ENTERPRISE BANCORP INC /MA/
Form 10-Q
May 10, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

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

For the quarterly period ended March 31, 2012
or
¨ TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number: 001-33912
Enterprise Bancorp, Inc.
(Exact name of registrant as specified in its charter)

Massachusetts	04-3308902
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
222 Merrimack Street, Lowell, Massachusetts	01852
(Address of principal executive offices)	(Zip code)

(978) 459-9000
(Registrant’s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files) x Yes o 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 for “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o (Do not check if smaller reporting company)	Smaller reporting company o

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: May 1, 2012 Common Stock - Par Value $0.01: 9,581,286 shares outstanding.

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PART I-FINANCIAL INFORMATION

ENTERPRISE BANCORP, INC.
Consolidated Balance Sheets

(Dollars in thousands)	March 31, 2012 (unaudited)	December 31, 2011
Assets		
Cash and cash equivalents:		
Cash and due from banks	$28,316	$30,231
Interest-earning deposits	50,277	6,785
Fed funds sold	17,567	2,115
Total cash and cash equivalents	96,160	39,131
Investment securities at fair value	154,085	140,405
Federal Home Loan Bank Stock	4,260	4,740
Loans, less allowance for loan losses of $22,607 at March 31, 2012 and $23,160 at December 31, 2011 respectively	1,228,774	1,227,329
Premises and equipment	27,026	27,310
Accrued interest receivable	5,698	5,821
Deferred income taxes, net	12,258	12,411
Bank-owned life insurance	15,071	14,937
Prepaid income taxes	807	287
Prepaid expenses and other assets	10,275	11,136
Goodwill	5,656	5,656
Total assets	$1,560,070	$1,489,163
Liabilities and Stockholders' Equity		
Liabilities		
Deposits	$1,405,007	$1,333,158
Borrowed funds	2,869	4,494
Junior subordinated debentures	10,825	10,825
Accrued expenses and other liabilities	10,346	12,487
Accrued interest payable	340	751
Total liabilities	$1,429,387	$1,361,715
Commitments and Contingencies		
Stockholders' Equity		
Preferred stock, $0.01 par value per share; 1,000,000 shares authorized; no shares issued	—	—
Common stock $0.01 par value per share; 20,000,000 shares authorized; 9,580,911, and 9,472,748 shares issued and outstanding at March 31, 2012 and December 31, 2011, respectively	96	95
Additional paid-in-capital	45,960	45,158
Retained earnings	81,128	78,999
Accumulated other comprehensive income	3,499	3,196
Total stockholders' equity	$130,683	$127,448
Total liabilities and stockholders' equity	$1,560,070	$1,489,163

See the accompanying notes to the unaudited consolidated financial statements.

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ENTERPRISE BANCORP, INC.
Consolidated Statements of Income
(unaudited)

	Three months ended March 31,	
(Dollars in thousands, except per share data)	2012	2011
Interest and dividend income:		
Loans	$15,958	$15,270
Investment securities	799	954
Other interest-earning assets	19	16
Total interest and dividend income	16,776	16,240
Interest expense:		
Deposits	1,537	1,915
Borrowed funds	16	22
Junior subordinated debentures	294	294
Total interest expense	1,847	2,231
Net interest income	14,929	14,009
Provision for loan losses	300	922
Net interest income after provision for loan losses	14,629	13,087
Non-interest income:		
Investment advisory fees	1,021	956
Deposit service fees	1,089	1,023
Income on bank-owned life insurance	134	140
Net gains on sales of investment securities	47	—
Gains on sales of loans	240	220
Other income	511	419
Total non-interest income	3,042	2,758
Non-interest expense:		
Salaries and employee benefits	7,503	6,976
Occupancy and equipment expenses	1,414	1,449
Technology and telecommunications expenses	999	973
Advertising and public relations expenses	789	665
Deposit insurance premiums	277	489
Audit, legal and other professional fees	483	310
Supplies and postage expenses	231	218
Investment advisory and custodial expenses	97	104
Other operating expenses	1,093	994
Total non-interest expense	12,886	12,178
Income before income taxes	4,785	3,667
Provision for income taxes	1,612	1,203
Net income	$3,173	$2,464
Basic earnings per share	$0.33	$0.26
Diluted earnings per share	$0.33	$0.26
Basic weighted average common shares outstanding	9,499,568	9,318,522
Diluted weighted average common shares outstanding	9,568,677	9,356,479

See the accompanying notes to the unaudited consolidated financial statements.

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ENTERPRISE BANCORP, INC.
Consolidated Statements of Comprehensive Income
(Unaudited)

	Three months ended March 31,	
(Dollars in thousands)	2012	2011
Net income	$3,173	$2,464
Other comprehensive income, net of taxes:		
Gross unrealized holding gains on investments arising during the period	504	376
Income tax expense	(170)	(127)
Net unrealized holding gains, net of tax	334	249
Less: Reclassification adjustment for net gains included in net income		
Net realized gains on sales of securities during the period	47	—
Income tax expense	(16)	—
Reclassification adjustment for gains realized, net of tax	31	—
Total other comprehensive income	303	249
Comprehensive income	$3,476	$2,713

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ENTERPRISE BANCORP, INC.
Consolidated Statement of Changes in Stockholders' Equity
(Unaudited)

(Dollars in thousands)	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
Balance at December 31, 2011	$95	$45,158	$78,999	$ 3,196	$127,448
Net income			3,173		3,173
Other comprehensive income, net				303	303
Tax benefit from exercise of stock options		1			1
Common stock dividend paid ($0.11 per share)			(1,044)		(1,044)
Common stock issued under dividend reinvestment plan	—	317			317
Stock-based compensation	1	430			431
Stock options exercised	—	54			54
Balance at March 31, 2012	$96	$45,960	$81,128	$ 3,499	$130,683

See the accompanying notes to the unaudited consolidated financial statements.

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ENTERPRISE BANCORP, INC.
Consolidated Statements of Cash Flows
(Unaudited)

	Three months ended March 31,	
(Dollars in thousands)	2012	2011
Cash flows from operating activities:		
Net income	$3,173	$2,464
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	300	922
Depreciation and amortization	1,036	1,020
Stock-based compensation expense	318	306
Mortgage loans originated for sale	(12,278)	(5,562)
Proceeds from mortgage loans sold	13,517	12,041
Gains on sales of loans	(240)	(220)
Gains on sales of OREO	(76)	—
Net gains on sales of investments	(47)	—
Income on bank-owned life insurance, net of costs	(134)	(138)
Changes in:		
Accrued interest receivable	123	(137)
Prepaid expenses and other assets	177	387
Accrued expenses and other liabilities	(2,542)	(874)
Accrued interest payable	(411)	(352)
Net cash provided by operating activities	2,916	9,857
Cash flows from investing activities:		
Proceeds from sales of investment securities available for sale	540	—
Proceeds from FHLB capital stock repurchase	480	—
Proceeds from maturities, calls and pay-downs of investment securities	3,600	8,975
Purchase of investment securities	(16,928)	(840)
Net increase in loans	(3,144)	(14,631)
Additions to premises and equipment, net	(613)	(1,514)
Proceeds from OREO sales and payments	626	—
Net cash used in investing activities	(15,439)	(8,010)
Cash flows from financing activities:		
Net increase in deposits	71,849	40,975
Net decrease in borrowed funds	(1,625)	(9,999)
Cash dividends paid	(1,044)	(977)
Proceeds from issuance of common stock	317	312
Proceeds from the exercise of stock options	54	1
Tax benefit from the exercise of stock option	1	—
Net cash provided by financing activities	69,552	30,312
Net increase in cash and cash equivalents	57,029	32,159
Cash and cash equivalents at beginning of period	39,131	55,006
Cash and cash equivalents at end of period	$96,160	$87,165
Supplemental financial data:		
Cash Paid For: Interest	$2,258	$2,583
Cash Paid For: Income Taxes	2,132	630

Supplemental schedule of non-cash investing activity:		
Purchase of investment securities not yet settled	514	—
Transfer from loans to other real estate owned	400	—

See accompanying notes to the unaudited consolidated financial statements.

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ENTERPRISE BANCORP, INC.
Notes to the Unaudited Consolidated Financial Statements

(1) Organization of Holding Company

The consolidated interim financial statements of Enterprise Bancorp, Inc. (the “Company” or “Enterprise”) include the accounts of the Company and its wholly owned subsidiary Enterprise Bank and Trust Company (the “Bank”). The Bank is a Massachusetts trust company organized in 1989. Substantially all of the Company’s operations are conducted through the Bank.

The Bank has five wholly owned subsidiaries. The Bank’s subsidiaries include Enterprise Insurance Services, LLC and Enterprise Investment Services, LLC, organized for the purposes of engaging in insurance sales activities and offering non-deposit investment products and services, respectively. In addition, the Bank has three subsidiary corporations incorporated in the state of Massachusetts and classified as security corporations in accordance with applicable Massachusetts General Laws. Theses subsidiaries are: Enterprise Security Corporation; Enterprise Security Corporation II; and Enterprise Security Corporation III, which hold various types of qualifying securities. The security corporations are limited to conducting securities investment activities that the Bank itself would be allowed to conduct under applicable laws.

Through the Bank and its subsidiaries, the Company offers a range of commercial and consumer loan products, deposit and cash management products, investment advisory and management, trust and insurance services. The services offered through the Bank and subsidiaries are managed as one strategic unit and represent the Company’s only reportable operating segment.

Pursuant to the Accounting Standards Codification (“ASC”) Topic 810 “Consolidation of Variable Interest Entities”, issued by the Financial Accounting Standards Board (originally issued as Financial Interpretation No. 46R) in December 2003, the Company carries, as a liability on its consolidated financial statements, $10.8 million, along with related interest expense, of Junior Subordinated Debentures issued by a statutory business trust (the "Trust") created by the Company in March 2000 under the laws of Delaware, and $10.5 million of trust preferred securities issued by the Trust, and the related non-interest expense, are excluded from the Company’s consolidated financial statements.

The Federal Deposit Insurance Corporation (the “FDIC”) and the Massachusetts Commissioner of Banks (the “Commissioner”) have regulatory authority over the Bank. The Bank is also subject to certain regulatory requirements of the Board of Governors of the Federal Reserve System (the “Federal Reserve Board”) and, with respect to its New Hampshire branch operations, the New Hampshire Banking Department. The business and operations of the Company are subject to the regulatory oversight of the Federal Reserve Board. The Commissioner also retains supervisory jurisdiction over the Company.

(2) Basis of Presentation

The accompanying unaudited consolidated financial statements and these notes should be read in conjunction with the Company’s December 31, 2011 audited consolidated financial statements and notes thereto contained in the Company’s 2011 Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 15, 2012. Interim results are not necessarily indicative of results to be expected for the entire year.

The Company has not changed its significant accounting and reporting policies from those disclosed in its 2011 Annual Report on Form 10-K.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information and the instructions for Form 10-Q through the rules and interpretive releases of the SEC under federal securities law. In the opinion of management, the accompanying consolidated financial statements reflect all necessary adjustments consisting of normal recurring accruals for a fair presentation. All significant intercompany balances and transactions have been eliminated in the accompanying consolidated financial statements.

Certain previous year amounts in the footnotes to the unaudited consolidated financial statements have been reclassified to conform to the current year's presentation.

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ENTERPRISE BANCORP, INC.
Notes to the Unaudited Consolidated Financial Statements (continued)

(3) Critical Accounting Estimates

In preparing the consolidated financial statements in conformity with U.S. GAAP, management is required to exercise judgment in determining many of the methodologies, assumptions and estimates to be utilized. These estimates and assumptions affect the reported amounts of assets and liabilities as of the balance sheet date and revenues and expenses for the period then ended. As future events and their effects cannot be determined with precision, actual results could differ significantly from these estimates should the assumptions and estimates used change over time due to changes in circumstances. Changes in those estimates resulting from continuing changes in the economic environment and other factors will be reflected in the financial statements and results of operations in future periods.

As discussed in the Company's 2011 Annual Report on Form 10-K, the three most significant areas in which management applies critical assumptions and estimates that are particularly susceptible to change relate to the determination of the allowance for loan losses, impairment review of investment securities and the impairment review of goodwill. Refer to note 1 to the Company's consolidated financial statements included in the Company's 2011 Annual Report on Form 10-K for significant accounting policies.

(4) Reporting Comprehensive Income

Comprehensive income is defined as all changes to equity except investments by and distributions to stockholders. Net income is one component of comprehensive income, with other components referred to in the aggregate as other comprehensive income. The Company's only other comprehensive income component is the net unrealized holding gains or losses on investments available for sale, net of deferred income taxes. In accordance with FASB Accounting Standards Update No. 2011-05, beginning in the first quarter of 2012, the Company has presented the components of comprehensive income as a separate financial statement following the consolidated income statement.

(5) Earnings per share

Basic earnings per share are calculated by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflects the effect on weighted average shares outstanding of the number of additional shares outstanding if dilutive stock options were converted into common stock using the treasury stock method.

The table below presents the increase in average shares outstanding, using the treasury stock method, for the diluted earnings per share calculation and the effect of those shares on earnings, for the periods indicated:

	Three months ended March 31,	
	2012	2011
Basic weighted average common shares outstanding	9,499,568	9,318,522
Dilutive shares	69,109	37,957
Diluted weighted average common shares outstanding	9,568,677	9,356,479
Basic earnings per share	$0.33	$0.26
Effect of dilutive shares	—	—
Diluted earnings per share	$0.33	$0.26

For the three months ended March 31, 2012, there were an additional 132,334 average stock options outstanding, which were excluded from the year-to-date calculation of diluted earnings per share due to the exercise price of these options exceeding the average market price of the Company's common stock for the period. These options, which were not dilutive at that date, may potentially dilute earnings per share in the future.

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ENTERPRISE BANCORP, INC.
Notes to the Unaudited Consolidated Financial Statements (continued)

(6) Investments

The amortized cost and carrying values of investment securities at the dates specified are summarized as follows:

	March 31, 2012			
(Dollars in thousands)	Amortized cost	Unrealized gains	Unrealized losses	Fair Value
Federal Agency Obligations (1)	$47,258	$172	$72	$47,358
Federal Agency mortgage backed securities (MBS) (1)	43,592	1,371	—	44,963
Municipal securities	49,379	2,517	23	51,873
Certificates of Deposit (2)	1,548	—	1	1,547
Total fixed income securities	141,777	4,060	96	145,741
Equity investments	6,875	1,506	37	8,344
Total available for sale securities, at fair value	$148,652	$5,566	$133	$154,085

	December 31, 2011			
(Dollars in thousands)	Amortized cost	Unrealized gains	Unrealized losses	Fair Value
Federal Agency Obligations(1)	$40,206	$191	$—	$40,397
Federal Agency mortgage backed securities (MBS) (1)	38,275	1,416	3	39,688
Municipal securities	48,393	2,821	5	51,209
Certificates of Deposit (2)	2,149	—	2	2,147
Total fixed income securities	129,023	4,428	10	133,441
Equity investments	6,405	804	245	6,964
Total available for sale securities, at fair value	$135,428	$5,232	$255	$140,405

(1) These categories may include investments issued or guaranteed by government sponsored enterprises such as Fannie Mae (FNMA), Freddie Mac (FHLMC), Ginnie Mae (GNMA), Federal Farm Credit Bank (FFCB), or one of several Federal Home Loan Banks (FHLBs). All agency MBS/Collateralized Mortgage Obligations ("CMOs") investments owned by the Company are backed by residential mortgages.
(2) Certificates of Deposits ("CD") represent term deposits issued by banks and purchased on the open market.

Included in the carrying amount of federal agency MBS category were CMOs totaling $20.3 million and $21.8 million at March 31, 2012 and December 31, 2011, respectively.

Net unrealized appreciation and depreciation on investments available for sale, net of applicable income taxes, are reflected as a component of accumulated other comprehensive income.

The net unrealized gain or loss in the Company’s fixed income portfolio fluctuates as market interest rates rise and fall. Due to the fixed rate nature of this portfolio, as market rates fall, the value of the portfolio rises, and as market rates rise, the value of the portfolio declines. The unrealized gains or losses on fixed income investments will also decline as the securities approach maturity. Unrealized gains or losses will be recognized in the statements of income if the securities are sold. However, if an unrealized loss on the fixed income portfolio is deemed to be other-than-temporarily, the credit loss portion is charged to earnings and the non-credit portion is recognized in accumulated other comprehensive income.

As of March 31, 2012, the unrealized losses on the federal agency obligations were limited to three individual securities, which was attributed to market interest rate volatility. The contractual cash flows of these investments are guaranteed by an agency of the U.S. government, and the agency that issued these securities are sponsored by the U.S. government. Accordingly, it is expected that the securities would not be settled at a price less than the par value of the Company's investment. The Company does not consider these investments to be other-than-temporarily impaired at March 31, 2012,

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Notes to the Unaudited Consolidated Financial Statements (continued)

because the decline in market value is attributable to changes in interest rate and not credit quality, and because the Company does not intend to, and it is more likely than not that it will not be required to, sell those investments prior to a market price recovery or maturity.

As of March 31, 2012, the unrealized losses on the Company's municipal securities were related to three obligations and were attributed to market interest rate volatility and not a fundamental deterioration in the issuers. The Company does not consider these investments to be other-than-temporarily impaired at March 31, 2012 based on management's assessment of these investments including a review of market pricing and ongoing credit evaluations. In addition, the Company does not intend to, and it is more likely than not that it will not be required to, sell these investments prior to a market price recovery or maturity.

The net unrealized gain or loss on equity securities will fluctuate based on changes in the market value of the funds and individual securities held in the portfolio. Unrealized gains or losses will be recognized in the statements of income if the securities are sold. However, if an unrealized loss on an equity security is deemed to be other than temporary prior to a sale, the loss is charged to earnings.

At March 31, 2012, the equity portfolio consisted primarily of investments in a diversified group of mutual funds, with a small portion of the portfolio (approximately 14%) invested in exchange traded funds or individual common stock of entities in the financial services industry. At March 31, 2012, the Company had four investments with total unrealized losses of $37 thousand which were short term in nature. Management regularly reviews the portfolio for securities with unrealized losses that are other than temporarily impaired. Management's assessment includes evaluating whether any equity security or fund exhibits fundamental deterioration and whether it is unlikely that the security or fund will completely recover its unrealized loss within a reasonable time period. In determining the amount of the other than temporary impairment charge, management considers the severity of the declines and the uncertainty of recovery in the short-term for these equities. Based upon this review, the Company did not consider those equity funds to be other-than-temporarily impaired at March 31, 2012.

During the three months ended March 31, 2012, the Company did not record any fair value impairment charges on equity investments; during that period, the Company sold $13 thousand of previously impaired equity funds and recognized gains of $2 thousand. In addition, the Company sold $480 thousand in other investment securities and recognized gains of $45 thousand.

During the three months ended March 31, 2011, there were no impairment charges or sales.

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ENTERPRISE BANCORP, INC.
Notes to the Unaudited Consolidated Financial Statements (continued)

The contractual maturity distribution at March 31, 2012, of total fixed income investments, excluding CDs which mature in less than a year, is as follows:

	Within One Year		After One, But Within Five Years		After Five, But within Ten Years		After Ten Years	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Federal agency obligations	$5,010	$5,022	$42,248	$42,336	$—	$—	$—	$—
MBS	—	—	135	140	13,528	14,106	29,929	30,717
Municipal securities	6,054	6,104	11,516	11,847	19,007	20,120	12,802	13,802
Total Fixed Income	$11,064	$11,126	$53,899	$54,323	$32,535	$34,226	$42,731	$44,519

Scheduled contractual maturities may not reflect the actual maturities of the investments. MBS/CMOs are shown at their final maturity. However, due to prepayments and amortization the actual MBS/CMO cash flows may be faster than presented above. Similarly, included in the carrying value of municipal and federal agency obligations categories are $43.0 million in securities which can be “called” before maturity. Actual maturity of these callable securities could be shorter if called. Management considers these factors when evaluating the net interest margin in the Company’s asset-liability management program. There was no significant change in the maturity distribution as of March 31, 2012 as compared to December 31, 2011.

See Note 13, “Fair Value Measurements” below for further information regarding the Company’s fair value measurements for available-for-sale securities.

From time to time the Company may pledge securities as collateral against deposit account balances of municipal deposit customers. The fair value of securities pledged as collateral for these purposes was $42.3 million at March 31, 2012. In addition, securities designated as qualified collateral for FHLB borrowing capacity amounted to $39.0 million at March 31, 2012. Securities designated as qualified collateral for borrowing from the Federal Reserve Bank of Boston (the “FRB”) through its discount window amounted to $51.1 million at March 31, 2012.

(7) Restricted Investments

As a member of the FHLB, the Company is required to purchase certain levels of FHLB capital stock in association with the Company’s borrowing relationship from the FHLB. This stock is classified as a restricted investment and carried at cost, which management believes approximates fair value. FHLB stock represents the only restricted investment held by the Company.

Beginning in 2008 through 2010, the FHLB implemented a number of measures in order to strengthen its financial position and to increase its capital levels, including the indefinite suspension of its quarterly dividends and a moratorium on the repurchase of excess capital stock from member banks, among other programs. However, in 2011, based on improved profitability and capital levels, the FHLB announced the reinstitution of modest quarterly dividends on capital stock balances. In February 2012, the FHLB announced a one-time capital stock repurchase of a small portion of members excess stock; apart from this one time repurchase the moratorium on the repurchase of excess capital stock continues in effect. Although financial results of the FHLB have recently improved, if negative events or further deterioration in the FHLB financial condition or capital levels occurs, the Company’s investment in

FHLB capital stock may become other-than-temporarily impaired to some degree. At March 31, 2012, the Company’s investment in FHLB capital stock amounted to $4.3 million, compared to $4.7 million at December 31, 2011. The change reflects the FHLB repurchase of $480 thousand of the Bank's capital stock holdings. Based on management’s ongoing review, the Company has not recorded any other-than-temporarily impairment charges on this investment to date. Additionally, if as a result of deterioration in its financial condition the FHLB restricts its lending activities, the Company may need to utilize alternative funding sources to meet its liquidity needs.

(8) Loans

Major classifications of loans and loans held for sale at the periods indicated, are as follows:

(Dollars in thousands)	March 31, 2012	December 31, 2011
Real estate:		
Commercial real estate	$644,387	$650,697
Commercial construction	121,678	117,398
Residential mortgages	83,606	83,368
Residential construction	1,827	2,943
Loans held for sale	4,062	5,061
Total real estate	855,560	859,467
Commercial and industrial	317,196	310,706
Home equity	76,475	77,135
Consumer	3,507	4,570
Gross loans	1,252,738	1,251,878
Deferred loan origination fees, net	(1,357)	(1,389)
Total loans	1,251,381	1,250,489
Allowance for loan losses	(22,607)	(23,160)
Net loans and loans held for sale	$1,228,774	$1,227,329

The Company manages its loan portfolio to avoid concentration by industry and loan size to minimize its credit risk exposure. In addition, the Company does not have a "sub-prime" mortgage program. However, inherent in the lending process is the risk of loss due to customer non-payment, or "credit risk."

Loan Categories

Commercial loans:

Commercial real estate loans include loans secured by both owner-use and non-owner occupied real estate. These loans are typically secured by a variety of commercial and industrial property types including apartment buildings, office or mixed-use facilities, strip shopping centers, or other commercial property and are generally guaranteed by the principals of the borrower. Commercial real estate loans generally have repayment periods of approximately fifteen to twenty-five years. Variable interest rate commercial real estate loans have a variety of adjustment terms and indices, and are generally fixed for the first one to five years before periodic rate adjustments begin.

Commercial and industrial loans include seasonal revolving lines of credit, working capital loans, equipment financing (including equipment leases), and term loans. Also included in commercial and industrial loans are loans partially guaranteed by the Small Business Administration (SBA), loans under various programs issued in conjunction with the Massachusetts Development Finance Agency and other agencies. Commercial and industrial credits may be unsecured loans and lines to financially strong borrowers, secured in whole or in part by real estate unrelated to the principal purpose of the loan or secured by inventories, equipment, or receivables, and are generally guaranteed by the principals of the borrower. Variable rate loans and lines in this portfolio have interest rates that are periodically adjusted, with loans generally having fixed initial periods of one to three years. Commercial and industrial loans have average repayment periods of one to seven years.

Commercial construction loans include the development of residential housing and condominium projects, the development of commercial and industrial use property, and loans for the purchase and improvement of raw land. These loans are secured in whole or in part by the underlying real estate collateral and are generally guaranteed by the principals of the borrowers. Construction lenders work to cultivate long-term relationships with established developers. The Company limits the amount of financing provided to any single developer for the construction of properties built on a speculative basis. Funds for construction projects are disbursed as pre-specified stages of construction are completed. Regular site inspections are performed, either by experienced construction lenders on staff or by independent outside inspection companies, at each construction phase, prior to advancing additional funds. Commercial construction loans generally are variable rate loans and lines with interest rates that are periodically adjusted and generally have terms of one to three years.

From time to time, the Company participates with other banks in the financing of certain commercial projects. In some cases, the Company may act as the lead lender, originating and servicing the loans, but participating out a portion of the funding to other banks. In other cases, the Company may participate in loans originated by other institutions. In each case, the participating bank funds a percentage of the loan commitment and takes on the related risk. In each case in which the Company participates in a loan, the rights and obligations of each participating bank are divided proportionately among the participating banks in an amount equal to their share of ownership and with equal priority among all banks. The balances participated out to other institutions are not carried as assets on the Company's financial statements. Loans originated by other banks in which the Company is the participating institution are carried in the loan portfolio at the Company's pro rata share of ownership. The Company performs an independent credit analysis of each commitment and a review of the participating institution prior to participation in the loan. Loans originated by other banks in which the Company is the participating institution amounted to $32.1 million at March 31, 2012 and $33.0 million at December 31, 2011.

Standby letters of credit are conditional commitments issued by the Company to guarantee the financial obligation or performance by a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. If the letter of credit is drawn upon, a loan is created for the customer, generally a commercial loan, with the same criteria associated with similar commercial loans.

Residential loans:

Enterprise originates conventional mortgage loans on one-to-four family residential properties. These properties may serve as the borrower's primary residence, vacation homes, or investment properties. Loan to value limits vary, generally from 80% for adjustable rate and multi-family, owner occupied properties, up to 97% for fixed rate loans on single family, owner occupied properties, with mortgage insurance coverage required for loan-to-value ratios greater than 80% based on program parameters. In addition, financing is provided for the construction of owner occupied primary residences. Residential mortgage loans may have terms of up to 30 years at either fixed or adjustable rates of interest. Fixed and adjustable rate residential mortgage loans are generally originated using secondary market underwriting and documentation standards.

Depending on the current interest rate environment, management projections of future interest rates and the overall asset-liability management program of the Company, management may elect to sell those fixed and adjustable rate residential mortgage loans which are eligible for sale in the secondary market, or hold some or all of this residential loan production for the Company's portfolio. Mortgage loans are generally not pooled for sale, but instead sold on an individual basis. The Company may retain or sell the servicing when selling the loans. All loans sold are currently sold without recourse, subject to an early payment default period covering the first four payments for certain loan sales.

Home equity loans and lines of credit:

Home equity loans are originated for one-to-four family residential properties with maximum original loan to value ratios generally up to 80% of the assessed or appraised value of the property securing the loan. Home equity loan payments consist of monthly principal and interest based on amortization ranging from three to fifteen years. The rates may also be fixed for three to fifteen years.

The Company originates home equity lines of credit for one-to-four family residential properties with maximum original loan to value ratios generally up to 80% of the appraised value of the property securing the loan. Home equity lines generally have interest rates that adjust monthly based on changes in the Prime Rate as published in the Wall Street Journal, although minimum rates may be applicable. Some home equity line rates may be fixed for a period of time and then adjusted monthly thereafter. The payment schedule for home equity lines for the first ten years of the lines are interest only payments. Generally at the end of ten years, the line is frozen to future advances, and principal plus interest payments are collected over a fifteen-year amortization schedule.

Consumer loans:

Consumer loans primarily consist of secured or unsecured personal loans and overdraft protection lines on checking accounts extended to individual customers. The aggregate amount of overdrawn deposit accounts are reclassified as loan balances.

Loans serviced for others

At March 31, 2012 and December 31, 2011, the Company was servicing residential mortgage loans owned by investors amounting to $24.2 million and $24.4 million, respectively. Additionally, the Company was servicing commercial loans participated out to various other institutions amounting to $44.7 million and $43.0 million at March 31, 2012 and December 31, 2011, respectively. See the discussion above for further information regarding commercial participations.

Loans Serving as Collateral

Loans designated as qualified collateral and pledged to the FHLB for borrowing capacity are summarized below:

	March 31, 2012	December 31, 2011
Commercial real estate	$238,728	$204,158
Residential mortgages	66,719	67,344
Home equity	15,532	19,835
Total loans pledged to FHLB	$320,979	$291,337

The increase since December 31, 2011 reflects the pledge of additional commercial real estate mortgage loans during the quarter in order to provide additional borrowing capacity as part of the Company's ongoing liquidity management.

(9) Allowance for Loan Loss

Credit Quality Indicators

Management believes that current adversely classified, past due and non-performing statistics are reflective of the regional economic environment and its impact on the local commercial markets. Management does not consider the current levels to be indicative of significant deterioration in the credit quality of the general loan portfolio at March 31, 2012, as indicated by the following factors: the ratio of non-performing loans to total loans given the size and mix of the Company’s loan portfolio; the minimal level of OREO; and the low levels of loans 60-89 days delinquent.

The level of adversely classified loans, delinquent and non-performing assets is largely a function of economic conditions and the overall banking environment. Despite prudent loan underwriting and ongoing credit risk management, adverse changes within the Company's market area or further deterioration in the local, regional or national economic conditions could negatively impact the Company's assets quality in the future.

Adversely Classified Loans

The Company’s loan risk rating system classifies loans depending on risk of loss characteristics. The classifications range from “substantially risk free” for the highest quality loans and loans that are secured by cash collateral, to the more severe adverse classifications of “substandard,” “doubtful” and “loss” based on criteria established under banking regulations.

Loans classified as substandard include those loans characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. These loans are inadequately protected by the sound net worth and paying capacity of the borrower; repayment has become increasingly reliant on collateral liquidation or reliance on guaranties; credit weaknesses are well-defined; borrower cash flow is insufficient to meet required debt service specified in loan terms and to meet other obligations, such as trade debt and tax payments.

Loans classified as doubtful have all the weaknesses inherent in a substandard rated loan with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The probability of loss is extremely high, but because of certain important and reasonably specific pending factors which may work to the advantage and strengthening of the loan, its classification as an estimated loss is deferred until more exact status may be determined.

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Loans classified as loss are generally considered uncollectible at present, although long term recovery of part or all of loan proceeds may be possible. These “loss” loans would require a specific loss reserve or charge-off.

Adversely classified loans may be accruing or in non-accrual status and may be additionally designated as impaired or restructured, or some combination thereof. Loans which are evaluated to be of weaker credit quality are reviewed on a more frequent basis by management.

The following tables presents the credit risk profile by internally assigned risk rating category at the periods indicated.