BANCORP RHODE ISLAND INC
Form 10-K
March 10, 2008

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PART IV

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C.

FORM 10-K

(Annual Report Under Section 13 of the Securities Exchange Act of 1934)

For the fiscal year ended December 31, 2007

Commission File No. 001-16101

BANCORP RHODE ISLAND, INC.

(Exact Name of Registrant as Specified in Its Charter)

Rhode Island	**05-0509802**
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification No.)

ONE TURKS HEAD PLACE, PROVIDENCE, RI 02903
(Address of Principal Executive Offices)

(401) 456-5000
(Issuer's Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act: None

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

Common Stock, par value $0.01 per share
(Title of Class)

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

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

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 ý No o

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

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

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

As of June 30, 2007, the aggregate market value of the voting common equity of the Registrant held by non-affiliates of the Registrant, based on the closing price on the Nasdaq Global Select Market[SM] was $150,796,218.

As of February 28, 2008, there were 4,537,021 shares of common stock (par value $0.01 per share) of the Registrant issued and outstanding.

Documents incorporated by reference:

Portions of Bancorp Rhode Island's Definitive Proxy Statement for the 2008 Annual Meeting of Shareholders are incorporated by reference into Parts II and III of this Form 10-K.

See pages 63-65 for the exhibit index.

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PART I

SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

We make certain forward looking statements in this Annual Report on Form 10-K and in other documents that we incorporate by reference into this report that are based upon our current expectations and projections about future events. We intend these forward looking statements to be covered by the safe harbor provisions for "forward looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and we are including this statement for purposes of these safe harbor provisions. You can identify these statements by reference to a future period or periods by our use of the words "estimate," "project," "may," "believe," "intend," "anticipate," "plan," "seek," "expect" and similar terms or variations of these terms. These forward looking statements include:

- statements of our goals, intentions and expectations;
- statements regarding our business plans and prospects and growth and operating strategies;
- statements regarding the quality of our products and our loan and investment portfolios; and
- estimates of our risks and future costs and benefits.

Actual results may differ materially from those set forth in forward looking statements as a result of these and other risks and uncertainties, including those detailed herein under Item 1A, "Risk Factors", and from time to time in other filings with the Federal Deposit Insurance Corporation ("FDIC") and the Securities and Exchange Commission ("SEC"). We have included important factors in the cautionary statements included or incorporated in this document, particularly under Item 1A, "Risk Factors", that we believe could cause actual results or events to differ materially from the forward looking statements that we make. Our forward looking statements do not reflect the potential impact of any future acquisitions, mergers, dispositions, joint ventures or investments we may make. We do not assume any obligation to update any forward looking statements.

ITEM 1. BUSINESS

Introduction

Bancorp Rhode Island, Inc. ("we" or the "Company"), a Rhode Island corporation, is the holding company for Bank Rhode Island (the "Bank"). The Company has no significant assets other than the common stock of the Bank. For this reason, substantially all of the discussion in this document relates to the operations of the Bank and its subsidiaries.

The Bank is a commercial bank chartered as a financial institution in the State of Rhode Island and was formed in 1996 as a result of the acquisition of certain assets and liabilities divested in connection with the merger of Fleet Financial Group, Inc. and Shawmut National Corporation. Headquartered in Providence, Rhode Island, the Bank conducts business through 16 full-service branches, with 12 located in Providence County, 3 located in Kent County and 1 located in Washington County. The Bank augments its branch network through online banking services and automatic teller machines ("ATMs"), both owned and leased, located throughout Rhode Island.

The Bank provides a community banking alternative in the greater Providence market which is dominated by three large banking institutions, two national and one regional. Based on total deposits as of June 30, 2007 (excluding one bank that draws its deposits primarily from the internet), the Bank is the fifth largest bank in Rhode Island and the only mid-sized commercially focused bank headquartered in Providence, the State's capital. The Bank offers its customers a wide range of business, commercial real estate, consumer and residential loans and leases, deposit products, nondeposit investment products, cash management and online banking services, private banking and other banking products and services

designed to meet the financial needs of individuals and small- to mid-sized businesses. As a full-service community bank, the Bank seeks to differentiate itself from its large bank competitors through superior personal service, responsiveness and local decision-making. The Bank's deposits are insured by the FDIC, subject to regulatory limits.

One of the Bank's principal subsidiaries, BRI Investment Corp., a Rhode Island corporation wholly-owned by the Bank, engages in the maintenance and management of intangible investments and the collection and distribution of the income from such investments.

The Company's headquarters and executive management are located at One Turks Head Place, Providence, Rhode Island 02903 and its telephone number is (401) 456-5000. The Bank also maintains an internet website at *http://www.bankri.com.*

The Company makes available free of charge through its website at *http://www.bankri.com* all reports it electronically files with, or furnishes to, the SEC, including its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, as well as any amendments to those reports, as soon as reasonably practicable after those documents are filed with, or furnished to, the SEC. These filings are also accessible on the SEC's website at *http://www.sec.gov.*

Overview

The Company, through the Bank, concentrates its business efforts in three main areas. First, the Bank emphasizes commercial lending. The high concentration of small to mid-size businesses in the Bank's predominately urban franchise makes deployment of funds in the commercial lending area practicable. Moreover, the Bank believes it can attract commercial customers from larger competitors through a higher level of service and its ability to set policies and procedures, as well as make decisions, locally. Second, the Bank has sought to grow its demand deposit, savings and other transaction-based accounts, collectively referred to as "core deposits." The Bank has stressed development of full relationships with customers, including its commercial customers, who tend to be more relationship oriented than those who are seeking stand-alone or single transaction products. Third, the Bank seeks to leverage its knowledge and customer base to develop related lines of business. Since inception, the Bank has grown its consumer loan portfolio and added sales of investment products; begun a private banking group and acquired an equipment leasing company.

In March 2007, the Bank marked its eleventh year in business. During the past eleven plus years, the Company has grown its assets, deposits and customer base significantly and has expanded the depth and breadth of its management team and staff. Also, the Bank has substantially enlarged and improved its branch network, enhanced its operating systems and infrastructure and has become an effective competitive force in the Greater Providence marketplace.

During the past year, the Company continued its transition from a young, high growth *de novo* bank into a more mature institution, which seeks to better leverage the footprint it has built and investments it has made. Thus, the Company aimed to combine its strong external focus on high quality loan and deposit growth with (i) the absorption of the Company's major recent initiatives, which included four new branches, the creation of a private bank and acquisition of a leasing subsidiary, and (ii) internally directed efforts to improve the Company's organizational structure and better control operational costs. Additionally, the Company took measures to deal with the industry-wide pressure on net interest margins presented by the shape of the yield curve and the intense competition for deposits and quality assets.

In late 2007, the Company's Chief Financial Officer assumed responsibility for operations, information technology and human resources in addition to overseeing all financial strategy, balance sheet management, investor relations and accounting. The Company also promoted its Director of Corporate Banking to the position of Chief Lending Officer, with responsibility for all commercial lending areas, the

Bank's Lending Services Unit, the Bank's private banking group, and Macrolease Corporation ("Macrolease"), the Bank's Long Island, NY-based equipment leasing company.

The Company achieved double-digit commercial loan and lease growth of 10.4% in 2007, with commercial outstandings increasing from $519.8 million at the prior year-end to $573.7 million at December 31, 2007. The Company's Providence-based lending team and its Macrolease subsidiary have contributed high-quality, high-yielding assets to the Company's balance sheet. In addition, originations of leases for third parties by Macrolease produced over $1.0 million of noninterest income in 2007, up from $407,000 in the prior year, an increase of over 150%.

The Company's loan and lease growth did not come at the expense of credit quality. Nonperforming assets were low at December 31, 2007 at 0.40% of total loans and 0.28% of total assets, respectively. Net charge-offs for the year were nominal at 0.05% of average loans outstanding.

Competition for deposits remained intense in the Bank's primary market area. In 2007, the Bank increased its core deposits by $6.0 million, or 0.9%. The Bank increased its savings accounts by $40.1 million, or 11.3%, during the year, which countered the decrease in demand deposit accounts of $27.6 million, or 13.8%. In 2007, the Bank did not experience the year-end build-up of customers' demand deposit accounts that it had experienced over the past several years. However, with the Bank's focus on core deposit account gathering, the Bank was able to reduce its brokered certificate of deposit account balance by $10.0 million from the December 31, 2006 level of $30.0 million. Overall, total deposits decreased by $1.6 million, or 0.2%, year-over-year.

The Bank's branches opened in 2004 and 2005 continue to make progress. The Bank's North Kingstown and East Greenwich branches had deposit growth in 2007 of 9.3% and 8.2%, respectively, while the Lincoln branch had deposit growth of 11.5%. In October 2007, the Bank opened a new branch office in Pawtucket.

Deposit service charges comprised approximately half of the Company's noninterest income in the past two years. Towards the end of 2006 and into early 2007, the Bank implemented deposit fee enhancement programs. As a result of these programs, the Bank experienced a 10.3% increase in deposit fee income in 2007.

In 2006, the Bank continued the deployment of its new service model for its branches. With the "Universal Banker" model, customers now have a single in-branch touch point for all banking services by removing the traditional split between the teller and customer service representative. By having one person service the customer's needs, the Bank believes it can elevate its service levels, as well as improves operational efficiencies. The Bank phased in this concept gradually throughout 2007 and will continue implementation in 2008.

The Company continued to proactively manage its balance sheet. The steps taken in 2006 to restructure a portion of the Company's investment portfolio benefited the net interest margin in 2007. The overall increase in yields on investment and mortgage-backed securities of 75 and 20 basis points, respectively, aided in partially offsetting increases in deposit costs. Additionally, the Company was active in repurchasing shares of its common stock. In November 2007, the Company expanded its original repurchase program of 245,000 shares by an additional 100,000 shares. By the end of the year, the Company had repurchased 305,200 shares, or 6.3% of its issued shares, for a total cost of $10.2 million. The Company concluded this repurchase program in February 2008. The Company further managed its capital position by redeeming $5 million of trust preferred securities in September 2007. Additionally, the Company's Board of Directors increased its quarterly dividend effective third quarter 2007 by $0.01 to $0.16 per share.

The Company also made strides in improving its operating efficiency. The Company reduced its noninterest expenses in 2007 by $702,000, or 1.8%. This overall decrease compares to increases of 6.6% in

2006 and 10.4% in 2005. Throughout 2008, the Company will continue to review its operational process in an effort to identify efficiencies and cost savings with the aim of improving earnings.

Lending Activities

The Bank's business strategy has been to grow its commercial and consumer loan portfolios while allowing its residential mortgage loan portfolio to decline gradually as a percent of total loans. The Bank has allocated substantial resources to its commercial and consumer lending functions to facilitate and promote such growth. From December 31, 2002, until December 31, 2007, commercial loan and lease outstandings have increased $292.7 million, or 104.2%, and consumer loan outstandings have increased $123.8 million, or 134.7%. Commercial loans and leases increased from 41.9% of total loans and leases at December 31, 2002, to 55.3% of total loans and leases at December 31, 2007, and consumer and other loans increased from 13.7% of total loans and leases at December 31, 2002, to 20.8% of total loans and leases at December 31, 2007. Meanwhile, residential mortgage loans decreased from 44.4% of total loans and leases at December 31, 2002, to 24.0% of total loans and leases at December 31, 2007.

The Bank offers a variety of loan facilities to serve both commercial and consumer borrowers primarily within the State of Rhode Island and nearby areas of Massachusetts. Approximately 74% of Rhode Island businesses and 79% of Rhode Island jobs are located in Providence and Kent Counties. More than 98% of Rhode Island businesses have fewer than 100 employees. The Bank believes the financing needs of these businesses generally match the Bank's lending profile and that the Bank's branches are well positioned to facilitate the generation of loans from this customer base.

The Bank's commercial lending function is organized into two groups. The commercial real estate group originates nonowner-occupied commercial real estate, multi-family residential real estate and construction loans. The business lending group originates business loans, often referred to as commercial and industrial loans, including owner-occupied commercial real estate loans, term loans, revolving lines of credit and equipment leases (through the Bank's subsidiary, Macrolease). The Bank's branch network and business development team also play a role in business lending relationships under $1 million. Underwriting, processing and monitoring of the bulk of business credit relationships under $1.0 million are supported by the Banks lending services unit ("LSU"). The creation of the LSU has enhanced the Bank's ability to reach more borrowers with the same number of personnel as well as achieve more efficient processing and improved monitoring of these credits.

The Bank also satisfies a variety of consumer credit needs by providing home equity term loans, home equity lines of credit, direct automobile loans, savings secured loans and personal loans, in addition to residential mortgage loans.

The Bank has tiered lending authorities. Certain senior executives have lending approval authority up to $3 million. Extensions of credit to a customer relationship greater than established authority levels (up to the Bank's house lending limit of $10.0 million) require the approval of the Credit Committee, which consists of members of the Bank's senior management and one outside director. Exceptions to the Bank's house lending limit require the approval of a committee of the Board of Directors. Other officers have limited lending authorities that can be exercised subject to lending policy guidelines to facilitate volume production and process flow.

The Bank issues loan commitments to prospective borrowers subject to various conditions. Commitments generally are issued in conjunction with commercial loans and residential mortgage loans and typically are for periods up to 90 days. The proportion of the total value of commitments derived from any particular category of loan varies from time to time and depends upon market conditions. At December 31, 2007, the Bank had $256.9 million of aggregate loan commitments outstanding to fund a variety of loans.

Overall, loans and leases produced total interest income of $67.0 million, or 77.9% of total interest and dividend income, in 2007 and $63.0 million, or 77.6%, of total interest and dividend income, during 2006.

Commercial Real Estate and Multi-Family Loans The Bank originates loans secured by mortgages on owner-occupied and nonowner-occupied commercial and multi-family residential properties. At December 31, 2007, owner-occupied commercial real estate loans totaled $157.4 million, or 15.2% of the total loan portfolio. Many of these customers have other commercial borrowing relationships with the Bank, as the Bank finances their other business needs. Generally these customer relationships are handled in the Bank's business lending group. Nonowner-occupied commercial real estate loans totaled $103.0 million, or 9.9% of the total loan portfolio, and multi-family residential loans totaled $42.5 million, or 4.1% of the total loan portfolio, and are generally handled in the Bank's commercial real estate group. These real estate secured commercial loans are offered as both fixed and adjustable rate products. The Bank typically charges higher interest rates on these loans than those charged on adjustable rate loans secured by one- to four-family residential units. Additionally, the Bank may charge origination fees on these loans.

The Bank's underwriting practices for permanent commercial real estate and multi-family residential loans are intended to assure that the property securing these loans will generate a positive cash flow after operating expenses and debt service payments. The Bank requires appraisals before making a loan and generally requires the personal guarantee of the borrower. Permanent loans on commercial real estate and multi-family properties generally are made at a loan-to-value ratio of no more than 80%.

Loans secured by nonowner-occupied commercial real estate and multi-family properties involve greater risks than owner-occupied properties because repayment generally depends on the rental income generated by the property. In addition, because the payment experience on loans secured by nonowner-occupied properties is often dependent on successful operation and management of the property, repayment of the loan is usually more subject to adverse conditions in the real estate market or the general economy than is the case with owner-occupied real estate loans. Also, the nonowner-occupied commercial real estate and multi-family residential business is cyclical and subject to downturns, over-building and local economic conditions.

Commercial and Industrial Loans The Bank originates non-real estate commercial loans that, in most instances, are secured by equipment, accounts receivable or inventory, as well as the personal guarantees of the principal owners of the borrower. Unlike many community banks, the Bank is able to offer asset-based commercial loan facilities that monitor advances against receivables and inventories on a formula basis. A number of commercial and industrial loans are granted in conjunction with the U.S. Small Business Administration's ("SBA") loan guaranty programs and include some form of SBA credit enhancement. The Bank utilizes credit scoring in evaluating business loans of up to $750,000. Commercial lending activities are supported by noncredit products and services, such as letters of credit and cash management services, which are responsive to the needs of the Bank's commercial customers.

At December 31, 2007, commercial and industrial loans totaled $131.9 million, or 12.7% of the total loan portfolio. Generally, commercial and industrial loans have relatively shorter maturities than residential and commercial real estate loans, or are at adjustable rates without interest rate caps. Unlike residential and commercial real estate loans, which generally are based on the borrower's ability to make repayment from employment and rental income and which are secured by real property whose value tends to be relatively easily ascertainable, commercial and industrial loans are typically made on the basis of the borrower's ability to make repayment from the cash flow of the business and are generally secured by business assets, such as accounts receivable, equipment and inventory. As a result, the availability of funds for the repayment of commercial and industrial loans may be significantly dependent on the success of the business itself. Further, the collateral securing the loans may be difficult to value, may fluctuate in value based on the success of the business and may deteriorate over time.

Leases In May 2005, the Bank, through its Macrolease subsidiary, purchased substantially all of the operating assets of Macrolease International Corporation, a privately held national equipment leasing company based on Long Island in Plainview, New York. With the Macrolease platform, the Bank originates equipment leases for its own portfolio, as well as originating leases for third parties as a source of noninterest income. In addition, the Bank historically has purchased equipment leases from originators outside of the Bank. The U.S. Government and its agencies are the principal lessees on the vast majority of these purchased leases. These "government" leases generally have maturities of five years or less and are not made in reliance on residual collateral values. At December 31, 2007, leases comprised 10.2% of the commercial loan and lease portfolio, with $43.4 million of Macrolease-generated leases and $15.3 million of purchased government leases. Included within these amounts were $3.3 million of leases generated for sale at December 31, 2007. The Bank increased its origination efforts intended for third parties in 2007 with leases originated for sale of $25.1 million, which generated $1.0 million of noninterest income.

Small Business Loans The Bank utilizes the term "small business loans" to describe business lending relationships of approximately $250,000 or less which it originates through business development officers and its branch network. These loans are generally secured by the assets of the business, as well as the personal guarantees of the business' principal owners. A number of these loans are granted in conjunction with the SBA's Low-Doc and Express programs and include some form of SBA credit enhancement. At December 31, 2007, small business loans totaled $45.8 million, or 4.4% of the total loan portfolio. Generally, small business loans are granted at higher rates than commercial and industrial loans. These loans have relatively short-term maturities or are at adjustable rates without interest rate caps.

The Bank's underwriting practices for small business loans are designed to provide quick turn-around and minimize the fees and expenses to the customer. Accordingly, the Bank utilizes a credit scoring process to assist in evaluating potential borrowers. The Bank distinguishes itself from larger financial institutions by providing personalized service through a branch manager or business development officer assigned to the customer relationships. Lending to small businesses may involve additional risks as a result of their more limited financial and personnel resources.

Construction Loans The Bank originates residential construction loans to individuals and professional builders to construct one- to four-family residential units, either as primary residences or for resale. The Bank also makes construction loans for the purpose of constructing multi-family or commercial properties. At December 31, 2007, outstanding construction loans totaled $38.8 million, or 3.7% of the total loan portfolio. In addition, the Bank offers interest-only construction loans during the construction period.

The Bank's underwriting practices for construction loans are similar to those for commercial real estate loans, but they also are intended to assure completion of the project and take into account the feasibility of the project, among other things. As a matter of practice, the Bank generally lends an amount sufficient to pay a percentage of the property's acquisition costs and a majority of the construction costs but requires that the borrower have equity in the project. The Bank requires property appraisals and generally the personal guarantee of the borrower, as is the case with commercial real estate loans.

The risks associated with construction lending are greater than those with commercial real estate lending and multi-family lending on existing properties for a variety of reasons. The Bank seeks to minimize these risks by, among other things, often using the inspection services of a consulting engineer for commercial construction loans, advancing money during stages of completion and generally lending for construction of properties within its market area to borrowers who are experienced in the type of construction for which the loan is made, as well as by adhering to the lending standards described above. The Bank generally requires from the borrower evidence of either pre-sale or pre-lease commitments on certain percentages of the construction project for which the loan is made.

Residential Mortgage Loans The Bank's one- to four-family residential mortgage loan portfolio consists primarily of whole loans purchased from other financial institutions. Currently, the Bank

purchases fixed- and adjustable-rate ("ARM") mortgage whole loans from other financial institutions both in New England and elsewhere in the country. The Bank anticipates continuing to purchase residential mortgage loans until such time as its commercial and consumer loan originations are sufficient to fully utilize available cash flows. With the exception of approximately $40 million of purchased mortgages, servicing rights related to the whole loan mortgage portfolio are retained by the mortgage servicing companies. The Bank pays a servicing fee ranging from ..25% to .375% to the mortgage servicing companies for administration of the loan portfolios. As of December 31, 2007, approximately 36% of the residential mortgage loan portfolio consisted of loans secured by real estate outside of New England.

Additionally, largely as an accommodation to the Bank's customers, fixed- and variable-rate mortgages are offered throughout the Bank's branch network. The majority of these mortgages are transferred to the Bank's correspondent third parties under precommitments to fund these transactions. However, the Bank does retain a portion of these residential mortgages for its own portfolio. In 2007, fees from these loans originated for third parties increased to $192,000 from $159,000 in the prior year. Overall, the Bank anticipates that its residential mortgage loan portfolio will decline long-term as it focuses its resources on commercial and consumer lending.

At December 31, 2007, one- to four-family residential mortgage loans totaled $248.7 million, or 24.0% of the total loan portfolio. The fixed rate portion of this portfolio totaled $92.9 million and had original maturities of 15 to 30 years. The adjustable rate portion of this portfolio totaled $155.8 and generally had original maturities of 30 years. Interest rates on adjustable rate loans are set for an initial period of one, three, five, seven or ten years with annual adjustments for the remainder of the loan. These loans have periodic rate adjustment caps of primarily 2% and lifetime rate adjustment caps of either 5% or 6%. There are no prepayment penalties for the one- to four-family residential mortgage loans.

Although adjustable rate mortgage loans allow the Bank to increase the sensitivity of its assets to changes in market interest rates, the terms of such loans include limitations on upward and downward rate adjustments. These limitations increase the likelihood of prepayments due to refinancings during periods of falling interest rates, particularly if rate adjustment caps keep the loan rate above market rates. Additionally, these limitations could keep the market value of the portfolio below market during periods of rising interest rates, particularly if rate adjustment caps keep the loan rate below market rates.

Consumer and Other Loans The Bank originates a variety of term loans and line of credit loans for consumers. At December 31, 2007, the consumer loan portfolio totaled $215.7 million, or 20.8% of the total loan portfolio. Over the past 5 years, consumer loans have increased by $123.8 million, or 134.7%. However, compared to the prior year-end, consumer loans have decreased by $4.8 million, or 2.2%. The Company believes this decrease was reflective of the softening of the housing market over the past 18 months, which has reduced consumer appetite for home equity loans and credit lines.

Home equity term loans and home equity lines of credit comprised 98.1% of the consumer loan portfolio at December 31, 2007. These loans and lines of credit are generally offered for up to 80% of the appraised value of the borrower's home, less the amount of the remaining balance of the borrower's first mortgage. The Bank also offers direct automobile loans, savings secured loans and personal loans.

Investment Activities

Investments, an important component of the Company's diversified asset structure, are a source of earnings in the form of interest and dividends, and provide a source of liquidity to meet lending demands and fluctuations in deposit flows. Overall, the portfolio, comprised primarily of overnight investments, U.S. agency securities, corporate debt securities, mortgage-backed securities ("MBSs"), collateralized mortgage obligations ("CMOs") and Federal Home Loan Bank of Boston ("FHLB") stock, represents $367.9 million, or 24.9% of total assets, as of December 31, 2007. The vast majority of these securities are rated investment grade by at least one major rating agency.

Loans and leases generally provide a better return than investments, and accordingly, the Company seeks to emphasize their generation rather than increasing its investment portfolio. The investments are managed by the Bank's Chief Financial Officer and Treasurer, subject to the supervision and review of the Asset/Liability Committee and are made in compliance with the Investment Policy approved by the Bank's Board of Directors.

Overall, in 2007, investments produced total interest and dividend income of $19.0 million, or 22.1% of total interest and dividend income compared to $18.2 million, or 22.4%, of total interest and dividend income, during 2006.

Deposits

Deposits are the principal source of funds for use in lending and for other general business purposes. The Bank attracts deposits from businesses, non-profit entities, governmental entities and the general public by offering a variety of deposit products ranging in maturity from demand-type accounts to certificates of deposit ("CDs"). The Bank relies mainly on quality customer service and diversified products, as well as competitive pricing policies and advertising, to attract and retain deposits. The Bank emphasizes retail deposits obtained locally.

The Bank seeks to develop relationships with its customers in order to become their primary bank. In order to achieve this, the Bank has stressed growing its core deposit account base. Core deposits increased moderately on a dollar amount basis compared to the prior year (up $6.0 million, or 0.9%). Within core deposits, demand deposit accounts decreased to $172.6 million at December 31, 2007 from $200.3 million at December 31, 2006. At the end of 2007, the Bank did not experience the year-end build-up in customers' demand deposit accounts it had in the past several years. Within total deposit growth, however, the balance sheet mix changed from the prior year due to the continuing growth of savings account balances. Savings balances grew to $396.8 million at December 31, 2007, compared to $356.7 million at December 31, 2006, an increase of $40.1 million, or 11.3%. Core deposits as a percentage of total deposits increased to 63.1% at December 31, 2007 from 62.4% at December 31, 2006.

As a by-product of the Bank's emphasis on checking account growth, as well as deposit fee enhancement programs, service charges on deposit accounts (which include insufficient funds ("NSF") fees) have grown over the years and represents the largest source of noninterest income for the Company. Service charges on deposit accounts produced a double-digit percentage increase from the prior year with an increase of $523,000, or 10.3%, from $5.1 million for 2006, to $5.6 million for 2007.

The Bank generally charges early withdrawal penalties on its CDs in an amount equal to three months' interest on accounts with original maturities of one year or less and six months' interest on accounts with original maturities longer than one year. Interest credited to an account during any term may be withdrawn without penalty at any time during the term. Upon renewal of a CD, only interest credited during the renewal term may be withdrawn without penalty during the renewal term. The Bank's withdrawal penalties are intended to offset the potentially adverse effects of the withdrawal of funds during periods of rising interest rates.

As a general policy, the Bank reviews the deposit accounts it offers to determine whether the accounts continue to meet customers' needs and the Bank's asset/liability management goals. This review is the responsibility of the Pricing Committee, which meets weekly to determine, implement and monitor pricing policies and practices consistent with the Bank's Asset and Liability Committee's strategy, as well as overall earnings and growth goals. The Pricing Committee analyzes the cost of funds and also reviews the pricing of deposit related fees and charges.

Borrowings

The Bank also derives cash flows from several sources, including loan repayments, deposit inflows and outflows, sales of available for sale investment securities and FHLB and other borrowings. Loan repayments and deposit inflows and outflows are significantly influenced by prevailing interest rates, competition and general economic conditions.

The Bank utilizes borrowings on both a shorter- and longer-term basis to compensate for reductions in normal sources of funds on a daily basis and as opportunities present themselves. Additionally, the Bank will utilize borrowings as part of the Bank's overall strategy to manage interest rate risk. At December 31, 2007, total borrowings stood at $331.7 million compared to $337.1 million at December 31, 2006.

Nondeposit Investment Products and Services

Since January 2001, the Bank has managed a nondeposit investment program through which it makes available to its customers a variety of mutual funds, fixed- and variable-annuities, stocks, bonds and other fee-based products. These investment products are offered through an arrangement with Commonwealth Equity Services, Inc., of Waltham, Massachusetts ("Commonwealth"). Commissions on nondeposit investment products for the years ending December 31, 2007, 2006 and 2005 were $575,000, $872,000 and $849,000, respectively.

Employees

At December 31, 2007, the Company had 229 full-time and 39 part-time employees. The Company's employees are not represented by any collective bargaining unit, and the Company believes its employee relations are good. The Company maintains a benefit program that includes health and dental insurance, life and long-term disability insurance and a 401(k) plan.

Supervision and Regulation

Overview The Company and the Bank are subject to extensive governmental regulation and supervision. Federal and state laws and regulations govern numerous matters affecting the Bank and/or the Company, including changes in the ownership or control, maintenance of adequate capital, financial condition, permissible types, amounts and terms of extensions of credit and investments, permissible non-banking activities, the level of reserves against deposits and restrictions on dividend payments. These regulations are intended primarily for the protection of depositors and customers, rather than for the benefit of shareholders. Compliance with such regulation involves significant costs to the Company and the Bank and may restrict their activities. In addition, the passage of new or amended federal and state legislation could result in additional regulation of, and restrictions on, the operations of the Company and/or the Bank. The Company cannot predict whether any legislation currently under consideration will be adopted or how such legislation or any other legislation that might be enacted in the future would affect the business of either the Company or the Bank. The following descriptions of applicable statutes and regulations are not intended to be complete descriptions of these provisions or their effects on the Company and the Bank, but are brief summaries which are qualified in their entirety by reference to such statutes and regulations.

The Company and the Bank are subject to extensive periodic reporting requirements concerning financial and other information. In addition, the Bank and the Company must file such additional reports as the regulatory and supervisory authorities may require. The Company also is subject to the reporting and other dictates of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and the Sarbanes-Oxley Act of 2002. Since 2002, changes to SEC rules have accelerated the reporting of numerous internal events and increased the Company's filing obligations and related costs.

The Company is a bank holding company registered under the Bank Holding Company Act of 1956, as amended (the "BHC Act"). As a bank holding company, the Company is regulated by the Board of Governors of the Federal Reserve System (the "FRB"), and also is subject to certain laws of the State of Rhode Island.

The Bank is a Rhode Island chartered non-member bank of the Federal Reserve System. The Bank's deposits are insured by the Bank Insurance Fund (the "BIF") of the FDIC. Accordingly, the Bank is subject to the supervision and regulation of the FDIC and the Rhode Island Department of Business Regulation (the "Department of Business Regulation").

Rhode Island Regulation

As a state chartered financial institution, the Bank is subject to the continued regulation and supervision and periodic examination by the Department of Business Regulation. Rhode Island law also imposes reporting requirements on the Bank. Rhode Island statutes and regulations govern among other things, investment powers, deposit activity, trust powers and borrowings. The approval of the Department of Business Regulation is required to establish, close or relocate a branch, merge with other banks, amend the Bank's Charter or By-laws and undertake certain other enumerated activities.

If it appears to the Department of Business Regulation that a Rhode Island bank has violated its charter, or any law or regulation, or is conducting its business in an unauthorized or unsafe manner, or that the bank has been notified by its federal insurer of such insurer's intent to terminate deposit insurance, the Director of the Department of Business Regulation (the "Director") may, under certain circumstances, restrict the withdrawal of deposits, order any person to cease violating any Rhode Island statutes or rules and regulations or cease engaging in any unsafe, unsound or deceptive banking practice, order that capital be restored, or suspend or remove directors, committee members, officers or employees who have violated the Rhode Island banking statutes, or a rule or regulation or order thereunder, or who are reckless or incompetent in the conduct of the bank's business.

Rhode Island law also requires any person or persons desiring to acquire "control", as defined in the BHC Act, of any Rhode Island financial institution to file an extensive application with the Director. The application requires detailed information concerning the Bank, the transaction and the principals involved. The Director may disapprove the acquisition if the proposed transaction would result in a monopoly, the financial stability of the institution would be jeopardized, the proposed management lacks competence, or the acquisition would not promote public convenience and advantage. The Company is also subject to the Rhode Island Business Combination Act.

In addition, whenever the Department of Business Regulation considers it advisable, the Department may conduct an examination of a Rhode Island bank holding company, such as the Company. Every Rhode Island bank holding company also must file an annual financial report with the Department of Business Regulation.

Federal Supervision: FDIC

Overview The FDIC issues rules and regulations, conducts periodic inspections, requires the filing of certain reports and generally supervises the operations of its insured state chartered banks, that, like the Bank, are not members of the Federal Reserve System. The FDIC's powers have been enhanced in the past two decades by federal legislation. With the passage of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, the Crime Control Act of 1990, and the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"), federal bank regulatory agencies, including the FDIC, were granted substantial additional enforcement powers to restrict the activities of financial institutions and to impose or seek the imposition of increased civil and/or criminal penalties upon financial institutions and the individuals who manage or control such institutions.

The Bank is subject to the FDIC regulatory capital requirements described below under "Regulatory Capital Requirements." An FDIC-insured bank also must conform to certain standards, limitations, and collateral requirements with respect to certain transactions with affiliates such as the Company. Further, an FDIC-insured bank is subject to laws and regulations that limit the amount of, and establish required approval procedures, reporting requirements and credit standards with respect to, loans and other

extensions of credit to officers, directors and principal shareholders of the Company, the Bank, and any subsidiary of the Bank, and to their related interests. FDIC approval also is required prior to the Bank's redemption of any stock. The prior approval of the FDIC or, in some circumstances, another regulatory agency, is required for mergers and consolidations. In addition, notice to the FDIC is required prior to the closing of any branch office, and the approval of the FDIC is required in order to establish or relocate a branch facility.

Proceedings may be instituted against any FDIC-insured bank, or any officer or director or employee of such bank and any other institution affiliated parties who engage in unsafe and unsound practices, breaches of any fiduciary duty, or violations of applicable laws, regulations, regulatory orders and agreements. The FDIC has the authority to terminate insurance of accounts, to issue orders to cease and desist, to remove officers, directors and other institution affiliated parties, and to impose substantial civil money penalties.

Deposit Insurance The Bank's deposits are insured by the BIF of the FDIC to the legal maximum for each separately insured depositor. The Federal Deposit Insurance Act, as amended (the "FDI Act"), provides that the FDIC shall set deposit insurance assessment rates on a semiannual basis and requires the FDIC to increase deposit insurance assessments whenever the ratio of BIF reserves to insured deposits in the BIF is less than 1.25%.

The FDIC has established a risk-based bank assessment system the rates of which are determined on the basis of a particular institution's supervisory rating and capital level. Under the Federal Deposit Insurance Reform Act of 2005, which became law in 2006, the Bank received a one-time assessment credit of $585,000 that could be applied against premiums, subject to certain limitations. Banks are now assessed rates ranging from 5 basis points per $100 of deposits for banks in Risk Category I (within which the Bank is classified) to 43 basis points for banks assigned to Risk Category IV. The Bank paid a minimum assessment of $2,000 in 2007, largely through the utilization of this one-time credit. In 2008, the Bank anticipates fully utilizing the remainder of this credit. This assessment increase is expected to have an adverse effect on the Company's earnings for 2008 and future years as compared to prior years.

The FDIC may terminate the deposit insurance of any insured depository institution if the FDIC determines that the institution had engaged in or is engaging in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, order or any condition imposed by the FDIC.

Safety and Soundness Standards The FDI Act also directs each federal banking agency to prescribe standards for safety and soundness for insured depository institutions and their holding companies relating to operations, management, asset quality, earnings and stock valuation.

Examination FDIC requires that nearly all insured depository institutions have annual, on-site regulatory examinations and annual audits by an independent public accountant. Management must prepare an annual report, attested to by the independent public accountant, confirming management's responsibility in preparing financial statements, maintaining internal controls for financial reporting and complying with safety and soundness standards. The audit process must be overseen by an independent audit committee composed of outside directors, provided that the federal banking agencies may permit the committee to include inside directors if the bank is unable to find competent outside directors, so long as outside directors comprise a majority of the committee.

Federal Supervision: FRB

The BHC Act mandates that the prior approval of the FRB must be obtained in order for the Company to engage in certain activities such as acquiring or establishing additional banks or non-banking subsidiaries or merging with other institutions and imposes capital adequacy requirements as described below under "Regulatory Capital Requirements."

Regulatory Capital Requirements

FDIC Requirements FDIC-insured institutions must meet specified minimal capital requirements and are subject to varying regulatory restrictions based upon their capital levels. All banks are subject to restrictions on capital distributions (such as dividends, stock repurchases and redemptions) and payment of management fees if, after making such distributions or payment, the institution would be undercapitalized. FDIC-insured banks that have the highest regulatory rating and are not anticipating or experiencing significant growth are required to maintain a capital ratio calculated using Tier 1 capital (as defined below) to total assets ("Tier 1 Leverage Ratio") of at least 3.0%. All other banks are required to maintain a minimum leverage capital ratio of 1.0% to 2.0% above 3.0%, with a minimum of 4.0%.

In addition, the FDIC has adopted capital guidelines based upon ratios of a bank's capital to total assets adjusted for risk, which require FDIC-insured banks to maintain capital-to-risk weighted assets ratios based on Tier 1 capital ("Tier 1 Risk-Based Capital Ratio") of at least 4.0% and on total capital ("Total Risk-Based Capital Ratio") of at least 8.0%. The guidelines provide a general framework for assigning assets and off-balance sheet items (such as standby letters of credit) to broad risk categories and provide procedures for the calculation of the Risk-Based Capital Ratio. Tier 1 (sometimes referred to as "core") capital consists of common shareholders' equity, qualifying, non-cumulative perpetual preferred stock, and minority interests in the equity accounts of consolidated subsidiaries. "Supplementary" or Tier 2 capital includes perpetual debt, mandatory convertible debt securities, a limited amount of subordinated debt, other preferred stock, and a limited amount of loan loss reserves. Certain intangible assets are deducted in computing the Capital Ratios.

Prompt Corrective Action Provisions In order to resolve the problems of undercapitalized institutions, FDICIA established a system known as "prompt corrective action." Under prompt corrective action provisions and implementing regulations, every institution is classified into one of five categories reflecting the institution's capitalization. These categories are the following: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. For an institution to be well capitalized, it must have a Total Risk-Based Capital Ratio of at least 10%, a Tier 1 Risk- Based Capital Ratio of at least 6% and a Tier 1 Leverage Ratio of at least 5% and not be subject to any specific capital order or directive. In contrast, an institution will be deemed to be significantly undercapitalized if it has a Total Risk-Based Capital Ratio that is less than 6%, or a Tier 1 Risk-Based Capital Ratio that is less than 3%, or a leverage ratio that is less than 3%, and will be deemed to be critically undercapitalized if the bank has a ratio of tangible equity to total assets that is equal to or less than 2%.

As of December 31, 2007, the Bank's Tier 1 Leverage Ratio was 7.72%, its Tier 1 Risk-Based Capital Ratio was 10.87% and its Total Risk-Based Capital Ratio was 12.09%. Based upon the above ratios, the Bank is considered "well capitalized" for regulatory capital purposes.

The activities in which a depository institution may engage and the remedies available to federal regulators vary depending upon the category described above into which an institution's level of capital falls. At each successive downward capital level, institutions are subject to more restrictions on their activities. For example, only "well capitalized" institutions may accept brokered deposits without prior regulatory approval (brokered deposits are defined to include deposits with an interest rate which is 75 basis points ("bps") above prevailing rates paid on similar deposits in an institution's normal market area).

The FDIC has broad powers to take prompt corrective action to resolve problems of insured depository institutions, depending upon a particular institution's level of capital. For example, a bank which does not meet applicable minimum capital requirements or is deemed to be in a "troubled" condition may be subject to additional restrictions, including a requirement of written notice to federal regulatory authorities prior to certain proposed changes in senior management or directors of the institution. Undercapitalized, significantly undercapitalized and critically undercapitalized institutions also are subject to a number of other requirements and restrictions.

FRB Requirements A bank holding company is required by the FRB to adhere to certain capital adequacy standards. It is the position of the FRB that a bank holding company, such as the Company, should be a source of financial strength to its subsidiary banks such as the Bank. In general, the FRB has adopted substantially identical capital adequacy guidelines as the FDIC. Such standards are applicable to bank holding companies and their bank subsidiaries on a consolidated basis for holding companies, like the Company, with consolidated assets in excess of $150 million. If a bank holding company's capital levels fall below the minimum requirements established by the capital adequacy guidelines, the holding company will be expected to develop and implement a plan, acceptable to the FRB, to achieve adequate levels of capital within a reasonable time. Until such capital levels are achieved, the holding company may be denied approval by the FRB for certain activities such as those described in the preceding paragraph. As of December 31, 2007, on a consolidated basis, the Company's Tier 1 Leverage Ratio was 7.87%, its Tier 1 Risk-Based Capital Ratio was 11.06% and its Total Risk-Based Capital Ratio was 12.28%. Based upon the above ratios, the Company is considered "well capitalized" for regulatory capital purposes.

Basel Accord U.S. bank regulatory authorities and international bank supervisory organizations, principally the Basel Committee on Banking Supervision (the "Basel Committee"), continue to consider and to make changes to the risk-based capital adequacy framework, which could affect the appropriate capital guidelines to which the Company and the Bank are subject.

In 2005, the federal banking agencies issued an advance notice of proposed rulemaking concerning potential changes in the risk-based capital rules ("Basel 1-A") that are designed to apply to, and potentially reduce the risk capital requirements of bank holding companies, such as the Company, that are not among the "core" 20 or so largest U.S. bank holding companies (the "Core Banks"). In December 2006, the FDIC issued a revised Interagency Notice of Proposed Rulemaking concerning Basel 1-A, which would allow banks and bank holding companies that are not among the Core Banks to either adopt Basel 1-A or remain subject to the existing risk-based capital rules. In July 2007 an interagency press release stated that the federal banking agencies have agreed to issue a proposed rule that would provide non-Core Banks with the option to adopt an approach consistent with the standardized approach of Basel II. This proposal would replace Basel 1-A. In December 2007 the federal banking agencies issued the final regulation that will implement Basel II for the Core Banks, permitting only the advanced approach. The final rule implementing Basel II reiterated that non-Core Banks would have the option to take the standardized approach and that it is the agencies intention to have the standardized proposal finalized before the Core Banks begin the first transitional floor period under Basel II. Accordingly, the Company is not yet in a position to determine the effect of such rules on its risk capital requirements.

Restrictions on Transactions with Affiliates and Insiders

The Bank is subject to certain federal statutes limiting transactions with non-banking affiliates and insiders. Section 23A of the Federal Reserve Act limits loans or other extensions of credit to, asset purchases with and investments in affiliates of the Bank, such as the Company, to ten percent (10%) of the Bank's capital and surplus. Further, such loans and extensions of credit, as well as certain other transactions, are required to be secured in specified amounts. Section 23B of the Federal Reserve Act, among other things, requires that certain transactions between the Bank and its affiliates must be on terms substantially the same, or at least as favorable to the Bank, as those prevailing at the time for comparable transactions with or involving other nonaffiliated persons. In the absence of comparable transactions, any transaction between the Bank and its affiliates must be on terms and under circumstances, including credit standards that in good faith would be offered to or would apply to nonaffiliated persons.

The restrictions on loans to officers, directors, principal shareholders and their related interests (collectively referred to herein as "insiders") contained in the Federal Reserve Act and Regulation O apply to all institutions and their subsidiaries. These restrictions include limits on loans to one borrower and conditions that must be met before such loans can be made. Loans made to insiders and their related interests cannot exceed the institution's total unimpaired capital and surplus. Insiders are subject to

enforcement actions for knowingly accepting loans in violation of applicable restrictions. All extensions of credit by the Bank to its insiders are in compliance with these restrictions and limitations.

Loans outstanding to executive officers and directors of the Bank, including their immediate families and affiliated companies ("related parties"), aggregated $7.6 million at December 31, 2007 and $5.4 million at December 31, 2006. Loans to related parties are made in the ordinary course of business under normal credit terms, including interest rates and collateral, prevailing at the time of origination for comparable transactions with other unaffiliated persons, and do not represent more than normal credit risk.

Interstate Banking

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 facilitated the interstate expansion and consolidation of banking organizations by permitting (i) bank holding companies such as the Company, that are adequately capitalized and managed, to acquire banks located in states outside their home states regardless of whether such acquisitions are authorized under the law of the host state, (ii) the interstate merger of banks after June 1, 1997, subject to the right of individual states to "opt in" early or "opt out" of this authority prior to such date, (iii) banks to establish new branches on an interstate basis provided that such action is specifically authorized by the law of the host state, (iv) foreign banks to establish, with approval of the appropriate regulators in the United States, branches outside their home states to the same extent that national or state banks located in such state would be authorized to do so and (v) banks to receive deposits, renew time deposits, close loans and receive payments on loans and other obligations as agent for any bank or thrift affiliate, whether the affiliate is located in the same or different state. Rhode Island adopted "opt in" legislation, which permits full interstate banking acquisition and branching.

Gramm-Leach-Bliley Act

In late 1999, Congress enacted the Gramm-Leach-Bliley Act (the "G-L-B Act"), which repealed provisions of the 1933 Glass-Steagall Act that required separation of the commercial and investment banking industries. The G-L-B Act expands the range of non-banking activities that certain bank holding companies may engage in while preserving existing authority for bank holding companies to engage in activities that are closely related to banking. In order to engage in these new non-banking activities, a bank holding company must qualify and register with the FRB as a "financial holding company" by demonstrating that each of its banking subsidiaries is "well capitalized" and "well managed" and has a rating of "Satisfactory" or better under the Community Reinvestment Act of 1977.

Under the G-L-B Act and its implementing regulations, financial holding companies may engage in any activity that (i) is financial in nature or incidental to a financial activity under the G-L-B Act or (ii) is complementary to a financial activity and does not impose a substantial risk to the safety and soundness of depository institutions or the financial system generally. The G-L-B Act and its accompanying regulations specify certain activities that are financial in nature such as acting as principal, agent or broker for insurance; underwriting, dealing in or making a market in securities; and providing financial and investment advice. The new financial activities authorized by the G-L-B Act may also be engaged in by a "financial subsidiary" of a national or state bank, except for insurance or annuity underwriting, insurance company portfolio investments, real estate investments and development and merchant banking, which must be conducted in a financial holding company. The FRB and the Secretary of the Treasury have the authority to decide whether other activities are also financial in nature or incidental thereto, taking into account changes in technology, changes in the banking marketplace, competition for banking services and other pertinent factors. Although the Company may meet the qualifications to become a financial holding company, it has no current plans to elect such status.

The G-L-B Act also establishes a system of functional regulation, under which the federal banking agencies will regulate the banking activities of financial holding companies and banks' financial subsidiaries, the SEC will regulate their securities activities and state insurance regulators will regulate their insurance activities. In addition, the G-L-B Act provides protections against the transfer and use by financial institutions of consumers' nonpublic, personal information. The G-L-B Act contains a variety of additional provisions, which, among others, impose additional regulatory requirements on certain depository institutions and reduce certain other regulatory burdens, modify the laws governing the Community Reinvestment Act of 1977, and address a variety of other legal and regulatory issues affecting both day-to-day operations and long-term activities of financial institutions.

In granting other types of financial institutions more flexibility, the G-L-B Act has increased the number and type of institutions engaging in the same or similar activities as those of the Company and the Bank, thereby creating a more competitive atmosphere.

Other Aspects of Federal and State Laws

Community Reinvestment Act The Community Reinvestment Act of 1977 ("CRA") and the regulations issued thereunder are intended to encourage banks to help meet the credit needs of their service area, including low and moderate income neighborhoods, consistent with the safe and sound operations of the banks. Under CRA, banks are rated on their performance in meeting these credit needs and the rating of a bank's performance is public. In connection with the filing of an application to conduct certain transactions, the CRA performance record of the banks involved are reviewed. Under the Bank's last CRA examination, the Bank received a "Satisfactory" rating.

USA PATRIOT Act The USA PATRIOT Act of 2001 (the "Patriot Act"), designed to deny terrorists and others the ability to obtain anonymous access to the United States financial system, has significant implications for depository institutions, brokers, dealers and other businesses involved in the transfer of money. The Patriot Act requires financial institutions to implement additional policies and procedures with respect to, or additional measures designed to address, the following matters, among others: money laundering; suspicious activities and currency transaction reporting; and currency crimes.

Sarbanes-Oxley Act of 2002 In July 2002, Congress enacted the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley") which imposed significant additional requirements and restrictions on publicly-held companies, such as the Company. These provisions include requirements governing the independence, composition and responsibilities of audit committees, financial disclosures and reporting and restrictions on personal loans to directors and officers. Sarbanes-Oxley, among other things, mandates chief executive and chief financial officer certifications of periodic financial reports, additional financial disclosures concerning off-balance sheet items, and speedier transaction reporting requirements for executive officers, directors and 10% shareholders. Rules promulgated by the SEC pursuant to Sarbanes-Oxley impose obligations and restrictions on auditors and audit committees intended to enhance their independence from management. In addition, penalties for non-compliance with the Exchange Act are heightened. The Company has not experienced any significant difficulties in complying with this legislation. However, the Company has incurred, and expects to continue to incur, costs in connection with its compliance with Section 404 of Sarbanes-Oxley which requires management to undertake an assessment of the adequacy and effectiveness of the Company's internal controls over financial reporting and requires the Company's auditors to attest to, and report on, management's assessment and the operating effectiveness of these controls.

Insurance Sales Rhode Island legislation enacted in 1996 permits financial institutions to participate in the sale of insurance products, subject to certain restrictions and license requirements. The regulatory approvals required from the Department of Business Regulation and the FDIC depend upon the form and structure used to engage in such activities.

Check 21 The Check Clearing for the 21st Century Act, or "Check 21" as it is commonly known, became effective in late 2004. Check 21 facilitates check collection by creating a new negotiable instrument called a "substitute check", which permits, but does not require, banks to replace original checks with substitute checks or information from the original check and process check information electronically. Banks that do use substitute checks must comply with certain notice and recredit rights. Check 21 is expected to cut the time and cost involved in physically transporting paper items and reduce float, i.e., the time between the deposit of a check in a bank and payment, especially in cases in which items were not already being delivered same-day or overnight. The Bank is currently implementing the Check 21 authority and expects to incur minimal additional costs until all banks have adopted Check 21.

Miscellaneous The Company and/or the Bank also are subject to federal and state statutory and regulatory provisions covering, among other things, reserve requirements, security procedures, currency and foreign transactions reporting, insider and affiliated party transactions, management interlocks, sales of non-deposit investment products, loan interest rate limitations, truth-in-lending, electronic funds transfers, funds availability, truth-in-savings, home mortgage disclosure and equal credit opportunity.

Effect of Governmental Policy

The Company's revenues consist of cash dividends paid to it by the Bank. Such payments are restricted pursuant to various state and federal regulatory limitations. Banking is a business that depends heavily on interest rate differentials. One of the most significant factors affecting the Bank's earnings is the difference between the interest rates paid by the Bank on its deposits and its other borrowings, on the one hand, and, on the other hand, the interest rates received by the Bank on loans extended to its customers and on securities held in the Bank's portfolio. The value and yields of its assets and the rates paid on its liabilities are sensitive to changes in prevailing market rates of interest. Thus, the earnings and growth of the Bank will be influenced by general economic conditions, the monetary and fiscal policies of the federal government, and policies of regulatory agencies, particularly the FRB, which implement national monetary policy. The nature and impact on the Bank of any future changes in such policies cannot be predicted.

ITEM 1A. RISK FACTORS

Overview

Investing in our common stock involves a degree of risk. The risks and uncertainties described below are not the only ones facing our Company. Additional risks and uncertainties may also impair our business operations. If any of the following risks actually occur, our business, financial condition or results of operations would likely suffer.

Risks Related to Our Business

Competition with other financial institutions could adversely affect our franchise growth and profitability.

We face significant competition from a variety of traditional and nontraditional financial service providers both within and outside of Rhode Island, both in making loans and generating deposits. Our most significant competition comes from two national banking institutions and one large regional banking institution that have significant market share positions in Rhode Island. These large banks have well-established, broad distribution networks and greater financial resources than we do, which have enabled them to market their products and services extensively, offer access to a greater number of locations and products, and price competitively.

We also face competition from a number of local financial institutions with branches in Rhode Island and in nearby Massachusetts, some of which have been acquired by both local and out-of-state service providers. Additionally, we face competition from out-of-state financial institutions which have established loan production offices in our marketplace, and from non-bank competitors.

Competition for deposits also comes from short-term money market funds, other corporate and government securities funds and non-bank financial service providers such as mutual fund companies, brokerage firms, insurance companies and credit unions. Many of our non-bank competitors have fewer regulatory constraints as those imposed on federally insured state chartered banks, which gives these competitors an advantage over us in providing certain services. Such competition may limit our growth and profitability in the future.

Current regional and national economic conditions could adversely affect our profitability.

The population in the Rhode Island area declined slightly in 2007, with slow growth over the past several years. Economic growth in Rhode Island has been slow to moderate during the same time period, while New England has trailed other parts of the nation in terms of general economic growth. Further, the Rhode Island unemployment rate continues to exceed the national average rate. Additionally, Rhode Island businesses, like many companies throughout the United States, are facing rising health care costs, which may adversely affect the earnings and growth potential for such companies, which may in turn negatively impact Rhode Island's ability to attract and retain businesses in the State.

Based upon recent forecasts, the State of Rhode Island is projecting a significant budget shortfall in the current fiscal year with larger projected budget deficits in future years. State and local government entities represent one of the largest employers in our market area. Proposed measures to address these budget shortfalls include reductions in State employee workforce and related health and pension benefits, cutbacks in social service programs, reductions in State aid to cities and towns and caps on historic preservation tax credits. In addition, there may be tax increases on both individuals and businesses to close the budget gap. The proposed reduction in State aid to cities and towns in Rhode Island may also lead to local property tax increases or reductions in municipal services. These measures, combined with the general slowdown in the national economy, could negatively impact the operations and financial condition of the Bank's customers, and thus the quality of the Bank's assets, as well as the Bank's ability to originate new business.

Our borrowers' ability to honor their repayment commitments is generally dependent upon the level of economic activity and general health of the regional and local economy. Furthermore, economic conditions beyond our control, such as the strength of credit demand by customers and changes in the general levels of interest rates, may have a significant impact on our operations, including decreases in the value of collateral securing loans. Therefore, an economic recession in this market area adversely affecting growth could cause significant increases in nonperforming assets, thereby reducing operating profits or causing operating losses, impairing liquidity and eroding capital.

Fluctuations in interest rates could adversely impact our net interest margin.

Our earnings and cash flows are heavily dependent on net interest margin, which is the difference between interest income that we earn on loans and investments and the interest expense paid on deposits and other borrowings. When maturities of assets and liabilities are not balanced, a rapid increase or decrease in interest rates could have an adverse effect on our net interest margin and results of operation. Interest rates are highly sensitive to factors that are beyond our control, including general economic conditions, inflation rates, flattening or inversion of the yield curve, business activity levels, money supply and the policies of various government and regulatory authorities. For example, decreases in the discount rate by the Board of Governors of the Federal Reserve System usually lead to falling interest rates, which affects interest income and interest expense. Falling interest rates have an immediate impact on the Company's variable-rate assets, while the Company is generally unable to bring deposit and borrowing costs down as quickly. The nature, timing and effect of any future changes in interest rates on us and our future results of operations are not predictable.

Change in the composition of our loan and lease portfolio may result in greater risk of losses.

At December 31, 2007, 55.3% of our loan and lease portfolio consisted of commercial real estate, business and construction loans and leases, an increase from 51.8% of our loan and lease portfolio at December 31, 2006. We intend to continue to emphasize the origination of these types of loans and leases. These loans generally have greater risk of nonpayment and loss than residential mortgage loans because repayment of these types of loans often depends on the successful business operation and income stream of the borrowers. Such loans typically involve larger loan balances to single borrowers or groups of related borrowers than do individual one-to four-family residential loans. Consequently, an adverse development with respect to one loan or one credit relationship can expose us to a significantly greater risk of loss compared to an adverse development with respect to a single one-to four-family residential mortgage loan.

Our allowance for loan and lease losses may be insufficient to cover actual loan and lease losses.

The risk of loan and lease losses varies with, among other things, business and economic conditions, the character and size of the portfolio, loan growth, delinquency trends, industry loss experience, nonperforming loan trends, the creditworthiness of borrowers and, in the case of a collateralized loan, the value of the collateral. Based upon such factors, our management arrives at an appropriate allowance for loan and lease losses by maintaining a risk rating system that classifies all loans and leases into varying categories by degree of credit risk, and establishes a level of allowance associated with each category. As part of our ongoing evaluation process, including a formal quarterly analysis of allowances, we make various subjective judgments as to the appropriate level of allowance with respect to each category, judgments as to the categorization of any individual loan or lease, as well as additional subjective judgments in ascertaining the probability and extent of any potential losses. If our subjective judgments prove to be incorrect, our allowance for loan and lease losses may not cover inherent losses in our loan and lease portfolio, or if bank regulatory officials or changes in economic conditions require us to increase the allowance for loan and lease losses, earnings could be significantly and adversely affected. Material additions to our allowance would materially decrease net income. At December 31, 2007, the allowance for loan and lease losses totaled $12.6 million, representing 1.22% of total loans.

Expanding the franchise may limit increases in profitability.

We have sought to increase the size of our franchise by pursuing business development opportunities and have grown substantially since inception. To the extent additional branches are opened, we are likely to experience higher operating expenses relative to operating income from the new branches, which may limit increases in profitability. The ability to increase profitability by establishing new branches is dependent on our ability to identify advantageous branch locations and generate new deposits and loans from those locations and an attractive mix of deposits that will create an acceptable level of net income. There can be no assurance that new and relocated branches will generate an acceptable level of net income or that we will be able to successfully establish new branch locations in the future. In addition, there can be no assurance that we will be successful in developing new business lines or that any new products or services introduced will be profitable.

Our growth is substantially dependent on our management team.

Our future success and profitability are substantially dependent upon the management and banking abilities of our senior executives, who have substantial background and experience in banking and financial services, as well as personal contacts, in the Rhode Island market and the region generally. Competition for such personnel is intense, and there is no assurance we will be successful in retaining such personnel. Changes in key personnel and their responsibilities may be disruptive to business and could have a material adverse effect on our business, financial condition and results of operations.

Our operating history is not necessarily indicative of future operating results.

The Company, as the holding company of the Bank, has no significant assets other than the common stock of the Bank. While we have operated profitably since the first full quarter of operations, future operating results may be affected by many factors, including regional and local economic conditions, interest rate fluctuations and other factors that may affect banks in general, all of which factors may limit or reduce our growth and profitability. For example, the yield curve has been flat-to-inverted during parts of the last three years. Also, customers in the past few years have indicated a preference for higher-yielding term deposit and savings account products. Nonperforming asset levels and loan and lease losses have been low since inception. Industry experience suggests that this is unlikely to continue indefinitely.

Our controls and procedures may fail or be circumvented.

Management regularly reviews and updates our internal controls, disclosure controls and procedures and corporate governance policies and procedures. Systems of controls are based upon certain assumptions and can only provide reasonable, not absolute, assurance that system objectives are met. Potential failure or circumvention of our controls and procedures or failure to comply with regulations related to controls and procedures could have an adverse effect on our business, results of operations and financial condition.

We face various technological risks.

We rely heavily on communication and information systems to conduct business. Potential failures, interruptions or breaches in system security could result in disruptions or failures in our key systems, such as general ledger, deposit or loan systems. We have developed policies and procedures aimed at preventing and limiting the effect of failure, interruption or security breaches of information systems; however, there cannot be assurance that these incidences will not occur, or if they do occur, that they will be appropriately addressed. The occurrence of any failures, interruptions or security breaches of our information systems could damage our reputation, result in the loss of business, subject us to increased regulatory scrutiny or subject us to civil litigation and possible financial liability, any of which could have an adverse effect on our results of operation and financial condition.

We encounter technological change continually.

The financial services industry continually undergoes technological change. Effective use of technology increases efficiency and enables banks and financial services institutions to better serve customers and reduce costs. Our future success depends, in part, upon our ability to meet the needs of customers by effectively using technology to provide the products and services that satisfy customer demands, as well as create operational efficiencies. Additionally, many of our competitors have greater resources to invest in technological improvements. Inability to keep pace with technological change affecting the financial services industry could have an adverse impact on our business and as a result, our financial condition and results of operation.

Extensive government regulation and supervision have a significant impact on our operations.

We operate in a highly regulated industry and are subject to examination, supervision and comprehensive regulation by various regulatory agencies. These regulations are intended primarily for the protection of depositors and customers, rather than for the benefit of investors. Our compliance with these regulations is costly and restricts certain activities, including payment of dividends, mergers and acquisitions, investments, loans and interest rates charged, interest rates paid on deposits and locations of offices. We are also subject to capitalization guidelines established by regulators, which require maintenance of adequate capital to support growth. Furthermore, the addition of new branches requires the approval of the FDIC as well as state banking authorities in Rhode Island.

The laws and regulations applicable to the banking industry could change at any time. There is no way to predict the effects of these changes on our business and profitability. Because government regulation greatly affects the business and financial results of all commercial banks and bank holding companies, the cost of compliance with new laws and regulations applicable to the banking industry could adversely affect operations and profitability.

Risks Related to the Company's Common Stock

Our common stock has limited liquidity.

Even though our common stock is currently traded on the Nasdaq Stock Market's Global Select Market^{SM}, it has less liquidity than the average stock quoted on a national securities exchange. Because of this limited liquidity, it may be more difficult for investors to sell a substantial number of shares and any such sales may adversely affect the stock price.

We cannot predict the effect, if any, that future equity offerings, issuance of common stock in acquisition transactions, or the availability of shares of common stock for sale in the market, will have on the market price of our common stock. We cannot give assurance that sales of substantial amounts of common stock in the market, or the potential for large amounts of sales in the market, would not cause the price of our common stock to decline or impair future ability to raise capital through sales of common stock.

Fluctuations in the price of our stock could adversely impact your investment.

The market price of our common stock may be subject to significant fluctuations in response to variations in the quarterly operating results, changes in management, announcements of new products or services by us or competitors, legislative or regulatory changes, general trends in the industry and other events or factors unrelated to our performance. The stock market has experienced price and volume fluctuations which have affected the market price of the common stock of many companies for reasons frequently unrelated to the operating performance of these companies, thereby adversely affecting the market price of these companies' common stock. Accordingly, there can be no assurance that the market price of our common stock will not decline.

There are limitations on our ability to pay dividends.

Our ability to pay dividends is subject to the financial condition of the Bank, as well as other business considerations. Payment of dividends by the Company is also restricted by statutory limitations. These limitations could have the effect of reducing the amount of dividends we can declare.

Certain Anti-Takeover measures affect the ability of shareholders to effect takeover transactions.

We are subject to the Rhode Island Business Combination Act which, subject to certain exceptions, prohibits business combinations involving certain shareholders of publicly held corporations for a period of five years after such shareholders acquire 10% or more of the outstanding voting stock of the corporation. In addition, our Articles of Incorporation and By-laws, among other things, provide that, in addition to any vote required by law, the affirmative vote of two-thirds of the holders of our voting stock, voting as a single class, is required for approval of all business combinations.

Our Board of Directors also has the authority, without further action by shareholders, to issue additional preferred stock in one or more series and to fix by resolution, the rights, preferences and privileges of such series to the extent permitted by law. Our Board could designate certain rights and privileges for such preferred stock which would discourage unsolicited tender offers or takeover proposals or have anti-takeover effects. Our Articles also provide for three classes of directors to be elected for

staggered three year terms, which make it more difficult to change the composition of our Board. All of these provisions may make it more difficult to effect a takeover transaction.

Directors and executive officers own a significant portion of our common stock.

Our directors and executive officers, as a group, beneficially owned approximately 25.8% of our outstanding common stock as of December 31, 2007. As a result of their ownership, the directors and executive officers would have the ability, if they vote their shares in a like manner, to significantly influence the outcome of all matters submitted to shareholders for approval, including the election of directors.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The Bank presently has a network of 16 branch offices located in Providence, Kent and Washington Counties. Eight of these branch office facilities are owned and eight are leased. Facilities are generally leased for a period of one to ten years with renewal options. The termination of any short-term lease would not have a material adverse effect on the operations of the Bank. The Company's offices are in good physical condition and are considered appropriate to meet the banking needs of the Bank's customers.

The following are the locations of the Bank's offices:

Location	Size (Square feet)	Year Opened or Acquired	Owned or Leased	Lease Expiration Date
Branch offices:				
1047 Park Avenue, Cranston, RI	4,700	1996	Owned	N.A.
383 Atwood Avenue, Cranston, RI	4,700	1996	Owned	N.A.
1269 South County Trail, East Greenwich, RI	2,600	2005	Leased	5/31/25
999 South Broadway, East Providence, RI	3,200	1996	Leased	11/30/12
195 Taunton Avenue, East Providence, RI	3,100	1996	Leased	12/31/09
1440 Hartford Avenue, Johnston, RI	4,700	1996	Land Leased	12/31/12
625 G. Washington Highway, Lincoln, RI	1,000	2005	Owned	N.A.
1140 Ten Rod Road, North Kingstown, RI	4,000	2004	Land Leased	6/30/19
499 Smithfield Avenue, Pawtucket, RI	3,500	2007	Land Leased	5/31/21
One Turks Head Place, Providence, RI	5,000	1996	Leased	4/30/09
165 Pitman Street, Providence, RI	3,300	1998	Leased	10/31/08
445 Putnam Pike, Smithfield, RI	3,500	1996	Leased	7/31/09
1062 Centerville Road, Warwick, RI	2,600	1996	Owned	N.A.
1300 Warwick Avenue, Warwick, RI	4,200	1996	Leased	6/30/09
2975 West Shore Road, Warwick, RI	3,500	2000	Leased	3/31/10
1175 Cumberland Hill Road, Woonsocket, RI	3,300	1998	Owned	N.A.
Administrative and operational offices:				
2104 Plainfield Pike, Cranston, RI	700	2002	Owned	N.A.
625 G. Washington Highway, Lincoln, RI	23,600	2003	Owned	N.A.
One Turks Head Place, Providence, RI	20,600	1999	Leased	6/30/09
One Ames Court, Plainview, NY	4,400	2005	Leased	1/31/13
Planned branch offices:				
40 Newport Avenue, East Providence, RI	(A)	N.A.	Leased	12/31/17

(A) Facility currently under construction or in planning.

ITEM 3. LEGAL PROCEEDINGS

The Company is involved only in routine litigation incidental to the business of banking, none of which the Company's management expects to have a material adverse effect on the Company.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There were no matters submitted to a vote of security holders in the fourth quarter of 2007.

PART II

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

Common Stock Prices and Dividends Our common stock is traded on the Nasdaq Global Select Market[SM] under the symbol "BARI." The following table sets forth certain information regarding our common stock for the periods indicated.

	Stock Price		
	High	Low	Dividend Paid
2006:			
First Quarter	$ 35.65	$ 32.75	$ 0.15
Second Quarter	39.94	33.31	0.15
Third Quarter	45.40	38.91	0.15
Fourth Quarter	45.37	42.09	0.15
2007:			
First Quarter	$ 44.75	$ 42.10	$ 0.15
Second Quarter	44.41	36.04	0.15
Third Quarter	39.84	32.07	0.16
Fourth Quarter	36.70	32.61	0.16

As of February 28, 2008, there were approximately 1,500 holders of record of our common stock.

Stock Repurchase Program The Company has maintained a stock repurchase program authorized by the Company's board of directors, which has enabled the Company to proactively manage its capital position. The program, which was initially approved on April 18, 2006, authorized the Company to repurchase up to 245,000 shares of its common stock from time to time through open market or privately negotiated purchases. On November 26, 2007, the Company expanded the stock repurchase program to 345,000 shares and also adopted a written purchase plan pursuant to Rule 10b5-1 of the Exchange Act.

The table below summarizes the Company's repurchases of common stock during the quarter ended December 31, 2007.

	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of announced plan	Maximum number of shares that may yet be purchased under the plan
10/1/07 through 10/31/07	1,700	$ 33.80	1,700	291,100
11/1/07 through 11/30/07	188,900	$ 33.97	188,900	102,200
12/1/07 through 12/31/07	62,400	$ 34.14	62,400	39,800

The following graph and table show changes in the value of $100 invested on December 31, 2002 through December 31, 2007 in our common stock, the SNL Bank $1 Billion to $5 Billion Index, the SNL New England Bank Index and the Russell 3000 Index. The investment values are based on share price appreciation plus dividends paid in cash, assuming that dividends were reinvested on the date they were paid.

Historically, the Company has used the SNL New England Bank Index to compare its relative performance. Effective this year, the Company is adopting the SNL Bank $1 Billion to $5 Billion Index as a replacement for the SNL New England Bank Index. The Company believes the SNL $1 Billion to $5 Billion Index provides a more appropriate comparison for assessing its relative performance. The SNL New England Bank Index is market capitalization-weighted and one large constituent bank (State Street Corp) comprised 82.3% of the SNL New England Bank Index at December 31, 2007, diminishing its

appropriateness as a comparison index. Comparatively, at December 31, 2007, the SNL $1 Billion to $5 Billion Index was comprised of 166 banks, with its largest constituent bank comprising 2.8% of the index.

Total Return Performance

	Period Ending					
Index	**12/31/02**	**12/31/03**	**12/31/04**	**12/31/05**	**12/31/06**	**12/31/07**
Bancorp Rhode Island, Inc.	100.00	147.36	180.34	154.00	203.25	163.06
SNL Bank $1B-$5B Index	100.00	135.99	167.83	164.97	190.90	139.06
SNL New England Bank Index	100.00	165.00	174.51	174.32	205.75	240.84
Russell 3000 Index	100.00	131.06	146.71	155.69	180.16	189.42

ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The following table represents selected consolidated financial data as of and for the years ended December 31, 2007, 2006, 2005, 2004 and 2003. The selected consolidated financial data set forth below does not purport to be complete and should be read in conjunction with, and are qualified in their entirety by, the more detailed information, including the Consolidated Financial Statements and related Notes, and "Management's Discussion and Analysis of Financial Condition and Results of Operations", appearing elsewhere herein.

	As of and for the year ended December 31,				
	2007	**2006**	**2005**	**2004**	**2003**
	(Dollars in thousands, except per share data)				
Statements of operations data:					
Interest income	$ 86,070	$ 81,202	$ 69,520	$ 57,719	$ 51,773
Interest expense	44,826	38,974	26,619	19,625	19,453
Net interest income	41,244	42,228	42,901	38,094	32,320
Provision for loan and lease losses	700	1,202	1,423	836	1,524
Noninterest income	10,785	8,988	9,274	8,581	8,830

	As of and for the year ended December 31,				
Noninterest expense	38,025	38,727	36,343	32,929	28,866
Income before taxes	13,304	11,287	14,409	12,910	10,760
Income taxes	4,259	3,576	4,840	4,296	3,546
Net income	$ 9,045	$ 7,711	$ 9,569	$ 8,614	$ 7,214

Per share data:										
Basic earnings per common share	$	1.89	$	1.62	$	2.14	$	2.17	$	1.89
Diluted earnings per common share	$	1.84	$	1.57	$	2.04	$	2.04	$	1.77
Dividends per common share	$	0.62	$	0.60	$	0.60	$	0.58	$	0.56
Dividend pay-out ratio		33.7%		38.2%		29.4%		28.4%		31.6%
Book value per common share	$	24.79	$	23.39	$	22.21	$	19.68	$	18.53
Tangible book value per common share	$	22.21	$	21.03	$	19.83	$	16.99	$	15.76
Average common shares outstanding Basic		4,791,625		4,766,854		4,478,081		3,975,413		3,819,232
Average common shares outstanding Diluted		4,918,763		4,920,569		4,697,134		4,222,856		4,085,878
Balance sheet data:										
Total assets	$	1,477,119	$	1,479,099	$	1,442,782	$	1,239,069	$	1,093,971
Investment securities		76,986		103,425		150,959		104,600		98,595
Mortgage-backed securities		258,195		240,462		234,858		159,946		106,618
Total loans and leases receivable		1,038,132		1,004,292		950,806		886,301		814,282
Allowance for loan and lease losses		12,619		12,377		11,665		11,454		10,690
Goodwill, net		11,772		11,317		11,234		10,766		10,766
Deposits		1,014,780		1,016,423		980,969		880,674		811,283
Borrowings		331,703		337,097		344,769		271,386		203,622
Total shareholders' equity		113,108		112,085		104,832		78,923		72,107
Average balance sheet data:										
Total assets	$	1,469,574	$	1,451,959	$	1,347,510	$	1,168,454	$	1,046,741
Investment securities		112,461		144,460		131,711		102,827		91,153
Mortgage-backed securities		229,872		227,973		209,004		132,946		123,524
Total loans and leases receivable		1,014,951		980,598		916,273		848,550		747,174
Allowance for loan and lease losses		12,503		12,002		11,560		11,072		10,739
Goodwill, net		11,318		11,290		11,067		10,766		10,766
Deposits		1,010,162		965,194		928,374		858,739		779,540
Borrowings		326,398		362,721		306,344		227,365		192,068
Total shareholders' equity		114,872		106,874		95,922		74,704		69,010
Operating ratios:										
Interest rate spread		2.29%		2.50%		2.92%		3.07%		2.91%
Net interest margin		2.96%		3.06%		3.35%		3.44%		3.28%
Efficiency ratio (a)		73.08%		75.62%		69.66%		70.55%		70.15%
Return on average assets		0.62%		0.53%		0.71%		0.74%		0.69%
Return on average equity		7.87%		7.22%		9.98%		11.53%		10.45%
Asset quality ratios:										
Nonperforming loans to total loans		0.40%		0.14%		0.04%		0.08%		0.30%
Nonperforming assets to total assets		0.28%		0.10%		0.03%		0.06%		0.23%
		304.15%		875.94%		2,810.84%		1,562.62%		434.20%

Allowance for loan and lease losses to nonperforming loans					
Allowance for loan and lease losses to total loans	1.22%	1.23%	1.23%	1.29%	1.31%
Net loans charged-off to average loans outstanding	0.05%	0.05%	0.13%	0.01%	0.08%
Capital ratios:					
Average shareholders' equity to average total assets	7.82%	7.36%	7.11%	6.40%	6.59%
Tier I leverage ratio	7.87%	8.37%	8.21%	7.06%	6.76%
Tier I risk-based capital ratio	11.06%	12.05%	12.62%	10.01%	9.71%
Total risk-based capital ratio	12.28%	13.27%	13.87%	11.26%	10.92%

(a) Calculated by dividing total noninterest expenses by net interest income plus noninterest income.

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

Introduction

Bancorp Rhode Island, Inc., a Rhode Island corporation, is the holding company for Bank Rhode Island. The Company has no significant assets other than the common stock of the Bank. For this reason, substantially all of the discussion in this document relates to the operations of the Bank and its subsidiaries.

The Bank is a commercial bank chartered as a financial institution in the State of Rhode Island. The Bank pursues a community banking mission and is principally engaged in providing banking products and services to businesses and individuals in Rhode Island and nearby areas of Massachusetts. The Bank is subject to competition from a variety of traditional and nontraditional financial service providers both within and outside of Rhode Island. The Bank offers its customers a wide range of business, commercial real estate, consumer and residential loans and leases, deposit products, nondeposit investment products, cash management, private banking and other banking products and services designed to meet the financial needs of individuals and small- to mid-sized businesses. The Bank also offers both commercial and consumer on-line banking products and maintains a web site at *http://www.bankri.com*. The Company and Bank are subject to the regulations of certain federal and state agencies and undergo periodic examinations by those regulatory authorities. The Bank's deposits are insured by the FDIC, subject to regulatory limits. The Bank is also a member of the FHLB.

Overview

In 2007, the Company continued its balance sheet conversion to a more commercial profile and improved its profitability. The Company increased its commercial loan and lease portfolio by over 10%. Net income and diluted earnings per common share improved in 2007, while the Company reduced its operating costs. For a fuller narrative commentary on these matters, refer to Item 1, "Business."

The primary drivers of the Company's operating income are net interest income, which is strongly affected by the net yield on interest-earning assets ("net interest margin"), and the quality of the Company's assets.

The Company's net interest income represents the difference between its interest income and its cost of funds. Interest income depends on the amount of interest-earning assets outstanding during the year and the interest rates earned thereon. Cost of funds is a function of the average amount of deposits and borrowed money outstanding during the year and the interest rates paid thereon. Net interest spread is the difference between the average rate earned on interest-earning assets and the average rate paid on interest-bearing liabilities. Net interest margin generally exceeds the net interest spread as a portion of interest-earning assets are funded by various noninterest-bearing sources (primarily noninterest-bearing deposits and shareholders' equity). The increases (decreases) in the components of interest income and interest expense, expressed in terms of fluctuation in average volume and rate, are summarized in the Rate/Volume Analysis table shown on page 31. Information as to the components of interest income and interest expense and average rates is provided under *"Average Balances, Yields and Costs"* on page 30.

Because the Company's assets are not identical in duration and in repricing dates to its liabilities, the spread between the two is vulnerable to changes in market interest rates as well as the overall shape of the yield curve. These vulnerabilities are inherent to the business of banking and are commonly referred to as "interest rate risk." How to measure interest rate risk and, once measured, how much risk to take are based on numerous assumptions and other subjective judgments. See discussion under "*Asset and Liability Management*."

The quality of the Company's assets also influences its earnings. Loans and leases that are not being paid on a timely basis and exhibit other weaknesses can result in the loss of principal and/or loss of interest

income. Additionally, the Company must make timely provisions to its allowance for loan and lease losses based on estimates of probable losses inherent in the loan and lease portfolio; these additions, which are charged against earnings, are necessarily greater when greater probable losses are expected. Further, the Company will incur expenses as a result of resolving troubled assets. All of these form the "credit risk" that the Company takes on in the ordinary course of its business and is further discussed under "*Financial Condition Asset Quality*."

The Company's business strategy has been to concentrate its asset generation efforts on commercial and consumer loans and its deposit generation efforts on checking and savings accounts. These deposit accounts are commonly referred to as "core deposit accounts." This strategy is based on the Company's belief that it can distinguish itself from its larger competitors, and indeed attract customers from them, through a higher level of service and through its ability to set policies and procedures, as well as make decisions, locally. The loan and deposit products referenced also tend to be geared more toward customers who are relationship oriented than those who are seeking stand-alone or single transaction products. The Company believes that its service-oriented approach enables it to compete successfully for relationship-oriented customers. Additionally, the Company is predominantly an urban franchise with a high concentration of businesses making deployment of funds in the commercial lending area practicable. Commercial loans are attractive, among other reasons, because of their higher yields. Similarly, core deposits are attractive because of their generally lower interest cost and potential for fee income.

The Company also seeks to leverage business opportunities presented by its customer base, franchise footprint and resources. In 2005, the Bank formed a private banking division and completed the Bank's first acquisition with the acquiring of an equipment leasing company located in Long Island, New York ("Macrolease"). The Bank is using the Macrolease platform to generate additional income by originating equipment leases for third parties, as well as increasing the Bank's portfolio of equipment leases.

The deposit market in Rhode Island is highly concentrated. The State's three largest banks have an aggregate market share of 85% (based upon June 2007 FDIC statistics, excluding one bank that draws its deposits primarily from the internet) in Providence and Kent Counties, the Bank's primary marketplace. Competition for loans and deposits remains intense. This competition has resulted in considerable advertising and promotional product offerings by competitors, including print, radio and television media.

In 2007, approximately 79.3% of the Company's total revenues (defined as net interest income plus noninterest income) were derived from its net interest income. In a continuing effort to diversify its sources of revenue, the Company has sought to expand its sources of noninterest income (primarily fees and charges for products and services the Bank offers). Service charges on deposit accounts remain the largest component of noninterest income, while the Bank has recently seen growth in gains on lease sales and commissions on loans originated for others.

In 2007, the Bank experienced an overall decrease in net interest margin, as the 2007 net interest margin of 2.96% was 10 basis points ("bps") lower than 2006 net interest margin of 3.06%. This decrease was primarily attributable to the shape of the yield curve and competition for deposits, loans and customers in the Bank's market area.

The future operating results of the Company will again depend on the ability to maintain and expand net interest margin, while minimizing exposure to credit risk, along with increasing sources of noninterest income, while controlling the growth of noninterest or operating expenses.

Critical Accounting Policies

Accounting policies involving significant judgments and assumptions by management, which have, or could have, a material impact on the carrying value of certain assets or net income, are considered critical accounting policies. The Company considers the following to be its critical accounting policies: allowance for credit losses, review of goodwill for impairment and income taxes. In 2007, the Company reassessed the

risk elements within the components of its loan and lease portfolio. There have been no other significant changes in the methods or assumptions used in accounting policies that require material estimates or assumptions.

Allowance for credit losses

Arriving at an appropriate level of allowance for loan and lease losses and reserve for unfunded lending commitments, collectively referred to as the allowance for credit losses, necessarily involves a significant degree of judgment. First and foremost in arriving at an appropriate allowance is the creation and maintenance of a risk rating system that accurately classifies all loans, leases and commitments into varying categories by degree of credit risk. Such a system also establishes a level of allowance associated with each category of loans and requires early identification and reclassification of deteriorating credits. Besides numerous subjective judgments as to the number of categories, appropriate level of allowance with respect to each category and judgments as to categorization of any individual loan or lease, additional subjective judgments are involved when ascertaining the probability as well as the extent of any probable losses. The Company's ongoing evaluation process includes a formal analysis of the allowance each quarter, which considers, among other factors, the character and size of the loan and lease portfolio, business and economic conditions, loan growth, delinquency trends, nonperforming loan trends, charge-off experience and other asset quality factors. These factors are based on observable information, as well as subjective assessment and interpretation. A similar process is employed with respect to unfunded lending commitments.

Nonperforming commercial, commercial real estate and small business loans and leases in excess of a specified dollar amount are deemed to be "impaired." The estimated reserves necessary for each of these credits is determined by reviewing the fair value of the collateral if collateral dependent, the present value of expected future cash flows, or where available, the observable market price of the loans. Provisions for losses on the remaining commercial, commercial real estate, small business, residential mortgage and consumer loans and leases are based on pools of similar loans or leases using a combination of payment status, historical loss experience, industry loss experience, market economic factors, delinquency rates and qualitative adjustments.

Management uses available information to establish the allowance for loan and lease losses at the level it believes is appropriate. However, future additions to the allowance may be necessary based on changes in estimates or assumptions resulting from changes in economic conditions and other factors. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for credit losses. Such agencies may require the Company to recognize adjustments to the allowance based on their judgments about information available to them at the time of their examination.

Review of goodwill for impairment

In March 1996, the Bank acquired certain assets and assumed certain liabilities from Fleet Financial Group, Inc. and related entities. This acquisition was accounted for utilizing the purchase method of accounting and generated $17.5 million of goodwill. This goodwill was amortized in the years prior to 2002, resulting in a net balance of $10.8 million on the Company's balance sheet as of December 31, 2001. Effective January 1, 2002, in accordance with Statement of Financial Accounting Standards ("SFAS") 142 "*Goodwill and Other Intangible Assets*" and SFAS 147 "*Acquisitions of Certain Financial Institutions*", the Company ceased amortizing this goodwill and began to review it at least annually for impairment.

On May 1, 2005, the Bank acquired certain operating assets from Macrolease International Corporation. This acquisition was accounted for utilizing the purchase method of accounting and has generated $1.0 million of goodwill through December 31, 2007.

Goodwill is evaluated for impairment using market value comparisons for similar institutions, such as price to earnings multiples, price to deposit multiples and price to equity multiples. This valuation technique utilizes verifiable market multiples, as well as subjective assessment and interpretation. The application of different market multiples, or changes in judgment as to which market transactions are reflective of the Company's specific characteristics, could affect the conclusions reached regarding possible impairment. In the event that the Company were to determine that its goodwill were impaired, the recognition of an impairment charge could have an adverse impact on its results of operations in the period that the impairment occurred or on its financial position.

Income taxes

Certain areas of accounting for income taxes require management's judgment, including determining the expected realization of deferred tax assets. Judgments are made regarding various tax positions, which are often subjective and involve assumptions about items that are inherently uncertain. If actual factors and conditions differ materially from estimates made by management, the actual realization of the net deferred tax assets could vary materially from the amounts previously recorded.

Deferred tax assets arise from items that may be used as a tax deduction or credit in future income tax returns, for which a financial statement tax benefit has already been recognized. The realization of the net deferred tax asset generally depends upon future levels of taxable income and the existence of prior years' taxable income to which refund claims could be carried back. Valuation allowances are recorded against those deferred tax assets determined not likely to be realized. Deferred tax liabilities represent items that will require a future tax payment. They generally represent tax expense recognized in the Company's financial statements for which payment has been deferred, or a deduction taken on the Company's tax return but not yet recognized as an expense in the Company's financial statements. Deferred tax liabilities are also recognized for certain non-cash items such as goodwill.

Results of Operations

Net Interest Income

Net interest income for 2007 was $41.2 million, compared to $42.2 million for 2006 and $42.9 million for 2005. The net interest margin decreased in 2007 to 2.96%, compared to 3.06% in 2006. In 2005, the net interest margin was 3.35%. The decrease in net interest income of $984,000, or 2.3%, during 2007 was primarily attributable to the shape of the yield curve and competition for deposits, loans and customers in the Bank's market area. Average earning assets increased $14.6 million, or 1.1%, and average interest-bearing liabilities increased $6.2 million, or 0.5%, during 2007, compared to 2006.

Average Balances, Yields and Costs

The following table sets forth certain information relating to the Company's average balance sheet and reflects the average yield on assets and average cost of liabilities for the years indicated. Such yields and costs are derived by dividing income or expense by the average balance of assets or liabilities. Average balances are derived from daily balances and include nonperforming loans. Available for sale securities are stated at amortized cost.

	Year ended December 31,								
	2007			2006			2005		
	Average balance	Interest earned/ paid	Average yield	Average balance	Interest earned/ paid	Average yield	Average balance	Interest earned/ paid	Average yield
	(Dollars in thousands)								
Assets									
Earning assets:									
Overnight investments	$ 21,030	$ 1,103	5.24%	$ 9,931	$ 517	5.21%	$ 8,015	$ 201	2.51%
Investment securities	112,461	5,707	5.07%	144,460	6,245	4.32%	131,711	5,537	4.20%
Mortgage-backed securities	229,872	11,166	4.86%	227,973	10,542	4.62%	209,004	9,313	4.46%
Stock in the FHLB	15,723	1,056	6.72%	16,473	906	5.50%	14,842	647	4.36%
Loans receivable:									
Commercial loans and leases	540,383	39,657	7.34%	473,851	34,381	7.26%	421,429	28,015	6.65%
Residential mortgage loans	255,442	13,768	5.39%	288,374	15,352	5.32%	307,659	15,670	5.09%
Consumer and other loans	219,126	13,613	6.21%	218,373	13,259	6.07%	187,185	10,137	5.42%
Total earning assets	1,394,037	86,070	6.17%	1,379,435	81,202	5.89%	1,279,845	69,520	5.43%
Cash and due from banks	24,178			22,274			25,218		
Allowance for loan and lease losses	(12,503)			(12,002)			(11,560)		
Premises and equipment	14,458			14,840			13,765		
Goodwill, net	11,318			11,290			11,067		
Accrued interest receivable	5,865			5,840			5,174		
Bank-owned life insurance	23,627			20,841			18,452		
Prepaid expenses and other assets	8,594			9,441			5,549		
Total assets	$ 1,469,574			$ 1,451,959			$ 1,347,510		
Liabilities and Shareholders' Equity									
Interest-bearing liabilities:									
Deposits:									
NOW accounts	$ 62,327	391	0.63%	$ 71,188	356	0.50%	$ 94,296	590	0.63%
Money market accounts	6,285	135	2.15%	8,757	161	1.84%	17,577	235	1.34%
Savings accounts	376,746	11,028	2.93%	349,675	7,929	2.27%	337,756	4,734	1.40%
Certificate of deposit accounts	382,711	17,676	4.62%	355,908	14,030	3.94%	304,572	8,962	2.94%
Overnight and short-term borrowings	57,117	2,717	4.76%	44,241	2,124	4.80%	23,019	652	2.83%
Wholesale repurchase agreements	11,425	602	5.27%	20,000	870	4.35%	9,417	276	2.93%
FHLB borrowings	240,668	10,768	4.47%	279,922	12,044	4.30%	255,350	9,898	3.88%
Subordinated deferrable interest debentures	17,188	1,509	8.78%	18,558	1,460	7.87%	18,558	1,272	6.85%
Total interest-bearing liabilities	1,154,467	44,826	3.88%	1,148,249	38,974	3.39%	1,060,545	26,619	2.51%
Noninterest-bearing deposits	182,093			179,666			174,173		
Other liabilities	18,142			17,170			16,870		
Total liabilities	1,354,702			1,345,085			1,251,588		
Shareholders' equity	114,872			106,874			95,922		
Total liabilities and shareholders' equity	$ 1,469,574			$ 1,451,959			$ 1,347,510		

	Year ended December 31,		
Net interest income	$ 41,244	$ 42,228	$ 42,901
Net interest rate spread	2.29%	2.50%	2.92%
Net interest rate margin	2.96%	3.06%	3.35%

Rate/Volume Analysis

The following table sets forth certain information regarding changes in the Company's interest income and interest expense for the periods indicated. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (i) changes in rate (changes in rate multiplied by old average balance) and (ii) changes in volume (changes in average balances multiplied by

old rate). The net change attributable to the combined impact of rate and volume was allocated proportionally to the individual rate and volume changes.

	Year ended December 31,					
	2007 vs. 2006 Increase/(decrease) due to			2006 vs. 2005 Increase/(decrease) due to		
	Rate	Volume	Total	Rate	Volume	Total
	(In thousands)					
Interest income:						
Overnight investments	$ 3	$ 583	$ 586	$ 258	$ 58	$ 316
Investment securities	982	(1,520)	(538)	239	469	708
Mortgage-backed securities	522	102	624	418	811	1,229
Stock in the FHLB	193	(43)	150	182	77	259
Commercial loans and leases	139	5,137	5,276	2,204	4,162	6,366
Residential mortgage loans	189	(1,773)	(1,584)	693	(1,011)	(318)
Consumer and other loans	366	(12)	354	1,368	1,754	3,122
Total interest income	2,394	2,474	4,868	5,362	6,320	11,682
Interest expense:						
NOW accounts	83	(48)	35	(105)	(129)	(234)
Money market accounts	24	(50)	(26)	69	(143)	(74)
Savings accounts	2,448	651	3,099	3,022	173	3,195
Certificate of deposit accounts	2,534	1,112	3,646	3,387	1,681	5,068
Overnight & short-term borrowings	(20)	613	593	632	840	1,472
FHLB and other borrowings	623	(2,167)	(1,544)	1,736	1,004	2,740
Capital trust and other subordinated securities	162	(113)	49	188		188
Total interest expense	5,854	(2)	5,852	8,929	3,426	12,355
Net interest income	$ (3,460)	$ 2,476	$ (984)	$ (3,567)	$ 2,894	$ (673)

Comparison of Years Ended December 31, 2007 and December 31, 2006

General

Net income for 2007 increased $1.3 million, or 17.3%, to $9.0 million from $7.7 million for 2006. Earnings per diluted common share ("EPS") increased also from $1.57 for 2006 to $1.84 for 2007. The 2007 earnings represented a return on average assets of 0.62% and a return on average equity of 7.87% for 2007, as compared to a return on average assets of 0.53% and a return on average equity of 7.22% for 2006.

Included within net income and EPS for 2007 were gains on available for sale ("AFS") securities of approximately $165,000 or $0.03, net of taxes. Comparatively, net income and EPS in 2006 were negatively impacted by approximately $558,000 or $0.11, net of taxes, due to the investment portfolio restructuring the Company undertook in the third quarter of 2006 in an effort to improve earnings in future periods.

To provide additional analysis regarding the Company's operating results, the following tables set forth certain non-GAAP information relating to the reconciliation of GAAP net income, EPS and related operating ratios to pro forma amounts, which adjust for AFS securities gains and losses over the past two years. Management believes this information is useful to the investor in comparing the Company's operating results to those from the prior year. This information should not be viewed as a substitute for operating results determined in accordance with GAAP, nor is it necessarily comparable to non-GAAP information which may be presented by other companies.

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The following tables summarize the impact of AFS securities gains and losses for the periods indicated below:

(In thousands, except per share data)	Year ended December 31, 2007	Year ended December 31, 2006
Net income (GAAP)	$ 9,045	$ 7,711
Adjust for:		
AFS security (gains) losses, net of tax	(165)	558
Pro forma net income	$ 8,880	$ 8,269
Diluted earnings per share (GAAP)	$ 1.84	$ 1.57
Effect of:		
AFS security (gains) losses, net of tax	(0.03)	0.11
Pro forma diluted earnings per share	$ 1.81	$ 1.68

Year Ended December 31, 2007	Return on Average Assets	Return on Average Equity	Efficiency Ratio
GAAP ratios	0.62%	7.87%	73.08%
Effect of:			
AFS security (gains) losses, net of tax	-0.01%	-0.14%	0.36%
Pro forma ratios	0.61%	7.73%	73.44%

Year Ended December 31, 2006	Return on Average Assets	Return on Average Equity	Efficiency Ratio
GAAP ratios	0.53%	7.22%	75.62%
Effect of:			
AFS security (gains) losses, net of tax	0.04%	0.52%	-1.25%
Pro forma ratios	0.57%	7.74%	74.37%

On a pro forma basis, operating results for 2007 improved as compared to 2006. Margin compression did lead to a decline in net interest income of $984,000, or 2.3%, which was partly countered by an increase in total average earning assets of approximately $14.6 million. Noninterest income excluding securities gains and losses increased by $684,000, or 6.9%, led primarily by gains on lease sales and increases in deposit service charges. Additionally, earnings benefited from a decline in noninterest expenses of $702,000, or 1.8%.

Net Interest Income

For 2007, net interest income was $41.2 million, compared to $42.2 million for 2006. The net interest margin for 2007 was 2.96% compared to a net interest margin of 3.06% for 2006. The decrease in net interest income of $984,000, or 2.3%, was attributable to margin pressures as the average earning assets increased $14.6 million, or 1.1%, and average interest-bearing liabilities increased $6.2 million, or 0.5%, over the preceding year. The decrease of 10 bps in the net interest margin was primarily due to the shape of the yield curve and competition for deposits, loans and customers in the Bank's market area.

Interest Income Investments

Total investment income (consisting of interest on overnight investments, investment securities and MBSs, and dividends on FHLB stock) was $19.0 million for 2007, compared to $18.2 million for 2006. This increase in total investment income of $822,000, or 4.5%, was attributable to a 45 basis point increase in the overall yield on investments, from 4.57% in 2006 to 5.02% in 2007, along with a decrease in the average balance of investments of approximately $20 million.

Interest Income Loans and Leases

Interest from loans was $67.0 million for 2007, and represented a yield on total loans of 6.61%. This compares to $63.0 million of interest, and a yield of 6.42%, for 2006. Increased interest income resulting from growth in the average balance of loans of $34.4 million, or 3.5%, was augmented by an increase in the yield on loans of 19 bps.

The average balance of the various components of the loan portfolio changed as follows: commercial loans and leases increased $66.5 million, or 14.0%; consumer and other loans increased $753,000, or 0.34%; and residential mortgage loans decreased $32.9 million, or 11.4%. The yield on the various components of the loan portfolio changed as follows: commercial loans and leases increased 8 bps, to 7.34%; consumer and other loans increased 14 bps, to 6.21%; and residential mortgage loans increased 7 bps, to 5.39%. The yields on loans and leases benefited primarily from higher yields on new originations and repricing of existing variable rate assets.

Interest Expense Deposits and Borrowings

Interest paid on deposits and borrowings increased by $5.8 million, or 15.0%, due to both market area competition as well as higher market interest rates during 2007. The overall average cost for interest-bearing liabilities increased 49 bps from 3.39% for 2006, to 3.88% for 2007. The average balance of total interest-bearing liabilities increased $6.2 million, or 0.5%, remaining constant at $1.15 billion for 2006 and 2007. The growth in deposit average balances was centered primarily in savings accounts (up $27.0 million, or 7.7%) and CD accounts (up $26.8 million, or 7.5%). These increases were partially offset by a decrease in NOW accounts (down $8.9 million, or 12.4%) and money market accounts (down $2.5 million, or 28.2%).

The average balance of borrowings decreased as compared to the prior year, with increases in short-term borrowings (up $12.9 million, or 29.1%) surpassed by decreases in FHLB funding (down $39.3 million, or 14.0%), as well as declines in wholesale repurchase agreements (down $8.6 million, or 42.9%). In September 2007, the Company redeemed $5.2 million of debentures held by BRI Statutory Trust II, resulting in a decline in the average balance of subordinated debentures (down $1.4 million, or 7.4%). This redemption resulted in $137,000 of additional interest expense from previously unamortized debt issuance costs. Overall, the cost of nondeposit borrowings increased 23 bps in 2007 to 4.78%, compared to 4.55% in the prior year.

The rise in deposit and borrowing costs can be attributed to a number of factors. Customer demand remains strong for higher-yielding deposit products, due in part to relatively high short-term rates for the majority of 2007. Competition for deposits continues to be strong. Additionally, bank and non-bank advertising continues to be prevalent in the Bank's local market area, which has increased customer awareness of attractive rates. Moreover, online banking has enabled customers to more actively manage their finances and has facilitated the movement of available funds from demand deposit accounts and lower-yielding deposit accounts into higher-yielding deposit products. In an effort to attract and retain customers and deposit relationships, the Bank has offered higher-yielding savings accounts in addition to the normally higher-yielding CDs.

Provision for Loan and Lease Losses

The provision for loan and lease losses was $700,000 for 2007, compared to $1.2 million for 2006. The primary reasons for the change in the provision for loan and lease losses were lower relative growth in commercial loans and a reassessment of risk within the components of the loan and lease portfolio. The allowance, expressed as a percentage of total loans and leases, was 1.22% as of December 31, 2007, compared to 1.23% at the prior year-end and stood at 304.2% of nonperforming loans and leases at December 31, 2007, compared to 876.0% of nonperforming loans and leases at December 31, 2006. Net charge-offs for 2007 were $458,000, compared to $490,000 for 2006.

In 2006, the Company reclassified the reserve for unfunded lending commitments from the allowance for loan and lease losses to other liabilities. The Company has reclassified prior period amounts accordingly, as illustrated within the activity analysis table on page 50. These reclassifications resulted in adjustments to prior period ending and average balances of the allowance for loan and lease losses and other liabilities, the allocation of the allowance for loan and lease losses, as well as previously reported expense amounts for the provision for loan and lease losses and other expenses and related asset quality ratios. Also see discussion under "*Allowance for Credit Losses*."

Management evaluates several factors including new loan originations, actual and estimated charge-offs, risk characteristics of the loan and lease portfolio and general economic conditions when determining the provision for loan and lease losses. As the loan and lease portfolio continues to grow and mature, or if economic conditions worsen, management believes it possible that the level of nonperforming assets may increase, which in turn may lead to increases to the provision for loan and lease losses. Also see discussion under "*Allowance for Credit Losses*."

Noninterest Income

Total noninterest income increased by $1.8 million or 20.0%, from $9.0 million for 2006, to $10.8 million for 2007. The following table sets forth the components of noninterest income:

	Year ended December 31,	
	2007	2006
	(In thousands)	
Service charges on deposit accounts	$ 5,578	$ 5,055
Net gains on lease sales and commissions on loans originated for others	1,216	566
Income from bank-owned life insurance	1,038	785
Loan related fees	649	694
Commissions on nondeposit investment products	575	872
Gain/(loss) on AFS securities	254	(859)
Other income	1,475	1,875
Total noninterest income	$ 10,785	$ 8,988

Noninterest income for 2007 benefited from gains on AFS securities of $254,000, while noninterest income for 2006 was negatively impacted by losses on AFS securities of $859,000 attributable to the investment portfolio restructuring described on page 39. Excluding securities gains and losses, noninterest income increased $684,000, or 6.9%. Deposit account service charges continue to represent the largest source of noninterest income for the Company and produced growth of $523,000, or 10.3%, as the Company implemented a revenue enhancement program. The Macrolease platform sold $21.8 million of leases in 2007, generating $1.0 million of noninterest income, compared to $407,000 in the prior year. Income from bank-owned life insurance ("BOLI") increased $253,000, or 32.2% from the prior year as a result of additional purchases of insurance during 2006, as well as the tax-free exchange the Company

conducted for a portion of its BOLI to other life insurance carriers in the fourth quarter of 2006. These increases were offset by volume based decreases in commissions on nondeposit investment products (down $297,000, or 34.1%) and loan related fees (down $45,000, or 6.5%). Additionally, other income decreased $400,000, or 21.3%, mainly due to decreases in customer external sweep income and reduced commissions on historic tax credits.

Noninterest Expense

Noninterest expenses for 2007 decreased a total of $702,000, or 1.8%, to $38.0 million. The following table sets forth the components of noninterest expense:

	Year ended December 31,	
	2007	**2006**
	(In thousands)	
Salaries and employee benefits	$ 20,859	$ 20,636
Occupancy and equipment	4,872	4,971
Data processing	2,850	2,880
Professional services	2,212	2,186
Marketing	1,562	1,880
Loan servicing	767	917
Loan workout and other real estate owned	190	188
Other expenses	4,713	5,069
Total noninterest expense	$ 38,025	$ 38,727

The Company realized savings in marketing costs (down $318,000, or 16.9%), loan servicing (down $150,000, or 16.4%) and occupancy and equipment ($99,000, or 2.0%). Additionally, other miscellaneous expenses decreased by $356,000, or 7.0%, for the year with savings from increased operating efficiencies. Partially offsetting these items were increases in salaries and benefits (up $223,000, or 1.1%) and professional services (up $26,000, or 1.2%).

Additionally, with respect to prior year other expenses, the Company recorded insurance recovery proceeds of $803,000 in December 2006 relating to a loss the Company incurred in the first quarter of 2006 of $868,000. These amounts are recorded net within other expenses in the preceding table and on the Consolidated Statement of Operations for the year ended December 31, 2006.

Overall, the Company's efficiency ratio improved to 73.08% for 2007, from 75.62% for 2006. After adjusting for securities gains and losses, the efficiency ratio improved on a pro forma basis to 73.44% for 2007, from 74.37% for 2006. However, these efficiency ratios continue to be negatively impacted by the compression in the net interest margin, which has partially lessened the impact of cost savings realized and noninterest income improvement.

Income Tax Expense

The Company recorded income tax expense of $4.3 million for 2007, compared to $3.6 million for 2006. This represented total effective tax rates of 32.0% and 31.7%, respectively. Tax-favored income from BOLI, along with the utilization of a Rhode Island passive investment company, has reduced the Company's effective tax rate from the 40.9% combined statutory federal and state tax rates.

Comparison of Years Ended December 31, 2006 and December 31, 2005

General

Net income for 2006 decreased $1.9 million, or 19.4%, from $9.6 million for 2005. EPS decreased from $2.04 for 2005 to $1.57 for 2006. The 2006 earnings represented a return on average assets of 0.53% and a return on average equity of 7.22% for 2006, as compared to a return on average assets of 0.71% and a return on average equity of 9.98% for 2005.

Net income and EPS for 2006 were negatively impacted by approximately $558,000 or $0.11, net of taxes, due to the investment portfolio restructuring the Company undertook in the third quarter of 2006 in an effort to improve earnings in future periods. The effect of these security losses on shareholders' equity was minimal as the securities had been carried at market value on the balance sheet.

To provide additional analysis regarding the Company's operating results, the following tables set forth certain non-GAAP information relating to the reconciliation of GAAP net income, EPS and related operating ratios to pro forma amounts, which adjust for AFS securities gains and losses in 2006 and 2005. Management believes this information is useful to the investor in comparing the Company's operating results to those from the prior year. This information should not be viewed as a substitute for operating results determined in accordance with GAAP, nor is it necessarily comparable to non-GAAP information which may be presented by other companies.

The following tables summarize the impact of AFS securities gains and losses for the periods indicated below:

	Year ended December 31,	
(In thousands, except per share data)	**2006**	**2005**
Net income (GAAP)	$ 7,711	$ 9,569
Adjust for:		
AFS security losses (gains), net of tax	558	(118)
Pro forma net income	$ 8,269	$ 9,451
Diluted earnings per share (GAAP)	$ 1.57	$ 2.04
Effect of:		
AFS security losses (gains), net of tax	0.11	(0.03)
Pro forma diluted earnings per share	$ 1.68	$ 2.01

	Year Ended December 31, 2006		
	Average Assets	**Average Equity**	**Efficiency**
GAAP ratios	0.53%	7.22%	75.62%
Effect of:			
AFS security losses (gains), net of tax	0.04%	0.52%	-1.25%
Pro forma ratios	0.57%	7.74%	74.37%

	Year Ended December 31, 2005		
	Return on Average Assets	**Return on Average Equity**	**Efficiency Ratio**
GAAP ratios	0.71%	9.98%	69.66%
Effect of:			
AFS security losses (gains), net of tax	-0.01%	-0.12%	0.24%
Pro forma ratios	0.70%	9.86%	69.90%

On a pro forma basis, operating results for 2006 were down as compared to 2005. Margin compression led to a decline in net interest income of $673,000, despite an increase in total average earning assets of approximately $100 million. The increases in noninterest income of $754,000, led primarily by increases in deposit service charges and income from loans and leases originated for third parties, were offset by increased noninterest expenses. In addition to costs for additions to the senior management team, noninterest expenses for 2006 also include the full year operating costs of Macrolease, the private banking group and the two newest branches, all of which began midway through 2005.

Net Interest Income

For 2006, net interest income was $42.2 million, compared to $42.9 million for 2005. The net interest margin for 2006 was 3.06% compared to a net interest margin of 3.35% for 2005. The decrease in net interest income of $673,000, or 1.6%, was attributable to margin pressures as the average earning assets increased $99.6 million, or 7.8%, and average interest-bearing liabilities increased $87.7 million, or 8.3%, over the preceding year. The decrease of 29 bps in the net interest margin was due to the compression of the yield curve, competitive asset pricing, increases in CD balances and heightened competition for savings and other core deposits in the Company's market area.

Interest Income Investments

Total investment income (consisting of interest on overnight investments, investment securities and MBSs, and dividends on FHLB stock) was $18.2 million for 2006, compared to $15.7 million for 2005. This increase in total investment income of $2.5 million, or 16.0%, was attributable to a 25 basis point increase in the overall yield on investments, from 4.32% in 2005 to 4.57% in 2006, along with an increase in the average balance of investments of approximately $35 million.

Interest Income Loans and Leases

Interest from loans was $63.0 million for 2006, and represented a yield on total loans of 6.42%. This compares to $53.8 million of interest, and a yield of 5.87%, for 2005. Increased interest income resulting from growth in the average balance of loans of $64.3 million, or 7.0%, was augmented by an increase in the yield on loans of 55 bps.

The average balance of the various components of the loan portfolio changed as follows: commercial loans and leases increased $52.4 million, or 12.4%; consumer and other loans increased $31.2 million, or 16.7%; and residential mortgage loans decreased $19.3 million, or 6.3%. The yield on the various components of the loan portfolio changed as follows: commercial loans and leases increased 61 bps, to 7.26%; consumer and other loans increased 66 bps, to 6.07%; and residential mortgage loans increased 23 bps, to 5.32%. The yields on loans and leases benefited primarily from the interest rate increases in 2006.

Interest Expense Deposits and Borrowings

Interest paid on deposits and borrowings increased by $12.4 million, or 46.4%, due to both market area competition as well as rises in short-term market interest rates during 2006. The overall average cost for interest-bearing liabilities increased 88 bps from 2.51% for 2005, to 3.39% for 2006. The average

balance of total interest-bearing liabilities increased $87.7 million, or 8.3%, from $1.06 billion in 2005, to $1.15 billion in 2006. The growth in deposit average balances was centered primarily in CD accounts (up $51.4 million, or 16.9%) and savings accounts (up $11.9 million, or 3.5%). These increases were partially offset by a decrease in NOW accounts (down $23.1 million, or 24.5%) and money market accounts (down $8.8 million, or 50.2%).

In addition, the average balance of borrowings increased as compared to the prior year, as the Bank utilized short-term borrowings (up $21.2 million, or 92.2%), FHLB funding (up $24.6 million, or 9.6%) and wholesale repurchase agreements (up $10.6 million, or 112.4%) to fund a portion of the new asset growth. The balance of wholesale repos has remained constant at $20 million since midway through the fourth quarter of 2005. Overall, the cost of nondeposit borrowings increased 60 bps in 2006 to 4.55%, compared to 3.95% in the prior year.

The rise in liability costs can be attributed to a number of factors. With the rises in interest rates during 2006, customer demand for higher-yielding deposit products has strengthened. Additionally, competition for deposits has become intense and extensive bank advertising has increased customer awareness of attractive rates. Moreover, online banking has enabled customers to more actively manage their finances and has facilitated the movement of available funds from demand deposit accounts and normally lower-costing deposit accounts into higher-yielding deposit products. In an effort to attract and retain customers and deposit relationships, the Bank has offered not only the typically higher-costing CDs, but also higher-yielding savings and NOW accounts.

Provision for Loan and Lease Losses

The provision for loan and lease losses was $1.2 million for 2006, compared to $1.4 million for 2005. The allowance, expressed as a percentage of total loans and leases, was 1.23% as of December 31, 2006, compared to 1.23% at the prior year-end and stood at 876.0% of nonperforming loans and leases at December 31, 2006, compared to 2,810.8% of nonperforming loans and leases at December 31, 2005. Net charge-offs for 2006 were $490,000, compared to $1.2 million for 2005.

In 2006, the Company reclassified the reserve for unfunded lending commitments (December 31, 2005 year-end balance of $503,000) from the allowance for loan and lease losses to other liabilities. The Company has reclassified prior period amounts accordingly, as illustrated within the activity analysis table on page 50. These reclassifications resulted in adjustments to the prior period ending and average balances of the allowance for loan and lease losses and other liabilities, the allocation of the allowance for loan and lease losses, as well as previously reported expense amounts for the provision for loan and lease losses and other expenses and related asset quality ratios. Also see discussion under "*Allowance for Credit Losses*."

Management evaluates several factors including new loan originations, actual and estimated charge-offs, risk characteristics of the loan and lease portfolio and general economic conditions when determining the provision for loan and lease losses. As the loan and lease portfolio continues to grow and mature, or if economic conditions worsen, management believes it possible that the level of nonperforming assets will increase, which in turn may lead to increases to the provision for loan and lease losses. Also see discussion under "*Allowance for Credit Losses*."

Noninterest Income

Total noninterest income decreased by $286,000, or 3.1%, from $9.3 million for 2005, to $9.0 million for 2006. The following table sets forth the components of noninterest income:

	Year ended December 31,	
	2006	2005
	(In thousands)	
Service charges on deposit accounts	$ 5,055	$ 4,561
Commissions on nondeposit investment products	872	849
Income from bank-owned life insurance	785	691
Loan related fees	694	1,024
Net gains on lease sales and commissions on loans originated for others	566	429
(Loss)/gain on AFS securities	(859)	181
Other income	1,875	1,539
Total noninterest income	$ 8,988	$ 9,274

In September 2006, the Company restructured a portion of its investment portfolio to improve earnings in future periods by capitalizing on a temporary increase in security valuations due to movements in the yield curve. The Company sold $62 million of its available for sale securities and reinvested the sales proceeds into higher-yielding securities. This investment portfolio restructuring resulted in losses of $859,000; however, the effect of these security losses on shareholders' equity was minimal as the securities had been carried at market value on the balance sheet.

Excluding securities gains and losses, noninterest income increased $754,000, or 8.3%. Deposit account service charges continued to represent the largest source of noninterest income for the Company and produced the highest growth within the category with an increase of $494,000, or 10.8%, to $5.1 million for 2006, compared to $4.6 million in the prior year. Income from leases and loans originated for third parties increased $137,000, or 31.9%, due to increased volume. Income from BOLI increased $94,000, or 13.6% from the prior year as a result of additional purchases of insurance throughout the year. The Company also conducted a tax-free exchange of a portion of its BOLI to other life insurance carriers in the fourth quarter of 2006, in order to increase income from BOLI in future years. In addition, the Company experienced a moderate increase in commissions on nondeposit investment products of $23,000, or 2.7%. Other income increased by $336,000, or 21.8%, with increases in customer external sweep income. These increases in noninterest income were partially offset by a decrease in loan related fees of $330,000, or 32.2%. Loan related fees in 2005 were higher primarily as a result of increased prepayment activity in 2005.

Noninterest Expense

Noninterest expenses for 2006 increased a total of $2.4 million, or 6.6%, to $38.7 million. The following table sets forth the components of noninterest expense:

	Year ended December 31,	
	2006	2005
	(In thousands)	
Salaries and employee benefits	$ 20,636	$ 19,476
Occupancy and equipment	4,971	4,695
Data processing	2,880	2,759
Professional services	2,186	2,017
Marketing	1,880	1,584
Loan servicing	917	968
Loan workout and other real estate owned	188	217
Other expenses	5,069	4,627
Total noninterest expense	$ 38,727	$ 36,343

Overall, noninterest expenses reflected the continued growth of the Company resulting in higher operating costs. Such growth includes the Bank opening two new branches in Lincoln and East Greenwich, Rhode Island and the addition of Macrolease and One Trust & Private Banking (all occurring during the second quarter of 2005). Also, additions were made to the Company's business ranks. The increases in costs were centered in the following areas: salaries and benefits (up $1.2 million, or 6.0%) and occupancy and equipment costs (up $276,000, or 5.9%).

Marketing costs were up by $296,000, or 18.7%, reflective of increased advertising spending and sponsorship of customer events. Additionally, professional services costs increased $169,000, or 8.4%, partially as a result of increased investor relations costs. Also, data processing costs increased $121,000, or 4.4%. Other expenses increased by $442,000, or 9.6%, as compared to 2005, with increases in costs of customer related sweep activity, which were in line with the related increase in noninterest income.

Other expenses for 2006 also included $89,000 related to director stock options, the fair value of which was required to be expensed in connection with the adoption of SFAS 123-R, "*Share-Based Payment*." In 2005, the Company was not required to recognize expenses for the estimated fair value of stock options as the Company accounted for stock options under SFAS 123, *"Accounting for Stock-Based Compensation."* Under SFAS 123, the Company utilized the intrinsic value method prescribed by Accounting Principles Board ("APB") Opinion No. 25, "*Accounting for Stock Issued to Employees*" ("APB 25") and did not recognize expenses for the granting of stock options. Including stock option costs for employee grants, stock option expenses for 2006 were $186,000 compared to $49,000 for 2005. The costs recorded in 2005 related exclusively to the December 2005 acceleration of vesting of then-outstanding stock options.

Additionally, in December 2006, the Company recorded insurance recovery proceeds of $803,000 relating to a loss the Company incurred in the first quarter of 2006 of $868,000. These amounts are recorded net within other expenses in the preceding table and on the Consolidated Statement of Operations for the year ended December 31, 2006.

Overall, the Company's efficiency ratio increased to 75.62% for 2006, from 69.66% for 2005; however, after adjusting for securities gains and losses, the pro forma efficiency ratios were 74.37% and 69.90%, respectively.

Income Tax Expense

The Company recorded income tax expense of $3.6 million for 2006, compared to $4.8 million for 2005. This represented total effective tax rates of 31.7% and 33.6%, respectively. Tax-favored income from BOLI, along with the utilization of a Rhode Island passive investment company, has reduced the Company's effective tax rate from the 40.9% combined statutory federal and state tax rates.

Financial Condition

Loans and Leases Receivable

Total loans and leases were $1.04 billion, or 70.3% of total assets, at December 31, 2007, compared to $1.00 billion, or 67.9% of total assets, at December 31, 2006, an increase of $33.8 million, or 3.4%. This increase was centered in commercial loans (where the Company concentrates its origination efforts) and was partially offset by decreases in residential mortgage loans (which the Company primarily purchases) and consumer loans. Total loans and leases as of December 31, 2007 are segmented in three broad categories: commercial loans and leases that aggregate $573.7 million, or 55.3% of the portfolio; residential mortgages that aggregate $248.7 million, or 24.0% of the portfolio; and consumer and other loans that aggregate $215.7 million, or 20.8% of the portfolio.

The following is a summary of loans and leases receivable:

	December 31,				
	2007	2006	2005	2004	2003
	(In thousands)				
Commercial loans and leases:					
Commercial real estate owner occupied	$ 157,431	$ 140,812	$ 112,987	$ 93,027	$ 77,317
Commercial & industrial	131,927	106,017	73,620	78,918	67,925
Commercial real estate nonowner occupied	102,990	102,390	95,779	90,716	78,083
Small business	45,778	41,785	38,641	37,820	30,429
Multi-family	42,536	34,294	33,725	32,415	28,730
Construction	38,832	37,237	37,772	32,319	30,632
Leases and other(1)	58,702	62,979	48,745	38,116	19,548
Subtotal	578,196	525,514	441,269	403,331	332,664
Unearned lease income(1)	(5,742)	(6,651)	(3,366)	(226)	
Net deferred loan origination costs (fees)	1,214	927	406	(335)	(398)
Total commercial loans and leases	573,668	519,790	438,309	402,770	332,266
Residential mortgage loans:					
One- to four-family adjustable rate	155,087	165,140	202,223	199,031	232,543
One- to four-family fixed rate	92,485	96,880	101,598	115,350	131,743
Subtotal	247,572	262,020	303,821	314,381	364,286
Premium on loans acquired	1,198	1,979	2,257	1,826	2,026
Net deferred loan origination fees	(42)	(54)	(62)	(72)	(82)
Total residential mortgage loans	248,728	263,945	306,016	316,135	366,230
Consumer and other loans:					
Home equity term loans	149,192	152,484	134,932	110,542	68,523
Home equity lines of credit	62,357	64,208	67,959	53,551	42,067
Unsecured and other	2,774	2,359	2,151	2,219	4,535
Subtotal	214,323	219,051	205,042	166,312	115,125
Premium on loans acquired			2	15	44
Net deferred loan origination costs	1,413	1,506	1,437	1,069	617
Total consumer and other loans	215,736	220,557	206,481	167,396	115,786
Total loans and leases receivable	$ 1,038,132	$ 1,004,292	$ 950,806	$ 886,301	$ 814,282

(1) Included within commercial loans and leases were $3.3 million of leases held for sale at December 31, 2007.

Commercial loans and leases During 2007, the commercial loan and lease portfolio (consisting of commercial real estate, commercial & industrial, equipment leases, multi-family real estate, construction and small business loans) increased $53.9 million, or 10.4%. The primary drivers of this growth occurred in the commercial & industrial and commercial real estate areas.

The Bank's business lending group originates business loans, also referred to as commercial and industrial loans, including owner-occupied commercial real estate loans, term loans and revolving lines of credit. Within the business lending portfolio, commercial and industrial loans increased $25.9 million, or 24.4%, and owner-occupied commercial real estate loans increased $16.6 million, or 11.8%, since year-end 2006.

With the Macrolease platform, the Bank originates equipment leases for its own portfolio, as well as originates leases for third parties as a source of noninterest income. In addition, the Bank historically has purchased equipment leases from originators outside of the Bank. The U.S. Government and its agencies are the principal lessees on the vast majority of these leases. These "government" leases generally have maturities of five years or less and are not dependent on residual collateral values. At December 31, 2007, leases comprised 10.2% of the commercial loan and lease portfolio, with $43.4 million of Macrolease-generated leases and $15.3 million of purchased government leases. Included within these amounts were $3.3 million of leases generated for sale at December 31, 2007.

The Bank's commercial real estate ("CRE") group originates nonowner-occupied commercial real estate, multi-family residential real estate and construction loans. These real estate secured commercial loans are offered as both fixed and adjustable-rate products. Since December 31, 2006, CRE loans have increased $10.4 million, or 6.0%, on a net basis. During the past twelve months, the Bank originated over $40 million of new CRE loans; however repayments were near $30 million during the same period.

At December 31, 2007, small business loans (business lending relationships of approximately $250,000 or less) were $45.8 million, compared to $41.8 million at December 31, 2006, representing 8.0% of the commercial portfolio at each year end. These loans reflect those originated by the Bank's business development group, as well as throughout the Bank's branch system. The Bank utilizes credit scoring and streamlined documentation, as well as traditional review standards in originating these credits.

The Bank is a participant in the SBA Preferred Lender Program in both Rhode Island and Massachusetts. SBA guaranteed loans are found throughout the portfolios managed by the Bank's various lending groups.

The Company believes it is well positioned for continued commercial growth. Particular emphasis is placed on generation of small- to medium-sized commercial relationships (those relationships with $10.0 million or less in total loan commitments). Unlike many community banks, the Bank offers asset-based commercial loan facilities that monitor advances against receivables and inventories on a formula basis.

Residential mortgage loans Residential mortgage loans decreased $15.2 million, or 5.8%, as repayments ($48.7 million) exceeded the total of purchases ($34.4 million) and originations ($725,000). Since inception, the Bank has concentrated its portfolio lending efforts on commercial and consumer lending opportunities, but originates mortgage loans for its own portfolio on a limited basis. The Bank does not employ any outside mortgage originators, but from time to time, purchases residential mortgage loans from third-party originators. Until such time as the Bank can originate sufficient commercial and consumer loans to utilize available cash flow, it intends to continue purchasing residential mortgage loans as opportunities develop.

Consumer loans During 2007, consumer loan outstandings decreased $4.8 million, or 2.2%, to $215.7 million at December 31, 2007, from $220.6 million at December 31, 2006. The decline in growth was reflective of the softening of housing prices in the local market area over the past 18 months. The Company believes the softening prices have reduced consumer appetite for borrowing against the value of their homes. However, the Company continues to promote consumer lending as it believes that these ten- to twenty-year fixed-rate products, along with the floating lines of credit, still possess attractive cash flow characteristics in the current interest rate environment.

The table below shows loan and lease originations, purchases and repayment activities.

	Year ended December 31,				
	2007	2006	2005	2004	2003
	(In thousands)				
Originations and principal additions:					
Loans and leases purchased:					
Commercial loans and leases	$ 8,143	$ 11,454	$ 9,243	$ 3,257	$
Residential mortgage loans	33,998	5,644	56,512	55,273	249,656
Total loans and leases purchased	42,141	17,098	65,755	58,530	249,656
Loans and leases originated:					
Commercial loans and leases	131,766	146,802	99,490	109,560	106,335
Residential mortgage loans	725	1,450	5,009	9,635	28,371
Consumer and other loans	38,623	64,715	82,426	90,655	65,831
Total loans and leases originated	171,114	212,967	186,925	209,850	200,537
Principal reductions:					
Net charge-offs/transfers to OREO:					
Commercial loans and leases	(152)	(453)	(1,205)	(98)	(565)
Residential mortgage loans	(835)				
Consumer and other loans	(58)	(37)	(7)	(51)	(64)
Total net charge-offs/transfers to OREO	(1,045)	(490)	(1,212)	(149)	(629)
Principal payments:					
Commercial loans and leases	(90,011)	(78,024)	(72,736)	(42,052)	(54,402)
Residential mortgage loans	(48,717)	(48,763)	(71,249)	(114,813)	(210,316)
Consumer and other loans	(42,995)	(50,205)	(42,978)	(39,417)	(41,970)
Total principal payments	(181,723)	(176,992)	(186,963)	(196,282)	(306,688)
Change in total loans and leases receivable (before net items)	$ 30,487	$ 52,583	$ 64,505	$ 71,949	$ 142,876

The following table sets forth certain information at December 31, 2007, regarding the aggregate dollar amount of certain loans maturing in the loan portfolio based on scheduled payments to maturity. Actual loan principal payments may vary from this schedule due to refinancings, modifications and other changes in loan terms. Demand loans and loans having no stated schedule of repayments and no stated maturity are reported as due in one year or less.

	Principal repayments contractually due		
	One year or less	After one, but within five years	After five years
	(In thousands)		
Commercial & industrial loans (including leases)	$ 67,134	$ 93,126	$