MERIDIAN INTERSTATE BANCORP INC
Form 10-Q
November 09, 2011

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

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

For the quarterly period ended September 30, 2011

OR

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

For the transition period from __________ to __________

Commission file number 001-33898

Meridian Interstate Bancorp, Inc.
(Exact name of registrant as specified in its charter)

Massachusetts	**20-4652200**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
10 Meridian Street, East Boston, Massachusetts	**02128**
(Address of Principal Executive Offices)	*Zip Code*

(617) 567-1500
(Registrant s telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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 and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 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 þ No o

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

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

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

At November 2, 2011, the registrant had 22,181,271 shares of no par value common stock outstanding.

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PART I FINANCIAL INFORMATION

Item 1. *FINANCIAL STATEMENTS*

MERIDIAN INTERSTATE BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Unaudited)

(Dollars in thousands)	September 30, 2011	December 31, 2010
ASSETS		
Cash and due from banks	$ 229,137	$ 155,430
Federal funds sold	63	63
Total cash and cash equivalents	229,200	155,493
Certificates of deposit affiliate bank	2,500	
Securities available for sale, at fair value	339,135	360,602
Federal Home Loan Bank stock, at cost	12,538	12,538
Loans held for sale	5,891	13,013
Loans	1,246,703	1,183,717
Less allowance for loan losses	(12,130)	(10,155)
Loans, net	1,234,573	1,173,562
Bank-owned life insurance	34,748	33,829
Foreclosed real estate, net	3,684	4,080
Investment in affiliate bank	12,629	11,497
Premises and equipment, net	35,800	34,425
Accrued interest receivable	6,799	7,543
Prepaid deposit insurance	1,653	3,026
Deferred tax asset, net	8,360	5,441
Goodwill	13,687	13,687
Other assets	3,434	7,094
Total assets	$ 1,944,631	$ 1,835,830
LIABILITIES AND STOCKHOLDERS EQUITY		
Deposits:		
Non interest-bearing	$ 134,537	$ 111,423
Interest-bearing	1,431,636	1,343,792
Total deposits	1,566,173	1,455,215
Short-term borrowings affiliate bank	7,468	1,949
Short-term borrowings other	10,052	10,037
Long-term debt	115,709	136,697
Accrued expenses and other liabilities	27,834	16,321

Total liabilities		1,727,236		1,620,219
Stockholders equity:				
Common stock, no par value, 50,000,000 shares authorized; 23,000,000 shares issued				
Additional paid-in capital		97,499		97,005
Retained earnings		132,569		122,563
Accumulated other comprehensive income		3,414		8,038
Treasury stock, at cost, 553,019 and 192,218 shares at September 30, 2011 and December 31, 2010, respectively		(6,920)		(2,121)
Unearned compensation ESOP, 672,750 and 703,800 shares at September 30, 2011 and December 31, 2010, respectively		(6,727)		(7,038)
Unearned compensation restricted shares, 318,295 and 326,905 at September 30, 2011 and December 31, 2010, respectively		(2,440)		(2,836)
Total stockholders equity		217,395		215,611
Total liabilities and stockholders equity	$	1,944,631	$	1,835,830

See accompanying notes to unaudited consolidated financial statements.

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MERIDIAN INTERSTATE BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(Dollars in thousands, except per share amounts)	**2011**	**2010**	**2011**	**2010**
Interest and dividend income:				
Interest and fees on loans	$ 16,458	$ 17,491	$ 49,068	$ 50,530
Interest on debt securities	2,610	3,461	8,611	10,291
Dividends on equity securities	257	232	792	665
Interest on certificates of deposit	8	8	25	42
Interest on other interest-earning assets	104	36	306	84
Total interest and dividend income	19,437	21,228	58,802	61,612
Interest expense:				
Interest on deposits	4,426	4,355	13,615	12,864
Interest on short-term borrowings	9	11	32	55
Interest on long-term debt	769	868	2,426	2,649
Total interest expense	5,204	5,234	16,073	15,568
Net interest income	14,233	15,994	42,729	46,044
Provision for loan losses	1,563	77	2,391	2,245
Net interest income, after provision for loan losses	12,670	15,917	40,338	43,799
Non-interest income:				
Customer service fees	1,401	1,555	4,196	4,459
Loan fees	245	238	708	536
Gain on sales of loans, net	873	309	1,478	1,073
Gain on sales of securities, net	467	785	4,256	785
Income from bank-owned life insurance	304	286	919	865
Equity income on investment in affiliate bank	314	145	1,132	321
Total non-interest income	3,604	3,318	12,689	8,039
Non-interest expenses:				
Salaries and employee benefits	7,666	6,967	21,825	19,580
Occupancy and equipment	1,765	1,670	5,850	5,164
Data processing	729	779	2,189	2,282
Data processing contract termination cost		3,075		3,075
Marketing and advertising	551	373	1,632	1,419
Professional services	537	465	2,002	1,940
Foreclosed real estate	30	28	130	304
Deposit insurance	211	578	1,469	1,670
Other general and administrative	771	710	2,268	2,297

Total non-interest expenses	12,260	14,645	37,365	37,731
Income before income taxes	4,014	4,590	15,662	14,107
Provision for income taxes	1,384	1,619	5,656	5,034
Net income	$ 2,630	$ 2,971	$ 10,006	$ 9,073
Earnings per share:				
Basic	$ 0.12	$ 0.13	$ 0.46	$ 0.41
Diluted	$ 0.12	$ 0.13	$ 0.46	$ 0.41
Weighted average shares:				
Basic	21,721,219	22,033,643	21,851,237	22,096,747
Diluted	21,843,081	22,037,561	21,976,728	22,103,406

See accompanying notes to unaudited consolidated financial statements.

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MERIDIAN INTERSTATE BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY
Nine Months Ended September 30, 2011 and 2010
(Unaudited)

(Dollars in thousands)	Shares of No Par Common Stock Outstanding	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Unearned Compensation ESOP	Unearned Compensation Restricted Shares	Total
Nine Months Ended September 30, 2010								
Balance at December 31, 2009	22,098,565	$ 100,972	$ 109,189	$ 5,583	$ (4,535)	$ (7,452)	$ (3,342)	$ 200,415
Comprehensive income:								
Net income			9,073					9,073
Change in net unrealized gain on securities available for sale, net of reclassification adjustment and tax effects				3,247				3,247
Change in defined benefit plan prior service costs and actuarial losses, net of reclassification adjustments and tax effects				102				102
Total comprehensive income								12,422
Purchase of treasury stock	(153,367)				(1,710)			(1,710)
ESOP shares earned (31,050 shares)		17				311		328
Issuance of 514,109 shares to Meridian Financial Services, Incorporated, the mutual holding company	514,109	(4,505)			4,505			
Share-based compensation expense	2,620	381					377	758
	22,461,927	$ 96,865	$ 118,262	$ 8,932	$ (1,740)	$ (7,141)	$ (2,965)	$ 212,213

Balance at September 30, 2010								
Nine Months Ended September 30, 2011								
Balance at December 31, 2010	22,480,877	$ 97,005	$ 122,563	$ 8,038	$ (2,121)	$ (7,038)	$ (2,836)	$ 215,611
Comprehensive income:								
Net income			10,006					10,006
Change in net unrealized gain on securities available for sale, net of reclassification adjustment and tax effects				(4,624)				(4,624)
Total comprehensive income								5,382
Purchase of treasury stock	(360,801)				(4,799)			(4,799)
ESOP shares earned (31,050 shares)		91				311		402
Share-based compensation expense	8,610	403					396	799
Balance at September 30, 2011	22,128,686	$ 97,499	$ 132,569	$ 3,414	$ (6,920)	$ (6,727)	$ (2,440)	$ 217,395

See accompanying notes to unaudited consolidated financial statements.

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MERIDIAN INTERSTATE BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended September 30,	
(In thousands)	**2011**	**2010**
Cash flows from operating activities:		
Net income	$ 10,006	$ 9,073
Adjustments to reconcile net income to net cash provided by operating activities:		
Accretion of acquisition fair value adjustments	(1,435)	(1,037)
Earned ESOP shares	402	328
Provision for loan losses	2,391	2,245
Amortization (accretion) of net deferred loan origination fees	250	(855)
Net amortization (accretion) of securities available for sale	501	(113)
Depreciation and amortization expense	1,764	1,804
Gain on sales of securities, net	(4,256)	(785)
Gain on sales of loans held in portfolio, net		(352)
Gain on sales and provision for foreclosed real estate, net	(130)	(125)
Deferred income tax provision (benefit)	166	(2,358)
Income from bank-owned life insurance	(919)	(865)
Equity income on investment in affiliate bank	(1,132)	(321)
Share-based compensation expense	799	758
Net changes in:		
Loans held for sale	7,122	(565)
Accrued interest receivable	744	724
Prepaid deposit insurance	1,373	1,542
Other assets	3,660	3,735
Accrued expenses and other liabilities	11,513	3,933
Net cash provided by operating activities	32,819	16,766
Cash flows from investing activities:		
Cash provided by business combination		14,422
Purchases of certificates of deposit	(2,500)	
Maturities of certificates of deposit		3,100
Activity in securities available for sale:		
Proceeds from maturities, calls and principal payments	124,597	54,336
Net redemption (purchases) of mutual funds	4,705	(6,130)
Proceeds from sales	41,274	5,943
Purchases	(152,810)	(58,314)
Loans originated, net of principal payments received	(65,433)	(70,003)
Proceeds from sales of fixed-rate loans held in portfolio		34,488
Purchases of premises and equipment	(3,077)	(1,396)
Capitalized costs on foreclosed real estate	(42)	(364)
Proceeds from sales of foreclosed real estate	1,993	3,525

Net cash used in investing activities	(51,293)	(20,393)

(continued)
See accompanying notes to unaudited consolidated financial statements.

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MERIDIAN INTERSTATE BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended September 30,			
(In thousands)	**2011**		**2010**	
Cash flows from financing activities:				
Net increase in deposits		111,446		107,330
Net change in borrowings with maturities less than three months		5,534		(6,410)
Proceeds from Federal Home Loan Bank advances with maturities of three months or more				15,475
Repayment of Federal Home Loan Bank advances with maturities of three months or more		(20,000)		(10,050)
Purchase of treasury stock		(4,799)		(1,710)
Net cash provided by financing activities		92,181		104,635
Net change in cash and cash equivalents		73,707		101,008
Cash and cash equivalents at beginning of period		155,493		19,966
Cash and cash equivalents at end of period	$	229,200	$	120,974
Supplemental cash flow information:				
Interest paid on deposits	$	14,197	$	12,807
Interest paid on borrowings		3,516		3,665
Income taxes paid, net of refunds		1,969		5,430
Non-cash investing and financing activities:				
Transfers from loans to foreclosed real estate		1,425		1,635
In conjunction with the purchase acquisition:				
Fair value of assets acquired, net of cash acquired				450,648
Fair value of liabilities assumed				465,070

See accompanying notes to unaudited consolidated financial statements.

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MERIDIAN INTERSTATE BANCORP, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

Meridian Interstate Bancorp, Inc. (the Company) is a Massachusetts mid-tier stock holding company that was formed in 2006 by East Boston Savings Bank (the Bank) to be its holding company. Meridian Interstate Bancorp owns all of East Boston Savings Bank s capital stock and directs, plans and coordinates East Boston Savings Bank s business activities. In addition, Meridian Interstate Bancorp owns approximately 40% of the capital stock of Hampshire First Bank, a New Hampshire chartered bank, organized in 2006 and headquartered in Manchester, New Hampshire. Meridian Financial Services, Incorporated is our Massachusetts-chartered mutual holding company parent. As a mutual holding company, Meridian Financial Services is a non-stock company. Meridian Financial Services owns 59.5% of Meridian Interstate Bancorp s common stock.

The accompanying unaudited interim consolidated financial statements of Meridian Interstate Bancorp, Inc. have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. Such adjustments were of a normal recurring nature. The results of operations for the three and nine months ended September 30, 2011 are not necessarily indicative of the results that may be expected for the entire year or any other interim period. For additional information, refer to the financial statements and footnotes thereto of Meridian Interstate included in Meridian Interstate s Form 10-K for the year ended December 31, 2010 which was filed with the Securities and Exchange Commission (SEC) on March 16, 2011, and is available through the SEC s website at www.sec.gov.

In preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the evaluation of goodwill for impairment, other-than-temporary impairment of securities and the valuation of deferred tax assets and foreclosed real estate.

2. RECENT ACCCOUNTING PRONOUNCEMENTS

In April 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-02, *Receivables (Topic 310), A Creditor s Determination of Whether a Restructuring Is a Troubled Debt Restructuring.* ASU 2011-02 provides additional guidance and clarification to help creditors in determining whether a creditor has granted a concession and whether a debtor is experiencing financial difficulties for purposes of determining whether a restructuring constitutes a troubled debt restructuring (TDR). ASU 2011-02 is effective for the first interim or annual period beginning on or after June 15, 2011, with retrospective application to the beginning of the annual period of adoption. The measurement of impairment should be done prospectively in the period of adoption for loans that are newly identified as TDRs upon adoption of ASU 2011-02. In addition, the TDR disclosures required by ASU 2010-20, *Receivables (Topic 310), Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses* should be provided beginning in the period of adoption of ASU 2011-02. The adoption of ASU 2011-02 resulted in additional disclosures see Note 6.

In May 2011, the FASB issued ASU No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS.* ASU 2011-04 guidance clarifies and expands the disclosures pertaining to unobservable inputs used in Level 3 fair value measurements, including the disclosure of quantitative information related to (1) the valuation processes used, (2) the sensitivity of the fair value measurement to changes in unobservable inputs and the interrelationships between those unobservable inputs, and (3) use of a nonfinancial asset in a way that differs from the asset s highest and best use. ASU 2011-04 also requires, for public companies, disclosure of the level within the fair value hierarchy for assets and liabilities not measured at fair value in the statement of financial position but for which the fair value is disclosed. The amendments in ASU 2011-04 are to be applied prospectively. For public entities, the amendments are effective during interim and annual periods beginning after December 15, 2011. Early application by public entities is not permitted. The Company does not expect this pronouncement to have a material effect on its consolidated financial statements.

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In June 2011, the FASB issued ASU No. 2011-05, *Comprehensive Income (Topic 220)*, *Presentation of Comprehensive Income*. ASU No. 2011-05 amends the disclosure requirements for the presentation of comprehensive income. The amended guidance eliminates the option to present components of other comprehensive income (OCI) as part of the statement of changes in stockholders equity. Under the amended guidance, all changes in OCI are to be presented either in a single continuous statement of comprehensive income or in two separate but consecutive financial statements. The changes are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Early application is permitted. There will be no impact to the consolidated financial results as the amendments relate only to changes in financial statement presentation.

In September 2011, the FASB issued ASU No. 2011-08, *Intangibles Goodwill and Other (Topic 350)*. ASU No. 2011-08 provides amended guidance that will allow an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Under the amended guidance, an entity would not be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. The amendments include a number of events and circumstances for an entity to consider in conducting the qualitative assessment. The amended guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early application is permitted. The Company does not anticipate the adoption of ASU No. 2011-08 will have a material impact on its consolidated financial statements.

3. FAIR VALUE HIERARCHY

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The fair value of assets and liabilities is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. 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 assets and liabilities. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. 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.

The Company groups its assets and liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1 Valuation is based on quoted prices in active markets for identical assets or liabilities. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 Valuation is based on observable inputs other than Level 1 prices, such as quoted prices for similar assets or 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 3 Valuation is based on 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 unobservable inputs to 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.

Transfers between levels are recognized at the end of a reporting period, if applicable.

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

<u>*Cash and cash equivalents*</u> The carrying amounts of cash and short-term instruments approximate fair values, based on the short-term nature of the assets.

<u>*Certificates of deposit*</u> Fair values of certificates of deposit are estimated using discounted cash flow analyses based on current market rates for similar types of deposits.

Securities available for sale All fair value measurements are obtained from a third party pricing service and are not adjusted by management. Securities available for sale are recorded at fair value on a recurring basis. Marketable equity securities are measured at fair value utilizing quoted market prices (Level 1). Corporate bonds, obligations of government-sponsored enterprises, municipal bonds and mortgage-backed securities are determined by pricing models that consider standard input factors such as observable market data, benchmark yields, reported trades, broker/dealer quotes, credit spreads, benchmark securities, as well as new issue data, monthly payment information, and collateral performance, among others (Level 2). Other debt securities are measured at fair value utilizing pricing models, discounted cash flow methodologies, or similar techniques that require significant management judgment or estimation (Level 3).

Federal Home Loan Bank stock The carrying value of Federal Home Loan Bank stock approximates fair value based on the redemption provisions of the Federal Home Loan Bank.

Loans held for sale The fair value is based on commitments in effect from investors or prevailing market prices.

Loans For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for other loans are estimated using discounted cash flow analyses, using market interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for non-performing loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Deposits The fair values disclosed for non-certificate accounts, by definition, equal to the amount payable on demand at the reporting date which is their carrying amounts. Fair values for certificates of deposit are estimated using a discounted cash flow calculation that applies market interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Borrowings The fair value is estimated using discounted cash flow analyses based on the current incremental borrowing rates in the market for similar types of borrowing arrangements.

Accrued interest The carrying amounts of accrued interest approximate fair value.

Forward loan sale commitments and derivative loan commitments Forward loan sale commitments and derivative loan commitments are based on fair values of the underlying mortgage loans and the probability of such commitments being exercised. Significant management judgment and estimation is required in determining these fair value measurements.

Off-balance sheet credit-related instruments Fair values for off-balance-sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties credit standing. The fair value of these instruments is considered immaterial.

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Assets and Liabilities Measured at Fair Value on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis are summarized as follows:

	September 30, 2011			
(In thousands)	Level 1	Level 2	Level 3	Total Fair Value
Assets				
Securities available for sale				
Debt securities:				
Corporate bonds	$	$ 176,030	$	$ 176,030
Government-sponsored enterprises		76,645		76,645
Municipal bonds		7,627		7,627
Residential mortgage-backed securities:				
Government-sponsored enterprises		28,544		28,544
Private label		7,698		7,698
Total debt securities		296,544		296,544
Marketable equity securities:				
Common stocks	33,405			33,405
Money market mutual funds	9,186			9,186
Total marketable equity securities	42,591			42,591
Total securities available for sale	42,591	296,544		339,135
Derivative loan commitments			653	653
Total assets	$ 42,591	$ 296,544	$ 653	$ 339,788
Liabilities				
Forward loan sale commitments	$	$	$ 251	$ 251
Total liabilities	$	$	$ 251	$ 251

	December 31, 2010			
(In thousands)	Level 1	Level 2	Level 3	Total Fair Value
Assets				
Debt securities:				
Corporate bonds	$	$ 222,038	$	$ 222,038
Government-sponsored enterprises		35,900		35,900
Municipal bonds		6,493		6,493
Residential mortgage-backed securities:				
Government-sponsored enterprises		34,542		34,542
Private label		10,334		10,334

Other debt securities			641	641
Total debt securities		309,307	641	309,948
Marketable equity securities:				
Common stocks	36,765			36,765
Money market mutual funds	13,889			13,889
Total marketable equity securities	50,654			50,654
Total securities available for sale	$ 50,654	$ 309,307	$ 641	$ 360,602

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For the three and nine months ended September 30, 2011, there were no transfers in or out of Levels 1 and 2 and the changes in Level 3 assets and liabilities that are measured at fair value on a recurring basis are as follows:

		Assets		
(In thousands)	Securities available for sale		Derivative loan commitments and forward loan sale commitments, net	
For the three months ended September 30, 2011:				
Balance as of June 30, 2010	$		$	
Securities sold				
Total realized and unrealized gains included net income				402
Balance as of September 30, 2011	$		$	402
Total realized gain on sales of Level 3 securities for the three months ended September 30, 2011	$		$	402
For the nine months ended September 30, 2011:				
Balance as of December 31, 2010	$	641	$	
Securities sold		(641)		
Total realized and unrealized gains included net income	$		$	402
Balance as of September 30, 2011	$		$	402
Total realized gain on sales of Level 3 securities for the nine months ended September 30, 2011	$	907	$	
Total unrealized gains (losses) relating to instruments still held at September 30, 2011	$		$	402

Assets Measured at Fair Value on a Non-recurring Basis

The Company may also be required, from time to time, to measure certain other assets on a non-recurring basis in accordance with generally accepted accounting principles. These adjustments to fair value usually result from the application of lower-of-cost-or market accounting or write-downs of individual assets.

The following tables summarize the fair value hierarchy used to determine each adjustment and the carrying value of the related individual assets. The gain/loss represents the amount of write-down, charge-off or specific reserve recorded during the periods noted on the assets held at period end. There were no liabilities measured at fair value on a non-recurring basis.

	September 30, 2011						**Three Months Ended September 30, 2011**		**Nine Months Ended September 30, 2011**	
(In thousands)	Level 1		Level 2		Level 3		Total Losses		Total Losses	
Impaired loans	$		$		$	6,876	$	(286)	$	(337)

Foreclosed real esate					3,684		(90)		(90)
	$		$	$	10,560	$	(376)	$	(427)

	September 30, 2010			Three Months Ended September 30, 2010	Nine Months Ended September 30, 2010
(In thousands)	Level 1	Level 2	Level 3	Total Losses	Total Losses
Impaired loans	$	$	$ 10,762	$ (27)	$ (943)
Foreclosed real esate			3,215	(51)	(51)
	$	$	$ 13,977	$ (78)	$ (994)

	December 31, 2010		
(In thousands)	Level 1	Level 2	Level 3
Impaired loans	$	$	$ 6,274
Foreclosed real esate			4,080
	$	$	$ 10,354

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Certain impaired loans were adjusted to fair value, less cost to sell, of the underlying collateral securing these loans resulting in losses. The loss is not recorded directly as an adjustment to current earnings, but rather as a component in determining the allowance for loan losses. Fair value was measured using appraised values of collateral and adjusted as necessary by management based on unobservable inputs for specific properties.

Certain properties in foreclosed real estate were adjusted to fair value using appraised values of collateral, less cost to sell, and adjusted as necessary by management based on unobservable inputs for specific properties. The loss on foreclosed assets represents adjustments in valuation recorded during the time period indicated and not for losses incurred on sales.

Summary of Fair Values of Financial Instruments

The estimated fair values, and related carrying amounts, of the Company s financial instruments are as follows. Certain financial instruments and all nonfinancial instruments are exempt from disclosure requirements. Accordingly, the aggregate fair value amounts presented herein do not represent the underlying fair value of the Company.

	September 30, 2011		**December 31, 2010**	
(In thousands)	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and cash equivalents	$ 229,200	$ 229,200	$ 155,493	$ 155,493
Certificates of deposit	2,500	2,522		
Securities available for sale	339,135	339,135	360,602	360,602
Federal Home Loan Bank stock	12,538	12,538	12,538	12,538
Loans and loans held for sale, net	1,240,464	1,268,822	1,186,575	1,195,661
Accrued interest receivable	6,799	6,799	7,543	7,543
Derivative loan commitments	653	653		
Financial liabilities:				
Deposits	1,566,173	1,573,338	1,455,215	1,463,016
Borrowings	133,229	137,990	148,683	153,618
Accrued interest payable	967	967	1,131	1,131
Forward loan sale commitments	251	251		

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4. EARNINGS PER SHARE

Basic earnings per share excludes dilution and is calculated by dividing net income available to common stockholders by the weighted-average number of common shares outstanding during the period. If rights to dividends on unvested options/awards are non-forfeitable, these unvested awards/options are considered outstanding in the computation of basic earnings per share. Diluted earnings per share is computed in a manner similar to that of basic earnings per share except that the weighted-average number of common shares outstanding is increased to include the number of incremental common shares (computed using the treasury method) that would have been outstanding if all potentially dilutive common stock equivalents (such as options) were issued during the period. Unallocated common shares held by the ESOP are shown as a reduction in stockholders equity and are not included in the weighted-average number of common shares outstanding for either basic or diluted earnings per share calculations.

Basic and diluted earnings per share have been computed based on the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(Dollars in thousands, except per share amounts)	**2011**	**2010**	**2011**	**2010**
Net income available to common stockholders	$ 2,630	$ 2,971	$ 10,006	$ 9,073
Average number of common shares outstanding	21,503,138	21,766,532	21,638,677	21,830,598
Effect of unvested stock awards	218,081	267,111	212,560	266,149
Basic weighted average shares outstanding	21,721,219	22,033,643	21,851,237	22,096,747
Effect of dilutive stock options	121,862	3,918	125,491	6,659
Diluted weighted average shares outstanding	21,843,081	22,037,561	21,976,728	22,103,406
Earnings per share:				
Basic	$ 0.12	$ 0.13	$ 0.46	$ 0.41
Diluted	$ 0.12	$ 0.13	$ 0.46	$ 0.41

Options of 36,500 and 502,572 shares for the three months ended September 30, 2011 and 2010, respectively, and options of 21,833 and 566,284 shares for the nine months ended September 30, 2011 and 2010, respectively, were not included in the calculation of diluted earnings per share because to do so would have been anti-dilutive.

5. SECURITIES

All securities held by the Company as of September 30, 2011 and December 31, 2010 were classified as available for sale and are carried at fair value. Unrealized gains and losses, net of tax, are excluded from earnings and reported as a separate component of stockholders equity. Gains or losses on the sale of available-for-sale securities are determined using the specific identification method. Premiums and discounts are recognized in interest income using the effective interest method over the period to maturity.

At September 30, 2011, the securities portfolio was $339.1 million, or 17.4% of total assets. At that date, 51.9% of the securities portfolio, or $176.0 million, was invested in corporate bonds. As of September 30, 2011, the fair value of corporate debt and marketable equity securities in the financial services sector amounted to $92.8 million, and $4.4 million, respectively.

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The following table sets forth the amortized cost and fair value of our securities available for sale.

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2011				
Debt securities:				
Corporate bonds:				
Financial services	$ 92,741	$ 1,306	$ (1,273)	$ 92,774
Industry and manufacturing	21,635	799		22,434
Consumer products and services	23,384	1,169		24,553
Technology	12,773	252	(2)	13,023
Healthcare	19,642	970		20,612
Other	2,542	92		2,634
Total corporate bonds	172,717	4,588	(1,275)	176,030
Government-sponsored enterprises	76,407	292	(54)	76,645
Municipal bonds	7,438	192	(3)	7,627
Residential mortgage-backed securities:				
Government-sponsored enterprises	27,170	1,374		28,544
Private label	7,707	248	(257)	7,698
Total debt securities	291,439	6,694	(1,589)	296,544
Marketable equity securities:				
Common stocks:				
Financial services	5,253	210	(1,094)	4,369
Industry and manufacturing	4,676	399	(232)	4,843
Consumer products and services	13,450	1,255	(443)	14,262
Technology	2,479	545	(53)	2,971
Healthcare	2,963	253	(35)	3,181
Other	3,304	486	(11)	3,779
Total common stocks	32,125	3,148	(1,868)	33,405
Money market mutual funds	9,199		(13)	9,186
Total marketable equity securities	41,324	3,148	(1,881)	42,591
Total securities available for sale	$ 332,763	$ 9,842	$ (3,470)	$ 339,135
December 31, 2010				
Debt securities:				
Corporate bonds:				
Financial services	$ 79,896	$ 1,983	$ (266)	$ 81,613
Industry and manufacturing	32,875	1,595		34,470
Consumer products and services	39,173	1,895		41,068
Technology	29,280	948		30,228

Healthcare	21,687	783		22,470
Other	11,714	475		12,189
Total corporate bonds	214,625	7,679	(266)	222,038
Government-sponsored enterprises	36,062	77	(239)	35,900
Municipal bonds	6,583	10	(100)	6,493
Residential mortgage-backed securities:				
Government-sponsored enterprises	33,625	927	(10)	34,542
Private label	9,737	687	(90)	10,334
Other debt securities	641			641
Total debt securities	301,273	9,380	(705)	309,948
Marketable equity securities:				
Common stocks:				
Financial services	5,482	975	(104)	6,353
Industry and manufacturing	3,994	1,532		5,526
Consumer products and services	12,763	2,113	(29)	14,847
Technology	3,189	512		3,701
Healthcare	3,253	341	(21)	3,573
Other	2,663	123	(21)	2,765
Total common stocks	31,344	5,596	(175)	36,765
Money market mutual funds	13,904		(15)	13,889
Total marketable equity securities	45,248	5,596	(190)	50,654
Total securities available for sale	$ 346,521	$ 14,976	$ (895)	$ 360,602

The amortized cost and fair value of debt securities by contractual maturity at September 30, 2011 are as follows. Expected maturities may differ from contractual maturities because` issuers may have the right to call or prepay obligations with or without prepayment penalties.

	Within 1 year		Over 1 year to 5 years		Over 5 years		Total	
(In thousands)	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Corporate bonds:								
Financial services	$ 21,294	$ 21,468	$ 60,925	$ 60,827	$ 10,522	$ 10,479	$ 92,741	$ 92,774
Industry and manufacturing	14,589	14,992	7,046	7,442			21,635	22,434
Consumer products and services	7,715	7,931	15,669	16,622			23,384	24,553
Technology	9,264	9,484	3,509	3,539			12,773	13,023
Healthcare	6,551	6,806	13,091	13,806			19,642	20,612
Other	1,517	1,553	1,025	1,081			2,542	2,634
Total corporate bonds	60,930	62,234	101,265	103,317	10,522	10,479	172,717	176,030
Government-sponsored enterprises	89	92	34,154	34,321	42,164	42,232	76,407	76,645
Municipal bonds			5,957	6,082	1,481	1,545	7,438	7,627
Residential mortgage-backed securities:								
Government-sponsored enterprises			6	6	27,164	28,538	27,170	28,544
Private label					7,707	7,698	7,707	7,698
Total	$ 61,019	$ 62,326	$ 141,382	$ 143,726	$ 89,038	$ 90,492	$ 291,439	$ 296,544

For the nine months ended September 30, 2011, proceeds from sales of securities available for sale amounted to $41.3 million. Gross gains and losses of $4.4 million and $131,000, respectively, were realized on those sales. Information pertaining to securities available for sale as of September 30, 2011 and December 31, 2010, with gross unrealized losses aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	Less Than Twelve Months		Over Twelve Months	
(In thousands)	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
September 30, 2011				
Debt securities:				
Corporate bonds:				
Financial services	$ 1,263	$ 34,982	$ 10	$ 989
Technology	2	2,509		
Government-sponsored enterprises	54	6,946		
Municipal bonds	3	1,247		
Residential mortgage-backed securities:				

Private label		257		1,955				
Total debt securities		1,579		47,639		10		989
Marketable equity securities:								
Common stocks:								
Financial services		871		2,613		223		442
Industry and manufacturing		232		1,975				
Consumer products and services		443		4,302				
Technology		53		706				
Healthcare		35		637				
Other		11		357				
Total common stocks		1,645		10,590		223		442
Money market mutual funds		13		986				
Total marketable equity securities		1,658		11,576		223		442
Total temporarily impaired securities	$	3,237	$	59,215	$	233	$	1,431

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	Less Than Twelve Months		Over Twelve Months	
(In thousands)	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
December 31, 2010				
Debt securities:				
Corporate bonds financial services	$ 213	$ 18,533	$ 53	$ 5,947
Government-sponsored enterprises	239	25,254		
Municipal bonds	100	4,983		
Residential mortgage-backed securities:				
Government-sponsored enterprises	10	271		
Private label	90	1,933		
Total debt securities	652	50,974	53	5,947
Marketable equity securities:				
Common stocks:				
Financial services	15	706	89	735
Consumer products and services	29	882		
Healthcare	21	240		
Other	21	728		
Total common stocks	86	2,556	89	735
Money market mutual funds	15	968		
Total marketable equity securities	101	3,524	89	735
Total temporarily impaired securities	$ 753	$ 54,498	$ 142	$ 6,682

The Company determined no securities were other-than-temporarily impaired for the nine months ended September 30, 2011. Management evaluates securities for other-than-temporary impairment on a quarterly basis, with more frequent evaluation for selected issuers or when economic or market concerns warrant such evaluations.

As of September 30, 2011, the net unrealized gain on the total debt securities portfolio was $5.1 million. At September 30, 2011, 38 debt securities had unrealized losses with aggregate depreciation of 3.2% from the Company s amortized cost basis. In analyzing a debt 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, industry analysts reports and, to a lesser extent given the relatively insignificant levels of depreciation in the Company s debt portfolio, spread differentials between the effective rates on instruments in the portfolio compared to risk-free rates. The unrealized losses are primarily caused by (a) recent declines in profitability and near-term profit forecasts by industry analysts resulting from a decline in the level of business activity and (b) recent downgrades by several industry analysts. The contractual terms of these investments do not permit the companies to settle the security at a price less than the par value of the investment. The Company currently does not believe it is probable that it will be unable to collect all amounts due according to the contractual terms of the investments. Therefore, it is expected that the bonds would not be settled at a price less than the par value of the investment. Because (1) the Company does not intend to sell the securities; (2) the Company does not believe it is more likely than not that the Company will be required to sell the securities before recovery of its amortized cost basis; and (3) the present value of expected cash flows is sufficient to recover the entire amortized cost basis of the securities, the Company does not consider these investments to be other-than-temporarily impaired at September 30, 2011.

As of September 30, 2011, the net unrealized gain on the total equity portfolio was $1.3 million. At September 30, 2011, 32 marketable equity securities have unrealized losses with aggregate depreciation of 13.5% from the Company s cost basis. Three equity securities had market value declines of 25.0% or more, with net unrealized losses of $709,000. Although the issuers have shown declines in earnings as a result of the weakened economy, no credit issues have been identified that cause management to believe the decline in market value is other than temporary, and the Company has the ability and intent to hold these investments until a recovery of fair value. In analyzing an equity issuer s financial condition, management considers industry analysts reports, financial performance and projected target prices of investment analysts within a one-year time frame. A decline of 10% or more in the value of an equity security is generally the triggering event for management to review individual securities for liquidation and/or classification as other-than-temporarily impaired. Impairment losses are recognized when management concludes that declines in the value of equity securities are other than temporary, or when they can no longer assert that they have the intent and ability to hold depreciated equity securities for a period of time sufficient to allow for any anticipated recovery in fair value. Unrealized losses on marketable equity securities that are in excess of 25% of cost and that have been sustained for more than twelve months are generally considered-other-than temporary and charged to earnings as impairment losses, or realized through sale of the security.

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6. LOANS

The Company s loan portfolio consists primarily of residential real estate, commercial real estate, construction, commercial and consumer segments. The residential real estate loans include classes for one-to four-family, multi-family and home equity lines of credit. There are no foreign loans outstanding. Interest rates charged on loans are affected principally by the demand for such loans, the supply of money available for lending purposes and the rates offered by our competitors. Loan detail by category was as follows:

	September 30, 2011		December 31, 2010	
(Dollars in thousands)	**Amount**	**%**	**Amount**	**%**
Real estate loans:				
Residential real estate:				
One-to four-family	$ 403,062	32.2%	$ 402,887	34.0%
Multi-family	177,755	14.3	135,290	11.4
Home equity lines of credit	64,247	5.2	62,750	5.3
Commercial real estate	463,574	37.2	433,504	36.6
Construction	97,539	7.8	113,142	9.6
Total real estate loans	1,206,177	96.7	1,147,573	96.9
Commercial business loans	35,585	2.9	30,189	2.6
Consumer	5,024	0.4	6,043	0.5
Total loans	1,246,786	100.0%	1,183,805	100.0%
Allowance for loan losses	(12,130)		(10,155)	
Net deferred loan origination fees	(83)		(88)	
Loans, net	$ 1,234,573		$ 1,173,562	

The Company has transferred a portion of its originated commercial real estate loans to participating lenders. The amounts transferred have been accounted for as sales and are therefore not included in the Company s accompanying balance sheets. The Company and participating lenders share ratably in any gains or losses that may result from a borrower s lack of compliance with contractual terms of the loan. The Company continues to service the loans on behalf of the participating lenders and, as such, collects cash payments from the borrowers, remits payments to participating lenders and disburses required escrow funds to relevant parties. At September 30, 2011 and December 31, 2010, the Company was servicing loans for participants aggregating $25.3 million and $22.5 million, respectively.

As a result of the Mt. Washington Co-operative Bank (Mt. Washington) acquisition in January 2010, the Company acquired loans at fair value of $345.3 million. Included in this amount was $27.7 million of loans with evidence of deterioration of credit quality since origination for which it was probable, at the time of the acquisition, that the Company would be unable to collect all contractually required payments receivable. The Company s evaluation of loans with evidence of credit deterioration as of the acquisition date resulted in a nonaccretable discount of $7.6 million, which is defined as the loan s contractually required payments receivable in excess of the amount of its cash flows expected to be collected. The Company considered factors such as payment history, collateral values, and accrual status when determining whether there was evidence of deterioration of the loan s credit quality at the acquisition date.

The following is a summary of the outstanding balance of the acquired loans with evidence of credit deterioration:

(In thousands)	**September 30, 2011**	**December 31, 2010**
Residential real estate:		
One-to four-family	$ 7,977	$ 10,685
Multi-family	1,871	2,120
Home equity lines of credit	392	667
Commercial real estate	3,284	4,769
Construction	1,670	2,361
Total mortgage loans on real estate	15,194	20,602
Other loans:		
Commercial business loans	95	111
Consumer	4	5
	99	116
Outstanding principal balance	15,293	20,718
Nonaccretable discount	(3,180)	(4,216)
Carrying amount	$ 12,113	$ 16,502

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An analysis of the allowance for loan losses and related information follows:

(In thousands)	**One-to four-family**	**Multi-family**	**Home equity lines of credit**	**Commercial real estate**	**Construction**	**Commercial business**	**Consumer**	**Unallocated**	**Total**
	For the Three Months Ended September 30, 2011								
Beginning Balance	$ 1,248	$ 1,382	$ 175	$ 5,993	$ 1,449	$ 538	$ 76	$	$ 10,861
Provision for loan loss	332	53	82	465	394	214	23		1,563
Charge-offs				(75)	(444)		(37)		(556)
Recoveries	47		3	3	200		9		262
Ending Balance	$ 1,627	$ 1,435	$ 260	$ 6,386	$ 1,599	$ 752	$ 71	$	$ 12,130
	For the Nine Months Ended September 30, 2011								
Beginning Balance	$ 1,130	$ 1,038	$ 227	$ 5,238	$ 2,042	$ 448	$ 32	$	$ 10,155
Provision for loan loss	532	354	56	1,284	(258)	337	86		2,391
Charge-offs	(135)		(27)	(149)	(675)	(33)	(85)		(1,104)
Recoveries	100	43	4	13	490		38		688
Ending Balance	$ 1,627	$ 1,435	$ 260	$ 6,386	$ 1,599	$ 752	$ 71	$	$ 12,130
	At September 30, 2011								
Amount of allowance for loan losses for loans deemed to be impaired	$ 85	$	$ 8	$ 257	$	$ 107	$	$	$ 457
Amount of allowance for loan losses for loans not deemed to be impaired	1,542	1,435	252	6,129	1,599	645	71		11,673
	$ 1,627	$ 1,435	$ 260	$ 6,386	$ 1,599	$ 752	$ 71	$	$ 12,130
Amount of allowance for loan losses for loans acquired with deteriorated credit	$	$	$	$	$	$	$	$	$

quality included above									
Loans deemed to be impaired	$ 3,890	$ 4,188	$ 124	$ 13,083	$ 32,039	$ 1,554	$	$	$ 54,878
Loans not deemed to be impaired	399,172	173,567	64,123	450,491	65,500	34,031	5,024		1,191,908
	$ 403,062	$ 177,755	$ 64,247	$ 463,574	$ 97,539	$ 35,585	$ 5,024	$	$ 1,246,786
	At December 31, 2010								
Amount of allowance for loan losses for loans deemed to be impaired	$ 37	$	$ 8	$ 38	$ 18	$ 19	$	$	$ 120
Amount of allowance for loan losses for loans not deemed to be impaired	1,093	1,038	219	5,200	2,024	429	32		10,035
	$ 1,130	$ 1,038	$ 227	$ 5,238	$ 2,042	$ 448	$ 32	$	$ 10,155
Amount of allowance for loan losses for loans acquired with deteriorated credit quality included above	$	$	$	$ 10	$	$	$	$	$ 10
Loans deemed to be impaired	$ 4,200	$ 3,732	$ 125	$ 11,710	$ 17,611	$ 186	$	$	$ 37,564
Loans not deemed to be impaired	398,687	131,558	62,625	421,794	95,531	30,003	6,043		1,146,241
	$ 402,887	$ 135,290	$ 62,750	$ 433,504	$ 113,142	$ 30,189	$ 6,043	$	$ 1,183,805

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(In thousands)	**One-to four-family**	**Multi-family**	**Home equity lines of credit**	**Commercial real estate**	**Construction**	**Commercial business**	**Consumer**	**Unallocated**	**Total**
				For the Three Months Ended September 30, 2010					
Beginning Balance	$ 2,328	$ 1,046	$ 129	$ 4,877	$ 2,388	$ 345	$ 152	$	$ 11,265
Provision for loan loss	(408)	32	4	335	101	11	2		77
Charge-offs	157			(106)	(156)		(33)		(138)
Recoveries	(23)				291		11		279
Ending Balance	$ 2,054	$ 1,078	$ 133	$ 5,106	$ 2,624	$ 356	$ 132	$	$ 11,483
				For the Nine Months Ended September 30, 2010					
Beginning Balance	$ 1,730	$ 467	$ 128	$ 4,435	$ 1,859	$ 586	$ 37	$	$ 9,242
Provision for loan loss	302	611	5	777	630	(230)	150		2,245
Charge-offs	(1)			(106)	(156)		(83)		(346)
Recoveries	23				291		28		342
Ending Balance	$ 2,054	$ 1,078	$ 133	$ 5,106	$ 2,624	$ 356	$ 132	$	$ 11,483
				At September 30, 2010					
Amount of allowance for loan losses for loans deemed to be impaired	$ 197	$ 71	$	$ 394	$ 425	$ 84	$	$	$ 1,171
Amount of allowance for loan losses for loans not deemed to be impaired	1,857	1,007	133	4,712	2,199	272	132		10,312
	$ 2,054	$ 1,078	$ 133	$ 5,106	$ 2,624	$ 356	$ 132	$	$ 11,483
Amount of allowance for loan losses for loans acquired with deteriorated credit quality included above	$	$	$	$ 196	$	$	$	$	$ 196

Loans deemed to be impaired	$ 4,391	$ 4,616	$ 100	$ 11,628	$ 17,393	$ 124	$	$	$ 38,252
Loans not deemed to be impaired	424,158	123,552	73,480	397,270	110,236	29,398	6,909		1,165,003
	$ 428,549	$ 128,168	$ 73,580	$ 408,898	$ 127,629	$ 29,522	$ 6,909	$	$ 1,203,255

The allowance consists of general and allocated components. The general component relates to pools of non-impaired loans and is based on historical loss experience adjusted for qualitative factors. The allocated component relates to loans that are classified as impaired, whereby an allowance is established when the discounted cash flows, collateral value or observable market price of the impaired loan is lower than the carrying value of that loan.

The following table provides information about delinquencies in the Company s loan portfolio at the dates indicated.

	September 30, 2011				**December 31, 2010**			
(In thousands)	**30-59 Days Past Due**	**60-89 Days Past Due**	**90 Days or Greater Past Due**	**Total Past Due**	**30-59 Days Past Due**	**60-89 Days Past Due**	**90 Days or Greater Past Due**	**Total Past Due**
Real estate loans:								
Residential real estate:								
One-to four-family	$ 6,033	$ 1,038	$ 5,641	$ 12,712	$ 4,434	$ 799	$ 7,400	$ 12,633
Multi-family	665	2,300		2,965	2,630		860	3,490
Home equity lines of credit	1,499	325	886	2,710	1,129	322	1,769	3,220
Commercial real estate	1,256	1,380	2,298	4,934	1,265	534	2,735	4,534
Construction		49	12,703	12,752			6,969	6,969
Total real estate loans	9,453	5,092	21,528	36,073	9,458	1,655	19,733	30,846
Commercial business loans	42	338	636	1,016	15	48	385	448
Consumer	323	165	6	494	293	245	5	543
Total	$ 9,818	$ 5,595	$ 22,170	$ 37,583	$ 9,766	$ 1,948	$ 20,123	$ 31,837

Delinquent loans at September 30, 2011 and December 31, 2010 included $5.0 million and $6.8 million of loans acquired with evidence of credit deterioration.

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The following table provides information with respect to the Company s non-performing loans at the dates indicated.

(Dollars in thousands)	**September 30, 2011**	**December 31, 2010**
Loans accounted for on a non-accrual basis:		
Real estate loans:		
Residential real estate:		
One-to four-family	$ 13,385	$ 11,529
Multi-family	528	2,246
Home equity lines of credit	1,959	2,408
Commercial real estate	11,921	11,290
Construction	20,334	15,326
Total real estate loans	48,127	42,799
Commercial business loans	941	335
Consumer		
Total non-accrual loans	$ 49,068	$ 43,134

Non-accrual loans at September 30, 2011 and December 31, 2010 included $6.6 million and $9.5 million of loans acquired with evidence of credit deterioration.

The following tables provide information with respect to the Company s impaired loans at the dates and for the periods indicated.

	September 30, 2011			**Three Months Ended September 30, 2011**			**Nine Months Ended September 30, 2011**		
(In thousands)	**Recorded Investment**	**Unpaid Principal Balance**	**Related Allowance**	**Average Recorded Investment**	**Interest Income Recognized**	**Interest Income Recognized on Cash Basis**	**Average Recorded Investment**	**Interest Income Recognized**	**Interest Income Recognized on Cash Basis**
Impaired loans without a valuation allowance:									
One-to four-family	$ 2,732	$ 3,056	$	$ 2,738	$ 42	$ 37	$ 2,619	$ 127	$ 119
Multi-family	4,188	4,216		4,175	39	78	3,437	222	254
Home equity lines of credit	100	100		100	2		100	5	4
Commercial real estate	7,938	8,302		6,545	213	188	4,020	374	336
Construction	32,039	33,512		26,477	798	618	21,748	1,474	975
Commercial business loans	548	573		543	10	6	290	30	18
Consumer									

Total	47,545	49,759		40,578	1,104	927	32,214	2,232	1,706
Impaired loans with a valuation allowance:									
One-to four-family	1,158	1,207	85	1,159	16	10	1,052	47	32
Multi-family									
Home equity lines of credit	24	24	8	24			24	1	1
Commercial real estate	5,145	5,145	257	5,168	84	49	5,208	243	142
Construction									
Commercial business loans	1,006	1,006	107	503	54	44	251	54	44
Consumer									
Total	7,333	7,382	457	6,854	154	103	6,535	345	219
Total impaired loans	$ 54,878	$ 57,141	$ 457	$ 47,432	$ 1,258	$ 1,030	$ 38,749	$ 2,577	$ 1,925

(In thousands)	December 31, 2010 Recorded Investment	December 31, 2010 Unpaid Principal Balance	December 31, 2010 Related Allowance	Three Months Ended September 30, 2010 Average Recorded Investment	Three Months Ended September 30, 2010 Interest Income Recognized	Three Months Ended September 30, 2010 Interest Income Recognized on Cash Basis	Nine Months Ended September 30, 2010 Average Recorded Investment	Nine Months Ended September 30, 2010 Interest Income Recognized	Nine Months Ended September 30, 2010 Interest Income Recognized on Cash Basis
Impaired loans without a valuation allowance:									
One-to four-family	$ 3,255	$ 3,255	$	$ 2,575	$ 36	$ 37	$ 2,948	$ 110	$ 101
Multi-family	3,732	3,732		3,040	139	130	3,875	236	214
Home equity lines of credit	100	100		100		2	109	5	8
Commercial real estate	6,494	6,578		2,616	22	26	1,689	31	34
Construction	17,422	18,285		15,731	251	115	15,200	723	441
Commercial business loans	167	167		9			6		
Consumer									
Total	31,170	32,117		24,071	448	310	23,827	1,105	798
Impaired loans with a valuation allowance:									
One-to four-family	945	945	37	1,654	18	19	1,524	57	57
Multi-family				838	13	1	842	39	17
Home equity lines of credit	25	25	8						
Commercial real estate	5,216	5,216	38	7,115	84	82	5,071	239	166
Construction	189	189	18	1,091	18		996	54	7
Commercial business loans	19	19	19	106			68		
Consumer									
Total	6,394	6,394	120	10,804	133	102	8,501	389	247
Total impaired loans	$ 37,564	$ 38,511	$ 120	$ 34,875	$ 581	$ 412	$ 32,328	$ 1,494	$ 1,045

The following table provides information on loans modified as TDRs during the three and nine months ended September 30, 2011 and 2010.

	For the Three Months Ended September 30,							
	2011				2010			
(Dollars In thousands)	**Number of Loans**	**Pre-Modification Balance**	**Post-Modification Balance**	**Coupon Rate**	**Number of Loans**	**Pre-Modification Balance**	**Post-Modification Balance**	**Coupon Rate**
Real estate loans:								
One-to four-family	3	$ 666	$ 666	4.8%	2	$ 386	$ 386	5.6%
Total	3	$ 666	$ 666	4.8%	2	$ 386	$ 386	5.6%

	For the Nine Months Ended September 30,							
	2011				2010			
(Dollars In thousands)	**Number of Loans**	**Pre-Modification Balance**	**Post-Modification Balance**	**Coupon Rate**	**Number of Loans**	**Pre-Modification Balance**	**Post-Modification Balance**	**Coupon Rate**
Real estate loans:								
One-to four-family	5	$ 1,242	$ 1,242	4.9%	5	$ 1,036	$ 1,036	5.6%
Multi-family	1	3,450	3,450	6.9				
Commercial real estate					1	4,797	4,797	6.3
Construction	2	3,847	3,847	5.7				
Total	8	$ 8,539	$ 8,539	6.1%	6	$ 5,833	$ 5,833	6.1%

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The following table provides information on how loans were modified as TDRs during the three and nine months ended September 30, 2011 and 2010.

	For the Three Months Ended September 30,				For the Nine Months Ended September 30,			
(In thousands)	2011		2010		2011		2010	
Adjusted interest rates	$	666	$	386	$	6,542	$	5,458
Combination of rate and maturity						1,997		375
Total	$	666	$	386	$	8,539	$	5,833

The Company generally places loans modified as TDRs on non-accrual status for a minimum period of six months. Loans modified as TDRs qualify for return to accrual status once they have demonstrated performance with the modified terms of the loan agreement for a minimum of six months. TDRs are reported as impaired loans with an allowance established as part of the allocated component of the allowance for loan losses when the discounted cash flows of the impaired loan is lower than the carrying value of that loan. Impaired and TDR classification may be removed if the borrower demonstrates compliance with the modified terms and the restructuring agreement specifies an interest rate equal to that which would be provided to a borrower with similar credit at the time of restructuring.

The following table provides information on loans modified as TDRs within the previous 12 months and for which there was a payment default during the nine months ended September 30, 2011 and 2010.

	For the Nine Months Ended September 30,					
	2011			2010		
(Dollars In thousands)	Number of Loans	Recorded Investment		Number of Loans	Recorded Investment	
Real estate loans:						
One-to four-family	1	$	223	2	$	589
Total	1	$	223	2	$	589

Losses on loans modified as TDRs, if any, are charged against the allowance for loan losses when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance for loan losses. Loans modified as TDRs with payment defaults are considered in the general component of the allowance for loan losses for each of the Company s loan portfolio segments. The Company s historical loss experience factors include charge-offs on loans modified as TDRs, if any, as adjusted for additional qualitative factors such as levels/trends in delinquent and non-performing loans.

The Company utilizes a nine grade internal loan rating system for multi-family, commercial real estate, construction and commercial loans as follows:

Loans rated 1, 2, 3 and 3A: Loans in these categories are considered pass rated loans with low to average risk.

Loans rated 4 and 4A: Loans in this category are considered special mention. These loans are starting to show signs of potential weakness and are being closely monitored by management.

Loans rated 5: Loans in this category are considered substandard. Generally, a loan is considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligors and/or the collateral pledged. There is a distinct possibility that the Company will sustain some loss if the weakness is not corrected.

Loans rated 6: Loans in this category are considered doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, highly questionable and improbable.

Loans rated 7: Loans in this category are considered uncollectible (loss) and of such little value that their continuance as loans is not warranted.

On an annual basis, or more often if needed, the Company formally reviews the ratings on all multi-family, commercial real estate, construction and commercial loans. The Company also engages an independent third-party to review a significant portion of loans within these segments on at least an annual basis. Management uses the results of these reviews as part of its annual review process.

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The following tables provide information with respect to the Company s risk rating at the dates indicated.

	September 30, 2011			
(In thousands)	**Multi-family residential real estate**	**Commercial real estate**	**Construction**	**Commercial business**
Loans rated 1 - 4	$ 167,789	$ 450,854	$ 71,926	$ 34,832
Loans rated 5	9,966	12,720	25,613	753
Loans rated 6				
Loans rated 7				
Total	$ 177,755	$ 463,574	$ 97,539	$ 35,585

	December 31, 2010			
(In thousands)	**Multi-family residential real estate**	**Commercial real estate**	**Construction**	**Commercial business**
Loans rated 1 - 4	$ 132,176	$ 425,010	$ 93,092	$ 29,872
Loans rated 5	3,114	8,494	20,050	317
Loans rated 6				
Loans rated 7				
Total	$ 135,290	$ 433,504	$ 113,142	$ 30,189

7. COMMITMENTS

At September 30, 2011 and December 31, 2010, we had total loan commitments outstanding, as follows:

(In thousands)	**September 30, 2011**	**December 31, 2010**
Unadvanced portion of existing loans:		
Construction	$ 83,653	$ 64,722
Home equity line of credit	38,578	39,791
Other lines and letters of credit	7,375	7,095
Commitments to originate:		
One-to four-family	13,196	15,362
Commercial real estate	62,220	65,187
Construction	36,262	12,625
Other loans	3,955	2,783
Total loan commitments outstanding	$ 245,239	$ 207,565

Historically, many of the commitments expire without being fully drawn; therefore the total amount of commitments does not necessarily represent future cash requirements. The Bank provided participating checking accounts with overdraft account protection covering $14.2 million of balances as of September 30, 2011. We also have a seven year contract with our core data processing provider with an outstanding commitment of $14.0 million as of September 30, 2011, with total annual payments of $2.2 million. The Bank is also developing plans to open new branches on leased property in Cambridge, Massachusetts and Danvers, Massachusetts later in 2011.

Another significant use of our liquidity is the funding of deposit withdrawals. Certificates of deposit due within one year of September 30, 2011 totaled $423.2 million, or 62.2% of total certificates of deposit. If these maturing deposits do not remain with us, we will be required to utilize other sources of funds. Historically, a significant portion of certificates of deposit that mature have remained at the Company. We have the ability to attract and retain deposits by adjusting the interest rates offered.

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8. DERIVATIVE INSTRUMENTS

The Company s derivative instruments do not meet the requirements to be accounted for as hedging instruments. These undesignated derivative instruments are recognized in the consolidated balance sheets at fair value, with changes in fair value recorded in non-interest income, if material.

Derivative Loan Commitments

Residential loan commitments are referred to as derivative loan commitments if the loan that will result from exercise of the commitment will be held for sale upon funding. The Company enters into commitments to fund residential real estate loans at specified times in the future, with the intention that these loans will subsequently be sold in the secondary market. A residential loan commitment requires the Company to originate a loan at a specific interest rate upon the completion of various underwriting requirements. Outstanding derivative loan commitments expose the Company to the risk that the price of the loans arising from the exercise of the loan commitment might decline from the inception of the rate lock to funding of the loan due to increases in loan interest rates. If interest rates increase, the value of these commitments decreases. Conversely, if interest rates decrease, the value of these loan commitments increase. Derivative loan commitments with notional amounts of $29.3 million and $8.9 million were outstanding at September 30, 2011 and December 31, 2010, respectively. The fair value of such commitments was an asset of $653,000 at September 30, 2011 and was immaterial at December 31, 2010.

Forward Loan Sale Commitments

To protect against the price risk inherent in derivative loan commitments, the Company utilizes both mandatory delivery and best efforts forward loan sale commitments to mitigate the risk of potential decreases in the values of loans that would result from the exercise of the derivative loan commitments. Under a mandatory delivery contract, the Company commits to deliver a certain principal amount of mortgage loans to an investor at a specified price on or before a specified date. If the Company fails to deliver the amount of mortgages necessary to fulfill the commitment by the specified date, it is obligated to pay the investor a pair-off fee, based then-current market prices, to compensate the investor for the shortfall. Under a best efforts contract, the Company commits to deliver an individual mortgage loan of a specified principal amount and quality to an investor and the investor commits to a price that it will purchase the loan from the Company if the loan to the underlying borrower closes. The Company generally enters into forward sale contracts on the same day it commits to lend funds to a potential borrower. The Company expects that these forward loan sale commitments will experience changes in fair value opposite to the change in fair value of derivative loan commitments. Forward loan sale commitments with notional amounts of $35.2 million and $21.0 million were outstanding at September 30, 2011 and December 31, 2010, respectively. The fair value of such commitments was a liability of $251,000 at September 30, 2011 and was immaterial at December 31, 2010.

The following table presents the fair values of derivative instruments in the balance sheet.

	September 30, 2011			
	Assets		**Liabilities**	
(In thousands)	**Balance Sheet Location**	**Fair Value**	**Balance Sheet Location**	**Fair Value**
Derivative loan commitments	Other assets	$ 653	N/A	$
Forward loan sale commitments	N/A		Other liabilities	251
Total		$ 653		$ 251

The following table presents information pertaining to the Company s derivative instruments.

(In thousands)	**Location of Gain/(Loss)**	**Three and Nine Months Ended September 30, 2011 Amount of Gain/(Loss)**

Derivative loan commitments	Gain on sales of loans, net	$	653
Forward loan sale commitments	Gain on sales of loans, net	$	(251)
Total		$	402

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

Management s discussion and analysis of the financial condition and results of operations is intended to assist in understanding the financial condition and results of operations of Meridian Interstate Bancorp. The following discussion should be read in conjunction with the consolidated financial statements, notes and tables included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2010, filed with the Securities and Exchange Commission.

Forward Looking Statements

This report contains forward-looking statements that are based on assumptions and may describe future plans, strategies and expectations of Meridian Interstate Bancorp. These forward-looking statements are generally identified by use of the words believe, expect, intend, anticipate, estimate, project or similar expressions. Meridian Bancorp s ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors which could have a material adverse effect on the operations of Meridian Interstate Bancorp and its subsidiaries include, but are not limited to:

- general economic conditions, either nationally or in our market area, that are worse than expected;
- inflation and changes in the interest rate environment that reduce our interest margins or reduce the fair value of financial instruments;
- increased competitive pressures among financial services companies;
- changes in consumer spending, borrowing and savings habits;
- our ability to enter new markets successfully and take advantage of growth opportunities, and the possible dilutive effect of potential acquisitions or *de novo* branches, if any;
- legislative or regulatory changes that adversely affect our business;
- adverse changes in the securities markets;
- changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Financial Accounting Standards Board or the Securities and Exchange Commission;
- inability of third-party providers to perform their obligations to us; and
- changes in our organization, compensation and benefit plans.

Management s ability to predict results or the effect of future plans or strategies is inherently uncertain. These factors include, but are not limited to, general economic conditions, changes in the interest rate environment, legislative or regulatory changes that may adversely affect our business, changes in accounting policies and practices, changes in competition and demand for financial services, adverse changes in the securities markets and changes in the quality or composition of Meridian Interstate Bancorp s loan or investment portfolios. Additional factors that may affect our results are discussed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010 filed with the Securities and Exchange Commission on March 16, 2011, under Risk Factors, which is available through the SEC s website at www.sec.gov, as updated by subsequent filings with the SEC. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Except as required by applicable law or regulation, Meridian Interstate Bancorp does not undertake, and specifically disclaims any obligation, to release publicly the result of any revisions that may be made to any forward-looking statements to reflect events or circumstances after the date of the statements or to reflect the occurrence of anticipated or unanticipated events.

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Critical Accounting Policies

The Company s summary of significant accounting policies are described in Note 1 to the Consolidated Financial Statements included in the 2010 Annual Report on Form 10-K for the year ended December 31, 2010. The preparation of financial statements in accordance with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Management has identified accounting for the allowance for loan losses, the valuation of goodwill and analysis for impairment, other-than-temporary impairment of securities and the valuation of deferred tax assets and foreclosed real estate as the Company s critical accounting policies.

Comparison of Financial Condition at September 30, 2011 and December 31, 2010

Assets

Total assets increased $108.8 million, or 5.9%, to $1.945 billion at September 30, 2011 from $1.836 billion at December 31, 2010. Cash and cash equivalents increased $73.7 million, or 47.4% to $229.2 million at September 30, 2011 from $155.5 million at December 31, 2010. Securities available for sale decreased $21.5 million, or 6.0%, to $339.1 million at September 30, 2011 from $360.6 million at December 31, 2010. Net loans increased $61.0 million, or 5.2%, to $1.235 billion at September 30, 2011 from $1.174 billion at December 31, 2010.

Asset Quality

Credit Risk Management

Our strategy for credit risk involves our maintaining and executing well-defined credit policies and uniform underwriting criteria and providing prompt attention to potential problem loans.

When a borrower fails to make a required loan payment, we take a number of steps to have the borrower cure the delinquency and restore the loan to current status, including contacting the borrower by letter and phone at regular intervals. When the borrower is in default, we may commence collection proceedings. If a foreclosure action is instituted and the loan is not brought current, paid in full, or refinanced before the foreclosure sale, the real property securing the loan generally is sold at foreclosure. Management informs the Executive Committee monthly of the amount of loans delinquent more than 30 days. Management provides detailed information to the Board of Directors on loans 60 or more days past due and all loans in foreclosure and repossessed property that we own.

Delinquencies

Total past due loans increased $5.7 million, or 18.0%, to $37.6 million at September 30, 2011 from $31.8 million at December 31, 2010, reflecting an increase of $2.0 million in loans 90 days or more past due and an increase of $3.7 million in loans 30 to 89 days past due. Delinquent loans at September 30, 2011 included $21.8 million of loans acquired in the Mt. Washington merger, including $7.4 million that were 30 to 59 days past due, $5.1 million that were 60 to 89 days past due and $9.2 million that were 90 days or more past due. At September 30, 2011, non-accrual loans exceed loans 90 days or more past due primarily due to loans which were placed on non-accrual status based on a determination that the ultimate collection of all principal and interest due was not expected and certain loans that remain on non-accrual status until they attain a sustained payment history of six months.

Non-performing Assets

Non-performing assets include loans that are 90 or more days past due or on non-accrual status and real estate and other loan collateral acquired through foreclosure and repossession. Loans 90 days or more past due may remain on an accrual basis if adequately collateralized and in the process of collection. At September 30, 2011, the Company did not have any accruing loans past due 90 days or more. For non-accrual loans, interest previously accrued but not collected is reversed and charged against income at the time a loan is placed on non-accrual status. Interest income is not recognized until the loan is returned to accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

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Real estate that we acquire as a result of foreclosure or by deed-in-lieu of foreclosure is classified as foreclosed real estate until it is sold. When property is acquired, it is initially recorded at the fair value less costs to sell at the date of foreclosure, establishing a new cost basis. Holding costs and declines in fair value after acquisition of the property result in charges against income.

Non-performing loans increased to $49.1 million, or 3.94% of total loans outstanding at September 30, 2011, from $43.1 million, or 3.64% of total loans outstanding at December 31, 2010 primarily due to increases of $5.0 million in non-accrual construction loans and $1.9 million in non-accrual one-to four-family loans, partially offset by decreases of $1.7 million in non-accrual multi-family loans and $449,000 in non-accrual home equity lines of credit. Foreclosed real estate decreased $396,000, or 9.7%, to $3.7 million at September 30, 2011 from $4.1 million at December 31, 2010. Non-performing assets increased to $52.8 million, or 2.71% of total assets, at September 30, 2011, from $47.2 million, or 2.57% of total assets, at December 31, 2010. Non-performing assets at September 30, 2011 included $18.2 million of assets acquired in the Mt. Washington merger, comprised of $16.0 million of non-performing loans and $2.2 million of foreclosed real estate. Interest income that would have been recorded for the nine months ended September 30, 2011 had nonaccruing loans been current according to their original terms amounted to $1.2 million.

Impaired Loans

A loan is considered impaired when, based on current information and events, it is probable that we will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. 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.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, we do not separately identify individual one-to four-family residential and consumer loans for impairment disclosures, unless such loans are subject to a troubled debt restructuring (TDR). The Company periodically may agree to modify the contractual terms of loans. When a loan is modified and a concession is made to a borrower experiencing financial difficulty, the modification is considered a TDR. All TDRs are initially classified as impaired.

We review residential and commercial loans for impairment based on the fair value of collateral, if collateral-dependent, or expected cash flows. Management has reviewed the collateral value for all impaired and non-accrual loans that were collateral-dependent as of September 30, 2011 and considered any probable loss in determining the allowance for loan losses.

For residential loans measured for impairment based on the collateral value, we will do the following:

- When a loan becomes seriously delinquent, generally 60 days past due, internal valuations are completed by our in-house appraiser who is a Massachusetts certified residential appraiser. We obtain third party appraisals, which are generally the basis for charge-offs when a loss is indicated, prior to the foreclosure sale. We generally are able to complete the foreclosure process within nine to 12 months from receipt of the internal valuation.
- We make adjustments to appraisals based on updated economic information, if necessary, prior to the foreclosure sale. We review current market factors to determine whether, in management s opinion, downward adjustments to the most recent appraised values may be warranted. If so, we use our best estimate to apply an estimated discount rate to the appraised values to reflect current market factors.
- Appraisals we receive are based on comparable property sales.

For commercial loans measured for impairment based on the collateral value, we will do the following:

- We obtain a third party appraisal at the time a loan is deemed to be in a workout situation and there is no indication that the loan will return to performing status, generally when the loan is 90 days or more past due. One or more updated third party appraisals are obtained prior to foreclosure depending on the foreclosure timeline. In general we order new appraisals every 180 days on loans in the process of foreclosure.
- We make downward adjustments to appraisals when conditions warrant. Adjustments are made by applying a discount to the appraised value based on occupancy, recent changes in condition to the property and certain other factors. Adjustments are also made to appraisals for construction projects involving residential

properties based on recent sales of units. Losses are recognized if the appraised value less estimated costs to sell is less than our carrying value of the loan.

Appraisals we receive are generally based on a reconciliation of comparable property sales and income capitalization approaches. For loans on construction projects involving residential properties, appraisals are generally based on a discounted cash flow analysis assuming a bulk sale to a single buyer.

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Troubled Debt Restructurings

In the course of resolving non-performing loans, the Bank may choose to restructure the contractual terms of certain loans, with terms modified to fit the ability of the borrower to repay in line with its current financial status. A loan is considered a troubled debt restructure if, for reasons related to the debtor s financial difficulties, a concession is granted to the debtor that would not otherwise be considered.

The following table summarizes the Company s TDRs at the dates indicated.

(In thousands)	September 30, 2011	December 31, 2010
TDRs on accrual status:		
One-to four-family	$ 860	$ 1,289
Multi-family	3,427	
	4,287	1,289
TDRs on non-accrual status:		
One-to four-family	1,634	288
Commercial real estate	4,690	4,797
Construction	7,105	3,487
	13,429	8,572
Total TDRs	$ 17,716	$ 9,861

The increase in multi-family TDRs during the first nine months of 2011 was due to a $3.5 million loan which was originated to consolidate five loans of an existing six-loan relationship. Of this amount, $375,000 was utilized to pay delinquent real estate taxes and other fees. The restructure and consolidation of this relationship reflected a slight increase in the monthly payment amount based on the combined monthly payment of the loans prior to consolidation and a slight increase in the interest rate to 6.875% (previous blended rate was 6.60%). The interest rate is equal to the Five Year Federal Home Loan Bank Advance Rate plus 275 basis points and the loan term is 30 years. No charge offs have been incurred on this loan.

The increase in construction TDRs was due to three loans originated during the first nine months of 2011. One loan was originated for $1.9 million to consolidated a two loan relationship. The restructure and consolidation of this relationship reflects a six month interest only balloon note with a fixed interest rate of 6% (a reduction of 50 basis points from the original loan). The Bank incurred charge offs totaling $194,000 on this loan during the first nine months of 2011. In addition, a two loan relationship originated with an interest rate fixed at 5.5% (a reduction of 100 basis points from the original loan). No charge offs have been incurred on this loan.

The increase in one-to four-family TDRs was due to five residential loan modifications completed during the first nine months of 2011. Modifications of one-to four-family TDRs consist of either rate reductions, loan term extensions or provisions for interest-only payments for specified periods up to 12 months. The Company has generally been successful with the concessions it has offered to borrowers to date. The Company generally returns TDRs to accrual status when they have sustained payments for six months based on the restructured terms.

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Potential Problem Loans

Certain loans are identified during the Company s loan review process that are currently performing in accordance with their contractual terms and we expect to receive payment in full of principal and interest, but it is deemed probable that we will be unable to collect all the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. This may result from deteriorating conditions such as cash flows, collateral values or creditworthiness of the borrower. These loans are classified as impaired but are not accounted for on a non-accrual basis. There were no potential problem loans identified at September 30, 2011 other than those already classified as non-performing, impaired or troubled debt restructurings.

Allowance for Loan Losses

The allowance for loan losses is maintained at levels considered adequate by management to provide for probable loan losses inherent in the loan portfolio as of the consolidated balance sheet reporting dates. The allowance for loan losses is based on management s assessment of various factors affecting the loan portfolio, including portfolio composition, delinquent and non-accrual loans, national and local business conditions and loss experience and an overall evaluation of the quality of the underlying collateral.

The following table sets forth the breakdown of the allowance for loan losses by loan category at the periods indicated:

	September 30, 2011			December 31, 2010		
(Dollars in thousands)	Amount	% of Allowance to Total Allowance	% of Loans in Category of Total Loans	Amount	% of Allowance to Total Allowance	% of Loans in Category of Total Loans
Real estate loans:						
Residential real estate:						
One-to four-family	$ 1,627	13.5%	32.2%	$ 1,130	11.1%	34.0%
Multi-family	1,435	11.8	14.3	1,038	10.2	11.4
Home equity lines of credit	260	2.1	5.2	227	2.2	5.3
Commercial real estate	6,386	52.6	37.2	5,238	51.7	36.6
Construction	1,599	13.2	7.8	2,042	20.1	9.6
Total real estate loans	11,307	93.2	96.7	9,675	95.3	96.9
Commercial business loans	752	6.2	2.9	448	4.4	2.6
Consumer	71	0.6	0.4	32	0.3	0.5
Total loans	$ 12,130	100.0%	100.0%	$ 10,155	100.0%	100.0%
Allowance to non-accrual loans	24.72%			23.54%		
Allowance to total loans outstanding	0.97%			0.86%		
Net charge-offs to average loans outstanding (annualized)	0.05%			0.19%		

The Company s provision for loan losses was $1.6 million for the quarter ended September 30, 2011 compared to $77,000 for the quarter ended September 30, 2010. For the nine months ended September 30, 2011, the provision for loan losses was $2.4 million compared to $2.2 million for the nine months ended September 30, 2010. These changes were based primarily on management s assessment of loan portfolio growth and composition changes, an ongoing evaluation of credit quality and current economic conditions. In addition, the increase in the provision for loan losses for the quarter ended September 30, 2011 reflects increases in net charge-offs and specific reserves recorded for impaired loans. The allowance for loan losses was $12.1 million or 0.97% of total loans outstanding at September 30, 2011, compared to $10.2 million or 0.86% of total loans outstanding at December 31, 2010. The Company continues to assess the adequacy of its allowance for loan losses in accordance with established policies.

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Loans that are partially charged off generally remain on non-accrual status until foreclosure or such time that they are performing in accordance with the terms of the loan and have a sustained payment history of at least six months. The accrual of interest is generally discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectibility of principal or interest, even though the loan is currently performing. Loan losses are charged against the allowance when we believe the uncollectibility of a loan balance is confirmed, generally when appraised values (as adjusted values, if applicable) less estimated costs to sell, are less than the Company s carrying values.

Although we believe that we use the best information available to establish the allowance for loan losses, future adjustments to the allowance for loan losses may be necessary and our results of operations could be adversely affected if circumstances differ substantially from the assumptions used in making the determinations. Furthermore, while we believe we have established our allowance for loan losses in conformity with generally accepted accounting principles in the United States of America, there can be no assurance that regulators, in reviewing our loan portfolio, will not require us to increase our allowance for loan losses. In addition, because future events affecting borrowers and collateral cannot be predicted with certainty, there can be no assurance that the existing allowance for loan losses is adequate or that increases will not be necessary should the quality of any loans deteriorate as a result of the factors discussed above. Any material increase in the allowance for loan losses may adversely affect our financial condition and results of operations.

Deposits

Deposits are a major source of our funds for lending and other investment purposes. Deposit inflows and outflows are significantly influenced by general interest rates and money market conditions. Our deposit base is comprised of demand, NOW, money market, regular and other deposits, and certificates of deposit. We consider demand, NOW, money market, and regular and other deposits to be core deposits. At September 30, 2011, core deposits were 56.6% of total deposits. Deposits increased $111.0 million, or 7.6%, to $1.566 billion at September 30, 2011 from $1.455 million at December 31, 2010, primarily as a result of growth of $128.2 million in core deposits. The growth for the nine months ended September 30, 2011 also reflects $37.4 million of new deposits in the three branches opened during the first half of 2011.

The following table summarizes the period end balance and the composition of deposits:

	September 30, 2011		December 31, 2010	
(Dollars in thousands)	**Balance**	**Percent of Total Deposits**	**Balance**	**Percent of Total Deposits**
Demand deposits	$ 134,537	8.7%	$ 111,423	7.7%
NOW deposits	142,435	9.1	134,677	9.3
Money market deposits	401,653	25.6	323,619	22.2
Regular and other deposits	207,473	13.2	188,178	12.9
Certificates of deposit	680,075	43.4	697,318	47.9
Total	$ 1,566,173	100.0%	$ 1,455,215	100.0%

Borrowings

We use borrowings from the Federal Home Loan Bank of Boston to supplement our supply of funds for loans and investments. In addition, we also purchase federal funds from local banking institutions as an additional short-term funding source for the Bank. Total borrowings decreased $15.5 million, or 10.4%, to $133.2 million at September 30, 2011 from $148.7 million at December 31, 2010, reflecting $21.0 million of reductions in Federal Home Loan Bank advances partially offset by a $5.5 million increase in short-term borrowings. At September 30, 2011 and December 31, 2010, FHLB advances totaled $115.7 million and $136.7 million, respectively, with a weighted average rate of 2.60% and 2.63% at the end of each periods. At September 30, 2011 and December 31, 2010, federal funds purchased totaled $17.5 million and $12.0 million, respectively, with a weighted average rate of 0.20% at the end of each of the periods. At September 30, 2011, we also had an available line of credit of $9.4 million with the Federal Home Loan Bank of Boston at an interest rate that adjusts daily, none of which was outstanding at that date.

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Stockholders Equity

Total stockholders equity increased $1.8 million, or 0.8%, to $217.4 million at September 30, 2011, from $215.6 million at December 31, 2010. The increase for the nine months ended September 30, 2011 was due primarily to $10.0 million in net income, partially offset by a $4.8 million increase in treasury stock resulting from the Company s repurchase of 360,801 shares and a $4.6 million decrease in accumulated other comprehensive income reflecting a decrease in fair value of available for sale securities, net of tax. Stockholders equity to assets was 11.18% at September 30, 2011, compared to 11.74% at December 31, 2010. Book value per share increased to $9.82 at September 30, 2011 from $9.59 at December 31, 2010. Tangible book value per share increased to $9.21 at September 30, 2011 from $8.98 at December 31, 2010. Market price per share decreased $0.88, or 7.5%, to $10.91 at September 30, 2011 from $11.79 at December 31, 2010. At September 30, 2011, the Company and the Bank continued to exceed all regulatory capital requirements.

Results of Operations for the Three and Nine Months Ended September 30, 2011 and 2010

Net Income

Our primary source of income is net interest income. Net interest income is the difference between interest income, which is the income that we earn on our loans and investments, and interest expense, which is the interest that we pay on our deposits and borrowings. Changes in levels of interest rates affect our net interest income. A secondary source of income is non-interest income, which includes revenue that we receive from providing products and services. The majority of our non-interest income generally comes from customer service fees, loan fees, bank-owned life insurance and gains on sales of loans and securities.

The Company recorded net income of $2.6 million, or $0.12 per diluted share, for the quarter ended September 30, 2011 compared to $3.0 million, or $0.13 per diluted share, for the quarter ended September 30, 2010. Income before income tax expense decreased $576,000 to $4.0 million, the net result of a decrease in net interest income of $1.8 million and an increase in the provision for loan loss of $1.5 million, partially offset by an increase non-interest income of $286,000 and a decrease in non-interest expense of $2.4 million.

For the nine months ended September 30, 2011, net income was $10.0 million, or $0.46 per diluted share compared to $9.1 million, or $0.41 per diluted share, for the nine months ended September 30, 2010. Income before income tax expense increased $1.6 million to $15.7 million, the net result of an increase in non-interest income of $4.7 million and a decrease in non-interest expense of $366,000, partially offset by a decrease in net interest income of $3.3 million and an increase in the provision for loan loss of $146,000.

Return on average equity decreased to 4.78% for the quarter ended September 30, 2011 and increased to 6.08% for the nine months ended September 30, 2011, compared to 5.64% and 5.83% for the respective periods of 2010. Return on average assets decreased to 0.54% for the quarter ended September 30, 2011 and 0.70% for the nine months ended September 30, 2011, compared to 0.68% and 0.71% for the respective periods of 2010.

Net Interest Income

Net interest income decreased $1.8 million, or 11.0%, to $14.2 million for the quarter ended September 30, 2011 from $16.0 million for the quarter ended September 30, 2010. The net interest rate spread and net interest margin were 2.98% and 3.15%, respectively, for the quarter ended September 30, 2011 compared to 3.75% and 3.93%, respectively, for the quarter ended September 30, 2010. For the nine months ended September 30, 2011, net interest income decreased $3.3 million, or 7.2%, to $42.7 million from $46.0 million for the nine months ended September 30, 2010. The net interest rate spread and net interest margin were 3.08% and 3.25%, respectively, for the nine months ended September 30, 2011 compared to 3.72% and 3.90%, respectively, for the nine months ended September 30, 2010. The decreases in net interest income were due primarily to deposit growth that was in excess of loan growth along with declines in yields on loans and securities for the third quarter and nine months ended September 30, 2011 compared to the same periods in 2010.

The Company s yield on loans declined by 51 basis points to 5.27%, which was partially offset by the increase in the average balance of the loan portfolio of $37.8 million, or 3.2%, to $1.239 billion for the quarter ended September 30, 2011 compared to the quarter ended September 30, 2010. For the nine months ended September 30, 2011, the yield on loans declined by 32 basis points to 5.43%, which was partially offset by the increase in the average balance of the loan portfolio of $33.6 million, or 2.9%, to $1.209 billion compared to the nine months ended September 30, 2010.

The average balance of the Company s interest-bearing deposits increased $168.3 million, or 13.4%, to $1.427 billion, which was partially offset by a decline in the cost of interest-bearing deposits of 14 basis points to 1.23% for the quarter ended September 30, 2011 compared to the quarter ended September 30, 2010. For the nine months ended September 30, 2011, the average balance of interest-bearing deposits increased $161.7 million, or 13.1%, to $1.394 billion, which was partially offset by a decline in the cost of interest-bearing deposits of nine basis points to 1.31% compared to the nine months ended September 30, 2010.

The Company s yield on interest-earning assets declined by 92 basis points to 4.30% for the quarter ended September 30, 2011 compared to 5.22% for the quarter ended September 30, 2010, while the cost of interest-bearing liabilities declined 15 basis points to 1.32% for the quarter ended September 30, 2011 compared to 1.47% for the quarter ended September 30, 2010. For the nine months ended September 30, 2011, the yield on interest-earning assets declined by 75 basis points to 4.47% compared to 5.22% for the nine months ended September 30, 2010, while the cost of interest-bearing liabilities declined by 11 basis points to 1.39% compared to 1.50% for the nine months ended September 30, 2010.

Average Balance Sheets and Related Yields and Rates

The following tables present information regarding average balances of assets and liabilities, the total dollar amounts of interest income and dividends from average interest-earning assets, the total dollar amounts of interest expense on average interest-bearing liabilities and the resulting annualized average yields and costs. The yields and costs for the periods indicated are derived by dividing income or expense by the average balances of assets or liabilities, respectively, for the periods presented. For purposes of these tables, average balances have been calculated using daily average balances, and non-accrual loans are included in average balances but are not deemed material. Loan fees are included in interest income on loans but are not material. None of the income reflected in the following table is tax-exempt income.

	For the Three Months Ended September 30,					
	2011			2010		
(Dollars in thousands)	**Average Balance**	**Interest**	**Yield/ Cost (4)**	**Average Balance**	**Interest**	**Yield/ Cost (4)**
Assets:						
Interest-earning assets:						
Loans (1)	$ 1,238,787	$ 16,458	5.27%	$ 1,200,946	$ 17,491	5.78%
Securities and certificates of deposits	351,591	2,875	3.24	349,691	3,701	4.20
Other interest-earning assets	201,536	104	0.20	62,513	36	0.23
Total interest-earning assets	1,791,914	19,437	4.30	1,613,150	21,228	5.22
Noninterest-earning assets	140,873			130,999		
Total assets	$ 1,932,787			$ 1,744,149		
Liabilities and stockholders equity:						
Interest-bearing liabilities:						
NOW deposits	$ 135,989	149	0.43	$ 116,282	129	0.44
Money market deposits	383,240	884	0.92	309,486	837	1.07
Regular and other deposits	205,681	257	0.50	184,920	254	0.54
Certificates of deposit	701,655	3,136	1.77	647,554	3,135	1.92
Total interest-bearing deposits	1,426,565	4,426	1.23	1,258,242	4,355	1.37
Borrowings	136,211	778	2.27	151,071	879	2.31
Total interest-bearing liabilities	1,562,776	5,204	1.32	1,409,313	5,234	1.47
Noninterest-bearing demand deposits	128,364			110,210		
Other noninterest-bearing liabilities	21,575			13,916		
Total liabilities	1,712,715			1,533,439		
Total stockholders equity	220,072			210,710		
Total liabilities and stockholders equity	$ 1,932,787			$ 1,744,149		
Net interest-earning assets	$ 229,138			$ 203,837		
Net interest income		$ 14,233			$ 15,994	

Interest rate spread (2)			2.98%			3.75%
Net interest margin (3)			3.15%			3.93%
Average interest-earning assets to average interest-bearing liabilities		114.66%			114.46%	
Supplemental Information:						
Total deposits, including noninterest-bearing demand deposits	$ 1,554,929	$ 4,426	1.13%	$ 1,368,452	$ 4,355	1.26%
Total deposits and borrowings, including noninterest-bearing demand deposits	$ 1,691,140	$ 5,204	1.22%	$ 1,519,523	$ 5,234	1.37%

(1) Loans on non-accrual status are included in average balances.

(2) Interest rate spread represents the difference between the yield on interest-earning assets and the cost of interest-bearing liabilities.

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

(4) Annualized.

	For the Nine Months Ended September 30,					
	2011			2010		
(Dollars in thousands)	**Average Balance**	**Interest**	**Yield/ Cost (4)**	**Average Balance**	**Interest**	**Yield/ Cost (4)**
Assets:						
Interest-earning assets:						
Loans (1)	$ 1,208,880	$ 49,068	5.43%	$ 1,175,322	$ 50,530	5.75%
Securities and certificates of deposits	372,858	9,428	3.38	347,711	10,998	4.23
Other interest-earning assets	178,020	306	0.23	55,549	84	0.20
Total interest-earning assets	1,759,758	58,802	4.47	1,578,582	61,612	5.22
Noninterest-earning assets	139,008			134,497		
Total assets	$ 1,898,766			$ 1,713,079		
Liabilities and stockholders equity:						
Interest-bearing liabilities:						
NOW deposits	$ 131,510	438	0.45	$ 112,462	394	0.47
Money market deposits	361,188	2,623	0.97	305,669	2,617	1.14
Regular and other deposits	199,331	794	0.53	183,406	756	0.55
Certificates of deposit	702,357	9,760	1.86	631,157	9,097	1.93
Total interest-bearing deposits	1,394,386	13,615	1.31	1,232,694	12,864	1.40
Borrowings	146,866	2,458	2.24	154,384	2,704	2.34
Total interest-bearing liabilities	1,541,252	16,073	1.39	1,387,078	15,568	1.50
Noninterest-bearing demand deposits	120,362			102,880		
Other noninterest-bearing liabilities	17,598			15,665		
Total liabilities	1,679,212			1,505,623		
Total stockholders equity	219,554			207,456		
Total liabilities and stockholders equity	$ 1,898,766			$ 1,713,079		
Net interest-earning assets	$ 218,506			$ 191,504		
Net interest income		$ 42,729			$ 46,044	

Interest rate spread (2)			3.08%			3.72%
Net interest margin (3)			3.25%			3.90%
Average interest-earning assets to average interest-bearing liabilities		114.18%			113.81%	
Supplemental Information:						
Total deposits, including noninterest-bearing demand deposits	$ 1,514,748	$ 13,615	1.20%	$ 1,335,574	$ 12,864	1.29%
Total deposits and borrowings, including noninterest-bearing demand deposits	$ 1,661,614	$ 16,073	1.29%	$ 1,489,958	$ 15,568	1.40%

(1) Loans on non-accrual status are included in average balances.

(2) Interest rate spread represents the difference between the yield on interest-earning assets and the cost of interest-bearing liabilities.

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

(4) Annualized.

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Rate/Volume Analysis

The following table sets forth the effects of changing rates and volumes on our net interest income. The rate column shows the effects attributable to changes in rate (changes in rate multiplied by prior volume). The volume column shows the effects attributable to changes in volume (changes in volume multiplied by prior rate). The net column represents the sum of the prior columns. For purposes of this table, changes attributable to changes in both rate and volume that cannot be segregated have been allocated proportionally based on the changes due to rate and the changes due to volume.

	Three Months Ended September 30, 2011 Compared to 2010 Increase (Decrease) Due to			Nine Months Ended September 30, 2011 Compared to 2010 Increase (Decrease) Due to		
(In thousands)	**Volume**	**Rate**	**Total**	**Volume**	**Rate**	**Total**
Interest Income:						
Loans	$ 538	$ (1,571)	$ (1,033)	$ 1,415	$ (2,877)	$ (1,462)
Securities and certificates of deposits	20	(846)	(826)	753	(2,323)	(1,570)
Other interest-earning assets	72	(4)	68	209	13	222
Total	630	(2,421)	(1,791)	2,377	(5,187)	(2,810)
Interest Expense:						
Deposits	481	(410)	71	1,563	(812)	751
Borrowings	(85)	(16)	(101)	(129)	(117)	(246)
Total	396	(426)	(30)	1,434	(929)	505
Change in net interest income	$ 234	$ (1,995)	$ (1,761)	$ 943	$ (4,258)	$ (3,315)

Provision for Loan Losses

The Company s provision for loan losses was $1.6 million for the quarter ended September 30, 2011 compared to $77,000 for the quarter ended September 30, 2010. For the nine months ended September 30, 2011, the provision for loan losses was $2.4 million compared to $2.2 million for the nine months ended September 30, 2010. These changes were based primarily on management s assessment of loan portfolio growth and composition changes, an ongoing evaluation of credit quality and current economic conditions. In addition, the increase in the provision for loan losses were primarily due to increases in net charge-offs and specific reserves recorded for impaired loans for the third quarter and nine months ended September 30, 2011 compared to the same periods in 2010. For further analysis of the changes in the allowance for loan losses including the provision for loans losses refer to *Management s Discussion and Analysis of Results of Operations and Financial Condition -Allowance for Loan Losses*.

Non-Interest Income

Non-interest income increased $286,000, or 8.6%, to $3.6 million for the quarter ended September 30, 2011 from $3.3 million for the quarter ended September 30, 2010, primarily due to increases of $564,000 in gain on sales of loans, net, and $169,000 in equity income from the Company s Hampshire First Bank affiliate, partially offset by decreases of $154,000 in customer service fees and $318,000 in gain on sales of securities, net. For the nine months ended September 30, 2011, non-interest income increased $4.7 million, or 57.8%, to $12.7 million from $8.0 million for the nine months ended September 30, 2010, primarily due to increases of $3.5 million in gain on sales of securities, net, $405,000 gain on sales of loans, net, and $811,000 in equity income from Hampshire First Bank.

Gain on sales of securities, net, of $4.3 million for the nine months ended September 30, 2011 included $2.0 million from sales of corporate bonds, $1.4 million from sales of marketable equity securities and $907,000 from sales of collateralized debt obligations acquired as part of the Mt. Washington merger.

Non-Interest Expense

Non-interest expense decreased $2.4 million, or 16.3%, to $12.3 million for the quarter ended September 30, 2011 from $14.6 million for the quarter ended September 30, 2010, primarily due to a $3.1 million charge during the quarter ended September 30, 2010 related to termination of the contract with Mt. Washington s data processing services provider and a $367,000 decrease in deposit insurance due to a change in the FDIC premium assessment base beginning April 1, 2011, partially offset by an increase of $699,000 in salaries and employee benefits. For the nine months ended September 30, 2011, non-interest expense decreased $366,000, or 1.0%, to $37.4 million from $37.7 million for the nine months ended September 30, 2010, primarily due to the $3.1 million charge during the quarter ended September 30, 2010 related to termination of the contract with Mt. Washington s data processing services provider, partially offset by increases of $2.2 million in salaries and employee benefits and $686,000 in occupancy and equipment expenses. The increases in salaries and employee benefits and occupancy and equipment expenses were associated with the new branches opened this year and costs associated with the expansion of residential and commercial lending capacity. The Company s efficiency ratio was 70.58% for the quarter ended September 30, 2011 compared to 62.45% for the quarter ended September 30, 2010, excluding the charge to terminate Mt. Washington s data processing contract. For the nine months ended September 30, 2011, the efficiency ratio was 73.03% compared to 65.02% for the nine months ended September 30, 2010, excluding the charge to terminate Mt. Washington Co-operative Bank s data processing contract.

During the second quarter of 2011, the Bank received regulatory approval to open new branches in Cambridge and Danvers, Massachusetts. The Danvers branch opened in a temporary location in October 2011, with opening of its permanent branch planned for December 2011. Opening of the Cambridge branch is also planned for December 2011. Along with the announced establishment in July 2011 of a new commercial and industrial lending division comprised of a veteran team of bankers, the Bank expanded its residential and commercial real estate lending division during the third quarter of 2011. As a result of this planned business expansion, the Company expects to incur increases in staffing, facilities and other overhead expenses.

Income Tax Provision

The Company recorded a provision for income taxes of $1.4 million for the quarter ended September 30, 2011, reflecting an effective tax rate of 34.5%, compared to $1.6 million, or 35.3%, for the quarter ended September 30, 2010. For the nine months ended September 30, 2011, the provision for income taxes was $5.7 million, reflecting an effective tax rate of 36.1%, compared to $5.0 million, or 35.7%, for the nine months ended September 30, 2010. The changes in the income tax provision were primarily due to the changes in pre-tax income.

Liquidity and Capital Management

Liquidity Management

Liquidity is the ability to meet current and future financial obligations of a short-term nature. Our primary sources of funds consist of deposit inflows, loan repayments, maturities of and payments on investment securities and borrowings from the Federal Home Loan Bank of Boston. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit flows and mortgage prepayments are greatly influenced by general interest rates, economic conditions and competition.

We regularly adjust our investments in liquid assets based upon our assessment of (1) expected loan demand, (2) expected deposit flows, (3) yields available on interest-earning deposits and securities and (4) the objectives of our asset/liability management policy.

Our most liquid assets are cash and cash equivalents. The levels of these assets depend on our operating, financing, lending and investing activities during any given period. At September 30, 2011, cash and cash equivalents totaled $229.2 million. In addition, at September 30, 2011, we had $70.9 million of available borrowing capacity with the Federal Home Loan Bank of Boston, including a $9.4 million line of credit. On September 30, 2011, we had $115.7 million of advances outstanding.

Our primary investing activities are the origination of loans and the purchase of securities. Our primary financing activities consist of activity in deposit accounts and Federal Home Loan Bank advances. Deposit flows are affected by the overall level of interest rates, the interest rates and products offered by us and our local competitors and other factors. We generally manage the pricing of our deposits to be competitive. Occasionally, we offer promotional rates on certain deposit products to attract deposits.

Capital Management

Both Meridian Interstate Bancorp and East Boston Savings Bank are subject to various regulatory capital requirements administered by the Federal Reserve Board and Federal Deposit Insurance Corporation, respectively, including a risk-based capital measure. The risk-based capital guidelines include both a definition of capital and a framework for calculating risk-weighted assets by assigning balance sheet assets and off-balance sheet items to broad risk categories. At September 30, 2011, both Meridian Interstate Bancorp and East Boston Savings Bank exceeded all of their respective regulatory capital requirements.

The following table details both the Company s and Bank s actual and minimum regulatory capital ratios.

	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
(Dollars in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
September 30, 2011						
Total Capital (to Risk Weighted Assets):						
Company	$ 212,944	14.2%	$ 120,008	8.0%	N/A	N/A
Bank	173,190	11.8	117,782	8.0	$ 147,228	10.0%
Tier 1 Capital (to Risk Weighted Assets):						
Company	200,239	13.3	60,004	4.0	N/A	N/A
Bank	160,494	10.9	58,891	4.0	88,337	6.0
Tier 1 Capital (to Average Assets):						
Company	200,239	10.5	76,412	4.0	N/A	N/A
Bank	160,494	8.5	75,183	4.0	93,979	5.0
December 31, 2010						
Total Capital (to Risk Weighted Assets):						
Company	$ 206,416	14.1%	$ 116,907	8.0%	N/A	N/A
Bank	162,779	11.4	114,514	8.0	$ 143,142	10.0%
Tier 1 Capital (to Risk Weighted Assets):						
Company	193,828	13.3	58,453	4.0	N/A	N/A
Bank	150,161	10.5	57,257	4.0	85,885	6.0
Tier 1 Capital (to Average Assets):						
Company	193,828	10.8	71,892	4.0	N/A	N/A
Bank	150,161	8.5	70,637	4.0	88,296	5.0

We may use capital management tools such as cash dividends and common share repurchases. Pursuant to Federal Reserve Board approval conditions imposed in connection with the formation of Meridian Interstate Bancorp, Meridian Interstate Bancorp has committed (i) to seek the Federal Reserve Board s prior approval before repurchasing any equity securities from Meridian Financial Services and (ii) that any repurchases of equity securities from stockholders other than Meridian Financial Services will be at the current market price for such stock repurchases. Meridian Interstate Bancorp is also subject to the Federal Reserve Board s notice guidelines for stock repurchases.

In August 2011, the Company completed its third repurchase program, which consisted of 472,428 shares at an average price of $12.53 per share. In addition, the Company s Board of Directors voted to adopt a fourth stock repurchase program of up to 10% of its outstanding common stock not held by its mutual holding company parent, or 904,224 shares of its common stock. As of September 30, 2011, the Company had repurchased 77,200 shares of its stock at an average price of $12.54 per share as included in treasury stock, or 8.5% of the shares authorized for repurchase under the Company s fourth stock repurchase program. The Company has repurchased 1,481,128 shares since December 2008.

Off-Balance Sheet Arrangements

In the normal course of operations, we engage in a variety of financial transactions that, in accordance with generally accepted accounting principles in the United States of America are not recorded in our financial statements. These transactions involve, to varying degrees, elements of credit, interest rate and liquidity risk. Such transactions are used primarily to manage customers requests for funding and take the form of loan commitments and lines of credit.

For the nine months ended September 30, 2011, we engaged in no off-balance sheet transactions reasonably likely to have a material effect on our financial condition, results of operations or cash flows.

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Item 3. *QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK*

Interest Rate Risk Management

Our earnings and the market value of our assets and liabilities are subject to fluctuations caused by changes in the level of interest rates. We manage the interest rate sensitivity of our interest-bearing liabilities and interest-earning assets in an effort to minimize the adverse effects of changes in the interest rate environment. Deposit accounts typically react more quickly to changes in market interest rates than mortgage loans because of the shorter maturities of deposits. As a result, sharp increases in interest rates may adversely affect our earnings while decreases in interest rates may beneficially affect our earnings. To reduce the potential volatility of our earnings, we have sought to improve the match between asset and liability maturities and rates, while maintaining an acceptable interest rate spread. Our strategy for managing interest rate risk emphasizes: originating loans with adjustable interest rates; selling the residential real estate fixed-rate loans with terms greater than 15 years that we originate; and promoting core deposit products and short-term time deposits.

We have an Asset/Liability Management Committee to coordinate all aspects of asset/liability management. The committee establishes and monitors the volume, maturities, pricing and mix of assets and funding sources with the objective of managing assets and funding sources to provide results that are consistent with liquidity, growth, risk limits and profitability goals.

Net Interest Income Simulation Analysis

We analyze our interest rate sensitivity position to manage the risk associated with interest rate movements through the use of interest income simulation. The matching of assets and liabilities may be analyzed by examining the extent to which such assets and liabilities are interest sensitive. An asset or liability is said to be interest rate sensitive within a specific time period if it will mature or reprice within that time period.

Our goal is to manage asset and liability positions to moderate the effects of interest rate fluctuations on net interest income. Interest income simulations are completed quarterly and presented to the Asset/Liability Committee and the board of directors. The simulations provide an estimate of the impact of changes in interest rates on net interest income under a range of assumptions. The numerous assumptions used in the simulation process are reviewed by the Asset/Liability Committee and the Executive Committee on a quarterly basis. Changes to these assumptions can significantly affect the results of the simulation. The simulation incorporates assumptions regarding the potential timing in the repricing of certain assets and liabilities when market rates change and the changes in spreads between different market rates. The simulation analysis incorporates management s current assessment of the risk that pricing margins will change adversely over time due to competition or other factors.

Simulation analysis is only an estimate of our interest rate risk exposure at a particular point in time. We continually review the potential effect changes in interest rates could have on the repayment of rate sensitive assets and funding requirements of rate sensitive liabilities.

The simulation uses projected repricing of assets and liabilities on the basis of contractual maturities, anticipated repayments and scheduled rate adjustments. Prepayment rates can have a significant impact on interest income simulation. Because of the large percentage of loans we hold, rising or falling interest rates have a significant impact on the prepayment speeds of our earning assets that in turn affect the rate sensitivity position. When interest rates rise, prepayments tend to slow. When interest rates fall, prepayments tend to rise. Our asset sensitivity would be reduced if prepayments slow and vice versa. While we believe such assumptions to be reasonable, there can be no assurance that assumed prepayment rates will approximate actual future mortgage-backed security and loan repayment activity.

The following table reflects changes in estimated net interest income for the Bank at October 1, 2011 through September 30, 2012.

Increase (Decrease) in Market Interest Rates (Rate Shock)	**Net Interest Income**		
	Amount	**Change**	**Percent**
(Dollars in Thousands)			
300	$ 53,367	$ (4,622)	(7.97)%
Flat	57,989		

-50	58,244	255	0.44

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Item 4. ***CONTROLS AND PROCEDURES***

(a) *Disclosure Controls and Procedures* Meridian Interstate Bancorp s management, including Meridian Interstate Bancorp s principal executive officer and principal financial officer, have evaluated the effectiveness of Meridian Interstate Bancorp s disclosure controls and procedures, as such term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act). Based upon their evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, Meridian Interstate Bancorp s disclosure controls and procedures were effective for the purpose of ensuring that the information required to be disclosed in the reports that Meridian Interstate Bancorp files or submits under the Exchange Act with the Securities and Exchange Commission (the SEC) (1) is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and (2) is accumulated and communicated to Meridian Interstate Bancorp s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

(b) *Internal Control over Financial Reporting* There have not been any changes in Meridian Interstate Bancorp s internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, Meridian Interstate Bancorp s internal control over financial reporting.

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PART II OTHER INFORMATION

Item 1. ***LEGAL PROCEEDINGS***

Periodically, there have been various claims and lawsuits against us, such as claims to enforce liens, condemnation proceedings on properties in which we hold security interests, claims involving the making and servicing of real property loans and other issues incident to our business. We are not a party to any pending legal proceedings that we believe would have a material adverse effect on our financial condition, results of operations or cash flows.

Item 1a. ***RISK FACTORS***

For information regarding our risk factors, see Risk Factors, in our 2010 Annual Report on Form 10-K, filed with the SEC on March 16, 2011, which is available through the SEC s website at www.sec.gov. As of September 30, 2011, our risk factors have not changed materially from those reported in the annual report. The risks described in our annual report are not the only risks that we face. Additional risks not presently known to us, or that we currently deem immaterial, may also adversely affect our business, financial condition or results of operations.

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

(a.) (b.) Not applicable.

(c.) The following table sets forth information with respect to any purchase made by or on behalf of the Company during the indicated periods:

Period	(a) Total Number of Shares (or Units) Purchased	(b) Average Price Paid Per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs (1)	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
July 1 31, 2011		$		34,419
August 1 31, 2011	101,062	$ 12.98	101,062	837,581
September 1 30, 2011	10,557	$ 11.95	10,557	827,024
Total	111,619	$ 12.89	111,619	827,024

(1) In August 2011, the Company completed its third repurchase program, which consisted of 472,428 shares, and the Company s Board of Directors voted to adopt a fourth stock repurchase program of up to 10% of its outstanding common stock not held by its mutual holding company parent, or 904,224 shares of its common stock.

Item 3. ***DEFAULTS UPON SENIOR SECUTIRIES***

Not applicable.

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

Item 5. ***OTHER INFORMATION***

None.

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Item 6. *EXHIBITS*

3.1	Amended and Restated Articles of Organization of Meridian Interstate Bancorp, Inc.*
3.2	Amended and Restated Bylaws of Meridian Interstate Bancorp, Inc.*
3.3	Articles of Correction of Meridian Interstate Bancorp, Inc.***
4	Form of Common Stock Certificate of Meridian Interstate Bancorp, Inc.*
10.1	Form of East Boston Savings Bank Employee Stock Ownership Plan*
10.2	Form of East Boston Savings Bank Employee Stock Ownership Plan Trust Agreement*
10.3	East Boston Savings Bank Employee Stock Ownership Plan Loan Agreement, Pledge Agreement and Promissory Note*
10.4	Form of Amended and Restated Employment Agreement*
10.5	Form of East Boston Savings Bank Employee Severance Compensation Plan*
10.6	Form of Supplemental Executive Retirement Agreements with certain directors*
10.7	[Reserved]
10.8	[Reserved]
10.9	[Reserved]
10.10	Form of Supplemental Executive Retirement Agreement with Richard J. Gavegnano filed as an exhibit to Form 10-Q filed on May 14, 2008
10.11	Form of Employment Agreement with Richard J. Gavegnano incorporated by reference to the Form 8-K filed on January 12, 2009
10.12	Form of Employment Agreement with Deborah J. Jackson incorporated by reference to the Form 8-K filed on January 22, 2009
10.13	Form of Supplemental Executive Retirement Agreement with Deborah J. Jackson incorporated by reference to the Form 8-K filed on January 22, 2009
10.14	2008 Equity Incentive Plan**
10.15	Amendment to Supplemental Executive Retirement Agreements with Certain Directors incorporated by reference to the Form 10-K/A filed on April 8, 2009
10.16	Agreement and Plan of Merger incorporated by reference to the Form 8-K filed on July 24, 2009
10.17	Employment Agreement between Edward J. Merritt and East Boston Savings Bank***
10.18	Supplemental Executive Retirement Agreement between East Boston Savings Bank and Edward J. Merritt***
10.19	Joint Beneficiary Designation Agreement between Edward J. Merritt and Mt. Washington Co-operative Bank***
10.20	First Amendment to Joint Beneficiary Designation Agreement between Edward J. Merritt and Mt. Washington Co-operative Bank***
10.21	Change in Control Agreement between Mark Abbate and East Boston Savings Bank incorporated by reference to the Form 8-K filed on December 15, 2009
21	Subsidiaries of Registrant*
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	The following financial statements for the quarter ended September 30, 2011, formatted in XBRL: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Changes in Stockholders Equity, (iv) Consolidated Statements of Cash Flows, and (v) the Notes to Consolidated Financial Statements, tagged as blocks of text.
101.INS	XBRL Instance Document

101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB	XBRL Taxonomy Extension Labels Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

* Incorporated by reference to the Registration Statement on Form S-1 of Meridian Interstate Bancorp, Inc. (File No. 333-146373), originally filed with the Securities and Exchange Commission on September 28, 2007.

** Incorporated by reference to Appendix A to the Company s Definitive Proxy Statement for its 2008 Annual Meeting, as filed with the Securities and Exchange Commission on July 11, 2008.

*** Incorporated by reference to the Company s Annual Report on Form 10-K as filed with the Securities and Exchange Commission on March 16, 2010.

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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.

	MERIDIAN INTERSTATE BANCORP, INC. (Registrant)
Dated: November 9, 2011	/s/ Richard J. Gavegnano Richard J. Gavegnano Chairman and Chief Executive Officer (Principal Executive Officer)
Dated: November 9, 2011	/s/ Mark L. Abbate Mark L. Abbate Senior Vice President, Treasurer and Chief Financial Officer (Principal Financial and Accounting Officer)