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SALISBURY BANCORP INC  
Form 10-K  
March 30, 2009

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2008

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-24751  
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SALISBURY BANCORP, INC.  
(Exact name of Registrant as specified in its charter)

Connecticut 06-1514263  
-----  
(State or Other Jurisdiction of (I.R.S. Employer Identification No.)  
Incorporation or Organization)

5 Bissell Street, Lakeville, CT 06039  
-----  
(Address of Principal Executive Offices) (Zip Code)

Registrant's telephone number, including area code: 860-435-9801  
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Securities registered pursuant to Section 12 (b) of the Act: Common stock par  
value \$.10 per share  
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Securities registered pursuant to Section 12 (g) of the Act: None  
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Name of exchange on which registered: NYSE AMEX  
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Indicate by check mark if the registrant is a well-known seasoned issuer as defined in Rule 405 of the Securities Act. Yes  No

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405

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of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

Large accelerated filer [ ] Accelerated filer [ ]  
Non-accelerated filer [ ] Smaller reporting company [X]

Indicate by check mark whether the registrant is a shell company. Yes [ ] No [X]

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter: June 30, 2008: \$47,326,639.

Note. If a determination as to whether a particular person or entity is an affiliate cannot be made without involving an unreasonable effort and expense, the aggregate market value of the common stock held by non-affiliates may be calculated on the basis of assumptions, reasonable under the circumstances, provided that the assumptions are set forth in this Form.

### APPLICABLE ONLY TO CORPORATE REGISTRANTS

The Company had 1,685,861 shares outstanding as of March 20, 2009.

### DOCUMENTS INCORPORATED BY REFERENCE

Incorporated by reference in Part III of this Form 10-K are portions of the Definitive Proxy Statement for the Annual Meeting of Shareholders to be held on May 27, 2009.

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### PART I

#### ITEM 1. BUSINESS

##### (a) General Development of the Business

Salisbury Bancorp, Inc. (NYSE AMEX:SAL) (Company) is a Connecticut corporation that was formed in 1998. Its primary activity is to act as the holding company for its sole subsidiary, the Salisbury Bank and Trust Company (Bank), which accounts for most of the Company's net income. The Bank assumed its present name in 1925 following the acquisition by the Robbins Burrall Trust Company of the Salisbury Savings Society. The Robbins Burrall Trust Company was incorporated in 1909 as the successor to a private banking firm established in 1874. The Salisbury Savings Society was incorporated in 1848. The Bank is chartered as a state bank and trust company by the State of Connecticut, and its deposits are insured by the Federal Deposit Insurance Corporation in accordance with the Federal Deposit Insurance Act. The Bank's main office is at 5 Bissell Street, Lakeville, Connecticut 06039. Its telephone number is (860) 435-9801, and its website address is: [www.salisburybank.com](http://www.salisburybank.com). The Company makes available free of charge on the Bank's website a link to its Annual Reports on Form 10-K, Quarterly Reports on Forms 10-Q and Current Reports on Form 8-K promptly after filing such reports with the Securities and Exchange Commission (SEC). Also

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available on the website are the respective Charters of the Board's Nominating and Governance Committee, Audit Committee and Human Resources and Compensation Committee.

The Bank currently operates seven (7) full service offices, which are located in North Canaan, Lakeville, Salisbury and Sharon, Connecticut, South Egremont and Sheffield, Massachusetts and Dover Plains, New York and a Trust and Wealth Advisory Services Division in Lakeville, Connecticut. In addition, the Bank has received regulatory approval to operate a branch office in Millerton, New York, which is expected to open in 2009.

### (b) Financial Information about Industry Segments

The Company's products and services are all of a nature of a commercial bank and trust company. The Bank is a full-service bank offering a wide range of commercial and personal banking services, including the following:

#### Lending

Lending is a principal business of the Bank, and loans represent a large portion of the Bank's assets. The portfolio consists of many types of loans. These include residential mortgages, home equity lines of credit, monthly installment loans for consumers, as well as commercial loans, which include lines of credit, short term loans, Small Business Administration (SBA) loans and real estate loans for business customers.

The primary lending activity has been the origination of first mortgage loans for the purchase, refinance or construction of residential properties in the Bank's market area. Loans secured by mortgages on a borrower's principal residence are generally viewed as the least vulnerable to major economic changes and at the same time provide a significant yet relatively stable source of interest income. Presently, loans are maintained in the Bank's portfolio as well as sold to investors on the secondary mortgage market. This provides customers the opportunity to choose from a wide array of competitive mortgage products and rate structures.

The Bank also originates a variety of other loans for consumer and business purposes. Although these loans represent a smaller percentage of the total loan portfolio, the Bank is in the position of being a full service retail lender to its consumers and a full service commercial lender to its business customers.

#### Investments

The Company's investment portfolio is also an important component of the Balance Sheet. It provides a source of earnings in the form of interest and dividends and plays a role in the interest rate risk management of the Company.

The portfolio is comprised primarily of U.S. Government sponsored agencies, U.S. Treasury and mortgage-backed securities and securities of political subdivisions of the states. At December 31, 2008, the portfolio totaled \$155,916,000, which represents approximately 31.45% of total assets, and it produced interest and dividend income of \$7,985,000 for the year 2008 as compared to \$8,115,000 for 2007.

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#### Deposits and Borrowings

The Bank's primary sources of funds are its core deposits, Federal Home Loan Bank of Boston (FHLBB) advances and principal payments on loans. Although

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competition for funds from non-banking institutions remains aggressive, the Bank continues its efforts to build account relationships with its customers. Deposits totaled \$344,925,000 at December 31, 2008 as compared with \$317,741,000 at December 31, 2007.

Advances from the FHLBB totaled \$87,914,000 at December 31, 2008 as compared with \$95,011,000 at December 31, 2007.

For additional information relating to the asset, deposit and borrowing components of the Company, see Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operation and the accompanying Consolidated Financial Statements, and Notes thereto.

### Fiduciary Activities

The Bank provides trust, investment and financial planning services to its customers.

The Bank has a full service Trust and Investment Services Division. Among the services offered are: custody and agency accounts, estate planning and estate settlement. Another service is that of serving as Guardian or Conservator of estates and managing the financial position of Guardianships or Conservatorships. Self directed IRAs and Pension plans are also offered.

### Other Services

The Company also offers safe deposit rentals, foreign exchange, a full menu of electronic fund transfer services and other ancillary services to businesses and individuals.

### (c) Narrative Description of Business

Salisbury Bancorp, Inc. is a bank holding company, which as described above, has one subsidiary, Salisbury Bank and Trust Company (Bank).

The Bank is a full-service commercial bank and its activities encompass a broad range of services, which include a complete menu of deposit services, multiple mortgage products and various other types of loans for both business and personal needs. Full trust and investment services are also available. The Bank owns and operates two subsidiaries, SBT Realty, Inc., which is incorporated under the laws of the State of New York, and SBT Mortgage Service Corporation, which is incorporated under the laws of the State of Connecticut. SBT Realty, Inc. holds and manages bank owned real estate situated in New York State. SBT Mortgage Service Corporation, a Passive Investment Company (PIC) was formed to take advantage of favorable Connecticut corporate tax benefits, which result when a Bank transfers a portion of its mortgage portfolio to a PIC. In general, the PIC will earn mortgage interest income and may dividend funds to the Bank. In turn, those funds will be exempt from the Connecticut corporate business tax.

### Competition

The Company and the Bank encounter competition in all phases of their business. There are numerous financial institutions that have offices in the areas in which the Company and Bank compete in northwestern Connecticut, western Massachusetts and proximate areas of New York State.

The offices of the Bank are located in Litchfield County, Connecticut, Berkshire County, Massachusetts and Dutchess County, New York. The Bank maintains seven (7) banking offices within these three counties and also attracts customers from nearby Columbia County, New York. The Bank's market area within the four counties is served by approximately 43 commercial banks and savings banks. The Bank's 3.14% market share of deposits within these four counties suggests that

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there is potential to further grow and expand the market share of the Bank.

Banks compete on the basis of price, including rates paid on deposits and charged on borrowings, convenience and quality of service. Savings and loan associations are able to compete aggressively with commercial banks in the important area of consumer lending. Credit unions and small loan companies are significant factors in the consumer market. Insurance companies, investment firms, credit and mortgage companies, brokerage firms cash management accounts, money-market funds and retailers are all significant competitors for various types of business. Insurance companies, investment counseling firms and other businesses and individuals actively compete with the Bank for personal and corporate trust services and investment counseling services. Many non-bank competitors are not subject to the extensive regulation described below

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under "Legislation, Regulation and Supervision" and in certain respects may have a competitive advantage over banks in providing certain services.

In marketing its services, the Bank emphasizes its position as a hometown bank with personal service, flexibility and prompt responsiveness to the needs of its customers. Moreover, the Bank competes for both deposits and loans by offering competitive rates and convenient business hours. In addition to providing banking services to customers in its primary service areas, the Bank is a member of the automatic teller machine networks and offers internet banking services, which allow the Bank to deliver certain financial services to customers regardless of their proximity to the primary service area of the Bank.

Connecticut grants banking powers for thrift institutions thereby improving their competitive position with other banks. In addition, the Connecticut Interstate Banking and Branching Act permits acquisitions and mergers of Connecticut banks and bank holding companies with banks and bank holding companies in other states. Accordingly, it is possible for large super-regional organizations to enter many new markets, including the market served by the Bank. Certain competitors, by virtue of their size and resources, may enjoy certain efficiencies and competitive advantages over the Bank in the pricing, delivery, and marketing of their products and services. It is possible that such legislative authority will increase the number or the size of financial institutions competing with the Bank for deposits and loans in its market place, although it is impossible to predict the effect upon competition of such legislation.

### Legislation, Regulation and Supervision

#### General

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Virtually every aspect of the business of banking is subject to regulation, including such matters as the amount of reserves that must be established against various deposits, the establishment of branches, mergers, non-banking activities and other operations. Numerous laws and regulations also set forth special restrictions and procedural requirements with respect to the extension of credit, credit practices, the disclosure of credit terms and discrimination in credit transactions.

The descriptions of the statutory provisions and regulations applicable to banks set forth below do not purport to be a complete description of such statutes and regulations and their effects on the Bank. Proposals to change the laws and regulations governing the banking industry are frequently introduced in Congress, in the state legislatures and before the various bank regulatory

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agencies. The likelihood and timing of any changes and the impact such changes might have on the Bank's future business and earnings are difficult to determine.

### Federal Reserve Board Regulation

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The Company is a registered bank holding company under the Bank Holding Company Act of 1956, as amended (BHCA). It is subject to the supervision and examination of the Board of Governors of the Federal Reserve System (Federal Reserve Board) and files with the Federal Reserve Board the reports as required under the BHCA.

The BHCA generally requires prior approval by the Federal Reserve Board of the acquisition by the Company of substantially all of the assets or more than five percent (5%) of the voting stock of any bank. The BHCA also allows the Federal Reserve Board to determine (by order or by regulation) what activities are so closely related to banking as to be a proper incident of banking, and thus, whether the Company can engage in such activities. The BHCA prohibits the Company and the Bank from engaging in certain tie-in arrangements in connection with any extension of credit, sale of property or furnishing of services.

Federal legislation permits adequately capitalized bank holding companies to venture across state lines to offer banking services through bank subsidiaries to a wide geographic market. It is possible for large super-regional organizations to enter many new markets, including the market served by the Bank, although it is impossible to assess what impact this will have on the Company or the Bank.

The Federal Reserve Act imposes certain restrictions on loans by the Bank to the Company and certain other activities, on investments in their stock or securities, and on the taking by the Bank of such stock or securities as collateral security for loans to any borrower.

Under the BHCA and the regulations of the Federal Reserve System promulgated thereunder (Regulation Y), no corporation may become a bank holding company as defined therein, without prior approval of the Federal Reserve Board. The Company received the approval to become a bank holding company on June 18, 1998. The Company will also have to secure prior approval of the Federal Reserve Board if it wishes to acquire voting shares of any other bank, if after such acquisition it would own or control more than five percent (5%) of the voting shares of such bank. The BHCA imposes limitations upon the Company as to the types of business in which it may engage.

Regulation Y requires bank holding companies to provide the Federal Reserve Board with written notice before purchasing or redeeming equity securities if the gross consideration for the purchase or redemption, when aggregated with the net

consideration paid by the Company for all such purchases or redemptions during the preceding twelve (12) months, is equal to ten percent (10%) or more of the Company's consolidated net worth. For purposes of Regulation Y, "net consideration" is the gross consideration paid by a company for all of its equity securities purchased or redeemed during the period, minus the gross consideration received for all of its equity securities sold during the period other than as part of a new issue. However, a bank holding company generally need not obtain Federal Reserve Board approval of any equity security redemption when: (i) the bank holding company's capital ratios exceed the threshold established for "well-capitalized" state member banks before and immediately

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after the redemption; (ii) the bank holding company is well-managed; and (iii) the bank holding company is not the subject of any unresolved supervisory issues. However, letters issued by the Federal Reserve Board to the industry dated February 24, 2009 and March 27, 2009 advise bank holding companies to inform the Federal Reserve Board of proposed stock repurchases resulting in a net reduction of common or preferred stock below the amount of such instrument outstanding at the beginning of the quarter in which the repurchase occurs. In addition, as a recipient of TARP CPP funds, the Company must communicate with the Treasury as well as the Federal Reserve Board in advance of any stock redemptions. Generally, during the first three years the Company participates in the TARP CPP, the approval of the Treasury will be required before the Company could repurchase any common stock. The Company may redeem the TARP CPP Preferred Stock at any time in consultation with the Treasury and its primary supervisory agencies.

### Gramm-Leach-Bliley Act

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The Gramm-Leach-Bliley Financial Services Modernization Act of 1999 (GLBA), provides bank holding companies, banks, securities firms, insurance companies, and investment management firms the option of engaging in a broad range of financial and related activities by opting to become a "financial holding company." The Company qualified and registered as a financial holding company on May 3, 2000. Financial holding companies are subject to oversight by the Federal Reserve Board, in addition to other regulatory agencies. Under the financial holding company structure, bank holding companies have greater ability to purchase or establish nonbank subsidiaries that are financial in nature or that engage in activities incidental or complementary to a financial activity. Additionally, pursuant to the GLBA, securities and insurance firms are permitted to purchase full-service banks. While the GLBA facilitates the ability of financial institutions to offer a wide range of financial services, large financial institutions would appear to be the beneficiaries of the GLBA because many community banks lack the capital and management resources needed to facilitate broad expansion of financial services.

### Sarbanes-Oxley Act

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The purpose of the Sarbanes-Oxley Act is to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes.

The Sarbanes-Oxley Act amends the Securities Exchange Act of 1934 (Exchange Act) to prohibit a registered public accounting firm from performing specified nonaudit services contemporaneously with a mandatory audit. The Sarbanes-Oxley Act also vests the audit committee of an issuer with responsibility for the appointment, compensation, and oversight of any registered public accounting firm employed to perform audit services. The Sarbanes-Oxley Act, among other things, also requires each committee member to be a member of the board of directors of the issuer, and to be otherwise independent. The Sarbanes-Oxley Act further requires the chief executive officer and chief financial officer of an issuer to make certain certifications as to each annual or quarterly report. Pursuant to the Sarbanes-Oxley Act the SEC has adopted rules to require:

- o Disclosure of all material off-balance sheet transactions and relationships that may have a material effect upon the financial status of an issuer; and
- o The presentation of pro forma financial information in a manner that is not misleading and which is reconcilable with the financial condition of the issuer under generally accepted accounting principles.



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The Sarbanes-Oxley Act also prohibits insider transactions in the Company's stock during a lock out period of Company's pension plans, and any profits of such insider transactions are to be disgorged. In addition, there is a prohibition of Company loans to its executives, except in certain circumstances. The Sarbanes-Oxley Act also provides for mandated internal control report and assessment with the annual report and an attestation and a report on such report by the Company's auditor. The SEC also requires an issuer to institute a code of ethics for senior financial officers of the Company. Furthermore, the Sarbanes-Oxley Act adds a criminal penalty of fines and imprisonment of up to 10 years for securities fraud.

### The Patriot Act

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The terrorist attacks in September, 2001 have impacted the financial services industry and led to federal legislation that attempts to address certain issues involving financial institutions. In 2001, President Bush signed into law the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the "Patriot Act"). On March 10, 2006, the President signed legislation making permanent certain provisions of the Patriot Act.

Part of the Patriot Act is the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001 (IMLA). IMLA authorizes the Secretary of the Treasury, in consultation with the heads of other government agencies, to adopt special measures applicable to banks, bank holding companies, and/or other financial institutions. These measures may include enhanced recordkeeping and reporting requirements for certain financial transactions that are of primary money laundering concern, due diligence requirements concerning the beneficial ownership of certain types of accounts, and restrictions or prohibitions on certain types of accounts with foreign financial institutions.

Among its other provisions, IMLA requires each financial institution to: (i) establish an anti-money laundering program; (ii)

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establish due diligence policies, procedures and controls with respect to its private banking accounts and correspondent banking accounts involving foreign individuals and certain foreign banks; and (iii) avoid establishing, maintaining, administering, or managing correspondent accounts in the United States for, or on behalf of, a foreign bank that does not have a physical presence in any country. In addition, IMLA contains a provision encouraging cooperation among financial institutions, regulatory authorities and law enforcement authorities with respect to individuals, entities and organizations engaged in, or reasonably suspected of engaging in, terrorist acts or money laundering activities. IMLA expands the circumstances under which funds in a bank account may be forfeited and requires covered financial institutions to respond under certain circumstances to requests for information from federal banking agencies within 120 hours. IMLA also amends the BHCA and the Bank Merger Act to require the federal banking agencies to consider the effectiveness of a financial institution's anti-money laundering activities when reviewing an application under these acts.

### State Regulation

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The Company is incorporated in the State of Connecticut and is subject to the Connecticut Business Corporation Act and the Connecticut Bank Holding Company

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Statutes. As a state-chartered bank and member of the Federal Deposit Insurance Corporation (FDIC), the Bank is subject to regulation both by the Connecticut Banking Commissioner and the FDIC. Applicable laws and regulations impose restrictions and requirements in many areas, including capital requirements, maintenance of reserves, establishment of new branch offices, mergers, making of loans and investments, consumer protection, employment practices and other matters. Any new regulations or amendments to existing regulations may materially affect the services offered, expenses incurred and/or income generated by the Bank.

The Connecticut Banking Commissioner regulates the Bank's internal organization as well as its deposit, lending and investment activities. The approval of the Connecticut Banking Commissioner is required to, among other things, open branch offices and consummate merger transactions and other business combinations. The Connecticut Banking Commissioner conducts periodic examinations of the Bank. The Connecticut banking statutes also restrict the ability of a bank to declare cash dividends to its shareholders.

Subject to certain limited exceptions, loans made to any one obligor may not exceed fifteen percent (15%) of the Bank's capital, surplus, undivided profits and loan reserves. In addition, under Connecticut law, the beneficial ownership of more than ten percent (10%) of any class of voting securities of a bank may not be acquired by any person or groups of persons acting in concert without the approval of the Connecticut Banking Commissioner. In addition, the Bank is subject to some supervision and regulations by the Commonwealth of Massachusetts and the State of New York in connection with its branch offices in such states.

### FDIC Regulation

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The Bank's deposits are insured under the Federal Deposit Insurance Act up to maximum limits by the Deposit Insurance Fund (DIF) and are subject to deposit insurance assessments.

Congress has temporarily increased FDIC deposit insurance from \$100,000 to \$250,000 per depositor through December 31, 2009. Effective April 1, 2006, the federal deposit insurance limits on certain retirement accounts increased so that such retirement accounts are separately insured up to \$250,000. In addition, the Bank participates in the Temporary Liquidity Guarantee Program, whereby non-interest bearing checking accounts and NOW accounts with interest rates no higher than 0.50 % will be FDIC insured in full.

FDIC insurance of deposits may be terminated by the FDIC, after notice and a hearing, upon a finding by the FDIC that the insured institution has engaged in unsafe or unsound practices, or is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule or order of, or condition imposed by the FDIC. A bank's failure to meet the minimum capital and risk-based capital guidelines discussed below would be considered to be unsafe and unsound banking practices. The Bank, as a Connecticut-chartered FDIC-insured bank, is regulated by the FDIC in many of the areas also regulated by the Connecticut Banking Commissioner. The FDIC also conducts its own periodic examinations of the Bank, and the Bank is required to submit financial and other reports to the FDIC on a quarterly and annual basis, or as otherwise required by the FDIC. FDIC-insured banks, such as the Bank, pay premium assessments to the FDIC for the insurance of deposits.

The Bank must meet certain minimum capital requirements, including a leverage capital ratio and a risk-based capital ratio. See "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION".

A few years ago the FDIC adopted a risk-based insurance assessment system designed to tie what banks pay for deposit insurance more closely to the risks

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they pose. The FDIC also adopted a schedule of rates that the FDIC could adjust up or down, depending on the needs of the DIF.

Recently, the FDIC adopted a restoration plan that would increase the reserve ratio to the 1.15% threshold within seven years.

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As part of that plan, in December, 2008, the FDIC voted to increase risk-based assessment rates due to deteriorating financial conditions in the banking industry. Changes to the risk-based assessment system include increasing premiums for institutions that rely on excessive amounts of brokered deposits, including CDARS, increasing premiums for excessive use of secured liabilities, including Federal Home Loan Bank advances, lowering premiums for smaller institutions with very high capital levels, and adding financial ratios and debt issuer ratings to the premium calculations for banks with over \$10 billion in assets, while providing a reduction for their unsecured debt. It is generally expected that rates will continue to increase in the near future due to the significant cost of bank failures beginning in the third quarter of 2008 and the increase in the number of troubled banks. The FDIC recently announced that, in view of the significant decrease in the deposit insurance funds' reserves, it will impose a special assessment in the second quarter of 2009. Banks must continue to pay base premium rates on top of any special assessment. Furthermore, banks may be subject to an "emergency" special assessment in 2009 in addition to other special assessments and regular premium rates. The amount of an emergency special assessment imposed on a bank will be determined by the FDIC if such amount is necessary to provide sufficient assessment income to repay amounts borrowed from the U.S. Department of Treasury (Treasury); to provide sufficient assessment income to repay obligations issued to and other amounts borrowed from insured depository institutions; or for any other purpose the FDIC may deem necessary.

The Community Reinvestment Act (CRA) requires the Bank to identify the communities served by its offices and to identify the types of credit the institution is prepared to extend within such communities. The FDIC conducts examinations of insured institutions' CRA compliance and rates banks as "Outstanding", "Satisfactory", "Needs to Improve" and "Substantial Noncompliance". As of its last CRA examination, the Bank received a rating of "Satisfactory". Failure to receive at least a "Satisfactory" rating may inhibit a bank from engaging in certain activities, including acquisitions of other financial institutions, which require regulatory approval based, in part, on CRA compliance considerations. Similarly, failure of the Bank to maintain a CRA rating of "Satisfactory" or better would preclude it or the Company from engaging in any new financial activities pursuant to the GLBA.

### Recent Legislative and Regulatory Initiatives to Address Difficult Market and ----- Economic Conditions -----

On October 3, 2008, President Bush signed into law the Emergency Economic Stabilization Act of 2008 (EESA) which, among other measures, authorizes the Treasury to purchase from financial institutions and their holding companies up to \$700 billion in mortgage loans, mortgage-related securities and certain other financial instruments, including debt and equity securities issued by financial institutions and their holding companies, under a Troubled Asset Relief Program Capital Purchase Program (TARP CPP). The purpose of TARP CPP is to restore confidence and stability to the U.S. banking system and to encourage financial institutions to increase their lending to customers and to each other. Under the TARP CPP, the Treasury is purchasing equity securities from participating

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institutions. The Series A Preferred Stock and warrant offered by this prospectus were issued by the Company to the Treasury pursuant to the TARP CPP. The EESA also increased federal deposit insurance on most deposit accounts from \$100,000 to \$250,000. This increase is in place until the end of 2009 and is not covered by deposit insurance premiums paid by the banking industry.

The EESA followed, and has been followed by, numerous actions by the Board of Governors of the Federal Reserve System, the U.S. Congress, the Treasury, the FDIC, the SEC and others to address the current liquidity and credit crisis that has followed the sub-prime meltdown that commenced in 2007. These measures include homeowner relief that encourage loan restructuring and modification; the establishment of significant liquidity and credit facilities for financial institutions and investment banks; the lowering of the federal funds rate; emergency action against short selling practices; a temporary guaranty program for money market funds; the establishment of a commercial paper funding facility to provide back-stop liquidity to commercial paper issuers; and coordinated international efforts to address illiquidity and other weaknesses in the banking sector.

On February 17, 2009, the American Recovery and Reinvestment Act of 2009 (ARRA) was signed into law. ARRA, more commonly known as the economic stimulus bill or economic recovery package, is intended to stimulate the economy and provides for broad infrastructure, education and health spending.

On October 14, 2008, the FDIC announced the establishment of a temporary liquidity guarantee program to provide full deposit insurance for all non-interest bearing transaction accounts and guarantees of certain newly issued senior unsecured debt issued by FDIC-insured institutions and their holding companies. Insured institutions were automatically covered by this program from October 14, 2008 until December 5, 2008, unless they opted out prior to that date. Under the program, the FDIC will guarantee timely payment of newly issued senior unsecured debt issued on or before June 30, 2009. The debt includes all newly issued unsecured senior debt including promissory notes, commercial paper and inter-bank funding. The aggregate coverage for an institution may not exceed 125% of its debt outstanding on September 30, 2008 that was scheduled to mature before June 30, 2009, or, for certain insured institutions, 2% of liabilities as of September 30, 2008. The guarantee will extend to June 30, 2012 even if the maturity of the debt is after that date.

The purpose of these legislative and regulatory actions is to stabilize the U.S. banking system. The EESA, the ARRA and the other regulatory initiatives described above may not have their desired effects. If the volatility in the markets continues and economic conditions fail to improve or worsen, the Company's business, financial condition, results of operations and cash

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flows could be materially and adversely affected.

The Securities Purchase Agreement Between the Company and the Treasury Permits the Treasury to Impose Certain Additional Restrictions on the Company So Long as the Company Participates in the TARP CPP.

The securities purchase agreement the Company entered into with the Treasury in connection with the Bank's participation in the TARP CPP permits the Treasury to unilaterally amend the terms of the securities purchase agreement to comply with any changes in federal statutes after the date of its execution. ARRA imposed additional executive compensation and expenditure limits on all current and future TARP recipients, including the Company, until the Company has repaid the Treasury. These additional restrictions may impede the Company's ability to

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attract and retain qualified executive officers. ARRA also permits TARP recipients to repay the Treasury without penalty or requirement that additional capital be raised, subject to the Treasury's consultation with the Company's primary federal regulator while the securities purchase agreement required that, for a period of three years, the Series A Preferred Stock could generally only be repaid if the Company raised additional capital to repay the securities and such capital qualified as Tier 1 capital. Additional unilateral changes in the securities purchase agreement could have a negative impact on the Company's financial condition and results of operations.

### Capital Resources

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On March 13, 2009, under the TARP CPP, the Company sold 8,816 shares of senior preferred stock to the Treasury, having a liquidation amount equal to \$1,000 per share, or \$8,816,000. Although the Company is currently well-capitalized under regulatory guidelines, the Board of Directors believed it was advisable to take advantage of the TARP CPP to raise additional capital to ensure that during these uncertain times, the Company is well-positioned to support the Company's existing operations as well as anticipated future growth. Additional information concerning the TARP CPP is included in Note 22 to the Consolidated Financial Statements.

### Employees

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The Company's current workforce at March 20, 2009 consists of 144 employees of whom 127 were full time and 17 were part time. The employees are not represented by a collective bargaining unit.

### (d) Financial Information about Geographic Areas

The Company does not have any foreign business operations or export sales of its own. However, the Company provides financial services including wire transfers and foreign currency exchange to various businesses involved in foreign trade.

### STATISTICAL DISCLOSURE REQUIRED PURSUANT TO SECURITIES EXCHANGE ACT, INDUSTRY GUIDE 3

The statistical disclosures required pursuant to Industry Guide 3, not contained in Management's Discussion and Analysis of Financial Condition and Results of Operations, are presented on the following pages of this Report on Form 10-K.

Item of Guide 3	Page(s) of This Report
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I. Distribution of Assets, Liabilities and Shareholders' Equity; Interest Rates and Interest Differential	17
II. Investment Portfolio	8
III. Loan Portfolio	9
IV. Summary of Loan Loss Experience	10
V. Deposits	21
VI. Return on Equity and Assets	9
VII. Short-Term Borrowings	11

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Investment Portfolio

The Company categorizes investments into three groups and further provides for the accounting and reporting treatment of each group. Investments may be classified as held-to-maturity, available-for-sale, or trading. The Bank does not purchase or hold any investment securities for the purpose of trading such investments. The following tables set forth the carrying amounts of the investment securities as of December 31:

(dollars in thousands)	2008	2007	2006
	-----	-----	-----
Available-for-sale securities: (at fair value)			
Equity securities	\$ 0	\$ 160	\$ 1,160
Preferred stock	20	1,825	2,500
U.S. Treasury securities and other U.S. government corporations and agencies	41,271	46,859	54,100
Obligations of states and political subdivisions	55,696	56,979	45,200
Mortgage-backed securities	53,540	41,554	54,400
	-----	-----	-----
	\$150,527	\$147,377	\$156,400
	=====	=====	=====
Held-to-maturity securities (at amortized cost)			
Mortgage-backed securities	\$ 66	\$ 71	\$ 0
	=====	=====	=====
Federal Home Loan Bank stock	\$ 5,323	\$ 5,176	\$ 4,600
	=====	=====	=====

For the following table, yields are not presented on a fully taxable-equivalent ("FTE") basis.

The scheduled maturities of held-to-maturity securities and available-for-sale securities (other than equity securities) were as follows as of December 31, 2008:

(dollars in thousands)	Maturing After 1 but within 5 Years Amount	Yield	Maturing After 5 but within 10 Years Amount	Yield
	-----		-----	
Held-to-maturity securities ----- (at amortized cost)				
Mortgage-backed securities	\$ 0		\$ 0	
	=====		=====	

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Available-for-sale securities

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(at fair value)

U.S. Treasury securities and other U.S. government corporations and agencies	\$	0		\$	1,001	5.50%
Obligations of states and political subdivisions		0			0	
Mortgage-backed securities		1,435	2.30%		728	4.99%
		-----			-----	
	\$	1,435		\$	1,729	
		=====			=====	

8

Loan Portfolio Analysis by Category  
(dollars in thousands)

	December 31				
	2008	2007	2006	2005	2004
	-----				
Commercial, financial and agricultural	\$ 20,785	\$ 20,629	\$ 16,465	\$ 15,354	\$ 15,127
Real Estate-construction and land development	33,343	28,928	21,169	18,814	14,290
Real Estate - residential	177,048	158,600	145,395	135,619	130,414
Real Estate-commercial	62,796	53,823	50,859	40,889	35,487
Consumer	5,551	8,005	8,816	7,900	9,122
Term federal funds	0	0	12,000	0	0
Other	175	376	69	47	69
	-----	-----	-----	-----	-----
	299,698	270,361	254,773	218,623	204,509
Deferred costs, net	393	306	168	0	0
Allowance for loan losses	(2,724)	(2,475)	(2,474)	(2,626)	(2,512)
Unearned income	0	(1)	(3)	(8)	(19)
	-----	-----	-----	-----	-----
Net loans	\$ 297,367	\$ 268,191	\$ 252,464	\$ 215,989	\$ 201,978
	=====	=====	=====	=====	=====

While a majority of the Bank's loans are secured by real estate located in the Bank's market area, there are no specific industry concentrations in the Bank's loan portfolio.

The following table shows the maturity of commercial, financial and agricultural loans, real estate commercial loans and real estate-construction and land development loans outstanding as of December 31, 2008. Also provided are the amounts due after one (1) year classified according to the sensitivity to changes in interest rates.

(dollars in thousands)	Due in one year or less	Due after one year to five years	Due
------------------------	-------------------------	----------------------------------	-----

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Commercial, financial, agricultural and real estate commercial	\$	1,218	\$	7,120	\$
Real estate-construction and land development		32,758		585	
	\$	33,976	\$	7,705	\$
Maturities after one year with:					
Fixed interest rates			\$	3,761	\$
Variable interest rates				3,944	
			\$	7,705	\$

Return on Equity and Assets

The following table summarizes various financial ratios of the Company for each of the last three (3) years:

	At or for the		
	Year ended December 31,		
	2008	2007	2006
Return on average total assets (net income divided by average total assets)	.23%	.85%	1.02%
Return on average shareholders' equity (net income divided by average shareholders' equity)	2.52%	8.50%	9.83%
Dividend payout ratio (total declared dividends per share divided by net income per share)	169.70%	47.79%	41.11%
Equity to assets ratio (average shareholders' equity divided by average total assets)	9.19%	9.94%	10.37%

Nonaccrual, Past Due and Restructured Loans

At December 31, 2008, there were eleven (11) nonaccrual loans aggregating \$5 million in the Bank's portfolio, ten of which were secured by real estate, compared with eleven (11) nonaccrual loans aggregating \$1 million at December 31, 2007. While the increase in dollar amount of nonaccrual loans is a matter to which management is devoting significant attention, it is important to note that ten of the eleven nonaccrual loans are secured by real estate and are not considered likely to ultimately result in losses based upon the current value of real estate collateral.

However, the growth of nonaccrual loans is a concern, and will be closely



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monitored. In the month following the month in which a mortgage loan becomes 90 days past due, the Bank generally stops accruing interest unless there are unusual circumstances which warrant an exception. Generally the only loan types that the Bank reclassifies to nonaccrual are those secured by real estate or large commercial loans on which substantial collateral exists. Other types of loans are generally charged off when they become 120 days or more delinquent.

### Nonaccrual, Past Due and Restructured Loans (dollars in thousands)

	December 31				
	2008	2007	2006	2005	2004
Nonaccrual	\$5,075	\$ 1,008	\$ 886	\$ 694	\$ 1,739
90 days or more past due	100	816	78	79	528
<b>Total nonperforming loans</b>	<b>\$5,175</b>	<b>\$ 1,824</b>	<b>\$ 964</b>	<b>\$ 773</b>	<b>\$ 2,267</b>
<hr/>					
Total nonperforming loans as percentage of the loan portfolio	1.72%	0.67%	0.38%	0.35%	1.11%
Allowance for loan losses as a percentage of nonperforming loans	52.64%	135.69%	256.64%	339.72%	110.81%

Information with respect to nonaccrual and restructured loans at  
December 31, 2008, 2007 and 2006 is as follows:

(dollars in thousands)	Year Ended December 31		
	2008	2007	2006
Interest income that would have been recorded under original terms	\$ 382	\$ 77	\$ 66
Less gross interest recorded	36	48	37
<b>Foregone interest</b>	<b>\$ 346</b>	<b>\$ 29</b>	<b>\$ 29</b>

### Summary of Loan Loss Experience (dollars in thousands)

	Year Ended December 31				
	2008	2007	2006	2005	2004
Balance of the allowance for loan losses at beginning of year	\$ 2,475	\$ 2,474	\$ 2,626	\$ 2,512	\$ 1,664
Charge-offs:					
Commercial, financial and agricultural	924	20	25	7	0
Consumer	151	83	107	128	70
<b>Total charge-offs</b>	<b>1,075</b>	<b>103</b>	<b>132</b>	<b>135</b>	<b>70</b>

Recoveries:

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Commercial, financial and agricultural	18	55	6	0	0
Consumer	27	49	61	39	28
	<hr/>				
Total recoveries	45	104	67	39	28
	<hr/>				
Net charge-offs (recoveries)	1,030	(1)	65	96	42
Provision (benefit) charged to operations	1,279	0	(87)	210	250
Balance acquired from CNB	0	0	0	0	640
	<hr/>				
Balance at end of year	\$ 2,724	\$ 2,475	\$ 2,474	\$ 2,626	\$ 2,512
	<hr/>				
Ratio of net charge-offs to average loans outstanding	.36%	.00%	.02%	.05%	