

SALISBURY BANCORP INC
Form 10-Q
November 14, 2011

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2011

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

Commission file number 0-24751

SALISBURY BANCORP, INC.

(Exact name of registrant as specified in its charter)

Connecticut

06-1514263

(State or other jurisdiction
of incorporation or organization)

(I.R.S. Employer
Identification No.)

5 Bissell Street, Lakeville, CT

06039

(Address of principal executive offices)

(Zip code)

(860) 435-9801

(Registrant's telephone number, including area code)

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

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) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes X No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

Yes [] No [X]

The number of shares of Common Stock outstanding as of November 1, 2011, is 1,688,731.

1

TABLE OF CONTENTS

	Page	
PART I FINANCIAL INFORMATION		
Item 1.	Financial Statements:	
	Consolidated Balance Sheets as of September 30, 2011 (unaudited) and December 31, 2010	3
	Consolidated Statements of Income for the three and nine month periods ended September 30, 2011 and 2010 (unaudited)	4
	Consolidated Statements of Changes in Shareholders' Equity for the nine month periods ended September 30, 2011 and 2010 (unaudited)	5
	Consolidated Statements of Cash Flows for the nine month periods ended September 30, 2011 and 2010 (unaudited)	6
	Notes to Consolidated Financial Statements (unaudited)	7
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	21
Item 3.	Quantitative and Qualitative Disclosures of Market Risk	38
Item 4.	Controls and Procedures	40
PART II Other Information		
Item 1.	Legal Proceedings	40
Item 1A.	Risk Factors	41
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	41
Item 3.	Defaults upon Senior Securities	41
Item 4.	Removed and Reserved	41
Item 5.	Other information	41
Item 6.	Exhibits	41

PART I - FINANCIAL INFORMATION

Salisbury Bancorp, Inc. and Subsidiary
CONSOLIDATED BALANCE SHEETS

in thousands (except share data)	September 30, 2011 Unaudited	December 31, 2010
ASSETS		
Cash and due from banks	\$ 6,019	\$ 6,694
Interest bearing demand deposits with other banks	59,498	20,214
Total cash and cash equivalents	65,517	26,908
Interest bearing time deposits with other banks	-	5,000
Securities		
Available-for-sale at fair value	151,078	147,422
Held-to-maturity at amortized cost (fair value: \$54 and \$58)	52	56
Federal Home Loan Bank of Boston stock at cost	6,032	6,032
Loans held-for-sale	1,057	1,184
Loans receivable, net (allowance for loan losses: \$4,027 and \$3,920)	362,879	352,449
Investment in real estate	75	75
Other real estate owned	37	610
Bank premises and equipment, net	12,126	12,190
Goodwill	9,829	9,829
Intangible assets (net of accumulated amortization: \$1,468 and \$1,301)	1,075	1,242
Accrued interest receivable	2,042	2,132
Cash surrender value of life insurance policies	3,974	3,854
Deferred taxes	472	2,540
Other assets	2,713	3,947
Total Assets	\$ 618,958	\$ 575,470
LIABILITIES and SHAREHOLDERS' EQUITY		
Deposits		
Demand (non-interest bearing)	\$ 82,425	\$ 71,565
Demand (interest bearing)	71,303	63,258
Money market	122,184	77,089
Savings and other	97,405	93,324
Certificates of deposit	105,274	125,053
Total deposits	478,591	430,289
Repurchase agreements	14,787	13,190
Federal Home Loan Bank of Boston advances	55,033	72,812
Accrued interest and other liabilities	3,160	4,163
Total Liabilities	551,571	520,454
Commitments and contingencies		
	-	-
Shareholders' Equity		
Preferred stock - \$.01 per share par value		
Authorized: 25,000; Issued: 16,000 (Series B) and 8,816 (Series A);		
Liquidation preference: \$1,000 per share	16,000	8,738
Common stock - \$.10 per share par value		
Authorized: 3,000,000;		

Edgar Filing: SALISBURY BANCORP INC - Form 10-Q

Issued: 1,688,731 and 1,687,661	169	168
Common stock warrants outstanding	112	112
Paid-in capital	13,227	13,200
Retained earnings	37,553	36,567
Accumulated other comprehensive loss, net	326	(3,769)
Total Shareholders' Equity	67,387	55,016
Total Liabilities and Shareholders' Equity	\$ 618,958	\$ 575,470

Salisbury Bancorp, Inc. and Subsidiary
CONSOLIDATED STATEMENTS OF INCOME

Periods ended September 30, (in thousands except per share amounts) unaudited	Three months ended		Nine months ended	
	2011	2010	2011	2010
Interest and dividend income				
Interest and fees on loans	\$4,630	\$4,693	\$13,989	\$13,780
Interest on debt securities				
Taxable	743	913	2,268	2,872
Tax exempt	553	558	1,661	1,678
Other interest and dividends	30	42	96	126
Total interest and dividend income	5,956	6,206	18,014	18,456
Interest expense				
Deposits	748	1,061	2,449	3,385
Repurchase agreements	19	25	46	71
Federal Home Loan Bank of Boston advances	565	765	1,772	2,283
Total interest expense	1,332	1,851	4,267	5,739
Net interest income	4,624	4,355	13,747	12,717
Provision for loan losses	180	180	860	620
Net interest and dividend income after provision for loan losses	4,444	4,175	12,887	12,097
Non-interest income				
Trust and wealth advisory	599	471	1,861	1,507
Service charges and fees	534	528	1,555	1,480
Gains on sales of mortgage loans, net	178	278	370	443
Mortgage servicing, net	(35)	(33)	(8)	27
Gains on securities, net	-	16	11	16
Other	58	62	176	208
Total non-interest income	1,334	1,322	3,965	3,681
Non-interest expense				
Salaries	1,816	1,750	5,202	4,989
Employee benefits	636	522	1,919	1,737
Premises and equipment	582	559	1,733	1,570
Data processing	366	308	1,028	1,080
Professional fees	307	393	887	1,248
Collections and OREO	152	12	519	63
FDIC insurance	137	195	541	549
Marketing and community support	85	79	245	200
Amortization of intangibles	56	56	167	167
Other	398	440	1,149	1,268
Total non-interest expense	4,535	4,314	13,390	12,871
Income before income taxes	1,243	1,183	3,462	2,907
Income tax provision	204	236	598	487
Net income	\$1,039	\$947	\$2,864	\$2,420
Net income available to common shareholders	\$865	\$832	\$2,459	\$2,073
Basic and diluted earnings per share	\$0.51	\$0.49	\$1.46	\$1.23

Common dividends per share	0.28	0.28	0.84	0.84
----------------------------	------	------	------	------

4

Salisbury Bancorp, Inc. and Subsidiary

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(dollars in thousands) unaudited	Common Stock				Paid-in capital	Retained earnings	Accumulated other comprehensive income (loss)	Total share- holders' equity
	Shares	Amount	Preferred Stock	Warrants				
Balances at December 31, 2009	1,686,701	\$ 168	\$ 8,717	\$ 112	\$ 13,177	\$ 35,259	\$ (5,078)	\$ 52,355
Net income for period	-	-	-	-	-	2,420	-	2,420
Other comprehensive income, net of tax	-	-	-	-	-	-	4,380	4,380
Total comprehensive income								6,800
Amortization (accretion) of preferred stock	-	-	16	-	-	(16)	-	-
Common stock dividends paid	-	-	-	-	-	(1,417)	-	(1,417)
Preferred stock dividends paid	-	-	-	-	-	(331)	-	(331)
Issuance of common stock for director fees	960	-	-	-	23	-	-	23
Balances at September 30, 2010	1,687,661	\$ 168	\$ 8,733	\$ 112	\$ 13,200	\$ 35,915	\$ (698)	\$ 57,430
Balances at December 31, 2010	1,687,661	\$ 168	\$ 8,738	\$ 112	\$ 13,200	\$ 36,567	\$ (3,769)	\$ 55,016
Net income for period	-	-	-	-	-	2,864	-	2,864
Other comprehensive income, net of tax	-	-	-	-	-	-	4,095	4,095
Total comprehensive income								6,959
Amortization (accretion) of preferred stock	-	-	78	-	-	(78)	-	-
Issuance of Series B preferred stock	-	-	16,000	-	-	-	-	16,000
Redemption of Series A preferred stock	-	-	(8,816)	-	-	-	-	(8,816)
Common stock dividends paid	-	-	-	-	-	(1,418)	-	(1,418)
Preferred stock dividends paid	-	-	-	-	-	(382)	-	(382)
Issuance of common stock for director fees	1,070	1	-	-	27	-	-	28
Balances September 30, 2011	1,688,731	\$ 169	\$ 16,000	\$ 112	\$ 13,227	\$ 37,553	\$ 326	\$ 67,387

Salisbury Bancorp, Inc. and Subsidiary

CONSOLIDATED STATEMENTS OF CASH FLOWS

Nine months ended September 30, (in thousands) unaudited

	2011	2010
Operating Activities		
Net income	\$2,864	\$2,420
Adjustments to reconcile net income to net cash provided by operating activities:		
(Accretion), amortization and depreciation		
Securities	222	408
Bank premises and equipment	631	632
Core deposit intangible	167	167
Mortgage servicing rights	165	118
Fair value adjustment on loans	33	33
Gain of calls of securities available-for-sale	(11)	(16)
Write down of other real estate owned	231	-
Provision for loan losses	860	620
Decrease (increase) in loans held-for-sale	127	(1,518)
Increase in deferred loan origination fees and costs, net	(122)	(157)
Mortgage servicing rights originated	(180)	(226)
Increase in mortgage servicing rights impairment reserve	80	51
Decrease in interest receivable	90	188
Deferred tax benefit	(41)	(23)
Decrease in prepaid expenses	371	529
Increase in cash surrender value of life insurance policies	(120)	(127)
Decrease (increase) in income tax receivable	728	(291)
Decrease in other assets	9	103
(Decrease) increase in accrued expenses	(235)	202
Decrease in interest payable	(152)	(73)
Decrease in other liabilities	(607)	(169)
Issuance of shares for directors' fee	28	23
Net cash provided by operating activities	5,138	2,894
Investing Activities		
Proceeds from maturities of interest-bearing time deposits	5,000	-
Purchases of securities available-for-sale	(35,729)	(42,987)
Proceeds from calls of securities available-for-sale	27,560	20,734
Proceeds from maturities of securities available-for-sale	10,457	23,115
Proceeds from maturities of securities held-to-maturity	4	4
Loan originations and principle collections, net	(11,569)	(13,373)
Recoveries of loans previously charged-off	55	21
Proceeds from sale of other real estate owned	655	-
Capital expenditures	(504)	(2,005)
Net cash (utilized) by investing activities	(4,071)	(14,491)
Financing Activities		
Increase in deposit transaction accounts, net	68,081	36,879
Decrease in time deposits, net	(19,779)	(23,561)
Increase in securities sold under agreements to repurchase, net	1,596	4,918
Principal payments on Federal Home Loan Bank of Boston advances	(17,779)	(1,832)
Redemption of Series A preferred stock	(8,816)	-
Proceeds from issuance of Series B preferred stock	16,000	-
Common stock dividends paid	(1,418)	(1,417)

Edgar Filing: SALISBURY BANCORP INC - Form 10-Q

Preferred stock dividends paid	(343)	(331)
Net cash provided by financing activities	37,542	14,656
Net increase in cash and cash equivalents	38,609	3,059
Cash and cash equivalents, beginning of period	26,908	43,298
Cash and cash equivalents, end of period	\$65,517	\$46,357
Cash paid during period		
Interest	\$4,419	\$5,815
Income taxes	(89)	173
Non-cash transfers		
Transfer from loans to other real estate owned	314	-

6

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

NOTE 1 - BASIS OF PRESENTATION

The interim (unaudited) consolidated financial statements of Salisbury Bancorp, Inc. ("Salisbury") include those of Salisbury and its wholly owned subsidiary, Salisbury Bank and Trust Company (the "Bank"). In the opinion of management, the interim unaudited consolidated financial statements include all adjustments (consisting of normal recurring adjustments) necessary to present fairly the financial position of Salisbury and the statements of income, shareholders' equity and cash flows for the interim periods presented.

The financial statements have been prepared in accordance with generally accepted accounting principles. In preparing the financial statements, management is required to make extensive use of estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet, and revenues and expenses for the period. Actual results could differ significantly 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 and the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans. In connection with the determination of the allowance for loan losses and valuation of real estate, management obtains independent appraisals for significant properties.

Certain financial information, which is normally included in financial statements prepared in accordance with generally accepted accounting principles, but which is not required for interim reporting purposes, has been condensed or omitted. Operating results for the interim period ended September 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011. The accompanying condensed financial statements should be read in conjunction with the financial statements and notes thereto included in Salisbury's 2010 Annual Report on Form 10-K for the period ended December 31, 2010.

The allowance for loan losses is a significant accounting policy and is presented in the Notes to Consolidated Financial Statements and in Management's Discussion and Analysis, which provide information on how significant assets are valued in the financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions and estimates underlying those amounts, management has identified the determination of the allowance for loan losses to be the accounting area that requires the most subjective judgments, and as such could be most subject to revision as new information becomes available.

Impact of New Accounting Pronouncements Issued

In June 2011, the FASB issued ASU 2011-05, "Presentation of Comprehensive Income." The objective of this ASU is to improve the comparability, consistency, and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. Under this ASU, an entity has the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. An entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. An entity is required to present on the face of the financial statements reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement(s) where the components of net income and the components of other comprehensive income are presented. The amendments in this ASU should be applied retrospectively. For public entities, the amendments are effective for fiscal years, and interim periods within

those years, beginning after December 15, 2011. The adoption of ASU 2011-05 is not expected to have a material impact on Salisbury's consolidated financial position, results of operations or cash flows.

In May 2011, the FASB issued ASU 2011-04, "Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards." The amendments in this ASU explain how to measure fair value. They do not require additional fair value measurements and are not intended to establish valuation standards or affect valuation practices outside of financial reporting. The amendments in this ASU are to be applied prospectively. For public entities, the amendments are effective during interim and annual periods beginning after December 15, 2011. The adoption of ASU 2011-04 is not expected to have a material impact on Salisbury's consolidated financial position, results of operations or cash flows.

In April 2011, the Financial Accounting Standards Board ("FASB") issued ASU 2011-02, "A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring." This ASU provides additional guidance or clarification to help creditors determine whether a restructuring constitutes a troubled debt restructuring. For public entities, the amendments in this ASU are effective for the first interim or annual period beginning on or after June 15, 2011, and were applied retrospectively to the beginning of the annual 2011 period. The adoption of ASU 2011-02 did not have a material impact on Salisbury's consolidated financial position, results of operations or cash flows.

In April 2011, the FASB issued ASU 2011-03, "Reconsideration of Effective Control for Repurchase Agreements." The objective of this ASU is to improve the accounting for repurchase agreements and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. This ASU prescribes when an entity may or may not recognize a sale upon the transfer of financial assets subject to repurchase agreements. The guidance in this ASU is effective for the first interim or annual period beginning on or after December 15, 2011. Early adoption is not permitted. The adoption of ASU 2011-03 is not expected to have a material impact on Salisbury's consolidated financial position, results of operations or cash flows.

NOTE 2 - SECURITIES

The composition of securities is as follows:

(in thousands)	Amortized cost (1)	Gross un- realized gains	Gross un- realized losses	Fair value
September 30, 2011				
Available-for-sale				
U.S. Treasury notes	\$5,000	\$ 562	\$ -	\$5,562
U.S. Government Agency notes	14,559	478	-	15,037
Municipal bonds	50,857	1,019	(1,280)	50,596
Mortgage backed securities				
U.S. Government Agencies	50,098	1,266	(7)	51,357
Collateralized mortgage obligations				
U.S. Government Agencies	7,562	60	-	7,622
Non-agency	15,785	337	(440)	15,682
SBA bonds	3,857	89	-	3,946
Corporate bonds	1,097	15	-	1,112
Preferred Stock	20	144	-	164
Total securities available-for-sale	\$ 148,835	\$ 3,970	\$ (1,727)	\$ 151,078
Held-to-maturity				
Mortgage backed security	\$52	\$ 2	\$ -	\$54
Non-marketable securities				
Federal Home Loan Bank of Boston stock	\$6,032	\$ -	\$ -	\$6,032
December 31, 2010				
Available-for-sale				
U.S. Treasury notes	\$4,999	\$ 197	\$ -	\$5,196
U.S. Government Agency notes	41,590	380	(92)	41,878
Municipal bonds	51,330	139	(5,371)	46,098
Mortgage backed securities				
U.S. Government Agencies	19,190	566	(20)	19,736
Collateralized mortgage obligations				
U.S. Government Agencies	9,283	29	(1)	9,311
Non-agency	19,002	714	(599)	19,117
SBA bonds	4,831	70	-	4,901
Corporate bonds	1,089	41	-	1,130
Preferred Stock	20	35	-	55
Total securities available-for-sale	\$ 151,334	\$ 2,171	\$ (6,083)	\$ 147,422

Held-to-maturity

Mortgage backed security	\$56	\$ 2	\$ -	\$58
Non-marketable securities				
Federal Home Loan Bank of Boston stock	\$6,032	\$ -	\$ -	\$6,032

(1) Net of other-than-temporary impairment write-down recognized in earnings.

Salisbury did not sell any securities available-for-sale during the nine month periods ended September 30, 2011 and 2010.

The following table summarizes, for all securities in an unrealized loss position, including debt securities for which a portion of other-than-temporary impairment has been recognized in other comprehensive income, the aggregate fair value and gross unrealized loss of securities that have been in a continuous unrealized loss position as of the date presented:

(in thousands)	Less than 12 Months		12 Months or Longer		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
September 30, 2011						
Available-for-sale						
U.S. Government Agency notes	\$-	\$-	\$-	\$-	\$-	\$-
Municipal Bonds	1,557	41	9,814	1,239	11,371	1,280
Mortgage backed securities	36	1	5,196	6	5,232	7
Collateralized mortgage obligations						
U.S. Government Agencies	-	-	-	-	-	-
Non-agency	1,752	78	1,904	190	3,656	268
Total temporarily impaired securities	3,345	120	16,914	1,435	20,259	1,555
Other-than-temporarily impaired securities						
Collateralized mortgage obligations						
Non-agency	3,586	110	713	62	4,299	172
Total temporarily impaired and other-than-temporarily impaired securities	\$6,931	\$230	\$17,627	\$1,497	\$24,558	\$1,727

Salisbury evaluates securities for Other Than Temporary Impairment (“OTTI”) where the fair value of a security is less than its amortized cost basis at the balance sheet date. As part of this process, Salisbury considers its intent to sell each debt security and whether it is more likely than not that it will be required to sell the security before its anticipated recovery. If either of these conditions is met, Salisbury recognizes an OTTI charge to earnings equal to the entire difference between the security’s amortized cost basis and its fair value at the balance sheet date. For securities that meet neither of these conditions, an analysis is performed to determine if any of these securities are at risk for OTTI.

The following summarizes, by security type, the basis for evaluating if the applicable securities were OTTI at September 30, 2011.

U.S Government Agency notes, U.S. Government Agency mortgage-backed securities and U.S. Government Agency CMOs: The contractual cash flows are guaranteed by U.S. government agencies and U.S. government-sponsored enterprises. Changes in fair values are a function of changes in investment spreads and interest rate movements and not changes in credit quality. Management expects to recover the entire amortized cost basis of these securities. Furthermore, Salisbury does not intend to sell these securities and it is not more likely than not that Salisbury will be required to sell these securities before recovery of their cost basis, which may be maturity. Therefore, management does not consider these securities to be OTTI at September 30, 2011.

Municipal bonds: Contractual cash flows are performing as expected. Salisbury purchased substantially all of these securities during 2006-to-2008 as bank qualified, insured, AAA rated general obligation or revenue bonds. Salisbury’s portfolio is mostly comprised of tax-exempt general obligation bonds or public-purpose revenue bonds for schools,

municipal offices, sewer infrastructure and fire houses, for small towns and municipalities across the United States. In the wake of the financial crisis, most monoline bond insurers had their ratings downgraded or withdrawn because of excessive exposure to insurance for collateralized debt obligations. Salisbury performed credit underwriting reviews of certain issuers, including some that have had their ratings withdrawn and are insured by insurers that have had their ratings withdrawn, to assess their default risk. For all completed reviews pass credit risk ratings have been assigned. Management expects to recover the entire amortized cost basis of these securities. Salisbury does not intend to sell these securities and it is not more likely than not that Salisbury will be required to sell these securities before recovery of their cost basis, which may be maturity. Management does not consider these securities to be OTTI at September 30, 2011.

Non-agency CMOs: Salisbury performed a detailed cash flow analysis of its non-agency CMOs at September 30, 2011 to assess whether any of the securities were OTTI. Salisbury uses third party provided cash flow forecasts of each security based on a variety of market driven assumptions and securitization terms, including prepayment speed, default or delinquency rate, and default severity for losses including interest, legal fees, property repairs, expenses and realtor fees, that, together with the loan amount are subtracted from collateral sales proceeds to determine severity. In 2009 Salisbury determined that five non-agency CMO securities reflected OTTI and recognized losses for deterioration in credit quality of \$1,128,000. Salisbury judged the four remaining securities not to have additional OTTI and all other CMO securities not to be OTTI as of September 30, 2011. It is possible that future loss assumptions could change necessitating Salisbury to recognize future OTTI for further deterioration in credit quality. Salisbury does not intend to sell these securities and it is not more likely than not that Salisbury will be required to sell these securities before recovery of their cost basis.

The following table presents activity related to credit losses recognized into earnings on the non-agency CMOs held by Salisbury for which a portion of an OTTI charge was recognized in accumulated other comprehensive income:

Nine months ended September 30 (in thousands)	2011	2010
Balance, beginning of period	\$ 1,128	\$ 1,128
Credit component on debt securities in which OTTI was not previously recognized	-	-
Balance, end of period	\$ 1,128	\$ 1,128

Federal Home Loan Bank of Boston (“FHLBB”): The Bank is a member of the FHLBB. The FHLBB is a cooperative that provides services, including funding in the form of advances, to its member banking institutions. As a requirement of membership, the Bank must own a minimum amount of FHLBB stock, calculated periodically based primarily on its level of borrowings from the FHLBB. No market exists for shares of the FHLBB and therefore, they are carried at par value. FHLBB stock may be redeemed at par value five years following termination of FHLBB membership, subject to limitations which may be imposed by the FHLBB or its regulator, the Federal Housing Finance Board, to maintain capital adequacy of the FHLBB. While the Bank currently has no intentions to terminate its FHLBB membership, the ability to redeem its investment in FHLBB stock would be subject to the conditions imposed by the FHLBB. In 2008, the FHLBB announced to its members that it is focusing on preserving capital in response to ongoing market volatility including the extension of a moratorium on excess stock repurchases and in 2009 announced the suspension of its quarterly dividends. On February 22, 2011, the FHLBB announced the resumption of modest quarterly cash dividends to its members through 2011 and on June 27, 2011 the FHLBB announced that its excess stock pool will be discontinued effective June 28, 2011, and designating December 28, 2011, as the required stock purchase date. Based on the capital adequacy and the liquidity position of the FHLBB, management believes there is no impairment related to the carrying amount of the Bank’s FHLBB stock as of September 30, 2011. Further deterioration of the FHLBB’s capital levels may require the Bank to deem its restricted investment in FHLBB stock to be OTTI. If evidence of impairment exists in the future, the FHLBB stock would reflect fair value using either observable or unobservable inputs. The Bank will continue to monitor its investment in FHLBB stock.

NOTE 3 - LOANS

The composition of loans receivable and loans held-for-sale is as follows:

(in thousands)	September 30, 2011	December 31, 2010
Residential 1-4 family	\$ 180,215	\$ 173,931
Residential 5+ multifamily	2,798	2,889
Construction of residential 1-4 family	8,065	8,949
Home equity credit	34,632	34,164
Residential real estate	225,710	219,933
Commercial	81,458	75,495
Construction of commercial	5,802	7,312
Commercial real estate	87,260	82,807
Farm land	5,719	5,690
Vacant land	12,685	12,979
Real estate secured	331,374	321,409
Commercial and industrial	27,460	25,123
Municipal	2,549	4,338

Edgar Filing: SALISBURY BANCORP INC - Form 10-Q

Consumer	4,578	4,677
Loans receivable, gross	365,961	355,547
Deferred loan origination fees and costs, net	945	822
Allowance for loan losses	(4,027)	(3,920)
Loans receivable, net	\$ 362,879	\$ 352,449
Loans held-for-sale		
Residential 1-4 family	\$ 1,057	\$ 1,184

Concentrations of Credit Risk

Salisbury's loans consist primarily of residential and commercial real estate secured loans located principally in northwestern Connecticut and adjacent New York and Massachusetts towns, which constitute Salisbury's service area. Salisbury offers a broad range of loan and credit facilities to borrowers in its service area, including residential mortgage loans, commercial real estate loans, construction loans, working capital loans, equipment loans, and a variety of consumer loans, including home equity lines of credit, and installment and collateral loans. All residential and commercial mortgage loans are collateralized by first or second mortgages on real estate. The ability of single family residential mortgage loan and consumer loan borrowers to honor their repayment commitments is generally dependent on the level of overall economic activity within the market area and real estate values. The ability of commercial borrowers to honor their repayment commitments is dependent on the general economy as well as the health of the real estate economic sector in Salisbury's market area.

Credit Quality

The composition of loans receivable by credit risk rating is as follows:

September 30, 2011 (in thousands)	Pass	Special mention	Substandard	Doubtful	Loss	Total
Residential 1-4 family	\$ 161,987	\$ 12,556	\$ 5,672	\$-	\$-	\$ 180,215
Residential 5+ multifamily	2,272	526	-	-	-	2,798
Construction of residential 1-4 family	3,932	415	3,718	-	-	8,065
Home equity credit	31,850	1,502	1,280	-	-	34,632
Residential real estate	200,041	14,999	10,670	-	-	225,710
Commercial	63,923	5,252	12,283	-	-	81,458
Construction of commercial	5,136	195	471	-	-	5,802
Commercial real estate	69,059	5,447	12,754	-	-	87,260
Farm land	3,105	1,774	840	-	-	5,719
Vacant land	7,686	888	4,111	-	-	12,685
Real estate secured	279,891	23,108	28,375	-	-	331,374
Commercial and industrial	19,551	6,320	1,589	-	-	27,460
Municipal	2,549	-	-	-	-	2,549
Consumer	4,314	199	65	-	-	4,578
Loans receivable, gross	\$ 306,305	\$ 29,627	\$ 30,029	\$-	\$-	\$ 365,961

Credit quality segments of loans receivable by credit risk rating are as follows:

September 30, 2011 (in thousands)	Pass	Special mention	Substandard	Doubtful	Loss	Total
Performing loans	\$ 306,039	\$ 29,460	\$-	\$-	\$-	\$ 335,499
Potential problem loans	-	-	14,499	-	-	14,499
Troubled debt restructurings – accruing	266	167	1,619	-	-	2,052
Troubled debt restructurings - non-accrual	-	-	7,360	-	-	7,360
Other non-accrual loans	-	-	6,551	-	-	6,551
Impaired loans	266	167	15,530	-	-	15,963
Loans receivable, gross	\$ 306,305	\$ 29,627	\$ 30,029	\$-	\$-	\$ 365,961

Potential problem loans are performing loans risk rated substandard that are not classified as impaired. Impaired loans are loans for which it is probable that Salisbury will not be able to collect all principal and interest amounts due according to the contractual terms of the loan agreements.

The components of impaired loans are as follows:

(in thousands)	September 30, 2011	December 31, 2010
Troubled debt restructurings – accruing	\$ 2,052	\$ 5,330
Troubled debt restructurings - non-accrual	7,360	4,254
All other non-accrual loans	6,551	5,791
Impaired loans	\$ 15,963	\$ 15,375
Commitments to lend additional amounts to impaired borrowers	\$ -	\$ -

The composition of loans receivable delinquency status by credit risk rating is as follows:

September 30, 2011 (in thousands)	Pass	Special mention	Substandard	Doubtful	Loss	Total
Current	\$303,894	\$ 26,668	\$ 17,490	\$-	\$-	\$348,052
Past due 001-029	1,606	2,386	4,769	-	-	8,761
Past due 030-059	306	364	1,323	-	-	1,993
Past due 060-089	499	209	141	-	-	849
Past due 090-179	-	-	729	-	-	729
Past due 180+	-	-	5,577	-	-	5,577
Loans receivable, gross	\$306,305	\$ 29,627	\$ 30,029	\$-	\$-	\$365,961

The composition of loans receivable by delinquency status is as follows:

September 30, 2011 (in thousands)	Current	Past due					180 days and over	30 days and over	Accruing 90 days and over	Non-accrual
		1-29 days	30-59 days	60-89 days	90-179 days					
Residential										
1-4 family	\$ 174,697	\$ 4,210	\$ 382	\$ 122	\$ 96	\$ 709	\$ 1,309	\$ -	\$ 5,752	
Residential 5+ multifamily	2,640	-	158	-	-	-	158	-	-	
Residential 1-4 family construction	7,366	-	699	-	-	-	699	-	-	
Home equity credit	33,533	768	147	93	52	39	331	-	248	
Residential real estate	218,236	4,978	1,386	215	148	748	2,497	-	6,000	
Commercial	76,590	2,735	507	623	120	883	2,133	-	3,084	
Construction of commercial	5,801	-	-	-	-	-	-	-	-	
Commercial real estate	82,391	2,735	507	623	120	883	2,133	-	3,084	
Farm land	5,276	443	-	-	-	-	-	-	-	
Vacant land	8,600	227	-	-	461	3,397	3,858	-	3,858	
Real estate secured	314,503	8,383	1,893	838	729	5,028	8,488	-	12,942	
Commercial and industrial	26,626	220	65	-	-	549	614	-	969	
Municipal	2,549	-	-	-	-	-	-	-	-	
Consumer	4,374	158	35	11	-	-	46	-	-	
Loans receivable, gross	\$ 348,052	\$ 8,761	\$ 1,993	\$ 849	\$ 729	\$ 5,577	\$ 9,148	\$ -	\$ 13,911	

Troubled Debt Restructurings

Troubled debt restructurings occurring during the periods are as follows:

Periods ended September 30, 2011 (in thousands)	Quantity	Three month period		Quantity	Nine month period	
		Pre- modification balance	Post- modification balance		Pre- modification balance	Post- modification balance
Residential real estate	-	\$ -	\$ -	2	\$ 1,233	\$ 1,260
Commercial real estate	-	-	-	1	20	55
Commercial and industrial	-	-	-	2	262	273
Troubled debt restructurings	-	\$ -	\$ -	5	\$ 1,515	\$ 1,588

There were no troubled debt restructurings during third quarter 2011 and five during year-to-date 2011. There were no defaults during third quarter 2011 or year-to-date 2011 of loans restructured within the past twelve months.

Allowance for Loan Losses

Changes in the allowance for loan losses are as follows:

(in thousands)	Three months ended September 30				Nine months ended September 30					
	Beginning balance	Charge- Provision	Reco- offs	Ending balance	Beginning balance	Charge- Provision	Reco- offs	Ending balance		
2011 Periods										
Residential	\$1,583	\$ 73	\$(50)	\$-	\$1,606	\$1,504	\$ 269	\$(170)	\$3	\$ 1,606
Commercial	1,239	(145)	(30)	1	1,065	1,132	138	(206)	1	1,065
Land	271	179	(75)	-	375	392	137	(154)	-	375
Real estate	3,093	107	(155)	1	3,046	3,028	544	(530)	4	3,046
Commercial & industrial	521	(92)	-	29	458	541	(22)	(89)	29	459
Municipal	28	(3)	-	-	25	51	(26)	-	-	25
Consumer	90	8	(10)	3	91	164	94	(189)	22	91
Unallocated	247	160	-	-	407	136	270	-	0	406
Totals	\$3,979	\$ 180	\$(165)	\$33	\$4,027	\$3,920	\$ 860	\$(808)	\$55	\$ 4,027
2010 Periods										
Totals	\$3,768	\$ 180	\$(109)	\$8	\$3,847	\$3,473	\$ 620	\$(268)	\$22	\$ 3,847

The composition of loans receivable and the allowance for loan losses is as follows:

September 30, 2011 (in thousands)	Collectively evaluated		Individually evaluated		Total portfolio	
	Loan balance	Allowance	Loan balance	Allowance	Loan balance	Allowance
Residential 1-4 family	\$175,177	\$721	\$5,038	\$473	\$180,215	\$1,194
Residential 5+ multifamily	2,798	19	-	-	2,798	19
Construction of residential 1-4 family	4,422	15	3,643	-	8,065	15
Home equity credit	34,345	378	287	-	34,632	378
Residential real estate	216,742	1,133	8,968	473	225,711	1,606
Commercial	73,484	835	7,974	166	81,458	1,001
Construction of commercial	5,802	64	-	-	5,802	64
Commercial real estate	79,286	899	7,974	166	87,260	1,065
Farm land	4,879	39	840	150	5,719	189
Vacant land	8,675	101	4,010	85	12,685	186
Real estate secured	309,582	2,172	21,792	874	331,374	3,046
Commercial and industrial	26,072	342	1,388	117	27,460	459
Municipal	2,549	25	-	-	2,549	25
Consumer	4,417	44	161	47	4,578	91
Unallocated allowance	-	-	-	-	-	406
Totals	\$342,620	\$2,583	\$23,341	\$1,038	\$365,961	\$4,027

The credit quality segments of loans receivable and the allowance for loan losses are as follows:

September 30, 2011 (in thousands)	Collectively evaluated		Individually evaluated		Total portfolio	
	Loan balance	Allowance	Loan balance	Allowance	Loan balance	Allowance

Edgar Filing: SALISBURY BANCORP INC - Form 10-Q

Performing loans	\$334,822	\$2,342	\$677	\$47	\$335,499	\$2,390
Potential problem loans	7,798	241	6,701	506	14,499	747
Impaired loans	-	-	15,963	484	15,963	484
Unallocated allowance	-	-	-	-	-	406
Totals	\$342,620	\$2,583	\$23,341	\$1,037	\$365,961	\$4,027

Certain data with respect to impaired loans individually evaluated is as follows:

September 30, 2011 (in thousands)	Impaired loans with specific allowance					Impaired loans with no specific allowance			
	Book	Loan balance Note	Average	Specific allowance	Income recognized	Book	Loan balance Note	Average	Income recognized
Residential 1-4 family	\$ 2,271	\$ 2,420	\$ 1,565	\$ 187	\$ 16	\$ 3,649	\$ 3,674	\$ 4,398	\$ 59
Home equity credit	-	-	-	-	-	248	254	246	1
Residential real estate	2,271	2,420	1,565	187	16	3,897	3,928	4,644	60
Commercial	2,482	2,650	2,618	146	68	2,221	2,699	2,156	25
Vacant land	594	774	701	35	-	3,263	3,627	3,233	-
Real estate secured	5,347	5,844	4,884	368	84	9,381	10,254	10,033	85
Commercial and industrial	140	144	263	116	2	1,095	1,724	898	6
Consumer	-	-	-	-	-	-	143	18	-
Totals	\$ 5,487	\$ 5,988	\$ 5,147	\$ 484	\$ 86	\$ 10,476	\$ 12,121	\$ 10,949	\$ 91

NOTE 4 - MORTGAGE SERVICING RIGHTS

Loans serviced for others are not included in the Consolidated Balance Sheets. The balance of loans serviced for others and the fair value of mortgage servicing rights are as follows:

September 30, (in thousands)	2011	2010
Residential mortgage loans serviced for others	\$105,256	\$78,119
Fair value of mortgage servicing rights	695	517

Changes in mortgage servicing rights are as follows:

Periods ended September 30, (in thousands)	Three months		Nine months	
	2011	2010	2011	2010
Loan Servicing Rights				
Balance, beginning of period	\$674	\$465	\$683	\$427
Originated	75	115	181	226
Amortization (1)	(50)	(45)	(165)	(118)
Balance, end of period	699	535	699	535
Valuation Allowance				
Balance, beginning of period	(25)	(24)	(10)	(30)
(Increase) decrease in impairment reserve (1)	(65)	(57)	(80)	(51)
Balance, end of period	(90)	(81)	(90)	(81)
Loan servicing rights, net	\$609	\$454	\$609	\$454

(1) Amortization expense and changes in the impairment reserve are recorded in loan servicing fee income.

NOTE 5 - PLEDGED ASSETS

The following securities and loans were pledged to secure public and trust deposits, securities sold under agreements to repurchase, FHLBB advances and credit facilities available.

in thousands)	September 30, 2011	December 31, 2010
Securities available-for-sale (at fair value)	\$ 70,081	\$ 62,764
Loans receivable	118,033	114,424
Total pledged assets	\$ 188,114	\$ 177,188

At September 30, 2011, securities were pledged as follows: \$47.5 million to secure public deposits, \$19.9 million to secure repurchase agreements and \$2.7 million to secure FHLBB advances. Loans receivable were pledged to secure FHLBB advances and credit facilities.

NOTE 6 – EARNINGS PER SHARE

The calculation of earnings per share is as follows:

Periods ended September 30, (in thousands, except per share amounts)	Three months		Nine months	
	2011	2010	2011	2010
Net income	\$1,039	\$947	\$2,864	\$2,420
Preferred stock net accretion	(67)	(5)	(78)	(16)
Preferred stock dividends paid	(107)	(110)	(327)	(331)
Net income available to common shareholders	\$865	\$832	\$2,459	\$2,073
Weighted average common stock outstanding – basic	1,689	1,686	1,688	1,686
Weighted average common and common equivalent stock outstanding- diluted	1,689	1,686	1,688	1,686
Earnings per common and common equivalent share				
Basic	\$0.51	\$0.49	\$1.46	\$1.23
Diluted	0.51	0.49	1.46	1.23

NOTE 7 – SHAREHOLDERS' EQUITY

Capital Requirements

Salisbury and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional and discretionary actions by the regulators that, if undertaken, could have a direct material effect on Salisbury and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, Salisbury and the Bank must meet specific guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. Salisbury and the Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require Salisbury and the Bank to maintain minimum amounts and ratios (set forth in the table below) of Tier 1 capital (as defined) to average assets (as defined) and total and Tier 1 capital (as defined) to risk-weighted assets (as defined). Management believes, as of September 30, 2011, that Salisbury and the Bank meet all of their capital adequacy requirements.

The Bank was classified, as of its most recent notification, as "well capitalized". The Bank's actual regulatory capital position and minimum capital requirements as defined "To Be Well Capitalized Under Prompt Corrective Action Provisions" and "For Capital Adequacy Purposes" are as follows:

(dollars in thousands)	Actual		For Capital Adequacy Purposes		To be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
September 30, 2011						
Total Capital (to risk-weighted assets)						
Salisbury	\$ 60,280	15.98 %	\$ 30,186	8.0 %	n/a	-
Bank	50,002	13.07	30,595	8.0	\$ 38,244	10.0 %
Tier 1 Capital (to risk-weighted assets)						
Salisbury	56,157	14.88	15,093	4.0	n/a	-
Bank	45,879	12.00	15,297	4.0	22,946	6.0
Tier 1 Capital (to average assets)						
Salisbury	56,157	9.49	24,102	4.0	n/a	-
Bank	45,879	7.77	24,056	4.0	30,070	5.0
September 30, 2010						
Total Capital (to risk-weighted assets)						
Salisbury	\$ 50,887	13.87 %	\$ 29,345	8.0 %	n/a	-
Bank	41,300	11.29	29,258	8.0	\$ 36,572	10.0 %
Tier 1 Capital (to risk-weighted assets)						
Salisbury	47,001	12.81	14,672	4.0	n/a	-
Bank	37,415	10.23	14,629	4.0	21,943	6.0
Tier 1 Capital (to average assets)						
Salisbury	47,001	8.32	22,599	4.0	n/a	-
Bank	37,415	6.62	22,599	4.0	28,249	5.0

Restrictions on Cash Dividends to Common Shareholders

Salisbury's ability to pay cash dividends is dependent on the Bank's ability to pay cash dividends to Salisbury. There are certain restrictions on the payment of cash dividends and other payments by the Bank to Salisbury. Under Connecticut law, the Bank cannot declare a cash dividend except from net profits, defined as the remainder of all earnings from current operations. The total of all cash dividends declared by the Bank in any calendar year shall not, unless specifically approved by the Banking Commissioner, exceed the total of its net profits of that year combined with its retained net profits of the preceding two years.

Federal Reserve Board ("FRB") Supervisory Letter SR 09-4, February 24, 2009, revised March 27, 2009, notes that, as a general matter, the Board of Directors of a Bank Holding Company ("BHC") should inform the Federal Reserve and should eliminate, defer, or significantly reduce dividends if (1) net income available to shareholders for the past four

quarters, net of dividends previously paid during that period, is not sufficient to fully fund the dividends; (2) the prospective rate of earnings retention is not consistent with capital needs and overall current and prospective financial condition; or (3) the BHC will not meet, or is in danger of not meeting, its minimum regulatory capital adequacy ratios. Moreover, a BHC should inform the Federal Reserve reasonably in advance of declaring or paying a dividend that exceeds earnings for the period (e.g., quarter) for which the dividend is being paid or that could result in a material adverse change to the BHC capital structure.

Preferred Stock

In August 2011, Salisbury issued to the U.S. Secretary of the Treasury (the "Treasury") \$16,000,000 of its Series B Preferred Stock under the Small Business Lending Fund (the "SBLF") program. The SBLF program is a \$30 billion fund established under the Small Business Jobs Act of 2010 to encourage lending to small businesses by providing Tier 1 capital to qualified community banks with assets of less than \$10 billion. The Preferred Stock qualifies as Tier 1 capital for regulatory purposes and ranks senior to the Common Stock.

The Series B Preferred Stock pays noncumulative dividends. The dividend rate on the Series B Preferred Stock for the initial quarterly dividend period ending September 30, 2011 and each of the next nine quarterly dividend periods the Series B Preferred Stock is outstanding is determined each quarter based on the increase in the Bank's Qualified Small Business Lending. The dividend rate in the initial quarterly dividend period ending September 30, 2011 was 2.45100% and in the quarterly dividend period ending December 31, 2011 will be 1.55925%. For the tenth quarterly dividend period through four and one-half years after its issuance, the dividend rate on the Series B Preferred Stock will be fixed at the rate in effect at the end of the ninth quarterly dividend period and after four and one-half years from its issuance the dividend rate will be fixed at 9 percent per annum. On September 30, 2011, Salisbury declared a Series B Preferred Stock dividend of \$39,216 payable on October 3, 2011. The Series B Preferred Stock is non-voting, other than voting rights on matters that could adversely affect the Series B Preferred Stock. The Series B Preferred Stock is redeemable at any time at one hundred percent of the issue price plus any accrued and unpaid dividends.

Simultaneously with the receipt of the SBLF capital, Salisbury repurchased for \$8,816,000 all of its Series A Preferred Stock sold to the Treasury in 2009 under the Capital Purchase Program, a part of the Troubled Asset Relief Program of the Emergency Economic Stabilization Act of 2008, and made a payment for accrued dividends. The transaction resulted in net capital proceeds to Salisbury of \$7,184,000, of which Salisbury invested \$6,465,600, or 90%, in the Bank as Tier 1 Capital.

As part of the CPP, Salisbury had issued to the Treasury a 10-year Warrant to purchase 57,671 shares of Common Stock at an exercise price of \$22.93 per share. The Warrant was repurchased for \$205,000 on November 2, 2011.

NOTE 8 – PENSION AND OTHER BENEFITS

The components of net periodic cost for Salisbury’s insured noncontributory defined benefit retirement plan were as follows:

Periods ended September 30, (in thousands)	Three months		Nine months	
	2011	2010	2011	2010
Service cost	\$67	\$87	\$258	\$261
Interest cost on benefit obligation	101	90	287	271
Expected return on plan assets	(102)	(99)	(314)	(298)
Amortization of prior service cost	-	-	-	-
Amortization of net loss	23	17	56	51
Net periodic benefit cost	\$89	\$95	\$287	\$285

Salisbury’s 401(k) Plan contribution expense was \$75,000 and \$41,000, respectively, for the three month periods ended September 30, 2011 and 2010. Other post-retirement benefit obligation expense for endorsement split-dollar life insurance arrangements was \$12,000 and \$12,000, respectively, for the three month periods ended September 30, 2011 and 2010.

NOTE 9 - COMPREHENSIVE INCOME

Comprehensive income includes net income and any changes in equity from non-owner sources that are not recorded in the income statement (such as changes in net unrealized gains (losses) on securities). The purpose of reporting comprehensive income is to report a measure of all changes in equity of an enterprise that result from recognized transactions and other economic events of the period other than transactions with owners in their capacity as owners.

The components of comprehensive income are as follows:

Periods ended September 30, (in thousands)	Three months		Nine months	
	2011	2010	2011	2010
Net income	\$1,039	\$947	\$2,864	\$2,420
Other comprehensive income				
Net unrealized gains on securities available-for-sale	2,544	3,291	6,144	6,600
Reclassification of net realized gains in net income	-	(16)	11	(16)
Unrealized gains on securities available-for-sale	2,544	3,275	6,155	6,584
Income tax expense	(865)	(587)	(2,093)	(2,238)
Unrealized gains on securities available-for-sale, net of tax	1,679	2,688	4,062	4,346
Pension plan income	17	17	50	52
Income tax expense	(6)	(6)	(17)	(18)
Pension plan income, net of tax	11	11	33	34
Other comprehensive income, net of tax	1,690	2,699	4,095	4,380
Comprehensive income	\$2,729	\$3,646	\$6,959	\$6,800

The components of accumulated other comprehensive losses are as follows:

September 30, (in thousands)	2011	2010
Unrealized losses on securities available-for-sale, net of tax	\$1,480	\$515
Unrecognized pension plan expense, net of tax	(1,154)	(1,213)
Accumulated other comprehensive loss, net	\$326	\$(698)

NOTE 10 – FAIR VALUE OF ASSETS AND LIABILITIES

Salisbury uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Securities available-for-sale are recorded at fair value on a recurring basis. Additionally, from time to time, other assets are recorded at fair value on a nonrecurring basis, such as loans held for sale, collateral dependent impaired loans, property acquired through foreclosure or repossession and mortgage servicing rights. These nonrecurring fair value adjustments typically involve the application of lower-of-cost-or-market accounting or write-downs of individual assets.

Salisbury adopted ASC 820-10, “Fair Value Measurements and Disclosures,” which provides a framework for measuring fair value under generally accepted accounting principles, in 2008. This guidance permitted Salisbury the irrevocable option to elect fair value for the initial and subsequent measurement for certain financial assets and liabilities on a contract-by-contract basis. Salisbury did not elect fair value treatment for any financial assets or liabilities upon adoption.

In accordance with ASC 820-10, Salisbury groups its financial assets and financial liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

GAAP specifies a hierarchy of valuation techniques based on whether the types of valuation information (“inputs”) are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect Salisbury’s market assumptions. These two types of inputs have created the following fair value hierarchy

- Level 1. Quoted prices in active markets for identical assets. Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. Level 1 also includes U.S. Treasury, other U.S. Government and agency mortgage-backed securities that are traded by dealers or brokers in active markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.
- Level 2. Significant other observable inputs. Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third party pricing services for identical or comparable assets or liabilities.
- Level 3. Significant unobservable inputs. Valuations for assets and liabilities that are derived from other methodologies, including option pricing models, discounted cash flow models and similar techniques, and are not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets and liabilities.

A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

The following is a description of valuation methodologies for assets recorded at fair value, including the general classification of such assets and liabilities pursuant to the valuation hierarchy.

- **Securities available-for-sale.** Securities available-for-sale are recorded at fair value on a recurring basis. Level 1 securities include exchange-traded equity securities. Level 2 securities include debt securities with quoted prices, which are traded less frequently than exchange-traded instruments, whose value is determined using matrix pricing with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes obligations of the U.S. Treasury and U.S. government-sponsored enterprises, mortgage-backed securities, collateralized mortgage obligations, municipal bonds, SBA bonds, corporate bonds and certain preferred equities. Level 3 is for positions that are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence. In the absence of such evidence, management's best estimate is used. Subsequent to inception, management only changes level 3

inputs and assumptions when corroborated by evidence such as transactions in similar instruments, completed or pending third-party transactions in the underlying investment or comparable entities, subsequent rounds of financing, recapitalization and other transactions across the capital structure, offerings in the equity or debt markets, and changes in financial ratios or cash flows.

- Collateral dependent loans that are deemed to be impaired are valued based upon the fair value of the underlying collateral less costs to sell. Such collateral primarily consists of real estate and, to a lesser extent, other business assets. Management may adjust appraised values to reflect estimated market value declines or apply other discounts to appraised values resulting from its knowledge of the property. Internal valuations are utilized to determine the fair value of other business assets. Collateral dependent impaired loans are categorized as Level 3.
- Other real estate owned acquired through foreclosure or repossession is adjusted to fair value less costs to sell upon transfer out of loans. Subsequently, it is carried at the lower of carrying value or fair value less costs to sell. Fair value is generally based upon independent market prices or appraised values of the collateral. Management adjusts appraised values to reflect estimated market value declines or apply other discounts to appraised values for unobservable factors resulting from its knowledge of the property, and such property is categorized as Level 3.

Assets measured at fair value are as follows:

(in thousands)	Fair value measurements using			Assets at fair value
	Level 1	Level 2	Level 3	
September 30, 2011				
Assets at fair value on a recurring basis				
Securities available-for-sale	\$ 164	\$ 151,078	\$ -	\$ 151,078
Assets at fair value on a non-recurring basis				
Impaired loans	-	-	5,003	5,003
Other real estate owned	-	-	37	37

Changes in Level 3 assets measured at fair value are as follows:

(in thousands)	Securities	Impaired	Other real	Level 3
	available-for-sale	Loans	estate owned	assets at fair value
Balance, December 31, 2010	\$ -	\$ 4,768	\$ 557	\$5,325
Gains and losses (realized/unrealized)				
Included in earnings	-	-	-	-
Included in other comprehensive income	-	-	-	-
Principal pay-downs of securities, net of accretion	-	-	-	-
Write-down of other real estate owned			(157)	(157)
Transfers in and/or out of Level 3	-	235	(363)	(128)
Balance, September 30, 2011	\$ -	\$ 5,003	\$ 37	\$5,040
Amount of total gains or losses for the period attributable to the change in unrealized gains or losses relating to assets still held at the reporting date	\$ -	\$ -	\$ -	\$ -

Carrying values and estimated fair values of financial instruments are as follows:

(in thousands)	September 30, 2011		December 31, 2010	
	Carrying Value	Estimated fair value	Carrying Value	Estimated fair value
Financial Assets				
Cash and due from banks	\$65,517	\$65,517	\$26,908	\$26,908
Interest bearing time deposits with other banks	-	-	5,000	5,000
Securities available-for-sale	151,078	151,078	147,422	147,422
Security held-to-maturity	52	54	56	58
Federal Home Loan Bank stock	6,032	6,032	6,032	6,032
Loans held-for-sale	1,057	1,065	1,184	1,193
Loans receivable net	362,879	362,491	352,449	351,628
Accrued interest receivable	2,042	2,042	2,132	2,132
Financial Liabilities				
Demand (non-interest-bearing)	82,425	82,425	71,565	71,565
Demand (interest-bearing)	71,303	71,303	63,258	63,258
Money market	122,184	122,184	77,089	77,089
Savings and other	97,405	97,405	93,324	93,324
Certificates of deposit	105,274	106,165	125,053	125,172
Deposits	478,591	479,482	430,289	430,408
FHLBB advances	55,033	59,617	72,812	78,317
Repurchase agreements	14,787	14,787	13,190	13,190
Accrued interest payable	284	284	435	435

The carrying amounts of financial instruments shown in the above table are included in the consolidated balance sheets under the indicated captions.

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

Management's Discussion and Analysis of Financial Condition and Results of Operations of Salisbury and its subsidiary should be read in conjunction with Salisbury's Annual Report on Form 10-K for the year ended December 31, 2010.

BUSINESS

Salisbury Bancorp, Inc. ("Salisbury"), a Connecticut corporation, formed in 1998, is a bank holding company for Salisbury Bank and Trust Company ("Bank"), a Connecticut-chartered and Federal Deposit Insurance Corporation (the "FDIC") insured commercial bank headquartered in Lakeville, Connecticut. Salisbury's principal business consists of the business of the Bank. The Bank, formed in 1848, is engaged in customary banking activities, including general deposit taking and lending activities to both retail and commercial markets, and trust and wealth advisory services. The Bank conducts its banking business from eight full-service offices in the towns of Canaan, Lakeville, Salisbury and Sharon, Connecticut, South Egremont and Sheffield, Massachusetts, Millerton and Dover Plains, New York, and its trust and wealth advisory services from offices in Lakeville, Connecticut.

Application of Critical Accounting Policies

Salisbury's consolidated financial statements follow GAAP as applied to the banking industry in which it operates. Application of these principles requires management to make estimates, assumptions and judgments that affect the amounts reported in the financial statements. These estimates, assumptions and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions and judgments and as such have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried at fair value warrants an impairment write-down or valuation reserve to be established, or when an asset or liability needs to be recorded contingent upon a future event.

Salisbury's significant accounting policies are presented in Note 1 of Notes to Consolidated Financial Statements in Salisbury's 2010 Annual Report on Form 10-K for the year ended December 31, 2010 and, along with this Management's Discussion and Analysis, provide information on how significant assets are valued in the financial statements and how those values are determined. Management believes that the following accounting estimates are the most critical to aid in fully understanding and evaluating Salisbury's reported financial results, and they require management's most difficult, subjective or complex judgments, resulting from the need to make estimates about the effect of matters that are inherently uncertain.

The allowance for loan losses represents management's estimate of credit losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on the balance sheet. Note 1 of Notes to Consolidated Financial Statements in Salisbury's 2010 Annual Report on Form 10-K for the period ended December 31, 2010 describes the methodology used to determine the allowance for loan losses. In addition, a discussion of the factors driving changes in the amount of the allowance for loan losses are included in the "Provision and Allowance for Loan Losses" section of Management's Discussion and Analysis of this Quarterly Report.

Management evaluates goodwill and identifiable intangible assets for impairment annually using valuation techniques that involve estimates for discount rates, projected future cash flows and time period calculations, all of which are susceptible to change based on changes in economic conditions and other factors. Future events or changes in the estimates, which are used to determine the carrying value of goodwill and identifiable intangible assets or which otherwise adversely affects their value or estimated lives could have a material adverse impact on the results of operations.

Management evaluates securities for other-than-temporary impairment giving consideration to the extent to which the fair value has been less than cost, estimates of future cash flows, delinquencies and default severity, and the intent and ability of Salisbury to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. The consideration of the above factors is subjective and involves estimates and assumptions about matters that are inherently uncertain. Should actual factors and conditions differ materially from those used by management, the actual realization of gains or losses on investment securities could differ materially from the amounts recorded in the financial statements.

The determination of the obligation and expense for pension and other postretirement benefits is dependent on certain assumptions used in calculating such amounts. Key assumptions used in the actuarial valuations include the discount rate, expected long-term rate of return on plan assets and rates of increase in compensation and health care costs.

Actual results could differ from the assumptions and market driven rates may fluctuate. Significant differences in actual experience or significant changes in the assumptions may materially affect the future pension and other postretirement obligations and expense.

RESULTS OF OPERATIONS

For the three month periods ended September 30, 2011 and 2010

Overview

Net income available to common shareholders was \$865,000, or \$0.51 per common share, for its third quarter ended September 30, 2011 (third quarter 2011), compared with \$766,000, or \$0.45 per common share, for the second quarter ended June 30, 2011 (second quarter 2011), and \$832,000, or \$0.49 per common share, for the third quarter ended September 30, 2010 (third quarter 2010).

Net income available to common shareholders for third quarter 2011 and 2010 is net of preferred stock dividends and accretion of \$174,000 and \$116,000, respectively.

- Earnings per common share increased \$0.06, or 13.3%, to \$0.51 versus second quarter 2011, and \$0.02, or 4.0%, versus third quarter 2010.
- Tax equivalent net interest income increased \$7,000, or 0.1%, versus second quarter 2011, and increased \$268,000, or 5.8%, versus third quarter 2010.
- Provision for loan losses was \$180,000, versus \$350,000 for second quarter 2011 and \$180,000 for third quarter 2010. Net loan charge-offs were \$132,000, versus \$349,000 for second quarter 2011 and \$101,000 for third quarter 2010.
- Non-interest income increased \$104,000, or 8.5%, versus second quarter 2011 and increased \$12,000, or 0.9%, versus third quarter 2010.
- Non-interest expense increased \$103,000, or 2.3%, versus second quarter 2011 and \$221,000, or 5.1%, versus third quarter 2010.
- Non-performing assets decreased \$1.1 million to \$13.9 million, or 2.25% of total assets, versus second quarter 2011 and \$3.0 million versus third quarter 2010. Loans receivable 30 days or more past due increased \$0.4 million to \$9.1 million, or 2.5% of gross loans, versus second quarter 2011 and increased \$768,000 versus third quarter 2010.

Net Interest Income

Tax equivalent net interest income increased \$268,000, or 5.8%, to \$489 million for third quarter 2011 as compared with third quarter 2010, and the net interest margin increased 4 basis points to 3.43% from 3.39%, for the respective periods.

The following table sets forth the components of Salisbury's tax-equivalent net interest income and yields on average interest-earning assets and interest-bearing funds.

Three months ended September 30, (dollars in thousands)	Average Balance		Income / Expense		Average Yield / Rate	
	2011	2010	2011	2010	2011	2010
Loans (a)	\$ 367,681	\$ 345,855	\$ 4,630	\$ 4,693	5.03 %	5.42 %
Securities (c)(d)	139,608	152,865	1,549	1,730	4.44	4.53
FHLBB stock	6,032	6,032	5	-	0.36	-
Short term funds (b)	54,159	38,200	30	42	0.22	0.44
Total earning assets	567,480	542,952	6,214	6,465	4.37	4.75
Other assets	35,066	34,248				
Total assets	\$ 602,546	\$ 577,200				
Interest-bearing demand deposits	\$ 65,906	\$ 61,090	108	161	0.65	1.04
Money market accounts	117,812	74,934	128	102	0.43	0.54
Savings and other	97,330	92,277	95	136	0.39	0.58
Certificates of deposit	106,627	130,802	417	662	1.55	2.01
Total interest-bearing deposits	387,675	359,103	748	1,061	0.77	1.17
Repurchase agreements	15,439	13,202	19	25	0.50	0.75
FHLBB advances	55,175	74,673	565	765	4.01	4.01
Total interest-bearing liabilities	458,289	446,978	1,332	1,851	1.15	1.64
Demand deposits	79,599	70,501				
Other liabilities	3,238	4,009				
Shareholders' equity	61,420	55,712				
Total liabilities & shareholders' equity	\$ 602,546	\$ 577,200				
Net interest income			\$ 4,882	\$ 4,614		
Spread on interest-bearing funds					3.22	3.11
Net interest margin (e)					3.43	3.39

- (a) Includes non-accrual loans.
(b) Includes interest-bearing deposits in other banks and federal funds sold.
(c) Average balances of securities are based on historical cost.
(d) Includes tax exempt income benefit of \$258,000 and \$259,000, respectively for 2011 and 2010 on tax-exempt securities whose income and yields are calculated on a tax-equivalent basis.
(e) Net interest income divided by average interest-earning assets.

The following table sets forth the changes in FTE interest due to volume and rate.

Three months ended September 30, (in thousands)	2011 versus 2010		
	Volume	Rate	Net
Change in interest due to Interest-earning assets			
Loans	\$286	\$(349)	\$(63)
Securities	(149)	(32)	(181)

Edgar Filing: SALISBURY BANCORP INC - Form 10-Q

FHLBB stock	-	5	5
Short term funds	13	(25)	(12)
Total	150	(401)	(251)
Interest-bearing liabilities			
Deposits	(40)	(273)	(313)
Repurchase agreements	3	(9)	(6)
FHLBB advances	(200)		(200)
Total	(237)	(282)	(519)
Net change in net interest income	\$387	\$(119)	\$268

Interest Income

Tax equivalent interest income decreased \$251,000, or 3.9%, to \$6.2 million for third quarter 2011 as compared with third quarter 2010.

Loan income decreased \$63,000, or 1.3%, primarily due to a 39 basis points decline in the average loan yield offset in part by a \$21.8 million, or 6.3%, increase in average loans.

Tax equivalent securities income decreased \$181,000, or 10.5%, for third quarter 2011 as compared with third quarter 2010, as a result of a \$13.3 million, or 8.7%, decrease in average volume and a 9 basis points decline in the average yield. The decline in volume resulted from the redeployment of some of the cash flows from securities maturities, principal payments and calls, into new loans. Changes in securities yields resulted from the effect of changes in market interest rates on securities purchases, calls of agency bonds and prepayments of mortgage backed securities.

Income from short term funds decreased \$12,000 for third quarter 2011 as compared with third quarter 2010 as a result of a 22 basis points decline in the average yield offset in part by a \$16.0 million increase in the average balance.

Interest Expense

Interest expense decreased \$519,000, or 28.0%, to \$1.3 million for third quarter 2011 as compared with third quarter 2010.

Interest on deposit accounts and retail repurchase agreements decreased \$313,000, or 29.5%, and \$6,000, or 24.0% respectively as a result of lower average rates, down 40 basis points to 0.77% on deposits and 25 basis points to 0.50% on repurchase agreements. Decreased rates were offset in part by a \$28.6 million, or 8.0%, increase in the average balance of deposits and an increase of \$2.2 million, or 16.9% increase in the average balance of repurchase agreements. The lower average rate resulted from the effect of lower market interest rates on rates paid and changes in product mix. The higher average volume resulted from deposit growth.

Interest expense on FHLBB borrowings decreased \$200,000 as a result of lower average borrowings, down \$19.5 million, and average borrowing rate remaining flat as compared with third quarter 2010. The decline in advances resulted from scheduled maturities that were not replaced with new advances.

Provision and Allowance for Loan Losses

The provision for loan losses was \$180,000 for third quarter 2011 and for third quarter 2010. Net loan charge-offs were \$132,000 and \$101,000, for the respective quarters. The following table sets forth changes in the allowance for loan losses and other selected statistics:

Periods ended September 30, (dollars in thousands)	Three months		Nine months	
	2011	2010	2011	2010
Balance, beginning of period	\$3,979	\$3,768	\$3,920	\$3,473
Provision for loan losses	180	180	860	620
Charge-offs				
Real estate mortgages	(155)	(100)	(531)	(235)
Commercial & industrial	-	-	(89)	-
Consumer	(10)	(9)	(188)	(33)
Total charge-offs	(165)	(109)	(808)	(268)
Recoveries				
Real estate mortgages	1	-	4	-
Commercial & industrial	29	-	29	-
Consumer	3	8	22	22
Total recoveries	33	8	55	22
Net charge-offs	(132)	(101)	(753)	(246)
Balance, end of period	\$4,027	\$3,847	\$4,027	\$3,847
Loans receivable, gross			\$365,961	\$343,491

Edgar Filing: SALISBURY BANCORP INC - Form 10-Q

Non-performing loans	13,911		10,917	
Accruing loans past due 30-89 days	2,398		1,649	
Ratio of allowance for loan losses:				
to loans receivable, gross	1.10	%	1.12	%
to non-performing loans	28.95		35.24	
Ratio of non-performing loans to loans receivable, gross	3.80		3.18	
Ratio of accruing loans past due 30-89 days to loans receivable, gross	0.66		0.48	

Reserve coverage at September 30, 2011, as measured by the ratio of allowance for loan losses to gross loans, remained substantially unchanged at 1.10%, as compared with 1.08% at June 30, 2011, 1.10% at December 31, 2010 and 1.12% a year ago at September 30, 2010. During the first nine months of 2011 non-performing loans (non-accrual loans and accruing loans past-due 90 days or more) increased \$3.8 million to \$13.9 million, or 3.80% of gross loans receivable, while accruing loans past due 30-89 days increased \$481,000 to \$2.4 million, or 0.66% of gross loans receivable. See “Financial Condition – Loan Credit Quality” for further discussion and analysis.

The credit quality segments of loans receivable and the allowance for loan losses are as follows:

(in thousands)	September 30, 2011		December 31, 2010	
	Loan Balance	Allowance	Loan Balance	Allowance
Performing loans	\$334,822	\$2,342	\$332,240	\$2,500
Potential problem loans	7,798	241	5,744	169
Collectively evaluated	342,620	2,583	337,984	2,669
Performing loans	677	47	-	-
Potential problem loans	6,701	506	2,188	330
Impaired loans	15,963	484	15,375	785
Individually evaluated	23,341	1,037	17,563	1,115
Unallocated allowance	-	407	-	136
Totals	\$365,961	\$4,027	\$355,547	\$3,920

The allowance for loan losses represents management's estimate of the probable credit losses inherent in the loan portfolio as of the reporting date. The allowance is increased by provisions charged to earnings and by recoveries of amounts previously charged off, and is reduced by loan charge-offs. Loan charge-offs are recognized when management determines a loan or portion of a loan to be uncollectible. The allowance for loan losses is computed by segregating the portfolio into three components: (1) loans collectively evaluated for impairment: general loss allocation factors for non-impaired loans are segmented into pools of loans based on similar risk characteristics such as loan product, collateral type and loan-to-value, loan risk rating, historical loss experience, delinquency factors and other similar economic indicators, (2) loans individually evaluated for impairment: individual loss allocations for loans deemed to be impaired based on discounted cash flows or collateral value, and (3) unallocated: general loss allocations for other environmental factors.

Impaired loans and certain potential problem loans, where warranted, are individually evaluated for impairment. Impairment is measured for each individual loan, or for a borrower's aggregate loan exposure, using either the fair value of the collateral if the loan is collateral dependent or the present value of expected future cash flows discounted at the loan's effective interest rate. An allowance is established when the collateral value or discounted cash flows of the loan is lower than the carrying value of that loan.

The component of the allowance for loan losses for loans collectively evaluated for impairment is estimated by stratifying loans into segments and credit risk ratings and applying management's general loss allocation factors. The general loss allocation factors are based on expected loss experience adjusted for historical loss experience and other qualitative factors, including levels/trends in delinquencies; trends in volume and terms of loans; effects of changes in risk selection and underwriting standards and other changes in lending policies, procedures and practices; experience/ability/depth of lending management and staff; and national and local economic trends and conditions. The qualitative factors are determined based on the various risk characteristics of each loan segment. There were no significant changes in Salisbury's policies or methodology pertaining to the general component of the allowance for loan losses during the quarter ended September 30, 2011.

The unallocated component of the allowance is maintained to cover uncertainties that could affect management's estimate of probable losses. It reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating allocated and general reserves in the portfolio.

Determining the adequacy of the allowance at any given period is difficult, particularly during deteriorating or uncertain economic periods, and management must make estimates using assumptions and information that are often subjective and changing rapidly. The review of the loan portfolio is a continuing event in light of a changing

economy and the dynamics of the banking and regulatory environment. Should the economic climate deteriorate, borrowers could experience difficulty and the level of non-performing loans, charge-offs and delinquencies could rise and require increased provisions. In management's judgment, Salisbury remains adequately reserved both against total loans and non-performing loans at September 30, 2011.

Management's loan risk rating assignments, loss percentages and specific reserves are subjected annually to an independent credit review by an external firm. In addition, the bank is examined annually on a rotational process by one of its two primary regulatory agencies, the FDIC and CTDOB. As an integral part of their examination process, the FDIC and CTDOB review the Bank's credit risk ratings and allowance for loan losses. The Bank was examined by the CTDOB April 2010 and by the FDIC in May 2011.

Non-interest income

The following table details the principal categories of non-interest income.

Three months ended September 30, (dollars in thousands)	2011	2010	2011 vs. 2010	
Trust and wealth advisory fees	\$599	\$471	\$128	27.18 %
Service charges and fees	534	528	6	1.14
Gains on sales of mortgage loans, net	178	278	(100)	(35.97)
Mortgage servicing, net	(35)	(33)	(2)	(6.06)
Gains on securities, net	-	16	(16)	(100.00)
Other	58	62	(4)	(6.45)
Total non-interest income	\$1,334	\$1,322	\$12	(0.91)%

Non-interest income for third quarter 2011 increased \$104,000 versus second quarter 2011 and increased \$12,000 versus third quarter 2010. Trust and Wealth Advisory revenues increased \$3,000 versus second quarter 2011 and increased \$128,000 versus third quarter 2010. The year-over-year revenue increase results from growth in managed assets and higher estate fees offset in part by lower asset valuations. Service charges and fees increased \$12,000 versus second quarter 2011 and \$6,000 versus third quarter 2010. Income from sales and servicing of mortgage loans increased \$89,000 versus second quarter 2011 and decreased \$102,000 versus third quarter 2010 due to interest rate driven fluctuations in fixed rate residential mortgage loan sales and mortgage servicing valuations. Mortgage loans sales totaled \$7.6 million for third quarter 2011, \$2.4 million for second quarter 2011 and \$16.7 million for third quarter 2010. Third quarter 2011, second quarter 2011 and third quarter 2010 included mortgage servicing valuation impairment charges of \$65,000, \$16,000 and \$56,000, respectively. Gains on securities represent the accretion of discounts on called securities. Other income consisted of bank owned life insurance income and rental income.

Non-interest expense

The following table details the principal categories of non-interest expense.

Three months ended September 30, (dollars in thousands)	2011	2010	2011 vs. 2010	
Salaries	\$1,816	\$1,750	\$66	3.77 %
Employee benefits	636	522	114	21.84
Premises and equipment	582	559	23	4.11
Data processing	366	308	58	18.83
Professional fees	307	393	(86)	(21.88)
Collections and OREO	152	12	140	1,166.67
FDIC insurance	137	195	(58)	(29.74)
Marketing and community contributions	85	79	6	7.59
Amortization of intangible assets	56	56	-	-
Other	398	440	(42)	(9.55)
Non-interest expense	\$4,535	\$4,314	\$221	5.12 %

Non-interest expense for third quarter 2011 increased \$103,000 versus second quarter 2011 and \$221,000 versus third quarter 2010. Salaries increased \$66,000 versus third quarter 2010 due to changes in staffing levels and mix. Employee benefits increased \$114,000 versus third quarter 2010 due to higher health benefits expense, caused by year-over-year premium increases and higher staff utilization, and higher 401K Plan expense due to the implementation of a Safe Harbor Plan. Premises and equipment increased \$14,000 versus second quarter 2011 and increased \$23,000 versus third quarter 2010. The year-over-year increase is due primarily to several facilities renovations, equipment replacement and asset disposals due to reorganization efforts. Data processing increased

\$81,000 versus second quarter 2011 and \$58,000 versus third quarter 2010. Second quarter 2011 benefited from a one-time vendor rebate. Professional fees increased \$7,000 versus second quarter 2011, and decreased \$86,000 versus third quarter 2010 due to reduced spending on audit, consulting and legal services. Collections and OREO decreased \$91,000 versus second quarter 2011 and increased \$140,000 versus third quarter 2010. FDIC insurance decreased \$45,000 versus second quarter 2011 and decreased \$58,000 versus third quarter 2010 due to a favorable change in the assessment method effective June 30, 2011. Other operating expenses increased \$44,000 versus second quarter 2011 and decreased \$42,000 versus third quarter 2010. Year-over-year decreases were due to reductions in other administrative and operational expenses.

Income taxes

The effective income tax rates for third quarter 2011, second quarter 2011 and third quarter 2010 were 16.43%, 17.18% and 19.93%, respectively. Fluctuations in the effective tax rate result from changes in the mix of taxable and tax exempt income. Salisbury's effective tax rate is generally less than the 34% federal statutory rate due to holdings of tax-exempt municipal bonds and bank owned life insurance.

Salisbury did not incur Connecticut income tax in 2011 or 2010, other than minimum state income tax, as a result of its utilization of Connecticut tax legislation that permits banks to shelter certain mortgage income from the Connecticut corporation business tax through the use of a special purpose entity called a Passive Investment Company ("PIC"). In accordance with this legislation, in 2004 the Bank formed a PIC, SBT Mortgage Service Corporation. Salisbury's income tax provision reflects the full impact of the Connecticut legislation. Salisbury does not expect to pay other than minimum state income tax in the foreseeable future unless there is a change in the State of Connecticut corporate tax law.

For the nine month periods ended September 30, 2011 and 2010

Overview

Net income available to common shareholders was \$2,459,000, or \$1.46 per common share, for the nine month period ended September 30, 2011 (year-to-date 2011) compared with \$2,073,000, or \$1.23 per common share, for the nine month period ended September 30, 2010 (year-to-date 2010).

Net income available to common shareholders for year-to-date 2011 and year-to-date 2010 is net of preferred stock dividends and accretion of \$405,000 and \$346,000, respectively.

Net Interest Income

Tax equivalent net interest income increased \$1,027,000, or 7.6%, to \$14.5 million for year-to-date 2011 as compared with year-to-date 2010, and the net interest margin increased 16 basis points to 3.51% from 3.35%, for the respective periods.

The following table sets forth the components of Salisbury's tax-equivalent net interest income and yields on average interest-earning assets and interest-bearing funds.

Nine months ended

September 30, (dollars in thousands)	Average Balance		Income / Expense		Average Yield / Rate	
	2011	2010	2011	2010	2011	2010
Loans (a)	\$ 366,198	\$ 339,172	\$ 13,989	\$ 13,780	5.10 %	5.42 %
Securities (c)(d)	141,237	156,563	4,686	5,328	4.42	4.54
FHLBB stock	6,032	6,032	18	-	0.40	-
Short term funds (b)	37,786	35,419	96	126	0.34	0.48
Total earning assets	551,253	537,186	18,789	19,234	4.55	4.78
Other assets	34,197	33,149				
Total assets	\$ 585,450	\$ 570,335				
Interest-bearing						
demand deposits	\$ 63,833	\$ 54,925	331	461	0.69	1.12
Money market accounts	103,820	72,148	397	303	0.51	0.56
Savings and other	96,515	89,713	289	421	0.40	0.63
Certificates of deposit	113,364	139,952	1,432	2,200	1.69	2.10
Total interest-bearing deposits	377,532	356,738	2,449	3,385	0.87	1.27
Repurchase agreements	12,339	11,847	46	71	0.50	0.80
FHLBB advances	57,924	75,166	1,772	2,283	4.03	4.01

Total interest-bearing liabilities	447,795	443,751	4,267	5,739	1.27	1.73
Demand deposits	76,121	68,526				
Other liabilities	3,653	3,821				
Shareholders' equity	57,881	54,237				
Total liabilities & shareholders' equity	\$ 585,450	\$ 570,335				
Net interest income			\$ 14,522	\$ 13,495		
S p r e a d o n interest-bearing funds					3.28	3.05
Net interest margin (e)					3.51	3.35
(a)	Includes non-accrual loans.					
(b)	Includes interest-bearing deposits in other banks and federal funds sold.					
(c)	Average balances of securities are based on historical cost.					
(d)	Includes tax exempt income benefit of \$775,000 and \$778,000, respectively for the 2011 and 2010 periods on tax-exempt securities whose income and yields are calculated on a tax-equivalent basis.					
(e)	Net interest income divided by average interest-earning assets.					

The following table sets forth the changes in tax equivalent interest due to volume and rate.

Nine months ended September 30, (in thousands)	2011 versus 2010		
	Volume	Rate	Net
Interest-earning assets			
Loans	\$1,065	\$(856)	\$209
Securities	(515)	(127)	(642)
FHLBB stock	-	18	18
Short term funds	7	(37)	(30)
Total	557	(1,002)	(445)
Interest-bearing liabilities			
Deposits	(164)	(772)	(936)
Repurchase agreements	2	(27)	(25)
FHLBB advances	(526)	15	(511)
Total	(688)	(784)	(1,472)
Net change in net interest income	\$1,245	\$(218)	\$1,027

Interest Income (tax equivalent)

Tax equivalent interest income decreased \$445,000, or 2.3%, to \$18.8 million for year-to-date 2011 compared with year-to-date 2010. Loan income increased \$209,000, or 1.5%, primarily due to a \$27.0 million, or 8.0%, increase in average loans, offset by a lower average yield, down 32 basis points.

Tax equivalent securities income decreased \$642,000, or 12.0%, for year-to-date 2011 compared with year-to-date 2010, as a result of a lower average yield, down 12 basis points, and a \$15.3 million, or 9.8%, decrease in average securities. The decline in volume resulted from the redeployment of some of the cash flows from securities maturities, principal payments and calls, into new loans. Changes in securities yields resulted from the effect of changes in market interest rates on securities purchases, calls of agency bonds and prepayments of mortgage backed securities.

Income from FHLBB stock increased \$18,000 due to the resumption of modest quarterly cash dividends to its members.

Income from short term funds decreased \$30,000 for year-to-date 2011 as compared with year-to-date 2010 as a result of a 14 basis points decrease in average yield, offset in part by a \$2.4 million decrease in average balance.

Interest Expense

Interest expense decreased \$1,472,000, or 25.6%, to \$4.3 million for year-to-date 2011 as compared with year-to-date 2010.

Interest on deposit accounts and retail repurchase agreements decreased \$936,000, or 27.7%, and \$25,000, or 35.2% respectively as a result of lower average rates, down 40 basis points to 0.87% on deposits and 30 basis points to 0.50% on repurchase agreements. Decreased rates were offset in part by a \$20.8 million, or 5.9%, increase in the average balance of deposits and an increase of \$492,000, or 4.2% increase in the average balance of repurchase agreements. The lower average rate resulted from the effect of lower market interest rates on rates paid and changes in product

mix. The higher average volume resulted from deposit growth.

Interest expense on FHLBB borrowings decreased \$511,000 due to lower average borrowings, down \$17.2 million, offset in part by a higher average borrowing rate, up 2 basis points, due to change in mix. The decline in advances resulted from scheduled maturities that were not replaced with new advances.

Provision and Allowance for Loan Losses

The provision for loan losses was \$860,000 for year-to-date 2011, compared with \$620,000 for year-to-date 2010. Net loan charge-offs were \$753,000 and \$246,000, for the respective periods. The increased provision for loan losses was necessitated by the increase in net charge-offs and increases in the level of impaired and potential problem loans.

Non-interest income

The following table details the principal categories of non-interest income.

Nine months ended September 30, (dollars in thousands)	2011	2010	2011 vs. 2010	
Trust and wealth advisory fees	\$ 1,861	\$ 1,507	\$ 354	23.49 %
Service charges and fees	1,555	1,480	75	5.07
Gains on sales of mortgage loans, net	370	443	(73)	(16.48)
Mortgage servicing, net	(8)	27	(35)	(129.63)
Gains on securities, net	11	16	(5)	(31.25)
Other	176	208	(32)	(15.38)
Total non-interest income	\$ 3,965	\$ 3,681	\$ 284	7.72

Non-interest income for year-to-date 2011 increased \$284,000 versus year-to-date 2010. Trust and Wealth Advisory revenues increased \$354,000 versus year-to-date 2010 due to growth in managed assets, higher asset valuations and increased estate fee income. Service charges and fees increased \$75,000 versus year-to-date 2010. Income from sales of mortgage loans decreased \$73,000 versus year-to-date 2010 due to lower volume of residential mortgage loan sales. Mortgage loans sales totaled \$16.1 million for year-to-date 2011 versus \$26.5 million for year-to-date 2010. Income from mortgage loan servicing of mortgage loans decreased \$35,000 versus year-to-date 2010 due to an \$80,000 2011 mortgage servicing valuation impairment charge and higher mortgage rights amortization expense, despite higher servicing and credit enhancement fees. Gains on securities represent the accretion of discounts on called securities. Other income for year-to-date 2010 included a gain from the sale of real estate.

Non-interest expense

The following table details the principal categories of non-interest expense.

Nine months ended September 30, (dollars in thousands)	2011	2010	2011 vs. 2010	
Salaries	\$ 5,202	\$ 4,989	\$ 213	4.27 %
Employee benefits	1,919	1,737	182	10.48
Premises and equipment	1,733	1,570	163	10.38
Data processing	1,028	1,080	(52)	(4.81)
Professional fees	887	1,248	(361)	(28.93)
FDIC insurance	541	549	(8)	(1.46)
Collections and OREO	519	63	456	723.81
Marketing and community contributions	245	200	45	22.50
Amortization of intangible assets	167	167	-	-
Other	1,149	1,268	(119)	(9.38)
Non-interest expense	\$ 13,390	\$ 12,871	\$ 519	4.03 %

Non-interest expense for year-to-date 2011 increased \$519,000 versus year-to-date 2010. Salaries increased \$213,000 versus year-to-date 2010 due to changes in staffing levels and mix. Employee benefits increased \$182,000 versus year-to-date 2010 due to higher health and dental benefits expense, caused by year-over-year premium increases and higher staff utilization, and higher 401K Plan expense due to the implementation of a Safe Harbor Plan. The increases were offset in part by lower pension plan expense. Premises and equipment increased \$163,000 versus year-to-date 2010 due primarily to several facilities renovations, equipment replacement and the disposal of assets related to the reorganization of departments within the bank. Data processing decreased \$52,000 versus year-to-date 2010 mostly

due to lower ATM processing fees in 2011. Professional fees decreased \$361,000 versus year-to-date 2010 due to reduced spending on audit, consulting, legal and investment management services. Expenses related to collections and OREO increased \$456,000 versus year-to-date 2010. Year-to-date 2011 included \$163,000 of OREO write-downs, OREO carrying costs, and collection related legal and appraisal services. FDIC insurance decreased \$8,000 versus year-to-date 2010. Other operating expenses decreased \$119,000 versus year-to-date 2010.

Income taxes

The effective income tax rate for year-to-date 2011 was 17.27%, compared with 16.76% for year-to-date 2010. Fluctuations in the effective tax rate result from changes in the mix of taxable and tax exempt income. Salisbury's effective tax rate is generally less than the 34% federal statutory rate due to holdings of tax-exempt municipal bonds and bank owned life insurance.

FINANCIAL CONDITION

Overview

Total assets were \$619 million at September 30, 2011, up \$44 million from December 31, 2010. Loans receivable, net, were \$363 million at September 30, 2011, up \$11 million, or 3.1%, from December 31, 2010. Non-performing assets were \$13.9 million at September 30, 2011, up \$3.2 million from \$10.7 million at December 31, 2010. Reserve coverage, as measured by the ratio of the allowance for loan losses to gross loans, was 1.10%, 1.10% and 1.12%, at September 30, 2011, December 31, 2010 and September 30, 2010, respectively. Deposits were \$479 million, up \$49 million from \$430 million at December 31, 2010.

At September 30, 2011, book value and tangible book value per common share were \$30.36 and \$23.91, respectively. Salisbury's Tier 1 leverage and total risk-based capital ratios were 9.49% and 15.98%, respectively, and above the "well capitalized" limits as defined by the FRB.

Securities and Short Term Funds

During year-to-date 2011, securities decreased \$3.8 million to \$157 million, and FHLBB advances decreased \$18 million, while cash and cash-equivalents (interest-bearing deposits with other banks, money market funds and federal funds sold) increased \$39 million to \$66 million as Salisbury increased its liquidity position in light of historically low interest rates and growth in volatile deposits.

Salisbury evaluates securities for OTTI where the fair value of a security is less than its amortized cost basis at the balance sheet date. As part of this process, Salisbury considers its intent to sell each debt security and whether it is more likely than not that it will be required to sell the security before its anticipated recovery. If either of these conditions is met, Salisbury recognizes an OTTI charge to earnings equal to the entire difference between the security's amortized cost basis and its fair value at the balance sheet date. For securities that meet neither of these conditions, an analysis is performed to determine if any of these securities are at risk for OTTI.

Salisbury does not intend to sell any of its securities and it is not more likely than not that Salisbury will be required to sell any of its securities before recovery of their cost basis, which may be maturity. Therefore, management does not consider any of its securities, other than the four non-agency CMO securities reflecting OTTI, to be OTTI at September 30, 2011.

In 2009 Salisbury determined that five non-agency CMO securities reflected OTTI and recognized losses for deterioration in credit quality of \$1,128,000. Salisbury judged the four remaining securities not to have additional OTTI and all other CMO securities not to be OTTI as of September 30, 2011. It is possible that future loss assumptions could change necessitating Salisbury to recognize future OTTI for further deterioration in credit quality. Salisbury does not intend to sell these securities and it is not more likely than not that Salisbury will be required to sell these securities before recovery of their cost basis.

Accumulated other comprehensive gain at September 30, 2011 included net unrealized holding gains, net of tax, of \$1,480,000, a gain of \$4,062,000 over December 2010.

Loans

Net loans receivable decreased \$2.0 million during third quarter 2011 to \$362.9 million at September 30, 2011, compared with \$364.9 million at June 30, 2011, and increased \$10.5 million for year-to-date 2011, compared with \$352.4 million at December 31, 2010.

The composition of loans receivable and loans held-for-sale is as follows:

(in thousands)	September 30, 2011	December 31, 2010
Residential 1-4 family	\$ 180,216	\$ 173,931
Residential 5+ multifamily	2,798	2,889
Construction of residential 1-4 family	8,065	8,949
Home equity credit	34,632	34,164
Residential real estate	225,711	219,933
Commercial	81,458	75,495
Construction of commercial	5,801	7,312
Commercial real estate	87,259	82,807
Farm land	5,719	5,690
Vacant land	12,685	12,979
Real estate secured	331,374	321,409
Commercial and industrial	27,460	25,123
Municipal	2,549	4,338
Consumer	4,578	4,677
Loans receivable, gross	365,961	355,547
Deferred loan origination fees and costs, net	945	822
Allowance for loan losses	(4,027)	(3,920)
Loans receivable, net	\$ 362,879	\$ 352,449
Loans held-for-sale		
Residential 1-4 family	\$ 1,057	\$ 1,184

Loan Credit Quality

The persistent weakness in the local and regional economies continues to impact the credit quality of Salisbury's loans receivable. During third quarter 2011 total impaired and potential problem loans decreased \$1.1 million to \$30.5 million, or 8.3% of gross loans receivable at September 30, 2011, from \$31.6 million, or 8.6% of gross loans receivable at June 30, 2011, and increased \$7.2 million for year-to-date 2011 from \$23.3 million, or 6.6% of gross loans receivable at December 31, 2010.

The credit quality segments of loans receivable and their credit risk ratings are as follows:

(in thousands)	September 30, 2011	December 31, 2010
Pass	\$ 306,039	\$ 292,815
Special mention	29,460	39,415
Performing loans	335,499	332,230
Substandard	14,499	7,932
Doubtful	-	10
Potential problem loans	14,499	7,942
Pass		
Troubled debt restructured loans, accruing	266	-
Special mention		
Troubled debt restructured loans, accruing	167	-
Substandard		
Troubled debt restructured loans, accruing	1,619	5,330

Edgar Filing: SALISBURY BANCORP INC - Form 10-Q

Troubled debt restructured loans, non-accrual	7,360	4,254
All other non-accrual loans	6,551	5,791
Impaired loans	15,963	15,375
Loans receivable, gross	\$ 365,961	\$ 355,547

31

Changes in impaired and potential problem loans are as follows:

(in thousands)	Three months ended September 30, 2011				Nine months ended September 30, 2011			
	Impaired loans Non- accrual	Accruing	Potential problem loans	Total	Impaired loans	Accruing	Potential problem loans	Total
Loans placed on non-accrual status	\$ (208)	\$ 163	\$ -	\$ (45)	\$ 5,684	\$ (2,797)	\$ (2,268)	\$ 619
Loan risk rating downgrades to substandard	-	-	427	427	-	-	11,190	11,190
Loan risk rating upgrades from substandard	-	-	(942)	(942)	-	-	(1,950)	(1,950)
Loan repayments	(319)	(11)	(140)	(470)	(774)	(33)	(405)	(1,212)
Loan charge-offs	(125)	(30)	-	(155)	(731)	(30)	-	(761)
Loans no longer classified as troubled debt restructurings	-	-	-	-	-	(417)	-	(417)
Real estate acquired in settlement of loans	-	-	-	-	(314)	-	-	(314)
Increase (decrease) in loans	\$ (652)	\$ 122	\$ (655)	\$ (1,185)	\$ 3,865	\$ (3,277)	\$ 6,567	\$ 7,155

Changes in impaired and potential problem loans were relatively modest during third quarter 2011. Loan risk rating downgrades to substandard totaled \$427,000, loans placed on non-accrual status as a result of deteriorated payment and financial performance totaled \$45,000 and loans charged-off due to collateral deficiencies totaled \$155,000. Offsetting these deteriorations were loan risk rating upgrades resulting from improved performance and loan repayments.

During the first nine months of 2011 Salisbury downgraded the risk ratings of \$111.2 million of loans to substandard, placed \$5.7 million of loans on non-accrual status as a result of deteriorated payment and financial performance and charged-off \$761,000 of losses primarily as a result of collateral deficiencies. Offsetting these deteriorations were loan risk rating upgrades resulting from improved performance, loan repayments, real estate acquired in settlement of a loan and a loan restructured in 2010 whose designation as troubled debt restructured was removed due to satisfactory performance.

Salisbury has cooperative relationships with the vast majority of its non-performing loan customers. Substantially all non-performing loans are collateralized with real estate and the repayment of such loans is largely dependent on the return of such loans to performing status or the liquidation of the underlying real estate collateral. Salisbury pursues the resolution of all non-performing loans through collections, restructures, voluntary liquidation of collateral by the borrower and, where necessary, legal action. When all attempts to work with a customer to return a loan to performing status, including restructuring the loan, are unsuccessful, Salisbury will initiate appropriate legal action seeking to acquire property by deed in lieu of foreclosure or through foreclosure, or to liquidate business assets.

Credit Quality Segments

Salisbury categorizes loans receivable into the following credit quality segments.

- Impaired loans consist of all non-accrual loans and troubled debt restructured loans, and represent loans for which it is probable that Salisbury will not be able to collect all principal and interest amounts due according to the contractual terms of the loan agreements.
- Non-accrual loans, a sub-set of impaired loans, are loans for which the accrual of interest has been discontinued because, in the opinion of management, full collection of principal or interest is unlikely.
 - Non-performing loans consist of non-accrual loans, and accruing loans past due 90 days and over that are well collateralized, in the process of collection and where full collection of principal and interest is assured. Non-performing assets consist of non-performing loans plus real estate acquired in settlement of loans.
- Troubled debt restructured loans are loans for which concessions such as reduction of interest rates, other than normal market rate adjustments, or deferral of principal or interest payments, extension of maturity dates, or reduction of principal balance or accrued interest, have been granted due to a borrower's financial condition. Loan restructuring is employed when management believes the granting of a concession will increase the probability of the full or partial collection of principal and interest.
- Potential problem loans consist of performing loans that have been assigned a substandard credit risk rating and that are not classified as impaired.

Credit Risk Ratings

Salisbury assigns credit risk ratings to loans receivable in order to manage credit risk and to determine the allowance for loan losses. Credit risk ratings categorize loans by common financial and structural characteristics that measure the credit strength of a borrower. Salisbury's rating model has eight risk rating grades, with each grade corresponding to a progressively greater risk of default. Grades 1 through 4 are pass ratings and 5 through 8 are ratings (special mention, substandard, doubtful and loss) defined by the bank's regulatory agencies, the FDIC and CTDOB. Risk ratings are assigned to differentiate risk within the portfolio and are reviewed on an ongoing basis and revised, if needed, to reflect changes in the borrowers' current financial position and outlook, risk profiles and the related collateral and structural positions.

- Loans risk rated as "special mention" possess credit deficiencies or potential weaknesses deserving management's close attention that if left uncorrected may result in deterioration of the repayment prospects for the loans at some future date.
- Loans risk rated as "substandard" are loans where the Bank's position is clearly not protected adequately by borrower current net worth or payment capacity. These loans have well defined weaknesses based on objective evidence and include loans where future losses to the Bank may result if deficiencies are not corrected, and loans where the primary source of repayment such as income is diminished and the Bank must rely on sale of collateral or other secondary sources of collection.
- Loans risk rated as "doubtful" have the same weaknesses as substandard loans with the added characteristic that the weakness makes collection or liquidation in full, given current facts, conditions, and values, to be highly improbable. The possibility of loss is high, but due to certain important and reasonably specific pending factors, which may work to strengthen the loan, its reclassification as an estimated loss is deferred until its exact status can be determined.
- Loans risk rated as "loss" are considered uncollectible and of such little value, that continuance as Bank assets is unwarranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather, it is not practical or desirable to defer writing off this basically worthless loan even though partial recovery may be made in the future.

Management actively reviews and tests its credit risk ratings against actual experience and engages an independent third-party to annually validate its assignment of credit risk ratings. In addition, the Bank's loan portfolio and risk ratings are examined annually on a rotating basis by its two primary regulatory agencies, the FDIC and CTDOB.

Impaired Loans

Impaired loans decreased \$0.5 million during third quarter 2011 to \$16.0 million, or 4.36% of gross loans receivable at September 30, 2011, from \$16.5 million, or 4.48% of gross loans receivable at June 30, 2011, and increased \$0.6 million for year-to-date 2011 from \$15.4 million, or 4.32% of gross loans receivable at December 31, 2010. The components of impaired loans are as follows:

(in thousands)	September 30, 2011	December 31, 2010
Troubled debt restructurings, accruing	\$ 2,052	\$ 5,330
Troubled debt restructuring, non-accrual	7,360	4,254
All other non-accrual loans	6,551	5,791
Impaired loans	\$ 15,963	\$ 15,375

Non-Performing Assets

Non-performing assets decreased \$1.1 million during third quarter 2011 to \$13.9 million, or 2.25% of assets at September 30, 2011, from \$15.0 million, or 2.55% of assets at June 30, 2011, and increased \$3.2 million for year-to-date 2011 from \$10.8 million, or 1.87% of assets at December 31, 2010.

The components of non-performing assets are as follows:

(in thousands)	September 30, 2011	December 31, 2010
Residential 1-4 family	\$ 2,808	\$ 2,534
Construction of residential 1-4 family	2,944	-
Home equity credit	248	362
Commercial	3,084	2,923
Vacant land	3,858	4,018
Real estate secured	12,942	9,837
Commercial and industrial	969	208
Consumer	-	-
Total non-accruing loans	13,911	10,045
Accruing loans past due 90 days and over	-	96
Total non-performing loans	13,911	10,141
Real estate acquired in settlement of loans	37	610
Total non-performing assets	\$ 13,948	\$ 10,751

The past due status of non-performing loans is as follows:

(in thousands)	September 30, 2011	December 31, 2010
Current	\$ 6,362	\$ 2,931
Past due 001-029 days	799	219
Past due 030-059 days	360	541
Past due 060-089 days	84	1,050
Past due 090-179 days	729	683
Past due 180 days and over	5,577	4,717
Total non-performing loans	\$ 13,911	\$ 10,141

At September 30, 2011, 45.7% of non-accrual loans were current with respect to loan payments, compared with 44.0% at June 30, 2011 and 28.9% at December 31, 2010. Loans past due 180 days include a \$3.0 million loan secured by vacant land (residential building lots) where Salisbury has initiated a foreclosure action that is referred to in Item 1 of Part II, Legal Proceedings.

Troubled Debt Restructured Loans

Troubled debt restructured loans decreased \$210,000 during third quarter 2011 to \$9.4 million, or 2.57% of gross loans receivable at September 30, 2011, from \$9.6 million, or 2.62% of gross loans receivable at June 31, 2011, and decreased \$171,000 for year-to-date 2011 from \$9.6 million, or 2.70% of gross loans receivable at December 31, 2010. The components of troubled debt restructured loans are as follows:

(in thousands)	September 30, 2011	December 31, 2010
Residential 1-4 family	\$ 167	\$ 3,377
Commercial	1,619	1,677
Real estate secured	1,786	5,054
Commercial and industrial	266	276
Accruing troubled debt restructured loans	2,052	5,330

Edgar Filing: SALISBURY BANCORP INC - Form 10-Q

Residential 1-4 family	4,186	552
Commercial	2,397	2,923
Vacant land	461	621
Real estate secured	7,044	4,096
Commercial and industrial	316	158
Non-accrual troubled debt restructured loans	7,361	4,254
Troubled debt restructured loans	\$ 9,412	\$ 9,584

The past due status of troubled debt restructured loans is as follows:

(in thousands)	September 30, 2011	December 31, 2010
Current	\$ 1,347	\$ 4,798
Past due 001-029 days	705	375
Past due 030-059 days	-	157
Accruing troubled debt restructured loans	2,052	5,330
Current	5,773	2,585
Past due 001-029 days	341	169
Past due 030-059 days	324	378
Past due 060-089 days	-	-
Past due 090-179 days	581	346
Past due 180 days and over	341	776
Non-accrual troubled debt restructured loans	7,360	4,254
Total troubled debt restructured loans	\$ 9,413	\$ 9,584

At September 30, 2011, 75.7% of troubled debt restructured loans were current with respect to loan payments, as compared with 77.9% at June 30, 2011 and 77.0% at December 31, 2010.

Past Due Loans

Loans past due 30 days or more increased \$459,000 during third quarter 2011 to \$9.1 million, or 2.50% of gross loans receivable at September 30, 2011, compared with \$8.7 million, or 2.36% of gross loans receivable at June 30, 2011, and have increased \$240,000 for year-to-date 2011, compared with \$8.9 million, or 2.51% of gross loans receivable at December 31, 2010.

The components of loans past due 30 days or greater are as follows:

(in thousands)	September 30, 2011	December 31, 2010
Past due 030-059 days	\$ 1,633	\$ 1,188
Past due 060-089 days	765	730
Past due 090-179 days	-	96
Accruing loans	2,398	2,014
Past due 030-059 days	360	541
Past due 060-089 days	84	1,050
Past due 090-179 days	729	587
Past due 180 days and over	5,577	4,716
Non-accrual loans	6,750	6,894
Total loans past due 30 days or greater	\$ 9,148	\$ 8,908

Potential Problem Loans

Potential problem loans decreased \$656,000 during third quarter 2011 to \$14.5 million, or 3.96% of gross loans receivable at September 30, 2011, compared with \$15.2 million, or 4.12% of gross loans receivable at June 30, 2011, and increased \$6.6 million for year-to-date 2011, compared with \$7.9 million, or 2.23% of gross loans receivable at December 31, 2010.

The components of potential problem loans are as follows:

(in thousands)	September 30, 2011	December 31, 2010
Residential 1-4 family	\$ 3,639	\$ 2,483
Residential 5+ multifamily	-	89
Construction of residential 1-4 family	-	75
Home equity credit	1,032	817
Residential real estate	4,671	3,464
Commercial	7,579	2,327
Construction of commercial	471	47
Commercial real estate	8,050	2,374
Farm land	840	881
Vacant land	253	249
Real estate secured	13,814	6,968
Commercial and Industrial	620	897
Consumer	65	67
Potential problem loans	\$ 14,499	\$ 7,932

The past due status of potential problem loans is as follows:

(in thousands)	September 30, 2011	December 31, 2010
Current	\$ 10,214	\$ 5,757
Past due 001-029 days	3,265	1,233
Past due 030-059 days	963	357
Past due 060-089 days	57	534
Past due 090-179 days	-	51
Total potential problem loans	\$ 14,499	\$ 7,932

At September 30, 2011, 70.45% of potential problem loans were current with respect to loan payments, as compared with 82.2% at June 30, 2011 and 72.6% at December 31, 2010.

Management cannot predict the extent to which economic or other factors may impact such borrowers' future payment capacity, and there can be no assurance that such loans will not be placed on nonaccrual status, restructured, or require increased provision for loan losses.

Deposits and Borrowings

Deposits increased \$19.6 million during third quarter 2011 to \$478.6 million at September 30, 2011, compared with \$459.0 million at June 30, 2011, and increased \$48.3 million for year-to-date 2011 compared with \$430.3 million at December 31, 2010. Retail repurchase agreements increased \$2.4 million during third quarter 2011 to \$14.8 million at September 30, 2011, compared with \$12.4 million at June 30, 2011, and decreased \$1.6 million for year-to-date 2011 compared with \$13.2 million at December 31, 2010.

Federal Home Loan Bank of Boston (FHLBB) advances decreased \$0.5 million during third quarter 2011 to \$55.0 million at September 30, 2011, compared with \$55.5 million at June 30, 2011, and decreased \$17.8 million for year-to-date 2011 compared with \$72.8 million at December 31, 2010. The decreases were due to amortizing advance payments and to advance maturities that were not renewed.

Liquidity

Salisbury manages its liquidity position to ensure that there is sufficient funding availability at all times to meet both anticipated and unanticipated deposit withdrawals, loan originations and advances, securities purchases and other operating cash outflows. Salisbury's primary sources of liquidity are principal payments and maturities of securities and loans, short-term borrowings through repurchase agreements and Federal Home Loan Bank advances, net deposit growth and funds provided by operations. Liquidity can also be provided through sales of loans and available-for-sale securities.

Salisbury manages its liquidity in accordance with a liquidity funding policy, and also maintains a contingency funding plan that provide for the prompt and comprehensive response to unexpected demands for liquidity. At September 30, 2011, Salisbury's liquidity ratio, as represented by cash, short term available-for-sale securities and marketable assets to net deposits and short term unsecured liabilities, was 33.0%, up from 28.4% at December 31, 2010. Management believes Salisbury's funding sources will meet anticipated funding needs.

Operating activities for the nine-month period ended September 30, 2011 provided net cash of \$5.1 million. Investing activities utilized net cash of \$4.0 million, principally from \$11.6 million of net loan advances, \$35.7 million of securities purchases offset by \$38.0 million in securities maturities and calls. Financing activities provided net cash of \$37.5 million, principally for \$49.9 million net increase in deposits and repurchase agreements and a net of \$7.2 million from issuance and redemption of preferred stock, offset in part by \$17.8 million of scheduled FHLB advance repayments and \$1.8 million of cash dividends paid.

At September 30, 2011, Salisbury had outstanding commitments to fund new loan originations of \$5.4 million and unused lines of credit of \$55.3 million. Salisbury believes that these commitments can be met in the normal course of business. Salisbury believes that its liquidity sources will continue to provide funding sufficient to support operating activities, loan originations and commitments, and deposit withdrawals.

CAPITAL RESOURCES

Shareholders' equity was \$67.4 million at September 30, 2011, up \$12.4 million from December 31, 2010. Book value and tangible book value per common share were \$30.36 and \$23.91, respectively, compared with \$27.37 and \$20.81, respectively, at December 31, 2010. Contributing to the increase in shareholders' equity for year-to-date 2011 was net income of \$2,864,000, other comprehensive gain of \$4,095,000, SBLF funding of \$16,000,000, and the issuance of common stock of \$28,000, less common and preferred stock dividends of \$1,418,000 and \$382,000, respectively, and TARP repayment of \$8,816,000. Other comprehensive income included unrealized gains on securities available-for-sale, net of tax, of \$33,000 and pension plan income, net of tax, of \$4,062,000.

In August 2011, Salisbury issued to the U.S. Secretary of the Treasury (the "Treasury") \$16,000,000 of its Series B Preferred Stock under the Small Business Lending Fund (the "SBLF") program. The SBLF program is a \$30 billion fund established under the Small Business Jobs Act of 2010 to encourage lending to small businesses by providing Tier 1 capital to qualified community banks with assets of less than \$10 billion. The Preferred Stock qualifies as Tier 1 capital for regulatory purposes and ranks senior to the Common Stock.

The Series B Preferred Stock pays noncumulative dividends. The dividend rate on the Series B Preferred Stock for the initial quarterly dividend period ending September 30, 2011 and each of the next nine quarterly dividend periods the Series B Preferred Stock is outstanding is determined each quarter based on the increase in the Bank's Qualified Small Business Lending. The dividend rate in the initial quarterly dividend period ending September 30, 2011 was 2.45100% and in the quarterly dividend period ending December 31, 2011 will be 1.55925%. For the tenth quarterly dividend period through four and one-half years after its issuance, the dividend rate on the Series B Preferred Stock will be fixed at the rate in effect at the end of the ninth quarterly dividend period and after four and one-half years from its issuance the dividend rate will be fixed at 9 percent per annum. On September 30, 2011, Salisbury declared a Series B Preferred Stock dividend of \$39,216, payable on October 3, 2011. The Series B Preferred Stock is non-voting, other than voting rights on matters that could adversely affect the Series B Preferred Stock. The Series B Preferred Stock is redeemable at any time at one hundred percent of the issue price plus any accrued and unpaid dividends.

Simultaneously with the receipt of the SBLF capital, Salisbury repurchased for \$8,816,000 all of its Series A Preferred Stock sold to the Treasury in 2009 under the Capital Purchase Program, a part of the Troubled Asset Relief Program of the Emergency Economic Stabilization Act of 2008, and made a payment for accrued dividends. The transaction resulted in net capital proceeds to Salisbury of \$7,184,000, of which Salisbury invested \$6,465,600, or 90%, in the Bank as Tier 1 Capital.

As part of the CPP, Salisbury had issued to the Treasury a 10-year Warrant to purchase 57,671 shares of Common Stock at an exercise price of \$22.93 per share. The Warrant was repurchased for \$205,000 on November 2, 2011.

Capital Requirements

Salisbury and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Under current regulatory definitions, Salisbury and the Bank are considered to be “well capitalized” for capital adequacy purposes. As a result, the Bank pays lower federal deposit insurance premiums than banks that are not “well capitalized.” Salisbury and the Bank's regulatory capital ratios are as follows:

	Well capitalized	September 30, 2011 Salisbury	Bank	December 31, 2010 Salisbury	Bank
Total Capital (to risk-weighted assets)	10.00 %	15.98 %	13.07 %	13.91 %	11.11 %
Tier 1 Capital (to risk-weighted assets)	6.00	14.88	12.00	12.84	10.06
Tier 1 Capital (to average assets)	5.00	9.49	7.77	8.39	6.72

A well-capitalized institution, which is the highest capital category for an institution as defined by the Prompt Corrective Action Regulations issued by the FDIC and the FRB, is one which maintains a Total Risk-Based ratio of 10% or above, a Tier 1 Risk-Based ratio of 6% or above and a Leverage ratio of 5% or above, and is not subject to any written order, written agreement, capital directive, or prompt corrective action directive to meet and maintain a specific capital level. Maintaining strong capital is essential to Salisbury's and the Bank's safety and soundness. However, the effective management of capital resources requires generating attractive returns on equity to build value for shareholders while maintaining appropriate levels of capital to fund growth, meet regulatory requirements and be consistent with prudent industry practices.

Dividends

During the nine month period ended September 30, 2011 Salisbury paid \$382,000 in Series A preferred stock dividends to the U.S. Treasury's TARP CPP, and \$1,418,000 in common stock dividends.

The Board of Directors of Salisbury declared a common stock dividend of \$0.28 per common share payable on November 25, 2011 to shareholders of record on November 11, 2011. Common stock dividends, when declared, will generally be paid the last business day of February, May, August and November, although Salisbury is not obligated to pay dividends on those dates or at any other time.

Salisbury's ability to pay cash dividends is substantially dependent on the Bank's ability to pay cash dividends to Salisbury. There are certain restrictions on the payment of cash dividends and other payments by the Bank to Salisbury. Under Connecticut law the Bank cannot declare a cash dividend except from net profits, defined as the remainder of all earnings from current operations. The total of all cash dividends declared by the Bank in any calendar year shall not, unless specifically approved by the Commissioner of Banking, exceed the total of its net profits of that year combined with its retained net profits of the preceding two years.

FRB Supervisory Letter SR 09-4, February 24, 2009, revised March 27, 2009, notes that, as a general matter, the board of directors of a bank holding company (“BHC”) should inform the Federal Reserve and should eliminate, defer, or significantly reduce dividends if (1) net income available to shareholders for the past four quarters, net of dividends previously paid during that period, is not sufficient to fully fund the dividends; (2) the prospective rate of earnings retention is not consistent with capital needs and overall current and prospective financial condition; or (3) the BHC will not meet, or is in danger of not meeting, its minimum regulatory capital adequacy ratios. Moreover, a BHC should inform the FRB reasonably in advance of declaring or paying a dividend that exceeds earnings for the period (e.g., quarter) for which the dividend is being paid or that could result in a material adverse change to the BHC capital structure.

Salisbury believes that the payment of common stock cash dividends is appropriate, provided that such payment considers Salisbury's capital needs, asset quality, and overall financial condition and does not adversely affect the financial stability of Salisbury or the Bank. The continued payment of common stock cash dividends by Salisbury will be dependent on Salisbury's future core earnings, financial condition and capital needs, regulatory restrictions, and other factors deemed relevant by the Board of Directors of Salisbury.

IMPACT OF INFLATION AND CHANGING PRICES

Salisbury's consolidated financial statements are prepared in conformity with generally accepted accounting principles that require the measurement of financial condition and operating results in terms of historical dollars without considering changes in the relative purchasing power of money, over time, due to inflation. Unlike most industrial companies, virtually all of the assets and liabilities of Salisbury are monetary and as a result, interest rates have a greater impact on Salisbury's performance than do the effects of general levels of inflation, although interest rates do not necessarily move in the same direction or with the same magnitude as the prices of goods and services. Although not a material factor in recent years, inflation could impact earnings in future periods.

FORWARD-LOOKING STATEMENTS

This Form 10-Q and future filings made by Salisbury with the Securities and Exchange Commission, as well as other filings, reports and press releases made or issued by Salisbury and the Bank, and oral statements made by executive officers of Salisbury and the Bank, may include forward-looking statements relating to such matters as:

- (a) assumptions concerning future economic and business conditions and their effect on the economy in general and on the markets in which Salisbury and the Bank do business; and
- (b) expectations for revenues and earnings for Salisbury and the Bank.

Such forward-looking statements are based on assumptions rather than historical or current facts and, therefore, are inherently uncertain and subject to risk. For those statements, Salisbury claims the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Act of 1995.

Salisbury notes that a variety of factors could cause the actual results or experience to differ materially from the anticipated results or other expectations described or implied by such forward-looking statements. The risks and uncertainties that may affect the operation, performance, development and results of Salisbury's and the Bank's business include the following:

- (a) the risk of adverse changes in business conditions in the banking industry generally and in the specific markets in which the Bank operates;
- (b) changes in the legislative and regulatory environment that negatively impacts Salisbury and Bank through increased operating expenses;
- (c) increased competition from other financial and non-financial institutions;
- (d) the impact of technological advances; and
- (e) other risks detailed from time to time in Salisbury's filings with the Securities and Exchange Commission.

Such developments could have an adverse impact on Salisbury's and the Bank's financial position and results of operations.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES OF MARKET RISK

Salisbury manages its exposure to interest rate risk through its Asset/Liability Management Committee ("ALCO") using risk limits and policy guidelines to manage assets and funding liabilities to produce financial results that are consistent with Salisbury's liquidity, capital adequacy, growth, risk and profitability targets. Interest rate risk is the risk of loss to future earnings due to changes in interest rates.

The ALCO manages interest rate risk using income simulation to measure interest rate risk inherent in Salisbury's financial instruments at a given point in time by showing the effect of interest rate shifts on net interest income over a 24-month horizon. In management's September 30, 2011 analysis, three of the simulations incorporate management's growth assumptions over the simulation horizons, with allowances made for loan, deposit and security product mix shifts in selected interest rate scenarios, such as movements between lower rate savings and money market deposit accounts and higher rate time deposits, and changes in the reinvestment of loan and securities cash flows. The fourth simulation incorporates management's balance sheet growth assumptions. Additionally, the simulations take into account the specific re-pricing, maturity and prepayment characteristics of differing financial instruments that may vary under different interest rate scenarios.

The ALCO reviews the simulation results to determine whether Salisbury's exposure to change in net interest income remains within established tolerance levels over the simulation horizons and to develop appropriate strategies to manage this exposure. Salisbury's tolerance levels for changes in net interest income in its income simulations varies depending on the magnitude of interest rate changes and level of risk-based capital. All changes are measured in comparison to the projected net interest income that would result from an "unchanged" rate scenario where interest rates remain stable over the forecast horizon. The ALCO also evaluates the directional trends of net interest income, net interest margin and other financial measures over the forecast horizon for consistency with its liquidity, capital adequacy, growth, risk and profitability targets.

The ALCO uses four interest rate scenarios to evaluate interest risk exposure and may vary these interest rate scenarios to show the effect of steepening or flattening changes in yield curves as well as parallel changes in interest rates. At September 30, 2011 the ALCO used the following interest rate scenarios: (1) unchanged interest rates; (2) immediately rising interest rates – immediate non-parallel upward shift in market interest rates ranging from 300 basis points for short term rates to 150 basis points for the 10-year Treasury; (3) immediately falling interest rates – immediate non-parallel downward shift in market interest rates ranging from 0 basis points for short term rates to 100 basis points for the 10-year Treasury; and (4) gradually rising interest rates – gradual non-parallel upward shift in market interest rates ranging from 400 basis points for short term rates to 185 basis points for the 10-year Treasury. Deposit rates are assumed to shift by lesser amounts due to their relative historical insensitivity to market interest rate movements. Further, deposits are assumed to have certain minimum rate levels below which they will not fall. Income simulations do not reflect adjustments in strategy that the ALCO could implement in response to rate shifts.

As of September 30, 2011 net interest income simulations indicated that the Bank's exposure to changing interest rates over the simulation horizons remained within its tolerance levels. The following table sets forth the estimated change in net interest income from an unchanged interest rate scenario over the periods indicated for changes in market interest rates using the Bank's financial instruments as of September 30, 2011:

As of September 30, 2011	Months 1-12	Months 13-24
Immediately rising interest rates (management's growth assumptions)	(10.56)%	(7.16)%
Immediately falling interest rates (management's growth assumptions)	(0.88)	(3.61)
Gradually rising interest rates (management's growth assumptions)	(3.07)	(7.88)

The negative exposure of net interest income to immediately and gradually rising rates as compared to the unchanged rate scenario results from a faster projected rise in the cost of funds versus income from earning assets, as relatively rate-sensitive money market and time deposits re-price faster than longer duration earning assets. The negative exposure of net interest income to immediately falling rates as compared to an unchanged rate scenario results from a greater decline in earning asset yields compared to rates paid on funding liabilities, as a result of faster prepayments on existing assets and lower reinvestment rates on future loans originated and securities purchased.

While the ALCO reviews simulation assumptions and back-tests simulation results to ensure that they are reasonable and current, income simulation may not always prove to be an accurate indicator of interest rate risk or future net interest margin. Over time, the re-pricing, maturity and prepayment characteristics of financial instruments and the composition of Salisbury's balance sheet may change to a different degree than estimated. Simulation modeling assumes Salisbury's expectation for future balance sheet growth, which is a function of the business environment and customer behavior. Another significant simulation assumption is the sensitivity of core savings deposits to fluctuations in interest rates. Income simulation results assume that changes in both core savings deposit rates and balances are related to changes in short-term interest rates. The assumed relationship between short-term interest rate changes and core deposit rate and balance changes used in income simulation may differ from the ALCO's estimates. Lastly, mortgage-backed securities and mortgage loans involve a level of risk that unforeseen changes in prepayment speeds may cause related cash flows to vary significantly in differing rate environments. Such changes could affect the level

of reinvestment risk associated with cash flow from these instruments, as well as their market value. Changes in prepayment speeds could also increase or decrease the amortization of premium or accretion of discounts related to such instruments, thereby affecting interest income.

Salisbury also monitors the potential change in market value of its available-for-sale debt securities in changing interest rate environments. The purpose is to determine market value exposure that may not be captured by income simulation, but which might result in changes to Salisbury's capital and liquidity position. Results are calculated using industry standard analytical techniques and securities data. Available-for-sale equity securities are excluded from this analysis because the market value of such securities cannot be directly correlated with changes in interest rates. The following table summarizes the potential change in market value of available-for-sale debt securities resulting from immediate parallel rate shifts:

As of September 30, 2011 (in thousands)	Rates up 100bp	Rates up 200bp
U.S. Treasury notes	\$ (256)	\$ (499)
U.S. Government agency notes	(228)	(450)
Municipal bonds	(2,850)	(6,486)
Mortgage backed securities	(1,435)	(3,228)
Collateralized mortgage obligations	(728)	(1,788)
SBA pools	(11)	(22)
Total available-for-sale debt securities	\$ (5,508)	\$ (12,473)

Item 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Salisbury's management, including its Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of the disclosure controls and procedures as of September 30, 2011. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures are effective.

Disclosure controls and procedures are controls and other procedures that are designed to ensure that the information required to be disclosed in reports filed or submitted under the Securities Exchange Act of 1934 (the "Exchange Act") is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in our reports filed under the Exchange Act is accumulated and communicated to management, including the principle executive officer and principle financial officer, as appropriate to allow timely decisions regarding required disclosure.

In addition, based on an evaluation of its internal controls over financial reporting, no change in Salisbury's internal control over financial reporting occurred during the quarter ended September 30, 2011 that has materially affected, or is reasonably likely to materially affect, Salisbury's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

The Bank is involved in various claims and legal proceedings arising out of the ordinary course of business.

The Bank, individually and in its capacity as a former Co-Trustee of the Erling C. Christophersen Revocable Trust (the "Trust"), has been named as a defendant in litigation currently pending in the Connecticut Complex Litigation Docket in Stamford, captioned John Christophersen v. Erling Christophersen, et al., X05-CV-08-5009597S (the "First Action"). The Bank also is a counterclaim-defendant in a related mortgage foreclosure litigation also pending in the

Connecticut Complex Litigation Docket in Stamford, captioned Salisbury Bank & Trust Company v. Erling C. Christophersen, et al., X05-CV-10-6005847-S (the "Foreclosure Action," together with the First Action, the "Actions"). The other parties to the Actions are John R. Christophersen; Erling C. Christophersen, individually and as Co-Trustee of the Trust; Bonnie Christophersen and Elena Dreiske, individually and as Co-Trustees of the Mildred B. Blount Testamentary Trust; People's United Bank; Law Offices of Gary Oberst, P.C.; Rhoda Rudnick; and Hinckley Allen & Snyder LLP.

The Actions involve a dispute over title to certain real property located in Westport, Connecticut that was conveyed by Erling Christophersen, as grantor, to the Trust on or about August 8, 2007. Subsequent to this conveyance, the Bank loaned \$3,386,609 to the Trust, which was secured by an open-end commercial mortgage in favor of the Bank on the Westport property. This mortgage is the subject of the Foreclosure Action brought by the Bank.

The gravamen of the plaintiff/counterclaim-plaintiff John Christophersen's claims in the Actions is that he has an interest in the Westport real property transferred to the Trust of which he was allegedly wrongfully divested on account of the actions of the defendants. In the Actions plaintiff seeks to quiet title to the property and to recover money damages from the defendants for the alleged wrongful divestiture of his claimed interest in the property.

In addition to the mortgage on the property, the Bank, at the time of the financing referenced above, acquired a lender's title insurance policy from the Chicago Title & Insurance Company, which is providing a defense to the Bank in the First Action under a reservation of rights. The Bank denies any wrongdoing, and is actively defending the case. The First Action presently is stayed, by Court order, pending resolution of a parallel action pending in New York Surrogate's Court to which the Bank is not a party. The Foreclosure Action remains in its early pleading stage. No discovery has been taken to date.

There are no other material pending legal proceedings, other than ordinary routine litigation incident to the registrant's business, to which Salisbury is a party or of which any of its property is subject.

Item 1A. **RISK FACTORS**

Not applicable.

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

None

Item 3. **DEFAULTS UPON SENIOR SECURITIES**

None

Item 4. **[REMOVED AND RESERVED]**

Item 5. **OTHER INFORMATION**

None

Item 6. **EXHIBITS**

31.1 Rule 13a-14(a)/15d-14(a) Certification.

31.2 Rule 13a-14(a)/15d-14(a) Certification.

32 Section 1350 Certifications

SIGNATURES

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

SALISBURY BANCORP, INC.

November 14, 2011 by /s/ Richard J. Cantele, Jr.
Richard J. Cantele, Jr.,
Chief Executive Officer

November 14, 2011 by /s/ B. Ian McMahon
B. Ian McMahon,
Chief Financial Officer

