SALISBURY BANCORP INC
Form 10-Q
November 14, 2013

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2013

OR

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

FOR THE TRANSITION PERIOD FROM ________ TO ________

Commission file number 0-24751

SALISBURY BANCORP, INC.

(Exact name of registrant as specified in its charter)

Connecticut (State or other jurisdiction of incorporation or organization)	06-1514263 (I.R.S. Employer Identification No.)
5 Bissell Street, Lakeville, CT (Address of principal executive offices)	06039 (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 [X] 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 X

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

Yes [ ] No [X]

The number of shares of Common Stock outstanding as of November 14, 2013 is 1,710,121.

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PART I - FINANCIAL INFORMATION

Salisbury Bancorp, Inc. and Subsidiary

CONSOLIDATED BALANCE SHEETS (unaudited)

(in thousands, except share data)	September 30, 2013	Duecember 31, 2012
ASSETS		
Cash and due from banks	$7,679	$9,545
Interest bearing demand deposits with other banks	16,040	34,029
Total cash and cash equivalents	23,719	43,574
Interest-bearing time deposits	5,220	-
Securities		
Available-for-sale at fair value	99,816	126,287
Federal Home Loan Bank of Boston stock at cost	5,340	5,747
Loans held-for-sale	708	1,879
Loans receivable, net (allowance for loan losses: $4,656 and $4,360)	420,306	388,758

Other real estate owned	571	244
Bank premises and equipment, net	11,253	11,520
Goodwill	9,829	9,829
Intangible assets (net of accumulated amortization: $1,912 and $1,745)	631	798
Accrued interest receivable	1,823	1,818
Cash surrender value of life insurance policies	7,480	7,295
Deferred taxes	719	-
Other assets	2,066	3,064
Total Assets	$589,481	$600,813
LIABILITIES and SHAREHOLDERS' EQUITY		
Deposits		
Demand (non-interest bearing)	$83,892	$98,850
Demand (interest bearing)	79,232	65,991
Money market	125,070	128,501
Savings and other	107,380	103,985
Certificates of deposit	84,295	93,888
Total deposits	479,869	491,215
Repurchase agreements	3,870	1,784
Federal Home Loan Bank of Boston advances	30,801	31,980
Deferred taxes	-	590
Accrued interest and other liabilities	3,730	3,247
Total Liabilities	518,270	528,816
Commitments and contingencies	-	-
Shareholders' Equity		
Preferred stock - $.01 per share par value		
Authorized: 25,000; Issued: 16,000 (Series B);		
Liquidation preference: $1,000 per share	16,000	16,000
Common stock - $.10 per share par value		
Authorized: 3,000,000;		
Issued: 1,710,121 and 1,689,691	171	169
Paid-in capital	13,668	13,158
Retained earnings	41,779	40,233
Unearned Compensation - restricted stock awards	(375)	-
Accumulated other comprehensive income (loss), net	(32)	2,437
Total Shareholders' Equity	71,211	71,997
Total Liabilities and Shareholders' Equity	$589,481	$600,813

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Salisbury Bancorp, Inc. and Subsidiary

CONSOLIDATED STATEMENTS OF INCOME (unaudited)

	Three months ended		Nine months ended	
Periods ended September 30, (in thousands except per share amounts) unaudited	2013	2012	2013	2012
Interest and dividend income				
Interest and fees on loans	$4,516	$4,500	$13,415	$13,678
Interest on debt securities				
Taxable	418	579	1,359	1,939
Tax exempt	475	495	1,441	1,539
Other interest and dividends	22	33	58	75

Total interest and dividend income	5,431	5,607	16,273	17,231
Interest expense				
Deposits	459	580	1,437	1,870
Repurchase agreements	2	3	4	21
Federal Home Loan Bank of Boston advances	311	452	935	1,398
Total interest expense	772	1,035	2,376	3,289
Net interest and dividend income	4,659	4,572	13,897	13,942
Provision for loan losses	240	330	876	690
Net interest and dividend income after provision for loan losses	4,419	4,242	13,021	13,252
Non-interest income				
Trust and wealth advisory	750	683	2,299	2,173
Service charges and fees	595	559	1,687	1,628
Gains on sales of mortgage loans, net	69	568	501	1,203
Mortgage servicing, net	(37)	(9)	(3)	(98)
Gains on securities, net	-	-	-	279
Other	82	86	251	252
Total non-interest income	1,459	1,887	4,735	5,437
Non-interest expense				
Salaries	1,922	1,810	5,508	5,268
Employee benefits(1)	693	597	2,140	2,244
Premises and equipment	622	603	1,789	1,799
Data processing	358	369	1,145	1,190
Professional fees	306	299	996	915
Collections and OREO(2)	74	301	305	767
FDIC insurance	111	116	350	363
Marketing and community support	99	92	326	267
Amortization of intangibles	56	56	167	167
Other	402	450	1,232	1,240
Total non-interest expense	4,643	4,693	13,958	14,220
Income before income taxes	1,235	1,436	3,798	4,469
Income tax provision	219	296	695	963
Net income	$1,016	$1,140	$3,103	$3,506
Net income available to common shareholders	$976	$1,094	$2,982	$3,328
Basic earnings per common share	$0.57	$0.65	$1.75	$1.97
Diluted earnings per common share	0.57	0.65	1.75	1.97
Common dividends per share	0.28	0.28	0.84	0.84

[1] *Included pension plan curtailment expense of $341,000 for the nine month period ended September 30, 2012.*

[2] *Included litigation expense of $193,000 and $533,000, respectively, for the three and nine month periods ended September 30, 2012.*

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Salisbury Bancorp, Inc. and Subsidiary

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (unaudited)

	Three months ended		Nine months ended	
Periods ended September 30, (in thousands)	2013	2012	2013	2012
Net income	$1,016	$1,140	$3,103	$3,506
Other comprehensive (loss) income				
Net unrealized (losses) gains on securities available-for-sale	(1,240)	921	(3,741)	2,698
Reclassification of net realized gains in net income	-	-	-	(279)
Unrealized (losses) gains on securities available-for-sale	(1,240)	921	(3,741)	2,419
Income tax benefit (expense)	422	(313)	1,272	(822)
Unrealized (losses) gains on securities available-for-sale, net of tax	(818)	608	(2,469)	1,597
Change in unrecognized pension plan costs	-	27	-	(31)
Income tax (benefit) expense	-	(9)	-	11
Pension plan income (loss), net of tax	-	18	-	(20)
Other comprehensive (loss) income, net of tax	(818)	626	(2,469)	1,577
Comprehensive income	$198	$1,766	$634	$5,083

Salisbury Bancorp, Inc. and Subsidiary

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (unaudited)

(dollars in thousands) unaudited	Common Stock Shares	Amount	Preferred Stock	Paid-in capital	Retained earnings	Unearned Compensation-Restricted Stock Awards	Accumulated other comp-rehensive income (loss)	Tot sha hol equ
Balances at December 31, 2011	1,688,731	$169	$16,000	$13,134	$38,264	$-	$(705)	$66,8
Net income for period	-	-	-	-	3,506	-	-	3,50
Other comprehensive income, net of tax	-	-	-	-	-	-	1,577	1,57
Common stock dividends paid	-	-	-	-	(1,419)	-	-	(1,4
Preferred stock dividends declared	-	-	-	-	(176)	-	-	(17
Issuance of common stock for director fees	960	-	-	24	-	-	-	24
Balances at September 30, 2012	1,689,691	$169	$16,000	$13,158	$40,175	$-	$872	$70,3
Balances at December 31, 2012	1,689,691	$169	$16,000	$13,158	$40,233	$-	$2,437	$71,9
Net income for period	-	-	-	-	3,103	-	-	3,10
	-	-	-	-	-	-	(2,469)	(2,4

Other comprehensive loss, net of tax								
Common stock dividends declared	-	-	-	-	(1,436)	-	-	(1,4
Preferred stock dividends declared	-	-	-	-	(121)	-	-	(12
Issuance of restricted common stock	19,600	2	-	488	-	(490)	-	-
Forfeiture of restricted common stock	(500)	-		(12)		12	-	-
Stock based compensation-restricted stock awards	-	-	-	-	-	103	-	103
Issuance of common stock for director fees	1,330	-	-	34	-	-	-	34
Balances at September 30, 2013	1,710,121	$171	$16,000	$13,668	$41,779	$(375)	$(32)	$71,2

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Salisbury Bancorp, Inc. and Subsidiary

CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

Nine months ended September 30, (in thousands) unaudited	2013	2012
Operating Activities		
Net income	$3,103	$3,506
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization and depreciation		
Securities	366	464
Bank premises and equipment	642	666
Core deposit intangible	167	167
Mortgage servicing rights	298	278
Fair value adjustment on loans	24	25
Gains on calls of securities available-for-sale	-	(12)
Gains on sales of securities available-for-sale	-	(267)
Loss on sale/disposals of premises and equipment	34	24
Loss recognized on other real estate owned	9	24
Provision for loan losses	876	690
Decrease (increase) in loans held-for-sale	1,171	(647)
Increase in deferred loan origination fees and costs, net	(117)	(44)
Mortgage servicing rights originated	(261)	(504)
Decrease in mortgage servicing rights impairment reserve	4	89
(Increase) decrease in interest receivable	(5)	160
Deferred tax benefit	(37)	(39)
Decrease (increase) in prepaid expenses	542	(87)
Increase in cash surrender value of life insurance policies	(185)	(202)
Decrease in income tax receivable	352	420
Decrease (increase) in other assets	63	(29)
Increase in accrued expenses	436	766
Decrease in interest payable	(29)	(53)
Increase in other liabilities	76	47

Issuance of shares for director fees	34	24
Issuance of shares of restricted stock	103	-
Net cash provided by operating activities	7,666	5,466
Investing Activities		
Redemption of Federal Home Loan Bank stock	407	285
Purchase of interest-bearing time deposit with other banks	(5,220)	-
Proceeds from calls of securities available-for-sale	1,650	12,668
Proceeds from maturities of securities available-for-sale	20,714	16,928
Proceeds from sale of securities available-for-sale	-	2,767
Proceeds from maturities of securities held-to-maturity	-	50
Loan originations and principal collections, net	(34,040)	(6,986)
Recoveries of loans previously charged-off	20	37
Proceeds from sales of other real estate owned	1,353	1,745
Capital expenditures	(409)	(286)
Net cash (utilized) provided by investing activities	(15,525)	27,208
Financing Activities		
(Decrease) increase in deposit transaction accounts, net	(1,753)	25,970
Decrease in time deposits, net	(9,593)	(7,070)
Increase (decrease) in securities sold under agreements to repurchase, net	2,086	(9,207)
Principal payments on Federal Home Loan Bank of Boston advances	(1,179)	(12,223)
Common stock dividends paid	(1,436)	(1,419)
Preferred stock dividends paid	(121)	(195)
Net cash utilized by financing activities	(11,996)	(4,144)
Net (decrease) increase in cash and cash equivalents	(19,855)	28,530
Cash and cash equivalents, beginning of period	43,574	36,886
Cash and cash equivalents, end of period	$23,719	$65,416
Cash paid during period		
Interest	$2,405	$3,342
Income taxes	380	582
Non-cash transfers		
Transfer from loans to other real estate owned	1,689	666
Transfer from other real estate owned to loans	-	(1,000)

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Salisbury Bancorp, Inc. and Subsidiary

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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, comprehensive 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, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013. The accompanying condensed financial statements should be read in conjunction with the financial statements and notes thereto included in Salisbury's 2012 Annual Report on Form 10-K for the period ended December 31, 2012.

The allowance for loan losses is a significant accounting policy and is presented in Note 3 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 July 2013, the FASB issued ASU 2013-10, “Derivatives and Hedging (Topic 815) - Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes.” The amendments in this ASU permit the Fed Funds Effective Swap Rate (OIS) to be used as a U.S. benchmark interest rate for hedge accounting purposes under Topic 815, in addition to Treasury Obligations of the U.S. government (UST) and the London Interbank Offered Rate (LIBOR). The amendments also remove the restriction on using different benchmark rates for similar hedges. The amendments apply to all entities that elect to apply hedge accounting of the benchmark interest rate under Topic 815. The amendments are effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. The adoption of this ASU did not have an impact on Salisbury’s results of operations or financial position.

In July 2013, the FASB issued ASU 2013-11, “Income Taxes - Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists.” The amendments in this ASU provide guidance for the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The amendments in this ASU are expected to reduce diversity in practice by providing guidance on the presentation of unrecognized tax benefits and will better reflect the manner in which an entity would settle at the reporting date any additional income taxes that would result from the disallowance of a tax position when net operating loss carryforwards, similar tax losses, or tax credit carryforwards exist. The amendments apply to all entities that have unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists at the reporting date and are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The adoption of this guidance is not expected to have an impact on Salisbury’s results of operations or financial position.

In April 2013, the FASB issued ASU 2013-07, “Presentation of Financial Statements (Topic 205): Liquidation Basis of Accounting.” The amendments in this ASU are being issued to clarify when an entity should apply the liquidation basis of accounting. The guidance provides principles for the recognition and measurement of assets and liabilities and requirements for financial statements prepared using the liquidation basis of accounting. Additionally, the amendments require disclosures about an entity’s plan for liquidation, the methods and significant assumptions used to measure assets and liabilities, the type and amount of costs and income accrued, and the expected duration of the liquidation process. The amendments are effective for entities that determine liquidation is imminent during annual reporting periods beginning after December 15, 2013, and interim reporting periods therein. Entities should apply the requirements prospectively from the day that liquidation becomes imminent. Early adoption is permitted. Salisbury anticipates that the adoption of this guidance will not have an impact on its consolidated financial statements.

In February 2013, the FASB issued ASU 2013-04, "Liabilities (Topic 405): Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date." The objective of the amendments in this ASU is to provide guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this guidance is fixed at the reporting date, except for obligations addressed within existing guidance in U.S. generally accepted accounting principles (GAAP). Examples of obligations within the scope of this ASU include debt arrangements, other contractual obligations, and settled litigation and judicial rulings. The amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013; and should be applied retrospectively to all prior periods presented for those obligations resulting from joint and several liability arrangements within the ASU scope that exist at the beginning of an entity's fiscal year of adoption. Salisbury anticipates that the adoption of this guidance will not have a material impact on its consolidated financial statements.

In October 2012, the FASB issued ASU 2012-06, "Business Combinations (Topic 805): Subsequent Accounting for an Indemnification Asset Recognized at the Acquisition Date as a Result of a Government-Assisted Acquisition of a Financial Institution." The amendments in this update clarify the applicable guidance for subsequently measuring an indemnification asset recognized as a result of a government-assisted acquisition of a financial institution. For public entities, the amendments in this update are effective for fiscal years, and interim periods within those years beginning on or after December 15, 2012. The adoption of ASU 2012-06 did not have a material impact on Salisbury's consolidated financial position, results of operations or cash flows.

In December 2011, the FASB issued ASU 2011-12, "Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05. The amendments in this update defer those changes in ASU 2011-05 that relate to the presentation of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. All other requirements in ASU 2011-05 are not affected by this update. The amendments are effective during interim and annual periods beginning after December 15, 2011. The adoption of ASU 2011-12 did not have a material impact on Salisbury's consolidated financial position, results of operations or cash flows.

In December 2011, the FASB issued ASU 2011-11, "Disclosures about Offsetting Assets and Liabilities." This ASU is to enhance current disclosures. Entities are required to disclose both gross information and net information about both instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting arrangement. The amendments in this ASU are effective for annual periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented. The adoption of ASU 2011-11 did not 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, 2013				
Available-for-sale				
U.S. Treasury notes	$ 2,496	$ 174	$ -	$ 2,670
U.S. Government Agency notes	2,509	110	-	2,619
Municipal bonds	43,850	842	(2,119)	42,573
Mortgage backed securities				
U.S. Government Agencies	35,720	654	(60)	36,314
Collateralized mortgage obligations				
U.S. Government Agencies	3,807	41	-	3,848
Non-agency	8,492	423	(20)	8,895
SBA bonds	2,260	101	-	2,361
Preferred Stock	20	516	-	536
Total securities available-for-sale	$ 99,154	$ 2,861	$ (2,199)	$ 99,816
Non-marketable securities				
Federal Home Loan Bank of Boston stock	$ 5,340	$ -	$ -	$ 5,340

(in thousands)	Amortized cost (1)	Gross un-realized gains	Gross un-realized losses	Fair value
December 31, 2012				
Available-for-sale				
U.S. Treasury notes	$ 2,496	$ 237	$ -	$ 2,733
U.S. Government Agency notes	7,515	211	-	7,726
Municipal bonds	45,395	2,138	(168)	47,365
Mortgage backed securities				
U.S. Government Agencies	47,465	1,284	(20)	48,729
Collateralized mortgage obligations				
U.S. Government Agencies	5,131	66	-	5,197
Non-agency	11,081	494	(68)	11,507
SBA bonds	2,781	82	-	2,863
Preferred Stock	20	147	-	167
Total securities available-for-sale	$ 121,884	$ 4,659	$ (256)	$ 126,287
Non-marketable securities				
Federal Home Loan Bank of Boston stock	$ 5,747	$ -	$ -	$ 5,747

(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 period ended September 30, 2013 and sold a $2,500,000 Treasury bond available-for-sale during the nine month period ended September 30, 2012. The pre-tax gain recognized on this sale was $267,000.

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 Fair value	Less than 12 Months Unrealized losses	12 Months or Longer Fair value	12 Months or Longer Unrealized losses	Total Fair value	Total Unrealized losses
September 30, 2013						
Available-for-sale						
Municipal bonds	$20,617	$ 1,497	$1,926	$ 622	$22,543	$ 2,119
Mortgage backed securities	4,689	59	42	1	4,731	60
Collateralized mortgage obligations						
Non-agency	432	1	824	12	1,256	13
Total temporarily impaired securities	25,738	1,557	2,792	635	28,530	2,192
Other-than-temporarily impaired securities						
Collateralized mortgage obligations						
Non-agency	339	7	-	-	339	7
Total temporarily and other-than-temporarily impaired securities	$26,077	$ 1,564	$2,792	$ 635	$28,869	$ 2,199

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 whether it has the 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, 2013.

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 evaluates these securities for strategic fit and may reduce its position in these securities, although 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, 2013.

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

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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. Where appropriate, Salisbury performs credit underwriting reviews of issuers, including some that have had their ratings withdrawn and are insured by insurers that have had their ratings withdrawn, to assess 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. 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, 2013.

Non-agency CMOs: Salisbury performed a detailed cash flow analysis of its non-agency CMOs at September 30, 2013 to assess whether any of the securities were OTTI. Salisbury uses first 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, 2013. It is possible that future loss assumptions could change necessitating Salisbury to recognize future OTTI for further deterioration in credit quality. Salisbury evaluates these securities for strategic fit and may reduce its position in these securities, although it has no present intention to do so, 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)	2013	2012
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 was 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. In 2011, the FHLBB resumed modest quarterly cash dividends to its members and in early 2012 the FHLBB repurchased its excess stock pool. 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, 2013. 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, 2013	December 31, 2012

Residential 1-4 family	$225,262	$198,552
Residential 5+ multifamily	4,894	3,889
Construction of residential 1-4 family	1,250	2,379
Home equity credit	34,163	34,162
Residential real estate	265,569	238,982
Commercial	91,817	87,382
Construction of commercial	9,154	5,823
Commercial real estate	100,971	93,205
Farm land	4,193	4,320
Vacant land	9,168	9,926
Real estate secured	379,901	346,433
Commercial and industrial	35,837	38,094
Municipal	4,101	3,378
Consumer	3,974	4,181
Loans receivable, gross	423,813	392,086
Deferred loan origination fees and costs, net	1,149	1,032
Allowance for loan losses	(4,656)	(4,360)
Loans receivable, net	$420,306	$388,758
Loans held-for-sale		
Residential 1-4 family	$708	$1,879

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Concentrations of Credit Risk

Salisbury's loans consist primarily of residential and commercial real estate loans located principally in northwestern Connecticut and nearby 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 and consumer 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.

Loan Credit Quality

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

(in thousands)	Pass	Special mention	Substandard	Doubtful	Loss	Total
September 30, 2013						
Residential 1-4 family	$206,691	$11,754	$6,721	$96	$-	$225,262
Residential 5+ multifamily	2,711	1,208	975	-	-	4,894
Construction of residential 1-4 family	1,250	-	-	-	-	1,250
Home equity credit	31,541	1,240	1,382	-	-	34,163
Residential real estate	242,193	14,202	9,078	96	-	265,569
Commercial	66,899	16,513	8,405	-	-	91,817
Construction of commercial	8,412	152	590	-	-	9,154
Commercial real estate	75,311	16,665	8,995	-	-	100,971
Farm land	1,611	1,436	1,146	-	-	4,193
Vacant land	5,759	293	3,116	-	-	9,168
Real estate secured	324,874	32,596	22,335	96	-	379,901

Commercial and industrial	28,149	6,675	1,013	-		35,837
Municipal	4,101	-	-	-	-	4,101
Consumer	3,854	102	18	-	-	3,974
Loans receivable, gross	$360,978	$39,373	$23,366	$96	$-	$423,813
(in thousands)	Pass	Special mention	Substandard	Doubtful	Loss	Total
December 31, 2012						
Residential 1-4 family	$180,442	$12,473	$5,538	$99	$-	$198,552
Residential 5+ multifamily	2,872	773	244	-	-	3,889
Construction of residential 1-4 family	1,570	-	809	-	-	2,379
Home equity credit	30,981	1,848	1,333	-	-	34,162
Residential real estate	215,865	15,094	7,924	99	-	238,982
Commercial	64,817	13,299	9,266	-	-	87,382
Construction of commercial	5,055	297	471	-	-	5,823
Commercial real estate	69,872	13,596	9,737	-	-	93,205
Farm land	2,799	341	1,180	-	-	4,320
Vacant land	4,885	863	4,178	-	-	9,926
Real estate secured	293,421	29,894	23,019	99	-	346,433
Commercial and industrial	28,453	8,300	1,341	-	-	38,094
Municipal	3,378	-	-	-	-	3,378
Consumer	3,994	159	28	-	-	4,181
Loans receivable, gross	$329,246	$38,353	$24,388	$99	$-	$392,086

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

		Past due							
(in thousands)	Current	1-29 days	30-59 days	60-89 days	90-179 days	180 days and over	30 days and over	Accruing 90 days and over	Non-accrual
September 30, 2013									
Residential 1-4 family	$217,263	$3,156	$2,644	$2,012	$53	$134	$4,843	$-	$3,013
Residential 5+ multifamily	4,678	115	-	101	-	-	101	-	-
Construction of residential 1-4 family	1,250	-	-	-	-	-	-	-	-
Home equity credit	33,018	337	447	191	132	38	808	23	420
Residential real estate	256,209	3,608	3,091	2,304	185	172	5,752	23	3,433
Commercial	88,105	1,902	213	438	127	1,032	1,810	-	2,114
Construction of commercial	7,940	1,074	-	140	0	-	140	-	-
Commercial real estate	96,045	2,976	213	578	127	1,032	1,950	-	2,114
Farm land	3,782	-	27	-	384	-	411	-	384
Vacant land	5,910	120	58	7	-	3,073	3,138	-	3,072
Real estate secured	361,946	6,704	3,389	2,889	696	4,277	11,251	23	9,003

Commercial and industrial	35,346	328	30	112	-	21	163	-	140
Municipal	4,091	10	-	-	-	-	-	-	-
Consumer	3,857	89	13	15	-	-	28	-	-
Loans receivable, gross	$405,240	$7,131	$3,432	$3,016	$696	$4,298	$11,442	$23	$9,143
December 31, 2012									
Residential 1-4 family	$190,488	$2,545	$3,578	$639	$1,185	$117	$5,519	$-	$3,024
Residential 5+ multifamily	3,889	-	-	-	-	-	-	-	-
Construction of residential 1-4 family	2,379	-	-	-	-	-	-	-	-
Home equity credit	32,540	890	113	396	-	223	732	-	442
Residential real estate	229,296	3,435	3,691	1,035	1,185	340	6,251	-	3,466
Commercial	83,477	864	1,104	566	58	1,313	3,041	-	2,214
Construction of commercial	5,659	-	164	-	-	-	164	-	21
Commercial real estate	89,136	864	1,268	566	58	1,313	3,205	-	2,235
Farm land	3,898	422	-	-	-	-	-	-	-
Vacant land	5,932	-	-	48	740	3,206	3,994	-	3,994
Real estate secured	328,262	4,721	4,959	1,649	1,983	4,859	13,450	-	9,695
Commercial and industrial	37,618	351	26	99	-	-	125	-	164
Municipal	3,378	-	-	-	-	-	-	-	-
Consumer	4,034	108	25	14	-	-	39	-	-
Loans receivable, gross	$373,292	$5,180	$5,010	$1,762	$1,983	$4,859	$13,614	$-	$9,859

Troubled Debt Restructurings

Troubled debt restructurings occurring during the periods are as follows:

	Three months ended September 30, 2013			Nine months ended September 30, 2013		
(in thousands)	Quantity	Pre-modification balance	Post-modification balance	Quantity	Pre-modification balance	Post-modification balance
Residential real estate	-	$ -	$ -	4	$ 1,906	$ 1,906
Commercial real estate	-	-	-	-	-	-
Commercial and industrial	-	-	-	1	91	91
Troubled debt restructurings	-	$ -	$ -	5	$ 1,997	$ 1,997
Rate reduction	-	$ -	$ -	2	$ 1,070	$ 1,070
Rate reduction and debt consolidation	-	-	-	1	91	91
	-	-	-	1	758	758

Rate reduction and interest only pursuant to sale						
Rate reduction and term extension	-	-	-	1	78	78
Troubled debt restructurings	-	$ -	$ -	5	$ 1,997	$ 1,997

No loans were modified under a troubled debt restructuring during the quarter ended September 30, 2013.

Allowance for Loan Losses

Changes in the allowance for loan losses are as follows:

	Three months ended September 30					Nine months ended September 30				
(in thousands)	Beginning balance	Provision	Charge-offs	Reco-veries	Ending balance	Beginning balance	Provision	Charge-offs	Reco-veries	Ending balance
2013 Periods										
Residential	$1,892	$ 227	$ (159)	$ -	$1,960	$1,934	$ 259	$ (233)	$ -	$1,960
Commercial	1,403	58	(19)	-	1,442	1,059	471	(94)	6	1,442
Land	137	22	(23)	-	136	301	56	(221)	-	136
Real estate	3,432	307	(201)	-	3,538	3,294	786	(548)	6	3,538
Commercial & industrial	541	(62)	-	-	479	499	(16)	(4)	-	479
Municipal	40	1	-	-	41	36	5	-	-	41
Consumer	69	8	(23)	9	63	91	5	(47)	14	63
Unallocated	549	(14)	-	-	535	440	96	(1)	-	535
Totals	$4,631	$ 240	$ (224)	$ 9	$4,656	$4,360	$ 876	$ (600)	$ 20	$4,656
2012 Periods										
Residential	$1,475	$ 92	$ (88)	$ -	$1,479	$1,478	$ 226	$ (225)	$ -	$1,479
Commercial	1,277	(206)	(41)	3	1,033	1,139	(72)	(41)	7	1,033
Land	219	318	(224)	-	313	410	169	(266)	-	313
Real estate	2,971	204	(353)	3	2,825	3,027	323	(532)	7	2,825
Commercial & industrial	820	(23)	-	1	798	704	114	(29)	9	798
Municipal	27	6	-	-	33	24	9	-	-	33
Consumer	66	74	(14)	5	131	79	92	(63)	22	130
Unallocated	323	69	-	-	392	242	152	-	(1)	393
Totals	$4,207	$ 330	$ (367)	$ 9	$4,179	$4,076	$ 690	$ (624)	$ 37	$4,179

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

	Collectively evaluated		Individually evaluated		Total portfolio	
(in thousands)	Loans	Allowance	Loans	Allowance	Loans	Allowance
September 30, 2013						
Residential 1-4 family	$219,211	$862	$6,051	$647	$225,262	$1,509
Residential 5+ multifamily	3,934	20	960	-	4,894	20
Construction of residential 1-4 family	1,250	6	-	-	1,250	6
Home equity credit	33,672	361	491	64	34,163	425
Residential real estate	258,067	1,249	7,502	711	265,569	1,960
Commercial	86,744	973	5,073	365	91,817	1,338
Construction of commercial	9,154	104	-	-	9,154	104
Commercial real estate	95,898	1,077	5,073	365	100,971	1,442
Farm land	3,809	66	384	-	4,193	66
Vacant land	6,096	65	3,072	5	9,168	70

Real estate secured	363,870	2,457	16,031	1,081	379,901	3,538
Commercial and industrial	34,997	408	840	71	35,837	479
Municipal	4,101	41	-	-	4,101	41
Consumer	3,893	36	81	27	3,974	63
Unallocated allowance	-	535	-	-	-	535
Totals	$406,861	$3,477	$16,952	$1,179	$423,813	$4,656

	Collectively evaluated		Individually evaluated		Total portfolio	
(in thousands)	Loans	Allowance	Loans	Allowance	Loans	Allowance
December 31, 2012						
Residential 1-4 family	$191,886	$743	$6,666	$652	$198,552	$1,395
Residential 5+ multifamily	2,913	22	976	50	3,889	72
Construction of residential 1-4 family	2,379	10	-	-	2,379	10
Home equity credit	33,697	365	465	92	34,162	457
Residential real estate	230,875	1,140	8,107	794	238,982	1,934
Commercial	81,635	931	5,747	64	87,382	995
Construction of commercial	5,802	64	21	-	5,823	64
Commercial real estate	87,437	995	5,768	64	93,205	1,059
Farm land	4,320	66	-	-	4,320	66
Vacant land	5,795	70	4,131	164	9,926	234
Real estate secured	328,427	2,271	18,006	1,022	346,433	3,293
Commercial and industrial	37,073	467	1,021	32	38,094	499
Municipal	3,378	36	-	-	3,378	36
Consumer	4,061	39	120	53	4,181	92
Unallocated allowance	-	440	-	-	-	440
Totals	$372,939	$3,253	$19,147	$1,107	$392,086	$4,360

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

	Collectively evaluated		Individually evaluated		Total portfolio	
(in thousands)	Loans	Allowance	Loans	Allowance	Loans	Allowance
September 30, 2013						
Performing loans	$398,638	$2,693	$80	$27	$398,718	$2,720
Potential problem loans	8,223	249	905	122	9,128	371
Impaired loans	-	-	15,967	1,030	15,967	1,030
Unallocated allowance	-	535	-	-	-	535
Totals	$406,861	$3,477	$16,952	$1,179	$423,813	$4,656
December 31, 2012						
Performing loans	$364,594	$2,567	$121	$52	$364,715	$2,619
Potential problem loans	8,345	246	2,464	131	10,809	377
Impaired loans	-	-	16,562	924	16,562	924
Unallocated allowance	-	440	-	-	-	440
Totals	$372,939	$3,253	$19,147	$1,107	$392,086	$4,360

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

	Impaired loans with specific allowance					Impaired loans with no specific allowance			
(in thousands)	Loan balance					Loan balance			
	Book	Note	Average	Specific allowance	Income recognized	Book	Note	Average	Income recognized

September 30, 2013									
Residential 1-4 family	$3,850	$4,085	$4,016	$573	$62	$2,648	$2,958	$2,286	$44
Home equity credit	87	88	104	41	1	381	387	212	2
Residential real estate	3,937	4,173	4,120	614	63	3,029	3,345	2,498	46
Commercial	3,264	3,301	2,083	365	104	1,559	1,995	2,709	26
Construction of commercial	-	-	4	-	-	-	20	10	-
Farm land	-	-	-	-	-	384	384	38	-
Vacant land	249	268	2,049	5	-	2,823	3,892	1,295	-
Real estate secured	7,450	7,742	8,256	984	167	7,795	9,636	6,550	72
Commercial and industrial	127	160	268	46	1	595	996	600	27
Consumer	-	-	-	-	-	-	-	-	-
Totals	$7,577	$7,902	$8,524	$1,030	$168	$8,390	$10,632	$7,150	$99

(in thousands)	Impaired loans with specific allowance Loan balance					Impaired loans with no specific allowance Loan balance			
	Book	Note	Average	Specific allowance	Income recognized	Book	Note	Average	Income recognized
December 31, 2012									
Residential 1-4 family	$3,857	$3,925	$2,404	$578	$77	$2,263	$2,460	$1,601	$34
Home equity credit	351	351	146	92	-	91	93	203	-
Residential real estate	4,208	4,276	2,550	670	77	2,354	2,553	1,804	34
Commercial	1,629	1,784	1,925	64	60	3,381	3,576	3,122	82
Vacant land	3,186	3,387	1,455	158	-	808	1,467	2,358	4
Real estate secured	9,023	9,447	5,930	892	137	6,543	7,596	7,284	120
Commercial and industrial	335	368	833	32	13	661	1,063	854	31
Consumer	-	-	-	-	-	-	-	-	-
Totals	$9,358	$9,815	$6,763	$924	$150	$7,204	$8,659	$8,138	$151

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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)	2013	2012
Residential mortgage loans serviced for others	$146,726	$141,834

Fair value of mortgage servicing rights	1,550	989

Changes in mortgage servicing rights are as follows:

	Three months		Nine months	
Periods ended September 30, (in thousands)	2013	2012	2013	2012
Loan Servicing Rights				
Balance, beginning of period	$1,109	$916	$1,076	$772
Originated	31	197	261	503
Amortization (1)	(101)	(115)	(298)	(277)
Balance, end of period	1,039	998	1,039	998
Valuation Allowance				
Balance, beginning of period	(4)	(123)	(38)	(22)
(Increase) decrease in impairment reserve (1)	(38)	12	(4)	(89)
Balance, end of period	(42)	(111)	(42)	(111)
Loan servicing rights, net	$997	$887	$997	$887

(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 deposits, securities sold under agreements to repurchase, FHLBB advances and credit facilities available.

(in thousands)	September 30, 2013	December 31, 2012
Securities available-for-sale (at fair value)	$51,175	$54,497
Loans receivable	125,000	106,457
Total pledged assets	$176,175	$160,954

At September 30, 2013, securities were pledged as follows: $42.0 million to secure public deposits, $9.1 million to secure repurchase agreements and $0.1 million to secure FHLBB advances. Loans receivable were pledged to secure FHLBB advances and credit facilities.

NOTE 6 - EARNINGS PER SHARE

The Company defines unvested share-based payment awards that contain nonforfeitable rights to dividends as participating securities that are included in computing Earnings Per Share (“EPS”) using the two-class method. The two-class method is an earnings allocation formula that determines earnings per share for each share of common stock and participating securities according to dividends declared and participation rights in undistributed earnings. Under this method, all earnings (distributed and undistributed) are allocated to common shares and participating securities based on their respective rights to receive dividends. Earnings per common share are calculated by dividing earnings allocated to common stockholders by the weighted-average number of common shares outstanding during the period. Basic EPS excludes dilution and is computed by dividing income allocated to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity.

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The following table sets forth the computation of earnings per share (basic and diluted) for the periods indicated:

	Three months		Nine months	
Periods ended September 30, (in thousands)	2013	2012	2013	2012
Net income	$1,016	$1,140	$3,103	$3,506
Less: Preferred stock dividends declared	(40)	(46)	(121)	(178)

Less: Undistributed earnings allocated to participating securities	(11)	-	(31)	-
Net income allocated to common stock	$965	$1,094	$2,951	$3,328
Common shares issued	1,710	1,690	1,707	1,690
Less: Unvested restricted stock awards	(19)	-	(17)	-
Common shares outstanding used to calculate basic earnings per common share	1,691	1,690	1,690	1,690
Add: Diluted effect of unvested restricted stock awards	-	-	-	-
Common shares outstanding used to calculate diluted earnings per common share	1,691	1,690	1,690	1,690
Earnings per common share (basic and diluted)	$0.57	$0.65	$1.75	$1.97

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, 2013, 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:

	Actual		For Capital Adequacy Purposes		To be Well Capitalized Under Prompt Corrective Action Provisions	
(dollars in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
September 30, 2013						
Total Capital (to risk-weighted assets)						
Salisbury	$65,703	16.67%	$31,531	8.0%	n/a	-
Bank	55,413	13.93	31,815	8.0	$39,768	10.0%
Tier 1 Capital (to risk-weighted assets)						
Salisbury	60,783	15.42	15,766	4.0	n/a	-
Bank	50,493	12.70	15,907	4.0	23,861	6.0
Tier 1 Capital (to average assets)						
Salisbury	60,783	10.28	23,659	4.0	n/a	-
Bank	50,493	8.60	23,485	4.0	29,357	5.0
December 31, 2012						
Total Capital (to risk-weighted assets)						
Salisbury	$63,391	16.63%	$30,494	8.0%	n/a	-
Bank	53,132	13.77	30,866	8.0	$38,582	10.0%
Tier 1 Capital (to risk-weighted assets)						

Salisbury	58,933	15.46	15,247	4.0	n/a	-
Bank	48,674	12.62	15,432	4.0	23,149	6.0
Tier 1 Capital (to average assets)						
Salisbury	58,933	9.87	23,876	4.0	n/a	-
Bank	48,674	8.15	23,876	4.0	29,845	5.0

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In December 2010, the Basel Committee, a group of bank regulatory supervisors from around the world, released its final framework for strengthening international capital and liquidity regulation, now officially identified by the Basel Committee as "Basel III." Basel III, when fully implemented by the U.S. bank regulatory agencies and fully phased-in, will require bank holding companies and their bank subsidiaries to maintain substantially more capital, with a greater emphasis on common equity.

In July 2013, the Federal Reserve Board, Office of the Comptroller of the Currency and Federal Deposit Insurance Corporation approved final rules to implement the Basel III capital framework. The rules will be effective on January 1, 2015 and phased-in over a multiple year period through 2019. The new capital rules call for higher quality capital with higher minimum capital level requirements. We are in the process of assessing the impact from these new regulatory requirements, and while we cannot be certain of the impact, we believe that we will exceed the requirements of adequately capitalized plus the buffer, once they become effective.

DIVIDENDS

Cash Dividends to Common Shareholders

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 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 FRB 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.

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 for the quarterly dividend periods ended September 30, 2013 and June 30, 2013, was 1.0000%. 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 27, 2013, Salisbury declared a Series B Preferred Stock dividend of $40,000, payable on October 1, 2013. 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.

Grants of Restricted Stock and Options

On February 8, 2013, Salisbury granted a total of 19,600 shares of restricted stock pursuant to its 2011 Long Term Incentive Plan, which was approved by shareholders at the 2011 Annual Meeting, to 22 employees, including 5,000 shares to one Named Executive Officer, Richard J. Cantele, Jr., President and Chief Executive Officer.

NOTE 8 - PENSION AND OTHER BENEFITS

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

	Three months		Nine months	
Periods ended September 30, (in thousands)	2013	2012	2013	2012
Service cost	$-	$94	$-	$310
Interest cost on benefit obligation	66	88	197	270
Expected return on plan assets	(67)	(113)	(202)	(342)
Amortization of net loss	1	28	5	95
Settlements and curtailments	-	-	-	341
Net periodic benefit cost	$-	$97	$-	$674

Salisbury's 401(k) Plan expense was $183,000 and $70,000, respectively, for the three month periods ended September 30, 2013 and 2012. Other post-retirement benefit obligation expense for endorsement split-dollar life insurance arrangements was $14,000 and $11,000 for the three month periods ended September 30, 2013 and 2012, respectively.

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NOTE 9 -ACCUMULATED OTHER COMPREHENSIVE (LOSS) INCOME

The components of accumulated other comprehensive (loss) income as follows:

At September 30, (in thousands)	2013	2012
Unrealized gains on securities available-for-sale, net of tax	$437	$2,950
Unrecognized pension plan expense, net of tax	(469)	(2,078)
Accumulated other comprehensive (loss) income, net	$(32)	$872

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.

ASC 820-10, “Fair Value Measurements and Disclosures,” provides a framework for measuring fair value under GAAP. This guidance provided 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. However, Salisbury did not elect fair value treatment for any financial assets or liabilities upon adoption of such ASC.

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 first 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, 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 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 first-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.

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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.

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Assets measured at fair value are as follows:

	Fair Value Measurements Using			
(in thousands)	Level 1	Level 2	Level 3	Assets at fair value
September 30, 2013				
Assets measured at fair value on a recurring basis				
U.S. Treasury notes	$-	$2,670	$-	$2,670
U.S. Government agency notes	-	2,619	-	2,619
Municipal bonds	-	42,573	-	42,573
Mortgage-backed securities:				
U.S. Government agencies	-	36,314	-	36,314
Collateralized mortgage obligations:				
U.S. Government agencies	-	3,848	-	3,848
Non-agency	-	8,895	-	8,895
SBA bonds	-	2,361	-	2,361
Preferred stocks	536	-	-	536
Securities available-for-sale	$536	$99,280	$-	$99,816
Assets measured at fair value on a non-recurring basis				
Collateral dependent impaired loans	$-	$-	$6,547	$6,547
Other real estate owned	-	-	571	571
December 31, 2012				
Assets measured at fair value on a recurring basis				
U.S. Treasury notes	$-	$2,733	$-	$2,733
U.S. Government agency notes	-	7,726	-	7,726
Municipal bonds	-	47,365	-	47,365
Mortgage-backed securities:				
U.S. Government agencies	-	48,729	-	48,729
Collateralized mortgage obligations:				
U.S. Government agencies	-	5,197	-	5,197
Non-agency	-	11,507	-	11,507
SBA bonds	-	2,863	-	2,863
Preferred stocks	167	-	-	167
Securities available-for-sale	$167	$126,120	$-	$126,287
Assets measured at fair value on a non-recurring basis				
Collateral dependent impaired loans	$	$	$8,434	$8,434
Other real estate owned	-	-	244	244

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

		Fair value measurements using		
(in thousands)	Carrying value	Level 1	Level 2	Level 3

		Estimated fair value			
September 30, 2013					
Financial Assets					
Cash and due from banks	$23,719	$23,719	$23,719	$-	$-
Interest-bearing time deposits	5,220	5,220	-	-	5,220
Securities available-for-sale	99,816	99,816	536	99,280	-
Federal Home Loan Bank stock	5,340	5,340	-	5,340	-
Loans held-for-sale	708	713	-	-	713
Loans receivable net	420,306	413,809	-	-	413,809
Accrued interest receivable	1,823	1,823	-	-	1,823
Financial Liabilities					
Demand (non-interest-bearing)	$83,892	$83,892	$-	$-	$83,892
Demand (interest-bearing)	79,232	79,232	-	-	79,232
Money market	125,070	125,070	-	-	125,070
Savings and other	107,380	107,380	-	-	107,380
Certificates of deposit	84,295	84,950	-	-	84,950
Deposits	479,869	480,524	-	-	480,524
FHLBB advances	30,801	33,692	-	-	33,692
Repurchase agreements	3,870	3,870	-	-	3,870
Accrued interest payable	166	166	-	-	166
December 31, 2012					
Financial Assets					
Cash and due from banks	$43,574	$43,574	$43,574	$-	$-
Securities available-for-sale	126,287	126,287	167	126,120	-
Federal Home Loan Bank stock	5,747	5,747	-	5,747	-
Loans held-for-sale	1,879	1,893	-	-	1,893
Loans receivable net	388,758	389,292	-	-	389,292
Accrued interest receivable	1,818	1,818	-	-	1,818
Financial Liabilities					
Demand (non-interest-bearing)	$98,850	$98,850	$-	$-	$98,850
Demand (interest-bearing)	65,991	65,991	-	-	65,991
Money market	128,501	128,501	-	-	128,501
Savings and other	103,985	103,985	-	-	103,985
Certificates of deposit	93,888	94,894	-	-	94,894
Deposits	491,215	492,221	-	-	492,221
FHLBB advances	31,980	35,363	-	-	35,363
Repurchase agreements	1,784	1,784	-	-	1,784
Accrued interest payable	196	196	-	-	196

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

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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, 2012.

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 operates its trust and wealth advisory services from offices in Lakeville, Connecticut.

Critical Accounting Policies and Estimates

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 2012 Annual Report on Form 10-K for the year ended December 31, 2012 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 2012 Annual Report on Form 10-K for the period ended December 31, 2012 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 affect 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.

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RESULTS OF OPERATIONS

For the three month periods ended September 30, 2013 and 2012

Overview

Net income available to common shareholders was $976,000, or $0.57 per common share, for the quarter ended September 30, 2013 (third quarter 2013), versus $1,103,000, or $0.65 per common share, for the quarter ended June 30, 2013 (second quarter 2013), and $1,094,000, or $0.65 per common share, for the quarter ended September 30, 2012 (third quarter 2012).

- Earnings per common share of $0.57 decreased $0.08, or 12.3%, as compared to $0.65 for the second quarter 2013 and third quarter 2012.
- Tax equivalent net interest income increased $25,000, or 0.5%, versus second quarter 2013, and increased $120,000, or 2.5%, versus third quarter 2012.
- Net loan charge-offs were $215,000 for third quarter 2013, versus $294,000 for second quarter 2013 and $358,000 for third quarter 2012. Provision for loan losses for the third quarter remained unchanged from the second quarter 2013 at $240,000, versus $330,000 for third quarter 2012.
- Non-interest income decreased $191,000, or 11.6%, versus second quarter 2013 and decreased $428,000, or 22.7%, versus third quarter 2012; which included $568,000 in gains on sales of mortgage loans.
- Non-interest expense increased $33,000, or 0.7%, versus second quarter 2013 and decreased $50,000, or 1.1%, versus third quarter 2012.
- Preferred stock dividends remained unchanged from the second quarter at $40,000 for third quarter 2013, and declined by $8,000 as compared with the third quarter 2012 dividend of $48,000.
- Non-performing assets increased $0.1 million, or 1.0%, to $9.7 million, or 1.7% of total assets, at September 30, 2013 versus June 30, 2013 and decreased $0.2 million versus September 30, 2012. Accruing loans receivable 30-to-89 days past due increased $0.8 million to $5.1 million, or 1.2% of gross loans receivable at September 30, 2013, versus June 30, 2013 and increased $1.9 million versus September 30, 2012.

Net Interest Income

Tax equivalent net interest income for third quarter 2013 increased $25,000, or 0.5%, versus second quarter 2013, and increased $120,000, or 2.5%, versus third quarter 2012. Average total interest bearing liabilities increased $12.6 million as compared with second quarter 2013 and decreased $2.8 million, or -0.6%, as compared with third quarter 2012. Average earning assets increased $6.7 million as compared with second quarter 2013 and decreased $6.2 million, or -1.1%, as compared with third quarter 2012. The net interest margin on a tax equivalent basis decreased 3 basis points from second quarter 2013 to 3.51% and increased 12 basis points versus third quarter 2012 from 3.39%.

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

Three months ended September 30,	Average Balance		Income / Expense		Average Yield / Rate	
(dollars in thousands)	2013	2012	2013	2012	2013	2012
Loans (a)(d)	$424,897	$383,954	$4,581	$4,526	4.31%	4.71%
Securities (c)(d)	102,361	129,945	1,131	1,324	4.42	4.08
FHLBB stock	5,340	5,747	5	7	0.38	0.51
Short term funds (b)	33,345	52,460	22	25	0.26	0.19
Total earning assets	565,943	572,106	5,739	5,882	4.05	4.11
Other assets	35,989	40,218				
Total assets	$601,932	$612,324				
Interest-bearing demand deposits	$83,271	$65,813	71	78	0.34	0.47
Money market accounts	132,480	136,865	84	104	0.25	0.30
Savings and other	107,665	102,039	56	67	0.20	0.26
Certificates of deposit	87,088	97,354	247	331	1.13	1.35
Total interest-bearing deposits	410,504	402,071	458	580	0.44	0.57
Repurchase agreements	3,943	3,594	2	3	0.20	0.29
FHLBB advances	30,935	42,535	312	452	3.94	4.16
Total interest-bearing liabilities	445,382	448,200	772	1,035	0.69	0.92
Demand deposits	82,573	89,225				
Other liabilities	3,049	4,808				
Shareholders' equity	70,928	70,091				
Total liabilities & shareholders' equity	$601,932	$612,324				
Net interest income			$4,967	$4,847		
Spread on interest-bearing funds					3.36	3.19
Net interest margin (e)					3.51	3.39

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(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 $308,000 and $275,000, respectively for 2013 and 2012 on tax-exempt securities and loans 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)	2013 versus 2012		
Change in interest due to	Volume	Rate	Net
Interest-earning assets			
Loans	$462	$(407)	$55
Securities	(293)	100	(193)
FHLBB stock	-	(2)	(2)
Short term funds	(11)	8	(3)
Total	158	(301)	(143)
Interest-bearing liabilities			
Deposits	(14)	(108)	(122)
Repurchase agreements	-	(1)	(1)
FHLBB advances	(120)	(20)	(140)
Total	(134)	(129)	(263)
Net change in net interest income	$292	$(172)	$120

Interest Income

Tax equivalent interest income decreased $143,000, or 2.4%, to $5.7 million for third quarter 2013 as compared with third quarter 2012.

Loan income increased $55,000, or 1.2%, primarily due to a 40 basis points decrease in the average loan yield and by a $40.9 million, or 10.7%, increase in average loans.

Tax equivalent securities income decreased $193,000, or 14.6%, for third quarter 2013 as compared with third quarter 2012, primarily due to a $27.6 million, or 21.2%, decrease in average volume due to calls, prepayments of mortgage backed securities, and the sale of an agency bond in 2012.

Interest Expense

Interest expense decreased $263,000, or 25.4%, to $0.8 million for third quarter 2013 as compared with third quarter 2012.

Interest on deposit accounts and retail repurchase agreements decreased $123,000, or 21.1%, as a result of lower average rates, down 13 basis points on deposits and 9 basis points on repurchase agreements, offset partially by an $8.4 million, or 2.1%, increase in the average balance of deposits. The lower average rate resulted from the effect of currently lower market interest rates paid on interest bearing deposits and changes in product mix.

Interest expense on FHLBB borrowings decreased $140,000 as a result of lower average borrowings, down $11.6 million, and by the average borrowing rate decrease of 22 basis points as compared with third quarter 2012. The decline in advances resulted from scheduled maturities that were not replaced with new advances and the prepayment of a $10 million FHLBB advance in fourth quarter 2012.

Provision and Allowance for Loan Losses

The provision for loan losses was $240,000 for third quarter 2013 and $330,000 for third quarter 2012. Net loan charge-offs were $215,000 and $358,000, for the respective quarters. The following table sets forth changes in the allowance for loan losses and other selected statistics:

	Three months		Nine months	
Periods ended September 30, (dollars in thousands)	2013	2012	2013	2012
Balance, beginning of period	$4,631	$4,207	$4,360	$4,076
Provision for loan losses	240	330	876	690
Charge-offs				
Real estate mortgages	(201)	(353)	(549)	(532)
Commercial & industrial	-	-	(4)	(29)
Consumer	(23)	(14)	(47)	(63)
Total charge-offs	(224)	(367)	(600)	(624)
Recoveries				
Real estate mortgages	-	3	6	7
Commercial & industrial	-	1	-	9
Consumer	9	5	14	21
Total recoveries	9	9	20	37
Net charge-offs	(215)	(359)	(580)	(587)
Balance, end of period	$4,656	$4,179	$4,656	$4,179
Loans receivable, gross			$423,813	$380,508

Non-performing loans	9,166	9,229
Accruing loans past due 30-89 days	5,093	3,152
Ratio of allowance for loan losses:		
to loans receivable, gross	1.10 %	1.10 %
to non-performing loans	50.80	45.28
Ratio of non-performing loans to loans receivable, gross	2.16	2.43
Ratio of accruing loans past due 30-89 days to loans receivable, gross	1.20	0.83

Reserve coverage, as measured by the ratio of the allowance for loan losses to gross loans, remained unchanged at 1.10% at September 30, 2013 and September 30, 2012.

During the third quarter of 2013, non-performing loans (non-accrual loans and accruing loans past-due 90 days or more) at $9.2 million, remained stable as 2.2% of gross loans receivable at September 30, 2013 and 2.2% at June 30, 2013 versus 2.4% at September 30, 2012. Accruing loans past due 30-89 days increased $0.8 million to $5.1 million, or 1.2% of gross loans receivable from 1.0% at June 30, 2013 and 0.8% at September 30, 2012. 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:

September 30, 2013 (in thousands)	Collectively evaluated		Individually evaluated		Total portfolio	
	Loans	Allowance	Loans	Allowance	Loans	Allowance
Performing loans	$ K98,638	$ J,693	$ 80	$ 27	$ K98,718	$ J,720
Potential problem loans	8,223	249	905	122	9,128	371
Impaired loans	-	-	15,967	1,030	15,967	1,030
Unallocated allowance	-	535	-	-	-	535
Totals	$ L06,861	$ K,477	$ I6,952	$ I,179	$ L23,813	$ L,656
December 31, 2012 (in thousands)	Collectively evaluated		Individually evaluated		Total portfolio	
	Loans	Allowance	Loans	Allowance	Loans	Allowance
Performing loans	$ K64,592	$ J,567	$ I21	$ 52	$ K64,715	$ J,619
Potential problem loans	8,345	246	2,4654	131	10,819	377
Impaired loans	-	-	16,562	924	16,562	924
Unallocated allowance	-	440	-	-	-	440
Totals	$ K72,939	$ K253	$ I9,147	$ I,107	$ K92,086	$ L,360

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, 2013.

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, 2013.

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 State of Connecticut Department of Banking ("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.

Non-interest Income

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

Three months ended September 30, (dollars in thousands)	2013	2012	2013 vs. 2012	
Trust and wealth advisory fees	$750	$683	$67	9.81 %
Service charges and fees	595	559	36	6.44
Gains on sales of mortgage loans, net	69	568	(499)	(87.85)
Mortgage servicing, net	(37)	(9)	(28)	(311.11)
Gains on securities, net	-	-	-	-
Other	82	86	(4)	(4.65)
Total non-interest income	$1,459	$1,887	$(428)	(22.68)%

Non-interest income decreased $191,000, or 11.6%, versus second quarter 2013 and decreased $428,000, or 22.7%, versus third quarter 2012. Trust and Wealth Advisory revenues decreased $74,000 versus second quarter 2013 and increased $67,000 versus third quarter 2012. The year-over-year revenue increase results from growth in managed assets, offset by slightly lower estate fees collected in third quarter 2013. Service charges and fees increased $20,000 versus second quarter 2013 and $36,000 versus third quarter 2012. Income from sales and servicing of mortgage loans in the third quarter decreased by $129,000 as compared to the second quarter 2013 and decreased $527,000 as compared to the third quarter 2012 due to interest rate driven fluctuations in the volume of fixed rate residential mortgage loan sales and mortgage servicing valuations. Mortgage loan sales totaled $2.2 million for third quarter 2013, $5.1 million for second quarter 2013 and $18.3 million for third quarter 2012. Third quarter 2013, second quarter 2013 and third quarter 2012 included mortgage servicing valuation (impairment) or benefit charges of ($38,000), $1,000 and $12,000, respectively. Other income includes income from bank owned life insurance 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)	2013	2012	2013 vs. 2012	
Salaries	$1,922	$1,810	$112	6.19 %
Employee benefits	693	597	96	16.08
Premises and equipment	622	603	19	3.15
Data processing	358	369	(11)	(2.98)
Professional fees	306	299	7	2.34
Collections and OREO	74	301	(227)	(75.42)
FDIC insurance	111	116	(5)	(4.31)
Marketing and community support	99	92	7	7.61
Amortization of intangible assets	56	56	-	-
Other	402	450	(48)	(10.67)
Non-interest expense	$4,643	$4,693	$(50)	(1.07)%

Non-interest expense for third quarter 2013 increased $33,000 versus second quarter 2013 and decreased $50,000 versus third quarter 2012. Compensation and employee benefits increased $17,000 versus second quarter 2013, and increased $208,000 versus third quarter 2012. Year-over-year expenses include higher 401(k) expense and new compensation plan expenses implemented to compensate for the hard freeze placed on the defined benefit pension plan as of December 31, 2012. Premises and equipment increased $39,000 versus second quarter 2013 and $19,000 versus third quarter 2012, mainly due to disposed assets related to modifications of the Millerton branch. Data processing decreased $9,000 versus second quarter 2013 and $11,000 versus third quarter 2012. Professional fees decreased $3,000 versus second quarter 2013, and increased $7,000 versus third quarter 2012. Collections and OREO decreased $1,000 versus second quarter 2013, and $227,000 versus third quarter 2012 due primarily to decreased related litigation and OREO expense. Salisbury had $571,000 in foreclosed property at September 30, 2013 compared to $435,000 at June 30, 2013 and $641,000 at September 30, 2012. FDIC insurance premiums decreased $3,000 versus second quarter 2013 and $5,000 versus third quarter 2012. Remaining operating expenses decreased $7,000 versus second quarter 2013 and $41,000 versus third quarter 2012 due primarily to reductions in other administrative and operational expenses.

Income Taxes

The effective income tax rates for third quarter 2013, second quarter 2013 and third quarter 2012 were 18%, 20% and 21%, 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, some tax-exempt loans and bank owned life insurance.

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Salisbury did not incur Connecticut income tax in 2013 or 2012, 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, 2013 and 2012

Overview

Net income available to common shareholders was $2,982,000, or $1.75 per common share, for the nine month period ended September 30, 2013 (nine month period 2013), compared with $3,328,000, or $1.97 per common share, for the nine month period ended September 30, 2012 (nine month period 2012).

- Earnings per common share decreased $0.22, or 11.2%, to $1.75 versus nine month period 2012.
- Tax equivalent net interest income increased $24,000, or 0.1%, to $14.8 million, versus nine month period 2012.
- Provision for loan losses was $876,000, versus $690,000 for nine month period 2012. Net loan charge-offs were $580,000, versus $587,000 for nine month period 2012.
- Non-interest income decreased $702,000, or 12.9%, versus nine month period 2012. Nine month period 2012 included a $279,000 securities gain and gains on sales of mortgages were higher by 58.4%.
- Non-interest expense decreased $262,000, or 1.8%, versus nine month period 2012. Nine month period 2012 included a pension plan curtailment expense of $341,000 and litigation expenses of $533,000, of which $400,000 was non-recurring.

Net Interest Income

Tax equivalent net interest income for nine month period 2013 increased $24,000, or 0.2%, versus nine month period 2012. The net interest margin increased 3 basis points to 3.53% from 3.50%.

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

Nine months ended September 30,	Average Balance		Income / Expense		Average Yield / Rate	
(dollars in thousands)	2013	2012	2013	2012	2013	2012
Loans (a)(d)	$414,050	$381,429	$13,600	$13,750	4.38%	4.81%
Securities (c)(d)	109,857	139,719	3,514	4,251	4.26	4.06
FHLBB stock	5,443	5,819	16	23	0.39	0.52
Short term funds (b)	30,606	36,526	58	53	0.25	0.19
Total earning assets	559,959	563,493	17,188	18,077	4.09	4.28
Other assets	38,605	40,392				
Total assets	$598,561	$603,885				
Interest-bearing demand deposits	$73,589	$66,058	210	275	0.38	0.56
Money market accounts	130,829	127,991	260	324	0.27	0.34
Savings and other	106,710	99,003	162	219	0.20	0.30
Certificates of deposit	90,081	99,944	804	1,052	1.19	1.41
Total interest-bearing deposits	401,209	392,996	1,436	1,870	0.48	0.64
Repurchase agreements	2,769	6,863	4	21	0.20	0.41
FHLBB advances	31,318	44,140	936	1,398	3.94	4.16
Total interest-bearing liabilities	435,296	443,999	2,376	3,289	0.73	0.99
Demand deposits	88,023	86,420				
Other liabilities	3,198	4,488				
Shareholders' equity	72,044	68,978				
Total liabilities & shareholders' equity	$598,561	$603,885				

Net interest income	$14,812	$14,788		
Spread on interest-bearing funds			3.36	3.29
Net interest margin (e)			3.53	3.50

(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 $915,000 and $846,000, respectively for 2013 and 2012 on tax-exempt securities and loans 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.

Nine months ended September 30, (in thousands)	2013 versus 2012		
Change in interest due to	Volume	Rate	Net
Interest-earning assets			
Loans	$1,124	$(1,274)	$(150)
Securities	(932)	195	(737)
FHLBB stock	(1)	(6)	(7)
Short term funds	(10)	15	5
Total	181	(1,070)	(889)
Interest-bearing liabilities			
Deposits	(50)	(384)	(434)
Repurchase agreements	(9)	(8)	(17)
FHLBB advances	(395)	(67)	(462)
Total	(454)	(459)	(913)
Net change in net interest income	$635	$(611)	$24

Interest Income

Tax equivalent interest income decreased $889,000, or 4.9%, to $17.2 million for nine month period 2013 versus nine month period 2012.

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Loan income decreased $150,000, or 1.1%, primarily due to a 43 basis points decline in the average loan yield offset in part by a $32.6 million, or 8.6%, increase in average loans. Tax equivalent securities income decreased $737,000, or 17.3%, primarily due to a $29.9 million, or 21.4%, decrease in average volume, offset in part by a 20 basis points increase in the average yield. Changes in securities yields resulted from the effect of changes in market interest rates on securities purchases, calls of agency bonds, prepayments of mortgage backed securities and the sale of $2.5 million of US Treasury bonds in 2012. Income from short term funds increased $5,000 as a result of a 6 basis points increase in the average yield, offset in part by a $5.9 million decrease in the average balance.

Interest Expense

Interest expense decreased $913,000, or 0.3%, to $2.4 million for nine month period 2013 versus nine month period 2012.

Interest on deposit accounts and retail repurchase agreements decreased $451,000, or 23.8%, as a result of lower average rates, down 16 and 21 basis points respectively, along with an average balance decrease of $4.1 million in repurchase agreements. Lower rates were offset in part by an $8.2 million, or 2.1%, increase in the average balance of deposits. 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 $462,000 as a result of lower average borrowings, down $12.8 million due to the prepayment of a $10 million FHLBB advance in fourth quarter 2012, scheduled maturities that were not replaced with new advances and a lower average borrowing rate, down 22 basis points.

Provision and Allowance for Loan Losses

The provision for loan losses was $876,000 for nine month period 2013 and $690,000 for nine month period 2012. Net loan charge-offs were $580,000 and $587,000, for the respective periods.

Reserve coverage at September 30, 2013, as measured by the ratio of allowance for loan losses to gross loans, remained unchanged at 1.10%, as compared with 1.10% a year ago at September 30, 2012. During the first nine months of 2013, non-performing loans (non-accrual loans and accruing loans past-due 90 days or more) decreased $0.7 million to $9.2 million. Such amount represents 2.16% of gross loans receivable, a decrease from 2.4% at September 30, 2012. At September 30, 2013 accruing loans past due 30-89 days decreased $0.5 million to $5.1 million, or 1.2% of gross loans receivable from 0.8% at September 30, 2012. See "Financial Condition - Loan Credit Quality" for further discussion and analysis.

Non-interest Income

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

Nine months ended September 30, (dollars in thousands)	2013	2012	2013 vs. 2012	
Trust and wealth advisory fees	$2,299	$2,173	$126	5.80 %
Service charges and fees	1,687	1,628	59	3.62
Gains on sales of mortgage loans, net	501	1,203	(702)	(58.35)
Mortgage servicing, net	(3)	(98)	95	96.94
Gains on securities, net	-	279	(279)	(100.00)
Other	251	252	(1)	(0.04)
Total non-interest income	$4,735	$5,437	$(702)	(12.91)%

Non-interest income for the nine month period 2013 decreased $702,000 versus nine month period 2012. Trust and Wealth Advisory revenues increased $126,000 from growth in managed assets, offset slightly by lower estate and tax preparation fees collected in 2013. Service charges and fees increased $59,000 due primarily to an increase in service charge fees and higher interchange fees resulting from increased volume; offset partially by reduced non-sufficient fund fees. Income from sales and servicing of mortgage loans decreased $702,000 due to increasing mortgage rates which adversely impacted demand for residential mortgages and resulted in a lower volume of loans sold. Mortgage loans sales totaled $15.9 million for nine month period 2013 and $46.8 million for nine month period 2012. Nine month period 2013 and 2012 included mortgage servicing valuation impairment charges of $4,000 and $90,000, respectively. For the nine month period 2013 no gains on securities were realized, while nine month period 2012 gains on securities resulted from the sale of $2.5 million of US Treasury bonds. Other income includes bank owned life insurance income and rental income.

Non-interest Expense

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

Nine months ended September 30, (dollars in thousands)	2013	2012	2013 vs. 2012	
Salaries	$5,508	$5,268	$240	4.56 %
Employee benefits	2,140	2,244	(104)	(4.63)
Premises and equipment	1,789	1,799	(10)	(0.56)

Data processing	1,145	1,190	(45)	(3.78)
Professional fees	996	915	81	8.85
Collections and OREO	305	767	(462)	(60.23)
FDIC insurance	350	363	(13)	(3.58)
Marketing and community support	326	267	59	22.10
Amortization of intangible assets	167	167	-	-
Other	1,232	1,240	(8)	(0.65)
Non-interest expense	$13,958	$14,220	$(262)	(1.84)%

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Non-interest expense for nine month period 2013 decreased $262,000 versus nine month period 2012. Salaries increased $240,000 due to changes in staffing levels and mix and annual salary increases. Employee benefits decreased $104,000 due primarily to lower pension plan expenses in 2013. A hard freeze was put on the defined benefit pension plan as of December 31, 2012 thereby reducing 2013 expenses and a curtailment expense of $341,000 from retiree lump-sum withdrawals was realized in 2012. These lower pension expenses were offset in part by new deferred compensation plans implemented to replace the pension plan. Premises and equipment decreased $10,000 due primarily to upgraded equipment and software purchased in 2012. The decrease was offset slightly by higher building maintenance and repairs and disposed assets related to modifications of the Millerton branch in 2013.

Data processing decreased $45,000 due primarily to lower tax preparation fees assessed in the Trust area. Professional fees increased $81,000 due primarily to higher investment management fees associated with the growth in trust and wealth advisory assets under management and increased legal fees associated with new compensation plans. Collections and OREO expense decreased $462,000 due primarily to lower litigation expenses, down $453,000, and delinquent real estate taxes, down $81,000, offset in part by higher appraisal and inspection expenses, up $84,000. Salisbury had three foreclosed properties at September 30, 2013. FDIC insurance decreased $13,000. Marketing and contributions increased $59,000 due primarily to an increase of general marketing campaigns and increased contributions to community organizations. Remaining operating expenses decreased $45,000 due to lower other administrative and operational expenses.

Income Taxes

The effective income tax rates for nine month period 2013 and nine month period 2012 were 18.30% and 21.55%, 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, some tax-exempt loans and bank owned life insurance.

FINANCIAL CONDITION

Overview

Total assets were $589.5 million at September 30, 2013, down $11.3 million from December 31, 2012. Loans receivable, net, were $420.3 million at September 30, 2013, up $31.5 million, or 8.4%, from December 31, 2012. Non-performing assets were $9.7 million at September 30, 2013, down $0.4 million from $10.1 million at December 31, 2012. Reserve coverage, as measured by the ratio of the allowance for loan losses to gross loans, was 1.10%, 1.11% and 1.10%, at September 30, 2013, December 31, 2012 and September 30, 2012, respectively. Deposits were $479.9 million, down $11.3 million from $491.2 million at December 31, 2012.

At September 30, 2013, book value and tangible book value per common share were $32.28 and $26.17, respectively. Salisbury's Tier 1 leverage and total risk-based capital ratios were 10.28% and 16.67%, respectively, and above the "well capitalized" limits as defined by the FRB.

Securities and Short Term Funds

Year-to-date 2013, securities decreased $26.5 million to $99.8 million as we continue to redeploy cash flow from the investment portfolio into loans. FHLBB advances decreased $1.2 million, while cash and cash-equivalents (non-time interest-bearing deposits with other banks, money market funds and federal funds sold) decreased $19.9 million to $23.7 million.

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 evaluates these securities for strategic fit and may reduce its position in these securities, although 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 four non-agency CMO securities reflecting OTTI, to be OTTI at September 30, 2013.

In 2009 Salisbury determined that five non-agency CMO securities reflected OTTI and recognized losses for deterioration in credit quality of $1.1 million. Salisbury judged the four remaining securities not to have additional OTTI and all other CMO securities not to be OTTI as of September 30, 2013. It is possible that future loss assumptions could change necessitating Salisbury to recognize future OTTI for further deterioration in credit quality. Salisbury evaluates these securities for strategic fit and may reduce its position in these securities, although it has no present intention to do so, 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.

Accumulated other comprehensive loss at September 30, 2013 of ($32,000) included net unrealized holding gains, net of tax, of $0.4 million, decrease of $2.5 million over December 2012, partially offset by unrecognized pension plan expense, net of tax, of $0.5 million.

Loans

Net loans receivable increased $31.5 million to $420.3 million at September 30, 2013, compared with $388.8 million at December 31, 2012.

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

(in thousands)	September 30, 2013	December 31, 2012
Residential 1-4 family	$225,262	$198,552
Residential 5+ multifamily	4,894	3,889
Construction of residential 1-4 family	1,250	2,379
Home equity credit	34,163	34,162
Residential real estate	265,569	238,982
Commercial	91,817	87,382
Construction of commercial	9,154	5,823
Commercial real estate	100,971	93,205
Farm land	4,193	4,320
Vacant land	9,168	9,926

Real estate secured	379,901	346,433
Commercial and industrial	35,837	38,094
Municipal	4,101	3,378
Consumer	3,974	4,181
Loans receivable, gross	423,813	392,086
Deferred loan origination fees and costs, net	1,149	1,032
Allowance for loan losses	(4,656)	(4,360)
Loans receivable, net	$420,306	$388,758
Loans held-for-sale		
Residential 1-4 family	$708	$1,879

Loan Credit Quality

The persistent weakness in the local and regional economies continues to impact the credit quality of Salisbury's loans receivable. During nine months of 2013, non-performing assets decreased $0.4 million, and the amount of total impaired and potential problem loans decreased $2.3 million.

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

(in thousands)	Pass	Special mention	Substandard	Doubtful	Loss	Total
September 30, 2013						
Residential 1-4 family	$206,691	$11,754	$ 6,721	$ 96	$ -	$ 225,262
Residential 5+ multifamily	2,711	1,208	975	-	-	4,894
Construction of residential 1-4 family	1,250	-	-	-	-	1,250
Home equity credit	31,541	1,240	1,382	-	-	34,163
Residential real estate	242,193	14,202	9,078	96	-	265,569
Commercial	66,899	16,513	8,405	-	-	91,817
Construction of commercial	8,412	152	590	-	-	9,154
Commercial real estate	75,311	16,665	8,995	-	-	100,971
Farm land	1,611	1,436	1,146	-	-	4,193
Vacant land	5,759	293	3,116	-	-	9,168
Real estate secured	324,874	32,596	22,335	96	-	379,901
Commercial and industrial	28,149	6,675	1,013	-	-	35,837
Municipal	4,101	-	-	-	-	4,101
Consumer	3,854	102	18	-	-	3,974
Loans receivable, gross	$360,978	$39,373	$ 23,366	$ 96	$ -	$ 423,813

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(in thousands)	Pass	Special mention	Substandard	Doubtful	Loss	Total
December 31, 2012						
Residential 1-4 family	$180,442	$12,473	$ 5,538	$ 99	$ -	$198,552
Residential 5+ multifamily	2,872	773	244	-	-	3,889
Construction of residential 1-4 family	1,570	-	809	-	-	2,379
Home equity credit	30,981	1,848	1,333	-	-	34,162
Residential real estate	215,865	15,094	7,924	99	-	238,982
Commercial	64,817	13,299	9,266	-	-	87,382
Construction of commercial	5,055	297	471	-	-	5,823
Commercial real estate	69,872	13,596	9,737	-	-	93,205

Farm land	2,799	341	1,180	-	-	4,320
Vacant land	4,885	863	4,178	-	-	9,926
Real estate secured	293,421	29,894	23,019	99	-	346,433
Commercial and industrial	28,453	8,300	1,341	-	-	38,094
Municipal	3,378	-	-	-	-	3,378
Consumer	3,994	159	28	-	-	4,181
Loans receivable, gross	$329,246	$38,353	$ 24,388	$ 99	$ -	$392,086

Changes in impaired and potential problem loans are as follows:

	September 30, 2013				September 30, 2012			
	Impaired loans				Impaired loans			
Nine months ended (in thousands)	Non-accrual	Accruing	Potential problem loans	Total	Non-accrual	Accruing	Potential problem loans	Total
Loans placed on non-accrual status	$3,671	$(758)	$(1,517)	$1,396	$3,858	$(665)	$(1,099)	$2,094
Loans restored to accrual status	(902)	385	143	(374)	(887)	563	23	(301)
Loan risk rating downgrades to substandard	-	-	3,586	3,586	-	-	1,680	1,680
Loan risk rating upgrades from substandard	-	-	(1,350)	(1,350)	-	-	(402)	(402)
Loan repayments	(2,246)	328	(2,540)	(4,458)	(596)	(155)	(301)	(1,052)
Loan charge-offs	(467)	19	(4)	(452)	(556)	-	-	(556)
Increase (decrease) in TDR loans	-	884	-	884	-	2,463	(1,830)	633
Real estate acquired in settlement of loans	(971)	(736)	-	(1,707)	(666)	-	-	(666)
Inter-month tax advances	198	-	-	198	-	-	-	-
Increase (decrease) in loans	$(717)	$122	$(1,682)	$(2,277)	$1,153	$2,206	$(1,929)	$1,430

For year-to-date 2013 Salisbury has placed $3.7 million of loans on non-accrual status as a result of deteriorated payment and financial performance and charged-off $580,000 of loans primarily as a result of collateral deficiencies.

Salisbury has cooperative relationships with the 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 Salisbury's reasonable 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.

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- 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

Loans individually evaluated for impairment (impaired loans) are loans for which Salisbury does not expect to collect all contractual principal and interest in accordance with the contractual terms of the loan. Impaired loans include all modified loans classified as troubled debt restructurings (TDRs) and loans on non-accrual status. The components of impaired loans are as follows:

(in thousands)	September 30, 2013	December 31, 2012
Non-accrual loans, excluding troubled debt restructured loans	$ 6,116	$ 7,579
Non-accrual troubled debt restructured loans	3,027	2,280
Accruing troubled debt restructured loans	6,824	6,703
Total impaired loans	$ 15,967	$ 16,562
Commitments to lend additional amounts to impaired borrowers	$ -	$ -

Non-Performing Assets

Non-performing assets decreased $0.4 million to $9.7 million, or 1.6% of assets at September 30, 2013, from $10.1 million, or 1.7% of assets at December 31, 2012, and decreased $0.1 million from $9.8 million, or 1.6% of assets at September 30, 2012.

The 4% decrease in non-performing assets in the first nine months 2013 resulted primarily from $0.9 million of loans returning to accrual status, $0.5 million charged off, and $4.7 million from loan repayments and payoffs. These declines were offset in part by a $1.1 million change in 90+ past due status, a $0.2 million advance for taxes and additions of $3.7 million in new non-accrual loans and $0.7 million of OREO additions.

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The components of non-performing assets are as follows:

(in thousands)	September 30, 2013	December 31, 2012

Residential 1-4 family	$ 3,013	$ 3,024
Home equity credit	420	442
Commercial	2,114	2,235
Farm land	384	-
Vacant land	3,072	3,994
Real estate secured	9,003	9,695
Commercial and industrial	140	164
Consumer	-	-
Non-accruing loans	9,143	9,859
Accruing loans past due 90 days and over	23	-
Non-performing loans	9,166	9,859
Real estate acquired in settlement of loans	571	244
Non-performing assets	$ 9,737	$ 10,103

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

(in thousands)	September 30, 2013	December 31, 2012
Current	$ 1,533	$ 1,797
Past due 001-029 days	1,285	75
Past due 030-059 days	758	701
Past due 060-089 days	596	445
Past due 090-179 days	696	1,983
Past due 180 days and over	4,298	4,858
Total non-performing loans	$ 9,166	$ 9,859

At September 30, 2013, 16.71% of non-accrual loans were current with respect to loan payments, compared with 18.23% at December 31, 2012. 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 increased $0.9 million during 2013 to $9.9 million, or 2.32% of gross loans receivable at September 30, 2013, from $9.0 million, or 2.29% of gross loans receivable at December 31, 2012.

The components of troubled debt restructured loans are as follows:

(in thousands)	September 30, 2013	December 31, 2012
Residential 1-4 family	$ 3,533	$ 3,098
Commercial	2,710	2,774
Real estate secured	6,243	5,872
Commercial and industrial	581	832
Accruing troubled debt restructured loans	6,824	6,704
Residential 1-4 family	2,246	1,041
Commercial	669	1,159
Vacant land	-	-
Real estate secured	2,915	2,200
Commercial and industrial	112	80
Non-accrual troubled debt restructured loans	3,027	2,280
Troubled debt restructured loans	$ 9,851	$ 8,984

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

(in thousands)	September 30, 2013	December 31, 2012
Current	$ 6,079	$ 5,354
Past due 001-029 days	437	445
Past due 030-059 days	308	905
Accruing troubled debt restructured loans	6,824	6,704
Current	1,039	1,333
Past due 001-029 days	1,285	-
Past due 030-059 days	214	301
Past due 060-089 days	489	194
Past due 090-179 days	-	-
Past due 180 days and over	-	452
Non-accrual troubled debt restructured loans	3,027	2,280
Total troubled debt restructured loans	$ 9,851	$ 8,984

At September 30, 2013, 72.26% of troubled debt restructured loans were current with respect to loan payments, as compared with 74.43% at December 31, 2012.

Past Due Loans

Loans past due 30 days or more decreased $2.2 million during 2013 to $11.4 million, or 2.69% of gross loans receivable at September 30, 2013, compared with $13.6 million, or 3.47% of gross loans receivable at December 31, 2012.

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

(in thousands)	September 30, 2013	December 31, 2012
Past due 030-059 days	$ 2,674	$ 4,309
Past due 060-089 days	2,420	1,317
Past due 090-179 days	23	-
Accruing loans	5,117	5,626
Past due 030-059 days	758	701
Past due 060-089 days	596	445
Past due 090-179 days	673	1,983
Past due 180 days and over	4,298	4,859
Non-accrual loans	6325	7,988
Total loans past due 30 days or greater	$ 11,442	$ 13,614

Potential Problem Loans

Potential problem loans decreased $1.7 million during the nine months of 2013 to $9.1 million, or 2.15% of gross loans receivable at September 30, 2013, compared with $10.8 million, or 2.76% of gross loans receivable at December 31, 2012.

The components of potential problem loans are as follows:

(in thousands)	September 30, 2013	December 31, 2012
Residential 1-4 family	$ 1,620	$ 3,108
Residential 5+ multifamily	975	-

Home equity credit	914	892
Residential real estate	3,509	4,000
Commercial	3,912	4,624
Construction of commercial	590	450
Commercial real estate	4,502	5,074
Farm land	762	1,180
Vacant land	45	183
Real estate secured	8,818	10,437
Commercial and Industrial	292	345
Consumer	18	28
Potential problem loans	$ 9,128	$ 10,810

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

(in thousands)	September 30, 2013	December 31, 2012
Current	$ 7,696	$ 7,992
Past due 001-029 days	175	452
Past due 030-059 days	304	2,065
Past due 060-089 days	930	301
Past due 090-179 days	23	-
Total potential problem loans	$ 9,128	$ 10,810

At September 30, 2013, 84.31% of potential problem loans were current with respect to loan payments, as compared with 73.93% at December 31, 2012.

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 decreased $12.1 million during third quarter 2013 to $479.9 million at September 30, 2013, from $492.0 million at June 30, 2013, and decreased $10.3 million for year-over-year from $490.2 million at September 30, 2012. Retail repurchase agreements increased $0.9 million during third quarter 2013 to $3.9 million at September 30, 2013, compared with $3.0 million at June 30, 2013, and increased $1.0 million for year-over-year compared with $2.9 million at September 30, 2012.

Federal Home Loan Bank of Boston (FHLBB) advances decreased $0.4 million during third quarter 2013 to $30.8 million at September 30, 2013, from $31.2 million at June 30, 2013, and decreased $11.6 million for year-over-year from $42.4 million at September 30, 2012. The decreases were due to amortizing payments of advances, maturities of advances that were not renewed, and the prepayment in fourth quarter 2012 of a $10.0 million advance maturing 12/16/2013 with a 4.88% coupon.

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 FHLBB 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, 2013, 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 21.14%, down from 30.55% at December 31, 2012. Management believes Salisbury’s funding sources will meet anticipated funding needs.

Operating activities for the nine-month period ended September 30, 2013 provided net cash of $7.7 million. Investing activities utilized net cash of $15.5 million, principally from $34.0 million of net loan originations and principal collections and $5.2 million in time deposits with other banks, offset by proceeds of $22.3 million from calls and maturities of securities available-for-sale and $1.4 million proceeds from sales of other real estate owned. Financing activities utilized net cash of $12.0 million, principally due to a net decrease of $9.2 million in deposits and repurchase agreements, pay downs of FHLBB advances of $1.2 million and common and preferred stock dividends paid totaling $1.6 million.

At September 30, 2013, Salisbury had outstanding commitments to fund new loan originations of $17.4 million and unused lines of credit of $56.9 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 $71.2 million at September 30, 2013, down $0.8 million from December 31, 2012. Book value and tangible book value per common share were $32.28 and $26.17, respectively, compared with $33.14 and $26.85, respectively, at December 31, 2012. Contributing to the decrease in shareholders’ equity for year-to-date 2013 was other comprehensive loss of $2.5 million, and common and preferred stock dividends of $1.6 million which were offset partially by net income of $3.1 million and issuance of stock awards and restricted stock of $0.1 million. Accumulated other comprehensive loss consists of unrealized gains on securities available-for-sale, net of tax, of $0.4 million and unrecognized pension plan costs, net of tax, of $0.5 million.

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In August 2011, Salisbury issued to the U.S. Secretary of the Treasury (the “Treasury”) $16.0 million 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 for the quarterly dividend periods ended September 30, 2013 and June 30, 2013, was 1.0000%. 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 27, 2013, Salisbury declared a Series B Preferred Stock dividend of $40,000, payable on October 1, 2013. 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.

On February 8, 2013, Salisbury granted a total of 19,600 shares of restricted stock pursuant to its 2011 Long Term Incentive Plan, which was approved by shareholders at the 2011 Annual Meeting, to 22 employees, including 5,000 shares to one Named Executive Officer, Richard J. Cantele, Jr., Chief Executive Officer and President.

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	September 30, 2013		December 31, 2012	
	capitalized	Salisbury	Bank	Salisbury	Bank
Total Capital (to risk-weighted assets)	10.00%	16.67%	13.93%	16.63%	13.77%
Tier 1 Capital (to risk-weighted assets)	6.00	15.42	12.70	15.46	12.62
Tier 1 Capital (to average assets)	5.00	10.28	8.60	9.87	8.15

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.

In December 2010, the Basel Committee, a group of bank regulatory supervisors from around the world, released its final framework for strengthening international capital and liquidity regulation, now officially identified by the Basel Committee as "Basel III." Basel III, when fully implemented by the U.S. bank regulatory agencies and fully phased-in, will require bank holding companies and their bank subsidiaries to maintain substantially more capital, with a greater emphasis on common equity.

In July 2013, the Federal Reserve Board, Office of the Comptroller of the Currency and Federal Deposit Insurance Corporation approved final rules to implement the Basel III capital framework. The rules will be effective on January 1, 2015 and phased-in over a multiple year period through 2019. The new capital rules call for higher quality capital with higher minimum capital level requirements. We are in the process of assessing the impact from these new regulatory requirements, and while we cannot be certain of the impact, we believe that we will exceed the requirements of adequately capitalized plus the capital conservation buffer, once they become effective.

Dividends

During the nine month period ended September 30, 2013 Salisbury paid $121,000 in Series B preferred stock dividends to the U.S. Treasury's SBLF program, and $1,436,000 in common stock dividends.

On October 25, 2013, the Board of Directors of Salisbury declared a common stock dividend of $0.28 per common share payable on November 29, 2013 to shareholders of record on November 8, 2013. Common stock dividends, when declared, will generally be paid the last Friday 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.

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FRB Supervisory Letter SR 09-4, February 24, 2009, revised September 27, 2009, notes that, as a general matter, the board of directors of a BHC should inform the FRB 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 and the Bank’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 Reform 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 ABOUT 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, 2013 analysis, all of the simulations incorporate a static growth assumption over the simulation horizons. 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.

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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, 2013 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 300 basis points for the 10-year Treasury; (3) immediately falling interest rates - immediate non-parallel downward shift in market interest rates ranging from 25 basis points for short term rates to 111 basis points for the 10-year Treasury; and (4) Static growth with assumption sensitivity stress testing with gradually rising interest rates - gradual non-parallel upward shift in market interest rates ranging from 200 basis points for short term rates to 150 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, 2013 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, 2013:

As of September 30, 2013	Months 1-12	Months 13-24
Immediately rising interest rates (static growth assumptions)	(14.69)%	(7.73)%

Immediately falling interest rates (static growth assumptions)	(1.24)	(4.29)
Immediately rising interest rates (static growth with assumption sensitivity stress testing)	(4.21)	(13.72)

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, 2013 (in thousands)	Rates up 100bp	Rates up 200bp
U.S. Treasury notes	$(76)	$(150)
U.S. Government agency notes	(103)	(265)
Municipal bonds	(2,675)	(5,431)
Mortgage backed securities	(1,244)	(2,603)
Collateralized mortgage obligations	(370)	(758)
SBA pools	(8)	(15)
Total available-for-sale debt securities	$(4,476)	$(9,222)

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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 Salisbury's disclosure controls and procedures as of September 30, 2013.

Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures are effective as of September 30, 2013.

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, as amended (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.

Changes in Internal Controls

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, 2013 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.

As previously disclosed, the Bank, individually and in its capacity as a former Co-Trustee of the Erling C. Christophersen Revocable Trust (the “Trust”), was named as a defendant in litigation filed in the Connecticut Complex Litigation Docket in Stamford, captioned John Christophersen v. Erling Christophersen, et al., X08-CV-08-5009597S (the “First Action”). The Bank also was a counterclaim-defendant in related mortgage foreclosure litigation in the Connecticut Complex Litigation Docket in Stamford, captioned Salisbury Bank and Trust Company v. Erling C. Christophersen, et al., X08-CV-10-6005847-S (the “Foreclosure Action,” together with the First Action, the “Actions”). The other parties to the Actions were 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 involved 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 a commercial mortgage in favor of the Bank on the Westport property. This mortgage is the subject of the Foreclosure Action brought by the Bank.

As previously disclosed, John Christophersen initially claimed an interest in the Westport real property transferred to the Trust and sought 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.

On June 25, 2012, the Bank and John R. Christophersen entered into a Settlement Agreement which resolved all differences between John R. Christophersen and the Bank, and resulted in the withdrawal (with prejudice) of the claims made by John R. Christophersen. All claims against the Bank have been withdrawn and the Bank is no longer a defendant or counterclaim defendant in any litigation involving the Actions. As an additional consequence of the Settlement Agreement, Bonnie Christophersen, Elena Dreiske and People's United Bank are no longer parties to any of the litigation referenced above.

On July 27, 2012, Erling Christophersen filed a Motion to Restore the First Action, and on October 15, 2012 filed a Motion to Stay the Foreclosure Action pending resolution of the Motion to Restore. The Bank opposed both motions. On February 1, 2013, the Court issued orders denying both motions. On February 14, 2013, Erling Christophersen filed a Notice of Appeal of the orders denying his Motion to Restore the First Action, and Motion to Stay the Foreclosure Action.

On April 4, 2013, the Bank moved to dismiss the appeal of the Foreclosure Action for lack of subject matter jurisdiction. The Appellate Court granted that motion on May 8, 2013. On June 6, 2013, the Appellate Court also denied Erling Christophersen's motion for reconsideration of its decision. Erling Christophersen's appeal of the order denying his Motion to Restore the First Action remains pending, and the Bank intends to vigorously oppose that appeal. Trial is scheduled to begin on January 6, 2014.

The Bank continues to proceed in its Foreclosure Action against Erling Christophersen. It has filed a motion to strike Erling Christophersen's special defenses and set-off claims, which is fully briefed and awaits adjudication by the court.

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. **MINE SAFETY DISCLOSURES**

Not Applicable

Item 5. OTHER INFORMATION

None

Item 6. EXHIBITS

3.1	Certificate of Incorporation of Salisbury Bancorp, Inc. (incorporated by reference to Exhibit 3.1 of Registrant's 1998 Registration Statement on Form S-4 filed April 23, 1998, File No.: 33-50857).
3.1.1	Amendment to Article Third of Certificate of Incorporation of Registrant (incorporated by reference to Exhibit 3.1 of Registrant's Form 8-K filed March 11, 2009).
3.1.2	Certificate of Amendment to Certificate of Incorporation of Registrant (incorporated by reference to Exhibit 3.1 of Registrant's Form 8-K filed March 19, 2009).
3.1.3	Certificate of Amendment to Certificate of Incorporation for the Series B Preferred Stock (incorporated by reference to Registrant's Form 8-K filed on August 25, 2011).
3.2	Amended and Restated Bylaws (incorporated by reference to Exhibit 3.2 of Form 8-K filed March 19, 2009).
10.1	Amended and Restated Supplemental Retirement Plan Agreement with John F. Perotti dated January 25, 2008 (incorporated by reference to Exhibit 10.1 of Registrant's Form 8-K filed January 30, 2008).
10.2	Consulting and Non-Compete Agreement dated June 1, 2009 by and between Salisbury and John F. Perotti. (incorporated by reference to Exhibit 10.2 of Registrant's 2010 Annual Report on Form 10-K filed March 31, 2011).
10.3	Letter Agreement dated March 13, 2009, including the Securities Purchase Agreement - Standard Terms, as supplemented by the letter dated March 13, 2009 relating to the American Recovery and Reinvestment Act to 2009 with the U.S. Treasury Department. (incorporated by reference to Exhibit 10.6 of Registrant's 2010 Annual Report on Form 10-K filed March 31, 2011).
10.4	Securities Purchase Agreement dated August 25, 2011 with the U.S. Treasury Department relating to the Small Business Lending Fund (incorporated by reference to Exhibit 10.1 of Registrant's Form 8-K filed on August 25, 2011).
10.5	Repurchase Letter Agreement between Salisbury and the United States Department of Treasury dated August 25, 2011 (incorporated by reference to Exhibit 10.1 of Registrant's Form 8-K filed on August 25, 2011).
10.6	2011 Long Term Incentive Plan adopted by the Board on March 25, 2011 and approved by the shareholders at Salisbury's 2011 Annual Meeting (incorporated by referenced to Exhibit 10.9 of Registrant's Annual Report on Form 10-K filed March 19, 2012).
10.7	Amendment Number One to 2011 Long Term Incentive Plan dated as of January 18, 2013.
10.8	Severance Agreement with Richard J. Cantele, Jr. dated February 11, 2013 (incorporated by reference to Exhibit 10.1 of Form 8-K filed February 15, 2013).
10.9	Participation Agreement of Richard J. Cantele, Jr. in the Non-Qualified Deferred Compensation Plan dated February 11, 2013 (incorporated by reference to Exhibit 10.2 of the Form 8-K filed on February 15, 2013).

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10.10	Change in Control Agreement with Donald E. White dated April 1, 2013. (incorporated by reference to Exhibit 10.3 of Form 10-Q filed May 14, 2013).
31.1	Rule 13a-14(a)/15d-14(a) Certification.
31.2	Rule 13a-14(a)/15d-14(a) Certification.
32	Section 1350 Certifications

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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, 2013 by	/s/ Richard J. Cantele, Jr. Richard J. Cantele, Jr., President and Chief Executive Officer
November 14, 2013 by	/s/ Donald E. White Donald E. White, Executive Vice President and Chief Financial Officer