

NORTHEAST COMMUNITY BANCORP INC  
Form 10-Q  
August 14, 2013

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, DC 20549**

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended June 30, 2013

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 0-51852

**Northeast Community Bancorp, Inc.**

(Exact name of registrant as specified in its charter)

<u>United States of America</u>	<u>06-1786701</u>
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

<u>325 Hamilton Avenue, White Plains, New York</u>	<u>10601</u>
(Address of principal executive offices)	(Zip Code)

**(914) 684-2500**

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

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

Large Accelerated Filer

Accelerated Filer

Non-accelerated Filer

Smaller Reporting Company

(Do not check if a smaller reporting company)

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

As of August 9, 2013, there were 12,644,752 shares of the registrant's common stock outstanding.

**NORTHEAST COMMUNITY BANCORP, INC.**

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION (UNAUDITED)**

	June 30, 2013	December 31, 2012
	(In thousands, except share and per share data)	
<b>ASSETS</b>		
Cash and amounts due from depository institutions	\$ 4,281	\$ 2,821
Interest-bearing deposits	34,845	46,421
Cash and cash equivalents	39,126	49,242
Certificates of deposit	150	399
Securities available-for-sale	123	129
Securities held-to-maturity (fair value of \$10,429 and \$12,561, respectively)	10,013	11,987
Loans receivable, net of allowance for loan losses of \$4,205 and \$4,646, respectively	332,856	333,787
Premises and equipment, net	12,531	12,898
Federal Home Loan Bank of New York stock, at cost	874	1,355
Bank owned life insurance	20,171	19,852
Accrued interest receivable	1,064	976
Goodwill	749	1,083
Intangible assets	375	406
Real estate owned	3,821	4,271
Other assets	7,011	7,839
Total assets	\$ 428,864	\$ 444,224
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Liabilities</b>		
<b>Deposits:</b>		
Non-interest bearing	\$ 20,925	\$ 22,932
Interest bearing	291,560	295,188
Total deposits	312,485	318,120
Advance payments by borrowers for taxes and insurance	2,590	3,516
Federal Home Loan Bank advances	5,000	15,000
Accounts payable and accrued expenses	4,480	3,739
Total liabilities	324,555	340,375
<b>Stockholders' equity:</b>		
Preferred stock, \$0.01 par value; 1,000,000 shares authorized, none issued	—	—
Common stock, \$0.01 par value; 19,000,000 shares authorized; 13,225,000 shares issued; 12,644,752 shares outstanding at June 30, 2013 and December 31, 2012	132	132
Additional paid-in capital	57,123	57,178
Unearned Employee Stock Ownership Plan ("ESOP") shares	(3,240 )	(3,370 )

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Retained earnings	54,179	53,893
Treasury stock – at cost, 580,248 shares	(3,712 )	(3,712 )
Accumulated comprehensive loss	(173 )	(272 )
Total stockholders' equity	104,309	103,849
Total liabilities and stockholders' equity	\$ 428,864	\$ 444,224

See Notes to Consolidated Financial Statements

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Table of Contents**CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(In thousands, except per share data)			
<b>INTEREST INCOME:</b>				
Loans	\$4,677	\$4,969	\$9,323	\$9,861
Interest-earning deposits	2	9	6	21
Securities – taxable	84	126	183	264
<b>Total Interest Income</b>	<b>4,763</b>	<b>5,104</b>	<b>9,512</b>	<b>10,146</b>
<b>INTEREST EXPENSE:</b>				
Deposits	730	785	1,458	1,817
Borrowings	45	137	146	280
<b>Total Interest Expense</b>	<b>775</b>	<b>922</b>	<b>1,604</b>	<b>2,097</b>
<b>Net Interest Income</b>	<b>3,988</b>	<b>4,182</b>	<b>7,908</b>	<b>8,049</b>
<b>PROVISION (CREDIT) FOR LOAN LOSSES</b>	<b>(423 )</b>	<b>117</b>	<b>(363 )</b>	<b>117</b>
<b>Net Interest Income after Provision (Credit) for Loan Losses</b>	<b>4,411</b>	<b>4,065</b>	<b>8,271</b>	<b>7,932</b>
<b>NON-INTEREST INCOME:</b>				
Other loan fees and service charges	122	233	340	423
Gain (loss) on disposition of equipment	—	3	—	(9 )
Earnings on bank owned life insurance	162	143	319	286
Investment advisory fees	176	233	354	439
Other	6	4	10	6
<b>Total Non-Interest Income</b>	<b>466</b>	<b>616</b>	<b>1,023</b>	<b>1,145</b>
<b>NON-INTEREST EXPENSES:</b>				
Salaries and employee benefits	1,990	2,224	4,335	4,375
Occupancy expense	346	312	740	601
Equipment	150	212	331	358
Outside data processing	283	281	560	515
Advertising	20	55	30	113
Impairment loss on goodwill	334	—	334	—
Real estate owned expense	173	—	259	—
FDIC insurance premiums	83	98	113	191
Other	978	1,167	1,846	2,274

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Total Non-Interest Expenses	4,357	4,349	8,548	8,427
Income before Provision for Income Taxes	520	332	746	650
PROVISION FOR INCOME TAXES	139	67	158	133
Net Income	\$381	\$265	\$588	\$517
Net Income per Common Share – Basic	\$0.03	\$0.02	\$0.05	\$0.04
Weighted Average Number of Common Shares Outstanding – Basic	12,318	12,292	12,314	12,288
Dividends Declared per Common Share	\$0.03	\$0.03	\$0.06	\$0.06

See Notes to Consolidated Financial Statements

Table of Contents**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	<b>(In thousands)</b>			
	2013	2012	2013	2012
Net income	\$381	\$265	\$ 588	\$ 517
Other comprehensive income (loss):				
Defined benefit pension:				
Reclassification adjustments:				
Amortization of prior service cost (1)	5	5	10	10
Amortization of actuarial loss (1)	9	—	18	—
Actuarial gains (losses) arising during period	69	(46 )	138	(106 )
<b>Total</b>	83	(41 )	166	(96 )
Income tax effect	(34 )	16	(67 )	33
Total other comprehensive income (loss)	49	(25 )	99	(63 )
Total comprehensive income	\$430	\$240	\$ 687	\$ 454

(1) Amounts are included in salaries and employees benefits in the unaudited consolidated statement of income as part of net periodic pension cost. See note 4 for further information.

See Notes to Consolidated Financial Statements



Table of Contents**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (UNAUDITED)****Six Months Ended June 30, 2013 and 2012 (in thousands)**

	Common Stock	Additional Paid-in Capital	Unearned ESOP Shares	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Loss	Total Equity
Balance at December 31, 2011	\$ 132	\$ 57,292	\$ (3,629 )	\$ 57,076	\$ (3,712 )	\$ (94 )	\$ 107,065
Net income	—	—	—	517	—	—	517
Other comprehensive loss	—	—	—	—	—	(63 )	(63 )
Cash dividend declared (\$.06 per share)	—	—	—	(519 )	—	—	(519 )
ESOP shares earned	—	(53 )	130	—	—	—	77
Balance – June 30, 2012	\$ 132	\$ 57,239	\$ (3,499 )	\$ 57,074	\$ (3,712 )	\$ (157 )	\$ 107,077
Balance at December 31, 2012	\$ 132	\$ 57,178	\$ (3,370 )	\$ 53,893	\$ (3,712 )	\$ (272 )	\$ 103,849
Net income	—	—	—	588	—	—	588
Other comprehensive income	—	—	—	—	—	99	99
Cash dividend declared (\$.06 per share)	—	—	—	(302 )	—	—	(302 )
ESOP shares earned	—	(55 )	130	—	—	—	75
Balance – June 30, 2013	\$ 132	\$ 57,123	\$ (3,240 )	\$ 54,179	\$ (3,712 )	\$ (173 )	\$ 104,309

See Notes to Consolidated Financial Statements

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## CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Six Months Ended June 30,	
	2013	2012
	(In thousands)	
Cash Flows from Operating Activities:		
Net income	\$588	\$517
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization of securities premiums and discounts, net	37	27
Provision (credit) for loan losses	(363 )	117
Depreciation	389	320
Net amortization of deferred loan fees and costs	73	98
Amortization of intangible assets	31	30
Deferred income tax expense	770	124
Impairment loss on goodwill	334	—
Retirement plan expense	149	135
Loss on sale of real estate owned	51	—
Loss on disposal of equipment	—	9
Earnings on bank owned life insurance	(319 )	(286 )
ESOP compensation expense	75	77
(Increase) decrease in accrued interest receivable	(88 )	555
Increase in other assets	(8 )	(143 )
(Decrease) increase in accounts payable and accrued expenses	758	(1,009 )
Net Cash Provided by Operating Activities	2,477	571
Cash Flows from Investing Activities:		
Net decrease in loans	1,221	1,993
Proceeds from sale of real estate owned	399	—
Principal repayments on securities available-for-sale	6	12
Principal repayments on securities held-to-maturity	1,937	2,055
Proceeds from maturities of certificates of deposit	249	1,245
Redemption of Federal Home Loan Bank of New York stock	481	278
Purchases of premises and equipment	(22 )	(830 )
Net Cash Provided by Investing Activities	4,271	4,753
Cash Flows from Financing Activities:		
Net decrease in deposits	(5,635 )	(29,641)
Repayment of FHLB of NY advances	(10,000)	(5,000 )
Decrease in advance payments by borrowers for taxes and insurance	(927 )	(424 )
Cash dividends paid	(302 )	(519 )
Net Cash Used in Financing Activities	(16,864)	(35,584)
Net Decrease in Cash and Cash Equivalents	(10,116)	(30,260)
Cash and Cash Equivalents - Beginning	49,242	82,583

Cash and Cash Equivalents - Ending	\$39,126	\$52,323
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SUPPLEMENTARY CASH FLOWS INFORMATION

Income taxes paid	\$4	\$2,375
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Interest paid	\$1,604	\$2,097
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SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING ACTIVITIES

<b>Real estate owned transferred to premises and equipment</b>	\$—	\$620
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See Notes to Consolidated Financial Statements

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**NORTHEAST COMMUNITY BANCORP, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 – BASIS OF PRESENTATION**

Northeast Community Bancorp, Inc. (the “Company”) is a federally-chartered corporation organized as a mid-tier holding company for Northeast Community Bank (the “Bank”), in conjunction with the Bank’s reorganization from a mutual savings bank to the mutual holding company structure on July 5, 2006. The Bank is a New York State-chartered savings bank and completed its conversion from a federally-chartered savings bank effective as of the close of business on June 29, 2012. The accompanying unaudited consolidated financial statements include the accounts of the Company, the Bank and the Bank’s wholly owned subsidiaries, New England Commercial Properties, LLC (“NECP”) and NECB Financial Services Group, LLC. NECB Financial Services Group was formed by the Bank in the second quarter of 2012 as a complement to the Bank’s existing investment advisory and financial planning services division, Hayden Wealth Management. As of the filing of this Form 10-Q, NECB Financial Services Group has not conducted any business. All significant intercompany accounts and transactions have been eliminated in consolidation.

The accompanying unaudited consolidated financial statements were prepared in accordance with generally accepted accounting principles for interim financial information as well as instructions for Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information or footnotes necessary for the presentation of financial position, results of operations, changes in stockholders’ equity and cash flows in conformity with accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the six-month period ended June 30, 2013 are not necessarily indicative of the results that may be expected for the full year or any other interim period. The December 31, 2012 consolidated statement of financial condition data was derived from audited consolidated financial statements, but does not include all disclosures required by U.S. generally accepted accounting principles. That data, along with the interim financial information presented in the consolidated statements of financial condition, income, comprehensive income, stockholders’ equity, and cash flows should be read in conjunction with the consolidated financial statements and notes thereto, included in the Company’s annual report on Form 10-K for the year ended December 31, 2012.

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain recorded amounts and disclosures. Accordingly, actual results could differ from those estimates. The most significant estimate pertains to the allowance for loan losses. In preparing these consolidated financial statements, the Company evaluated the events that occurred after June 30, 2013 and through the date these consolidated financial statements were issued.

Loans

Loans are stated at unpaid principal balances plus net deferred loan origination fees and costs less an allowance for loan losses. Interest on loans receivable is recorded on the accrual basis. An allowance for uncollected interest is established on loans where management has determined that the borrowers may be unable to meet contractual principal and/or interest obligations or where interest or principal is 90 days or more past due, unless the loans are well secured and in the process of collection. When a loan is placed on nonaccrual, an allowance for uncollected interest is established and charged against current income. Thereafter, interest income is not recognized unless the financial condition and payment record of the borrower warrant the recognition of interest income. Interest on loans that have been restructured is accrued according to the renegotiated terms, unless on non-accrual. Net loan origination fees and costs are deferred and amortized into income over the contractual lives of the related loans by use of the level yield method. Past due status of loans is based upon the contractual due date.

### **Allowance for Loan Losses**

The allowance for loan losses represents management's estimate of losses inherent in the loan portfolio as of the statement of financial condition date and is recorded as a reduction to loans. The allowance for loan losses is increased by the provision for loan losses, and decreased by charge-offs, net of recoveries. Loans deemed to be uncollectible are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance. All, or part, of the principal balance of loans receivable are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely.

The allowance for loan losses is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. Management performs a quarterly evaluation of the adequacy of the allowance. The allowance is based on the Company's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions, and other relevant factors.

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**NOTE 1 – BASIS OF PRESENTATION (Continued)**

**Allowance for Loan Losses (Continued)**

This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revision as more information becomes available.

Risk characteristics associated with the types of loans the Company underwrites are as follows:

**Multi-family, Mixed-use and Non-residential Real Estate Loans.** Loans secured by multi-family, mixed-use, and non-residential real estate generally have larger balances and involve a greater degree of risk than one- to four-family residential mortgage loans. Of primary concern in multi-family, mixed-use and non-residential real estate lending is the current and potential cash flow of the property and the borrower's demonstrated ability to operate that type of property. Payments on loans secured by income properties often depend on successful operation and management of the properties. As a result, repayment of such loans may be subject to a greater extent than residential real estate loans to adverse conditions in the real estate market or the economy. To monitor cash flows on income producing properties, we require borrowers to provide annual financial statements for all multi-family, mixed-use and non-residential real estate loans. In reaching a decision on whether to make a multi-family, mixed-use or non-residential real estate loan, we consider the net operating income of the property, the borrower's expertise, credit history and profitability and the value of the underlying property. In addition, with respect to non-residential real estate properties, we also consider the term of the lease and the quality of the tenants. An appraisal of the real estate used as collateral for the real estate loan is also obtained as part of the underwriting process. We have generally required that the properties securing these real estate loans have debt service coverage ratios (the ratio of earnings after subtracting all operating expenses to debt service payments) of at least 1.25x. In underwriting these loans, we take into account projected increases in interest rates in determining whether a loan meets our debt service coverage ratios at the higher interest rate under the adjustable rate mortgage. Environmental surveys and property inspections are utilized for all loans.

**Commercial and Industrial Loans.** Unlike multi-family, mixed-use, and non-residential mortgage loans, which are generally made on the basis of a borrower's ability to make repayment from the operation and cash flow from the real property whose value tends to be more ascertainable, commercial and industrial loans are of higher risk and tend to be made on the basis of a borrower's ability to make repayment from the cash flow of the borrower's business. As a result, the availability of funds for the repayment of commercial and industrial loans may depend substantially on the success of the business itself. Further, any collateral securing such loans may depreciate over time, may be difficult to appraise and may fluctuate in value.

**Construction Loans.** Construction financing affords us the opportunity to achieve higher interest rates and fees with shorter terms to maturity than does residential mortgage loans. However, construction financing is generally considered to involve a higher degree of risk of loss than long-term financing on improved, occupied real estate due to (1) the increased difficulty at the time the loan is made of estimating the building costs and the selling price of the property to be built; (2) the increased difficulty and costs of monitoring the loan; (3) the higher degree of sensitivity to increases in market rates of interest; and (4) the increased difficulty of working out loan problems. We have sought to minimize this risk by limiting the amount of construction loans outstanding at any time and by spreading the loans among multi-family, mixed-use and non-residential projects. In connection with construction loans that convert to permanent loans with us, we underwrite these loans using the same underwriting standards as our multi-family, mixed-use and non-residential real estate loans. If we do not offer permanent financing to the borrower, we minimize risks by requiring the borrower to obtain permanent financing from another financial institution.

**Residential One-to-Four Family Loans.** Residential one-to-four family mortgage loans are secured by the borrower's personal residence. These loans have varying loan rates, depending on the financial condition of the borrower and the loan to value ratio, and have amortizations up to 30 years. Such loans are considered to have a lower degree of risk when compared to our other loan types.

**Consumer Loans.** We offer personal loans, loans secured by passbook savings accounts, certificates of deposit accounts or statement savings accounts, and overdraft protection for checking accounts. We do not believe these loans represent a significant risk of loss to the Company.

The allowance consists of specific and general reserves. The specific component relates to loans that are classified as impaired. For loans that are classified as impaired, a specific allowance is established or a partial charge-off is taken when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan.

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**NOTE 1 – BASIS OF PRESENTATION (Continued)**

**Allowance for Loan Losses (Continued)**

Beginning in the fourth quarter of 2012, the Company discontinued the use of specific allowances. If an impairment is identified, the Company now charges off the impaired portion immediately. A loan is 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 records, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis.

The Company does not evaluate consumer or residential one- to four-family loans for impairment, unless such loans are part of a larger relationship that is impaired, or are classified as a troubled debt restructuring.

The estimated fair values of substantially all of the Company's impaired loans are measured based on the estimated fair value of the loan's collateral or discounted cash flows.

For loans secured by real estate, estimated fair values are determined primarily through in-house or third-party appraisals. When a real estate secured loan becomes impaired, a decision is made regarding whether an updated certified appraisal of the real estate is necessary. This decision is based on various considerations, including the age of the most recent appraisal, the loan-to-value ratio based on the original appraisal and the condition of the property. Appraised values might be discounted to arrive at the estimated selling price of the collateral, which is considered to be the estimated fair value. The discounts also include estimated costs to sell the property.

For loans secured by non-real estate collateral, such as accounts receivable, inventory and equipment, estimated fair values are determined based on the borrower's financial statements, inventory reports, accounts receivable aging or equipment appraisals or invoices. Indications of value from these sources are generally discounted based on the age of the financial information or the quality of the assets.



The general component covers pools of loans by loan class including loans not considered impaired, as well as smaller balance homogeneous loans, such as residential real estate and consumer loans. These pools of loans are evaluated for loss exposure based upon historical loss rates, adjusted for qualitative factors. These qualitative risk factors include:

- 1.Changes in policies and procedures in underwriting standards and collections.
- 2.Changes in economic conditions.
- 3.Changes in nature and volume of lending.
- 4.Experience of origination team.
- 5.Changes in past due loan volume and severity of classified assets.
- 6.Quality of loan review system.
- 7.Collateral values in general throughout lending territory.
- 8.Concentrations of credit.
- 9.Competition, legal and regulatory issues.

Each factor is assigned a value to reflect improving, stable or declining conditions based on management's best judgment using relevant information available at the time of the evaluation. Adjustments to the factors are supported through documentation of changes in conditions in a narrative accompanying the allowance for loan loss calculation.

The allowance calculation methodology includes further segregation of loan classes into risk rating categories. The borrower's overall financial condition, repayment sources, guarantors and value of collateral, if appropriate, are evaluated annually for commercial loans or when credit deficiencies arise, such as delinquent loan payments, for commercial, residential and consumer loans. Credit quality risk ratings include regulatory classifications of pass, special mention, substandard, doubtful and loss. Loans criticized as special mention have potential weaknesses that deserve management's close attention. If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. Loans classified substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They include loans that are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any.

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**NOTE 1 – BASIS OF PRESENTATION (Continued)**

**Allowance for Loan Losses (Continued)**

Loans classified doubtful have all the weaknesses inherent in loans classified substandard with the added characteristic that collection or liquidation in full, on the basis of current conditions and facts, is highly improbable. Loans classified as a loss are considered uncollectible and are charged to the allowance for loan losses. Loans not classified are rated pass.

The allowance calculation for each pool of loans is also based on the loss factors that reflect the Company's historical charge-off experience adjusted for current economic conditions applied to loan groups with similar characteristics or classifications in the current portfolio. To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a loan as agreed, the Company has a structured loan rating process which allows for a periodic review of its loan portfolio and the early identification of potential impaired loans. Such system takes into consideration, among other things, delinquency status, size of loans, type of collateral and financial condition of the borrowers. The Company's Chief Executive Officer is ultimately responsible for the timely and accurate risk rating of the loan portfolio.

Loans whose terms are modified are classified as troubled debt restructurings if the Company grants such borrowers concessions and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a troubled debt restructuring generally involve a temporary reduction in interest rate or an extension of a loan's stated maturity date. Adversely classified, non-accrual troubled debt restructurings may be reclassified if principal and interest payments, under the modified terms, are current for six consecutive months after modification.

In addition, banking regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses and may require the Company to recognize additions to the allowance based on their judgments about information available to them at the time of their examination, which may not be currently available to management. Based on management's comprehensive analysis of the loan portfolio, management believes the allowance for loan losses is adequate as of June 30, 2013.

**Goodwill**

The Company recognized goodwill in connection with the acquisition of its wealth management division in 2007. In the fourth quarter of 2012, the Company performed an impairment test and determined that the fair value of this division was less than its carrying value and, accordingly, recorded an impairment charge of \$227,000 in 2012. During

the second quarter of 2013, the Company determined that an adjustment to the goodwill impairment previously recorded in 2012 was necessary. As a result, an additional impairment charge of \$334,000 was recognized during the second quarter of 2013.

The impairment charge was the result of a reduction in expected cash flow from this division resulting from the departure of two employees, one of which had generated significant other commission income from sales of insurance and annuity products. We expect future commission income to decline 50% from prior levels. This decline resulted in a decrease in the value of this division.

## **NOTE 2 – EARNINGS PER SHARE**

Basic earnings per common share is calculated by dividing the net income available to common stockholders by the weighted-average number of common shares outstanding during the period. Diluted earnings per common share is computed in a manner similar to basic earnings per common share except that the weighted average number of common shares outstanding is increased to include the incremental common shares (as computed using the treasury stock method) that would have been outstanding if all potentially dilutive common stock equivalents were issued during the period. Common stock equivalents may include restricted stock awards and stock options. Anti-dilutive shares are common stock equivalents with weighted-average exercise prices in excess of the weighted-average market value for the periods presented. The Company has not granted any restricted stock awards or stock options and, during the six-month periods ended June 30, 2013 and 2012, had no potentially dilutive common stock equivalents. Unallocated common shares held by the Employee Stock Ownership Plan (“ESOP”) are not included in the weighted-average number of common shares outstanding for purposes of calculating both basic and diluted earnings per common share until they are committed to be released.

Table of Contents**NOTE 3 – EMPLOYEE STOCK OWNERSHIP PLAN**

As of December 31, 2012 and June 30, 2013, the ESOP trust held 518,420 shares of the Company’s common stock, which represents all allocated and unallocated shares held by the plan. As of December 31, 2012, the Company had allocated 155,526 shares to participants, and an additional 25,921 shares had been committed to be released. As of June 30, 2013, the Company had allocated 181,447 shares to participants, and an additional 12,960 shares had been committed to be released.

The Company recognized compensation expense of \$39,000 and \$37,000 during the three-month periods ended June 30, 2013 and 2012, respectively, and \$75,000 and \$77,000 during the six-month periods ended June 30, 2013 and 2012, respectively, which equals the fair value of the ESOP shares when they became committed to be released.

**NOTE 4 -Outside Director Retirement Plan (“DRP”)**

Periodic expenses for the Company’s DRP were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	<b>(In thousands)</b>			
	2013	2012	2013	2012
Service cost	\$ 18	\$ 11	\$ 36	\$ 21
Interest cost	11	15	21	30
Amortization of prior service cost	5	5	11	10
Amortization of actuarial loss	9	—	18	—
Total	\$ 43	\$ 31	\$ 86	\$ 61

This plan is an unfunded, non-contributory defined benefit pension plan covering all non-employee directors meeting eligibility requirements as specified in the plan document. The amortization of prior service cost and actuarial loss in the three-month periods ended June 30, 2013 and 2012 and the six-month periods ended June 30, 2013 and 2012 is also reflected in other comprehensive income during those periods.

**NOTE 5 – INVESTMENTS**

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The following table sets forth the amortized cost and fair values of our securities portfolio at the dates indicated:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
June 30, 2013				
Securities available for sale:				
Mortgage-backed securities – residential:				
Federal Home Loan Mortgage Corporation	\$71	\$ 2	\$ —	\$73
Federal National Mortgage Association	48	2	—	50
Total	\$119	\$ 4	\$ —	\$123
Securities held to maturity:				
Mortgage-backed securities – residential:				
Government National Mortgage Association	\$7,667	\$ 320	\$ —	\$7,987
Federal Home Loan Mortgage Corporation	251	9	—	260
Federal National Mortgage Association	189	7	—	196
Collateralized mortgage obligations-GSE	1,905	80	—	1,985
Other	1	—	—	1
Total	\$10,013	\$ 416	\$ —	\$10,429

Table of Contents**NOTE 5 – INVESTMENTS (Continued)**

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
December 31, 2012				
Securities available for sale:				
Mortgage-backed securities – residential:				
Federal Home Loan Mortgage Corporation	\$76	\$ 2	\$ —	\$78
Federal National Mortgage Association	49	2	—	51
Total	\$125	\$ 4	\$ —	\$129
Securities held to maturity:				
Mortgage-backed securities – residential:				
Government National Mortgage Association	\$9,044	\$ 442	\$ —	\$9,486
Federal Home Loan Mortgage Corporation	267	9	—	276
Federal National Mortgage Association	215	8	—	223
Collateralized mortgage obligations-GSE	2,460	115	—	2,575
Other	1	—	—	1
Total	\$11,987	\$ 574	\$ —	\$12,561

Contractual final maturities of mortgage-backed securities available for sale were as follows:

	June 30, 2013	
	Amortized Cost	Fair Value
	(In Thousands)	
Due after five but within ten years	\$ 26	\$ 26
Due after ten years	93	97
	\$ 119	\$ 123

Contractual final maturities of mortgage-backed securities held to maturity were as follows:

	June 30, 2013	
	Amortized Cost	Fair Value
	(In Thousands)	
Due after one but within five years	\$60	\$ 62
Due after five but within ten years	147	153
Due after ten years	9,806	10,214
	\$10,013	\$ 10,429

The maturities shown above are based upon contractual final maturity. Actual maturities will differ from contractual maturities due to scheduled monthly repayments and due to the underlying borrowers having the right to prepay their obligations.

#### **NOTE 6 – FAIR VALUE DISCLOSURES**

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The Company's securities available for sale are recorded at fair value on a recurring basis. Additionally, from time to time, we may be required to record at fair value other assets and liabilities on a non-recurring basis, such as impaired loans and other real estate owned. U.S. GAAP has established a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

Table of Contents**NOTE 6 – Fair Value DISCLOSURES (Continued)**

*Level 1:* Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

*Level 2:* Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability.

*Level 3:* Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported with little or no market activity).

An asset's or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

For financial assets measured at fair value on a recurring and nonrecurring basis, the fair value measurements by level within the fair value hierarchy used are as follows:

Description	Total	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
June 30, 2013:	(In Thousands)			
Recurring:				
Mortgage-backed securities - residential:				
Federal Home Loan Mortgage Corporation	\$ 73	\$ —	\$ 73	\$ —
Federal National Mortgage Association	50	—	50	—
Total	\$ 123	\$ —	\$ 123	\$ —
Nonrecurring:				
Impaired loans	\$ 16,296	\$ —	\$ —	\$ 16,296
Real estate owned	\$ 3,821	\$ —	\$ —	\$ 3,821
December 31, 2012:				
Recurring:				
Mortgage-backed securities - residential:				
Federal Home Loan Mortgage Corporation	\$ 78	\$ —	\$ 78	\$ —
Federal National Mortgage Association	51	—	51	—
Total	\$ 129	\$ —	\$ 129	\$ —
Nonrecurring:				
Impaired loans	\$ 10,515	\$ —	\$ —	\$ 10,515
Real estate owned	\$ 4,271	\$ —	\$ —	\$ 4,271





Table of Contents**NOTE 6 – Fair Value DISCLOSURES (Continued)**

The following table presents additional quantitative information about assets measured at fair value on a nonrecurring basis and for which the Company has utilized Level 3 inputs to determine fair value:

(in thousands)	Quantitative Information about Level 3 Fair Value Measurements			
	Fair Value Estimate	Unobservable Valuation Techniques	Input	Range
June 30, 2013:				
Impaired loans	\$16,296	Appraisal of collateral (1)	Appraisal adjustments (2)	2% to 71%
Real estate owned	\$3,821	Appraisal of collateral (1)	Appraisal adjustments (2)	7% to 50%

(1) Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various level 3 inputs which are not identifiable.

Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated (2) liquidation expenses. The range of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal.

(in thousands)	Quantitative Information about Level 3 Fair Value Measurements			
	Fair Value Estimate	Unobservable Valuation Techniques	Input	Range
December 31, 2012:				
Impaired loans	\$10,515	Appraisal of collateral (1)	Appraisal adjustments (2)	6.4% to 63%
Real estate owned	\$4,271	Appraisal of collateral (1)	Appraisal adjustments (2)	6.8% to 50%

(1) Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various level 3 inputs which are not identifiable.

Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated (2) liquidation expenses. The range of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal.

Management uses its best judgment in estimating the fair value of the Company's financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts the Company could have realized in a sale transaction on the dates indicated. The estimated fair value amounts have been measured as of their respective year-ends and have not been re-evaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each year-end.

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

The following methods and assumptions were used to estimate the fair values of the Company's financial instruments at June 30, 2013 and December 31, 2012:

#### **Cash and Cash Equivalents, Certificates of Deposit and Accrued Interest Receivable and Payable**

For these short-term instruments, the carrying amount is a reasonable estimate of fair value.

#### **Securities**

Fair values for securities available for sale and held to maturity are determined utilizing Level 2 inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayments speeds, credit information and the security's terms and conditions, among other things.

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**NOTE 6 – Fair Value DISCLOSURES (Continued)**

**Loans Receivable**

Fair values are estimated for portfolios of loans with similar financial characteristics. The total loan portfolio is first divided into performing and non-performing categories. Performing loans are then segregated into adjustable and fixed rate interest terms. Fixed rate loans are segmented by type, such as construction and land development, other loans secured by real estate, commercial and industrial loans, and loans to individuals. Certain types, such as commercial loans and loans to individuals, are further segmented by maturity and type of collateral.

For performing loans, fair value is calculated by discounting scheduled future cash flows through estimated maturity using a current market rate. The discounted value of the cash flows is reduced by a credit risk adjustment based on internal loan classifications.

For certain impaired loans, fair value is calculated by first reducing the carrying value by a credit risk adjustment based on internal loan classifications, and then discounting the estimated future cash flows from the remaining carrying value at a market rate.

For the remaining impaired loans which the Company has measured and recorded impairment generally based on the fair value of the loan's collateral, fair value is generally determined based upon independent third-party appraisals of the properties. These assets are typically included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements.

**FHLB of New York Stock**

The carrying amount of the FHLB of New York stock is equal to its fair value, and considers the limited marketability of this security.

**Deposit Liabilities**

The fair value of deposits with no stated maturity, such as non-interest-bearing demand deposits, money market accounts, interest checking accounts, and savings accounts is equal to the amount payable on demand. Time deposits are segregated by type, size, and remaining maturity. The fair value of time deposits is based on the discounted value of contractual cash flows. The discount rate is based on rates currently offered in the market.

#### **FHLB of New York Advances**

The fair value of the FHLB advances is estimated based on the discounted value of future contractual payments. The discount rate is equivalent to the estimated rate at which the Company could currently obtain similar financing.

#### **Off-Balance- Sheet Financial Instruments**

The fair value of commitments to extend credit is estimated based on an analysis of the interest rates and fees currently charged to enter into similar transactions, considering the remaining terms of the commitments and the credit-worthiness of the potential borrowers. At June 30, 2013 and December 31, 2012, the estimated fair values of these off-balance-sheet financial instruments were immaterial.

Table of Contents**NOTE 6 – Fair Value DISCLOSURES (Continued)**

The carrying amounts and estimated fair values of the Company's financial instruments are summarized below:

(In thousands)	Carrying Amount	Fair Value Estimate	Fair Value at June 30, 2013		
			Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Financial Assets</b>					
Cash and cash equivalents	\$39,126	\$39,126	\$39,126	\$ —	\$ —
Certificates of deposit	150	150	—	150	—
Securities available for sale	123	123	—	123	—
Securities held to maturity	10,013	10,429	—	10,429	—
Loans receivable	332,856	343,944	—	—	343,944
FHLB of New York stock	874	874	—	874	—
Accrued interest receivable	1,064	1,064	—	1,064	—
<b>Financial Liabilities</b>					
Deposits, including accrued interest	312,485	315,425	—	315,425	—
FHLB of New York advances	5,000	5,122	—	5,122	—

(In thousands)	Carrying Amount	Fair Value Estimate	Fair Value at December 31, 2012		
			Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)

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Financial Assets

Cash and cash equivalents	\$49,242	\$49,242	\$49,242	\$ —	\$ —
Certificates of deposit	399	399	—	399	—
Securities available for sale	129	129	—	129	—
Securities held to maturity	11,987	12,561	—	12,561	—
Loans receivable	333,787	350,420	—	—	350,420
FHLB of New York stock	1,355	1,355	—	1,355	—
Accrued interest receivable	976	976	—	976	—

Financial Liabilities

Deposits, including accrued interest	318,120	321,236	—	321,236	—
FHLB of New York advances	15,000	15,256	—	15,256	—

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## NOTE 7 – LOANS RECEIVABLE AND THE ALLOWANCE FOR LOAN LOSSES

	June 30, 2013	December 31, 2012
	(In Thousands)	
Residential real estate:		
One-to-four family	\$7,982	\$ 7,761
Multi-family	172,840	178,644
Mixed use	43,965	41,895
Total residential real estate	224,787	228,300
Non-residential real estate	81,744	82,312
Construction	2,526	841
Commercial and Industrial	27,241	26,274
Consumer	162	77
 Total Loans	 336,460	 337,804
 Allowance for loan losses	 (4,205 )	 (4,646 )
Deferred loan costs, net	601	629
 Net Loans	 \$332,856	 \$ 333,787

The following is an analysis of the allowance for loan losses:

**At and for the Six Months Ended June 30, 2013 (in thousands)**

	Residential Real Estate	Non- residential Real Estate	Construction	Commercial and Industrial	Consumer	Total
Allowance for loan losses:						
Beginning balance	\$ 3,216	\$ 996	\$ —	\$ 434	\$ —	\$4,646
Charge-offs	—	(105 )	—	—	—	(105 )
Recoveries	23	4	—	—	—	27
Provision	(435 )	(26 )	75	23	—	(363 )
Ending balance	\$ 2,804	\$ 869	\$ 75	\$ 457	\$ —	\$4,205
Ending balance: individually evaluated for impairment	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
 Ending balance: collectively evaluated for impairment	 \$ 2,804	 \$ 869	 \$ 75	 \$ 457	 \$ —	 \$4,205
 Loans receivable:						
Ending balance	\$ 224,787	\$ 81,744	\$ 2,526	\$ 27,241	\$ 162	\$336,460



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Ending balance: individually evaluated for impairment	\$ 10,414	\$ 11,041	\$ —	\$ 1,833	\$ —	\$23,288
Ending balance: collectively evaluated for impairment	\$ 214,373	\$ 70,703	\$ 2,526	\$ 25,408	\$ 162	\$313,172

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## NOTE 7 – LOANS RECEIVABLE AND THE ALLOWANCE FOR LOAN LOSSES (Continued)

**At and for the Three Months Ended June 30, 2013 (in thousands)**

	Residential Real Estate	Non- residential Real Estate	Construction	Commercial	Consumer	Total
Allowance for loan losses:						
Beginning balance	\$ 3,261	\$ 984	\$ —	\$ 461	\$ —	\$4,706
Charge-offs	—	(105 )	—	—	—	(105 )
Recoveries	23	4	—	—	—	27
Provision	(480 )	(14 )	75	(4 )	—	(423 )
Ending balance	\$ 2,804	\$ 869	\$ 75	\$ 457	\$ —	\$4,205

**At and for the Six Months Ended June 30, 2012 (in thousands)**

	Residential Real Estate	Non- residential Real Estate	Construction	Commercial and Industrial	Consumer	Total
Allowance for loan losses:						
Beginning balance	\$ 3,781	\$ 1,596	\$ 1,724	\$ 296	\$ —	\$7,397
Charge-offs	(1,173 )	(764 )	(1,715 )	—	—	(3,652)
Recoveries	5	—	—	—	—	5
Provision	68	65	(9 )	(7 )	—	117
Ending balance	\$ 2,681	\$ 897	\$ —	\$ 289	\$ —	\$3,867

**At and for the Three Months Ended June 30, 2012 (in thousands)**

	Residential Real Estate	Non- residential Real Estate	Construction	Commercial	Consumer	Total
Allowance for loan losses:						
Beginning balance	\$ 3,280	\$ 1,855	\$ 1,660	\$ 291	\$ —	\$7,086
Charge-offs	(868 )	(764 )	(1,704 )	—	—	(3,336)
Recoveries	—	—	—	—	—	—
Provision	269	(194 )	44	(2 )	—	117

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Ending balance	\$ 2,681	\$ 897	\$ —	\$ 289	\$ —	\$3,867
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## NOTE 7 – LOANS RECEIVABLE AND THE ALLOWANCE FOR LOAN LOSSES (Continued)

**At and for the Year Ended December 31, 2012 (in thousands)**

	Residential Real Estate	Non- residential Real Estate	Construction	Commercial and Industrial	Consumer	Total
Allowance for loan losses:						
Beginning balance	\$ 3,781	\$ 1,596	\$ 1,724	\$ 296	\$ —	\$ 7,397
Charge-offs	(4,372 )	(2,374 )	(1,715 )	(28 )	—	(8,489 )
Recoveries	115	—	—	—	—	115
Provision	3,692	1,774	(9 )	166	—	5,623
Ending balance	\$ 3,216	\$ 996	\$ —	\$ 434	\$ —	\$ 4,646
Ending balance: individually evaluated for impairment	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Ending balance: collectively evaluated for impairment	\$ 3,216	\$ 996	\$ —	\$ 434	—	\$ 4,646
Loans receivable:						
Ending balance	\$ 228,300	\$ 82,312	\$ 841	\$ 26,274	\$ 77	\$ 337,804
Ending balance: individually evaluated for impairment	\$ 10,272	\$ 8,272	\$ —	\$ 2,152	\$ —	\$ 20,696
Ending balance: collectively evaluated for impairment	\$ 218,028	\$ 74,040	\$ 841	\$ 24,122	\$ 77	\$ 317,108

The following is a summary of impaired loans at June 30, 2013 and December 31, 2012:

	June 30, 2013			December 31, 2012		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(In thousands)					
Impaired loans without a valuation allowance:						
Residential real estate-Multi-family	\$ 10,414	\$ 11,472	\$ —	\$ 10,272	\$ 11,742	\$ —
Non-residential real estate	11,041	14,293	—	8,272	11,345	—
Construction	—	—	—	—	—	—

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Commercial and Industrial	1,833	1,833	—	2,152	2,179	—
Total	\$23,288	\$27,598	\$	\$20,696	\$25,266	\$
Impaired loans with a valuation allowance:						
Residential real estate-Multi-family	—	—	—	—	—	—
Non-residential real estate	—	—	—	—	—	—
Construction	—	—	—	—	—	—
Commercial and Industrial	—	—	—	—	—	—
Total	\$—	\$—	\$	\$—	\$—	\$
Total impaired loans	\$23,288	\$27,598	\$	\$20,696	\$25,266	\$

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## NOTE 7 – LOANS RECEIVABLE AND THE ALLOWANCE FOR LOAN LOSSES (Continued)

Further information pertaining to impaired loans follows:

	Three Months Ended June 30, 2013			Six Months Ended June 30, 2013		
	Average Interest Recorded Income Investment	Interest Recognized	Interest Income Recognized on Cash Basis	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized on Cash Basis
	(In thousands)					
Residential real estate-Multi-family	\$ 10,954	\$ 96	\$ 96	\$ 10,727	\$ 260	\$ 260
Non-residential real estate	11,286	39	39	10,282	39	39
Commercial and Industrial	1,842	20	20	1,945	49	49
Total	\$24,082	\$ 155	\$ 155	\$ 22,954	\$ 348	\$ 348

	Three Months Ended June 30, 2012		Six Months Ended June 30, 2012	
	Average Interest Recorded Income Investment	Interest Recognized	Average Recorded Investment	Interest Income Recognized
	(In thousands)			
Residential real estate-Multi-family	\$ 10,245	\$ 74	\$ 10,216	\$ 148
Non-residential real estate	16,112	1,595	16,113	1,636
Commercial and Industrial	1,750	26	1,713	52
Total	\$28,107	\$ 1,695	\$ 28,042	\$ 1,836

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## NOTE 7 – LOANS RECEIVABLE AND THE ALLOWANCE FOR LOAN LOSSES (Continued)

The following table provides information about delinquencies in our loan portfolio at the dates indicated.

**Age Analysis of Past Due Loans as of June 30, 2013 (in Thousands)**

	30-59 Days Past Due	60 – 89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable	Recorded Investment > 90 Days and Accruing
Residential real estate:							
One- to four-family	\$ —	\$ —	\$ —	\$ —	\$ 7,982	\$ 7,982	\$ —
Multi-family	—	—	—	—	172,840	172,840	—
Mixed-use	—	—	—	—	43,965	43,965	—
Non-residential real estate	303	—	1,957	2,260	79,484	81,744	—
Construction loans	—	—	—	—	2,526	2,526	—
Commercial and industrial loans	—	—	—	—	27,241	27,241	—
Consumer	—	—	—	—	162	162	—
Total loans	\$ 303	\$ —	\$ 1,957	\$ 2,260	\$ 334,200	\$ 336,460	\$ —

**Age Analysis of Past Due Loans as of December 31, 2012 (in Thousands)**

	30-59 Days Past Due	60 – 89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable	Recorded Investment > 90 Days and Accruing
Residential real estate:							
One- to four-family	\$ —	\$ —	\$ —	\$ —	\$ 7,761	\$ 7,761	\$ —
Multi-family	—	89	1,266	1,355	177,289	178,644	—
Mixed-use	—	—	—	—	41,895	41,895	—
Non-residential real estate	1,259	—	1,221	2,480	79,832	82,312	—
Construction loans	—	—	—	—	841	841	—
Commercial and industrial loans	—	—	—	—	26,274	26,274	—
Consumer	—	—	—	—	77	77	—
Total loans	\$ 1,259	\$ 89	\$ 2,487	\$ 3,835	\$ 333,969	\$ 337,804	\$ —





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## NOTE 7 – LOANS RECEIVABLE AND THE ALLOWANCE FOR LOAN LOSSES (Continued)

The following tables provide certain information related to the credit quality of the loan portfolio.

**Credit Quality Indicators as of June 30, 2013 (in thousands)****Credit Risk Profile by Internally Assigned Grade**

	Residential Real Estate	Non- residential Real Estate	Construction	Commercial and Industrial	Consumer	Total
Grade:						
Pass	\$ 220,514	\$ 70,703	\$ 2,526	\$ 25,408	\$ 162	\$319,313
Special Mention	2,565	3,219	—	—	—	5,784
Substandard	1,708	7,822	—	1,833	—	11,363
Total	\$ 224,787	\$ 81,744	\$ 2,526	\$ 27,241	\$ 162	\$336,460

**Credit Quality Indicators as of December 31, 2012 (in thousands)****Credit Risk Profile by Internally Assigned Grade**

	Residential Real Estate	Non- residential Real Estate	Construction	Commercial and Industrial	Consumer	Total
Grade:						
Pass	\$ 221,794	\$ 74,040	\$ 841	\$ 24,122	\$ 77	\$320,874
Special Mention	2,553	505	—	—	—	3,058
Substandard	3,953	7,767	—	2,152	—	13,872
Total	\$ 228,300	\$ 82,312	\$ 841	\$ 26,274	\$ 77	\$337,804

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## NOTE 7 - LOANS RECEIVABLE AND THE ALLOWANCE FOR LOAN LOSSES (Continued)

The following table sets forth the composition of our nonaccrual loans at the dates indicated.

**Loans Receivable on Nonaccrual Status as of June 30, 2013 and December 31, 2012 (in thousands)**

	2013	2012
Residential real estate-Multi-family	\$ 195	\$ 1,477
Non-residential real estate	1,957	2,480
Construction loans	—	—
Total	\$2,152	\$3,957

The following table shows the breakdown of loans modified for the periods indicated:

	Three Months Ended June 30, 2013		Six Months Ended June 30, 2013	
	Recorded Investment Number Prior to Modification	Recorded Investment After Modification	Recorded Investment Number Prior to Modification	Recorded Investment After Modification
(dollars in thousands)				
Real estate loans:				
Multi-family	1 \$ 307	\$ 307	1 \$ 307	\$ 307
Non-residential	3 3,253	3,253	3 3,253	3,253
Total	4 \$ 3,560	\$ 3,560	4 \$ 3,560	\$ 3,560

The multi-family mortgage loan had an original interest rate of 6.75% with an amortization of 25 years. We reduced the interest rate and converted the monthly payments to interest only for twenty months and then amortizing for 30 years, with a balloon payment after approximately five and one-half years from the modification date.

Two non-residential mortgage loans had an original interest rate of 4.00% with an amortization of 25 years. We reduced the interest rate and converted the monthly payments to interest only for twenty months and then amortizing for 30 years, with a balloon payment after approximately five and one-half years from the modification date.

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One non-residential mortgage loan had an original interest rate of 4.00% with an amortization of 30 years. We reduced the interest rate and converted the monthly payments to interest only for nineteen months and then amortizing for 30 years, with a balloon payment after two years from the modification date.

	Three Months Ended June 30, 2012		Six Months Ended June 30, 2012	
	Recorded Investment Number Prior to Modification	Recorded Investment After Modification	Recorded Investment Number Prior to Modification	Recorded Investment After Modification
(dollars in thousands)				
Real estate:				
Multi-family	—	\$ —	2	\$ 1,900
Non-residential	4	10,500	4	10,500
Total	4	\$ 10,500	6	\$ 12,400

As of June 30, 2013, none of the loans that were modified during the previous twelve months had defaulted in the three and six month periods ended June 30, 2013.

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**NOTE 8 – EFFECT OF RECENT ACCOUNTING PRONOUNCEMENTS**

In July 2012, the FASB issued Accounting Standards Update (“ASU”) 2012-02, *Testing Indefinite-Lived Intangible Assets for Impairment. Similar to ASU 2011-08, Intangibles - Goodwill and Other (Topic 250) - Testing Goodwill for Impairment*. ASU 2012-02 addresses the growing cost and complexity of performing an analysis to evaluate indefinite-lived intangible assets (other than goodwill) for impairment. This ASU introduces qualitative factors which would simplify the analysis if facts and circumstances make it more-likely-than-not that impairment would not exist. Rather than requiring a purely quantitative impairment test, the ASU provides entities with the option to first examine qualitative factors to make this determination. Factors to be considered would include, but are not limited to:

Increases in interest rates, salaries, or other operating expenses, which would have a negative impact on future earnings or cash flows;

Recent financial performance and cash flow trends;

Aspects of the legal and regulatory environment which are expected to impact future cash flows, such as the Dodd-Frank Act;

Management turnover;

Economic and industry conditions.

Entities are required by the guidance to consider both positive and negative impacts of such factors before determining whether it is more-likely-than-not (i.e. greater than 50% probability) that the indefinite-lived intangible asset is impaired. It should be noted that the qualitative portion of the analysis is optional for all issuers.

This ASU is effective for impairment tests performed during fiscal years beginning after September 15, 2012, and may be early adopted if the entity’s financial statements for the most recent fiscal or interim period have not yet been issued. The Company adopted this guidance in 2013. The adoption had no material effect on the Company’s financial statements.

ASU 2013-02: *Comprehensive Income (Topic 220) – Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. The objective of this ASU is to improve the reporting of reclassifications out of accumulated other comprehensive income. This ASU requires an entity to report the effect of significant reclassifications out of accumulated other comprehensive income, by component, on the respective line items in the income statement if the amount being reclassified is required under U.S. generally accepted accounting principles (GAAP) to be reclassified

in its entirety to net income. Reclassifications that are not required under U.S. GAAP to be reclassified in their entirety to net income in the same reporting period are required to be cross-referenced to other U.S. GAAP disclosures that provide additional detail about those amounts. This is the case when a portion of the amount reclassified out of accumulated other comprehensive income is reclassified to a balance sheet account rather than directly to income or expense in the same reporting period. For example, some portion of net periodic pension cost is immediately reported in net income, but other portions may be capitalized to an asset balance such as fixed assets or inventory. An entity with significant defined benefit pension costs reclassified out of accumulated other comprehensive income but not to net income in its entirety in the same reporting period should identify the amount of each pension cost component reclassified out of accumulated other comprehensive income and make reference to the relevant pension cost disclosure that provides greater detail about these reclassifications.

The amendments do not change the current requirements for reporting net income or other comprehensive income in financial statements. However, the amendments require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income.

The provisions of this ASU are effective for public entities prospectively for reporting periods beginning after December 15, 2012. The Company adopted this guidance in 2013. The adoption had no material effect on the Company's financial statements.

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**NOTE 9 – DIVIDEND RESTRICTION**

NorthEast Community Bancorp MHC (the “MHC”) held 7,273,750 shares, or 57.5%, of the Company’s issued and outstanding common stock, and the minority public shareholders held 42.5% of outstanding stock, at June 30, 2013. The MHC filed notice with, and received approval from, the Federal Reserve Bank of Philadelphia to waive its right to receive cash dividends for the period from November 9, 2012 through November 9, 2013.

The MHC has waived receipt of all past dividends paid by the Company through June 30, 2013, with the exception of the dividend for the quarter ended June 30, 2012. Because the MHC determined not to waive receipt of the dividend for the quarter ended June 30, 2012, the MHC received \$218,000 in dividends in August 2012. The dividends waived are considered as a restriction on the retained earnings of the Company. As of June 30, 2013 and December 31, 2012, the aggregate retained earnings restricted for cash dividends waived were \$4,801,000 and \$4,364,000, respectively.

**Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations**

**FORWARD-LOOKING STATEMENTS**

This quarterly report contains forward-looking statements that are based on assumptions and may describe future plans, strategies and expectations of the Company. These forward-looking statements 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, national and regional economic conditions, legislative and 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 and composition of the loan or investment portfolios, demand for loan products, deposit flows, competition, demand for financial services in the Company’s market area, changes in real estate market values in the Company’s market area, and changes in relevant accounting principles and guidelines. Additional factors that may affect the Company’s results are discussed in the Company’s Annual Report on Form 10-K under “Item 1A. Risk Factors.” These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Except as required by applicable law or regulation, the Company does not undertake, and specifically disclaims any obligation, to release publicly the result of any revisions that may be made to any forward-looking statements to reflect events or circumstances after the date of the statements or to reflect the occurrence of anticipated or unanticipated events.

**CRITICAL ACCOUNTING POLICIES**

We consider accounting policies involving significant judgments and assumptions by management that have, or could have, a material impact on the carrying value of certain assets or on income to be critical accounting policies. We consider the allowance for loan losses to be a critical accounting policy.

***Allowance for Loan Losses.*** The allowance for loan losses is the amount estimated by management as necessary to cover probable credit losses in the loan portfolio at the statement of financial condition date. The allowance is established through the provision for loan losses, which is charged to income. Determining the amount of the allowance for loan losses necessarily involves a high degree of judgment. Among the material estimates required to establish the allowance are: loss exposure at default; the amount and timing of future cash flows on impaired loans; value of collateral; and determination of loss factors to be applied to the various elements of the portfolio. All of these estimates are susceptible to significant change. Management reviews the level of the allowance on a quarterly basis and establishes the provision for loan losses based upon an evaluation of the portfolio, past loss experience, current economic conditions and other factors related to the collectability of the loan portfolio. Although we believe that we use the best information available to establish the allowance for loan losses, future adjustments to the allowance may be necessary if economic conditions differ substantially from the assumptions used in making the evaluation.

Due to the conversion of the Bank to a New York State-chartered savings bank on June 29, 2012, the Federal Deposit Insurance Corporation (“FDIC”) and the New York State Department of Financial Services (“NYS”) are now the Bank’s primary regulators. As such, the FDIC and NYS, as an integral part of their examination process, periodically review our allowance for loan losses. The FDIC and NYS could require us to recognize adjustments to the allowance based on their judgments about information available to them at the time of their examinations. A large loss or a series of losses could deplete the allowance and require increased provisions to replenish the allowance, which would negatively affect earnings. For additional discussion, see Note 1 to the consolidated financial statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2012.

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**Second Quarter Performance Highlights**

The Company's earnings for the quarter ended June 30, 2013 increased by \$116,000 compared to the same period in 2012 primarily due to a decrease in provision for loan losses, partially offset by a decrease in net interest income, a decrease in non-interest income, an increase in non-interest expenses, and an increase in the provision for income taxes. The decrease in provision for loan losses was due to a decrease in the loan portfolio of \$931,000, or 0.3%, to \$332.9 million at June 30, 2013 from \$333.8 million at December 31, 2012 and a decrease in the balance of non-performing loans.

Non-performing loans decreased by \$1.8 million, or 54.4%, to \$2.2 million as of June 30, 2013 from \$4.0 million as of December 31, 2012. Furthermore, non-performing loans decreased by \$5.9 million, or 73.4%, to \$2.2 million as of June 30, 2013 from \$8.1 million as of June 30, 2012. The decrease in non-performing loans from June 30, 2012 to June 30, 2013 was due to the conversion from non-performing to performing status of three mortgage loans totaling \$4.6 million, the charge-off of two mortgage loans totaling \$1.9 million, and the satisfaction of two mortgage loans totaling \$1.1 million, partially offset by the addition of four mortgage loans totaling \$1.7 million. We will continue to monitor our loan portfolio closely and adjust the level of allowance for loan losses appropriately as updated information becomes available.

Our interest rate spread improved to 3.92% for the three months ended June 30, 2013 from 3.41% for the three months ended June 30, 2012 and our net interest margin improved to 4.16% for the three months ended June 30, 2013 from 3.65% for the three months ended June 30, 2012.

**Comparison of Financial Condition at June 30, 2013 and December 31, 2012**

Total assets decreased by \$15.4 million, or 3.5%, to \$428.9 million at June 30, 2013 from \$444.2 million at December 31, 2012. The decrease in total assets was due to decreases of \$10.1 million in cash and cash equivalents, \$2.0 million in securities held-to-maturity, \$931,000 in loans receivable, net, \$828,000 in other assets, \$481,000 in Federal Home Loan Bank of New York ("FHLB") stock, \$450,000 in real estate owned, \$367,000 in premises and equipment, \$334,000 in goodwill, and \$249,000 in certificates of deposits at other financial institutions, partially offset by an increase of \$319,000 in bank owned life insurance. The decrease in total assets primarily resulted from decreases of \$5.6 million in deposits, \$10.0 million in FHLB advances, and \$926,000 in advance payments by borrowers for taxes and insurance, partially offset by increases of \$741,000 in accounts payable and accrued expenses and \$460,000 in stockholders' equity.

Cash and cash equivalents decreased by \$10.1 million, or 20.5%, to \$39.1 million at June 30, 2013 from \$49.2 million at December 31, 2012 due primarily to the above mentioned decreases in deposits, advance payments by borrowers for taxes and insurance, securities held-to-maturity, loans receivable, FHLB stock, and certificates of deposits at other



financial institutions, and repayment of FHLB advances.

Securities held-to-maturity decreased by \$2.0 million, or 16.5%, to \$10.0 million at June 30, 2013 from \$12.0 million at December 31, 2012 due primarily to repayments of \$2.1 million. Certificates of deposits at other financial institutions decreased by \$249,000, or 62.4%, to \$150,000 at June 30, 2013 from \$399,000 at December 31, 2012 due to the maturity and redemption of a certificate of deposit.

Loans receivable, net, decreased by \$931,000, or 0.3%, to \$332.9 million at June 30, 2013 from \$333.8 million at December 31, 2012 due primarily to loan repayments and charge-offs totaling \$26.1 million that exceeded loan originations totaling \$25.1 million. FHLB stock decreased by \$481,000, or 35.5%, to \$874,000 at June 30, 2013 from \$1.4 million at December 31, 2012 due primarily to a decrease in the amount of FHLB stock that we are required to hold as a result of decreases in FHLB advances and the mortgage loan portfolio.

Bank owned life insurance increased by \$319,000, or 1.6%, to \$20.2 million at June 30, 2013 from \$19.9 million at December 31, 2012 due to accrued earnings during 2013. Real estate owned decreased by \$450,000, or 10.5%, to \$3.8 million at June 30, 2013 from \$4.3 million at December 31, 2012 due to the sale of a foreclosed property. Premises and equipment decreased by \$367,000, or 2.8%, to \$12.5 million at June 30, 2013 from \$12.9 million at December 31, 2012 due primarily to depreciation. Other assets decreased by \$828,000, or 10.6%, to \$7.0 million at June 30, 2013 from \$7.8 million at December 31, 2012 due to a refund of the FDIC prepaid insurance and reductions in tax accruals and prepaid insurance.

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Deposits decreased by \$5.6 million, or 1.8%, to \$312.5 million at June 30, 2013 from \$318.1 million at December 31, 2012. The decrease in deposits was primarily attributable to decreases of \$2.0 million in non-interest bearing accounts, \$1.6 million in regular savings accounts, \$1.1 million in certificates of deposits, and \$971,000 in NOW and money market accounts.

Advance payments by borrowers for taxes and insurance decreased by \$926,000, or 26.3%, to \$2.6 million at June 30, 2013 from \$3.5 million at December 31, 2012 due primarily to remittances of taxes for our borrowers.

FHLB advances decreased by \$10.0 million, or 66.7%, to \$5.0 million at June 30, 2013 from \$15.0 million at December 31, 2012 due primarily to the maturity and repayment of certain FHLB advances.

Stockholders' equity increased by \$460,000 to \$104.3 million at June 30, 2013, from \$103.8 million at December 31, 2012. This increase was primarily the result of comprehensive income of \$687,000 and the amortization of \$75,000 for the ESOP for the period, partially offset by cash dividends declared of \$302,000.

**Comparison of Operating Results for the Three Months Ended June 30, 2013 and 2012**

**General.** Net income increased by \$116,000, or 43.8%, to \$381,000 for the quarter ended June 30, 2013, from \$265,000 for the quarter ended June 30, 2012. The increase was primarily the result of a decrease of \$541,000 in provision for loan losses, offset by a decrease of \$194,000 in net interest income, a decrease of \$151,000 in non-interest income, an increase of \$8,000 in non-interest expenses and an increase of \$72,000 in the provision for income taxes.

**Net Interest Income.** Net interest income decreased by \$194,000, or 4.6%, to \$4.0 million for the three months ended June 30, 2013 from \$4.2 million for the three months ended June 30, 2012. The decrease in net interest income resulted primarily from a decrease of \$341,000 in interest income that exceeded a decrease of \$147,000 in interest expense.

The net interest spread increased by 51 basis points to 3.92% for the three months ended June 30, 2013 from 3.41% for the three months ended June 30, 2012. The net interest margin increased by 51 basis points between these periods from 3.65% for the quarter ended June 30, 2012 to 4.16% for the quarter ended June 30, 2013. The increase in the interest rate spread and the net interest margin in the second quarter of 2013 compared to the same period in 2012 was due to an increase in the yield on our interest-earning assets that exceeded an increase in the cost of our interest-bearing liabilities.

The average yield on our interest-earning assets increased by 52 basis points to 4.97% for the three months ended June 30, 2013 from 4.45% for the three months ended June 30, 2012 and the cost of our interest-bearing liabilities increased by 1 basis points to 1.05% for the three months ended June 30, 2013 from 1.04% for the three months ended June 30, 2012. The increase in the yield on our interest-earning assets was due to a decrease in other interest-earning assets, resulting in a shift in the composition of interest-earning assets whereby higher yielding loans receivable represented a larger percentage of total interest-earning assets in the June 30, 2013 quarter compared to the June 30, 2012 quarter. The increase in the yield of our interest-earning assets was also due to a decrease in our non-performing assets by \$6.4 million, or 78.8%, to \$1.7 million as of June 30, 2013 from \$8.1 million as of June 30, 2012. The increase in the cost of our interest-bearing liabilities was due to the offering of competitive interest rates to generate deposits in connection with the opening of two new branches in Framingham and Quincy, Massachusetts during the latter part of the third quarter of 2012 and, offset by the Company's decision to reduce our interest rates offered on our deposits during the second quarter of 2013.

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The following table summarizes average balances and average yields and costs of interest-earning assets and interest-bearing liabilities for the three months ended June 30, 2013 and 2012.

	Three Months Ended June 30,			2012		
	2013	Interest and Dividends	Yield/ Cost	Average Balance	Interest and Dividends	Yield/ Cost
(Dollars in thousands)						
Assets:						
Interest-earning assets:						
Loans	\$343,487	\$ 4,677	5.45 %	\$356,024	\$ 4,969	5.58 %
Securities (including FHLB stock)	11,720	84	2.87	16,187	126	3.11
Other interest-earning assets	28,476	2	0.03	86,665	9	0.04
Total interest-earning assets	383,683	4,763	4.97	458,876	5,104	4.45
Allowance for loan losses	(4,683 )			(6,667 )		
Non-interest-earning assets	50,110			38,696		
Total assets	\$429,110			\$490,905		
Liabilities and equity:						
Interest-bearing liabilities:						
Interest-bearing demand	\$61,107	\$ 52	0.34 %	\$112,014	\$ 127	0.45 %
Savings and club accounts	82,049	110	0.54	91,808	131	0.57
Certificates of deposit	147,395	568	1.54	137,369	527	1.53
Total interest-bearing deposits	290,551	730	1.00	341,191	785	0.92
Borrowings	5,000	45	3.60	15,000	137	3.65
Total interest-bearing liabilities	295,551	775	1.05	356,191	922	1.04
Noninterest-bearing demand	20,567			18,030		
Other liabilities	8,572			8,988		
Total liabilities	324,690			383,209		
Stockholders' equity	104,420			107,696		
Total liabilities and Stockholders' equity	\$429,110			\$490,905		
Net interest income		\$ 3,988			\$ 4,182	
Interest rate spread			3.92 %			3.41 %
Net interest margin			4.16 %			3.65 %
Net interest-earning assets	\$88,132			\$102,685		
Interest-earning assets to interest-bearing liabilities	129.82 %			128.83 %		

Total interest income decreased by \$341,000, or 6.7%, to \$4.8 million for the three months ended June 30, 2013, from \$5.1 million for the three months ended June 30, 2012. Interest income on loans decreased by \$292,000, or 5.9%, to \$4.7 million for the three months ended June 30, 2013 from \$5.0 million for the three months ended June 30, 2012. The decrease was primarily the result of a decrease of 13 basis points in the average yield on loans to 5.45% for the three months ended June 30, 2013 from 5.58% for the three months ended June 30, 2012. The decrease in interest

income and the average yield on loans was also due to the pay-off of numerous higher yielding mortgage loans and the refinancing and/or re-pricing to lower interest rates of numerous mortgage loans in our loan portfolio. The decrease in interest income was also due to a decrease of \$12.5 million, or 3.5%, in the average balance of the loan portfolio to \$343.5 million for the three months ended June 30, 2013 from \$356.0 million for the three months ended June 30, 2012 as repayments outpaced originations and charge-offs, net of recoveries.

Interest income on securities decreased by \$42,000, or 33.3%, to \$84,000 for the three months ended June 30, 2013 from \$126,000 for the three months ended June 30, 2012. The decrease was primarily due to a decrease of \$4.5 million, or 27.6%, in the average balance of securities to \$11.7 million for the three months ended June 30, 2013 from \$16.2 million for the three months ended June 30, 2012. The decrease in the average balance was due to the principal repayments on investment securities and a decrease in FHLB New York stock. The decrease in interest income on securities was also due to a decrease of 24 basis points in the average yield on securities to 2.87% for the three months ended June 30, 2013 from 3.11% for the three months ended June 30, 2012. The decline in the yield was also due to the re-pricing of the yield of our adjustable rate investment securities and a decrease in FHLB stock yield from 4.5% at June 30, 2012 to 4.0% at June 30, 2013.

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Interest income on other interest-earning assets (consisting solely of interest-earning deposits) decreased by \$7,000, or 77.8% to \$2,000 for the three months ended June 30, 2013 from \$9,000 for the three months ended June 30, 2012. The decrease was primarily due to a decrease of \$58.2 million, or 67.1%, in the average balance of interest-earning assets to \$28.5 million for the three months ended June 30, 2013 from \$86.7 million for the three months ended June 30, 2012. The decrease was also due to a decrease of 1 basis point in the average yield on other interest-earning assets to 0.03% for the three months ended June 30, 2013 from 0.04% for the three months ended June 30, 2012.

The decrease in the average balance of other interest-earning assets was due to decreases in cash and cash equivalents and certificates of deposit at other financial institutions. The decline in the yield was due to the maturity of higher yielding certificates of deposits at other financial institutions.

Total interest expense decreased by \$147,000, or 15.9%, to \$775,000 for the three months ended June 30, 2013 from \$922,000 for the three months ended June 30, 2012. Interest expense on deposits decreased by \$55,000, or 7.0%, to \$730,000 for the three months ended June 30, 2013 from \$785,000 for the three months ended June 30, 2012. The decrease in the interest expense on deposits was a result of our decision to reduce our interest rates offered on our interest-bearing demand deposits and interest-bearing savings and club deposits in order to improve our net interest spread and net interest margin to increase profitability, offset by an increase in the average balance and average interest cost of our certificates of deposit as a result of offering competitive interest rates to generate deposits in connection with the opening of two new branches in Framingham and Quincy, Massachusetts during the latter part of the third quarter of 2012. This resulted in an increase of 8 basis points in the average interest cost of deposits to 1.00% for the three months ended June 30, 2013 from 0.92% for the three months ended June 30, 2012.

The decrease in interest expense on deposits was also due to a decrease of \$50.6 million, or 14.8%, in the average balance of interest-bearing deposits to \$290.6 million for the three months ended June 30, 2013 from \$341.2 million for the three months ended June 30, 2012. The decrease in the average balance of interest-bearing deposits was due to decreases in the average balance of our interest-bearing demand deposits and interest-bearing savings and club accounts, offset by increases in the average balance of our interest-bearing certificates of deposits. The decrease in the average balances of our interest-bearing demand deposits and interest-bearing savings and club accounts was due to the Company's decision to reduce our interest rates offered on our deposits. The increase in the average balance of our interest-bearing certificates of deposit was due to offering competitive interest rates in connection with the opening of two new branches in Framingham and Quincy, Massachusetts during the latter part of the third quarter of 2012.

The interest expense of our interest-bearing demand deposits decreased by \$75,000, or 59.1%, to \$52,000 for the three months ended June 30, 2013 from \$127,000 for the three months ended June 30, 2012. The decrease in interest expense in our interest-bearing demand deposits was due to our decision to reduce our interest rates in interest-bearing demand deposits that resulted in an 11 basis point decrease in the average interest cost to 0.34% for the three months ended June 30, 2013 from 0.45% for the three months ended June 30, 2012. The decrease in interest expense on our interest-bearing demand deposits was also due to a decrease of \$50.9 million, or 45.5%, in the average balance of our interest-bearing demand deposits to \$61.1 million for the three months ended June 30, 2013 from \$112.0 million for the three months ended June 30, 2012.

The interest expense of our interest-bearing savings and club deposits decreased by \$21,000, or 16.0%, to \$110,000 for the three months ended June 30, 2013 from \$131,000 for the three months ended June 30, 2012. The decrease in interest expense in our interest-bearing savings and club deposits resulted from our decision to reduce our interest rates in interest-bearing savings and club deposits that resulted in a 3 basis point decrease in the average interest cost to 0.54% for the three months ended June 30, 2013 from 0.57% for the three months ended June 30, 2012. The decrease in interest expense on our interest-bearing savings and club deposits was also due to a decrease of \$9.8 million, or 10.6%, in the average balance of our interest-bearing savings and club deposits to \$82.0 million for the three months ended June 30, 2013 from \$91.8 million for the three months ended June 30, 2012.

The interest expense of our interest-bearing certificates of deposit increased by \$41,000, or 7.8%, to \$568,000 for the three months ended June 30, 2013 from \$527,000 for the three months ended June 30, 2012. The increase in interest expense in our interest-bearing certificates of deposit was due to offering competitive interest rates in connection with the opening of two new branches in Framingham and Quincy, Massachusetts during the latter part of the third quarter of 2012. This resulted in an increase of \$10.0 million, or 7.3%, in the average balance of our interest-bearing certificates of deposit to \$147.4 million for the three months ended June 30, 2013 from \$137.4 million for the three months ended June 30, 2012. The increase in interest expense of our interest-bearing certificates of deposit was also due to a 1 basis point increase in the average interest cost to 1.54% for the three months ended June 30, 2013 from 1.53% for the three months ended June 30, 2012.

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Interest expense on borrowings decreased by \$92,000, or 67.2%, to \$45,000 for the three months ended June 30, 2013 from \$137,000 for the three months ended June 30, 2012. The decrease was primarily due to a decrease of \$10.0 million, or 66.7%, in the average balance of borrowed money to \$5.0 million for the three months ended June 30, 2013 from \$15.0 million for the three months ended June 30, 2012. The decrease in interest expense on borrowings was also due to a decrease of 5 basis points in the cost of borrowed money to 3.60% for the three months ended June 30, 2013 from 3.65% for the three months ended June 30, 2012 due primarily to the maturity and repayment of higher costing FHLB advances from 2012 to 2013.

**Provision for Loan Losses.** The following table summarizes the activity in the allowance for loan losses and provision for loan losses for the three months ended June 30, 2013 and 2012.

	Three Months Ended June 30,	
	2013	2012
	(Dollars in thousands)	
Allowance at beginning of period	\$ 4,706	\$ 7,086
Provision for loan losses	(423 )	117
Charge-offs	105	3,336
Recoveries	27	—
Net charge-offs	78	3,336
Allowance at end of period	\$ 4,205	\$ 3,867
Allowance to nonperforming loans	195.40 %	47.89 %
Allowance to total loans outstanding at the end of the period	1.25 %	1.10 %
Net charge-offs (recoveries) to average loans outstanding during the period	0.02 %	0.94 %

The allowance to non-performing loans ratio increased to 195.40% at June 30, 2013 from 47.89% at June 30, 2012 due primarily to the decrease in non-performing loans to \$2.2 million at June 30, 2013 from \$8.1 million at June 30, 2012 coupled with an increase in the allowance for loan losses. The decrease in non-performing loans was due to the identification, monitoring and resolution of several non-performing loans that were paid-off or became performing as of June 30, 2013.

The allowance for loan losses was \$4.21 million at June 30, 2013, \$4.65 million at December 31, 2012, and \$3.87 million at June 30, 2012. We recorded a credit provision for loan losses of (\$423,000) for the three month period ended June 30, 2013 compared to provision for loan losses of \$117,000 for the three month period ended June 30, 2012. The reduction in the provision for loan losses was due to a decrease in the loan portfolio of \$931,000, or 0.3%, to \$332.9 million at June 30, 2013 from \$333.8 million at December 31, 2012 and a decrease in the amount of non-performing loans in the loan portfolio.



We charged-off \$105,000 against two non-performing non-residential mortgage loans during the three months ended June 30, 2013 compared to charge-offs of \$3.3 million against four non-performing multi-family mortgage loans, four non-performing non-residential mortgage loans, and one non-performing construction mortgage loan during the three months ended June 30, 2012. We recorded recoveries of \$27,000 during the three months ended June 30, 2013 compared to no recoveries during the three months ended June 30, 2012.

**Non-interest Income.** Non-interest income decreased by \$150,000, or 24.4%, to \$466,000 for the three months ended June 30, 2013 from \$616,000 for the three months ended June 30, 2012. The decrease was primarily due to a \$111,000 decrease in other loan fees and service charges, primarily due to a decrease of \$137,000 in mortgage broker fee income, and a \$57,000 decrease in fee income generated by our wealth management division, partially offset by a \$19,000 increase in earnings on bank owned life insurance.

**Non-interest Expense.** Non-interest expense increased by \$8,000, or 0.2%, to \$4.36 million for the three months ended June 30, 2013 from \$4.35 million for the three months ended June 30, 2012. The increase resulted primarily from increases of \$334,000 in impairment loss on goodwill, \$171,000 in real estate owned expenses, \$34,000 in occupancy expense, and \$2,000 in outside data processing expense, offset by decreases of \$234,000 in salaries and employee benefits, \$187,000 in other non-interest expense, \$62,000 in equipment expense, \$35,000 in advertising expense, and \$15,000 in FDIC insurance expense.

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During the second quarter of 2013, the Company determined that an adjustment to the goodwill impairment of \$227,000 previously recorded in 2012 was necessary. As a result, an additional impairment charge of \$334,000 was recognized during the second quarter of 2013. The goodwill was recorded in connection with the Hayden Financial Group acquisition in 2007. The impairment was caused primarily by the expected decrease in other revenue from this division resulting from a reduction in personnel. The Company did not have any impairment loss on goodwill in the quarter ended June 30, 2012.

Real estate owned expense increased by \$171,000 due to a loss of \$51,000 on the sale of a real estate owned and the addition of two foreclosed properties subsequent to June 30, 2012 resulting in an increase in real estate owned to \$3.8 million as of June 30, 2013 from no real estate owned as of June 30, 2012.

Occupancy expense increased by \$34,000, or 10.9%, to \$346,000 in 2013 from \$312,000 in 2012 due to the addition of the new Framingham and Quincy, Massachusetts branch offices. Outside data processing expense increased by \$2,000, or 0.7%, to \$283,000 in 2013 from \$281,000 in 2012 due to nominal increases from the Company's data processing vendors.

Salaries and employee benefits, which represented 45.7% of the Company's non-interest expense during the quarter ended June 30, 2013, decreased by \$234,000, or 10.5%, to \$2.0 million in 2013 from \$2.2 million in 2012 due to a decrease in the number of full time equivalent employees to 104 at June 30, 2013 from 114 at June 30, 2012. The decrease in full time employees was due to the Company's efforts to control the increase in salaries and employee benefits by reducing staff in various departments, including the mortgage brokerage department, the wealth management department, and branch operations from June 30, 2012 to June 30, 2013.

Other non-interest expense decreased by \$187,000, or 16.1%, to \$978,000 in 2013 from \$1.2 million in 2012 due mainly to decreases of \$103,000 in recruitment expenses related to the hiring of additional personnel in the Company's Headquarters and Massachusetts locations, \$91,000 in directors, officers and employee expenses, \$70,000 in legal fees, \$17,000 in service contracts, and \$4,000 in office supplies and stationery. These decreases were partially offset by increases of \$44,000 in audit and accounting fees, \$21,000 in director's compensation, \$17,000 in telephone expenses, \$8,000 in consulting fees, and \$4,000 in insurance expenses.

Equipment expense decreased by \$62,000, or 29.2%, to \$150,000 in 2013 from \$212,000 in 2012 and advertising expense decreased by \$35,000, or 63.6%, to \$20,000 in 2013 from \$55,000 in 2012 due to decreases in the purchases of additional equipment and a decrease in marketing efforts in order to contain expenses. FDIC insurance expense decreased by \$15,000, or 15.3%, to \$83,000 in 2013 from \$98,000 in 2012 due to a decrease in deposits.

**Income Taxes.** Income tax expense increased by \$72,000, or 107.5%, to \$139,000 for the three months ended June 30, 2013 from \$67,000 for the three months ended June 30, 2012. The increase resulted primarily from a \$188,000

increase in pre-tax income in 2013 compared to 2012. The effective tax rate was 26.7% for the three months ended June 30, 2013 and 20.2% for the three months ended June 30, 2012. The increase in the effective tax rate was primarily due to the decreased portion of pre-tax income during 2013 attributed to tax-exempt earnings on bank-owned life insurance.

### **Comparison of Operating Results For The Six Months Ended June 30, 2013 and 2012**

**General.** Net income increased by \$71,000, or 13.7%, to \$588,000 for the six months ended June 30, 2013 from \$517,000 for the six months ended June 30, 2012. The increase was primarily the result of a decrease of \$480,000 in provision for loan losses, offset by a decrease of \$141,000 in net interest income, a decrease of \$122,000 in non-interest income, an increase of \$121,000 in non-interest expenses and an increase of \$25,000 in the provision for income taxes.

**Net Interest Income.** Net interest income decreased by \$141,000, or 1.8%, to \$7.9 million for the six months ended June 30, 2013 from \$8.0 million for the six months ended June 30, 2012. The decrease in net interest income resulted primarily from a decrease of \$634,000 in interest income that exceeded a decrease of \$493,000 in interest expense.

The net interest spread increased by 60 basis points to 3.82% for the six months ended June 30, 2013 from 3.22% for the six months ended June 30, 2012. The net interest margin increased by 59 basis points between these periods from 3.47% for the six months ended June 30, 2012 to 4.06% for the six months ended June 30, 2013. The increase in the interest rate spread and the net interest margin in the first half of 2013 compared to the same period in 2012 was due to an increase in the yield on our interest-earning assets coupled with a decrease in the cost of our interest-bearing liabilities.

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The average yield on our interest-earning assets increased by 51 basis points to 4.89% for the six months ended June 30, 2013 from 4.38% for the six months ended June 30, 2012 and the cost of our interest-bearing liabilities decreased by 9 basis points to 1.07% for the six months ended June 30, 2013 from 1.16% for the six months ended June 30, 2012. The increase in the yield on our interest-earning assets was due to a decrease in other interest-earning assets, resulting in a shift in the composition of interest-earning assets whereby higher yielding loans receivable represented a larger percentage of total interest-earning assets for the six months ended June 30, 2013 quarter compared to the six months ended June 30, 2012. The increase in the yield of our interest-earning assets was also due to a decrease in our non-performing assets by \$6.4 million, or 78.8%, to \$1.7 million as of June 30, 2013 from \$8.1 million as of June 30, 2012. The decrease in the cost of our interest-bearing liabilities was due to the Company's decision to reduce interest rates offered on our deposits.

The following table summarizes average balances and average yields and costs of interest-earning assets and interest-bearing liabilities for the six months ended June 30, 2013 and 2012.

	Six Months Ended June 30, 2013			2012		
	Average Balance	Interest and Dividends	Yield/ Cost	Average Balance	Interest and Dividends	Yield/ Cost
	(Dollars in thousands)					
Assets:						
Interest-earning assets:						
Loans	\$344,039	\$ 9,323	5.42 %	\$358,414	\$ 9,861	5.50 %
Securities	12,353	183	2.96	16,837	264	3.14
Other interest-earning assets	32,960	6	0.04	88,091	21	0.05
Total interest-earning assets	389,352	9,512	4.89	463,342	10,146	4.38
Allowance for loan losses	(4,504 )			(6,940 )		
Non-interest-earning assets	50,017			37,725		
Total assets	\$434,865			\$494,127		
Liabilities and equity:						
Interest-bearing liabilities:						
Interest-bearing demand	\$61,480	\$ 102	0.33 %	\$115,640	\$ 378	0.65 %
Savings and club accounts	82,642	219	0.53	89,706	329	0.73
Certificates of deposit	147,701	1,137	1.54	139,014	1,110	1.60
Total interest-bearing deposits	291,823	1,458	1.00	344,360	1,817	1.06
Borrowings	8,122	146	3.60	17,044	280	3.29
Total interest-bearing liabilities	299,945	1,604	1.07	361,404	2,097	1.16
Noninterest-bearing demand	22,108			17,268		
Other liabilities	7,856			7,874		
Total liabilities	329,909			386,546		
Stockholders' equity	104,956			107,581		

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Total liabilities and Stockholders' equity	\$434,865		\$494,127	
Net interest income		\$ 7,908		\$ 8,049
Interest rate spread			3.82 %	3.22 %
Net interest margin			4.06 %	3.47 %
Net interest-earning assets	\$89,407		\$101,938	
Average interest-earning assets to average interest-bearing liabilities	129.81 %		128.21 %	

Total interest income decreased by \$634,000, or 6.2%, to \$9.5 million for the six months ended June 30, 2013, from \$10.1 million for the six months ended June 30, 2012. Interest income on loans decreased by \$538,000, or 5.5%, to \$9.3 million for the six months ended June 30, 2013 from \$9.9 million for the six months ended June 30, 2012 as a result of a decrease of 8 basis points in the average yield on loans to 5.42% for the six months ended June 30, 2013 from 5.50% for the six months ended June 30, 2012. The decrease in interest income and the average yield on loans was due to the pay-off of higher yielding mortgage loans and the refinancing and/or re-pricing to lower interest rates of mortgage loans in our loan portfolio. The decrease in interest income was also due to a decrease of \$14.4 million, or 4.0%, in the average balance of the loan portfolio to \$344.0 million for the six months ended June 30, 2013 from \$358.4 million for the six months ended June 30, 2012 as repayments outpaced originations.

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Interest income on securities decreased by \$81,000, or 30.7%, to \$183,000 for the six months ended June 30, 2013 from \$264,000 for the six months ended June 30, 2012. The decrease was primarily due to a decrease of \$4.5 million, or 26.6%, in the average balance of securities to \$12.4 million for the six months ended June 30, 2013 from \$16.8 million for the six months ended June 30, 2012. The decrease in the average balance was due to principal repayments on investment securities and a decrease in FHLB New York stock. The decrease in interest income on securities was also due to a decrease of 18 basis points in the average yield on securities to 2.96% for the six months ended June 30, 2013 from 3.14% for the six months ended June 30, 2012. The decline in the yield was due to the re-pricing of the yield of our adjustable rate investment securities and a decrease in FHLB stock yield from 4.5% at June 30, 2012 to 4.0% at June 30, 2013.

Interest income on other interest-earning assets (consisting solely of interest-earning deposits) decreased by \$15,000, or 71.4%, to \$6,000 for the six months ended June 30, 2013 from \$21,000 for the six months ended June 30, 2012. The decrease was primarily the result of a decrease of \$55.1 million, or 62.6%, in the average balance of other interest-earning assets to \$33.0 million for the six months ended June 30, 2013 from \$88.1 million for the six months ended June 30, 2012. The decrease in the average balance of other interest-earning assets was due to decreases in cash, cash equivalents, and certificates of deposit. The decrease in interest income on other interest-earning assets was also due to a decrease of 1 basis point in the yield to 0.04% for the six months ended June 30, 2013 from 0.05% for the six months ended June 30, 2012. The decline in the yield was due to the maturity of higher yielding certificates of deposits at other financial institutions.

Total interest expense decreased by \$493,000, or 23.5%, to \$1.6 million for the six months ended June 30, 2013 from \$2.1 million for the six months ended June 30, 2012. Interest expense on deposits decreased by \$359,000, or 19.8%, to \$1.5 million for the six months ended June 30, 2013 from \$1.8 million for the six months ended June 30, 2012. During this same period, the average interest cost of deposits decreased by 6 basis points to 1.00% for the six months ended June 30, 2013 from 1.06% for the six months ended June 30, 2012.

The decrease in interest expense on deposits was also due to a decrease of \$52.5 million, or 15.3%, in the average balance of interest-bearing deposits to \$291.8 million for the six months ended June 30, 2013 from \$344.4 million for the six months ended June 30, 2012. The decrease in the average balance of interest-bearing deposits was due to decreases in the average balance of our interest-bearing demand deposits and interest-bearing savings and club accounts, offset by increases in the average balance of our interest-bearing certificates of deposits. The decrease in the average balances of our interest-bearing demand deposits and interest-bearing savings and club accounts was due to the Company's decision to reduce our interest rates offered on our deposits. The increase in the average balance of our interest-bearing certificates of deposit was due to offering competitive interest rates in connection with the opening of two new branches in Framingham and Quincy, Massachusetts during the latter part of the third quarter of 2012.

The interest expense of our interest-bearing demand deposits decreased by \$276,000, or 73.0%, to \$102,000 for the six months ended June 30, 2013 from \$378,000 for the six months ended June 30, 2012. The decrease in interest expense in our interest-bearing demand deposits was due to our decision to reduce our interest rates in interest-bearing demand deposits that resulted in a 33 basis point decrease in the average interest cost to 0.33% for the six months ended June 30, 2013 from 0.65% for the six months ended June 30, 2012. The decrease in interest expense on our

interest-bearing demand deposits was also due to a decrease of \$54.2 million, or 46.8%, in the average balance of our interest-bearing demand deposits to \$61.5 million for the six months ended June 30, 2013 from \$115.6 million for the six months ended June 30, 2012.

The interest expense of our interest-bearing savings and club deposits decreased by \$110,000, or 33.4%, to \$219,000 for the six months ended June 30, 2013 from \$329,000 for the six months ended June 30, 2012. The decrease in interest expense in our interest-bearing savings and club deposits resulted from our decision to reduce our interest rates in interest-bearing savings and club deposits that resulted in a 20 basis point decrease in the average interest cost to 0.53% for the six months ended June 30, 2013 from 0.73% for the six months ended June 30, 2012. The decrease in interest expense on our interest-bearing savings and club deposits was also due to a decrease of \$7.1 million, or 7.9%, in the average balance of our interest-bearing savings and club deposits to \$82.6 million for the six months ended June 30, 2013 from \$89.7 million for the six months ended June 30, 2012.

The interest expense of our interest-bearing certificates of deposit increased by \$27,000, or 2.4%, to \$1.14 million for the six months ended June 30, 2013 from \$1.11 million for the six months ended June 30, 2012. The increase in interest expense in our interest-bearing certificates of deposit was due to an increase of \$8.7 million, or 6.3%, in the average balance of our interest-bearing certificates of deposit to \$147.7 million for the six months ended June 30, 2013 from \$139.0 million for the six months ended June 30, 2012, offset by a 6 basis point decrease in the average interest cost to 1.54% for the six months ended June 30, 2013 from 1.60% for the six months ended June 30, 2012. The increase in the average balance of our interest-bearing certificates of deposit was due to offering competitive interest rates in connection with the opening of two new branches in Framingham and Quincy, Massachusetts during the latter part of the third quarter of 2012. The decrease in the average interest cost was due to our decision to reduce our interest rates in interest-bearing certificates of deposit.

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Interest expense on borrowings decreased by \$134,000, or 47.9%, to \$146,000 for the six months ended June 30, 2013 from \$280,000 for the six months ended June 30, 2012. The decrease was primarily due to a decrease of \$8.9 million, or 52.4%, in the average balance of borrowed money to \$8.1 million for the six months ended June 30, 2013 from \$17.0 million for the six months ended June 30, 2012. Offsetting the decrease in interest expense on borrowings was an increase of 31 basis points in the cost of borrowed money to 3.60% for the six months ended June 30, 2013 from 3.29% for the six months ended June 30, 2012 due primarily to the maturity and repayment of lower costing FHLB advances from 2012 to 2013.

**Allowance for Loan Losses.** The following table summarizes the activity in the allowance for loan losses for the six months ended June 30, 2013 and 2012.

	Six Months Ended June 30,	
	2013	2012
	(Dollars in thousands)	
Allowance at beginning of period	\$ 4,646	\$ 7,397
Provision for loan losses	(363 )	117
Charge-offs	105	3,652
Recoveries	27	5
Net charge-offs	78	3,647
Allowance at end of period	\$ 4,205	\$ 3,867

We recorded provisions (credit) for loan losses of (\$363,000) and \$117,000 for the six-month periods ended June 30, 2013 and 2012, respectively. We charged-off \$105,000 against two non-performing non-residential mortgage loans during the six months ended June 30, 2013 compared to charge-offs of \$3.7 million against six non-performing multi-family mortgage loans, four non-performing non-residential mortgage loans, and one non-performing construction mortgage loan during the six months ended June 30, 2012. We recorded recoveries of \$27,000 during the six months ended June 30, 2013 compared to recoveries of \$5,000 during the six months ended June 30, 2012.

**Non-interest Income.** Non-interest income decreased by \$122,000, or 10.7%, to \$1.0 million for the six months ended June 30, 2013 from \$1.1 million for the six months ended June 30, 2012. The decrease was primarily due to an \$85,000 decrease in fee income generated by our wealth management division, an \$83,000 decrease in other loan fees and service charges, partially offset by a \$33,000 increase in earnings on bank owned life insurance and a \$4,000 increase in other non-interest income. The decrease in other loan fees and service charges was due to a decrease of \$160,000 in mortgage broker fee income, offset by increases of \$40,000 in commercial and industrial loan fee income, \$24,000 in deposit and ATM fees, and \$14,000 in other loan fees.

**Non-interest Expense.** Non-interest expense increased by \$121,000, or 1.4%, to \$8.6 million for the six months ended June 30, 2013 from \$8.4 million for the six months ended June 30, 2012. The increase resulted primarily from increases of \$334,000 in impairment loss on goodwill, \$251,000 in real estate owned expenses, \$139,000 in



occupancy expense, and \$45,000 in outside data processing expense, offset by decreases of \$420,000 in other non-interest expense, \$83,000 in advertising expense, \$78,000 in FDIC insurance expense, \$40,000 in salaries and employee benefits, and \$27,000 in equipment expense.

During the second quarter of 2013, the Company determined that an adjustment to the goodwill impairment of \$227,000 previously recorded in 2012 was necessary. As a result, an additional impairment charge of \$334,000 was recognized for the six months ended June 30, 2013. The goodwill was recorded in connection with the Hayden Financial Group acquisition in 2007. The impairment was caused primarily by the expected decrease in other revenue from this division resulting from a reduction in personnel. The Company did not have any impairment loss on goodwill for the six months ended June 30, 2012.

Real estate owned expense increased by \$251,000 due to a loss of \$51,000 on the sale of a real estate owned and the addition of two foreclosed properties subsequent to June 30, 2012 resulting in an increase in real estate owned to \$3.8 million as of June 30, 2013 from no real estate owned as of June 30, 2012.

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Occupancy expense increased by \$139,000, or 23.1%, to \$740,000 in 2013 from \$601,000 in 2012 due to the addition of the new Framingham and Quincy, Massachusetts branch offices and payment of arrearage cooperative assessments for the 23<sup>rd</sup> Street, New York branch office. Outside data processing expense increased by \$45,000, or 8.7%, to \$560,000 in 2013 from \$515,000 in 2012 due to the addition of two new branch offices in the latter part of the third quarter of 2012 and additional services provided by the Company's data processing vendors.

Other non-interest expense decreased by \$420,000, or 18.5%, to \$1.8 million in 2013 from \$2.3 million in 2012 due mainly to decreases of \$237,000 in directors, officers and employee expenses, \$193,000 in recruitment expenses related to the hiring of additional personnel in the Company's Headquarters and Massachusetts locations, \$38,000 in regulatory assessments, \$21,000 in donations, \$17,000 in consulting fees, \$14,000 in service contracts, and \$7,000 in postage expenses, offset by increases of \$74,000 in audit and accounting fees, \$50,000 in director's compensation, \$29,000 in telephone expenses, and \$5,000 in insurance expense.

FDIC insurance expense decreased by \$78,000, or 40.8%, to \$113,000 in 2013 from \$191,000 in 2012 due to a decrease in deposits. Advertising expense decreased by \$83,000, or 73.5%, to \$30,000 in 2013 from \$113,000 in 2012 and equipment expense decreased by \$27,000, or 7.5%, to \$331,000 in 2013 from \$358,000 in 2012 due to efforts to contain cost that resulted in decreases in marketing efforts and decreases in the purchases of additional equipment.

Salaries and employee benefits, which represented 50.7% of the Company's non-interest expense during the six months ended June 30, 2013, decreased by \$40,000, or 0.9%, to \$4.34 million in 2013 from \$4.38 million in 2012 due to a decrease in the number of full time equivalent employees to 104 at June 30, 2013 from 114 at June 30, 2012, offset by the staffing of the Framingham and Quincy, Massachusetts branch offices that opened during the latter part of the third quarter of 2012. The decrease in full time employees was due to the Company's efforts to control the increase in salaries and employee benefits by reducing staff in various departments, including the mortgage brokerage department, the wealth management department, and branch operations from June 30, 2012 to June 30, 2013.

**Income Taxes.** Income tax expense increased by \$25,000, or 18.8%, to \$158,000 for the six months ended June 30, 2013 from \$133,000 for the six months ended June 30, 2012. The increase resulted primarily from a \$96,000 increase in pre-tax income in 2013 compared to 2012. The effective tax rate was 21.2% for the six months ended June 30, 2013 and 20.5% for the six months ended June 30, 2012. The increase in the effective tax rate was primarily due to the decreased portion of pre-tax income during 2013 attributed to tax-exempt earnings on bank-owned life insurance.

**NON PERFORMING ASSETS**

The following table provides information with respect to our non-performing assets at the dates indicated.

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	At June 30, 2013	At December 31, 2012		
	(Dollars in thousands)			
Non-accrual loans	\$ 2,152	\$ 3,957		
Loans past due 90 days or more and accruing	—	—		
Total nonaccrual and 90 days or more past due loans	2,152	3,957		
Other non-performing loans	—	—		
Total non-performing loans	2,152	3,957		
Real estate owned	3,821	4,271		
Total non-performing assets	5,973	8,228		
Accruing troubled debt restructurings	15,826	12,236		
Nonaccrual troubled debt restructurings	1,230	1,197		
Total troubled debt restructurings	17,056	13,433		
Less nonaccrual troubled debt restructurings in total nonaccrual loans	1,230	1,197		
Total troubled debt restructurings and non-performing assets	\$ 21,799	\$ 20,464		
Total non-performing loans to total loans	0.64	%	1.17	%
Total non-performing assets to total assets	1.39	%	1.85	%
Total non-performing assets and troubled debt restructurings to total assets	4.99	%	4.61	%

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The non-accrual loans at June 30, 2013 consisted of five loans in the aggregate – two multi-family mortgage loans and three non-residential mortgage loans.

Non-performing loans decreased by \$1.8 million, or 45.6%, to \$2.2 million at June 30, 2013 from \$4.0 million at December 31, 2012. The decrease in non-performing loans was due to the satisfaction of two non-accrual mortgage loans totaling \$196,000 and the conversion from non-performing to performing status of four mortgage loans totaling \$1.8 million, partially offset by the addition of two mortgage loans totaling \$195,000.

The non-accrual non-residential mortgage loans, net of charge-offs of \$1.0 million, totaled \$2.0 million at June 30, 2013 consisted primarily of the following mortgage loans:

An outstanding balance of \$792,000, net of a charge-off of \$371,000, secured by a gasoline service station and car (1) wash. The loan is classified as substandard. A foreclosure action is proceeding and we are evaluating the options available to us.

(2) An outstanding balance of \$727,000, net of a charge-off of \$234,000, secured by a medical office building. We classified this loan as substandard. The Company has commenced a foreclosure action and the Court has appointed a receiver who is collecting rent and managing the building. We are evaluating the options available to us.

Based on current appraisals and/or fair value analyses of these properties, the Company does not anticipate any losses beyond the amounts already charged off.

At June 30, 2013, we owned one foreclosed property with a net balance of \$3.8 million consisting of an office building located in New Jersey. The Company's managing agent is operating and marketing the building.

**TROUBLED DEBT RESTRUCTURED LOANS**

There were four loans modified during the three and six months ended June 30, 2013.

The multi-family mortgage loan had an original interest rate of 6.75% with an amortization of 25 years. We reduced the interest rate and converted the monthly payments to interest only for twenty months and then amortizing for 30 years, with a balloon payment after approximately five and one-half years from the modification date.

Two non-residential mortgage loans had an original interest rate of 4.00% with an amortization of 25 years. We reduced the interest rate and converted the monthly payments to interest only for twenty months and then amortizing for 30 years, with a balloon payment after approximately five and one-half years from the modification date.

One non-residential mortgage loan had an original interest rate of 4.00% with an amortization of 30 years. We reduced the interest rate and converted the monthly payments to interest only for nineteen months and then amortizing for 30 years, with a balloon payment after two years from the modification date.

As of June 30, 2013, none of the loans that were modified during the previous twelve months had defaulted in the three and six month periods ended June 30, 2013.

The following tables show the activity in troubled debt restructured loans for the period indicated:

	Residential Real Estate	Nonresidential Real Estate	Construction	Commercial and Industrial	Consumer	Total
Balance at December 31, 2012	\$ 6,444	\$ 6,989	\$	— \$	— \$	— \$13,433
Additions	307	3,333		—	—	— 3,640
Repayments	(17 )	—		—	—	— (17 )
Balance - June 30, 2013	\$ 6,734	\$ 10,322	\$	— \$	— \$	— \$17,056
Related allowance	\$ —	\$ —	\$	— \$	— \$	— \$—

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There were no charge offs of loans classified as troubled debt restructurings in the three and six months ended June 30, 2013.

Additions for the period consist of the aforementioned four mortgage loans that were modified, real estate taxes and similar items paid to protect the collateral position of the Company.

The following tables show the activity in troubled debt restructured loans for the period indicated:

	Residential Real Estate	Nonresidential Real Estate	Construction	Commercial and Industrial	Consumer	Total
Balance at December 31, 2011	\$ 9,886	\$ 5,587	\$ —	\$ —	\$ —	\$15,473
Additions	1,243	10,597	—	—	—	11,840
Repayments	(2,746 )	(4,637 )	—	—	—	(7,383 )
Balance - June 30, 2012	\$ 8,383	\$ 11,547	\$ —	\$ —	\$ —	\$19,930
Related allowance	\$ —	\$ —	\$ —	\$ —	\$ —	\$—

There were charge offs of \$1.8 million against loans classified as troubled debt restructurings in the three and six months ended June 30, 2012.

Additions for the period consist of four non-residential mortgage loans and one residential mortgage loans that were modified, real estate taxes and similar items paid to protect the collateral position of the Company.

**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, and borrowings from the Federal Home Loan Bank of New York. 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.

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. Cash and cash equivalents totaled \$39.1 million at June 30, 2013 and consist primarily of interest-bearing deposits at other financial institutions and miscellaneous cash items. The Company can also borrow an additional \$97.1 million from the FHLB of New York to provide additional liquidity.

At June 30, 2013, we had \$49.0 million in loan commitments outstanding, consisting of \$25.7 million in unused commercial and industrial loan lines of credit, \$12.9 million of real estate loan commitments, \$6.7 million in unused real estate equity lines of credit, \$3.6 million in unused loans in process, and \$139,000 in consumer lines of credit. Certificates of deposit due within one year of June 30, 2013 totaled \$65.1 million. This represented 44.7% of certificates of deposit at June 30, 2013. We believe a large percentage of certificates of deposit that mature within one year reflects customers' hesitancy to invest their funds for long periods in the current interest rate environment. 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 paid on the certificates of deposit due on or before June 30, 2013. We believe, however, based on past experience, 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.

Our primary investing activities are the origination of loans and the purchase of securities. Our primary financing activities consist of deposit accounts and FHLB advances. At June 30, 2013, we had the ability to borrow \$97.1 million, net of \$5.0 million in outstanding advances, from the FHLB of New York. At June 30, 2013, we had no overnight advances outstanding. Deposit flows are affected by the overall level of interest rates, the interest rates and products offered by us and our local competitors and other factors. We generally manage the pricing of our deposits to be competitive and to maintain or increase our core deposit relationships depending on our level of real estate loan commitments outstanding. Occasionally, we offer promotional rates on certain deposit products to attract deposits or to lengthen repricing time frames.

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The Company is a separate legal entity from the Bank and must provide for its own liquidity. In addition to its operating expenses, the Company is responsible for paying any dividends declared to its shareholders and for the repurchase, if any, of its shares of common stock. At June 30, 2013, the Company had liquid assets of \$13.9 million.

**Capital Management.** The Bank is subject to various regulatory capital requirements administered by the 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 June 30, 2013, the Bank exceeded all regulatory capital requirements. The Bank is considered “well capitalized” under regulatory guidelines.

**Off-Balance Sheet Arrangements.** In the normal course of operations, we engage in a variety of financial transactions that, in accordance with U.S. generally accepted accounting principles, 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.

For the three and six months ended June 30, 2013 and the year ended December 31, 2012, we engaged in no off-balance sheet transactions reasonably likely to have a material effect on our financial condition, results of operations or cash flows.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

**Qualitative Aspects of Market Risk.** The Company’s most significant form of market risk is interest rate 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: originating mortgage real estate loans that re-price to market interest rates in three to five years; purchasing securities that typically re-price within a three year time frame to limit exposure to market fluctuations; and, where appropriate, offering higher rates on long term certificates of deposit to lengthen the re-pricing time frame of our liabilities. 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, comprised of our Chief Executive Officer, Chief Operating Officer, Interim Chief Financial Officer, Chief Retail Banking Officer, Chief Lending Officer – New England Region, and Chief Lending Officer – Mid-Atlantic Region, whose function is to communicate, coordinate and control all aspects involving asset/liability management. The committee 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.

Our goal is to manage asset and liability positions to moderate the effects of interest rate fluctuations on net interest income and net income.

**Quantitative Aspects of Market Risk.** We use an interest rate sensitivity analysis prepared by an independent third party to review our level of interest rate risk. This analysis measures interest rate risk by computing changes in the net portfolio value of our cash flows from assets, liabilities and off-balance sheet items in the event of a range of assumed changes in market interest rates. Net portfolio value represents the market value of portfolio equity and is equal to the market value of assets minus the market value of liabilities, with adjustments made for off-balance sheet items. These analyses assess the risk of loss in market risk-sensitive instruments in the event of a sudden and sustained 50 to 300 basis point increase or 50 and 100 basis point decrease in market interest rates with no effect given to any steps that we might take to counter the effect of that interest rate movement.

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The following table presents the change in our net portfolio value at June 30, 2013 that would occur in the event of an immediate change in interest rates based on the independent third party assumptions, with no effect given to any steps that we might take to counteract that change.

Basis Point (“bp”) Change in Rates	Net Portfolio Value (Dollars in thousands)			Net Portfolio Value as % of Portfolio Value of Assets		
	\$ Amount	\$ Change	% Change	NPV Ratio		Change
300	\$ 108,920	\$(12,065)	(10.0)%	26.09 %		(119) bp
200	112,791	(8,194 )	(6.8 )%	26.53 %		(75) bp
100	117,343	(3,642 )	(3.0 )%	27.02 %		(26) bp
0	120,985		—	27.28 %		
(100)	125,272	4,287	3.5 %	27.73 %		45 bp

We use various assumptions in assessing interest rate risk. These assumptions relate to interest rates, loan prepayment rates, deposit decay rates and the market values of certain assets under differing interest rate scenarios, among others. As with any method of measuring interest rate risk, certain shortcomings are inherent in the methods of analyses presented in the foregoing tables. For example, although certain assets and liabilities may have similar maturities or periods to repricing, they may react in different degrees to changes in market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates.

Additionally, certain assets, such as adjustable-rate mortgage loans, have features that restrict changes in interest rates on a short-term basis and over the life of the asset. Further, in the event of a change in interest rates, expected rates of prepayments on loans and early withdrawals from certificates could deviate significantly from those assumed in calculating the table. 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 future loan repayment activity.

**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 were no changes in the Company’s internal control over financial reporting during the three months ended June 30, 2013 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**

On October 31, 2011 a complaint was filed by Stilwell Value Partners IV, L.P. in the Supreme Court of New York, New York County (the “Court”), against the Company, the MHC and each of the directors of the Company and the MHC. The complaint alleged that the directors had breached their fiduciary duties by not expanding the Company board to allow for disinterested consideration of a “second-step” conversion of the MHC. As relief, the complaint requested, among other things, that the Company’s board of directors be increased by at least three new members, that such new members be given sole responsibility to determine whether the Company should engage in a second-step conversion and that the Court order the Company to engage in a second-step conversion. A motion to dismiss the Complaint was filed on December 14, 2011. On September 27, 2012, the Court granted the Company’s motion to dismiss and dismissed the complaint granting Stilwell leave to file an amended complaint within 20 days. On December 14, 2012 Stilwell filed an amended complaint, alleging that the directors had breached their fiduciary duties by not voting to authorize a second step conversion. Stilwell asserted claims against the MHC, as majority shareholder of the Company, for breach of fiduciary duty and for aiding and abetting the directors’ alleged breach of fiduciary duty. The Company filed a motion to dismiss on February 1, 2013. Stilwell filed his opposition on March 8, 2013, and the Company filed its reply brief on March 29, 2013. The Court held a hearing on the motion on June 12, 2013. It is anticipated that the Court will rule on the motion in the next several months.

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The Company and Bank are also subject to claims and litigation that arise primarily in the ordinary course of business. Based on information presently available and advice received from legal counsel representing the Company and Bank in connection with such claims and litigation, it is the opinion of management that the disposition or ultimate determination of such claims and litigation will not have a material adverse effect on the consolidated financial position, results of operations or liquidity 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, 2012, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks that we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially affect our business, financial condition and/or operating results.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None

**Item 3. Defaults Upon Senior Securities**

Not applicable

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

None

**Item 6. Exhibits**

31.1 CEO certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 CFO certification pursuant to Section 302 of the Sarbanes Oxley Act of 2002.

32.1 CEO and CFO certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2013, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Statements of 101.0\* Financial Condition, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Stockholders' Equity, (v) the Consolidated Statements of Cash Flows and (vi) the Notes to the Consolidated Financial Statements.

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\* Furnished, not filed.

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**Signatures**

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

Northeast Community Bancorp, Inc.

Date: August 14, 2013 By: /s/ Kenneth A. Martinek  
Kenneth A. Martinek  
Chief Executive Officer

Date: August 14, 2013 By: /s/ Donald S. Hom  
Donald S. Hom  
Senior Vice President and Interim Chief Financial  
Officer