CHICOPEE BANCORP, INC.
Form 10-Q
May 08, 2015

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

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

For the quarterly period ended March 31, 2015
or
[ ]
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from $\qquad$ to $\qquad$
Commission File Number: 000-51996
CHICOPEE BANCORP, INC.
(Exact name of registrant as specified in its charter)

Massachusetts
(State or other jurisdiction of incorporation or organization)

70 Center Street, Chicopee, Massachusetts
(Address of principal executive offices)
(413) 594-6692
(Registrant's telephone number, including area code)

20-4840562
(I.R.S. Employer Identification No.)

01013
(Zip Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes [X] No [ ]
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [X] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.
Large Accelerated Filer [ ]
Accelerated Filer [X]
Non-Accelerated Filer [ ]
Smaller Reporting Company [ ]

Indicate be check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes [ ] No [X]

As of May 4, 2015, there were $5,270,670$ shares of the Registrant's Common Stock outstanding.

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## PART I. FINANCIAL INFORMATION

| Item 1. Financial Statements |  |  |
| :---: | :---: | :---: |
| CHICOPEE BANCORP, INC. AND SUBSIDIARIES |  |  |
| CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION |  |  |
| (Dollars In Thousands) |  |  |
| (Unaudited) |  |  |
|  | $\begin{aligned} & \text { March 31, } \\ & 2015 \end{aligned}$ | $\begin{aligned} & \text { December 31, } \\ & 2014 \end{aligned}$ |
| ASSETS |  |  |
| Cash and due from banks | \$9,588 | \$8,794 |
| Federal funds sold | 2,563 | 2,915 |
| Interest-bearing deposits with the Federal Reserve Bank of Boston | 38,565 | 38,060 |
| Total cash and cash equivalents | 50,716 | 49,769 |
| Securities available for sale, at fair value | 399 | 414 |
| Securities held to maturity, at cost (fair value of \$34,208 at March 31, 2015 and $\$ 34,229$ at December 31, 2014) | 33,424 | 33,747 |
| Federal Home Loan Bank stock, at cost | 4,292 | 3,914 |
| Loans, net of allowance for loan losses of \$5,184 at March 31, 2015 and $\$ 4,927$ at December 31, 2014 | 540,327 | 519,757 |
| Loans held for sale | 217 | - |
| Other real estate owned | 865 | 1,050 |
| Mortgage servicing rights | 242 | 269 |
| Bank owned life insurance | 14,619 | 14,531 |
| Premises and equipment, net | 8,777 | 8,855 |
| Accrued interest and dividends receivable | 1,651 | 1,591 |
| Deferred income tax asset | 3,688 | 3,683 |
| Other assets | 1,615 | 1,642 |
| Total assets | \$660,832 | \$639,222 |
| LIABILITIES AND STOCKHOLDERS' EQUITY |  |  |
| Deposits |  |  |
| Demand deposits | \$96,185 | \$97,922 |
| NOW accounts | 42,533 | 42,177 |
| Savings accounts | 53,049 | 50,716 |
| Money market deposit accounts | 114,678 | 121,106 |
| Total core deposits | 306,445 | 311,921 |
| Certificates of deposit | 182,261 | 171,637 |
| Total deposits | 488,706 | 483,558 |
| Federal Home Loan Bank of Boston advances | 83,537 | 67,039 |
| Accrued expenses and other liabilities | 374 | 491 |
| Total liabilities | 572,617 | 551,088 |
| Stockholders' equity |  |  |
| Common stock (no par value, 20,000,000 shares authorized, 7,439,368 shares issued; 5,270,670 shares outstanding at March 31, 2015 and December 31, 2014) | 72,479 | 72,479 |
| Treasury stock, at cost ( $2,168,698$ shares at March 31, 2015 and December 31, 2014) | (29,119 | ) (29,119 ) |


| Additional paid-in-capital | 3,665 | 3,595 |
| :--- | :--- | :--- |
| Unearned compensation (restricted stock awards) | $(6,198$ | $)(7)(3,273$ |
| Unearned compensation (Employee Stock Ownership Plan) | $(3,198$ | $)$ |
| Retained earnings | 44,374 | 44,430 |
| Accumulated other comprehensive income | 20 | 29 |
| Total stockholders' equity | 88,215 | 88,134 |
| Total liabilities and stockholders' equity | $\$ 660,832$ | $\$ 639,222$ |

See accompanying notes to unaudited consolidated financial statements.
1


Diluted

Adjusted weighted average shares outstanding:
Basic
4,942,636 5,079,063
Diluted
5,012,777 5,176,226

See accompanying notes to unaudited consolidated financial statements.

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CHICOPEE BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(In Thousands)
(Unaudited)

|  | Three Months Ended <br> March 31, |  |
| :--- | :--- | :--- |
| Net income (loss) | 2015 | 2014 |
|  | $\$ 313$ | $\$(1,359)$ |
| Other comprehensive loss, net of tax |  |  |
| Unrealized holding losses arising during period on available-for-sale securities | $(15$ | $)(8$, |
| Reclassification adjustment for gains realized in net income (1) | - | $(34$ |
| Tax effect | 6 | 15 |
| Total other comprehensive loss, net of tax | $(9)$ | $(27$ |
| Total comprehensive income (loss) | $\$ 304$ | $\$(1,386)$ |

(1) Reclassified into the consolidated statements of operations in net gain on sales of available-for-sale securities.

See accompanying notes to unaudited consolidated financial statements.
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CHICOPEE BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Three Months Ended March 31, 2015 and 2014
(Dollars In Thousands)
(Unaudited)


Comprehensive loss:


Comprehensive income:

 unrealized gain on
available-for-sale
securities (net of
deferred income taxes
of \$6)
$\begin{array}{ll}\text { Total comprehensive } \\ \text { income } & 304\end{array}$
$\begin{array}{lllllllll}\text { Stock option expense } & - & - & 22 & - & - & - & & \end{array}$
Change in unearned
compensation:
Restricted stock awar $\qquad$
expense
Common stock held by
ESOP committed to be released
Cash dividends declared
( $\$ 0.07$ per share)
Balance at March 31,
2015
See accompanying notes to unaudited consolidated financial statements.
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## CHICOPEE BANCORP, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

Supplemental cash flow information:
Interest paid on deposits ..... \$713 ..... \$714
Interest paid on borrowings ..... 246 ..... 200Income taxes paid47

See accompanying notes to unaudited consolidated financial statements.
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CHICOPEE BANCORP, INC. AND SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements
March 31, 2015 and 2014

## 1. Basis of Presentation

Chicopee Bancorp, Inc. (the "Corporation") has no significant assets other than all of the outstanding shares of its wholly-owned subsidiaries, Chicopee Savings Bank (the "Bank") and Chicopee Funding Corporation (collectively, the "Company"). The Corporation was formed on March 14, 2006 and became the holding company for the Bank upon completion of the Bank's conversion from a mutual savings bank to a stock savings bank. The conversion of the Bank was completed on July 19, 2006. The accounts of the Bank include its wholly-owned subsidiaries and a $99 \%$ owned subsidiary. The consolidated financial statements of the Company as of March 31, 2015 and for the periods ended March 31, 2015 and 2014 included herein are unaudited. In the opinion of management, all adjustments, consisting only of normal recurring adjustments necessary for a fair presentation of the financial condition, results of operations, changes in stockholders' equity and cash flows, as of and for the periods covered herein, have been made. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2014 included in the Company's Annual Report on Form 10-K.

The results for the three months ended March 31, 2015 are not necessarily indicative of the operating results for a full year.

## 2. Earnings (Loss) Per Share

Basic earnings (loss) per share represents income available to common stockholders divided by the adjusted weighted-average number of common shares outstanding during the period. The adjusted outstanding common shares equals the gross number of common shares issued less average treasury shares, unallocated shares of the Chicopee Savings Bank Employee Stock Ownership Plan ("ESOP"), and average dilutive restricted stock awards under the 2007 Equity Incentive Plan. Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may be issued by the Company relate to outstanding stock options and certain stock awards and are determined using the treasury stock method.

Earnings (loss) per share have been computed based on the following:
(\$ in thousands, except share data )
Net income (loss)
Average number of shares issued
Less: average number of treasury shares
Less: average number of unallocated ESOP shares
Less: average number of dilutive restricted stock awards
Adjusted weighted average number of common shares outstanding
Plus: dilutive outstanding restricted stock awards
Plus: dilutive outstanding stock options
Weighted average number of diluted shares outstanding
$\left.\begin{array}{lll}\begin{array}{l}\text { Three Months Ended } \\ \text { March 31, } \\ 2015\end{array} & \\ \$ 313 & 2014 \\ & \$(1,359 \quad) \\ 7,439,368 & 7,439,368 \\ (2,168,698 & ) & (2,002,114 \quad) \\ (327,332 & (357,089 \quad) \\ (702 & ) & (1,102\end{array}\right)$

Net income (loss) per share:
$\left.\begin{array}{llll}\text { Basic-common stock } & \$ 0.06 & \$(0.27 & \$(0.27\end{array}\right)$

There were 92,000 stock options that were not included in the calculation of diluted earnings per share for the three months ended March 31, 2014 and March 31, 2015 because the effect was anti-dilutive. Given the loss for the three months ended March 31, 2014, diluted loss per share did not differ from basic loss per share as all potential shares were anti-dilutive.

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## 3. Equity Incentive Plan

## Stock Options

The Company's 2007 Equity Incentive Plan (the "Plan") was approved by the Company's stockholders at the annual meeting of the Company's stockholders on May 30, 2007. The Plan provides that the Company may grant options to directors, officers and employees for up to 743,936 shares of common stock. Both incentive stock options and non-qualified stock options may be granted under the Plan. The exercise price for each option is equal to the market price of the Company's stock on the date of grant and the maximum term of each option is ten years. The stock options vest over five years in five equal installments on each anniversary of the date of grant.

The Company recognizes compensation expense over the vesting period, based on the grant-date fair value of the options granted. The fair value of each option granted is estimated on the date of grant using the Black-Scholes option-pricing model. There were no stock options granted during the three month periods ended March 31, 2015 or 2014.

A summary of options under the Plan as of March 31, 2015 and changes during the three months ended March 31, 2015 , is as follows:

Outstanding at December 31, 2014
$\left.\begin{array}{llll}\text { Number of } \\ \text { Shares }\end{array} \quad \begin{array}{l}\text { Weighted } \\ \text { Average } \\ \text { Exercise Price }\end{array} \quad \begin{array}{l}\text { Weighted } \\ \text { Average } \\ \text { Remaining } \\ \text { Contractual } \\ \text { Term } \\ \text { (in years) }\end{array} \quad \begin{array}{l}\text { Aggregate } \\ \text { Intrinsic } \\ \text { Value } \\ \text { (000's) }\end{array}\right\}$

The weighted-average grant-date fair value of the options outstanding and exercisable at March 31, 2015 was $\$ 3.81$ and $\$ 3.85$, respectively. For the three months ended March 31, 2015, share based compensation expense applicable to options granted under the Plan was $\$ 22,000$. For the three months ended March 31, 2014, share based compensation expense applicable to options granted under the Plan was $\$ 30,000$. As of March 31, 2015, unrecognized stock-based compensation expense related to non-vested options amounted to $\$ 243,000$. This amount is expected to be recognized over a period of 2.39 years.

## Stock Awards

The Plan provides that the Company may grant stock awards to its directors, officers and employees for up to 297,574 shares of common stock. The stock awards vest $20 \%$ per year beginning on the first anniversary of the date of grant. The fair market value of the stock awards, based on the market price at the date of grant, is recorded as unearned compensation. Unearned compensation is amortized over the applicable vesting period. The weighted-average grant-date fair value of stock awards as of March 31, 2015 is $\$ 14.08$. The Company recorded compensation cost related to stock awards of approximately $\$ 1,000$ for each of the three month periods ended March 31, 2015 and 2014. There were no stock awards granted prior to July 1, 2007. There were no stock awards granted by the Company during the three months ended March 31, 2015. The Company granted 2,000 stock awards during the year ended December 31,2011 with a grant price of $\$ 14.08$. As of March 31, 2015, unrecognized stock-based compensation expense related
to non-vested restricted stock awards amounted to $\$ 6,000$. This amount is expected to be recognized over a period of 0.94 years.

A summary of the status of the Company's stock awards as of March 31, 2015, and changes during the three months ended March 31, 2015, is as follows:

| Nonvested Shares | Number of <br> Shares | Weighted <br> Average <br> Grant-Date |
| :--- | :--- | :--- |
| Fair Value |  |  |

## 4. Long-term Incentive Plan

On March 13, 2012, the Company adopted the Chicopee Bancorp, Inc. 2012 Phantom Stock Unit Award and Long-Term Incentive Plan (the "Phantom Stock Plan"), effective January 1, 2012, to promote the long-term financial success of the Company and its subsidiaries by providing a means to attract, retain and reward individuals who contribute to such success and to further align their interest with those of the Company's stockholders.

A total of 150,000 phantom stock units are available for awards under the Phantom Stock Plan. The only awards that may be granted under the Phantom Stock Plan are Phantom Stock Units. A Phantom Stock Unit represents the right to receive a cash payment on the determination date equal to the book value of a share of the Company's stock on the determination date. The settlement of a Phantom Stock Unit on the determination date shall be in cash. Unless the Compensation Committee of the Board of Directors of the Company determines otherwise, the required period of service for full vesting will be three years. The Company's total expense under the Phantom Stock Plan for the three months ended March 31, 2015 and 2014, was $\$ 7,000$ and $\$ 8,000$, respectively. There were no phantom stock units granted during the three months ended March 31, 2015 and 2014. As of March 31, 2015 and December 31, 2014, 7,016 phantom stock units were outstanding.

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## 5. Recent Accounting Pronouncements (Applicable to the Company)

In January 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-04, Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure. The amendments in this ASU clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure. The amendments in this ASU are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. Management has applied this ASU and it did not have a material effect on the Company's consolidated financial statements.

In May 2014, FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). The ASU was issued to clarify the principles for recognizing revenue and to develop a common revenue standard. The ASU is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. The Company is currently evaluating the potential impact of the ASU on its consolidated financial statements.

In June 2014, FASB issued ASU No. 2014-11, Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures. The ASU was issued to respond to concerns about current accounting and disclosures for repurchase agreements and similar transactions. The concern was that under current accounting guidance there is an unnecessary distinction between the accounting for different types of repurchase agreements. Under current guidance, the repurchase-to-maturity transactions are accounted for as sales with forward agreements, whereas repurchase agreements that settle before the maturity of the transferred financial asset are accounted for as secured borrowings. The ASU amendments require new disclosures for repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions accounted for as secure borrowings. The ASU is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The ASU does not have a material effect on the Company's consolidated financial statements.

In June 2014, FASB issued ASU No. 2014-12, Compensation - Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period. The ASU was issued because current U.S. generally accepted accounting principles (GAAP) does not contain explicit guidance on how to account for share-based payments when a performance target could be achieved after the requisite service period. The ASU is effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. The ASU will not have a material effect on the Company's consolidated financial statements.

## 6. Investment Securities

The following tables set forth, at the dates indicated, information regarding the amortized cost and fair value, with gross unrealized gains and losses of the Company's investment securities:

|  | March 31, 2015 |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | Amortized Cost <br> (In Thousa | Gross <br> Unrealized Gains <br> s) | Gross <br> Unrealized Losses | Fair Value |
| Available-for-sale securities: |  |  |  |  |
| Marketable equity securities | \$369 | \$30 | \$- | \$399 |
| Total available-for-sale securities | \$369 | \$30 | \$- | \$399 |
| Held-to-maturity securities: |  |  |  |  |
| Corporate and industrial revenue bonds | \$33,077 | \$772 | \$- | \$33,849 |
| Collateralized mortgage obligations | 347 | 12 | - | 359 |
| Total held-to-maturity securities | \$33,424 | \$784 | \$- | \$34,208 |
| Non-marketable securities: |  |  |  |  |
| Federal Home Loan Bank stock | \$4,292 | \$- | \$- | \$4,292 |
| Banker's Bank Northeast stock | 183 | - | - | 183 |
| Total non-marketable securities | \$4,475 | \$- | \$- | \$4,475 |
|  | December 31, 2014 |  |  |  |
|  | Amortized | Gross | Gross |  |
|  | Cost | Unrealized | Unrealized <br> Losses | Value |
|  | (In Thousands) |  |  |  |
| Available-for-sale securities: |  |  |  |  |
| Marketable equity securities | \$369 | \$45 | \$- | \$414 |
| Total available-for-sale securities | \$369 | \$45 | \$- | \$414 |
| Held-to-maturity securities: |  |  |  |  |
| Corporate and industrial revenue bonds | \$33,344 | \$467 | - | \$33,811 |
| Collateralized mortgage obligations | 403 | 15 | - | 418 |
| Total held-to-maturity securities | \$33,747 | \$482 | \$- | \$34,229 |
| Non-marketable securities: |  |  |  |  |
| Federal Home Loan Bank stock | \$3,914 | \$- | \$- | \$3,914 |
| Banker's Bank Northeast stock | 183 | - | - | 183 |
| Total non-marketable securities | \$4,097 | \$- | \$- | \$4,097 |

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The amortized cost and estimated fair value of debt securities by contractual maturity at March 31, 2015 are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without prepayment penalties. The collateralized mortgage obligations are allocated to maturity categories according to final maturity date.

Due in one year or less
Due after one year through five years
Due after five years through ten years
Due after ten years
Total

| Held-to-maturity <br> Amortized |  |
| :--- | :--- |
| Cost <br> (In Thousands) | Fair Value |
| $\$-$ | $\$-$ |
| 8,194 | 8,564 |
| - | - |
| 25,230 | 25,644 |
| $\$ 33,424$ | $\$ 34,208$ |

There were no sales of available-for-sale securities during the three months ended March 31, 2015. During the three months ended March 31, 2014, proceeds from sales of available-for-sale securities amounted to $\$ 187,000$ with gross realized gains of $\$ 34,000$. The tax provision applicable to the net realized gain for the three months ended March 31, 2014 was $\$ 8,000$.

Management conducts, at least on a monthly basis, a review of its investment portfolio including available-for-sale and held-to-maturity securities to determine if the fair value of any security has declined below its cost or amortized cost and whether such security is other-than-temporarily impaired.

Unrealized Losses on Investment Securities
There were no continuous unrealized losses as of March 31, 2015 and December 31, 2014.
Non-Marketable Securities
The Company is a member of the Federal Home Loan Bank of Boston ("FHLB"). The FHLB is a cooperatively owned wholesale bank for housing and finance in the six New England States. Its mission is to support the residential mortgage and community development lending activities of its members, which include over 450 financial institutions across New England. As a requirement of membership in the FHLB, the Company must own a minimum required amount of FHLB stock, calculated periodically based primarily on the Company's level of borrowings from the FHLB. The Company uses the FHLB for much of its wholesale funding needs. The Company's investment in FHLB stock totaled $\$ 4.3$ million and $\$ 3.9$ million at March 31, 2015 and December 31, 2014, respectively.

FHLB stock is a non-marketable equity security and therefore is reported at cost, which equals par value. Shares held in excess of the minimum required amount are generally redeemable at par value. For the three months ended March 31, 2015 and 2014, the Company received $\$ 17,000$ and $\$ 15,000$, respectively, in dividend income from its FHLB stock investment.

The Company periodically evaluates its investment in FHLB stock for impairment based on, among other factors, the capital adequacy of the FHLB and its overall financial condition. There have not been any impairment losses recorded through March 31, 2015 and the Company will continue to monitor its FHLB stock investment.

Banker's Bank Northeast (BBN) stock is reported under other assets in the consolidated statement of financial condition and is carried at cost. The BBN stock investment is evaluated for impairment based on an estimate of the ultimate recovery to par value. As of March 31, 2015 and December 31, 2014, the Company's investment in BBN totaled $\$ 183,000$. There have not been any impairment losses recorded through March 31, 2015 and the Company will continue to monitor its BBN stock investment.

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## 7. Loans and Allowance for Loan Losses

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

\left.|  | March 31, 2015 |  | December 31, 2014 |  |
| :--- | :--- | :--- | :--- | :--- | :--- |
| Percent |  |  |  |  |
| of Total |  |  |  |  |$\right]$

The Company has transferred a portion of its originated commercial real estate and commercial loans to participating lenders. The amounts transferred have been accounted for as sales and therefore not included in the Company's consolidated statements of financial condition. The Company and participating lenders share proportionally, based on participating agreements, any gains or losses that may result from the borrowers lack of compliance with the terms of the loan. The Company continues to service the loans on behalf of the participating lenders. At March 31, 2015 and December 31, 2014, the Company was servicing loans for participating lenders totaling $\$ 17.0$ million and $\$ 18.0$ million, respectively.

In accordance with the Company's asset/liability management strategy and in an effort to reduce interest rate risk, the Company continues to sell fixed rate, low coupon residential real estate loans to the secondary market. The Company sold $\$ 334,000$ and $\$ 1.6$ million in residential real estate loans to the secondary market during the three month periods ended March 31, 2015 and 2014, respectively. The unpaid principal balance of residential real estate loans serviced for others was $\$ 89.0$ million at March 31, 2015 and $\$ 91.3$ million at December 31, 2014. Management expects to continue to retain servicing rights on all loans written and sold in the secondary market.

Credit Quality

To evaluate the risk in the loan portfolio, internal credit risk ratings are used for the following loan classes: commercial real estate, commercial construction and commercial and industrial. The risks evaluated in determining an adequate credit risk rating include the financial strength of the borrower and the collateral securing the loan. Commercial loans, including commercial and industrial, commercial real estate and commercial construction loans, are rated from one through nine. Credit risk ratings one through five are considered pass ratings. Classified assets include credit risk ratings of special mention through loss. At least quarterly, classified assets are reviewed by management and by an independent third party. Credit risk ratings are updated as soon as information is obtained that indicates a change in the credit risk rating may be warranted.

Residential real estate and residential construction loans are categorized into performing and nonperforming risk ratings. They are considered nonperforming when they are 90 days past due or have not returned to accrual status. Nonperforming residential loans are individually evaluated for impairment.

Consumer loans are considered nonperforming when they are 90 days past due or have not returned to accrual status. Consumer loans are not individually evaluated for impairment.

Home equity loans are considered nonperforming when they are 90 days past due or have not returned to accrual status. Each nonperforming home equity loan is individually evaluated for impairment.

The following describes the credit risk ratings for classified assets:
Special mention. Assets that do not currently expose the Company to sufficient risk to warrant classification in one of the following categories but possess potential weaknesses.

Substandard. Assets that have one or more defined weaknesses and are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Non-accruing loans are typically classified as substandard.

Doubtful. Assets that have the weaknesses of substandard assets with the additional characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions and values questionable, and there is a high possibility of loss.

Loss. Assets rated in this category are considered uncollectible and are charged off against the allowance for loan losses.

The following table presents an analysis of total loans segregated by risk rating and segment as of March 31, 2015:

|  | Commercial Credit Risk Exposure |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | Commercial and Industrial <br> (In Thousands) | Commercial Construction | Commercial <br> Real Estate | Total |
| Pass | \$64,371 | \$28,975 | \$260,345 | \$353,691 |
| Special mention | 3,775 | 5,826 | 8,535 | 18,136 |
| Substandard | 2,947 | 2,167 | 3,180 | 8,294 |
| Total commercial loans | \$71,093 | \$36,968 | \$272,060 | \$380,121 |
|  | Residential Credit Risk Exposure |  |  |  |
|  | Residential | Residential |  | Total |
|  | Real Estate <br> (In Thousands) | Construction |  | Total |
| Performing | \$116,054 | \$7,545 |  | \$123,599 |
| Nonperforming | 4,042 | - |  | 4,042 |
| Total residential loans (1) | \$120,096 | \$7,545 |  | \$127,641 |
|  | Consumer Credit Risk Exposure |  |  |  |
|  | Consumer (In Thousands) | Home Equity |  | Total |

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| Performing | $\$ 2,529$ | $\$ 33,983$ | $\$ 36,512$ |
| :--- | :--- | :--- | :--- |
| Nonperforming | 32 | 346 | 378 |
| Total consumer loans | $\$ 2,561$ | $\$ 34,329$ | $\$ 36,890$ |

(1) At March 31, 2015, the Company had a total of $\$ 481,000$ in residential real estate loans in the process of foreclosure.

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The following table presents an analysis of total loans segregated by risk rating and segment as of December 31, 2014:

|  | Commercial Credit Risk Exposure |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | Commercial and Industrial <br> (In Thousands) | Commercial Construction | Commercial Real Estate | Total |
| Pass | \$66,442 | \$27,547 | \$234,866 | \$328,855 |
| Special mention | 4,991 | 5,843 | 10,034 | 20,868 |
| Substandard | 2,898 | 2,396 | 4,732 | 10,026 |
| Total commercial loans | \$74,331 | \$35,786 | \$249,632 | \$359,749 |
|  | Residential Credit Risk Exposure |  |  |  |
|  | Residential | Residential |  | Total |
|  | Real Estate (In Thousands) |  |  |  |
| Performing | \$114,586 | \$8,129 |  | \$ 122,715 |
| Nonperforming | 4,106 | - |  | 4,106 |
| Total residential loans | \$118,692 | \$8,129 |  | \$126,821 |
|  | Consumer Credit Risk Exposure |  |  |  |
|  | Consumer <br> (In Thousands) | Home Equity |  | Total |
| Performing | \$2,630 | \$34,159 |  | \$36,789 |
| Nonperforming | 32 | 349 |  | 381 |
| Total consumer loans | \$2,662 | \$34,508 |  | \$37,170 |

## Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. The allowance for loan losses is evaluated on a regular basis by management. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of general and allocated components, as further described below.
Loans charged off
Commercial and industrial loans. Loans past due more than 120 days are considered for one of three options: charge off the balance of the loan, charge off any excess balance over the fair value of the collateral securing the loan, or continue collection efforts subject to a monthly review until either the balance is collected or a charge-off recommendation can be reasonably made.

Residential loans. In general, one-to-four family residential loans and home equity loans that are delinquent 90 days or more or are on nonaccrual status are classified nonperforming. An updated appraisal is obtained when the loan is 90 days or more delinquent. Any outstanding balance in excess of the fair value of the property, less cost to sell, is charged-off against the allowance for loan losses.

Consumer loans. Generally all loans are automatically considered for charge-off at 90 to 120 days from the contractual due date, unless there is liquid collateral in hand sufficient to repay principal and interest in full.

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## General Component

The general component of the allowance for loan losses is based on historical loss experience adjusted for qualitative factors stratified by the following portfolio segments: residential real estate, residential construction, commercial real estate, commercial and industrial, commercial construction, consumer and home equity. Management uses an average of historical losses based on a time frame appropriate to capture relevant loss data for each portfolio segment. Management deems 48 months to be an appropriate time frame on which to base historical losses for each portfolio segment. This historical loss factor is adjusted for qualitative factors for each portfolio segment including, but not limited to: levels/trends in delinquencies; trends in volume and terms of loans; effects of changes in risk selection and changes in lending policies, experience, ability, depth of lending management and staff; and national and local economic conditions. Management follows a similar process to estimate its liability for off-balance-sheet commitments to extend credit.

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

Residential real estate loans enable the borrower to purchase or refinance existing homes, most of which serve as the primary residence of the owner. Repayment is dependent on the credit quality of the borrower. Factors attributable to failure of repayment may include a weakened economy and/or unemployment, as well as possible personal considerations. While management anticipates adjustable-rate mortgages will better offset the potential adverse effects of an increase in interest rates as compared to fixed-rate mortgages, the increased mortgage payments required of adjustable-rate loan borrowers in a rising interest rate environment could cause an increase in delinquencies and defaults. The marketability of the underlying property also may be adversely affected in a high interest rate environment.

Commercial real estate loans are secured by commercial real estate and residential investment real estate and generally have larger balances and involve a greater degree of risk than one- to four-family residential mortgage loans. Risks in commercial real estate and residential investment lending are borrower's creditworthiness and the feasibility and cash flow potential of the project. Payments on loans secured by income properties often depend on successful operation and management of the properties. As a result, repayment of such loans may be subject to a greater extent than residential real estate loans to adverse conditions in the real estate market or the economy.

Commercial and residential construction loans are generally considered to involve a higher degree of risk of loss than long-term financing on improved, occupied real estate. Risk of loss on a construction loan depends largely upon the accuracy of the initial estimate of the property's value at completion of construction and the estimated cost (including interest) of construction.

Commercial and industrial loans are of higher risk and typically are made on the basis of the borrower's ability to make repayment from the cash flow of the borrower's business. As a result, the availability of funds for the repayment of commercial loans may depend substantially on the success of the business itself. Further, any collateral securing such loans may depreciate over time, may be difficult to appraise and may fluctuate in value.

Consumer and home equity loans may entail greater risk than do residential mortgage loans, particularly in the case of consumer loans that are unsecured or secured by assets that depreciate rapidly. In such cases, repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment for the outstanding loan and the remaining deficiency often does not warrant further substantial collection efforts against the borrower. In addition, consumer loan collections depend on the borrower's continuing financial stability, and therefore are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount that can be recovered on such loans.

The Company does not disaggregate its portfolio segments into loan classes.

## Allocated Component

The allocated component relates to loans that are classified as impaired. Impairment is measured on a loan by loan basis for residential real estate, home equity loans, commercial real estate and commercial loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. An allowance is established when the discounted cash flows or collateral value of the impaired loan is lower than the carrying value of that loan. The Company recognizes the change in present value attributable to the passage of time as provision for loan losses. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment, and the resulting allowance is reported as the general component, as described above.

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

The Company may periodically agree to modify the contractual terms of loans. When a loan is modified and a concession is made to a borrower experiencing financial difficulty, the modification is considered a troubled debt restructuring ("TDR"). All TDRs are classified as impaired.
Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer loans for impairment evaluation, except for home equity loans.

During the three months ended March 31, 2015, there were no changes in the Company's allowance methodology related to the qualitative or quantitative factors.

The following table presents the allowance for loan losses and select loan information as of and for the three months ended March 31, 2015 :

| Residential | Residential Commercial Commercial |  |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- |
| Commercial |  |  |  |  |
| Real | Consumer Home | Total |  |  |
| Estate | ConstructiorReal Estate Construction Industrial |  | Equity |  |


| Allowance for loan losses | (In Thousands) |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Balance as of December $31,2014$ | $\text { r } \$ 486$ | \$ 107 |  | \$ 2,699 | \$ 568 | \$ 879 | \$35 | \$153 |  | \$4,927 |
| Provision for (reduction of) loan losses | $145$ | (7 | ) | 152 | 83 | 24 | 5 | (2 | ) | 400 |
| Recoveries | - | - |  | 1 | - | - | 7 | 1 |  | 9 |
| Loans charged off | (85 | ) - |  | (3 | ) - | (53 | ) (11 | ) - |  | (152 |
| Balance as of March 31, 2015 | '\$546 | \$ 100 |  | \$ 2,849 | \$ 651 | \$ 850 | \$36 | \$152 |  | \$5,184 |


| Allowance for loan losses <br> Collectively evaluated <br> for impairment | $\$ 499$ | $\$ 100$ | $\$ 2,816$ | $\$ 651$ | $\$ 818$ | $\$ 36$ | $\$ 149$ | $\$ 5,069$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Individually evaluated <br> for impairment | 47 | - | 33 | - | 32 | - | 3 | 115 |
| Total ending balance | $\$ 546$ | $\$ 100$ | $\$ 2,849$ | $\$ 651$ | $\$ 850$ | $\$ 36$ | $\$ 152$ | $\$ 5,184$ |


| Total loans <br> Collectively evaluated <br> for impairment | $\$ 116,054$ | $\$ 7,545$ | $\$ 270,053$ | $\$ 34,801$ | $\$ 69,313$ | $\$ 2,561$ | $\$ 33,983$ | $\$ 534,310$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Individually evaluated <br> for impairment | 4,042 | - | 2,007 | 2,167 | 1,780 | - | 346 | 10,342 |
| $\quad$ Total ending balance | $\$ 120,096$ | $\$ 7,545$ | $\$ 272,060$ | $\$ 36,968$ | $\$ 71,093$ | $\$ 2,561$ | $\$ 34,329$ | $\$ 544,652$ |

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The following table presents the allowance for loan losses and select loan information as of and for the year ended December 31, 2014:

| Residential | Residential Commercial Commercial | Commercial |  |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- |
| and | Consumer Home |  |  |  |  |
| Real | Retal |  |  |  |  |
| Estate | Constructio Real Estate Construction | Industrial | Loans | Equity |  |

Allowance for loan losses (In Thousands)

| Balance as of December $31,2013$ | \$650 | \$ 94 | \$ 2,121 |  | \$ 435 |  | \$ 1,110 |  | \$35 |  | \$151 | \$4,596 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Provision for loan losses | s139 | 13 | 1,479 |  | 1,672 |  | 1,867 |  | 43 |  | 58 | 5,271 |
| Recoveries | - | - | 74 |  | - |  | 83 |  | 23 |  | 1 | 181 |
| Loans charged off | (303 | ) - | (975 | ) | (1,539 | ) | (2,181 | ) | (66 | ) | (57 | ) $(5,121$ |
| Balance as of December 31,2014 | \$486 | \$ 107 | \$ 2,699 |  | \$ 568 |  | \$ 879 |  | \$35 |  | \$153 | \$4,927 |

Allowance for loan losses

| Collectively evaluated | $\$ 481$ | $\$ 107$ | $\$ 2,634$ | $\$ 568$ | $\$ 879$ | $\$ 35$ | $\$ 150$ | $\$ 4,854$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |

for impairment

$\begin{array}{lllllllll}\text { Total ending balance } & \$ 486 & \$ 107 & \$ 2,699 & \$ 568 & \$ 879 & \$ 35 & \$ 153 & \$ 4,927\end{array}$
Total loans
$\begin{array}{lllllllll}\text { Collectively evaluated } \\ & \$ 114,586 & \$ 8,129 & \$ 246,123 & \$ 33,391 & \$ 73,286 & \$ 2,662 & \$ 34,160 & \$ 512,337\end{array}$
for impairment
$\begin{array}{llllllllll}\text { Individually evaluated } & 4,106 & - & 3,509 & 2,395 & 1,045 & - & 348 & 11,403\end{array}$
$\begin{array}{llllllll}\text { Total ending balance } & \$ 118,692 & \$ 8,129 & \$ 249,632 & \$ 35,786 & \$ 74,331 & \$ 2,662 & \$ 34,508\end{array}$

The following table presents the allowance for loan losses and select loan information as of and for the three months ended March 31, 2014 :

| Residential | Residential Commercial Commercial |  |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- |
| Commercial |  |  |  |  |
| and | Consumer Home |  |  |  |
| Real | Cotal |  |  |  |
| Estate | ConstructiorReal Estate Construction Industrial | Loans | Equity |  |

Allowance for loan losses (In Thousands)
Balance as of December
31,2013
Provision for (reduction (6 ) 16
of) loan losses

| Recoveries <br> Loans charged off | $(233$ | $)$ | - | - | - | 1 | 5 | - | 6 |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Balance as of March 31, <br> 314 | $\$ 411$ | $\$ 110$ | $\$ 2,269$ | $\$ 496$ | $\$ 1,007$ | $\$ 34$ | $\$ 135$ | $\$ 4,462$ |  |

Allowance for loan losses
Collectively evaluated
for impairment
$\begin{array}{lllllll}\$ 407 & \$ 110 & \$ 2,129 & \$ 996 & \$ 997\end{array}$

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| $\quad$Individually evaluated <br> for impairment | - | 140 | - | 10 | - | - | 154 |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Total ending balance | $\$ 411$ | $\$ 110$ | $\$ 2,269$ | $\$ 496$ | $\$ 1,007$ | $\$ 34$ | $\$ 135$ | $\$ 4,462$ |
|  |  |  |  |  |  |  |  |  |
| Total loans |  |  |  |  |  |  |  |  |
| Collectively evaluated <br> for impairment | $\$ 110,092$ | $\$ 7,109$ | $\$ 208,845$ | $\$ 39,341$ | $\$ 77,238$ | $\$ 2,358$ | $\$ 31,196$ | $\$ 476,179$ |
| Individually evaluated <br> for impairment <br> Total ending balance | $\$ 1165$ | - | 6,358 | 4,098 | 1,674 | - | 240 | 15,535 |

Impairment
The following table presents a summary of information pertaining to impaired loans by segment as of and for the three months ended March 31, 2015:

| Recorded | Unpaid | Average | Related | Interest |
| :--- | :--- | :--- | :--- | :--- |
| Investment | Balance | Recorded <br> Investment | Allowance | Income |
| Recognized |  |  |  |  |
| (In Thousands) |  |  |  |  |

Impaired loans without a valuation allowance:

| Residential real estate | $\$ 3,182$ | $\$ 3,389$ | $\$ 3,338$ | $\$-$ | $\$ 34$ |
| :--- | :--- | :--- | :--- | :--- | :--- |
| Residential construction | - | - | - | - | - |
| Commercial real estate | 1,454 | 1,491 | 2,077 | - | 29 |
| Commercial construction | 2,167 | 3,706 | 2,281 | - | 4 |
| Commercial and industrial | 1,343 | 1,375 | 1,194 | - | 7 |
| Consumer | - | - | - | - | - |
| Home equity | 299 | 362 | 300 | - | 1 |
| Total | $\$ 8,445$ | $\$ 10,323$ | $\$ 9,190$ | $\$-$ | $\$ 75$ |


| Impaired loans with a valuation allowance: |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Residential real estate | \$860 | \$860 | \$736 | \$47 | \$12 |
| Residential construction | - | - | - | - | - |
| Commercial real estate | 553 | 599 | 681 | 33 | 6 |
| Commercial construction | - | - | - | - | - |
| Commercial and industrial | 437 | 437 | 219 | 32 | 2 |
| Consumer | - | - | - | - | - |
| Home equity | 47 | 47 | 47 | 3 | - |
| Total | \$ 1,897 | \$1,943 | \$ 1,683 | \$115 | \$20 |
| Total impaired loans: |  |  |  |  |  |
| Residential real estate | \$4,042 | \$4,249 | \$4,074 | \$47 | \$46 |
| Residential construction | - | - | - | - | - |
| Commercial real estate | 2,007 | 2,090 | 2,758 | 33 | 35 |
| Commercial construction | 2,167 | 3,706 | 2,281 | - | 4 |
| Commercial and industrial | 1,780 | 1,812 | 1,413 | 32 | 9 |
| Consumer | - | - | - | - | - |
| Home equity | 346 | 409 | 347 | 3 | 1 |
| Total | \$ 10,342 | \$12,266 | \$10,873 | \$115 | \$95 |

The $\$ 10.3$ million of impaired loans include $\$ 8.8$ million of non-accrual loans. The remaining impaired loans are TDRs or loans for which the Company believes, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement.

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The following table presents a summary of information pertaining to impaired loans by segment as of and for the year ended December 31, 2014:

|  | Recorded <br> Investment <br> (In Thousands) | Unpaid <br> Balance | Average <br> Recorded <br> Investment | Related <br> Allowance | Interest <br> Income <br> Recognized |
| :--- | :--- | :--- | :--- | :--- | :--- |
| Impaired loans without a valuation <br> allowance: | $\$ 3,495$ | $\$ 3,617$ | $\$ 2,634$ | $\$-$ | $\$ 105$ |
| Residential real estate | - | - | - | - | - |
| Residential construction <br> Commercial real estate | 2,700 | 3,317 | 3,535 | - | 55 |
| Commercial construction | 2,395 | 3,934 | 3,270 | - | 111 |
| Commercial and industrial | 1,045 | 1,057 | 1,300 | - | 43 |
| Consumer | - | - | - | - | - |
| Home equity | 301 | 366 | 238 | - | 10 |
| Total | $\$ 9,936$ | $\$ 12,291$ | $\$ 10,977$ | $\$-$ | $\$ 324$ |


| Impaired loans with a valuation allowance: |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Residential real estate | \$611 | \$611 | \$859 | \$5 | \$32 |
| Residential construction | - | - | - | - | - |
| Commercial real estate | 809 | 809 | 694 | 65 | 23 |
| Commercial construction | - | - | - | - | - |
| Commercial and industrial | - | - | 47 | - | 1 |
| Consumer | - | - | - | - | - |
| Home equity | 47 | 47 | 65 | 3 | 1 |
| Total | \$ 1,467 | \$ 1,467 | \$ 1,665 | \$73 | \$57 |
| Total impaired loans: |  |  |  |  |  |
| Residential real estate | \$4,106 | \$4,228 | \$3,493 | \$5 | \$137 |
| Residential construction | - | - | - | - | - |
| Commercial real estate | 3,509 | 4,126 | 4,229 | 65 | 78 |
| Commercial construction | 2,395 | 3,934 | 3,270 | - | 111 |
| Commercial and industrial | 1,045 | 1,057 | 1,347 | - | 44 |
| Consumer | - | - | - | - | - |
| Home equity | 348 | 413 | 303 | 3 | 11 |
| Total | \$11,403 | \$13,758 | \$ 12,642 | \$73 | \$381 |

The $\$ 11.4$ million of impaired loans include $\$ 11.2$ million of non-accrual loans. The remaining impaired loans are TDRs or loans for which the Company believes, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement.

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The following table presents a summary of information pertaining to impaired loans by segment as of and for the three months ended March 31, 2014:

|  | Recorded Investment (In Thousan | Unpaid <br> Balance <br> ds) | Average Recorded Investment | Related <br> Allowance | Interest <br> Income <br> Recognized |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Impaired loans without a valuation allowance: |  |  |  |  |  |
| Residential real estate | \$2,640 | \$2,870 | \$2,088 | \$- | \$28 |
| Residential construction | - | - | - | - | - |
| Commercial real estate | 4,914 | 5,036 | 4,506 | - | 17 |
| Commercial construction | 4,098 | 4,098 | 3,993 | - | 46 |
| Commercial and industrial | 1,560 | 3,593 | 1,407 | - | 16 |
| Consumer | - | - | - | - | - |
| Home equity | 240 | 296 | 185 | - | 3 |
| Total | \$13,452 | \$15,893 | \$12,179 | \$- | \$110 |
| Impaired loans with a valuation allowance: |  |  |  |  |  |
| Residential real estate | \$525 | \$525 | \$824 | \$4 | \$7 |
| Residential construction | - | - | - | - | - |
| Commercial real estate | 1,444 | 1,444 | 846 | 140 | 3 |
| Commercial construction | - | - | - | - | - |
| Commercial and industrial | 114 | 114 | 116 | 10 | 1 |
| Consumer | - | - | - | - | - |
| Home equity | - | - | 81 | - | - |
| Total | \$2,083 | \$2,083 | \$1,867 | \$154 | \$11 |
| Total impaired loans: |  |  |  |  |  |
| Residential real estate | \$3,165 | \$3,395 | \$2,912 | \$4 | \$35 |
| Residential construction | - | - | - | - | - |
| Commercial real estate | 6,358 | 6,480 | 5,352 | 140 | 20 |
| Commercial construction | 4,098 | 4,098 | 3,993 | - | 46 |
| Commercial and industrial | 1,674 | 3,707 | 1,523 | 10 | 17 |
| Consumer | - | - | - | - | - |
| Home equity | 240 | 296 | 266 | - | 3 |
| Total | \$15,535 | \$17,976 | \$14,046 | \$154 | \$121 |

The $\$ 15.5$ million of impaired loans include $\$ 10.3$ million of non-accrual loans. The remaining impaired loans are TDRs or loans for which the Company believes, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement.

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Delinquency and Nonaccrual

All loan segments greater than 30 days past due are considered delinquent. The Company calculates the number of days past due based on a 30 day month. Management continuously monitors delinquency and nonaccrual levels and trends. It is the Company's policy to discontinue the accrual of interest on all loan classes when principal or interest payments are delinquent 90 days or more. The accrual of interest is also discontinued for impaired loans that are delinquent 90 days or more or at management's discretion.

All interest accrued, but not collected, for all loan classes, including impaired loans that are placed on nonaccrual or charged off, is reversed against interest income. Interest recognized on these loans is limited to interest payments received until qualifying for return to accrual. All loan classes are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

The following table presents an aging analysis of past due loans and non-accrual loans at March 31, 2015:

|  | $31-59$ <br> Days <br> Past Due <br> (In Thousands) | $60-89$ <br> Days <br> Past Due | 90 Days <br> or Greater <br> Past Due | Total <br> Past Due | Current | Total <br> Loans | Loans on <br> Nonaccrual |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Residential real estate | $\$ 2,078$ | $\$ 176$ | $\$ 807$ | $\$ 3,061$ | $\$ 117,035$ | $\$ 120,096$ | $\$ 4,239$ |
| Residential construction | - | - | - | - | 7,545 | 7,545 | - |
| Commercial real estate | 423 | 68 | 81 | 572 | 271,488 | 272,060 | 907 |
| Commercial construction | 396 | - | 1,483 | 1,879 | 35,089 | 36,968 | 2,167 |
| Commercial and industrial | 374 | 537 | 547 | 1,458 | 69,635 | 71,093 | 1,150 |
| Consumer | 20 | 32 | - | 52 | 2,509 | 2,561 | 32 |
| Home equity | 108 | - | 260 | 368 | 33,961 | 34,329 | 261 |
| Total | $\$ 3,399$ | $\$ 813$ | $\$ 3,178$ | $\$ 7,390$ | $\$ 537,262$ | $\$ 544,652$ | $\$ 8,756$ |

The following table presents an aging analysis of past due loans and non-accrual loans at December 31, 2014:

|  | 31-59 <br> Days <br> Past Due <br> (In Thous | 60-89 <br> Days <br> Past Due <br> nds) | 90 Days <br> or Greater <br> Past Due | Total <br> Past Due | Current | Total Loans | Loans on Nonaccrual |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Residential real estate | \$3,396 | \$542 | \$1,212 | \$5,150 | \$113,542 | \$118,692 | \$4,308 |
| Residential construction | - | - | - | - | 8,129 | 8,129 | - |
| Commercial real estate | 913 | - | 2,385 | 3,298 | 246,334 | 249,632 | 3,000 |
| Commercial construction | 550 | - | 1,558 | 2,108 | 33,678 | 35,786 | 2,396 |
| Commercial and industrial | 218 | 434 | 513 | 1,165 | 73,166 | 74,331 | 1,196 |
| Consumer | 28 | - | 13 | 41 | 2,621 | 2,662 | 32 |
| Home equity | 77 | 30 | 263 | 370 | 34,138 | 34,508 | 261 |
| Total | \$5,182 | \$1,006 | \$5,944 | \$ 12,132 | \$511,608 | \$523,740 | \$11,193 |

## Troubled Debt Restructuring (TDR)

TDR loans consist of loans where the Company, for economic or legal reasons related to the borrower's financial difficulties, granted a concession to the borrower that the Company would not otherwise consider. TDR loans can take the form of a reduction in the stated interest rate, receipts of assets from a debtor in partial or full satisfaction of a
loan, the extension of the maturity date, or the reduction of either the interest or principal. Once a loan has been identified as a TDR, it is classified as impaired and will continue to be reported as a TDR until the loan is paid in full.

In the normal course of business, the Company may modify a loan for a credit worthy borrower where the modified loan is not considered a TDR. In these cases, the modified terms are consistent with loan terms available to credit worthy borrowers and within normal loan pricing. The modifications to such loans are done according to existing underwriting standards which include review of historical financial statements, including current interim information if available, and an analysis of the borrower's performance and projections to assess repayment ability going forward.

During the three months ended March 31, 2015, the Company had no TDRs that had defaulted and had been modified within the previous twelve month period. During the three months ended March 31, 2014, the Company had one TDR totaling $\$ 201,000$ that had defaulted and had been modified within the previous twelve month period. TDR loans are considered defaulted at 90 days past due.

The Company did not have any new TDR activity during the three months ended March 31, 2015 and 2014.

The following is a summary of TDR loans by segment as of the dates indicated:

As of March 31, 2015
Number of Recorded
Loans Investment
(Dollars In Thousands)
Residential real estate
Residential construction
Commercial real estate
Commercial construction
Commercial and industrial
Consumer
Home equity
Total
$4 \quad \$ 862$
-
4
2
$4 \quad 128$
-
$1 \quad 33$
15
\$3,474

As of December 31, 2014
Number of Recorded
Loans Investment
4
\$865
-
4
575
2 2,108
4 141

1
15
33
\$3,722

## 8. Fair Value Measurements and Disclosures

Certain assets and liabilities are recorded at fair value to provide additional insight into the Company's quality of earnings. Some of these assets and liabilities are measured on a recurring basis while others are measured on a nonrecurring basis, with the determination based upon applicable existing accounting pronouncements. For example, available-for-sale securities are recorded at fair value on a recurring basis. Other assets, such as, mortgage servicing rights, loans held for sale, and impaired loans, are recorded at fair value on a nonrecurring basis using the lower of cost or market methodology to determine impairment of individual assets. The Company groups assets and liabilities which are recorded at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. Levels within the fair value hierarchy are based on the lowest level of input that is significant to the fair value measurement (with Level 1 considered highest and Level 3 considered lowest). A brief description of each level follows.

Level 1 - Valuation is based upon quoted prices for identical instruments in active markets.
Level 2 - Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant
assumptions are observable in the market.
Level 3 - Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates that market participants would use in pricing the asset or liability. Valuation includes use of discounted cash flow models and similar techniques.

The fair value methods and assumptions are set forth below.
Cash and cash equivalents. The carrying amounts of cash equivalents, due from banks and federal funds sold approximate their relative fair values. As such, the Company classifies these financial instruments as Level 1.

Held-to-maturity and non-marketable securities. The fair values of held-to-maturity securities are estimated by independent providers using matrix pricing and quoted market prices for similar securities. In obtaining such valuation information from third parties, the Company has evaluated their valuation methodologies used to develop the fair values in order to determine whether the valuations are representative of an exit price in the Company's principal markets. The Company's principal markets for its securities portfolios are the secondary institutional markets, with an exit price that is predominately reflective of bid level pricing in those markets. Fair values are calculated based on the value of one unit without regard to any premium or discount that may result from concentrations of ownership of a financial instrument, possible tax ramifications, or estimated transaction costs. If these considerations had been incorporated into the fair value estimates, the aggregate fair value could have been changed. The carrying values of non-marketable securities approximate fair values. As such, the Company classifies held-to-maturity and non-marketable securities as Level 2.

Available-for-sale securities. Fair value of securities are primarily measured using unadjusted information from an independent pricing service. The securities measured at fair value in Level 1 are based on quoted market prices in an active exchange market. These securities include marketable equity securities.

Loans. Fair values are estimated for portfolios of loans with similar financial characteristics. The fair values of performing loans are calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest risk inherent in the loan. The estimates of maturity are based on the Company's historical experience with repayments for each loan classification, modified, as required, by an estimate of the effect of current economic and lending conditions, and the effects of estimated prepayments. Assumptions regarding risk, cash flows, and discount rates are judgmentally determined using available market information and specific borrower information. Management has made estimates of fair value presented below that would be indicative of the value negotiated in an actual sale. As such, the Company classifies loans as level 3. Fair values of impaired loans are based on estimated cash flows and are discounted using a rate commensurate with the risk associated with the estimated cash flows, or if collateral dependent, discounted to the appraised value of the collateral, less costs to sell.

Loans held for sale. Loans held for sale are recorded at the lower of carrying value or fair value. The fair value of mortgage loans held for sale is based on what secondary markets are currently offering for portfolios with similar characteristics. As such, the Company classifies loans held for sale as nonrecurring Level 2.

Other real estate owned ("OREO"). Real estate acquired through foreclosure is recorded at fair value. The fair value of OREO is based on property appraisals and an analysis of similar properties currently available. As such, the Company records OREO as nonrecurring Level 2.

Mortgage servicing rights. Mortgage servicing rights represent the value associated with servicing residential mortgage loans. Servicing assets and servicing liabilities are reported using the amortization method and compared to fair value for impairment. In evaluating the fair values of the mortgage servicing rights, the Company obtains third party valuations based on loan level data including note rate, type and term of the underlying loans. As such, the Company classifies mortgage servicing rights as Level 2.

Accrued interest and dividends receivable. The fair value estimate of this financial instrument approximates the carrying value as this financial instrument has a short maturity. It is the Company's policy to stop accruing interest on loans for which it is probable that the interest is not collectable. Therefore, this financial instrument has been adjusted for estimated credit loss. As such, the Company classifies accrued interest and dividends receivable as Level 2.

Deposits. The fair value of deposits is based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar remaining maturities. The fair value estimates do not
include the benefit that results from the low-cost funding provided by the deposits compared to the cost of borrowing funds in the market. If that value were considered, the fair value of the Company's net assets could increase. As such, the Company classifies deposits as Level 2.
Borrowed funds. The fair value of borrowed funds is based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently available for borrowings of similar remaining maturities. As such, the Company classifies borrowed funds as Level 2.
Accrued interest payable. The fair value estimate approximates the carrying amount as this financial instrument has a short maturity. As such, the Company classifies accrued interest payable as Level 2.

Off-balance-sheet instruments. Off-balance-sheet instruments include loan commitments. Fair values for loan commitments have not been presented as the future revenue derived from such financial instruments is not significant.

Limitations. Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These values do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on Management's judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect these estimates. Fair value estimates are based on existing on- and off-balance-sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Other significant assets and liabilities that are not considered financial instruments include the deferred tax asset, premises and equipment, and OREO. In addition, tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates.

Assets measured at fair value as of March 31, 2015 and December 31, 2014 on a recurring basis are summarized below:
Fair Value Measurements Using
Readily
Available
March 31, 2015

| Market |
| :--- |
| Prices |
| (Level 1) | | Observable |
| :--- |
| Market Data |
| (Level 2) |$\quad$| Determined |
| :--- |
| (Dair Value |
| (Level 3) |

Fair Value Measurements Using

Readily
December 31,
Available

2014 $\quad$\begin{tabular}{lll}
Market \& Observable \& Determined <br>
Prices <br>
(Level 1)

$\quad$

Market Data <br>
(Level 2)

$\quad$

Fair Value <br>
(Level 3)
\end{tabular}

Available-for-sale securities:
Equity securities by industry type:

| Financial | $\$ 414$ | $\$ 414$ | $\$-$ | $\$-$ |
| :---: | :---: | :---: | :---: | :---: |
| Total equity securities | $\$ 414$ | $\$ 414$ | $\$-$ | $\$-$ |

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Assets measured at fair value on a nonrecurring basis as of March 31, 2015 and December 31, 2014 are summarized below:

| Fair Value Measurements Using |  |  |  |
| :--- | :--- | :--- | :--- |
|  | Readily |  |  |
| March 31, | Available | Observable | Determined |
| 2015 | Market | Market Data | Fair Value |
|  | Prices | (Level 2) | (Level 3) |
| (Level 1) |  |  |  |
| (Dollars In Thousands) |  |  |  |

Assets

| Impaired loans | $\$ 5,454$ | $\$-$ | $\$-$ | $\$ 5,454$ |
| :--- | :--- | :--- | :--- | :--- |
| Other real estate owned | 865 | - | 865 | - |
| Loans held for sale | 217 | - | 217 | - |

Impaired loans are presented net of their related specific reserves of $\$ 115,000$ and charge offs of $\$ 1.9$ million as of March 31, 2015.

Fair Value Measurements Using
Readily
December 31, Available Observable Determined 2014

Market Market Data Fair Value
Prices (Level 2) (Level 3)
(Level 1)
(Dollars In Thousands)
Assets

| Impaired loans | $\$ 5,184$ | $\$-$ | $\$-$ | $\$ 5,184$ |
| :--- | :--- | :--- | :--- | :--- |
| Other real estate owned | 1,050 | - | 1,050 | - |

Impaired loans are presented net of their related specific reserves of $\$ 73,000$ and charge offs of $\$ 2.3$ million as of December 31, 2014.

## Fair Value of Financial Instruments

Accounting Standards Codification ("ASC") Topic 825, "Financial Instruments," requires disclosures of fair value information about financial instruments, whether or not recognized in the statement of financial condition, if the fair values can be reasonably determined. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instrument's. In cases where quoted prices are not available, fair values are based on estimates using present value or other valuation techniques using observable inputs when available. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. FASB ASC Topic 825 excludes certain financial instruments and all non-financial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company.

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The carrying amounts and estimated fair values for financial instruments as of March 31, 2015 and December 31, 2014 were as follows:

Financial assets:
Cash and cash equivalents
Available-for-sale securities
Held-to-maturity securities
FHLB stock
Loans:
Residential real estate
Residential construction
Commercial real estate
Commercial construction
Commercial and industrial
Consumer
Home equity
Net loans
Loans held for sale
Accrued interest and dividends receivable
Mortgage servicing rights
$\$ 50,716$
399
33,424 - 399

| $\$ 50,716$ | $\$ 50,716$ | $\$-$ | $\$-$ |
| :--- | :--- | :--- | :--- |
| 399 | 399 | - | - |
| 33,424 | - | 34,208 | - |
| 4,292 | - | 4,292 | - |

4,292 - $\quad$ -

Financial liabilities:
Deposits
FHLB advances
Accrued interest payable
\$488,706
83,537
98

Fair Value Using
Readily

| Carrying Amount | Available | Observable | Determined |
| :--- | :--- | :--- | :--- |
| at March 31, | Market | Market Data | Fair Value |
| 2015 | Prices | (Level 2) | (Level 3) |
|  | (Level 1) |  |  |

(Dollars In Thousands)

| 120,172 | - | - | 122,858 |
| :--- | :--- | :--- | :--- |
| 7,445 | - | - | 7,432 |
| 269,448 | - | - | 271,356 |
| 36,317 | - | - | 36,565 |
| 70,243 | - | - | 70,480 |
| 2,525 | - | - | 2,720 |
| 34,177 | - | - | 34,269 |
| 540,327 | - | - | 545,680 |

217 - $\quad 217$ -
1,651 - $\quad 1,651 \quad-$
242 - 521 -

26

|  | Fair Value Using |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | Carrying Amount at December 31, 2014 <br> (Dollars In Thous | Readily <br> Available Market Prices (Level 1) ands) | Observable <br> Market Data <br> (Level 2) | Determined Fair Value (Level 3) |
| Financial assets: |  |  |  |  |
| Cash and cash equivalents | \$49,769 | \$49,769 | \$- | \$- |
| Available-for-sale securities | 414 | 414 | - | - |
| Held-to-maturity securities | 33,747 | - | 34,229 | - |
| FHLB stock | 3,914 | - | 3,914 | - |
| Loans: |  |  |  |  |
| Residential real estate | 118,837 | - | - | 121,296 |
| Residential construction | 8,022 | - | - | 8,008 |
| Commercial real estate | 247,246 | - | - | 248,316 |
| Commercial construction | 35,218 | - | - | 35,463 |
| Commercial and industrial | 73,452 | - | - | 73,668 |
| Consumer | 2,627 | - | - | 2,804 |
| Home equity | 34,355 | - | - | 34,453 |
| Net loans | 519,757 | - | - | 524,008 |
| Loans held for sale | - | - | - | - |
| Accrued interest and dividends receivable | 1,591 | - | 1,591 | - |
| Mortgage servicing rights | 269 | - | 622 | - |
| Financial liabilities: |  |  |  |  |
| Deposits | \$483,558 | \$- | \$484,423 | \$- |
| FHLB advances | 67,039 | - | 67,644 | - |
| Accrued interest payable | 82 | - | 82 | - |

## 9. Common Stock

On June 1, 2012, the Company announced that the Board of Directors authorized a Seventh Stock Repurchase Program for the purchase of up to 272,000 shares, or approximately $5 \%$, of the Company's then outstanding common stock. As of March 31, 2015, a total of 60,731 shares may be repurchased under the current stock repurchase program. The Company may repurchase its shares from time to time at prevailing prices in the open market, in block transactions or in privately negotiated transactions. Repurchases are made under rule 10b-5(1) repurchase plans. The repurchased shares are held by the Company as treasury stock and are available for general corporate purposes.

## 10. Subsequent Events

Subsequent events represent events or transactions occurring after the statements of financial condition date but before the financial statements are issued or are available to be issued. Financial statements are considered "issued" when they are widely distributed to shareholders and others for general use and reliance in a form and format that complies with GAAP. Financial statements are considered "available to be issued" when they are complete in form and format that complies with GAAP and all approvals necessary for their issuance have been obtained.

The Company is a Securities and Exchange Commission filer and management has evaluated subsequent events through the date that the financial statements were issued. On April 24, 2015, the Company announced a quarterly cash dividend of $\$ 0.07$ per share of its common stock to stockholders of record as of the close of business on May 8, 2015, payable on or about May 22, 2015.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.
The following analysis discusses changes in the financial condition and results of operations of Chicopee Bancorp Inc. ("the, Company") at March 31, 2015 and December 31, 2014 and for the three months ended March 31, 2015 and 2014, and should be read in conjunction with the Company's Unaudited Consolidated Financial Statements and the notes thereto, appearing in Part I, Item 1 of this document.

## Forward-Looking Statements

This Form 10-Q contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The Company intends such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and is including this statement for purposes of these safe harbor provisions. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies and expectations of the Company, are generally identified by use of the words "believe," "expect," "intend," "anticipate," "estimate," "project" or similar expressions. The Company's ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors which could have a material adverse effect on the operations of the Company include, but are not limited to: changes in interest rates, general economic conditions, legislative/regulatory changes, monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board, the quality or composition of the loan or investment portfolios, demand for loan products, deposit flows, competition, demand for financial services in the Company's market area and accounting principles and guidelines. Additional factors are discussed in the Company's 2014 Annual Report on Form 10-K under "Item 1A-Risk Factors" and in "Part II. Item 1A. Risk Factors" of this 10-Q. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements.

Except as required by law, the Company does not undertake - and specifically disclaims any obligation - to publicly release the result of any revisions which may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

## General

Chicopee Savings Bank ("the Bank"), a subsidiary of the Company, is a community-oriented financial institution dedicated to serving the financial services needs of consumers and businesses within its market area. We attract deposits from the general public and use such funds to originate primarily one- to four-family residential real estate loans, commercial real estate loans, commercial loans, multi-family loans, construction loans and consumer loans. At March 31, 2015, we operated out of our main office, lending and operations center, and eight branch offices located in Chicopee, Ludlow, South Hadley, Ware, and West Springfield. All of our offices are located in Western Massachusetts.

## CRITICAL ACCOUNTING POLICIES

Management's discussion and analysis of the Company's financial condition is based on the consolidated financial statements which are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The preparation of such financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On an ongoing basis, Management evaluates its estimates, including those related to the allowance for loan losses, other-than-temporary impairment of securities, the valuation of mortgage servicing rights, and the valuation of other real estate owned. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis in making judgments about the carrying values of assets that are not readily apparent from other sources. Actual results could differ from the amount derived from management's estimates and assumptions under different
assumptions or conditions. Our accounting policies are more fully described in Note 1 in the "Notes to Consolidated Financial Statements" presented in our 2014 Annual Report on Form 10-K. A brief description of our current accounting policies involving significant management judgment are discussed in the Company's 2014 Annual Report on Form 10-K under "Critical Accounting Policies."

Comparison of Financial Condition at March 31, 2015 and December 31, 2014
Total assets increased $\$ 21.6$ million, or $3.4 \%$, from $\$ 639.2$ million at December 31, 2014 to $\$ 660.8$ million at March 31, 2015. The increase in total assets was primarily due to the increase in cash and cash equivalents of $\$ 947,000$, or $1.9 \%$, and an increase in net loans of $\$ 20.6$ million, or $4.0 \%$, from $\$ 519.8$ million, or $81.3 \%$ of total assets at December 31, 2014, to $\$ 540.3$ million, or $81.8 \%$ of total assets at March 31, 2015, partially offset by a decrease in held-to-maturity securities of $\$ 323,000$, or $1.0 \%$, to $\$ 33.4$ million at March 31, 2015.

The significant components of the $\$ 20.6$ million, or $4.0 \%$, increase in net loans were an increase of $\$ 22.4$ million, or $9.0 \%$, in commercial real estate loans, an increase of $\$ 1.4$ million, or $1.2 \%$, in one-to-four-family residential real estate loans, and an increase of $\$ 598,000$, or $1.4 \%$, in construction loans. These increases were partially offset by a decrease in commercial and industrial loans of $\$ 3.2$ million, or $4.4 \%$, a decrease of $\$ 101,000$, or $3.8 \%$, in consumer loans and a decrease of $\$ 179,000$, or $0.5 \%$, in home equity loans. The increase in commercial real estate loans was due to the funding of outstanding loan commitments. In accordance with the Company's asset/liability management strategy and in an effort to reduce interest rate risk, the Company continues to sell fixed rate, low coupon residential real estate loans to the secondary market. The Company currently services $\$ 89.0$ million in loans sold to the secondary market. In order to service our customers management intends to continue to retain the servicing rights on all loans written and sold in the secondary market.

The held-to-maturity investment portfolio decreased $\$ 323,000$, or $1.0 \%$, from $\$ 33.7$ million at December 31, 2014 to $\$ 33.4$ million at March 31, 2015. The fair value of available-for-sale securities decreased $\$ 15,000$, or $3.6 \%$, from $\$ 414,000$, at December 31, 2014 to $\$ 399,000$, at March 31, 2015.

Total deposits increased $\$ 5.1$ million, or $1.1 \%$, from $\$ 483.6$ million at December 31, 2014 to $\$ 488.7$ million at March 31, 2015. Core deposits, which we consider to include all deposits except for certificates of deposit, decreased $\$ 5.5$ million, or $1.8 \%$, from $\$ 311.9$ million at December 31, 2014 to $\$ 306.4$ million at March 31, 2015. Demand deposits decreased $\$ 1.7$ million, or $1.8 \%$, to $\$ 96.2$ million, money market accounts decreased $\$ 6.4$ million, or $5.3 \%$, to $\$ 114.7$ million, NOW accounts increased $\$ 356,000$, or $0.8 \%$, to $\$ 42.5$ million, and savings accounts increased $\$ 2.3$ million, or $4.6 \%$, to $\$ 53.0$ million. Certificates of deposit increased $\$ 10.6$ million, or $6.2 \%$, from $\$ 171.6$ million at December 31, 2014 to $\$ 182.3$ million at March 31, 2015. The decrease of $1.8 \%$ in core deposits was mostly due to fluctuations in commercial accounts related to seasonal business activity and the decrease in money market accounts.

The Company utilizes borrowings from a variety of sources to supplement its supply of funds for loans and investments. FHLB advances increased $\$ 16.5$ million, or $24.6 \%$, from $\$ 67.0$ million at December 31, 2014 to $\$ 83.5$ million at March 31, 2015. The increase in FHLB advances was due to the $\$ 23.5$ million increase in long-term advances, partially offset by paydowns of $\$ 7.0$ million on long-term advances.

Stockholders' equity was $\$ 88.2$ million, or $13.3 \%$ of total assets, at March 31, 2015, compared to $\$ 88.1$ million, or $13.8 \%$ of total assets, at December 31, 2014. The Company's stockholders' equity increased due to net income of $\$ 313,000$ for the three months ended March 31, 2015, $\$ 146,000$ in additional paid-in capital and earned compensation related to stock-based compensation, partially offset by the $\$ 369,000$ cash dividend paid on February 19, 2015. The Company's book value per share increased $\$ 0.02$, or $0.1 \%$, from $\$ 16.72$ at December 31, 2014 to $\$ 16.74$ at March 31, 2015.

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Following is the activity in the allowance for loan losses and related ratios as of and for the periods indicated:
At or for the Three Months Ended March 31,
$2015 \quad 2014$
(Dollars In Thousands)
Allowance for loan losses, beginning of period:
Charged off loans:

| Residential real estate | $(85$ | $)$ | $(233$ |  |
| :--- | :--- | :--- | :--- | :--- |
| Construction | - | - |  |  |
| Commercial real estate | $(3$ | $)$ |  |  |
| Commercial | $(53$ | $)$ | $(2,033$ | $)$ |
| Home equity | - | $(56$ | $)$ |  |
| Consumer | $(11$ | $)$ | $(19$ | $)$ |
| $\quad$ Total charged off loans | $(152$ | $)$ | $(2,341$ |  |

Recoveries on loans previously charged off:
Residential real estate
Construction
Commercial real estate
Commercial
Home equity
Consumer
Total recoveries
Net loan charge offs
Provision for loan losses
Allowance for loan losses, end of period
Ratios:

| Net loan charge offs to total average loans | 0.03 | $\%$ | 0.48 |
| :--- | :--- | :--- | :--- |
| Allowance for loan losses to total loans (1) | 0.95 | $\%$ | 0.91 |

(1) Total loans includes net loans plus the allowance for loan losses, excludes deferred loan origination costs.

Nonperforming loans consist of all loans 90 days or more past due and other loans which have been identified by the Company as presenting uncertainty with respect to the collectability of interest or principal. At March 31, 2015, the Company had fifteen troubled debt restructured loans totaling $\$ 3.5$ million, of which ten totaling $\$ 3.0$ million
(2) were included in nonperforming loans. Five of the fifteen restructured loans totaling $\$ 490,000$ were performing as modified. At March 31, 2014, the Company had twelve troubled debt restructured loans totaling $\$ 1.3$ million, of which eight totaling $\$ 832,000$ were included in nonperforming loans. Four of the twelve restructured loans totaling $\$ 496,000$ were performing as modified.

Analysis and determination of the allowance for loan losses. The allowance for loan losses is a valuation allowance for probable and estimable credit losses inherent in the loan portfolio. Management evaluates the need to establish allowances against losses on loans on a quarterly basis. When additional allowances are necessary, a provision for loan losses is charged to earnings. The allowance for loan losses is maintained at an amount that management considers appropriate to cover inherent, probable and estimable losses in the loan portfolio.

Our methodology for assessing the appropriateness of the allowance for loan losses consists of: (1) a specific allowance on identified problem loans; and (2) a general valuation allowance on the remainder of the loan portfolio. Although we determine the amount of each element of the allowance separately, the entire allowance for loan losses is available for the entire portfolio. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

Specific allowance required for identified problem loans. The allocated component of the allowance for loan losses relates to loans that are classified as impaired. Impairment is measured on a loan by loan basis for residential real estate, home equity loans, commercial real estate and commercial loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. An allowance is established when the discounted cash flows or collateral value of the impaired loan is lower than the carrying value of that loan. The Company recognizes the change in present value attributable to the passage of time as provision for loan losses. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment, and the resulting allowance is reported as the general component, as described above.

General valuation allowance on the remainder of the loan portfolio. The Company establishes a general allowance for loans that are not delinquent. If not all delinquent loans are impaired, then some delinquent loans are in the general pool. This general valuation allowance is determined by segregating the loans by loan segment and assigning percentages to each segment. The percentages are adjusted for significant factors that, in management's judgment, affect the collectability of the portfolio as of the evaluation date. These significant factors include: levels and historical trends in delinquencies, impaired loans, nonaccrual loans, charge-offs, recoveries, and classified assets; trends in the volume and terms of loans; effects of any change in underwriting, policies, procedures, and practices; experience, ability, and depth of management and staff; national and local economic trends and conditions; trends and conditions in the industries in which borrowers operate; and effects of changes in credit concentrations. The applied loss factors are reevaluated quarterly to ensure their relevance in the current economic environment.

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

The allowance for loan losses is based on management's estimate of the amount required to reflect the potential inherent losses in the loan portfolio, based on circumstances and conditions known or anticipated at each reporting date. There are inherent uncertainties with respect to the collectability of the Company's loans and it is reasonably possible that actual loss experience in the near term may differ from the amounts reflected in this report.

At March 31, 2015, the allowance for loan losses represented $0.95 \%$ of total loans and $59.2 \%$ of nonperforming loans. The allowance for loan losses increased $\$ 257,000$, or $5.2 \%$, from $\$ 4.9$ million at December 31, 2014 to $\$ 5.2$ million at March 31, 2015. The increase of $\$ 257,000$ was due to the $\$ 400,000$ provision for loan losses, offset by net charge-offs of $\$ 143,000$.

For the three months ended March 31, 2015, the provision for loan losses decreased $\$ 1.8$ million from $\$ 2.2$ million, for the three months ended March 31, 2014 to $\$ 400,000$. The provision for loan losses of $\$ 2.2$ million for the three months ended March 31, 2014 was due to the $\$ 2.0$ million loan charge-off previously disclosed. Of the $\$ 400,000$ provision for loan losses for the three months ended March 31, 2015, $\$ 215,000$, or $53.8 \%$, was due to the $\$ 20.9$ million, or $4.0 \%$, increase in total loans from $\$ 523.7$ million at December 31, 2014 to $\$ 544.7$ million at March 31, 2015, $\$ 42,000$ was due to the increase in specific reserves and $\$ 143,000$ was due to net charge-offs.

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Nonperforming Assets
The following table sets forth information regarding nonaccrual loans and other real estate owned at the dates indicated:

March 31, 2015
December 31, 2014
(Dollars In Thousands)
Nonaccrual loans (3):
Residential real estate
Commercial real estate
Commercial construction
Commercial and industrial
Home equity
Consumer
Total nonaccrual loans
Other real estate owned
Total nonperforming assets
\$4,239
\$4,308
907
3,000
2,167 2,396
$1,150 \quad 1,196$
$261 \quad 261$
$32 \quad 32$
8,756 11,193
$865 \quad 1,050$

Ratios:
Total nonperforming loans as a percentage of total loans (1)
Total nonperforming assets as a percentage of total assets (2)
\$12,243
(1) Total loans equals net loans plus the allowance for loan losses, excludes deferred loan origination costs. Nonperforming assets consist of nonperforming loans including nonperforming TDRs and OREO. Nonperforming
(2)loans consist of all loans 90 days or more past due and other loans which have been identified by the Company as presenting uncertainty with respect to the collectability of interest or principal.
Loans are placed on nonaccrual status either when reasonable doubt exists as to the timely collection of principal
(3) and interest or when a loan becomes 90 days past due unless an evaluation clearly indicates that the loan is well-secured and in the process of collection. At March 31, 2015, there were no loans that were over 90 days delinquent and still accruing interest.

At March 31, 2015, nonperforming loans decreased $\$ 2.4$ million, or $21.8 \%$, to $\$ 8.8$ million compared to $\$ 11.2$ million at December 31, 2014. The decrease in nonperforming loans is primarily due to the decrease of $\$ 2.1$ million, or $69.8 \%$ in commercial real estate loans, a decrease of $\$ 229,000$, or $9.6 \%$, in commercial construction loans, a decrease of $\$ 69,000$, or $1.6 \%$, in residential real estate loans, and a decrease of $\$ 46,000$, or $3.8 \%$ in commercial and industrial loans. The decrease in nonperforming commercial real estate loans was due to the sale of the underlying collateral of a $\$ 2.5$ million commercial loan relationship previously disclosed. Proceeds from the sale of collateral were used to pay off the loan without any additional write-downs. Loans that are less than 90 days past due and were previously on nonaccrual continue to be on nonaccrual status until all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. At March 31, 2015, other real estate owned decreased $\$ 185,000$, or $17.6 \%$, to $\$ 865,000$ compared to $\$ 1.1$ million at December 31, 2014.

Asset quality continues to be the top focus for management and we continue to proactively work to resolve problem loans as they arise. Management continues to monitor the loan portfolio to minimize any further deterioration in the collateral that could result in future losses.

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Deposits
The following table sets forth the Company's deposit accounts at the dates indicated:


Total deposits increased $\$ 5.1$ million, or $1.1 \%$, from $\$ 483.6$ million at December 31, 2014 to $\$ 488.7$ million at March 31, 2015. Core deposits, which we consider to include all deposits except for certificates of deposit, decreased $\$ 5.5$ million, or $1.8 \%$, from $\$ 311.9$ million at December 31, 2014 to $\$ 306.4$ million at March 31, 2015. Demand deposits decreased $\$ 1.7$ million, or $1.8 \%$, to $\$ 96.2$ million, money market accounts decreased $\$ 6.4$ million, or $5.3 \%$, to $\$ 114.7$ million, NOW accounts increased $\$ 356,000$, or $0.8 \%$, to $\$ 42.5$ million, and savings accounts increased $\$ 2.3$ million, or $4.6 \%$, to $\$ 53.0$ million. Certificates of deposit increased $\$ 10.6$ million, or $6.2 \%$, from $\$ 171.6$ million at December 31, 2014 to $\$ 182.3$ million at March 31, 2015. The decrease of $1.8 \%$ in core deposits was mostly due to fluctuations in commercial accounts related to seasonal business activity and the decrease in money market accounts.

Comparison of Operating Results for the Three Months Ended March 31, 2015 and 2014

## General

The Company reported net income of $\$ 313,000$, or $\$ 0.06$ earnings per share, for the three months ended March 31, 2015, compared to a net loss of $\$ 1.4$ million, or $\$ 0.27$ loss per share, for the same period in 2014. The increase in net income for the three months ended March 31, 2015 compared to the three months ended March 31, 2014, was the result of a $\$ 1.8$ million, or $81.8 \%$, decrease in the provision for loan losses, an increase of $\$ 327,000$, or $7.0 \%$ in net interest income and an increase of $\$ 53,000$, or $9.0 \%$, in non-interest income, partially offset by an increase of $\$ 252,000$, or $5.5 \%$, in non-interest expense and an increase of $\$ 257,000$, or $146.9 \%$, in income tax expense due to the higher level of taxable income during the three months ended March 31, 2015.

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

The following table sets forth average balances, interest income and expense and yields earned or rates paid on the major categories of assets and liabilities for the periods indicated. The average yields and costs are derived by
dividing interest income or expense by the average balance of interest-earning assets or interest-bearing liabilities, respectively. The yields and costs are annualized. Average balances are derived from average daily balances. The yields and costs include fees which are considered adjustments to yields. Loan interest and yield data does not include any accrued interest from non-accruing loans.


Municipal securities income and net interest income are presented on a tax equivalent basis using a tax rate of $41 \%$. (1) The tax equivalent adjustment is deducted from the tax equivalent net interest income to agree to the amount reported on the statement of operations. See 'Explanation of Use of Non-GAAP Financial Measurements'.
(2) Total loans excludes loans held for sale and includes nonperforming loans.
(3) Savings accounts include mortgagors' escrow deposits.

Tax equivalent interest rate spread represents the difference between the weighted average yield on interest-earning (4) assets and the weighted average cost of interest-bearing liabilities. See 'Explanation of Use of Non-GAAP Financial Measurements'.
(5) Tax equivalent net interest margin represents tax equivalent net interest income divided by total average ${ }^{5)}$ interest-earning assets.

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Net interest income, on a tax equivalent basis, increased $\$ 312,000$, or $6.3 \%$, to $\$ 5.3$ million for the three months ended March 31, 2015, compared to the three months ended March 31, 2014. Net interest margin, on a tax equivalent basis, decreased 12 basis points from $3.64 \%$ for the three months ended March 31, 2014 to $3.52 \%$ for the three months ended March 31, 2015.

Interest and dividend income, on a tax equivalent basis, increased $\$ 361,000$, or $6.1 \%$, from $\$ 5.9$ million for the three months ended March 31, 2014 to $\$ 6.2$ million for the three months ended March 31, 2015. Average interest-earning assets increased $\$ 54.9$ million, or $9.9 \%$, from $\$ 552.5$ million at March 31, 2014 to $\$ 607.4$ million at March 31, 2015. Average loans increased $\$ 46.8$ million, or $9.6 \%$, primarily due to the increase in average commercial real estate loans of $\$ 48.7$ million, or $23.0 \%$. Average investment securities decreased $\$ 10.1$ million, or $20.9 \%$, for the period due to the maturities in the U.S. Treasury and certificate of deposit investment portfolio. Other interest earning assets, consisting of overnight fed funds, increased $\$ 18.2$ million, or $117.0 \%$. The tax equivalent yield on average interest-earning assets decreased 15 basis points to $4.17 \%$ for the three months ended March 31, 2015, primarily as a result of lower market rates of interest.

Total interest expense increased $\$ 49,000$, or $5.3 \%$, to $\$ 976,000$ for the three months ended March 31, 2015 from $\$ 927,000$ for the three months ended March 31, 2014, due to the $\$ 50,000$, or $23.5 \%$, increase in other borrowed funds. Average interest-bearing liabilities decreased $\$ 54.0$ million, or $13.3 \%$, to $\$ 459.6$ million for the three months ended March 31, 2015 from $\$ 405.6$ million for the three months ended March 31, 2014. Rates paid on average interest-bearing liabilities declined seven basis points from $0.93 \%$ for the three months ended March 31, 2014 to $0.86 \%$ for the three months ended March 31, 2015. The lower interest rate environment led to a decrease in rates paid for certificates of deposit of 13 basis points from $1.38 \%$ at March 31, 2014 to $1.25 \%$ for the three months ended March 31, 2015. The cost of FHLB advances decreased 25 basis points from $1.77 \%$ for the three months ended March 31, 2014 to $1.52 \%$ for the three months ended March 31, 2015.

Provision for Loan Losses
The provision for loan losses decreased $\$ 1.8$ million, or $81.8 \%$, from $\$ 2.2$ million for the three months ended March 31, 2014 to $\$ 400,000$ for the three months ended March 31, 2015. For the three months ended March 31, 2015, net charge-offs decreased $\$ 2.2$ million from $\$ 2.3$ million, or $0.48 \%$ of total average loans, for the three months ended March 31, 2014, to $\$ 143,000$, or $0.03 \%$ of total average loans. Nonperforming loans decreased $\$ 1.6$ million, or $15.3 \%$, from $\$ 10.3$ million, or $2.14 \%$ of total loans, at March 31, 2014, to $\$ 8.8$ million, or $1.61 \%$ of total loans, at March 31, 2015. The allowance for loan losses as a percentage of total loans increased from $0.91 \%$ at March 31, 2014 to $0.95 \%$ at March 31, 2015. The allowance for loan losses as a percentage of nonperforming loans increased from $43.2 \%$ at March 31, 2014 to 59.2\% at March 31, 2015.

## Non-Interest Income

Non-interest income increased $\$ 53,000$, or $9.0 \%$, from $\$ 589,000$ for the three months ended March 31, 2014 to $\$ 642,000$ for the three months ended March 31, 2015. The increase was due to the $\$ 82,000$, or $100.0 \%$, decrease in net losses on the sale of OREO and an increase of $\$ 19,000$, or $3.8 \%$, in income from service charges, fees and commissions, partially offset by a decrease of $\$ 34,000$, or $100.0 \%$, in gain on the sale of available-for-sale securities and a decrease of $\$ 14,000$, or $26.4 \%$, in income from loan sales and servicing.

## Non-Interest Expenses

Non-interest expense increased $\$ 252,000$, or $5.5 \%$, to $\$ 4.9$ million for the three months ended March 31, 2015 compared to $\$ 4.6$ million the three months ended March 31, 2014. The increase in non-interest expense was a result of
the $\$ 79,000$, or $98.8 \%$, increase in foreclosure related expenses, an increase in occupancy expense of $\$ 27,000$, or $6.0 \%$, due to the increased cost of snow removal during the three months ended March 31, 2015, an increase in FDIC insurance expense of $\$ 39,000$, or $46.4 \%$, an increase in data processing of $\$ 20,000$, or $5.8 \%$, an increase in salaries and benefits of $\$ 19,000$, or $0.8 \%$, an increase in other non-interest expense of $\$ 81,000$, or $14.7 \%$, and an increase in stationary, supplies and postage of $\$ 15,000$, or $25.0 \%$. These increases were partially offset by the decrease in advertising expense of $\$ 24,000$, or $14.2 \%$, a decrease of $\$ 2,000$, or $1.1 \%$, in professional fees and a decrease in furniture and equipment of $\$ 2,000$, or $1.1 \%$,

Income Taxes
Income tax expense increased from a tax benefit of $\$ 175,000$ for the three months ended March 31, 2014 to a tax expense of $\$ 82,000$ for the three months ended March 31, 2015. The tax expense was the result of a higher level of taxable income during the three months ended March 31, 2015 compared to the three months ended March 31, 2014.

## Explanation of Use of Non-GAAP Financial Measurements

We believe that it is common practice in the banking industry to present interest income and related yield information on tax exempt securities on a tax-equivalent basis and that such information is useful to investors because it facilitates comparisons among financial institutions. However, the adjustment of interest income and yields on tax exempt securities to a tax equivalent amount may be considered to include financial information that is not in compliance with GAAP. A reconciliation from GAAP to non-GAAP is provided below.

|  | Three Months Ended March 31, 2015 2014 <br> (Dollars in Thousands) |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  |  |  |  |  |
|  | Interest | Average Yield |  | Interest | Average Yield |  |
| Investment securities (no tax adjustment) | \$376 | 4.02 | \% | \$411 | 3.47 | \% |
| Tax equivalent adjustment (1) | 243 |  |  | 258 |  |  |
| Investment securities (tax equivalent basis) | \$619 | 6.62 | \% | \$669 | 5.65 | \% |
| Net interest income (no tax adjustment) | \$5,023 |  |  | \$4,696 |  |  |
| Tax equivalent adjustment (1) | 243 |  |  | 258 |  |  |
| Net interest income (tax equivalent basis) | \$5,266 |  |  | \$4,954 |  |  |
| Interest rate spread (no tax adjustment) |  | 3.15 | \% |  | 3.20 | \% |
| Net interest margin (no tax adjustment) |  | 3.35 | \% |  | 3.45 | \% |

(1) The tax equivalent adjustment is based on a combined federal and state tax rate of $41 \%$ for all periods presented.

## Liquidity Management

Liquidity is the ability to meet current and future financial obligations of a short-term nature. Our primary sources of funds consist of deposit inflows, loan repayments, maturities and sales of securities, borrowings from the FHLB and securities sold under agreements to repurchase. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit flows and loan prepayments are greatly influenced by general interest rates, economic conditions and competition. Prepayment rates can have a significant impact on interest income. Because of the large percentage of loans we hold, rising or falling interest rates have a significant impact on the prepayment speeds of our earning assets that, in turn, affect the rate sensitivity position. When interest rates rise, prepayments tend to slow. When interest rates fall, prepayments tend to rise. Our asset sensitivity would be reduced if prepayments slow and vice versa. While we believe these assumptions to be reasonable, there can be no assurance that assumed prepayment rates will approximate actual loan repayment activity. Our short-term securities primarily consist of U.S. Treasury and government agencies, which we use primarily for collateral purposes for sweep accounts maintained by commercial customers. The balances of these securities fluctuate as the aggregate balance of our sweep accounts fluctuate.

We regularly adjust our investments in liquid assets based upon our assessment of: (1) expected loan demands; (2) expected deposit flows; (3) yields available on interest-earning deposits and securities; and (4) the objectives of our asset/liability management policy.

Our most liquid assets are cash and cash equivalents. The levels of these assets depend on our operating, financing, lending and investing activities during any given period. At March 31, 2015, total cash and cash equivalents totaled $\$ 50.7$ million, net of reserve requirements.

In addition, at March 31, 2015, the Company had the ability to borrow a total of approximately $\$ 138.1$ million from the FHLB. On March 31, 2015, we had $\$ 83.5$ million of such borrowings outstanding. The Company's unused borrowing capacity with the Federal Reserve Bank of Boston was approximately $\$ 52.6$ million at March 31, 2015. In addition, we had the following available lines of credit to use as contingency funding sources: $\$ 4.0$ million with Banker's Bank Northeast and available Fed Funds to purchase of $\$ 3.0$ million.

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Certificates of deposit due within one year of March 31,2015 totaled $\$ 114.0$ million, or $62.64 \%$, of our certificates of deposit. If these maturing deposits do not remain with us, we will be required to seek other sources of funds, including other certificates of deposit and borrowings. Depending on market conditions, we may be required to pay higher rates on such deposits or other borrowings than we currently pay on the certificates of deposit due on or before March 31, 2016. We believe, however, based on past experience that a significant portion of our certificates of deposit will remain with us. We have the ability to attract and retain deposits by adjusting the interest rates offered.

## Capital Management

We are subject to various regulatory capital requirements administered by the Federal Deposit Insurance Corporation (FDIC), including a risk-based capital measure. The risk-based capital guidelines include both a definition of capital and a framework for calculating risk-weighted assets by assigning balance sheet assets and off-balance sheet items to broad risk categories. At March 31, 2015, the Company exceeded all of its regulatory capital requirements. The Company is considered "well capitalized" under regulatory guidelines. The Company is subject to the Federal Reserve Board's capital adequacy guidelines for bank holding companies (on a consolidated basis) substantially similar to those of the FDIC. The Company exceeded these requirements at March 31, 2015.

The Company's and Bank's actual capital amounts and ratios as of March 31, 2015 and December 31, 2014 are presented in the following tables:
$\left.\begin{array}{lllllllll} & & & & & \begin{array}{l}\text { Minimum } \\ \text { to be Well }\end{array} \\ \text { Capitalized Under }\end{array}\right)$

|  |  | Minimum <br> to be Well |
| :--- | :--- | :--- |
| Capitalized Under |  |  |

As of December 31, 2014
Total Capital to Risk Weighted Assets
Company
Bank
Tier 1 Capital to Risk Weighted Assets
Company
Bank
Tier 1 Capital to Average Assets
Company
Bank

| $\$ 91,331$ | 17.5 | $\%$ | $\$ 41,808$ | 8.0 | $\%$ | N/A | N/A |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| $\$ 78,337$ | 15.0 | $\%$ | $\$ 41,677$ | 8.0 | $\%$ | $\$ 52,096$ | 10.0 | $\%$ |
|  |  |  |  |  |  |  |  |  |
| $\$ 86,384$ | 16.5 | $\%$ | $\$ 20,904$ | 4.0 | $\%$ | N/A | N/A |  |
| $\$ 73,390$ | 14.1 | $\%$ | $\$ 20,838$ | 4.0 | $\%$ | $\$ 31,257$ | 6.0 | $\%$ |
|  |  |  |  |  |  |  |  |  |
| $\$ 86,384$ | 13.8 | $\%$ | $\$ 24,956$ | 4.0 | $\%$ | N/A | N/A |  |
| $\$ 73,390$ | 11.8 | $\%$ | $\$ 24,871$ | 4.0 | $\%$ | $\$ 31,088$ | 5.0 | $\%$ |

In July 2013, the FDIC and the other federal bank regulatory agencies issued a final rule that revised their leverage and risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with agreements that were reached by the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act. Among other things, the rule establishes a new common equity Tier 1 minimum capital requirement ( $4.5 \%$ of risk-weighted assets), increases the minimum Tier 1 capital to risk-based assets requirement (from $4 \%$ to $6 \%$ of risk-weighted assets) and assigns a higher risk weight ( $150 \%$ ) to exposures that are more than 90 days past due or are on nonaccrual status and to certain commercial real estate facilities that finance the acquisition, development or construction of real property. The final rule also requires unrealized gains and losses on certain "available-for-sale" securities holdings to be included for purposes of calculating regulatory capital unless a one-time opt-out is exercised. The rule limits a banking organization's capital distributions and certain discretionary bonus payments if the banking organization does not hold a "capital conservation buffer" consisting of $2.5 \%$ of common equity Tier 1 capital to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements. The final rule became effective for the Company and the Bank on January 1, 2015. The capital conservation buffer requirement will be phased in beginning January 1, 2016 and ending January 1, 2019, when the full capital conservation buffer requirement will be effective.
The following is a reconciliation of the Company's stockholders' equity as disclosed in the consolidated balance sheet under GAAP to regulatory capital as disclosed in the table above.

[^0]| March 31, <br> 2015 <br> (In Thousands) <br> $\$ 88,215$ | 2014 |
| :--- | :--- |
| $(20$ | ) |

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## Restrictions on Dividends and Stock Repurchases

Dividends from Chicopee Bancorp, Inc. may depend, in part, upon receipt of dividends from the Bank. The subsidiary may pay dividends to its parent out of so much of its net income as the Bank's directors deem appropriate, subject to the limitation that the total of all dividends declared by the Bank in any calendar year may not exceed the total of its net income of that year combined with its retained net income of the preceding two years and subject to minimum regulatory capital requirements. The approval of the Massachusetts Commissioner of Banks is required if the total of all dividends declared in any calendar year exceeds the total of its net profits for that year combined with its retained net profits of the preceding two years. Net profits for this purpose means the remainder of all earnings from current operations plus actual recoveries on loans and investments and other assets after deducting from the total thereof all current operating expenses, actual losses, accrued dividends on preferred stock, if any and all federal and state taxes.

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

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

On January 26, 2015, the Company declared a cash dividend of $\$ 0.07$ per share payable on February 20, 2015.
On April 24, 2015, the Company declared a cash dividend of $\$ 0.07$ per share payable on May 22, 2015.
See Item 2. Unregistered Sales of Equity Securities and Use of Proceeds regarding stock repurchases.

## Off-Balance Sheet Arrangements

In the normal course of operations, we engage in a variety of financial transactions that, in accordance with GAAP, are not recorded in our financial statements. These transactions involve, to varying degrees, elements of credit, interest rate and liquidity risk. Such transactions are used primarily to manage customers' requests for funding and take the form of loan commitments, letters of credit and lines of credit. We currently have no plans to engage in hedging
activities in the future.

## Credit-Related Financial Instruments

The Company is a party to credit related financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit, and various financial instruments with off-balance-sheet risk. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets.

The Company's exposure to credit loss is represented by the contractual amount of these commitments. The Company follows the same credit policies in making commitments as it does for on-balance-sheet instruments.

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The following financial instruments were outstanding whose contract amounts represent credit risk:

|  |  | March 31, 2015 |
| :--- | :--- | :--- |
| December 31, |  |  |
| 2014 |  |  |,

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 generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments for equity lines of credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Company, is based on management's credit evaluation of the customer. Collateral held varies but may include cash, securities, accounts receivable, inventory, property, plant and equipment, and real estate.

Unfunded commitments under commercial lines of credit, revolving credit lines and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines of credit are uncollateralized, usually do not contain a specified maturity date, and may not be drawn upon to the total extent to which the Company is committed.

The Company does not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. The Company has issued conditional commitments in the form of standby letters of credit to guarantee payment on behalf of a customer and guarantee the performance of a customer to a third party. Standby letters of credit generally arise in connection with lending relationships. The credit risk involved in issuing these instruments is essentially the same as that involved in extending loans to customers. Contingent obligations under standby letters of credit totaled $\$ 1.0$ million and $\$ 904,000$ at March 31, 2015 and December 31, 2014, respectively, and represent the maximum potential future payments the Company could be required to make. Typically, these instruments have terms of 12 months or less and expire unused; therefore, the total amounts do not necessarily represent future cash requirements. Each customer is evaluated individually for creditworthiness under the same underwriting standards used for commitments to extend credit and on-balance sheet instruments. The Company's policies governing loan collateral apply to standby letters of credit at the time of credit extension. Loan-to-value ratios are generally consistent with loan-to-value requirements for other commercial loans secured by similar types of collateral. The fair value of the Company's standby letters of credit at March 31, 2015 and December 31, 2014 was not significant.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

## Qualitative Aspects of Market Risk

We manage the interest rate sensitivity of our interest-bearing liabilities and interest-earning assets in an effort to minimize the adverse effects of changes in the interest rate environment. Deposit accounts typically react more quickly to changes in market interest rates than mortgage loans because of the shorter maturities of deposits. As a result, sharp increases in interest rates may adversely affect our earnings while decreases in interest rates may beneficially affect our earnings. To reduce the potential volatility of our earnings, we have sought to improve the match between asset and liability maturities and rates, while maintaining an acceptable interest rate spread. Our strategy for managing interest rate risk emphasizes: adjusting the maturities of borrowings; adjusting the investment
portfolio mix and duration; increasing our focus on shorter-term, adjustable-rate commercial and multi-family lending; selling fixed-rate mortgage loans; and periodically selling available-for-sale securities. We currently do not participate in hedging programs, interest rate swaps or other activities involving the use of derivative financial instruments.

We have an Asset/Liability Committee, which includes members of management, to communicate, coordinate and control all aspects involving asset/liability management. The committee reports to the Board of Directors of the Bank quarterly and establishes and monitors the volume, maturities, pricing and mix of assets and funding sources with the objective of managing assets and funding sources to provide results that are consistent with liquidity, growth, risk limits and profitability goals.

## Quantitative Aspects of Market Risk

We analyze our interest rate sensitivity to manage the risk associated with interest rate movements through the use of interest income simulation. The matching of assets and liabilities may be analyzed by examining the extent to which such assets and liabilities are "interest rate sensitive." An asset or liability is said to be "interest rate sensitive" within a specific time period if it will mature or reprice within that time period.

Our 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 the Asset/Liability Committee and Board of Directors of the Bank. The simulations provide an estimate of the impact of changes in interest rates on net interest income under a range of assumptions. The numerous assumptions used in the simulation process are reviewed by the Asset/Liability Committee and the Board of Directors of the Bank on a quarterly basis. Changes to these assumptions can significantly affect the results of the simulation. 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. The simulation analysis incorporates management's current assessment of the risk that pricing margins will change adversely over time due to competition or other factors.

Simulation analysis is only an estimate of our interest rate risk exposure at a particular point in time. We continually review 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 an approximation of our exposure as a percentage of estimated net interest income for the next 12 month period using interest income simulation. The simulation uses projected repricing of assets and liabilities at March 31, 2015 on the basis of contractual maturities, anticipated repayments and scheduled rate adjustments. Prepayment rates can have a significant impact on interest income simulation. Because of the large percentage of loans we hold, rising or falling interest rates have a significant impact on the prepayment speeds of our earning assets that, in turn, affect the rate sensitivity position. When interest rates rise, prepayments tend to slow. When interest rates fall, prepayments tend to rise. Our asset sensitivity would be reduced if prepayments slow and vice versa. While we believe such assumptions to be reasonable, there can be no assurance that assumed prepayment rates will approximate future mortgage-backed security and loan repayment activity.

The following table reflects changes in estimated net interest income for the Company at March 31, 2015 through March 31, 2016 under varying assumptions:

Changes in Interest Rates
(Basis Points)
Up 500-24 months
Up 400-24 months
Up 300-12 months shock
Up 200-12 months
Up 100-12 months shock Percentage Change in Estimated Net Interest Income over Twelve Months
(0.9)\%
(0.3)\%
0.3\%
(0.3)\%
0.5\%

Base
Down 100-12 months

As indicated in the table above, the results of a 100 and 300 basis point shock increase in interest rates is estimated to increase net interest income over a 12 -month time horizon by $0.5 \%$ and $0.3 \%$, respectively. A 200 basis point increase over 12 -months is estimated to decrease net interest income by $0.3 \%$. A 400 and 500 basis point increase in market interest rates over a 24 -month time horizon is estimated to decrease net interest income by $0.3 \%$ and $0.9 \%$ in the first
twelve months, respectively. A 100 basis point gradual decrease over a 12 -month time horizon is estimated to decrease net interest income by $1.0 \%$.

Item 4. Controls and Procedures.
The Company's management, including the Company's principal executive officer and principal financial officer, have evaluated the effectiveness of the Company's "disclosure controls and procedures," as such term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended, (the "Exchange Act"). Based upon their evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective for the purpose of ensuring that the information required to be disclosed in the reports that the Company files or submits under the Exchange Act with the Securities and Exchange Commission (the "SEC") (1) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (2) is accumulated and communicated to the Company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

There have been no changes in the Company's internal control over financial reporting during the three months ended March 31, 2015 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II. OTHER INFORMATION

Item 1. Legal Proceedings.
The Company is not involved in any pending legal proceedings other than routine legal proceedings occurring in the ordinary course of business. Such routine legal proceedings, in the aggregate, are believed by management to be immaterial to the financial condition and results of operations of the Company.

Item 1A. Risk Factors.
In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2014, which could materially affect our business, financial condition or future results. Additional risks not presently known to us, or that we currently deem immaterial, may also adversely affect our business, financial condition or results of operations. At March 31, 2015, the risk factors for the Company have not changed materially from those reported in our 2014 Annual Report on Form 10-K. However, the risks described in our 2014 Annual Report on Form 10-K are not the only risks that we face.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.
On June 1, 2012, the Company announced that the Board of Directors authorized a Seventh Stock Repurchase Program (the "Seventh Stock Repurchase Program") for the purchase of up to 272,000 shares of the Company's stock, or $5 \%$ of the Company's then outstanding common stock. During the three months ended March 31, 2015, the Company did not repurchase any shares of Company stock. The following table provides information regarding the Company's purchase of its equity securities during the three months ended March 31, 2015:


The Company may want to repurchase its shares under the Seventh Repurchase Program from time to time at prevailing prices in the open market, in block transactions or in privately negotiated transactions. Repurchases will be made under rule $10 \mathrm{~b}-5(1)$ repurchase plans. The repurchased shares will be held by the Company as treasury stock and will be available for general corporate purposes.

Item 3. Defaults Upon Senior Securities.
None.

Item 4. Mine Safety Disclosures.
Not applicable.

Item 5. Other Information.
None.

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Item 6. Exhibits.
3.1 Articles of Incorporation of Chicopee Bancorp, Inc. (1)
3.2 Bylaws of Chicopee Bancorp, Inc. (2)
4.0 Stock Certificate of Chicopee Bancorp, Inc. (1)
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
32.0 Section 1350 Certification

The following financial information from Chicopee Bancorp Inc.'s Quarterly Report on Form 10-Q for the three months ended March 31, 2015, formatted in XBRL (Extensible Business Reporting Language) includes: (i) the Consolidated Balance Sheets as of March 31, 2015 and December 31, 2014, (ii) the
101.0 Consolidated Statements of Operations for the three months ended March 31, 2015 and 2014, (iii) the Consolidated Statement of Comprehensive Income (Loss) for each of the three months ended March 31, 2015 and 2014, (iv) the Consolidated Changes in Stockholders' Equity for each of the three months ended March 31, 2015 and 2014, (v) the Consolidated Statements of Cash Flows for the three months ended March 31, 2015 and 2014, and (vi) the Notes to Consolidated Financial Statements, tagged in summary and detail.
(1) Incorporated herein by reference to the Exhibits to the Company's Registration Statement on Form S-1 (File ${ }^{(1)}$ No. 333-132512), as amended, initially filed with the Securities and Exchange Commission on March 17, 2006. Incorporated herein by reference to Exhibit 3.2 to the Company's 8-K (File No. 000-51996) filed with the Securities and Exchange Commission on August 1, 2007.

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## SIGNATURES

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

CHICOPEE BANCORP, INC.

Dated: May 8, 2015

Dated: May 8, 2015
By: /s/ William J. Wagner William J. Wagner
Chairman of the Board, President and Chief Executive Officer
(principal executive officer)
/s/ Guida R. Sajdak
By: Guida R. Sajdak
Senior Vice President, Chief Financial Officer and Treasurer (principal financial and chief accounting officer)


[^0]:    Total equity determined under GAAP
    Accumulated other comprehensive income
    Disallowed mortgage servicing assets
    Disallowed deferred tax assets
    Tier 1 Capital
    Allowable allowance for loan losses
    Unrealized gain on available-for-sale equity securities, net of tax
    Total regulatory capital

