

MERIDIAN INTERSTATE BANCORP INC

Form 10-Q

May 12, 2014

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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

x **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
**For the Quarterly Period Ended March 31, 2014**

**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 001-33898**

**Meridian Interstate Bancorp, Inc.**

**(Exact name of registrant as specified in its charter)**

**Massachusetts**  
**(State or other jurisdiction of**  
**incorporation or organization)**

**20-4652200**  
**(I.R.S. Employer**  
**Identification No.)**

**67 Prospect Street,**  
**Peabody, Massachusetts**  
**(Address of Principal Executive Offices)**  
**(617) 567-1500**

**01960**  
**Zip Code**

**(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 and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

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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 ☐ Smaller Reporting Company ☐

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

At April 30, 2014, the registrant had 22,232,239 shares of no par value common stock outstanding.

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**FORM 10-Q**

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**Table of Contents****PART I FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****MERIDIAN INTERSTATE BANCORP, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****(Unaudited)**

|                                              | March 31,<br>2014      | December 31,<br>2013 |
|----------------------------------------------|------------------------|----------------------|
|                                              | (Dollars in thousands) |                      |
| ASSETS                                       |                        |                      |
| Cash and due from banks                      | \$ 156,632             | \$ 86,271            |
| Securities available for sale, at fair value | 191,361                | 201,137              |
| Federal Home Loan Bank stock, at cost        | 11,989                 | 11,907               |
| Loans held for sale                          | 1,208                  | 2,363                |
| Loans, net of fees and costs                 | 2,343,988              | 2,290,735            |
| Less allowance for loan losses               | (25,440)               | (25,335)             |
| Loans, net                                   | 2,318,548              | 2,265,400            |
| Bank-owned life insurance                    | 37,727                 | 37,446               |
| Foreclosed real estate, net                  | 850                    | 1,390                |
| Premises and equipment, net                  | 39,161                 | 39,426               |
| Accrued interest receivable                  | 7,008                  | 7,127                |
| Deferred tax asset, net                      | 13,571                 | 13,478               |
| Goodwill                                     | 13,687                 | 13,687               |
| Other assets                                 | 3,395                  | 2,469                |
| Total assets                                 | \$ 2,795,137           | \$ 2,682,101         |
| LIABILITIES AND STOCKHOLDERS' EQUITY         |                        |                      |
| Deposits:                                    |                        |                      |
| Non interest-bearing                         | \$ 265,078             | \$ 255,639           |
| Interest-bearing                             | 2,052,401              | 1,992,961            |
| Total deposits                               | 2,317,479              | 2,248,600            |
| Long-term debt                               | 202,123                | 161,903              |
| Accrued expenses and other liabilities       | 20,968                 | 22,393               |
| Total liabilities                            | 2,540,570              | 2,432,896            |

|                                                                                                                     |              |              |
|---------------------------------------------------------------------------------------------------------------------|--------------|--------------|
| Stockholders' equity:                                                                                               |              |              |
| Common stock, no par value, 50,000,000 shares authorized; 23,000,000 shares issued                                  |              |              |
| Additional paid-in capital                                                                                          | 99,762       | 99,553       |
| Retained earnings                                                                                                   | 167,159      | 162,388      |
| Accumulated other comprehensive income                                                                              | 4,129        | 4,104        |
| Treasury stock, at cost, 767,761 and 778,821 shares at March 31, 2014 and December 31, 2013, respectively           |              |              |
|                                                                                                                     | (9,769)      | (9,919)      |
| Unearned compensation - ESOP, 569,250 and 579,600 shares at March 31, 2014 and December 31, 2013, respectively      |              |              |
|                                                                                                                     | (5,693)      | (5,796)      |
| Unearned compensation - restricted shares, 96,590 and 103,810 at March 31, 2014 and December 31, 2013, respectively |              |              |
|                                                                                                                     | (1,021)      | (1,125)      |
| Total stockholders' equity                                                                                          | 254,567      | 249,205      |
|                                                                                                                     |              |              |
| Total liabilities and stockholders' equity                                                                          | \$ 2,795,137 | \$ 2,682,101 |

See accompanying notes to unaudited consolidated financial statements.

**Table of Contents****MERIDIAN INTERSTATE BANCORP, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF NET INCOME****(Unaudited)**

|                                                      | <b>Three Months Ended March 31,</b>                     |             |
|------------------------------------------------------|---------------------------------------------------------|-------------|
|                                                      | <b>2014</b>                                             | <b>2013</b> |
|                                                      | <i>(Dollars in thousands, except per share amounts)</i> |             |
| Interest and dividend income:                        |                                                         |             |
| Interest and fees on loans                           | \$ 24,435                                               | \$ 20,794   |
| Interest on debt securities:                         |                                                         |             |
| Taxable                                              | 745                                                     | 1,156       |
| Tax-exempt                                           | 45                                                      | 53          |
| Dividends on equity securities                       | 313                                                     | 349         |
| Other interest and dividend income                   | 90                                                      | 64          |
| Total interest and dividend income                   | 25,628                                                  | 22,416      |
| Interest expense:                                    |                                                         |             |
| Interest on deposits                                 | 4,405                                                   | 3,948       |
| Interest on borrowings                               | 621                                                     | 842         |
| Total interest expense                               | 5,026                                                   | 4,790       |
| Net interest income                                  | 20,602                                                  | 17,626      |
| Provision for loan losses                            | 133                                                     | 1,260       |
| Net interest income, after provision for loan losses | 20,469                                                  | 16,366      |
| Non-interest income:                                 |                                                         |             |
| Customer service fees                                | 1,799                                                   | 1,586       |
| Loan fees                                            | 213                                                     | 56          |
| Mortgage banking gains, net                          | 120                                                     | 155         |
| Gain on sales of securities, net                     | 1,560                                                   | 2,273       |
| Income from bank-owned life insurance                | 281                                                     | 291         |
| Other income                                         | 11                                                      |             |
| Total non-interest income                            | 3,984                                                   | 4,361       |
| Non-interest expenses:                               |                                                         |             |
| Salaries and employee benefits                       | 10,801                                                  | 10,075      |
| Occupancy and equipment                              | 2,561                                                   | 2,334       |
| Data processing                                      | 1,161                                                   | 991         |
| Marketing and advertising                            | 807                                                     | 691         |
| Professional services                                | 641                                                     | 601         |

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|                                  |            |            |
|----------------------------------|------------|------------|
| Foreclosed real estate           | 11         | 106        |
| Deposit insurance                | 551        | 475        |
| Other general and administrative | 888        | 1,019      |
| Total non-interest expenses      | 17,421     | 16,292     |
| Income before income taxes       | 7,032      | 4,435      |
| Provision for income taxes       | 2,261      | 1,367      |
| Net income                       | \$ 4,771   | \$ 3,068   |
| Income per share:                |            |            |
| Basic                            | \$ 0.22    | \$ 0.14    |
| Diluted                          | \$ 0.22    | \$ 0.14    |
| Weighted average shares:         |            |            |
| Basic                            | 21,651,659 | 21,639,122 |
| Diluted                          | 22,083,647 | 21,952,607 |

See accompanying notes to unaudited consolidated financial statements.

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**MERIDIAN INTERSTATE BANCORP, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
**(Unaudited)**

|                                                             | <b>Three Months Ended March 31,</b> |             |
|-------------------------------------------------------------|-------------------------------------|-------------|
|                                                             | <b>2014</b>                         | <b>2013</b> |
|                                                             | <i>(In thousands)</i>               |             |
| Net income                                                  | \$ 4,771                            | \$ 3,068    |
| Other comprehensive income:                                 |                                     |             |
| Securities available for sale:                              |                                     |             |
| Unrealized holding gain on securities available for sale    | 1,566                               | 5,029       |
| Reclassification adjustment for gain realized in income (1) | (1,560)                             | (2,273)     |
| Net unrealized gain                                         | 6                                   | 2,756       |
| Tax effect                                                  | 19                                  | (1,102)     |
| Total other comprehensive income                            | 25                                  | 1,654       |
| Comprehensive income                                        | \$ 4,796                            | \$ 4,722    |

- (1) Amounts are included in gain on sales of securities, net in the Consolidated Statements of Net Income. Provision for income tax associated with the reclassification adjustment for the three months ended March 31, 2014 and 2013 was \$502,000 and \$909,000, respectively.

See accompanying notes to unaudited consolidated financial statements.

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**MERIDIAN INTERSTATE BANCORP, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**

**Three Months Ended March 31, 2014 and 2013**

**(Unaudited)**

|                                                                          | Shares of<br>Common Stock<br>Outstanding<br>(1) | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income | Treasury<br>Stock | Unearned<br>Compensation -<br>ESOP | Unearned<br>Compensation -<br>Restricted<br>Shares | Total      |
|--------------------------------------------------------------------------|-------------------------------------------------|----------------------------------|----------------------|-------------------------------------------------|-------------------|------------------------------------|----------------------------------------------------|------------|
| <i>(Dollars in thousands)</i>                                            |                                                 |                                  |                      |                                                 |                   |                                    |                                                    |            |
| <b>Three Months Ended</b>                                                |                                                 |                                  |                      |                                                 |                   |                                    |                                                    |            |
| <b>March 31, 2013</b>                                                    |                                                 |                                  |                      |                                                 |                   |                                    |                                                    |            |
| Balance at<br>December 31, 2012                                          | 22,135,855                                      | \$ 98,338                        | \$ 146,959           | \$ 4,915                                        | \$ (8,331)        | \$ (6,210)                         | \$ (1,728)                                         | \$ 233,943 |
| Comprehensive<br>income                                                  |                                                 |                                  | 3,068                | 1,654                                           |                   |                                    |                                                    | 4,722      |
| Purchase of treasury<br>stock                                            | (3,184)                                         |                                  |                      |                                                 | (57)              |                                    |                                                    | (57)       |
| ESOP shares earned<br>(10,350 shares)                                    |                                                 | 81                               |                      |                                                 |                   | 104                                |                                                    | 185        |
| Share-based<br>compensation expense                                      | 5,060                                           | 153                              |                      |                                                 |                   |                                    | 146                                                | 299        |
| Stock options<br>exercised                                               | 3,674                                           | (41)                             |                      |                                                 | 46                |                                    |                                                    | 5          |
| Balance at March 31,<br>2013                                             | 22,141,405                                      | \$ 98,531                        | \$ 150,027           | \$ 6,569                                        | \$ (8,342)        | \$ (6,106)                         | \$ (1,582)                                         | \$ 239,097 |
| <b>Three Months Ended</b>                                                |                                                 |                                  |                      |                                                 |                   |                                    |                                                    |            |
| <b>March 31, 2014</b>                                                    |                                                 |                                  |                      |                                                 |                   |                                    |                                                    |            |
| Balance at<br>December 31, 2013                                          | 22,117,369                                      | \$ 99,553                        | \$ 162,388           | \$ 4,104                                        | \$ (9,919)        | \$ (5,796)                         | \$ (1,125)                                         | \$ 249,205 |
| Comprehensive<br>income                                                  |                                                 |                                  | 4,771                | 25                                              |                   |                                    |                                                    | 4,796      |
| ESOP shares earned<br>(10,350 shares)                                    |                                                 | 150                              |                      |                                                 |                   | 103                                |                                                    | 253        |
| Share-based<br>compensation expense                                      | 7,060                                           | 120                              |                      |                                                 |                   |                                    | 104                                                | 224        |
| Excess tax benefits in<br>connection with<br>share-based<br>compensation |                                                 | 40                               |                      |                                                 |                   |                                    |                                                    | 40         |

|                         |        |       |  |  |     |  |  |  |    |
|-------------------------|--------|-------|--|--|-----|--|--|--|----|
| Stock options exercised | 11,220 | (101) |  |  | 150 |  |  |  | 49 |
|-------------------------|--------|-------|--|--|-----|--|--|--|----|

|                           |            |           |            |          |            |            |            |            |
|---------------------------|------------|-----------|------------|----------|------------|------------|------------|------------|
| Balance at March 31, 2014 | 22,135,649 | \$ 99,762 | \$ 167,159 | \$ 4,129 | \$ (9,769) | \$ (5,693) | \$ (1,021) | \$ 254,567 |
|---------------------------|------------|-----------|------------|----------|------------|------------|------------|------------|

- (1) Shares of common stock outstanding exclude unvested restricted shares totaling 96,590 shares at March 31, 2014, 103,810 shares at December 31, 2013, 113,975 shares at March 31, 2013, and 119,055 shares at December 31, 2012 that were outstanding for voting purposes.

See accompanying notes to unaudited consolidated financial statements.

**Table of Contents****MERIDIAN INTERSTATE BANCORP, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

|                                                                                   | <b>Three Months Ended March 31,</b> |             |
|-----------------------------------------------------------------------------------|-------------------------------------|-------------|
|                                                                                   | <b>2014</b>                         | <b>2013</b> |
|                                                                                   | <i>(In thousands)</i>               |             |
| Cash flows from operating activities:                                             |                                     |             |
| Net income                                                                        | \$ 4,771                            | \$ 3,068    |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                     |             |
| Accretion of acquisition fair value adjustments                                   | (9)                                 | (75)        |
| ESOP shares earned                                                                | 253                                 | 185         |
| Provision for loan losses                                                         | 133                                 | 1,260       |
| (Accretion) amortization of net deferred loan origination costs/fees              | (85)                                | 31          |
| Net accretion of securities available for sale                                    | (1)                                 | (15)        |
| Capitalization of mortgage servicing rights                                       | (10)                                | (63)        |
| Amortization of mortgage servicing rights                                         | 48                                  | 100         |
| Depreciation and amortization expense                                             | 593                                 | 553         |
| Gain on sales of securities, net                                                  | (1,560)                             | (2,273)     |
| Net loss and provision for foreclosed real estate                                 |                                     | 6           |
| Deferred income tax benefit                                                       | (74)                                | (23)        |
| Income from bank-owned life insurance                                             | (281)                               | (291)       |
| Share-based compensation expense                                                  | 224                                 | 299         |
| Excess tax benefits in connection with share-based compensation                   | 40                                  |             |
| Net changes in:                                                                   |                                     |             |
| Loans held for sale                                                               | 1,155                               | 4,889       |
| Accrued interest receivable                                                       | 119                                 | (62)        |
| Other assets                                                                      | (182)                               | (308)       |
| Accrued expenses and other liabilities                                            | (2,448)                             | (1,237)     |
| Net cash provided by operating activities                                         | 2,686                               | 6,044       |
| Cash flows from investing activities:                                             |                                     |             |
| Activity in securities available for sale:                                        |                                     |             |
| Proceeds from maturities, calls and principal payments                            | 14,614                              | 15,453      |
| Redemption of mutual funds, net                                                   | 396                                 | 4,018       |
| Proceeds from sales                                                               | 7,651                               | 19,754      |
| Purchases                                                                         | (11,127)                            | (7,447)     |
| Loans originated, net of principal payments received                              | (53,204)                            | (64,385)    |
| Purchases of premises and equipment                                               | (307)                               | (1,740)     |
| (Purchase) redemption of Federal Home Loan Bank stock                             | (82)                                | 157         |
| Proceeds from sales of foreclosed real estate                                     | 540                                 | 718         |

|                                       |          |          |
|---------------------------------------|----------|----------|
| Net cash used in investing activities | (41,519) | (33,472) |
|---------------------------------------|----------|----------|

**Table of Contents****MERIDIAN INTERSTATE BANCORP, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

|                                                                                       | <b>Three Months Ended March 31,</b> |             |
|---------------------------------------------------------------------------------------|-------------------------------------|-------------|
|                                                                                       | <b>2014</b>                         | <b>2013</b> |
|                                                                                       | <i>(In thousands)</i>               |             |
| Cash flows from financing activities:                                                 |                                     |             |
| Net increase in deposits                                                              | 68,885                              | 92,083      |
| Proceeds from Federal Home Loan Bank advances with maturities of three months or more | 45,000                              | 30,000      |
| Repayment of Federal Home Loan Bank advances with maturities of three months or more  | (4,780)                             | (4,431)     |
| Stock options exercised                                                               | 49                                  | 5           |
| Excess tax benefits in connection with share-based compensation                       | 40                                  |             |
| Purchase of treasury stock                                                            |                                     | (57)        |
| Net cash provided by financing activities                                             | 109,194                             | 117,600     |
| Net change in cash and cash equivalents                                               | 70,361                              | 90,172      |
| Cash and cash equivalents at beginning of period                                      | 86,271                              | 93,192      |
| Cash and cash equivalents at end of period                                            | \$ 156,632                          | \$ 183,364  |
| Supplemental cash flow information:                                                   |                                     |             |
| Interest paid on deposits                                                             | \$ 4,403                            | \$ 3,929    |
| Interest paid on borrowings                                                           | 615                                 | 924         |
| Income taxes paid, net of refunds                                                     | 2,783                               | 1,225       |
| Non-cash investing and financing activities:                                          |                                     |             |
| Transfers from loans to foreclosed real estate                                        |                                     | 200         |
| Net change in amounts due to broker on security transactions                          | 201                                 |             |

See accompanying notes to unaudited consolidated financial statements.

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**MERIDIAN INTERSTATE BANCORP, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**1. BASIS OF PRESENTATION**

The consolidated financial statements include the accounts of Meridian Interstate Bancorp, Inc., a 59.2%-owned subsidiary of Meridian Financial Services, Incorporated ( Meridian ), a mutual holding company, and all other entities in which it has a controlling financial interest (collectively referred to as the Company ). The Company was formed in a corporate reorganization in 2006 and owns East Boston Savings Bank and its subsidiaries (the Bank ) and Meridian Interstate Funding Corporation, which was established in 2008 to fund a loan to the Company s Employee Stock Ownership Plan ( ESOP ). The Bank s subsidiaries include Prospect, Inc., which engages in securities transactions on its own behalf, EBOSCO, LLC and Berkeley Riverbend Estates LLC, both of which hold foreclosed real estate; and East Boston Investment Services, Inc., which is authorized for third-party investment sales and is currently inactive. All significant intercompany balances and transactions have been eliminated in consolidation.

On March 5, 2014, the Board of Trustees of Meridian and the Boards of Directors of the Company and the Bank adopted a Plan of Conversion (the Plan ). Pursuant to the Plan, Meridian will convert from the mutual holding company form of organization to the fully public form. Meridian and the Company will no longer exist. As part of the conversion, Meridian s ownership interest in the Company will be offered for sale in a public offering by a new Maryland corporation named Meridian Bancorp, Inc. The existing publicly held shares of the Company will be exchanged for new shares of common stock of Meridian Bancorp, Inc., the new Maryland corporation. When the conversion and public offering are completed, all of the capital stock of the Bank will be owned by the new Maryland corporation. The Plan provides for the establishment, upon the completion of the conversion, of special liquidation accounts for the benefit of certain depositors of the Bank in an amount equal to Meridian s ownership interest in the equity of the Company as of the date of the latest balance sheet contained in the prospectus plus the value of the net assets of Meridian as of the date of the latest statement of financial condition of Meridian prior to the consummation of the conversion (excluding its ownership of the Company). Direct costs incurred totaling \$294,000 have been deferred as of March 31, 2014 related to the conversion. The Plan is subject to regulatory approvals as well as approvals by the Company s stockholders and Meridian s corporators.

For further information, see Note 17 of the Notes to the Consolidated Financial Statements included in the Company s annual report on Form 10-K for the year ended December 31, 2013.

The accompanying unaudited interim consolidated financial statements of the Company have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. Such adjustments were of a normal recurring nature. The results of operations for the three months ended March 31, 2014 are not necessarily indicative of the results that may be expected for the entire year or any other interim period. For additional information, refer to the financial statements and footnotes thereto of the Company included in the Company s Form 10-K for the year ended December 31, 2013 which was filed with the Securities and Exchange Commission ( SEC ) on March 17, 2014, and is available through the SEC s website at [www.sec.gov](http://www.sec.gov).

In preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts

of assets and liabilities as of the date of the consolidated balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the evaluation of goodwill for impairment, other-than-temporary impairment of securities and the valuation of deferred tax assets.

**Table of Contents****2. RECENT ACCOUNTING PRONOUNCEMENT**

In January 2014, the Financial Accounting Standards Board issued Accounting Standards Update No. 2014-04, *Troubled Debt Restructurings by Creditors (Subtopic 310-40), Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*. This update is intended to reduce diversity in the application of guidance by clarifying when an in substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. Amendments in this update are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The adoption is not expected to have a material impact on the Company's consolidated financial statements.

**3. EARNINGS PER SHARE**

Basic earnings per share excludes dilution and is calculated by dividing net income available to common stockholders by the weighted-average number of common shares outstanding during the period. If rights to dividends on unvested stock awards are non-forfeitable, these unvested stock awards are considered outstanding in the computation of basic earnings per share. Diluted earnings per share is computed in a manner similar to that of basic earnings per share except that the weighted-average number of common shares outstanding is increased to include the number of incremental common shares (computed using the treasury method) that would have been outstanding if all potentially dilutive common stock equivalents (such as options) were issued during the period. Unallocated common shares held by the ESOP are shown as a reduction in stockholders' equity and are not included in the weighted-average number of common shares outstanding for either basic or diluted earnings per share calculations.

Basic and diluted earnings per share have been computed based on the following:

|                                             | <b>Three Months Ended March 31,</b>                     |             |
|---------------------------------------------|---------------------------------------------------------|-------------|
|                                             | <b>2014</b>                                             | <b>2013</b> |
|                                             | <i>(Dollars in thousands, except per share amounts)</i> |             |
| Net income available to common stockholders | \$ 4,771                                                | \$ 3,068    |
| Average number of common shares outstanding | 21,550,355                                              | 21,521,944  |
| Effect of unvested stock awards             | 101,304                                                 | 117,178     |
| Basic weighted average shares outstanding   | 21,651,659                                              | 21,639,122  |
| Effect of dilutive stock options            | 431,988                                                 | 313,485     |
| Diluted weighted average shares outstanding | 22,083,647                                              | 21,952,607  |
| Earnings per share:                         |                                                         |             |

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|         |    |      |    |      |
|---------|----|------|----|------|
| Basic   | \$ | 0.22 | \$ | 0.14 |
| Diluted | \$ | 0.22 | \$ | 0.14 |

There were no anti-dilutive options for the three months ended March 31, 2014 and 2013.

**Table of Contents****4. SECURITIES AVAILABLE FOR SALE**

The amortized cost and fair values of securities available for sale, with gross unrealized gains and losses, follows:

|                                         | <b>Amortized<br/>Cost</b> | <b>Gross<br/>Unrealized<br/>Gains</b> | <b>Gross<br/>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b> |
|-----------------------------------------|---------------------------|---------------------------------------|----------------------------------------|-----------------------|
| <i>(In thousands)</i>                   |                           |                                       |                                        |                       |
| <b><u>March 31, 2014</u></b>            |                           |                                       |                                        |                       |
| Debt securities:                        |                           |                                       |                                        |                       |
| Corporate bonds:                        |                           |                                       |                                        |                       |
| Financial services                      | \$ 51,674                 | \$ 1,043                              | \$ (49)                                | \$ 52,668             |
| Industry and manufacturing              | 13,905                    | 224                                   |                                        | 14,129                |
| Consumer products and services          | 4,730                     |                                       |                                        | 4,730                 |
| Technology                              | 2,502                     | 14                                    |                                        | 2,516                 |
| Healthcare                              | 4,005                     | 99                                    |                                        | 4,104                 |
| Other                                   | 1,010                     | 38                                    |                                        | 1,048                 |
| Total corporate bonds                   | 77,826                    | 1,418                                 | (49)                                   | 79,195                |
| Government-sponsored enterprises        | 34,558                    | 2                                     | (934)                                  | 33,626                |
| Municipal bonds                         | 5,705                     | 159                                   |                                        | 5,864                 |
| Residential mortgage-backed securities: |                           |                                       |                                        |                       |
| Government-sponsored enterprises        | 10,557                    | 623                                   |                                        | 11,180                |
| Private label                           | 1,546                     | 91                                    |                                        | 1,637                 |
| Total debt securities                   | 130,192                   | 2,293                                 | (983)                                  | 131,502               |
| Marketable equity securities:           |                           |                                       |                                        |                       |
| Common stocks:                          |                           |                                       |                                        |                       |
| Financial services                      | 8,079                     | 529                                   | (46)                                   | 8,562                 |
| Industry and manufacturing              | 19,163                    | 1,879                                 | (193)                                  | 20,849                |
| Consumer products and services          | 13,296                    | 1,643                                 | (100)                                  | 14,839                |
| Technology                              | 3,256                     | 234                                   | (88)                                   | 3,402                 |
| Healthcare                              | 4,842                     | 1,204                                 |                                        | 6,046                 |
| Other                                   | 3,442                     | 1,090                                 |                                        | 4,532                 |
| Total common stocks                     | 52,078                    | 6,579                                 | (427)                                  | 58,230                |
| Money market mutual funds               | 1,669                     |                                       | (40)                                   | 1,629                 |
| Total marketable equity securities      | 53,747                    | 6,579                                 | (467)                                  | 59,859                |
| Total securities available for sale     | \$ 183,939                | \$ 8,872                              | \$ (1,450)                             | \$ 191,361            |

**December 31, 2013**

Debt securities:

Corporate bonds:

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|                                         |            |          |            |            |
|-----------------------------------------|------------|----------|------------|------------|
| Financial services                      | \$ 58,166  | \$ 1,148 | \$ (66)    | \$ 59,248  |
| Industry and manufacturing              | 13,893     | 264      | (16)       | 14,141     |
| Consumer products and services          | 7,234      | 32       |            | 7,266      |
| Technology                              | 2,503      | 18       |            | 2,521      |
| Healthcare                              | 9,009      | 149      |            | 9,158      |
| Other                                   | 1,011      | 43       |            | 1,054      |
| Total corporate bonds                   | 91,816     | 1,654    | (82)       | 93,388     |
| Government-sponsored enterprises        | 34,562     | 3        | (1,417)    | 33,148     |
| Municipal bonds                         | 5,721      | 137      |            | 5,858      |
| Residential mortgage-backed securities: |            |          |            |            |
| Government-sponsored enterprises        | 11,138     | 592      |            | 11,730     |
| Private label                           | 1,578      | 86       |            | 1,664      |
| Total debt securities                   | 144,815    | 2,472    | (1,499)    | 145,788    |
| Marketable equity securities:           |            |          |            |            |
| Common stocks:                          |            |          |            |            |
| Financial services                      | 6,909      | 614      |            | 7,523      |
| Industry and manufacturing              | 18,092     | 2,413    | (58)       | 20,447     |
| Consumer products and services          | 9,909      | 1,530    | (3)        | 11,436     |
| Technology                              | 3,442      | 132      | (66)       | 3,508      |
| Healthcare                              | 5,048      | 1,115    |            | 6,163      |
| Other                                   | 3,441      | 807      |            | 4,248      |
| Total common stocks                     | 46,841     | 6,611    | (127)      | 53,325     |
| Money market mutual funds               | 2,065      |          | (41)       | 2,024      |
| Total marketable equity securities      | 48,906     | 6,611    | (168)      | 55,349     |
| Total securities available for sale     | \$ 193,721 | \$ 9,083 | \$ (1,667) | \$ 201,137 |

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At March 31, 2014, securities with an amortized cost of \$24.1 million and \$2.1 million, respectively, were pledged as collateral for Federal Home Loan Bank of Boston borrowings and Federal Reserve Bank discount window borrowings.

The amortized cost and fair value of debt securities by contractual maturity at March 31, 2014 are as follows. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without prepayment penalties.

|                                               | One Year or Less  |               | After One Year<br>Through Five<br>Years |               | After Five Years  |               | Total             |               |
|-----------------------------------------------|-------------------|---------------|-----------------------------------------|---------------|-------------------|---------------|-------------------|---------------|
|                                               | Amortized<br>Cost | Fair<br>Value | Amortized<br>Cost                       | Fair<br>Value | Amortized<br>Cost | Fair<br>Value | Amortized<br>Cost | Fair<br>Value |
| <i>(In thousands)</i>                         |                   |               |                                         |               |                   |               |                   |               |
| Corporate bonds:                              |                   |               |                                         |               |                   |               |                   |               |
| Financial services                            | \$ 16,387         | \$ 16,603     | \$ 35,287                               | \$ 36,065     | \$                | \$            | \$ 51,674         | \$ 52,668     |
| Industry and<br>manufacturing                 | 7,996             | 8,055         | 5,909                                   | 6,074         |                   |               | 13,905            | 14,129        |
| Consumer products and<br>services             | 4,730             | 4,730         |                                         |               |                   |               | 4,730             | 4,730         |
| Technology                                    | 2,502             | 2,516         |                                         |               |                   |               | 2,502             | 2,516         |
| Healthcare                                    | 2,003             | 2,050         | 2,002                                   | 2,054         |                   |               | 4,005             | 4,104         |
| Other                                         |                   |               | 1,010                                   | 1,048         |                   |               | 1,010             | 1,048         |
| Total corporate bonds                         | 33,618            | 33,954        | 44,208                                  | 45,241        |                   |               | 77,826            | 79,195        |
| Government-sponsored<br>enterprises           |                   |               | 58                                      | 60            | 34,500            | 33,566        | 34,558            | 33,626        |
| Municipal bonds                               | 250               | 251           | 5,455                                   | 5,613         |                   |               | 5,705             | 5,864         |
| Residential<br>mortgage-backed<br>securities: |                   |               |                                         |               |                   |               |                   |               |
| Government-sponsored<br>enterprises           | 2                 | 2             |                                         |               | 10,555            | 11,178        | 10,557            | 11,180        |
| Private label                                 |                   |               |                                         |               | 1,546             | 1,637         | 1,546             | 1,637         |
| Total                                         | \$ 33,870         | \$ 34,207     | \$ 49,721                               | \$ 50,914     | \$ 46,601         | \$ 46,381     | \$ 130,192        | \$ 131,502    |

For the three months ended March 31, 2014 and 2013, proceeds from sales of securities available for sale amounted to \$7.7 million and \$19.8 million, respectively. Gross gains of \$1.6 million and \$2.3 million and gross losses of \$0 and \$10,000, respectively, were realized on those sales.

Information pertaining to securities available for sale as of March 31, 2014 and December 31, 2013, with gross unrealized losses aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

|                                       | Less Than Twelve Months       | Twelve Months or Longer |                               |               |
|---------------------------------------|-------------------------------|-------------------------|-------------------------------|---------------|
|                                       | Gross<br>Unrealized<br>Losses | Fair<br>Value           | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|                                       | <i>(In thousands)</i>         |                         |                               |               |
| <b>March 31, 2014</b>                 |                               |                         |                               |               |
| Debt securities:                      |                               |                         |                               |               |
| Corporate bonds - financial services  | \$ 4                          | \$ 1,996                | \$ 45                         | \$ 1,455      |
| Government-sponsored enterprises      | 849                           | 31,652                  | 85                            | 1,915         |
| Total debt securities                 | 853                           | 33,648                  | 130                           | 3,370         |
| Marketable equity securities:         |                               |                         |                               |               |
| Common stocks:                        |                               |                         |                               |               |
| Financial services                    | 46                            | 1,826                   |                               |               |
| Industry and manufacturing            | 182                           | 3,983                   | 11                            | 995           |
| Consumer products and services        | 100                           | 3,499                   |                               |               |
| Technology                            | 88                            | 1,050                   |                               |               |
| Total common stocks                   | 416                           | 10,358                  | 11                            | 995           |
| Money market mutual funds             |                               |                         | 40                            | 1,003         |
| Total marketable equity securities    | 416                           | 10,358                  | 51                            | 1,998         |
| Total temporarily impaired securities | \$ 1,269                      | \$ 44,006               | \$ 181                        | \$ 5,368      |

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|                                       | Less Than Twelve Months       | Twelve Months or Longer |                               |               |
|---------------------------------------|-------------------------------|-------------------------|-------------------------------|---------------|
|                                       | Gross<br>Unrealized<br>Losses | Fair<br>Value           | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|                                       | <i>(In thousands)</i>         |                         |                               |               |
| <b>December 31, 2013</b>              |                               |                         |                               |               |
| Debt securities:                      |                               |                         |                               |               |
| Corporate bonds:                      |                               |                         |                               |               |
| Financial services                    | \$ 19                         | \$ 6,981                | \$ 47                         | \$ 1,453      |
| Industry and manufacturing            | 16                            | 984                     |                               |               |
| Total corporate bonds                 | 35                            | 7,965                   | 47                            | 1,453         |
| Government-sponsored enterprises      | 1,296                         | 31,205                  | 121                           | 1,879         |
| Total debt securities                 | 1,331                         | 39,170                  | 168                           | 3,332         |
| Marketable equity securities:         |                               |                         |                               |               |
| Common stocks:                        |                               |                         |                               |               |
| Industry and manufacturing            | 58                            | 3,089                   |                               |               |
| Consumer products and services        | 3                             | 606                     |                               |               |
| Technology                            | 66                            | 1,872                   |                               |               |
| Total common stocks                   | 127                           | 5,567                   |                               |               |
| Money market mutual funds             |                               |                         | 41                            | 998           |
| Total marketable equity securities    | 127                           | 5,567                   | 41                            | 998           |
| Total temporarily impaired securities | \$ 1,458                      | \$ 44,737               | \$ 209                        | \$ 4,330      |

The Company determined no securities were other-than-temporarily impaired for the three months ended March 31, 2014. Management evaluates securities for other-than-temporary impairment on a quarterly basis, with more frequent evaluation for selected issuers or when economic or market concerns warrant such evaluations.

As of March 31, 2014, the net unrealized gain on the total debt securities portfolio was \$1.3 million. At March 31, 2014, 27 debt securities had unrealized losses with aggregate depreciation of 2.6% from the Company's amortized cost basis. In analyzing a debt issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, industry analysts reports and, to a lesser extent given the relatively insignificant levels of depreciation in the Company's debt portfolio, spread differentials between the effective rates on instruments in the portfolio compared to risk-free rates. The unrealized losses are primarily caused by (a) recent declines in profitability and near-term profit forecasts by industry analysts resulting from a decline in the level of business activity (b) recent downgrades by several industry analysts and (c) recent increases in interest rates. The contractual terms of these investments do not permit the issuers to settle the security at a price less than the par value of the investment. The Company currently does not believe it is probable that it will be unable to collect all amounts due according to the contractual terms of the investments. Therefore, it is expected that the bonds would not be settled at a price less than the par value of the investment. Because (1) the Company does not intend to sell the securities; (2) the Company does not believe it is more likely than not that the Company will be required to sell the securities before recovery of its amortized cost basis; and (3) the present value of

expected cash flows is sufficient to recover the entire amortized cost basis of the securities, the Company does not consider these investments to be other-than-temporarily impaired at March 31, 2014.

As of March 31, 2014, the net unrealized gain on the total marketable equity portfolio was \$6.1 million. At March 31, 2014, 25 marketable equity securities had unrealized losses with aggregate depreciation of 3.6% from the Company's cost basis. Although the issuers have shown declines in earnings as a result of the weakened economy, no credit issues have been identified that cause management to believe the decline in market value is other than temporary, and the Company has the ability and intent to hold these investments until a recovery of fair value. In analyzing an equity issuer's financial condition, management considers industry analysts' reports, financial performance and projected target prices of investment analysts within a one-year time frame. A decline of 10% or

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more in the value of an acquired equity security is generally the triggering event for management to review individual securities for liquidation and/or classification as other-than-temporarily impaired. Impairment losses are recognized when management concludes that declines in the value of equity securities are other than temporary, or when they can no longer assert that they have the intent and ability to hold depreciated equity securities for a period of time sufficient to allow for any anticipated recovery in fair value. Unrealized losses on marketable equity securities that are in excess of 25% of cost and that have been sustained for more than twelve months are generally considered-other-than-temporary and charged to earnings as impairment losses, or realized through sale of the security.

**5. LOANS**

The Company's loan portfolio consists primarily of residential real estate, commercial real estate, construction, commercial business and consumer segments. The residential real estate loans include classes for one-to four-family, multi-family and home equity lines of credit. There are no foreign loans outstanding. Interest rates charged on loans are affected principally by the demand for such loans, the supply of money available for lending purposes and the rates offered by our competitors. A summary of loans follows:

|                                    | <b>March 31, 2014</b>         |                | <b>December 31, 2013</b> |                |
|------------------------------------|-------------------------------|----------------|--------------------------|----------------|
|                                    | <b>Amount</b>                 | <b>Percent</b> | <b>Amount</b>            | <b>Percent</b> |
|                                    | <i>(Dollars in thousands)</i> |                |                          |                |
| Real estate loans:                 |                               |                |                          |                |
| Residential real estate:           |                               |                |                          |                |
| One- to four-family                | \$ 451,668                    | 19.3%          | \$ 454,148               | 19.8%          |
| Multi-family                       | 364,159                       | 15.5           | 288,172                  | 12.6           |
| Home equity lines of credit        | 51,572                        | 2.2            | 54,499                   | 2.4            |
| Commercial real estate             | 994,945                       | 42.4           | 1,032,408                | 45.0           |
| Construction                       | 204,863                       | 8.7            | 208,799                  | 9.1            |
| Total real estate loans            | 2,067,207                     | 88.1           | 2,038,026                | 88.9           |
| Commercial business loans          | 270,728                       | 11.6           | 247,005                  | 10.8           |
| Consumer                           | 7,648                         | 0.3            | 7,225                    | 0.3            |
| Total loans                        | 2,345,583                     | 100.0%         | 2,292,256                | 100.0%         |
| Allowance for loan losses          | (25,440)                      |                | (25,335)                 |                |
| Net deferred loan origination fees | (1,595)                       |                | (1,521)                  |                |
| Loans, net                         | \$ 2,318,548                  |                | \$ 2,265,400             |                |

The Company has transferred a portion of its originated commercial real estate loans to participating lenders. The amounts transferred have been accounted for as sales and are therefore not included in the Company's accompanying balance sheets. The Company and participating lenders share ratably in any gains or losses that may result from a borrower's lack of compliance with contractual terms of the loan. The Company continues to service the loans on behalf of the participating lenders and, as such, collects cash payments from the borrowers, remits payments to participating lenders and disburses required escrow funds to relevant parties. At March 31, 2014 and December 31,

2013, the Company was servicing loans for participants aggregating \$77.3 million and \$62.8 million, respectively.

As a result of the Mt. Washington Co-operative Bank acquisition in January 2010, the Company acquired loans at fair value of \$345.3 million. Included in this amount was \$27.7 million of loans with evidence of deterioration of credit quality since origination for which it was probable, at the time of the acquisition, that the Company would be unable to collect all contractually required payments receivable. The Company's evaluation of loans with evidence of credit deterioration as of the acquisition date resulted in a nonaccretable discount of \$7.6 million, which is defined as the loan's contractually required payments receivable in excess of the amount of its cash flows expected to be collected. The Company considered factors such as payment history, collateral values, and accrual status when determining whether there was evidence of deterioration of the loan's credit quality at the acquisition date.

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The following is a summary of the outstanding balance of the acquired loans with evidence of credit deterioration:

|                               | <b>March 31,<br/>2014</b> | <b>December 31,<br/>2013</b> |
|-------------------------------|---------------------------|------------------------------|
|                               | <i>(In thousands)</i>     |                              |
| Real estate loans:            |                           |                              |
| Residential real estate:      |                           |                              |
| One- to four-family           | \$ 6,455                  | \$ 6,494                     |
| Multi-family                  | 840                       | 846                          |
| Home equity lines of credit   | 509                       | 509                          |
| Commercial real estate        | 700                       | 720                          |
| Total real estate loans       | 8,504                     | 8,569                        |
| Commercial business loans     | 78                        | 78                           |
| Consumer                      | 4                         | 4                            |
| Outstanding principal balance | 8,586                     | 8,651                        |
| Discount                      | (2,205)                   | (2,215)                      |
| Carrying amount               | \$ 6,381                  | \$ 6,436                     |

A rollforward of accretable yield follows:

|                   | <b>Three Months Ended March 31,<br/>2014</b> | <b>2013</b> |
|-------------------|----------------------------------------------|-------------|
|                   | <i>(In thousands)</i>                        |             |
| Beginning balance | \$ 1,181                                     | \$ 1,047    |
| Accretion         | (11)                                         | (7)         |
| Ending balance    | \$ 1,170                                     | \$ 1,040    |

An analysis of the allowance for loan losses and related information follows:

|                                   | <b>One-<br/>to<br/>four-family</b> | <b>Multi-<br/>family</b> | <b>Home<br/>equity lines<br/>of credit</b> | <b>Commercial<br/>real<br/>estate</b> | <b>Commercial<br/>Construction</b> | <b>Commercial<br/>business</b> | <b>Consumer</b> | <b>Unallocated</b> | <b>Total</b> |
|-----------------------------------|------------------------------------|--------------------------|--------------------------------------------|---------------------------------------|------------------------------------|--------------------------------|-----------------|--------------------|--------------|
|                                   | <i>(In thousands)</i>              |                          |                                            |                                       |                                    |                                |                 |                    |              |
| <b>Allowance for loan losses:</b> | \$ 2,507                           | \$ 1,431                 | \$ 226                                     | \$ 10,405                             | \$ 3,656                           | \$ 2,174                       | \$ 105          | \$                 | \$ 20,504    |

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Balance at December 31,  
2012

|                                    |       |      |      |     |       |      |       |       |
|------------------------------------|-------|------|------|-----|-------|------|-------|-------|
| Provision (credit) for loan losses | (281) | (26) | (49) | 215 | 1,425 | (99) | 75    | 1,260 |
| Charge-offs                        | (108) | (90) |      |     | (627) |      | (132) | (957) |
| Recoveries                         | 32    |      |      |     | 5     | 3    | 36    | 76    |

Balance at March 31,  
2013

\$ 2,150   \$ 1,315   \$ 177   \$ 10,620   \$ 4,459   \$ 2,078   \$ 84   \$ 20,883

Balance at December 31,  
2013

|                                    |      |     |      |       |       |     |      |       |
|------------------------------------|------|-----|------|-------|-------|-----|------|-------|
| Provision (credit) for loan losses | (16) | 857 | (50) | (895) | (236) | 492 | (19) | 133   |
| Charge-offs                        | (54) |     |      | (12)  |       |     | (50) | (116) |
| Recoveries                         | 39   |     |      |       | 11    | 3   | 35   | 88    |

Balance at March 31,  
2014

\$ 1,960   \$ 3,276   \$ 105   \$ 11,924   \$ 4,149   \$ 3,928   \$ 98   \$ 25,440

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|                                                                                                                             | One- to<br>four-family | Multi-<br>family | Home<br>equity lines<br>of<br>credit | Commercial<br>real estate | Construction | Commercial<br>business | Consumer | Unallocated | Total        |
|-----------------------------------------------------------------------------------------------------------------------------|------------------------|------------------|--------------------------------------|---------------------------|--------------|------------------------|----------|-------------|--------------|
| <i>(In thousands)</i>                                                                                                       |                        |                  |                                      |                           |              |                        |          |             |              |
| <b>March 31,<br/>2014</b>                                                                                                   |                        |                  |                                      |                           |              |                        |          |             |              |
| Amount of<br>allowance for<br>loan losses for<br>loans deemed<br>to be impaired                                             | \$ 113                 | \$ 174           | \$                                   | \$ 9                      | \$ 101       | \$ 55                  | \$       | \$          | 452          |
| Amount of<br>allowance for<br>loan losses for<br>loans not<br>deemed to be<br>impaired                                      | 1,847                  | 3,102            | 105                                  | 11,915                    | 4,048        | 3,873                  | 98       |             | 24,988       |
|                                                                                                                             | \$ 1,960               | \$ 3,276         | \$ 105                               | \$ 11,924                 | \$ 4,149     | \$ 3,928               | \$ 98    | \$          | 25,440       |
| Amount of<br>allowance for<br>loan losses for<br>loans acquired<br>with<br>deteriorated<br>credit quality<br>included above | \$ 43                  | \$               | \$                                   | \$                        | \$           | \$                     | \$       | \$          | 43           |
| Loans deemed<br>to be impaired                                                                                              | \$ 4,277               | \$ 5,331         | \$ 21                                | \$ 9,454                  | \$ 13,944    | \$ 1,353               | \$       | \$          | 34,380       |
| Loans not<br>deemed to be<br>impaired                                                                                       | 447,391                | 358,828          | 51,551                               | 985,491                   | 190,919      | 269,375                | 7,648    |             | 2,311,203    |
|                                                                                                                             | \$ 451,668             | \$ 364,159       | \$ 51,572                            | \$ 994,945                | \$ 204,863   | \$ 270,728             | \$ 7,648 |             | \$ 2,345,583 |
| <b>December 31,<br/>2013</b>                                                                                                |                        |                  |                                      |                           |              |                        |          |             |              |
| Amount of<br>allowance for<br>loan losses for<br>loans deemed<br>to be impaired                                             | \$ 132                 | \$               | \$                                   | \$ 190                    | \$ 54        | \$                     | \$       | \$          | 376          |
| Amount of<br>allowance for                                                                                                  | 1,859                  | 2,419            | 155                                  | 12,641                    | 4,320        | 3,433                  | 132      |             | 24,959       |

loan losses for  
loans not  
deemed to be  
impaired

\$ 1,991 \$ 2,419 \$ 155 \$ 12,831 \$ 4,374 \$ 3,433 \$ 132 \$ 25,335

Amount of  
allowance for  
loan losses for  
loans acquired  
with  
deteriorated  
credit quality  
included above

\$ 44 \$ \$ 12 \$ \$ \$ \$ 56

Loans deemed  
to be impaired

\$ 4,089 \$ 4,002 \$ 21 \$ 10,820 \$ 13,308 \$ 1,232 \$ 33,472

Loans not  
deemed to be  
impaired

450,059 284,170 54,478 1,021,588 195,491 245,773 7,225 2,258,784

\$ 454,148 \$ 288,172 \$ 54,499 \$ 1,032,408 \$ 208,799 \$ 247,005 \$ 7,225 \$ 2,292,256

The following table provides information about the Company's past due and non-accrual loans:

|  | 30-59<br>Days<br>Past Due | 60-89<br>Days<br>Past Due | 90 Days<br>or Greater<br>Past Due | Total<br>Past<br>Due | Loans on<br>Non-accrual |
|--|---------------------------|---------------------------|-----------------------------------|----------------------|-------------------------|
|--|---------------------------|---------------------------|-----------------------------------|----------------------|-------------------------|

(In thousands)

### **March 31, 2014**

Real estate loans:

Residential real estate:

|                     |          |          |          |           |           |
|---------------------|----------|----------|----------|-----------|-----------|
| One- to four-family | \$ 4,255 | \$ 1,009 | \$ 6,371 | \$ 11,635 | \$ 16,684 |
|---------------------|----------|----------|----------|-----------|-----------|

|              |  |  |     |     |     |
|--------------|--|--|-----|-----|-----|
| Multi-family |  |  | 109 | 109 | 109 |
|--------------|--|--|-----|-----|-----|

|                             |     |  |       |       |       |
|-----------------------------|-----|--|-------|-------|-------|
| Home equity lines of credit | 766 |  | 1,144 | 1,910 | 2,636 |
|-----------------------------|-----|--|-------|-------|-------|

|                        |       |  |       |       |       |
|------------------------|-------|--|-------|-------|-------|
| Commercial real estate | 2,940 |  | 3,879 | 6,819 | 8,836 |
|------------------------|-------|--|-------|-------|-------|

|              |  |       |        |        |        |
|--------------|--|-------|--------|--------|--------|
| Construction |  | 1,033 | 10,144 | 11,177 | 12,772 |
|--------------|--|-------|--------|--------|--------|

|                         |       |       |        |        |        |
|-------------------------|-------|-------|--------|--------|--------|
| Total real estate loans | 7,961 | 2,042 | 21,647 | 31,650 | 41,037 |
|-------------------------|-------|-------|--------|--------|--------|

|                           |     |     |       |       |       |
|---------------------------|-----|-----|-------|-------|-------|
| Commercial business loans | 764 | 106 | 1,127 | 1,997 | 1,210 |
|---------------------------|-----|-----|-------|-------|-------|

|          |     |     |  |     |  |
|----------|-----|-----|--|-----|--|
| Consumer | 460 | 320 |  | 780 |  |
|----------|-----|-----|--|-----|--|

|       |          |          |           |           |           |
|-------|----------|----------|-----------|-----------|-----------|
| Total | \$ 9,185 | \$ 2,468 | \$ 22,774 | \$ 34,427 | \$ 42,247 |
|-------|----------|----------|-----------|-----------|-----------|

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|                             | <b>30-59<br/>Days<br/>Past Due</b> | <b>60-89<br/>Days<br/>Past Due</b> | <b>90 Days<br/>or Greater<br/>Past Due<br/>(In thousands)</b> | <b>Total<br/>Past<br/>Due</b> | <b>Loans on<br/>Non-accrual</b> |
|-----------------------------|------------------------------------|------------------------------------|---------------------------------------------------------------|-------------------------------|---------------------------------|
| <b>December 31, 2013</b>    |                                    |                                    |                                                               |                               |                                 |
| Real estate loans:          |                                    |                                    |                                                               |                               |                                 |
| Residential real estate:    |                                    |                                    |                                                               |                               |                                 |
| One- to four-family         | \$ 6,203                           | \$ 1,185                           | \$ 6,714                                                      | \$ 14,102                     | \$ 17,622                       |
| Multi-family                | 75                                 |                                    | 85                                                            | 160                           |                                 |
| Home equity lines of credit | 2,504                              | 178                                | 744                                                           | 3,426                         | 2,689                           |
| Commercial real estate      | 314                                |                                    | 2,742                                                         | 3,056                         | 8,972                           |
| Construction                | 497                                |                                    | 11,297                                                        | 11,794                        | 11,298                          |
| Total real estate loans     | 9,593                              | 1,363                              | 21,582                                                        | 32,538                        | 40,581                          |
| Commercial business loans   | 284                                | 50                                 | 852                                                           | 1,186                         | 949                             |
| Consumer                    | 461                                | 282                                |                                                               | 743                           |                                 |
| Total                       | \$ 10,338                          | \$ 1,695                           | \$ 22,434                                                     | \$ 34,467                     | \$ 41,530                       |

At March 31, 2014 and December 31, 2013, the Company did not have any accruing loans past due 90 days or more. Delinquent loans at March 31, 2014 and December 31, 2013 included \$1.4 million and \$1.3 million of loans acquired with evidence of credit deterioration. At both March 31, 2014 and December 31, 2013, non-accrual loans included \$1.2 million of loans acquired with evidence of credit deterioration.

The following tables provide information with respect to the Company's impaired loans:

|                                               | <b>March 31, 2014</b>          |                              |                              | <b>December 31, 2013</b>       |                              |                              |
|-----------------------------------------------|--------------------------------|------------------------------|------------------------------|--------------------------------|------------------------------|------------------------------|
|                                               | <b>Unpaid</b>                  |                              |                              | <b>Unpaid</b>                  |                              |                              |
|                                               | <b>Recorded<br/>Investment</b> | <b>Principal<br/>Balance</b> | <b>Related<br/>Allowance</b> | <b>Recorded<br/>Investment</b> | <b>Principal<br/>Balance</b> | <b>Related<br/>Allowance</b> |
| <i>(In thousands)</i>                         |                                |                              |                              |                                |                              |                              |
| Impaired loans without a valuation allowance: |                                |                              |                              |                                |                              |                              |
| One- to four-family                           | \$ 2,609                       | \$ 2,821                     |                              | \$ 2,399                       | \$ 2,699                     |                              |
| Multi-family                                  | 3,863                          | 3,862                        |                              | 4,002                          | 4,002                        |                              |
| Home equity lines of credit                   | 21                             | 21                           |                              | 21                             | 21                           |                              |
| Commercial real estate                        | 5,026                          | 5,266                        |                              | 9,327                          | 10,014                       |                              |
| Construction                                  | 11,844                         | 14,878                       |                              | 12,930                         | 15,926                       |                              |
| Commercial business loans                     | 1,148                          | 1,264                        |                              | 1,232                          | 1,635                        |                              |
| Total                                         | 24,511                         | 28,112                       |                              | 29,911                         | 34,297                       |                              |
| Impaired loans with a valuation allowance:    |                                |                              |                              |                                |                              |                              |
| One- to four-family                           | 1,668                          | 1,784                        | \$ 113                       | 1,690                          | 1,806                        | \$ 132                       |
| Multi-family                                  | 1,468                          | 1,468                        | 174                          |                                |                              |                              |

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|                           |               |               |            |               |               |            |
|---------------------------|---------------|---------------|------------|---------------|---------------|------------|
| Commercial real estate    | 4,428         | 4,915         | 9          | 1,493         | 1,493         | 190        |
| Construction              | 2,100         | 2,100         | 101        | 378           | 389           | 54         |
| Commercial business loans | 205           | 494           | 55         |               |               |            |
| <b>Total</b>              | <b>9,869</b>  | <b>10,761</b> | <b>452</b> | <b>3,561</b>  | <b>3,688</b>  | <b>376</b> |
| <br>Total impaired loans  | <br>\$ 34,380 | <br>\$ 38,873 | <br>\$ 452 | <br>\$ 33,472 | <br>\$ 37,985 | <br>\$ 376 |

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|                             | Three Months Ended March 31,      |                                  |                                                |                                   |                                  |                                                |
|-----------------------------|-----------------------------------|----------------------------------|------------------------------------------------|-----------------------------------|----------------------------------|------------------------------------------------|
|                             | 2014                              |                                  |                                                | 2013                              |                                  |                                                |
|                             | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized | Interest<br>Income<br>Recognized on Cash Basis | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized | Interest<br>Income<br>Recognized on Cash Basis |
|                             | <i>(In thousands)</i>             |                                  |                                                |                                   |                                  |                                                |
| One- to four-family         | \$ 4,090                          | \$ 53                            | \$ 43                                          | \$ 4,610                          | \$ 59                            | \$ 48                                          |
| Multi-family                | 5,358                             | 77                               | 103                                            | 5,715                             | 109                              | 109                                            |
| Home equity lines of credit | 21                                |                                  |                                                | 22                                |                                  |                                                |
| Commercial real estate      | 9,502                             | 142                              | 59                                             | 11,466                            | 165                              | 74                                             |
| Construction                | 13,618                            | 234                              | 54                                             | 17,843                            | 269                              | 158                                            |
| Commercial business loans   | 1,364                             | 25                               | 8                                              | 413                               | 8                                | 5                                              |
| <b>Total impaired loans</b> | <b>\$ 33,953</b>                  | <b>\$ 531</b>                    | <b>\$ 267</b>                                  | <b>\$ 40,069</b>                  | <b>\$ 610</b>                    | <b>\$ 394</b>                                  |

At March 31, 2014, additional funds of \$5.9 million are committed to be advanced in connection with impaired construction loans.

The following table summarizes the TDRs at the dates indicated:

|                                         | March 31,<br>2014     | December 31,<br>2013 |
|-----------------------------------------|-----------------------|----------------------|
|                                         | <i>(In thousands)</i> |                      |
| <b>TDRs on accrual status:</b>          |                       |                      |
| One- to four-family                     | \$ 2,574              | \$ 2,588             |
| Multi-family                            | 1,359                 | 109                  |
| Home equity lines of credit             | 21                    | 21                   |
| Commercial real estate                  |                       | 1,368                |
| Commercial business loans               | 142                   |                      |
| <b>Total TDRs on accrual status</b>     | <b>4,096</b>          | <b>4,086</b>         |
| <b>TDRs on non-accrual status:</b>      |                       |                      |
| One- to four-family                     | 1,703                 | 1,500                |
| Multi-family                            | 109                   |                      |
| Commercial real estate                  | 4,283                 | 4,309                |
| Construction                            | 9,544                 | 9,489                |
| Commercial business loans               | 186                   | 192                  |
| <b>Total TDRs on non-accrual status</b> | <b>15,825</b>         | <b>15,490</b>        |
| <b>Total TDRs</b>                       | <b>\$ 19,921</b>      | <b>\$ 19,576</b>     |

For the three months ended March 31, 2014 and 2013, new troubled debt restructurings were immaterial. The Company generally places loans modified as TDRs on non-accrual status for a minimum period of six months. Loans

modified as TDRs qualify for return to accrual status once they have demonstrated performance with the modified terms of the loan agreement for a minimum of six months and future payments are reasonably assured. TDRs are reported as impaired loans with an allowance established as part of the allocated component of the allowance for loan losses when the discounted cash flows of the impaired loan is lower than the carrying value of that loan. TDRs may be removed from impairment disclosures in the year following the restructure if the borrower demonstrates compliance with the modified terms and the restructuring agreement specifies an interest rate equal to that which would be provided to a borrower with similar credit at the time of restructuring.

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The Company utilizes a nine grade internal loan rating system for multi-family, commercial real estate, construction and commercial loans as follows:

*Loans rated 1, 2, 3 and 3A:* Loans in these categories are considered pass rated loans with low to average risk.

*Loans rated 4 and 4A:* Loans in these categories are considered special mention. These loans are starting to show signs of potential weakness and are being closely monitored by management.

*Loans rated 5:* Loans in this category are considered substandard. Generally, a loan is considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligors and/or the collateral pledged. There is a distinct possibility that the Company will sustain some loss if the weakness is not corrected.

*Loans rated 6:* Loans in this category are considered doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, highly questionable and improbable.

*Loans rated 7:* Loans in this category are considered uncollectible (loss) and of such little value that their continuance as loans is not warranted.

On an annual basis, or more often if needed, the Company formally reviews the ratings on all multi-family, commercial real estate, construction and commercial business loans. The Company also engages an independent third-party to review a significant portion of loans within these segments on at least an annual basis. Management uses the results of these reviews as part of its annual review process.

The following tables provide information with respect to the Company's risk rating:

|                       | March 31, 2014                                |                              |              |                        | December 31, 2013                             |                           |              |                        |
|-----------------------|-----------------------------------------------|------------------------------|--------------|------------------------|-----------------------------------------------|---------------------------|--------------|------------------------|
|                       | Multi-family<br>residential<br>real<br>estate | Commercial<br>real<br>estate | Construction | Commercial<br>business | Multi-family<br>residential<br>real<br>estate | Commercial<br>real estate | Construction | Commercial<br>business |
|                       | <i>(In thousands)</i>                         |                              |              |                        |                                               |                           |              |                        |
| Loans rated 1<br>- 3A | \$ 346,436                                    | \$ 979,245                   | \$ 174,139   | \$ 269,065             | \$ 275,711                                    | \$ 1,015,172              | \$ 178,980   | \$ 245,646             |
| Loans rated 4<br>- 4A | 5,551                                         | 4,492                        |              | 232                    | 1,665                                         | 4,315                     |              | 4                      |
| Loans rated 5         | 12,172                                        | 11,208                       | 30,724       | 1,431                  | 10,796                                        | 12,921                    | 29,819       | 1,355                  |
| Loans rated 6         |                                               |                              |              |                        |                                               |                           |              |                        |

Loans rated 7

|       |            |            |            |            |            |              |            |            |
|-------|------------|------------|------------|------------|------------|--------------|------------|------------|
| Total | \$ 364,159 | \$ 994,945 | \$ 204,863 | \$ 270,728 | \$ 288,172 | \$ 1,032,408 | \$ 208,799 | \$ 247,005 |
|-------|------------|------------|------------|------------|------------|--------------|------------|------------|

For one- to four-family real estate loans, home equity lines of credit and consumer loans, management uses delinquency reports as the key credit quality indicator.

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A summary of deposit balances, by type follows:

|                                           | <b>March 31,<br/>2014</b> | <b>December 31,<br/>2013</b> |
|-------------------------------------------|---------------------------|------------------------------|
|                                           | <i>(In thousands)</i>     |                              |
| Demand deposits                           | \$ 265,078                | \$ 255,639                   |
| NOW deposits                              | 253,263                   | 210,277                      |
| Money market deposits                     | 851,460                   | 847,360                      |
| Regular savings and other deposits        | 268,342                   | 259,608                      |
| <b>Total non-certificate accounts</b>     | <b>1,638,143</b>          | <b>1,572,884</b>             |
| <br>Term certificates less than \$100,000 | <br>294,261               | <br>296,525                  |
| Term certificates \$100,000 and greater   | 385,075                   | 379,191                      |
| <br>Total term certificates               | <br>679,336               | <br>675,716                  |
| <br><b>Total deposits</b>                 | <br><b>\$ 2,317,479</b>   | <br><b>\$ 2,248,600</b>      |

A summary of term certificates, by maturity, follows:

|                         | <b>March 31, 2014</b>         |                          | <b>December 31, 2013</b> |                          |
|-------------------------|-------------------------------|--------------------------|--------------------------|--------------------------|
| Maturing                | Amount                        | Weighted<br>Average Rate | Amount                   | Weighted<br>Average Rate |
|                         | <i>(Dollars in thousands)</i> |                          |                          |                          |
| Within 1 year           | \$ 443,565                    | 1.05%                    | \$ 440,178               | 1.08%                    |
| Over 1 year to 2 years  | 145,463                       | 1.50                     | 140,466                  | 1.48                     |
| Over 2 years to 3 years | 53,534                        | 1.58                     | 55,628                   | 1.75                     |
| Over 3 years to 4 years | 14,207                        | 1.68                     | 18,703                   | 1.82                     |
| Over 4 years to 5 years | 19,477                        | 1.48                     | 17,685                   | 1.47                     |
| Greater than 5 years    | 3,090                         | 5.14                     | 3,056                    | 5.13                     |
|                         | <b>\$ 679,336</b>             | <b>1.23%</b>             | <b>\$ 675,716</b>        | <b>1.27%</b>             |

**7. BORROWINGS**

Long-term debt consists of FHLB advances as follows:

| Maturing | March 31, 2014 |                                                    | December 31, 2013 |                          |
|----------|----------------|----------------------------------------------------|-------------------|--------------------------|
|          | Amount         | Weighted<br>Average Rate<br>(Dollars in thousands) | Amount            | Weighted<br>Average Rate |
| 2014     | \$             | %                                                  | \$ 4,000          | 2.37%                    |
| 2015     | 39,500         | 1.20                                               | 19,500            | 2.05                     |
| 2016     | 31,500         | 1.36                                               | 16,500            | 1.97                     |
| 2017     | 87,500         | 1.31                                               | 77,500            | 1.35                     |
| 2018     | 25,000         | 1.19                                               | 25,000            | 1.19                     |
| 2019     | 9,768          | 1.23                                               | 10,203            | 1.23                     |
| 2020     | 8,855          | 1.22                                               | 9,200             | 1.22                     |
|          | \$ 202,123     | 1.28%                                              | \$ 161,903        | 1.48%                    |

At March 31, 2014, advances amounting to \$6.5 million are callable by the FHLB prior to maturity.

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As of March 31, 2014, the Company also has an available line of credit of \$9.4 million with the FHLB at an interest rate that adjusts daily. No amounts were drawn on the line of credit as of March 31, 2014 and December 31, 2013. All borrowings from the FHLB are secured by investment securities (see Note 4) and qualified collateral, consisting of a blanket lien on one- to four-family loans and certain multi-family and commercial real estate loans held in the Bank's portfolio. At March 31, 2014, the Company pledged multi-family and commercial real estate loans with carrying values totaling \$62.2 million and \$234.5 million, respectively.

**8. COMMITMENTS AND DERIVATIVES**

In the normal course of business, there are outstanding commitments which are not reflected in the accompanying consolidated financial statements.

***Loan Commitments***

The Company is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. The instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the accompanying consolidated balance sheets. The contract amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the counterparty to the financial instrument for loan commitments is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments as it does for on-balance sheet instruments.

A summary of outstanding financial instruments whose contract amounts represent credit risk is as follows:

|                                           | <b>March 31,<br/>2014</b> | <b>December 31,<br/>2013</b> |
|-------------------------------------------|---------------------------|------------------------------|
|                                           | <b>(In thousands)</b>     |                              |
| Unadvanced portion of existing loans:     |                           |                              |
| Construction                              | \$ 234,842                | \$ 239,977                   |
| Home equity line of credit                | 37,693                    | 37,422                       |
| Other lines and letters of credit         | 122,153                   | 104,956                      |
| Commitments to originate:                 |                           |                              |
| One- to four-family                       | 11,635                    | 11,592                       |
| Commercial real estate                    | 79,875                    | 92,526                       |
| Construction                              | 76,336                    | 83,439                       |
| Commercial business loans                 | 31,440                    | 39,928                       |
| Other loans                               | 790                       | 3,749                        |
| <b>Total loan commitments outstanding</b> | <b>\$ 594,764</b>         | <b>\$ 613,589</b>            |

Commitments to originate loans are agreements to lend to a customer provided there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may

require payment of a fee. Since a portion of the commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. The Company evaluates each customer's credit worthiness on a case by case basis. The amount of collateral obtained, if deemed necessary by the Company for the extension of credit, is based upon management's credit evaluation of the borrower. Collateral held includes, but is not limited to, residential real estate and deposit accounts.

Unfunded commitments under lines of credit are commitments for possible future extensions of credit to existing customers. These lines of credit are collateralized if deemed necessary and usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Company is committed. Letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

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***Derivative Loan Commitments***

Residential real estate loan commitments are referred to as derivative loan commitments if the loan that will result from exercise of the commitment will be held for sale upon funding. The Company enters into commitments to fund residential real estate loans at specified times in the future, with the intention that these loans will subsequently be sold in the secondary market. A residential loan commitment requires the Company to originate a loan at a specific interest rate upon the completion of various underwriting requirements. Outstanding derivative loan commitments expose the Company to the risk that the price of the loans arising from the exercise of the loan commitment might decline from the inception of the rate lock to funding of the loan due to increases in loan interest rates. If interest rates increase, the value of these commitments decreases. Conversely, if interest rates decrease, the value of these loan commitments increases. Derivative loan commitments with a notional amount of \$10.2 million and \$4.8 million were outstanding at March 31, 2014 and December 31, 2013, respectively. The fair value of such commitments was a net asset of \$51,000 and \$13,000 at March 31, 2014 and December 31, 2013, respectively.

***Forward Loan Sale Commitments***

To protect against the price risk inherent in derivative loan commitments, the Company utilizes both mandatory delivery and best efforts forward loan sale commitments to mitigate the risk of potential decreases in the values of loans that would result from the exercise of the derivative loan commitments. Under a mandatory delivery contract, the Company commits to deliver a certain principal amount of mortgage loans to an investor at a specified price on or before a specified date. If the Company fails to deliver the amount of mortgages necessary to fulfill the commitment by the specified date, it is obligated to pay the investor a pair-off fee, based then-current market prices, to compensate the investor for the shortfall. Under a best efforts contract, the Company commits to deliver an individual mortgage loan of a specified principal amount and quality to an investor and the investor commits to a price that it will purchase the loan from the Company if the loan to the underlying borrower closes. The Company generally enters into forward sale contracts on the same day it commits to lend funds to a potential borrower. The Company expects that these forward loan sale commitments will experience changes in fair value opposite to the change in fair value of derivative loan commitments. Forward loan sale commitments with a notional amount of \$10.8 million and \$7.0 million were outstanding at March 31, 2014 and December 31, 2013, respectively. The fair value of such commitments was a net asset of \$39,000 and \$75,000 at March 31, 2014 and December 31, 2013, respectively.

***Derivative Financial Instruments***

The Company is a party to interest rate derivatives that are not designated as hedging instruments. These derivatives relate to interest rate swaps that the Company enters into with commercial business customers to synthetically convert their loans from a variable rate to a fixed rate. The Company pays interest to the customer at a floating rate on the notional amount and receives interest from the customer at a fixed rate for the same notional amount. Concurrently, the Company enters into an offsetting interest rate swap with a 3<sup>rd</sup> party financial institution. In the offsetting swap, the Company pays the other financial institution interest at the same fixed rate on the same notional amount as the swap entered into with the customer, and receives interest from the financial institution for the same floating rate on the same notional amount. The changes in the fair value of the swaps offset each other, except for the credit risk of the counterparties, which is determined by taking into consideration the risk rating, probability of default and loss of given default for all counterparties. At both March 31, 2014 and December 31, 2013, the Company had \$300,000 in cash pledged as collateral on its interest rate swap with the 3<sup>rd</sup> party financial institution.

Summary information regarding these derivatives is presented below:

|                              |                 |          |                    |                        | Fair Value     |                   |
|------------------------------|-----------------|----------|--------------------|------------------------|----------------|-------------------|
|                              | Notional Amount | Maturity | Interest Rate Paid | Interest Rate Received | March 31, 2014 | December 31, 2013 |
|                              |                 |          | (In thousands)     |                        |                |                   |
| Customer interest rate swap  | \$ 11,268       | 10/17/33 | 1 Mo Libor + 175bp | Fixed (4.1052%)        | \$ 306         | \$ 57             |
| 3rd party interest rate swap | 11,268          | 10/17/33 | Fixed (4.1052%)    | 1 Mo Libor + 175bp     | (306)          | (57)              |

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The following table presents the fair values of derivative instruments in the balance sheet.

|                                | <b>Assets</b>        |                       | <b>Liabilities</b>   |              |
|--------------------------------|----------------------|-----------------------|----------------------|--------------|
|                                | <b>Balance Sheet</b> | <b>Fair</b>           | <b>Balance Sheet</b> | <b>Fair</b>  |
|                                | <b>Location</b>      | <b>Value</b>          | <b>Location</b>      | <b>Value</b> |
|                                |                      | <i>(In thousands)</i> |                      |              |
| <b>March 31, 2014</b>          |                      |                       |                      |              |
| Derivative loan commitments    | Other assets         | \$ 77                 | Other liabilities    | \$ 26        |
| Forward loan sale commitments  | Other assets         | 51                    | Other liabilities    | 12           |
| Loan level interest rate swaps | Other assets         | 306                   | Other liabilities    | 306          |
| Total                          |                      | \$ 434                |                      | \$ 344       |
| <b>December 31, 2013</b>       |                      |                       |                      |              |
| Derivative loan commitments    | Other assets         | \$ 38                 | Other liabilities    | \$ 25        |
| Forward loan sale commitments  | Other assets         | 82                    | Other liabilities    | 7            |
| Loan level interest rate swaps | Other assets         | 57                    | Other liabilities    | 57           |
| Total                          |                      | \$ 177                |                      | \$ 89        |

The following table presents information pertaining to gains (losses) on the Company's derivative instruments included in the consolidated statement of income.

| <b>Derivative Instrument</b>  | <b>Location of Gain/(Loss)</b> | <b>Three Months Ended March 31,</b> |             |
|-------------------------------|--------------------------------|-------------------------------------|-------------|
|                               |                                | <b>2014</b>                         | <b>2013</b> |
|                               |                                | <i>(In thousands)</i>               |             |
| Derivative loan commitments   | Mortgage banking gains, net    | \$ 38                               | \$ (69)     |
| Forward loan sale commitments | Mortgage banking gains, net    | (36)                                | (8)         |
| Total                         |                                | \$ 2                                | \$ (77)     |

For the three months ended March 31, 2014, the Company recognized net mortgage banking gains of \$120,000, consisting of \$118,000 in net gains on sale of loans and \$2,000 in net derivative mortgage banking gains. The Company recognized net mortgage banking gains of \$155,000, consisting of \$232,000 in net gains on sale of loans and \$77,000 in net derivative mortgage banking losses for the three months ended March 31, 2013.

**Other Commitments**

In July 2010, we extended the contract with our core data processing provider through December 2017. This contract extension resulted in an outstanding commitment of \$8.4 million as of March 31, 2014, with total annual payments of \$2.2 million.

## **9. FAIR VALUES OF ASSETS AND LIABILITIES**

### ***Determination of Fair Value***

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The fair value of assets and liabilities is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various assets and liabilities. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the asset or liability.

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The following methods and assumptions were used by the Company in estimating fair value disclosures:

**Cash and cash equivalents** The carrying amounts of cash and short-term instruments approximate fair values, based on the short-term nature of the assets.

**Securities available for sale** All fair value measurements are obtained from a third party pricing service and are not adjusted by management. Marketable equity securities are measured at fair value utilizing quoted market prices (Level 1). Corporate bonds, obligations of government-sponsored enterprises, municipal bonds and mortgage-backed securities are determined by pricing models that consider standard input factors such as observable market data, benchmark yields, reported trades, broker/dealer quotes, credit spreads, benchmark securities, as well as new issue data, monthly payment information, and collateral performance, among others (Level 2).

**Federal Home Loan Bank stock** The carrying value of Federal Home Loan Bank stock approximates fair value based on the redemption provisions of the Federal Home Loan Bank.

**Loans held for sale** The fair value is based on commitments in effect from investors or prevailing market prices.

**Loans** For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for other loans are estimated using discounted cash flow analyses, using market interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for non-accrual loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

**Deposits** The fair values disclosed for non-certificate accounts are, by definition, equal to the amount payable on demand at the reporting date which is their carrying amounts. Fair values for certificates of deposit are estimated using a discounted cash flow calculation that applies market interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

**Borrowings** The fair value is estimated using discounted cash flow analyses based on the current incremental borrowing rates in the market for similar types of borrowing arrangements.

**Accrued interest** The carrying amounts of accrued interest approximate fair value.

**Forward loan sale commitments and derivative loan commitments** Forward loan sale commitments and derivative loan commitments are based on fair values of the underlying mortgage loans and the probability of such commitments being exercised. Management judgment and estimation is required in determining these fair value measurements.

**Loan level interest rate swaps** The fair value is based on settlement values adjusted for credit risks associated with the counterparties and the Company and observable market interest rate curves.

**Off-balance sheet credit-related instruments** Fair values for off-balance-sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The fair value of these instruments is considered immaterial.

**Table of Contents*****Assets and Liabilities Measured at Fair Value on a Recurring Basis***

Assets and liabilities measured at fair value on a recurring basis are summarized as follows:

|                                 | Level 1          | Level 2           | Level 3       | Total<br>Fair<br>Value |
|---------------------------------|------------------|-------------------|---------------|------------------------|
| <i>(In thousands)</i>           |                  |                   |               |                        |
| <b><u>March 31, 2014</u></b>    |                  |                   |               |                        |
| <b>Assets:</b>                  |                  |                   |               |                        |
| Debt securities                 | \$               | \$ 131,502        | \$            | \$ 131,502             |
| Marketable equity securities    | 59,859           |                   |               | 59,859                 |
| Derivative loan commitments     |                  |                   | 77            | 77                     |
| Forward loan sale commitments   |                  |                   | 51            | 51                     |
| Loan level interest rate swaps  |                  |                   | 306           | 306                    |
| <b>Total assets</b>             | <b>\$ 59,859</b> | <b>\$ 131,502</b> | <b>\$ 434</b> | <b>\$ 191,795</b>      |
| <b>Liabilities:</b>             |                  |                   |               |                        |
| Derivative loan commitments     | \$               | \$                | \$ 26         | \$ 26                  |
| Forward loan sale commitments   |                  |                   | 12            | 12                     |
| Loan level interest rate swaps  |                  |                   | 306           | 306                    |
| <b>Total liabilities</b>        | <b>\$</b>        | <b>\$</b>         | <b>\$ 344</b> | <b>\$ 344</b>          |
| <b><u>December 31, 2013</u></b> |                  |                   |               |                        |
| <b>Assets:</b>                  |                  |                   |               |                        |
| Debt securities                 | \$               | \$ 145,788        | \$            | \$ 145,788             |
| Marketable equity securities    | 55,349           |                   |               | 55,349                 |
| Derivative loan commitments     |                  |                   | 38            | 38                     |
| Forward loan sale commitments   |                  |                   | 82            | 82                     |
| Loan level interest rate swaps  |                  |                   | 57            | 57                     |
| <b>Total assets</b>             | <b>\$ 55,349</b> | <b>\$ 145,788</b> | <b>\$ 177</b> | <b>\$ 201,314</b>      |
| <b>Liabilities:</b>             |                  |                   |               |                        |
| Derivative loan commitments     | \$               | \$                | \$ 25         | \$ 25                  |
| Forward loan sale commitments   |                  |                   | 7             | 7                      |
| Loan level interest rate swaps  |                  |                   | 57            | 57                     |
| <b>Total liabilities</b>        | <b>\$</b>        | <b>\$</b>         | <b>\$ 89</b>  | <b>\$ 89</b>           |

For the three months ended March 31, 2014 and 2013, there were no transfers in or out of Levels 1 and 2 and the

changes in Level 3 assets and liabilities that are measured at fair value on a recurring basis are as follows:

|                                                                      | <b>Three Months Ended March 31,</b> |             |
|----------------------------------------------------------------------|-------------------------------------|-------------|
|                                                                      | <b>2014</b>                         | <b>2013</b> |
|                                                                      | <i>(In thousands)</i>               |             |
| Derivative loan commitments and forward sale commitments, net:       |                                     |             |
| Beginning balance                                                    | \$ 88                               | \$ 276      |
| Total realized and unrealized losses included in net income          | 2                                   | (77)        |
| Ending balance                                                       | \$ 90                               | \$ 199      |
| Total realized gain relating to instruments still held at period end | \$ 90                               | \$ 199      |

**Table of Contents*****Assets Measured at Fair Value on a Non-recurring Basis***

The Company may also be required, from time to time, to measure certain other assets on a non-recurring basis in accordance with generally accepted accounting principles. These adjustments to fair value usually result from the application of lower-of-cost-or market accounting or write-downs of individual assets.

The following tables summarize the fair value hierarchy used to determine each adjustment and the carrying value of the related individual assets. The gain/loss represents the amount of write-down, charge-off or specific reserve recorded during the periods noted on the assets held at period end. There were no liabilities measured at fair value on a non-recurring basis.

|                        | <b>March 31, 2014</b> |         |           | <b>Three Months Ended<br/>March 31, 2014</b> |
|------------------------|-----------------------|---------|-----------|----------------------------------------------|
|                        | Level 1               | Level 2 | Level 3   | Total<br>Losses                              |
|                        | <i>(In thousands)</i> |         |           |                                              |
| Impaired loans         | \$                    | \$      | \$ 18,784 | \$ (57)                                      |
| Foreclosed real estate |                       |         | 850       |                                              |
|                        | \$                    | \$      | \$ 19,634 | \$ (57)                                      |

|                        | <b>December 31, 2013</b> |         |            | <b>Three Months Ended<br/>March 31, 2013</b> |
|------------------------|--------------------------|---------|------------|----------------------------------------------|
|                        | Level 1                  | Level 2 | Level<br>3 | Total<br>Losses                              |
|                        | <i>(In thousands)</i>    |         |            |                                              |
| Impaired loans         | \$                       | \$      | \$ 8,000   | \$ (780)                                     |
| Foreclosed real estate |                          |         | 1,390      | (16)                                         |
|                        | \$                       | \$      | \$ 9,390   | \$ (796)                                     |

Certain impaired loans were adjusted to fair value, less cost to sell, of the underlying collateral securing these loans resulting in losses. The loss is not recorded directly as an adjustment to current earnings, but rather as a component in determining the allowance for loan losses. Fair value was measured using appraised values of collateral and adjusted as necessary by management based on unobservable inputs for specific properties.

Certain properties in foreclosed real estate were adjusted to fair value using appraised values of collateral, less cost to sell, and adjusted as necessary by management based on unobservable inputs for specific properties. The loss on foreclosed assets represents adjustments in valuation recorded during the time period indicated and not for losses incurred on sales.

**Table of Contents****Summary of Fair Values of Financial Instruments**

The estimated fair values, and related carrying amounts, of the Company's financial instruments are as follows. Certain financial instruments and all nonfinancial instruments are exempt from disclosure requirements. Accordingly, the aggregate fair value amounts presented herein do not represent the underlying fair value of the Company.

|                                                    | Carrying<br>Amount | Level 1    | Fair Value     |           | Total      |
|----------------------------------------------------|--------------------|------------|----------------|-----------|------------|
|                                                    |                    |            | Level 2        | Level 3   |            |
|                                                    |                    |            | (In thousands) |           |            |
| <b>March 31, 2014</b>                              |                    |            |                |           |            |
| Financial assets:                                  |                    |            |                |           |            |
| Cash and due from banks                            | \$ 156,632         | \$ 156,632 | \$             | \$        | \$ 156,632 |
| Securities available for sale                      | 191,361            | 59,859     | 131,502        |           | 191,361    |
| Federal Home Loan Bank stock                       | 11,989             |            |                | 11,989    | 11,989     |
| Loans and loans held for sale, net                 | 2,319,756          |            |                | 2,347,714 | 2,347,714  |
| Accrued interest receivable                        | 7,008              |            |                | 7,008     | 7,008      |
| Financial liabilities:                             |                    |            |                |           |            |
| Deposits                                           | 2,317,479          |            |                | 2,321,843 | 2,321,843  |
| Borrowings                                         | 202,123            |            | 200,973        |           | 200,973    |
| Accrued interest payable                           | 832                |            |                | 832       | 832        |
| On-balance sheet derivative financial instruments: |                    |            |                |           |            |
| Assets:                                            |                    |            |                |           |            |
| Derivative loan commitments                        | 77                 |            |                | 77        | 77         |
| Forward loan sale commitments                      | 51                 |            |                | 51        | 51         |
| Loan level interest rate swaps                     | 306                |            |                | 306       | 306        |
| Liabilities:                                       |                    |            |                |           |            |
| Derivative loan commitments                        | 26                 |            |                | 26        | 26         |
| Forward loan sale commitments                      | 12                 |            |                | 12        | 12         |
| Loan level interest rate swaps                     | 306                |            |                | 306       | 306        |
| <b>December 31, 2013</b>                           |                    |            |                |           |            |
| Financial assets:                                  |                    |            |                |           |            |
| Cash and due from banks                            | \$ 86,271          | \$ 86,271  | \$             | \$        | \$ 86,271  |
| Securities available for sale                      | 201,137            | 55,349     | 145,788        |           | 201,137    |
| Federal Home Loan Bank stock                       | 11,907             |            |                | 11,907    | 11,907     |
| Loans and loans held for sale, net                 | 2,267,763          |            |                | 2,298,488 | 2,298,488  |
| Accrued interest receivable                        | 7,127              |            |                | 7,127     | 7,127      |
| Financial liabilities:                             |                    |            |                |           |            |
| Deposits                                           | 2,248,600          |            |                | 2,253,543 | 2,253,543  |
| Borrowings                                         | 161,903            |            | 160,581        |           | 160,581    |
| Accrued interest payable                           | 818                |            |                | 818       | 818        |
| On-balance sheet derivative financial instruments: |                    |            |                |           |            |
| Assets:                                            |                    |            |                |           |            |
| Derivative loan commitments                        | 38                 |            |                | 38        | 38         |

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|                                |    |    |    |
|--------------------------------|----|----|----|
| Forward loan sale commitments  | 82 | 82 | 82 |
| Loan level interest rate swaps | 57 | 57 | 57 |
| Liabilities:                   |    |    |    |
| Derivative loan commitments    | 25 | 25 | 25 |
| Forward loan sale commitments  | 7  | 7  | 7  |
| Loan level interest rate swaps | 57 | 57 | 57 |

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**10. SUBSEQUENT EVENTS**

On May 9, 2014, the U.S. Securities and Exchange Commission declared effective the registration statement filed by Meridian Bancorp, Inc. with respect to the conversion described in Note 1. Basis of Presentation. In addition, on May 9, 2014, the Massachusetts Commissioner of Banks authorized the commencement of Meridian Bancorp, Inc.'s stock offering and the use of the information statement to be sent to incorporators of Meridian in connection with the conversion.

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Management's discussion and analysis reflects our consolidated financial statements and other relevant statistical data, and is intended to enhance your understanding of our financial condition and results of operations. You should read the information in this section in conjunction with our business and financial information and the Consolidated Financial Statements and related notes included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2013, filed with the Securities and Exchange Commission.

**Forward Looking Statements**

This report contains forward-looking statements that are based on assumptions and may describe future plans, strategies and expectations of the Company. These forward-looking statements are generally identified by use of the words believe, expect, intend, anticipate, estimate, project or similar expressions. The Company's ability to achieve the results or the actual effect of future plans or strategies is inherently uncertain. Factors which could have a material adverse effect on the operations of the Company and its subsidiaries include, but are not limited to:

general economic conditions, either nationally or in our market area, that are worse than expected;

inflation and changes in the interest rate environment that reduce our interest margins or reduce the fair value of financial instruments;

increased competitive pressures among financial services companies;

changes in consumer spending, borrowing and savings habits;

our ability to enter new markets successfully and take advantage of growth opportunities, and the possible dilutive effect of potential acquisitions or *de novo* branches, if any;

legislative or regulatory changes that adversely affect our business;

adverse changes in the securities markets;

changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Financial Accounting Standards Board or the Securities and Exchange Commission;

inability of third-party providers to perform their obligations to us; and

changes in our organization, compensation and benefit plans.

Management's ability to predict results or the effect of future plans or strategies is inherently uncertain. These factors include, but are not limited to, general economic conditions, changes in the interest rate environment, legislative or regulatory changes that may adversely affect our business, changes in accounting policies and practices, changes in competition and demand for financial services, adverse changes in the securities markets and changes in the quality or composition of the Company's loan or investment portfolios. Additional factors that may affect our results are discussed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2013 filed with the Securities and Exchange Commission on March 17, 2014, under "Risk Factors," which is available through the SEC's website at [www.sec.gov](http://www.sec.gov), as updated by subsequent filings with the SEC. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Except as required by applicable law or regulation, the Company does not undertake, and specifically disclaims any obligation, to release publicly the result of any revisions that may be made to any forward-looking statements to reflect events or circumstances after the date of the statements or to reflect the occurrence of anticipated or unanticipated events.

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### **Critical Accounting Policies**

A summary of significant accounting policies is described in Note 1 to the Consolidated Financial Statements included in the 2013 Annual Report on Form 10-K for the year ended December 31, 2013. Critical accounting estimates are necessary in the application of certain accounting policies and procedures and are particularly susceptible to significant change. Critical accounting policies are defined as those involving significant judgments and assumptions by management that could have a material impact on the carrying value of certain assets or on income under different assumptions or conditions. Management believes that the most critical accounting policies are the allowance for loan losses, the evaluation of goodwill for impairment, other-than-temporary impairment of securities and the valuation of deferred tax assets.

### **Comparison of Financial Condition at March 31, 2014 and December 31, 2013**

**Assets.** Our total assets increased \$113.0 million, or 4.2%, to \$2.795 billion at March 31, 2014 from \$2.682 billion at December 31, 2013. Net loans increased \$53.1 million, or 2.3%, to \$2.319 billion at March 31, 2014 from \$2.265 billion at December 31, 2013. Cash and due from banks increased \$70.4 million, or 81.6%, to \$156.6 million at March 31, 2014 from \$86.3 million at December 31, 2013. Securities available for sale decreased \$9.8 million, or 4.9%, to \$191.4 million at March 31, 2014 from \$201.1 million at December 31, 2013.

**Loan Portfolio.** At March 31, 2014, net loans were \$2.319 billion, or 82.9% of total assets. During the three months ended March 31, 2014, net loans increased \$53.1 million, or 2.3%. The increase was primarily due to a \$23.7 million increase in the commercial business loan portfolio and a \$15.1 million increase in multi-family loans, excluding a reclassification during the current quarter of \$60.9 million of commercial real estate loans to multi-family loans in accordance with regulatory guidance. Refer to Note 5 *Loans* in the Notes to the Unaudited Consolidated Financial Statements within this report for more detail regarding the loans held in the Company's loan portfolio.

**Credit Risk Management.** Our strategy for credit risk management focuses on having well-defined credit policies and uniform underwriting criteria and providing prompt attention to potential problem loans. Management of asset quality is accomplished by internal controls, monitoring and reporting of key risk indicators, and both internal and independent third-party loan reviews. The primary objective of our loan review process is to measure borrower performance and assess risk for the purpose of identifying loan weakness in order to minimize loan loss exposure. From the time of loan origination through final repayment, multi-family, commercial real estate, construction and commercial business loans are assigned a risk rating based on pre-determined criteria and levels of risk. The risk rating is monitored annually for most loans; however, it may change during the life of the loan as appropriate.

Internal and independent third-party loan reviews vary by loan type, as well as the nature and complexity of the loan. Depending on the size and complexity of the loan, some loans may warrant detailed individual review, while other loans may have less risk based upon size, or be of a homogeneous nature reducing the need for detailed individual analysis. Assets with these characteristics, such as consumer loans and loans secured by residential real estate, may be reviewed on the basis of risk indicators such as delinquency or credit rating. In cases of significant concern, a total re-evaluation of the loan and associated risks are documented by completing a loan risk assessment and action plan. Some loans may be re-evaluated in terms of their fair market value or net realizable value in order to determine the likelihood of potential loss exposure and, consequently, the adequacy of specific and general loan loss reserves.

When a borrower fails to make a required loan payment, we take a number of steps to have the borrower cure the delinquency and restore the loan to current status, including contacting the borrower by letter and phone at regular intervals. When the borrower is in default, we may commence collection proceedings. If a foreclosure action is instituted and the loan is not brought current, paid in full, or refinanced before the foreclosure sale, the real property

securing the loan generally is sold at foreclosure. Management informs the Executive Committee monthly of the amount of loans delinquent more than 30 days. Management provides detailed information to the Board of Directors on loans 60 or more days past due and all loans in foreclosure and repossessed property that we own.

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**Delinquencies.** Total past due loans decreased \$40,000, or 0.1%, to \$34.4 million at March 31, 2014 from \$34.5 million at December 31, 2013, reflecting an increase of \$340,000 in loans 90 days or greater past due and a decrease of \$380,000 in loans 30 to 89 days past due. Delinquent loans at March 31, 2014 included \$9.8 million of loans acquired in the Mt. Washington Co-operative Bank merger completed in January 2010, including \$2.0 million that were 30 to 59 days past due, \$832,000 that were 60 to 89 days past due and \$7.0 million that were 90 days or greater past due. At March 31, 2014, non-accrual loans exceeded loans 90 days or greater past due primarily due to loans which were placed on non-accrual status based on a determination that the ultimate collection of all principal and interest due was not expected and certain loans that remain on non-accrual status until they attain a sustained payment history of six months.

**Non-performing Assets.** Non-performing assets include loans that are 90 or more days past due or on non-accrual status, including troubled debt restructurings ( TDRs ) on non-accrual status, and real estate and other loan collateral acquired through foreclosure and repossession. Loans 90 days or greater past due may remain on an accrual basis if adequately collateralized and in the process of collection. At March 31, 2014, we did not have any accruing loans past due 90 days or greater. For non-accrual loans, interest previously accrued but not collected is reversed and charged against income at the time a loan is placed on non-accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Real estate that we acquire as a result of foreclosure or by deed-in-lieu of foreclosure is classified as foreclosed real estate until it is sold. When property is acquired, it is initially recorded at the fair value less costs to sell at the date of foreclosure, establishing a new cost basis. Holding costs and declines in fair value after acquisition of the property result in charges against income.

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

|                                             | <b>March 31,<br/>2014</b>     | <b>December 31,<br/>2013</b> |
|---------------------------------------------|-------------------------------|------------------------------|
|                                             | <i>(Dollars in thousands)</i> |                              |
| Loans accounted for on a non-accrual basis: |                               |                              |
| Real estate loans:                          |                               |                              |
| Residential real estate:                    |                               |                              |
| One- to four-family                         | \$ 16,684                     | \$ 17,622                    |
| Multi-family                                | 109                           |                              |
| Home equity lines of credit                 | 2,636                         | 2,689                        |
| Commercial real estate                      | 8,836                         | 8,972                        |
| Construction                                | 12,772                        | 11,298                       |
| Total real estate loans                     | 41,037                        | 40,581                       |
| Commercial business loans                   | 1,210                         | 949                          |
| Total non-accrual loans (1)                 | 42,247                        | 41,530                       |
| Foreclosed assets                           | 850                           | 1,390                        |
| Total non-performing assets                 | \$ 43,097                     | \$ 42,920                    |

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|                                       |       |       |
|---------------------------------------|-------|-------|
| Non-accrual loans to total loans      | 1.80% | 1.81% |
| Non-accrual loans to total assets     | 1.51% | 1.55% |
| Non-performing assets to total assets | 1.54% | 1.60% |

(1) TDRs on accrual status not included above totaled \$4.1 million at both March 31, 2014 and December 31, 2013.

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Non-performing assets increased to \$43.1 million or 1.54% of total assets, at March 31, 2014, from \$42.9 million, or 1.60% of total assets, at December 31, 2013. Non-performing assets at March 31, 2014 included \$15.3 million of assets acquired in the Mt. Washington merger, all of which were non-accrual loans. Interest income that would have been recorded for the three months ended March 31, 2014 had non-accruing loans been current according to their original terms amounted to \$350,000. We recognized \$290,000 of interest income, on a cash basis, on such loans for the three months ended March 31, 2014. Construction loans, including related foreclosed real estate, represented approximately 31.6% of our non-performing assets at March 31, 2014. Approximately \$8.3 million, or 65.3%, of our \$12.8 million of non-accrual construction loans at March 31, 2014 relate to the following three construction projects originated in 2007 and 2008.

A construction loan relationship collateralized by a 42 unit townhouse development project located in eastern Massachusetts, originated for \$3.7 million with an aggregate balance of \$3.1 million at March 31, 2014. This loan relationship was modified with a new borrower as a TDR in 2011 based on a common guarantor. The property was appraised in May 2013 for \$3.2 million based on the as is market value of the then-remaining 28 unsold units, including 22 units where construction had not begun. As of March 31, 2014, 16 completed units were sold. The loan relationship is also collateralized by other properties owned by the guarantors consisting of a second mortgage with a first mortgage of less than \$300,000 on a commercial property and first mortgages on two residential properties in northern Massachusetts, appraised in early 2013 with a cumulative value of \$1.5 million. This loan relationship is secured by multiple guarantors including one individual guarantor. Foreclosure proceedings on the other properties owned by the guarantors were stayed due to the individual guarantor's Chapter 7 bankruptcy filing. The bankruptcy was dismissed by the court in March 2014 and we are proceeding with the foreclosure sales.

A construction loan relationship collateralized by a 45 unit townhouse development project located in eastern Massachusetts originated for \$11.2 million with an aggregate balance of \$3.0 million at March 31, 2014 after loan charge-offs totaling \$996,000. This loan relationship was modified as a TDR in 2013 with an extension of the maturity date to allow for loan repayments of \$3.2 million during the year ended December 31, 2013. An additional modification was made to this loan relationship in January 2014 with an increase in the principal balance and an extension to the maturity date to allow for completion of the project. The property was appraised in March 2014 for \$7.7 million based on the as complete value of the then remaining 8 unsold units. As of March 31, 2014, 37 units have been sold, five units are under sales agreements and marketing activity continues for the three remaining units. The principal developer is the co-borrower on the loan relationship. We expect the sales proceeds from the remaining eight units to be sufficient to repay the remaining loan balance.

A construction loan relationship collateralized by a seven lot single-family residential development project located in Nantucket, Massachusetts originated for \$5.4 million with a balance of \$2.2 million as of March 31, 2014 after loan charge-offs totaling \$1.7 million. This loan relationship was modified as a TDR in 2010 with a reduction of the interest rate and an extension of the maturity date. The property was appraised in May 2013 for \$1.8 million based on the developer cost approach. This loan relationship is also collateralized by other properties,

owned by the individual co-borrowers, which consist of a second mortgage on a single family residence located in Nantucket, Massachusetts with a first mortgage of less than \$600,000 and a first mortgage on a single family residence located in Rhode Island. The Nantucket, Massachusetts single family property was appraised in May 2013 for \$855,000 and the Rhode Island single family residence was appraised in June 2013 for \$407,000. We have filed foreclosure actions on all collateral. The residential development project foreclosure action was stayed by the corporate entity's Chapter 11 bankruptcy filing. The corporate entity's Chapter 11 bankruptcy filing was converted to a Chapter 7 bankruptcy filing and we will proceed with the foreclosure sale once relief is obtained or the case is discharged, whichever occurs first. We have entered into a forbearance agreement with the borrowers for the Rhode Island collateral only to allow for the orderly disposition of the property and collection of net proceeds.

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Together, these three non-accrual construction loan relationships comprised 19.7% of total non-accrual loans at March 31, 2014.

Non-accrual loans increased \$717,000, or 1.7%, to \$42.2 million, or 1.80% of total loans outstanding at March 31, 2014, from \$41.5 million, or 1.81% of total loans outstanding at December 31, 2013. At March 31, 2014, our allowance for loan losses was \$25.4 million, or 1.08% of total loans and 60.2% of non-accrual loans, compared to \$25.3 million, or 1.11% of total loans and 61.0% of non-accrual loans at December 31, 2013. Included in our allowance at March 31, 2014 was a general component of \$25.0 million, which is based upon our evaluation of various factors relating to loans not deemed to be impaired. We continue to believe our level of non-accrual loans and assets, which declined significantly during the past two years, is manageable and we believe that we have sufficient capital and human resources to manage the collection of our non-performing assets in an orderly fashion.

Foreclosed real estate decreased \$540,000, or 38.8%, to \$850,000 at March 31, 2014 from \$1.4 million at December 31, 2013. At March 31, 2014, foreclosed real estate consisted of one townhouse construction development project. We continue to be actively engaged with our borrowers in resolving remaining problem assets and with the effective management of real estate owned as a result of foreclosures.

***Troubled Debt Restructurings.*** In the course of resolving loans of borrowers with financial difficulties, we may choose to restructure the contractual terms of certain loans, with terms modified to fit the ability of the borrower to repay in line with its current financial status. A loan is considered a troubled debt restructure if, for reasons related to the debtor's financial difficulties, a concession is granted to the debtor that would not otherwise be considered.

Total TDRs increased \$345,000, or 1.8%, to \$19.9 million at March 31, 2014 from \$19.6 million at December 31, 2013. Modifications of one- to four-family TDRs consist of rate reductions, loan term extensions or provisions for interest-only payments for specified periods up to 12 months. We have generally been successful with the concessions we have offered to borrowers to date. We generally return TDRs to accrual status when they have sustained payments for six months based on the restructured terms and future payments are reasonably assured. Interest income that would have been recorded for the three months ended March 31, 2014 had TDRs been current according to their original terms amounted to \$230,000. We recognized \$60,000 of interest income on TDRs for the three months ended March 31, 2014.

***Potential Problem Loans.*** Certain loans are identified during our loan review process that are currently performing in accordance with their contractual terms and we expect to receive payment in full of principal and interest, but it is deemed probable that we will be unable to collect all the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. This may result from deteriorating conditions such as cash flows, collateral values or creditworthiness of the borrower. These loans are classified as impaired but are not accounted for on a non-accrual basis.

Other potential problem loans are those loans that are currently performing, but where known information about possible credit problems of the borrowers causes us to have concerns as to the ability of such borrowers to comply with contractual loan repayment terms. These other potential problem loans are generally loans classified as substandard or 5-rated loans in accordance with our nine-grade internal loan rating system that is consistent with guidelines established by banking regulators. At March 31, 2014, other potential problem loans totaled \$25.2 million, including \$16.8 million of construction loans, \$6.7 million of multi-family loans and \$1.7 million of commercial real estate.



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**Allowance for Loan Losses.** The allowance for loan losses is maintained at levels considered adequate by management to provide for probable loan losses inherent in the loan portfolio as of the consolidated balance sheet reporting dates. The allowance for loan losses is based on management's assessment of various factors affecting the loan portfolio, including portfolio composition, delinquent and non-accrual loans, national and local business conditions and loss experience and an overall evaluation of the quality of the underlying collateral.

Changes in the allowance for loan losses during the periods indicated were as follows:

|                                              | <b>Three Months Ended March 31,</b> |             |
|----------------------------------------------|-------------------------------------|-------------|
|                                              | <b>2014</b>                         | <b>2013</b> |
|                                              | <i>(Dollars in thousands)</i>       |             |
| Beginning balance                            | \$ 25,335                           | \$ 20,504   |
| Provision for loan losses                    | 133                                 | 1,260       |
| Charge offs:                                 |                                     |             |
| Residential real estate:                     |                                     |             |
| One- to four-family                          | (54)                                | (108)       |
| Multi-family                                 |                                     | (90)        |
| Commercial real estate                       | (12)                                |             |
| Construction                                 |                                     | (627)       |
| Consumer                                     | (50)                                | (132)       |
| Total charge-offs                            | (116)                               | (957)       |
| Recoveries:                                  |                                     |             |
| Residential real estate:                     |                                     |             |
| One- to four-family                          | 39                                  | 32          |
| Construction                                 | 11                                  | 5           |
| Commercial business                          | 3                                   | 3           |
| Consumer                                     | 35                                  | 36          |
| Total recoveries                             | 88                                  | 76          |
| Net charge-offs                              | (28)                                | (881)       |
| Ending balance                               | \$ 25,440                           | \$ 20,883   |
| Allowance to non-accrual loans               | 60.22%                              | 45.22%      |
| Allowance to total loans outstanding         | 1.08%                               | 1.12%       |
| Net charge-offs to average loans outstanding | 0.00%                               | 0.19%       |

Our provision for loan losses was \$133,000 for the three months ended March 31, 2014 compared to \$1.3 million for the three months ended March 31, 2013. The changes in the provision for loan losses were based on management's assessment of loan portfolio growth and composition changes, a decline in historical charge-off trends, an ongoing evaluation of credit quality and improving economic conditions. The allowance for loan losses was \$25.4 million or 1.08% of total loans outstanding at March 31, 2014, compared to \$20.9 million or 1.12% of total loans outstanding at March 31, 2013. The increase in the allowance for loan losses was primarily due to increases in the multi-family,

commercial real estate, construction and commercial business loan categories, as such loans have higher inherent credit risk than loans in our residential real estate loan categories. We continue to assess the adequacy of our allowance for loan losses in accordance with established policies.

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The following tables set forth the breakdown of the allowance for loan losses by loan category at the dates indicated:

|                               | March 31, 2014 |                                         |                                             | December 31, 2013 |                                         |                                             |
|-------------------------------|----------------|-----------------------------------------|---------------------------------------------|-------------------|-----------------------------------------|---------------------------------------------|
|                               | Amount         | Percent of Allowance to Total Allowance | Percent of Loans in Category of Total Loans | Amount            | Percent of Allowance to Total Allowance | Percent of Loans in Category of Total Loans |
| <i>(Dollars in thousands)</i> |                |                                         |                                             |                   |                                         |                                             |
| Real estate loans:            |                |                                         |                                             |                   |                                         |                                             |
| Residential real estate:      |                |                                         |                                             |                   |                                         |                                             |
| One- to four-family           | \$ 1,960       | 7.7%                                    | 19.3%                                       | \$ 1,991          | 7.9%                                    | 19.8%                                       |
| Multi-family                  | 3,276          | 12.9                                    | 15.5                                        | 2,419             | 9.5                                     | 12.6                                        |
| Home equity lines of credit   | 105            | 0.4                                     | 2.2                                         | 155               | 0.6                                     | 2.4                                         |
| Commercial real estate        | 11,924         | 46.9                                    | 42.4                                        | 12,831            | 50.6                                    | 45.0                                        |
| Construction                  | 4,149          | 16.3                                    | 8.7                                         | 4,374             | 17.3                                    | 9.1                                         |
| Total real estate loans       | 21,414         | 84.2                                    | 88.1                                        | 21,770            | 85.9                                    | 88.9                                        |
| Commercial business loans     | 3,928          | 15.4                                    | 11.6                                        | 3,433             | 13.6                                    | 10.8                                        |
| Consumer                      | 98             | 0.4                                     | 0.3                                         | 132               | 0.5                                     | 0.3                                         |
| Total loans                   | \$ 25,440      | 100.0%                                  | 100.0%                                      | \$ 25,335         | 100.0%                                  | 100.0%                                      |

The allowance consists of general and allocated components. The general component relates to pools of non-impaired loans and is based on historical loss experience adjusted for qualitative factors. The allocated component relates to loans that are classified as impaired, whereby an allowance is established when the discounted cash flows, collateral value or observable market price of the impaired loan is lower than the carrying value of that loan.

We had impaired loans totaling \$34.4 million and \$33.5 million as of March 31, 2014 and December 31, 2013, respectively. A loan is considered impaired when, based on current information and events, it is probable that we will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Impairment is measured on a loan by loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. At March 31, 2014, impaired loans totaling \$9.9 million had a valuation allowance of \$452,000. Impaired loans totaling \$3.6 million had a valuation allowance of \$376,000 at December 31, 2013. Our average investment in impaired loans was \$34.0 million and \$40.1 million for the three months ended March 31, 2014 and 2013, respectively.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment based on payment status. Accordingly, we do not separately identify individual one- to four-family residential and consumer loans for impairment disclosures, unless such loans are subject to a troubled debt restructuring. We periodically may agree to modify the contractual terms of loans. When a loan is modified and a concession is made to a borrower experiencing financial difficulty, the modification is considered a TDR. All TDRs are initially classified as impaired.

We review residential and commercial loans for impairment based on the fair value of collateral, if collateral-dependent, or the present value of expected cash flows. Management has reviewed the collateral value for all impaired and non-accrual loans that were collateral-dependent as of March 31, 2014 and considered any probable loss in determining the allowance for loan losses.

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For residential loans measured for impairment based on the collateral value, we will do the following:

When a loan becomes seriously delinquent, generally 60 days past due, we obtain third-party appraisals that are generally the basis for charge-offs when a loss is indicated, prior to the foreclosure sale, but usually no later than when such loans are 180 days past due. We generally are able to complete the foreclosure process within six to nine months from receipt of the third-party appraisal.

We make adjustments to appraisals based on updated economic information, if necessary, prior to the foreclosure sale. We review current market factors to determine whether, in management's opinion, downward adjustments to the most recent appraised values may be warranted. If so, we use our best estimate to apply an estimated discount rate to the appraised values to reflect current market factors.

Appraisals we receive are based on comparable property sales.

For commercial loans measured for impairment based on the collateral value, we will do the following:

We obtain a third party appraisal at the time a loan is deemed to be in a workout situation and there is no indication that the loan will return to performing status, generally when the loan is 90 days or more past due. One or more updated third party appraisals are obtained prior to foreclosure depending on the foreclosure timeline. In general we order new appraisals annually on loans in the process of foreclosure.

We make downward adjustments to appraisals when conditions warrant. Adjustments are made by applying a discount to the appraised value based on occupancy, recent changes in condition to the property and certain other factors. Adjustments are also made to appraisals for construction projects involving residential properties based on recent sales of units. Losses are recognized if the appraised value less estimated costs to sell is less than our carrying value of the loan.

Appraisals we receive are generally based on a reconciliation of comparable property sales and income capitalization approaches. For loans on construction projects involving residential properties, appraisals are generally based on a discounted cash flow analysis assuming a bulk sale to a single buyer.

Loans that are partially charged off generally remain on non-accrual status until foreclosure or such time that they are performing in accordance with the terms of the loan and have a sustained payment history of at least six months. The accrual of interest is generally discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectability of principal or interest, even though the loan is currently performing. Loan losses are charged against the allowance when we believe the uncollectability of a loan balance is confirmed; for collateral-dependent loans, generally when appraised values (as adjusted values, if applicable) less estimated costs to sell, are less than our carrying values.

Although we believe that we use the best information available to establish the allowance for loan losses, future adjustments to the allowance for loan losses may be necessary and our results of operations could be adversely affected if circumstances differ substantially from the assumptions used in making the determinations. Furthermore, while we believe we have established our allowance for loan losses in conformity with generally accepted accounting principles in the United States of America, there can be no assurance that regulators, in reviewing our loan portfolio, will not require us to increase our allowance for loan losses. In addition, because future events affecting borrowers and collateral cannot be predicted with certainty, there can be no assurance that the existing allowance for loan losses is adequate or that increases will not be necessary should the quality of any loans deteriorate as a result of the factors discussed above. Any material increase in the allowance for loan losses may adversely affect our financial condition and results of operations.

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**Securities Portfolio.** At March 31, 2014, our securities portfolio was \$191.4 million, or 6.8% of total assets. At that date, 41.4% of the securities portfolio, or \$79.2 million, was invested in corporate bonds. The amortized cost and fair value of corporate bonds in the financial services sector was \$51.7 million, and \$52.7 million, respectively. The remainder of the corporate bond portfolio includes companies from a variety of industries. Refer to Note 4 *Securities Available for Sale* in the Notes to the Unaudited Consolidated Financial Statements within this report for more detail regarding the investments held in the Company's securities portfolio.

At March 31, 2014, we had no investments in a single company or entity, other than Government-sponsored enterprises, that had an aggregate book value in excess of 10% of our equity.

Money market mutual funds included in the marketable equity securities portfolio totaled \$1.6 million at March 31, 2014 and \$2.0 million at December 31, 2013.

Each reporting period, we evaluate all securities with a decline in fair value below the amortized cost of the investment to determine whether or not the impairment is deemed to be other-than-temporary ( OTTI ). OTTI is required to be recognized if (1) we intend to sell the security; (2) it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis; or (3) for debt securities, the present value of expected cash flows is not sufficient to recover the entire amortized cost basis. Marketable equity securities are evaluated for OTTI based on the severity and duration of the impairment and, if deemed to be other than temporary, the declines in fair value are reflected in earnings as realized losses. For impaired debt securities that we intend to sell, or more likely than not will be required to sell, the full amount of the depreciation is recognized as OTTI through earnings. For all other impaired debt securities, credit-related OTTI is recognized through earnings and non-credit related OTTI is recognized in other comprehensive income/loss, net of applicable taxes.

At March 31, 2014, unrealized losses in our debt portfolio ranged from 0% to 4.3% of amortized cost, and unrealized losses in our equity portfolio ranged from 0% to 13.3% of cost. As of March 31, 2014, the net unrealized gain on the total debt securities portfolio was \$1.3 million. The most significant market valuation decrease related to any one debt security within the portfolio at March 31, 2014 is \$82,000. We have no indication that the issuer will be unable to continue to service the obligations, and management does intend not to sell, and more likely than not will not be required to sell, such bond before the earlier of recovery or maturity. As a result, management considers the decline in market value to be temporary. No other debt securities had a market decline greater than 3.4% of amortized cost.

As of March 31, 2014 the net unrealized gain on the total marketable equity securities portfolio was \$6.1 million. The most significant market valuation decrease related to any one equity security within the portfolio at March 31, 2014 is \$103,000. Although the issuers have shown declines in earnings as a result of the weakened economy, no credit issues have been identified that cause management to believe the decline in market value is other than temporary, and we have the ability and intent to hold these investments until a recovery of fair value. In analyzing an equity issuer's financial condition, management considers industry analysts' reports, financial performance and projected target prices of investment analysts within a one-year time frame.

**Deposits.** Deposits are a major source of our funds for lending and other investment purposes. Deposit inflows and outflows are significantly influenced by general interest rates and money market conditions. Our deposit base is comprised of demand, NOW, money market, regular savings and other deposits, and certificates of deposit. We consider demand, NOW, money market, and regular savings and other deposits to be core deposits. Total deposits increased \$68.9 million, or 3.1%, to \$2.317 billion at March 31, 2014 from \$2.249 billion at December 31, 2013. Our continuing focus on the acquisition and expansion of core deposit relationships resulted in net growth in those non-term deposits of \$65.3 million, or 4.1%, to \$1.638 billion at March 31, 2014, or 70.7% of total deposits at that date. For further information about our borrowings, refer to Note 6 *Deposits* in Notes to the Unaudited Consolidated

Financial Statements within this report.

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The following table sets forth the average balances of deposits for the periods indicated.

|                                    | Three Months Ended March 31,  |                 |                                 |                    |                 |                                 |
|------------------------------------|-------------------------------|-----------------|---------------------------------|--------------------|-----------------|---------------------------------|
|                                    | 2014                          |                 |                                 | 2013               |                 |                                 |
|                                    | Average<br>Balance            | Average<br>Rate | Percent<br>of Total<br>Deposits | Average<br>Balance | Average<br>Rate | Percent<br>of Total<br>Deposits |
|                                    | <i>(Dollars in thousands)</i> |                 |                                 |                    |                 |                                 |
| Demand deposits                    | \$ 257,122                    |                 | % 11.5%                         | \$ 200,162         |                 | % 11.0%                         |
| NOW deposits                       | 216,795                       | 0.56            | 10.9                            | 175,732            | 0.53            | 9.3                             |
| Money market deposits              | 851,592                       | 0.88            | 36.7                            | 616,801            | 0.89            | 32.1                            |
| Regular savings and other deposits | 262,386                       | 0.26            | 11.6                            | 246,854            | 0.26            | 12.9                            |
| Certificates of deposit            | 678,808                       | 1.24            | 29.3                            | 648,882            | 1.38            | 34.7                            |
| Total                              | \$ 2,266,703                  | 0.79%           | 100.0%                          | \$ 1,888,431       | 0.85%           | 100.0%                          |

**Borrowings.** We use borrowings from the Federal Home Loan Bank of Boston to supplement our supply of funds for loans and investments. In addition, we may also purchase federal funds from local banking institutions as an additional short-term funding source for the Bank. Total borrowings increased \$40.2 million, or 24.8%, to \$202.1 million at March 31, 2014 from \$161.9 million at December 31, 2013, reflecting new advances with the Federal Home Loan Bank of Boston totaling \$45.0 million with terms of one to three years and fixed interest rates of 0.33% to 0.99% during the three months ended March 31, 2014. At March 31, 2014 and December 31, 2013, Federal Home Loan Bank of Boston advances totaled \$202.1 million and \$161.9 million, respectively, with a weighted average rate of 1.28% and 1.48%, respectively. At March 31, 2014, we also had an available line of credit of \$9.4 million with the Federal Home Loan Bank of Boston at an interest rate that adjusts daily, none of which was outstanding at that date. For further information about our borrowings, refer to Note 7 *Borrowings* in Notes to the Unaudited Consolidated Financial Statements within this report.

Information relating to borrowings, including the federal funds purchased, is detailed in the following table.

|                                                  | Three Months Ended March 31,  |            |
|--------------------------------------------------|-------------------------------|------------|
|                                                  | 2014                          | 2013       |
|                                                  | <i>(Dollars in thousands)</i> |            |
| Balance outstanding at end of period             | \$ 202,123                    | \$ 186,721 |
| Average amount outstanding during the period     | \$ 183,868                    | \$ 177,006 |
| Weighted average interest rate during the period | 1.37%                         | 1.93%      |
| Maximum outstanding at any month end             | \$ 202,123                    | \$ 186,899 |
| Weighted average interest rate at end of period  | 1.28%                         | 2.07%      |

**Stockholders' Equity.** Total stockholders' equity increased \$5.4 million, or 2.2%, to \$254.6 million at March 31, 2014, from \$249.2 million at December 31, 2013. The increase was due primarily to \$4.8 million in net income and \$566,000 related to stock-based compensation plans. Stockholders' equity to assets was 9.11% at March 31, 2014, compared to 9.29% at December 31, 2013. Book value per share increased to \$11.45 at March 31, 2014 from \$11.21 at December 31, 2013. Tangible book value per share increased to \$10.83 at March 31, 2014 from \$10.60 at

December 31, 2013. At March 31, 2014, the Company and the Bank continued to exceed all regulatory capital requirements. For further information regarding regulatory capital requirements and the actual capital amounts and ratios for the Bank and the Company, refer to *Capital Management*.

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**Average Balance Sheets and Related Yields and Rates.** The following table presents information regarding average balances of assets and liabilities, the total dollar amounts of interest income and dividends from average interest-earning assets, the total dollar amounts of interest expense on average interest-bearing liabilities and the resulting annualized average yields and costs. The yields and costs for the periods indicated are derived by dividing income or expense by the average balances of assets or liabilities, respectively, for the periods presented. For purposes of this table, average balances have been calculated using daily average balances, and non-accrual loans are included in average balances but are not deemed material. Loan fees are included in interest income on loans but are not material.

| Three Months Ended March 31,                |                    |              |                        |                    |              |                       |
|---------------------------------------------|--------------------|--------------|------------------------|--------------------|--------------|-----------------------|
|                                             | 2014               |              |                        | 2013               |              |                       |
|                                             | Average<br>Balance | Interest (1) | Yield/<br>Cost (1)(2)  | Average<br>Balance | Interest (1) | Yield/<br>Cost (1)(2) |
|                                             |                    |              | (Dollars in thousands) |                    |              |                       |
| <b>Assets:</b>                              |                    |              |                        |                    |              |                       |
| Interest-earning assets:                    |                    |              |                        |                    |              |                       |
| Loans (3)                                   | \$ 2,312,889       | \$ 25,029    | 4.39%                  | \$ 1,829,617       | \$ 21,050    | 4.67%                 |
| Securities and certificates of deposits     | 195,268            | 1,240        | 2.58                   | 252,626            | 1,713        | 2.75                  |
| Other interest-earning assets (4)           | 101,703            | 90           | 0.36                   | 116,171            | 64           | 0.22                  |
| Total interest-earning assets               | 2,609,860          | 26,359       | 4.10                   | 2,198,414          | 22,827       | 4.21                  |
| Noninterest-earning assets                  | 111,774            |              |                        | 121,645            |              |                       |
| Total assets                                | \$ 2,721,634       |              |                        | \$ 2,320,059       |              |                       |
| <b>Liabilities and stockholders equity:</b> |                    |              |                        |                    |              |                       |
| Interest-bearing liabilities:               |                    |              |                        |                    |              |                       |
| NOW deposits                                | \$ 216,795         | 301          | 0.56                   | \$ 175,732         | 231          | 0.53                  |
| Money market deposits                       | 851,592            | 1,857        | 0.88                   | 616,801            | 1,355        | 0.89                  |
| Regular savings and other deposits          | 262,386            | 168          | 0.26                   | 246,854            | 161          | 0.26                  |
| Certificates of deposit                     | 678,808            | 2,079        | 1.24                   | 648,882            | 2,201        | 1.38                  |
| Total interest-bearing deposits             | 2,009,581          | 4,405        | 0.89                   | 1,688,269          | 3,948        | 0.95                  |
| Borrowings                                  | 183,868            | 621          | 1.37                   | 177,006            | 842          | 1.93                  |
| Total interest-bearing liabilities          | 2,193,449          | 5,026        | 0.93                   | 1,865,275          | 4,790        | 1.04                  |
| Noninterest-bearing demand deposits         | 257,122            |              |                        | 200,162            |              |                       |
| Other noninterest-bearing liabilities       | 19,756             |              |                        | 18,762             |              |                       |
| Total liabilities                           | 2,470,327          |              |                        | 2,084,199          |              |                       |
| Total stockholders equity                   | 251,307            |              |                        | 235,860            |              |                       |
|                                             | \$ 2,721,634       |              |                        | \$ 2,320,059       |              |                       |

Total liabilities and stockholders  
equity

|                                                                         |            |            |
|-------------------------------------------------------------------------|------------|------------|
| Net interest-earning assets                                             | \$ 416,411 | \$ 333,139 |
| Fully tax-equivalent net interest income                                | 21,333     | 18,037     |
| Less: tax-equivalent adjustments                                        | (731)      | (411)      |
| Net interest income                                                     | \$ 20,602  | \$ 17,626  |
| Interest rate spread (1)(5)                                             | 3.17%      | 3.17%      |
| Net interest margin (1)(6)                                              | 3.32%      | 3.33%      |
| Average interest-earning assets to average interest-bearing liabilities | 118.98%    | 117.86%    |

**Supplemental Information:**

|                                                                              |              |          |       |              |          |       |
|------------------------------------------------------------------------------|--------------|----------|-------|--------------|----------|-------|
| Total deposits, including noninterest-bearing demand deposits                | \$ 2,266,703 | \$ 4,405 | 0.79% | \$ 1,888,431 | \$ 3,948 | 0.85% |
| Total deposits and borrowings, including noninterest-bearing demand deposits | \$ 2,450,571 | \$ 5,026 | 0.83% | \$ 2,065,437 | \$ 4,790 | 0.94% |

*(footnotes begin on following page)*

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- (1) Income on debt securities, equity securities and revenue bonds included in commercial real estate loans, resulting yields, and interest rate spread and net interest margin, are presented on a tax-equivalent basis. The tax-equivalent adjustments are deducted from tax-equivalent net interest income to agree to amounts reported in the consolidated statements of net income. For the three months ended March 31, 2014 and 2013, yields on loans before tax-equivalent adjustments were 4.28% and 4.61%, respectively, yields on securities and certificates of deposit before tax-equivalent adjustments were 2.29% and 2.50%, respectively, and yield on total interest-earning assets before tax-equivalent adjustments were 3.98% and 4.14%, respectively. Interest rate spread before tax-equivalent adjustments for the three months ended March 31, 2014 and 2013 was 3.05% and 3.10%, respectively, while net interest margin before tax-equivalent adjustments for the three months ended March 31, 2014 and 2013 was 3.20% and 3.25%, respectively.
- (2) Annualized.
- (3) Loans on non-accrual status are included in average balances.
- (4) Includes Federal Home Loan Bank stock and associated dividends.
- (5) Interest rate spread represents the difference between the tax-equivalent yield on interest-earning assets and the cost of interest-bearing liabilities.
- (6) Net interest margin represents net interest income (tax-equivalent basis) divided by average interest-earning assets.

**Rate/Volume Analysis.** The following table sets forth the effects of changing rates and volumes on our fully tax-equivalent net interest income. The rate column shows the effects attributable to changes in rate (changes in rate multiplied by prior volume). The volume column shows the effects attributable to changes in volume (changes in volume multiplied by prior rate). The net column represents the sum of the prior columns. For purposes of this table, changes attributable to changes in both rate and volume that cannot be segregated have been allocated proportionally based on the changes due to rate and the changes due to volume.

|                                                        | <b>Three Months Ended March 31,<br/>2014 Compared to 2013<br/>Increase (Decrease) Due to</b> |                |              |
|--------------------------------------------------------|----------------------------------------------------------------------------------------------|----------------|--------------|
|                                                        | <b>Volume</b>                                                                                | <b>Rate</b>    | <b>Net</b>   |
|                                                        | <i>(In thousands)</i>                                                                        |                |              |
| <b>Interest Income:</b>                                |                                                                                              |                |              |
| Loans                                                  | \$ 5,290                                                                                     | \$ (1,311)     | \$ 3,979     |
| Securities and certificates of deposits                | (370)                                                                                        | (103)          | (473)        |
| Other interest-earning assets                          | (9)                                                                                          | 35             | 26           |
| <b>Total</b>                                           | <b>4,911</b>                                                                                 | <b>(1,379)</b> | <b>3,532</b> |
| <b>Interest Expense:</b>                               |                                                                                              |                |              |
| Deposits                                               | 677                                                                                          | (220)          | 457          |
| Borrowings                                             | 32                                                                                           | (253)          | (221)        |
| <b>Total</b>                                           | <b>709</b>                                                                                   | <b>(473)</b>   | <b>236</b>   |
| <br>Change in fully tax-equivalent net interest income | <br>\$ 4,202                                                                                 | <br>\$ (906)   | <br>\$ 3,296 |

**Results of Operations for the Three Months Ended March 31, 2014 and 2013**

**Net Income.** Our primary source of income is net interest income. Net interest income is the difference between interest income, which is the income that we earn on our loans and investments, and interest expense, which is the interest that we pay on our deposits and borrowings. Changes in levels of interest rates affect our net interest income. A secondary source of income is non-interest income, which includes revenue that we receive from providing products and services. The majority of our non-interest income generally comes from customer service fees, loan fees, bank-owned life insurance, mortgage banking gains and gains on sales of securities.

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Net income information is as follows:

|                           | Three Months Ended March 31,  |           | Change   |         |
|---------------------------|-------------------------------|-----------|----------|---------|
|                           | 2014                          | 2013      | Amount   | Percent |
|                           | <i>(Dollars in thousands)</i> |           |          |         |
| Net interest income       | \$ 20,602                     | \$ 17,626 | \$ 2,976 | 16.9%   |
| Provision for loan losses | 133                           | 1,260     | (1,127)  | (89.4)  |
| Non-interest income       | 3,984                         | 4,361     | (377)    | (8.6)   |
| Non-interest expenses     | 17,421                        | 16,292    | 1,129    | 6.9     |
| Net income                | 4,771                         | 3,068     | 1,703    | 55.5    |
| Return on average assets  | 0.70%                         | 0.53%     | 0.17     | 32.1    |
| Return on average equity  | 7.59%                         | 5.20%     | 2.39     | 46.0    |

**Net Interest Income.** Net interest income increased \$3.0 million, or 16.9%, to \$20.6 million for the quarter ended March 31, 2014 from \$17.6 million for the quarter ended March 31, 2013. The net interest rate spread and net interest margin were 3.05% and 3.20%, respectively, for the quarter ended March 31, 2014 compared to 3.10% and 3.25%, respectively, for the quarter ended March 31, 2013. The increase in net interest income was due primarily to loan growth along with declines in the cost of funds, partially offset by declines in yields on interest-earning assets and deposit growth for the quarter ended March 31, 2014 compared to the quarter ended March 31, 2013.

The average balance of our loan portfolio increased \$483.3 million, or 26.4%, to \$2.313 billion, which was partially offset by the decline in the yield on loans of 33 basis points to 4.28% for the quarter ended March 31, 2014 compared to 4.61% for the quarter ended March 31, 2013. The average balance of our total deposits increased \$378.3 million, or 20.0%, to \$2.267 billion, which was partially offset by the decline in cost of total deposits of six basis points to 0.79% for the quarter ended March 31, 2014 compared to the quarter ended March 31, 2013. Our yield on interest-earning assets declined 16 basis points to 3.98% for the quarter ended March 31, 2014 compared to 4.14% for the quarter ended March 31, 2013, while the cost of funds declined 11 basis points to 0.83% for the quarter ended March 31, 2014 compared to 0.94% for the quarter ended March 31, 2013.

**Provision for Loan Losses.** Our provision for loan losses was \$133,000 for the three months ended March 31, 2014 compared to \$1.3 million for the three months ended March 31, 2013. For further discussion of the changes in the provision and allowance for loan losses, refer to Asset Quality Allowance for Loan Losses.

**Non-Interest Income.** Non-interest income information is as follows:

|                                       | Three Months Ended March 31,  |          | Change |         |
|---------------------------------------|-------------------------------|----------|--------|---------|
|                                       | 2014                          | 2013     | Amount | Percent |
|                                       | <i>(Dollars in thousands)</i> |          |        |         |
| Customer service fees                 | \$ 1,799                      | \$ 1,586 | \$ 213 | 13.4%   |
| Loan fees                             | 213                           | 56       | 157    | 280.4   |
| Mortgage banking gains, net           | 120                           | 155      | (35)   | (22.6)  |
| Gain on sales of securities, net      | 1,560                         | 2,273    | (713)  | (31.4)  |
| Income from bank-owned life insurance | 281                           | 291      | (10)   | (3.4)   |
| Other income                          | 11                            |          | 11     |         |

|                           |          |          |          |        |
|---------------------------|----------|----------|----------|--------|
| Total non-interest income | \$ 3,984 | \$ 4,361 | \$ (377) | (8.6)% |
|---------------------------|----------|----------|----------|--------|

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Non-interest income decreased \$377,000, or 8.6%, to \$4.0 million for the quarter ended March 31, 2014 from \$4.4 million for the quarter ended March 31, 2013, primarily due to decreases of \$713,000 in gain on sales of securities, net and \$35,000 in mortgage banking gains, net, partially offset by increases of \$213,000 in customer service fees and \$157,000 in loan fees.

**Non-Interest Expense.** Non-interest expense information is as follows:

|                                    | Three Months Ended March 31,  |                  | Change          |             |
|------------------------------------|-------------------------------|------------------|-----------------|-------------|
|                                    | 2014                          | 2013             | Amount          | Percent     |
|                                    | <i>(Dollars in thousands)</i> |                  |                 |             |
| Salaries and employee benefits     | \$ 10,801                     | \$ 10,075        | \$ 726          | 7.2%        |
| Occupancy and equipment            | 2,561                         | 2,334            | 227             | 9.7         |
| Data processing                    | 1,161                         | 991              | 170             | 17.2        |
| Marketing and advertising          | 807                           | 691              | 116             | 16.8        |
| Professional services              | 641                           | 601              | 40              | 6.7         |
| Foreclosed real estate             | 11                            | 106              | (95)            | (89.6)      |
| Deposit insurance                  | 551                           | 475              | 76              | 16.0        |
| Other general and administrative   | 888                           | 1,019            | (131)           | (12.9)      |
| <b>Total non-interest expenses</b> | <b>\$ 17,421</b>              | <b>\$ 16,292</b> | <b>\$ 1,129</b> | <b>6.9%</b> |

Non-interest expense increased \$1.1 million, or 6.9%, to \$17.4 million for the quarter ended March 31, 2014 from \$16.3 million for the quarter ended March 31, 2013, primarily due to increases of \$726,000 in salaries and employee benefits, \$227,000 in occupancy and equipment expense, \$170,000 in data processing, \$116,000 in marketing and advertising, \$40,000 in professional services and \$76,000 in deposit insurance, partially offset by decreases of \$95,000 in foreclosed real estate expense and \$131,000 in other non-interest expenses. The increases in salaries and benefits, occupancy and equipment, and data processing expenses reflect costs associated with three new branches opened in 2013, the expansion of residential and commercial lending capacity including the selective recruitment of qualified employees, and enhancements to infrastructure and technology.

**Income Tax Provision.** We recorded a provision for income taxes of \$2.3 million for the three months ended March 31, 2014, reflecting an effective tax rate of 32.2%, compared to \$1.4 million, or 30.8%, for the three months ended March 31, 2013. The change in the income tax provision was primarily due to changes in the components of pre-tax income.

**Liquidity Management.** Liquidity is the ability to meet current and future financial obligations of a short-term nature. Our primary sources of funds consist of deposit inflows, loan repayments, maturities of and payments on investment securities and borrowings from the Federal Home Loan Bank of Boston. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit flows and mortgage prepayments are greatly influenced by general interest rates, economic conditions and competition.

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

Our most liquid assets are cash and cash equivalents. The levels of these assets depend on our operating, financing, lending and investing activities during any given period. At March 31, 2014, cash and due from banks totaled \$156.6 million. In addition, at March 31, 2014, we had \$193.3 million of available borrowing capacity with the Federal Home Loan Bank of Boston, including a \$9.4 million line of credit. On March 31, 2014, we had \$202.1 million of advances outstanding.

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A significant use of our liquidity is the funding of loan originations. At March 31, 2014, we had total loan commitments outstanding of \$594.8 million. Historically, many of the commitments expire without being fully drawn; therefore the total amount of commitments does not necessarily represent future cash requirements.

Another significant use of our liquidity is the funding of deposit withdrawals. Certificates of deposit due within one year of March 31, 2014 totaled \$443.6 million, or 65.3% of total certificates of deposit. If these maturing deposits do not remain with us, we will be required to utilize other sources of funds. Historically, a significant portion of certificates of deposit that mature have remained with us. We have the ability to attract and retain deposits by adjusting the interest rates offered.

Our primary investing activities are the origination of loans and the purchase of securities. Our primary financing activities consist of activity in deposit accounts and Federal Home Loan Bank advances. Deposit flows are affected by the overall level of interest rates, the interest rates and products offered by us and our local competitors and other factors. We generally manage the pricing of our deposits to be competitive. Occasionally, we offer promotional rates on certain deposit products to attract deposits.

We have a contract with our core data processing provider through December 2017, with a related outstanding commitment of \$8.4 million as of March 31, 2014 and with total annual payments of \$2.2 million.

**Capital Management.** Both the Company and the Bank are subject to various regulatory capital requirements administered by the Federal Reserve Board and the Federal Deposit Insurance Corporation, respectively, including a risk-based capital measure. The risk-based capital guidelines include both a definition of capital and a framework for calculating risk-weighted assets by assigning balance sheet assets and off-balance sheet items to broad risk categories. At March 31, 2014, both the Company and the Bank exceeded all of their respective regulatory capital requirements. The Bank is considered well capitalized under regulatory guidelines.

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The Company's and the Bank's actual capital amounts and ratios follow:

|                                           | Actual<br>Amount | Ratio | Minimum<br>Capital<br>Requirement<br>Amount | Ratio | Minimum<br>To Be Well<br>Capitalized Under<br>Prompt Corrective<br>Action Provisions<br>Amount | Ratio |
|-------------------------------------------|------------------|-------|---------------------------------------------|-------|------------------------------------------------------------------------------------------------|-------|
| <i>(Dollars in thousands)</i>             |                  |       |                                             |       |                                                                                                |       |
| <b>March 31, 2014</b>                     |                  |       |                                             |       |                                                                                                |       |
| Total Capital (to Risk Weighted Assets):  |                  |       |                                             |       |                                                                                                |       |
| Company                                   | \$ 264,873       | 10.9% | \$ 195,029                                  | 8.0%  | N/A                                                                                            | N/A   |
| Bank                                      | 251,340          | 10.3  | 194,760                                     | 8.0   | \$ 243,451                                                                                     | 10.0% |
| Tier 1 Capital (to Risk Weighted Assets): |                  |       |                                             |       |                                                                                                |       |
| Company                                   | 236,683          | 9.7   | 97,515                                      | 4.0   | N/A                                                                                            | N/A   |
| Bank                                      | 223,150          | 9.2   | 97,380                                      | 4.0   | 146,070                                                                                        | 6.0   |
| Tier 1 Capital (to Average Assets):       |                  |       |                                             |       |                                                                                                |       |
| Company                                   | 236,683          | 8.8   | 108,168                                     | 4.0   | N/A                                                                                            | N/A   |
| Bank                                      | 223,150          | 8.3   | 108,022                                     | 4.0   | 135,028                                                                                        | 5.0   |
| <b>December 31, 2013</b>                  |                  |       |                                             |       |                                                                                                |       |
| Total Capital (to Risk Weighted Assets):  |                  |       |                                             |       |                                                                                                |       |
| Company                                   | \$ 259,577       | 10.8% | \$ 192,797                                  | 8.0%  | N/A                                                                                            | N/A   |
| Bank                                      | 246,100          | 10.2  | 192,511                                     | 8.0   | \$ 240,639                                                                                     | 10.0% |
| Tier 1 Capital (to Risk Weighted Assets): |                  |       |                                             |       |                                                                                                |       |
| Company                                   | 231,342          | 9.6   | 96,398                                      | 4.0   | N/A                                                                                            | N/A   |
| Bank                                      | 217,865          | 9.1   | 96,256                                      | 4.0   | 144,383                                                                                        | 6.0   |
| Tier 1 Capital (to Average Assets):       |                  |       |                                             |       |                                                                                                |       |
| Company                                   | 231,342          | 8.7   | 105,999                                     | 4.0   | N/A                                                                                            | N/A   |
| Bank                                      | 217,865          | 8.2   | 105,702                                     | 4.0   | 132,127                                                                                        | 5.0   |

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A reconciliation of the Company's and Bank's stockholders' equity to regulatory capital follows:

|                                                             | <b>March 31, 2014</b> |            | <b>December 31, 2013</b> |            |
|-------------------------------------------------------------|-----------------------|------------|--------------------------|------------|
|                                                             | Consolidated          | Bank       | Consolidated             | Bank       |
|                                                             | <i>(In thousands)</i> |            |                          |            |
| Total stockholders' equity per financial statements         | \$ 254,567            | \$ 241,034 | \$ 249,205               | \$ 235,728 |
| Adjustments to Tier 1 capital:                              |                       |            |                          |            |
| Accumulated other comprehensive income                      | (4,129)               | (4,129)    | (4,104)                  | (4,104)    |
| Goodwill disallowed                                         | (13,687)              | (13,687)   | (13,687)                 | (13,687)   |
| Servicing assets disallowed                                 | (68)                  | (68)       | (72)                     | (72)       |
| Total Tier 1 capital                                        | 236,683               | 223,150    | 231,342                  | 217,865    |
| Adjustments to total capital:                               |                       |            |                          |            |
| Allowance for loan losses                                   | 25,440                | 25,440     | 25,335                   | 25,335     |
| 45% of net unrealized gains on marketable equity securities | 2,750                 | 2,750      | 2,900                    | 2,900      |
| Total regulatory capital                                    | \$ 264,873            | \$ 251,340 | \$ 259,577               | \$ 246,100 |

We may use capital management tools such as cash dividends and common share repurchases. Pursuant to Federal Reserve Board approval conditions imposed in connection with the formation of the Company, we have committed (i) to seek the Federal Reserve Board's prior approval before repurchasing any equity securities from Meridian and (ii) that any repurchases of equity securities from stockholders other than Meridian will be at the current market price for such stock repurchases. We are also subject to the Federal Reserve Board's notice provisions for stock repurchases.

As of March 31, 2014, we had repurchased 287,652 shares of our stock at an average price of \$14.68 per share, or 31.8% of the 904,224 shares authorized for repurchase under our fourth repurchase program as adopted during 2011. We have repurchased 1,691,580 shares at an average price of \$10.89 per share since December 2008. We terminated the repurchase program in connection with Meridian's adoption of the Plan of Conversion.

**Off-Balance Sheet Arrangements.** In the normal course of operations, we engage in a variety of financial transactions that, in accordance with generally accepted accounting principles in the United States of America are not recorded in our financial statements. These transactions involve, to varying degrees, elements of credit, interest rate and liquidity risk. Such transactions are used primarily to manage customers' requests for funding and take the form of loan commitments and lines of credit.

For the three months ended March 31, 2014, we engaged in no off-balance sheet transactions reasonably likely to have a material effect on our financial condition, results of operations or cash flows.

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### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

***Interest Rate Risk Management.*** Our earnings and the market value of our assets and liabilities are subject to fluctuations caused by changes in the level of interest rates. We manage the interest rate sensitivity of our interest-bearing liabilities and interest-earning assets in an effort to minimize the adverse effects of changes in the interest rate environment. Deposit accounts typically react more quickly to changes in market interest rates than mortgage loans because of the shorter maturities of deposits. As a result, sharp increases in interest rates may adversely affect our earnings while decreases in interest rates may beneficially affect our earnings. To reduce the potential volatility of our earnings, we have sought to improve the match between asset and liability maturities and rates, while maintaining an acceptable interest rate spread. Our strategy for managing interest rate risk emphasizes: originating loans with adjustable interest rates; selling the residential real estate fixed-rate loans with terms greater than 10 years that we originate; promoting core deposit products; and adjusting the interest rates and maturities of funding sources, as necessary.

We have an Asset/Liability Management Committee to coordinate all aspects of asset/liability management. The committee establishes and monitors the volume, maturities, pricing and mix of assets and funding sources with the objective of managing assets and funding sources to provide results that are consistent with liquidity, growth, risk limits and profitability goals.

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

Our goal is to manage asset and liability positions to moderate the effects of interest rate fluctuations on net interest income. Interest income simulations are completed quarterly and presented to the Asset/Liability Committee and the Board of Directors. The simulations provide an estimate of the impact of changes in interest rates on net interest income under a range of assumptions. The numerous assumptions used in the simulation process are reviewed by the Asset/Liability Committee and the Executive Committee on a quarterly basis. Changes to these assumptions can significantly affect the results of the simulation. The simulation incorporates assumptions regarding the potential timing in the repricing of certain assets and liabilities when market rates change and the changes in spreads between different market rates. The simulation analysis incorporates management's current assessment of the risk that pricing margins will change adversely over time due to competition or other factors.

Simulation analysis is only an estimate of our interest rate risk exposure at a particular point in time. We continually review the potential effect changes in interest rates could have on the repayment of rate sensitive assets and funding requirements of rate sensitive liabilities.

The simulation uses projected repricing of assets and liabilities on the basis of contractual maturities, anticipated repayments and scheduled rate adjustments. Prepayment rates can have a significant impact on interest income simulation. Because of the large percentage of loans we hold, rising or falling interest rates have a significant impact on the prepayment speeds of our earning assets that in turn affect the rate sensitivity position. When interest rates rise, prepayments tend to slow. When interest rates fall, prepayments tend to rise. Our asset sensitivity would be reduced if prepayments slow and vice versa. While we believe such assumptions to be reasonable, there can be no assurance that assumed prepayment rates will approximate actual future mortgage-backed security and loan repayment activity.



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The following table reflects changes in estimated net interest income for the Bank due to immediate non-parallel changes in interest rates at April 1, 2014 through March 31, 2015.

| Increase (Decrease) in Market Interest Rates | Net Interest Income           |            |          |
|----------------------------------------------|-------------------------------|------------|----------|
|                                              | Amount                        | Change     | Percent  |
|                                              | <i>(Dollars in Thousands)</i> |            |          |
| 300                                          | \$ 73,127                     | \$ (9,419) | (11.41)% |
| Flat                                         | 82,546                        |            |          |
| -100                                         | 83,190                        | 644        | 0.78     |

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**ITEM 4. CONTROLS AND PROCEDURES**

- (a) *Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures* The Company's management, including the Company's principal executive officer and principal financial officer, have evaluated the effectiveness of the Company's disclosure controls and procedures, as such term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act). Based upon their evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective for the purpose of ensuring that the information required to be disclosed in the reports that the Company files or submits under the Exchange Act with the Securities and Exchange Commission (the SEC) (1) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and (2) is accumulated and communicated to the Company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.
- (b) *Changes in Internal Controls over Financial Reporting* There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Table of Contents****PART II OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS**

Periodically, there have been various claims and lawsuits against us, such as claims to enforce liens, condemnation proceedings on properties in which we hold security interests, claims involving the making and servicing of real property loans and other issues incident to our business. We are not a party to any pending legal proceedings that we believe would have a material adverse effect on our financial condition, results of operations or cash flows.

**ITEM 1A. RISK FACTORS**

For information regarding our risk factors, see Risk Factors, in our 2013 Annual Report on Form 10-K, filed with the SEC on March 17, 2014, which is available through the SEC's website at [www.sec.gov](http://www.sec.gov). As of March 31, 2014, our risk factors have not changed materially from those reported in the annual report. The risks described in our annual report are not the only risks that we face. Additional risks not presently known to us, or that we currently deem immaterial, may also adversely affect our business, financial condition or results of operations.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

(a.) Not applicable.

(b.) Not applicable.

(c.) The following table sets forth information with respect to any purchase made by or on behalf of the Company during the indicated periods:

| Period | (a)<br>Total Number of<br>Shares (or Units)<br>Purchased | (b)<br>Average Price<br>Paid Per Share (or<br>Unit) | (c)<br>Total Number of<br>Shares (or Units)<br>Purchased as Part<br>of<br>Publicly<br>Announced Plans<br>or<br>Programs<br>(1) | (d)<br>Maximum Number<br>(or<br>Approximate<br>Dollar Value)<br>of<br>Shares (or<br>Units)<br>that May Yet<br>Be<br>Purchased<br>Under<br>the Plans or<br>Programs |
|--------|----------------------------------------------------------|-----------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------|
|        |                                                          |                                                     |                                                                                                                                |                                                                                                                                                                    |

|            |          |    |         |
|------------|----------|----|---------|
| January 1  | 31, 2014 | \$ | 616,572 |
| February 1 | 28, 2014 | \$ | 616,572 |
| March 1    | 31, 2014 | \$ | 616,572 |
| Total      |          | \$ | 616,572 |

- (1) In August 2011, the Company's Board of Directors voted to adopt a fourth stock repurchase program of up to 10% of its outstanding common stock not held by its mutual holding company parent, or 904,224 shares of its common stock. We terminated the repurchase program in connection with Meridian's adoption of the plan of conversion.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

**ITEM 5. OTHER INFORMATION**

Not applicable.

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**ITEM 6. EXHIBITS**

- 3.1 Amended and Restated Articles of Organization of Meridian Interstate Bancorp, Inc.\*
- 3.2 Amended and Restated Bylaws of Meridian Interstate Bancorp, Inc.\*\*\*\*
- 3.3 Articles of Correction of Meridian Interstate Bancorp, Inc.\*\*\*
- 4 Form of Common Stock Certificate of Meridian Interstate Bancorp, Inc.\*
- 10.1 Form of East Boston Savings Bank Employee Stock Ownership Plan\*
- 10.2 Form of East Boston Savings Bank Employee Stock Ownership Plan Trust Agreement\*
- 10.3 East Boston Savings Bank Employee Stock Ownership Plan Loan Agreement, Pledge Agreement and Promissory Note\*
- 10.4 Form of Amended and Restated Employment Agreement\*
- 10.5 Form of East Boston Savings Bank Employee Severance Compensation Plan\*
- 10.6 Form of Supplemental Executive Retirement Agreements with certain directors\*
- 10.7 [Reserved]
- 10.8 [Reserved]
- 10.9 [Reserved]
- 10.10 Form of Supplemental Executive Retirement Agreement with Richard J. Gavegnano filed as an exhibit to Form 10-Q filed on May 14, 2008
- 10.11 Form of Employment Agreement with Richard J. Gavegnano incorporated by reference to the Form 8-K filed on January 12, 2009
- 10.12 Form of Employment Agreement with Deborah J. Jackson incorporated by reference to the Form 8-K filed on January 22, 2009
- 10.13 Form of Supplemental Executive Retirement Agreement with Deborah J. Jackson incorporated by reference to the Form 8-K filed on January 22, 2009
- 10.14 2008 Equity Incentive Plan\*\*
- 10.15 Amendment to Supplemental Executive Retirement Agreements with Certain Directors incorporated by reference to the Form 10-K/A filed on April 8, 2009
- 10.16 Agreement and Plan of Merger incorporated by reference to the Form 8-K filed on July 24, 2009
- 10.17 Employment Agreement between Edward J. Merritt and East Boston Savings Bank\*\*\*\*
- 10.18 Supplemental Executive Retirement Agreement between East Boston Savings Bank and Edward J. Merritt\*\*\*
- 10.19 Joint Beneficiary Designation Agreement between Edward J. Merritt and Mt. Washington Cooperative Bank\*\*\*
- 10.20 First Amendment to Joint Beneficiary Designation Agreement between Edward J. Merritt and Mt. Washington Co-operative Bank\*\*\*
- 10.21

Change in Control Agreement between Mark Abbate and East Boston Savings Bank incorporated by reference to the Form 8-K filed on December 15, 2009

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|         |                                                                                                                                                                                                                                                                                                                                                                                                     |
|---------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.22   | Incentive Compensation Plan filed as an exhibit to Form 10-K filed on March 17, 2014                                                                                                                                                                                                                                                                                                                |
| 10.23   | Change in Control Agreement between John Miglioizzi and East Boston Savings Bank incorporated by reference to the Form 8-K filed on December 18, 2013                                                                                                                                                                                                                                               |
| 21      | Subsidiaries of Registrant*                                                                                                                                                                                                                                                                                                                                                                         |
| 31.1    | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                                                                                                                                                                                                                                                                                                  |
| 31.2    | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                                                                                                                                                                                                                                                                                                  |
| 32      | Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002                                                                                                                                                                                                                                                                      |
| 101     | The following financial statements for the quarter ended March 31, 2014, formatted in XBRL: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Net Income, (iii) Consolidated Statements of Comprehensive Income, (iv) Consolidated Statements of Changes in Stockholders' Equity (v) Consolidated Statements of Cash Flows, and (vi) the Notes to Consolidated Financial Statements. |
| 101.INS | XBRL Instance Document                                                                                                                                                                                                                                                                                                                                                                              |
| 101.SCH | XBRL Taxonomy Extension Schema Document                                                                                                                                                                                                                                                                                                                                                             |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document                                                                                                                                                                                                                                                                                                                                               |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document                                                                                                                                                                                                                                                                                                                                                |
| 101.LAB | XBRL Taxonomy Extension Labels Linkbase Document                                                                                                                                                                                                                                                                                                                                                    |
| 101.PRE | XBRL XBRL Taxonomy Extension Presentation Linkbase Document                                                                                                                                                                                                                                                                                                                                         |
|         |                                                                                                                                                                                                                                                                                                                                                                                                     |
| *       | Incorporated by reference to the Registration Statement on Form S-1 of Meridian Interstate Bancorp, Inc. (File No. 333-146373), originally filed with the Securities and Exchange Commission on September 28, 2007.                                                                                                                                                                                 |
| **      | Incorporated by reference to Appendix A to the Company's Definitive Proxy Statement for its 2008 Annual Meeting, as filed with the Securities and Exchange Commission on July 11, 2008.                                                                                                                                                                                                             |
| ***     | Incorporated by reference to the Company's Annual Report on Form 10-K as filed with the Securities and Exchange Commission on March 16, 2010.                                                                                                                                                                                                                                                       |
| ****    | Incorporated by reference to the Company's Form 8-K as filed with the Securities and Exchange Commission on May 17, 2012.                                                                                                                                                                                                                                                                           |

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**MERIDIAN INTERSTATE BANCORP, INC.**

(Registrant)

Date: May 12, 2014

By: /s/ Richard J. Gavegnano  
Richard J. Gavegnano  
Chairman, President and Chief Executive Officer

(Principal Executive Officer)

Date: May 12, 2014

By: /s/ Mark L. Abbate  
Mark L. Abbate  
Senior Vice President, Treasurer and Chief Financial Officer

(Principal Financial and Accounting Officer)