 3,593,058	$ 3,593,058	$	$ 3,593,058
Substandard						1,258,710	1,258,710
Total Construction to Permanent	$	$	$	$ 3,593,058	$ 3,593,058	$ 1,258,710	$ 4,851,768
Residential Real Estate							
Pass	$ 40,838	$	$ 40,838	$ 102,944,976	$ 102,985,814	$	$ 102,985,814
Special Mention				5,310,178	5,310,178		5,310,178
Substandard						10,737,033	10,737,033
Total Residential Real Estate	$ 40,838	$	$ 40,838	$ 108,255,154	$ 108,295,992	$ 10,737,033	$ 119,033,025
Consumer							
Pass	$	$ 12,443	$ 12,443	$ 50,608,110	$ 50,620,553	$	$ 50,620,553
Special Mention				662,705	662,705		662,705
Substandard				58,000	58,000	2,368	60,368
Total Consumer	$	$ 12,443	$ 12,443	$ 51,328,815	$ 51,341,258	$ 2,368	$ 51,343,626
Total	$ 51,009	$ 12,443	$ 63,452	$ 438,042,598	$ 438,106,050	$ 26,044,432	$ 464,150,482

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The following table summarizes impaired loans as of June 30, 2013:

	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:			
Commercial	$ 9,050	$ 93,944	$
Commercial Real Estate	12,323,812	13,540,163	
Construction			
Construction to Permanent	1,228,429	1,425,000	
Residential	8,108,728	8,240,449	
Consumer	597,886	616,840	
Total:	$ 22,267,905	$ 23,916,396	$
With an allowance recorded:			
Commercial	$ 6,339,875	$ 6,516,667	$ 1,250,663
Commercial Real Estate	3,291,000	3,606,947	538,714
Construction	3,470,518	3,645,247	236,484
Construction to Permanent			
Residential	645,533	2,647,198	158,247
Consumer	1,936	2,156	1,936
Total:	$ 13,748,862	$ 16,418,215	$ 2,186,044
Commercial	$ 6,348,925	$ 6,610,611	$ 1,250,663
Commercial Real Estate	15,614,812	17,147,110	538,714
Construction	3,470,518	3,645,247	236,484
Construction to Permanent	1,228,429	1,425,000	
Residential	8,754,261	10,887,647	158,247
Consumer	599,822	618,996	1,936
Total:	$ 36,016,767	$ 40,334,611	$ 2,186,044

Impaired loans consist of non-accrual loans, TDRs and loans that were previously classified as TDRs that have been upgraded.

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The following table summarizes impaired loans as of December 31, 2012:

	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:			
Commercial	$ 46,301	$ 131,195	$
Commercial Real Estate	12,328,103	13,369,985	
Construction			
Construction to Permanent	1,258,710	1,425,000	
Residential	10,760,965	12,786,388	
Consumer	564,175	564,175	
Total:	$ 24,958,254	$ 28,276,743	$
With an allowance recorded:			
Commercial	$ 173,208	$ 350,000	$ 33,280
Commercial Real Estate	3,581,000	3,606,947	728,607
Construction	1,862,038	2,013,663	120,616
Construction to Permanent			
Residential	2,806,210	2,806,766	83,543
Consumer	2,368	2,506	2,368
Total:	$ 8,424,824	$ 8,779,882	$ 968,414
Commercial	$ 219,509	$ 481,195	$ 33,280
Commercial Real Estate	15,909,103	16,976,932	728,607
Construction	1,862,038	2,013,663	120,616
Construction to Permanent	1,258,710	1,425,000	
Residential	13,567,175	15,593,154	83,543
Consumer	566,543	566,681	2,368
Total:	$ 33,383,078	$ 37,056,625	$ 968,414

The recorded investment of impaired loans at June 30, 2013 and December 31, 2012 was $36.0 million and $33.4 million, with related allowances of $2.2 million and $1.0 million, respectively.

Included in the tables above at June 30, 2013 and December 31, 2012 are loans with carrying balances of $22.3 million and $25.0 million that required no specific reserves in our allowance for loan losses. Loans that did not require specific reserves at June 30, 2013 and December 31, 2012 have sufficient collateral values, less costs to sell, supporting the carrying balances of the loans. In some cases, there may be no specific reserves because the Company already charged-off the specific impairment. Once a borrower is in default, the Company is under no obligation to advance additional funds on unused commitments.

On a case-by-case basis, the Company may agree to modify the contractual terms of a borrower s loan to remain competitive and assist customers who may be experiencing financial difficulty, as well as preserve the Company s position in the loan. If the borrower is experiencing financial difficulties and a concession has been made at the time of such modification, the loan is classified as a troubled debt restructured loan.

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The following table presents the total troubled debt restructured loans as of June 30, 2013:

	Accrual		Non-accrual		Total	
	# of Loans	Amount	# of Loans	Amount	# of Loans	Amount
Commercial Real Estate		$	2	$ 3,921,256	2	$ 3,921,256
Residential Real Estate			2	846,888	2	846,888
Construction to permanent	2	4,698,372	1	1,228,429	3	5,926,801
Total Troubled Debt Restructurings	2	$ 4,698,372	5	$ 5,996,573	7	$ 10,694,945

The following table presents the total troubled debt restructured loans as of December 31, 2012:

	Accrual		Non-accrual		Total	
	# of Loans	Amount	# of Loans	Amount	# of Loans	Amount
Commercial Real Estate		$	2	$ 4,255,658	2	$ 4,255,658
Residential Real Estate			3	5,519,232	3	5,519,232
Construction to permanent			1	1,258,710	1	1,258,710
Commercial			1	37,251	1	37,251
Consumer home equity	1	564,175			1	564,175
Total Troubled Debt Restructurings	1	$ 564,175	7	$ 11,070,851	8	$ 11,635,026

No loans were modified in a troubled debt restructuring during the three months ended June 30, 2013. The following table summarizes loans that were modified in a troubled debt restructuring during the six months ended June 30, 2013.

	Six months ended June 30, 2013			
	Number of Relationships	Pre-Modification Outstanding Recorded Investment	Number of Relationships	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings Construction to permanent	2	$ 4,730,324	2	$ 4,698,372
Total Troubled Debt Restructurings	2	$ 4,730,324	2	$ 4,698,372

Substantially all of our troubled debt restructured loan modifications involve lowering the monthly payments on such loans through either a reduction in interest rate below market rate, an extension of the term of the loan, or a combination of these two methods. These modifications rarely result in the forgiveness of principal or accrued interest. In addition, we frequently obtain additional collateral or guarantor support when modifying commercial loans. If the borrower had demonstrated performance under the previous terms and our underwriting process shows the borrower has the capacity to continue to perform under the restructured terms, the loan will continue to accrue interest. Non-accruing restructured loans may be returned to accrual status when there has been a sustained period of repayment performance (generally six consecutive months of payments) and both principal and interest are deemed collectible.

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During the six months ended June 30, 2013, two construction to permanent loans to one borrower in the amount of $3.7 million and $1.0 million were downgraded due to the financial hardship of the borrower. Two troubled debt restructured loans, a commercial loan for $37,000 and a residential real estate loan for $4.4 million has since paid off. One troubled debt restructured loan, a home equity installment loan for $563,000, was upgraded due to the improvement in the borrower s financial condition.

All troubled debt restructurings are impaired loans, which are individually evaluated for impairment.

Note 4: Deposits

The following table is a summary of the Company s deposits at:

	June 30, 2013	December 31, 2012
Non-interest bearing	$ 63,869,164	$ 65,176,125
Interest bearing		
NOW	33,705,921	30,191,403
Savings	94,601,276	77,760,967
Money market	36,494,053	42,401,428
Time certificates, less than $100,000	136,324,642	160,610,601
Time certificates, $100,000 or more	112,647,818	121,142,374
Total interest bearing	413,773,710	432,106,773
Total Deposits (1)	$ 477,642,874	$ 497,282,898

(1) Included in total deposits are $24.7 million of deposits held for sale at December 31, 2012.

Note 5: Share-Based Compensation

The Company maintains the Patriot National Bancorp, Inc. 2012 Stock Plan to provide an incentive to directors and employees of the Company by the grant of options, restricted stock awards or phantom stock units. The Plan provides for the issuance of up to 3,000,000 shares of the Company s common stock subject to certain Plan limitations. 2,882,613 shares of stock remain available for issuance under the Plan as of June 30, 2013. The vesting of restricted stock awards and options may be accelerated in accordance with terms of the plan. The Compensation Committee shall make terms and conditions applicable to the vesting of restricted stock awards and stock options. Restricted stock grants are available only to directors and vest in quarterly installments over a four year period from the date of grant. The Compensation Committee accelerated the vesting of the initial grant of restricted stock in 2012, whereby the first year of the tranche vested immediately. Stock options were granted at an exercise price equal to $2.20 based on a price determined by the Compensation Committee and all have an expiration period of 10 years. The fair value of stock options granted on January 24, 2012, was estimated utilizing the Black-Scholes option pricing model using the following assumptions: an expected life of 6.28 years utilizing the simplified method, risk-free rate of return of 1.28%, volatility of 61.29% and no dividend yield. The Company is expensing the grant date fair value of all share-based compensation over the requisite vesting periods on a straight-line basis.

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During the three months ended June 30, 2013 and June 30, 2012, the Company recorded $7,560 and $53,497 of total stock-based compensation, respectively. During the six months ended June 30, 2013 and June 30, 2012, the Company recorded $15,211 and $133,128 of total stock-based compensation, respectively. During the six months ended June 30, 2013, there were no awards granted under the 2012 Stock Plan.

The following table is a summary of the Company s non-vested stock options as of June 30, 2013, and changes therein during the period then ended:

	Number of Stock Options	Weighted Average Grant Date Fair Value	Weighted Average Exercise Price	Weighted Average Contractual Life (years)
Outstanding - December 31, 2012	850,000	$ 0.90	$ 2.20	10
Granted				
Exercised				
Forfeited	(850,000)	0.90	2.20	10
Outstanding - June 30, 2013		$	$	
Exercisable - June 30, 2013		$	$	

The following is a summary of the status of the Company s restricted shares as of June 30, 2013, and changes therein during the period then ended.

	Number of Shares Awarded	Weighted Average Grant Date Fair Value
Non-vested at December 31, 2012	44,566	$ 1.73
Vested	(8,875)	1.73
Non-vested at June 30, 2013	35,691	$ 1.73

Expected future stock award expense related to the non-vested restricted awards as of June 30, 2013, is $61,567 over an average period of 2.15 years.

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Note 6: Income Taxes

The determination of the amount of deferred income tax assets which are more likely than not to be realized is primarily dependent on projections of future earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. A valuation allowance related to deferred tax assets is required when it is considered more likely than not that all or part of the benefit related to such assets will not be realized. Management has reviewed the deferred tax position of the Company at June 30, 2013. The deferred tax position has been affected by several significant transactions in prior years. These transactions include increased provision for loan losses, the levels of non-accrual loans and other-than-temporary impairment write-offs of certain investments, as well as a loss on the bulk sale of loans in 2011. As a result, the Company is in a cumulative net loss position at June 30, 2013, and under the applicable accounting guidance, has concluded that it is not more-likely-than-not that the Company will be able to realize its deferred tax assets and, accordingly, has established a full valuation allowance totaling $17.6 million against its deferred tax asset at June 30, 2013. The valuation allowance is analyzed quarterly for changes affecting the deferred tax asset. If, in the future, the Company generates taxable income on a sustained basis, management s conclusion regarding the need for a deferred tax asset valuation allowance could change, resulting in the reversal of all or a portion of the deferred tax asset valuation allowance.

As measured under the rules of the Tax Reform Act of 1986, the Company has undergone a greater than 50% change of ownership in 2010. Consequently, use of the Company s net operating loss carryforward and certain built in deductions available against future taxable income in any one year are limited. The maximum amount of carryforwards available in a given year is limited to the product of the Company s fair market value on the date of ownership change and the federal long-term tax-exempt rate, plus any limited carryforward not utilized in prior years.

The Company has analyzed the impact of its recent ownership change and has calculated the annual limitation under IRC 382 to be $284,000. Based on the analysis, the Company has determined that the pre-change net operating losses and net unrealized built-in deductions were approximately $36.2 million. Based on a 20 year carryforward period, the Company could utilize approximately $5.6 million of the pre-change net operating losses and built-in deductions. Therefore, the Company wrote-off approximately $10.4 million of deferred tax assets in 2011. Accordingly, the write-off of the deferred tax asset did not affect the consolidated financial statements as there was a full valuation allowance against the deferred tax asset.

Note 7: Income (loss) per share

The Company is required to present basic income (loss) per share and diluted income (loss) per share in its consolidated statements of operations. Basic income (loss) per share amounts are computed by dividing net income (loss) by the weighted average number of common shares outstanding. Diluted income (loss) per share reflects additional common shares that would have been outstanding if potentially dilutive common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Company relate to outstanding stock options and are determined using the treasury stock method. The Company is also required to provide a reconciliation of the numerator and denominator used in the computation of both basic and diluted income (loss) per share.

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The stock options and non-vested restricted stock awards did not have an impact on the diluted earnings per share. The following is information about the computation of income (loss) per share for the three and six months ended June 30, 2013 and 2012:

Three months ended June 30, 2013

	Net Loss	Weighted Average Common Shares O/S	Amount
Basic and Diluted Loss Per Share Income attributable to common shareholders	$ (3,911,831)	38,434,298	$ (0.10)

Three months ended June 30, 2012

	Net Income	Weighted Average Common Shares O/S	Amount
Basic and Diluted Income Per Share Loss attributable to common shareholders	$ 345,282	38,381,988	$ 0.01

Six months ended June 30, 2013

	Net Loss	Weighted Average Common Shares O/S	Amount
Basic and Diluted Loss Per Share Income attributable to common shareholders	$ (5,868,798)	38,434,919	$ (0.15)

Six months ended June 30, 2012

	Net Income	Weighted Average Common Shares O/S	Amount
Basic and Diluted Income Per Share Loss attributable to common shareholders	$ 890,812	38,377,166	$ 0.02

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Note 8: Other Comprehensive Income

Other comprehensive income, which is comprised solely of the change in unrealized gains and losses on available-for-sale securities, is as follows:

	Three Months Ended June 30, 2013			Six Months Ended June 30, 2013		
	Before Tax Amount	Tax Effect	Net of Tax Amount	Before Tax Amount	Tax Effect	Net of Tax Amount
Unrealized holding losses arising during the period	$(629,406)	$	$ (629,406)	$ (574,445)	$	$ (574,445)
Reclassification adjustment for losses recognized in income						
Unrealized holding losses on available for sale securities, net of taxes	$ (629,406)	$	$ (629,406)	$ (574,445)	$	$ (574,445)

	Three Months Ended June 30, 2012			Six Months Ended June 30, 2012		
	Before Tax Amount	Tax Effect	Net of Tax Amount	Before Tax Amount	Tax Effect	Net of Tax Amount
Unrealized holding gains arising during the period	$198,155	$ (75,299)	$ 122,856	$ 306,842	$ (116,601)	$ 190,241
Reclassification adjustment for (losses) recognized in income				(8,042)	3,056	(4,986)
Unrealized holding gains on available for sale securities, net of taxes	$ 198,155	$ (75,299)	$ 122,856	$ 298,800	$ (113,545)	$ 185,255

Note 9: Financial Instruments with Off-Balance Sheet Risk

In the normal course of business, the Company is a party to financial instruments with off-balance-sheet risk to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit and involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the balance sheet. The contractual amounts of these instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

The contractual amount of commitments to extend credit and standby letters of credit represent the total amount of potential accounting loss should: the contracts be fully drawn upon; the customers default; and the value of any existing collateral becomes worthless. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments and evaluates each customer s creditworthiness on a case-by-case basis. Management believes that the Company controls the credit risk of these financial instruments through credit approvals, credit limits, monitoring procedures and the receipt of collateral as deemed necessary.

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Financial instruments whose contractual amounts represent credit risk at June 30, 2013 are as follows:

Commitments to extend credit:	
Future loan commitments	$ 20,000,271
Home equity lines of credit	30,770,683
Unused lines of credit	36,297,354
Undisbursed construction loans	4,376,483
Financial standby letters of credit	1,059,997
	$ 92,504,788

Standby letters of credit are written commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Guarantees that are not derivative contracts are recorded on the Company s consolidated balance sheet at their fair value at inception.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments to extend credit generally have fixed expiration dates, or other termination clauses, and may require payment of a fee by the borrower. Since these commitments could expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management s credit evaluation of the counterparty. Collateral held varies, but may include residential and commercial property, deposits and securities. Based on an analysis of unfunded commitments, the bank has established a reserve of $12,469 as of June 30, 2013.

Note 10: Regulatory and Operational Matters

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory - and possibly additional discretionary - actions by regulators that, if undertaken, could have a direct material effect on the Company s financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of the Company s and the Bank s assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company s and the Bank s capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). In addition, due to the Bank s asset profile and current economic conditions in its markets, the Bank s capital plan pursuant to the Agreement described below does target a minimum 9% Tier 1 leverage capital ratio.

In February 2009 the Bank entered into a formal written agreement (the Agreement) with the Office of the Comptroller of the Currency. Under the terms of the Agreement, the Bank has appointed a Compliance Committee of outside directors and the Chief Executive Officer. The Committee must report quarterly to the Board of Directors and to the OCC on the Bank s progress in complying with the Agreement. The Agreement requires the Bank to review, adopt and implement a number of policies and programs related to credit and operational issues. The Agreement further provides for limitations on the acceptance of certain brokered deposits and the extension of credit to borrowers whose loans are criticized. The Bank may pay dividends during the term of the Agreement only with prior written permission from the OCC. The Agreement also requires that the Bank develop and implement a three-year capital plan. The Bank has taken or put into process all of the steps required by the Agreement, and does not anticipate that the restrictions included within the Agreement will impair its current business plan.

In June 2010 the company entered into a formal written agreement (the Reserve Bank Agreement) with the Federal Reserve Bank of New York (the Reserve Bank). Under the terms of the Reserve Bank Agreement, the Board of Directors of the Company are required to take appropriate steps to fully utilize the Company s financial and managerial resources to serve as a source of strength to the Bank including taking steps to insure that the Bank complies with the Agreement with the OCC. The Reserve Bank Agreement requires the Company to submit, adopt and implement a capital plan that is acceptable to the Reserve Bank. The Company must also report to the Reserve Bank quarterly on the Company s progress in complying with the Reserve Bank Agreement. The Agreement further provides for certain restrictions on the payment or receipt of dividends, distributions of interest or principal on subordinate debentures or trust preferred securities and the Company s ability to incur debt or to purchase or redeem its stock without the prior written approval of the Reserve Bank. The Company has taken or put into process all of the steps required by the Reserve Bank Agreement, and does not anticipate that the restrictions included within the Reserve Bank Agreement will impair its current business plan.

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The Company s and the Bank s actual capital amounts and ratios at June 30, 2013 and December 31, 2012 were:

(dollars in thousands)	Actual Amount	Actual Ratio	For Capital Adequacy Purposes Amount	For Capital Adequacy Purposes Ratio	To Be Well Capitalized Under Prompt Corrective Action Provisions Amount	To Be Well Capitalized Under Prompt Corrective Action Provisions Ratio
June 30, 2013						
The Company:						
Total Capital (to Risk Weighted Assets)	$ 57,483	13.96%	$ 32,942	8.00%	N/A	N/A
Tier 1 Capital (to Risk Weighted Assets)	52,332	12.71%	16,470	4.00%	N/A	N/A
Tier 1 Capital (to Average Assets)	52,332	9.13%	22,927	4.00%	N/A	N/A
The Bank:						
Total Capital (to Risk Weighted Assets)	$ 56,937	13.84%	$ 32,912	8.00%	$ 41,139	10.00%
Tier 1 Capital (to Risk Weighted Assets)	51,792	12.59%	16,455	4.00%	24,682	6.00%
Tier 1 Capital (to Average Assets)	51,792	9.05%	22,891	4.00%	28,614	5.00%
December 31, 2012						
The Company:						
Total Capital (to Risk Weighted Assets)	$ 63,253	15.64%	$ 32,354	8.00%	N/A	N/A
Tier 1 Capital (to Risk Weighted Assets)	58,186	14.39%	16,174	4.00%	N/A	N/A
Tier 1 Capital (to Average Assets)	58,186	9.33%	24,946	4.00%	N/A	N/A
The Bank:						
Total Capital (to Risk Weighted Assets)	$ 61,908	15.31%	$ 32,349	8.00%	$ 40,468	10.00%
Tier 1 Capital (to Risk Weighted Assets)	56,840	14.05%	16,182	4.00%	24,280	6.00%
Tier 1 Capital (to Average Assets)	56,840	9.11%	24,957	4.00%	31,191	5.00%

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Restrictions on dividends, loans and advances

The Company s ability to pay dividends is dependent on the Bank s ability to pay dividends to the Company. Pursuant to the February 9, 2009 Agreement between the Bank and the OCC, the Bank can pay dividends to the Company only pursuant to a dividend policy requiring compliance with the Bank s OCC-approved capital program, in compliance with applicable law and with the prior written determination of no supervisory objection by the Assistant Deputy Comptroller. In addition to the Agreement, certain other restrictions exist regarding the ability of the Bank to transfer funds to the Company in the form of cash dividends, loans or advances. The approval of the OCC is required to pay dividends in excess of the Bank s earnings retained in the current year plus retained net earnings for the preceding two years. As of June 30, 2013, the Bank had an accumulated deficit; therefore, dividends may not be paid to the Company. The Bank is also prohibited from paying dividends that would reduce its capital ratios below minimum regulatory requirements.

The Company s ability to pay dividends and incur debt is also restricted by the Reserve Bank Agreement. Under the terms of the Reserve Bank Agreement, the Company has agreed that it shall not declare or pay any dividends or incur, increase or guarantee any debt without the prior written approval of the Reserve Bank and the Director of the Division of Banking Supervision and Regulation (the Director) of the Board of Governors.

Loans or advances to the Company from the Bank are limited to 10% of the Bank s capital stock and surplus on a secured basis.

Recent Legislative Developments

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Act) was signed into law on July 21, 2010. The Act is a significant piece of legislation that continues to have a major impact on the financial services industry, including the organization, financial condition and operations of banks and bank holding companies. Management continues to evaluate the impact of the Act; however, uncertainty remains as to its operational impact, which could have a material adverse impact on the Company s business, results of operations and financial condition. Many of the provisions of the Act are aimed at financial institutions that are significantly larger than the Company and the Bank. Notwithstanding this, there are many other provisions that the Company and the Bank are subject to and will have to comply with, including any new rules applicable to the Company and the Bank promulgated by the Bureau of Consumer Financial Protection, a new regulatory body dedicated to consumer protection. As rules and regulations are promulgated by the agencies responsible for implementing and enforcing the Act, the Company and the Bank will have to address each to ensure compliance with applicable provisions of the Act and compliance costs are expected to increase.

On June 28, 2011, the Federal Reserve Board approved a final debit-card interchange rule. This primarily impacts larger banks and has not had a material impact on the Company.

It is difficult to predict at this time what specific impact the Dodd-Frank Act and the yet to be written implementing rules and regulations will have on the Company. The financial reform legislation and any implementing rules that are ultimately issued could have adverse implications on the financial industry, the competitive environment, and our ability to conduct business. Management will have to apply resources to ensure compliance with all applicable provisions of the Dodd-Frank Act and any implementing rules, which may increase our costs of operations and adversely impact our earnings.

Note 11: Fair Value and Interest Rate Risk

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in certain instances, there are no quoted market prices for certain assets or liabilities. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the asset or liability.

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Fair value measurements focus on exit prices in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment.

The Company s fair value measurements are classified into a fair value hierarchy based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. The three categories within the hierarchy are as follows:

Level 1 Inputs - Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 Inputs - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are derived principally from or corroborated by market data by correlation or other means.

Level 3 Inputs - Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity s own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

The fair value measurement level of an asset or liability within the fair value hierarchy is based on the lower level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

A description of the valuation methodologies used for assets and liabilities recorded at fair value, and for estimating fair value for financial and non-financial instruments not recorded at fair value, is set forth below.

Cash and due from banks, federal funds sold, short-term investments and accrued interest receivable and payable: The carrying amount is a reasonable estimate of fair value. These financial instruments are not recorded at fair value on a recurring basis.

Available-for-Sale Securities: These financial instruments are recorded at fair value in the financial statements. Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted prices are not available, then fair values are estimated by using pricing models (i.e., matrix pricing) or quoted prices of securities with similar characteristics and are classified within Level 2 of the valuation hierarchy. Examples of such instruments include U.S. government agency bonds and mortgage-backed securities and corporate bonds. The prices for these instruments are obtained through an independent pricing service or dealer market participants with whom the Company has historically transacted both purchases and sales of investment securities. Prices obtained from these sources include prices derived from market quotations and matrix pricings. The fair value measurements considered observable data may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading execution data, market consensus prepayment speeds, credit information and the bond s terms and conditions, among other things. Management reviews the data and assumptions used in pricing the securities by its third party provider to ensure the highest level of significant inputs are derived from market observable data. Level 3 securities are instruments for which significant unobservable input are utilized. Available-for-sale securities are recorded at fair value on a recurring basis.

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Loans: For variable rate loans, which reprice frequently and have no significant change in credit risk, carrying values are a reasonable estimate of fair values, adjusted for credit losses inherent in the portfolios. The fair value of fixed rate loans is estimated by discounting the future cash flows using the period end rates, estimated by using local market data, at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities, adjusted for credit losses inherent in the portfolios. The Company does not record loans at fair value on a recurring basis. However, from time to time, nonrecurring fair value adjustments to collateral-dependent impaired loans are recorded to reflect partial write-downs based on the observable market price or current appraised value of collateral. Fair values estimated in this manner do not fully incorporate an exit-price approach to fair value, but instead are based on a comparison to current market rates for comparable loans.

Other Real Estate Owned: The fair values of the Company s other real estate owned (OREO) properties are based on the estimated current property valuations less estimated selling costs. When the fair value is based on current observable appraised values, OREO is classified within Level 2. The Company classifies OREO within Level 3 when unobservable adjustments are made to appraised values. The Company does not record other real estate owned at fair value on a recurring basis.

Deposits: The fair value of demand deposits, regular savings and certain money market deposits is the amount payable on demand at the reporting date. The fair value of certificates of deposit and other time deposits is estimated using a discounted cash flow calculation that applies interest rates currently being offered for deposits of similar remaining maturities, estimated using local market data, to a schedule of aggregated expected maturities on such deposits. The Company does not record deposits at fair value on a recurring basis.

Short-term borrowings: The carrying amounts of borrowings under short-term repurchase agreements and other short-term borrowings maturing within 90 days approximate their fair values. The Company does not record short-term borrowings at fair value on a recurring basis.

Junior Subordinated Debt: Junior subordinated debt reprices quarterly and as a result the carrying amount is considered a reasonable estimate of fair value. The Company does not record junior subordinated debt at fair value on a recurring basis.

Federal Home Loan Bank Borrowings: The fair value of the advances is estimated using a discounted cash flow calculation that applies current Federal Home Loan Bank interest rates for advances of similar maturity to a schedule of maturities of such advances. The Company does not record these borrowings at fair value on a recurring basis.

Other Borrowings: The fair values of longer term borrowings and fixed rate repurchase agreements are estimated using a discounted cash flow calculation that applies current interest rates for transactions of similar maturity to a schedule of maturities of such transactions. The Company does not record these borrowings at fair value on a recurring basis.

Off-balance sheet instruments: Fair values for the Company s off-balance-sheet instruments (lending commitments) are based on interest rate changes and fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties credit standing. The Company does not record its off-balance-sheet instruments at fair value on a recurring basis.

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The following table details the financial assets measured at fair value on a recurring basis as of June 30, 2013 and December 31, 2012, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine fair value:

June 30, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of June 30, 2013
U.S. Government agency mortgage-backed securities	$	$ 23,744,379	$	$ 23,744,379
U.S. Government agency bonds		7,188,603		7,188,603
Corporate bonds		8,610,093		8,610,093
Securities available for sale	$	$ 39,543,075	$	$ 39,543,075

December 31, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of December 31, 2012
U.S. Government agency mortgage-backed securities	$	$ 25,706,891	$	$ 25,706,891
U.S. Government agency bonds		7,526,170		7,526,170
Corporate bonds		8,486,259		8,486,259
Securities available for sale	$	$ 41,719,320	$	$ 41,719,320

There were no transfers of assets between levels 1, 2 or 3 as of June 30, 2013 or December 31, 2012. Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment).

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The following tables reflect financial assets measured at fair value on a non-recurring basis as of June 30, 2013 and December 31, 2012, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

June 30, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance
Impaired Loans [1]	**$**	**$**	**$ 14,030,002**	**$ 14,030,002**
Other real estate owned [2]	**$**	**$**	**$ 3,845,041**	**$ 3,845,041**
December 31, 2012				
Impaired Loans [1]	$	$	$ 8,424,786	$ 8,424,786
Other real estate owned [2]	$	$	$ 4,873,844	$ 4,873,844

(1) Represents carrying value for which adjustments are based on the appraised value of the collateral.
(2) Represents carrying value for which adjustments are based on the appraised value of the property.

The Company discloses fair value information about financial instruments, whether or not recognized in the consolidated balance sheet, for which it is practicable to estimate that value. Certain financial instruments are excluded from disclosure requirements and, accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

The estimated fair value amounts have been measured as of June 30, 2013 and December 31, 2012 and have not been reevaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the estimated fair value of these financial instruments subsequent to the respective reporting dates may be different than amounts reported on those dates.

The information presented should not be interpreted as an estimate of the fair value of the Company since a fair value calculation is only required for a limited portion of the Company s assets and liabilities. Due to the wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Company s disclosures and those of other bank holding companies may not be meaningful.

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The following is a summary of the carrying amounts and estimated fair values of the Company s financial instruments not measured and not reported at fair value on the consolidated balance sheets at June 30, 2013 and December 31, 2012 (in thousands):

		June 30, 2013		December 31, 2012	
	Fair Value Hierarchy	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial Assets:					
Cash and noninterest bearing balances due from banks	Level 1	$ 3,866	$ 3,866	$ 2,736	$ 2,736
Interest-bearing deposits due from banks	Level 1	20,509	20,509	67,567	67,567
Short-term investments	Level 1	711	711	711	711
Other investments	Level 2	3,500	3,500	3,500	3,500
Federal Reserve Bank stock	Level 1	1,634	1,634	1,730	1,730
Federal Home Loan Bank stock	Level 1	4,143	4,143	4,344	4,344
Loans receivable, net	Level 3	447,813	454,625	458,794	464,551
Accrued interest receivable	Level 1	1,711	1,711	1,894	1,894
Financial Liabilities:					
Demand deposits	Level 1	$ 63,869	$ 63,869	$ 65,176	$ 65,176
Savings deposits	Level 1	94,601	94,601	77,761	77,761
Money market deposits	Level 1	36,494	36,494	42,401	42,401
NOW accounts	Level 1	33,706	33,706	30,191	30,191
Time deposits	Level 2	248,972	250,436	281,753	284,974
FHLB Borrowings	Level 2	35,000	35,691	50,000	52,448
Securities sold under repurchase agreements	Level 2			7,000	7,683
Subordinated debentures	Level 2	8,248	8,248	8,248	8,248
Accrued interest payable	Level 1	1,278	1,278	1,241	1,241

The following are the methods and assumptions that were used to estimate the fair value of other financial assets and liabilities in the table above:

Cash and due from banks and interest deposits with banks: The carrying amount is considered to be a reasonable estimate of fair value due to the short maturity of these items.

Short term investments: The carrying amount is considered to be a reasonable estimate of fair value due to the short maturity of these items.

Other Investments: The redeemable carrying amount of this security, with limited marketability, approximates its fair value.

Federal Reserve Bank and Federal Home Loan Bank stock*:* The redeemable carrying amount of these securities, with limited marketability, approximates their fair value.

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Loans Receivable: The fair values of loans are estimated by discounting the projected future cash flows using market discount rates, primarily based on the Bank s current offer rates on comparable products, which reflect credit and interest-rate risk inherent in the loan. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments and prepayments of principal. Fair values estimated in this manner do not fully incorporate an exit price approach to fair value, but instead are based on a comparison to current market rates for comparable loans.

Accrued interest receivable and payable: The carrying amounts of accrued interest approximate their fair value due to the short-term nature of these items.

Deposits: Current carrying amounts approximate estimated fair value of demand deposits, savings, money market and NOW accounts. The fair value of time deposits is based on the discounted value of contractual cash flows using the Bank s current offer rates on comparable products of similar remaining maturities.

FHLB borrowings and securities sold under repurchase agreements*:* The fair values of the borrowings are estimated by discounting the estimated future cash flows using current market discount rates of financial instruments with similar characteristics, terms and remaining maturities.

Junior Subordinated Debt: There is no active market for the trust preferred securities issued by the Company s capital trust. The carrying amount is considered to be a reasonable estimate of fair value because of the frequency they reprice to market rates.

The Company assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, the fair values of the Company s financial instruments will change when interest rate levels change and that change may be either favorable or unfavorable to the Company. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk. However, borrowers with fixed rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities and attempts to minimize interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the Company s overall interest rate risk.

Off-balance sheet instruments

Loan commitments on which the committed interest rate is less than the current market rate were insignificant at June 30, 2013 and December 31, 2012. The estimated fair value of fee income on letters of credit at June 30, 2013 and December 31, 2012 was insignificant.

Note 12. Restructuring Charges and Asset Disposals

The Company recorded restructuring charges of $394,458 for the six months ended June 30, 2013, compared to $495,207 in the same period as last year. These costs are included in restructuring charges and asset disposals in the Consolidated Statements of Operations.

During 2011, the Company announced that it would be undertaking a series of initiatives that are designed to transform and enhance its operations in order to strengthen the Company s competitive position and return it to its goal of restored health and profitability.

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On March 30, 2012, the Company announced that it would close the NYC branch, effective June 2012. During the first quarter of 2012, the Company also executed a workforce reduction of back office personnel to further reduce operating expenses. There were twelve employees in total affected by this announcement. This initiative resulted in a restructuring charge of $495,207, which was comprised of $445,429 for severance expenses for the branch and back office personnel, asset disposals of $39,445 and $10,333 in lease liabilities.

On June 29, 2012, the Company announced that it would be consolidating three more branches in its continued effort to reduce operating expenses. Restructuring charges for the consolidation of these branches of $444,285 were comprised of $247,163 for severance expenses, lease liability charges of $140,292 and $56,830 in asset disposals.

On May 29, 2013, the Company purchased a branch location where the cost of the lease exceeded the cost to own. This branch was part of a restructuring initiative in 2011, resulting in a reduction of $120,703 in lease liability costs.

On June 13, 2013, the Company executed a workforce reduction of the residential lending group and retail operations to further reduce operating expenses. There were nineteen employees in total affected by this announcement. Restructuring charges for this initiative resulted in $515,161 in severance expenses.

Restructuring reserves at June 30, 2013 for the restructuring activities taken in connection with these initiatives are comprised of the following:

	Balance at December 31, 2012	Expenses	Cash payments	Non-cash charges	Balance at June 30, 2013
Lease liability costs 2011	$ 172,999	$ (120,703)	$	$ (52,296)	$
Lease liability costs 2012	80,220		(22,112)	(17,433)	40,675
Severance and benefit costs 2013		515,161			515,161
Total	$ 253,219	$ 394,458	$ (22,112)	$ (69,729)	$ 555,836

The restructuring reserves at June 30, 2013 are included in accrued expenses and other liabilities in the Consolidated Balance Sheet.

Note 13: Recent Accounting Pronouncements

Accounting Standards Update (ASU) No. 2011-04, *Fair Value Measurements (Topic 820) Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs,* was issued as a result of the effort to develop common fair value measurement and disclosure requirements in U.S. GAAP and International Financial Reporting Standards (IFRS). While ASU No. 2011-04 is largely consistent with existing fair value measurement principles in U.S. GAAP, it expands the existing disclosure requirements for fair value measurements and clarifies the existing guidance or wording changes to align with IFRS No. 13. Many of the requirements for the amendments in ASU No. 2011-04 do not result in a change in the application of the requirements in Topic 820. The Company adopted ASU No. 2011-04 on January 1, 2012 and it did not have a material impact on the consolidated financial statements.

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ASU No. 2011-05, Comprehensive Income (Topic 220) Presentation of Comprehensive Income, requires an entity to present components of comprehensive income either in a single continuous statement of comprehensive income or in two separate consecutive statements. These amendments will make the financial statement presentation of other comprehensive income more prominent by eliminating the alternative to present comprehensive income within the statement of equity. As originally issued, ASU No. 2011-05 required entities to present reclassification adjustments out of accumulated other comprehensive income by component in the statement in which net income is presented and the statement in which other comprehensive income is presented (for both interim and annual financial statements). This requirement was deferred by *ASU No.2011-12, Comprehensive Income (Topic 220) Deferral of the Effective Date for Amendments to the Presentation of Reclassification of Items Out of Accumulated Other Comprehensive Income in Accounting Standards* . ASU No. 2011-05 is effective for all interim and annual periods beginning on or after December 15, 2011. The Company adopted this guidance in the first quarter of 2012 and elected to present comprehensive income in a separate consolidated statement of comprehensive income.

ASU No. 2013-02, Comprehensive Income (Topic 220) Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income, requires an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. GAAP to be reclassified in its entirety to net income. ASU No 2013-02 is effective prospectively for reporting periods beginning after December 15, 2012. The Company adopted this guidance on January 1, 2013 and it did not have a material impact on the consolidated financial statements.

Item 2: Management s Discussion and Analysis of Financial Condition and Results of Operations

SAFE HARBOR STATEMENT UNDER PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

Certain statements contained in Bancorp s public reports, including this report, and in particular in Management s Discussion and Analysis of Financial Condition and Results of Operations, may be forward looking and subject to a variety of risks and uncertainties. These factors include, but are not limited to; (1) changes in prevailing interest rates which would affect the interest earned on Bancorp s interest earning assets and the interest paid on its interest bearing liabilities; (2) the timing of repricing of Bancorp s interest earning assets and interest bearing liabilities; (3) the effect of changes in governmental monetary policy; (4) the effect of changes in regulations applicable to Bancorp and the Bank and the conduct of its business; (5) changes in competition among financial service companies, including possible further encroachment of non-banks on services traditionally provided by banks; (6) the ability of competitors that are larger than Bancorp to provide products and services which it is impracticable for Bancorp to provide; (7) the state of the economy and real estate values in Bancorp s market areas, and the consequent effect on the quality of Bancorp s loans, customers, vendors and communities; (8) recent governmental initiatives that are expected to have a profound effect on the financial services industry and could dramatically change the competitive environment of Bancorp; (9) other legislative or regulatory changes, including those related to residential mortgages, changes in accounting standards, and Federal Deposit Insurance Corporation (FDIC) premiums that may adversely affect Bancorp.

Although Bancorp believes that it offers the loan and deposit products and has the resources needed for continued success, future revenues and interest spreads and yields cannot be reliably predicted. These trends may cause Bancorp to adjust its operations in the future. Because of the foregoing and other factors, recent trends should not be considered reliable indicators of future financial results or stock prices.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in accordance with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and to disclose contingent assets and liabilities. Actual results could differ from those estimates. Management has identified the accounting for the allowance for loan losses, the analysis of its investment securities and the valuation of deferred income tax assets, as Bancorp s most critical accounting policies and estimates in that they are important to the portrayal of Bancorp s financial condition and results of operations. They require management s subjective and most complex judgment as a result of the need to make an estimate about the effect of matters that are inherently uncertain. These accounting policies, including the nature of the estimates and types of assumptions used, are described throughout this Management s Discussion and Analysis.

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Summary

During the second quarter of 2013, Bancorp took several steps to restructure its balance sheet and operations intended to result in future profitable operations. First, Bancorp repaid $27.0 million net of high cost borrowings incurring a prepayment penalty of $2.7 million. Second, Bancorp purchased the Bedford Street building as the cost of the lease exceeded the cost to own the property. Third, Bancorp streamlined branch operations and changed strategy relating to originating mortgages for sale where we had not been able to achieve the scale necessary for success. In this process, Bancorp incurred $515,000 of one-time restructuring expenses. Based on the steps taken during this quarter, we believe we positioned ourselves for profitability in subsequent quarters, not withstanding Bancorp taking comparable steps in future quarters.

Bancorp reported a net loss of $3.9 million ($0.10 basic and diluted loss per share) for the quarter ended June 30, 2013, compared to net income of $345,000 ($0.01 basic and diluted income per share) for the quarter ended June 30, 2012. For the six-month period ended June 30, 2013, Bancorp realized a net loss of $5.9 million ($0.15 basic and diluted income per share) compared to net income of $891,000 ($0.02 basic and diluted income per share) for the six months ended June 30, 2012. The primary reason for the decrease in the quarterly comparison, in addition to the $3.2 million in non-interest expense discussed above, is the release of $1.7 million in excess loan loss reserves recorded in the second quarter of 2012, the decline in interest and fees on loans of $766,000 due to the lower interest rate environment and loan balances, and lower interest income of $201,000 on investment securities. The decrease in interest income on investment securities is primarily due to the sale of investment securities in the third quarter of the prior year. The decline in interest expense of $651,000 is primarily due to the reduction of total deposits and lower interest rates paid on deposits of $388,000, and lower borrowing costs of $258,000 due to the $27.0 million net prepayment of higher interest rate borrowings. Bancorp s net interest income for the quarter ended June 30, 2013 was $4.0 million compared to $4.4 million for the quarter ended June 30, 2012. Interest income and interest expense decreased by 16% and 34%, respectively, for the quarter ended June 30, 2013 compared to the quarter ended June 30, 2012. Of the $1.0 million decline in interest income, $760,000 is due to lower interest rates and $240,000 is due to changes in the volume of interest earning assets. Operating expenses increased $2.5 million primarily due to the $3.2 million previously discussed, partially offset by decreases in occupancy expense of $199,000, regulatory assessments of $157,000 and salary and benefits of $149,000.

Total assets decreased $49.1 million from $617.9 million at December 31, 2012 to $568.8 million at June 30, 2013. The decrease in total assets is primarily due to Bancorp s balance sheet strategies. Cash and cash equivalents decreased $45.9 million from $71.0 million at December 31, 2012 to $25.1 million at June 30, 2013. The available-for-sale securities portfolio decreased $2.2 million from $41.7 million at December 31, 2012 to $39.5 million June 30, 2013. This decrease is primarily due to principal paydowns of $1.5 million on mortgage backed securities. The net loan portfolio decreased $11.0 million from $458.8 million at December 31, 2012 to $447.8 million at June 30, 2013. Loans held for sale increased $10.0 million from $1.5 million at December 31, 2012 to $11.6 million at June 30, 2013. The decrease in the net loan portfolio is primarily a result of loan payoffs in commercial real estate loans of $11.3 million and consumer home equity loans of $2.1 million. Residential real estate loans decreased $1.6 million, primarily due to a $10.5 million bulk sale of residential loans. These were partially offset with increases in residential real estate loans of $8.9 million. Construction to permanent loans increased $5.1 million. Deposits decreased $19.6 million from $497.3 million at December 31, 2012 to $477.6 million at June 30, 2013. During the second quarter, the Bank sold $14.5 million of branch deposits. The decreases in certificates of deposit (CDs) and money market accounts of $32.8 million and $5.9 million respectively, were primarily due to the planned reduction of higher cost deposit accounts and the low interest rate environment. These were partially offset by increases in savings accounts and NOW accounts of $16.8 million and $3.5 million, respectively. Borrowings decreased $22.0 million from $65.2 million at December 31, 2012 to $43.2 million at June 30, 2013.

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Financial Condition

Cash and Cash Equivalents

Cash and cash equivalents decreased $45.9 million, or 65%, to $25.1 million at June 30, 2013 compared to $71.0 million at December 31, 2012. This decrease is primarily the result of $22.0 million in repayments on borrowings, $19.6 million reduction in deposits and a $2.3 million purchase of a branch location, partially offset by loan payoffs.

Investments

The following table is a summary of Bancorp s available-for-sale securities portfolio, at fair value, at the dates shown:

	June 30, 2013	December 31, 2012
U.S. Government Agency bonds	$ 7,188,603	$ 7,526,170
U.S. Government Agency mortgage- backed securities	23,744,379	25,706,891
Corporate bonds	8,610,093	8,486,259
Total Available-for-Sale Securities	$ 39,543,075	$ 41,719,320

Available-for-sale securities decreased $2.2 million, or 5%, from $41.7 million at December 31, 2012 to $39.5 million at June 30, 2013. This decrease is primarily due to principal pay downs of $1.5 million on mortgage backed securities and an increase of $574,000 in unrealized losses on the portfolio.

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Loans

The following table is a summary of Bancorp s loan portfolio at the dates shown:

	June 30, 2013	December 31, 2012
Real Estate		
Commercial	$ 236,223,829	$ 247,495,321
Residential	117,416,181	119,033,025
Construction	3,470,518	4,997,991
Construction to permanent	9,904,369	4,851,768
Commercial	36,278,299	36,428,751
Consumer home equity	47,097,674	49,180,908
Consumer installment	1,992,136	2,162,718
Total Loans	452,383,006	464,150,482
Premiums on purchased loans	203,801	219,649
Net deferred costs	548,696	439,041
Allowance for loan losses	(5,322,070)	(6,015,636)
Loans receivable, net	$ 447,813,433	$ 458,793,536

Bancorp s net loan portfolio decreased $11.0 million, or 2%, from $458.8 million at December 31, 2012 to $447.8 million at June 30, 2013. The decrease is primarily a result of loan payoffs in commercial real estate loans of $11.3 million and consumer home equity loans of $2.1 million. Residential real estate loans decreased $1.6 million, primarily due to a $10.5 million bulk sale of residential loans. These were partially offset with increases in residential real estate loans of $8.9 million. Construction to permanent loans increased $5.1 million.

At June 30, 2013, the net loan to deposit ratio was 94% and the net loan to total assets ratio was 79%. At December 31, 2012, these ratios were 92% and 74%, respectively. Excluding the deposits held for sale at December 31, 2012, the net loan to deposit ratio was 97%.

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 collectibility of a loan balance is considered doubtful. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a quarterly basis by management and is based upon management s periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower s ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as additional information becomes available.

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As of the first quarter of 2012, the Bank had used a 12 quarter un-weighted average to calculate loss history. Beginning in the second quarter of 2012, the Bank implemented changes to the allowance methodology, resulting in a reduction of the allowance for loan losses of $1.1 million. In making this transition, the changes serve to update and enhance the methodology to better reflect the direction of the current loan portfolio. The changes are threefold:

First, the Bank adopted a two year, instead of a three year, weighted average historical loss factor as the basis for the calculation of its historical loss experience. This is used to calculate expected losses in the ASC 450-20, *Contingencies* pools prior to the application of qualitative risk adjustment factors. Weightings were allocated 59% to the last four quarters and 41% to the previous four quarters. This change was made to be more responsive to the changing credit environment. Net charge-offs have declined. This shorter average historical loss period will produce results more indicative of the current and expected behavior of the portfolio.

Second, the Bank adopted an Internal Risk Ratings Based (IRB) approach to calculating historical loss rates. This approach calibrates expected losses with actual risk assessment and equates the likelihood of loss to the level of risk in a credit facility rating. All loans are reviewed annually. Similarly, the Loan Committee can adjust a risk rating. Previously, loss history was applied to categories of loans and qualitative adjustments were apportioned by risk rating within the categories.

Third, the Bank increased the detail of analysis within the segments, particularly within Commercial Real Estate lending, which is currently the Bank s largest concentration overall, by expanding the number of ASC 450-20 pools. In all, ten sub-concentrations have been added to the analysis. The greater level of detail enables the Bank to better apply qualitative risk adjustment factors to the segments affected and to monitor changes in credit risk within the portfolio.

The accrual of interest on loans is discontinued at the time the loan is 90 days past due for payment unless the loan is well-secured and in process of collection. Consumer installment loans are typically charged off no later than 180 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual status or charged-off at an earlier date if collection of principal or interest is considered doubtful. All interest accrued but not collected for loans that are placed on nonaccrual status or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis method until qualifying for return to accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Management considers all non-accrual loans and troubled debt restructurings to be impaired. In most cases, loan payments that are past due less than 90 days, based on contractual terms, are considered collection delays and the related loans are not considered to be impaired. The Bank considers consumer installment loans to be pools of smaller balance homogeneous loans, which are collectively evaluated for impairment.

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The changes in the allowance for loan losses for the periods shown are as follows:

	Three months ended		Six months ended	
(Thousands of dollars)	June 30, 2013	June 30, 2012	June 30, 2013	June 30, 2012
Balance at beginning of period	$ 5,717	$ 8,461	$ 6,016	$ 9,385
Charge-offs	(412)	(91)	(717)	(193)
Recoveries	17	17	53	41
Net Charge-offs	(395)	(74)	(664)	(152)
Provision charged to operations		(1,713)	(30)	(2,559)
Balance at end of period	$ 5,322	$ 6,674	$ 5,322	$ 6,674
Ratio of net charge-offs during the period to average loans outstanding during the period	0.09%	0.02%	0.14%	0.03%
Ratio of ALL / Gross Loans	1.18%	1.36%	1.18%	1.36%

Based upon the overall assessment and evaluation of the loan portfolio, management believes the allowance for loan losses of $5.3 million, at June 30, 2013, which represents 1.18% of gross loans outstanding, is adequate under prevailing economic conditions, to absorb existing losses in the loan portfolio.

Non-Accrual, Past Due and Restructured Loans

The following table presents non-accruing loans and loans past due 90 days or more and still accruing:

(Thousands of dollars)	June 30, 2013	December 31, 2012
Loans past due over 90 days still accruing	$ 1,654	$ 2,234
Non accruing loans	26,565	23,810
Total	$ 28,219	$ 26,044
% of Total Loans	6.23%	5.60%
% of Total Assets	4.96%	4.22%

Loans delinquent over 90 days and still accruing aggregating $1.7 million are comprised of 4 loans, all of which have matured, continue to make payments and are in the process of being renewed. Impaired loans, which are comprised of non-accruing loans, troubled debt restructured loans, and loans previously classified as TDRs that have been upgraded, increased by $3.1 million to $36.0 million for the quarter ended June 30, 2013 and increased $2.6 million for the six months ended June 30, 2013. Impaired loans are attributable to the lingering effects of the downturn in the economy, which has severely impacted the real estate market and placed unprecedented stress on credit markets. The Bank s customers, many of whom are associated with the financial services industry, have been affected by the impact of the poor economy on employment and real estate values.

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The $26.6 million of non-accrual loans at June 30, 2013 is comprised of 25 loans, for which a specific reserve of $2.2 million has been established. In all cases, the Bank has obtained appraisal reports from independent licensed appraisal firms and discounted those values for estimated selling costs to determine estimated impairment. Of the $26.6 million of non-accrual loans at June 30, 2013 borrowers of 7 loans with aggregate balances of $8.5 million continue to make loan payments and these loans are current within one and two months as to payments. Subsequently, $232,000 of the $26.6 million of non-accrual loans have paid off.

Potential Problem Loans

In addition to the above, there are $7.9 million of substandard accruing loans comprised of 13 loans and $18.8 million of special mention loans comprised of 33 loans for which management has a concern as to the ability of the borrowers to comply with the present repayment terms. All but $2.8 million of the substandard accruing loans and $800,000 of the special mention loans continue to make timely payments and are within 30 days at June 30, 2013.

Other Real Estate Owned

The following table is a summary of Bancorp s other real estate owned at the dates shown:

	June 30, 2013	December 31, 2012
Residential construction	$	$ 1,109,204
Residential real estate	3,845,041	3,764,640
Other real estate owned	$ 3,845,041	$ 4,873,844

The balance of other real estate owned at June 30, 2013 is comprised of one property with an aggregate carrying value of $3.8 million that was obtained through loan foreclosure proceedings. During the six months ended June 30, 2013, one OREO property was sold with an aggregate carrying value of $1.1 million.

Deferred Taxes

The determination of the amount of deferred income tax assets which are more likely than not to be realized is primarily dependent on projections of future earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. A valuation allowance related to deferred tax assets is required when it is considered more likely than not that all or part of the benefit related to such assets will not be realized. Management has reviewed the deferred tax position of the Company at June 30, 2013. The deferred tax position has been affected by several significant transactions in prior years. These transactions include increased provision for loan losses, the levels of non-accrual loans and other-than-temporary impairment write-offs of certain investments, as well as a loss on the bulk sale of loans in 2011. As a result, the Company is in a cumulative net loss position at June 30, 2013, and under the applicable accounting guidance, has concluded that it is not more-likely-than-not that the Company will be able to realize its deferred tax assets and, accordingly, has established a full valuation allowance totaling $17.6 million against its deferred tax asset at June 30, 2013. The valuation allowance is analyzed quarterly for changes affecting the deferred tax asset. In the future, if the Company generates taxable income on a sustained basis, management s conclusion regarding the need for a deferred tax asset valuation allowance could change, resulting in the reversal of all or a portion of the deferred tax asset valuation allowance.

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Deposits

The following table is a summary of Bancorp s deposits at the dates shown:

	June 30, 2013	December 31, 2012
Non-interest bearing	$ 63,869,164	$ 65,176,125
Interest bearing		
NOW	33,705,921	30,191,403
Savings	94,601,276	77,760,967
Money market	36,494,053	42,401,428
Time certificates, less than $100,000	136,324,642	160,610,601
Time certificates, $100,000 or more	112,647,818	121,142,374
Total interest bearing	413,773,710	432,106,773
Total Deposits (1)	$ 477,642,874	$ 497,282,898

(1) Included in total deposits are $24.7 million of deposits held for sale at December 31, 2012. There were no deposits held for sale at June 30, 2013.

Total deposits decreased $19.6 million, or 4%, from $497.3 million at December 31, 2012 to $477.6 million at June 30, 2013. During the second quarter, the Bank sold $14.5 million of branch deposits. Interest bearing accounts decreased $18.3 million. This was primarily due to decreases in certificates of deposit (CDs) of $32.8 million and money market accounts of $5.9 million due to the planned reduction of higher cost deposit accounts and the low interest rate environment. These were partially offset by increases of $16.8 million in savings accounts and $3.5 million in NOW accounts. Demand deposits decreased $1.3 million primarily as a result of decreases in personal checking accounts of $4.5 million, partially offset by increases in official checks and commercial checking accounts of $1.9 million and $1.3 million, respectively. The overall cost of total deposits decreased from 1.04% at December 31, 2012 to 0.89% at June 30, 2013.

Borrowings

Total borrowings decreased $22.0 million from $65.2 million at December 31, 2012 to $43.2 million at June 30, 2013, as part of Bancorp s balance sheet strategies. In addition to the outstanding borrowings disclosed in the consolidated balance sheet, the Bank has the ability to borrow approximately $72.0 million in additional advances from the Federal Home Loan Bank of Boston, including a $2.0 million overnight line of credit. The Bank has also established a line of credit at the Federal Reserve Bank.

The subordinated debentures of $8,248,000 are unsecured obligations of the Company and are subordinate and junior in right of payment to all present and future senior indebtedness of the Company. The Company has entered into a guarantee, which together with its obligations under the subordinated debentures and the declaration of trust governing the Trust, provides a full and unconditional guarantee of amounts on the capital securities. The subordinated debentures, which bear interest at three-month LIBOR plus 3.15% (3.4268% at June 30, 2013), mature on March 26, 2033. Beginning in the second quarter of 2009, the Company began deferring interest payments on the subordinated debentures as permitted under the terms of the debentures. The deferral in the second quarter of 2013 represented the seventeenth consecutive quarter of deferral. The Company continues to accrue and charge interest to operations. The Company may defer the payment of interest through March 2014, and all accrued interest must be paid at the completion of the deferral period, June 2014.

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Capital

Capital decreased $6.4 million compared to December 31, 2012 primarily as a result of the net loss of $5.9 million for the six months ended June 30, 2013, and by the change in other comprehensive income.

Off-Balance Sheet Arrangements

Bancorp s off-balance sheet arrangements, which primarily consist of commitments to lend, increased by $3.0 million from $89.5 million at December 31, 2012 to $92.5 million at June 30, 2013, due to increases of $3.4 million in future loan commitments, $726,000 in home equity lines of credit, $1.1 million in undisbursed construction loans and $1.1 million in financial standby letters of credit, partially offset by decreases of $3.4 million in unused lines of credit.

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RESULTS OF OPERATIONS

Interest and dividend income and expense

The following tables present average balance sheets (daily averages), interest income, interest expense and the corresponding yields earned and rates paid for major balance sheet components:

	Three months ended June 30,					
	2013			2012		
	Average Balance	Interest Income/ Expense	Average Rate	Average Balance	Interest Income/ Expense	Average Rate
	(dollars in thousands)					
Interest earning assets:						
Loans	$ 470,236	$ 5,045	4.29%	$ 479,545	$ 5,812	4.85%
Investments	50,727	256	2.02%	67,849	458	2.70%
Interest bearing deposits in banks	18,583	9	0.19%	76,144	40	0.21%
Total interest earning assets	539,546	5,310	3.94%	623,538	6,310	4.05%
Cash and due from banks	4,458			5,005		
Premises and equipment, net	4,803			4,762		
Allowance for loan losses	(5,739)			(8,449)		
Other assets	29,308			26,890		
Total Assets	$ 572,376			$ 651,746		
Interest bearing liabilities:						
Deposits	$ 416,326	$ 1,033	0.99%	$ 466,788	$ 1,421	1.22%
FHLB advances	37,209	167	1.80%	51,319	354	2.76%
Subordinated debt	8,248	71	3.44%	8,248	75	3.64%
Other borrowings	538	6	4.46%	7,000	77	4.40%
Total interest bearing liabilities	462,321	1,277	1.10%	533,355	1,927	1.45%
Demand deposits	61,016			62,056		
Accrued expenses and other liabilities	4,170			5,141		
Shareholders equity	44,869			51,194		
Total liabilities and equity	$ 572,376			$ 651,746		
Net interest income		$ 4,033			$ 4,383	
Interest margin			2.99%			2.81%
Interest spread			2.84%			2.60%

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	Six months ended June 30,					
	2013			2012		
	Average Balance	Interest Income/ Expense	Average Rate	Average Balance	Interest Income/ Expense	Average Rate
	(dollars in thousands)					
Interest earning assets:						
Loans	$ 468,077	$ 10,241	4.38%	$ 501,011	$ 12,477	4.98%
Investments	51,172	532	2.08%	71,613	969	2.71%
Interest bearing deposits in banks	37,731	37	0.20%	57,480	51	0.18%
Total interest earning assets	556,980	10,810	3.88%	630,104	13,497	4.28%
Cash and due from banks	4,978			4,999		
Premises and equipment, net	4,400			4,345		
Allowance for loan losses	(5,877)			(8,915)		
Other assets	30,112			27,569		
Total Assets	$ 590,593			$ 658,102		
Interest bearing liabilities:						
Deposits	$ 422,016	$ 2,161	1.02%	$ 473,274	$ 2,938	1.24%
FHLB advances	43,569	518	2.38%	53,247	712	2.67%
Subordinated debt	8,248	142	3.44%	8,248	151	3.66%
Other borrowings	3,751	82	4.37%	7,000	154	4.40%
Total interest bearing liabilities	477,584	2,903	1.22%	541,769	3,955	1.46%
Demand deposits	61,135			60,215		
Accrued expenses and other liabilities	4,898			5,192		
Shareholders equity	46,976			50,926		
Total liabilities and equity	$ 590,593			$ 658,102		
Net interest income		$ 7,907			$ 9,542	
Interest margin			2.84%			3.03%
Interest spread			2.66%			2.82%

The following rate volume analysis reflects the impact that changes in interest rates and changes in the volume of interest-earning assets and interest-bearing liabilities had on net interest income during the periods indicated. Information is provided in each category with respect to changes attributable to changes in volume (changes in volume multiplied by prior rate), changes attributable to changes in rates (changes in rates multiplied by prior volume) and the total net change. The change resulting from the combined impact of volume and rate is allocated proportionately to the change due to volume and the change due to rate.

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	Three months ended June 30, 2013 vs 2012 Increase (decrease) in Interest Income/Expense Due to change in:			Six months ended June 30, 2013 vs 2012 Increase (decrease) in Interest Income/Expense Due to change in:		
	Volume	Rate	Total	Volume	Rate	Total
	(dollars in thousands)			*(dollars in thousands)*		
Interest earning assets:						
Loans	$ (111)	$ (656)	$ (767)	$ (789)	$ (1,447)	$ (2,236)
Investments	(101)	(101)	(202)	(241)	(196)	(437)
Interest bearing deposits in banks	(28)	(3)	(31)	(16)	2	(14)
Total interest earning assets	(240)	(760)	(1,000)	(1,046)	(1,641)	(2,687)
Interest bearing liabilities:						
Deposits	$ (142)	$ (247)	$ (389)	$ (341)	$ (436)	$ (777)
FHLB advances	(112)	(74)	(186)	(137)	(57)	(194)
Subordinated debt		(4)	(4)		(10)	(10)
Other borrowings	(70)	(1)	(71)	(71)		(71)
Total interest bearing liabilities	(324)	(326)	(650)	(549)	(503)	(1,052)
Net interest income	$ 84	$ (434)	$ (350)	$ (497)	$ (1,138)	$ (1,635)

For the quarter ended June 30, 2013, average interest earning assets decreased $84.0 million, or 13%, to $539.5 million from $623.5 million for the quarter ended June 30, 2012, resulting in interest income for Bancorp of $5.3 million compared to $6.3 million for the same period in 2012. Interest and fees on loans decreased $0.8 million or 13%, from $5.8 million for the quarter ended June 30, 2012 to $5.0 million for the quarter ended June 30, 2013. This decrease is primarily the result of lower average interest rates on new loan growth and a decrease of $9.3 million in the average balance of the loan portfolio. When compared to the same period last year, interest income on investments decreased by 47% due to a decrease of $17.1 million in the average balance of investments outstanding. Income on interest-bearing deposits in banks decreased from $40,000 to $9,000 for the quarter ended June 30, 2013 compared to the quarter ended June 30, 2012, which is reflective of a decrease of $57.6 million in the average balance of interest bearing deposits and lower yields earned on funds.

Total interest expense for the quarter ended June 30, 2013 of $1.3 million represents a decrease of $650,000, or 34%, compared to interest expense of $1.9 million for the same period last year. This decrease in interest expense is the result of a decrease in the average balances of interest-bearing liabilities and lower interest rates on deposit accounts and FHLB advances. Average balances of interest bearing deposit accounts decreased $50.5 million, or 11%, which is comprised primarily of decreases in certificates of deposit and money market accounts of $76.0 million and $9.7 million, respectively. These were partially offset by increases in savings of $31.4 million and NOW accounts of $3.9 million. In addition, lower interest rates contributed to the overall decrease of $389,000 in interest expense on deposits. Average FHLB advances decreased by $14.1 million, resulting in a decrease of $186,000 in interest expense. Interest expense on the junior subordinated debt and borrowed funds decreased by $75,000.

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As a result of the above, Bancorp s net interest income decreased $0.4 million or 8%, to $4.0 million for the three months ended June 30, 2013 compared to $4.4 million for the same period last year. The net interest margin for the three months ended June 30, 2013 was 2.99% as compared to 2.81% for the three months ended June 30, 2012 as a result of the various reasons mentioned above.

Interest and dividend income was $10.8 million for the six months ended June 30, 2013, which represents a decrease of $2.7 million or 20%, as compared to interest and dividend income of $13.5 million for the same period last year. This decrease was due primarily to lower interest rates, in addition to the $32.9 million decrease in the average balance of the loan portfolio, resulting in a decrease of $2.2 million in interest and fees on loans. This was combined with a decrease in interest and dividend income of $437,000 earned on the investment securities. The average balance of the investment portfolio decreased $20.4 million when compared to the six months ended June 30, 2012.

For the six months ended June 30, 2013, total interest expense decreased $1.1 million, or 27%, to $2.9 million from $4.0 million for the six months ended June 30, 2012. The decrease in interest expense was due primarily to lower interest rates and a $64.2 million reduction in the average balances of interest-bearing liabilities. Interest expense on the FHLB advances decreased $194,000 due to lower interest rates and a $9.7 million decrease in the average balance when compared to the same period last year.

As a result of the above, net interest income decreased $1.6 million, or 17%, for the six months ended June 30, 2013 to $7.9 million as compared to $9.5 million at June 30, 2012. The net interest margin for the six months ended June 30, 2013 was 2.84% as compared to 3.03% for the six months ended June 30, 2012.

Provision for Loan Losses

Based on management s most recent evaluation of the adequacy of the allowance for loan losses, the provision for loan losses released from operations for the three months ended June 30, 2013 was not necessary, compared to a reduction of $1.7 million from the loan loss provision for the three months ended June 30, 2012 due to the reduction of the loan balances and improved credit quality. The allowance for loan losses decreased by $694,000 from December 31, 2012 to June 30, 2013 due primarily to $30,000 release of excess reserves, as previously discussed, after net charge-offs of $664,000.

An analysis of the changes in the allowance for loan losses is presented under Allowance for Loan Losses.

Non-interest income

Non-interest income increased $313,000 from $455,000 for the quarter ended June 3, 2012 to $769,000 for the quarter ended June 30, 2013. This is primarily due to increases in loan application fees and mortgage banking activity of $100,000 and 97,000, respectively, when compared to the same period last year. In addition, gains recognized on the sale of loans and earnings on the cash surrender value of life insurance increased $28,000 and $22,000, respectively. Other income increased $83,000 primarily due to the gain recognized on the sale of branch deposits of $51,000. These were partially offset by decreases in fees and service charges on deposits of $16,000.

For the six months ended June 30, 2013, non-interest income increased $51,000, or 4%, to $1.3 million as compared to $1.2 million for the six months ended June 30, 2012. This increase is primarily due to increases in mortgage banking activity and loan application fees of $130,000 and 124,000, respectively. Other income increased $91,000 primarily due to the gain recognized on the sale of branch deposits of $51,000. These were partially offset by decreases in gains recognized on the sale of loans $235,000 and in fees and service charges on deposits of $73,000 when compared to the same period last year.

Non-interest expenses

Non-interest expenses increased $2.5 million or 40% from $6.2 million to $8.7 million for the quarter ended June 30, 2013 as compared to the quarter ended June 30, 2012. This increase is primarily due to a prepayment penalty on borrowings of $2.7 million and $394,000 in restructuring costs primarily due to a change in strategy of originating mortgages for sale. These were partially offset by the impact of the restructurings in the prior year, resulting in lower occupancy expenses and salary and benefits of $199,000 and $149,000 respectively. In addition, regulatory assessments and professional and outside services decreased $157,000 and $84,000 respectively.

For the six months ended June 30, 2013, non-interest expense increased $2.7 million, or 21% to $15.1 million from $12.4 million for the same period in 2012. This increase was primarily due to a prepayment penalty on borrowings of $2.7 million. Other real estate owned operations and professional and outside services increased $191,000 and $190,000 respectively. Loan administration and processing expense increased $97,000 when compared to the same period as last year. These were partially offset by decreases in occupancy expense and regulatory assessments of $284,000 and $194,000 respectively. Restructuring charges and asset disposals of $394,000 related to branch closings and reduction-in-force of personnel decreased $101,000 when compared to the prior year.

LIQUIDITY

Bancorp s liquidity ratio was 11% at June 30, 2013 compared to 19% at June 30, 2012. The liquidity ratio is defined as the percentage of liquid assets to total assets. The following categories of assets, as described in the accompanying consolidated balance sheets, are considered liquid assets: cash and due from banks, federal funds sold, short-term investments and available-for-sale securities. Liquidity is a measure of Bancorp s ability to generate adequate cash to meet financial obligations. The principal cash requirements of a financial institution are to cover downward fluctuations in deposit accounts and increases in its loan portfolio. Management believes Bancorp s short-term assets provide sufficient liquidity to cover loan demand, potential fluctuations in deposit accounts and to meet other anticipated cash operating requirements.

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CAPITAL

The following table illustrates Bancorp s regulatory capital ratios at June 30, 2013 and December 31, 2012 respectively:

	June 30, 2013	December 31, 2012
Tier 1 Leverage Capital	9.13%	9.33%
Tier 1 Risk-based Capital	12.71%	14.39%
Total Risk-based Capital	13.96%	15.64%

The following table illustrates the Bank s regulatory capital ratios at June 30, 2013 and December 31, 2012 respectively:

	June 30, 2013	December 31, 2012
Tier 1 Leverage Capital	9.05%	9.11%
Tier 1 Risk-based Capital	12.59%	14.05%
Total Risk-based Capital	13.84%	15.31%

IMPACT OF INFLATION AND CHANGING PRICES

Bancorp s consolidated financial statements have been prepared in terms of historical dollars, without considering changes in the relative purchasing power of money over time due to inflation. Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a more significant impact on a financial institution s performance than the general levels of inflation. Interest rates do not necessarily move in the same direction or with the same magnitude as the prices of goods and services. Notwithstanding this, inflation can directly affect the value of loan collateral, in particular, real estate. Inflation, or disinflation, could significantly affect Bancorp s earnings in future periods.

MANAGEMENT CHANGES

As previously reported on February 26, 2013, the Company announced the appointment of Kenneth T. Neilson as President and Chief Executive Officer of both the Company and the Bank effective March 18, 2013. This is following the departure of Christopher Maher, who resigned as President, CEO and director for personal reasons.

Item 3: Quantitative and Qualitative Disclosures about Market Risk

Market risk is defined as the sensitivity of income to fluctuations in interest rates, foreign exchange rates, equity prices, commodity prices and other market-driven rates or prices. Based upon the nature of Bancorp s business, the primary source of market risk is interest rate risk, which is the impact that changing interest rates have on current and future earnings. In addition, Bancorp s loan portfolio is primarily secured by real estate in the company s market area. As a result, the changes in valuation of real estate could also impact Bancorp s earnings.

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Qualitative Aspects of Market Risk

Bancorp s goal is to maximize long term profitability while minimizing its exposure to interest rate fluctuations. The first priority is to structure and price Bancorp s assets and liabilities to maintain an acceptable interest rate spread while reducing the net effect of changes in interest rates. In order to accomplish this, the focus is on maintaining a proper balance between the timing and volume of assets and liabilities re-pricing within the balance sheet. One method of achieving this balance is to originate variable rate loans for the portfolio and purchase short-term investments to offset the increasing short term re-pricing of the liability side of the balance sheet. In fact, a number of the interest-bearing deposit products have no contractual maturity. Therefore, deposit balances may run off unexpectedly due to changing market conditions. Additionally, loans and investments with longer term rate adjustment frequencies are matched against longer term deposits and borrowings to lock in a desirable spread.

The exposure to interest rate risk is monitored by the Management Asset and Liability Committee consisting of senior management personnel. The Committee meets on a monthly basis, but may convene more frequently as conditions dictate. The Committee reviews the interrelationships within the balance sheet to maximize net interest income within acceptable levels of risk. This Committee reports to the Board of Directors on a monthly basis regarding its activities. In addition to the Management Asset and Liability Committee, there is a Board Asset and Liability Committee (ALCO), which meets quarterly. ALCO monitors the interest rate risk analyses, reviews investment transactions during the period and determines compliance with Bank policies.

Quantitative Aspects of Market Risk

In order to manage the risk associated with interest rate movements, management analyzes Bancorp s interest rate sensitivity position through the use of interest income simulation and GAP analysis. The matching of assets and liabilities may be analyzed by examining the extent to which such assets and liabilities are interest sensitive. An asset or liability is said to be interest sensitive within a specific time period if it will mature or reprice within that time period.

Management s goal is to manage asset and liability positions to moderate the effects of interest rate fluctuations on net interest income. Interest income simulations are completed quarterly and presented to ALCO. The simulations provide an estimate of the impact of changes in interest rates on net interest income under a range of assumptions. Changes to these assumptions can significantly affect the results of the simulations. The simulation incorporates assumptions regarding the potential timing in the repricing of certain assets and liabilities when market rates change and the changes in spreads between different market rates.

Simulation analysis is only an estimate of Bancorp s interest rate risk exposure at a particular point in time. Management regularly reviews the potential effect changes in interest rates could have on the repayment of rate sensitive assets and funding requirements of rate sensitive liabilities.

The table below sets forth examples of changes in estimated net interest income and the estimated net portfolio value based on projected scenarios of interest rate increases and decreases. The analyses indicate the rate risk embedded in Bancorp s portfolio at the dates indicated should all interest rates instantaneously rise or fall. The results of these changes are added to or subtracted from the base case; however, there are certain limitations to these types of analyses. Rate changes are rarely instantaneous and these analyses may also overstate the impact of short-term repricings. As a result of the historically low interest rate environment, the calculated effects of the 100 and 200 basis point downward shocks cannot absolutely reflect the risk to earnings and equity since the interest rates on certain balance sheet items have approached their minimums, and, therefore, it is not possible for the analyses to fully measure the true impact of these downward shocks.

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June 30, 2013

Projected Interest Rate Scenario	Net Interest Income Estimated Value	$ Change from Base	% Change from Base	Net Portfolio Value Estimated Value	$ Change from Base	% Change from Base
+200	17,052	(90)	-0.53%	69,889	(9,436)	-11.90%
+100	17,207	65	0.38%	74,294	(5,031)	-6.34%
BASE	17,142			79,325		
-100	17,425	283	1.65%	85,779	6,454	8.13%
-200	17,238	96	0.56%	90,004	10,679	13.46%

December 31, 2012

Projected Interest Rate Scenario	Net Interest Income Estimated Value	$ Change from Base	% Change from Base	Net Portfolio Value Estimated Value	$ Change from Base	% Change from Base
+200	21,113	2,434	13.03%	46,403	(8,067)	-14.81%
+100	20,011	1,332	7.13%	50,576	(3,894)	-7.15%
BASE	18,679			54,470		
-100	18,873	194	1.04%	58,725	4,255	7.81%
-200	18,819	140	0.75%	69,726	15,256	28.01%

Item 4: Controls and Procedures

Based on an evaluation of the effectiveness of Bancorp s disclosure controls and procedures performed by Bancorp s management, with the participation of Bancorp s Chief Executive Officer and its Chief Financial Officer as of the end of the period covered by this report, Bancorp s Chief Executive Officer and Chief Financial Officer concluded that Bancorp s disclosure controls and procedures have been effective.

As used herein, disclosure controls and procedures means controls and other procedures of Bancorp that are designed to ensure that information required to be disclosed by Bancorp in the reports that it files or submits under the Securities Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by Bancorp in the reports that it files or submits under the Securities Exchange Act is accumulated and communicated to Bancorp s management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

There were no changes in Bancorp s internal controls over financial reporting identified in connection with the evaluation described in the preceding paragraph that occurred during Bancorp s fiscal quarter ended June 30, 2013 that has materially affected, or is reasonably likely to materially affect, Bancorp s internal controls over financial reporting.

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PART II - OTHER INFORMATION.

Item 1: Legal Proceedings

Neither Bancorp nor the Bank has any pending legal proceedings, other than ordinary routine litigation incidental to its business, to which Bancorp or the Bank is a party or any of its property is subject.

Item 1A: Risk Factors

During the three months ended June 30, 2013, there were no material changes to the risk factors relevant to Bancorp s operations, which are described in the Annual Report on Form 10-K for the year ended December 31, 2012.

Item 6: Exhibits

No.	Description
2	Agreement and Plan of Reorganization dated as of June 28, 1999 between Bancorp and the Bank (incorporated by reference to Exhibit 2 to Bancorp s Current Report on Form 8-K dated December 1, 1999 (Commission File No. 000-29599)).
2.1	Securities Purchase Agreement by and among Patriot National Bancorp, Inc., Patriot National Bank and PNBK Holdings LLC dated as of December 16, 2009 (incorporated by reference to Exhibit 10.1 to Bancorp s Current Report on Form 8-K dated December 17, 2009).
2.2	Amendment to Securities Purchase Agreement by and among Patriot National Bancorp, Inc., Patriot National Bank and PNBK Holdings LLC dated as of May 3, 2010 (incorporated by reference to Exhibit 10(a) to Bancorp s Current Report on Form 8-K dated May 4, 2010).
3(i)	Certificate of Incorporation of Bancorp, (incorporated by reference to Exhibit 3(i) to Bancorp s Current Report on Form 8-K dated December 1, 1999 (Commission File No. 000-29599)).
3(i)(A)	Certificate of Amendment of Certificate of Incorporation of Patriot National Bancorp, Inc. dated July 16, 2004 (incorporated by reference to Exhibit 3(i)(A) to Bancorp s Annual Report on Form 10-KSB for the year ended December 31, 2004 (Commission File No. 000-29599)).
3(i)(B)	Certificate of Amendment of Certificate of Incorporation of Patriot National Bancorp, Inc. dated June 15, 2006 (incorporated by reference to Exhibit 3(i)(B) to Bancorp s Quarterly Report of Form 10-Q for the quarter ended September 30, 2006 (commission File No. 000-29599)).

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No.	Description
3(i)(C)	Certificate of Amendment of Certificate of Incorporation of Patriot National Bancorp, Inc. (incorporated by reference to Exhibit 3(i) to Bancorp s current report Form 8-K dated October 21, 2010.
3(ii)	Amended and Restated By-laws of Bancorp (incorporated by reference to Exhibit 3(ii) to Bancorp s Current Report on Form 8-K dated November 1, 2010 (Commission File No. 000-29599))
10(a)(1)	2001 Stock Appreciation Rights Plan of Bancorp (incorporated by reference to Exhibit 10(a)(1) to Bancorp s Annual Report on Form 10-KSB for the year ended December 31, 2001 (Commission File No. 000-29599)).
10(a)(2)	2012 Stock Plan of Bancorp (incorporated by reference from Annex A to the Proxy Statement on Form 14C filed November 1, 2011.
10(a)(14)	Change of Control Agreement, dated as of January 1, 2007 among Philip W. Wolford, Patriot National Bank and Bancorp (incorporated by reference to Exhibit 10(a)(14) to Bancorp s Annual Report on Form 10-K for the year ended December 31, 2006 (Commission File No. 000-29599)).
10(a)(15)	Formal Written Agreement between Patriot National Bank and the Office of the Comptroller of the Currency (incorporated by reference to Exhibit 10(a)(15) to Bancorp s Current Report on Form 8-K dated February 9, 2009 (Commission File No. 000-29599)).
10(a)(16)	Formal Written Agreement between Patriot National Bank and the Federal Reserve Bank of New York (incorporated by reference to Exhibit 10(a)(16) to Bancorp s Annual Report on Form 10-K for the year ended December 31, 2010 (Commission File No. 000-29599)).
10(a)(17)	Financial Services Agreement dated November 8, 2011 of Bancorp (incorporated by reference to Exhibit 10(a)(20) on the Quarterly Report on Form 10-Q dated November 10, 2011).
10(a)(18)	Employment letter between Kenneth T. Neilson, Bancorp and Patriot National Bank dated July 9, 2013.
14	Code of Conduct for Senior Financial Officers (incorporated by reference to Exhibit 14 to Bancorp s Annual Report on Form 10 -KSB for the year ended December 31, 2004 (Commission File No. 000-29599).
21	Subsidiaries of Bancorp (incorporated by reference to Exhibit 21 to Bancorp s Annual Report on Form 10-KSB for the year ended December 31, 1999 (Commission File No. 000-29599)).
31(1)	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
31(2)	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer
32	Section 1350 Certifications
101.INS#	XBRL Instance Document

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No.	Description
101.SCH#	XBRL Schema Document
101.CAL#	XBRL Calculation Linkbase Document
101.LAB#	XBRL Labels Linkbase Document
101.PRE#	XBRL Presentation Linkbase Document
101.DEF#	XBRL Definition Linkbase Document

The exhibits marked with the section symbol (#) are interactive data files. Pursuant to Rule 406T of Regulations S-T, these interactive data files (i) are not deemed filed or part of a registration statement of prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, are not deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, irrespective of any general incorporation language included in any such filings, and otherwise are not subject to liability under these sections; and (ii) are deemed to have complied with Rule 405 of Regulations S-T (Rule 405) and are not subject to liability under the anti-fraud provisions of the Section 17(a)(1) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 or under any other liability provision if we have made a good faith attempt to comply with Rule 405 and, after we become aware that the interactive data files fail to comply with Rule 405, we promptly amend the interactive data files.

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SIGNATURES

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

PATRIOT NATIONAL BANCORP, INC.
(Registrant)

By: /s/ William C. Gray
William C. Gray,
Executive Vice President
Chief Financial Officer

(On behalf of the registrant and as chief financial officer)

August 12, 2013