TRI COUNTY FINANCIAL CORP /MD/
Form 10-Q
May 10, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended March 31, 2013

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ______ to ______

Commission File Number 0-18279

Tri-County Financial Corporation

(Exact name of registrant as specified in its charter)

Maryland	52-1652138
(State of other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

3035 Leonardtown Road, Waldorf, Maryland	20601
(Address of principal executive offices)	(Zip Code)

(301) 645-5601

(Registrant's telephone number, including area code)

Not applicable

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

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

Yes x No¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x No¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer ¨	Accelerated Filer ¨
Non-accelerated Filer ¨ (Do not check if a smaller reporting company)	Smaller Reporting Company x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ¨ No x

As of April 18, 2013, the registrant had 3,052,385 shares of common stock outstanding.

TRI-COUNTY FINANCIAL CORPORATION

FORM 10-Q

INDEX

PART I FINANCIAL STATEMENTS

TRI-COUNTY FINANCIAL CORPORATION

PART I FINANCIAL STATEMENTS

ITEM I. FINANCIAL STATEMENTS

TRI-COUNTY FINANCIAL CORPORATION

CONSOLIDATED BALANCE SHEETS MARCH 31, 2013 AND DECEMBER 31, 2012

	March 31, 2013 (Unaudited)	December 31, 2012
Assets		
Cash and due from banks	$ 15,550,883	$ 10,696,653
Federal funds sold	420,000	190,000
Interest-bearing deposits with banks	575,620	409,002
Securities available for sale (AFS), at fair value	44,552,200	47,205,663
Securities held to maturity (HTM), at amortized cost	110,751,230	112,619,434
Federal Home Loan Bank and Federal Reserve Bank stock - at cost	5,629,150	5,476,050
Loans receivable - net of allowance for loan losses of $8,350,000 and $8,246,957	734,918,520	747,640,752
Premises and equipment, net	19,516,325	19,782,236
Other real estate owned (OREO)	6,951,653	6,891,353
Accrued interest receivable	3,027,847	2,904,325
Investment in bank owned life insurance	18,882,013	18,730,580
Other assets	8,414,278	9,093,164
Total Assets	$ 969,189,719	$ 981,639,212
Liabilities and Stockholders' Equity		
Liabilities		
Deposits		
Non-interest-bearing deposits	$ 95,813,418	$ 102,319,581
Interest-bearing deposits	703,040,007	717,910,707
Total deposits	798,853,425	820,230,288
Short-term borrowings	-	1,000,000
Long-term debt	70,514,549	60,527,208
Guaranteed preferred beneficial interest in junior subordinated debentures	12,000,000	12,000,000
Accrued expenses and other liabilities	7,135,385	8,834,455

Total Liabilities	888,503,359	902,591,951
Stockholders' Equity		
Preferred Stock, Senior Non-Cumulative Perpetual, Series C - par value $1,000; authorized 20,000; issued 20,000	20,000,000	20,000,000
Common stock - par value $.01; authorized - 15,000,000 shares; issued 3,050,385 and 3,052,416 shares, respectively	30,504	30,524
Additional paid in capital	18,168,428	17,873,560
Retained earnings	43,238,747	41,986,633
Accumulated other comprehensive gain	63,576	139,184
Unearned ESOP shares	(814,895)	(982,640)
Total Stockholders' Equity	80,686,360	79,047,261
Total Liabilities and Stockholders' Equity	$ 969,189,719	$ 981,639,212

See notes to Consolidated Financial Statements

3

TRI-COUNTY FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (UNAUDITED)

THREE MONTHS ENDED MARCH 31, 2013 AND 2012

	Three Months Ended March 31,	
	2013	2012
Interest and Dividend Income		
Loans, including fees	$ 9,247,666	$ 9,224,883
Taxable interest and dividends on investment securities	589,693	881,817
Interest on deposits with banks	2,598	1,684
Total Interest and Dividend Income	9,839,957	10,108,384
Interest Expenses		
Deposits	1,532,963	2,412,342
Short-term borrowings	22,406	15,841
Long-term debt	467,918	595,502
Total Interest Expenses	2,023,287	3,023,685
Net Interest Income	7,816,670	7,084,699
Provision for loan losses	154,173	341,074
Net Interest Income After Provision For Loan Losses	7,662,497	6,743,625
Noninterest Income		
Loan appraisal, credit, and miscellaneous charges	188,428	181,314
Net losses on sale of OREO	-	(96,917)
Income from bank owned life insurance	151,433	159,206
Service charges	470,633	536,512
Gain on sale of loans held for sale	378,584	65,975
Total Noninterest Income	1,189,078	846,090
Noninterest Expense		
Salary and employee benefits	3,556,996	3,319,866
Occupancy expense	482,771	437,472
Advertising	103,888	80,008
Data processing expense	363,834	368,440
Professional fees	197,337	225,209
Depreciation of furniture, fixtures, and equipment	192,430	134,925
Telephone communications	48,948	43,774
Office supplies	63,453	62,062
FDIC Insurance	301,432	443,615
Valuation allowance on OREO	310,500	300,000
Other	521,235	482,048
Total Noninterest Expense	6,142,824	5,897,419

Income before income taxes	2,708,751	1,692,296
Income tax expense	990,360	587,043
Net Income	$ 1,718,391	$ 1,105,253
Preferred stock dividends	50,000	50,000
Net Income Available to Common Shareholders	$ 1,668,391	$ 1,055,253
Net Income	$ 1,718,391	$ 1,105,253
Other comprehensive loss net of tax:		
Net unrealized holding losses arising during period, net of tax	(75,608)	(41,906)
Comprehensive Income	$ 1,642,783	$ 1,063,347
Earnings Per Common Share		
Basic	$ 0.55	$ 0.35
Diluted	$ 0.54	$ 0.35
Cash dividends paid per common share	$ 0.10	$ 0.40

See notes to Consolidated Financial Statements

TRI-COUNTY FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

THREE MONTHS ENDED MARCH 31, 2013 AND 2012

	2013	2012
Cash Flows from Operating Activities		
Net income	$1,718,391	$1,105,253
Adjustments to reconcile net income to net cash provided by operating activities Provision for loan losses	154,173	341,074
Depreciation and amortization	323,233	249,149
Loans originated for resale	(12,609,950)	(1,718,600)
Proceeds from sale of loans originated for sale	12,904,666	1,774,555
Gain on sale of loans held for sale	(378,584)	(65,975)
Net losses on the sale of OREO	-	96,917
Net amortization of premium/discount on investment securities	183,936	116,842
Increase in OREO valuation allowance	310,500	300,000
Increase in cash surrender of bank owned life insurance	(151,433)	(159,206)
Deferred income tax benefit	(166,396)	(333,582)
(Increase) Decrease in accrued interest receivable	(123,522)	31,456
Stock based compensation	249,129	201,060
Decrease in deferred loan fees	(1,581)	(33,169)
Increase in accounts payable, accrued expenses and other liabilities	(1,699,070)	(1,552,278)
Decrease in other assets	887,715	1,673,791
Net Cash Provided by Operating Activities	1,601,207	2,027,287
Cash Flows from Investing Activities		
Purchase of AFS investment securities	(22,258)	(27,457)
Proceeds from redemption or principal payments of AFS investment securities	2,519,650	7,641,683
Purchase of HTM investment securities	(10,932,813)	(849,785)
Proceeds from maturities or principal payments of HTM investment securities	12,658,595	13,615,678
Net decrease of FHLB and Federal Reserve stock	(153,100)	(401,900)
Loans originated or acquired	(37,456,655)	(58,330,528)
Principal collected on loans	49,739,363	45,043,677
Purchase of premises and equipment	(57,322)	(1,771,651)
Proceeds from sale of OREO	-	299,032
Net Cash Provided by Investing Activities	16,295,460	5,218,749

TRI-COUNTY FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

THREE MONTHS ENDED MARCH 31, 2013 AND 2012 (continued)

	2013	2012
Cash Flows from Financing Activities		
Net decrease in deposits	$(21,376,863)	$(21,564,090)
Proceeds from long-term borrowings	10,000,000	-
Payments of long-term borrowings	(12,659)	(12,162)
Net (decrease) increase in short term borrowings	(1,000,000)	7,000,000
Exercise of stock options	33,200	66,895
Dividends paid	(353,999)	(55,001)
Net change in unearned ESOP shares	176,843	(35,990)
Redemption of common stock	(112,341)	-
Net Cash Used in Financing Activities	(12,645,819)	(14,600,348)
Increase (Decrease) in Cash and Cash Equivalents	$5,250,848	$(7,354,312)
Cash and Cash Equivalents - January 1	11,295,655	19,118,189
Cash and Cash Equivalents - March 31	$16,546,503	$11,763,877
Supplemental Disclosures of Cash Flow Information		
Cash paid during the years for		
Interest	$2,082,743	$2,941,360
Income taxes	$200,000	$-
Supplemental Schedule of Non-Cash Operating Activities		
Issuance of common stock for payment of compensation	$249,129	$201,060
Transfer from loans to OREO	$370,800	$135,270

See notes to Consolidated Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

THREE MONTHS ENDED MARCH 31, 2013 AND 2012

1. BASIS OF PRESENTATION

General - The consolidated financial statements of Tri-County Financial Corporation (the "Company") and its wholly owned subsidiary, Community Bank of Tri-County (the "Bank"), and the Bank's wholly owned subsidiary, Community Mortgage Corporation of Tri-County, included herein are unaudited. However, they reflect all adjustments consisting only of normal recurring accruals that, in the opinion of management, are necessary to present fairly the Company's financial condition, results of operations, and cash flows for the periods presented. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. The Company believes that the disclosures are adequate to make the information presented not misleading. The balances as of December 31, 2012 have been derived from audited financial statements. There have been no significant changes to the Company's accounting policies as disclosed in the 2012 Annual Report. The results of operations for the three months ended March 31, 2013 are not necessarily indicative of the results of operations to be expected for the remainder of the year or any other period. Certain previously reported amounts have been restated to conform to the 2013 presentation.

These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company's 2012 Annual Report.

2. NATURE OF BUSINESS

The Company provides a variety of financial services to individuals and businesses through its offices in Southern Maryland and King George, Virginia. Its primary deposit products are demand, savings and time deposits, and its primary lending products are commercial and residential mortgage loans, commercial loans, construction and land development loans, home equity and second mortgages and commercial equipment loans.

3. FAIR VALUE MEASUREMENTS

The Company adopted FASB ASC Topic 820, "Fair Value Measurements" and FASB ASC Topic 825, "The Fair Value Option for Financial Assets and Financial Liabilities", which provides a framework for measuring and disclosing fair value under generally accepted accounting principles. FASB ASC Topic 820 requires disclosures about the fair value of assets and liabilities recognized in the balance sheet in periods subsequent to initial recognition, whether the measurements are made on a recurring basis (for example, available for sale investment securities) or on a nonrecurring basis (for example, impaired loans).

FASB ASC Topic 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. FASB ASC Topic 820 also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The Company utilizes fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Securities available for sale are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis such as loans held for investment and certain other assets. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

Under FASB ASC Topic 820, the Company groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine the fair value. These hierarchy levels are:

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

Level 2 inputs - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals.

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

Transfers between levels of the fair value hierarchy are recognized on the actual date of the event or circumstances that caused the transfer, which generally coincides with the Company’s monthly or quarterly valuation process.

There were no transfers between levels of the fair value hierarchy and the Company had no Level 3 fair value assets or liabilities for the three months ended March 31, 2013 and the year ended December 31, 2012, respectively.

Following is a description of valuation methodologies used for assets and liabilities recorded at fair value:

Securities Available for Sale

Investment securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities ("GSEs"), municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.

Loans Receivable

The Company does not record loans at fair value on a recurring basis, however, from time to time, a loan is considered impaired and an allowance for loan loss is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan are considered impaired. Management estimates the fair value of impaired loans using one of several methods, including the collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Impaired loans not requiring a specific allowance represent loans for which the fair value of expected repayments or collateral exceed the recorded investment in such loans. At December 31, 2012, substantially all of the impaired loans were evaluated based upon the fair value of the collateral. In accordance with FASB ASC 820, impaired loans where an allowance is established based on the fair value of collateral (loans with impairment) require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the loan as nonrecurring Level 3.

Other Real Estate Owned ("OREO")

OREO is adjusted for fair value upon transfer of the loans to foreclosed assets. Subsequently, OREO is carried at the lower of carrying value and fair value. Fair value is based upon independent market prices, appraised value of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the foreclosed asset as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the foreclosed asset at nonrecurring Level 3.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

The tables below present the recorded amount of assets as of March 31, 2013 and December 31, 2012 measured at fair value on a recurring basis.

	March 31, 2013			
Description of Asset	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available for sale securities				
Asset-backed securities issued by GSEs				
Collateralized Mortgage Obligations ("CMOs")	$40,015,701	$ -	$ 40,015,701	$ -
Mortgage Backed Securities ("MBS")	225,530	-	225,530	-
Corporate equity securities	37,664	-	37,664	-
Bond mutual funds	4,273,305	-	4,273,305	-
Total available for sale securities	$44,552,200	$ -	$ 44,552,200	$ -

8

Description of Asset	December 31, 2012 Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available for sale securities				
Asset-backed securities issued by GSEs				
CMOs	$42,655,799	$ -	$ 42,655,799	$ -
MBS	231,386	-	231,386	-
Corporate equity securities	37,332	-	37,332	-
Bond mutual funds	4,281,146	-	4,281,146	-
Total available for sale securities	$47,205,663	$ -	$ 47,205,663	$ -

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

The Company may be required from time to time to measure certain assets at fair value on a nonrecurring basis in accordance with U.S. GAAP. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. Assets measured at fair value on a nonrecurring basis as of March 31, 2013 and December 31, 2012 are included in the tables below.

Description of Asset	March 31, 2013 Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Loans with impairment				
Commercial real estate	$2,069,575	$ -	$ 2,069,575	$ -
Residential first mortgage	469,025	-	469,025	-
Commercial loans	2,145	-	2,145	-
Commercial equipment	148	-	148	-
Total loans with impairment	$2,540,893	$ -	$ 2,540,893	$ -
Other real estate owned	$6,951,653	$ -	$ 6,951,653	$ -

Description of Asset	December 31, 2012 Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)

Loans with impairment				
Commercial real estate	$2,028,534	$ -	$ 2,028,534	$ -
Residential first mortgage	602,290	-	602,290	-
Commercial loans	94,355	-	94,355	-
Total loans with impairment	$2,725,179	$ -	$ 2,725,179	$ -
Other real estate owned	$6,891,353	$ -	$ 6,891,353	$ -

Loans with impairment have unpaid principal balances of $4,124,703 and $4,272,836 at March 31, 2013 and December 31, 2012, respectively, and include impaired loans with a specific allowance.

4. INCOME TAXES

The Company files a consolidated federal income tax return with its subsidiaries. Deferred tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws and when it is considered more likely than not that deferred tax assets will be realized. It is the Company's policy to recognize accrued interest and penalties related to unrecognized tax benefits as a component of tax expense.

5. EARNINGS PER COMMON SHARE

Basic earnings per common share represent income available to common shareholders, divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may be issued by the Company relate to outstanding stock options and are determined using the treasury stock method. As of March 31, 2013 and 2012, there were 101,549 and 187,367 shares, respectively, excluded from the diluted net income per share computation because the exercise price of the stock options were greater than the market price, and thus were anti-dilutive. Basic and diluted earnings per share have been computed based on weighted-average common and common equivalent shares outstanding as follows:

	Three Months Ended March 31,	
	2013	2012
Net Income	$1,718,391	$1,105,253
Less: dividends paid and accrued on preferred stock	(50,000)	(50,000)
Net income available to common shareholders	$1,668,391	$1,055,253
Average number of common shares outstanding	3,053,204	3,037,380
Effect of dilutive options	21,283	8,939
Average number of shares used to calculate diluted earnings per share	3,074,487	3,046,319

6. STOCK-BASED COMPENSATION

The Company has stock option and incentive arrangements to attract and retain key personnel. In May 2005, the 2005 Equity Compensation Plan (the "Plan") was approved by the shareholders, which authorizes the issuance of restricted stock, stock appreciation rights, stock units and stock options to the Board of Directors and key employees. Compensation expense for service based awards is recognized over the vesting period. Performance based awards are recognized based on a vesting, if applicable, and the probability of achieving the goals.

Stock-based compensation expense totaled $134,305 and $65,522 for the three months ended March 31, 2013 and 2012, respectively, which consisted of grants of restricted stock and restricted stock units. Stock-based compensation for the three months ended March 31, 2013 and 2012 included director compensation of $3,320 and $6,807, respectively, for stock granted in lieu of cash compensation. All outstanding options are fully vested and the Company has not granted any stock options since 2007.

The fair value of the Company’s employee stock options granted is estimated on the date of grant using the Black-Scholes option pricing model. The Company estimates expected market price volatility and expected term of the options based on historical data and other factors.

The exercise price for options granted is set at the discretion of the committee administering the Plan, but is not less than the market value of the shares as of the date of grant. An option’s maximum term is 10 years and the options vest at the discretion of the committee.

The following tables below summarize outstanding and exercisable options at March 31, 2013 and December 31, 2012.

	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value	Weighted-Average Contractual Life Remaining In Years
Outstanding at January 1, 2013	236,059	$ 18.49	$ 164,304	
Granted at fair value	-	-		
Exercised	(2,518)	13.19	10,248	
Expired	-	-		
Forfeited	(1)	13.19		
Outstanding at March 31, 2013	233,540	$ 18.55	$ 225,938	1.0
Exercisable at March 31, 2013	233,540	$ 18.55	$ 225,938	1.0

	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value	Weighted-Average Contractual Life Remaining In Years
Outstanding at January 1, 2012	264,156	$ 17.90	$ 175,911	
Granted at fair value	-	-		
Exercised	(24,780)	12.25	88,607	
Expired	-	-		
Forfeited	(3,317)	18.25		
Outstanding at December 31, 2012	236,059	$ 18.49	$ 164,304	1.0
Exercisable at December 31, 2012	236,059	$ 18.49	$ 164,304	1.0

Options outstanding are all currently exercisable and are summarized as follows:

Number Outstanding March 31, 2013	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price
49,340	1 years	$ 12.94
82,651	2 years	15.89
80,138	3 years	22.29
21,411	5 years	27.70

233,540	$ 18.55

The aggregate intrinsic value of outstanding stock options and exercisable stock options was $225,938 and $164,304 at March 31, 2013 and December 31, 2012, respectively. Aggregate intrinsic value represents the difference between the Company's closing stock price on the last trading day of the period, which was $16.50 and $15.98 at March 31, 2013 and December 31, 2012, respectively, and the exercise price multiplied by the number of options outstanding.

11

The Company has outstanding restricted stock and stock units granted in accordance with the Plan. The following tables summarize the unvested restricted stock awards and units outstanding at March 31, 2013 and December 31, 2012, respectively.

	Restricted Stock		Restricted Stock Units	
	Number of Shares	Weighted Average Grant Date Fair Value	Number of Units	Fair Value
Nonvested at January 1, 2013	23,569	$ 15.64	5,211	$ 15.98
Granted	13,656	18.00	2,105	16.87
Vested	(16,678)	16.35	(3,106)	15.98
Nonvested at March 31, 2013	20,547	$ 16.63	4,210	$ 16.50

	Restricted Stock		Restricted Stock Units	
	Number of Shares	Weighted Average Grant Date Fair Value	Number of Units	Fair Value
Nonvested at January 1, 2012	8,113	$ 16.47	6,845	$ 15.00
Granted	23,281	15.21	2,105	15.98
Vested	(7,825)	15.20	(3,739)	14.80
Nonvested at December 31, 2012	23,569	$ 15.64	5,211	$ 15.98

7. GUARANTEED PREFERRED BENEFICIAL INTEREST IN JUNIOR SUBORDINATED DEBENTURES

On June 15, 2005, Tri-County Capital Trust II ("Capital Trust II"), a Delaware business trust formed, funded and wholly owned by the Company, issued $5,000,000 of variable-rate capital in a private pooled transaction. The variable rate is based on the 90-day LIBOR rate plus 1.70%. The Trust used the proceeds from this issuance, along with the $155,000 for Capital Trust II's common securities, to purchase $5,155,000 of the Company's junior subordinated debentures. The interest rate on the debentures and the trust preferred securities is variable and adjusts quarterly. These capital securities qualify as Tier I capital and are presented in the Consolidated Balance Sheets as "Guaranteed Preferred Beneficial Interests in Junior Subordinated Debentures." Both the capital securities of Capital Trust II and the junior subordinated debentures are scheduled to mature on June 15, 2035, unless called by the Company.

On July 22, 2004, Tri-County Capital Trust I ("Capital Trust I"), a Delaware business trust formed, funded and wholly owned by the Company, issued $7,000,000 of variable-rate capital securities in a private pooled transaction. The variable rate is based on the 90-day LIBOR rate plus 2.60%. The Trust used the proceeds from this issuance, along with the Company's $217,000 capital contribution for Capital Trust I's common securities, to purchase $7,217,000 of the Company’s junior subordinated debentures. The interest rate on the debentures and the trust preferred securities is variable and adjusts quarterly. These debentures qualify as Tier I capital and are presented in the Consolidated Balance Sheets as “Guaranteed Preferred Beneficial Interests in Junior Subordinated Debentures.” Both the capital securities of Capital Trust I and the junior subordinated debentures are scheduled to mature on July 22, 2034, unless called by the Company.

8. PREFERRED STOCK

Small Business Lending Fund Preferred Stock

On September 22, 2011, the Company entered into a Securities Purchase Agreement (the “Purchase Agreement”) with the Secretary of the Treasury (the “Secretary”), pursuant to which the Company issued 20,000 shares of the Company’s Senior Non-Cumulative Perpetual Preferred Stock, Series C (the “Series C Preferred Stock”), having a liquidation amount per share equal to $1,000, for a total purchase price of $20,000,000. The Purchase Agreement was entered into, and the Series C Preferred Stock was issued, as authorized by the Small Business Lending Fund program.

The Series C Preferred Stock is entitled to receive non-cumulative dividends, payable quarterly. The dividend rate, as a percentage of the liquidation amount, can fluctuate on a quarterly basis during the first 10 quarters during which the Series C Preferred Stock is outstanding, based upon changes in the level of “Qualified Small Business Lending” or “QSBL” (as defined in the Purchase Agreement) by the Bank. Based upon the increase in the Bank’s level of QSBL over the baseline level calculated under the terms of the Purchase Agreement, the dividend rate for the initial dividend period was set at one percent (1%). For the second through ninth calendar quarters, the dividend rate may be adjusted to between one percent (1%) and five percent (5%) per annum, to reflect the amount of change in the Bank’s level of QSBL. If the level of the Bank’s qualified small business loans declines so that the percentage increase in QSBL as compared to the baseline level is less than 10%, then the dividend rate payable on the Series C Preferred Stock would increase. For the tenth calendar quarter through four and one half years after issuance, the dividend rate will be fixed at between one percent (1%) and seven percent (7%) based upon the increase in QSBL as compared to the baseline. After four and one half years from issuance, the dividend rate will increase to nine percent (9%). In addition, beginning on January 1, 2014, and on all Series C Preferred Stock dividend payment dates thereafter ending on April 1, 2016, the Company will be required to pay to the Secretary, on each share of Series C Preferred Stock, but only out of assets legally available, a fee equal to 0.5% of the liquidation amount per share of Series C Preferred Stock.

The Series C Preferred Stock is non-voting, except in limited circumstances. If the Company misses five dividend payments, whether or not consecutive, the holder of the Series C Preferred Stock will have the right, but not the obligation, to appoint a representative as an observer on the Company’s Board of Directors. The Series C Preferred Stock may be redeemed at any time at the Company’s option, at a redemption price of 100% of the liquidation amount plus accrued but unpaid dividends to the date of redemption for the current period, subject to the approval of our federal banking regulator. The Company is permitted to repay its SBLF funding in increments of 25% or $5.0 million, subject to the approval of its federal banking regulator.

The Series C Preferred Stock was issued in a private placement exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended. The Company has agreed to register the Series C Preferred Stock under certain circumstances set forth in Annex E to the Purchase Agreement. The Series C Preferred Stock is not subject to any contractual restrictions on transfer.

9. OTHER REAL ESTATE OWNED (“OREO”)

OREO assets are presented net of the allowance for losses. The Company considers OREO as classified assets for regulatory and financial reporting. An analysis of the activity follows.

	Three Months Ended March 31,		Year Ended December 31,
	2013	2012	2012
Balance at beginning of year	$ 6,891,353	$ 5,028,513	$ 5,028,513
Additions of underlying property	370,800	135,270	4,020,494
Disposals of underlying property	-	(395,949)	(1,483,449)

Valuation allowance	(310,500)	(300,000)	(674,205)
Balance at end of period	$ 6,951,653	$ 4,467,834	$ 6,891,353

During the three months ended March 31, 2012, the Bank disposed of two OREO properties resulting in proceeds of $299,032 and recognized net losses of $96,917. There were no disposals during the three months ended March 31, 2013.

Expenses applicable to OREO assets include the following.

	Three Months Ended March 31,	
	2013	2012
Valuation allowance	$ 310,500	$ 300,000
Operating expenses	40,862	(1,701)
	$ 351,362	$ 298,299

Operating expenses for the three months ended March 31, 2012 included $7,600 in deposits refunded on sold foreclosed real estate.

13

10. SECURITIES

	March 31, 2013 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities available for sale (AFS)				
Asset-backed securities issued by GSEs				
Residential MBS	$193,394	$ 32,136	$ -	$225,530
Residential CMOs	39,954,131	241,340	179,770	40,015,701
Corporate equity securities	37,310	613	259	37,664
Bond mutual funds	4,034,867	238,438	-	4,273,305
Total securities available for sale	$44,219,702	$ 512,527	$ 180,029	$44,552,200
Securities held to maturity (HTM)				
Asset-backed securities issued by GSEs:				
Residential MBS	$27,511,471	$ 1,074,600	$ 21,887	$28,564,184
Residential CMOs	78,229,508	616,529	109,075	78,736,962
Asset-backed securities issued by Others:				
Residential CMOs	4,160,465	246,082	465,312	3,941,235
Total debt securities held to maturity	109,901,444	1,937,211	596,274	111,242,381
U.S. government obligations	849,786	-	-	849,786
Total securities held to maturity	$110,751,230	$ 1,937,211	$ 596,274	$112,092,167

	December 31, 2012 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities available for sale (AFS)				
Asset-backed securities issued by GSEs				
Residential MBS	$198,400	$ 32,986	$ -	$231,386
Residential CMOs	42,507,542	266,775	118,518	42,655,799
Corporate equity securities	37,310	306	284	37,332
Bond mutual funds	4,012,609	268,537	-	4,281,146
Total securities available for sale	$46,755,861	$ 568,604	$ 118,802	$47,205,663
Securities held to maturity (HTM)				
Asset-backed securities issued by GSEs:				
Residential MBS	$31,239,176	$ 1,237,277	$ -	$32,476,453