

SECURITIES & EXCHANGE COMMISSION EDGAR FILING

Community Bancorp /VT

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K

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

For the fiscal year ended December 31, 2012

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 No. 000-16435



Vermont

(State of Incorporation)

03-0284070

(IRS Employer Identification Number)

Address of Principal Executive Offices: 4811 US Route 5, Derby, Vermont 05829

Registrant's telephone number, including area code: (802) 334-7915

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class

NONE

Name of each exchange on which registered

NONE

Securities registered pursuant to Section 12(g) of the Act:

Common Stock - \$2.50 par value per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES NO

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company)

Accelerated filer

Smaller reporting company

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

As of June 30, 2012 the aggregate market value of the voting stock held by non-affiliates of the registrant was \$43,111,072, based on a per share trade price on June 26, 2012 of \$10.07, as reported on the OTC Link® system maintained by the OTC Markets Group Inc. For purposes of the calculation, all directors and executive officers were deemed to be affiliates of the registrant. However, such assumption is not intended as an admission of affiliate status as to any such individual.

There were 4,810,735 shares outstanding of the issuer's class of common stock as of the close of business on March 14, 2013.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Annual Report to Shareholders for the year ended December 31, 2012 are incorporated by reference to Part I of this Report.

Portions of the Annual Report to Shareholders for the year ended December 31, 2012 are incorporated by reference to Part II of this report.

Portions of the Proxy Statement for the Annual Meeting of Shareholders to be held Ma y 14, 2013 are incorporated by reference to Part III of this report.

FORM 10-K ANNUAL REPORT

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PART I

ITEM 1. THE BUSINESS

Organization and Operation

Community Bancorp. (the "Company") was organized under the laws of the State of Vermont in 1982 and became a registered bank holding company under the Bank Holding Company Act of 1956, as amended, in October 1983 when it acquired all of the voting shares of Community National Bank (the "Bank"). The Bank is the only subsidiary of the Company and principally all of the Company's business operations are presently conducted through it. Therefore, the following narrative and the other information contained in this report are based primarily on the Bank's operations.

Community National Bank was organized in 1851 as the Peoples Bank, and was subsequently reorganized as the National Bank of Derby Line in 1865. In 1975, after 110 continuous years of operation as the National Bank of Derby Line, the Bank acquired the Island Pond National Bank and changed its name to "Community National Bank." On December 31, 2007, the Company completed its acquisition of LyndonBank, a Vermont bank headquartered in Lyndonville, Vermont, in a cash merger transaction. As a result of the merger, the Company added three office locations in Caledonia County and one office location in each of Orleans, Lamoille and Franklin Counties.

Community National Bank provides a broad range of retail banking services to the residents, businesses and municipalities in northeastern and central Vermont. These services include checking, savings and time deposit accounts, mortgage, consumer, municipal and commercial loans, safe deposit and night deposit services, ACH, wire transfer services, automatic teller machine (ATM) facilities, credit card services, 24 hour telephone banking, remote deposit and mobile and internet banking. Additionally, the Bank maintains cash machines at 10 third party business locations in the counties of Orleans, Washington, Caledonia and Franklin. The Company focuses on establishing and maintaining long-term relationships with customers and is committed to providing for the financial services needs of the communities it serves. In particular, the Company continues to emphasize its relationships with individual customers and small-to-medium-sized businesses. The Company actively evaluates the banking needs of its markets, including low- and moderate-income areas, and offers products that are responsive to the needs of its customer base. The markets served by the Company provide a mix of real estate, commercial and industrial, municipal and consumer lending opportunities, as well as a stable core deposit base. Additional information about our business, including the Company's deposit-taking activities, lending activities and credit and risk management policies, is set forth under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" contained in the Annual Report to Shareholders for 2012 filed as Exhibit 13 to this Report and is incorporated herein by reference.

In 2002, the Bank transferred its trust operations to a newly formed Vermont-chartered nondepository trust and investment management affiliate, Community Financial Services Group, LLC, based in Newport, Vermont ("CFSG"). The Bank's ownership interest in CFSG is held indirectly, through Community Financial Services Partners, LLC, a Vermont limited liability company ("Partners"), which owns 100% of the limited liability company equity interests of CFSG. Immediately following transfer of its trust operations to CFSG, the Bank sold a two-thirds interest in Partners, equally to the National Bank of Middlebury, headquartered in Middlebury, Vermont and Guaranty Bancorp Inc., the bank holding company parent of Woodsville Guaranty Savings Bank, headquartered in Woodsville, New Hampshire. CFSG offers fiduciary services throughout the market areas of the three owner financial institutions.

In 2007, the Company formed CMTV Statutory Trust I (the "Trust"), a Delaware statutory business trust, for the purpose of issuing \$12.5 million of trust preferred securities and lending the proceeds to the Company. This funding provided a portion of the cash consideration paid by the Company in the acquisition of LyndonBank and provided additional regulatory capital. The Trust is a variable interest entity for which the Company is not the primary beneficiary, within the meaning of applicable accounting standards. Accordingly, the Trust is not consolidated with the Company for financial reporting purposes.

In 2011, the Company formed a limited liability company ("LLC") to facilitate its purchase of federal New Markets Tax Credits ("NMTCs") under an investment structure designed by a local community development entity. The LLC is a variable interest entity for which, in the context of the overall NMTC structure, the Company is not the primary beneficiary, within the meaning of applicable accounting standards. Accordingly, the LLC is not consolidated with the Company for financial reporting purposes.

Competition

All of the Bank's offices are located in northern and central Vermont. The Bank's main office is located in Derby, in Orleans County. In addition to its main office, the Bank has four other banking offices in Orleans County, one office in Essex County, four offices in Caledonia County, two offices in Washington County and one office each in Franklin and Lamoille Counties.

The Bank competes in all aspects of its business with other banks and credit unions in northern and central Vermont, including three of the largest banks in the state, which maintain branch offices throughout the Bank's service area. Historically, competition in Orleans and Essex Counties has come primarily from two of the largest banks in the state, People's United Bank, FSB based in Bridgeport, Connecticut and TD Bank, N.A., a subsidiary of Toronto Dominion (based in Toronto, Ontario), based in Portland, Maine and Cherry Hill, New Jersey. People's United Bank (formerly Chittenden Bank) maintains a branch office in Newport, and TD Bank, N.A. maintains branch offices in Barton, Orleans, and St. Johnsbury. The Bank also competes in Orleans County with one local bank, Passumpsic Savings Bank, based in St. Johnsbury with a branch in Newport, and with two local credit unions, Orlex Credit Union, based in Newport and North Country Federal Credit Union, based in South Burlington. The Bank's primary competitors in Caledonia County are Passumpsic Savings Bank, Union Bank based in Morrisville, TD Bank, N.A., Northern Lights Federal Credit Union, based in St. Johnsbury, Vermont State Employees Credit Union, based in Montpelier, Burlington-based Merchants Bank, the largest Vermont-based bank, and North Country Federal Credit Union. In Washington County, the Bank competes with Merchants Bank, People's United Bank and TD Bank, N.A, as well as Northfield Savings Bank, based in Northfield, Key Bank, based in Ohio, Citizens Bank Vermont, based in Rhode Island, Vermont State Employees Credit Union, North Country Federal Credit Union, and Granite Hills Credit Union, based in Barre. In Franklin County, the Bank competes with Peoples Trust Company, based in St. Albans, TD Bank, N.A., People's United Bank, Citizens Bank Vermont, Key Bank, Merchants Bank, and Union Bank. In Lamoille County the Bank's competitors are Union Bank, TD Bank, People's United Bank and Merchants Bank.

Changes in the regulatory framework of the banking industry during the past decade have broadened the competition for commercial bank products, such as deposits and loans, to include not only traditional rivals such as the mutual savings banks, stock savings banks, and credit unions, but also many non-traditional rivals such as insurance companies, brokerage firms, mutual funds and consumer and commercial finance and leasing companies. In addition, many out-of-market nationwide banks, nonbank lenders and other financial service firms operate in the Company's market areas through mass marketing solicitations by mail, radio, television, the internet and email. At the same time, technological changes have facilitated remote delivery of financial services by bank and nonbank competitors outside the context of a traditional branch bank network, thereby intensifying competition from out-of-market firms.

Competition from the tax-exempt credit union industry has also intensified in recent years. Three of the Bank's credit union competitors, including the largest state-chartered Vermont credit union, Vermont State Employees Credit Union, have converted in recent years from an employment based common bond to a community common bond, thereby significantly increasing their fields of membership in the Bank's market areas. Similarly, another of the Bank's credit union competitors, which previously had an employment based common bond, merged in 2009 into a much larger credit union which has a community common bond. At the same time, regulatory changes in the credit union industry, including passage in 2005 of a comprehensive Vermont credit union modernization statute, have steadily increased the financial services and products that credit unions are authorized to offer, such as small business lending and products for non-profit organizations. Because federal law subsidizes credit unions by giving them a general exemption from federal income taxes, they have a significant pricing advantage over commercial banks for their deposit and loan products. This pricing advantage, coupled with the relaxing of membership and product restrictions, has resulted in increased competition for the Bank from this tax exempt sector of the financial services industry.

In order to compete with other bank and non-bank service providers, the Company stresses the community orientation of its banking operations and relies to a large extent upon personal relationships established by its officers, directors and employees with their customers and on their strong ties to the local community. In addition, management's knowledge of the local community assists it in tailoring the Company's products and services to meet the needs of its customer base. Although competition is strong throughout the Company's market area, management believes that the Company can continue to compete effectively, in view of its local market knowledge and community ties and its understanding of customer needs.

Employees

As of December 31, 2012, the Company did not have any employees at the holding company level. However, as of such date, the Bank employed 130 full-time employees and 24 part-time employees. Management of the Bank considers its employee relations to be good.

Regulation and Supervision

The following discussion describes elements of an extensive regulatory framework applicable to bank holding companies and banks, to which the Company and the Bank are subject. Regulation of banks and bank holding companies is intended primarily for the protection of depositors and the Deposit Insurance Fund (the “DIF”) of the FDIC, rather than for the protection of shareholders and creditors.

The Company’s earnings are affected by general economic conditions, management policies, changes in state and federal laws and regulations and actions of various regulatory authorities, including those referred to below. Banking is a highly regulated business and proposals to change the laws and regulations to which the Company and the Bank are subject are frequently introduced at both the federal and state levels. The likelihood and timing of any such changes and the impact such changes may have on the Company and the Bank is impossible to predict with any certainty.

The following summary does not purport to be complete and is qualified by reference to the particular statutes and regulations.

Dodd–Frank Act. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”) represents a comprehensive revision and restructuring of many aspects of financial services industry regulation and impacts practically all aspects of a banking organization. Implementation of the Dodd-Frank Act continued throughout 2012, including through various agency rulemakings. Many of the provisions of the Dodd-Frank Act are designed to reduce systemic risk from large, complex “systemically significant” financial institutions, and thus do not apply to a smaller banking organization such as the Company. Nevertheless, certain of its provisions do directly apply to the Company and others will indirectly impact its operations, as the Dodd-Frank Act continues to reshape the financial services environment. Among other things, the Act:

- Granted new powers to the Federal Reserve to monitor the systemic safety of the financial system and to take proactive steps to reduce or eliminate threats, including imposing strict controls on large, systemically significant bank and non-bank financial holding companies;
- Established a new independent agency, the Consumer Financial Protection Bureau (“CFPB”), with centralized responsibility for implementing and (with respect to large organizations) enforcing and examining compliance with federal consumer financial laws. Although the CFPB does not have enforcement or examination authority over smaller banking organizations such as the Company, its regulatory standards and mandates will ultimately affect all financial service providers;
- Applies the same leverage and risk-based capital requirements that apply to insured depository institutions to most bank holding companies, savings and loan holding companies and systemically important non-bank financial companies on a consolidated basis. These changes prohibit the use of additional trust preferred securities as Tier 1 capital, but the Company’s existing trust preferred securities are grandfathered;
- Requires debit card interchange transaction fees charged by large financial institutions to be reasonable and proportional to the cost incurred by the issuer for the transaction. The Federal Reserve adopted regulations during 2011 establishing such fee standards, eliminating exclusivity arrangements between issuers and networks for debit card transactions and limiting restrictions on merchant discounting for use of certain payment forms and minimum or maximum amount thresholds as a condition for acceptance of credit cards. Although smaller institutions such as the Company are not subject to the interchange fee restrictions, it is possible that, over time, competitive pricing pressures in the marketplace may operate to make the restrictions applicable to them by default;
- Requires public companies to periodically seek “say on executive pay” and “say on frequency” votes of shareholders, and in some circumstances, a “say on golden parachute” vote of shareholders. As a smaller reporting company, these vote requirements first become applicable for the Company’s 2013 annual meeting of shareholders;
- Allows depository institutions to pay interest on demand deposits effective July 21, 2011;
- Established by statute the Federal Reserve’s “source of strength” doctrine mandating holding company financial support of subsidiary insured depository institutions;
- Eliminated state restrictions on de novo interstate branching;
- Established new requirements related to mortgage lending, including prohibitions against payment of steering incentives and provisions relating to underwriting standards, disclosures, appraisals and escrows. Many of these provisions have been implemented through CFPB rulemakings;

- Weakened federal preemption standards for national banks and federal savings associations and their operating subsidiaries by granting states greater authority to enforce consumer protection laws against them;

- Provided permanent relief for smaller reporting companies, such as the Company, from the requirements of Section 404 of the Sarbanes-Oxley Act for auditor attestation of management's assessment of internal controls and their effectiveness;
- Requires a bank holding company to be well capitalized and well managed to receive regulatory approval of an interstate bank acquisition; and
- Permanently increases the FDIC's standard maximum deposit insurance amount to \$250,000, changes the FDIC insurance assessment base to assets rather than deposits and increases the reserve ratio for the deposit insurance fund to ensure the future strength of the fund. A temporary extension of unlimited deposit insurance on non-interest bearing transaction accounts expired on December 31, 2012.

While significant elements of the Dodd-Frank Act have been implemented through agency rulemakings, additional rulemakings and further studies are required for implementation of other provisions of the Act. The Company will continue to monitor the impact of implementation of this significant legislation.

Bank Holding Company Act. As a registered bank holding company, the Company is subject to on-going regulation, supervision and examination by the Board of Governors of the Federal Reserve System ("Federal Reserve"), under the Bank Holding Company Act of 1956, as amended (the "Act"). A bank holding company for example, must generally obtain the prior approval of the Federal Reserve before it acquires all or substantially all of the assets of any bank, or acquires ownership or control of more than 5% of the voting shares of a bank. Federal Reserve approval is also generally required before a bank holding company may acquire more than 5% of any outstanding class of voting securities of a company other than a bank or a more than 5% interest in its property.

The Act generally limits the activity in which the Company and its subsidiaries may engage to certain specified activities, including those activities which the Federal Reserve may find, by order or regulation, to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. Some of the activities that the Federal Reserve has determined to be closely related to banking are: (1) making and servicing loans that could be made by mortgage, finance, credit card or factoring companies; (2) performing the functions of a trust company; (3) certain leasing of real or personal property; (4) providing certain financial, banking or economic data processing services; (5) except as otherwise prohibited by law, acting as an insurance agent or broker with respect to insurance that is directly related to the extension of credit or the provision of other financial services or, under certain circumstances, with respect to insurance that is sold in certain small communities in which the bank holding company system maintains banking offices; (6) acting as an underwriter for credit life insurance and credit health and accident insurance directly related to extensions of credit by the holding company system; (7) providing certain kinds of management consulting advice to unaffiliated banks and non-bank depository institutions; (8) performing real estate appraisals; (9) issuing and selling money order and similar instruments and travelers checks and selling U.S. Savings Bonds; (10) providing certain securities brokerage and related services for the account of bank customers; (11) underwriting and dealing in certain government obligations and other obligations such as bankers' acceptances and certificates of deposit; (12) providing consumer financial counseling; (13) providing tax planning and preparation services; (14) providing check guarantee services to merchants; (15) operating a collection agency; and (16) operating a credit bureau. Trust and investment management activities conducted through a nondepository trust company such as the Company's affiliate, CFSG, are also considered by the Federal Reserve to be permissible nonbanking activities that are closely related to banking.

Except for CFSG's trust and investment management operations, the Company does not presently engage, directly or indirectly, in any other permissible non-banking activities.

A bank holding company must also obtain prior Federal Reserve approval in order to purchase or redeem its own stock if the gross consideration to be paid, when added to the net consideration paid by the company for all purchases or redemptions by the company of its equity securities within the preceding 12 months, will equal 10% or more of the company's consolidated net worth.

The Company is required to file with the Federal Reserve Board annual and parent company quarterly reports and such additional information as the Board may require pursuant to the Act. The Board may also make examinations of the Company and any direct or indirect subsidiary of the Company.

Community Bancorp. and its wholly-owned subsidiary, Community National Bank, as well as its non-subsi-dary affiliates, Partners and CFSG, are all considered "affiliates" of each other for the purposes of Section 18(j) of the Federal Deposit Insurance Act ("FDIA"), as amended, and Sections 23A and 23B of the Federal Reserve Act, as amended. In particular, section 23A limits loans or other extensions of credit to, asset purchases with and investments in affiliates of the Bank to 10% of the Bank's capital and surplus. In addition, such loans and extensions of credit and certain other transactions must be collateralized in specified amounts. Section 23B requires, among other things, that certain transactions between the Bank and its affiliates must be on terms substantially the same, or at least as favorable to the Bank, as those prevailing at the time for comparable transactions with or involving non-affiliated persons. Further, the Company is prohibited from engaging in certain tie-in arrangements in connection with any extension of credit or lease or sale of any property or the furnishing of services.

Bank Holding Company Consolidated Capital Requirements Under the Dodd-Frank Act and longstanding Federal Reserve policy, a bank holding company is expected to act as a source of financial strength to its subsidiary banks and to commit resources to support them. In implementing this requirement, the Federal Reserve could require the Company to provide such support when the Company otherwise would not consider it advisable to do so.

The Company is subject to Federal Reserve's risk-based capital requirements for assessing bank holding company capital adequacy. These standards define regulatory capital and establish minimum ratios in relation to assets, both on an aggregate basis and as adjusted for credit risks and off-balance sheet exposures. Bank holding companies are required to maintain a minimum ratio of qualifying total capital to risk-weighted assets of 8%, of which one-half must be in the form of Tier 1 capital (as defined). The Federal Reserve also requires a minimum leverage ratio of Tier 1 capital to total average assets of 3% for strong bank holding companies, defined as those bank holding companies rated a composite "1" under the rating system used by the Federal Reserve. For all other bank holding companies, the minimum ratio of Tier 1 capital to total assets is 4.0 percent. Bank holding companies with supervisory, financial, operational, or managerial weaknesses, as well as those that are anticipating or experiencing significant growth, are expected to maintain capital ratios well above the minimum levels.

The Federal Reserve's capital guidelines classify bank holding company capital into two categories. Tier 1 or "core capital" generally is defined as the sum of eligible core capital elements, less any amounts of goodwill and other items that are required to be deducted in accordance with the Federal Reserve capital guidelines. Eligible Tier 1 or core capital elements include qualifying common stockholders' equity, qualifying preferred stock (such as the Company's Series A preferred stock), and qualifying trust preferred securities (such as those of the Company), subject to certain limitations. Tier 1 capital must represent at least 50% of a bank holding company's qualifying total capital. Eligible Tier 2, or "supplementary capital" includes the allowance for loan and lease losses (subject to limitations), preferred stock that does not qualify as Tier 1 capital, certain hybrid capital instruments, and certain subordinated and mandatory convertible debt securities.

The Federal Reserve capital guidelines limit the amount of restricted core elements that a bank holding company may include in Tier 1 capital. Until March 31, 2011, the aggregate amount of restricted core elements consisting of certain preferred stock and qualifying trust preferred securities that were includable in Tier 1 capital was limited to 25%. Beginning March 31, 2011, the aggregate amount of all restricted core capital elements that may be included by a bank holding company as Tier 1 capital may not exceed 25% of the sum of all core capital elements, including restricted core capital elements, net of goodwill less any associated deferred tax liability.

The excess of restricted core capital not included in Tier 1 may generally be included in the Tier 2 capital calculation. However, beginning March 31, 2011, the aggregate of excess qualifying trust preferred securities and other excess restricted core capital elements that may be treated as Tier 2 capital is limited to 50% of Tier 1 capital. Amounts of these instruments in excess of this limit, although not included in Tier 2 capital, will be taken into account by the Federal Reserve in its overall assessment of a bank holding company's funding and financial condition.

As of December 31, 2012, the Company had consolidated regulatory capital at the level required to be considered well capitalized. As of such date, the Company had a total consolidated capital to risk-weighted assets ratio of 12.57%, a Tier 1 capital to risk-weighted assets ratio of 10.80%, and a leverage ratio of 7.27%.

As noted above, the Dodd-Frank Act requires the Federal Reserve to establish minimum capital levels for bank holding companies on a consolidated basis that are as stringent as those required for insured depository institutions, as in effect on the enactment date of the Act. After a three year phase-in period which begins January 1, 2013, existing trust preferred securities for holding companies with consolidated assets greater than \$15 billion and all new issuances of trust preferred securities are removed as a permitted component of a holding company's Tier 1 capital. Trust preferred securities outstanding as of May 19, 2010 that were issued by bank holding companies with total consolidated assets of less than \$15 billion, such as the Company, will continue to count as Tier 1 capital. However, as a result of the Dodd-Frank Act, in the future the Company will not be able to raise additional Tier 1 capital through the issuance of new trust preferred securities.

Basel III. In December 2010, the Basel Committee on Banking Supervision (the “Basel Committee”), an international forum for cooperation on banking supervisory matters, announced the “Basel III” capital rules, which set new capital requirements for banking organizations. In June 2012, the Federal Reserve requested comment on three proposed rules that, taken together, would establish an integrated regulatory capital framework implementing the Basel III regulatory capital reforms for United States banking institutions, including community banks. As proposed, the U.S. implementation of Basel III would lead to significantly higher capital requirements and more restrictive leverage and liquidity ratios than those currently in place. One of the rule proposals addresses the components of capital and other issues affecting the numerator in banking institutions’ regulatory capital ratios, while another of the proposals addresses risk weights and other issues affecting the denominator in banking institutions’ regulatory capital ratios and would replace the existing risk weighting approach with a more risk-sensitive approach. Among other things, the proposed rules would revise the definition of various regulatory capital components and related calculation methods, add a new regulatory capital component (common equity tier 1 capital), increase the minimum required tier 1 capital, implement a new capital conservation buffer and restrictions on dividends and certain discretionary bonus payments when the buffer is not maintained. The revisions most troubling to the Company are the changes to risk-weighting of assets, the inclusion of unrealized gains and losses on available-for-sale securities in regulatory capital and the exclusion of trust preferred securities from regulatory capital accomplished over a 10 year phase out period. The proposed rules indicated that the final rule would become effective on January 1, 2013, and the changes set forth in the final rules would be phased in from January 1, 2013 through January 1, 2019. However, due to the volume of public comments received, the Federal Reserve delayed the proposed January 1, 2013 effective date as it continues to study the potential effects of the proposed changes. In March 2013, the Basel Committee announced that it will examine whether the Basel III capital rules should be simplified in light of the criticism that they are too complex to be effective. Management is evaluating the potential impact of the proposed Basel III capital standards on the Company and the Bank and will continue to monitor related regulatory action on the rules. However, the ultimate effects will depend on the terms of the final regulations and cannot be predicted with certainty at this time. In addition, important questions remain as to how the numerous capital and liquidity mandates of the Dodd-Frank Act will be integrated with the requirements of Basel III.

Financial Modernization. In 1999 Congress enacted the federal Gramm-Leach-Bliley financial modernization act (“Gramm-Leach-Bliley”), which repealed provisions of the Glass-Steagall Act of 1933 that required separation of banking and commercial entities. Under Gramm-Leach-Bliley, eligible bank holding companies may elect to become financial holding companies and thereby affiliate with securities firms and insurance companies and engage in a broader range of activities than is otherwise permissible for bank holding companies. A bank holding company is eligible to elect to become a “financial holding company” and to engage in activities that are “financial in nature” if each of its subsidiary banks is well capitalized for regulatory capital purposes, is well managed and has at least a satisfactory rating under the Community Reinvestment Act (“CRA”). Activities which are deemed “financial in nature” under Gramm-Leach-Bliley would include activities generally permitted to bank holding companies as described above, and in addition securities underwriting, dealing and market making; sponsoring mutual funds and investment companies; insurance underwriting and agency; and merchant banking. Gramm-Leach-Bliley also contains similar provisions authorizing eligible national banks to engage indirectly through a “financial subsidiary” in activities that are financial in nature, other than insurance underwriting, insurance company portfolio investment, real estate development and real estate investment. In order to be considered eligible for these expanded activities, the bank must be well capitalized, well managed and have at least a satisfactory CRA rating. A national bank’s investment in financial subsidiaries is subject to certain limitations under Gramm-Leach-Bliley.

As of the date of filing this report with the SEC, the Company had not elected to become a financial holding company, nor had the Bank created any financial subsidiaries.

Implementation of Gramm-Leach-Bliley has resulted in an increase in the number and type of institutions engaging in the same or similar financial activities as those of the Company and the Bank, thereby creating a more competitive financial services environment generally. However, management of the Company believes that Gramm-Leach-Bliley has thus far had a more significant competitive impact on larger institutions, such as regional and national holding companies and banks, than on community-based institutions serving largely rural populations, such as the Company and the Bank, which are engaged primarily in traditional banking activities and have a stronger local marketing focus.

USA Patriot Act. In response to the terrorist events of September 11, 2001, Congress enacted the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the “USA Patriot Act” or the “Act”). The USA Patriot Act is intended to strengthen the ability of U.S. law enforcement and the intelligence community to work cooperatively to combat terrorism on a variety of fronts. The impact of the USA Patriot Act on financial institutions is significant and wide ranging. The Act contains sweeping anti-money laundering and financial transparency laws and imposes various regulations, including standards for verifying client identification at account opening, and rules to promote cooperation among financial institutions, regulators and law enforcement entities in identifying parties that may be involved in terrorism or money laundering. The Secretary of the Treasury and banking regulators have adopted several regulations to implement these provisions. The Act also amended the federal Bank Holding Company Act and the Bank Merger Act to require the federal banking regulatory authorities to consider the effectiveness of a bank holding company or a financial institution’s anti-money laundering activities when reviewing an application to expand operations. As required by law, Community National Bank has in place a Bank Secrecy Act and Anti-Money Laundering compliance program, as well as a customer identification program.

Sarbanes-Oxley Act. The Sarbanes-Oxley Act of 2002 (the "Act") was enacted to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws. The Act is the most far-reaching U.S. securities legislation enacted in decades, and generally applies to companies that file or are required to file periodic reports with the SEC under the Securities Exchange Act of 1934 ("Exchange Act"). The SEC has engaged in extensive rulemaking to implement the Act's provisions.

The Act includes provisions addressing, among other matters, the duties, functions and qualifications of audit committees for all public companies; certification of financial statements by the chief executive officer and the chief financial officer; the forfeiture of bonuses or other incentive-based compensation and profits from the sale of an issuer's securities by directors and senior officers in the twelve month period following initial publication of any financial statements that later require restatement; disclosure of off-balance sheet transactions; a prohibition on personal loans to directors and officers, except (in the case of banking companies) loans in the normal course of business; expedited filing requirements for reports of beneficial ownership of company stock by insiders; disclosure of a code of ethics for senior officers, and of any change or waiver of such code; the formation of a public accounting oversight board; auditor independence; disclosure of fees paid to the company's auditors for non-audit services and limitations on the provision of such services; attestation requirements for company management and external auditors, relating to internal controls and procedures; and various increased criminal penalties for violations of federal securities laws.

In response to Sarbanes-Oxley, the Board of Directors of the Company approved a series of actions to strengthen and improve its already strong corporate governance practices. Among other measures, the Board adopted a Code of Ethics for Senior Financial Officers and the Principal Executive Officer, adopted an Insider Trading Policy, adopted amendments to the Audit Committee Charter, appointed a Compensation Committee and a Corporate Governance/Nominating Committee and adopted charters for those committees.

Since 2007 Section 404 of Sarbanes-Oxley has required management of the Company to undertake a periodic assessment of the adequacy and effectiveness of the Company's internal controls over financial reporting. Management's report on internal control over financial reporting for 2012 is contained in Item 9A of this Report. The Company has incurred, and expects to continue to incur, costs in connection with its on-going compliance with Section 404.

As enacted in 2002 and implemented by the SEC, Sarbanes-Oxley provided that, beginning with annual financial statements for 2010, the Company's external auditors would be required to attest to, and report on, management's assessment of the Company's internal controls and the operating effectiveness of these controls. As noted above, however, the Dodd-Frank Act included permanent relief from this requirement for smaller reporting companies such as the Company.

More information on the Company's corporate governance practices, including committee charters, is available on the Company's website at www.communitybancorpvt.com.

SEC Regulatory Relief for Smaller Reporting Companies. In December 2007, the SEC adopted amendments to its disclosure and reporting rules to extend to more public companies the benefits of the simplified and less rigorous disclosure requirements previously applicable only to "small business issuers." The amendments established a new category of "smaller reporting companies" with a public float of less than \$75 million. The Company continues to qualify as a smaller reporting company as of its last measurement date (June 30, 2012). Under the amendments, smaller reporting companies are able to elect whether to comply with specified financial and nonfinancial disclosure requirements on an item by item basis. The amendments were effective February 4, 2008 and the Company has elected to avail itself of some of the relief provided in the amendments in connection with preparation of the Company's annual meeting proxy statement and its periodic reports, including this annual report on Form 10-K.

Interstate Banking and Branching. The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 authorized interstate mergers and permitted a bank holding company to acquire banks in states other than its home state, without regard to the permissibility of such acquisitions under state law, but subject to certain state law requirements. As noted above, the Dodd-Frank Act effectively eliminated the remaining state law limitations on de novo interstate banking. Interstate branching generally heightens the competitive environment for financial services and, although it is difficult to predict with any certainty, it is likely that the trend toward increasing competition will continue in the future. As of December 31, 2012, the Company did not maintain any interstate branches.

Prompt Corrective Action. Community National Bank is subject to regulatory capital requirements established under the Federal Deposit Insurance Company Improvement Act of 1991 ("FDICIA"). Among other things, FDICIA identifies five capital categories for insured depository institutions (well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized) and requires the respective U.S. federal regulatory agencies to implement systems for "prompt corrective action" for insured depository institutions that do not meet minimum capital requirements within such categories. FDICIA imposes progressively more restrictive constraints on operations, management and capital distributions, depending on the category in which an institution is classified. Failure to meet the capital guidelines could also subject a banking institution to capital raising requirements. An "undercapitalized" bank must develop a capital restoration plan and its parent holding company must guarantee that bank's compliance with the plan. The liability of the parent holding company under any such guarantee is limited to the lesser of 5% of the bank's assets at the time it became undercapitalized or the amount needed to comply with the plan. Furthermore, in the event of the bankruptcy of the parent holding company, such guarantee would take priority over the parent's general unsecured creditors. In addition, FDICIA requires the various regulatory agencies to prescribe certain non-capital standards for safety and soundness related generally to operations and management, asset quality and executive compensation and permits regulatory action against a financial institution that does not meet such standards.

The various federal bank regulatory agencies have adopted substantially similar regulations that define the five capital categories identified by FDICIA, using the total risk-based capital, Tier 1 risk-based capital and leverage capital ratios as the relevant capital measures. Such regulations establish various degrees of corrective action to be taken when an institution is considered undercapitalized. Under the regulations, a "well capitalized" institution must have a Tier 1 capital ratio to risk weighted assets of at least 6%, a total capital ratio to risk weighted assets of at least 10% and a leverage ratio of at least 5% and not be subject to a capital directive order. An "adequately capitalized" institution must have a Tier 1 capital ratio to risk weighted assets of at least 4%, a total capital ratio to risk weighted assets of at least 8% and a leverage ratio of at least 4%, or 3% in some cases.

As noted above, the Dodd-Frank Act mandates similar capital requirements for bank and thrift holding companies on a consolidated basis to those applicable to insured depository institutions under the Prompt Corrective Action provisions of FDICIA.

As of December 31, 2012, Community National Bank was considered "well capitalized" under FDICIA's regulatory capital requirements.

Dividends. The Company derives funds for payment of dividends to its shareholders primarily from dividends received from its subsidiary, Community National Bank. Under the National Bank Act, prior approval from the Office of the Comptroller of the Currency (OCC) is required if the total of all dividends declared by a national bank in any calendar year will exceed the sum of such bank's net profits for that last year and its retained net profits for the preceding two calendar years, less any required transfers to surplus. Federal law also prohibits national banks from paying dividends greater than the bank's undivided profits after deducting statutory bad debt in excess of the bank's allowance for loan losses.

In addition, the Company and the Bank are subject to various general regulatory policies and requirements relating to the payment of dividends, including requirements to maintain adequate capital above regulatory minimums. The appropriate federal or state banking agency is authorized to determine under certain circumstances relating to the financial condition of a bank or bank holding company that the payment of dividends would be an unsafe or unsound practice and to prohibit such payment.

In February 2009, the Federal Reserve issued supervisory guidance on the payment of dividends and redemption and repurchases of stock by bank holding companies. The guidance heightened expectations that a bank holding company will inform and consult with Federal Reserve supervisory staff in advance of declaring and paying any dividend that could raise safety and soundness concerns, such as a dividend exceeding current period earnings; redeeming or repurchasing regulatory capital instruments when the bank holding company is experiencing financial weaknesses; or redeeming or repurchasing common stock or perpetual preferred stock that would result in a net reduction in the amount of such equity instruments outstanding compared with the beginning of the quarter in which the redemption or repurchase occurred. The guidance provides that a bank holding company should eliminate, defer or severely limit dividends if net income for the past four quarters is not sufficient to fully fund dividends; the prospective rate of earnings retention is not consistent with the holding company's capital needs and overall current and prospective financial condition; or the holding company will not meet, or is in danger of not meeting, its minimum regulatory capital ratios. The Company would be required in future periods to consult with, and obtain the approval of, the Federal Reserve for payment of any dividends, including regular quarterly cash dividends, that are in excess of earnings for the applicable quarterly period.

OCC Supervision. The Bank is a national banking association and subject to the provisions of the National Bank Act and federal and state statutes and rules and regulations applicable to national banks. The primary supervisory authority for the Bank is the OCC. The OCC's examinations are designed for the protection of the Bank's depositors and not its shareholders. The Bank is subject to periodic examination by the OCC and must file periodic reports with the OCC containing a complete statement of its financial condition and results of operations.

Deposit Insurance. The deposits of the Bank are insured by the Deposit Insurance Fund ("DIF") of the FDIC up to the limits set forth under applicable law and are subject to the deposit insurance premium assessments of the DIF. The FDIC imposes a risk-based deposit premium assessments system, which was amended pursuant to the Federal Deposit Insurance Reform Act of 2005 (the "Reform Act") and further amended by the Dodd-Frank Act. Under this system, as amended, the assessment rates for an insured depository institution vary according to the level of risk incurred in its activities. To arrive at an assessment rate for a banking institution, the FDIC places it in one of four risk categories determined by reference to its capital levels and supervisory ratings. In addition, in the case of those institutions in the lowest risk category, the FDIC further determines its assessment rate based on certain specified financial ratios or, if applicable, its long-term debt ratings. The assessment rate schedule can change from time to time, at the discretion of the FDIC, subject to certain limits. On November 12, 2009, the FDIC adopted a rule requiring banks to prepay deposit insurance premiums through 2012 to replenish the depleted insurance fund. In addition, all FDIC insured depository institutions are required to pay a pro rata portion of the interest due on the obligations issued by the Financing Corporation ("FICO") to fund the closing and disposal of failed thrift institutions by the Resolution Trust Corporation.

The Dodd-Frank Act changed the assessment formula for determining deposit insurance premiums and modified certain insurance coverage provisions of the FDIA. The FDIC's implementing rules, which redefined the base for FDIC insurance assessments from the amount of insured deposits to "average consolidated total assets less average tangible equity," became effective April 1, 2011. The Bank's total FDIC insurance assessment for 2012 was \$389,909.

The Dodd-Frank Act also permanently increased from \$100,000 to \$250,000 the maximum per depositor FDIC insurance amount and extended to December 31, 2012 the temporary unlimited deposit insurance coverage on noninterest bearing transaction accounts.

Brokered Deposits. Under FDICIA, an FDIC-insured bank is prohibited from accepting brokered deposits without prior approval of the FDIC unless it is well capitalized under the FDICIA's prompt corrective actions guidelines. In January of 2003, the Company entered into an agreement with Promontory Interfinancial Network (PIN) making it possible to offer our customers insurance protection for their deposits in excess of FDIC limits. This Certificate of Deposit Account Registry Service (CDARS) uses a deposit-matching engine to match CDARS deposits in other participating banks, dollar-for-dollar. This product is designed to enhance customer attraction and retention, build deposits and improve net interest margins, while providing additional FDIC coverage to customers. Promontory also offers member banks an opportunity to participate with one-way orders. Banks can either accept deposits as a surplus bank or place deposits in CDARS offered by banks seeking funding without matching funds. In June of 2010, the Company added Promontory's Insured Cash Sweep (ICS) account to the deposit-matching products available to customers through PIN. The PIN provides the Company an alternative source of funding or investment opportunities, while at the same time increasing the level of FDIC insurance available to deposit customers. The Company's Asset, Liability and Funds Management Policy limits the use of brokered deposits to 5% of total assets.

As of December 31, 2012 the Company had \$1,028,152 in CDARS deposits, all of which were exchanged deposits, and ICS deposits of \$13,529,424. CDARS are considered brokered deposits for certain purposes under the Federal Deposit Insurance Act and FDIC regulations.

Financial Privacy. Under the Gramm-Leach-Bliley Act (discussed above) all financial institutions, including the Company, are required to adopt privacy policies, restrict the sharing of nonpublic consumer customer data with nonaffiliated parties, and establish procedures and practices to protect customer data from unauthorized access. The Company is also subject to similar, but more stringent, requirements under state law, including the Vermont Financial Privacy Act. In addition, the Company is subject to the federal Fair Credit Reporting Act, including the amendments adopted in the federal Fair and Accurate Credit Transactions Act of 2003 (FACT Act). The FACT Act includes many provisions concerning national credit reporting standards and permits consumers to opt out of information sharing among affiliated companies for marketing purposes. It also requires financial institutions to notify their customers if they report negative information about them to a credit bureau or if they are granted credit terms less favorable than those generally available. The Federal Reserve and the OCC have extensive rulemaking authority under the FACT Act and have promulgated rules implementing the Act, including rules limiting information sharing for affiliate marketing and rules requiring programs to identify, detect and mitigate certain identity theft red flags. The Company is also subject to the requirements of the Vermont Fair Credit Reporting Act, which generally requires an individual's consent in order to obtain a credit report, and to data security standards and data breach notice requirements.

Other Consumer Protection and Community Reinvestment Laws The Bank is subject to a variety of federal and state laws intended to protect borrowers, depositors and other Bank customers and to promote lending to various sectors of the economy and population. These laws include, but are not limited to, the Federal Real Estate Settlement Procedures Act, the Federal Truth In Lending Act, the Federal and Vermont Equal Credit Opportunity Acts, the Federal Right to Financial Privacy Act, the Federal Truth in Savings Act, the Federal Electronic Funds Transfer Act, and the Federal Community Reinvestment Act ("CRA").

The CRA requires banks to define the communities they serve, identify the credit needs of those communities, collect and maintain data for each small business or small farm loan originated or purchased by the Bank, and maintain a Public File at each location. The federal banking regulators examine the institutions they regulate for compliance with the CRA and assign one of the following four ratings: "outstanding," "satisfactory," "needs to improve" or "substantial noncompliance". The rating assigned reflects the bank's record of helping to meet the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of the bank. As of the Bank's last CRA examination, completed during 2011, it received a rating of "outstanding".

Home Mortgage Disclosure Act The federal Home Mortgage Disclosure Act ("HMDA"), which is implemented by Federal Reserve Board Regulation C, requires mortgage lenders that maintain offices within Metropolitan Statistical Areas (MSAs) to report and make available to the public specified information regarding their residential mortgage lending activities, such as the pricing of home mortgage loans, including the "rate spread" between the interest rate on loans and certain treasury securities and other benchmarks. Community National Bank became subject to HMDA reporting requirements as a result of its merger with LyndonBank in 2007, as the former LyndonBank branch in Enosburg Falls in Franklin County is included within the Burlington, Vermont MSA.

Reserve Requirements Federal Reserve Board Regulation D requires all depository institutions to maintain reserves against their transaction accounts (generally, demand deposits, NOW accounts and certain other types of accounts that permit payments or transfers to third parties) or non-personal time deposits (generally, money market deposit accounts or other savings deposits held by corporations or other depositors that are not natural persons, and certain other types of time deposits), subject to certain exemptions. Because required reserves must be maintained in the form of either vault cash, a non-interest bearing account at the Federal Reserve Bank of Boston or a pass through account (as defined by the Federal Reserve Board), the effect of these reserve requirements is to reduce the amount of the Company's interest-bearing assets.

Management reviewed and reclassified the Company's deposits during 2012 and 2011, to the extent permissible under Regulation D, resulting in a reduction in required reserves compared to reserve levels in prior years.

Federal Home Loan Bank System Community National Bank is a member of the Federal Home Loan Bank System, which consists of 12 regional Federal Home Loan Banks. The Federal Home Loan Bank provides a central credit facility primarily for member institutions. Member institutions are required to purchase and hold shares of capital stock in the applicable regional Federal Home Loan Bank (the Federal Home Loan Bank of Boston, in the case of Community National Bank), in an amount at least equal to the sum of 0.35% of the aggregate principal amount of its unpaid residential mortgage loans and similar obligations at the beginning of each year and 4.5% of its advances (borrowings) from the Federal Home Loan Bank. Community National Bank was in compliance with this requirement with an investment in Federal Home Loan Bank of Boston (FHLBB) stock at December 31, 2012 of approximately \$3.4 million. During 2009, the FHLBB experienced significant net operating losses, and as a result temporarily ceased paying dividends on its stock and instituted a moratorium on stock repurchases and redemptions. In 2011, the FHLBB resumed paying dividends, but at a more modest rate than previous years and in February 2012 it lifted the moratorium on stock redemptions. As a member, the Bank is subject to future capital calls by the FHLBB in order to maintain compliance with its capital plan.

Executive Compensation Guidelines In October 2009, the Federal Reserve issued comprehensive guidance on executive compensation policies, intended to ensure that the incentive compensation practices of banking organizations do not undermine their safety and soundness by encouraging excessive risk-taking. The guidance covers all employees that have the ability to affect materially an institution's risk profile, either individually or as part of a group, and establishes that incentive compensation arrangements should (1) provide incentives that do not encourage risk-taking beyond the institution's ability to identify and manage effectively; (2) be compatible with effective internal controls and risk management; and (3) be supported by strong corporate governance, including active and effective oversight by the board of directors. The guidance instructed institutions to begin an immediate review of their incentive compensation policies to ensure that they do not encourage excessive risk-taking and implement corrective programs as needed. Where deficiencies in incentive compensation arrangements exist, they must be immediately addressed. For institutions such as the Company that are not "large, complex banking organizations" as defined in the guidance, the Federal Reserve will review the incentive compensation arrangements as part of its regular, risk-focused examination process and not in a separate examination. These examinations will be tailored to the scope and complexity of the institution's activity and compensation arrangements. The findings will be included in the Federal Reserve's examination report and deficiencies will be incorporated into the institution's supervisory ratings. Enforcement actions may be taken against an institution if its incentive compensation arrangements, or related risk management control or governance processes, pose a risk to the institution's safety and soundness and the institution fails to take prompt and effective measures to correct the deficiencies.

Pursuant to the Dodd-Frank Act, in February 2011, the federal banking agencies issued a joint proposed rulemaking imposing various restrictions on incentive compensation arrangements for institutions with over \$1 billion in assets. Although not directly applicable to smaller institutions such as the Company, the proposal will likely help set “best practices” at financial institutions of all sizes.

In addition to the statutes, regulations and regulatory initiatives described above, new legislation and regulations affecting financial institutions are frequently proposed. If enacted or adopted, these measures could change banking statutes and the Company's operating environment in substantial and unpredictable ways and could further increase reporting and compliance requirements, governance structures and costs of doing business. The Company cannot predict whether any such additional legislation or other regulatory initiatives will be adopted or the effect they may have on the Company's business, results of operations or financial condition.

Effects of Government Monetary Policy

The earnings of the Company are affected by general and local economic conditions and by the policies of various governmental regulatory authorities. In particular, the Federal Reserve Board regulates money supply, credit conditions and interest rates in order to influence general economic conditions, primarily through open market operations in United States Government Securities, varying the discount rate on member bank borrowings, setting reserve requirements against member and nonmember bank deposits, regulating interest rates payable by member banks on time and savings deposits and expanding or contracting the money supply. Federal Reserve Board monetary policies have had a significant effect on the operating results of commercial banks, including the Company, in the past and are expected to continue to do so in the future.

Other Available Information

This annual report on Form 10-K is on file with SEC. The Company also files with the SEC quarterly reports on Form 10-Q and current reports on Form 8-K, as well as proxy materials for its annual meetings of shareholders. You may obtain copies of these documents by visiting the SEC's Public Reference Room at 100F Street, NE, Washington, DC 20549-0213, by calling the SEC at 1-800-SEC-0330 or by accessing the SEC's website at <http://www.sec.gov>. The Company's SEC-filed reports and proxy statements are also available through a link on the Company's website at www.communitybancorpvt.com. The Company has also posted on its website the Company's Code of Ethics for Senior Financial Officers and the Principal Executive Officer; the Insider Trading Policy and the charters of the Audit, Compensation, and Nominating Committees. The information and documents contained on the Company's website do not constitute part of this report. Copies of the Company's reports filed with the SEC (other than exhibits) can also be obtained by contacting Chris Bumps, Corporate Secretary, at our principal offices, which are located at 4811 U.S. Route 5, Derby, Vermont 05829 or by calling (802) 334-7915.

ITEM 1A. RISK FACTORS

Omitted, in accordance with the regulatory relief available to smaller reporting companies in SEC Release Nos. 33-8876 and 34-56994 (effective February 4, 2008).

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not Applicable

ITEM 2. PROPERTIES

Although Community Bancorp. does not itself own or lease real property, the Bank owns and leases various properties for its banking operations. The Company's administrative offices are located at the main offices of the Bank in Derby, Vermont. All of the Bank's offices are located in Vermont. In addition to the main office in Derby, the Bank maintains branches in the Cities of Newport, Montpelier and Barre; the Towns of Barton, Troy, Lyndon, Enosburg, Morristown and St. Johnsbury, and the Villages of Island Pond, Derby Line, and Lyndonville.

The Bank's main offices are located on U.S. Route 5 in Derby, Vermont, with total office space of approximately 34,000 square feet, including an operations center as well as a community room used by the Bank for meetings and various functions. This community room has a secure outside access making it possible for the Bank to offer it to non-profit organizations after banking hours free of charge. This office is equipped with a remote drive-up facility and a drive-up ATM as well as an inside lobby ATM.

The Bank owns the Derby Line office located on Main Street in a renovated bank building. The facility consists of a small banking lobby of approximately 200 square feet with additional office space on the first and second floor. This office is also equipped with a walk-up ATM.

The Bank's Island Pond office is located in the renovated "Railroad Station" acquired by the town of Brighton in 1993. The Bank leases approximately two-thirds of the downstairs including a banking lobby, a drive-up window, and an ATM. The other portion of the downstairs is occupied by an information center, and the upstairs section houses the Island Pond Historical Society.

The Bank's Barton office is located on Church Street, in a renovated facility. This office is equipped with a banking lobby, a drive-up window, and an ATM. The lease was entered into in 1985 with an initial fifteen-year term, and was most recently renewed in 2000 for an additional 10 years. This lease is currently on a month to month basis, with negotiations on renewal terms in process.

The Bank owns condominium space in the state office building on Main Street in Newport to house its Newport office. The Bank occupies approximately 3,084 square feet on the first floor of the building for a full service banking facility equipped with an ATM and a remote drive-up facility. In addition, the Bank owns approximately 4,400 square feet on the second floor, a portion of which is leased to the Company's Trust Company affiliate, CFSG, with another portion leased to a law firm.

The Bank owns the Troy office located in the town of Troy. This building was built in 1986 and acquired by the Bank in 1992. This office is also equipped with an ATM to provide the same type of limited 24-hour accessibility as all of the other offices. The marketing department is also located at this facility.

One of the Company's two St. Johnsbury offices is located at the corner of the I-91 Access Road and Route 5 in the town of St. Johnsbury. The Bank occupies approximately 2,250 square feet in the front of the Price Chopper building. Fully equipped with an ATM and a drive-up window, this office operates as a full service banking facility. This space is leased on market terms from St. Johnsbury Properties, Inc., a wholly owned subsidiary of Murphy Realty Co. Inc. of St. Johnsbury. Peter Murphy, President of Murphy Realty, is a director of the Company and the Bank.

The second St. Johnsbury office is located on the southern end of Railroad Street, which consists of approximately 1,600 square feet. The Company leases the building that houses one office, customer service areas and a small meeting room. This is a full service facility consisting of a walk-up ATM in the front vestibule and a two-lane drive-up window.

The Bank leases approximately 1,500 square feet of office space for the Montpelier office located at 95 State Street in Montpelier. This office opened at the end of May, 2001, operating as a full service banking facility. Additional space is leased nearby at 99 State Street to accommodate a stand-alone drive-up ATM in a Kiosk building.

The Barre office is a two-story, 8,000 square foot building located at 316 North Main Street. The Bank owns this building which houses a full-service branch, a two-lane drive-up window, including a drive-up ATM, as well as an inside lobby ATM. The branch also includes an office leased to CFSG and a Community Room that is made available as a public service to outside non-profit groups to be used for meetings and gatherings at no charge.

The Bank owns an office located on Broad Street in Lyndonville. The building is approximately 6,200 square feet. The first floor is used for customer services and the second floor has clerical offices and a meeting room. The building is primarily constructed of brick with a front exterior of polished red granite. A walk-up ATM is located in the front entry vestibule.

The Memorial Drive office in the town of Lyndon is a full service banking facility consisting of approximately 2,600 square feet with a 3-lane drive-up, one of which is exclusively for night drops and ATM usage. This facility is leased on market terms from a neighboring business, 48 Broad Street, LLC, owned by David Stahler who is a member of Community National Bank's Caledonia County advisory board. CFSG leases office space in this building as well.

The Bank owns a full service banking office in Enosburg consisting of approximately 3,056 square feet and houses offices and customer service areas. The office has a drive-up ATM plus two additional drive-through banking lanes.

The Bank leases approximately 2,688 square feet of space for the Morrisville office located on Route 15 West in Morristown. It is a one story building with a walk-up ATM in the front vestibule and a two-lane drive-up window.

ITEM 3. LEGAL PROCEEDINGS

There are no pending legal proceedings to which the Company or the Bank is a party or of which any of its property is the subject, other than routine litigation incidental to its banking business, none of which is material to the Company's consolidated operations or financial condition.

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable

PART II.

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Information on the trading market in, market price of, and dividends paid on, the Company's common stock is incorporated by reference to the section of the Annual Report to Shareholders for 2012 under the caption "Common Stock Performance by Quarter" immediately following the "Management's Discussion and Analysis of Financial Condition and Results of Operations", filed as Exhibit 13 to this report. The balance of the information required by item 201 of Regulation S-K is omitted in accordance with the regulatory relief available to smaller reporting companies in SEC Release Nos. 33-8876 and 34-56994 (effective February 4, 2008).

During the fourth quarter ended December 31, 2012, there were no purchases of the Company's common stock by the Company or by any affiliated purchaser (as defined in SEC Rule 10b-18):

ITEM 6. SELECTED FINANCIAL DATA

Omitted, in accordance with the regulatory relief available to smaller reporting companies in SEC Release Nos. 33-8876 and 34-56994 (effective Feb. 4, 2008).

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Incorporated by reference to the section of the Annual Report to Shareholders for 2012 under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations," immediately following the "Notes to Consolidated Financial Statements", filed as Exhibit 13 to this report.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Incorporated by reference to the subsection labeled "Risk Management" of Management's Discussion and Analysis of Financial Condition and Results of Operations, contained in the Annual Report to Shareholders for 2012, filed as Exhibit 13 to this report.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The audited consolidated financial statements and related notes of Community Bancorp. and Subsidiary and the report thereon of the independent registered accounting firm of Berry Dunn McNeil & Parker, LLC are incorporated herein by reference from the Annual Report to Shareholders for 2012, filed as Exhibit 13 to this report.

In accordance with the regulatory relief available to smaller reporting companies in SEC Release Nos. 33-8876 and 34-56994 (effective Feb. 4, 2008), the Company has elected to present audited statements of income, cash flows and changes in shareholders' equity for each of the preceding two, rather than three, fiscal years.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Management is responsible for establishing and maintaining effective disclosure controls and procedures, as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the “Exchange Act”). As of December 31, 2012, an evaluation was performed under the supervision and with the participation of management, including the principal executive officer and principal financial officer, of the effectiveness of the design and operation of the Company’s disclosure controls and procedures. Based on that evaluation, management concluded that its disclosure controls and procedures as of December 31, 2012 were effective in ensuring that material information required to be disclosed in the reports it files with the Commission under the Exchange Act was recorded, processed, summarized, and reported on a timely basis.

Management’s Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining effective internal controls over financial reporting, as defined in Rule 13a-15(f) under the Exchange Act. As of December 31, 2012, an evaluation was performed under the supervision and with the participation of management, including the principal executive officer and principal financial officer, of the effectiveness of the design and operation of the Company’s internal controls over financial reporting. Management assessed the Company’s system of internal control over financial reporting as of December 31, 2012, in relation to criteria for effective internal control over financial reporting as described in “Internal Control – Integrated Framework,” issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management believes that, as of December 31, 2012, its system of internal control over financial reporting met those criteria and is effective.

This Annual Report does not include an attestation report of the Company’s independent registered public accounting firm regarding internal control over financial reporting. Management’s report is not subject to attestation by the Company’s independent registered public accounting firm pursuant to permanent relief accorded to smaller reporting companies in the Dodd-Frank Act.

Changes in Internal Control Over Financial Reporting

There were no changes in the Company’s internal control over financial reporting that occurred during the quarter ended December 31, 2012 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

Not Applicable

PART III.

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The following is incorporated by reference to the Company's Proxy Statement for the Annual Meeting of Shareholders to be held on May 14, 2013.

Listing of the names, ages, principal occupations, business experience and specific qualifications of the incumbent directors and nominees under the caption "PROPOSAL I AND 2 - ELECTION OF DIRECTORS."

Listing of the names, ages, titles and business experience of the executive officers under the caption EXECUTIVE OFFICERS."

Information regarding compliance with Section 16(a) of the Securities Exchange Act of 1934 under the caption "SHARE OWNERSHIP INFORMATION -Section 16(a) Beneficial Ownership Reporting Compliance."

Information regarding changes in the Company's procedures for submission of director nominations by shareholders under the caption "SHAREHOLDER NOMINATIONS AND OTHER PROPOSALS."

Information regarding whether a member of the Audit Committee qualifies as an audit committee financial expert under applicable SEC rules, under the caption "CORPORATE GOVERNANCE - Board Committees."

The Code of Ethics for Senior Financial Officers and the Principal Executive Officer is available on the Company's website at www.communitybancorpvt.com. The Code is also listed as Exhibit 14 to this report and incorporated by reference to a prior filing with the SEC. There were no waivers of any provision of the Code during 2012.

ITEM 11. EXECUTIVE COMPENSATION

The following is incorporated by reference to the Company's Proxy Statement for the Annual Meeting of Shareholders to be held on May 14, 2013:

Information regarding compensation of directors under the captions "PROPOSAL I AND 2 - ELECTION OF DIRECTORS - Directors' Fees and Other Compensation" and "-Directors' Deferred Compensation Plan."

Information regarding executive compensation and benefit plans under the caption "EXECUTIVE COMPENSATION."

Information regarding management interlocks and certain transactions under the caption "CORPORATE GOVERNANCE - Compensation Committee Interlocks and Insider Participation."

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The following is incorporated by reference to the Company's Proxy Statement for the Annual Meeting of Shareholders to be held on May 14, 2013:

Information regarding the share ownership of management and principal shareholders under the caption "SHARE OWNERSHIP INFORMATION."

The Company does not maintain any equity compensation plans for which disclosure is required under Item 201(d) of SEC Regulation S-K.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The following is incorporated by reference to the Company's Proxy Statement for the Annual Meeting of Shareholders to be held on May 14, 2013:

Information regarding transactions with management under the caption "CORPORATE GOVERNANCE -Transactions with Management."

Information regarding the independence of directors under the caption "CORPORATE GOVERNANCE – Director Independence."

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The following is incorporated by reference to the Company's Proxy Statement for the Annual Meeting of Shareholders to be held on May 14, 2013 under the caption "PROPOSAL 5- RATIFICATION OF SELECTION OF INDEPENDENT AUDITORS - Fees Paid to Independent Auditors":

Fees paid to the principal accountant for various audit functions including, but not limited to, the audit of the annual financial statements in the Company's Form 10-K Report and review of the financial statements in the Company's Form 10-Q Reports.

Description of the audit committee's pre-approval policies and procedures required by paragraph (c) (7)(I) of rule 2-01of Regulation S-X.

PART IV.

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) Financial Statements

The Company's audited consolidated financial statements and notes thereto and the report of Berry Dunn McNeil & Parker, LLC thereon, are incorporated by reference to the Annual Report to Shareholders for the years ended December 31, 2012 and 2011, filed as Exhibit 13 to this report.

(b) Exhibits

The following exhibits, previously filed with the Commission, are incorporated by reference:

Exhibit 3(i) - Amended and Restated Articles of Association, filed as Exhibit 3.1 to the Company's Form 8-K Report filed on July 12, 2010.

Exhibit 3(ii) – Certificate of Creation, Designation, Powers, Preferences, Rights, Privileges, Qualifications, Limitations, Restrictions, Terms and Conditions of the Series A Fixed-to-Floating Non-Cumulative Perpetual Preferred Stock, filed as Exhibit 3(i) to the Company's Form 8-K Report filed on December 31, 2007.

Exhibit 3(iii) - Amended and Restated By-laws of Community Bancorp. as amended and restated through March 12, 2013, filed as Exhibit 3.1 in the Company's Form 8-K Report filed on March 14, 2013.

Exhibit 4(i) – Indenture dated as of October 31, 2007 between Community Bancorp., as issuer and Wilmington Trust Company, as indenture trustee, filed as Exhibit 4.1 to the Company's Form 8-K Report filed on November 2, 2007.

Exhibit 4(ii) – Amended and Restated Declaration of Trust dated as of October 31, 2007 among Community Bancorp., as sponsor, Wilmington Trust Company, as Delaware and institutional Trustee, and the administrators named therein, filed as Exhibit 4.2 to the Company's Form 8-K Report filed on November 2, 2007.

Exhibit 10(i) – Guarantee Agreement dated as of October 31, 2007 between Community Bancorp., as guarantor and Wilmington Trust Company, as guarantee trustee, filed as Exhibit 10.1 to the Company's Form 8-K Report filed on November 2, 2007.

Exhibit 10(ii)* - Amended and Restated Deferred Compensation Plan for Directors, filed as Exhibit 10.2 to the Company's Form 8-K Report filed on December 15, 2008.

Exhibit 10(iii)* - Amended and Restated Supplemental Retirement Plan, filed as Exhibit 10.1 to the Company's Form 8-K Report filed on December 15, 2008.

Exhibit 10(iv)* - Amended and Restated Officer Incentive Plan, filed as Exhibit 10.1 to the Company's Form 8-K Report filed on February 14, 2011.

Exhibit 10(v)* - Description of the Directors Retirement Plan, filed as Exhibit 10(iv) to the Company's Form 10-K Report filed on March 30, 2005; plan terminated in 2005 with respect to future accruals, as disclosed in the Company's Form 8-K Report filed on December 19, 2005.

Exhibit 14 – Amended Code of Ethics for Senior Financial Officers and the Principal Executive Officer, filed as Exhibit 14 to the Company's Form 8-K Report on July 12, 2010.

The following exhibits are filed as part of this report:**

Exhibit 13 - Portions of the Annual Report to Shareholders of Community Bancorp. for 2012, specifically incorporated by reference into this report.

Exhibit 21 - Subsidiaries of Community Bancorp.

Exhibit 23 - Consent of Berry Dunn McNeil & Parker, LLC

Exhibit 31(i) - Certification from the Chief Executive Officer of the Company pursuant to section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 31(ii) - Certification from the Chief Financial Officer of the Company pursuant to section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 32(i) - Certification from the Chief Executive Officer of the Company pursuant to section 906 of the Sarbanes-Oxley Act of 2002

Exhibit 32(ii) - Certification from the Chief Financial Officer of the Company pursuant to section 906 of the Sarbanes-Oxley Act of 2002

Exhibit 101--The following materials from the Company's Annual Report on Form 10-K for the year ended December 31, 2012 formatted in eXtensible Business Reporting Language (XBRL): (i) the audited consolidated balance sheets, (ii) the audited consolidated statements of income, (iii) the audited consolidated statements of comprehensive income; (iv) the audited consolidated statements of changes in shareholders' equity, (v) the audited consolidated statements of cash flows and (vi) related notes, for the years ended December 31, 2012 and 2011.***

* Denotes compensatory plan or arrangement.

** Exhibit 12 (Statement re Computation of Ratios) is omitted in accordance with the regulatory relief available to smaller reporting companies in SEC Release Nos. 33-8876 and 34-56994 (effective February 4, 2008).

***This exhibit shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to the liability of that section, and shall not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934. As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

SIGNATURES

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

COMMUNITY BANCORP.

By: /s/ Stephen P. Marsh Date: March 28, 2013
Stephen P. Marsh, President
and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

By: /s/ Stephen P. Marsh Date: March 28, 2013
Stephen P. Marsh, President
and Chief Executive Officer

By: /s/ Louise M. Bonvechio Date: March 28, 2013
Louise M. Bonvechio, Treasurer
(Principal Financial Officer)

By: /s/ Candace A. Patenaude Date: March 28, 2013
Candace A. Patenaude
(Principal Accounting Officer)

COMMUNITY BANCORP. DIRECTORS

/s/ Thomas E. Adams Date: March 28, 2013
Thomas E. Adams

/s/ Charles W. Bucknam, Jr. Date: March 28, 2013
Charles W. Buckman, Jr.

/s/ Aminta K. Conant Date: March 28, 2013
Aminta K. Conant

/s/ Jacques R. Couture Date: March 28, 2013
Jacques R. Couture

/s/ Elwood G. Duckless Date: March 28, 2013
Elwood G. Duckless

/s/ Rosemary M. Lalime Date: March 28, 2013
Rosemary M. Lalime

/s/ Stephen P. Marsh Date: March 28, 2013
Stephen P. Marsh

/s/ Dorothy R. Mitchell Date: March 28, 2013
Dorothy R. Mitchell

/s/ Anne T. Moore Date: March 28, 2013
Anne T. Moore

/s/ Peter J. Murphy Date: March 28, 2013
Peter J. Murphy

/s/ Frederic Oeschger Date: March 28, 2013
Frederic Oeschger

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Shareholders
Community Bancorp. and Subsidiary

We have audited the accompanying consolidated balance sheets of Community Bancorp. and Subsidiary as of December 31, 2012 and 2011 and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Community Bancorp. and Subsidiary as of December 31, 2012 and 2011, and the consolidated results of their operations and their consolidated cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Berry Dunn McNeil & Parker, LLC

Portland, Maine
March 28, 2013
Vermont Registration No. 92-0000278

Portland, ME • Bangor, ME • Manchester, NH
www.berrydunn.com

Community Bancorp. and Subsidiary
Consolidated Balance Sheets

	<u>December 31</u> 2012	<u>December 31</u> 2011
Assets		
Cash and due from banks	\$ 11,273,575	\$ 23,459,776
Federal funds sold and overnight deposits	18,608,265	5,000
Total cash and cash equivalents	29,881,840	23,464,776
Securities held-to-maturity (fair value \$42,291,000 at December 31, 2012 and \$30,289,000 at December 31, 2011)	41,865,555	29,702,159
Securities available-for-sale	40,886,059	66,098,917
Restricted equity securities, at cost	4,021,350	4,308,550
Loans held-for-sale	1,501,706	2,285,567
Loans	416,375,448	386,386,472
Allowance for loan losses	(4,312,080)	(3,886,502)
Deferred net loan costs	169,501	7,251
Net loans	412,232,869	382,507,221
Bank premises and equipment, net	12,243,320	12,715,226
Accrued interest receivable	1,751,085	1,700,600
Bank owned life insurance	4,187,644	4,063,246
Core deposit intangible	1,363,476	1,704,346
Goodwill	11,574,269	11,574,269
Other real estate owned (OREO)	1,074,705	90,000
Prepaid expense - Federal Deposit Insurance Corporation (FDIC)	775,595	1,131,861
Other assets	12,378,772	11,558,779
Total assets	<u>\$575,738,245</u>	<u>\$552,905,517</u>
Liabilities and Shareholders' Equity		
Liabilities		
Deposits:		
Demand, non-interest bearing	\$ 72,956,097	\$ 62,745,782
NOW	128,824,165	123,493,475
Money market funds	86,973,835	71,408,069
Savings	65,216,698	59,284,631
Time deposits, \$100,000 and over	44,229,470	51,372,782
Other time deposits	77,296,594	86,088,570
Total deposits	475,496,859	454,393,309
Federal funds purchased and other borrowed funds	6,000,000	18,010,000
Repurchase agreements	34,149,608	21,645,446
Capital lease obligations	774,701	833,467
Junior subordinated debentures	12,887,000	12,887,000
Accrued interest and other liabilities	3,077,502	4,217,886
Total liabilities	<u>532,385,670</u>	<u>511,987,108</u>
Commitments and contingent liabilities (Notes 5, 15, 16, 17 and 20)		
Shareholders' Equity		
Preferred stock, 1,000,000 shares authorized, 25 shares issued and outstanding (\$100,000 liquidation value)	2,500,000	2,500,000
Common stock - \$2.50 par value; 10,000,000 shares authorized at December 31, 2012 and 2011, and 5,023,026 and 4,938,262 shares issued at December 31, 2012 and 2011, respectively (including 19,182 and 24,324 shares issued February 2, 2013 and 2012, respectively)	12,557,565	12,345,655
Additional paid-in capital	28,047,829	27,410,049
Retained earnings	2,698,200	1,151,751
Accumulated other comprehensive income	171,758	133,731
Less: treasury stock, at cost; 210,101 shares at December 31, 2012 and 2011	(2,622,777)	(2,622,777)
Total shareholders' equity	<u>43,352,575</u>	<u>40,918,409</u>
Total liabilities and shareholders' equity	<u>\$575,738,245</u>	<u>\$552,905,517</u>

The accompanying notes are an integral part of these consolidated financial statements.

Community Bancorp. and Subsidiary
Consolidated Statements of Income

For the Years Ended December 31,

	<u>2012</u>	<u>2011</u>
Interest income		
Interest and fees on loans	\$ 21,203,038	\$ 21,242,577
Interest on debt securities		
Taxable	533,018	357,437
Tax-exempt	992,413	996,387
Dividends	82,444	75,469
Interest on federal funds sold and overnight deposits	10,418	72,493
Total interest income	<u>22,821,331</u>	<u>22,744,363</u>
Interest expense		
Interest on deposits	3,408,441	4,064,057
Interest on federal funds purchased and other borrowed funds	355,377	415,647
Interest on repurchase agreements	144,244	141,667
Interest on junior subordinated debentures	974,257	974,257
Total interest expense	<u>4,882,319</u>	<u>5,595,628</u>
Net interest income	17,939,012	17,148,735
Provision for loan losses	1,000,000	1,000,000
Net interest income after provision for loan losses	<u>16,939,012</u>	<u>16,148,735</u>
Non-interest income		
Service fees	2,348,219	2,339,674
Income from sold loans	1,827,045	1,337,100
Other income from loans	899,849	722,554
Net realized gains on sale of securities available-for-sale	351,301	0
Other income	762,546	802,841
Total non-interest income	<u>6,188,960</u>	<u>5,202,169</u>
Non-interest expense		
Salaries and wages	6,178,891	5,841,453
Employee benefits	2,110,498	2,170,862
Occupancy expenses, net	3,295,752	3,068,071
FHLB prepayment fee	306,338	0
FDIC insurance	389,909	439,306
Amortization of core deposit intangible	340,870	426,086
Other expenses	6,244,512	5,587,304
Total non-interest expense	<u>18,866,770</u>	<u>17,533,082</u>
Income before income taxes	4,261,202	3,817,822
Income tax (benefit) expense	(139,488)	234,276
Net income	<u>\$ 4,400,690</u>	<u>\$ 3,583,546</u>
Earnings per common share	\$ 0.88	\$ 0.73
Weighted average number of common shares used in computing earnings per share	4,769,645	4,674,806
Dividends declared per common share	\$ 0.56	\$ 0.56
Book value per share on common shares outstanding at December 31,	\$ 8.49	\$ 8.13

The accompanying notes are an integral part of these consolidated financial statements.

Community Bancorp. and Subsidiary
Consolidated Statements of Comprehensive Income

For the Years Ended December 31,

	<u>2012</u>	<u>2011</u>
Net income	\$ 4,400,690	\$ 3,583,546
Other comprehensive income, net of tax:		
Change in unrealized holding (loss) gain on available-for-sale securities arising during the period	(293,685)	86,475
Reclassification adjustment for gains realized in income	351,301	0
Net change in unrealized gain	57,616	86,475
Tax effect	(19,589)	(29,401)
Other comprehensive income, net of tax	38,027	57,074
Total comprehensive income	<u>\$ 4,438,717</u>	<u>\$ 3,640,620</u>

The accompanying notes are an integral part of these consolidated financial statements.

COMMUNITY BANCORP. AND SUBSIDIARY
Consolidated Statements of Changes in Shareholders' Equity
Years Ended December 31, 2012 and 2011

	Common stock		Preferred stock	
	Shares	Amount	Shares	Amount
Balances, December 31, 2010	4,624,514	\$ 12,086,538	25	\$ 2,500,000
Comprehensive income				
Net income	0	0	0	0
Other comprehensive income	0	0	0	0
Total comprehensive income				
Cash dividends declared - common stock	0	0	0	0
Cash dividends declared - preferred stock	0	0	0	0
Issuance of common stock	103,647	259,117	0	0
Balances, December 31, 2011	4,728,161	12,345,655	25	2,500,000
Comprehensive income				
Net income	0	0	0	0
Other comprehensive income	0	0	0	0
Total comprehensive income				
Cash dividends declared - common stock	0	0	0	0
Cash dividends declared - preferred stock	0	0	0	0
Issuance of common stock	84,764	211,910	0	0
Balances, December 31, 2012	4,812,925	\$ 12,557,565	25	\$ 2,500,000

The accompanying notes are an integral part of these consolidated financial statements.

<u>Additional paid-in capital</u>	<u>Retained earnings</u>	<u>Accumulated other comprehensive income</u>	<u>Treasury stock</u>	<u>Total shareholders' equity</u>
\$ 26,718,403	\$ 368,848	\$ 76,657	\$ (2,622,777)	\$ 39,127,669
0	3,583,546	0	0	3,583,546
0	0	57,074	0	<u>57,074</u>
				<u>3,640,620</u>
0	(2,613,143)	0	0	(2,613,143)
0	(187,500)	0	0	(187,500)
<u>691,646</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>950,763</u>
27,410,049	1,151,751	133,731	(2,622,777)	40,918,409
0	4,400,690	0	0	4,400,690
0	0	38,027	0	<u>38,027</u>
				<u>4,438,717</u>
0	(2,666,741)	0	0	(2,666,741)
0	(187,500)	0	0	(187,500)
<u>637,780</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>849,690</u>
<u>\$ 28,047,829</u>	<u>\$ 2,698,200</u>	<u>\$ 171,758</u>	<u>\$ (2,622,777)</u>	<u>\$ 43,352,575</u>

Community Bancorp. and Subsidiary
Consolidated Statements of Cash Flows

For the Years Ended December 31,

	<u>2012</u>	<u>2011</u>
Cash Flows from Operating Activities:		
Net income	\$ 4,400,690	\$ 3,583,546
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization, bank premises and equipment	1,112,094	1,022,178
Provision for loan losses	1,000,000	1,000,000
Deferred income tax	(231,970)	(114,334)
Net gain on sale of securities available-for-sale	(351,301)	0
Net gain on sale of loans	(1,375,689)	(792,303)
Loss on sale of bank premises and equipment	4,583	0
(Gain) loss on sale of OREO	(15,139)	7,212
Gain on Trust LLC	(149,715)	(147,779)
Amortization of bond premium, net	514,934	399,486
Write down of OREO	0	10,000
Proceeds from sales of loans held-for-sale	48,721,888	41,847,797
Originations of loans held-for-sale	(46,562,338)	(40,977,123)
Decrease in taxes payable	(747,180)	(492,939)
(Increase) decrease in interest receivable	(50,485)	89,021
Amortization of FDIC insurance assessment	356,266	401,296
Decrease (increase) in mortgage servicing rights	87,819	(20,734)
(Increase) decrease in other assets	(799,545)	62,072
Increase in cash surrender value of bank owned life insurance	(124,398)	(129,915)
Amortization of core deposit intangible	340,870	426,086
Amortization of limited partnerships	1,214,839	615,864
Decrease in unamortized loan fees	(162,250)	(81,602)
Decrease in interest payable	(57,313)	(41,966)
Increase (decrease) in accrued expenses	155,052	(55,074)
Increase (decrease) in other liabilities	1,411	(321,870)
Net cash provided by operating activities	<u>7,283,123</u>	<u>6,288,919</u>
Cash Flows from Investing Activities:		
Investments - held-to-maturity		
Maturities and pay downs	29,136,655	46,799,907
Purchases	(41,300,051)	(39,061,352)
Investments - available-for-sale		
Maturities, calls, pay downs and sales	43,421,610	14,000,000
Purchases	(18,314,769)	(58,981,492)
Proceeds from redemption of restricted equity securities	287,200	0
(Decrease) increase in limited partnership contributions payable	(1,289,000)	1,816,000
Investments in limited partnerships	(213,830)	(2,779,260)
(Increase) decrease in loans, net	(31,945,256)	1,519,714
Capital expenditures, net of proceeds from sale of bank premises and equipment	(644,772)	(945,433)
Proceeds from sales of OREO	291,132	1,324,088
Recoveries of loans charged off	121,160	100,240
Net cash used in investing activities	<u>(20,449,921)</u>	<u>(36,207,588)</u>

	<u>2012</u>	<u>2011</u>
Cash Flows from Financing Activities:		
Net increase in demand and NOW accounts	15,541,005	21,711,190
Net increase in money market and savings accounts	21,497,833	760,602
Net decrease in time deposits	(15,935,288)	(6,270,746)
Net increase in repurchase agreements	12,504,162	2,537,631
Repayments on long-term borrowings	(12,010,000)	(15,000,000)
Decrease in capital lease obligations	(58,766)	(1,372)
Dividends paid on preferred stock	(187,500)	(187,500)
Dividends paid on common stock	(1,767,584)	(1,614,647)
Net cash provided by financing activities	<u>19,583,862</u>	<u>1,935,158</u>
Net increase (decrease) in cash and cash equivalents	6,417,064	(27,983,511)
Cash and cash equivalents:		
Beginning	23,464,776	51,448,287
Ending	<u>\$ 29,881,840</u>	<u>\$ 23,464,776</u>
Supplemental Schedule of Cash Paid During the Period		
Interest	<u>\$ 4,939,632</u>	<u>\$ 5,637,594</u>
Income taxes	<u>\$ 800,000</u>	<u>\$ 841,550</u>
Supplemental Schedule of Noncash Investing and Financing Activities:		
Change in unrealized gain on securities available-for-sale	<u>\$ 57,616</u>	<u>\$ 86,475</u>
Loans transferred to OREO	<u>\$ 1,260,698</u>	<u>\$ 221,000</u>
Investments in limited partnerships		
Investments in limited partnerships	\$ (213,830)	\$ (2,779,260)
(Decrease) increase in limited partnership contributions payable	(1,289,000)	1,816,000
	<u>\$ (1,502,830)</u>	<u>\$ (963,260)</u>
Common Shares Dividends Paid		
Dividends declared	\$ 2,666,741	\$ 2,613,143
Increase in dividends payable attributable to dividends declared	(49,467)	(47,733)
Dividends reinvested	(849,690)	(950,763)
	<u>\$ 1,767,584</u>	<u>\$ 1,614,647</u>

The accompanying notes are an integral part of these consolidated financial statements.

COMMUNITY BANCORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Significant Accounting Policies

The accounting policies of Community Bancorp. and Subsidiary ("Company") are in conformity, in all material respects, with accounting principles generally accepted in the United States of America ("US GAAP") and general practices within the banking industry. The following is a description of the Company's significant accounting policies.

Basis of presentation and consolidation

The consolidated financial statements include the accounts of Community Bancorp. and its wholly-owned subsidiary, Community National Bank ("Bank"). All significant intercompany accounts and transactions have been eliminated. The Company is considered a "smaller reporting company" under applicable disclosure rules of the Securities and Exchange Commission and accordingly, has elected to provide its audited statements of income, comprehensive income, cash flows and changes in shareholders' equity for a two year, rather than a three year, period.

Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 810, "Consolidation", in part, addresses limited purpose trusts formed to issue trust preferred securities. It also establishes the criteria used to identify variable interest entities ("VIE") and to determine whether or not to consolidate a VIE. In general, ASC Topic 810 provides that the enterprise with the controlling financial interest, known as the primary beneficiary, consolidates the VIE. In 2007 the Company formed CMTV Statutory Trust I for the purposes of issuing trust preferred securities to unaffiliated parties and investing the proceeds from the issuance thereof and the common securities of the trust in junior subordinated debentures issued by the Company. The Company is not the primary beneficiary of CMTV Statutory Trust I; accordingly, the trust is not consolidated with the Company for financial reporting purposes. CMTV Statutory Trust I is considered an affiliate of the Company (see Note 10).

In December 2011, the Company formed a limited liability company ("LLC") to facilitate its purchase of federal New Markets Tax Credits ("NMTC") under an investment structure designed by a local community development entity. Management has evaluated the Company's interest in the LLC under the ASC guidance relating to VIEs in light of the overall structure and purpose of the NMTC financing transaction and has concluded that the LLC should not be consolidated in the Company's financial statements for financial reporting purposes, as the Company is not the primary beneficiary of the NMTC structure, does not exercise control within the overall structure and is not obligated to absorb a majority of any losses of the NMTC structure.

Nature of operations

The Company provides a variety of deposit and lending services to individuals, municipalities, and corporate customers through its branches, ATMs and telephone and internet banking capabilities in northern and central Vermont, which is primarily a small business and agricultural area. The Company's primary deposit products are checking and savings accounts and certificates of deposit. Its primary lending products are commercial, real estate, municipal and consumer loans.

Concentration of risk

The Company's operations are affected by various risk factors, including interest rate risk, credit risk, and risk from geographic concentration of its deposit taking and lending activities. Management attempts to manage interest rate risk through various asset/liability management techniques designed to match maturities and repricing of assets and liabilities. Loan policies and administration are designed to provide assurance that loans will only be granted to creditworthy borrowers, although credit losses are expected to occur because of subjective factors and factors beyond the control of the Company. While the Company has a diversified loan portfolio by loan type, most of its lending activities are conducted within the geographic area where its banking offices are located. As a result, the Company and its borrowers may be especially vulnerable to the consequences of changes in the local economy in northern and central Vermont. In addition, a substantial portion of the Company's loans are secured by real estate, which is susceptible to a decline in value, especially during times of adverse economic conditions.

Use of estimates

The preparation of consolidated financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates and assumptions involve inherent uncertainties. Accordingly, actual results could differ from those estimates and those differences could be material.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses and the valuation of OREO. In connection with evaluating loans for impairment or assigning the carrying value of OREO, management generally obtains independent evaluations or appraisals for significant properties. While the allowances for loan losses and OREO represent management's best estimate of probable loan and OREO losses as of the balance sheet date, the ultimate collectibility of a substantial portion of the Company's loan portfolio and the recovery of a substantial portion of the fair value of OREO are susceptible to uncertainties and changes in a number of factors, especially local real estate market conditions. The amount of the change that is reasonably possible cannot be estimated.

While management uses available information to recognize losses on loans and OREO, future additions to the allowances may be necessary based on changes in local economic conditions or other relevant factors. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company's allowances for losses on loans and OREO. Such agencies may require the Company to recognize additions to the allowances based on their judgment about information available to them at the time of their examination.

Mortgage servicing rights associated with loans originated and sold in the secondary market, where servicing is retained, are capitalized and included in other assets in the consolidated balance sheets. Mortgage servicing rights are amortized into non-interest income in proportion to, and over the period of, estimated future net servicing income of the underlying loans. The value of capitalized servicing rights represents the present estimated value of the future servicing fees arising from the right to service loans in the portfolio. The carrying value of the mortgage servicing rights is periodically reviewed for impairment based on a determination of estimated fair value as compared to amortized cost, and impairment, if any, is recognized through a valuation allowance and is recorded as a write down. Critical accounting policies for mortgage servicing rights relate to the initial valuation and subsequent impairment tests. The methodology used to determine the valuation of mortgage servicing rights requires the development and use of a number of estimates, including anticipated principal amortization and prepayments of that principal balance. Events that may significantly affect the estimates used are changes in interest rates and the payment performance of the underlying loans.

Management evaluates securities for other-than-temporary impairment on at least a quarterly basis, and more frequently when economic or market conditions warrant such evaluation. Consideration is given to various factors, including the length of time and the extent to which the fair value has been less than cost; the nature of the issuer and its financial condition and near-term prospects; and the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. The evaluation of these factors is a subjective process 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.

Management utilizes numerous techniques to estimate the carrying value of various other assets held by the Company, including, but not limited to, bank premises and equipment and deferred taxes. The assumptions considered in making these estimates are based on historical experience and on various other factors that are believed by management to be reasonable under the circumstances. Management acknowledges that the use of different estimates or assumptions could produce different estimates of carrying values.

Accounting for a business combination that was completed prior to 2009 requires the application of the purchase method of accounting. Under the purchase method, the Company was required to record the assets and liabilities acquired through the LyndonBank merger in 2007 at fair market value, with the excess of the purchase price over the fair market value of the net assets recorded as goodwill and evaluated annually for impairment. The determination of the fair value of the acquired LyndonBank assets and liabilities requires the use of numerous assumptions, including discount rates, changes in which could significantly affect fair values.

Presentation of cash flows

For purposes of presentation in the consolidated statements of cash flows, cash and cash equivalents includes cash on hand, amounts due from banks (including cash items in process of clearing), federal funds sold (generally purchased and sold for one day periods) and overnight deposits.

Investment securities

Securities the Company has the positive intent and ability to hold to maturity are classified as held-to-maturity and reported at amortized cost. Debt and equity securities not classified as held-to-maturity are classified as available-for-sale. Investments classified as available-for-sale are carried at fair value, with unrealized gains and losses, net of tax and reclassification adjustments, reflected as a net amount in the statements of changes in shareholders' equity. Investment securities transactions are accounted for on a trade date basis. The specific identification method is used to determine realized gains and losses on sales of securities available-for-sale. Premiums and discounts are recognized in interest income using the interest method over the period to maturity or call date. The Company does not hold any securities purchased for the purpose of selling in the near term and classified as trading.

Declines in the fair value of individual equity securities that are deemed to be other than temporary are reflected in earnings when identified. For individual debt securities where the Company does not intend to sell the security and it is not more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis, the other-than-temporary decline in the fair value of the debt security related to (1) credit loss is recognized in earnings and (2) other factors is recognized in other comprehensive income or loss. Credit loss is deemed to exist if the present value of expected future cash flows using the interest rates at acquisition is less than the amortized cost basis of the debt security. For individual debt securities where the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost, the other-than-temporary impairment is recognized in earnings equal to the entire difference between the security's cost basis and its fair value at the balance sheet date.

Other investments

On December 19, 2011, the Company made an equity investment in a NMTC financing structure, as discussed further in Note 7 of this report. The Company's investment in the NMTC is amortized using the effective yield method.

The Company acquires partnership interests in limited partnerships for low income housing projects. The investments in limited partnerships are amortized using the effective yield method.

The Company has a one-third ownership interest in Community Financial Services Group, LLC ("CFSG"), a non-depository trust company, as discussed further in Note 7 of this report. The Company's investment in CFSG is accounted for under the equity method of accounting.

Restricted equity securities

Restricted equity securities are comprised of Federal Reserve Bank stock and Federal Home Loan Bank stock. These securities are carried at cost. As a member of the Federal Reserve Bank of Boston ("FRBB"), the Company is required to invest in FRBB stock in an amount equal to 6% of the Bank's capital stock and surplus.

As a member of the Federal Home Loan Bank of Boston ("FHLBB"), the Company is required to invest in \$100 par value stock of the FHLBB in an amount that approximates 1% of unpaid principal balances on qualifying loans, plus an additional amount to satisfy an activity based requirement. The stock is nonmarketable and redeemable at par value, subject to the FHLBB's right to temporarily suspend such redemptions. Members are subject to capital calls in some circumstances to ensure compliance with the FHLBB's capital plan.

Loans held-for-sale

Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value in the aggregate. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income.

Loans

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding principal adjusted for any charge-offs, the allowance for loan losses, loan premiums or discounts for acquired loans and any unearned fees or costs on originated loans.

Loan interest income is accrued daily on the outstanding balances. On all classes of loans the accrual of interest is discontinued when a loan is specifically determined to be impaired or when the loan is delinquent 90 days and management believes, after considering collection efforts and other factors, that the borrower's financial condition is such that collection of interest is doubtful. Any unpaid interest previously accrued on those loans is reversed from income. Interest income is generally not recognized on specific impaired loans unless the likelihood of further loss is remote. Interest payments received on impaired loans are generally applied as a reduction of the loan principal balance. Loans are returned to accrual status when principal and interest payments are brought current and the customer has demonstrated the ability to make future payments on a timely basis. Loans are written down or charged off when collection of principal is considered doubtful. Past due status is determined on a contractual basis.

Loan origination and commitment fees and certain direct loan origination costs are deferred and the net amount amortized as an adjustment of the related loan's yield. The Company generally amortizes these amounts over the contractual life of the loans.

Loan premiums and discounts on loans acquired in the merger with LyndonBank are amortized as an adjustment to yield over the life of the loans.

Allowance for loan losses

The allowance for loan losses is established through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is probable. Subsequent recoveries, if any, are credited to the allowance.

As described below, the allowance consists of general, specific and unallocated components. However, the entire allowance is available to absorb losses in the loan portfolio, regardless of specific, general and unallocated components considered in determining the amount of the allowance.

General component

The general component of the allowance for loan losses is based on historical loss experience, adjusted for qualitative factors and stratified by the following loan segments: commercial and industrial, commercial real estate, residential real estate first ("1st") lien, residential real estate junior ("Jr") lien and consumer loans. The Company does not disaggregate its portfolio segments further into classes. Loss ratios are calculated by loan segment for one year, two year and five year look back periods. The highest loss ratio among these look-back periods is then applied against the respective segment. Management uses an average of historical losses based on a time frame appropriate to capture relevant loss data for each loan segment. This historical loss factor is adjusted for the following qualitative factors: levels of and trends in delinquencies and non-performing loans, levels of and trends in loan risk groups, trends in volumes and terms of loans, effects of any changes in loan related policies, experience, ability and the depth of management, documentation and credit data exception levels, national and local economic trends, external factors such as competition and regulation and lastly, concentrations of credit risk in a variety of areas, including portfolio product mix, the level of loans to individual borrowers and their related interests, loans to industry segments, and the geographic distribution of commercial real estate loans. This evaluation is inherently subjective as it requires estimates that are susceptible to revision as more information becomes available.

During the fourth quarter of 2011 the Company modified its allowance methodology by further segmenting the residential real estate portfolio into 1st lien residential mortgages and Jr lien residential mortgages, also known as home equity loans. No additional allowance was estimated as the modification was made to allow the Company to more closely monitor and appropriately reserve for the risk inherent with home equity lending, given the modest repayment requirements, relaxed documentation compared to first lien residential mortgage loans, higher loan to value ratios, subordinate lien position, and recent decline of home property values. No changes in the Company's policies or methodology pertaining to the general component for loan losses were made during 2012.

The qualitative factors are determined based on the various risk characteristics of each loan segment. The Company has policies, procedures and internal controls that management believes are commensurate with the risk profile of each of these segments. Major risk characteristics relevant to each portfolio segment are as follows:

Commercial & Industrial – Loans in this segment include commercial and industrial loans and to a lesser extent loans to finance agricultural production. Commercial loans are made to businesses and are generally secured by assets of the business, including trade assets and equipment. While not the primary collateral, in many cases these loans may also be secured by the real estate of the business. Repayment is expected from the cash flows of the business. A weakened economy, soft consumer spending, unfavorable foreign trade conditions and the rising cost of labor or raw materials are examples of issues that can impact the credit quality in this segment.

Commercial Real Estate – Loans in this segment are principally made to businesses and are generally secured by either owner-occupied, or non-owner occupied commercial real estate. A relatively small portion of this segment includes farm loans secured by farm land and buildings. As with commercial and industrial loans, repayment of owner-occupied commercial real estate loans is expected from the cash flows of the business and the segment would be impacted by the same risk factors as commercial and industrial loans. The non-owner occupied commercial real estate portion includes both residential and commercial construction loans, vacant land and real estate development loans, multi-family dwelling loans and commercial rental property loans. Repayment of construction loans is expected from permanent financing takeout; the Company generally requires a commitment or eligibility for the take-out financing prior to construction loan origination. Real estate development loans are generally repaid from the sale of the subject real property as the project progresses. Construction and development lending entail additional risks, including the project exceeding budget, not being constructed according to plans, not receiving permits, or the pre-leasing or occupancy rate not meeting expectations. Repayment of multi-family loans and commercial rental property loans is expected from the cash flow generated by rental payments received from the individuals or businesses occupying the real estate. Commercial real estate loans are impacted by factors such as competitive market forces, vacancy rates, cap rates, net operating incomes, lease renewals and overall economic demand. In addition, loans in the recreational and tourism sector can be affected by weather conditions, such as unseasonably low winter snowfalls. Commercial real estate lending also carries a higher degree of environmental risk than other real estate lending.

Residential Real Estate - 1st Lien – All loans in this segment are collateralized by first mortgages on 1 – 4 family owner-occupied residential real estate and repayment is dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, has an impact on the credit quality of this segment.

Residential Real Estate – Jr Lien – All loans in this segment are collateralized by junior lien mortgages on 1 – 4 family residential real estate and repayment is primarily dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, has an impact on the credit quality of this segment.

Consumer – Loans in this segment are made to individuals for consumer and household purposes. This segment includes both loans secured by automobiles and other consumer goods, as well as loans that are unsecured. This segment also includes overdrafts, which are extensions of credit made to both individuals and businesses to cover temporary shortages in their deposit accounts and are generally unsecured. The Company maintains policies restricting the size and length of these extensions of credit. The overall health of the economy, including unemployment rates, has an impact on the credit quality of this segment.

Specific component

The specific component of the allowance for loan losses relates to loans that are impaired. A specific allowance is established when a loan's impaired basis is less than the carrying value of the loan. For all loan segments, except consumer loans, a loan is considered impaired when, based on current information and events, in management's estimation it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Impaired loans are loan(s) to a borrower that in the aggregate are greater than \$100,000 and that are in non-accrual status or are troubled debt restructurings ("TDR"). Factors considered by management in determining impairment include payment status, collateral value and probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant or temporary payment delays and payment shortfalls generally are not classified as impaired. Management evaluates the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length and frequency of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis, by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Impaired loans also include troubled loans that are restructured. A TDR occurs when the Company, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower that would otherwise not be granted. TDRs may include the transfer of assets to the Company in partial satisfaction of a troubled loan, a modification of a loan's terms, or a combination of the two.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer loans for impairment evaluation, unless such loans are subject to a restructuring agreement.

Unallocated component

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

Bank premises and equipment

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed principally by the straight-line method over the estimated useful lives of the assets. The cost of assets sold or otherwise disposed of, and the related accumulated depreciation, are eliminated from the accounts and the resulting gains or losses are reflected in the consolidated statements of income. Maintenance and repairs are charged to current expense as incurred and the cost of major renewals and betterments is capitalized.

Other real estate owned

Real estate properties acquired through or in lieu of loan foreclosure or properties no longer used for bank operations are initially recorded at fair value less estimated selling cost at the date of acquisition, foreclosure or transfer. Such properties are carried at fair value, which is the market value less estimated cost of disposition, i.e. sales commissions and costs associated with the sale. Fair value is determined, as appropriate, either by obtaining a current appraisal or evaluation prepared by an independent, qualified appraiser, by obtaining a Market Value Analysis, and finally, if the Company has limited exposure and limited risk of loss, by the opinion of management as supported by an inspection of the property and its most recent tax valuation. Under recent and current market conditions, and periods of declining market values, the Company will generally obtain a new appraisal or evaluation. Any write-down based on the asset's fair value at the date of acquisition or institution of foreclosure is charged to the allowance for loan losses. After acquisition through or in lieu of foreclosure, these assets are carried at their new cost basis. Costs of significant property improvements are capitalized, whereas costs relating to holding the property are expensed as incurred. Appraisals by an independent, qualified appraiser are performed periodically on properties that management deems significant, or evaluations may be performed by management or a qualified third party on properties in the portfolio that are less vulnerable to market conditions. Subsequent write-downs are recorded as a charge to other expense. Gains or losses on the sale of such properties are included in income when the properties are sold.

Intangible assets

Intangible assets include the excess of the purchase price over the fair value of net assets acquired (goodwill) in the 2007 acquisition of LyndonBank, as well as a core deposit intangible related to the deposits acquired from LyndonBank (see Note 6). The core deposit intangible is amortized on an accelerated basis over 10 years to approximate the pattern of economic benefit to the Company. The Company evaluates the valuation and amortization of the core deposit intangible asset if events occur that could result in possible impairment. Goodwill is reviewed for impairment annually, or more frequently as events or circumstances warrant.

Income taxes

The Company recognizes income taxes under the asset and liability method. Under this method, deferred tax assets and liabilities are established for the temporary differences between the accounting bases and the tax bases of the Company's assets and liabilities at enacted tax rates expected to be in effect when the amounts related to such temporary differences are realized or settled. Adjustments to the Company's deferred tax assets are recognized as deferred income tax expense or benefit based on management's judgments relating to the realizability of such asset.

Mortgage servicing

Servicing assets are recognized as separate assets when rights are acquired through purchase or retained upon the sale of loans. Capitalized servicing rights are reported in other assets and are amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans. Servicing rights are periodically evaluated for impairment, based upon the estimated fair value of the rights as compared to amortized cost. Impairment is determined by stratifying the rights by predominant characteristics, such as interest rates and terms. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions. Impairment is recognized through a valuation allowance and is recorded as amortization of other assets, to the extent that estimated fair value is less than the capitalized amount. Subsequent improvement, if any, in the estimated fair value of impaired mortgage servicing rights is reflected in a positive valuation adjustment and is recognized in other income up to (but not in excess of) the amount of the prior impairment.

Pension costs

Pension costs are charged to salaries and employee benefits expense and accrued over the active service period.

Advertising costs

The Company expenses advertising costs as incurred.

Comprehensive income

Accounting principles generally require recognized revenue, expenses, gains and losses to be included in net income. Certain changes in assets and liabilities, such as the after-tax effect of unrealized gains and losses on available-for-sale securities, are not reflected in the statement of income, but the cumulative effect of such items from period-to-period is reflected as a separate component of the shareholders' equity section of the balance sheet (accumulated other comprehensive income or loss). Other comprehensive income or loss, along with net income, comprises the Company's total comprehensive income.

Preferred stock

The Company issued 25 shares of fixed-to-floating rate non-cumulative perpetual preferred stock, without par value and with a liquidation preference of \$100,000 per share, on December 27, 2007. Under the terms of the preferred stock, the Company pays non-cumulative cash dividends quarterly, when, as and if declared by the Board of Directors. Dividends are payable at a fixed rate of 7.50% per annum for the first five years, and thereafter at a variable dividend rate at the Wall Street Journal Prime Rate in effect on the first business day of each quarterly dividend period. The first dividend using the variable rate calculation is payable on March 31, 2013 with a variable rate of 3.25%.

Earnings per common share

Earnings per common share amounts are computed based on the weighted average number of shares of common stock issued during the period, including Dividend Reinvestment Plan ("DRIP") shares issuable upon reinvestment of dividends (retroactively adjusted for any stock dividends declared) and reduced for shares held in treasury.

The following table illustrates the calculation for the years ended December 31, as adjusted for the cash dividend declared on the preferred stock:

	<u>2012</u>	<u>2011</u>
Net income, as reported	\$ 4,400,690	\$ 3,583,546
Less: dividends to preferred shareholders	187,500	187,500
Net income available to common shareholders	<u>\$ 4,213,190</u>	<u>\$ 3,396,046</u>
Weighted average number of common shares used in calculating earnings per share	4,769,645	4,674,806
Earnings per common share	\$ 0.88	\$ 0.73

Off-balance-sheet financial instruments

In the ordinary course of business, the Company is a party to off-balance-sheet financial instruments consisting of commitments to extend credit, commercial and municipal letters of credit, standby letters of credit, and risk-sharing commitments on residential mortgage loans sold through the FHLBB's Mortgage Partnership Finance ("MPF") program. Such financial instruments are recorded in the consolidated financial statements when they are funded.

Transfers of financial assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Reclassification

Certain amounts in the 2011 financial statements have been reclassified to conform to the current year presentation.

Impact of recently issued accounting standards

In April 2011, the FASB issued Accounting Standards Update ("ASU") 2011-03, "Reconsideration of Effective Control for Repurchase Agreements," amending the criteria under ASC Topic 860 for determining whether the transferor under a repurchase agreement involving a financial asset has retained effective control over the financial asset and therefore must account for the transaction as a secured borrowing rather than a sale. The guidance removes from the effective control criteria the consideration of whether the transferor has the ability to repurchase or redeem the financial asset on substantially the agreed terms. The guidance is applied prospectively and is effective for new transactions and for existing transactions that are modified as of the beginning of the first interim or annual period beginning on or after December 15, 2011. Adoption of ASU 2011-03 did not have a material impact on the Company's consolidated financial statements.

In May 2011, the FASB issued ASU 2011-04, "Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in United States Generally Accepted Accounting Principles (US GAAP) and IFRS," amending ASC Topic 820. Although ASU 2011-04 deals primarily with development of a single fair value framework for US GAAP and International Financial Reporting Standards, the ASU also contains additional guidance on fair value measurements. Among other things, ASU 2011-04: clarifies how a principal market is determined; addresses the fair value measurement or counterparty credit risks and the concept of valuation premise and highest and best use of nonfinancial assets; prescribes a model for measuring the fair value of an instrument classified in shareholders' equity; limits the use of premiums or discounts based on the size of a holding; and requires certain new disclosures, including disclosures of all transfers between Levels 1 and 2 of the fair value hierarchy, whether or not significant, and additional disclosures regarding unobservable inputs and valuation processes for Level 3 measurements. The guidance in ASU 2011-04 is to be applied prospectively, and is effective for interim and annual periods beginning on or after December 15, 2011. Adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In June 2011, the FASB issued ASU 2011-05, "Presentation of Comprehensive Income," amending Topic 220. The ASU provides that an entity has the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The Company has chosen the latter option. This ASU eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders' equity. The ASU does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income, nor does it require any transition disclosures. The amendments in this ASU are applied retrospectively, and are effective for fiscal years and interim periods beginning after December 15, 2011. In December 2011, the FASB issued ASU No. 2011-12, "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", which defers the effective date of a requirement in ASU 2011-05 related to reclassifications of items out of accumulated other comprehensive income. The deferral of the effective date was made to allow the FASB time to consider whether to require presentation on the face of the financial statements of the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. Adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In September 2011, the FASB issued ASU 2011-08, "Testing Goodwill for Impairment," amending Topic 350. The guidance changes the manner of testing of goodwill for impairment by providing an entity with the option of first assessing qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not (more than 50%) that the fair value of a reporting unit is less than its carrying amount. Such qualitative factors may include the following: macroeconomic conditions; industry and market considerations; cost factors; overall financial performance; and other relevant entity-specific events. If an entity elects to perform a qualitative assessment and determines that an impairment is more likely than not, the entity is then required to perform the existing two-step quantitative impairment test; otherwise, no further analysis is required. An entity also may elect not to perform the qualitative assessment and instead go directly to the two-step quantitative impairment test. These changes are effective for fiscal years beginning on or after December 15, 2011. Adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In December 2011, the FASB issued ASU 2011-11, "Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities," amending Topic 210. The amendments require an entity to disclose both gross and net information about both instruments and transactions that are eligible for offset on the balance sheet and instruments and transactions that are subject to an agreement similar to a master netting arrangement. This guidance is effective for annual periods beginning on or after January 1, 2013 and interim periods within those annual periods, with retrospective disclosure for all comparative periods presented. The Company is evaluating the impact of ASU 2011-11 but does not expect that adoption of the ASU will have a material impact on the Company's consolidated financial statements.

In July 2012, the FASB issued ASU 2012-02, "Intangibles-Goodwill and Other (Topic 35): Testing Indefinite-Lived Intangible Assets for Impairment," amending Topic 350. The guidance allows entities to first perform an optional qualitative assessment to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired in order to determine whether the asset should be further evaluated under quantitative impairment testing. The guidance does not revise the requirement that indefinite-lived intangible assets be tested for impairment at least annually, or more frequently if circumstances warrant, although it does revise the examples of events and circumstances that an entity should consider during interim periods. The ASU is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, although early adoption is permitted. The Company is evaluating the impact of ASU 2012-02 but does not expect its adoption will have a material impact on the Company's consolidated financial statements.

In February 2013, the FASB issued ASU 2013-02, "Comprehensive Income (Topic 220): Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income." This ASU improves the reporting of reclassifications out of accumulated other comprehensive income. The amendments in the ASU seek to attain that objective by requiring an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under US GAAP to be reclassified in its entirety to net income. For other amounts that are not required under US GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under US GAAP that provide additional detail about those amounts. This guidance is effective for reporting periods beginning after December 15, 2012, with early adoption permitted. Other than matters of presentation, the Company believes the adoption of this new guidance will not have a material effect on the Company's consolidated financial statements.

Note 2. Investment Securities

Securities available-for-sale (AFS) and held-to-maturity (HTM) consist of the following:

Securities AFS	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2012				
U.S. Government sponsored enterprise (GSE) debt securities	\$ 33,552,376	\$ 247,029	\$ 13,936	\$ 33,785,469
U.S. Government securities	7,073,445	28,217	1,072	7,100,590
	<u>\$ 40,625,821</u>	<u>\$ 275,246</u>	<u>\$ 15,008</u>	<u>\$ 40,886,059</u>

December 31, 2011				
U.S. GSE debt securities	\$ 60,846,954	\$ 215,595	\$ 99,310	\$ 60,963,239
U.S. Government securities	5,006,979	37,424	848	5,043,555
U.S. GSE preferred stock	42,360	49,763	0	92,123
	<u>\$ 65,896,293</u>	<u>\$ 302,782</u>	<u>\$ 100,158</u>	<u>\$ 66,098,917</u>

Securities HTM	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value*
December 31, 2012				
States and political subdivisions	\$ 41,865,555	\$ 425,445	\$ 0	\$ 42,291,000

December 31, 2011				
States and political subdivisions	\$ 29,702,159	\$ 586,841	\$ 0	\$ 30,289,000

*Method used to determine fair value rounds values to nearest thousand.

The entire balance under "Securities HTM - States and political subdivisions" consists of securities of local municipalities which are attributable to private financing transactions with the Company. The reported fair value of these securities is an estimate based on an analysis that takes into account future maturities and scheduled future repricing. The Company anticipates no losses on these securities and expects to hold them until their maturity.

Securities AFS with a book value of \$40,625,821 and \$28,236,279 and a fair value of \$40,886,059 and \$28,425,092 at December 31, 2012 and 2011, respectively, were pledged as collateral for larger dollar repurchase agreement accounts and for other purposes as required or permitted by law.

Proceeds from sales of securities AFS were \$36,421,608 in 2012 with gains of \$351,301. There were no sales from the securities AFS portfolio during 2011.

The carrying amount and estimated fair value of securities by contractual maturity are shown below. Expected maturities will differ from contractual maturities because issuers may call or prepay obligations with or without call or prepayment penalties, pursuant to contractual terms.

The scheduled maturities of debt securities AFS at December 31, 2012 were as follows:

	<u>Amortized Cost</u>	<u>Fair Value</u>
Due in one year or less	\$ 4,088,947	\$ 4,104,324
Due from one to five years	36,536,874	36,781,735
	<u>\$ 40,625,821</u>	<u>\$ 40,886,059</u>

The scheduled maturities of debt securities HTM at December 31, 2012 were as follows:

	<u>Amortized Cost</u>	<u>Fair Value*</u>
Due in one year or less	\$ 32,741,241	\$ 32,741,000
Due from one to five years	3,849,709	3,956,000
Due from five to ten years	1,916,266	2,023,000
Due after ten years	3,358,339	3,571,000
	<u>\$ 41,865,555</u>	<u>\$ 42,291,000</u>

*Method used to determine fair value rounds values to nearest thousand.

All investments with unrealized losses have been in a continuous loss position less than 12 months. Investments with unrealized losses at December 31 were as follows:

	2012		2011	
	<u>Less than 12 months</u>		<u>Less than 12 months</u>	
	<u>Fair Value</u>	<u>Unrealized Loss</u>	<u>Fair Value</u>	<u>Unrealized Loss</u>
U.S. GSE debt securities	\$ 8,715,492	\$ 13,936	\$ 29,940,644	\$ 99,310
U.S. Government securities	1,052,639	1,072	999,766	848
	<u>\$ 9,768,131</u>	<u>\$ 15,008</u>	<u>\$ 30,940,410</u>	<u>\$ 100,158</u>

The unrealized losses are a result of changes in market interest rates and not of deterioration in the creditworthiness of the issuer. At December 31, 2012, there were eight U.S. GSE securities and one U.S. Government security in the investment portfolio that were in an unrealized loss position compared to 21 U.S. GSE securities and one U.S. Government security at December 31, 2011.

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market conditions, or adverse developments relating to the issuer, warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition.

As the Company has the ability to hold its debt securities until maturity, or for the foreseeable future if classified as AFS, and it is more likely than not that the Company will not have to sell such securities before recovery of their cost basis, no declines in such securities were deemed to be other-than-temporary at December 31, 2012 and 2011.

The Bank is a member of the FHLBB. The FHLBB is a cooperatively owned wholesale bank for housing and finance in the six New England States. Its mission is to support the residential mortgage and community-development lending activities of its members, which include over 450 financial institutions across New England. As a requirement of membership in the FHLBB, the Bank must own a minimum required amount of FHLBB stock, calculated periodically based primarily on the Bank's level of borrowings from the FHLBB. The Company obtains much of its wholesale funding from the FHLBB. As of December 31, 2012 and 2011, the Company's investment in FHLBB stock was \$3.4 million and \$3.7 million, respectively.

FHLBB stock is a non-marketable equity security and therefore is reported at cost, which equals its par value. Shares held in excess of the minimum required amount are generally redeemable at par value. In the first quarter of 2012 the FHLBB announced the termination of a moratorium on member stock redemptions that it had instituted in 2009 in order to preserve its capital in response to adverse market conditions and declining retained earnings. Effective September 5, 2011, the FHLBB amended and restated its capital plan to implement the provisions of a Joint Capital Enhancement Agreement of the 12 Federal Home Loan Banks ("FHLBs") intended to enhance the capital position of each FHLB, whereby each FHLB will allocate 20 percent of net earnings into its own separate restricted retained earnings account until the account balance equals at least one percent of the FHLB's average balance of outstanding consolidated obligations for the previous quarter. The agreement is intended to benefit members and investors in FHLBs by further strengthening the FHLB balance sheets and creating an additional buffer to absorb losses.

As a member of the FHLBB, the Company is subject to future capital calls by the FHLBB in order to maintain compliance with its capital plan. In February, 2011, FHLBB announced its intention to declare modest cash dividends beginning in 2011 after a brief period (2008 – 2010) of no dividends. The Company had dividend income on its FHLBB stock of \$17,892 in 2012 and \$10,917 in 2011.

The Company periodically evaluates its investment in FHLBB stock for impairment based on, among other factors, the capital adequacy of the FHLBB and its overall financial condition. No impairment losses have been recorded through December 31, 2012. The Bank will continue to monitor its investment in FHLBB stock.

Note 3. Loans, Allowance for Loan Losses and Credit Quality

The composition of net loans at December 31 was as follows:

	<u>2012</u>	<u>2011</u>
Commercial & industrial	\$ 49,283,948	\$ 39,514,607
Commercial real estate	139,807,517	132,269,368
Residential real estate - 1 st lien	171,114,515	159,535,958
Residential real estate – Jr lien	47,029,023	45,886,967
Consumer	<u>10,642,151</u>	<u>11,465,139</u>
	<u>417,877,154</u>	<u>388,672,039</u>
Deduct (add):		
Allowance for loan losses	4,312,080	3,886,502
Deferred net loan costs	(169,501)	(7,251)
Loans held-for-sale	<u>1,501,706</u>	<u>2,285,567</u>
	<u>5,644,285</u>	<u>6,164,818</u>
Net Loans	<u>\$412,232,869</u>	<u>\$382,507,221</u>

The following is an age analysis of past due loans (including non-accrual) by class:

December 31, 2012	<u>30-89 Days</u>	<u>90 Days or More</u>	<u>Total Past Due</u>	<u>Current</u>	<u>Total Loans</u>	<u>Non-Accrual Loans</u>	<u>Over 90 Days and Accruing</u>
Commercial & industrial	\$ 782,937	\$ 377,145	\$ 1,160,082	\$ 48,123,866	\$ 49,283,948	\$ 596,777	\$ 0
Commercial real estate	785,890	888,179	1,674,069	138,133,448	139,807,517	1,892,195	53,937
Residential real estate - 1st lien	4,654,077	844,803	5,498,880	164,113,929	169,612,809	1,928,097	281,845
Residential real estate - Jr lien	379,363	57,128	436,491	46,592,532	47,029,023	338,383	41,434
Consumer	132,624	844	133,468	10,508,683	10,642,151	0	844
Total	<u>\$ 6,734,891</u>	<u>\$ 2,168,099</u>	<u>\$ 8,902,990</u>	<u>\$407,472,458</u>	<u>\$416,375,448</u>	<u>\$ 4,755,452</u>	<u>\$ 378,060</u>

December 31, 2011	<u>30-89 Days</u>	<u>90 Days or More</u>	<u>Total Past Due</u>	<u>Current</u>	<u>Total Loans</u>	<u>Non-Accrual Loans</u>	<u>Over 90 Days and Accruing</u>
Commercial & industrial	\$ 655,168	\$ 265,668	\$ 920,836	\$ 38,593,771	\$ 39,514,607	\$ 1,066,945	\$ 59,618
Commercial real estate	2,266,412	1,288,616	3,555,028	128,714,340	132,269,368	3,714,146	98,554
Residential real estate - 1st lien	5,614,513	2,517,282	8,131,795	149,118,596	157,250,391	2,703,920	969,078
Residential real estate - Jr lien	431,885	2,754,129	3,186,014	42,700,953	45,886,967	464,308	111,061
Consumer	152,151	1,498	153,649	11,311,490	11,465,139	0	1,498
Total	<u>\$ 9,120,129</u>	<u>\$ 6,827,193</u>	<u>\$ 15,947,322</u>	<u>\$370,439,150</u>	<u>\$386,386,472</u>	<u>\$ 7,949,319</u>	<u>\$ 1,239,809</u>

The following summarizes changes in the allowance for loan losses and select loan information, by portfolio segment.

For the year ended December 31, 2012

	<u>Commercial & Industrial</u>	<u>Commercial Real Estate</u>	<u>Residential Real Estate 1st Lien</u>	<u>Residential Real Estate Jr Lien</u>	<u>Consumer</u>	<u>Unallocated</u>	<u>Total</u>
Allowance for loan losses							
Beginning balance	\$ 342,314	\$ 1,385,939	\$ 1,578,493	\$ 331,684	\$ 124,779	\$ 123,293	\$ 3,886,502
Charge-offs	(159,309)	(57,923)	(246,237)	(135,622)	(96,491)	0	(695,582)
Recoveries	29,769	51,863	5,538	1,538	32,452	0	121,160
Provision	215,607	156,561	225,782	134,956	77,959	189,135	1,000,000
Ending balance	<u>\$ 428,381</u>	<u>\$ 1,536,440</u>	<u>\$ 1,563,576</u>	<u>\$ 332,556</u>	<u>\$ 138,699</u>	<u>\$ 312,428</u>	<u>\$ 4,312,080</u>

Allowance for loan losses

Evaluated for impairment

Individually	\$ 0	\$ 0	\$ 134,800	\$ 39,200	\$ 0	\$ 0	\$ 174,000
Collectively	428,381	1,536,440	1,428,776	293,356	138,699	312,428	4,138,080
Total	<u>\$ 428,381</u>	<u>\$ 1,536,440</u>	<u>\$ 1,563,576</u>	<u>\$ 332,556</u>	<u>\$ 138,699</u>	<u>\$ 312,428</u>	<u>\$ 4,312,080</u>

Loans evaluated for impairment

Individually	\$ 435,165	\$ 1,762,615	\$ 1,641,960	\$ 309,606	\$ 0	\$ 4,149,346
Collectively	48,848,783	138,044,902	167,970,849	46,719,417	10,642,151	412,226,102
Total	<u>\$ 49,283,948</u>	<u>\$139,807,517</u>	<u>\$169,612,809</u>	<u>\$ 47,029,023</u>	<u>\$ 10,642,151</u>	<u>\$416,375,448</u>

For the year ended December 31, 2011

	<u>Commercial & Industrial</u>	<u>Commercial Real Estate</u>	<u>Residential Real Estate 1st Lien</u>	<u>Residential Real Estate Jr Lien</u>	<u>Consumer</u>	<u>Unallocated</u>	<u>Total</u>
Allowance for loan losses							
Beginning balance	\$ 302,421	\$ 1,391,898	\$ 1,830,816	\$ 0	\$ 151,948	\$ 50,852	\$ 3,727,935
Charge-offs	(22,050)	(197,367)	(521,608)	(96,961)	(103,687)	0	(941,673)
Recoveries	13,225	8,479	42,593	20	35,923	0	100,240
Provision	48,718	182,929	226,692	428,625	40,595	72,441	1,000,000
Ending balance	<u>\$ 342,314</u>	<u>\$ 1,385,939</u>	<u>\$ 1,578,493</u>	<u>\$ 331,684</u>	<u>\$ 124,779</u>	<u>\$ 123,293</u>	<u>\$ 3,886,502</u>

Allowance for loan losses

Evaluated for
impairment

Individually	\$ 70,600	\$ 57,500	\$ 283,200	\$ 47,200	\$ 0	\$ 0	\$ 458,500
Collectively	271,714	1,328,439	1,295,293	284,484	124,779	123,293	3,428,002
Total	<u>\$ 342,314</u>	<u>\$ 1,385,939</u>	<u>\$ 1,578,493</u>	<u>\$ 331,684</u>	<u>\$ 124,779</u>	<u>\$ 123,293</u>	<u>\$ 3,886,502</u>

Loans evaluated for impairment

Individually	\$ 1,000,120	\$ 3,669,260	\$ 2,366,326	\$ 434,664	\$ 0		\$ 7,470,370
Collectively	38,514,487	128,600,108	154,884,065	45,452,303	11,465,139		378,916,102
Total	<u>\$ 39,514,607</u>	<u>\$132,269,368</u>	<u>\$157,250,391</u>	<u>\$ 45,886,967</u>	<u>\$ 11,465,139</u>		<u>\$386,386,472</u>

Impaired loans by segment were as follows:

For the year ended December 31, 2012

	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>
With no related allowance recorded				
Commercial & industrial	\$ 435,165	\$ 473,664	\$ 0	\$ 536,973
Commercial real estate	1,762,615	2,123,371	0	2,019,449
Residential real estate - 1st lien	1,024,598	1,250,224	0	893,629
Residential real estate - Jr lien	15,694	76,680	0	34,602
With an allowance recorded				
Commercial & industrial	0	0	0	232,743
Commercial real estate	0	0	0	920,842
Residential real estate - 1st lien	617,362	669,288	134,800	892,339
Residential real estate - Jr lien	293,912	319,020	39,200	295,372
Total				
Commercial & industrial	\$ 435,165	\$ 473,664	\$ 0	\$ 769,716
Commercial real estate	\$ 1,762,615	\$ 2,123,371	\$ 0	\$ 2,940,291
Residential real estate - 1st lien	\$ 1,641,960	\$ 1,919,512	\$ 134,800	\$ 1,785,968
Residential real estate - Jr lien	\$ 309,606	\$ 395,700	\$ 39,200	\$ 329,974
Total	<u>\$ 4,149,346</u>	<u>\$ 4,912,247</u>	<u>\$ 174,000</u>	<u>\$ 5,825,949</u>

For the year ended December 31, 2011

	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>
With no related allowance recorded				
Commercial & industrial	\$ 380,624	\$ 391,800	\$ 0	\$ 332,523
Commercial real estate	2,041,101	2,246,905	0	960,407
Residential real estate - 1st lien	1,000,819	1,191,437	0	1,210,137
Residential real estate - Jr lien	125,786	185,142	0	25,157
With an allowance recorded				
Commercial & industrial	619,496	637,729	70,600	237,724
Commercial real estate	1,628,159	1,653,646	57,500	1,128,795
Residential real estate - 1st lien	1,365,507	1,869,338	283,200	1,629,151
Residential real estate - Jr lien	308,878	321,475	47,200	61,776
Total				
Commercial & industrial	\$ 1,000,120	\$ 1,029,529	\$ 70,600	\$ 570,247
Commercial real estate	\$ 3,669,260	\$ 3,900,551	\$ 57,500	\$ 2,089,202
Residential real estate - 1st lien	\$ 2,366,326	\$ 3,060,775	\$ 283,200	\$ 2,839,288
Residential real estate - Jr lien	\$ 434,664	\$ 506,617	\$ 47,200	\$ 86,933
Total	<u>\$ 7,470,370</u>	<u>\$ 8,497,472</u>	<u>\$ 458,500</u>	<u>\$ 5,585,670</u>

Interest income recognized on impaired loans is immaterial for all periods presented.

Interest accrued but not collected for loans that are placed on non-accrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

The Company is not contractually committed to lend additional funds to debtors with impaired, non-accrual or restructured loans.

Credit Quality Grouping

In developing the allowance for loan losses, management uses credit quality grouping to help evaluate trends in credit quality. The Company groups credit risk into Groups A, B and C. The manner the Company utilizes to assign risk grouping is driven by loan purpose. Commercial purpose loans are individually risk graded while the retail portion of the portfolio is generally grouped by delinquency pool.

Group A loans - Acceptable Risk— are loans that are expected to perform as agreed under their respective terms. Such loans carry a normal level of risk that does not require management attention beyond that warranted by the loan or loan relationship characteristics, such as loan size or relationship size. Group A loans include commercial purpose loans that are individually risk rated and retail loans that are rated by pool. Group A retail loans include both performing consumer and residential real estate loans. Residential real estate loans are loans to individuals secured by 1-4 family homes, including first mortgages, home equity and home improvement loans. Loan balances fully secured by deposit accounts or that are fully guaranteed by the Federal Government are considered acceptable risk.

Group B loans – Management Involved - are loans that require greater attention than the acceptable loans in Group A. Characteristics of such loans may include, but are not limited to, borrowers that are experiencing negative operating trends such as reduced sales or margins, borrowers that have exposure to adverse market conditions such as increased competition or regulatory burden, or borrowers that have had unexpected or adverse changes in management. These loans have a greater likelihood of migrating to an unacceptable risk level if these characteristics are left unchecked. Group B is limited to commercial purpose loans that are individually risk rated.

Group C loans – Unacceptable Risk – are loans that have distinct shortcomings that require a greater degree of management attention. Examples of these shortcomings include a borrower's inadequate capacity to service debt, poor operating performance, or insolvency. These loans are more likely to result in repayment through collateral liquidation. Group C loans range from those that are likely to sustain some loss if the shortcomings are not corrected, to those for which loss is imminent and non-accrual treatment is warranted. Group C loans include individually rated commercial purpose loans, and retail loans adversely rated in accordance with the Federal Financial Institutions Examination Council's Uniform Retail Credit Classification Policy. Group C retail loans include 1-4 family residential real estate loans and home equity loans past due 90 days or more with loan-to-value ratios greater than 60%, home equity loans 90 days or more past due where the bank does not hold first mortgage, irrespective of loan-to-value, loans in bankruptcy where repayment is likely but not yet established, and lastly consumer loans that are 90 days or more past due.

Commercial purpose loan ratings are assigned by the commercial account officer; for larger and more complex commercial loans, the credit rating is a collaborative assignment by the lender and the credit analyst. The credit risk rating is based on the borrower's expected performance, i.e., the likelihood that the borrower will be able to service its obligations in accordance with the loan terms. Credit risk ratings are meant to measure risk versus simply record history. Assessment of expected future payment performance requires consideration of numerous factors. While past performance is part of the overall evaluation, expected performance is based on an analysis of the borrower's financial strength, and historical and projected factors such as size and financing alternatives, capacity and cash flow, balance sheet and income statement trends, the quality and timeliness of financial reporting, and the quality of the borrower's management. Other factors influencing the credit risk rating to a lesser degree include collateral coverage and control, guarantor strength and commitment, documentation, structure and covenants and industry conditions. There are uncertainties inherent in this process.

Credit risk ratings are dynamic and require updating whenever relevant information is received. The risk ratings of larger or more complex loans, and Group B and C rated loans, are assessed at the time of their respective annual reviews, during quarterly updates, in action plans or at any other time that relevant information warrants update. Lenders are required to make immediate disclosure to the Chief Credit Officer of any known increase in loan risk, even if considered temporary in nature.

The risk ratings within the loan portfolio by class were as follows:

Total Loans

December 31, 2012	Commercial	Commercial	Residential	Residential	Consumer	Total
	& Industrial	Real Estate	Real Estate 1st Lien	Real Estate Jr Lien		
Group A	\$ 47,689,238	\$131,643,756	\$167,876,199	\$ 46,162,420	\$ 10,632,404	\$404,004,017
Group B	593,838	4,139,367	404,752	318,248	0	5,456,205
Group C	1,000,872	4,024,394	2,833,564	548,355	9,747	8,416,932
Total	<u>\$ 49,283,948</u>	<u>\$139,807,517</u>	<u>\$171,114,515</u>	<u>\$ 47,029,023</u>	<u>\$ 10,642,151</u>	<u>\$417,877,154</u>

Total Loans

December 31, 2011	Commercial	Commercial	Residential	Residential	Consumer	Total
	& Industrial	Real Estate	Real Estate 1st Lien	Real Estate Jr Lien		
Group A	\$ 36,971,880	\$119,410,381	\$153,954,604	\$ 44,943,200	\$ 11,459,371	\$366,739,436
Group B	530,523	4,037,860	98,603	322,022	0	4,989,008
Group C	2,012,204	8,821,127	5,482,751	621,745	5,768	16,943,595
Total	<u>\$ 39,514,607</u>	<u>\$132,269,368</u>	<u>\$159,535,958</u>	<u>\$ 45,886,967</u>	<u>\$ 11,465,139</u>	<u>\$388,672,039</u>

Modifications of Loans and TDRs

A loan is classified as a TDR if, for economic or legal reasons related to a borrower's financial difficulties, the Company grants a concession to the borrower that it would not otherwise consider.

The Company is deemed to have granted such a concession if it has modified a troubled loan in any of the following ways:

- Reduced accrued interest;
- Reduced the original contractual interest rate to a rate that is below the current market rate for the borrower;
- Converted a variable-rate loan to a fixed-rate loan;
- Extended the term of the loan beyond an insignificant delay;
- Deferred or forgiven principal in an amount greater than three months of payments; or
- Performed a refinancing and deferred or forgiven principal on the original loan.

An insignificant delay or insignificant shortfall in the amount of payments typically would not require the loan to be accounted for as a TDR. However, pursuant to regulatory guidance, any delay longer than three months is generally not considered insignificant. The assessment of whether a concession has been granted also takes into account payments expected to be received from third parties, including third-party guarantors, provided that the third party has the ability to perform on the guarantee.

The Company's TDRs are principally a result of extending loan repayment terms to relieve cash flow difficulties. The Company has only, on a limited basis, reduced interest rates for borrowers below the current market rate for the borrower. The Company has not forgiven principal or reduced accrued interest within the terms of original restructurings, nor has it converted variable rate terms to fixed rate terms. However, the Company evaluates each TDR situation on its own merits and does not foreclose the granting of any particular type of concession.

TDRs by segment for the year ended December 31, 2012 were as follows:

	<u>Number of Contracts</u>	<u>Pre- Modification Outstanding Recorded Investment</u>	<u>Post- Modification Outstanding Recorded Investment</u>
Commercial real estate	2	\$ 1,030,645	\$ 997,645
Residential real estate - 1st lien	3	197,127	192,478
Total	<u>5</u>	<u>\$ 1,227,772</u>	<u>\$ 1,190,123</u>

TDRs by segment for the year ended December 31, 2011 were as follows:

	<u>Number of Contracts</u>	<u>Pre- Modification Outstanding Recorded Investment</u>	<u>Post- Modification Outstanding Recorded Investment</u>
Commercial & industrial	10	\$ 985,666	\$ 985,666
Commercial real estate	6	1,202,546	1,202,546
Residential real estate - 1st lien	4	299,505	299,505
Residential real estate - Jr lien	2	71,928	71,928
Total	<u>22</u>	<u>\$ 2,559,645</u>	<u>\$ 2,559,645</u>

There were no TDRs for which there was a payment default under the restructured terms during the twelve month period ended December 31, 2012. The TDRs for which there was a payment default during the year ended December 31, 2011 were as follows:

	<u>Number of Contracts</u>	<u>Recorded Investment</u>
Commercial & industrial	8	\$ 741,090
Commercial real estate	1	401,002
Residential real estate - 1st lien	2	178,492
Residential real estate - Jr lien	1	34,687
Total	<u>12</u>	<u>\$ 1,355,271</u>

TDRs are treated as other impaired loans and carry individual specific reserves with respect to the calculation of the allowance for loan losses. These loans are categorized as non-performing, may be past due, and are generally adversely risk rated. The TDRs that have defaulted under their restructured terms are generally in collection status and their reserve is typically calculated using the fair value of collateral method. At December 31, 2012 and 2011, the allowance related to TDRs was approximately \$23,000 and \$203,000, respectively.

At December 31, 2012, the Company did not have any commitments to lend additional funds to borrowers with loans classified as TDRs.

Note 4. Loan Servicing

Mortgage loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of mortgage loans serviced for others were \$198,438,802 and \$201,405,241 at December 31, 2012 and 2011, respectively. Net gain realized on the sale of loans was \$1,375,689 and \$792,303 for the years ended December 31, 2012 and 2011, respectively.

Changes in mortgage servicing rights for the years ended December 31 are summarized as follows:

	<u>December 31, 2012</u>	<u>December 31, 2011</u>
Balance at beginning of year	\$ 1,097,442	\$ 1,076,708
Mortgage servicing rights capitalized	406,807	355,730
Mortgage servicing rights amortized	(409,584)	(346,165)
Change in valuation allowance	(85,042)	11,169
Balance at end of year	<u>\$ 1,009,623</u>	<u>\$ 1,097,442</u>

Note 5. Bank Premises and Equipment

The major classes of bank premises and equipment and accumulated depreciation and amortization at December 31 were as follows:

	<u>2012</u>	<u>2011</u>
Buildings and improvements	\$ 10,762,761	\$ 10,668,590
Land and land improvements	2,403,921	2,378,813
Furniture and equipment	7,340,676	7,011,347
Leasehold improvements	1,302,395	1,296,405
Capital lease	976,907	976,907
Other prepaid assets	175,507	17,490
	<u>22,962,167</u>	<u>22,349,552</u>
Less accumulated depreciation and amortization	(10,718,847)	(9,634,326)
	<u>\$ 12,243,320</u>	<u>\$ 12,715,226</u>

The Company is obligated under non-cancelable operating leases for bank premises expiring in various years through 2016, with options to renew. Minimum future rental payments for these leases with original terms in excess of one year as of December 31, 2012 for each of the next five years and in aggregate are:

2013	\$ 171,374
2014	147,083
2015	123,028
2016	55,000
2017	0
	<u>\$ 496,485</u>

Total rental expense amounted to \$230,756 and \$222,180 for the years ended December 31, 2012 and 2011, respectively.

Capital lease obligations

The following is a schedule by years of future minimum lease payments under capital leases, together with the present value of the net minimum lease payments as of December 31, 2012:

2013	\$ 123,755
2014	126,255
2015	129,755
2016	129,755
2017	133,255
Subsequent to 2017	<u>420,657</u>
Total minimum lease payments	1,063,432
Less amount representing interest	(288,731)
Present value of net minimum lease payments	<u>\$ 774,701</u>

Note 6. Goodwill and Other Intangible Asset

As a result of the merger with LyndonBank on December 31, 2007, the Company recorded goodwill amounting to \$11.6 million. The goodwill is not amortizable and is not deductible for tax purposes.

The Company also recorded \$4,161,000 of acquired identified intangible assets representing the core deposit intangible, which is subject to amortization as a non-interest expense over a ten year period. The accumulated amortization expense was \$2,797,524 and \$2,456,654 as of December 31, 2012 and 2011, respectively.

The amortization expense related to the remaining core deposit intangible at December 31, 2012 is expected to be as follows:

2013	272,695
2014	272,695
2015	272,695
2016	272,695
2017	272,696
Total remaining core deposit intangible expense	<u>\$ 1,363,476</u>

Management evaluated goodwill for impairment at December 31, 2012 and 2011 and concluded that no impairment existed as of such dates.

Note 7. Other Investments

On December 19, 2011, the Company established a single-member LLC to facilitate the purchase of federal NMTC through an investment structure designed by a local community development entity. The LLC will not conduct any business apart from its role in the NMTC financing structure. The NMTC equity investment generated tax credits of \$170,750 for each of the years ended December 31, 2012 and 2011, with an amortization expense of \$39,662 and \$136,518, respectively, for the years ended December 31, 2012 and 2011. The carrying value of the NMTC equity investment was \$785,080 and \$824,742 at December 31, 2012 and 2011, respectively, and is included in other assets.

The Company has purchased from time to time interests in various limited partnerships established to acquire, own and rent residential housing for low and moderate income Vermonters located in northeastern and central Vermont. The tax credits from these investments were \$1,157,541 for the year ended December 31, 2012 and \$534,076 for the year ended December 31, 2011. Expenses related to amortization of the investments in the limited partnerships are recognized as a component of "other expenses", and were \$1,175,177 and \$479,346 for 2012 and 2011, respectively. The carrying values of the limited partnership investments were \$2,808,551 and \$3,769,898 at December 31, 2012 and 2011, respectively, and are included in other assets.

The Bank has a one-third ownership interest in a nondepository trust company, CFSG, based in Newport, Vermont, which is held indirectly through Community Financial Services Partners, LLC ("Partners"), a Vermont LLC that owns 100% of the LLC equity interests of CFSG. The Bank accounts for its investment in Partners under the equity method of accounting. The Company's investment in Partners, included in other assets, amounted to \$666,661 as of December 31, 2012 and \$516,946 as of December 31, 2011. The Company recognized income of \$149,715 for 2012 and income of \$147,779 for 2011 through Partners from the operations of CFSG.

Note 8. Time Deposits

The following is a maturity distribution of time deposits at December 31, 2012:

2013	\$ 63,765,442
2014	16,819,956
2015	18,840,356
2016	13,146,423
2017	8,953,887
Total time deposits	<u>\$121,526,064</u>

Note 9. Borrowed Funds

Borrowings from the FHLBB as of December 31 were as follows:

	<u>2012</u>	<u>2011</u>
Long-Term Borrowings		
FHLBB Community Investment Program borrowing, 7.67% fixed rate, due November 16, 2012	\$ 0	\$ 10,000
FHLBB term borrowing, 1.00% fixed rate, due January 27, 2012	0	6,000,000
FHLBB term borrowing, 1.71% fixed rate, due January 28, 2013	6,000,000	6,000,000
FHLBB term borrowing, 2.72% fixed rate, due January 27, 2015	0	6,000,000
Total borrowings	<u>\$ 6,000,000</u>	<u>\$ 18,010,000</u>

The Company maintained a \$500,000 IDEAL Way Line of Credit with the FHLBB at December 31, 2012 and 2011 with no outstanding advances under this line at either year-end date. Interest on these borrowings is at a rate determined daily by the FHLBB and payable monthly.

Borrowings from the FHLBB are secured by a blanket lien on qualified collateral consisting primarily of loans with first mortgages secured by 1-4 family properties. Qualified collateral for these borrowings totaled \$116,101,167 and \$110,950,040 as of December 31, 2012 and 2011, respectively. As of December 31, 2012 and 2011, the Company's potential borrowing capacity was \$72,591,692 and \$77,902,569, respectively, reduced by outstanding advances.

Under a separate agreement, the Company has the authority to collateralize public unit deposits, up to its available borrowing capacity, with letters of credit issued by the FHLBB. At December 31, 2012, \$15,800,000 in FHLBB letters of credit was utilized as collateral for these deposits compared to \$15,950,000 at December 31, 2011. Total fees paid by the Company in connection with issuance of these letters of credit were \$41,749 for 2012 and \$44,656 for 2011.

The Company also has a line of credit with the FRBB, which is intended to be used as a contingency funding source. For this Borrower-in-Custody arrangement, the Company pledged eligible commercial and industrial loans, commercial real estate loans and home equity loans resulting in an available line of \$71,345,734 and \$69,222,549 as of December 31, 2012 and 2011, respectively. Credit advances in the FRBB lending program are overnight advances with interest chargeable at the primary credit rate (generally referred to as the discount rate), which was 75 basis points as of December 31, 2012. As of December 31, 2012 and 2011, the Company had no outstanding advances against this line.

Note 10. Junior Subordinated Debentures

As of December 31, 2012 and 2011, the Company had outstanding \$12,887,000 principal amount of Junior Subordinated Debentures due 2037 (the "Debentures"). The Company pays interest on the Debentures quarterly at a fixed annual rate of 7.56% through December 15, 2012, and thereafter at a floating rate equal to the 3-month London Interbank Offered Rate (LIBOR) plus 2.85%. The Debentures mature on December 15, 2037 and are subordinated and junior in right of payment to all senior indebtedness of the Company, as defined in the Indenture dated as of October 31, 2007 between the Company and Wilmington Trust Company, as Trustee. The Debentures first became redeemable, in whole or in part, by the Company on December 15, 2012. Interest paid on the Debentures for 2012 and 2011 was \$974,257 each year, and is deductible for tax purposes.

The Debentures were issued and sold to CMTV Statutory Trust I (the "Trust"). The Trust is a special purpose trust funded by a capital contribution of \$387,000 from the Company, in exchange for 100% of the Trust's common equity. The Trust was formed for the purpose of issuing corporation-obligated mandatorily redeemable Capital Securities ("Capital Securities") in the principal amount of \$12.5 million to third-party investors and using the proceeds from the sale of such Capital Securities and the Company's initial capital contribution to purchase the Debentures. The Debentures are the sole asset of the Trust. Distributions on the Capital Securities issued by the Trust are payable quarterly at a rate per annum equal to the interest rate being earned by the Trust on the Debentures. The Capital Securities are subject to mandatory redemption, in whole or in part, upon repayment of the Debentures. The Company has entered into an agreement which, taken collectively, fully and unconditionally guarantees the Capital Securities subject to the terms of the guarantee.

The Debentures are currently includable in the Company's Tier 1 capital up to 25% of core capital elements (see Note 20).

Note 11. Repurchase Agreements

Securities sold under agreements to repurchase amounted to \$34,149,608 and \$21,645,446 as of December 31, 2012 and 2011, respectively. These agreements are collateralized by U. S. GSE securities and U. S. Treasury notes with a book value of \$40,625,821 and \$28,236,279 and a fair value of \$40,886,059 and \$28,425,092 at December 31, 2012 and 2011, respectively.

The average daily balance of these repurchase agreements was \$26,383,409 and \$21,725,160 during 2012 and 2011, respectively. The maximum borrowings outstanding on these agreements at any month-end reporting period of the Company were \$34,149,608 and \$24,090,954 during 2012 and 2011, respectively. These repurchase agreements mature daily and carried a weighted average interest rate of .55% during 2012 and .65% during 2011.

Note 12. Income Taxes

The Company prepares its federal income tax return on a consolidated basis. Federal income taxes are allocated to members of the consolidated group based on taxable income.

Federal income tax expense (benefit) for the years ended December 31 was as follows:

	<u>2012</u>	<u>2011</u>
Currently paid or payable	\$ 92,482	\$ 348,610
Deferred expense (benefit)	(231,970)	(114,334)
Total income tax (benefit) expense	<u>\$ (139,488)</u>	<u>\$ 234,276</u>

Total income tax expense (benefit) differed from the amounts computed at the statutory federal income tax rate of 34 percent primarily due to the following for the years ended December 31:

	<u>2012</u>	<u>2011</u>
Computed expense at statutory rates	\$ 1,448,808	\$ 1,298,059
Tax exempt interest & BOLI	(379,715)	(382,943)
Disallowed interest	20,169	20,786
Partnership tax credits	(1,260,200)	(704,826)
New markets tax credit amortization expense	26,177	0
Other	5,273	3,200
	<u>\$ (139,488)</u>	<u>\$ 234,276</u>

The deferred income tax benefit consisted of the following items for the years ended December 31:

	<u>2012</u>	<u>2011</u>
Depreciation	\$ (37,653)	\$ (46,560)
Mortgage servicing rights	(29,859)	7,050
Deferred compensation	(22,827)	115,239
Bad debts	(249,202)	(53,913)
Non-accrual loan interest	73,065	(19,867)
Limited partnership amortization	(340,021)	0
Investment in Partners	44,991	0
Fair value adjustment on acquired premises and equipment	153,862	0
Core deposit intangible	(115,896)	(144,869)
Loan fair value	(18,031)	(29,648)
Fannie Mae preferred stock write down	779,578	16,919
Alternative minimum tax	59,031	0
OREO write down	0	53,210
Tax credit carryovers	(604,096)	0
Other	75,088	(11,895)
Change in deferred tax benefit	<u>\$ (231,970)</u>	<u>\$ (114,334)</u>

Listed below are the significant components of the net deferred tax asset at December 31:

	<u>2012</u>	<u>2011</u>
Components of the deferred tax asset:		
Bad debts	\$ 1,396,437	\$ 1,147,235
Non-accrual loan interest	26,907	99,972
Deferred compensation	245,037	222,210
Limited partnerships	84,741	0
Contingent liability - MPF program	40,526	42,139
Fair value adjustment on acquired securities		
available-for-sale	0	528,205
Fannie Mae preferred stock write down	0	251,373
Capital lease	71,041	66,995
Alternative minimum tax	0	59,031
Fair value adjustment on acquired premises		
and equipment	0	153,862
Tax and rehab credit carryforwards	604,096	0
Other	34,789	112,310
Total deferred tax asset	<u>2,503,574</u>	<u>2,683,332</u>
Components of the deferred tax liability:		
Depreciation	260,607	298,260
Limited partnerships	0	255,280
Mortgage servicing rights	343,271	373,130
Unrealized gain on securities available-for-sale	88,482	68,892
Investment in Partners	44,991	0
Core deposit intangible	463,582	579,478
Fair value adjustment on acquired loans	54,513	72,544
Total deferred tax liability	<u>1,255,446</u>	<u>1,647,584</u>
Net deferred tax asset	<u>\$ 1,248,128</u>	<u>\$ 1,035,748</u>

US GAAP provides for the recognition and measurement of deductible temporary differences (including general valuation allowances) to the extent that it is more likely than not that the deferred tax asset will be realized.

The net deferred tax asset is included in other assets in the consolidated balance sheets.

ASC Topic 740, "Income Taxes", defines the criteria that an individual tax position must satisfy for some or all of the benefits of that position to be recognized in a company's financial statements. Topic 740 prescribes a recognition threshold of more-likely-than-not, and a measurement attribute for all tax positions taken or expected to be taken on a tax return, in order for those tax positions to be recognized in the consolidated financial statements. The Company has adopted these provisions and there was no material effect on the consolidated financial statements. The Company is currently open to audit under the statute of limitations by the Internal Revenue Service for the years ended December 31, 2009 through 2011.

Note 13. 401(k) and Profit-Sharing Plan

The Company has a defined contribution plan covering all employees who meet certain age and service requirements. The pension expense was \$481,875 and \$506,640 for 2012 and 2011, respectively. These amounts represent discretionary matching contributions of a portion of the voluntary employee salary deferrals under the 401(k) plan and discretionary profit-sharing contributions under the plan.

Note 14. Deferred Compensation and Supplemental Employee Retirement Plans

The Company maintains a directors' deferred compensation plan and, prior to 2005, maintained a retirement plan for its directors. Participants are general creditors of the Company with respect to these benefits. The benefits accrued under these plans were \$413,884 and \$409,684 at December 31, 2012 and 2011, respectively. Expenses associated with these plans were \$24,199 and \$31,377 for the years ended December 31, 2012 and 2011, respectively.

The Company also maintains a supplemental employee retirement plan for certain key employees of the Company. Benefits accrued under this plan were \$306,815 and \$243,875 at December 31, 2012 and 2011, respectively. The expense associated with this plan was \$62,940 and \$30,165 for the years ended December 31, 2012 and 2011, respectively.

Note 15. Financial Instruments with Off-Balance-Sheet Risk

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit, standby letters of credit and financial guarantees, commitments to sell loans and risk-sharing commitments on certain sold loans. Such instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The contract or notional amounts of those instruments reflect the maximum extent of involvement the Company has in particular classes of financial instruments.

The Company's maximum exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit and financial guarantees written is represented by the contractual notional amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

The Company generally requires collateral or other security to support financial instruments with credit risk. At December 31, the following off balance sheet financial instruments representing credit risk were outstanding:

	Contract or Notional Amount	
	2012	2011
Unused portions of home equity lines of credit	\$ 21,120,077	\$ 20,161,629
Other commitments to extend credit	45,551,282	38,106,476
Residential construction lines of credit	1,138,872	588,290
Commercial real estate and other construction lines of credit	1,762,424	2,126,558
Standby letters of credit and commercial letters of credit	1,193,480	1,954,885
Recourse on sale of credit card portfolio	352,000	398,200
MPF credit enhancement obligation, net (See Note 16)	2,035,858	1,979,684

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future funding requirements. At December 31, 2012 and 2011, the Company had binding loan commitments to sell residential mortgages at fixed rates totaling \$3,395,249 and \$5,623,474, respectively (see Note 16). The recourse provision under the terms of the sale of the Company's credit card portfolio in 2007 is based on total lines, not balances outstanding. Based on historical losses, the Company does not expect any significant losses from this commitment.

The Company evaluates each customer's credit-worthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Company upon extension of credit, or a commitment to extend credit, is based on management's credit evaluation of the counter-party. Collateral held varies but may include real estate, accounts receivable, inventory, property, plant and equipment, and income-producing commercial properties.

Standby letters of credit and financial guarantees written are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. The fair value of standby letters of credit has not been included in the balance sheets as the fair value is immaterial.

In connection with its trust preferred securities financing completed on October 31, 2007, the Company guaranteed the payment obligations under the capital securities of its subsidiary, CMTV Statutory Trust I. The source of funds for payments by the Trust on its capital trust securities is payments made by the Company on its debentures issued to the Trust. The Company's obligation under those debentures is fully reflected in the Company's consolidated balance sheet, in the amount of \$12,887,000 at December 31, 2012 and 2011. Of this amount, \$12,500,000 represents external financing through the issuance to investors of Capital Securities by CMTV Statutory Trust I (See Note 10).

Note 16. Contingent Liability

The Company sells first lien 1-4 family residential mortgage loans under the MPF program with FHLBB. Under this program the Company shares in the credit risk of each mortgage loan, while receiving fee income in return. The Company is responsible for a Credit Enhancement Obligation (CEO) based on the credit quality of these loans. FHLBB funds a First Loss Account (FLA) based on the Company's outstanding MPF mortgage balances. This creates a laddered approach to sharing in any losses. In the event of default, homeowner's equity and private mortgage insurance, if any, are the first sources of repayment; the FHLBB's FLA funds are then utilized, followed by the participant's CEO, with the balance of losses absorbed by FHLBB. These loans must meet specific underwriting standards of the FHLBB. As of December 31, 2012 and 2011, the Company had \$53,255,305 and \$54,682,000, respectively, in loans sold through the MPF program and on which the Company had a CEO. As of December 31, 2012, the notional amount of the maximum CEO related to this program was \$2,155,052 compared to \$2,103,622 as of December 31, 2011. The Company had accrued a contingent liability for this CEO in the amount of \$119,194 and \$123,938 as of December 31, 2012 and 2011, respectively, which is calculated based on the methodology used in calculating its allowance for loan losses, adjusted to reflect the risk sharing arrangements with the FHLBB. The volume of loans sold to the MPF program and the corresponding credit obligation continue to be closely monitored by management.

Note 17. Legal Proceedings

In the normal course of business, the Company is involved in various claims and legal proceedings. In the opinion of the Company's management, after consulting with the Company's legal counsel, any liabilities resulting from such proceedings are not expected to be material to the Company's consolidated financial condition or results of operations.

Note 18. Transactions with Related Parties

The Company has had, and may be expected to have in the future, banking transactions in the ordinary course of business with directors, principal officers, their immediate families and affiliated companies in which they are principal shareholders (commonly referred to as related parties), all of which have been, in the opinion of management, made on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others and which do not represent more than the normal risk of collectibility, or present other unfavorable features.

Aggregate loan transactions with related parties as of December 31 were as follows:

	<u>2012</u>	<u>2011</u>
Balance, beginning of year	\$ 5,998,756	\$ 7,015,993
Loans - New Principal Officers/Directors	0	67,458
New loans to existing Officers/Directors	36,354,194	26,240,945
Retirement of Director	0	(175,388)
Repayment*	(35,289,237)	(27,150,252)
Balance, end of year	<u>\$ 7,063,713</u>	<u>\$ 5,998,756</u>

*Includes loans sold to the secondary market.

Total deposits with related parties were \$7,901,009 and \$6,591,585 at December 31, 2012 and 2011, respectively.

The Company leases 2,253 square feet of condominium space in the state office building on Main Street in Newport, Vermont to its trust company affiliate, CFSG, for its principal offices. CFSG also leases offices in the Company's Barre and Lyndonville branches. The amount of rental income received from CFSG for the years ended December 31, 2012 and 2011 was \$37,177 and \$33,950, respectively.

The Company utilizes the services of CFSG as an investment advisor for the Company's 401(k) plan. The Human Resources committee of the Board of Directors is the Trustee of the plan, and CFSG provides investment advice for the plan. CFSG also acts as custodian of the retirement funds and makes investments on behalf of the plan and its participants. The Company pays monthly management fees to CFSG based on the market value of the total assets under management. The amount paid to CFSG for the years ended December 31, 2012 and 2011 was \$36,318 and \$38,982, respectively.

Note 19. Restrictions on Cash and Due From Banks

Due to a change in FRBB policies, the Company is no longer required to maintain reserve balances in cash at the FRBB beginning in 2012. At December 31, 2011, the reserve requirement was \$0.

In the ordinary course of business the Company may, from time to time, maintain amounts due from correspondent banks that exceed federally insured limits. However, no losses have occurred in these accounts and the Company believes it is not exposed to any significant risk with respect to such accounts. The Company was required to maintain contracted balances with other correspondent banks of \$462,500 at December 31, 2012 and 2011. Of the \$462,500 balance, \$262,500 was a separate agreed upon "impressed" balance to avoid monthly charges on the Company's current federal funds liquidity line.

Note 20. Regulatory Capital Requirements

The Company (on a consolidated basis) 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 discretionary - actions by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance-sheet items, as calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action capital requirements are applicable to banks, but not bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). The Company's non-cumulative Series A preferred stock (\$2.5 million liquidation preference) is includable without limitation in its Tier 1 capital. In accordance with changes in the regulatory requirements for calculating capital ratios, beginning with the quarter ended March 31, 2011, the Company deducts the amount of goodwill for purposes of calculating the amount of its trust preferred junior subordinated debentures includable in Tier 1 capital. Management believes, as of December 31, 2012, that the Company and the Bank met all capital adequacy requirements to which they are subject.

As of December 31, 2012 the Bank was considered well capitalized under the regulatory capital framework for Prompt Corrective Action and the Company exceeded applicable consolidated regulatory capital guidelines.

The following table shows the regulatory capital ratios for the Company and the Bank as of December 31:

	Actual		Minimum For Capital Adequacy Purposes:		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions:	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<i>(Dollars in Thousands)</i>						
As of December 31, 2012:						
Total capital (to risk-weighted assets)						
Company	\$ 47,385	12.57%	\$ 30,164	8.00%	N/A	N/A
Bank	\$ 46,796	12.44%	\$ 30,099	8.00%	\$ 37,623	10.00%
Tier I capital (to risk-weighted assets)						
Company	\$ 40,724	10.80%	\$ 15,082	4.00%	N/A	N/A
Bank	\$ 42,440	11.28%	\$ 15,049	4.00%	\$ 22,574	6.00%
Tier I capital (to average assets)						
Company	\$ 40,724	7.27%	\$ 22,416	4.00%	N/A	N/A
Bank	\$ 42,440	7.58%	\$ 22,387	4.00%	\$ 27,984	5.00%
As of December 31, 2011:						
Total capital (to risk-weighted assets)						
Company	\$ 44,289	11.95%	\$ 29,660	8.00%	N/A	N/A
Bank	\$ 43,710	11.82%	\$ 29,596	8.00%	\$ 36,995	10.00%
Tier I capital (to risk-weighted assets)						
Company	\$ 37,231	10.04%	\$ 14,830	4.00%	N/A	N/A
Bank	\$ 39,768	10.75%	\$ 14,798	4.00%	\$ 22,197	6.00%
Tier I capital (to average assets)						
Company	\$ 37,231	6.81%	\$ 21,882	4.00%	N/A	N/A
Bank	\$ 39,768	7.28%	\$ 21,853	4.00%	\$ 27,316	5.00%

The Company's ability to pay dividends to its shareholders is largely dependent on the Bank's ability to pay dividends to the Company. The Bank is restricted by law as to the amount of dividends that can be paid. Dividends declared by national banks that exceed net income for the current and preceding two years must be approved by the Bank's primary banking regulator, the Office of the Comptroller of the Currency ("OCC"). Regardless of formal regulatory restrictions, the Bank may not pay dividends that would result in its capital levels being reduced below the minimum requirements shown above.

Note 21. Fair Value

Certain assets and liabilities are recorded at fair value to provide additional insight into the Company's quality of earnings. Some of these assets and liabilities are measured on a recurring basis while others are measured on a nonrecurring basis, with the determination based upon applicable existing accounting pronouncements. For example, securities available-for-sale are recorded at fair value on a recurring basis. Other assets, such as mortgage servicing rights, loans held-for-sale, and impaired loans, are recorded at fair value on a nonrecurring basis using the lower of cost or market methodology to determine impairment of individual assets. The Company groups assets and liabilities which are recorded 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. 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 (with Level 1 considered highest and Level 3 considered lowest). A brief description of each level follows.

- Level 1 Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as U.S. Treasury, other U.S. Government and agency mortgage-backed debt securities that are highly liquid and are actively traded in over-the-counter markets.
- Level 2 Observable inputs other than Level 1 prices such as quoted prices for similar assets and liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments and derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes mortgage servicing rights, impaired loans, and OREO.
- Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

Fair values of financial instruments

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

Cash and cash equivalents: The carrying amounts reported in the balance sheet for cash and cash equivalents approximate their fair values. As such, the Company classifies these financial instruments as Level 1.

Securities Available-for-Sale. Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices for similar assets, if available. If quoted prices are not available, fair values are measured using matrix pricing models, or other model-based valuation techniques requiring observable inputs other than quoted prices such as yield curves, prepayment speeds and default rates. Level 1 securities would include U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets. Level 2 securities include federal agency securities.

Restricted equity securities: Restricted equity securities are comprised of FRBB stock and FHLBB stock. These securities are carried at cost, which is believed to approximate fair value, based on the redemption provisions of the FRBB and the FHLBB. The stock is nonmarketable, and redeemable at par value, subject to certain conditions, and, in the case of FHLBB stock, a moratorium on redemptions.

Loans and loans held-for-sale: For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying amounts. The fair values for other loans (for example, fixed rate residential, commercial real estate, and rental property mortgage loans, and commercial and industrial loans) are estimated using discounted cash flow analyses, based on interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Loan fair value estimates include judgments regarding future expected loss experience and risk characteristics. Loan impairment is deemed to exist when full repayment of principal and interest according to the contractual terms of the loan is no longer probable. Impaired loans are reported based on one of three measures: the present value of expected future cash flows discounted at the loan's effective interest rate; the loan's observable market price; or the fair value of the collateral if the loan is collateral dependent. If the fair value is less than an impaired loan's recorded investment, an impairment loss is recognized as part of the allowance for loan losses. Accordingly, certain impaired loans may be subject to measurement at fair value on a non-recurring basis. Management has estimated the fair values of these assets using Level 2 inputs, such as the fair value of collateral based on independent third-party appraisals for collateral-dependent loans.

The fair value of loans held-for-sale is based upon an actual purchase and sale agreement between the Company and an independent market participant. The sale is executed within a reasonable period following quarter end at the stated fair value.

Mortgage servicing rights. Mortgage servicing rights represent the value associated with servicing residential mortgage loans. Servicing assets and servicing liabilities are reported using the amortization method. In evaluating the carrying values of mortgage servicing rights, the Company obtains third party valuations based on loan level data including note rate, and the type and term of the underlying loans. As such, the Company classifies mortgage servicing rights as nonrecurring Level 2.

OREO. Real estate acquired through foreclosure is initially recorded at market value. The fair value of other real estate owned is based on property appraisals and an analysis of similar properties currently available. As such, the Company records other real estate owned as nonrecurring Level 2.

Impaired loans. A loan is considered to be impaired when it is probable that all of the principal and interest due under the original underwriting terms of the loan may not be collected. Impairment is measured based on the fair value of the underlying collateral or present value of expected cash flows. As such, the Company records impaired loans as nonrecurring Level 2.

Deposits, federal funds purchased and borrowed funds: The fair values disclosed for demand deposits (for example, checking and savings accounts) are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The fair values for certificates of deposit and borrowed funds are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates and indebtedness to a schedule of aggregated contractual maturities on such time deposits and indebtedness. As such the Company classifies deposits as Level 2.

Junior subordinated debentures: Fair value is estimated using current rates for debentures of similar maturity. As such the Company classifies these instruments as Level 2.

Capital lease obligations: Fair value is determined using a discounted cash flow calculation using current rates. Based on current rates, carrying value approximates fair value. As such the Company classifies these obligations as Level 2.

Accrued interest: The carrying amounts of accrued interest approximate their fair values. As such the Company classifies accrued interest as Level 2.

Off-balance-sheet credit related instruments: Commitments to extend credit are evaluated and fair value is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present credit-worthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates.

FASB ASC Topic 825 "Financial Instruments", requires disclosures of fair value information about financial instruments, whether or not recognized in the balance sheet, if the fair values can be reasonably determined. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques using observable inputs when available. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. Topic 825 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company.

Assets Recorded at Fair Value on a Recurring Basis

Assets measured at fair value on a recurring basis and reflected in the consolidated balance sheets at the dates presented, segregated by fair value hierarchy, are summarized below:

December 31, 2012	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
Assets: (market approach)			
U.S. GSE debt securities	\$ 0	\$ 33,785,469	\$ 33,785,469
U.S. Government securities	7,100,590	0	7,100,590

December 31, 2011

Assets: (market approach)			
U.S. GSE debt securities	\$ 0	\$ 60,963,239	\$ 60,963,239
U.S. Government securities	5,043,555	0	5,043,555
U.S. GSE preferred stock	92,123	0	92,123

There were no transfers between Levels 1 and 2 during the periods presented. There were no Level 3 financial instruments as of the balance sheet dates presented.

Assets Recorded at Fair Value on a Non-Recurring Basis

The following table includes assets measured at fair value on a nonrecurring basis that have had a fair value adjustment since their initial recognition. Impaired loans measured at fair value only include impaired loans with a related specific allowance for loan losses and are presented net of specific allowances as disclosed in Note 3.

Assets measured at fair value on a nonrecurring basis and reflected in the balance sheet at the dates presented, segregated by fair value hierarchy, are summarized below:

December 31, 2012	<u>Level 2</u>
Assets: (market approach)	
Mortgage servicing rights	\$ 1,009,623
Impaired loans, net of related allowance	737,274
OREO	1,074,705

December 31, 2011

Assets: (market approach)	
Mortgage servicing rights	\$ 1,167,808
Impaired loans, net of related allowance	3,463,540
OREO	90,000

There were no Level 1 or Level 3 financial instruments measured on a non-recurring basis as of the balance sheet dates presented.

The carrying amounts and estimated fair values of the Company's financial instruments were as follows:

December 31, 2012

	Carrying Amount	Fair Value			Fair Value
		(Dollars in Thousands)			
		Level 1	Level 2	Level 3	
Financial assets:					Total
Cash and cash equivalents	\$ 29,882	\$ 29,882	\$ 0	\$ 0	\$ 29,882
Securities held-to-maturity	41,866	0	42,291	0	42,291
Securities available-for-sale	40,886	7,101	33,785	0	40,886
Restricted equity securities	4,021	0	4,021	0	4,021
Loans and loans held-for-sale					
Commercial & industrial	49,284	0	0	49,876	49,876
Commercial real estate	139,808	0	0	140,938	140,938
Residential real estate - 1st lien	171,115	0	0	177,201	177,201
Residential real estate - Jr lien	47,029	0	0	47,794	47,794
Consumer	10,642	0	0	11,079	11,079
Mortgage servicing rights	1,010	0	1,010	0	1,010
Accrued interest receivable	1,751	0	1,751	0	1,751
Financial liabilities:					
Deposits					
Other deposits	460,939	0	463,168	0	463,168
Brokered deposits	14,558	0	14,559	0	14,559
Federal funds purchased and other borrowed funds	6,000	0	6,004	0	6,004
Repurchase agreements	34,150	0	34,150	0	34,150
Capital lease obligations	775	0	775	0	775
Subordinated debentures	12,887	0	13,158	0	13,158
Accrued interest payable	93	0	93	0	93

December 31, 2011

	Carrying Amount	Fair Value
Financial assets:		
Cash and cash equivalents	\$ 23,465	\$ 23,465
Securities held-to-maturity	29,702	30,289
Securities available-for-sale	66,099	66,099
Restricted equity securities	4,309	4,309
Loans and loans held-for-sale, net	384,793	395,386
Mortgage servicing rights	1,097	1,168
Accrued interest receivable	1,701	1,701
Financial liabilities:		
Deposits	454,393	457,347
Federal funds purchased and other borrowed funds	18,010	18,404
Repurchase agreements	21,645	21,645
Capital lease obligations	833	833
Subordinated debentures	12,887	11,691
Accrued interest payable	150	150

The estimated fair values of commitments to extend credit and letters of credit were immaterial at December 31, 2012 and 2011.

Note 22. Condensed Financial Information (Parent Company Only)

The following condensed financial statements are for Community Bancorp. (Parent Company Only), and should be read in conjunction with the consolidated financial statements of Community Bancorp. and Subsidiary.

Community Bancorp. (Parent Company Only)
Condensed Balance Sheets
December 31, 2012 and 2011

Assets	<u>2012</u>	<u>2011</u>
Cash	\$ 236,514	\$ 196,945
Investment in subsidiary - Community National Bank	55,650,407	53,226,506
Investment in Capital Trust	387,000	387,000
Income taxes receivable	436,944	416,781
Total assets	<u>\$ 56,710,865</u>	<u>\$ 54,227,232</u>
Liabilities and Shareholders' Equity		
Liabilities		
Junior subordinated debentures	\$ 12,887,000	\$ 12,887,000
Dividends payable	471,290	421,823
Total liabilities	<u>13,358,290</u>	<u>13,308,823</u>
Shareholders' Equity		
Preferred stock, 1,000,000 shares authorized, 25 shares issued and outstanding at December 31, 2012 and 2011 (\$100,000 liquidation value)	2,500,000	2,500,000
Common stock - \$2.50 par value; 10,000,000 shares authorized at December 31, 2012 and 2011, and 5,023,026 and 4,938,262 shares issued at December 31, 2012 and 2011, respectively (including 19,182 and 24,324 shares issued February 1, 2013 and 2012, respectively)	12,557,565	12,345,655
Additional paid-in capital	28,047,829	27,410,049
Retained earnings	2,698,200	1,151,751
Accumulated other comprehensive income	171,758	133,731
Less: treasury stock, at cost; 210,101 shares at December 31, 2012 and 2011	<u>(2,622,777)</u>	<u>(2,622,777)</u>
Total shareholders' equity	<u>43,352,575</u>	<u>40,918,409</u>
Total liabilities and shareholders' equity	<u>\$ 56,710,865</u>	<u>\$ 54,227,232</u>

The investment in the subsidiary bank is carried under the equity method of accounting. The investment and cash, which is on deposit with the Bank, have been eliminated in consolidation.

Community Bancorp. (Parent Company Only)
Condensed Statements of Income
Years Ended December 31, 2012 and 2011

	2012	2011
Income		
Bank subsidiary distributions	\$ 2,863,000	\$ 2,660,000
Dividends on Capital Trust	29,257	29,257
Total income	2,892,257	2,689,257
Expense		
Interest on junior subordinated debentures	974,257	974,257
Administrative and other	340,129	280,826
Total expense	1,314,386	1,255,083
Income before applicable income tax benefit and equity undistributed net income of subsidiary	1,577,871	1,434,174
Income tax benefit	436,944	416,781
Income before equity in undistributed net income of subsidiary	2,014,815	1,850,955
Equity in undistributed net income of subsidiary	2,385,875	1,732,591
Net income	\$ 4,400,690	\$ 3,583,546

Community Bancorp. (Parent Company Only)
Condensed Statements of Cash Flows
Years Ended December 31, 2012 and 2011

	2012	2011
Cash Flows from Operating Activities		
Net income	\$ 4,400,690	\$ 3,583,546
Adjustments to reconcile net income to net cash provided by operating activities		
Equity in undistributed net income of subsidiary	(2,385,875)	(1,732,591)
Decrease (increase) in income taxes receivable	(20,162)	25,021
Net cash provided by operating activities	1,994,653	1,875,976
Cash Flows from Financing Activities		
Dividends paid on preferred stock	(187,500)	(187,500)
Dividends paid on common stock	(1,767,584)	(1,614,647)
Net cash used in financing activities	(1,955,084)	(1,802,147)
Net increase in cash	39,569	73,829
Cash		
Beginning	196,945	123,116
Ending	\$ 236,514	\$ 196,945
Cash Received for Income Taxes	\$ 416,781	\$ 441,802
Cash Paid for Interest	\$ 974,257	\$ 974,257
Dividends paid:		
Dividends declared	\$ 2,666,741	\$ 2,613,143
Increase in dividends payable attributable to dividends declared	(49,467)	(47,733)
Dividends reinvested	(849,690)	(950,763)
	\$ 1,767,584	\$ 1,614,647

Note 23. Quarterly Financial Data (Unaudited)

A summary of financial data for the four quarters of 2012 and 2011 is presented below:

	Quarters in 2012 ended			
	March 31,	June 30,	Sept. 30,	Dec. 31,
Interest income	\$ 5,589,896	\$ 5,632,862	\$ 5,782,081	\$ 5,816,492
Interest expense	1,270,927	1,239,156	1,238,391	1,133,845
Provision for loan losses	250,003	249,999	249,999	249,999
Non-interest income	1,354,977	1,533,032	1,530,217	1,770,734
Non-interest expense	4,549,932	4,718,213	4,553,023	5,045,602
Net income	964,849	1,021,192	1,267,351	1,147,298
Earnings per common share	0.19	0.20	0.26	0.23

	Quarters in 2011 ended			
	March 31,	June 30,	Sept. 30,	Dec. 31,
Interest income	\$ 5,677,112	\$ 5,740,797	\$ 5,681,164	\$ 5,645,290
Interest expense	1,511,470	1,421,507	1,344,414	1,318,237
Provision for loan losses	187,500	237,500	287,500	287,500
Non-interest income	1,459,469	1,279,195	1,114,448	1,349,057
Non-interest expense	4,349,514	4,386,659	4,252,653	4,544,256
Net income	944,868	871,318	820,624	946,736
Earnings per common share	0.19	0.18	0.17	0.19

Note 24. Other Income and Other Expenses

The components of other expenses which are in excess of one percent of total revenues are as follows:

	2012	2011
Expenses		
Marketing	\$ 284,641	\$ 318,761
State deposit tax	516,348	484,540
Amortization of tax credit investments	1,175,177	615,864
ATM fees	363,478	338,327
Telephone	338,239	332,496
Collection and non-accrual loan expense	249,572	431,186

There were no components of other income in excess of one percent of total revenues for the years ended December 31, 2012 and 2011.

Note 25. Subsequent Events**Declaration of Cash Dividend**

On December 11, 2012, the Company declared a cash dividend of \$0.14 per share payable February 1, 2013 to shareholders of record as of January 15, 2013. On March 13, 2013, the Company declared a cash dividend of \$0.14 per share payable May 1, 2013 to shareholders of record as of April 15, 2013. These dividends have been recorded as of each declaration date, including shares issuable under the DRIP plan.

For purposes of accrual or disclosure in these financial statements, the Company has evaluated subsequent events through the date of issuance of these financial statements.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

For the Years Ended December 31, 2012 and 2011

The following discussion analyzes the consolidated financial condition of Community Bancorp. (the "Company") and its wholly-owned subsidiary, Community National Bank, as of December 31, 2012 and 2011, and its consolidated results of operations for the years then ended. The Company is considered a "smaller reporting company" under applicable regulations of the Securities and Exchange Commission ("SEC") and is therefore eligible for relief from certain disclosure requirements. In accordance with such provisions, the Company has elected to provide its audited consolidated statements of income, comprehensive income, cash flows and changes in shareholders' equity for two, rather than three, years.

The following discussion should be read in conjunction with the Company's audited consolidated financial statements and related notes.

FORWARD-LOOKING STATEMENTS

This Management's Discussion and Analysis of Financial Condition and Results of Operations contains certain forward-looking statements about the results of operations, financial condition and business of the Company and its subsidiary. Words used in the discussion below such as "believes," "expects," "anticipates," "intends," "estimates," "plans," "predicts," or similar expressions, indicate that management of the Company is making forward-looking statements.

Forward-looking statements are not guarantees of future performance. They necessarily involve risks, uncertainties and assumptions. Future results of the Company may differ materially from those expressed in these forward-looking statements. Examples of forward looking statements included in this discussion include, but are not limited to, estimated contingent liability related to assumptions made within the asset/liability management process, management's expectations as to the future interest rate environment and the Company's related liquidity level, credit risk expectations relating to the Company's loan portfolio and its participation in the Federal Home Loan Bank of Boston ("FHLBB") Mortgage Partnership Finance ("MPF") program, and management's general outlook for the future performance of the Company or the local or national economy. Although forward-looking statements are based on management's current expectations and estimates, many of the factors that could influence or determine actual results are unpredictable and not within the Company's control. Readers are cautioned not to place undue reliance on such statements as they speak only as of the date they are made. The Company does not undertake, and disclaims any obligation, to revise or update any forward-looking statements to reflect the occurrence or anticipated occurrence of events or circumstances after the date of this Report, except as required by applicable law. The Company claims the protection of the safe harbor for forward-looking statements provided in the Private Securities Litigation Reform Act of 1995.

Factors that may cause actual results to differ materially from those contemplated by these forward-looking statements include, among others, the following possibilities: (1) general economic conditions, either nationally, regionally or locally continue to deteriorate, resulting in a decline in credit quality or a diminished demand for the Company's products and services; (2) competitive pressures increase among financial service providers in the Company's northern New England market area or in the financial services industry generally, including competitive pressures from non-bank financial service providers, from increasing consolidation and integration of financial service providers, and from changes in technology and delivery systems; (3) interest rates change in such a way as to reduce the Company's margins; (4) changes in laws or government rules, or the way in which courts or government agencies interpret or implement those laws or rules, increase our costs of doing business or otherwise adversely affect the Company's business; (5) changes in federal or state tax policy; (6) changes in the level of nonperforming assets and charge-offs; (7) changes in estimates of future reserve requirements based upon relevant regulatory and accounting requirements; (8) changes in consumer and business spending, borrowing and savings habits; (9) proposed changes to the calculation of the Company's regulatory capital ratios which, among other things, would require additional regulatory capital, phase out the Tier 1 capital treatment for trust preferred securities, change the framework for risk-weighting of assets and require accumulated other comprehensive income to be reflected in regulatory capital; and (10) the effect of and changes in the United States monetary and fiscal policies, including the interest rate policies, regulation of the money supply by the Federal Reserve Board ("FRB"), and adverse changes in the credit rating of U.S. government debt.

NON-GAAP FINANCIAL MEASURES

Under SEC Regulation G, public companies making disclosures containing financial measures that are not in accordance with generally accepted accounting principles in the United States ("US GAAP" or "GAAP") must also disclose, along with each non-GAAP financial measure, certain additional information, including a reconciliation of the non-GAAP financial measure to the closest comparable GAAP financial measure, as well as a statement of the company's reasons for utilizing the non-GAAP financial measure. The SEC has exempted from the definition of non-GAAP financial measures certain commonly used financial measures that are not based on GAAP. However, two non-GAAP financial measures commonly used by financial institutions, namely tax-

equivalent net interest income and tax-equivalent net interest margin, have not been specifically exempted by the SEC, and may therefore constitute non-GAAP financial measures under Regulation G. We are unable to state with certainty whether the SEC would regard those measures as subject to Regulation G.

Management believes that these non-GAAP financial measures are useful in evaluating the Company's financial performance and facilitate comparisons with the performance of other financial institutions. However, that information should be considered supplemental in nature and not as a substitute for related financial information prepared in accordance with GAAP.

OVERVIEW

The Company's consolidated assets at December 31, 2012 were \$575,738,245 compared to \$552,905,517 at December 31, 2011, an increase of \$22,832,728 or 4.1%. The growth in assets was attributable to loan growth of \$29,205,115, or 7.5% related to an increase in demand for commercial loans and demand for 1-4 family residential loans, spurred by the continued low interest rate environment. The Company has retained in the loan portfolio some 10 and 15 year fixed rate mortgages to help maintain the relative level of the 1-4 family loans in the overall portfolio, while continuing to sell 30 year mortgage loans in the secondary market to manage interest rate risk. During the latter part of 2011 and continuing into the first quarter of 2012, when loan demand was weak, excess cash was used to purchase available-for-sale securities. As loan demand increased throughout 2012, cash was used to fund loan growth, which resulted in a decrease of \$25,212,858 in securities available-for-sale from December 31, 2011 to December 31, 2012. The Company took an opportunity to sell lower yielding bonds to support the loan growth. The held-to-maturity portfolio, which consists only of municipal investments, increased by \$12,163,396 or 41.0%, reflecting management's competitive pricing strategy. Deposits increased to \$475,496,859 as of December 31, 2012, an increase of \$21,103,550 from the prior year end, helping to fund the asset growth. Contributing to the deposit growth was an increase of \$10,210,315, or 16.3%, in the Company's non-interest bearing account checking accounts, of which \$6,878,999 was from business checking accounts. Other increases were attributable to NOW and savings accounts, an increase of \$5,330,690, or 4.3% and \$5,932,067, or 10.0% respectively. A portion of the increase in money market accounts is due to an increase in municipal accounts that are subject to the municipal bidding process each year. These increases in non-maturing account balances were offset by a decrease in time deposits of \$15,935,288, or 11.6%. The decrease in time deposits is a trend that has been prevalent for several years while rates have been at all time lows. Management believes that the low interest rates being paid on certificates of deposit and other investment products is likely causing some depositors to place their money in non maturing products such as demand and savings accounts while awaiting an improvement in interest rates and market conditions. Another source of funds came from the repurchase agreement program, primarily with commercial customers, which grew \$12,504,162, or 57.8% year over year. During the year, the Company paid off \$12,010,000 in long-term borrowings with FHLBB. One of the \$6,000,000 advances was not due until January of 2015 and carried a prepayment fee of \$306,338, which was more than offset from realized gains from the sale of securities in the available-for-sale portfolio. Paying off the borrowing early was a strategic measure to help manage the net interest margin in the prolonged low interest rate environment by lowering interest expense, given the challenge in increasing interest income.

Interest rates have remained at historically low levels for several years causing erosion of yields on earning assets. However in 2012, the growth in earning assets helped to offset the decreases in average yields on earning assets compared to average yields in 2011. Average earning assets increased \$11,830,200 in 2012 contributing to an increase in tax-equivalent interest income of \$74,921 year over year, despite a decrease in yields of 9 basis points. Management was able to limit the decrease in the average yield on interest earning assets to 9 basis points due to the growth in the loan portfolio which provides higher yields than other assets. While average interest bearing liabilities increased \$8,807,261, the rates paid on these liabilities decreased by 18 basis points resulting in a decrease in interest expense of \$713,309. Contributing to the decrease in the average rate paid on the interest bearing liabilities was the shift of customer funds out of higher yielding CDs to lower yielding demand and savings accounts. The combined effects of these changes resulted in an increase of \$788,230 in tax-equivalent net interest income. With the recent news from the Federal Open Market Committee ("FOMC") stating that due to current economic conditions and a subdued outlook for inflation, policy makers are likely to keep interest rates low through late 2015, maintaining current levels of net interest income in future periods will remain a challenge.

Net income for 2012 was \$4,400,690, or \$0.88 per common share, compared to \$3,583,546, or \$0.73 per common share in 2011. Total non-interest income was \$6,188,960 in 2012 compared to \$5,202,169 in 2011, an increase of 19.0%. One of the components of non-interest income is income generated from selling loans in the secondary market. The Federal Reserve's continued effort to stimulate the real estate market by keeping mortgage interest rates low has provided for several refinancing cycles which continued throughout 2012, exceeding levels in 2011. Strong mortgage refinancing activity resulted in originations of \$46,562,338 in 2012 compared to \$40,977,123 in 2011. The Company reported net gains from the sales of these mortgages of \$1,375,689 in 2012 compared to \$792,303 in 2011. This increase accounted for most of the difference in non-interest income year over year. Also contributing to the difference was the realized gains of \$351,301 on sale of securities in the available-for-sale portfolio during 2012.

Non-interest expense in 2012 was \$18,866,770 compared to \$17,533,082 in 2011, an increase of 7.6%. The Company recorded one non-recurring expense item in the prepayment fee of \$306,338 incurred on the early repayment of the FHLBB advance mentioned above. The increase in salaries and wages was partially due to normal salary increases as well as an increase in volume based incentives to lenders and bonuses paid to management based on earnings. Increases in occupancy expense were driven partly by higher costs for depreciation expense and service contracts on software and equipment largely related to supporting new and existing technology. Upgrades made to the Company's ATM network continued, including replacement of older machines and upgrading the operating systems for the remaining machines to comply with certain Americans with Disabilities Act requirements. Decisions to implement new systems are based on improving the customer service experience and efficiencies. The variance in other expenses was driven by an increase in losses on limited partnerships of \$696,181, or 145.3%, due to the affect of tax credits of \$545,228 taken in 2012. A decrease was noted in expenses related to the collection of non performing loans of \$181,615 year over year, or 42.1%, but offset partially by an increase in expense on other real estate owned of \$33,865, or 79.2%. Decreases were noted in FDIC insurance and amortization of the core deposit intangible from the Company's 2007 acquisition of LyndonBank. FDIC insurance expense decreased \$49,397 year over year due to a decrease in the factor used in the insurance premium calculation method implemented in the third quarter of 2011 and the amortization expense of the core deposit intangible decreased \$85,216.

Reported losses from external fraud related to debit card transactions were \$77,125 in 2012, compared to \$70,875 in 2011. Though the reported fraud losses decreased year over year, the actual losses from this activity in 2012 were \$94,556. During December 2012, many of the Company's debit card customers were subject to a wide spread cell phone texting fraud event. Losses from this event totaled \$27,431; however the Company maintains insurance coverage for such losses, subject to a deductible of \$10,000. At year end, an insurance claim for \$17,431 plus additional expense was pending. Debit card fraud is generally on the rise and most often results in the financial institution, rather than the customer, the merchant or the processor bearing the loss.

The Company declared dividends of \$0.56 per common share in 2012 and 2011. The Company reported retained earnings of \$2,698,200 as of December 31, 2012 compared to \$1,151,751 as of December 31, 2011 and total shareholders' equity of \$43,352,575 and \$40,918,409 for the same comparison periods. The Company is committed to remaining a well-capitalized community bank, working to meet the needs of our customers, while providing a fair return to our shareholders.

National economic data suggests that growth in economic activity has paused in recent months, largely due to weather-related disruptions and other temporary factors. Although employment has continued to expand at a moderate pace, the unemployment rate remains elevated. The FOMC recently indicated that inflation has been running somewhat below their long run objective, other than effects of fluctuations in energy prices, and longer-term inflation expectations have remained stable. The committee expects economic growth will proceed at a moderate pace and the unemployment rate will gradually decline. The FOMC is committed to continue purchasing additional agency mortgage-backed securities and rolling over maturing Treasury securities to maintain downward pressure on long-term interest rates and support the mortgage markets until the labor market improves.

The national economy continues to show signs of a gradual recovery from the recent recession; however the pace of the recovery has been slow. Spending, production and job market activity indicate the economy is expanding moderately, yet these gains are overshadowed by the recent payroll tax increase, the federal budget sequester and general uncertainty regarding the federal budget deficit and global economic turbulence from the European debt crisis which leaves the economy vulnerable to shocks. The economic outlook remains uncertain, and close monitoring of economic developments will remain necessary.

More locally, economic indicators in Vermont, such as the unemployment rate and employment by industry, are more positive. According to the State of Vermont Department of Labor, the annual 2012 unemployment rate in Vermont was 5.0%, more than one half of one percent lower than 2011 and well below the national average of 7.9% for 2012. According to industry statistics, real estate sales activity increased in 2012 compared to the lows of 2009 through 2010, with a gradual increase in median sale prices across most counties. New construction remains sluggish with the relative cost of existing homes much less than building construction. In the farming sector, average milk prices in 2012 exceeded the average price for 2011, however the high cost of fuel and grain continue to squeeze profit margins. Opportunities in this sector appear to be for the organic producers who are still seeing a solid premium and improving demand for their products. Employers in the manufacturing, professional and business services and tourism industries are reporting significant over-the-year increases in employment. Lack of snowfall during the 2011 through 2012 winter season had a negative impact on hotels, restaurants and convenience stores that rely on those who travel to the area for skiing and snowmobiling. However tourism activity during the summer and fall foliage season was good with local hotels reporting stable bookings and stronger results for 2012. The 2012 through 2013 winter season had a slow start, with below average snowfall but recent snowfall has improved, providing plenty of snow for winter activities. A positive addition to Northern Vermont is a multi-phase expansion project of an Orleans County ski area, where construction of two hotels, a hockey arena, an indoor water park and a golf clubhouse has transformed the ski resort to a year-round indoor and outdoor recreation and wedding destination resort. This project initially injected nearly \$100 million of construction funding into the local economy over the last two years utilizing Federal EB5 program capital from foreign investors. A second project is well underway to upgrade snowmaking and build hotels at another local ski resort in Caledonia County. It was recently announced that further investments of EB5 capital are intended to be utilized for several projects in the region including a bio-tech manufacturing and research facility, a window manufacturing plant, a water-front hotel and conference center, a major revitalization project for downtown Newport, and an expansion and improvements to the local

airport, with construction to take place between 2013 and 2015. Separate from the EB5 projects, it was announced recently that a Vermont developer has committed to bringing a Wal-Mart Super Store to Orleans County. The projects that are underway have created jobs and boosted economic activity in the area.

The regulatory environment continues to increase operating costs and place extensive burden on personnel resources to comply with a myriad of legal requirements, including those under the Dodd-Frank Act of 2010, the Sarbanes-Oxley Act of 2002, the USA Patriot Act, the Bank Secrecy Act, the Real Estate Settlement Procedures Act and the Truth in Lending Act. It is unlikely that these administrative costs and burdens will moderate in the future.

CRITICAL ACCOUNTING POLICIES

The Company's consolidated financial statements are prepared according to US GAAP. The preparation of such financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities in the consolidated financial statements and related notes. The SEC has defined a company's critical accounting policies as those that are most important to the portrayal of the Company's financial condition and results of operations, and which require the Company to make its most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Because of the significance of these estimates and assumptions, there is a high likelihood that materially different amounts would be reported for the Company under different conditions or using different assumptions or estimates. Management evaluates on an ongoing basis its judgment as to which policies are considered to be critical.

Allowance for Loan Losses - Management believes that the calculation of the allowance for loan losses ("ALL") is a critical accounting policy that requires the most significant judgments and estimates used in the preparation of its consolidated financial statements. In estimating the ALL, management considers historical experience as well as other qualitative factors, including the effect of current economic indicators and their probable impact on borrowers and collateral, trends in delinquent and non-performing loans, trends in criticized and classified assets, concentrations of credit, levels of exceptions, and the impact of competition in the market. Management's estimates used in calculating the ALL may increase or decrease based on changes in these factors, which in turn will affect the amount of the Company's provision for loan losses charged against current period income. Actual results could differ significantly from these estimates under different assumptions, judgments or conditions.

Other Real Estate Owned ("OREO") - Real estate properties acquired through or in lieu of foreclosure or properties no longer used for bank operations, are initially recorded at fair value less estimated selling cost at the date of acquisition, foreclosure or transfer. Such properties are carried at fair value, which is the market value less estimated cost of disposition, i.e. sales commissions and costs associated with the sale. Fair value is determined, as appropriate, either by obtaining a current appraisal or evaluation prepared by an independent, qualified appraiser, by obtaining a Market Value Analysis, and finally, if the Company has limited exposure and limited risk of loss, by the opinion of management as supported by an inspection of the property and its most recent tax valuation. Under recent and current market conditions, and periods of declining market values, the Company will generally obtain a new appraisal or evaluation. Any write-down based on the asset's fair value at the date of acquisition or institution of foreclosure is charged to the allowance for loan losses. After acquisition through or in lieu of foreclosure, these assets are carried at their new cost basis. Costs of significant property improvements are capitalized, whereas costs relating to holding the property are expensed as incurred. Appraisals, by an independent, qualified appraiser, are performed periodically on properties that management deems significant, or evaluations may be performed by management or a qualified third party on properties in the portfolio that are less vulnerable to market conditions. Subsequent write-downs are recorded as a charge to other expense. Gains or losses on the sale of such properties are included in income when the properties are sold.

The amount, if any, by which the recorded amount of the loan exceeds the fair value, less cost to sell, is a loss which is charged to the allowance for loan losses at the time of foreclosure or repossession. The recorded amount of the loan is the loan balance adjusted for any unamortized premium or discount and unamortized loan fees or costs, less any amount previously charged off, plus recorded accrued interest.

Investment Securities - Management performs quarterly reviews of individual debt and equity securities in the investment portfolio to determine whether a decline in the fair value of a security is other than temporary. A review of other-than-temporary impairment requires management to make certain judgments regarding the materiality of the decline and the probability, extent and timing of a valuation recovery, the Company's intent to continue to hold the security and, in the case of debt securities, the likelihood that the Company will not have to sell the security before recovery of its cost basis. Management assesses fair value declines to determine the extent to which such changes are attributable to fundamental factors specific to the issuer, such as financial condition and business prospects, or to market-related or other external factors, such as interest rates, and in the case of debt securities, the extent to which the impairment relates to credit losses of the issuer, as compared to other factors. Declines in the fair value of securities below their cost that are deemed to be other than temporary, and declines in fair value of debt securities below their cost that are related to credit losses, are recorded in earnings as realized losses. The non-credit loss portion of an other than temporary decline in the fair value of debt securities below their cost basis (generally, the difference between the fair value and the estimated net present value of expected future cash flows from the debt security) is recognized in other comprehensive income as an unrealized loss.

Mortgage Servicing Rights - Mortgage servicing rights associated with loans originated and sold, where servicing is retained, are required to be initially capitalized at fair value and subsequently accounted for using the "fair value method" or the "amortization method". Capitalized mortgage servicing rights are included in other assets in the consolidated balance sheets and are initially recorded at estimated fair value on the acquisition date. Mortgage servicing rights are amortized into non-interest income in proportion to, and over the period of, estimated future net servicing income of the underlying financial assets. The value of capitalized servicing rights represents the estimated present value of the future servicing fees arising from the right to service loans in the portfolio. The carrying value of the mortgage servicing rights is periodically reviewed for impairment based on a determination of estimated fair value compared to amortized cost, and impairment, if any, is recognized through a valuation allowance and is recorded as amortization of other assets. Subsequent improvement (if any) in the estimated fair value of impaired mortgage servicing rights is reflected in a positive valuation adjustment and is recognized in other income up to (but not in excess of) the amount of the prior impairment. Critical accounting policies for mortgage servicing rights relate to the initial valuation and subsequent impairment tests. The methodology used to determine the valuation of mortgage servicing rights requires the development and use of a number of estimates, including anticipated principal amortization and prepayments of that principal balance. Factors that may significantly affect the estimates used are changes in interest rates and the payment performance of the underlying loans. The Company analyzes and accounts for the value of its servicing rights with the assistance of a third party consultant.

Goodwill - Management utilizes numerous techniques to estimate the value of various assets held by the Company, including methods to determine the appropriate carrying value of goodwill. Goodwill from a purchase acquisition, such as the Company's 2007 acquisition of LyndonBank, is subject to ongoing periodic impairment tests, which include an evaluation of the ongoing assets, liabilities and revenues from the acquisition and an estimation of the impact of business conditions.

Other - Management utilizes numerous techniques to estimate the carrying value of various assets held by the Company, including, but not limited to, bank premises and equipment and deferred taxes. The assumptions considered in making these estimates are based on historical experience and on various other factors that are believed by management to be reasonable under the circumstances. The use of different estimates or assumptions could produce different estimates of carrying values and those differences could be material in some circumstances.

RESULTS OF OPERATIONS

The Company's net income of \$4,400,690 for the year ended December 31, 2012 increased \$817,144 or 22.8% from net income of \$3,583,546 for the year ended December 31, 2011, resulting in earnings per common share of \$0.88 and \$0.73, respectively. An increase of \$790,277 or 4.6% is noted in net interest income for 2012 compared to 2011. Interest income increased \$76,968 or 0.3% in 2012, while interest expense decreased \$713,309 or 12.8%. The modest increase in interest income together with the significant decrease in interest expense are both attributable to the low interest rate environment which continues to put pressure on the net interest spread and net interest margin. Non-interest income increased \$986,791 or 19.0%, and non-interest expense increased \$1,333,688 or 7.6%. Income from the sale of loans to the secondary market accounted for a major portion of the increase in non-interest income with figures of \$1,827,045 for 2012 compared to \$1,337,100 for 2011. This translates to an increase of \$489,945 or 36.6% year over year. The Company sold investments from its available-for-sale ("AFS") portfolio, including its Fannie Mae preferred stock, resulting in an overall gain of \$351,301 for 2012 compared to no gains in 2011. Salaries and wages increased \$337,438 or 5.8%, while a decrease of \$60,364 or 2.8% is noted in employee benefits. Year over year decreases in FDIC insurance expense and amortization of the core deposit intangible were \$49,397 or 11.2% and \$85,217 or 20.0%, respectively. Other expenses increased \$657,209 or 11.8% year over year with a substantial portion of the increase attributable to a prepayment fee of \$306,338 on the early prepayment of a higher cost \$6.0 million advance from FHLBB and an increase of \$695,831 in losses on limited partnerships. These increases were partially offset by a decrease of \$181,615 or 42.1% in collection and non-accruing loan expenses and \$57,428 or 73.2% in other taxes.

Return on average assets ("ROA"), which is net income divided by average total assets, measures how effectively a corporation uses its assets to produce earnings. Return on average equity ("ROE"), which is net income divided by average shareholders' equity, measures how effectively a corporation uses its equity capital to produce earnings.

The following table shows these ratios, as well as other equity ratios, for each of the last three fiscal years:

	December 31,		
	2012	2011	2010
Return on Average Assets	0.79%	0.66%	0.76%
Return on Average Equity	10.44%	8.91%	10.43%
Dividend Payout Ratio (1)	63.64%	76.71%	58.54%
Average Equity to Average Assets Ratio	7.53%	7.43%	7.26%

(1) Dividends declared per common share divided by earnings per common share.

The following table summarizes the earnings performance and balance sheet data of the Company during each of the last five fiscal years:

SELECTED FINANCIAL DATA

Years Ended December 31,	2012	2011	2010	2009	2008
Operating Data					
Total interest income	\$ 22,821,331	\$ 22,744,363	\$ 23,686,983	\$ 24,119,272	\$ 27,087,650
Total interest expense	4,882,319	5,595,628	6,527,737	7,684,480	10,503,016
Net interest income	17,939,012	17,148,735	17,159,246	16,434,792	16,584,634
Provision for loan losses	1,000,000	1,000,000	1,016,668	625,004	499,163
Net interest income after provision for loan losses	16,939,012	16,148,735	16,142,578	15,809,788	16,085,471
Non-interest income	6,188,960	5,202,169	5,641,302	5,656,433	4,036,325
Non-interest expense	18,866,770	17,533,082	17,282,150	18,033,678	18,245,072
Income before income taxes	4,261,202	3,817,822	4,501,730	3,432,543	1,876,724
Applicable income tax (benefit) expense (1)	(139,488)	234,276	555,722	(315,319)	(324,622)
Net income	\$ 4,400,690	\$ 3,583,546	\$ 3,946,008	\$ 3,747,862	\$ 2,201,346
Balance Sheet Data					
Net loans	\$413,734,575	\$384,792,788	\$387,630,511	\$378,656,376	\$362,459,591
Total assets	575,738,245	552,905,517	545,932,649	505,287,097	487,799,232
Total deposits	475,496,859	454,393,309	438,192,263	418,785,730	402,240,780
Borrowed funds	6,000,000	18,010,000	33,010,000	13,411,000	12,572,000
Total liabilities	532,385,670	511,987,108	506,804,980	468,397,259	452,526,340
Total shareholders' equity	43,352,575	40,918,409	39,127,669	36,889,838	35,272,892
Per Common Share Data					
Earnings per common share	\$ 0.88	\$ 0.73	\$ 0.82	\$ 0.79	\$ 0.46
Dividends declared per common share	\$ 0.56	\$ 0.56	\$ 0.48	\$ 0.48	\$ 0.68
Book value per common shares outstanding	\$ 8.49	\$ 8.13	\$ 7.92	\$ 7.56	\$ 7.33
Weighted average number of common shares outstanding	4,769,645	4,674,806	4,584,145	4,504,943	4,430,657
Number of common shares outstanding	4,812,925	4,728,161	4,624,514	4,549,812	4,469,105

(1) Applicable income tax expense (benefit) above includes the income tax effect, assuming a 34% tax rate, on securities gains which totaled \$119,442 in 2012, \$0 in 2011 and 2010, \$160,159 in 2009, and \$0 in 2008.

INTEREST INCOME VERSUS INTEREST EXPENSE (NET INTEREST INCOME)

The largest component of the Company's operating income is net interest income, which is the difference between interest earned on loans and investments versus the interest paid on deposits and other sources of funds (i.e. other borrowings). The Company's level of net interest income can fluctuate over time due to changes in the level and mix of earning assets, and sources of funds (volume) and from changes in the yield earned and costs of funds (rate). A portion of the Company's income from municipal investments is not subject to income taxes. Because the proportion of tax-exempt items in the Company's portfolio varies from year-to-year, to improve comparability of information across years, the non-taxable income shown in the tables below has been converted to a tax equivalent basis. Because the Company's corporate tax rate is 34%, to equalize tax-free and taxable income in the comparison, we divide the tax-free income by 66%, with the result that every tax-free dollar is equivalent to \$1.52 in taxable income.

Tax-exempt income is derived from municipal investments, which comprised the entire held-to-maturity portfolio of \$41,865,555, \$29,702,159 and \$37,440,714, at December 31, 2012, 2011 and 2010, respectively.

The following table provides the reconciliation between net interest income presented in the statements of income and the tax equivalent net interest income presented in the table immediately following for each of the last three years.

For the Years Ended December 31,	<u>2012</u>	<u>2011</u>	<u>2010</u>
	(Dollars in Thousands)		
Net interest income as presented	\$ 17,939	\$ 17,149	\$ 17,159
Effect of tax-exempt income	511	513	662
Net interest income, tax equivalent	<u>\$ 18,450</u>	<u>\$ 17,662</u>	<u>\$ 17,821</u>

The following table presents average earning assets and average interest-bearing liabilities supporting earning assets. Interest income (excluding interest on non-accrual loans) and interest expense are both expressed on a tax equivalent basis, both in dollars and as a rate/yield for the last three years.

	For the Years Ended December 31,								
	2012			2011			2010		
	Average Balance	Income/ Expense	Average Rate/ Yield	Average Balance	Income/ Expense	Average Rate/ Yield	Average Balance	Income/ Expense	Average Rate/ Yield
(Dollars in Thousands)									
Interest-Earning Assets									
Loans (1)	\$403,681	\$ 21,203	5.25%	\$391,330	\$ 21,243	5.43%	\$387,268	\$ 21,976	5.67%
Taxable investment securities	57,571	533	0.93%	32,904	357	1.09%	22,681	344	1.52%
Tax-exempt investment securities	40,058	1,504	3.75%	35,627	1,510	4.24%	48,031	1,945	4.05%
Sweep and interest earning accounts	3,881	10	0.27%	33,267	73	0.22%	15,205	19	0.12%
Other investments (4)	4,464	82	1.85%	4,696	75	1.61%	975	65	6.67%
Total	\$509,655	\$ 23,332	4.58%	\$497,824	\$ 23,258	4.67%	\$474,160	\$ 24,349	5.14%
Interest-Bearing Liabilities									
NOW	\$110,752	\$ 348	0.31%	\$110,725	\$ 469	0.42%	\$ 86,976	\$ 431	0.50%
Money market accounts	79,659	788	0.99%	72,476	757	1.04%	66,698	918	1.38%
Savings deposits	64,908	103	0.16%	60,285	110	0.18%	56,027	164	0.29%
Time deposits	132,571	2,170	1.64%	141,397	2,728	1.93%	149,528	3,246	2.17%
Federal funds purchased and other borrowed funds	20,245	290	1.43%	19,095	350	1.83%	33,806	547	1.62%
Repurchase agreements	26,383	144	0.55%	21,725	142	0.65%	19,427	179	0.92%
Capital lease obligations	802	65	8.10%	810	66	8.12%	854	69	8.08%
Junior subordinated debentures	12,887	974	7.56%	12,887	974	7.56%	12,887	974	7.56%
Total	\$448,207	\$ 4,882	1.09%	\$439,400	\$ 5,596	1.27%	\$426,203	\$ 6,528	1.53%
Net interest income		\$ 18,450			\$ 17,662			\$ 17,821	
Net interest spread (2)			3.49%			3.40%			3.61%
Net interest margin (3)			3.62%			3.55%			3.76%

(1) Included in gross loans are non-accrual loans with an average balance of \$6,311,031, \$5,715,680 and \$4,426,331 for the years ended December 31, 2012, 2011 and 2010, respectively. Loans are stated before deduction of unearned discount and allowance for loan losses.

(2) Net interest spread is the difference between the average yield on average earning assets and the average rate paid on average interest-bearing liabilities.

(3) Net interest margin is net interest income divided by average earning assets.

(4) Included in other investments is the Company's FHLBB Stock with an average balance of \$3,488,914 and \$3,720,400, respectively, for 2012 and 2011, and a payout rate of approximately 0.48% per quarter in 2012 and 0.30% in 2011. The FHLBB Stock was not included in 2010 interest-earning assets presented in the table as the FHLBB had suspended all dividend payments throughout the year.

Interest income from loans of \$21,203,038 accounts for 90.9% of total tax-equivalent interest income for 2012 compared to \$21,242,577 or 91.3% for 2011 and \$21,975,775 or 90.3% for 2010, with average yields of 5.25%, 5.43% and 5.67%, respectively.

The average volume of loans increased \$12,350,376, or 3.2% from 2011 to 2012 and \$4,062,786 or 1.1% from 2010 to 2011, while the average rate earned on these assets decreased 18 basis points from 2011 to 2012 and 24 basis points from 2010 to 2011 reflecting the prevailing low interest rate environment in both comparison periods. The average volume of taxable investments increased \$24,666,478 from 2011 to 2012 and \$10,222,943 from 2010 to 2011, resulting in increases of \$175,581 and \$13,841, respectively, in interest income on taxable investment securities despite a decline of 16 basis points and 42 basis points, respectively, in average yield. During the fourth quarter of 2011 and into the first quarter of 2012, the Company redeployed a substantial portion of the money held in its account at the Federal Reserve Bank of Boston (FRBB) to purchase taxable investments that earned a slightly better rate than the FRBB account. However, yields still remain low on these investments, contributing to the overall decrease in the average yield. Sweep and interest earning assets consist primarily of excess funds held in the Company's account at the FRBB. The average volume of these earning assets decreased from \$33,267,247 to \$3,880,952 from 2011 to 2012 to help fund loan growth. The average volume of these investments increased \$18,062,458 from 2010 to 2011, while the average rate paid increased 10 basis points. During this period, the FRBB began paying interest to financial institutions on balances left in their accounts overnight at a slightly higher rate than that of the Company's other correspondent banks, causing the Company to leave the funds in this account rather than selling the funds overnight to the other correspondent banks.

Interest expense on time deposits represents 44.4% of total interest expense for 2012, compared to 48.8% for 2011, and 49.7% for 2010, with interest expense totaling \$2,169,578, \$2,728,478 and \$3,246,174, respectively, and average rates paid of 1.64%, 1.93% and 2.17%, respectively. The average volume of time deposits decreased \$8,826,701 or 6.2% from 2011 to 2012 and \$8,131,352 or 5.4% from 2010 to 2012, and the average rate paid on such deposits decreased 29 basis points and 24 basis points, respectively. Increases are noted in the average volumes of other components of interest-bearing liabilities, with money market accounts reporting the largest increase of \$7,182,536 or 9.9% in average volume, followed by repurchase agreements with an increase of \$4,658,249 or 21.4% from 2011 to 2012 while, in the 2010 to 2011 comparison period NOW accounts reported the largest increase of \$23,748,720 or 27.3%, followed by money market funds with an increase of \$5,778,490 or 8.7%. The average rate paid on money market accounts decreased throughout the comparison periods to 0.99% for 2012 compared to 1.04% for 2011, and 1.38% for 2010.

Overall, during 2012, the average yield on interest-earning assets decreased less than the average rate paid on interest-bearing liabilities, causing the net interest spread to increase nine basis points to 3.49% for 2012, compared to last year's net interest spread of 3.40%. During 2011, the prolonged low-rate environment was a significant factor to the decrease in the net interest spread of 21 basis points, with a spread of 3.40% for 2011, compared to 3.61% for 2010.

The following table summarizes the variances in income for the years 2012, 2011 and 2010 resulting from volume changes in assets and liabilities and fluctuations in rates earned and paid compared to the prior year.

Changes in Interest Income and Interest Expense

	2012 vs. 2011			2011 vs. 2010		
	Variance Due to Rate (1)	Variance Due to Volume (1)	Total Variance	Variance Due to Rate (1)	Variance Due to Volume (1)	Total Variance
(Dollars in Thousands)						
Average Interest-Earning Assets						
Loans	\$ (711)	\$ 671	\$ (40)	\$ (963)	\$ 230	\$ (733)
Taxable investment securities	(93)	269	176	(142)	155	13
Tax-exempt investment securities	(194)	188	(6)	91	(526)	(435)
Sweep and interest earning accounts	16	(79)	(63)	32	22	54
Other investments	11	(4)	7	(238)	248	10
Total	<u>\$ (971)</u>	<u>\$ 1,045</u>	<u>\$ 74</u>	<u>\$ (1,220)</u>	<u>\$ 129</u>	<u>\$ (1,091)</u>
Average Interest-Bearing Liabilities						
NOW	\$ (121)	\$ 0	\$ (121)	\$ (81)	\$ 119	\$ 38
Money market accounts	(44)	75	31	(241)	80	(161)
Savings deposits	(15)	8	(7)	(67)	13	(54)
Time deposits	(413)	(145)	(558)	(361)	(157)	(518)
Federal funds purchased and other borrowed funds	(81)	21	(60)	72	(269)	(197)
Repurchase agreements	(28)	30	2	(58)	21	(37)
Capital lease obligations	0	(1)	(1)	1	(4)	(3)
Total	<u>\$ (702)</u>	<u>\$ (12)</u>	<u>\$ (714)</u>	<u>\$ (735)</u>	<u>\$ (197)</u>	<u>\$ (932)</u>
Changes in net interest income	<u>\$ (269)</u>	<u>\$ 1,057</u>	<u>\$ 788</u>	<u>\$ (485)</u>	<u>\$ 326</u>	<u>\$ (159)</u>

(1) Items which have shown a year-to-year increase in volume have variances allocated as follows:

Variance due to rate = Change in rate x new volume
Variance due to volume = Change in volume x old rate

Items which have shown a year-to-year decrease in volume have variances allocated as follows:

Variance due to rate = Change in rate x old volume
Variance due to volume = Change in volume x new rate

NON-INTEREST INCOME AND NON-INTEREST EXPENSE

Non-interest Income: The Company's non-interest income increased \$986,791 or 19.0% to \$6,188,960 in 2012 from \$5,202,169 in 2011. Secondary market residential mortgage sales volume was higher in 2012 compared to 2011 with originations of loans sold to the secondary market of \$46,562,338 in 2012 compared to \$40,977,123 in 2011. This resulted in a year over year increase in income from sold loans of \$489,945 or 36.6%. In 2012, the Company recorded gains through the sale of investments in its AFS portfolio of \$351,301, with no gains recorded in 2011, significantly contributing to the increase in non-interest income year over year. Other income from loans increased \$177,295 or 24.5% from 2011 to 2012 due in part in an increase in loan activity both in the commercial and residential loan portfolios. Other income decreased \$40,295 or 5.0% from 2011 to 2012, due in part to a decrease of \$45,452 or 32.6% in foreign exchange income and a decrease of \$34,983 or 41.2% in income earned from insurance companies through the sale of credit life and disability insurance. These decreases were offset in part by an increase of \$38,948 or 63.4% in income from the Company's Supplemental Employee Retirement Program ("SERP").

Non-interest Expense: The Company's non-interest expense increased 7.6% to \$18,866,770 for 2012 compared to \$17,533,082 for 2011. Salaries increased \$337,438 or 5.8% and occupancy expense increased \$227,681 or 7.4% for 2012 compared to 2011. The Company chose to prepay a higher rate borrowing with the FHLBB, resulting in prepayment fees totaling \$306,338, which contributed to the increase in non-interest expense year over year. Other expenses increased \$657,209 or 11.8% from \$5,587,304 in 2011 to \$6,244,513 in 2012. The components of other expenses noting substantial increases were losses on limited partnerships with an increase of \$695,831 or 145.2% and expenses related to OREO properties with an increase of \$66,216 or 259.1%. The Company experienced an increase in OREO activity and the related expenses during 2012 accounting for the increase in these expenses. A decrease of \$181,615 or 42.1% is noted in collection and non-accrual loan expense, which coincides with the increase in OREO expense for 2012. Other decreases include \$49,397 or 11.2% in FDIC insurance premiums and \$85,217 or 20% in the amortization expense related to the Company's core deposit intangible from the LyndonBank acquisition (see Note 6).

Total losses relating to various limited partnership investments for affordable housing in our market area constitute a notable portion of other expenses. These losses amounted to \$1,175,177 or 18.8% of other expenses for 2012 compared to \$479,346 or 8.6% of other expenses in 2011. These investments provide tax benefits, including tax credits, and are designed to yield a return of between 8% and 10%. The Company amortizes its investments in these limited partnerships under the effective yield method, resulting in the asset being amortized consistent with the periods in which the Company receives the tax benefit. The carrying values of the limited partnerships were \$2,808,551 and \$3,769,898, at December 31, 2012 and 2011, respectively.

The tax credit from the Company's New Markets Tax Credit ("NMTC") investment was \$170,750 for each of the years ended December 31, 2012 and 2011, with an amortization expense of \$39,662 and \$136,518, respectively, for the years ended December 31, 2012 and 2011. The carrying value of this investment was \$785,080 at December 31, 2012 and \$824,742 at December 31, 2011, and is recorded in other assets.

APPLICABLE INCOME TAXES

The provision for income taxes decreased from a tax expense of \$234,276 in 2011 to a tax benefit of \$139,488 in 2012, a decrease of \$373,764 or 159.5%. Income before taxes increased \$443,380 or 11.6% for 2012 compared to 2011. The decrease in income tax expense is due entirely to the tax credits relating to the Company's affordable housing and NMTC investments.

CHANGES IN FINANCIAL CONDITION

The following discussion refers to the volume of average assets, liabilities and shareholders' equity in the table labeled "Distribution of Assets, Liabilities and Shareholders' Equity" on the following page.

Average assets increased \$19.2 million or 3.5% from December 31, 2011 to December 31, 2012. The average volume of loans increased \$12.4 million or 3.2%, due in part to the prevailing low-rate interest environment throughout the comparison periods. The interest-bearing balance at the FRBB makes up the entire average volume of federal funds sold and overnight deposits in 2012 and 2011. Although the interest rate earned on the FRBB account was higher than the federal funds sold rates at other financial institutions, the yields on U.S government sponsored enterprise securities (carried in the Company's taxable investment portfolio) was more favorable, causing the Company to shift its balances into these funds. As a result, the average volume of federal funds sold and overnight deposits decreased \$29.4 million or 88.4%, while the average volume of taxable investments increased \$24.6 million or 74.5%. The average volume of the tax-exempt portfolio increased \$4.4 million or 12.4% year over year. The tax-exempt portfolio is made up of local municipal accounts and through competitive pricing strategies the Company was able to bring on new relationships throughout 2012.

Average liabilities increased \$17.2 million or 3.4% from December 31, 2011 to December 31, 2012. The average volume of time deposits decreased \$8.8 million or 6.2% from 2011 to 2012. The average volume of all other deposits increased with demand deposits increasing \$7.9 million in average volume or 13.5% and money market funds increasing \$7.2 million or 9.9% year over year, accounting for the two largest increases within the deposit accounts. The average volume of savings accounts increased \$4.6 million or 7.7% and repurchase agreements increased \$4.7 million or 21.4%. The increase in the average volume of money market funds is attributable to new municipal customers and the increase in the average volume of repurchase agreements is attributable to new commercial customer relationships originated during 2012 and the latter part of 2011. The insured cash sweep account ("ICS") that the Company started offering in 2010 has gained in popularity, increasing in average volume from \$9.2 million in 2011 to \$12.1 million in 2012, which further supports the increase in money market funds during 2012. The Company strives to keep its core customers but is not placing much emphasis on attracting rate shoppers as it has sufficient liquidity to meet reasonably foreseeable loan demand and other requirements.

The following table provides a visual comparison of the breakdown of average assets and average liabilities as well as average shareholders' equity for the comparison periods.

Distribution of Assets, Liabilities and Shareholders' Equity

	Year ended December 31,					
	2012		2011		2010	
	Balance	%	Balance	%	Balance	%
(Dollars in Thousands)						
Average Assets						
Cash and due from banks						
Non-interest bearing	\$ 9,660	1.72%	\$ 3,907	0.72%	\$ 3,588	0.69%
Federal funds sold and overnight deposits	3,881	0.69%	33,267	6.15%	15,205	2.92%
Taxable investment securities (1)	57,662	10.29%	33,040	6.11%	22,739	4.36%
Tax-exempt investment securities (1)	40,058	7.15%	35,627	6.59%	48,031	9.22%
Other securities (1)	4,077	0.73%	4,309	0.80%	3,989	0.77%
Total investment securities	101,797	18.17%	72,976	13.50%	74,759	14.35%
Gross loans	403,681	72.06%	391,330	72.33%	387,268	74.32%
Reserve for loan losses and net deferred costs	(4,000)	-0.71%	(3,876)	-0.72%	(3,655)	-0.70%
Bank premises and equipment	12,501	2.23%	12,749	2.36%	13,118	2.52%
Other real estate owned	665	0.12%	376	0.07%	919	0.18%
Investment in Capital Trust	387	0.07%	387	0.07%	332	0.06%
Bank owned life insurance	4,121	0.74%	3,993	0.74%	3,869	0.74%
Core deposit intangible	1,529	0.27%	1,909	0.35%	2,383	0.46%
Goodwill	11,574	2.07%	11,574	2.14%	11,574	2.22%
Other assets	14,396	2.57%	12,438	2.29%	11,699	2.24%
Total average assets	<u>\$ 560,192</u>	<u>100%</u>	<u>\$ 541,030</u>	<u>100%</u>	<u>\$ 521,059</u>	<u>100%</u>
Average Liabilities						
Demand deposits	\$ 66,242	11.82%	\$ 58,388	10.79%	\$ 54,115	10.39%
NOW	110,752	19.77%	110,725	20.47%	86,976	16.69%
Money market funds	79,659	14.22%	72,476	13.40%	66,698	12.80%
Savings	64,908	11.59%	60,285	11.14%	56,027	10.75%
Time deposits	132,571	23.67%	141,397	26.13%	149,528	28.70%
Total average deposits	<u>454,132</u>	<u>81.07%</u>	<u>443,271</u>	<u>81.93%</u>	<u>413,344</u>	<u>79.33%</u>
Federal funds purchased and other borrowed funds	20,245	3.61%	19,095	3.53%	33,806	6.49%
Repurchase agreements	26,383	4.71%	21,725	4.02%	19,427	3.73%
Junior subordinated debentures	12,887	2.30%	12,887	2.38%	12,887	2.47%
Other liabilities	4,376	0.78%	3,835	0.71%	3,778	0.72%
Total average liabilities	<u>518,023</u>	<u>92.47%</u>	<u>500,813</u>	<u>92.57%</u>	<u>483,242</u>	<u>92.74%</u>
Average Shareholders' Equity						
Preferred stock	2,500	0.45%	2,500	0.46%	2,500	0.48%
Common stock	12,399	2.21%	12,168	2.25%	11,919	2.29%
Additional paid-in capital	27,634	4.93%	26,980	4.98%	26,299	5.05%
Retained earnings (accumulated deficit)	1,986	0.36%	1,052	0.19%	(397)	-0.08%
Less: Treasury stock	(2,623)	-0.47%	(2,623)	-0.48%	(2,623)	-0.50%
Accumulated other comprehensive income (1)	273	0.05%	140	0.03%	119	0.02%
Total average shareholders' equity	<u>42,169</u>	<u>7.53%</u>	<u>40,217</u>	<u>7.43%</u>	<u>37,817</u>	<u>7.26%</u>
Total average liabilities and shareholders' equity	<u>\$ 560,192</u>	<u>100%</u>	<u>\$ 541,030</u>	<u>100%</u>	<u>\$ 521,059</u>	<u>100%</u>

- (1) In accordance with accounting for investments, securities classified as held-to-maturity are carried at book value and securities classified as available-for-sale are carried at fair value with the unrealized gain (loss), net of applicable income taxes, reported as a net amount in accumulated other comprehensive income. The Company does not carry securities classified as trading.

CERTAIN TIME DEPOSITS

Increments of maturity of time certificates of deposit of \$100,000 or more outstanding on December 31, 2012 are summarized as follows:

Maturity

3 months or less	\$ 6,272,351
Over 3 through 6 months	7,708,827
Over 6 through 12 months	7,598,368
Over 12 months	22,649,924
Total	\$ 44,229,470

RISK MANAGEMENT

Interest Rate Risk and Asset and Liability Management - Management actively monitors and manages the Company's interest rate risk exposure and attempts to structure the balance sheet to maximize net interest income while controlling its exposure to interest rate risk. The Company's Asset/Liability Management Committee ("ALCO") is made up of the Executive Officers and all the Vice Presidents of the Bank. The ALCO formulates strategies to manage interest rate risk by evaluating the impact on earnings and capital of such factors as current interest rate forecasts and economic indicators, potential changes in such forecasts and indicators, liquidity and various business strategies. The ALCO meets monthly to review financial statements, liquidity levels, yields and spreads to better understand, measure, monitor and control the Company's interest rate risk. In the ALCO process, the committee members apply policy limits set forth in the Asset Liability, Liquidity and Investment policies approved and periodically reviewed by the Company's Board of Directors. The ALCO's methods for evaluating interest rate risk include an analysis of the effects of interest rate changes on net interest income and an analysis of the Company's interest rate sensitivity "gap", which provides a static analysis of the maturity and repricing characteristics of the entire balance sheet.

Interest rate risk represents the sensitivity of earnings to changes in market interest rates. As interest rates change, the interest income and expense streams associated with the Company's financial instruments also change, thereby impacting net interest income ("NII"), the primary component of the Company's earnings. Fluctuations in interest rates can also have an impact on liquidity. The ALCO uses an outside consultant to perform rate shock simulations to the Company's net interest income, as well as a variety of other analyses. It is the ALCO's function to provide the assumptions used in the modeling process. The ALCO utilizes the results of this simulation model to quantify the estimated exposure of NII and liquidity to sustained interest rate changes. The simulation model captures the impact of changing interest rates on the interest income received and interest expense paid on all interest-earning assets and interest-bearing liabilities reflected on the Company's balance sheet. Furthermore, the model simulates the balance sheet's sensitivity to a prolonged flat rate environment. All rate scenarios are simulated assuming a parallel shift of the yield curve; however further simulations are performed utilizing a flattening yield curve as well. This sensitivity analysis is compared to the ALCO policy limits which specify a maximum tolerance level for NII exposure over a 1-year horizon, assuming no balance sheet growth, given a 200 basis point ("bp") shift upward and a 100 bp shift downward in interest rates. The analysis also provides a summary of the Company's liquidity position. Furthermore, the analysis provides testing of the assumptions used in previous simulation models by comparing the projected NII with actual NII. The asset/liability simulation model provides management with an important tool for making sound economic decisions regarding the balance sheet.

The Company's Asset/Liability Policy has been enhanced with a contingency funding plan to help management prepare for unforeseen liquidity restrictions to include hypothetical severe liquidity crises.

While assumptions are developed based upon current economic and local market conditions, the Company cannot provide any assurances as to the predictive nature of these assumptions, including how customer preferences or competitor influences might change.

The following reflects the Company's NII sensitivity analysis over one-year and two-year horizons, assuming a parallel shift of the yield curve as of December 31, 2012.

One Year Horizon		Two Year Horizon	
Rate Change	Percent Change in NII	Rate Change	Percent Change in NII
Down 100 basis points	-0.80%	Down 100 basis points	-7.70%
Up 200 basis points	4.30%	Up 200 basis points	11.00%

The preceding sensitivity analysis does not represent a Company forecast and should not be relied upon as being indicative of expected operating results. These hypothetical estimates are based upon numerous assumptions and factors, some of which are outside the Company's control, including, among others, the nature and timing of interest rate levels, yield curve shape, prepayments on loans and securities, deposit decay rates, pricing decisions on loans and deposits, and reinvestment/replacement of asset and liability cash flows. While assumptions are developed based upon current economic and local market conditions, the Company cannot make any assurances as to the predictive nature of these assumptions, including how customer preferences or competitor influences might change.

Credit Risk - As a financial institution, one of the primary risks the Company manages is credit risk, the risk of loss stemming from borrowers' failure to repay loans or inability to meet other contractual obligations. The Company's Board of Directors prescribes policies for managing credit risk, including loan, appraisal and environmental policies. These policies are supplemented by comprehensive underwriting standards and procedures. The Company maintains a credit administration department whose function includes credit analysis and monitoring of and reporting on the status of the loan portfolio, including delinquent and non-performing loan trends. The Company also monitors concentration of credit risk in a variety of areas, including portfolio mix, the level of loans to individual borrowers and their related interest, loans to industry segments, and the geographic distribution of commercial real estate loans. Loans are reviewed periodically by an independent loan review firm in order to assure accuracy of the Company's internal risk ratings and compliance with various internal policies and procedures and regulatory guidance.

The residential mortgage portfolio is the largest segment of the loan portfolio and as a result of the severity and depth of the recent recession and slow economic recovery it has recently seen the greatest degree of collection and foreclosure activity and losses. The Company however, has not experienced delinquencies and losses to the extent of national peers as the Company maintains a mortgage loan portfolio of traditional mortgage products and has not engaged in higher risk loans such as option adjustable rate mortgage products, high loan-to-value products, interest only mortgages, subprime loans and products with deeply discounted teaser rates. While real estate values have declined in the Company's market area, the sound underwriting standards historically employed by the Company have mitigated the trends in defaults and property surrenders experienced elsewhere. Residential mortgages with loan-to-values exceeding 80% are generally covered by private mortgage insurance ("PMI"). A 90% loan-to-value residential mortgage product without PMI is only available to borrowers with excellent credit and low debt-to-income ratios and has not been widely originated. Junior lien home equity products make up 22% of the residential mortgage portfolio with maximum loan-to-value ratios (including prior liens) of 80%. The residential mortgage portfolio has had satisfactory performance in light of the depth of the recent recession and the slow recovery.

Risk in the Company's commercial and commercial real estate loan portfolios is mitigated in part by government guarantees issued by federal agencies such as the U.S. Small Business Administration and USDA Rural Development. At December 31, 2012, the Company had \$24,676,611 in guaranteed loans with guaranteed balances of \$19,787,843, compared to \$28,077,575 in guaranteed loans with guaranteed balances of \$22,885,794 at December 31, 2011.

The Company's strategy is to continue growing the commercial and commercial real estate portfolios. Consistent with management's strategic focus on commercial lending, the Company saw increases in commercial real estate and commercial and industrial loans over the past year. Growth in the residential mortgage first lien portfolio during 2012 resulted from the Company holding rather than selling most of its 10 and 15 year fixed rate residential mortgage originations, with strong volume driven by the low interest rate environment and related refinancing activity.

The following table reflects the composition of the Company's loan portfolio as of December 31,

Composition of Loan Portfolio (1)

	2012		2011		2010		2009		2008	
	Total Loans	% of Total								
(Dollars in Thousands)										
Real estate loans										
Construction & land development	\$ 12,751	3.05%	\$ 12,589	3.24%	\$ 19,126	4.89%	\$ 16,869	4.41%	\$ 15,204	4.15%
Farm land	9,321	2.23%	10,223	2.63%	10,556	2.70%	10,039	2.63%	8,534	2.33%
1-4 Family residential -										
1st lien	171,115	40.95%	159,536	41.04%	166,475	42.53%	169,476	44.33%	166,178	45.41%
Jr lien	47,029	11.25%	45,887	11.81%	47,360	12.10%	46,982	12.29%	47,101	12.87%
Commercial	117,736	28.18%	109,458	28.16%	103,813	26.52%	97,620	25.54%	88,547	24.19%
Loans to finance agricultural production	2,590	0.62%	1,282	0.33%	1,158	0.29%	952	0.25%	884	0.24%
Commercial & industrial	46,694	11.17%	38,232	9.84%	29,887	7.63%	26,496	6.93%	23,307	6.37%
Consumer	10,642	2.55%	11,465	2.95%	13,058	3.34%	13,825	3.62%	16,239	4.44%
Gross loans	417,877	100%	388,672	100%	391,433	100%	382,259	100%	365,994	100%
Less:										
Allowance for loan losses and deferred net loan costs	(4,143)		(3,880)		(3,802)		(3,603)		(3,534)	
Net loans	\$413,735		\$384,792		\$387,631		\$378,656		\$362,460	

(1) Includes loans held for sale

The following table shows the estimated maturity of the Company's commercial loan portfolio as of December 31, 2012.

Maturity Schedule

	Fixed Rate Loans				Variable Rate Loans			
	Within 1 Year	2 - 5 Years	After 5 Years	Total	Within 1 Year	2 - 5 Years	After 5 Years	Total
(Dollars in Thousands)								
Real estate								
Construction & land development	\$ 2,484	\$ 193	\$ 4,018	\$ 6,695	\$ 3,636	\$ 2,420	\$ 0	\$ 6,056
Secured by farm land	324	187	1,824	2,335	3,359	3,567	60	6,986
Commercial real estate	2,698	4,666	7,023	14,387	49,475	46,585	7,289	103,349
Loans to finance agricultural production	18	292	0	310	2,138	142	0	2,280
Commercial & industrial	5,069	8,697	2,799	16,565	26,357	3,772	0	30,129
Total	\$ 10,593	\$ 14,035	\$ 15,664	\$ 40,292	\$ 84,965	\$ 56,486	\$ 7,349	\$ 148,800

The Company began experiencing increasing delinquencies and collection activity in 2008 when the most recent economic downturn began. The slow recovery has resulted in prolonged work through of some of these delinquencies and problem loans. The Company works actively with customers early in the delinquency process to help them to avoid default and foreclosure. During the same period the Company experienced increasing trends in the levels of non-performing loans and criticized and classified assets, which is consistent with the length and depth of the economic recession and the slow recovery. During 2009 the Company had carried the maximum qualitative factor adjustment for weak economic conditions and is now slowly decreasing that factor as the recovery progresses. With the economic recovery continuing, the levels of both Group B (Management Involved) and Group C (Unacceptable Risk) loans (as defined in Note 3 to the Company's unaudited interim consolidated financial statements) have shown gradual improvement and thus the factors for trends in delinquency and non-accrual loans and criticized and classified have also been gradually decreased. Alternatively, qualitative factors have been increased to account for growth in the loan portfolio.

The Company's non-performing assets decreased \$3.1 million or 33.1% for 2012 compared to 2011, while they increased in all prior comparison periods year over year beginning with an increase of \$2.3 million or 32.7% for 2011 compared to 2010, \$1.8 million or 35.9% for 2010 compared to 2009, and \$2.6 million or 101.7% for 2009 compared to 2008. The decrease from 2011 to 2012 is attributable to both improvement in economic conditions and the resolution of numerous problem loans. Those resolutions included completion of the foreclosure process, recognition of government loan guarantee claims receivable, borrower repayment or in limited circumstances, the transition of loans to performing accrual status. The non-performing loan increase for 2011 was attributable in large part to an increase in non-accrual commercial real estate loans. Two commercial real estate loans to one borrower totaling just over \$1.0 million moved into non-accrual as a result of diminished cash flow due to the devastation caused by Tropical Storm Irene. Four other commercial real estate loan relationships moved into non-performing status as a result of the inability to weather the economic recession.

Commercial and commercial real estate loans are generally placed on non-accrual status when there is deterioration in the financial position of the borrower, payment in full of principal and interest is not expected, and/or principal or interest has been in default for 90 days or more. However, such a loan need not be placed on non-accrual status if it is both well secured and in the process of collection. Residential mortgages and home equity loans are considered for non-accrual status at 90 days past due and are evaluated on a case-by-case basis. The Company obtains current property appraisals or market value analyses and considers the cost to carry and sell collateral in order to assess the level of specific allocations required. Consumer loans are generally not placed in non-accrual but are charged off by the time they reach 120 days past due. When a loan is placed in non-accrual status, the Company's policy is to reverse the accrued interest against current period income and to discontinue the accrual of interest until the borrower clearly demonstrates the ability and intention to resume normal payments, typically demonstrated by regular timely payments for a period of not less than six months. Interest payments received on non-accrual or impaired loans are generally applied as a reduction of the loan principal balance. Deferred taxes are calculated monthly, based on interest amounts that would have accrued through the normal accrual process. As of December 31, for each respective year, this interest amounted to \$223,665 for 2012, \$294,034 for 2011, \$235,602 for 2010, \$117,575 for 2009, and \$72,954 for 2008.

Non-performing assets were made up of the following:

December 31,	Non-Performing Assets				
	2012	2011	2010	2009	2008
	(Dollars in Thousands)				
Accruing loans past due 90 days or more:					
Commercial & industrial	\$ 0	\$ 60	\$ 29	\$ 0	\$ 0
Commercial real estate	54	99	95	0	0
Residential real estate - 1st lien	282	969	1,055	436	216
Residential real estate - Jr. lien	42	111	140	102	29
Consumer	1	1	38	20	2
Total past due 90 days or more	379	1,240	1,357	558	247
Non-accrual loans:					
Commercial & industrial	597	1,067	61	201	470
Commercial real estate	1,892	3,714	1,146	1,161	120
Residential real estate - 1st lien	1,928	2,704	2,831	2,482	944
Residential real estate - Jr. lien	338	464	388	0	311
Consumer	0	0	0	0	274
Total non-accrual loans	4,755	7,949	4,426	3,844	2,119
Total non-accrual and past due loans	5,134	9,189	5,783	4,402	2,366
Other real estate owned	1,075	90	1,210	743	185
Total non-performing assets	\$ 6,209	\$ 9,279	\$ 6,993	\$ 5,145	\$ 2,551

Percent of gross loans	1.49%	2.39%	1.79%	1.35%	0.70%
Reserve coverage of non-performing assets	69.45%	41.89%	53.31%	67.07%	126.73%

Non-performing loans as of December 31, 2012 includes approximately 43% residential first mortgages, 7% junior lien home equity loans, 38% commercial real estate and 12% in commercial loans not secured by real estate, compared to 40%, 6%, 42%, and 12% respectively at December 31, 2011.

The Company is not contractually committed to lend additional funds to debtors with impaired, non-accrual or modified loans.

The Company's OREO portfolio totaling \$1,074,705 at December 31, 2012 consisted of two commercial properties and two single family residential properties and one vacation home. During 2012 the Company sold \$310,000 of OREO acquired during 2012. During January of 2013 two of the single family homes were sold reducing the OREO portfolio to \$879,705.

Allowance for loan losses and provisions - The Company maintains an allowance for loan losses (allowance) at a level that management believes is appropriate to absorb losses inherent in the loan portfolio (See Critical Accounting Policies). Although the Company, in establishing the allowance, considers the inherent losses in individual loans and pools of loans, the allowance is a general reserve available to absorb all credit losses in the loan portfolio. No part of the allowance is segregated to absorb losses from any particular loan or class of loans.

When establishing the allowance each quarter the Company applies a combination of historical loss factors and qualitative factors to loan classes including residential first and junior lien mortgages, commercial real estate, commercial and industrial, and consumer loan portfolios. No changes were made to the allowance methodology during 2012. The Company will shorten or lengthen its look back period for determining average portfolio historical loss rates as the economy either contracts or expands; during a period of economic contraction a shortening of the look back period may more conservatively reflect the current economic climate. The highest loss rates experienced for the look back period are applied to the various segments in establishing the allowance.

The Company then applies numerous qualitative factors to each of these segments of the loan portfolio. Those factors include the levels of and trends in delinquencies and non-accrual loans, criticized and classified assets, volumes and terms of loans, and the impact of any loan policy changes. Experience, ability and depth of lending personnel, levels of policy and documentation exceptions, national and local economic trends, the competitive environment, and concentrations of credit are also factors considered.

The adequacy of the allowance is reviewed quarterly by the risk management committee of the Board of Directors and then presented to the full Board of Directors for approval.

The following table summarizes the Company's loan loss experience for each of the last five years.

Summary of Loan Loss Experience

December 31,	2012	2011	2010	2009	2008
	(Dollars in Thousands)				
Loans outstanding, end of year	\$ 417,877	\$ 388,672	\$ 391,433	\$ 382,259	\$ 365,994
Average loans outstanding during year	\$ 403,681	\$ 391,330	\$ 387,268	\$ 370,527	\$ 358,127
Non-accruing loans, end of year	\$ 4,755	\$ 7,949	\$ 4,426	\$ 3,844	\$ 1,845
Non-accruing loans, net of government guarantees	\$ 3,537	\$ 5,385	\$ 3,382	\$ 3,809	\$ 1,800
Allowance, beginning of year	\$ 3,887	\$ 3,728	\$ 3,451	\$ 3,233	\$ 3,026
Loans charged off:					
Residential real estate - 1st lien	(246)	(522)	(512)	(86)	(162)
Residential real estate - Jr. lien	(136)	(97)	(54)	(24)	0
Commercial real estate	(58)	(197)	(149)	(80)	(16)
Commercial & industrial	(159)	(22)	(32)	(140)	(109)
Consumer	(97)	(103)	(106)	(146)	(115)
Total	(696)	(941)	(853)	(476)	(402)
Recoveries:					
Residential real estate - 1st lien	6	43	28	2	7
Residential real estate - Jr lien	2	0	2	0	0
Commercial real estate	52	8	8	18	2
Commercial & industrial	29	13	42	12	21
Consumer	32	36	33	37	80
Total	121	100	113	69	110
Net loans charged off	(575)	(841)	(740)	(407)	(292)
Provision charged to income	1,000	1,000	1,017	625	499
Allowance, end of year	\$ 4,312	\$ 3,887	\$ 3,728	\$ 3,451	\$ 3,233
Net charge offs to average loans outstanding	0.14%	0.21%	0.19%	0.11%	0.08%
Provision charged to income as a percent of average loans	0.25%	0.26%	0.26%	0.17%	0.14%
Allowance to average loans outstanding	1.07%	0.99%	0.96%	0.93%	0.90%
Allowance to non-accruing loans	90.68%	48.90%	84.23%	89.78%	175.23%
Allowance to non-accruing loans net of government guarantees	121.91%	72.18%	110.23%	90.60%	179.61%

In establishing the allowance, specific allocations to the allowance are made for certain impaired loans. Impaired loans are loans to a borrower that in aggregate are greater than \$100,000 and that are in non-accrual status. A loan is considered impaired when it is probable that the Company will be unable to collect all amounts due, including interest and principal, according to the contractual terms of the loan agreement. The Company will review all the facts and circumstances surrounding non-accrual loans and on a case-by-case basis may consider loans below the threshold as impaired when such treatment is material to the financial statements. See Note 3 to the accompanying audited consolidated financial statements for information on the recorded investment in impaired loans and their related allocations.

Net loan losses increased from 2007 through 2011, peaking at \$841,000 in 2011. Given the trend in losses and depth of the recent recession and the sluggish recovery, management increased its provisions for loan losses to \$1.0 million for each of the years 2011 and 2012, compared to \$625,004 for 2009. This increase was directionally consistent with the trends and risk in the loan portfolio and with the growth of the loan portfolio. The Company has an experienced collections department that continues to work actively with borrowers to resolve problem loans, and management continues to monitor the loan portfolio closely.

The portion of the allowance termed "unallocated" is established to absorb inherent losses that exist as of the valuation date although not specifically identified through management's process for estimating credit losses. While the allowance is described as consisting of separate allocated portions, the entire allowance is available to support loan losses, regardless of category.

The following table shows the allocation of the allowance for loan losses, as well as the percent of each loan category to the total loan portfolio for each of the last five years:

Allocation of Allowance for Loan Losses

December 31,	2012	%	2011	%	2010	%	2009	%	2008	%
	(Dollars in Thousands)									
Domestic										
Residential real estate	\$ 1,896	52%	\$ 1,910	53%	\$ 1,831	55%	\$ 1,589	57%	\$ 1,404	58%
Commercial (1)	1,965	45%	1,728	44%	1,694	42%	1,616	40%	1,497	37%
Consumer	139	3%	125	3%	152	3%	182	3%	255	5%
Unallocated	312	0%	124	0%	51	0%	64	0%	77	0%
Total	\$ 4,312	100%	\$ 3,887	100%	\$ 3,728	100%	\$ 3,451	100%	\$ 3,233	100%

(1) Includes commercial loans secured by real estate, as well as unsecured commercial loans and those secured by other types of collateral.

Market Risk - In addition to credit risk in the Company's loan portfolio and liquidity risk in its loan and deposit-taking operations, the Company's business activities also generate market risk. Market risk is the risk of loss in a financial instrument arising from adverse changes in market prices and rates, foreign currency exchange rates, commodity prices and equity prices. Declining capital markets can result in fair value adjustments necessary to record decreases in the value of the investment portfolio for other-than-temporary-impairment. The Company does not have any market risk sensitive instruments acquired for trading purposes. The Company's market risk arises primarily from interest rate risk inherent in its lending and deposit taking activities. During times of recessionary periods, a declining housing market can result in an increase in loan loss reserves or ultimately an increase in foreclosures. Interest rate risk is directly related to the different maturities and repricing characteristics of interest-bearing assets and liabilities, as well as to loan prepayment risks, early withdrawal of time deposits, and the fact that the speed and magnitude of responses to interest rate changes vary by product. The prolonged weak economy and disruption in the financial markets in recent years may heighten the Company's market risk. As discussed above under "Interest Rate Risk and Asset and Liability Management", the Company actively monitors and manages its interest rate risk through the ALCO process.

INVESTMENT SECURITIES

The Company maintains an investment portfolio of various securities to diversify its revenues, as well as provide interest rate risk and credit risk diversification and to provide for its liquidity and funding needs. The Company's portfolio of available-for-sale securities decreased \$25,212,858 in 2012, from \$66,098,917 at December 31, 2011 to \$40,886,059 at December 31, 2012. The Company sold investments at various times throughout 2012 when prices were favorable, recognizing net gains each time. The Company's held-to-maturity portfolio consisted entirely of obligations of state and political subdivisions with a book value of \$41,865,555 as of December 31, 2012, compared to \$29,702,159 as of December 31, 2011. The Company has acquired several new municipal investment relationships accounting for the increase in the held-to-maturity investment portfolio.

Accounting standards require banks to recognize all appreciation or depreciation of investments classified as either trading securities or available-for-sale either through the income statement or on the balance sheet even though a gain or loss has not been realized. Securities classified as trading securities are marked to market with any gain or loss charged to income. The Company's investment policy does not permit the holding of trading securities. Securities classified as held-to-maturity are recorded at book value, subject to adjustment for other-than-temporary impairment. Securities classified as available-for-sale are marked to market with any gain or loss after taxes charged to shareholders' equity in the consolidated balance sheets. These adjustments in the available-for-sale portfolio resulted in an accumulated unrealized gain after taxes of \$171,758 at December 31, 2012, up from \$133,731 at December 31, 2011. This increase of \$38,027 was due primarily to a change in the interest rate environment. Although classified as available-for-sale, these securities are short term and we anticipate keeping them until maturity. The unrealized loss positions within the investment portfolio as of December 31, 2012 and 2011 are considered by management to be temporary.

During the fourth quarter of 2012, the Company sold all of its Fannie Mae preferred stock, resulting in a net book gain of \$87,858. At the time of sale, the aggregate cost basis, net of previous write downs, was \$42,360.

The restricted equity securities comprise the Company's membership stock in the FRBB and FHLBB. On December 31, 2012 and 2011 the Company held \$588,150 in FRBB stock and \$3,433,200 and \$3,720,400, respectively, in FHLBB stock. Membership in the FRBB and FHLBB requires the purchase of their stock in specified amounts. The stock is typically held for an extended period of time and can only be sold back to the issuer, or in the case of FHLBB, a member institution. Restricted equity stock is sold and redeemed at par. Due to the unique nature of the restricted equity stock, including the non-investment purpose for owning it, the ownership structure and restrictions and the absence of a trading market for the stock, these securities are not marked to market, but carried at par.

Some of the Company's investment securities have a call feature, meaning that the issuer may call in the investment before maturity, at predetermined call dates and prices. In 2012, three investments with such call features were exercised, compared to no calls during 2011.

The Company's investment portfolios as of December 31 were as follows:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
December 31, 2012				
Available-for-Sale				
U.S. GSE debt securities	\$ 33,552,376	\$ 247,029	\$ 13,936	\$ 33,785,469
U.S. Government securities	7,073,445	28,217	1,072	7,100,590
	<u>\$ 40,625,821</u>	<u>\$ 275,246</u>	<u>\$ 15,008</u>	<u>\$ 40,886,059</u>
Held-to-Maturity				
States and political subdivisions	\$ 41,865,555	\$ 425,445	\$ 0	\$ 42,291,000
Restricted Equity Securities (1)	\$ 4,021,350	\$ 0	\$ 0	\$ 4,021,350
Total	<u>\$ 86,512,726</u>	<u>\$ 700,691</u>	<u>\$ 15,008</u>	<u>\$ 87,198,409</u>
December 31, 2011				
Available-for-Sale				
U.S. GSE debt securities	\$ 60,846,954	\$ 215,595	\$ 99,310	\$ 60,963,239
U.S. Government securities	5,006,979	37,424	848	5,043,555
U.S. GSE preferred stock	42,360	49,763	0	92,123
	<u>\$ 65,896,293</u>	<u>\$ 302,782</u>	<u>\$ 100,158</u>	<u>\$ 66,098,917</u>
Held-to-Maturity				
States and political subdivisions	\$ 29,702,159	\$ 586,841	\$ 0	\$ 30,289,000
Restricted Equity Securities (1)	\$ 4,308,550	\$ 0	\$ 0	\$ 4,308,550
Total	<u>\$ 99,907,002</u>	<u>\$ 889,623</u>	<u>\$ 100,158</u>	<u>\$ 100,696,467</u>
December 31, 2010				
Available-for-Sale				
U.S. GSE debt securities	\$ 16,234,676	\$ 88,091	\$ 9,377	\$ 16,313,390
U.S. Government securities	5,037,252	37,666	232	5,074,686
U.S. GSE preferred stock	42,360	0	0	42,360
	<u>\$ 21,314,288</u>	<u>\$ 125,757</u>	<u>\$ 9,609</u>	<u>\$ 21,430,436</u>
Held-to-Maturity				
States and political subdivisions	\$ 37,440,714	\$ 716,286	\$ 0	\$ 38,157,000
Restricted Equity Securities (1)	\$ 4,308,550	\$ 0	\$ 0	\$ 4,308,550
Total	<u>\$ 63,063,552</u>	<u>\$ 842,043</u>	<u>\$ 9,609</u>	<u>\$ 63,895,986</u>

(1) Required equity purchases for membership in the Federal Reserve System and Federal Home Loan Bank System.

In 2012 there were realized gains of \$263,443 from the sale of investments from the Company's U.S. GSE debt securities portfolio and \$87,858 from the sale of the Company's Fannie Mae preferred stock as mentioned above. In 2011 and 2010 there were no sales of investments from the available-for-sale portfolio.

The following is an analysis of the maturities and yields of the debt securities in the Company's investment portfolio for each of the last three fiscal years:

Maturities and Yields of Investment Portfolio

December 31,	2012		2011		2010	
	Fair Value (1)	Weighted Average Yield (2)	Fair Value (1)	Weighted Average Yield (2)	Fair Value (1)	Weighted Average Yield (2)
Available-for-Sale						
U.S. Treasury & Agency Obligations						
Due in one year or less	\$ 4,104,324	0.86%	\$ 5,035,711	1.12%	\$ 14,248,432	1.34%
Due from one to five years	36,781,735	0.74%	58,970,925	0.95%	7,139,643	1.01%
Due from five to ten years	0	0.00%	2,000,158	1.28%	0	0.00%
Total	<u>\$ 40,886,059</u>	<u>0.75%</u>	<u>\$ 66,006,794</u>	<u>0.98%</u>	<u>\$ 21,388,075</u>	<u>1.23%</u>
FRBB Stock (3)	<u>\$ 588,150</u>	<u>6.00%</u>	<u>\$ 588,150</u>	<u>6.00%</u>	<u>\$ 588,150</u>	<u>6.00%</u>
FHLBB Stock (3)	<u>\$ 3,433,200</u>	<u>0.52%</u>	<u>\$ 3,720,400</u>	<u>0.29%</u>	<u>\$ 3,720,400</u>	<u>0.00%</u>
Preferred Stock	<u>\$ 0</u>	<u>0.00%</u>	<u>\$ 92,123</u>	<u>0.00%</u>	<u>\$ 42,360</u>	<u>0.00%</u>
Held-to-Maturity						
Obligations of State & Political Subdivisions						
Due in one year or less	\$ 32,741,241	3.07%	\$ 20,589,247	3.26%	\$ 28,468,783	3.48%
Due from one to five years	3,849,709	3.87%	4,534,944	4.16%	4,253,527	4.54%
Due from five to ten years	1,916,266	5.49%	822,735	4.70%	789,962	5.52%
Due after ten years	3,358,339	5.76%	3,755,233	7.17%	3,928,442	7.21%
Total	<u>\$ 41,865,555</u>	<u>3.47%</u>	<u>\$ 29,702,159</u>	<u>3.93%</u>	<u>\$ 37,440,714</u>	<u>4.04%</u>

(1) Investments classified as available-for-sale are presented at fair value, and investments classified as held-to-maturity are presented at book value.

(2) The yield on obligations of state and political subdivisions is calculated on a tax equivalent basis assuming a 34 percent tax rate.

(3) Required equity purchases for membership in the Federal Reserve System and Federal Home Loan Bank System.

BANK PREMISES AND EQUIPMENT

Major classes of bank premises and equipment and the total accumulated depreciation and amortization are as follows:

	<u>2012</u>	<u>2011</u>
Buildings and improvements	\$ 10,762,761	\$ 10,668,590
Land and land improvements	2,403,921	2,378,813
Furniture and equipment	7,340,676	7,011,347
Leasehold improvements	1,302,395	1,296,405
Capital lease	976,907	976,907
Other prepaid assets	175,507	17,490
	<u>22,962,167</u>	<u>22,349,552</u>
Less accumulated depreciation and amortization	<u>(10,718,847)</u>	<u>(9,634,326)</u>
	<u>\$ 12,243,320</u>	<u>\$ 12,715,226</u>

Depreciation included in occupancy and equipment expense amounted to \$1,112,094 and \$1,022,178, for the years ended December 31, 2012 and 2011, respectively.

The Company leases seven of its fourteen banking office locations, including two under capital lease arrangements. The leases for these seven locations expire in various years through 2022 with options to renew.

COMMITMENTS, CONTINGENCIES AND OFF-BALANCE-SHEET ARRANGEMENTS

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit and risk-sharing commitments on certain sold loans. Such instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The contract or notional amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments. During 2012, the Company did not engage in any activity that created any additional types of off-balance-sheet risk.

The Company generally requires collateral or other security to support financial instruments with credit risk. The Company's financial instruments whose contract amount represents credit risk as of December 31 were as follows:

	<u>-Contract or Notional Amount-</u>	
	<u>2012</u>	<u>2011</u>
Unused portions of home equity lines of credit	\$ 21,120,077	\$ 20,161,629
Other commitments to extend credit	45,551,282	38,106,476
Residential construction lines of credit	1,138,872	588,290
Commercial real estate and other construction lines of credit	1,762,424	2,126,558
Standby letters of credit and commercial letters of credit	1,193,480	1,954,885
Recourse on sale of credit card portfolio	352,000	398,200
MPF credit enhancement obligation, net (See Note 16)	2,035,858	1,979,684

Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future funding requirements. The Company sold its credit card portfolio during the third quarter of 2007, but retained a partial recourse obligation under the terms of the sale, based on total lines, not balances outstanding. Based on historical losses, the Company does not expect any significant losses from this commitment.

In connection with its trust preferred securities financing completed on October 31, 2007, the Company guaranteed the payment obligations under the \$12,500,000 of capital securities of its subsidiary, CMTV Statutory Trust I. The source of funds for payments by the Trust on its capital securities is payments made by the Company on its debentures issued to the Trust. The Company's obligation under those debentures is fully reflected in the Company's balance sheet, in the gross amount of \$12,887,000 at both December 31, 2012 and 2011, of which \$12,500,000 represents external financing.

EFFECTS OF INFLATION

Rates of inflation affect the reported financial condition and results of operations of all industries, including the banking industry. The effect of monetary inflation is generally magnified in bank financial and operating statements because most of a bank's assets and liabilities are monetary in nature and, as costs and prices rise, cash and credit demands of individuals and businesses increase, while the purchasing power of net monetary assets declines. During the recent economic downturn, the capital and credit markets experienced significant volatility and disruption, with the federal government taking unprecedented steps to deal with the economic situation. These measures include significant deficit spending as well as quantitative easing of the money supply by the FRB, which could result in inflation in future periods.

The impact of inflation on the Company's financial results is affected by management's ability to react to changes in interest rates in order to reduce inflationary effect on performance. Interest rates do not necessarily move in conjunction with changes in the prices of other goods and services. As discussed above, management seeks to manage the relationship between interest-sensitive assets and liabilities in order to protect against significant interest rate fluctuations, including those resulting from inflation.

LIQUIDITY AND CAPITAL RESOURCES

Managing liquidity risk is essential to maintaining both depositor confidence and stability in earnings. Liquidity management refers to the ability of the Company to adequately cover fluctuations in assets and liabilities. Meeting loan demand (assets) and covering the withdrawal of deposit funds (liabilities) are two key components of the liquidity management process. The Company's principal sources of funds are deposits, amortization and prepayment of loans and securities, maturities of investment securities, sales of loans available-for-sale, and earnings and funds provided from operations. Maintaining a relatively stable funding base, which is achieved by diversifying funding sources, competitively pricing deposit products, and extending the contractual maturity of liabilities, reduces the Company's exposure to roll over risk on deposits and limits reliance on volatile short-term borrowed funds. Short-term funding needs arise from declines in deposits or other funding sources and funding requirements for loan commitments. The Company's strategy is to fund assets to the maximum extent possible with core deposits that provide a sizable source of relatively stable and low-cost funds.

Currently, the Company is not offering competitive rates to attract or retain "rate chasers". The Company however, recognizes that, at times, when loan demand exceeds deposit growth it may be desirable to utilize alternative sources of deposit funding to augment retail deposits and borrowings. One-way deposits purchased through the CDARS provide an alternative funding source when needed. Such deposits are generally considered a form of brokered deposits. The Company had no one-way deposits at December 31, 2012 and 2011. In addition, two-way CDARS deposits allow the Company to provide FDIC deposit insurance to its customers in excess of account coverage limits by exchanging deposits with other CDARS members. At December 31, 2012, the Company reported \$1,028,152 in CDARS deposits representing exchanged deposits with other CDARS participating banks, compared to \$1,121,632 at December 31, 2011. The balance in ICS deposits discussed above under "Changes in Financial Condition" was \$13,529,424 at December 31, 2012, compared to \$10,872,204 at December 31, 2011.

The Company has a Borrower-in-Custody arrangement with the FRBB secured by eligible commercial loans, commercial real estate loans and home equity loans, resulting in an available line of \$71,345,734 and \$69,222,549, respectively at December 31, 2012 and 2011. Credit advances in the FRBB lending program are overnight advances with interest chargeable at the primary credit rate (generally referred to as the discount rate), currently 75 basis points. At December 31, 2012 and 2011, the Company had no outstanding advances against this line.

The Company has an unsecured Federal Funds line with the FHLBB with an available balance of \$500,000 at December 31, 2012 and 2011. Interest is chargeable at a rate determined daily approximately 25 basis points higher than the rate paid on federal funds sold. In addition, at December 31, 2012 and 2011, additional borrowing capacity of approximately \$72,591,692 and \$77,902,569, respectively, was available through the FHLBB secured by the Company's qualifying loan portfolio (generally, residential mortgages).

At December 31, 2012 and 2011, the Company had advances against the respective lines, consisting of the following:

	<u>2012</u>	<u>2011</u>
Long-Term Advances		
FHLBB Community Investment Program advance, 7.67% fixed rate, due November 16, 2012	\$ 0	\$ 10,000
FHLBB term advance, 1.00% fixed rate, due January 27, 2012	0	6,000,000
FHLBB term advance, 1.71% fixed rate, due January 28, 2013	6,000,000	6,000,000
FHLBB term advance, 2.72% fixed rate, due January 27, 2015	0	6,000,000
	<u>\$ 6,000,000</u>	<u>\$ 18,010,000</u>

The \$6,000,000 advance that was due on January 27, 2015 was paid off in December 2012 as a strategic measure to reduce future interest expense during the prolonged low interest rate environment. The prepayment penalty was \$306,338.

Under a separate agreement, the Company has the authority to collateralize public unit deposits up to its FHLBB borrowing capacity (\$72,591,692 and \$77,902,569, respectively, less outstanding advances) with letters of credit issued by the FHLBB. The Company offers a Government Agency Account to its municipal customers collateralized with these FHLBB letters of credit. At December 31, 2012 and 2011, approximately \$15,800,000 and \$15,950,000, respectively, of qualifying residential real estate loans was pledged as collateral to the FHLBB for these collateralized governmental unit deposits. Total fees paid by the Company to the FHLBB in connection with these letters of credit were \$41,749 for 2012 and \$44,656 for 2011.

Total cash dividends of \$0.56 per common share were declared during 2012 and 2011. In December, 2012, the Company declared a \$0.14 per common share cash dividend, payable February 1, 2013 to shareholders of record as of January 15, 2013, requiring the Company to accrue a liability of \$671,124 for this dividend in the fourth quarter of 2012.

The following table illustrates the changes in shareholders' equity from December 31, 2011 to December 31, 2012:

Balance at December 31, 2011 (book value \$8.13 per common share)	\$ 40,918,409
Net income	4,400,690
Issuance of stock through the Dividend Reinvestment Plan	849,690
Dividends declared on common stock	(2,666,741)
Dividends declared on preferred stock	(187,500)
Change in unrealized gain on available-for-sale securities, net of tax	38,027
Balance at December 31, 2012 (book value \$8.49 per common share)	<u>\$ 43,352,575</u>

In February 2009, the FRBB issued supervisory guidance on the payment of dividends and redemption and repurchases of stock by bank holding companies. The guidance heightened expectations that a bank holding company will inform and consult with FRBB supervisory staff in advance of declaring and paying any dividend that could raise safety and soundness concerns, such as a dividend exceeding current period earnings; redeeming or repurchasing regulatory capital instruments when the bank holding company is experiencing financial weaknesses; or redeeming or repurchasing common stock or perpetual preferred stock that would result in a net reduction in the amount of such equity instruments outstanding compared with the beginning of the quarter in which the redemption or repurchase occurred. The guidance provides that a bank holding company should eliminate, defer or severely limit dividends if net income for the past four quarters is not sufficient to fully fund dividends; the prospective rate of earnings retention is not consistent with the holding company's capital needs and overall current and prospective financial condition; or the holding company will not meet, or is in danger of not meeting, its minimum regulatory capital ratios. The Company would be required to consult with, and obtain the approval of, FRBB staff for payment of any dividends, including regular quarterly cash dividends, in future periods that are in excess of earnings for the applicable quarterly period. The Company reported dividend payout ratios of 63.64% in 2012 and 76.71% in 2011.

The primary source of funds for the Company's payment of dividends to its shareholders is dividends paid to the Company by the Bank. The Bank, as a national bank, is subject to the dividend restrictions set forth by the Comptroller of the Currency ("OCC"). Under such restrictions, the Bank may not, without the prior approval of the OCC, declare dividends in excess of the sum of the current year's earnings (as defined) plus the retained earnings (as defined) from the prior two years.

The Company (on a consolidated basis) 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 discretionary - actions by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance-sheet items, as calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action capital requirements are applicable to banks, but not bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). The Company's non-cumulative Series A preferred stock (\$2.5 million liquidation preference) is includable without limitation in its Tier 1 capital. In accordance with changes in the regulatory requirements for calculating capital ratios, beginning with the quarter ended March 31, 2011, the Company deducts the amount of goodwill, for purposes of calculating the amount of trust preferred junior subordinated debentures includable in Tier 1 capital. Management believes, as of December 31, 2012, that the Company and the Bank met all capital adequacy requirements to which they are subject.

As of December 31, 2012 the Bank was considered well capitalized under the regulatory capital framework for Prompt Corrective Action and the Company exceeded applicable consolidated regulatory capital guidelines.

The following table shows the regulatory capital ratios for the Company and the Bank as of year end 2012 and 2011:

	Actual		Minimum For Capital Adequacy Purposes:		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions:	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(Dollars in Thousands)						
As of December 31, 2012:						
Total capital (to risk-weighted assets)						
Company	\$ 47,385	12.57%	\$ 30,164	8.00%	N/A	N/A
Bank	\$ 46,796	12.44%	\$ 30,099	8.00%	\$ 37,623	10.00%
Tier I capital (to risk-weighted assets)						
Company	\$ 40,724	10.80%	\$ 15,082	4.00%	N/A	N/A
Bank	\$ 42,440	11.28%	\$ 15,049	4.00%	\$ 22,574	6.00%
Tier I capital (to average assets)						
Company	\$ 40,724	7.27%	\$ 22,416	4.00%	N/A	N/A
Bank	\$ 42,440	7.58%	\$ 22,387	4.00%	\$ 27,984	5.00%
As of December 31, 2011:						
Total capital (to risk-weighted assets)						
Company	\$ 44,289	11.95%	\$ 29,660	8.00%	N/A	N/A
Bank	\$ 43,710	11.82%	\$ 29,596	8.00%	\$ 36,995	10.00%
Tier I capital (to risk-weighted assets)						
Company	\$ 37,231	10.04%	\$ 14,830	4.00%	N/A	N/A
Bank	\$ 39,768	10.75%	\$ 14,798	4.00%	\$ 22,197	6.00%
Tier I capital (to average assets)						
Company	\$ 37,231	6.81%	\$ 21,882	4.00%	N/A	N/A
Bank	\$ 39,768	7.28%	\$ 21,853	4.00%	\$ 27,316	5.00%

The Company intends to continue the past policy of maintaining a strong capital resource position to support its asset size and level of operations. Consistent with that policy, management will continue to anticipate the Company's future capital needs and will adjust its dividend payment practices consistent with those needs.

From time to time the Company may make contributions to the capital of Community National Bank. At present, regulatory authorities have made no demand on the Company to make additional capital contributions.

In June 2012, the Federal Reserve Board proposed new rules implementing the Basel III capital standards, which if adopted as proposed would significantly revise the regulatory capital standards for U.S. financial institutions, including community banks. Among other things, the proposed rules would revise the definition of various regulatory capital components and related calculation methods, add a new regulatory capital component (common equity tier 1 capital), increase the minimum required tier 1 capital, implement a new capital conservation buffer and restrict dividends and certain discretionary bonus payments when the buffer is not maintained. The revisions most troubling to the Company are the changes to risk-weighting of assets, the inclusion of unrealized gains and losses on available-for-sale securities in regulatory capital and the exclusion of trust preferred securities from regulatory capital accomplished over a 10 year phase out period. In November 2012 the Federal Reserve delayed the proposed January 1, 2013 effective date in light of the volume of adverse comments received from the banking industry and others, and in March 2013 the Basel Committee on Banking Supervision likewise announced it would review its Basel III capital rules in light of similar criticisms. Management is evaluating the potential impact of the proposed capital rules on the Company and monitoring related regulatory developments.

Common Stock Performance by Quarter*

	2012				2011				
	First	Second	Third	Fourth	First	Second	Third	Fourth	
Trade Price									
High	\$ 9.75	\$ 10.25	\$ 10.75	\$ 11.25	\$ 11.00	\$ 10.00	\$ 11.00	\$ 9.75	
Low	\$ 8.90	\$ 9.65	\$ 10.00	\$ 10.50	\$ 8.14	\$ 9.00	\$ 9.06	\$ 9.50	
Bid Price									
High	\$ 9.75	\$ 10.20	\$ 10.80	\$ 10.90	\$ 9.25	\$ 9.65	\$ 10.00	\$ 9.65	
Low	\$ 8.75	\$ 9.50	\$ 9.61	\$ 10.80	\$ 8.14	\$ 8.75	\$ 9.02	\$ 9.36	
Cash Dividends Declared	\$ 0.14	\$ 0.14	\$ 0.14	\$ 0.14	\$ 0.14	\$ 0.14	\$ 0.14	\$ 0.14	

* There is no active public trading market for the Company's common stock. However, several brokerage firms follow the stock and execute trades in the stock for their customers. Trade price and bid information in the table is based on information reported by participating FINRA-registered brokers in the OTC Link® system maintained by the OTC Markets Group Inc. and may not represent all trades or high and low bids during the relevant periods. The OTC trading symbol for the Company's common stock is CMTV.

As of February 1, 2013, there were 4,810,735 shares of the Corporation's common stock (\$2.50 par value) outstanding, owned by approximately 930 shareholders of record.

Form 10-K

A copy of the Form 10-K Report filed with the Securities and Exchange Commission may be obtained without charge upon written request to:

Stephen P. Marsh, President & CEO
Community Bancorp.
4811 US Route 5
Newport, Vermont 05855

Shareholder Services

For shareholder services or information contact:

Chris Bumps, Corporate Secretary
Community Bancorp.
4811 US Route 5
Newport, Vermont 05855
(802) 334-7915

Transfer Agent:

Registrar & Transfer Company
Attn: Investors Relations Department
10 Commerce Drive
Cranford, NJ 07016
(800)368-5948
info@rtco.com
www.rtco.com

Annual Shareholders' Meeting

The 2013 Annual Shareholders' Meeting will be held at 5:30 p.m., May 14, 2013, at the Elks Club in Derby. We hope to see many of our shareholders there.

Subsidiaries of the Company

The wholly-owned subsidiary of Community Bancorp. is Community National Bank, a national banking association incorporated under the Banking Laws of The United States. Community National Bank is considered to be a "significant subsidiary" of Community Bancorp., within the meaning of Rule 1-02(w) of SEC Regulation S-X.

The unconsolidated subsidiary of Community Bancorp. is CMTV Statutory Trust I, a Delaware statutory business trust.



CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the inclusion in this Annual Report (Form 10-K) of Community Bancorp of our report dated March 28, 2013, with respect to the consolidated financial statements included in the 2012 Annual Report to Shareholders of Community Bancorp.

We also consent to the incorporation by reference in the Registration Statement (Form S-3 No. 333-160875) pertaining to the Community Bancorp Dividend Reinvestment Plan and in the Registration Statement (Form S-8 No. 333-133631) pertaining to the Community Bancorp Retirement Savings Plan of our report dated March 28, 2013, with respect to the consolidated financial statements incorporated therein by reference of Community Bancorp included in the Annual Report (Form 10-K) for the year ended December 31, 2012.

Portland, Maine

March 28, 2013

Vermont Registration No. 92-0000278

Portland, ME • Bangor,
ME • Manchester, NH

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CERTIFICATION

I, Stephen P. Marsh, Chairman, President and Chief Executive Officer, certify that:

1. I have reviewed this annual report on Form 10-K of Community Bancorp.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 28, 2013

/s/ Stephen P. Marsh
Chairman, President and Chief Executive
Officer

CERTIFICATION

I, Louise M. Bonvechio, Treasurer (Principal Financial Officer), certify that:

1. I have reviewed this annual report on Form 10-K of Community Bancorp.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 28, 2013

/s/ Louise M. Bonvechio

Treasurer

(Principal Financial Officer)

**CERTIFICATION PURSUANT TO 18 U. S. C. SECTION 1350 AS ADOPTED
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Community Bancorp. (the "Company") on Form 10-K for the period ended December 31, 2012, filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned Principal Executive Officer of the Company hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that: 1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and 2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of and for the periods covered in the Report.

A signed original of this written statement required by Section 906 has been provided to Community Bancorp. and will be retained by Community Bancorp. and furnished to the Securities and Exchange Commission or its staff upon request.

/s/ Stephen P. Marsh

Stephen P. Marsh,
Chairman, President & Chief Executive Officer

March 28, 2013

**CERTIFICATION PURSUANT TO 18 U. S. C. SECTION 1350 AS ADOPTED
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Community Bancorp. (the "Company") on Form 10-K for the period ended December 31, 2012 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned Principal Financial Officer of the Company hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that: 1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and 2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of and for the periods covered in the Report.

A signed original of this written statement required by Section 906 has been provided to Community Bancorp. and will be retained by Community Bancorp. and furnished to the Securities and Exchange Commission or its staff upon request.

/s/ Louise M. Bonvechio

Louise M. Bonvechio, Treasurer

(Principal Financial Officer)

March 28, 2013