

ENTERPRISE BANCORP INC /MA/

Form 10-Q

November 08, 2013

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended September 30, 2013

Commission File Number: 001-33912

Enterprise Bancorp, Inc.

(Exact name of registrant as specified in its charter)

Massachusetts

(State or other jurisdiction of
incorporation or organization)

04-3308902

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

222 Merrimack Street, Lowell, Massachusetts

(Address of principal executive offices)

(978) 459-9000

(Registrant's telephone number, including area code)

01852

(Zip code)

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

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

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

Large accelerated filer o

Accelerated filer x

Non-accelerated filer o

Smaller reporting company o

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

As of November 4, 2013, there were 9,966,167 shares of the issuer's common stock outstanding- Par Value \$0.01 per share

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PART I-FINANCIAL INFORMATION

Item 1 - Financial Statements

ENTERPRISE BANCORP, INC.

Consolidated Balance Sheets

(Dollars in thousands)	September 30, 2013 (Unaudited)	December 31, 2012
Assets		
Cash and cash equivalents:		
Cash and due from banks	\$48,960	\$38,007
Interest-earning deposits	33,944	12,218
Fed funds sold	26,003	2,510
Total cash and cash equivalents	108,907	52,735
Investment securities at fair value	195,418	184,464
Federal Home Loan Bank Stock	4,324	4,260
Loans held for sale	1,061	8,557
Loans, less allowance for loan losses of \$25,999 at September 30, 2013 and \$24,254 at December 31, 2012, respectively	1,446,697	1,335,401
Premises and equipment	28,860	27,206
Accrued interest receivable	5,835	5,828
Deferred income taxes, net	13,489	12,548
Bank-owned life insurance	15,789	15,443
Prepaid income taxes	736	174
Prepaid expenses and other assets	5,777	13,454
Goodwill	5,656	5,656
Total assets	\$1,832,549	\$1,665,726
Liabilities and Stockholders' Equity		
Liabilities		
Deposits	\$1,653,947	\$1,475,027
Borrowed funds	1,880	26,540
Junior subordinated debentures	10,825	10,825
Accrued expenses and other liabilities	17,393	13,182
Accrued interest payable	267	603
Total liabilities	\$1,684,312	\$1,526,177
Commitments and Contingencies		
Stockholders' Equity		
Preferred stock, \$0.01 par value per share; 1,000,000 shares authorized; no shares issued	—	—
Common stock, \$0.01 par value per share; 20,000,000 shares authorized; 9,964,730 issued and outstanding at September 30, 2013 (including 169,693 shares of unvested participating restricted awards) and 9,676,477 shares issued and outstanding at December 31, 2012 (including 154,186 shares of unvested participating restricted awards)	100	97
Additional paid-in-capital	52,092	48,194
Retained earnings	93,815	87,159
Accumulated other comprehensive income	2,230	4,099
Total stockholders' equity	\$148,237	\$139,549
Total liabilities and stockholders' equity	\$1,832,549	\$1,665,726

See the accompanying notes to the unaudited consolidated financial statements.

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

	Three months ended September 30,		Nine months ended September 30,	
(Dollars in thousands, except per share data)	2013	2012	2013	2012
Interest and dividend income:				
Loans and loans held for sale	\$17,104	\$16,324	\$50,130	\$48,510
Investment securities	823	833	2,427	2,467
Other interest-earning assets	19	25	40	68
Total interest and dividend income	17,946	17,182	52,597	51,045
Interest expense:				
Deposits	1,013	1,228	3,043	4,133
Borrowed funds	6	12	92	41
Junior subordinated debentures	294	294	883	883
Total interest expense	1,313	1,534	4,018	5,057
Net interest income	16,633	15,648	48,579	45,988
Provision for loan losses	583	800	1,900	2,150
Net interest income after provision for loan losses	16,050	14,848	46,679	43,838
Non-interest income:				
Investment advisory fees	1,102	925	3,163	2,880
Deposit and interchange fees	1,229	1,153	3,518	3,281
Income on bank-owned life insurance, net	111	122	346	384
Net gains on sales of investment securities	83	38	1,031	197
Gains on sales of loans	171	211	728	669
Other income	472	536	1,574	1,500
Total non-interest income	3,168	2,985	10,360	8,911
Non-interest expense:				
Salaries and employee benefits	8,548	8,190	25,247	23,534
Occupancy and equipment expenses	1,449	1,400	4,508	4,244
Technology and telecommunications expenses	1,085	1,122	3,441	3,198
Advertising and public relations expenses	481	408	2,047	1,694
Audit, legal and other professional fees	439	336	1,264	1,306
Deposit insurance premiums	287	283	820	843
Supplies and postage expenses	232	232	719	659
Investment advisory and custodial expenses	134	110	394	319
Other operating expenses	1,126	929	3,256	3,003
Total non-interest expense	13,781	13,010	41,696	38,800
Income before income taxes	5,437	4,823	15,343	13,949
Provision for income taxes	1,904	1,760	5,298	4,808
Net income	\$3,533	\$3,063	\$10,045	\$9,141
Basic earnings per share	\$0.36	\$0.32	\$1.02	\$0.96
Diluted earnings per share	\$0.35	\$0.32	\$1.01	\$0.95
Basic weighted average common shares outstanding	9,932,060	9,613,386	9,824,984	9,567,294
Diluted weighted average common shares outstanding	10,026,588	9,692,290	9,909,019	9,639,122

See the accompanying notes to the unaudited consolidated financial statements.

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

	Three months ended September 30,		Nine months ended September 30,		
(Dollars in thousands)	2013	2012	2013	2012	
Net income	\$3,533	\$3,063	\$10,045	\$9,141	
Other comprehensive (loss) income, net of taxes:					
Gross unrealized holding (losses) gains on investments arising during the period	431	861	(1,955) 1,677	
Income tax benefit (expense)	(136) (307) 748	(594)
Net unrealized holding (losses) gains, net of tax	295	554	(1,207) 1,083	
Less: Reclassification adjustment for net gains included in net income					
Net realized gains on sales of securities during the period	83	38	1,031	197	
Income tax expense	(30) (12) (369) (68)
Reclassification adjustment for gains realized, net of tax	53	26	662	129	
Total other comprehensive (loss) income	242	528	(1,869) 954	
Comprehensive income	\$3,775	\$3,591	\$8,176	\$10,095	

See the accompanying notes to the unaudited consolidated financial statements.

ENTERPRISE BANCORP, INC.

Consolidated Statement of Changes in Stockholders' Equity

(Unaudited)

(Dollars in thousands)	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
Balance at December 31, 2012	\$97	\$48,194	\$87,159	\$ 4,099	\$139,549
Net income			10,045		10,045
Other comprehensive loss, net				(1,869)	(1,869)
Tax benefit from exercise of stock options		24			24
Common stock dividend paid (\$0.345 per share)			(3,389)		(3,389)
Common stock issued under dividend reinvestment plan	1	947			948
Stock-based compensation	1	1,273			1,274
Stock options exercised, net	1	1,654			1,655
Balance at September 30, 2013	\$100	\$52,092	\$93,815	\$ 2,230	\$148,237

See the accompanying notes to the unaudited consolidated financial statements.

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

	Nine months ended September 30,	
(Dollars in thousands)	2013	2012
Cash flows from operating activities:		
Net income	\$ 10,045	\$ 9,141
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,900	2,150
Depreciation and amortization	3,686	3,291
Stock-based compensation expense	1,239	956
Mortgage loans originated for sale	(31,751)	(35,041)
Proceeds from mortgage loans sold	39,975	35,085
Net gains on sales of loans	(728)	(669)
Net gains on sales of OREO	(121)	(45)
Net gains on sales of investments	(1,031)	(197)
Income on bank-owned life insurance, net	(346)	(384)
OREO fair value adjustment	23	—
Changes in:		
Accrued interest receivable	(7)	(9)
Prepaid expenses and other assets	6,686	(1,807)
Deferred income taxes	176	(245)
Accrued expenses and other liabilities	3,599	(1,568)
Accrued interest payable	(336)	(428)
Net cash provided by operating activities	33,009	10,230
Cash flows from investing activities:		
Proceeds from sales of investment securities available for sale	8,293	3,240
Net proceeds (purchase) from FHLB capital stock	(64)	480
Proceeds from maturities, calls and pay-downs of investment securities	13,730	22,332
Purchase of investment securities	(35,301)	(70,115)
Net increase in loans	(113,364)	(54,719)
Additions to premises and equipment, net	(4,281)	(2,730)
Proceeds from OREO sales and payments	652	885
Purchase of OREO	—	(245)
Net cash used in investing activities	(130,335)	(100,872)
Cash flows from financing activities:		
Net increase in deposits	178,920	137,268
Net decrease in borrowed funds	(24,660)	(1,500)
Cash dividends paid	(3,389)	(3,155)
Proceeds from issuance of common stock	948	956
Proceeds from the exercise of stock options	1,655	211
Tax benefit from the exercise of stock options	24	1
Net cash provided by financing activities	153,498	133,781
Net increase in cash and cash equivalents	56,172	43,139
Cash and cash equivalents at beginning of period	52,735	39,131
Cash and cash equivalents at end of period	\$ 108,907	\$ 82,270

Supplemental financial data:

Cash Paid For: Interest	\$4,354	\$5,485
Cash Paid For: Income Taxes	5,634	5,485

Supplemental schedule of non-cash investing activity:

Purchase of investment securities not yet settled	400	5,548
Transfer from loans to other real estate owned	168	400
Capital expenditures incurred not yet paid	247	—

See accompanying notes to the unaudited consolidated financial statements.

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ENTERPRISE BANCORP, INC.

Notes to the Unaudited Consolidated Financial Statements

(1) Organization of Holding Company and Basis of Presentation

The accompanying unaudited consolidated financial statements and these notes should be read in conjunction with the December 31, 2012 audited consolidated financial statements and notes thereto contained in the 2012 Annual Report on Form 10-K of Enterprise Bancorp, Inc. (the "Company" or "Enterprise"), a Massachusetts corporation, as filed with the Securities and Exchange Commission (the "SEC") on March 15, 2013. The Company has not changed its reporting policies from those disclosed in its 2012 Annual Report on Form 10-K.

The accompanying unaudited consolidated interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information and the instructions for Form 10-Q through the rules and interpretive releases of the SEC under federal securities law. In the opinion of management, the accompanying unaudited consolidated interim financial statements reflect all necessary adjustments consisting of normal recurring accruals for a fair presentation. All significant intercompany balances and transactions have been eliminated in the accompanying unaudited consolidated interim financial statements. Certain previous year amounts in the unaudited consolidated interim financial statements and accompanying footnotes have been reclassified to conform to the current year's presentation. Interim results are not necessarily indicative of results to be expected for the entire year.

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

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

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

Comprehensive income is defined as all changes to equity except investments by and distributions to stockholders. Net income is one component of comprehensive income, with other components referred to in the aggregate as other comprehensive income. The Company's only other comprehensive income component is the net unrealized holding gains or losses on investments available-for-sale. Pursuant to Accounting Standards Update ("ASU") No. 2013-02, Comprehensive Income (Topic 220): Reporting Amounts Reclassified Out of Accumulated Other Comprehensive Income, the Company initially excludes these unrealized holding gains and losses from net income; however, they are later reported as reclassifications out of accumulated other comprehensive income into net income when the securities

are sold. When securities are sold, the reclassification of realized gains and losses on available-for-sale securities are included on the Consolidated Statements of Income under the "non-interest income" subheading on the line item "net gains on sales of investment securities" and the related income tax expense is included in the line item "provision for income taxes," both of which are also detailed on the Consolidated Statements of Comprehensive Income under the subheading "reclassification adjustment for net gains included in net income."

The Company has 21 full service branches serving the Merrimack Valley and North Central regions of Massachusetts and Southern New Hampshire. The Company is currently constructing a branch office in Nashua, NH with an anticipated opening in the fourth quarter of 2013. Through the Bank and its subsidiaries, the Company offers a range of commercial and consumer loan products, deposit and cash management products, investment advisory and wealth management, and insurance services. The services offered through the Bank and subsidiaries are managed as one strategic unit and represent the Company's only reportable operating segment.

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

(2)Critical Accounting Estimates

As discussed in the Company's 2012 Annual Report on Form 10-K, the three most significant areas in which management applies critical assumptions and estimates that are particularly susceptible to change relate to the determination of the allowance for loan losses, impairment review of investment securities and the impairment review of goodwill. Refer to Note 1, "Summary of Significant Accounting Policies," to the Company's consolidated financial statements included in the Company's 2012 Annual Report on Form 10-K for significant accounting policies. The Company has not changed its significant accounting policies from those disclosed in its 2012 Annual Report filed on Form 10-K.

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

(3)Recent Accounting Pronouncements

In February 2013, the FASB issued ASU No. 2013-02, Comprehensive Income (Topic 220): Reporting Amounts Reclassified Out of Accumulated Other Comprehensive Income. The new amendment requires an organization to present the effects on the income statement of significant amounts reclassified out of accumulated other comprehensive income or cross-reference to other disclosures currently required under GAAP for certain items. The new amended standard is effective for annual periods beginning after December 15, 2012, and interim periods within those annual periods. As this ASU addresses only disclosure requirements, the adoption in the first quarter of 2013 did not have a material impact on the Company's financial statements. See Note 1, "Organization of Holding Company and Basis of Presentation," for the disclosure of the effects of amounts reclassified out of accumulated other comprehensive income.

(4) Investments

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

(Dollars in thousands)	September 30, 2013			Fair Value
	Amortized cost	Unrealized gains	Unrealized losses	
Federal agency obligations ⁽¹⁾	\$63,043	\$174	\$33	\$63,184
Federal agency mortgage backed securities (MBS) ⁽¹⁾	56,772	568	1,329	56,011
Municipal securities	57,442	1,781	327	58,896
Corporate bonds	4,763	23	55	4,731
Certificates of deposit	693	—	6	687
Total fixed income securities	182,713	2,546	1,750	183,509
Equity investments	9,324	2,605	20	11,909
Total available for sale securities, at fair value	\$192,037	\$5,151	\$1,770	\$195,418

(Dollars in thousands)	December 31, 2012			Fair Value
	Amortized cost	Unrealized gains	Unrealized losses	
Federal agency obligations ⁽¹⁾	\$65,247	\$438	\$—	\$65,685
Federal agency mortgage backed securities (MBS) ⁽¹⁾	48,429	1,287	42	49,674
Municipal securities	53,437	3,103	17	56,523
Corporate bonds	1,905	15	6	1,914
Total fixed income securities	169,018	4,843	65	173,796
Equity investments	9,080	1,622	34	10,668
Total available for sale securities, at fair value	\$178,098	\$6,465	\$99	\$184,464

These categories may include investments issued or guaranteed by government sponsored enterprises such as Fannie Mae (FNMA), Freddie Mac (FHLMC), Ginnie Mae (GNMA), Federal Farm Credit Bank, or one of several ⁽¹⁾ Federal Home Loan Banks. All agency MBS/Collateralized Mortgage Obligations ("CMOs") investments owned by the Company are backed by residential mortgages.

Included in the carrying amount of the federal agency MBS category were CMOs totaling \$18.9 million and \$23.6 million at September 30, 2013 and December 31, 2012, respectively.

Certificates of Deposit (CDs) represent term deposits issued by banks that are subject to FDIC insurance and purchased on the open market. The Company utilizes these CDs as an alternative investment option to holding short-term excess cash in lower yielding overnight deposit accounts. These securities have maturities of less than a year and the market value approximates the carrying value.

At September 30, 2013, the equity portfolio consisted primarily of investments in a diversified group of mutual funds, with a small portion of the portfolio (approximately 14%) invested in exchange traded funds or individual common stock of entities in the financial services industry.

The net unrealized gain or loss in the Company's fixed income portfolio fluctuates as market interest rates rise and fall. Due to the fixed rate nature of this portfolio, as market rates fall, the value of the portfolio rises, and as market

rates rise, the value of the portfolio declines. The unrealized gains or losses on fixed income investments will also decline as the securities approach maturity, or if the issuer is credit impaired. Unrealized gains or losses will be recognized in the statements of

income if the securities are sold. However, if an unrealized loss on the fixed income portfolio is deemed to be other than temporary, the credit loss portion is charged to earnings and the noncredit portion is recognized in accumulated other comprehensive income. Net unrealized appreciation and depreciation on investments available for sale, net of applicable income taxes, are reflected as a component of accumulated other comprehensive income.

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

Management regularly reviews the portfolio for securities with unrealized losses that are other-than-temporarily impaired. During the nine months ended September 30, 2013 and 2012, the Company did not record any fair value impairment charges on its investments. As of September 30, 2013, there were a total of 66 investments (fixed income and equity, excluding CDs), with a fair market value of \$57.6 million, in an unrealized loss position totaling \$1.8 million. As of September 30, 2013, these unrealized loss positions were less than twelve months in duration. Management attributes these unrealized losses to increases in current market yields compared to the yields at the time the investments were purchased by the Company, and management does not consider these investments to be other-than-temporarily impaired at September 30, 2013 because the decline in market value is not attributable to credit quality for fixed income securities, or a fundamental deterioration in the equity fund or issuers, and because the Company does not intend to, and it is more likely than not that it will not be required to, sell those investments prior to a market price recovery or maturity.

In assessing MBS investments and Federal Agency obligations, the contractual cash flows of these investments are guaranteed by an agency of the U.S. Government, and the agency that issued these securities is sponsored by the U.S. Government. Accordingly, it is expected that the securities would not be settled at a price less than the par value of the Company's investments. Management's assessment of other fixed income investments within the portfolio includes reviews of market pricing, ongoing credit quality evaluations, assessment of the investment's materiality, and duration of the unrealized loss position. In addition, the Company utilizes an outside registered investment adviser to manage the corporate and municipal bond portfolios, within prescribed guidelines set by management. At September 30, 2013, the Company's corporate and municipal bond portfolios did not contain any securities below investment grade, as reported by major credit rating agencies. For equities and funds, management's assessment includes the severity of the declines, whether it is unlikely that the security or fund will completely recover its unrealized loss within a reasonable time period and if the equity security or fund exhibits fundamental deterioration.

The small portion of the portfolio invested in short-term CDs was also in an unrealized loss position at September 30, 2013 due to market rates. The unrealized loss was not considered to be material and the securities are expected to be settled at par value at maturity.

The contractual maturity distribution at September 30, 2013 of total fixed income investments, excluding CDs which mature in less than one year, is as follows:

	Within One Year		After One, But Within Five Years		After Five, But within Ten Years		After Ten Years	
	Amortized Cost	Yields	Amortized Cost	Yields	Amortized Cost	Yields	Amortized Cost	Yields
At amortized cost:								
Federal agency obligations	\$15,507	0.79 %	\$47,536	0.90 %	\$—	— %	\$—	— %
MBS	—	— %	37	1.51 %	11,978	2.85 %	44,757	2.32 %
Municipal securities	2,836	2.12 %	17,558	2.90 %	30,692	4.43 %	6,356	6.24 %
Corporate bonds	—	— %	3,288	2.61 %	1,475	4.62 %	—	— %

Total fixed income securities	\$18,343	1.00	%	\$68,419	1.50	%	\$44,145	4.01	%	\$51,113	2.81	%
At fair value:												
Total fixed income securities	\$18,407			\$68,906			\$45,206			\$50,303		

Scheduled contractual maturities may not reflect the actual maturities of the investments. MBS/CMOs are shown at their final maturity. However, due to prepayments and amortization the actual MBS/CMO cash flows may be faster than presented above. Similarly, included in the carrying value of fixed income investments above are callable securities, comprised of municipal securities, federal agency obligations and corporate bonds totaling \$47.0 million, which can be redeemed by the issuer prior to the maturity presented above. Management considers these factors when evaluating the net interest margin in the Company's asset-liability management program.

See Note 12, "Fair Value Measurements" below for further information regarding the Company's fair value measurements for available-for-sale securities.

From time to time, the Company may pledge securities as collateral against deposit account balances of municipal deposit customers, for Federal Home Loan Bank of Boston ("FHLB") borrowing capacity and as collateral for borrowing from the Federal Reserve Bank of Boston ("FRB"). The fair value of securities pledged as collateral for these purposes was \$182.8 million at September 30, 2013.

(5) Restricted Investments

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

Based on management's ongoing review, the Company has not recorded any other-than-temporary impairment charges on this investment to date. However, if negative events or deterioration in the FHLB financial condition or capital levels occurs the Company's investment in FHLB capital stock may become other-than-temporarily impaired to some degree.

(6) Loans

Major classifications of loans at the periods indicated, are as follows:

(Dollars in thousands)	September 30, 2013	December 31, 2012
Real estate:		
Commercial real estate	\$803,069	\$710,265
Commercial construction	115,254	121,367
Residential mortgages	129,422	120,278
Total real estate	1,047,745	951,910
Commercial and industrial	346,888	328,579
Home equity	72,832	75,648
Consumer	6,706	4,911
Gross loans	1,474,171	1,361,048
Deferred loan origination fees, net	(1,475)	(1,393)
Total loans	1,472,696	1,359,655
Allowance for loan losses	(25,999)	(24,254)
Net loans	\$1,446,697	\$1,335,401

The Company specializes in lending to business entities, non-profit organizations, professionals and individuals. The Company's primary lending focus is on the development of high quality commercial relationships achieved through active business development efforts, long-term relationships with established commercial developers, strong

community involvement and focused marketing strategies. Loans made to businesses include commercial mortgage loans, construction and land development loans, secured and unsecured commercial loans and lines of credit, and standby letters of credit. The Company also originates equipment lease financing for businesses. Loans made to individuals include conventional residential mortgage loans, home equity loans and lines, residential construction loans on primary and secondary residences, and secured and

unsecured personal loans and lines of credit (see Note 7, "Allowance for Loan Losses," for additional information on the Company's credit risk management).

Loan Categories

- Commercial loans:

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

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

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

From time to time, the Company participates with other banks in the financing of certain commercial projects. In some cases, the Company may act as the lead lender, originating and servicing the loans, but participating out a portion of the funding to other banks. In other cases, the Company may participate in loans originated by other institutions. In each case, the participating bank funds a percentage of the loan commitment and takes on the related risk. In each case in which the Company participates in a loan, the rights and obligations of each participating bank are divided proportionately among the participating banks in an amount equal to their share of ownership and with equal priority among all banks. The balances participated out to other institutions are not carried as assets on the Company's financial statements. Loans originated by other banks in which the Company is the participating institution are carried in the loan portfolio at the Company's pro rata share of ownership. The Company performs an independent credit analysis of each commitment and a review of the participating institution prior to participation in the loan. Loans originated by other banks in which the Company is the participating institution amounted to \$35.0 million at September 30, 2013 and \$28.6 million at December 31, 2012.

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

customer, generally a commercial loan, with the same criteria associated with similar commercial loans.

- Residential loans:

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

mortgage loans may have terms of up to 30 years at either fixed or adjustable rates of interest. Fixed and adjustable rate residential mortgage loans are generally originated using secondary market underwriting and documentation standards.

Depending on the current interest rate environment, management projections of future interest rates and the overall asset-liability management program of the Company, management may elect to sell those fixed and adjustable rate residential mortgage loans which are eligible for sale in the secondary market, or hold some or all of this residential loan production for the Company's portfolio. Mortgage loans are generally not pooled for sale, but instead sold on an individual basis. The Company may retain or sell the servicing when selling the loans. Loans sold are subject to standard secondary market underwriting and eligibility representations and warranties over the life of the loan and are subject to an early payment default period covering the first four payments for certain loan sales. Loans classified as held for sale are carried as a separate line item on the balance sheet.

- Home equity loans and lines of credit:

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

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

- Consumer loans:

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

Loans serviced for others

At September 30, 2013 and December 31, 2012, the Company was servicing residential mortgage loans owned by investors amounting to \$20.7 million and \$22.2 million, respectively. Additionally, the Company was servicing commercial loans participated out to various other institutions amounting to \$52.9 million and \$53.6 million at September 30, 2013 and December 31, 2012, respectively. See the discussion above for further information regarding commercial participations.

Loans serving as collateral

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

(Dollars in thousands)	September 30, 2013	December 31, 2012
Commercial real estate	\$329,363	\$216,080

Residential mortgages	95,923	94,552
Home equity	17,763	18,907
Total loans pledged to FHLB	\$443,049	\$329,539

During the quarter ended September 30, 2013, as part of its regular liquidity management reviews, the Company pledged additional commercial real estate loans to the FHLB as collateral to provide additional borrowing capacity.

(7) Allowance for Loan Loss

The Company manages its loan portfolio to avoid concentration by industry and loan size to minimize its credit risk exposure. In addition, the Company does not have a “sub-prime” mortgage program. However, inherent in the lending process is the risk of loss due to customer non-payment, or “credit risk.” While the Company endeavors to minimize this risk through the credit risk management function, management recognizes that loan losses will occur and that the amount of these losses will fluctuate depending on the risk characteristics of the loan portfolio and economic conditions.

Credit Quality Indicators

The level of adversely classified loans, and delinquent and non-performing assets is largely a function of economic conditions, the overall banking environment, the Company's underwriting, and credit risk management standards. The Company's commercial lending focus may entail significant additional risks compared to long term financing on existing, owner-occupied residential real estate. The Company endeavors to minimize this risk through sound underwriting practices and the risk management function. The credit risk management function focuses on a wide variety of factors, including, among others, current and expected economic conditions, the real estate market, the financial condition of borrowers, the ability of borrowers to adapt to changing conditions or circumstances affecting their business and the continuity of borrowers' management teams. Early detection of credit issues is critical to minimize credit losses. Accordingly, management regularly monitors these factors, among others, through ongoing credit reviews by the Credit Department, an external loan review service, reviews by members of senior management and the Loan Committee of the Board of Directors. This review includes the assessment of internal credit quality indicators such as the risk classification of individual loans, adversely classified loans, past due and non-accrual loans, impaired and restructured loans, and the level of foreclosure activity. However, despite prudent loan underwriting and ongoing credit risk management, adverse changes within the Company's market area or deterioration in the local, regional or national economic conditions could negatively impact the portfolio's credit risk profile and the Company's asset quality in the future.

The loan portfolio continued to show improving statistics related to migration of adversely classified, non-accrual, impaired loans and the level of Other Real Estate Owned ("OREO") properties held during the quarter ended September 30, 2013. However, management believes that the credit profile of the portfolio will continue to be affected by lagging effects that the economic environment has had on the regional and local commercial markets.

- Adversely Classified Loans

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

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

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

loan, its classification as an estimated loss is deferred until more exact status may be determined.

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

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

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

(Dollars in thousands)	September 30, 2013				
	Adversely Classified			Not Adversely	
	Substandard	Doubtful	Loss	Classified	Gross Loans
Commercial real estate	\$12,900	\$1,285	\$—	\$788,884	\$803,069
Commercial and industrial	5,614	498	—	340,776	346,888
Commercial construction	4,193	—	—	111,061	115,254
Residential	1,030	—	—	128,392	129,422
Home equity	506	—	—	72,326	72,832
Consumer	38	—	—	6,668	6,706
Total gross loans	\$24,281	\$1,783	\$—	\$1,448,107	\$1,474,171

(Dollars in thousands)	December 31, 2012				
	Adversely Classified			Not Adversely	
	Substandard	Doubtful	Loss	Classified	Gross Loans
Commercial real estate	\$21,999	\$—	\$—	\$688,266	\$710,265
Commercial and industrial	5,993	1,460	48	321,078	328,579
Commercial construction	2,986	—	—	118,381	121,367
Residential	1,254	—	—	119,024	120,278
Home equity	661	—	—	74,987	75,648
Consumer	34	—	—	4,877	4,911
Total gross loans	\$32,927	\$1,460	\$48	\$1,326,613	\$1,361,048

The decrease in adversely classified loans since the prior period was due primarily to paydowns on several commercial relationships, and upgraded commercial loans, in particular one larger commercial real estate relationship of approximately \$6.0 million classified as an accruing TDR at December 31, 2012 which was upgraded during the nine months ended September 30, 2013, due to the borrower's improved financial condition and sustained performance over time, partially offset by additional credit downgrades during the period.

- Past Due and Non-Accrual Loans

Loans on which the accrual of interest has been discontinued are designated as non-accrual loans. Accrual of interest on loans is generally discontinued when a loan becomes contractually past due, with respect to interest or principal, by 90 days, or when reasonable doubt exists as to the full and timely collection of interest or principal. When a loan is placed on non-accrual status, all interest previously accrued but not collected is reversed against current period interest income. Interest accruals are resumed on such loans only when payments are brought current and have remained current for a period of 180 days and when, in the judgment of management, the collectability of both principal and interest is reasonably assured. Interest payments received on loans in a non-accrual status are generally applied to principal on the books of the Company. Additionally, deposit accounts overdrawn for 90 or more days are included in the consumer non-accrual numbers below.

The following tables present age analysis of past due loans as of the dates indicated.
Balance at September 30, 2013

(Dollars in thousands)	Loans 30-59 Days Past Due	Loans 60-89 Days Past Due	Loans 90 or More Days Past Due (non- accrual)	Total Past Due Loans	Current Loans	Gross Loans
Commercial real estate	\$2,040	\$187	\$ 11,276	\$ 13,503	\$789,566	\$803,069
Commercial and industrial	739	214	5,722	6,675	340,213	346,888
Commercial construction	198	—	1,950	2,148	113,106	115,254
Residential	128	122	648	898	128,524	129,422
Home equity	209	89	287	585	72,247	72,832
Consumer	37	—	15	52	6,654	6,706
Total gross loans	\$3,351	\$612	\$ 19,898	\$23,861	\$1,450,310	\$1,474,171

Balance at December 31, 2012

(Dollars in thousands)	Loans 30-59 Days Past Due	Loans 60-89 Days Past Due	Loans 90 or More Days Past Due (non- accrual)	Total Past Due Loans	Current Loans	Gross Loans
Commercial real estate	\$1,560	\$551	\$ 12,608	\$ 14,719	\$695,546	\$710,265
Commercial and industrial	472	55	6,993	7,520	321,059	328,579
Commercial construction	—	—	743	743	120,624	121,367
Residential	42	558	862	1,462	118,816	120,278
Home equity	73	9	390	472	75,176	75,648
Consumer	42	11	5	58	4,853	4,911
Total gross loans	\$2,189	\$1,184	\$ 21,601	\$24,974	\$1,336,074	\$1,361,048

At September 30, 2013 and December 31, 2012, all loans 90 days or more past due were carried as non-accruing. Included in the consumer non-accrual numbers in the table above were \$11 thousand and \$5 thousand of overdraft deposit account balances 90 days or more past due at September 30, 2013 and December 31, 2012, respectively. Total non-performing loans amounted to \$19.9 million and \$21.6 million at September 30, 2013 and December 31, 2012, respectively. Non-accrual loans which were not adversely classified amounted to \$1.0 million at September 30, 2013 and \$1.2 million at December 31, 2012. These balances primarily represented the guaranteed portions of non-performing SBA loans. The majority of the non-accrual loan balances were also carried as impaired loans during the periods noted, and are discussed further below. The increase in loans 30-59 days past due occurred primarily within the commercial real estate, commercial and industrial and construction portfolios, with the majority of these loans just 30 days overdue at September 30, 2013, and had subsequent payments made in October.

The ratio of non-accrual loans to total loans amounted to 1.35% at September 30, 2013, 1.59% at December 31, 2012, and 1.80% at September 30, 2012.

At September 30, 2013, additional funding commitments for loans on non-accrual status totaled \$700 thousand. The Company's obligation to fulfill the additional funding commitments on non-accrual loans is generally contingent on the borrower's compliance with the terms of the credit agreement. If the borrower is not in compliance, additional funding commitments may be made at the Company's discretion.

- Impaired Loans

Impaired loans are individually significant loans for which management considers it probable that not all amounts due (principal and interest) in accordance with the original contractual terms will be collected. The majority of impaired loans are included within the non-accrual balances; however, not every loan in non-accrual status has been designated as impaired.

Impaired loans include TDR loans. Impaired loans exclude large groups of smaller-balance homogeneous loans, such as residential mortgage loans and consumer loans, which are collectively evaluated for impairment and loans that are measured at fair value, unless the loan is amended in a TDR.

Management does not set any minimum delay of payments as a factor in reviewing for impaired classification. Management considers the individual payment status, net worth and earnings potential of the borrower, and the value and cash flow of the collateral as factors to determine if a loan will be paid in accordance with its contractual terms.

Impaired loans are individually evaluated for credit loss and a specific reserve is assigned for the amount of the estimated credit loss. Refer to heading "Allowance for probable loan losses methodology" contained in Note 5 "Allowance For Loan Losses," to the Company's consolidated financial statements contained in the Company's 2012 Annual Report on Form 10-K for further discussion of management's methodology used to estimate specific reserves for impaired loans.

Total impaired loans amounted to \$28.6 million and \$37.4 million, at September 30, 2013 and December 31, 2012, respectively. Total accruing impaired loans amounted to \$9.1 million and \$16.6 million at September 30, 2013 and December 31, 2012, respectively, while non-accrual impaired loans amounted to \$19.5 million and \$20.8 million as of September 30, 2013 and December 31, 2012, respectively. The decrease was primarily due to the changes discussed above under the heading "Adversely Classified Loans."

The following tables set forth the recorded investment in impaired loans and the related specific allowance allocated as of the dated indicated.

Balance at September 30, 2013

(Dollars in thousands)	Unpaid contractual principal balance	Total recorded investment in impaired loans	Recorded investment with no allowance	Recorded investment with allowance	Related allowance
Commercial real estate	\$ 17,001	\$ 14,702	\$ 11,630	\$ 3,072	\$ 544
Commercial and industrial	10,215	8,942	3,934	5,008	2,602
Commercial construction	4,319	4,193	2,232	1,961	875
Residential	677	628	373	255	68
Home equity	110	108	—	108	34
Consumer	18	18	—	18	18
Total	\$ 32,340	\$ 28,591	\$ 18,169	\$ 10,422	\$ 4,141

Balance at December 31, 2012

(Dollars in thousands)	Unpaid contractual principal balance	Total recorded investment in impaired loans	Recorded investment with no allowance	Recorded investment with allowance	Related allowance
Commercial real estate	\$ 24,760	\$ 22,859	\$ 18,735	\$ 4,124	\$ 1,041
Commercial and industrial	12,184	10,831	6,016	4,815	2,186
Commercial construction	3,091	2,932	995	1,937	753
Residential	687	648	390	258	65
Home equity	110	109	—	109	87
Consumer	14	14	—	14	14
Total	\$ 40,846	\$ 37,393	\$ 26,136	\$ 11,257	\$ 4,146

The following table presents the average recorded investment in impaired loans and the related interest recognized during the three month periods indicated.

(Dollars in thousands)	Three Months Ended September 30, 2013		Three Months Ended September 30, 2012	
	Average recorded investment	Interest income recognized	Average recorded investment	Interest income recognized
Commercial real estate	\$15,405	\$ 42	\$22,952	\$127
Commercial and industrial	9,081	23	9,613	19
Commercial construction	3,540	17	2,438	24
Residential	741	3	836	3
Home equity	109	—	50	—
Consumer	18	1	15	—
Total	\$28,894	\$ 86	\$35,904	\$173

The following table presents the average recorded investment in impaired loans and the related interest recognized during the nine month periods indicated.

(Dollars in thousands)	Nine Months Ended September 30, 2013		Nine Months Ended September 30, 2012	
	Average recorded investment	Interest income recognized	Average recorded investment	Interest income recognized
Commercial real estate	\$18,572	\$191	\$23,853	\$437
Commercial and industrial	9,312	77	10,028	105
Commercial construction	3,114	50	2,195	41
Residential	785	7	758	8
Home equity	119	—	50	—
Consumer	17	1	17	1
Total	\$31,919	\$326	\$36,901	\$592

At September 30, 2013, additional funding commitments for impaired loans totaled \$700 thousand. The Company's obligation to fulfill the additional funding commitments on impaired loans is generally contingent on the borrower's compliance with the terms of the credit agreement. If the borrower is not in compliance, additional funding commitments may be made at the Company's discretion.

- Troubled Debt Restructures

Loans are designated as a TDR when, as part of an agreement to modify the original contractual terms of the loan, the Bank grants the borrower a concession on the terms, that would not otherwise be considered, as a result of financial difficulties of the borrower. Typically, such concessions may consist of a reduction in interest rate to a below market rate, taking into account the credit quality of the note, or a deferment or reduction of payments (principal or interest) which materially alters the Bank's position or significantly extends the note's maturity date, such that the present value of cash flows to be received is materially less than those contractually established at the loan's origination. All loans that are modified are reviewed by the Company to identify if a TDR has occurred. TDR loans are included in the impaired loan category and, as such, these loans are individually evaluated and a specific reserve is assigned for the amount of the estimated credit loss.

Total TDR loans, included in the impaired loan figures above, as of September 30, 2013 and December 31, 2012, were \$19.4 million and \$26.6 million, respectively.

TDR loans on accrual status amounted to \$8.6 million and \$16.0 million at September 30, 2013 and December 31, 2012, respectively. During the current quarter, an accruing TDR commercial real estate relationship of approximately \$6.0 million

was upgraded and removed from impaired/TDR status, due to the borrower's improved financial condition and sustained performance over time. TDR loans included in non-performing loans amounted to \$10.8 million and \$10.5 million at September 30, 2013 and December 31, 2012, respectively. The Company continues to work with commercial relationships and enters into loan modifications to the extent deemed to be necessary or appropriate while attempting to achieve the best mutual outcome given the current economic environment.

Troubled debt restructure agreements entered into during the three month period ended September 30, 2013 are detailed below.

(Dollars in thousands)	Three months ended September 30, 2013		
	Number of	Pre-modification	Post-modification
	restructurings	outstanding recorded investment	outstanding recorded investment
Commercial real estate	1	\$ 342	\$ 291
Commercial and industrial	1	89	42
Commercial construction	1	769	769