ENTERPRISE BANCORP INC /MA/
Form 10-K
March 16, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

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

For the fiscal year ended December 31, 2008

OR

o **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 **0-21021**

Enterprise Bancorp, Inc.

(Exact name of registrant as specified in its charter)

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

Registrant s telephone number, including area code

(978) 459-9000

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

Common Stock, $0.01 par value per share	**NASDAQ Global Market**
(Title of each class)	(Name of exchange on which registered)

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

NONE

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
o Yes x No

Indicate by check mark if the registrant is not required to file pursuant to Section 13 or Section 15(d) of the Act.
o Yes x No

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

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 accelerated filer and large accelerated filer 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)
o Yes x No

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid price and asked price of such common equity, as of the last business day of the registrant s most recently completed second fiscal quarter.
$66,807,253 as of June 30, 2008

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: March 4, 2009, Common Stock - Par Value $01: 8,068,581 shares outstanding

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the issuer s proxy statement for its annual meeting of stockholders to be held on May 5, 2009 are incorporated by reference in Part III of this Form 10-K.

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ENTERPRISE BANCORP, INC.

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PART I

Item 1. Business

Organization

Enterprise Bancorp, Inc. (the Company) is a Massachusetts corporation organized in 1996, which operates as the parent holding company of Enterprise Bank and Trust Company commonly referred to as Enterprise Bank (the Bank). Substantially all of the Company s operations are conducted through the Bank. The Bank, a Massachusetts trust company which commenced banking operations in 1989, has five wholly owned subsidiaries which are included in the Company s consolidated financial statements:

- Enterprise Insurance Services, LLC, organized in 2000 for the purposes of engaging in insurance sales activities;

- Enterprise Investment Services, LLC, organized in 2000 for the purpose of offering non-deposit investment products and services, and;

- Three Massachusetts security corporations, Enterprise Security Corporation (2005), Enterprise Security Corporation II (2007) and Enterprise Security Corporation III (2007), 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.

The Company s headquarters are located at 222 Merrimack Street in Lowell, Massachusetts.

The services offered through the Bank and subsidiaries are managed as one strategic unit and represent the Company s only reportable operating segment.

All material intercompany balances and transactions have been eliminated in consolidation.

Market Area

The Company s primary market area is the Merrimack Valley and North Central regions of Massachusetts and South Central New Hampshire. The Company has sixteen full service branch banking offices located in the Massachusetts cities and towns of Acton, Andover, Billerica, Chelmsford, Dracut, Fitchburg, Leominster, Lowell, Methuen, Tewksbury, and Westford; and in Salem, New Hampshire which serve those cities and towns as well as the surrounding communities. The Company expects to open an additional branch facility, in the town of Derry, New Hampshire, in late 2009 or early 2008.

Products and Services

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. These products and services are outlined below.

Lending

General

The Company specializes in lending to business entities, non-profit organizations, professionals and individuals. The Company s primary lending focus is on the development of high quality commercial relationships achieved through active business development efforts, strong community involvement and focused marketing strategies. Loans made by the Company to businesses include commercial mortgage loans, construction and land development loans, secured and unsecured commercial loans and lines of credit, and standby letters of credit. The Company also originates equipment lease financing for businesses. Loans made to individuals include conventional residential mortgage loans, home equity loans, residential construction loans on primary residences, secured and unsecured personal loans and lines of credit. The Company does not have a sub-prime mortgage program.

The Company employs a seasoned commercial lending staff, with commercial lenders supporting each branch location. The Company has an internal loan review function that assesses the compliance of loan originations with the Company s internal policies and underwriting guidelines and monitors the ongoing quality of the loan portfolio. The Company also contracts with an external loan review company to review loans in the loan portfolio on a pre-determined schedule, based on the type, size, rating, and overall risk of the loan.

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A management loan review committee, consisting of senior lending officers and loan review personnel, is responsible for setting loan policy and procedures, as well as reviewing loans on the Company s internal watched asset list and classified loan report. The Company has an internal credit review committee, consisting of senior lending officers and loan review personnel. The committee generally meets three times per month, or on an as needed basis, to review loan requests related to borrowing relationships of certain levels, as well as other borrower relationships recommended for discussion by committee members.

The Company s Executive Committee of the Board of Directors, consisting of four outside members of the Board and three executive officers who are also members of the Board, also approves loan relationships exceeding certain prescribed limits. A Loan Committee, consisting of five outside members of the Board, and two executive officers who are also members of the Board, reviews current portfolio statistics, new credits, construction loan reviews, watched assets, loan delinquencies, and the allowance for loan losses, as well as current market conditions and issues relating to the construction and real estate development industry. The Board s Loan Committee is also responsible for approval of charge-offs recommended by management. Approved charge-offs are forwarded to the full Board for ratification.

At December 31, 2008, the Bank s statutory lending limit, based on 20% of capital (capital stock plus surplus and undivided profits, but excluding other comprehensive income), to any individual borrower was approximately $20.1 million, subject to certain exceptions provided under applicable law.

See also Risk Factors contained in Item 1A, for further discussion on a variety of risks and uncertainties that may affect the Company s loan portfolio.

Commercial Real Estate, Commercial and Industrial, and Construction 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 malls, 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 years. Variable interest rate loans have a variety of adjustment terms and indices, and are generally fixed for the first one to five years before periodic rate adjustments begins.

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 in this portfolio have interest rates that are periodically adjusted, generally with 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 borrower. The Company s 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 have terms of one to three years.

From time to time the Company participates in the financing of certain large commercial projects with other banks. 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. 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 participation institution prior to participation in the loan.

Standby letters of credit are conditional commitments issued by the Company to guarantee the 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 the Company creates a loan for the customer, generally a commercial loan, with the same criteria associated with similar commercial loans.

Residential Loans

The Company 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 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 the Company provides financing for the construction of owner occupied primary residences. Residential mortgage loans made by the Company 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. The Company generally does not pool mortgage loans for sale, but instead sells the loans 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 the Company s portfolio for one-to-four family residential properties with maximum original loan to values 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 initially be fixed for a one year period and reviewed annually thereafter, or fixed for a three year period and reviewed every three years thereafter, or the rate may be fixed for three to fifteen years.

Home equity lines are originated for the Company s portfolio 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 lines generally have interest rates that adjust monthly based on changes in the Prime rate as published in the Wall Street Journal. Some home equity lines 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 loans 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 Company s residential, home equity and consumer lending activities are supported by the branch relationship managers, a centralized walk-in mortgage center, and an internet based eMortgage center.

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Credit Risk and Allowance for Loan Losses

Information regarding the Company s credit risk and allowance for loan losses is contained in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations , under the headings Credit Risk/Asset Quality and Allowance for Loan Losses , contained in the section Financial Condition , and under the heading Allowance for Loan Losses , which is contained in the Critical Accounting Estimates section of Item 7.

Investment Activities

The Company s investment activity is an integral part of the overall asset-liability management program of the Company. The investment function provides readily available funds to support loan growth as well as to meet withdrawals and maturities of deposits and attempts to provide maximum return consistent with liquidity constraints and general prudence, including diversification and safety of investments.

The securities in which the Company may invest are limited by regulation. In addition, the Company has an internal investment policy which restricts fixed income investments to high quality securities within the following categories: U.S. treasury securities, federal agency obligations (obligations issued by government sponsored enterprises that are not backed by the full faith and credit of the United States government), mortgage-backed securities (MBS s), including collateralized mortgage obligations (CMO s), and state, county and municipal securities (Municipals). The Company has not purchased sub-prime mortgage-backed securities or capital stock of FNMA or FHLMC. The Company is required to purchase Federal Home Loan Bank of Boston (FHLB) stock in association with the Bank s outstanding advances from the FHLB; this stock is classified as a restricted investment and carried at cost. The Company may also invest in certificates of deposit and, within prescribed regulatory limits, in both publicly traded and unlisted equity securities, registered mutual funds and unregistered funds, including private hedge funds, venture capital and private equity funds and funds of funds that may in turn invest in any of the foregoing. The investment policy also limits the categories within the investment portfolio to particular percentages of the total portfolio and to certain percentages of total assets and/or capital. The effect of changes in interest rates, principal payments and market values are considered when purchasing securities.

The short-term investments classified as cash equivalents may be comprised of short-term U.S. Agency Discount Notes, money market mutual funds and overnight or short-term federal funds sold. Short-term investments not carried as cash equivalents are classified as other short-term investments .

As of the balance sheet dates all of the Company s investment securities (with the exception of restricted FHLB stock) were classified as available for sale and carried at fair value. The Company regularly reviews the portfolio for securities with unrealized losses that are other than temporarily impaired. Management s assessment includes: evaluating the level and duration of the loss on individual securities; evaluating the credit quality of fixed income issuers; determining if any individual equity securities or mutual or other funds exhibit fundamental deterioration; and estimating whether it is unlikely that the individual security or fund will completely recover its unrealized loss within a reasonable period of time, or in the case of fixed income securities prior to maturity. If a decline in market value of a security is considered other than temporary, the cost basis of the individual security is written down to market value with a charge to earnings.

Investment transaction summaries, portfolio allocations and projected cash flows are prepared monthly and presented to the Company s Asset-Liability Committee of the board of directors (ALCO) on a periodic basis. ALCO is comprised of five outside directors and three executive officers of the Company who are also directors, with various management liaisons. In addition, several directors who are not on the committee rotate in on a regular basis. ALCO regularly reviews the composition and key risk characteristics of the Company s investment portfolio, including effective duration, cash flow, market value at risk and asset class concentration. Credit risk inherent in the portfolio is closely monitored by management and presented at least annually to ALCO. ALCO also approves the Company s ongoing investment strategy and management updates the committee at each meeting.

See also Risk Factors contained in Item 1A, for further discussion on a variety of risks and uncertainties that may affect the Company s investment portfolio.

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Source of Funds

Deposits

Deposits have traditionally been the principal source of the Company s funds. The Company offers commercial checking, business and municipal savings accounts, money market and business sweep accounts, and escrow management accounts, as well as checking and Simplified Employee Pension (SEP) accounts to employees of our business customers. The Company also offers a broad selection of deposit products to the general public, including personal interest checking accounts (PIC), savings accounts, money market accounts, individual retirement accounts (IRA) and certificates of deposit (CDs).

In addition to on-balance sheet sweep products, the Company utilizes third party money market mutual funds for sweep accounts. Management believes that commercial customers benefit from enhanced interest rate options on these sweep accounts, while retaining a conservative investment option of the highest quality and safety. The balances transferred into mutual funds do not represent obligations of the Company.

Terms on CDs range from one week to thirty months. In addition to traditional in-house CDs, the Company also offers CDs through the Certificate of Deposit Account Registry Service (CDARS) nationwide network. This allows the Company to offer full FDIC insurance coverage on larger CD balances by placing the excess funds in FDIC insured CD s issued by other banks in the network. In exchange, the other CDARS institutions place dollar-for-dollar matching funds with the Company. Essentially, the equivalent of the original deposit comes back to the Company in increments that are covered by FDIC insurance and is available to fund local loan growth. The Company s first CDAR s CD was placed with the network in January 2009.

The Company also utilizes brokered certificates of deposit (brokered CD s) as an alternative to borrowed funds to support asset growth in excess of internally generated deposits. Brokered CD terms generally range from one to twelve months.

Management determines the interest rates offered on deposit accounts based on current and expected economic conditions, competition, liquidity needs, the volatility of existing deposits, the asset-liability position of the Company and the overall objectives of the Company regarding the growth and retention of relationships.

Borrowed Funds

The Company s total borrowing capacity includes borrowing arrangements at the FHLB and the Federal Reserve Bank of Boston (FRB) discount window, entering into repurchase agreements with customers and through federal funds purchase arrangements with correspondent banks.

The Bank s membership in the FHLB enables the Bank to borrow funds based on the qualifying collateral balances pledged to the FHLB, including certain residential loans, commercial loans and U.S. Government and Agency securities. The Company utilizes borrowings from the FHLB to fund short-term liquidity needs. This facility is an integral component of the Company s asset-liability management program.

In order to provide additional contingent liquidity and a competitive funding source, the Company recently applied for and received approval from the FRB to establish short-term borrowing capacity based on the pledge of qualifying collateral balances to the FRB. At December 31, 2008, the collateral for FRB borrowing purposes was comprised primarily of certain municipal securities from the Company s investment portfolio. The Company has the ability to add additional types of collateral to increase its borrowing capacity with the FRB if necessary. The Company established this facility to enhance funding alternatives as part of its asset-liability management program.

The Company also borrows funds from customers (generally commercial and municipal customers) by entering into agreements to sell and repurchase investment securities from the Company s portfolio, with terms that may range from one week to six months. These repurchase agreements represent a cost competitive funding source for the Company. Interest rates paid by the Company on these repurchase agreements are based on market conditions and the Company s need for additional funds at the time of the transaction.

The Company has pre-established federal funds purchase arrangements with large regional correspondent banks in order to provide overnight and short-term borrowing capacity.

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See also Risk Factors contained in Item 1A, for further discussion on a variety of risks and uncertainties that may affect the Company s ability to obtain funding and sustain liquidity.

Junior Subordinated Debentures

In March 2000 the Company organized Enterprise (MA) Capital Trust I (the Trust), a statutory business trust created under the laws of Delaware, in order to issue $10.5 million of 10.875% trust preferred securities that mature in 2030 and are callable beginning in 2010. The proceeds from the sale of the trust preferred securities were used by the Trust, along with the Company s $325 thousand capital contribution, to acquire $10.8 million in aggregate principal amount of the Company s 10.875% Junior Subordinated Debentures that mature in 2030 and are callable beginning in 2010.

Pursuant to Financial Interpretation No. 46R, issued by the Financial Accounting Standards Board in December 2003, the Company carries the $10.8 million of Junior Subordinated Debentures on the Company s financial statements as a liability, with related interest expense, and the $10.5 million of trust preferred securities issued by the Trust, and the related non-interest expense, are excluded from the Company s financial statements.

Investment Advisory Group

The Company provides a range of investment advisory and management services to individuals, family groups, businesses, trusts, foundations, non-profit organizations, endowments and retirement plans. These services include a combination of securities brokerage services through a third party service arrangement with Commonwealth Financial Network, a licensed securities brokerage firm, and fee only investment advisory and trust services for management of equity and fixed income portfolios. Portfolios are managed based on the individual investment objectives of each client.

The Company s Investment Advisory Group utilizes an open-architecture, manager of managers approach to client investment management. The philosophy is to identify and hire high performing independent investment management firms on behalf of our clients. During 2008, the Company entered into a consulting agreement with Fortigent, LLC, an investment research and diligence firm, with over $20 billion in advisory assets under management, to strengthen the Company is strategic development, manager selection, manager access and performance monitoring capabilities. Fortigent will perform a detailed search and due diligence reviews and objective analysis of each independent management firm based on historic returns, management, longevity, investment style, risk profile, and other criteria, and will maintain ongoing oversight and monitoring of their performance. This due diligence is intended to enable the Company to customize investment portfolios to meet each customer s financial objectives and deliver superior long-term performance.

Enterprise Insurance Services

Enterprise Insurance Services LLC engages in insurance sales activities through a third party arrangement with HUB International New England, LLC (HUB), which is a full service insurance agency, with offices in Massachusetts and New Hampshire, and is part of HUB

International Limited, which operates throughout the United States and Canada. Enterprise Insurance Services provides, through HUB, a full array of insurance products including property and casualty, employee benefits and risk-management solutions tailored to serve the specific insurance needs of businesses in a range of industries operating in the Company s market area.

On-line Banking and Cash Management

The Company uses an in-house turn-key solution from its core banking system vendor for internet banking services for retail and commercial customers. Major on-line banking capabilities include the following: opening of personal deposit and CD accounts; balance inquiry; internal transfers; loan payments; bill payments; federal tax payments; placement of stop payments; access to images of checks paid; and access to prior period account statements. In addition, commercial customers may take advantage of remote deposit capture service and have the ability to initiate on-line electronic funds transfers, including ACH originations and wire transfers. On-line banking security features include the use of a two-factor authentication process involving unique individualized logon IDs and passwords, registered personalized security profile, and the use of security tokens

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which provide one-time passwords to initiate and execute higher-risk commercial transactions. The site also returns unique confirmations to validate that the user has accessed the Company s online banking site. In addition on-line banking security makes use of 128-bit encryption for all passwords and account information transferred over the internet; automatic session termination after 20 minutes of inactivity; and firewalls, which check to make sure that communications only occur between approved individuals, that ensure the communication is in the proper protocol, and refuse entry to anyone without proper authorization.

Company Website

The Company currently uses an outside vendor to design, support and host its internet website. The underlying structure of the site provides for dynamic maintenance of the information by Company personnel. The site provides information on the Company and its services, the ability to submit mortgage loan applications online, as well as providing the access point to various specified banking services and to various financial management tools. In addition, the site includes the following major capabilities: career opportunities; calculators; an ATM/Branch Locator/Map; and investor and corporate information, which includes a corporate governance page. The corporate governance page includes the Company s corporate governance guidelines, code of business conduct and ethics, and whistleblower protection policy, as well as the charters of the board of Directors audit, compensation and personnel, and corporate governance/nominating committees.

The Company makes available free of charge, through a link on its web site to its SEC filings, copies of the Company s annual report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, as well as all registration statements that the Company has been required to file in connection with the issuance of its shares. The Company similarly makes available all insider stock ownership and transaction reports filed with the SEC by the Company s executive officers, directors and any 10% stockholders under Section 16 of the Securities Exchange Act of 1934 (Forms 3, 4 and 5). Access to all of these reports is essentially simultaneous with the SEC s posting of these reports on its EDGAR system through the SEC website (www.SEC.gov). The Company s internet web address is: EnterpriseBanking.com.

Competition

The Company faces strong competition to generate loans and to attract deposits and investment advisory assets. National and larger regional banks have a local presence in the Company s market area. Numerous local savings banks, commercial banks, cooperative banks and credit unions have one or more offices in the Company s market area. Larger banks have certain competitive advantages over the Company, including the ability to make larger loans to a single borrower than is possible for the Company. The greater financial resources of larger banks also allow them to offer a broad range of automated banking services, to maintain numerous branch offices and to mount extensive advertising and promotional campaigns. While the recent tightening of credit markets and contraction of liquidity for larger regional and national banks has resulted in some banks restricting their lending activity, it has also increased competition and rates for deposit resources within the Company s market area. This competition has an impact on the Company s deposit strategy, as the Company may or may not choose to compete on rates depending on its funding needs and asset-liability position at any given time.

Competition for loans, investment advisory assets and deposits also comes from other businesses that provide financial services, including consumer finance companies, mortgage brokers, private lenders, insurance companies, securities brokerage firms, institutional mutual funds, registered investment advisors and internet based banks.

Notwithstanding the substantial competition with which the Company is faced, management believes that the Company has established a solid reputation within its market area and has differentiated itself from competitors based upon service level, a targeted sales focus on small to medium sized business, professionals, non-profits and high net worth individuals, and active community involvement, which has lead to a strong network with business and community leaders. In addition, the Company continually examines new products and technologies in order to maintain a highly competitive mix of offerings and to target product lines to customer needs. Management actively seeks to strengthen its position, by capitalizing on the market opportunities, and the continued pursuit of strategic growth within existing and neighboring geographic markets and market segments.

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Advances in, and the increased use of, technology, such as internet banking, electronic transaction processing and information security, are expected to have a significant impact on the future competitive landscape confronting financial institutions.

See also Supervision and Regulation below, and Item 1A, Risk Factors , and Opportunities and Risks included in the section entitled Overview , which is contained in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations for further discussion on how new laws and regulations and other factors may effect the Company s competitive position, growth and/or profitability.

Supervision and Regulation

General

To the extent that the information in this report under the heading Supervision and Regulation describes statutory or regulatory provisions, it is qualified in its entirety by reference to the particular statutory or regulatory provision so described. Any changes in applicable laws or regulations may have a material effect on the business and prospects of the Company.

Bank holding companies and banks are subject to extensive government regulation through federal and state statutes and related regulations, which are subject to changes that can significantly affect the way in which financial service organizations conduct business.

Regulation of the banking and financial services industries has undergone significant developments over the past several years, some of which have eased legal and regulatory restrictions while others have increased regulatory requirements. Such developments on the federal level have included the following: increasing anti-money laundering and customer identification requirements; enhancing internal controls over financial reporting, corporate accountability and improving the quality of investor information; imposing requirements as to fraud prevention and data breach response programs; providing consumers with greater access to and control over personal credit data; and automating the nation s check-processing system, among other legal and regulatory developments.

Legislative initiatives at the state level in Massachusetts have also further addressed data security requirements for protecting consumer financial information and residential mortgage lending and foreclosure requirements.

The current financial crisis has also resulted in significant new federal legislation and administrative initiatives intended to stabilize the U.S. banking system and residential real estate market and stimulate the economy. Recent federal legislation has included the Emergency Economic Stabilization Act of 2008 (EESA), under which the U.S. Treasury has injected capital directly into U.S. banks through its Troubled Asset Recovery Program (TARP), and the American Recovery and Reinvestment Act of 2009 (ARRA), under which Congress has approved various spending and tax measures, while also imposing significant new executive compensation restrictions and corporate governance standards on institutions that have either received TARP funding or receive such funding in the future. Administrative initiatives have included President Obama s recently announced Financial Stability Plan, which is comprised of several components, including additional capital assistance to banks, a potential public-private vehicle for purchasing toxic assets from financial institutions, various consumer, business and community lending initiatives, and affordable housing support and foreclosure prevention plans Possible future Congressional actions may also address a variety of additional issues, including federal bankruptcy reform, regulatory consolidation and creation of a single federal systemic risk regulator. Some or all of these recently adopted or currently proposed measures may result in increased regulation of the U.S. banking and financial services industries and additional restrictions on banking and other financial activities.

Any future increase in the extent of regulation imposed upon the banking or financial services industries generally could result in the Company incurring additional operating and compliance costs, which in turn could impede profitability.

Regulation of the Holding Company

The Company is a registered bank holding company under the federal Bank Holding Company Act of 1956, as amended (the Bank Holding Company Act). The business and operations of the Company are subject to the supervision and examination of the Board of Governors of the Federal Reserve System (the Federal Reserve Board). Under applicable state laws, the Company, through the Bank, is also subject to the supervisory jurisdiction of the

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Massachusetts Commissioner of Banks (the Commissioner) and, with respect to its New Hampshire branch operations, the New Hampshire Banking Department.

The Bank Holding Company Act requires prior approval by the Federal Reserve Board of the acquisition by the Company of substantially all the assets or more than five percent of the voting stock of any bank. The Bank Holding Company Act also authorizes the Federal Reserve Board to determine (by order or by regulation) what activities are so closely related to banking as to be a proper incident of banking, and thus, whether the Company, either directly or indirectly through non-bank subsidiaries, can engage in such activities. The Bank Holding Company Act prohibits the Company and the Bank from engaging in certain tie-in arrangements in connection with any extension of credit, sale of property or furnishing of services. There are also restrictions on extensions of credit and other transactions between the Bank, on the one hand, and the Company, or other affiliates of the Bank, on the other hand.

Under the Gramm-Leach-Bliley Act (the GLB Act), a bank holding company may elect to become a financial holding company , by which a qualified parent company of a banking institution may engage, directly or through its non-bank subsidiaries, in any activity that is financial in nature or incidental to such financial activity or in any other activity that is complimentary to a financial activity and does not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally. A bank holding company will be able to successfully elect to be regulated as a financial holding company if all of its depository institution subsidiaries meet certain prescribed standards pertaining to management, capital adequacy and compliance with the federal Community Reinvestment Act. Financial holding companies remain subject to regulation and oversight by the Federal Reserve Board. The Company believes that the Bank, which is the Company s sole depository institution subsidiary, presently satisfies all of the requirements that must be met to enable the Company to successfully elect to become a financial holding company. However, the Company has no current intention of seeking to become a financial holding company. Such a course of action may become necessary or appropriate at some time in the future depending upon the Company s strategic plan.

Regulation of the Bank

As a trust company organized under Chapter 172 of the Massachusetts General Laws, the deposits of the Bank are insured by the Deposit Insurance Fund of the Federal Deposit Insurance Corporation (the FDIC), up to the maximum amount provided by law. The Bank is subject to regulation, supervision and examination by the Commissioner and the FDIC. The Bank is also subject to certain regulatory requirements of the Federal Reserve Board and, with respect to its New Hampshire branch operations, the New Hampshire Banking Department.

The regulations of these agencies govern many aspects of the Bank s business, including permitted investments, the opening and closing of branches, the amount of loans which can be made to a single borrower, mergers, appointment and conduct of officers and directors, capital levels and terms of deposits. The Federal Reserve Board also requires the Bank to maintain minimum reserves on its deposits. Federal and state regulators can impose sanctions on the Bank and its management if the Bank engages in unsafe or unsound practices or otherwise fails to comply with regulatory standards. Various other federal and state laws and regulations, such as truth-in-lending and truth-in-savings statutes, the Equal Credit Opportunity Act, the Bank Secrecy Act, the Real Estate Settlement Procedures Act, the Community Reinvestment Act, Check 21 and the FACT Act, also govern the Bank s activities and operations.

Pursuant to the GLB Act, the Bank may also form, subject to the approvals of the Commissioner and the FDIC, financial subsidiaries to engage in any activity that is financial in nature or incidental to a financial activity. In order to qualify for the authority to form a financial subsidiary, the Bank would be required to satisfy certain conditions, some of which are substantially similar to those that the Company would be required to satisfy in order to elect to become a financial holding company. The Company believes that the Bank would be able to satisfy all of the conditions that would be required to form a financial subsidiary, although the Company has no current intention of doing so. Such a course of action may become necessary or appropriate at some time in the future depending upon the Company s strategic plan.

Deposit Insurance Assessment

The Company s deposit accounts are insured by the Deposit Insurance Fund (the DIF) of the FDIC up to the maximum amount provided by law.

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Prior to 2007, under the former FDIC system for assessing deposit insurance premiums, the Bank was not assessed any deposit insurance premium based on its designation as well capitalized .

Effective January 1, 2007, the FDIC implemented a revised risk-based deposit insurance assessment system in accordance with the requirements of the Federal Deposit Insurance Reform Act of 2005 (the Deposit Insurance Reform Act). Under the revised system, the deposit insurance assessment rates are determined based upon a combination of an institution s financial ratios and supervisory factors. There are four established risk categories under the assessment rules. Under this deposit insurance assessment system, even the highest risk-rated (i.e., least risk) banks and thrifts are subject to some level of assessment payable to the DIF.

In 2007, the Bank qualified as a Risk Category I (least risk) and was assessed deposit insurance premiums, under the revised system, at an annualized rate of 5.2 basis points of the Bank s deposit assessment base, as defined by the FDIC. Under the Deposit Insurance Reform Act, eligible insured depository institutions, such as the Bank, shared in a one-time assessment credit pool of approximately $4.7 billion. This one-time credit was applied against the institutions 2007 deposit insurance assessment. In the case of the Company, the one-time credit of approximately $333 thousand offset approximately 94% of the Bank s deposit insurance assessment for 2007.

In 2008, the Bank again qualified as Risk Category I and was assessed deposit insurance premiums at an annualized base rate of approximately 5.3 basis points.

As a result of recent bank failures, the DIF reserve ratio (DIF reserves as a percent of estimated insured deposits) has declined substantially, and the FDIC has taken steps, as required by law, to restore the DIF reserve ratio. Under the FDIC s DIF restoration plan, the assessment schedule was raised uniformly by seven basis points for all insured institutions for the first quarter of 2009. This increase to the annualized base assessment rates is expected to increase the Company s deposit insurance expense by approximately $150 - $200 thousand for the quarter ending March 31, 2009.

In addition to the increase in first quarter assessment rates, the FDIC has also adopted a final rule that, among other matters, modifies the risk-based assessment system to require riskier institutions to pay a larger share of premiums beginning with the second quarter of 2009 and sets initial base assessment rates beginning April 1, 2009 at 12 to 45 basis points. The modified assessment system imposes higher rates for institutions with a significant reliance on secured liabilities, and higher rates for institutions with a significant reliance on brokered deposits but, for well-managed and well-capitalized institutions, only when accompanied by rapid asset growth. The modified system also provides incentives in the form of a reduction in assessment rates for institutions to hold long-term unsecured debt and, for smaller institutions, high levels of Tier 1 capital. Management expects that the Bank s FDIC insurance premiums will increase beginning in April 2009. Management expects that the Bank will again qualify as Risk Category I in 2009, and is currently assessing the impact of the modified assessment system on the Company s results of operations.

As an additional measure to restore the DIF s reserve ratio, the FDIC has also adopted an interim rule (meaning that its final effectiveness remains subject to FDIC consideration of public comments) imposing an emergency 20 basis point special assessment on all insured depository institutions as of June 30, 2009, which would be collected on September 30, 2009. The interim rule would also allow the FDIC Board to impose possible additional special assessments of up to 10 basis points thereafter to maintain public confidence in the DIF. Following its adoption of this interim rule, the FDIC indicated that if Congress authorizes an increase in the FDIC s borrowing capacity through the U.S. Treasury, then the contemplated June 30 special assessment could be significantly reduced to approximately 10 basis points. Any special assessment in the second quarter of 2009 or thereafter, as well as any future increases in annual assessment rates, will further increase the Company s deposit insurance expense.

In addition to general increases in the FDIC s assessment rates and any future special assessments, the Company s insurance costs will increase in 2009 due to its participation in the FDIC s Transaction Account Guarantee Program (the TAGP) as described further below.

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Participation in Temporary Liquidity Guarantee Program and Transaction Account Guarantee Program

On October 14, 2008, the U.S. Treasury and the FDIC jointly announced two new temporary programs to strengthen confidence and encourage liquidity in the nation s banking system. Under the Temporary Liquidity Guarantee Program (the TLGP), the FDIC will guarantee certain newly issued senior unsecured debt of banks, thrifts and certain holding companies. Institutions opting to participate will be charged a 75-basis point fee to protect newly issued debt (issued on or before June 30, 2009). In addition, under the TAGP the FDIC will provide participating depository institutions with full insurance coverage for non-interest bearing deposit transaction accounts, regardless of the dollar amount. The FDIC has made exceptions for certain interest bearing transaction accounts and funds swept into non-interest bearing savings accounts to also be covered under the TAGP. Participating institutions will be charged a 10-basis point surcharge, on those non-interest bearing account balances over the existing insurance limit of $250,000, which will be added to the institutions deposit insurance assessment. On November 13, 2008, the Company began participating in these programs. As of December 31, 2008, the Company did not have any debt guaranteed under the TLGP. The Company expects that participation in the TAGP will increase its 2009 deposit insurance expense by an estimated $300 - $375 thousand.

Dividends

Under Massachusetts law, the Company s board of directors is generally empowered to pay dividends on the Company s capital stock out of its net profits and only to the extent that such payments will not impair the Bank s capital stock.

See also Dividends contained in Item 5 below, for further discussion on restrictions that may effect the Company s and/or the Bank s ability to pay dividends.

Capital Resources

Capital planning by the Company and the Bank considers current needs and anticipated future growth. The primary sources of capital have been the sale of common stock in 1988 and 1989, the issuance of $10.5 million of trust preferred securities in 2000 by the Trust, retention of earnings less dividends paid since the Bank commenced operations, proceeds from the exercise of employee stock options and proceeds from purchases of shares pursuant to the Company s dividend reinvestment plan and employee stock purchase plan.

The Company

The Federal Reserve Board has adopted capital adequacy guidelines that generally require bank holding companies to maintain total capital equal to 8% of total risk-weighted assets, with at least one-half of that amount (or 4% of total risk-weighted assets) consisting of core or Tier 1 capital. Total capital for the Company consists of Tier 1 capital and supplementary or Tier 2 capital. Tier 1 capital for the Company begins with common stockholders equity and is reduced by certain intangible assets. In addition, trust preferred securities may compose up to 25% of the Company s Tier 1 capital (subject to certain limitations and with any excess allocable to Tier 2 capital). Supplementary capital for the Company is comprised solely of a portion of the allowance for loan losses. Assets are adjusted under the risk-based capital guidelines to take into account different levels of credit risk; for example, cash and government securities are placed in a 0% risk category (requiring no additional capital), most home mortgage loans are placed in a 50% risk category, and the bulk of assets that, by their nature in the ordinary course of business, pose a direct credit risk to a bank holding company, including commercial real estate loans, commercial business loans and consumer loans, are placed in a 100% risk category.

In addition to the risk-based capital requirements, the Federal Reserve Board requires bank holding companies to maintain a minimum leverage ratio of Tier 1 capital to quarterly average total assets of 4% (3% percent if given the highest regulatory rating and not experiencing significant growth).

The Bank

The Bank is subject to separate capital adequacy requirements of the FDIC, which are substantially similar to the requirements of the Federal Reserve Board applicable to the

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Company. However, trust preferred proceeds contributed to the Bank from the Company are included in Tier 1 capital of the Bank without limitation. The Company contributed $10.3 million of proceeds from the sale of these securities to the Bank in 2000. Under the FDIC requirements, the minimum total capital requirement is 8% of total assets and certain off-balance sheet items, weighted by risk. At least 4% of the total 8% ratio must consist of Tier 1 capital (primarily common equity including retained earnings) and the remainder may consist of subordinated debt, cumulative preferred stock and a limited amount of loan loss reserves. At the Bank level, as at the Company level on a consolidated basis, certain intangible assets are deducted from Tier 1 capital in calculating regulatory capital ratios.

Under the applicable FDIC capital requirements, the Bank is also required to maintain a minimum leverage ratio. The ratio is determined by dividing Tier 1 capital by quarterly average total assets, less intangible assets and other adjustments. FDIC rules require a minimum of 3% for the highest rated banks. Banks experiencing high growth rates are expected to maintain capital positions well above minimum levels.

Depository institutions, such as the Bank, are also subject to the prompt corrective action framework for capital adequacy established by the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA). Under FDICIA, the federal banking regulators are required to take prompt supervisory and regulatory actions against undercapitalized depository institutions. FDICIA establishes five capital categories: well capitalized , adequately capitalized , undercapitalized , significantly undercapitalized , and critically undercapitalized . A well capitalized institution has a total capital to total risk-weighted assets ratio of at least 10%, a Tier 1 capital to total risk-weighted assets ratio of at least 6%, a leverage ratio of at least 5% and is not subject to any written order, agreement or directive; an adequately capitalized institution has a total capital to total risk-weighted assets ratio of at least 8%, a Tier 1 capital to total risk-weighted assets ratio of at least 4%, and a leverage ratio of at least 4% (3% percent if given the highest regulatory rating and not experiencing significant growth), but does not qualify as well capitalized . An undercapitalized institution fails to meet one of the three minimum capital requirements. A significantly undercapitalized institution has a total capital to total risk-weighted assets ratio of less than 6%, a Tier 1 capital to total risk-weighted assets ratio of less than 3%, and a leverage ratio of less than 3%. A critically undercapitalized institution has a ratio of tangible equity to assets of 2%, or less.

Under certain circumstances, a well capitalized , adequately capitalized or undercapitalized institution may be required to comply with supervisory actions as if the institution were in the next lowest category.

Failure to meet applicable minimum capital requirements, including a depository institution being classified as less than adequately capitalized within FDICIA s prompt corrective action framework, may subject a bank holding company or its subsidiary depository institution(s) to various enforcement actions, including substantial restrictions on operations and activities, dividend limitations, issuance of a directive to increase capital and, for a depository institution, termination of deposit insurance and the appointment of a conservator or receiver.

The Treasury s Capital Purchase Program

In October 2008, the U.S. Treasury implemented a capital purchase program (CPP) under the TARP provisions contained in EESA, which made capital available directly to qualifying publicly held banking institutions. Under the CPP, as initially implemented under EESA, qualifying banks could receive capital from the U.S. Treasury in exchange for issuing non-voting preferred stock with an annual dividend rate of 5% for the first five years and 9% thereafter. The dividends on the Treasury s preferred stock are not tax-deductible and thus are equivalent to pretax rates of approximately 8.5% for the first five years and 15.25% thereafter. The preferred shares that have been issued to the U.S. Treasury under the CPP are also accompanied by ten-year warrants to purchase common stock of the participating banks at current prices. These warrants are exercisable at any time and may be sold or transferred by the U.S. Treasury to any outside party. In addition, under the terms of the CPP, companies that participated in the program were subject to a number of operating guidelines and restrictions, including restrictions on executive compensation, dividend payments and stock repurchases, which could be changed unilaterally by the U.S. Treasury pursuant to a subsequent act of Congress.

The Company s Board of Directors carefully considered the Company s potential involvement in the CPP. The Company was notified in early December that it had received preliminary

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approval to receive up to $28.5 million in capital under the program, which was the maximum amount available to the Company based on its asset size. In December the Board of Directors concluded that declining this government funding was in the best interests of the Company and its shareholders. In making this decision, the Board gave careful consideration to many factors. First and foremost was the Company s strong capital position (under regulatory guidelines the Company is classified as well capitalized which is the highest classification) and strong asset quality. The Board of Directors also believed that this government capital would have come with a high cost in terms of its dividend rate, which most likely would dilute earnings in the short term, the dilution to its shareholders from the warrants attached to the capital (management estimated that these warrants could represent an ownership interest in the Company of up to 5% when fully exercised), the potential restriction on future increases to dividends on its common stock, and the potential unknown operating restrictions that could be unilaterally imposed in the future by an act of Congress. The Board was also concerned about the intended purpose of the TARP funding. While the U.S. Treasury initially indicated that the capital was intended to be used to further strengthen healthy banks and to add capital to the banking industry generally so as to promote lending, and that it could be used by healthy banks in the acquisition of weaker banks, various members of Congress advocated putting binding conditions on the participating banks use of the TARP funds.

As described above, under ARRA, Congress has imposed significant new executive compensation restrictions and corporate governance standards that go well beyond the original terms of the CPP not only on institutions that may accept government funding in the future, but also on those institutions that participated in the initial TARP funding.

The Treasury s Capital Assistance Program

The Capital Assistance Program (CAP) component of President Obama s Financial Stability Plan will provide an additional capital opportunity to banks, whether or not they participated in the CPP, on terms that have been revised from those included in the original CPP, including changes to the dividend rate and conversion features of the preferred shares that would be issued to the U.S. Treasury, additional mandatory reporting requirements for participants and further restrictions on a participating institution s common stock dividends, stock repurchases and cash acquisitions. Management is in the process of reviewing the terms of the CAP as part of its ongoing review of recent legislative and administrative developments.

Patents, Trademarks, etc.

The Company holds a number of registered service marks related to product names and corporate branding. The Company holds no patents, registered trademarks, licenses (other than licenses required to be obtained from appropriate banking regulatory agencies), franchises or concessions which are material to its business.

Employees

At December 31, 2008, the Company employed 306.88 full-time equivalent employees, including 111 officers. None of the Company s employees are presently represented by a union or covered by a collective bargaining agreement. Management believes its employee relations to be excellent.

Item 1A. Risk Factors

An investment in the Company s common stock is subject to a variety of risks and uncertainties. The material risks and uncertainties that management believes affect the Company are described below. These risks and uncertainties are not listed in any particular order of priority and are not necessarily the only ones facing the Company. Additional risks and uncertainties that management is not aware of or focused on or that management currently deems immaterial may also impair the Company s business and results of operations.

This report is qualified in its entirety by these risk factors. If any of the following risks actually occur, the Company s financial condition and results of operations could be materially and adversely affected. If this were to happen, the value of the Company s common stock could decline significantly, and shareholders could lose some or all of their investment.

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The Company s Profitability Depends Significantly on Economic Conditions in the Company s Primary Market Areas

The Company s success depends principally on the general economic conditions of the primary market areas in which the Company operates. The local economic conditions in these areas have a significant impact on the demand for the Company s products and services as well as the ability of the Company s customers to repay loans, the value of the collateral securing loans and the stability of the Company s deposit funding sources.

What began as the sub-prime mortgage crisis , referring to the dramatic increase in the level of home foreclosures both locally and nationally which began in 2007, has had far-reaching consequences in the financial services industry, the national economy in general, and a global economic impact. The current U.S. financial crisis has been marked by the collapse of the market for sub-prime mortgage-backed securities, the government takeover of the national mortgage agencies, and the failure or government-assisted acquisition of several large national mortgage brokers, banks and investment banks. Nationwide, the crisis has led to increased volatility in financial markets and significant market declines on certain investment securities, the tightening of credit for both consumers and businesses, federal legislation aimed at rescuing the financial industry and stimulating the national economy, further weakening of the real estate market, historically low interest rates, increasing unemployment, declines in consumer spending and deterioration of general nationwide economic conditions resulting in an economic recession. Although the current economic crisis has not impacted the New England region as severely as many regions of the country, any long-term continuation of these national and global trends, or possible subsequent effects, could further weaken the local economy and have long-term adverse consequences on local industries, which could negatively impact the Company s financial condition, capital position, liquidity, and performance in a variety of ways. Potential adverse effects on the Company that could result include: the Company could experience continued pressure on its net interest margin; deterioration in its asset quality and an increased level of delinquencies; an increase in the level of its allowance for loan losses; a decline in the value of its investment portfolio; unanticipated charges against capital; funding sources may become restricted thereby impacting the Company s ability to meet cash needs; and a decline in the market price of the Company s common stock.

In addition to the consequences of the current economic recession, any significant and sustained decline in general economic conditions caused by acts of terrorism, an outbreak of hostilities or other international or domestic occurrences, market interest rate changes, or other factors, could also impact local economic conditions and, in turn, have a material adverse effect on the Company s financial condition and results of operations.

The Company is Subject to Lending Risk

There are inherent risks associated with the Company s lending activities. These risks include, among other things, the impact of changes in the economic conditions in the market areas in which the Company operates and changes in interest rates. Weakening of economic conditions within the Company s market area or increases in interest rates could adversely impact the ability of borrowers to repay outstanding loans or the value of the collateral securing these loans.

The Company s loan portfolio consists primarily of commercial real estate, commercial and industrial and construction loans. These types of loans are generally viewed as having more risk of default than owner occupied residential real estate loans or consumer loans, and are also typically larger. The underlying commercial real estate values, the actual costs necessary to complete a construction project, or customer cash flow and payment expectations on such loans can be more easily influenced by adverse conditions in the related industries, the real estate market or in the economy in general. Any significant deterioration in the Company s commercial loan portfolio or underlying collateral values could have a material adverse effect on the Company s financial condition and results of operations.

See the discussions contained in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations , under the headings Loans and Credit Risk/Asset Quality included in the section entitled Financial Condition , for further information regarding the Company s commercial loan portfolio and credit risk.

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The Company May Increase the Allowance for Loan Losses

The Company maintains an allowance for loan losses, which is established through a provision for loan losses charged to earnings that represents management s estimate of probable losses that have been incurred within the existing portfolio of loans. The determination of the appropriate level of the allowance for loan losses inherently involves a high degree of subjectivity and requires the Company to make significant estimates of current credit risks and future trends, all of which may undergo material changes. In addition, bank regulatory agencies periodically review the Company s allowance for loan losses and may require an increase in the provision for loan losses or the recognition of further loan charge-offs, based on judgments that differ from those of the Company s management. Any increases in the allowance for loan losses will result in a decrease in net income and, depending upon the magnitude of the changes, could have a material adverse effect on the Company s financial condition and results of operations.

See the discussions contained in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations , under the heading Allowance for Loan Losses , which is contained in the Critical Accounting Estimates section and under the headings Credit Risk/Asset Quality and Allowance for Loan Losses , included in the section entitled Financial Condition , for further information regarding the process by which the Company determines the appropriate level of its allowance for loan losses.

The Company s Investment Portfolio Could Incur Losses

There are inherent risks associated with the Company s investment activities. These risks include the impact of changes in interest rates, weakness in the real estate or other industries, adverse changes in regional or national economic conditions, and general turbulence in domestic and foreign financial markets, among other things. These conditions could adversely impact the fair market value and the ultimate collectability of the Company s investments.

In addition to fair market value impairment, carrying values may be adversely impacted due to a fundamental deterioration of the individual municipality or government agency whose debt obligations the Company owns or of the individual company or fund in which the Company has invested. At December 31, 2008, approximately 90% of the Company s investment portfolio, or $144 million, was invested in obligations issued by federal government agencies, including Fannie Mae and Freddie Mac, or municipal government entities, while 7%, or $10.7 million, was invested in equity securities, including $4.7 million in FHLB stock.

If an investment s value is deemed other than temporarily impaired , then the Company is required to write down the carrying value of the investment through a charge to earnings. The determination of the level of other-than-temporary impairment (OTTI) involves a high degree of subjectivity and requires the Company to make significant estimates of current market risks and future trends, all of which may undergo material changes. Any OTTI charge will result in a decrease in net income and, depending upon the magnitude of the charges, could have a material adverse effect on the Company s financial condition and results of operations.

At December 31, 2008, the Company s investment in FHLB capital stock amounted to $4.7 million. The FHLB is currently operating with retained earnings below its target level. The FHLB has instituted a plan to increase retained earnings which includes suspending its quarterly dividend and a moratorium on the repurchase of excess capital stock from member banks, among other programs. If further deterioration in the FHLB financial condition or capital levels occurs, the FHLB capital stock may become other than temporarily impaired to some degree.

Additionally, if as a result of deterioration in its financial condition the FHLB restricts its lending activities, the Company may need to seek alternative funding sources to meet its liquidity needs. See also the discussion contained in this Item 1A under the heading Sources of External Funding May Become Restricted and Impact the Company s Liquidity.

See the discussions contained in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations , under the heading Impairment Review of Securities , which is contained in the Critical Accounting Estimates section, and under the heading Investment Securities , included in the section entitled Financial Condition , for further information regarding the process by which the Company determines the level of other-than-temporary impairment.

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The Company is Subject to Interest Rate Risk

The Company s earnings and cash flows are largely dependent upon its net interest income, meaning the difference between interest income earned on interest-earning assets and interest expense paid on interest-bearing liabilities. Interest rates are highly sensitive to many factors that are beyond the Company s control, including monetary policy of the federal government, inflation and deflation, volatility of financial and credit markets, and competition. If the interest rates paid on interest-bearing liabilities increase at a faster rate than the interest rates received on loans and other investments, the Company s net interest income, and therefore earnings, could be adversely affected. Earnings could also be adversely affected if the interest rates received on loans and other investments fall more quickly than the interest rates paid on interest-bearing liabilities.

See Item 7A, Quantitative and Qualitative Disclosures about Market Risk , for further discussions related to the Company s management of interest rate risk.

Sources of External Funding May Become Restricted and Impact the Company s Liquidity

The Company s external funding sources include borrowing capacity in the brokered CD market, at the FHLB and FRB, and through federal fund purchase arrangements with correspondent banks. The Company has in the past also issued junior subordinated debentures. If, as a result of general economic conditions or other events, these sources of external funding withdraw or limit the Company s borrowing capacity, the Company may not be able to raise adequate funds or may incur substantially higher cost or operating restrictions in order to raise necessary funds elsewhere. Any such increase in funding cost or restrictions could have a negative impact on the Company s net interest income and, consequently, on its results of operations and financial condition.

Increased Reliance on Borrowings and Brokered CD s as Sources of Funds Could Adversely Affect the Company s Profitability

The Company has traditionally funded asset growth principally through deposits and borrowings. As a general matter, deposits are a lower cost source of funds than external wholesale funding (brokered CD s or borrowings), because interest rates paid for deposits are typically less than interest rates charged for wholesale funding (notwithstanding the recent declines in overnight borrowing rates). If, as result of competitive pressures, market interest rates, general economic conditions or other events, the balance of the Company s deposits decreases relative to the Company s overall banking operations, the Company may have to rely more heavily on wholesale funding in the future. Any such increased reliance on wholesale funding could have a negative impact on the Company s net interest income and, consequently, on its results of operations and financial condition.

The Use of Independent Investment Management Firms Expose the Company to Additional Risk

The Company relies on outside mutual fund companies and independent investment management firms to provide key services necessary to conducting its investment advisory and management business. These firms are subject to a variety of risk and uncertainties, including significant exposures to changes in financial market conditions and poor investment decisions, turnover in key personnel, internal and external securities fraud, information security or data breach, and financial losses, among others, any of which could in turn expose the Company itself to various risks. The risks to the Company include but are not limited to, the loss of customer business, damage to the Company s reputation, exposure of the Company to civil litigation and possible financial liability, and a reduction in fee income, any of which could have a material adverse effect on the Company s financial condition and results of operations.

The Company s Capital Levels Could Fall Below Regulatory Minimums

The Company and the Bank are both subject to the capital adequacy guidelines of the FRB and FDIC, respectively. Failure to meet applicable minimum capital ratio requirements may subject the Company and/or the Bank to various enforcement actions. If capital levels decline due to possible future net operating losses, impairment charges against tangible

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or intangible assets, adjustments to retained earnings due to changes in accounting rules, among other things, and if the Company is unable to raise additional capital to offset theses charges, the Company s capital ratios may fall below regulatory capital adequacy levels.

See the section entitled Capital Resources contained in Item 1, Business , for additional information regarding regulatory capital requirement for the Company and the Bank.

The Company is Subject to Extensive Government Regulation and Supervision

The Company is subject to extensive federal and state regulation and supervision. Banking regulations are primarily intended to protect depositors funds, federal deposit insurance funds and the banking system as a whole, not the interests of shareholders. These regulations affect the Company s lending practices, capital structure, investment practices, dividend policy and growth, among other things. Federal and state statutes and related regulations, including tax policy and corporate governance rules, can significantly affect the way in which bank holding companies, and public companies in general, conduct business. Changes to federal or state statutes, regulations or regulatory and tax policies, including changes in interpretation or implementation of existing statutes, regulations or policies, or new regulation aimed at resolving the current financial crisis could affect the Company in substantial and unpredictable ways, including subjecting the Company to additional operating and compliance costs, increasing the Company s deposit insurance premiums, limiting the types of financial services and products the Company may offer and/or increasing competition from other non-bank providers of financial services.

See the section entitled Supervision and Regulation contained in Item 1, Business , for additional information regarding the supervisory and regulatory issues facing the Company.

The Company Operates in a Highly Competitive Industry and Market Area

The Company faces substantial competition in all areas of its operations from a variety of different competitors, many of which are larger and have more financial resources than the Company. Competitors within the Company s market area include not only national, regional, and other community banks, but also various types of other non-bank financial institutions, including credit unions, consumer finance companies, mortgage brokers, private lenders, insurance companies, securities brokerage firms, institutional mutual funds, registered investment advisors, internet based banks and other financial intermediaries.

See the section entitled Competition contained in Item 1, Business , for additional information regarding the competitive issues facing the Company.

The Company Continually Encounters Technological Change

The banking industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. Many of the Company s competitors have substantially greater resources to invest in technological improvements. Failure to successfully keep pace with technological change affecting the banking industry could have a material adverse effect on the Company s business and, in turn, the Company s financial condition and results of operations.

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The Company s Information Systems May Experience an Interruption or Breach in Security

The Company relies heavily on communications and information systems to conduct its business. The occurrence of any failures, interruptions or security breaches of the Company s information systems could interrupt the Company s ability to conduct business, process transactions, damage the Company s reputation, result in a loss of customer business, expose customers personal information to unauthorized parties, subject the Company to additional regulatory scrutiny, and expose the Company to civil litigation and possible financial liability, any of which could have a material adverse effect on the Company s financial condition and results of operations.

See the discussion under the heading Opportunities and Risks included in the section entitled Overview , which is contained in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations , for further information regarding the Company s information security and technology practices.

The Company Relies on Independent Service Providers

The Company relies on independent firms to provide key services necessary to conducting its business. These services include, but are not limited to: electronic funds delivery networks; check clearing houses; electronic banking services; investment advisory, management and custodial services; correspondent banking services; information security assessments; and loan underwriting and review services. The occurrence of any failures, interruptions or security breaches of the independent firms systems or in their delivery of services, could result in a loss of customer business, expose customers personal information to unauthorized parties, damage the Company s reputation and expose the Company to civil litigation and possible financial liability, any of which could have a material adverse effect on the Company s financial condition and results of operations.

The Company s Controls and Procedures May Fail or Be Circumvented

Management regularly reviews and updates the Company s internal controls over financial reporting, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of the Company s controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on the Company s business, results of operations and financial condition.

The Company May Not be Able to Attract and Retain Key Personnel

The Company s success depends, in large part, on its ability to attract and retain key personnel. Competition for the best people in most activities engaged in by the Company can be intense and the Company may not be able to hire or retain the key personnel that it depends upon for success. The unexpected loss of services of one or more of the Company s key personnel could have a material adverse impact on the Company s business because of their skills, knowledge of the Company s market, years of industry experience and the difficulty of promptly finding qualified replacement personnel.

Slower than Expected Growth in New Branches and New Products and Services Could Adversely Affect the Company s Profitability

The Company has placed a strategic emphasis on expanding the Bank s branch network and products and service offerings. Executing this strategy carries risks of slower than anticipated growth both in new branches and new products and services. New branches and new products and services require a significant investment of both financial and personnel resources. Lower than expected loan and deposit growth in new branches and/or lower than expected fee or other income from new products and services could decrease anticipated revenues and net income generated by such investments. In addition, new branches require the approval of various regulatory agencies, which may or may not approve the Company s application for a branch. Opening new branches and introducing new products and services could also divert resources from current core operations and thereby further adversely affect the Company s growth and profitability**.**

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Growth Strategies Involving Acquisitions Could Adversely Affect the Company s Profitability

The Company may in the future explore growth opportunities through acquisition of other banks, financial services companies or lines of business. Any future acquisition could adversely affect the Company s profitability based on management s ability to successfully complete the acquisition and integration of the acquired business.

The Trading Volume in the Company s Common Stock is Less Than That of Larger Companies

Although the Company s common stock is listed for trading on the NASDAQ Global Market, the trading volume in the Company s common stock is substantially less than that of larger companies. Given the lower trading volume of the Company s common stock, significant purchases or sales of the Company s common stock, or the expectation of such purchases or sales, could cause significant swings up or down in the Company s stock price.

The Market Price of the Company s Common Stock May be Affected by General Industry Issues

The banking industry may be more affected than other industries by certain economic, credit, regulatory or information security issues. Although the Company itself may or may not be directly impacted by such issues, the Company s stock price may swing up or down due to the influence, both real and perceived, of these issues among others on the banking industry in general.

The Carrying Value of the Company s Goodwill May Become Impaired

In accordance with generally accepted accounting principles, the Company does not amortize goodwill and instead, at least annually, evaluates whether the carrying value of goodwill has become impaired. Impairment of the goodwill may occur when the estimated fair value of the Company is less than its recorded book value (i.e., the net book value of its recorded assets and liabilities). A determination that goodwill has become impaired results in immediate write-down of goodwill to its determined value with a resulting charge to operations. If the estimated fair value of the Company declines due to changes in the assumptions and input used in management s estimate of the fair value, the carrying value of the Company s goodwill may become impaired. Any write down of goodwill will result in a decrease in net income and, depending upon the magnitude of the charge, could have a material adverse effect on the Company s financial condition and results of operations.

See the discussions contained in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations , under the heading Impairment Review of Goodwill and Other Intangible Assets , which is contained in the Critical Accounting Estimates section, for further information regarding the process by which the Company determines whether an impairment of goodwill has occurred.

Shareholder Dilution May Occur if Additional Stock is Issued in the Future

If the Company s Board of Directors should determine in the future that there is a need to obtain additional capital through the issuance of additional shares of the Company s common stock or securities convertible into shares of common stock, such issuances could result in dilution to existing shareholders ownership interest. Similarly, if the Board of Directors decides to grant additional restricted stock shares or options for the purchase of shares of common stock, the issuance of such additional restricted stock shares and/or the issuance of additional shares upon the exercise of such options may expose shareholders to dilution.

The Company s Articles Of Organization, By-Laws and Shareholders Rights Plan as Well as Certain Banking and Corporate Laws May Have an Anti-Takeover Effect

Provisions of the Company s articles of organization and by-laws, its shareholders rights plan and certain federal and state banking laws and state corporate laws, including regulatory approval requirements for any acquisition of control of the Company, could make it more difficult for a third party to acquire the Company, even if doing so would be perceived to be beneficial to the Company s shareholders. The combination of these provisions effectively inhibits a non-negotiated merger or other business combination involving an acquisition of the Company, which, in turn, could adversely affect the market price of the Company s common stock.

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Directors and Executive Officers Own a Significant Portion of Common Stock

The Company s directors and executive officers as a group beneficially own approximately 29% of the Company s outstanding common stock as of December 31, 2008. As a result of this combined ownership interest, the directors and executive officers have the ability, if they vote their shares in a like manner, to significantly influence the outcome of all matters submitted to shareholders for approval, including the election of directors.

The Company Relies on Dividends from the Bank for Substantially All of its Revenue

The Company is a separate and distinct legal entity from the Bank. It receives substantially all of its revenue from dividends paid by the Bank. These dividends are the principal source of funds used to pay dividends on the Company s common stock and interest and principal on the Company s subordinated debt. Various federal and state laws and regulations limit the amount of dividends that the Bank may pay to the Company. If the Bank is unable to pay dividends to the Company, then the Company will be unable to service debt, pay obligations or pay dividends on the Company s common stock. The Bank s inability to pay dividends could have a material adverse effect on the Company s business, financial condition and results of operations.

Additional Factors Described Elsewhere in This Report

In addition to the factors listed above in this section, additional important factors that could adversely affect the results of the Company s future operations are described below under the heading Special Note Regarding Forward-Looking Statements contained in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The Company conducts its business from its main office and operational support and lending offices in Lowell, Massachusetts. The Company currently has sixteen full service branch banking offices serving the Merrimack Valley and North Central regions of Massachusetts and South Central New Hampshire, with an additional location in the permitting phase. The Company is obligated under various non-cancelable operating leases, most of which provide for periodic adjustments. Several leases provide the Company the right of first refusal should the property be offered for sale. The Company believes that all its facilities are well maintained and suitable for the purpose for which they are used.

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The following table sets forth general information related to facilities owned or used by the Company as of December 31, 2008. All locations are in Massachusetts unless otherwise noted.

BRANCH LOCATION	OWNED OR LEASED
Andover	
6-8 High Street	Leased
Acton	
340 Great Road(1)	Leased
Billerica	
674 Boston Road	Owned
Chelmsford	
20 Drum Hill Road	Owned
185 Littleton Road	Owned
Dracut	
1168 Lakeview Avenue	Leased
Fitchburg	
420 John Fitch Highway	Leased
Leominster	
4 Central Street (2)	Leased
Lowell	
430-434 Gorham Street	Leased
222 Merrimack Street *(Main Office)*	Leased
Methuen	
255 Broadway Street	Owned
North Billerica	
223 Boston Road	Owned
Salem, NH	
130 Main Street	Leased
Tewksbury	
910 Andover Street	Leased
1120 Main Street	Leased
Westford	
237 Littleton Road	Owned
OPERATION/LENDING OFFICES	
Lowell	
170 Merrimack/19 Palmer Street(3)	Owned
PLANNED BRANCH LOCATION	
Salem, NH	
126 Main Street(4)	Leased
Derry, NH	
47 Crystal Avenue(5)	Leased

(1) This branch opened for business in January 2009

(2) The Company has the option to purchase this facility at any time during any extended term at the price of $550 thousand as adjusted for increases in the producer s price index. The Company s last five-year extended-term option ends in September 2020.

(3) The Company purchased these facilities, which had formerly been leased, in September 2007.

(4) The Company plans to relocate its current Salem, NH office to this new location by Summer of 2009.

(5) This location is under lease and has been approved by the Town of Derry; the approval has been appealed by a competitor. Subject to a favorable resolution, the Company expects to open the branch in late 2009 or early 2010.

See note 4, Premises and Equipment and note 12, Related Party Transactions to the consolidated financial statements in Item 8 below, for further information regarding the Company s lease obligations listed above.

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Item 3. Legal Proceedings

The Company is involved in various legal proceedings incidental to its business. Management does not believe resolution of any present litigation will have a material adverse effect on the financial condition of the Company.

Item 4. Submission of Matters to a Vote of Security Holders

There were no matters submitted to a vote of security holders during the quarter ended December 31, 2008.

PART II

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

Market for Common Stock

The Company s shares trade on the NASDAQ Global Market under the trading symbol EBTC .

The following table sets forth sales volume and price information, to the best of management s knowledge, for the common stock of the Company for the periods indicated.

Fiscal Year	Trading Volume	Share Price High	Share Price Low
2008:			
4th Quarter	215,940	$ 12.88	$ 9.50
3rd Quarter	138,779	13.25	10.50
2nd Quarter	47,629	14.00	11.42
1st Quarter	141,956	14.05	12.45
2007:			
4th Quarter	72,061	$ 14.89	$ 12.00
3rd Quarter	82,731	16.00	12.42
2nd Quarter	142,138	16.39	15.06
1st Quarter	115,074	16.84	15.17

As of March 4, 2009, there were 717 registered shareholders of the Company s common stock and 8,068,581 shares of the Company s common stock outstanding.

Dividends

As the principal asset of the Company, the Bank currently provides the only source of cash for the payment of dividends by the Company. Under Massachusetts law, trust companies such as the Bank may pay dividends only out of net profits and only to the extent that such payments will not impair the Bank s capital stock. Any dividend payment that would exceed the total of the Bank s net profits for the current year plus its retained net profits of the preceding two years would require the Commissioner s approval. FDICIA also prohibits a bank from paying any dividends on its capital stock if the Bank is in default on the payment of any assessment to the FDIC or if the payment of dividends would otherwise cause the Bank to become undercapitalized. These restrictions on the ability of the Bank to pay dividends to the Company may restrict the ability of the Company to pay dividends to the holders of its common stock.

The statutory term net profits essentially equates with the accounting term net income and is defined under the Massachusetts banking statutes to mean the remainder of all earnings from current operations plus actual recoveries on loans and investments and other assets after deducting from such total all current operating expenses, actual losses, accrued dividends on any preferred stock and all federal and state taxes.

In 2008, quarterly dividends of $0.09 per share were paid in March, June, September and December. Total 2008 dividends of $0.36 per share represented an increase of 12.5% compared to total dividends of $0.32 also paid on a quarterly basis in 2007.

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The Company maintains a dividend reinvestment plan (the DRP). The DRP enables stockholders, at their discretion, to elect to reinvest dividends paid on their shares of the Company s common stock by purchasing additional shares of common stock from the Company at a purchase price equal to fair market value. Shareholders utilized the DRP to reinvest $1.0 million, of the $2.9 million dividends paid by the Company in 2008, into 85,586 shares of the Company s common stock.

On January 28, 2009, the Company announced a quarterly dividend of $0.095 per share, paid on March 2, 2009 to shareholders of record as of February 9, 2009. On an annualized basis, this quarterly dividend represents a 5.6% increase over the 2008 dividend rate.

Securities Authorized for Issuance under Equity Compensation Plans

The following table provides information as of December 31, 2008 with respect to the Company s Amended and Restated 1998 Stock Incentive Plan and 2003 Stock Incentive Plan, as amended, which together constitute all of the Company s existing equity compensation plans that have been previously approved by the Company s stockholders. The Company does not have any existing equity compensation plans, including any existing individual equity compensation arrangements, which have not been previously approved by the Company s stockholders.

Plan Category	Number of Securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of Securities remaining available for future issuance under equity compensation plans (excluding securities reflected in second column from left)
Equity compensation plans approved by security holders	771,331	$ 13.83	196,631
Equity compensation plans not approved by security holders			
TOTAL	771,331	$ 13.83	196,631

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Performance Graph

The following graph compares the cumulative total return (which assumes the reinvestment of all dividends) on the Company s common stock with the cumulative total return reflected by a broad based equity market index and an appropriate published industry index. This graph shows the changes over the five-year period ended on December 31, 2008 in the value of $100 invested in (i) the Company s common stock, (ii) the Standard & Poors 500 Index and (iii) the NASDAQ Bank Index. Prior to February 14, 2005 (when the Company s shares began trading on the NASDAQ National Market, now NASDAQ Global Market), there was no active trading market for the Company s common stock, although shares were traded periodically on a privately negotiated basis. For each year prior to 2005 shown on the graph, the increase in the value of the Company s common stock is based on the actual prices known to the Company at which shares of the common stock were traded as of the most recent date prior to December 31 of each of these earlier periods. For purposes of the graph, the reinvestment of dividends paid prior to 2005 is based upon the annual valuation analysis of the Company s common stock that was formerly undertaken in the years prior to the Company s listing on the NASDAQ National Market pursuant to the Company s administration of its dividend reinvestment plan.

	2003	**2004**	**2005**	**2006**	**2007**	**2008**
Enterprise Bancorp	100	122.81	123.26	129.83	104.18	95.88
S&P 500	100	110.88	116.32	134.69	142.09	89.52
NASDAQ Bank	100	113.67	111.47	126.88	101.62	79.73

Sales of Unregistered Securities and Repurchases of Shares

The Company has not sold any equity securities that were not registered under the Securities Exchange Act of 1934 during the year ended December 31, 2008. Neither the Company nor any   affiliated purchaser   (as defined in the SEC s Rule 10b-18(a)(3)) has repurchased any of the Company s outstanding shares, nor caused any such shares to be repurchased on its behalf, during the fiscal quarter ended December 31, 2008.

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Item 6. Selected Financial Data

	Year Ended December 31,				
(Dollars in thousands, except per share data)	**2008**	**2007**	**2006**	**2005**	**2004**
EARNINGS DATA					
Net interest income	$ 42,195	$ 40,679	$ 41,560	$ 38,102	$ 32,120
Provision for loan losses	2,505	1,000	1,259	1,135	1,650
Net interest income after provision for loan losses	39,690	39,679	40,301	36,967	30,470
Non-interest income	9,488	8,453	7,020	6,244	6,071
Other than temporary impairment oninvestment securities	(3,702)				
Net gains (losses) on sales of investment securities	305	1,655	(204)	191	906
Non-interest expense	37,884	34,844	32,540	30,235	25,687
Income before income taxes	7,897	14,943	14,577	13,167	11,760
Provision for income taxes	2,349	5,045	5,343	4,753	4,253
Net income	$ 5,548	$ 9,898	$ 9,234	$ 8,414	$ 7,507
COMMON SHARE DATA					
Basic earnings per share	$ 0.70	$ 1.27	$ 1.21	$ 1.13	$ 1.03
Diluted earnings per share	0.69	1.25	1.18	1.09	0.99
Book value per share at year end	11.35	11.00	9.98	8.93	8.36
Dividends paid per share	$ 0.360	$ 0.320	$ 0.280	$ 0.240	$ 0.215
Basic weighted average shares outstanding	7,973,527	7,819,160	7,661,178	7,468,498	7,294,760
Diluted weighted average shares outstanding	8,005,535	7,913,006	7,821,297	7,690,526	7,613,196
YEAR END BALANCE SHEET AND OTHER DATA					
Total assets	$ 1,180,477	$ 1,057,666	$ 979,259	$ 918,477	$ 848,171
Loans serviced for others	28,341	20,826	21,659	22,938	35,067
Investment assets under management	439,711	573,608	502,059	424,953	363,250
Total assets under management	$ 1,648,529	$ 1,652,100	$ 1,502,977	$ 1,366,368	$ 1,246,488
Total loans	$ 948,641	$ 833,819	$ 761,113	$ 699,726	$ 570,459
Allowance for loan losses	15,269	13,545	12,940	12,050	10,923
Investment securities at fair value	159,373	145,517	131,540	156,521	187,601
Total short-term investments	3,797	7,788	15,304	5,431	40,290
Deposits	947,903	868,786	867,522	775,387	768,644
Borrowed funds	121,250	81,429	15,105	58,639	3,651
Junior subordinated debentures	10,825	10,825	10,825	10,825	10,825
Total stockholders equity	91,104	87,012	77,043	67,830	61,684
RATIOS					
Return on average total assets	0.51%	0.99%	0.98%	0.97%	0.95%
Return on average stockholders equity	6.26%	12.11%	12.89%	13.10%	12.99%
Allowance for loan losses to total loans	1.61%	1.62%	1.70%	1.72%	1.91%
Stockholders equity to total assets	7.72%	8.23%	7.87%	7.39%	7.27%
Dividend payout ratio	51.43%	25.20%	23.14%	21.24%	20.87%

On June 30, 2006, the Company issued 3,842,015 shares in a two-for-one stock split paid in the form of a stock dividend. All share and per share amounts have been retroactively adjusted to reflect the stock dividend for all periods presented.

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

Management s discussion and analysis should be read in conjunction with the Company s consolidated financial statements and notes thereto, contained in Item 8, the information contained in the description of the Company s business in Item 1 and other financial and statistical information contained in this annual report.

Special Note Regarding Forward-Looking Statements

This report contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including statements concerning plans, objectives, future events or performance and assumptions and other statements that are other than statements of historical fact. Forward-looking statements may be identified by reference to a future period or periods or by use of forward-looking terminology such as anticipates , believes , expects , intends , may , plans , pursue , views and similar terms or expressions. Various stat contained in Item 1 Business , Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations and Item 7A Quantitative and Qualitative Disclosures About Market Risk, including, but not limited to, statements related to management s views on the banking environment and the economy, competition and market expansion opportunities, the interest rate environment, credit risk and the level of future non-performing assets and charge-offs, potential asset and deposit growth, future non-interest expenditures and non-interest income growth, and borrowing capacity are forward-looking statements. The Company wishes to caution readers that such forward-looking statements reflect numerous assumptions and involve a number of risks and uncertainties that may adversely affect the Company s future results. The following important factors, among others, could cause the Company s results for subsequent periods to differ materially from those expressed in any forward-looking statement made herein: (i) changes in interest rates could negatively impact net interest income; (ii) changes in the business cycle and downturns in the local, regional or national economies, including deterioration in the local real estate market, could negatively impact credit and/or asset quality and result in credit losses and increases in the Company s reserve for loan losses; (iii) changes in consumer spending could negatively impact the Company s credit quality and financial results; (iv) increasing competition from larger regional and out-of-state banking organizations as well as non-bank providers of various financial services could adversely affect the Company s competitive position within its market area and reduce demand for the Company s products and services; (v) deterioration of securities markets could adversely affect the value or credit quality of the Company s assets and the availability of funding sources necessary to meet the Company s liquidity needs; (vi) changes in technology could adversely impact the Company s operations and increase technology-related expenditures; (vii) increases in employee compensation and benefit expenses could adversely affect the Company s financial results; (viii) changes in laws and regulations that apply to the Company s business and operations could increase the Company s regulatory compliance costs and adversely affect the Company s business environment, operations and financial results; (ix) changes in accounting standards, policies and practices, as may be adopted or established by the regulatory agencies, the Financial Accounting Standards Board or the Public Company Accounting Oversight Board could negatively impact the Company s financial results; and (x) some or all of the risks and uncertainties described above in Item 1A could be realized, which could have a material adverse effect on the Company s business, financial condition and results of operation. Therefore, the Company cautions readers not to place undue reliance on any such forward-looking information and statements.

Critical Accounting Estimates

The Company s significant accounting policies are described in note 1, Summary of Significant Accounting Policies , to the consolidated financial statements contained in Item 8. In applying these accounting policies, management is required to exercise judgment in determining many of the methodologies, assumptions and estimates to be utilized. Certain of the critical accounting estimates are more dependent on such judgment and in some cases may contribute to volatility in the Company s reported financial performance should the assumptions and estimates used change over time due to changes in circumstances. The three most significant areas in which management applies critical assumptions and estimates include the areas described further below.

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Allowance for Loan Losses

The allowance for loan losses is an estimate of credit losses inherent in the loan portfolio. The Company s allowance is accounted for in accordance with SFAS No. 114, as amended by SFAS No. 118, Accounting by Creditors for Impairment of a Loan-Income Recognition and Disclosures , and SFAS No. 5, Accounting for Contingencies . The allowance for loan losses is established through a provision for loan losses, a direct charge to earnings. Loan losses are charged against the allowance when management believes that the collectability of the loan principal is unlikely. Recoveries on loans previously charged off are credited to the allowance. The Company maintains the allowance at a level that it deems adequate to absorb all reasonably probable losses from specifically known and other credit risks associated with the portfolio. Arriving at an appropriate level of allowance for loan losses involves a high degree of management judgment.

The Company uses a systematic process to measure the amount of estimated loan loss exposure inherent in the portfolio for purposes of establishing a sufficient allowance for loan losses. The methodology makes use of specific reserves for loans individually evaluated and deemed impaired and general reserves for larger groups of homogeneous loans which rely on a combination of qualitative and quantitative factors that could have an impact on the credit quality of the portfolio.

Management believes that the allowance for loan losses is adequate to absorb reasonably probable losses from specifically known and other credit risks associated with the loan portfolio as of the balance sheet dates. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company s allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance based on judgments different from those of management.

Management s assessment of the adequacy of the allowance for loan losses is contained under the headings Credit Risk/Asset Quality and Allowance for Loan Losses , which are contained in the Financial Condition section of this Item 7.

Impairment Review of Investment Securities

There are inherent risks associated with the Company s investment activities which could adversely impact the fair market value and the ultimate collectability of the Company s investments. The determination of other-than-temporary impairment involves a high degree of subjectivity and requires management to make significant estimates of current market risks and future trends. Management s assessment includes: evaluating the level and duration of the loss on individual securities; evaluating the credit quality of fixed income issuers; determining if any individual equity security or mutual or other fund exhibits fundamental deterioration; and estimating whether it is unlikely that the individual security or fund will completely recover its unrealized loss within a reasonable period of time, or in the case of fixed income securities prior to maturity. While management uses available information to measure other-than-temporary impairment at the balance sheet date, future write-downs may be necessary based on extended duration of current unrealized losses, changing market conditions, or circumstances surrounding individual issuers and funds.

Should an investment be deemed other than temporarily impaired , the Company is required to write-down the carrying value of the investment through a charge to earnings. Once written-down a security may not be written-up to reflect future increases in market prices. Such write-down(s) may have a material adverse effect on the Company s financial condition and results of operations.

Based on these impairment reviews, at December 31, 2008, management booked a $3.7 million OTTI charge on certain equity securities in the investment portfolio. Management determined that the remaining unrealized losses in the Company s investment portfolio were not other than temporary in nature at December 31, 2008.

Management s assessment of impairment of the unrealized losses in the investment portfolio is contained under the heading Investment Securities , which is contained in the Financial Condition section of this Item 7.

Impairment Review of Goodwill and Other Intangible Assets

In accordance with generally accepted accounting principles, the Company does not amortize goodwill and instead, at least annually, evaluates whether the carrying value of goodwill

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has become impaired. Impairment of the goodwill may occur when the estimated fair value of the Company is less than its recorded book value. A determination that goodwill has become impaired results in immediate write-down of goodwill to its determined value with a resulting charge to operations.

The annual impairment test is a two-step process used to identify potential goodwill impairment and measure the amount of goodwill impairment loss to be recognized, if any. The assessment is performed at the operating unit level. In the case of the Company, the services offered through the Bank and subsidiaries are managed as one strategic unit and represent the Company s only reportable operating segment. The first step of the goodwill impairment test, used to identify potential impairment, compares the estimated fair value of the reporting unit with its carrying amount, or the book value of the reporting unit, including goodwill. If the estimated fair value of the reporting unit equals or exceeds its book value, goodwill is considered not impaired, and the second step of the impairment test is unnecessary. Management s assessment of the fair value of the Company takes into consideration the Company s market capitalization, stock trading volume, price-multiples valuations of comparable companies and control premiums in transactions involving comparable companies. The value of a control premium to use in the marketplace will depend on a number of factors including the target bank stock s liquidity, where the stock is currently trading, the perceived attractiveness of the entity and economic conditions. Management evaluates each of these factors as they relate to the Company and subjectively determines a comparable assumed control premium.

The second step, if necessary, measures the amount of goodwill impairment loss to be recognized. The reporting unit must determine fair values for all assets and liabilities, excluding goodwill. The net of the assigned fair value of assets and liabilities is then compared to the book value of the reporting unit, and any excess book value becomes the implied fair value of goodwill. If the carrying amount of the goodwill exceeds the newly calculated implied fair value of that goodwill, an impairment loss is recognized in the amount required to write down the goodwill to the implied fair value.

The Company s consolidated financial statements also include intangible assets (core deposit intangibles), which are amortized to expense over their estimated useful life of ten years and reviewed for impairment on an ongoing basis or whenever events or changes in business circumstances warrant a review of the carrying value. If impairment is determined to exist, the related write-down of the intangible asset s carrying value is charged to operations.

Based on these impairment reviews management determined that the Company s goodwill and core deposit intangible assets were not impaired at December 31, 2008.

Overview

Summary

The Company had net income of $5.5 million, or $0.69 on a diluted earnings per share basis, for the year ended December 31, 2008, compared to $9.9 million, or $1.25, respectively, for the year ended December 31, 2007. Net income for the three months ended December 31, 2008, was $29 thousand, or $0.00 on a diluted earnings per share basis, compared to $2.7 million, or $0.34, respectively for the same period in 2007.

The decline in 2008 earnings from the prior periods included the impact of an OTTI charge on certain equity securities in the investment portfolio, which reflected declines in the equity markets, margin compression caused by market interest rate reductions, which began in September 2007 and continued through 2008, significant increases in expenses associated with accelerated expansion and growth initiatives, and an increase in FDIC insurance premiums incurred by all banking institutions. Expenses related to expansion and growth initiatives included the expenses incurred in opening two new branches, the additional loan loss provisions required by the loan growth, and increased marketing and advertising expenses. While these factors adversely affect earnings in the short-term, management believes that this is an opportune time to incur such expenses in order to invest in the Company s long-term growth.

Loan growth was strong in 2008 and particularly so during the fourth quarter. Loans increased by 14% in 2008. During the three months ended December 31, 2008, loans increased by $40 million, a quarterly increase which amounts to an annualized growth rate of 18%. Loan quality remained strong, particularly in light of the challenging economic environment, with loan quality ratios remaining favorable.

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Composition of Earnings

The Company s earnings are largely dependent on its net interest income, which is the difference between interest earned on loans and investments and the cost of funding (primarily deposits and borrowings). Tax equivalent net interest income expressed as a percentage of average interest earning assets is referred to as net interest margin (margin).

For the year ended December 31, 2008, net interest income amounted to $42.2 million, an increase of 4% compared to 2007. Net interest income for the quarter ended December 31, 2008 amounted to $11.2 million, an increase of 9% compared to the December 2007 quarter. The increases in net interest income over the comparable prior-year periods were due primarily to strong loan growth, which was partially offset by margin compression as described further below. Average loan growth for the year-over-year and quarter-over-quarter periods amounted to $86.8 million and $100.2 million, respectively.

The Company s year-to-date net interest margin decreased as a result of asset yields repricing downward, due to the market-rate reductions that have occurred since late 2007 as the Federal Reserve Board s target rates have declined 500 basis points, including 175 basis points during the December quarter. However, the Company s strong loan growth throughout the year, along with reductions in funding costs, partially offset the reduction in asset yields. Due to tight credit markets and a highly-competitive marketplace for funding during the year, deposit costs declined at a slower pace than asset yields. However, the decline in wholesale funding costs accelerated during the second half of the year, primarily as a result of reductions in FHLB short-term funding rates. Net interest margin was 4.23% for the year ended December 31, 2008, compared to 4.48% for the year ended December 31, 2007. Quarterly net interest margin was 4.24% for the three months ended December 31, 2008, compared to 4.27% and 4.36% for the quarters ended September 30, 2008 and December 31, 2007, respectively.

The provision for loan losses amounted to $2.5 million for the year compared to $1.0 million in 2007. The increase over the prior year was due primarily to loan growth and an increase in net charge-offs. Total loans increased $114.8 million, or 14%, since December 31, 2007. For the year ended December 31, 2008, the Company recorded net charge-offs of $781 thousand, compared to net charge-offs of $395 thousand for the year ended December 31, 2007. In light of the current economic environment overall asset quality remains strong, with net charge-offs for the year amounting to 0.09% of average total loans, and non-performing assets to total assets of 0.73% at December 31, 2008, compared to 0.05% and 0.39%, respectively, in 2007. The allowance for loan losses to total loans ratio was 1.61% at December 31, 2008, compared to 1.62% at December 31, 2007.

Non-interest income for the year ended December 31, 2008, amounted to $6.1 million compared to $10.1 million in the prior year. The decrease was due primarily to the $3.7 million OTTI charge on certain equity investments and a reduction in net security gains, which were $305 thousand for the year-ended December 31, 2008, compared to $1.7 million for the year-ended December 31, 2007. In the fourth quarter of 2008, the Company recorded the OTTI charge on certain equity securities contained in its investment portfolio to reflect the impact of fourth quarter declines in the equity markets. This net income charge ($2.4 million after-taxes) had no impact on the Company s capital, as the unrealized fair market value losses were already reflected in capital. Excluding the OTTI charge and the securities gains in both 2007 and 2008, non-interest income in 2008 increased $1.0 million, or 12%, over the prior year, due primarily to an increase in deposit service fee income.

Non-interest expense for the year ended December 31, 2008, amounted to $37.9 million, an increase of 9%, compared to $34.8 million for the year ended December 31, 2007. The increase in non-interest expense was related primarily to the Company s strategic growth initiatives resulting in increases in the areas of compensation-related costs, advertising, and training expenses. In addition, in 2008 the Company s deposit insurance premiums increased due to changes in the FDIC insurance assessment rates, related to 2005 legislation which applied to all insured banks.

In 2008, the Company benefited from a decrease in its effective income tax rate; however, in the third quarter income taxes were impacted by approximately $130 thousand in tax expense related to legislative changes in future tax rates applicable to Massachusetts financial institutions.

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Sources and Uses of Funds

The Company s primary sources of funds are deposits, brokered CD s, FHLB borrowings, repurchase agreements, current earnings and proceeds from the sales, maturities and paydowns on loans and investment securities. The Company uses funds to originate loans, purchase investment securities, conduct operations, expand the branch network, and pay dividends to shareholders.

Total assets amounted to $1.18 billion at December 31, 2008, an increase of 12% since December 31, 2007. The Company s core asset strategy is to grow loans, primarily commercial loans.

Total loans increased 14% since December 31, 2007 and amounted to $948.6 million, or 80% of total assets. Commercial loans increased 13% over the prior year and amounted to $802.5 million, or 85% of the total loan portfolio at December 31, 2008. Management closely monitors the credit quality of individual delinquent and non-performing credit relationships, portfolio mix and industry concentrations, the local and regional real estate markets and current economic conditions. Although non-performing statistics have increased from 2007, as would be expected during the current economic decline, management does not consider the increase to be indicative of significant deterioration in the overall credit quality of the general loan portfolio at December 31, 2008.

The investment portfolio is the other key component of the Company s earning assets and is primarily used to invest excess funds, provide liquidity and to manage the Company s asset-liability position. The fair value of total investments amounted to $159.4 million at December 31, 2008, or 14% of total assets. The carrying value of the portfolio has increased 10% since December 31, 2007 due primarily to purchases of US agency backed CMO/MBS and municipal securities, offset by sales, principal paydowns and maturities during the period. As noted above, in December 2008 the Company booked a $3.7 million OTTI charge on certain equity investments in the investment portfolio which reflected the fourth quarter downturn in the stock market in general. Recognizing the impairment has the benefit of enhancing management s discretion in managing the affected securities, which may include selling a portion of the investments in the first half of 2009. A sale of the securities would also ensure that, for tax purposes, a portion of the losses on sales could be applied against investment gains realized on the portfolio during the past two years, before the ability to carry back losses against these gains expires.

The Company does not purchase sub-prime mortgage backed securities and has never invested in the stock of Fannie Mae or Freddie Mac.

Management s preferred strategy for funding asset growth is to grow low cost deposits (comprised of demand deposit accounts, interest and business checking accounts and traditional savings accounts). Asset growth in excess of low cost deposits is typically funded through higher cost deposits (certificates of deposit, business money market accounts and investment savings products), brokered CD s, repurchase agreements, FHLB borrowings, and investment portfolio cash flow.

The current environment has continued to impact the Company s ability to generate growth in lower costing deposits, which remained relatively flat compared to December 31, 2007. However, year-end balances in higher cost deposits increased 19% compared to December 31, 2007. The increase is primarily attributed to customers seeking a safer, higher yielding alternative to the volatile equity markets and mutual funds. In addition the Company has continued to utilize brokered CD s and FHLB borrowings as alternative funding sources to support asset growth. As previously described, the Company has also recently added access to the FRB s discount window as an additional source of alternative funding.

At December 31, 2008, total deposits, excluding brokered CDs, amounted to $872.5 million, representing $74.4 million, or 9%, growth over December 31, 2007 balances. Total deposits, including brokered CDs, amounted to $947.9 million at December 31, 2008, representing an increase of $79.1 million, or 9% since December 31, 2007.

At December 31, 2008, the Company had $75.4 million in brokered CDs and $121.3 million in borrowed funds outstanding compared to $70.7 million and $81.4 million, respectively, at December 31, 2007.

Opportunities and Risks

Recent global economic events have had a severe impact on nationwide financial markets, the financial services industry and the national economy. The economic recession has lead

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to tightening of credit markets, contraction of lending for larger regional and national banks, asset write-downs and credit quality concerns across the financial industry. Although the current economic crisis has not impacted the New England region as severely as many regions of the country, any long-term continuation of these national trends, or possible subsequent effects, could further weaken the local economy and have a severe impact on the Company s financial condition, capital position, liquidity, and performance.

While the current economic environment presents significant challenges for all companies, management also believes that it creates opportunities for growth and expansion. The Company s disciplined and consistent lending and credit review practices, and the prudent investment strategies and strategic growth initiatives that have been in place since the Company was established twenty years ago, have served to provide quality asset growth over varying economic cycles. Management believes that the Company s strong capital position and high-quality balance sheet will enable it to expand its lending while larger regional and national banks tighten their underwriting standards. This has been demonstrated by the Company s strong loan growth, particularly by an 18% annualized loan growth in the fourth quarter of 2008. The Company has concentrated on community lending with traditional mortgages and commercial loans to local business, professionals, non-profit organizations and individuals. In addition, the Company continues to position itself to increase market share, with carefully planned expansion into neighboring markets through new branch development. The Company opened a Methuen, Massachusetts branch in May 2008, a new Acton, Massachusetts branch on January 12, 2009, and a second New Hampshire branch is scheduled to open in late 2009 or early 2010, in Derry. Management also undertook many significant initiatives in 2008, including investments in employee training, education and professional development, marketing and public relations, technology and facilities. While management recognizes that such investments will increase expenses in the short-term, before the long-term benefits are fully realized, the Company believes that the opportunities for long-term benefits, including growth and expansion and increased market share, have never been stronger than they are at the present time.

Notwithstanding the market opportunities that management believes the current economic environment has created, the Company s primary market area will continue to be marked by substantial competition from multiple sources, including the expanded commercial lending capabilities of credit unions, the shift to commercial lending by traditional savings banks, the continuing presence of large regional and national commercial banks, the products offered by non-bank financial services competitors and increased competition for investment advisory assets and deposit resources within the Company s market area. The Company will continue to face significant business risk in seeking to achieve its long-term growth objectives, which will continue to depend upon the Company s success in developing strong relationships with business and community leaders, and providing a superior customer experience through a full range of diversified financial products and services, delivered through consistent, responsive and personal service based on an understanding of the financial needs of customers.

Continued volatility in the financial markets, tightening of credit markets, and any possible subsequent effects of the current economic crisis, could have a negative impact on the value of the Company s investment portfolio as a whole, or on individual securities held, including restricted FHLB capital stock, which could possibly result in the recognition of additional OTTI charges in the future.

Any further changes in government regulation or oversight as a result of the financial crisis could affect the Company in substantial and unpredictable ways, including but, not limited to, subjecting the Company to additional operating and compliance costs and increasing the Company s deposit insurance premiums.

Management believes the Company s business model, strong service and technology cultures, experienced banking professionals, in-depth knowledge of our markets and trusted reputation within the community create opportunities for the Company to be the leading provider of banking and investment management services in its growing market area and that the Company is well positioned, both financially and strategically, to capitalize on opportunities created by the current challenging banking landscape.

Additional significant challenges facing the Company continue to be the effective management of interest rate and credit risk, liquidity management and capital adequacy and operational risk.

The re-pricing frequency of interest earning assets and liabilities are not identical, and therefore subject the Company to the risk of adverse changes in interest rates. This is

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often referred to as interest rate risk and is reviewed in more detail under Item 7A, Quantitative and Qualitative Disclosures About Market Risk.

The risk of loss due to customers non-payment of loans or lines of credit is called credit risk. Credit risk management is reviewed below in this Item 7 under the headings Credit Risk/Asset Quality and Allowance for Loan Losses.

Liquidity management is the coordination of activities so that cash needs are anticipated and met, readily and efficiently. Liquidity management is reviewed under this Item 7 under the heading Liquidity.

Federal banking agencies require the Company and the Bank to meet minimum capital requirements. At December 31, 2008, the Company was categorized as well capitalized ; however future unanticipated charges against capital could impact that regulatory capital designation. For information regarding the capital requirements applicable to the Company and the Bank and their respective capital levels at December 31, 2008, see the section entitled Capital Resources contained in Item 1 Business and note 8, Stockholders Equity , to the consolidated financial statements contained in Item 8.

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people or systems, or from external events. Operational risk management is also a key component of the Company s risk management process, particularly as it relates to technology administration, information security, and business continuity.

Management utilizes a combination of third party security assessments, key technologies and ongoing internal evaluations in order to protect non-public customer information and continually monitor and safeguard information on its operating systems and those of third party service providers. The Company contracts with outside parties to perform a broad scope of both internal and external security assessments on the Company s systems on a regular basis. These third parties test the Company s network configuration and security controls, and assess internal practices aimed at protecting the Company s operating systems. In addition, the Company contracts with an outside service provider to monitor usage patterns and identify unusual activity on bank issued debit/ATM cards. The Company also utilizes firewall technology and a combination of software and third-party monitoring to detect intrusion, protect against unauthorized access and continuously scans for computer viruses on the Company s information systems.

The Company has a Business Continuity Plan that consists of the information and procedures required to enable rapid recovery from an occurrence that would disable the Company for an extended period. The plan establishes responsibility for assessing a disruption of business, contains alternative strategies for the continuance of critical business functions, assigns responsibility for restoring services, and sets priorities by which critical services will be restored.

In addition to the risks discussed above numerous other factors that could adversely affect the Company s future results of operations and financial condition are addressed in Item 1A, Risk Factors . This Opportunities and Risk discussion should be read in conjunction with Item 1A.

Financial Condition

Total assets increased $122.8 million, or 12%, over the prior year, amounting to $1.18 billion at December 31, 2008. The increase was primarily attributable to an increase in total loans.

Loans

Total loans increased $114.8 million, or 14%, and amounted to 80% of total assets at December 31, 2008, compared with 79% of total assets, at December 31, 2007. The Company attributes the increase to its seasoned lending team, the Company s sales and service culture and geographic expansion. The mix of loans within the Company s portfolio remained relatively unchanged with commercial loans amounting to approximately 85% of gross loans, reflecting the Company s continued focus on commercial loan development.

The following table sets forth the loan balances by certain loan categories at the dates indicated and the percentage of each category to gross loans.

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	December 31,									
	2008		2007		2006		2005		2004	
(Dollars in thousands)	**Amount**	**% of Total**	**Amount**	**% of Total**	**Amount**	**% of Total**	**Amount**	**% of total**	**Amount**	**% of Total**
Comm l real estate	$ 472,279	49.7%	$ 406,410	48.7%	$ 368,621	48.3%	$ 326,963	46.6%	$ 257,657	45.1%
Comm l & industrial	231,815	24.4%	188,866	22.6%	164,865	21.6%	165,982	23.7%	142,909	25.0%
Comm l construction	98,365	10.4%	112,671	13.5%	114,078	15.0%	108,048	15.4%	80,597	14.1%
Total Commercial	802,459	84.5%	707,947	84.8%	647,564	84.9%	600,993	85.7%	481,163	84.2%
Residential mortgages	84,609	8.9%	73,933	8.9%	61,854	8.1%	47,207	6.7%	40,654	7.1%
Resid construction	6,375	0.7%	4,120	0.5%	3,981	0.5%	4,154	0.6%	2,848	0.5%
Home equity	49,773	5.2%	44,292	5.3%	44,038	5.8%	44,444	6.4%	42,823	7.5%
Consumer	4,857	0.5%	4,493	0.5%	4,307	0.6%	3,986	0.6%	4,139	0.7%
Loans held for sale	1,596	0.2%	268	0.0%	549	0.1%	267	0.0%	101	0.0%
Gross loans	949,669	100%	835,053	100.0%	762,293	100.0%	701,051	100.0%	571,728	100.0%
Deferred fees, net	(1,028)		(1,234)		(1,180)		(1,325)		(1,269)	
Total loans	948,641		833,819		761,113		699,726		570,459	
Allowance for loan losses	(15,269)		(13,545)		(12,940)		(12,050)		(10,923)	
Net loans	$ 933,372		$ 820,274		$ 748,173		$ 687,676		$ 559,536	

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The following table sets forth the scheduled maturities of commercial real estate, commercial & industrial and commercial construction loans in the Company s portfolio at December 31, 2008. The table also sets forth the dollar amount of loans which are scheduled to mature after one year which have fixed or adjustable rates.

(Dollars in thousands)	Commercial real estate	Commercial & industrial	Commercial construction
Amounts due:			
One year or less	$ 35,064	$ 112,436	$ 75,030
After one year through five years	20,723	60,040	10,770
Beyond five years	416,492	59,339	12,565
	$ 472,279	$ 231,815	$ 98,365
Interest rate terms on amounts due after one year:			
Fixed	$ 24,300	$ 51,795	$ 6,317
Adjustable	$ 412,915	$ 67,584	$ 17,018

Scheduled contractual maturities may not reflect the actual maturities of loans. The average maturity of loans may be shorter than their contractual terms principally due to prepayments.

During 2008, commercial real estate loans increased $65.9 million, or 16%. Commercial real estate loans are typically secured by apartment buildings, office or mixed-use facilities, strip shopping malls or other commercial or industrial property.

Commercial and industrial loans increased by $42.9 million, or 23%, since December 31, 2007. These 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 under various U.S. Small Business Administration programs.

Commercial construction loans decreased year over year, by $14.3 million, or 13%. The decline is attributed to limited new construction projects by qualified builders, as a result of the general economic environment. 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. At December 31, 2008, 13 commercial construction loans with outstanding balances of $11.9 million carried reserves of $604 thousand for the payment of future interest. These reserves may be funded by the borrower through proceeds from unit sales or through loan proceeds at origination. The Company closely monitors the impact of the interest reserve, the financial condition of the project and the borrower on the credit classification of the loan.

Residential real estate loans, residential construction and home equity mortgages combined, increased by $18.4 million, or 15%, and consumer loans increased $364 thousand or 8% since December 31, 2007.

At December 31, 2008, the Company had commercial loan balances participated out to various banks amounting to $19.2 million, compared to $6.8 million at December 31, 2007. These 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 at the Company s prorata share of ownership and amounted to $24.9 million and $13.9 million at December 31, 2008 and 2007, respectively.

Credit Risk/Asset Quality

Inherent in the lending process is the risk of loss. The Company s primary lending focus is on the development of high quality commercial real estate, commercial construction and commercial and industrial lending relationships with business entities, non-profit organizations, professionals and individuals. However, commercial lending may entail significant additional risks compared to long term financing on existing owner occupied residential real estate. Commercial loan size is typically larger and the underlying collateral values, the actual cost necessary to complete a project or customer cash flow and payment expectations on such loans can be more easily influenced by adverse conditions in the related industries, the real estate market or in the economy in general. While the Company endeavors to minimize this risk through the risk management function, management recognizes that loan losses will occur and that the amount of these losses will fluctuate depending on the risk characteristics of the loan portfolio and economic conditions.

The Company s credit risk management function focuses on a wide variety of factors, including, among others, current and expected economic conditions, the real estate market, the financial condition of borrowers, the ability of borrowers to adapt to changing conditions or circumstances affecting their business and the continuity of borrowers management teams. Early detection of credit issues is critical to minimize credit losses. Accordingly, management regularly monitors these factors, among others, through ongoing credit reviews by the credit department, an external loan review service, reviews by members of senior management and the Loan Committee of the Board of Directors.

On a quarterly basis, the Company prepares an estimate of the necessary loan loss allowance. Except for loans specifically identified as impaired, the estimate is a two-tiered approach that allocates loan loss allowance to adversely classified loans by credit rating and to non-classified loans by credit type. The general loss allocations take into account the quantitative and qualitative factors identified above. The adequacy of the allowance for loan losses is reviewed and evaluated on a regular basis by an internal management committee, a sub-committee of the Board of Directors and the full Board itself.

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 most severe classifications of substandard , doubtful and loss based on criteria established under banking regulations. Loans classified as substandard include those characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. 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. 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.

Impaired loans are individually significant loans for which management considers it probable that not all amounts due in accordance with original contractual terms will be collected. The majority of impaired loans are included within the non-accrual balances; however, not every loan in non-accrual status has been designated as impaired. Management does not set any minimum delay of payments as a factor in reviewing for impaired classification. Management considers the payment status, net worth and earnings potential of the borrower, and the value and cash flow of the collateral as factors to determine if a loan will be paid in accordance with its contractual terms. When a loan is deemed to be impaired, management estimates the credit loss by comparing the loan s carrying value against either 1) the present value of the expected future cash flows discounted at the loan s effective interest rate; 2) the loan s observable market price; or 3) the expected realizable fair value of the collateral, in the case of collateral dependent loans. A specific allowance is assigned to the impaired loan for the amount of estimated credit loss. Impaired loans are charged off, in whole or in part, when management believes that the recorded investment in the loan is uncollectible.

Impaired loans exclude large groups of smaller-balance homogeneous loans, such as residential mortgage loans and consumer loans, which are collectively evaluated for impairment, loans that are measured at fair value and leases as defined in SFAS No. 114.

Loans on which the accrual of interest has been discontinued are designated as non-accrual loans. Accrual of interest on loans is generally discontinued when a loan becomes contractually past due, with respect to interest or principal, by ninety days for real estate loans and generally sixty to ninety days for all other loans, or when reasonable doubt exists as to the full and timely collection of interest or principal. When a loan is placed on non-accrual status, all interest previously accrued but not collected is reversed against current period interest income. Interest accruals are resumed on such loans only when payments are brought current and have remained current for a period of ninety days or when, in the judgment of management, the collectability of both principal and interest is reasonably assured. Interest payments received on loans in a non-accrual status are generally applied to principal.

Loans are designated as restructured when a concession is made on a credit as a result of financial difficulties of the borrower. Typically, such concessions consist of a reduction in interest rate to a below market rate, taking into account the credit quality of the note, or a deferment of payments, principal or interest, which materially alters

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the Bank s position or significantly extends the note s maturity date, such that the present value of cash flows to be received is materially less than those contractually established at the loan s origination. Restructured loans are included in the impaired loan category.

Real estate acquired by the Company through foreclosure proceedings or the acceptance of a deed in lieu of foreclosure is classified as Other Real Estate Owned (OREO). When property is acquired, it is recorded at the lesser of the loan s remaining principal balance or the estimated fair value of the property acquired, less estimated costs to sell. Any loan balance in excess of the estimated realizable fair value on the date of transfer is charged to the allowance for loan losses on that date. All costs incurred thereafter in maintaining the property, as well as subsequent declines in fair value are charged to non-interest expense.

Non-performing assets are comprised of non-accrual loans, deposit account overdrafts that are more than 90 days past due and OREO. The designation of a loan or other asset as non-performing does not necessarily indicate that loan principal and interest will ultimately be uncollectible. However, management recognizes the greater risk characteristics of these assets and therefore considers the potential risk of loss on assets included in this category in evaluating the adequacy of the allowance for loan losses. Despite prudent loan underwriting, adverse changes within the Bank s market area, or deterioration in local, regional or national economic conditions, could negatively impact the Company s level of non-performing assets in the future.

The following table sets forth information regarding non-performing assets, restructured loans and delinquent loans 60-89 days past due as to interest or principal, held by the Company at the dates indicated:

			December 31,		
(Dollars in thousands)	**2008**	**2007**	**2006**	**2005**	**2004**
Non-accrual loans	$ 8,011	$ 3,956	$ 1,785	$ 1,475	$ 2,140
Overdrafts > 90 days past due	256		7	1	
Total non-performing loans	8,267	3,956	1,792	1,476	2,140
Other real estate owned	318	200			
Total non-performing assets	$ 8,585	$ 4,156	$ 1,792	$ 1,476	$ 2,140
Total Loans	$ 948,641	$ 833,819	$ 761,113	$ 699,726	$ 570,459
Accruing restructured loans not included above	$ 3,697	$ 76	$ 128	$ 82	$ 26
Delinquent loans 60-89 days past due	$ 2,689	$ 275	$ 964	$ 59	$ 404
Non-performing loans to total loans	0.87%	0.47%	0.24%	0.21%	0.38%
Non-performing assets to total assets	0.73%	0.39%	0.18%	0.16%	0.25%
Loans 60-89 days past due to total loans	0.28%	0.03%	0.13%	0.01%	0.07%
Adversely Classified loans to total loans	1.46%	0.76%	0.88%	0.77%	1.55%

In general, non-performing statistics trended upward in 2007 and 2008, as would be expected during the current economic decline. However, the amount of non-performing assets from 2004 through 2006 represented historically low levels. As such, management does not consider the increase in 2007 and into 2008 to be indicative of significant deterioration in the overall credit quality of the general loan portfolio at December 31, 2008. Overall asset quality remained favorable during the period as indicated by the following factors: the reasonable ratio of non-performing loans given the size and mix of the Company s loan portfolio; the minimal level of OREO; the low levels of loans 60-89 days delinquent; and management s assessment that the majority of non-performing loans are adequately collateralized at December 31, 2008.

The $4.3 million net increase in total non-performing loans, and the resulting increase in the ratio of non-performing loans as a percentage of total loans outstanding, was primarily due to net additions within the commercial real estate ($1.5 million), commercial construction ($1.0 million) and commercial and industrial portfolios ($589 thousand). In addition, one overdraft deposit account of $256 thousand outstanding at December 31, 2008, was subsequently funded in January 2009. In the opinion of management the majority of the non-performing loans were adequately supported by expected future cash

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flows or the value of the underlying collateral and management expects that these principal advances will ultimately be collected. Management closely monitors these relationships for collateral or credit deterioration.

At December 31, 2008, the Company had adversely classified loans (loans carrying substandard or doubtful classifications) amounting to $13.9 million, compared to $6.3 million at December 31, 2007. There were no loans classified as Loss at either December 31, 2008 or 2007. Included in the adversely classified balances were non-accrual loans amounting to $7.4 million and $3.6 million at December 31, 2008 and 2007, respectively. At December 31, 2008 and 2007, non-accrual loans which were not adversely classified amounted to $584 thousand and $400 thousand, respectively, and represented the guaranteed portions of non-performing Small Business Administration loans. The remaining balances of adversely classified loans were performing but possessed potential weaknesses and, as a result, could ultimately become non-performing loans.

Total impaired commercial loans amounted to $10.4 million and $4.1 million at December 31, 2008 and 2007, respectively. Included in these impaired balances were non-accrual loans amounting to $6.7 million and $3.9 million as of December 31, 2008 and 2007, respectively. Accruing impaired loans amounted to $3.7 million and $75 thousand at December 31, 2008 and 2007, respectively. In the opinion of management, at December 31, 2008, impaired loans totaling $5.2 million required specific reserve allocations of $478 thousand and impaired loans totaling $5.2 million required no specific reserves. At December 31, 2007, $200 thousand of impaired loans required $195 thousand of specific reserve allocations.

Total restructured loans outstanding as of December 31, 2008 and 2007 were $4.7 million and $1.3 million, respectively. Restructured loans included in non-performing assets amounted to $1.0 million and $1.2 million at December 31, 2008 and 2007, respectively.

Four properties were transferred into OREO in 2008 as the result of foreclosure proceedings. One of the OREO properties was subsequently sold in November 2008. The carrying value of OREO at December 31, 2008 was $318 thousand. There was one property carried in the Company s OREO portfolio at December 31, 2007; the carrying value of that property was recovered upon the sale of the property in February of 2008. Gains recognized on the sales of OREO amounted to $27 thousand and $0 for the years ended December 31, 2008 and 2007, respectively.

Allowance for Loan Losses

The allowance for loan losses is an estimate of credit risk inherent in the loan portfolio as of the balance sheet dates. In making its assessment on the adequacy of the allowance, management considers several quantitative and qualitative factors that could have an effect on the credit quality of the portfolio including individual assessment of larger and high risk credits, delinquency trends and the level of non-performing loans, net charge-offs, the growth and composition of the loan portfolio, expansion in geographic market area, the strength of the local and national economy, and comparison to industry peers, among other factors. There were no significant changes to the allowance assessment methodology, the Company s underwriting, or in credit quality during the past year.

The allowance for loan loss to total loans ratio was 1.61% at December 31, 2008 compared to 1.62% at December 31, 2007. The slight decrease in the allowance ratio reflects the continued overall strong asset quality, level of loan growth and the low level of charge-offs during the 2008 period.

Based on the foregoing, as well as management s judgment as to the existing credit risks inherent in the loan portfolio, the Company s allowance for loan losses is deemed adequate to absorb reasonably probable losses from specifically known and other credit risks associated with the portfolio as of December 31, 2008.

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The following table summarizes the activity in the allowance for loan losses for the periods indicated:

(Dollars in thousands)	2008	2007	Years Ended December 31, 2006	2005	2004
Balance at beginning of year	$ 13,545	$ 12,940	$ 12,050	$ 10,923	$ 9,986
Charged-off loans:					
Commercial real estate	360	27	200		
Commercial and industrial	943	422	241	70	901
Construction		100			
Residential mortgage					
Home equity	50	77	68		
Consumer	25	25	70	57	84
Total charged-off	1,378	651	579	127	985
Recovereries on charged-off loans:					
Commercial real estate	2	82			
Commercial and industrial	427	152	182	102	259
Construction	96				
Residential mortgage					
Home equity	61				
Consumer	11	22	28	17	13
Total recoveries	597	256	210	119	272
Net loans charged-off	781	395	369	8	713
Provision charged to operations	2,505	1,000	1,259	1,135	1,650
Balance at December 31	$ 15,269	$ 13,545	$ 12,940	$ 12,050	$ 10,923
Allowance to non-performing loans	184.70%	342.39%	722.10%	816.40%	510.42%
Recoveries to charge-offs	43.32%	39.32%	36.27%	93.70%	27.61%
Net loans charged-off to allowance	5.11%	2.92%	2.85%	0.07%	6.53%
Average loans outstanding	$ 880,228	$ 793,395	$ 732,813	$ 625,403	$ 527,903
Increase in avg loans over prior year	11%	8%	17%	18%	17%
Net loans charged-off to avg total loans	0.09%	0.05%	0.05%	0.00%	0.14%
Allowance to total loans outstanding	1.61%	1.62%	1.70%	1.72%	1.91%

The following table sets forth the allocation of the Company s allowance for loan losses amongst the categories of loans and the percentage of loans in each category to gross loans for the periods ending on the respective dates indicated:

	2008		2007		December 31, 2006		2005		2004	
(Dollars in thousands)	Allowance allocation	Loan category as % of gross loans	Allowance allocation	Loan category as % of gross loans	Allowance allocation	Loan category as % of gross loans	Allowance allocation	Loan category as % of gross loans	Allowance allocation	Loan category as % of gross loans

Comm l real estate	$	7,953	49.7%	$	6,908	48.7%	$	6,551	48.3%	$	5,753	46.6%	$	5,617	45.1%
Comm l industrial		3,817	24.4%		3,196	22.6%		2,929	21.6%		2,979	23.7%		2,925	25.0%
Comm l constr.		2,094	10.4%		2,341	13.5%		2,423	15.0%		2,373	15.4%		1,613	14.1%
Resid: mortg, cnstr and HELOC s		1,268	15.0%		988	14.7%		925	14.5%		840	13.7%		699	15.1%
Consumer		137	0.5%		112	0.5%		112	0.6%		105	0.6%		69	0.7%
Total	$	15,269	100.0%	$	13,545	100.0%	$	12,940	100.0%	$	12,050	100.0%	$	10,923	100.0%

The allocation of the allowance for loan losses above reflects management s judgment of the relative risks of the various categories of the Company s loan portfolio. This allocation should not be considered an indication of the future amounts or types of possible loan charge-offs.

Short-Term Investments

As of December 31, 2008, short-term investments amounted to 0.3% of total assets, compared to 0.7% of total assets, at December 31, 2007. Short-term investments carried as cash equivalents at December 31, 2008 and 2007 consisted of overnight and term federal funds sold and money market mutual funds. The Company had no other short-term investments at December 31, 2008 or 2007.

Investment Securities

As of December 31, 2008, the carrying amount of the investment portfolio increased $13.9 million, or 10%, compared to December 31, 2007. The increase was primarily due to purchases of agency CMO/MBS and municipal securities, offset by sales, calls, principal paydowns and maturities during the year. At December 31, 2008 and 2007, all investment securities (other than FHLB stock) were classified as available for sale and were carried at fair market value. During the fourth quarter of 2008, the Company recorded a $3.7 million (pretax) impairment charge on certain equity investments in the investment portfolio. The other than temporary impairment (OTTI) charge reflected the fourth quarter

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downturn in the stock market in general. The cost basis of these investments has been adjusted to reflect the market value as of December 31, 2008. A prolonged downturn or any further declines in the stock market could result in an additional OTTI charge to earnings in the future.

The investment portfolio represented 14% of total assets at December 31, 2008 and 2007. Fixed income securities comprised the majority of the carrying value of the portfolio and represented 93% of total investments at both December 31, 2008 and 2007 respectively.

The following table summarizes the fair market value of investments at the dates indicated:

	December 31,		
(Dollars in thousands)	**2008**	**2007**	**2006**
Federal agency obligations(1)	$	$ 12,543	$ 10,405
Federal agency collateralized mortgage obligations and Mortgage backed securities (CMO/MBS)(1)	82,936	57,156	55,450
Non-agency CMO/MBS	4,316	5,062	5,981
Municipal securities	61,386	60,049	48,762
Fixed income securities	148,638	134,810	120,598
Certificates of deposit			1,033
Federal Home Loan Bank stock	4,740	3,895	1,428
Equity securities	5,995	6,812	8,481
Total investments	$ 159,373	$ 145,517	$ 131,540

(1) Investments guaranteed by government enterprises such as Fannie Mae, Freddie Mac, Ginnie Mae and the FHLB.

As a member of the FHLB, the Company is required to purchase FHLB capital stock in association with the Bank s outstanding advances from the FHLB; this stock is classified as a restricted investment and carried at cost. The FHLB is currently operating with retained earnings below its target level. The FHLB has instituted a plan to increase retained earnings which includes suspending its quarterly dividend and a moratorium on the repurchase of excess capital stock from member banks, among other programs. If further deterioration in the FHLB financial condition or capital levels occurs, the FHLB capital stock may become other than temporarily impaired to some degree and its carry value correspondingly reduced.

As of December 31, 2008, the net unrealized gains in the investment portfolio were $1.7 million compared to the net unrealized gains of $382 thousand at December 31, 2007. The unrealized gains at December 31, 2008 consisted of net unrealized gains on fixed income securities of $1.9 million (comprised of $2.7 million gains and $796 thousand losses) and net unrealized losses on equity securities of $180 thousand (comprised of $21 thousand gains and $201 thousand losses).

Unrealized gains or losses will only be recognized in the statements of income if the securities are sold. However, if an unrealized loss on a fixed income or equity security is deemed to be other than temporary, the Company marks the investment down to its carrying value through a charge to earnings.

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 loss on fixed income investments will also decline as the securities approach maturity. The decline in market value on the fixed income portfolio at December 31, 2008 was due to interest rate volatility and not credit quality, as all these securities were government agency guaranteed, AAA credit or investment grade rated. At December 31, 2008, management had the intent and ability to hold the fixed income securities in the portfolio with unrealized losses until the recovery of fair value, which may be upon maturity. Therefore, the remaining unrealized losses were not considered other than temporary in nature at December 31, 2008.

The net unrealized gain or loss on equity securities will fluctuate based on changes in the market value of the individual securities and mutual and other funds in the portfolio. Management regularly reviews the portfolio for securities with unrealized losses that are other than temporarily impaired. Management s assessment includes evaluating if any equity security or fund exhibits fundamental deterioration and whether it is unlikely that

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the security or fund will completely recover its unrealized loss within a reasonable time period. During the fourth quarter of 2008, the Company recorded a fair market value impairment charge, on certain mutual fund investments contained in its equity portfolio, to reflect the impact of recent declines in the equity markets. Management s decision to record this charge was based primarily on the severity of the declines in the stock market and the general economy and the uncertainty in determining the likelihood of recovery in the short-term for these equities. The pretax impairment charge of $3.7 million represented a $2.4 million after tax charge against earnings. There were no other securities at December 31, 2008 that were considered other than temporarily impaired.

During 2008 the Company recognized net gains on the sales of $4.6 million of securities, amounting to $305 thousand and a $3.7 million impairment charge on certain equity investments. Principal paydowns, calls and maturities on fixed income securities totaled $31.8 million during 2008. These proceeds along with additional funds were utilized to purchase $52.5 million of securities during 2008.

The contractual maturity distribution at amortized cost, as of December 31, 2008, of the fixed income securities above with the weighted average yield for each category is set forth below:

(Dollars in thousands)	Under 1 Year Balance	Under 1 Year Yield	>1 - 3 Years Balance	>1 - 3 Years Yield	>3 - 5 Years Balance	>3 - 5 Years Yield	>5 - 10 Years Balance	>5 - 10 Years Yield	Over 10 Years Balance	Over 10 Years Yield
CMO/MBS	$		$		$ 1,581	3.89%	$ 33,355	4.16%	$ 50,907	5.25%
Municipals(1)	7,023	4.63%	10,719	5.96%	6,927	6.42%	8,277	7.50%	27,978	6.81%
	$ 7,023	4.63%	$ 10,719	5.96%	$ 8,508	5.95%	$ 41,632	4.83%	$ 78,885	5.80%

(1) Municipal security yields and total yields are shown on a tax equivalent basis.

Scheduled contractual maturities may not reflect the actual maturities of the investments. CMO/MBS are shown at their final maturity. However, due to prepayments and amortization the actual CMO/MBS cash flows may be faster than presented above. Similarly, included in the municipal categories were $43.9 million in securities which can be called before maturity. Actual maturity of these callable securities could be shorter if market interest rates decline further. Management considers these factors when evaluating the net interest margin in the Company s asset-liability management program.

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Bank Owned Life Insurance (BOLI)

The Company has purchased BOLI as an investment vehicle, utilizing the earnings on BOLI to offset the cost of the Company s benefit plans. There were no BOLI purchases in 2008 or 2007. The cash surrender value of BOLI was $13.3 million and $12.7 million at December 31, 2008 and 2007, respectively. The Company recorded income from the BOLI policies, net of related expenses, of $554 thousand, $548 thousand, and $339 thousand for 2008, 2007 and 2006, respectively

Further information regarding the Company s retirement benefit plans is contained in note 10, Employee Benefit Plans , to the consolidated financial statements contained in Item 8 below, under the heading Supplemental Retirement Plan.

Deposits

Total deposits increased $79.1 million, or 9%, as of December 31, 2008 compared to year end balances at December 31, 2007. Deposits, excluding brokered deposits, increased $74.4 million, or 9%, compared to the prior year-end balance. The current interest rate environment has continued to impact the Company s ability to generate growth in lower costing deposits. However, non-brokered CD balances have increased and the Company has continued to utilize low-cost overnight FHLB borrowings as alternative funding sources to support asset growth. Total deposits as a percentage of total assets were 80% at December 31, 2008 compared to 82% at December 31, 2007.

The following table sets forth deposit balances by certain categories at the dates indicated and the percentage of each deposit category to total deposits.

	December 31, 2008		**December 31, 2007**		**December 31, 2006**	
(Dollars in thousands)	**Amount**	**% of Total**	**Amount**	**% of Total**	**Amount**	**% of Total**