ENTERPRISE BANCORP INC /MA/
Form 10-Q
August 09, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended June 30, 2011

or

o **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission File Number: 001-33912

Enterprise Bancorp, Inc.

(Exact name of registrant as specified in its charter)

Massachusetts (State or other jurisdiction of incorporation or organization)	**04-3308902** (I.R.S. Employer Identification No.)
222 Merrimack Street, Lowell, Massachusetts (Address of principal executive offices)	**01852** (Zip code)

(978) 459-9000

(Registrant s telephone number, including area code)

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

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

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

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o (Do not check if smaller reporting company)	Smaller reporting company o

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date:

August 1, 2011 Common Stock - Par Value **$0.01: 9,423,349** shares outstanding.

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Consolidated Balance Sheets

(Dollars in thousands)	June 30, 2011 (unaudited)	December 31, 2010
Assets		
Cash and cash equivalents:		
Cash and due from banks	$ 29,205	$ 30,541
Short-term investments	74,091	24,465
Total cash and cash equivalents	103,296	55,006
Investment securities at fair value	134,124	142,060
Federal Home Loan Bank Stock	4,740	4,740
Loans, less allowance for loan losses of $21,310 at June 30, 2011, and $19,415 at December 31, 2010, respectively	1,154,303	1,123,931
Premises and equipment	25,658	24,924
Accrued interest receivable	5,447	5,532
Deferred income taxes, net	10,425	11,039
Bank-owned life insurance	14,670	14,397
Prepaid income taxes	1,113	379
Prepaid expenses and other assets	11,076	9,657
Goodwill	5,656	5,656
Total assets	$ 1,470,508	$ 1,397,321
Liabilities and Stockholders Equity		
Liabilities		
Deposits	$ 1,319,959	$ 1,244,071
Borrowed funds	4,779	15,541
Junior subordinated debentures	10,825	10,825
Accrued expenses and other liabilities	11,715	9,297
Accrued interest payable	815	914
Total liabilities	1,348,093	1,280,648
Commitments and Contingencies		
Stockholders Equity		
Preferred stock, $0.01 par value per share; 1,000,000 shares authorized; no shares issued		
Common stock $0.01 par value per share; 20,000,000 shares authorized; 9,422,087, and 9,290,465 shares issued and outstanding at June 30, 2011 and December 31, 2010, respectively	94	93
Additional paid-in-capital	44,039	42,590
Retained earnings	75,186	72,000
Accumulated other comprehensive income	3,096	1,990
Total stockholders equity	122,415	116,673
Total liabilities and stockholders equity	$ 1,470,508	$ 1,397,321

See the accompanying notes to the unaudited consolidated financial statements.

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ENTERPRISE BANCORP, INC.

Consolidated Statements of Income

(unaudited)

(Dollars in thousands, except per share data)	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Interest and dividend income:				
Loans	$ 15,567	$ 15,354	$ 30,837	$ 30,123
Investment securities	907	1,057	1,866	2,147
Short-term investments	16	14	27	20
Total interest and dividend income	16,490	16,425	32,730	32,290
Interest expense:				
Deposits	1,903	2,224	3,818	4,555
Borrowed funds	22	50	44	107
Junior subordinated debentures	295	295	589	589
Total interest expense	2,220	2,569	4,451	5,251
Net interest income	14,270	13,856	28,279	27,039
Provision for loan losses	1,192	1,033	2,114	1,912
Net interest income after provision for loan losses	13,078	12,823	26,165	25,127
Non-interest income:				
Investment advisory fees	969	879	1,925	1,733
Deposit service fees	1,116	1,034	2,139	2,006
Income on bank-owned life insurance	160	166	322	322
Other than temporary impairment on investment securities		(7)		(8)
Net gains on sales of investment securities	261	276	261	777
Gains on sales of loans	64	103	284	184
Other income	476	406	895	934
Total non-interest income	3,046	2,857	5,826	5,948
Non-interest expense:				
Salaries and employee benefits	7,122	6,676	14,098	13,122
Occupancy and equipment expenses	1,334	1,332	2,778	2,639
Technology and telecommunications expenses	961	1,010	1,934	1,922
Advertising and public relations expenses	581	755	1,246	1,281
Deposit insurance premiums	284	449	773	909
Audit, legal and other professional fees	362	328	672	595
Supplies and postage expenses	206	201	424	397
Investment advisory and custodial expenses	126	110	230	246
Other operating expenses	1,118	911	2,139	1,794
Total non-interest expense	12,094	11,772	24,294	22,905
Income before income taxes	4,030	3,908	7,697	8,170
Provision for income taxes	1,345	1,305	2,548	2,681
Net income	$ 2,685	$ 2,603	$ 5,149	$ 5,489
Basic earnings per share	$ 0.29	$ 0.28	$ 0.55	$ 0.60

Diluted earnings per share	$	0.28	$	0.28	$	0.55	$	0.60
Basic weighted average common shares outstanding		9,401,932		9,219,171		9,360,458		9,172,194
Diluted weighted average common shares outstanding		9,497,299		9,223,965		9,426,633		9,176,734

See the accompanying notes to the unaudited consolidated financial statements.

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ENTERPRISE BANCORP, INC.

Consolidated Statement of Changes in Stockholders Equity

(Unaudited)

Six months ended June 30, 2011

(Dollars in thousands)	**Common Stock**	**Additional Paid-in Capital**	**Retained Earnings**	**Comprehensive Income**	**Accumulated Other Comprehensive Income**	**Total Stockholders Equity**
Balance at December 31, 2010	$ 93	$ 42,590	$ 72,000		$ 1,990	$ 116,673
Comprehensive income						
Net income			5,149	$ 5,149		5,149
Other comprehensive income, net				1,106	1,106	1,106
Total comprehensive income				$ 6,255		
Tax benefit from exercise of stock options		4				4
Common stock dividend paid ($0.21 per share)			(1,963)			(1,963)
Common stock issued under dividend reinvestment plan		626				626
Stock-based compensation	1	583				584
Stock options exercised		236				236
Balance at June 30, 2011	$ 94	$ 44,039	$ 75,186		$ 3,096	$ 122,415

See the accompanying notes to the unaudited consolidated financial statements.

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ENTERPRISE BANCORP, INC.

Consolidated Statements of Cash Flows

(Unaudited)

	Six months ended June 30,	
(Dollars in thousands)	**2011**	**2010**
Cash flows from operating activities:		
Net income	$ 5,149	$ 5,489
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	2,114	1,912
Depreciation and amortization	2,048	1,883
Amortization of intangible assets		66
Stock-based compensation expense	547	441
Mortgage loans originated for sale	(9,874)	(16,226)
Proceeds from mortgage loans sold	16,236	15,082
Gains on sales of loans	(284)	(184)
Gains on sales of OREO		(120)
Net gains on sales of investment securities	(261)	(777)
Other-than-temporary-impairment on investment securities		8
Income on bank-owned life insurance, net of costs	(273)	(279)
Changes in:		
Accrued interest receivable	85	(64)
Prepaid expenses and other assets	(2,507)	(583)
Accrued expenses and other liabilities	(576)	435
Accrued interest payable	(99)	(309)
Net cash provided by operating activities	12,305	6,774
Cash flows from investing activities:		
Proceeds from sales of investment securities available for sale	2,629	5,330
Proceeds from maturities, calls and pay-downs of investment securities	24,741	16,952
Purchase of investment securities	(14,578)	(25,724)
Net increase in loans	(38,564)	(33,300)
Additions to premises and equipment, net	(2,597)	(3,124)
Proceeds from OREO sales and payments	325	1,556
Net cash used in investing activities	(28,044)	(38,310)
Cash flows from financing activities:		
Net increase in deposits	75,888	70,213
Net (decrease) increase in borrowed funds	(10,762)	496
Cash dividends paid	(1,963)	(1,832)
Proceeds from issuance of common stock	626	603
Proceeds from the exercise of common stock options	236	
Tax benefit from the exercise of common stock option	4	
Net cash provided by financing activities	64,029	69,480
Net increase in cash and cash equivalents	48,290	37,944
Cash and cash equivalents at beginning of period	55,006	32,610
Cash and cash equivalents at end of period	$ 103,296	$ 70,554
Supplemental financial data:		
Cash Paid For: Interest	$ 4,550	$ 5,560
Income taxes	3,278	3,834
Supplemental schedule of non-cash investing activity:		
Purchase of investment securities not yet settled	3,031	

Transfer from loans to other real estate owned	350

See accompanying notes to the unaudited consolidated financial statements.

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ENTERPRISE BANCORP, INC.

Notes to the Unaudited Consolidated Financial Statements

(1) Organization of Holding Company

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

The Bank has five wholly owned subsidiaries. The Bank s subsidiaries include Enterprise Insurance Services, LLC and Enterprise Investment Services, LLC, organized for the purposes of engaging in insurance sales activities and offering non-deposit investment products and services, respectively. In addition, the Bank has three subsidiary security corporations (Enterprise Security Corporation, Enterprise Security Corporation II, and Enterprise Security Corporation III), which hold various types of qualifying securities. The security corporations are limited to conducting securities investment activities that the Bank itself would be allowed to conduct under applicable laws.

Through the Bank and its subsidiaries, the Company offers a range of commercial and consumer loan products, deposit and cash management products, investment advisory and management, trust and insurance services. The services offered through the Bank and subsidiaries are managed as one strategic unit and represent the Company s only reportable operating segment.

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

(2) Basis of Presentation

The accompanying unaudited consolidated financial statements and these notes should be read in conjunction with the Company s December 31, 2010 audited consolidated financial statements and notes thereto contained in the Company s 2010 Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 15, 2011. Interim results are not necessarily indicative of results to be expected for the entire year.

The Company has not changed its significant accounting and reporting policies from those disclosed in its 2010 Annual Report on Form 10-K.

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles (GAAP) for interim financial information and the instructions for Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, the accompanying consolidated financial statements reflect all necessary adjustments consisting of normal recurring accruals for a fair presentation. All significant intercompany balances and transactions have been eliminated in the accompanying consolidated financial statements.

Certain previous year amounts in the footnotes to the consolidated financial statements have been reclassified to conform to the current year s presentation.

(3) Critical Accounting Estimates

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

As discussed in the Company s 2010 Annual Report on Form 10-K, the three most significant areas in which management applies critical assumptions and estimates that are particularly susceptible to change relate to the determination of the allowance for loan losses, impairment review of investment securities and the impairment review of goodwill. Refer to note 1 to the Company s

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ENTERPRISE BANCORP, INC.

Notes to the Unaudited Consolidated Financial Statements

consolidated financial statements included in the Company s 2010 Annual Report on Form 10-K for significant accounting policies.

(4) Reporting Comprehensive Income

Comprehensive income is defined as all changes to equity except investments by and distributions to stockholders. Net income is one component of comprehensive income, with other components referred to in the aggregate as other comprehensive income. The Company s only other comprehensive income component is the net unrealized holding gains or losses on investments available for sale, net of deferred income taxes.

The following table summarizes the components of other comprehensive income for the six month periods ended June 30, 2011 and 2010.

(Dollars in thousands)	**2011**	**2010**
Gross unrealized holding gains on investments arising during the period	$ 1,984	$ 1,094
Income tax expense	(711)	(416)
Net unrealized holding gains, net of tax	1,273	678
Less: Reclassification adjustment for impairment included in net income:		
Other than temporary impairment loss arising during the period		(8)
Income tax benefit		3
Reclassification adjustment for impairment realized, net of tax		(5)
Less: Reclassification adjustment for net gains included in net income		
Net realized gains on sales of securities during the period	261	777
Income tax expense	(94)	(271)
Reclassification adjustment for gains realized, net of tax	167	506
Other comprehensive income, net of reclassifications	$ 1,106	$ 177

(5) Earnings per share

Basic earnings per share are calculated by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflects the effect on weighted average shares outstanding of the number of additional shares outstanding if dilutive stock options were converted into common stock using the treasury stock method.

The table below presents the increase in average shares outstanding, using the treasury stock method, for the diluted earnings per share calculation and the effect of those shares on earnings, for the periods indicated:

	Three months ended June 30,				Six months ended June 30,			
		2011		2010		2011		2010
Basic weighted average common shares outstanding		9,401,932		9,219,171		9,360,458		9,172,194
Dilutive shares		95,367		4,794		66,175		4,540
Diluted weighted average common shares outstanding		9,497,299		9,223,965		9,426,633		9,176,734
Basic earnings per share	$	0.29	$	0.28	$	0.55	$	0.60
Effect of dilutive shares		(0.01)						
Diluted earnings per share	$	0.28	$	0.28	$	0.55	$	0.60

For the six months ended June 30, 2011, there was an additional 133,669 average stock options outstanding, which were excluded from the year-to-date calculation of diluted earnings per share due to the exercise price of these options exceeding the average market price of the Company s common stock for the period. These options, which were not dilutive at that date, may potentially dilute earnings per share in the future.

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Notes to the Unaudited Consolidated Financial Statements

(6) Investment Securities

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

	June 30, 2011			
(Dollars in thousands)	**Amortized cost**	**Unrealized gains**	**Unrealized losses**	**Carrying Amount**
Federal agency obligations (1)	$ 39,127	$ 106	$ 2	$ 39,231
Federal agency mortgage backed securities (MBS) (1)	37,744	1,382		39,126
Municipal securities	47,520	2,011	3	49,528
Total fixed income securities	124,391	3,499	5	127,885
Equity investments	4,915	1,343	19	6,239
Total available for sale securities, at fair value	$ 129,306	$ 4,842	$ 24	$ 134,124

	December 31, 2010			
(Dollars in thousands)	**Amortized cost**	**Unrealized gains**	**Unrealized losses**	**Carrying Amount**
Federal agency obligations(1)	$ 41,149	$ 55	$ 264	$ 40,940
MBS(1)	41,581	1,056	112	42,525
Non-agency CMO	2,386	53		2,439
Municipal securities	50,576	1,109	96	51,589
Total fixed income securities	135,692	2,273	472	137,493
Equity investments	3,273	1,300	6	4,567
Total available for sale securities, at fair value	$ 138,965	$ 3,573	$ 478	$ 142,060

(1) This category may include investments issued or guaranteed by government sponsored enterprises such as Fannie Mae (FNMA), Freddie Mac (FHLMC), Ginnie Mae (GNMA), Federal Farm Credit Bureau (FFCB), or one of several Federal Home Loan Banks (FHLBs). All agency MBS/CMO investments owned by the Company are backed by residential mortgages.

Included in the carrying amount of federal agency MBS category were Collateralized Mortgage Obligations (CMO s) totaling $24.1 million and $26.0 million at June 30, 2011 and December 31, 2010, respectively.

See Note 13, Fair Value Measurements below for further information regarding the Company s fair value measurements for available-for-sale securities.

The net unrealized gain or loss in the Company s fixed income portfolio fluctuates as market interest rates rise and fall. Due to the fixed rate nature of this portfolio, as market rates fall the value of the portfolio rises, and as market rates rise, the value of the portfolio declines. The unrealized gains or losses on fixed income investments will also decline as the securities approach maturity. Unrealized gains or losses will be recognized in the statements of income if the securities are sold. However, if an unrealized loss on the fixed income portfolio is deemed to be other than temporary, the credit loss portion is charged to earnings and the noncredit portion is recognized in accumulated other comprehensive income.

As of June 30, 2011, the unrealized loss on the federal agency investments was related to one individual security, which was attributed to market volatility. The contractual cash flows of those investments are guaranteed by an agency of the U.S. Government, and the agencies that issued these securities are sponsored by the U.S. Government. Accordingly, it is expected that the securities would not be settled at a price less than the par value of the Company s investment. The Company does not consider that investment to be other-than-temporarily impaired at June 30, 2011, because the decline in market value is attributable to changes in interest rate volatility and not credit quality, additionally, the Company does not intend to, and it is more likely than not that it will not be required to, sell that investment prior to a market price recovery or maturity.

As of June 30, 2011, the unrealized loss on the Company s municipal securities was related to one obligation, and was attributed to market volatility and not a fundamental deterioration in the issuers. The Company does not consider that investment to be other-than-temporarily impaired at June 30, 2011 based on management s assessment of that investment including a review of market pricing and ongoing credit evaluations. In addition, the Company does not intend to, and it is more likely than not that it will not be required to, sell that investment prior to a market price recovery or maturity.

The net unrealized gain or loss on equity securities will fluctuate based on changes in the market value of the funds and individual securities held in the portfolio. Unrealized gains or losses will be recognized in the statements of income if the securities are sold.

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However, if an unrealized loss on an equity security is deemed to be other than temporary prior to a sale, the loss is charged to earnings.

At June 30, 2011, the equity portfolio consisted primarily of investments in a diversified group of mutual funds, with a small portion of the portfolio (approximately 16%) invested in funds or individual common stock of entities in the financial services industry. At June 30, 2011, the Company had seven investments in equity mutual funds or individual stocks having combined unrealized losses of $19 thousand which were short term in nature. Management regularly reviews the portfolio for securities with unrealized losses that are other than temporarily impaired. Management s assessment includes evaluating if any equity security or fund exhibits fundamental deterioration and whether it is unlikely that the security or fund will completely recover its unrealized loss within a reasonable time period. In determining the amount of the other than temporary impairment charge, management considers the severity of the declines and the uncertainty of recovery in the short-term for these equities. Based upon this review, the Company did not consider those equity funds to be other-than-temporarily impaired at June 30, 2011.

During the six months ended June 30, 2011, the Company did not record any fair value impairment charges on equity investments; during that period, the Company sold $388 thousand of previously impaired equity funds and recognized book gains of $207 thousand, in addition to gains of $54 thousand on the sale of another investment security over the period.

During the six months ended June 30, 2010, the Company recorded fair value impairment charges of $8 thousand, on a previously impaired equity investment; also during that period, the Company sold $1.6 million of previously impaired equity funds and recognized book gains of $752 thousand, in addition to gains of $25 thousand on other investment securities over the period.

From time to time the Company may pledge securities from its investment portfolio as collateral for various municipal deposit accounts and repurchase agreements. The fair value of securities pledged as collateral for these purposes was $47.7 million at June 30, 2011. In addition, securities designated as qualified collateral for FHLB borrowing capacity amounted to $25.6 million at June 30, 2011. Securities designated as qualified collateral for borrowing from the Federal Reserve Bank of Boston (the FRB) through its discount window amounted to $48.5 million at June 30, 2011.

(7) Restricted Investments

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

In February 2009, the FHLB began implementing a number of measures in order to strengthen its financial position and to increase its capital levels, including the indefinite suspension of its quarterly dividends and a moratorium on the repurchase of excess capital stock from member banks, among other programs. However, in the first quarter of 2011, the FHLB announced the reinstitution of quarterly dividends on capital stock balances based on improved profitability and capital levels. The FHLB noted that the board of directors anticipates continuing to declare modest cash dividends through 2011, but cautioned that negative events such as further credit losses, a decline in income or regulatory disapproval could lead them to reconsider this plan. The FHLB continues to take steps to protect members capital and improve its profitability, including amendments to its capital plan and a joint capital enhancement agreement with the other eleven FHLBs, and a continuation of the moratorium on excess capital stock repurchases. Although recent financial results of the FHLB have improved, if further deterioration in the FHLB financial condition or capital levels occurs, the Company s investment in FHLB capital stock may become other than temporarily impaired to some degree. At June 30, 2011, the Company s investment in FHLB capital stock amounted to $4.7 million. Based on management s review of this investment, FHLB stock was not other than temporarily impaired as of June 30, 2011.

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ENTERPRISE BANCORP, INC.

Notes to the Unaudited Consolidated Financial Statements

(8) Loans

Major classifications of loans and loans held for sale at the periods indicated, are as follows:

(Dollars in thousands)	June 30, 2011	December 31, 2010
Real estate:		
Commercial real estate	$ 611,016	$ 595,075
Commercial construction	123,853	111,681
Residential mortgages	89,079	86,560
Residential construction	2,845	2,874
Loans held for sale	330	6,408
Total real estate	827,123	802,598
Commercial and industrial	276,828	274,829
Home equity	69,155	63,108
Consumer	3,924	4,228
Gross loans	1,177,030	1,144,763
Deferred loan origination fees, net	(1,417)	(1,417)
Total loans	1,175,613	1,143,346
Allowance for loan losses	(21,310)	(19,415)
Net loans and loans held for sale	$ 1,154,303	$ 1,123,931

The Company manages its loan portfolio to avoid concentration by industry and loan size to minimize its credit risk exposure. In addition, the Company does not have a sub-prime mortgage program. However, inherent in the lending process is the risk of loss due to customer non-payment, or credit risk.

Loan Categories

Commercial loans:

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

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

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

From time to time, the Company participates with other banks in the financing of certain commercial projects. In some cases, the Company may act as the lead lender, originating and servicing the loans, but participating out a portion of the funding to other

ENTERPRISE BANCORP, INC.

Notes to the Unaudited Consolidated Financial Statements

banks. In other cases, the Company may participate in loans originated by other institutions. In each case, the participating bank funds a percentage of the loan commitment and takes on the related risk. In each case in which the Company participates in a loan, the rights and obligations of each participating bank are divided proportionately among the participating banks in an amount equal to their share of ownership and with equal priority among all banks. The balances participated out to other institutions are not carried as assets on the Company s financial statements. Loans originated by other banks in which the Company is the participating institution are carried in the loan portfolio at the Company s pro rata share of ownership. The Company performs an independent credit analysis of each commitment and a review of the participating institution prior to participation in the loan. Loans originated by other banks in which the Company is the participating institution amounted to $23.6 million at June 30, 2011 and $32.7 million at December 31, 2010.

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

Other loans:

Enterprise originates conventional mortgage loans on one-to-four family residential properties. These properties may serve as the borrower s primary residence, or be vacation homes or investment properties. Loan to value limits vary, generally from 80% for adjustable rate and multi-family, owner occupied properties, up to 97% for fixed rate loans on single family, owner occupied properties, with mortgage insurance coverage required for loan-to-value ratios greater than 80% based on program parameters. In addition, financing is provided for the construction of owner occupied primary residences. Residential mortgage loans may have terms of up to 30 years at either fixed or adjustable rates of interest. Fixed and adjustable rate residential mortgage loans are generally originated using secondary market underwriting and documentation standards.

Depending on the current interest rate environment, management projections of future interest rates and the overall asset-liability management program of the Company, management may elect to sell those fixed and adjustable rate residential mortgage loans which are eligible for sale in the secondary market, or hold some or all of this residential loan production for the Company s portfolio. Mortgage loans are generally not pooled for sale, but instead sold on an individual basis. The Company may retain or sell the servicing when selling the loans. All loans sold are currently sold without recourse, subject to an early payment default period covering the first four payments for certain loan sales.

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

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

Consumer loans primarily consist of secured or unsecured personal loans and overdraft protection lines on checking accounts extended to individual customers.

Loans serviced for others

At June 30, 2011 and December 31, 2010, the Company was servicing residential mortgage loans owned by investors amounting to $26.7 million and $27.2 million, respectively. Additionally, the Company was servicing commercial loans participated out to various other institutions amounting to $34.5 million and $36.6 million at June 30, 2011 and December 31, 2010, respectively.

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Loans Serving as Collateral

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

	June 30, 2011	December 31, 2010
Commercial real estate	$ 217,314	$ 227,926
Residential mortgages	64,782	63,166
Home equity	24,504	24,417
Total loans pledged to FHLB	$ 306,600	$ 315,509

(9) Allowance for Loan Loss

Credit Quality Indicators

Adversely Classified Loans

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

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

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

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

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

The following table presents the credit risk profile by internally assigned risk rating category at the periods indicated.

	June 30, 2011				
	Adversely Classified			Not Adversely	
(Dollars in thousands)	Substandard	Doubtful	Loss	Classified	Gross Loans
Cmml real estate	$ 23,384	$ 250	$	$ 587,382	$ 611,016
Cmml and industrial	7,314	121		269,393	276,828
Cmml construction	5,119			118,734	123,853
Residential	1,550			90,374	91,924
Home Equity	157			68,998	69,155
Consumer	9			3,915	3,924
Loans held for sale				330	330
Total gross loans	$ 37,533	$ 371	$	$ 1,139,126	$ 1,177,030

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	December 31, 2010				
		Adversely Classified		Not Adversely	
(Dollars in thousands)	**Substandard**	**Doubtful**	**Loss**	**Classified**	**Gross Loans**
Cmml real estate	$ 12,885	$ 250	$	$ 581,940	$ 595,075
Cmml and industrial	6,765	47		268,017	274,829
Cmml construction	2,890			108,791	111,681
Residential	2,132			87,302	89,434
Home Equity	207			62,901	63,108
Consumer	18	4		4,206	4,228
Loans held for sale				6,408	6,408
Total gross loans	$ 24,897	$ 301	$	$ 1,119,565	$ 1,144,763

In comparison to the numbers noted above, at June 30, 2010 total adversely classified loans amounted to $24.5 million. The increase in adversely classified loans as of June 30, 2011, as compared to December and June 2010, was primarily due to the downgrade of five commercial real estate relationships and two construction relationships, partially offset by paydowns and credit upgrades during the period. Management continues to closely monitor these adversely classified relationships.

Past Due and Non-Accrual Loans

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

The following table presents an age analysis of past due loans as of June 30, 2011.

(Dollars in thousands)	**Loans 30-59 Days Past Due**	**Loans 60-89 Days Past Due**	**Loans 90 or More Days Past Due (non-accrual)**	**Total Past Due Loans**	**Current Loans**	**Gross Loans**
Cmml real estate	$ 5,631	$ 1,341	$ 12,961	$ 19,933	$ 591,083	$ 611,016
Cmml and industrial	1,269	315	8,614	10,198	266,630	276,828
Cmml construction	4,900		2,124	7,024	116,829	123,853
Residential	200		1,083	1,283	90,641	91,924
Home Equity			82	82	69,073	69,155

Consumer	29	69	11	109	3,815	3,924
Loans held for sale					330	330
Total gross loans	$ 12,029	$ 1,725	$ 24,875	$ 38,629	$ 1,138,401	$ 1,177,030

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The following table presents an age analysis of past due loans as of December 31, 2010.

(Dollars in thousands)	Loans 30-59 Days Past Due	Loans 60-89 Days Past Due	Loans 90 or More Days Past Due (non-accrual)	Total Past Due Loans	Current Loans	Gross Loans
Cmml real estate	$ 4,363	$ 2,002	$ 8,065	$ 14,430	$ 580,645	$ 595,075
Cmml and industrial	816	317	7,573	8,706	266,123	274,829
Cmml construction	247		2,890	3,137	108,544	111,681
Residential	622		1,667	2,289	87,145	89,434
Home Equity	40		135	175	62,933	63,108
Consumer	24	5	11	40	4,188	4,228
Loans held for sale					6,408	6,408
Total gross loans	$ 6,112	$ 2,324	$ 20,341	$ 28,777	$ 1,115,986	$ 1,144,763

Total non-accrual loans amounted to $24.9 million at June 30, 2011, $20.3 million at December 31, 2010 and $19.2 million at June 30, 2010. Non-accrual loans which were not adversely classified amounted to $2.5 million at June 30, 2011, $2.4 million at December 31, 2010, and $1.8 million at June 30, 2010. These balances primarily represented the guaranteed portions of non-performing Small Business Administration loans.

The ratio of non- accrual loans to total loans amounted to 2.12%, 1.78% and 1.72% at June 30, 2011, December 31, 2010 and June 30, 2010, respectively.

The level of delinquent and non-performing assets is largely a function of economic conditions and the overall banking environment. Despite prudent loan underwriting, adverse changes within the Company s market area or further deterioration in the local, regional or national economic conditions could negatively impact the Company s level of non-performing assets in the future.

At June 30, 2011, additional funding commitments for loans on non-accrual status totaled $157 thousand. The Company s obligation to fulfill the additional funding commitments on non-accrual loans is generally contingent on the borrower s compliance with the terms of the credit agreement, or if the borrower is not in compliance additional funding commitments may be made at the Company s discretion.

The majority of the non-accrual loan balances were also carried as impaired loans during the periods, and are discussed further below.

Impaired Loans

Impaired loans are individually significant loans for which management considers it probable that not all amounts due in accordance with original contractual terms will be collected. The majority of impaired loans are included within the non-accrual balances; however, not every loan in non-accrual status has been designated as impaired. Impaired loans include loans that have been modified in a troubled debt restructuring (or TDR , see below). Management does not set any minimum delay of payments as a factor in reviewing for impaired classification. Management considers the payment status, net worth and earnings potential of the borrower, and the value and cash flow of the collateral as factors to determine if a loan will be paid in accordance with its contractual terms.

Impaired loans exclude large groups of smaller-balance homogeneous loans, such as residential mortgage loans and consumer loans, which are collectively evaluated for impairment, loans that are measured at fair value and leases, unless the loan is amended in a TDR. Impaired loans are individually evaluated for credit loss and a specific reserve is assigned for the amount of the estimated credit loss. Refer to heading Allowance for probable loan losses methodology contained in Note 3 Loans and Allowance For Loan Losses , to the Company s consolidated financial statements contained in the Company s 2010 Annual Report on Form 10-K for further discussion of management s methodology used to estimated specific reserves for impaired loans.

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Total impaired loans amounted to $36.1 million and $49.8 million at June 30, 2011 and December 31, 2010, respectively. Total accruing impaired loans amounted to $11.9 million and $30.7 million at June 30, 2011 and December 31, 2010, respectively, while non accrual impaired loans amounted to $24.2 million and $19.1 million as of June 30, 2011 and December 31, 2010, respectively. During the current quarter, an accruing commercial real estate relationship of approximately $13.2 million was upgraded and removed from impaired/TDR status, due to the borrower s improved financial condition and sustained performance over time. In addition, the decrease was impacted by paydowns and, in particular, the payoff of one larger commercial real estate impaired/TDR relationship during the first quarter of 2011.

The following table sets forth the recorded investment in impaired loans and the related specific allowance allocated as of June 30, 2011.

(Dollars in thousands)	Unpaid contractual principal balance	Related allowance	Recorded investment with allowance	Recorded investment with no allowance	Total recorded investment in impaired loans
Cmml real estate	$ 23,434	$ 1,128	$ 4,143	$ 18,149	$ 22,292
Cmml and industrial	10,808	1,799	7,189	2,279	9,468
Cmml construction	3,879	641	2,206	1,558	3,764
Residential	570	129	338	210	548
Home Equity					
Consumer	18	18	18		18
Total	$ 38,709	$ 3,715	$		