WASHINGTON TRUST BANCORP INC
Form 10-Q
November 07, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

x	Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended SEPTEMBER 30, 2013 or
o	Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from ______ to ______.

Commission file number: 001-32991

WASHINGTON TRUST BANCORP, INC.
(Exact name of registrant as specified in its charter)

RHODE ISLAND	05-0404671
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
23 BROAD STREET	
WESTERLY, RHODE ISLAND	02891
(Address of principal executive offices)	(Zip Code)

(401) 348-1200
(Registrant’s telephone number, including area code)

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

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

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

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

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

The number of shares of common stock of the registrant outstanding as of November 1, 2013 was 16,600,385.

FORM 10-Q
WASHINGTON TRUST BANCORP, INC. AND SUBSIDIARIES
For the Quarter Ended September 30, 2013

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ITEM 1. FINANCIAL STATEMENTS
WASHINGTON TRUST BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS (unaudited)

(Dollars in thousands, except par value)

	September 30, 2013	December 31, 2012
Assets:		
Cash and due from banks	$136,724	$73,474
Short-term investments	3,204	19,176
Mortgage loans held for sale, at fair value; amortized cost $12,772 in 2013 and $48,370 in 2012	13,105	50,056
Securities:		
Available for sale, at fair value; amortized cost $380,994 in 2013 and $363,408 in 2012	388,085	375,498
Held to maturity, at cost; fair value $31,962 in 2013 and $41,420 in 2012	31,264	40,381
Total securities	419,349	415,879
Federal Home Loan Bank stock, at cost	37,730	40,418
Loans:		
Commercial	1,297,892	1,252,419
Residential real estate	731,692	717,681
Consumer	324,182	323,903
Total loans	2,353,766	2,294,003
Less allowance for loan losses	28,008	30,873
Net loans	2,325,758	2,263,130
Premises and equipment, net	25,921	27,232
Investment in bank-owned life insurance	56,214	54,823
Goodwill	58,114	58,114
Identifiable intangible assets, net	5,657	6,173
Other assets	50,182	63,409
Total assets	$3,131,958	$3,071,884
Liabilities:		
Deposits:		
Demand deposits	$420,075	$379,889
NOW accounts	301,250	291,174
Money market accounts	623,631	496,402
Savings accounts	292,765	274,934
Time deposits	817,110	870,232
Total deposits	2,454,831	2,312,631
Federal Home Loan Bank advances	288,485	361,172
Junior subordinated debentures	22,681	32,991
Other borrowings	797	1,212
Other liabilities	41,579	68,226
Total liabilities	2,808,373	2,776,232
Commitments and contingencies		
Shareholders' Equity:		
Common stock of $.0625 par value; authorized 30,000,000 shares; issued and outstanding 16,589,472 shares in 2013 and 16,379,771 shares in 2012	1,037	1,024
Paid-in capital	96,536	91,453
Retained earnings	227,352	213,674
Accumulated other comprehensive loss	(1,340)	(10,499)

Total shareholders’ equity	323,585	295,652
Total liabilities and shareholders’ equity	$3,131,958	$3,071,884

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

WASHINGTON TRUST BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME (unaudited)

(Dollars and shares in thousands, except per share amounts)

		Three Months		Nine Months	
Periods ended September 30,		2013	2012	2013	2012
Interest income:					
Interest and fees on loans		$26,096	$25,840	$76,832	$76,547
Interest on securities:	Taxable	2,582	3,672	8,003	12,118
	Nontaxable	629	660	1,935	2,035
Dividends on corporate stock and Federal Home Loan Bank stock		36	52	113	207
Other interest income		47	27	99	64
Total interest income		29,390	30,251	86,982	90,971
Interest expense:					
Deposits		3,064	3,391	9,354	10,210
Federal Home Loan Bank advances		2,693	3,726	8,109	11,809
Junior subordinated debentures		241	393	1,243	1,176
Other interest expense		4	5	12	244
Total interest expense		6,002	7,515	18,718	23,439
Net interest income		23,388	22,736	68,264	67,532
Provision for loan losses		700	600	2,000	2,100
Net interest income after provision for loan losses		22,688	22,136	66,264	65,432
Noninterest income:					
Wealth management services:					
Trust and investment advisory fees		6,291	5,877	18,587	17,474
Mutual fund fees		1,075	1,024	3,174	3,051
Financial planning, commissions and other service fees		263	292	1,254	1,326
Wealth management services		7,629	7,193	23,015	21,851
Merchant processing fees		3,359	3,207	7,949	7,927
Net gains on loan sales and commissions on loans originated for others		3,883	3,504	11,534	9,616
Service charges on deposit accounts		855	833	2,436	2,356
Card interchange fees		731	675	2,013	1,844
Income from bank-owned life insurance		464	1,006	1,392	1,969
Net realized gains on securities		—	—	—	299
Net gains on interest rate swap contracts		54	63	225	87
Equity in earnings (losses) of unconsolidated subsidiaries		(47)	27	(65)	114
Other income		472	413	1,233	1,473
Noninterest income, excluding other-than-temporary impairment losses		17,400	16,921	49,732	47,536
Total other-than-temporary impairment losses on securities		—	—	(613)	(85)
Portion of loss recognized in other comprehensive income (before tax)		—	—	(2,159)	(124)
Net impairment losses recognized in earnings		—	—	(2,772)	(209)
Total noninterest income		17,400	16,921	46,960	47,327
Noninterest expense:					
Salaries and employee benefits		14,640	15,214	45,624	44,125
Net occupancy		1,404	1,468	4,282	4,521
Equipment		1,222	1,168	3,658	3,418
Merchant processing costs		2,862	2,707	6,746	6,690
Outsourced services		878	845	2,590	2,660
Legal, audit and professional fees		529	598	1,691	1,599
FDIC deposit insurance costs		448	427	1,330	1,311
Advertising and promotion		312	445	1,143	1,295
Amortization of intangibles		170	182	516	555

Foreclosed property costs		38	136	222	604
Debt prepayment penalties		1,125	1,173	1,125	2,134
Other expenses		1,920	1,927	5,810	6,005
Total noninterest expense		25,548	26,290	74,737	74,917
Income before income taxes		14,540	12,767	38,487	37,842
Income tax expense		4,580	3,867	12,123	11,791
Net income		$9,960	$8,900	$26,364	$26,051
Weighted average common shares outstanding - basic		16,563	16,366	16,473	16,351
Weighted average common shares outstanding - diluted		16,696	16,414	16,600	16,392
Per share information:	Basic earnings per common share	$0.60	$0.54	$1.59	$1.59
	Diluted earnings per common share	$0.59	$0.54	$1.58	$1.58
	Cash dividends declared per share	$0.26	$0.24	$0.76	$0.70

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

WASHINGTON TRUST BANCORP, INC. AND SUBSIDIARIES (Dollars in thousands)
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (unaudited)

	Three Months		Nine Months	
Periods ended September 30,	2013	2012	2013	2012
Net income	$9,960	$8,900	$26,364	$26,051
Other comprehensive income (loss), net of tax:				
Securities available for sale:				
Changes in fair value of securities available for sale	(129)	(218)	(5,003)	(676)
Net losses (gains) on securities reclassified into earnings	—	—	393	(138)
Net change in fair value of securities available for sale	(129)	(218)	(4,610)	(814)
Reclassification adjustment for other-than-temporary impairment losses transferred into earnings	—	—	1,384	80
Cash flow hedges:				
Change in fair value of cash flow hedges	(47)	(127)	(15)	(331)
Net cash flow hedge losses reclassified into earnings	91	113	331	336
Net change in fair value of cash flow hedges	44	(14)	316	5
Defined benefit plan obligation adjustment	11,440	171	12,069	527
Total other comprehensive income (loss), net of tax	11,355	(61)	9,159	(202)
Total comprehensive income	$21,315	$8,839	$35,523	$25,849

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

WASHINGTON TRUST BANCORP, INC. AND SUBSIDIARIES (Dollars and shares in thousands)
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (unaudited)

	Common Shares Outstanding	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive (Loss)	Total
Balance at January 1, 2012	16,292	$1,018	$88,030	$194,198	($1,895)	$281,351
Net income				26,051		26,051
Total other comprehensive loss, net of tax					(202)	(202)
Cash dividends declared				(11,610)		(11,610)
Share-based compensation			1,404			1,404
Deferred compensation plan	10	1	145			146
Exercise of stock options, issuance of other compensation-related equity instruments and related tax benefit	69	4	1,250			1,254
Balance at September 30, 2012	16,371	$1,023	$90,829	$208,639	($2,097)	$298,394

	Common Shares Outstanding	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive (Loss)	Total
Balance at January 1, 2013	16,380	$1,024	$91,453	$213,674	($10,499)	$295,652
Net income				26,364		26,364
Total other comprehensive income, net of tax					9,159	9,159
Cash dividends declared				(12,686)		(12,686)
Share-based compensation			1,377			1,377
Deferred compensation plan	2	—	30			30
Exercise of stock options, issuance of other compensation-related equity instruments and related tax benefit	207	13	3,676			3,689
Balance at September 30, 2013	16,589	$1,037	$96,536	$227,352	($1,340)	$323,585

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

WASHINGTON TRUST BANCORP, INC. AND SUBSIDIARIES (Dollars in thousands)
CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

Nine months ended September 30,		2013	2012
Cash flows from operating activities:			
Net income		$26,364	$26,051
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses		2,000	2,100
Depreciation of premises and equipment		2,489	2,370
Foreclosed and repossessed property valuation adjustments		79	298
Net gain on sale of bank property		—	(358)
Net amortization of premium and discount		1,196	1,679
Net amortization of intangibles		516	555
Share-based compensation		1,377	1,404
Income from bank-owned life insurance		(1,392)	(1,969)
Net gains on loan sales and commissions on loans originated for others		(11,534)	(9,616)
Net realized gains on securities		—	(299)
Net impairment losses recognized in earnings		2,772	209
Net gains on interest rate swap contracts		(225)	(87)
Equity in losses (earnings) of unconsolidated subsidiaries		65	(114)
Proceeds from sales of loans		356,932	336,919
Loans originated for sale		(313,227)	(344,532)
Decrease (increase) in other assets		12,388	(7,567)
(Decrease) increase in other liabilities		(13,769)	1,711
Net cash provided by operating activities		66,031	8,754
Cash flows from investing activities:			
Purchases of:	Mortgage-backed securities available for sale	(66,569)	—
	Other investment securities available for sale	(25,404)	—
Proceeds from sale of:	Mortgage-backed securities available for sale	—	6,247
	Other investment securities available for sale	2,660	6,338
Maturities and principal payments of:	Mortgage-backed securities available for sale	64,270	85,059
	Other investment securities available for sale	3,890	911
	Mortgage-backed securities held to maturity	8,704	8,138
Remittance of Federal Home Loan Bank stock		2,688	1,590
Net increase in loans		(100,655)	(103,402)
Proceeds from sale of portfolio loans		49,588	—
Purchases of loans, including purchased interest		(9,103)	(5,007)
Proceeds from the sale of property acquired through foreclosure or repossession		2,142	3,146
Purchases of premises and equipment		(1,178)	(4,513)
Net proceeds from the sale of bank property		—	1,571
Proceeds from bank-owned life insurance		—	1,419
Net cash (used in) provided by investing activities		(68,967)	1,497
Cash flows from financing activities:			
Net increase in deposits		142,200	108,344
Net decrease in other borrowings		(415)	(19,529)
Proceeds from Federal Home Loan Bank advances		204,000	472,930
Repayment of Federal Home Loan Bank advances		(276,687)	(595,705)
Proceeds from the exercise of stock options and issuance of other compensation-related equity instruments		3,287	1,251
		432	149

Tax benefit from stock option exercises and issuance of other compensation-related equity instruments		
Redemption of junior subordinated debentures	(10,310)	—
Cash dividends paid	(12,293)	(11,177)
Net cash provided by (used in) financing activities	50,214	(43,737)
Net increase (decrease) in cash and cash equivalents	47,278	(33,486)
Cash and cash equivalents at beginning of period	92,650	87,020
Cash and cash equivalents at end of period	$139,928	$53,534
Noncash Investing and Financing Activities:		
Loans charged off	$5,319	$1,801
Loans transferred to property acquired through foreclosure or repossession	1,073	3,255
Supplemental Disclosures:		
Interest payments	$18,401	$22,869
Income tax payments	11,528	12,729

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

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WASHINGTON TRUST BANCORP, INC. AND SUBSIDIARIES
CONDENSED NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(1) General Information
Washington Trust Bancorp, Inc. (the “Bancorp”) is a publicly-owned registered bank holding company and financial holding company. The Bancorp owns all of the outstanding common stock of The Washington Trust Company (the “Bank”), a Rhode Island chartered commercial bank founded in 1800. Through its subsidiaries, the Bancorp offers a complete product line of financial services including commercial, residential and consumer lending, retail and commercial deposit products, and wealth management services through its offices in Rhode Island, eastern Massachusetts and Connecticut.

The consolidated financial statements include the accounts of the Bancorp and its subsidiaries (collectively, the “Corporation” or “Washington Trust”). All significant intercompany transactions have been eliminated.

The accounting and reporting policies of the Corporation conform to accounting principles generally accepted in the United States of America (“GAAP”) and to general practices of the banking industry. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to change are the determination of the allowance for loan losses and the review of goodwill, other intangible assets and investments for impairment. The current economic environment has increased the degree of uncertainty inherent in such estimates and assumptions.

The unaudited consolidated financial statements of the Corporation presented herein have been prepared pursuant to the rules of the Securities and Exchange Commission (“SEC”) for quarterly reports on Form 10-Q and do not include all of the information and note disclosures required by GAAP. In the opinion of management, all adjustments (consisting of normal recurring adjustments) and disclosures considered necessary for the fair presentation of the accompanying consolidated financial statements have been included. Interim results are not necessarily reflective of the results of the entire year. The accompanying unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

(2) Recently Issued Accounting Pronouncements
Balance Sheet - Topic 210
Accounting Standards Update No. 2011-11, “Disclosures about Offsetting Assets and Liabilities” (“ASU 2011-11”), was issued in December 2011 and was intended to enhance current disclosure requirements on offsetting financial assets and liabilities. The requirements of ASU 2011-11 enable users to compare balance sheets prepared under U.S. GAAP and International Financial Reporting Standards (“IFRS”), which are subject to different offsetting models. The requirements affect all entities that have financial instruments that are either offset in the balance sheet or subject to an enforceable master netting arrangement or similar agreement. Accounting Standards Update No. 2013-01, “Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities” (“ASU 2013-01”), was issued in January 2013 to address implementation issues about the scope of ASU 2011-11. Both ASU 2011-11 and ASU 2013-01 were effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. The required disclosures were effective retrospectively for all comparative periods presented. The adoption of ASU 2011-11 and ASU 2013-01 did not have a material impact on the Corporation’s consolidated financial statements.

Comprehensive Income - Topic 220
Accounting Standards Update No. 2013-02, “Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income” (“ASU 2013-02”) was issued in February 2013 and requires additional disclosure of the effects of reclassifications out of accumulated other comprehensive income (“AOCI”) in a single location, either on the face of

the financial statement that reports net income or in the notes to the financial statements. ASU 2013-02 does not change the current requirements and carries forward the existing requirements that reclassifications out of AOCI be separately presented for each component of other comprehensive income. For items reclassified out of AOCI and into net income in their entirety, the effect of the reclassification on each affected net income line must be disclosed. For AOCI reclassification items that are not reclassified in their entirety into net income, a cross reference to other required disclosures is required. The amendments were effective prospectively for reporting periods beginning after December 15, 2012. The adoption of this standard did not have a material impact on the Corporation's consolidated financial statements, see Note 15.

(3) Cash and Due from Banks

The Bank maintains certain average reserve balances to meet the requirements of the Board of Governors of the Federal Reserve System ("FRB"). Some or all of these reserve requirements may be satisfied with vault cash. Reserve balances amounted to

WASHINGTON TRUST BANCORP, INC. AND SUBSIDIARIES
CONDENSED NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

$7.7 million at September 30, 2013 and $5.5 million at December 31, 2012 and were included in cash and due from banks in the Consolidated Balance Sheets.

As of September 30, 2013 and December 31, 2012, cash and due from banks included interest-bearing deposits in other banks of $87.8 million and $32.2 million, respectively.

(4) Securities

The following tables present the amortized cost, gross unrealized gains, gross unrealized losses and fair value of securities by major security type and class of security:

(Dollars in thousands)

September 30, 2013	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities Available for Sale:				
Obligations of U.S. government-sponsored enterprises	$54,461	$1,208	$—	$55,669
Mortgage-backed securities issued by U.S. government agencies and U.S. government-sponsored enterprises	218,598	9,943	(36)	228,505
States and political subdivisions	64,833	2,507	—	67,340
Trust preferred securities:				
Individual name issuers	30,705	—	(5,930)	24,775
Collateralized debt obligations	1,264	—	(839)	425
Corporate bonds	11,133	254	(16)	11,371
Total securities available for sale	$380,994	$13,912	($6,821)	$388,085
Held to Maturity:				
Mortgage-backed securities issued by U.S. government agencies and U.S. government-sponsored enterprises	$31,264	$698	$—	$31,962
Total securities held to maturity	$31,264	$698	$—	$31,962
Total securities	$412,258	$14,610	($6,821)	$420,047

(Dollars in thousands)

December 31, 2012	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities Available for Sale:				
Obligations of U.S. government-sponsored enterprises	$29,458	$2,212	$—	$31,670
Mortgage-backed securities issued by U.S. government agencies and U.S. government-sponsored enterprises	217,136	14,097	—	231,233
States and political subdivisions	68,196	4,424	—	72,620
Trust preferred securities:				
Individual name issuers	30,677	—	(5,926)	24,751
Collateralized debt obligations	4,036	—	(3,193)	843
Corporate bonds	13,905	476	—	14,381
Total securities available for sale	$363,408	$21,209	($9,119)	$375,498
Held to Maturity:				
Mortgage-backed securities issued by U.S. government agencies and U.S. government-sponsored enterprises	$40,381	$1,039	$—	$41,420
Total securities held to maturity	$40,381	$1,039	$—	$41,420
Total securities	$403,789	$22,248	($9,119)	$416,918

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WASHINGTON TRUST BANCORP, INC. AND SUBSIDIARIES
CONDENSED NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

At September 30, 2013 and December 31, 2012, securities available for sale and held to maturity with a fair value of $391.7 million and $386.5 million, respectively, were pledged as collateral for Federal Home Loan Bank of Boston ("FHLBB") borrowings and letters of credit, potential borrowings with the FRB, certain public deposits and for other purposes.

The schedule of maturities of debt securities available for sale and held to maturity as of September 30, 2013 is presented below. Mortgage-backed securities are included based on weighted average maturities, adjusted for anticipated prepayments. All other debt securities are included based on contractual maturities. Actual maturities may differ from amounts presented because certain issuers have the right to call or prepay obligations with or without call or prepayment penalties. Yields on tax exempt obligations are not computed on a tax equivalent basis.

(Dollars in thousands)	Within 1 Year		1-5 Years		5-10 Years		After 10 Years		Totals	
Securities Available for Sale:										
Obligations of U.S. government-sponsored enterprises:										
Amortized cost	$54,461		$—		$—		$—		$54,461	
Weighted average yield	4.04	%	—	%	—	%	—	%	4.04	%
Mortgage-backed securities issued by U.S. government-sponsored enterprises:										
Amortized cost	60,133		106,040		37,563		14,862		218,598	
Weighted average yield	4.30	%	3.76	%	2.65	%	2.43	%	3.63	%
State and political subdivisions:										
Amortized cost	12,296		52,537		—		—		64,833	
Weighted average yield	3.89	%	3.91	%	—	%	—	%	3.91	%
Trust preferred securities:										
Amortized cost	—		—		—		31,969		31,969	
Weighted average yield	—	%	—	%	—	%	1.38	%	1.38	%
Corporate bonds:										
Amortized cost	5,027		5,704		402		—		11,133	
Weighted average yield	6.64	%	2.82	%	2.45	%	—	%	4.53	%
Total debt securities available for sale:										
Amortized cost	$131,917		$164,281		$37,965		$46,831		$380,994	
Weighted average yield	4.25	%	3.77	%	2.65	%	1.71	%	3.57	%
Fair value	$133,376		$167,772		$39,432		$47,505		$388,085	
Securities Held to Maturity:										
Mortgage-backed securities issued by U.S. government-sponsored enterprises:										
Amortized cost	$6,995		$15,465		$6,710		$2,094		$31,264	
Weighted average yield	2.57	%	2.48	%	2.37	%	0.88	%	2.37	%
Fair value	$7,151		$15,810		$6,860		$2,141		$31,962	

Included in debt securities as of September 30, 2013 were debt securities with an amortized cost balance of $111.4 million and a fair value of $106.7 million that are callable at the discretion of the issuers. Final maturities of these callable securities range from two to twenty-four years, with call features ranging from one month to four years.

Other-Than-Temporary Impairment Assessment

The Corporation assesses whether the decline in fair value of investment securities is other-than-temporary on a regular basis. Unrealized losses on debt securities may occur from current market conditions, increases in interest rates since the time of purchase, a structural change in an investment, volatility of earnings of a specific issuer, or deterioration in credit quality of the issuer. Management evaluates impairments in value both qualitatively and quantitatively to assess whether they are other-than-temporary.

WASHINGTON TRUST BANCORP, INC. AND SUBSIDIARIES
CONDENSED NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following tables summarize temporarily impaired securities, segregated by length of time the securities have been in a continuous unrealized loss position:

(Dollars in thousands)	Less than 12 Months			12 Months or Longer			Total		
September 30, 2013	#	Fair Value	Unrealized Losses	#	Fair Value	Unrealized Losses	#	Fair Value	Unrealized Losses
Mortgage-backed securities issued by U.S. government agencies and U.S. government-sponsored enterprises	2	$969	($36)	—	$—	$—	2	$969	($36)
Trust preferred securities:									
Individual name issuers	—	—	—	11	24,775	(5,930)	11	24,775	(5,930)
Collateralized debt obligations	—	—	—	1	425	(839)	1	425	(839)
Corporate bonds	2	407	(16)	—	—	—	2	407	(16)
Total temporarily impaired securities	4	$1,376	($52)	12	$25,200	($6,769)	16	$26,576	($6,821)

(Dollars in thousands)	Less than 12 Months			12 Months or Longer			Total		
December 31, 2012	#	Fair Value	Unrealized Losses	#	Fair Value	Unrealized Losses	#	Fair Value	Unrealized Losses
Trust preferred securities:									
Individual name issuers	—	$—	$—	11	$24,751	($5,926)	11	$24,751	($5,926)
Collateralized debt obligations	—	—	—	2	843	(3,193)	2	843	(3,193)
Total temporarily impaired securities	—	$—	$—	13	$25,594	($9,119)	13	$25,594	($9,119)

Further deterioration in credit quality of the underlying issuers of the securities, further deterioration in the condition of the financial services industry, a continuation or worsening of the current economic environment, or additional declines in real estate values, among other things, may further affect the fair value of these securities and increase the potential that certain unrealized losses be designated as other-than-temporary in future periods, and the Corporation may incur additional write-downs.

Trust Preferred Debt Securities of Individual Name Issuers

Included in debt securities in an unrealized loss position at September 30, 2013 and December 31, 2012 were 11 trust preferred security holdings issued by seven individual companies in the financial services industry, specifically, the banking sector. Management believes the decline in fair value of these trust preferred securities primarily reflects investor concerns about global economic growth and how it will affect the recent and potential future losses in the financial services industry. These concerns resulted in increased risk premiums for securities in this sector. Based on the information available through the filing date of this report, all individual name trust preferred debt securities held in our portfolio continue to accrue and make payments as expected with no payment deferrals or defaults on the part of the issuers. As of September 30, 2013, trust preferred debt securities with an amortized cost of $11.9 million and unrealized losses of $2.1 million were rated below investment grade by Standard & Poors, Inc. ("S&P"). Management reviewed the collectibility of these securities taking into consideration such factors as the financial condition of the issuers, reported regulatory capital ratios of the issuers, credit ratings including ratings in effect as of the reporting period date as well as credit rating changes between the reporting period date and the filing date of this report and other information. We noted no additional downgrades to below investment grade between the reporting period date and the filing date of this report. Based on these analyses, management concluded that it expects to recover the entire amortized cost basis of these securities. Furthermore, Washington Trust does not intend to sell these securities and it is not more likely than not that Washington Trust will be required to sell these securities before recovery of their cost basis, which may be at maturity. Therefore, management does not consider these investments to be other-than-temporarily impaired at September 30, 2013.

Trust Preferred Debt Securities in the Form of Collateralized Debt Obligations (“CDO”)
Washington Trust has invested in pooled trust preferred holdings in the form of collateralized debt obligations. The pooled trust preferred holdings consist of trust preferred obligations of banking industry companies and, to a lesser extent, insurance industry companies.

Valuations of pooled trust preferred holdings are dependent in part on cash flows from underlying issuers. Unexpected cash flow disruptions could have an adverse impact on the fair value and performance of pooled trust preferred securities. Management

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believes the unrealized losses primarily reflect investor concerns about global economic growth and how it will affect the recent and potential future losses in the financial services industry and the possibility of further incremental deferrals of or defaults on interest payments on trust preferred debentures by financial institutions participating in these pools. These concerns have resulted in a substantial decrease in market liquidity and increased risk premiums for securities in this sector. Credit spreads for issuers in this sector have remained wide during recent months, causing prices to remain at low levels.

The following table summarizes Washington Trust's pooled trust preferred holdings:

(Dollars in thousands)	September 30, 2013			December 31, 2012		
Deal Name	Amortized Cost (1)	Fair Value	Unrealized Losses	Amortized Cost (1)	Fair Value	Unrealized Losses
Tropic CDO 1, tranche A4L	$—	$—	$—	$2,772	$613	($2,159)
Preferred Term Securities [PreTSL] XXV, tranche C1	1,264	425	(839)	1,264	230	(1,034)
Totals	$1,264	$425	($839)	$4,036	$843	($3,193)

(1) Net of other-than-temporary impairment losses recognized in earnings.

On March 22, 2013, the trustee for the Tropic CDO I security issued a notice that liquidation of the CDO entity would take place at the direction of holders of the CDO tranches senior to the subordinate tranche interest held by Washington Trust. Accordingly, Washington Trust recognized an other-than-temporary impairment charge in the first quarter of 2013 on the entire $2.8 million million carrying value of this security, based on the expectation that proceeds from the liquidation would be insufficient to satisfy the amount owed to the subordinate tranche. The liquidation was conducted in August 2013 and was insufficient to satisfy any amount owed on the subordinate tranche.

Washington Trust's investment in the PreTSL XXV, tranche C1 ("PreTSL") is subordinate to two senior tranche levels. This investment security has been on nonaccrual status and has been deferring interest payments since December 2008. The September 30, 2013 amortized cost was net of $1.2 million of credit-related impairment losses previously recognized in earnings reflective of payment deferrals and credit deterioration of the underlying collateral. As of September 30, 2013, this security had unrealized losses of $839 thousand and a below investment grade rating of "C" by Moody's. Through the filing date of this report, there have been no additional rating changes on this security. This credit rating status has been considered by management in its assessment of the impairment status of this security. Based on information available through the filing date of this report, there have been no additional adverse changes in deferral or default status of the underlying issuer institutions. Based on cash flow forecasts for this security, management expects to recover the remaining amortized cost of this security. Furthermore, Washington Trust does not intend to sell this security and it is not more likely than not that Washington Trust will be required to sell this security before recovery of its cost basis, which may be at maturity. Therefore, management does not consider the unrealized losses on this security to be other-than-temporary at September 30, 2013.

Credit-Related Impairment Losses Recognized on Debt Securities

The following table presents a roll forward of the balance of cumulative credit-related impairment losses recognized on debt securities for the periods indicated:

(Dollars in thousands)	Three months		Nine months	
Periods ended September 30,	2013	2012	2013	2012
Balance at beginning of period	$6,097	$3,313	$3,325	$3,104
Credit-related impairment loss on debt securities for which an other-than-temporary impairment was not previously recognized	—	—	—	—
	—	—	2,772	209

Additional increases to the amount of credit-related impairment loss on debt securities for which an other-than-temporary impairment was previously recognized				
Balance at end of period	$6,097	$3,313	$6,097	$3,313

The anticipated cash flows expected to be collected from pooled trust preferred debt securities were discounted at the rate equal to the yield used to accrete the current and prospective beneficial interest for each security. Significant inputs included estimated cash flows and prospective defaults and recoveries. Estimated cash flows were generated based on the underlying seniority status and subordination structure of the pooled trust preferred debt tranche at the time of measurement. Prospective default

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and recovery estimates affecting projected cash flows were based on analysis of the underlying financial condition of individual issuers, and took into account capital adequacy, credit quality, lending concentrations, and other factors.

All cash flow estimates were based on the underlying security's tranche structure and contractual rate and maturity terms. The present value of the expected cash flows was compared to the current outstanding balance of the tranche to determine the ratio of the estimated present value of expected cash flows to the total current balance for the tranche. This ratio was then multiplied by the principal balance of Washington Trust's holding to determine the credit-related impairment loss. The estimates used in the determination of the present value of the expected cash flows are susceptible to changes in future periods, which could result in additional credit-related impairment losses.

(5) Loans

The following is a summary of loans:

(Dollars in thousands)	September 30, 2013			December 31, 2012		
	Amount	%		Amount	%	
Commercial:						
Mortgages (1)	$727,375	31	%	$710,813	31	%
Construction and development (2)	51,951	2		27,842	1	
Other (3)	518,566	22		513,764	23	
Total commercial	1,297,892	55		1,252,419	55	
Residential real estate:						
Mortgages (4)	711,427	30		692,798	30	
Homeowner construction	20,265	1		24,883	1	
Total residential real estate	731,692	31		717,681	31	
Consumer:						
Home equity lines (5)	227,063	10		226,861	10	
Home equity loans (5)	41,158	2		39,329	2	
Other (6)	55,961	2		57,713	2	
Total consumer	324,182	14		323,903	14	
Total loans (7)	$2,353,766	100	%	$2,294,003	100	%

(1) Amortizing mortgages and lines of credit, primarily secured by income producing property. As of September 30, 2013 and December 31, 2012, $204.1 million and $238.6 million, respectively, were pledged as collateral for FHLBB borrowings and letters of credit.

(2) Loans for construction commercial properties, loans to developers for construction of residential properties, and loans for land development.

(3) Loans to businesses and individuals, a substantial portion of which are fully or partially collateralized by real estate. As of September 30, 2013, $47.5 million and $24.3 million, respectively, were pledged as collateral for FHLBB borrowings and letters of credit and were collateralized for the discount window at the Federal Reserve Bank. Comparable amounts for December 31, 2012 were $51.8 million and $29.5 million, respectively.

(4) As of September 30, 2013 and December 31, 2012, $647.3 million and $627.4 million, respectively, were pledged as collateral for FHLBB borrowings and letters of credit.

(5) As of September 30, 2013 and December 31, 2012, $191.8 million and $189.4 million, respectively, were pledged as collateral for FHLBB borrowings and letters of credit.

(6) Fixed-rate consumer installment loans.

(7) Includes net unamortized loan origination costs of $531 thousand and $39 thousand, respectively, and net unamortized premiums on purchased loans of $100 thousand and $83 thousand, respectively, at September 30, 2013 and December 31, 2012.

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Nonaccrual Loans

Loans, with the exception of certain well-secured loans that are in the process of collection, are placed on nonaccrual status and interest recognition is suspended when such loans are 90 days or more overdue with respect to principal and/or interest or sooner if considered appropriate by management. Well-secured loans are permitted to remain on accrual status provided that full collection of principal and interest is assured and the loan is in the process of collection. Loans are also placed on nonaccrual status when, in the opinion of management, full collection of principal and interest is doubtful. Interest previously accrued but not collected on such loans is reversed against current period income. Subsequent interest payments received on nonaccrual loans are applied to the outstanding principal balance of the loan or recognized as interest income depending on management's assessment of the ultimate collectability of the loan. Loans are removed from nonaccrual status when they have been current as to principal and interest for a period of time, the borrower has demonstrated an ability to comply with repayment terms, and when, in management's opinion, the loans are considered to be fully collectible.

The following is a summary of nonaccrual loans, segregated by class of loans, as of the dates indicated:

(Dollars in thousands)	Sep 30, 2013	Dec 31, 2012
Commercial:		
Mortgages	$8,956	$10,681
Construction and development	—	—
Other	1,248	4,412
Residential real estate:		
Mortgages	8,095	6,158
Homeowner construction	—	—
Consumer:		
Home equity lines	412	840
Home equity loans	768	371
Other	24	81
Total nonaccrual loans	$19,503	$22,543
Accruing loans 90 days or more past due	$—	$—

As of September 30, 2013 and December 31, 2012, nonaccrual loans of $2.2 million and $1.6 million, respectively, were current as to the payment of principal and interest.

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Past Due Loans

Past due status is based on the contractual payment terms of the loan. The following tables present an age analysis of past due loans, segregated by class of loans, as of the dates indicated:

(Dollars in thousands)	Days Past Due					
September 30, 2013	30-59	60-89	Over 90	Total Past Due	Current	Total Loans
Commercial:						
Mortgages	$—	$730	$8,226	$8,956	$718,419	$727,375
Construction and development	—	—	—	—	51,951	51,951
Other	2,648	8	929	3,585	514,981	518,566
Residential real estate:						
Mortgages	2,624	1,960	4,843	9,427	702,000	711,427
Homeowner construction	—	—	—	—	20,265	20,265
Consumer:						
Home equity lines	636	220	262	1,118	225,945	227,063
Home equity loans	339	104	416	859	40,299	41,158
Other	38	4	15	57	55,904	55,961
Total loans	$6,285	$3,026	$14,691	$24,002	$2,329,764	$2,353,766

(Dollars in thousands)	Days Past Due					
December 31, 2012	30-59	60-89	Over 90	Total Past Due	Current	Total Loans
Commercial:						
Mortgages	$373	$408	$10,300	$11,081	$699,732	$710,813
Construction and development	—	—	—	—	27,842	27,842
Other	260	296	3,647	4,203	509,561	513,764
Residential real estate:						
Mortgages	4,840	1,951	3,658	10,449	682,349	692,798
Homeowner construction	—	—	—	—	24,883	24,883
Consumer:						
Home equity lines	753	207	528	1,488	225,373	226,861
Home equity loans	252	114	250	616	38,713	39,329
Other	129	64	66	259	57,454	57,713
Total loans	$6,607	$3,040	$18,449	$28,096	$2,265,907	$2,294,003

Included in past due loans as of September 30, 2013 and December 31, 2012, were nonaccrual loans of $17.3 million and $21.0 million, respectively. All loans 90 days or more past due at September 30, 2013 and December 31, 2012 were classified as nonaccrual.

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Impaired Loans

Impaired loans are loans for which it is probable that the Corporation will not be able to collect all amounts due according to the contractual terms of the loan agreements and loans restructured in a troubled debt restructuring. Impaired loans do not include large groups of smaller-balance homogeneous loans that are collectively evaluated for impairment, which consist of most residential mortgage loans and consumer loans.

The following is a summary of impaired loans, as of the dates indicated:

(Dollars in thousands)	Recorded Investment (1)		Unpaid Principal		Related Allowance	
	Sep 30, 2013	Dec 31, 2012	Sep 30, 2013	Dec 31, 2012	Sep 30, 2013	Dec 31, 2012
No Related Allowance Recorded:						
Commercial:						
Mortgages	$2,913	$2,357	$6,940	$2,360	$—	$—
Construction and development	—	—	—	—	—	—
Other	1,633	1,058	1,629	1,057	—	—
Residential real estate:						
Mortgages	182	1,294	199	1,315	—	—
Homeowner construction	—	—	—	—	—	—
Consumer:						
Home equity lines	—	—	—	—	—	—
Home equity loans	—	—	—	—	—	—
Other	—	—	—	—	—	—
Subtotal	$4,728	$4,709	$8,768	$4,732	$—	$—
With Related Allowance Recorded:						
Commercial:						
Mortgages	$29,972	$17,897	$31,596	$19,738	$1,110	$1,720
Construction and development	—	—	—	—	—	—
Other	1,196	9,939	1,572	10,690	331	694
Residential real estate:						
Mortgages	3,494	2,576	3,882	2,947	569	463
Homeowner construction	—	—	—	—	—	—
Consumer:						
Home equity lines	173	187	174	255	1	1
Home equity loans	57	117	57	160	—	—
Other	129	137	130	136	2	2
Subtotal	$35,021	$30,853	$37,411	$33,926	$2,013	$2,880
Total impaired loans	$39,749	$35,562	$46,179	$38,658	$2,013	$2,880
Total:						
Commercial	$35,714	$31,251	$41,737	$33,845	$1,441	$2,414
Residential real estate	3,676	3,870	4,081	4,262	569	463
Consumer	359	441	361	551	3	3
Total impaired loans	$39,749	$35,562	$46,179	$38,658	$2,013	$2,880

(1) The recorded investment in impaired loans consists of unpaid principal balance, net of charge-offs, interest payments received applied to principal and unamortized deferred loan origination fees and costs. For impaired accruing loans (troubled debt restructurings for which management has concluded that the collectibility of the loan is not in doubt), the recorded investment also includes accrued interest.

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The following table presents the average recorded investment and interest income recognized on impaired loans segregated by loan class for the periods indicated:

(Dollars in thousands)	Average Recorded Investment		Interest Income Recognized	
Three months ended September 30,	2013	2012	2013	2012
Commercial:				
Mortgages	$29,430	$9,611	$192	$71
Construction and development	—	—	—	—
Other	3,536	10,176	43	73
Residential real estate:				
Mortgages	3,818	4,400	51	21
Homeowner construction	—	—	—	—
Consumer:				
Home equity lines	173	121	2	—
Home equity loans	58	120	1	2
Other	131	144	2	2
Totals	$37,146	$24,572	$291	$169

(Dollars in thousands)	Average Recorded Investment		Interest Income Recognized	
Nine months ended September 30,	2013	2012	2013	2012
Commercial:				
Mortgages	$26,110	$8,795	$444	$176
Construction and development	—	—	—	—
Other	7,159	10,756	157	231
Residential real estate:				
Mortgages	4,104	4,867	100	66
Homeowner construction	—	—	—	—
Consumer:				
Home equity lines	209	167	6	2
Home equity loans	77	138	5	5
Other	146	151	6	7
Totals	$37,805	$24,874	$718	$487

At September 30, 2013, there were no significant commitments to lend additional funds to borrowers whose loans were on nonaccrual status.

Troubled Debt Restructurings

Loans are considered restructured in a troubled debt restructuring when the Corporation has granted concessions to a borrower due to the borrower’s financial condition that it otherwise would not have considered. These concessions may include modifications of the terms of the debt such as deferral of payments, extension of maturity, reduction of principal balance, reduction of the stated interest rate other than normal market rate adjustments, or a combination of these concessions. Debt may be bifurcated with separate terms for each tranche of the restructured debt. Restructuring a loan in lieu of aggressively enforcing the collection of the loan may benefit the Corporation by increasing the ultimate probability of collection.

Restructured loans are classified as accruing or non-accruing based on management’s assessment of the collectibility of the loan. Loans which are already on nonaccrual status at the time of the restructuring generally remain on nonaccrual status for approximately six months before management considers such loans for return to accruing status. Accruing restructured loans

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are placed into nonaccrual status if and when the borrower fails to comply with the restructured terms and management deems it unlikely that the borrower will return to a status of compliance in the near term.

Troubled debt restructurings are reported as such for at least one year from the date of the restructuring. In years after the restructuring, troubled debt restructured loans are removed from this classification if the restructuring did not involve a below market rate concession and the loan is not deemed to be impaired based on the terms specified in the restructuring agreement.

Troubled debt restructurings are classified as impaired loans. The Corporation identifies loss allocations for impaired loans on an individual loan basis. The recorded investment in troubled debt restructurings was $27.2 million and $20.2 million, respectively, at September 30, 2013 and December 31, 2012. These amounts included accrued interest of $44 thousand and $13 thousand, respectively. The allowance for loan losses included specific reserves for these troubled debt restructurings of $381 thousand and $898 thousand, respectively, at September 30, 2013 and December 31, 2012. As of September 30, 2013, there were no significant commitments to lend additional funds to borrowers whose loans had been restructured.

The following tables present loans modified as a troubled debt restructuring during the periods indicated:

(Dollars in thousands)			Outstanding Recorded Investment (1)			
	# of Loans		Pre-Modifications		Post-Modifications	
Three months ended September 30,	2013	2012	2013	2012	2013	2012
Commercial:						
Mortgages	1	2	$6,018	$8,183	$4,909	$8,183
Construction and development	—	—	—	—	—	—
Other	2	—	30	—	30	—
Residential real estate:						
Mortgages	—	—	—	—	—	—
Homeowner construction	—	—	—	—	—	—
Consumer:						
Home equity lines	—	—	—	—	—	—
Home equity loans	—	—	—	—	—	—
Other	—	—	—	—	—	—
Totals	3	2	$6,048	$8,183	$4,939	$8,183

(Dollars in thousands)			Outstanding Recorded Investment (1)			
	# of Loans		Pre-Modifications		Post-Modifications	
Nine months ended September 30,	2013	2012	2013	2012	2013	2012
Commercial:						
Mortgages	6	5	$15,974	$9,044	$14,785	$9,044
Construction and development	—	—	—	—	—	—
Other	7	7	1,198	1,625	1,198	1,625
Residential real estate:						
Mortgages	—	2	—	651	—	651
Homeowner construction	—	—	—	—	—	—
Consumer:						
Home equity lines	1	—	92	—	92	—
Home equity loans	—	—	—	—	—	—
Other	—	2	—	5	—	5
Totals	14	16	$17,264	$11,325	$16,075	$11,325

(1) The recorded investment in troubled debt restructurings consists of unpaid principal balance, net of charge-offs and unamortized deferred

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loan origination fees and costs, at the time of the restructuring. For accruing troubled debt restructured loans, the recorded investment also includes accrued interest.

The following table provides information on how loans were modified as a troubled debt restructuring during the periods indicated.

(Dollars in thousands)	Three months		Nine months	
Periods ended September 30,	2013	2012	2013	2012
Below market interest rate concession	$6,018	$—	$15,836	$1,426
Payment deferral	—	—	—	240
Maturity / amortization concession	21	—	21	917
Interest only payments	9	—	424	361
Combination (1)	—	8,183	983	8,381
Total	$6,048	$8,183	$17,264	$11,325

(1) Loans included in this classification were modified with a combination of any two of the concessions listed in this table.

The following tables present loans modified in a troubled debt restructuring within the previous twelve months for which there was a payment default during the periods indicated:

(Dollars in thousands)	# of Loans		Recorded Investment (1)	
Three months ended September 30,	2013	2012	2013	2012
Commercial:				
Mortgages	1	—	$482	$—
Construction and development	—	—	—	—
Other	—	3	—	428
Residential real estate:				
Mortgages	—	2	—	670
Homeowner construction	—	—	—	—
Consumer:				
Home equity lines	—	—	—	—
Home equity loans	—	—	—	—
Other	—	1	—	13
Totals	1	6	$482	$1,111

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(Dollars in thousands)	# of Loans		Recorded Investment (1)	
Nine months ended September 30,	2013	2012	2013	2012
Commercial:				
Mortgages	1	1	$482	$195
Construction and development	—	—	—	—
Other	—	3	—	428
Residential real estate:				
Mortgages	—	2	—	670
Homeowner construction	—	—	—	—
Consumer:				
Home equity lines	—	—	—	—
Home equity loans	—	—	—	—
Other	—	1	—	13
Totals	1	7	$482	$1,306

(1) The recorded investment in troubled debt restructurings consists of unpaid principal balance, net of charge-offs and unamortized deferred loan origination fees and costs. For accruing troubled debt restructured loans, the recorded investment also includes accrued interest.

Credit Quality Indicators

Commercial

The Corporation utilizes an internal rating system to assign a risk to each of its commercial loans. Loans are rated on a scale of 1 to 10. This scale can be assigned to three broad categories including “pass” for ratings 1 through 6, “special mention” for 7-rated loans, and “classified” for loans rated 8, 9 or 10. The loan rating system takes into consideration parameters including the borrower’s financial condition, the borrower’s performance with respect to loan terms, and the adequacy of collateral. As of September 30, 2013 and December 31, 2012, the weighted average risk rating of the Corporation’s commercial loan portfolio was 4.69 and 4.77, respectively.

For non-impaired loans, the Corporation assigns a loss allocation factor to each loan, based on its risk rating for purposes of establishing an appropriate allowance for loan losses. See Note 6 for additional information.

Descriptions of the commercial loan categories are as follows:

Pass - Loans with acceptable credit quality, defined as ranging from superior or very strong to a status of lesser stature. Superior or very strong credit quality is characterized by a high degree of cash collateralization or strong balance sheet liquidity. Lesser stature loans have an acceptable level of credit quality but exhibit some weakness in various credit metrics such as collateral adequacy, cash flow, or performance inconsistency or may be in an industry or of a loan type known to have a higher degree of risk.

Special Mention - Loans with potential weaknesses that deserve management’s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the Bank’s position as creditor at some future date. Special Mention assets are not adversely classified and do not expose the Bank to sufficient risk to warrant adverse classification. Examples of these conditions include but are not limited to outdated or poor quality financial data, strains on liquidity and leverage, losses or negative trends in operating results, marginal cash flow, weaknesses in occupancy rates or trends in the case of commercial real estate and frequent delinquencies.

Classified - Loans identified as “substandard”, “doubtful” or “loss” based on criteria consistent with guidelines provided by banking regulators. A “substandard” loan has defined weaknesses which make payment default or principal exposure likely, but not yet certain. Such loans are apt to be dependent upon collateral liquidation, a secondary source of repayment or an event outside of the normal course of business. The loans are closely watched and are either already on nonaccrual status or may be placed on nonaccrual status when management determines there is uncertainty of collectibility. A "doubtful" loan is placed on non-accrual status and has a high probability of loss, but the extent of the loss is difficult to quantify due to dependency upon collateral having a value that is difficult to determine or upon some near-term event which lacks certainty. A loan in the "loss" category is considered generally uncollectible or the timing or amount of payments cannot be determined. “Loss” is not intended to imply that the loan has no recovery value but rather it is not practical or desirable to continue to carry the asset.

The Corporation’s procedures call for loan ratings and classifications to be revised whenever information becomes available that indicates a change is warranted. An annual loan review program is conducted by a third party to provide an independent evaluation of the creditworthiness of the commercial loan portfolio, the quality of the underwriting and credit risk management practices and the appropriateness of the risk rating classifications. This review is also supplemented with selected targeted internal reviews of the commercial loan portfolio. The criticized loan portfolio, which consists of commercial and commercial real estate loans that are risk rated special mention or worse, are reviewed by management on a quarterly basis, focusing on the current status and strategies to improve the credit.

The following table presents the commercial loan portfolio, segregated by category of credit quality indicator:

(Dollars in thousands)	Pass		Special Mention		Classified	
	Sep 30, 2013	Dec 31, 2012	Sep 30, 2013	Dec 31, 2012	Sep 30, 2013	Dec 31, 2012
Mortgages	$685,924	$669,220	$23,753	$21,649	$17,698	$19,944
Construction and development	51,951	27,842	—	—	—	—
Other	498,231	483,371	16,325	24,393	4,010	6,000
Total commercial loans	$1,236,106	$1,180,433	$40,078	$46,042	$21,708	$25,944

Residential and Consumer

The residential and consumer portfolios are monitored on an ongoing basis by the Corporation using delinquency information and loan type as credit quality indicators. These credit quality indicators are assessed on an aggregate basis in these relatively homogeneous portfolios.

For non-impaired loans, the Corporation assigns loss allocation factors to each respective loan type and delinquency status. See Note 6 for additional information.

Various other techniques are utilized to monitor indicators of credit deterioration in the portfolios of residential real estate mortgages and home equity lines and loans. Among these techniques is the periodic tracking of loans with an updated FICO score and an estimated loan to value (“LTV”) ratio. LTV is determined via statistical modeling analyses. The indicated LTV levels are estimated based on such factors as the location, the original LTV, and the date of origination of the loan and do not reflect actual appraisal amounts. The results of these analyses are taken into consideration in the determination of loss allocation factors for residential mortgage and home equity consumer credits. See Note 6 for additional information.

The following table presents the residential and consumer loan portfolios, segregated by category of credit quality indicator:

(Dollars in thousands)	Under 90 Days Past Due		Over 90 Days Past Due	
	Sep 30, 2013	Dec 31, 2012	Sep 30, 2013	Dec 31, 2012
Residential Real Estate:				
Accruing mortgages	$703,332	$686,640	$—	$—
Nonaccrual mortgages	3,252	2,500	4,843	3,658
Homeowner construction	20,265	24,883	—	—
Total residential real estate loans	$726,849	$714,023	$4,843	$3,658
Consumer:				

Home equity lines	$226,801	$226,333	$262	$528
Home equity loans	40,742	39,078	416	251
Other	55,946	57,648	15	65
Total consumer loans	$323,489	$323,059	$693	$844

(6) Allowance for Loan Losses

The allowance for loan losses is management's best estimate of inherent risk of loss in the loan portfolio as of the balance sheet date. The allowance is increased by provisions charged to earnings and by recoveries of amounts previously charged off, and is reduced by charge-offs on loans. The Corporation uses a methodology to systematically measure the amount of estimated loan loss exposure inherent in the loan portfolio for purposes of establishing a sufficient allowance for loan losses. The methodology includes three elements: (1) identification of loss allocations for individual loans deemed to be impaired, (2) loss allocation factors for non-impaired loans based on credit grade, loss experience, delinquency factors and other similar economic indicators, and (3) general loss allocations for other environmental factors, which is classified as "unallocated."

Periodic assessments and revisions to the loss allocation factors used in the assignment of loss exposure are made to appropriately reflect the analysis of migrational loss experience. The Corporation analyzes historical loss experience in the various portfolios over periods deemed to be relevant to the inherent risk of loss in the respective portfolios as of the balance sheet date. The Corporation adjusts the loss allocations for various factors it believes are not adequately presented in historical loss experience, including trends in real estate values, trends in rental rates on commercial real estate, consideration of general economic conditions and our assessments of credit risk associated with certain industries and an ongoing trend toward larger credit relationships. These factors are also evaluated taking into account the geographic location of the underlying loans. Revisions to loss allocation factors are not retroactively applied.

Loss allocations for loans deemed to be impaired are measured on a discounted cash flow method based upon the loan's contractual effective interest rate, or at the loan's observable market price, or, if the loan is collateral dependent, at the fair value of the collateral less costs to sell. For collateral dependent loans, management may adjust appraised values to reflect estimated market value declines or apply other discounts to appraised values for unobservable factors resulting from its knowledge of circumstances associated with the property.

Loss allocation factors are used for non-impaired loans based on credit grade, loss experience, delinquency factors and other similar credit quality indicators. Individual commercial loans and commercial mortgage loans not deemed to be impaired are evaluated using the internal rating system described in Note 5 under the caption "Credit Quality Indicators" and the application of loss allocation factors. The loan rating system and the related loss allocation factors take into consideration parameters including the borrower's financial condition, the borrower's performance with respect to loan terms, and the adequacy of collateral. Portfolios of more homogeneous populations of loans including the various categories of residential mortgages and consumer loans are analyzed as groups, taking into account delinquency ratios and other indicators and our historical loss experience for each type of credit product.

An additional unallocated allowance is maintained to allow for measurement imprecision attributable to uncertainty in the economic environment and ever changing conditions and to reflect management's consideration of qualitative and quantitative assessments of other environmental factors, including, but not limited to, conditions that may affect the collateral position such as environmental matters, regulatory changes affecting the foreclosure process, as well as conditions that may affect the ability of borrowers to meet debt service requirements.

Because the methodology is based upon historical experience and trends, current economic data as well as management's judgment, factors may arise that result in different estimations. Significant factors that could give rise to changes in these estimates may include, but are not limited to, changes in economic conditions in our market area, concentration of risk and declines in local property values. Adversely different conditions or assumptions could lead to increases in the allowance. In addition, various regulatory agencies periodically review the allowance for loan losses. Such agencies may require additions to the allowance based on their judgments about information available to them at the time of their examination.

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WASHINGTON TRUST BANCORP, INC. AND SUBSIDIARIES
CONDENSED NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following tables present the activity in the allowance for loan losses for the periods presented:
For the three months ended September 30, 2013:

(Dollars in thousands)	Commercial Mortgages	Construction	Other	Total Commercial	Residential	Consumer	Un-allocated	Total
Beginning Balance	$6,748	$277	$5,442	$12,467	$4,691	$2,455	$8,271	$27,884
Charge-offs	(640)	—	(81)	(721)	—	(49)		(770)
Recoveries	38	—	83	121	—	73		194
Provision	493	164	126	783	(11)	16	(88)	700
Ending Balance	$6,639	$441	$5,570	$12,650	$4,680	$2,495	$8,183	$28,008

For the three months ended September 30, 2012:

(Dollars in thousands)	Commercial Mortgages	Construction	Other	Total Commercial	Residential	Consumer	Un-allocated	Total
Beginning Balance	$8,945	$164	$6,239	$15,348	$4,713	$2,381	$8,006	$30,448
Charge-offs	(258)	—	(15)	(273)	(65)	(86)		(424)
Recoveries	46	—	37	83	24	21		128
Provision	520	54	245	819	(408)	323	(134)	600
Ending Balance	$9,253	$218	$6,506	$15,977	$4,264	$2,639	$7,872	$30,752

For the nine months ended September 30, 2013:

(Dollars in thousands)	Commercial Mortgages	Construction	Other	Total Commercial	Residential	Consumer	Un-allocated	Total
Beginning Balance	$9,407	$224	$5,996	$15,627	$4,269	$2,684	$8,293	$30,873
Charge-offs	(4,754)	—	(259)	(5,013)	(48)	(258)		(5,319)
Recoveries	230	—	127	357	3	94		454
Provision	1,756	217	(294)	1,679	456	(25)	(110)	2,000
Ending Balance	$6,639	$441	$5,570	$12,650	$4,680	$2,495	$8,183	$28,008

For the nine months ended September 30, 2012:

(Dollars in thousands)	Commercial Mortgages	Construction	Other	Total Commercial	Residential	Consumer	Un-allocated	Total
Beginning Balance	$8,195	$95	$6,200	$14,490	$4,694	$2,452	$8,166	$29,802
Charge-offs	(267)	—	(925)	(1,192)	(315)	(294)		(1,801)
Recoveries	436	—	74	510	97	44		651
Provision	889	123	1,157	2,169	(212)	437	(294)	2,100
Ending Balance	$9,253	$218	$6,506	$15,977	$4,264	$2,639	$7,872	$30,752

WASHINGTON TRUST BANCORP, INC. AND SUBSIDIARIES
CONDENSED NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table presents the Corporation's loan portfolio and associated allowance for loan loss by portfolio segment and by impairment methodology.

(Dollars in thousands)	September 30, 2013		December 31, 2012	
	Loans	Related Allowance	Loans	Related Allowance
Loans Individually Evaluated for Impairment:				
Commercial:				
Mortgages	$32,849	$1,110	$20,250	$1,720
Construction & development	—	—	—	—
Other	2,822	331	10,989	694
Residential real estate mortgages	3,674	569	3,868	463
Consumer	359	3	440	3
Subtotal	$39,704	$2,013	$35,547	$2,880
Loans Collectively Evaluated for Impairment:				
Commercial:				
Mortgages	$694,526	$5,529	$690,563	$7,687
Construction & development	51,951	441	27,842	224
Other	515,744	5,239	502,775	5,302
Residential real estate mortgages	728,018	4,111	713,813	3,806
Consumer	323,823	2,492	323,463	2,681
Subtotal	$2,314,062	$17,812	$2,258,456	$19,700
Unallocated	—	8,183	—	8,293
Total	$2,353,766	$28,008	$2,294,003	$30,873

WASHINGTON TRUST BANCORP, INC. AND SUBSIDIARIES
CONDENSED NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(7) Time Certificates of Deposit

Scheduled maturities and weighted average interest rates paid on time certificates of deposit outstanding at September 30, 2013 were as follows:

(Dollars in thousands)	Scheduled Maturity	Weighted Average Rate	
October 1, 2013 through December 31, 2013	$257,253	0.62	%
2014	268,853	1.18	%
2015	136,786	1.89	%
2016	82,690	1.62	%
2017	39,730	1.57	%
Thereafter	31,798	1.28	%
	$817,110		

The following table represents the amount of certificates of deposit of $100 thousand or more at September 30, 2013 maturing during the periods indicated:

(Dollars in thousands)	Scheduled Maturity
October 1, 2013 to December 31, 2013	$185,221
January 1, 2014 to March 31, 2014	36,355
April 1, 2014 to September 30, 2014	42,703
October 1, 2014 and beyond	119,867
	$384,146

(8) Borrowings

Federal Home Loan Bank Advances

Advances payable to the FHLBB amounted to $288.5 million and $361.2 million, respectively, at September 30, 2013 and December 31, 2012. The Bank also has access to an unused line of credit with the FHLBB amounting to $8.0 million. In addition, the FHLBB has issued standby letters of credit to depositor customers of the Bank to collateralize public deposits. The Bank’s FHLBB borrowings, line of credit and letters of credit are collateralized by a blanket pledge agreement on the Bank’s FHLBB stock, certain qualified investment securities and loans, as well as amounts maintained on deposit at the FHLBB. The Bank’s unused remaining available borrowing capacity at the FHLBB was approximately $604.7 million and $536.2 million, respectively, at September 30, 2013 and December 31, 2012.

The following table presents maturities and weighted average interest rates paid on FHLBB advances outstanding as of the dates indicated:

(Dollars in thousands)	September 30, 2013				December 31, 2012			
	Scheduled Maturity	Redeemed at Call Date (1)	Weighted Average Rate (2)		Scheduled Maturity	Redeemed at Call Date (1)	Weighted Average Rate (2)	
2013	$403	$403	5.01	%	$48,630	$48,630	0.81	%
2014	2,519	2,519	3.54	%	2,519	2,519	3.54	%
2015	1,569	1,569	4.89	%	79,069	79,069	3.63	%
2016	85,066	85,066	3.05	%	85,066	85,066	3.05	%
2017	70,875	70,875	3.04	%	80,335	80,335	2.94	%
2018 and thereafter	128,053	128,053	3.88	%	65,553	65,553	4.58	%
	$288,485	$288,485	3.43	%	$361,172	$361,172	3.13	%

(1) Callable FHLBB advances are shown in the respective periods assuming that the callable debt is redeemed at the call date while all other advances are shown in the periods corresponding to their scheduled maturity date.

(2) Weighted average rate based on scheduled maturity dates.

WASHINGTON TRUST BANCORP, INC. AND SUBSIDIARIES
CONDENSED NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Redemption of Certain Trust Preferred Securities and Related Junior Subordinated Debentures
The Bancorp is the sponsor of the Washington Preferred Capital Trust, a statutory trust created for the sole purpose of the April 7, 2008 issuance of trust preferred securities, the proceeds of which were invested in junior subordinated debentures of the Bancorp. On June 17, 2013, the Bancorp redeemed in whole at par the outstanding trust preferred securities and related subordinated debentures totaling $10.0 million in trust preferred securities at an interest rate of three-month LIBOR plus 3.50%. The source of funds used for the redemption was made available from our balance sheet liquidity. The Bancorp also had a related interest rate swap contract designated as a cash flow hedge, which matured at redemption on June 17, 2013. As a result of the redemption, unamortized debit issuance costs of $244 thousand were expensed and classified as interest expense in June 2013.

(9) Shareholders' Equity
Regulatory Capital Requirements
The following table presents the Corporation's and the Bank's actual capital amounts and ratios as well as the corresponding minimum and well capitalized regulatory amounts and ratios:

(Dollars in thousands)	Actual			For Capital Adequacy Purposes			To Be "Well Capitalized" Under Prompt Corrective Action Provisions		
	Amount	Ratio		Amount	Ratio		Amount	Ratio	
September 30, 2013									
Total Capital (to Risk-Weighted Assets):									
Corporation	$313,239	13.44	%	$186,384	8.00	%	$232,980	10.00	%
Bank	$308,816	13.27	%	$186,227	8.00	%	$232,784	10.00	%
Tier 1 Capital (to Risk-Weighted Assets):									
Corporation	$284,935	12.23	%	$93,192	4.00	%	$139,788	6.00	%
Bank	$280,512	12.05	%	$93,114	4.00	%	$139,670	6.00	%
Tier 1 Capital (to Average Assets): (1)									
Corporation	$284,935	9.41	%	$121,182	4.00	%	$151,478	5.00	%
Bank	$280,512	9.27	%	$121,013	4.00	%	$151,267	5.00	%
December 31, 2012									
Total Capital (to Risk-Weighted Assets):									
Corporation	$304,716	13.26	%	$183,876	8.00	%	$229,845	10.00	%
Bank	$299,503	13.05	%	$183,651	8.00	%	$229,564	10.00	%
Tier 1 Capital (to Risk-Weighted Assets):									
Corporation	$275,956	12.01	%	$91,938	4.00	%	$137,907	6.00	%
Bank	$270,778	11.80	%	$91,826	4.00	%	$137,738	6.00	%
Tier 1 Capital (to Average Assets): (1)									
Corporation	$275,956	9.30	%	$118,733	4.00	%	$148,417	5.00	%
Bank	$270,778	9.14	%	$118,535	4.00	%	$148,169	5.00	%

(1) Leverage ratio

(10) Derivative Financial Instruments
The Corporation's derivative financial instruments are used to manage differences in the amount, timing, and duration of the Corporation's known or expected cash receipts and its known or expected cash payments principally to manage the Corporation's interest rate risk. Additionally, the Corporation enters into interest rate derivatives to accommodate

the business requirements of its customers. All derivatives are recognized as either assets or liabilities on the balance sheet and are measured at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative and resulting designation.

Interest Rate Risk Management Agreements

Interest rate swaps are used from time to time as part of the Corporation's interest rate risk management strategy. Swaps are agreements in which the Corporation and another party agree to exchange interest payments (e.g., fixed-rate for variable-rate payments) computed on a notional principal amount. The credit risk associated with swap transactions is the risk of default by the counterparty. To minimize this risk, the Corporation enters into interest rate agreements only with highly rated counterparties that management believes to be creditworthy. The notional amounts of these agreements do not represent amounts exchanged by the parties and, thus, are not a measure of the potential loss exposure.

Cash Flow Hedging Instruments

As of September 30, 2013, the Bancorp had two interest rate swap contracts designated as cash flow hedges to hedge the interest rate associated with $23 million of variable rate junior subordinated debentures, compared to three interest rate swap contracts designated as cash flow hedges to hedge the interest rate associated with $33 million of variable rate junior subordinated debentures as of December 31, 2012. See additional disclosure in Note 8 regarding the June 2013 redemption of junior subordinated debentures. The effective portion of the changes in fair value of derivatives designated as cash flow hedges is recorded in other comprehensive income and subsequently reclassified to earnings when gains or losses are realized. The ineffective portion of changes in fair value of the derivatives is recognized directly in earnings as interest expense. The Bancorp has pledged collateral to derivative counterparties in the form of cash totaling $1.7 million at September 30, 2013 and $2.0 million at December 31, 2012. The Bancorp may need to post additional collateral in the future in proportion to potential increases in unrealized loss positions.

Customer Related Derivative Contracts

The Corporation has entered into interest rate swap contracts to help commercial loan borrowers manage their interest rate risk. The interest rate swap contracts with commercial loan borrowers allow them to convert floating rate loan payments to fixed-rate loan payments. When we enter into an interest rate swap contract with a commercial loan borrower, we simultaneously enter into a “mirror” swap contract with a third party. The third party exchanges the client’s fixed-rate loan payments for floating rate loan payments. We retain the risk that is associated with the potential failure of counterparties and the risk inherent in making loans. As of September 30, 2013 and December 31, 2012, Washington Trust had interest rate swap contracts with commercial loan borrowers with notional amounts of $64.9 million and $70.5 million, respectively, and equal amounts of “mirror” swap contracts with third-party financial institutions. These derivatives are not designated as hedges and therefore, changes in fair value are recognized in earnings.

Loan Commitments

Interest rate lock commitments are extended to borrowers that relate to the origination of residential real estate mortgage loans held for sale. To mitigate the interest rate risk inherent in these rate locks, as well as closed residential real estate mortgage loans held for sale, best efforts forward commitments are established to sell individual residential real estate mortgage loans. Both interest rate lock commitments and commitments to sell fixed-rate residential real estate mortgage loans are derivative financial instruments, but do not meet criteria for hedge accounting and as such are treated as derivatives not designated as hedging instruments. These derivative financial instruments are recorded at fair value and changes in fair value of these commitments are reflected in earnings in the period of change. The Corporation has elected to carry newly originated closed residential real estate mortgage loans held for sale at fair value, as changes in fair value in these loans held for sale generally offset changes in interest rate lock and forward sale commitments.

WASHINGTON TRUST BANCORP, INC. AND SUBSIDIARIES
CONDENSED NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table presents the fair values of derivative instruments in the Corporation's Consolidated Balance Sheets as of the dates indicated:

(Dollars in thousands)	Asset Derivatives			Liability Derivatives		
		Fair Value			Fair Value	
	Balance Sheet Location	Sep 30, 2013	Dec 31, 2012	Balance Sheet Location	Sep 30, 2013	Dec 31, 2012
Derivatives Designated as Cash Flow Hedging Instruments:						
Interest rate risk management contracts:						
Interest rate swap contracts	Other assets	$—	$—	Other liabilities	$1,125	$1,619
Derivatives not Designated as Hedging Instruments:						
Forward loan commitments:						
Commitments to originate fixed-rate mortgage loans to be sold	Other assets	867	2,513	Other liabilities	—	—
Commitments to sell fixed-rate mortgage loans	Other assets	1	—	Other liabilities	1,135	4,191
Customer related derivative contracts:						
Interest rate swaps with customers	Other assets	2,195	3,851	Other liabilities	178	—
Mirror swaps with counterparties	Other assets	210	—	Other liabilities	2,245	3,952
Total		$3,273	$6,364		$4,683	$9,762

The following tables present the effect of derivative instruments in the Corporation's Consolidated Statements of Income and Changes in Shareholders' Equity for the periods indicated:

(Dollars in thousands)	Gain (Loss) Recognized in Other Comprehensive Income (Effective Portion)				Location of Gain (Loss) Recognized in Income (Ineffective Portion and Amount Excluded from Effectiveness Testing)	Gain (Loss) Recognized in Income (Ineffective Portion)			
	Three months		Nine months			Three months		Nine months	
Periods ended September 30,	2013	2012	2013	2012		2013	2012	2013	2012
Derivatives in Cash Flow Hedging Relationships:									
Interest rate risk management contracts:									
Interest rate swap contracts	$44	($14)	$316	$5	Interest Expense	$—	$—	$—	$—
Total	$44	($14)	$316	$5		$—	$—	$—	$—

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WASHINGTON TRUST BANCORP, INC. AND SUBSIDIARIES
CONDENSED NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Dollars in thousands)		Gain (Loss) Recognized in Income			
	Location of Gain (Loss) Recognized	Three months		Nine months	
Periods ended September 30,	in Income	2013	2012	2013	2012
Derivatives not Designated as Hedging Instruments:					
Forward loan commitments:					
Commitments to originate fixed-rate mortgage loans to be sold	Net gains on loan sales & commissions on loans originated for others	$127	$1,810	($1,646)	$3,009
Commitments to sell fixed-rate mortgage loans	Net gains on loan sales & commissions on loans originated for others	(667)	(2,660)	3,057	(3,965)
Customer related derivative contracts:					
Interest rate swaps with customers	Net gains (losses) on interest rate swaps	306	340	(105)	949
Mirror swaps with counterparties	Net gains (losses) on interest rate swaps	(252)	(277)	330	(862)
Total		($486)	($787)	$1,636	($869)

(11) Fair Value Measurements
The Corporation uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. As of September 30, 2013 and December 31, 2012, securities available for sale, residential real estate mortgage loans held for sale and derivatives were recorded at fair value on a recurring basis. Additionally, from time to time, we may be required to record at fair value other assets on a nonrecurring basis, such as collateral dependent impaired loans, property acquired through foreclosure or repossession and mortgage servicing rights. These nonrecurring fair value adjustments typically involve the application of lower of cost or market accounting or write-downs of individual assets.

Fair value is a market-based measurement, not an entity-specific measurement. Fair value measurements are determined based on the assumptions the market participants would use in pricing the asset or liability. In addition, GAAP specifies a hierarchy of valuation techniques based on whether the types of valuation information (“inputs”) are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Corporation’s market assumptions. These two types of inputs have created the following fair value hierarchy:

- Level 1 – Quoted prices for identical assets or liabilities in active markets.
- Level 2 – Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets.
- Level 3 – Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable in the markets and which reflect the Corporation’s market assumptions.

Determination of Fair Value
Fair values are based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When available, the Corporation uses quoted market prices to determine fair value. If quoted prices are not available, fair value is based upon valuation techniques such as matrix pricing or other models that use, where possible, current market-based or independently sourced

market parameters, such as interest rates. If observable market-based inputs are not available, the Corporation uses unobservable inputs to determine appropriate valuation adjustments using methodologies applied consistently over time.

The following is a description of valuation methodologies for assets and liabilities recorded at fair value, including the general classification of such assets and liabilities pursuant to the valuation hierarchy.

Items Measured at Fair Value on a Recurring Basis

Securities

Level 2 securities include debt securities with quoted prices, which are traded less frequently than exchange-traded instruments, whose value is determined using matrix pricing with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes obligations of U.S. government-sponsored enterprises, mortgage-backed securities issued by U.S. government agencies and U.S. government-sponsored enterprises, municipal bonds, trust preferred securities and corporate bonds.

In certain cases where there is limited activity or less transparency around inputs to the valuation, securities may be classified as Level 3. Level 3 securities were comprised of pooled trust preferred debt securities, in the form of collateralized debt obligations, which were not actively traded. In the first quarter of 2013, Washington Trust recognized an other-than-temporary impairment charge on one of its pooled trust preferred debt securities, reducing its carrying value to zero. See Note 4 for additional disclosure regarding pooled trust preferred debt securities. As of September 30, 2013 and December 31, 2012, the Corporation concluded that the low level of activity for its Level 3 pooled trust preferred debt securities continued to indicate that quoted market prices are not indicative of fair value. The Corporation obtained valuations including broker quotes and cash flow scenario analyses prepared by a third party valuation consultant. The cash flow scenarios (Level 3) were given substantially more weight than the broker quotes (Level 2) as management believed that the broker quotes reflected highly limited sales evidenced by an inactive market. The cash flow scenarios were prepared using discounted cash flow methodologies based on detailed cash flow and credit analysis of the security. The weighting was then used to determine an overall fair value. Management believes that this approach is most representative of fair value for such securities in current market conditions.

Our internal review procedures have confirmed that the fair value provided by the aforementioned third party valuation sources utilized by the Corporation are consistent with GAAP. Our fair value assumed liquidation in an orderly market and not under distressed circumstances. Due to the continued market illiquidity and credit risk for securities in the financial sector, the fair value of such securities is highly sensitive to assumption changes and market volatility.

Mortgage Loans Held for Sale
Washington Trust has elected to carry newly originated closed residential real estate mortgage loans held for sale at fair value pursuant to Accounting Standards Codification (“ASC”) 825, “Financial Instruments.” Level 2 mortgage loans held for sale fair values are estimated based on what secondary markets are currently offering for loans with similar characteristics. In certain cases when quoted market prices are not available, fair value is determined by utilizing a discounted cash flow analysis and these assets are classified as Level 3. Any change in the valuation of mortgage loans held for sale is based upon the change in market interest rates between closing the loan and the measurement date and an immaterial portion attributable to changes in instrument-specific credit risk.

The aggregate principal amount of the residential real estate mortgage loans held for sale portfolio was $12.8 million and $48.4 million, respectively, at September 30, 2013 and December 31, 2012. The aggregate fair value of this portfolio as of the same dates was $13.1 million and $50.1 million, respectively. As of September 30, 2013 and December 31, 2012, the aggregate fair value of mortgage loans held for sale exceeded the aggregate principal amount by $333 thousand and $1.7 million, respectively. There were no mortgage loans for sale 90 days or more past due at September 30, 2013 and December 31, 2012.

The following table presents the changes in fair value related to mortgage loans held for sale, commitments to originate fixed-rate residential real estate mortgage loans to be sold and commitments to sell fixed-rate residential real estate mortgage loans for the periods indicated. Changes in fair values are reported as a component of net gains on loan sales and commissions on loans originated for others in the Consolidated Statements of Income.
(Dollars in thousands)

	Three Months		Nine months	
Periods ended September 30,	2013	2012	2013	2012
Mortgage loans held for sale	$606	$850	($1,353)	$956
Commitments to originate	127	1,810	(1,646)	3,009
Commitments to sell	(667)	(2,660)	3,057	(3,965)

Total changes in fair value	$66	$—	$58	$—

Derivatives

Interest rate swap contracts are traded in over-the-counter markets where quoted market prices are not readily available. Fair value measurements are determined using independent pricing models that utilize primarily market observable inputs, such as swap rates of different maturities and LIBOR rates and, accordingly, are classified as Level 2. Our internal review procedures have confirmed that the fair values determined with independent pricing models and utilized by the Corporation are consistent with GAAP. For purposes of potential valuation adjustments to its interest rate swap contracts, the Corporation evaluates the credit risk of its counterparties as well as that of the Corporation. Accordingly, Washington Trust considers factors such as the likelihood of default by the Corporation and its counterparties, its net exposures and remaining contractual life, among other factors, in determining if any fair value adjustments related to credit risk are required. Counterparty exposure is evaluated by netting positions that are subject to master netting agreements, as well as considering the amount of collateral securing the position. Additionally, in accordance with fair value measurement guidance in ASU 2011-04, Washington Trust has made an accounting policy election to measure the credit risk of its derivative financial instruments that are subject to master netting agreements on a net basis by counterparty portfolio.

Level 2 fair value measurements of forward loan commitments (interest rate lock commitments and commitments to sell fixed-rate residential mortgages) are estimated using the anticipated market price based on pricing indications provided from syndicate banks. In certain cases when quoted market prices are not available, fair value is determined by utilizing a discounted cash flow analysis and these assets are classified as Level 3.

Items Measured at Fair Value on a Nonrecurring Basis
Collateral Dependent Impaired Loans
Collateral dependent loans that are deemed to be impaired are valued based upon the fair value of the underlying collateral less costs to sell. Such collateral primarily consists of real estate and, to a lesser extent, other business assets. Management may adjust appraised values to reflect estimated market value declines or apply other discounts to appraised values resulting from its knowledge of the property. Internal valuations are utilized to determine the fair value of other business assets. Collateral dependent impaired loans are categorized as Level 3.

Property Acquired Through Foreclosure or Repossession
Property acquired through foreclosure or repossession included in other assets in the Consolidated Balance Sheets is adjusted to fair value less costs to sell upon transfer out of loans through a charge to allowance for loan losses. Subsequently, it is carried at the lower of carrying value or fair value less costs to sell. Such subsequent valuation charges are charged through earnings. Fair value is generally based upon appraised values of the collateral. Management adjusts appraised values to reflect estimated market value declines or apply other discounts to appraised values for unobservable factors resulting from its knowledge of the property, and such property is categorized as Level 3.

WASHINGTON TRUST BANCORP, INC. AND SUBSIDIARIES
CONDENSED NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Items Recorded at Fair Value on a Recurring Basis
The tables below present the balances of assets and liabilities reported at fair value on a recurring basis:
(Dollars in thousands)

	Fair Value Measurements Using			Assets/Liabilities at Fair Value
September 30, 2013	Level 1	Level 2	Level 3	
Assets:				
Securities available for sale:				
Obligations of U.S. government-sponsored enterprises	$—	$55,669	$—	$55,669
Mortgage-backed securities issued by U.S. government agencies and U.S. government-sponsored enterprises	—	228,505	—	228,505
States and political subdivisions	—	67,340	—	67,340
Trust preferred securities:				
Individual name issuers	—	24,775	—	24,775
Collateralized debt obligations	—	—	425	425
Corporate bonds	—	11,371	—	11,371
Mortgage loans held for sale	—	13,105	—	13,105
Derivative assets (1):				
Interest rate swap contracts with customers	—	2,405	—	2,405
Forward loan commitments	—	868	—	868
Total assets at fair value on a recurring basis	$—	$404,038	$425	$404,463
Liabilities:				
Derivative liabilities (1):				
Mirror swap contracts with customers	$—	$2,423	$—	$2,423
Interest rate risk management swap contracts	—	1,125	—	1,125
Forward loan commitments	—	1,135	—	1,135
Total liabilities at fair value on a recurring basis	$—	$4,683	$—	$4,683

(1) Derivative assets are included in other assets and derivative liabilities are reported in other liabilities in the Consolidated Balance Sheets.

WASHINGTON TRUST BANCORP, INC. AND SUBSIDIARIES
CONDENSED NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Dollars in thousands)

	Fair Value Measurements Using			Assets/Liabilities at Fair Value
December 31, 2012	Level 1	Level 2	Level 3	
Assets:				
Securities available for sale:				
Obligations of U.S. government-sponsored enterprises	$—	$31,670	$—	$31,670
Mortgage-backed securities issued by U.S. government agencies and U.S. government-sponsored enterprises	—	231,233	—	231,233
States and political subdivisions	—	72,620	—	72,620
Trust preferred securities:				
Individual name issuers	—	24,751	—	24,751
Collateralized debt obligations	—	—	843	843
Corporate bonds	—	14,381	—	14,381
Mortgage loans held for sale	—	40,243	9,813	50,056
Derivative assets (1):				
Interest rate swap contracts with customers	—	3,851	—	3,851
Forward loan commitments	—	2,469	44	2,513
Total assets at fair value on a recurring basis	$—	$421,218	$10,700	$431,918
Liabilities:				
Derivative liabilities (1):				
Mirror swap contracts with customers	$—	$3,952	$—	$3,952
Interest rate risk management swap contracts	—	1,619	—	1,619
Forward loan commitments	—	4,005	186	4,191
Total liabilities at fair value on a recurring basis	$—	$9,576	$186	$9,762

(1) Derivative assets are included in other assets and derivative liabilities are reported in other liabilities in the Consolidated Balance Sheets.

It is the Corporation’s policy to review and reflect transfers between Levels as of the financial statement reporting date. During the nine months ended September 30, 2013 and 2012, there were no transfers in and/or out of Level 1, 2 or 3.

WASHINGTON TRUST BANCORP, INC. AND SUBSIDIARIES
CONDENSED NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following tables present the changes in Level 3 assets and liabilities measured at fair value on a recurring basis during the periods indicated:

Three months ended September 30,	2013	2012			
(Dollars in thousands)	Securities Available for Sale (1)	Securities Available for Sale (1)	Mortgage Loans Held for Sale (2)	Derivative Assets / (Liabilities) (3)	Total
Balance at beginning of period	$397	$767	—	$—	$767
Gains and losses (realized and unrealized):					
Included in earnings (4)	—	—	55	(55)	—
Included in other comprehensive income	28	163	—	—	163
Purchases	—	—	—	—	—
Issuances	—	—	4,178	—	4,178
Sales	—	—	—	—	—
Settlements	—	—	—	—	—
Transfers into Level 3	—	—	—	—	—
Transfers out of Level 3	—	—	—	—	—
Balance at end of period	$425	$930	$4,233	($55)	$5,108

Nine months ended September 30,	2013				2012			
(Dollars in thousands)	Securities Available for Sale (1)	Mortgage Loans Held for Sale (2)	Derivative Assets / (Liabilities) (3)	Total	Securities Available for Sale (1)	Mortgage Loans Held for Sale (2)	Derivative Assets / (Liabilities) (3)	Total
Balance at beginning of period	$843	$9,813	($142)	$10,514	$887	—	$—	$887
Gains and losses (realized and unrealized):								
Included in earnings (4)	(2,772)	(150)	142	(2,780)	(209)	—	—	(209)
Included in other comprehensive income	2,487	—	—	2,487	252	—	—	252
Purchases	—	—	—	—	—	—	—	—
Issuances	—	12,692	—	12,692	—	4,233	(55)	4,178
Sales	—	(22,355)	—	(22,355)	—	—	—	—
Settlements	(133)	—	—	(133)	—	—	—	—
Transfers into Level 3	—	—	—	—	—	—	—	—
Transfers out of Level 3	—	—	—	—	—	—	—	—
Balance at end of period	$425	$—	$—	$425	$930	4,233	($55)	$5,108

(1) During the periods indicated, Level 3 securities available for sale were comprised of pooled trust preferred debt securities in the form of collateralized debt obligations.

(2) During the periods indicated, Level 3 mortgage loans held for sale consisted of certain mortgage loans whose fair value was determined utilizing a discounted cash flow analysis.

(3) During the periods indicated, Level 3 derivative assets / liabilities consisted of forward loan commitments (interest rate lock commitments and commitments to sell fixed-rate residential real estate mortgages) whose fair value was determined utilizing a discounted cash flow analysis.

(4) Losses included in earnings for Level 3 securities available for sale were included in net impairment losses recognized in earnings in the Consolidated Income Statement. Losses included in earnings for Level 3 mortgage

loans held for sale and derivative assets and liabilities were included in net gains on loan sales and commissions on loans originated for others in the Consolidated Statements of Income.

WASHINGTON TRUST BANCORP, INC. AND SUBSIDIARIES
CONDENSED NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following tables present additional quantitative information about assets measured at fair value on a recurring basis for which the Corporation has utilized Level 3 inputs to determine fair value as of the dates indicated.

(Dollars in thousands)	September 30, 2013			
	Fair Value	Valuation Technique	Unobservable Input	Range of Inputs Utilized (Weighted Average)
Trust preferred securities:				
Collateralized debt obligations	$425	Discounted Cash Flow	Discount Rate	17.00%
			Cumulative Default %	2.9% - 100% (18.2%)
			Loss Given Default %	85% - 100% (91.4%)

(Dollars in thousands)	December 31, 2012			
	Fair Value	Valuation Technique	Unobservable Input	Range of Inputs Utilized (Weighted Average)
Trust preferred securities:				
Collateralized debt obligations	$843	Discounted Cash Flow	Discount Rate	16.75%
			Cumulative Default %	3.3% - 100% (25.7%)
			Loss Given Default %	85% - 100% (90.9%)
Mortgage loans held for sale	$9,813	Discounted Cash Flow	Interest Rate	2.875% - 4.95% (3.71%)
			Credit Risk Adjustment	0.25%
Forward loan commitments - assets	$44	Discounted Cash Flow	Interest Rate	3.25% - 3.875% (3.56%)
			Credit Risk Adjustment	0.25%
Forward loan commitments - liabilities	($186)	Discounted Cash Flow	Interest Rate	3.25% - 3.875% (3.69%)
			Credit Risk Adjustment	0.25%

Trust Preferred Debt Securities in the Form of Collateralized Debt Obligations
Given the low level of market activity for trust preferred securities in the form of collateralized debt obligations, the discount rate utilized in the fair value measurement was derived by analyzing current market yields for trust preferred securities of individual name issuers in the financial services industry. Adjustments were then made for credit and structural differences between these types of securities. There is an inverse correlation between the discount rate and the fair value measurement. When the discount rate increases, the fair value decreases.

Other significant unobservable inputs to the fair value measurement of collateralized debt obligations included prospective defaults and recoveries. The cumulative default percentage represents the lifetime defaults assumed, excluding currently defaulted collateral and including all performing and currently deferring collateral. As a result, the cumulative default percentage also reflects assumptions of the possibility of currently deferring collateral curing and becoming current. The loss given default percentage represents the percentage of current and projected defaults assumed to be lost. There is an inverse correlation between the cumulative default and loss given default percentages and the fair value measurement. When the default percentages increase, the fair value decreases.

Mortgage Loans Held for Sale and Derivative Assets / Liabilities
Significant unobservable inputs to the fair market value measurement for certain mortgage loans held for sale and certain forward loan commitments include interest rate and credit risk. Interest rates approximate the Corporation's current origination rates for similar loans. Credit risk approximates the Corporation's current loss exposure factor for

similar loans.

WASHINGTON TRUST BANCORP, INC. AND SUBSIDIARIES
CONDENSED NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Items Recorded at Fair Value on a Nonrecurring Basis
Certain assets are measured at fair value on a nonrecurring basis in accordance with GAAP. These adjustments to fair value usually result from the application of lower of cost or market accounting or write-downs of individual assets. The valuation methodologies used to measure these fair value adjustments are described above.

The following tables present the carrying value of certain assets measured at fair value on a nonrecurring basis as of the dates indicated:

(Dollars in thousands)	September 30, 2013			
	Level 1	Level 2	Level 3	Total
Collateral dependent impaired loans	$—	$—	$12,475	$12,475
Property acquired through foreclosure or repossession	—	—	416	416
Total assets at fair value on a nonrecurring basis	$—	$—	$12,891	$12,891

The allowance for loan losses on collateral dependent impaired loans amounted to $633 thousand at September 30, 2013.

(Dollars in thousands)	December 31, 2012			
	Level 1	Level 2	Level 3	Total
Collateral dependent impaired loans	$—	$—	$9,550	$9,550
Property acquired through foreclosure or repossession	—	—	1,073	1,073
Total assets at fair value on a nonrecurring basis	$—	$—	$10,623	$10,623

The allowance for loan losses allocation on collateral dependent impaired loans amounted to $2.0 million at December 31, 2012.

The following tables present additional quantitative information about assets measured at fair value on a nonrecurring basis for which the Corporation has utilized Level 3 inputs to determine fair value for the dates indicated.

(Dollars in thousands)	September 30, 2013			
	Fair Value	Valuation Technique	Unobservable Input	Range of Inputs Utilized (Weighted Average)
Collateral dependent impaired loans	$12,475	Appraisals of collateral	Discount for costs to sell	1% - 25% (10%)
			Appraisal adjustments (1)	0% - 45% (2%)
Property acquired through foreclosure or repossession	$416	Appraisals of collateral	Discount for costs to sell	2% - 10% (9%)
			Appraisal adjustments (1)	6% - 22% (13%)

(Dollars in thousands)	December 31, 2012			
	Fair Value	Valuation Technique	Unobservable Input	Range of Inputs Utilized (Weighted Average)
Collateral dependent impaired loans	$9,550	Appraisals of collateral	Discount for costs to sell	0% - 50% (11%)
			Appraisal adjustments (1)	0% - 27% (18%)
Property acquired through foreclosure or repossession	$1,073	Appraisals of collateral	Discount for costs to sell	0% - 10% (5%)
			Appraisal adjustments (1)	15% - 34% (21%)

(1) Management may adjust appraisal values to reflect market value declines or other discounts resulting from its knowledge of the property.

Valuation of Other Financial Instruments

The methodologies for estimating the fair value of financial instruments that are measured at fair value on a recurring or nonrecurring basis are discussed above. The methodologies for other financial instruments are discussed below.

WASHINGTON TRUST BANCORP, INC. AND SUBSIDIARIES
CONDENSED NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Loans
Fair values are estimated for categories of loans with similar financial characteristics. Loans are segregated by type and are then further segmented into fixed-rate and adjustable rate interest terms to determine their fair value. The fair value of fixed-rate commercial and consumer loans is calculated by discounting scheduled cash flows through the estimated maturity of the loan using interest rates offered at September 30, 2013 and December 31, 2012 that reflect the credit and interest rate risk inherent in the loan. The estimate of maturity is based on the Corporation's historical repayment experience. For residential mortgages, fair value is estimated by using quoted market prices for sales of similar loans on the secondary market. The fair value of floating rate commercial and consumer loans approximates carrying value. Fair value for impaired loans is estimated using a discounted cash flow method based upon the loan's contractual effective interest rate, or at the loan's observable market price, or if the loan is collateral dependent, at the fair value of the collateral less costs to sell. Loans are classified within Level 3 of the fair value hierarchy.

Time Deposits
The discounted values of cash flows using the rates currently offered for deposits of similar remaining maturities were used to estimate the fair value of time deposits. Time deposits are classified within Level 2 of the fair value hierarchy.

Federal Home Loan Bank Advances
Rates currently available to the Corporation for advances with similar terms and remaining maturities are used to estimate fair value of existing advances. FHLBB advances are categorized as Level 2.

Junior Subordinated Debentures
The fair value of the junior subordinated debentures is estimated using rates currently available to the Corporation for debentures with similar terms and maturities. Junior subordinated debentures are categorized as Level 2.

The following tables present the carrying amount, estimated fair value and placement in the fair value hierarchy of the Corporation's financial instruments as of September 30, 2013 and December 31, 2012. The tables exclude financial instruments for which the carrying value approximates fair value. Financial assets for which the fair value approximates carrying value include cash and cash equivalents, FHLBB stock, accrued interest receivable and bank-owned life insurance. Financial liabilities for which the fair value approximates carrying value include non-maturity deposits, other borrowings and accrued interest payable.

(Dollars in thousands)			Fair Value Measurements		
September 30, 2013	Carrying Amount	Estimated Fair Value	Level 1	Level 2	Level 3
Financial Assets:					
Securities held to maturity	$31,264	$31,962	$—	$31,962	$—
Loans, net of allowance for loan losses	2,325,758	2,391,266	—	—	2,391,266
Loan servicing rights (1)	2,479	2,609	—	—	2,609
Financial Liabilities:					
Time deposits	$817,110	$824,264	$—	$824,264	$—
FHLBB advances	288,485	310,158	—	310,158	—
Junior subordinated debentures	22,681	15,189	—	15,189	—

(1) The carrying value of loan servicing rights is net of $130 thousand in reserves as of September 30, 2013. The estimated fair value does not include such adjustment.

WASHINGTON TRUST BANCORP, INC. AND SUBSIDIARIES
CONDENSED NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Dollars in thousands)			Fair Value Measurements		
December 31, 2012	Carrying Amount	Estimated Fair Value	Level 1	Level 2	Level 3
Financial Assets:					
Securities held to maturity	$40,381	$41,420	$—	$41,420	$—
Loans, net of allowance for loan losses	2,263,130	2,350,153	—	—	2,350,153
Loan servicing rights (1)	1,110	1,275	—	—	1,275
Financial Liabilities:					
Time deposits	$870,232	$879,705	$—	$879,705	$—
FHLBB advances	361,172	392,805	—	392,805	—
Junior subordinated debentures	32,991	23,371	—	23,371	—

(1) The carrying value of loan servicing rights is net of $165 thousand in reserves as of December 31, 2012. The estimated fair value does not include such adjustment.

(12) Defined Benefit Pension Plans

The Corporation maintains a tax-qualified defined benefit pension plan for the benefit of certain eligible employees who were hired prior to October 1, 2007. The Corporation also has non-qualified retirement plans to provide supplemental retirement benefits to certain employees, as defined in the plans. The supplemental retirement plans provide eligible participants with an additional retirement benefit.

Effective September 19, 2013, the Corporation amended its defined benefit pension plans to freeze benefit accruals after a ten-year transition period ending in December 2023. Due to the amendment, a remeasurement of the value of pension plan liabilities was conducted and, as a result, pension plan liabilities were reduced by $17.5 million and the accumulated other comprehensive income component of shareholders' equity was increased by $11.2 million, after tax. The remeasurement impact also reflected an increase in the discount rates used to measure the present value of pension plan liabilities as a result of an increase in market rates of interest and continued asset performance.

The pension plan is funded on a current basis, in compliance with the requirements of ERISA.

The composition of net periodic benefit cost was as follows for the periods indicated:

(Dollars in thousands)	Qualified Pension Plan				Non-Qualified Retirement Plans			
	Three months		Nine months		Three months		Nine months	
Periods ended September 30,	2013	2012	2013	2012	2013	2012	2013	2012
Service cost	$710	$644	$2,171	$1,931	$48	$38	$147	$113
Interest cost	722	705	2,160	2,117	116	126	346	378
Expected return on plan assets	(931)	(746)	(2,780)	(2,239)	—	—	—	—
Amortization of prior service cost	17	(8)	—	(25)	—	(1)	—	(1)
Recognized net actuarial loss	354	246	1,182	737	47	29	145	88
Curtailment	(61)	—	(61)	—	(2)	—	(2)	—
Net periodic benefit cost	$811	$841	$2,672	$2,521	$209	$192	$636	$578

(13) Share-Based Compensation Arrangements

On April 23, 2013, Bancorp’s shareholders approved the 2013 Stock Option and Incentive Plan (“2013 Plan”). Under the 2013 Plan, the maximum number of shares of the Bancorp’s common stock to be issued is 1,748,250. Under the 2013 Plan, the Corporation is permitted to issue various incentive awards, such as stock options (both incentive and non-qualified options), stock appreciation rights, restricted stock, restricted stock units, unrestricted stock, performance shares, dividend equivalent rights and cash-based awards. The Corporation also has two other share-based compensation plans, the 2003 Stock Incentive

Plan, as amended, and the 1997 Equity Incentive Plan, as amended. See our Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

Nonvested Share Units
During the nine months ended September 30, 2013, the Corporation granted the following nonvested share units to directors.

Date	Units Granted	Fair Value	Plan	Vesting Period
4/23/2013	12,000	$26.79	2013 Plan	3 year cliff vesting

The nonvested share units awarded were valued at the fair market value as of the award date.

Nonvested Performance Shares
During the nine months ended September 30, 2013, the Corporation granted the following performance share award to certain executive officers.

Date	Share Range	Fair Value	Plan	Vesting Period
1/22/2013	0 to 60,300	$26.05	2003 Stock Incentive Plan	3 year performance period

The performance shares awarded were valued at the fair market value as of the award date. The number of shares earned will range from zero to 200% of the target number of shares dependent upon the Corporation's core return on equity and core earnings per share growth ranking compared to an industry peer group. The current assumption based on the most recent peer group information available results in shares earned at 150% of the target, or 45,225 shares.

(14) Business Segments
Washington Trust segregates financial information in assessing its results among its Commercial Banking and Wealth Management Services operating segments. The amounts in the Corporate column include activity not related to the segments, such as the investment securities portfolio, wholesale funding activities and administrative units. The Corporate column is not considered to be an operating segment. The methodologies and organizational hierarchies that define the business segments are periodically reviewed and revised. Results may be restated, when necessary, to reflect changes in organizational structure or allocation methodology. Any changes in estimates and allocations that may affect the reported results of any business segment will not affect the consolidated financial position or results of operations of Washington Trust as a whole.

Management uses certain methodologies to allocate income and expenses to the business lines. A funds transfer pricing methodology is used to assign interest income and interest expense to each interest-earning asset and interest-bearing liability on a matched maturity funding basis. Certain indirect expenses are allocated to segments. These include support unit expenses such as technology and processing operations and other support functions.

Commercial Banking
The Commercial Banking segment includes commercial, commercial real estate, residential and consumer lending activities; equity in losses of unconsolidated investments in real estate limited partnerships, mortgage banking, secondary market and loan servicing activities; deposit generation; merchant credit card services; cash management activities; and direct banking activities, which include the operation of ATMs, telephone and Internet banking services and customer support and sales.

Wealth Management Services
Wealth Management Services includes asset management services provided for individuals, institutions and mutual funds; personal trust services, including services as executor, trustee, administrator, custodian and guardian;

institutional trust services, including services as trustee for pension and profit sharing plans; and other financial planning and advisory services.

Corporate

Corporate includes the Treasury Unit, which is responsible for managing the wholesale investment portfolio and wholesale funding needs. It also includes income from bank-owned life insurance as well as administrative and executive expenses not allocated to the business lines and the residual impact of methodology allocations such as funds transfer pricing offsets.

WASHINGTON TRUST BANCORP, INC. AND SUBSIDIARIES
CONDENSED NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following tables present the statement of operations and total assets for Washington Trust's reportable segments:

(Dollars in thousands)	Commercial Banking		Wealth Management Services		Corporate		Consolidated Total	
Three months ended September 30,	2013	2012	2013	2012	2013	2012	2013	2012
Net interest income (expense)	$20,364	$19,946	($4)	$—	$3,028	$2,790	$23,388	$22,736
Noninterest income	8,302	8,683	7,629	7,193	1,469	1,045	17,400	16,921
Total income	28,666	28,629	7,625	7,193	4,497	3,835	40,788	39,657
Provision for loan losses	700	600	—	—	—	—	700	600
Noninterest expenses:								
Depreciation and amortization expense	614	588	316	325	52	55	982	968
Other noninterest expenses	15,840	16,538	4,944	4,850	3,782	3,934	24,566	25,322
Total noninterest expenses	16,454	17,126	5,260	5,175	3,834	3,989	25,548	26,290
Income before income taxes	11,512	10,903	2,365	2,018	663	(154)	14,540	12,767
Income tax expense (benefit)	3,875	3,751	876	755	(171)	(639)	4,580	3,867
Net income	$7,637	$7,152	$1,489	$1,263	$834	$485	$9,960	$8,900
Total assets at period end	$2,460,150	$2,384,219	$50,297	$51,525	$621,511	$613,124	$3,131,958	$3,048,868
Expenditures for long-lived assets	$277	$935	$39	$72	$25	$53	$341	$1,060

(Dollars in thousands)	Commercial Banking		Wealth Management Services		Corporate		Consolidated Total	
Nine months ended September 30,	2013	2012	2013	2012	2013	2012	2013	2012
Net interest income (expense)	$59,606	$59,126	$5	$1	$8,653	$8,405	$68,264	$67,532
Noninterest income	24,239	22,970	23,015	21,850	(294)	2,507	46,960	47,327
Total income	83,845	82,096	23,020	21,851	8,359	10,912	115,224	114,859
Provision for loan losses	2,000	2,100	—	—	—	—	2,000	2,100
Noninterest expenses:								
Depreciation and amortization	1,876	1,792	968	958	161	175	3,005	2,925

expense								
Other noninterest expenses	47,244	47,162	15,078	14,649	9,410	10,181	71,732	71,992
Total noninterest expenses	49,120	48,954	16,046	15,607	9,571	10,356	74,737	74,917
Income before income taxes	32,725	31,042	6,974	6,244	(1,212)	556	38,487	37,842
Income tax expense (benefit)	11,421	10,665	2,635	2,332	(1,933)	(1,206)	12,123	11,791
Net income	$21,304	$20,377	$4,339	$3,912	$721	$1,762	$26,364	$26,051
Total assets at period end	$2,460,150	$2,384,219	$50,297	$51,525	$621,511	$613,124	$3,131,958	$3,048,868
Expenditures for long-lived assets	$1,014	$3,609	$93	$785	$71	$119	$1,178	$4,513

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WASHINGTON TRUST BANCORP, INC. AND SUBSIDIARIES
CONDENSED NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(15) Other Comprehensive Income (Loss)

The following table presents the activity in other comprehensive income (loss) and the affected line item in the Consolidated Statement of Income for the periods indicated:

Three months ended September 30,	2013			2012		
(Dollars in thousands)	Pre-tax Amounts	Income Taxes	Net of Tax	Pre-tax Amounts	Income Taxes	Net of Tax
Securities available for sale:						
Changes in fair value of securities available for sale	($202)	($73)	($129)	($339)	($121)	($218)
Net losses (gains) on securities reclassified into earnings (1)	—	—	—	—	—	—
Net change in fair value of securities available for sale	(202)	(73)	(129)	(339)	(121)	(218)
Reclassification adjustment for other-than-temporary impairment losses transferred into earnings (2)	—	—	—	—	—	—
Cash flow hedges:						
Change in fair value of cash flow hedges	(72)	(25)	(47)	(198)	(71)	(127)
Net cash flow hedge losses reclassified into earnings (3)	141	50	91	176	63	113
Net change in fair value of cash flow hedges	69	25	44	(22)	(8)	(14)
Defined benefit plan obligation adjustment (4)	17,842	6,402	11,440	266	95	171
Total other comprehensive income (loss)	$17,709	$6,354	$11,355	($95)	($34)	($61)

Nine months ended September 30,	2013			2012		
(Dollars in thousands)	Pre-tax Amounts	Income Taxes	Net of Tax	Pre-tax Amounts	Income Taxes	Net of Tax
Securities available for sale:						
Changes in fair value of securities available for sale	($7,771)	($2,768)	($5,003)	($1,032)	($356)	($676)
Net losses (gains) on securities reclassified into earnings (1)	613	220	393	(214)	(76)	(138)
Net change in fair value of securities available for sale	(7,158)	(2,548)	(4,610)	(1,246)	(432)	(814)
Reclassification adjustment for other-than-temporary impairment losses transferred into earnings (2)	2,159	775	1,384	124	44	80
Cash flow hedges:						
Change in fair value of cash flow hedges	(27)	(12)	(15)	(518)	(187)	(331)
Net cash flow hedge losses reclassified into earnings (3)	515	184	331	523	187	336
Net change in fair value of cash flow hedges	488	172	316	5	—	5
Defined benefit plan obligation adjustment (4)	18,751	6,682	12,069	799	272	527
Total other comprehensive income (loss)	$14,240	$5,081	$9,159	($318)	($116)	($202)

(1) Reported as total other-than-temporary impairment losses on securities in the Consolidated Statement of Income.

(2) Reported as the portion of loss recognized in other comprehensive income in the Consolidated Statement of Income.

(3) Included in interest expense on junior subordinated debentures in the Consolidated Statement of Income.

(4) Included in salaries and employee benefits expense in the Consolidated Statement of Income. See Note 12 and the Annual Report on Form 10-K for fiscal year 2012 for additional information.

WASHINGTON TRUST BANCORP, INC. AND SUBSIDIARIES
CONDENSED NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table presents the changes in accumulated other comprehensive income (loss) by component, net of tax, for the nine months ended September 30, 2013:

(Dollars in thousands)	Net Unrealized Gains on Available For Sale Securities	Noncredit -related Impairment	Net Unrealized Losses on Cash Flow Hedges	Pension Benefit Adjustment	Total
Balance at December 31, 2012	$9,711	($1,938)	($1,006)	($17,266)	($10,499)
Other comprehensive income before reclassifications	(5,003)	—	(15)	—	(5,018)
Amounts reclassified from accumulated other comprehensive income	393	1,384	331	12,069	14,177
Net other comprehensive income (loss)	(4,610)	1,384	316	12,069	9,159
Balance at September 30, 2013	$5,101	($554)	($690)	($5,197)	($1,340)

The following table presents the changes in accumulated other comprehensive income (loss) by component, net of tax, for the nine months ended September 30, 2012:

(Dollars in thousands)	Net Unrealized Gains on Available For Sale Securities	Noncredit -related Impairment	Net Unrealized Losses on Cash Flow Hedges	Pension Benefit Adjustment	Total
Balance at December 31, 2011	$13,143	($2,062)	($1,127)	($11,849)	($1,895)
Net other comprehensive income (loss)	(814)	80	5	527	(202)
Balance at September 30, 2012	$12,329	($1,982)	($1,122)	($11,322)	($2,097)

(16) Earnings Per Common Share

Washington Trust utilizes the two-class method earnings allocation formula to determine earnings per share of each class of stock according to dividends and participation rights in undistributed earnings. Share-based payments that entitle holders to receive non-forfeitable dividends before vesting are considered participating securities and included in earnings allocation for computing basic earnings per share under this method. Undistributed income is allocated to common shareholders and participating securities under the two-class method based upon the proportion of each to the total weighted average shares available.

The calculation of earnings per common share is presented below.
(Dollars and shares in thousands, except per share amounts)

	Three Months		Nine months	
Periods ended September 30,	2013	2012	2013	2012
Net income	$9,960	$8,900	$26,364	$26,051
Less dividends and undistributed earnings allocated to participating securities	(37)	(42)	(115)	(116)
Net income applicable to common shareholders	$9,923	$8,858	$26,249	$25,935
Weighted average basic common shares	16,563	16,366	16,473	16,351
Dilutive effect of common stock equivalents	133	48	127	41
Weighted average diluted common shares	16,696	16,414	16,600	16,392

Earnings per common share:				
Basic	$0.60	$0.54	$1.59	$1.59
Diluted	$0.59	$0.54	$1.58	$1.58

Weighted average common stock equivalents, not included in common stock equivalents above because they were anti-dilutive, were zero and 400 thousand, respectively, for the three months ended September 30, 2013 and 2012. These amounts were 7 thousand and 342 thousand, respectively, for the nine months ended September 30, 2013 and 2012.

(17) Commitments and Contingencies

Financial Instruments with Off-Balance Sheet Risk

The Corporation is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers and to manage the Corporation's exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit, standby letters of credit, interest rate swap agreements and commitments to originate and commitments to sell fixed-rate mortgage loans. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the Corporation's Consolidated Balance Sheets. The contract or notional amounts of these instruments reflect the extent of involvement the Corporation has in particular classes of financial instruments. The Corporation's credit policies with respect to interest rate swap agreements with commercial borrowers, commitments to extend credit, and financial guarantees are similar to those used for loans. The interest rate swaps with other counterparties are generally subject to bilateral collateralization terms.

The contractual and notional amounts of financial instruments with off-balance sheet risk are as follows:

(Dollars in thousands)	Sep 30, 2013	Dec 31, 2012
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit:		
Commercial loans	$253,400	$223,426
Home equity lines	196,281	184,941
Other loans	33,622	30,504
Standby letters of credit	1,361	1,039
Financial instruments whose notional amounts exceed the amount of credit risk:		
Forward loan commitments:		
Commitments to originate fixed-rate mortgage loans to be sold	20,750	67,792
Commitments to sell fixed-rate mortgage loans	33,521	116,162
Customer related derivative contracts:		
Interest rate swaps with customers	64,898	70,493
Mirror swaps with counterparties	64,898	70,493
Interest rate risk management contract:		
Interest rate swap	22,681	32,991

Commitments to Extend Credit

Commitments to extend credit are agreements to lend to a customer as long as there are no violations of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Each borrower's creditworthiness is evaluated on a case-by-case basis. The amount of collateral obtained is based on management's credit evaluation of the borrower.

Standby Letters of Credit

Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. These standby letters of credit are primarily issued to support the financing needs of the Bank's commercial customers. The credit risk involved in issuing standby letters of credit is essentially the same as that involved in extending loan facilities to customers. The collateral supporting those commitments is essentially the same as for other commitments. Most standby letters of credit extend for one year. As of September 30, 2013 and December 31, 2012, the maximum potential amount of undiscounted future payments, not reduced by amounts that may be recovered, totaled $1.4 million and $1.0 million, respectively. At September 30, 2013 and December 31, 2012, there were no liabilities to beneficiaries resulting from standby letters of credit. Fee income on standby letters of credit for the three and nine months ended September 30, 2013 and 2012 was immaterial.

Forward Loan Commitments

Interest rate lock commitments are extended to borrowers that relate to the origination of residential real estate mortgage loans held for sale. To mitigate the interest rate risk inherent in these rate locks, as well as closed residential real estate mortgage loans held for sale, best efforts forward commitments are established to sell individual residential real estate mortgage loans. Both interest rate lock commitments and commitments to sell fixed-rate residential real estate mortgage loans are derivative financial instruments.

Leases

As of September 30, 2013 and December 31, 2012, the Corporation was obligated under various non-cancellable operating leases for properties used as banking offices and other office facilities. Rental expense under the operating leases amounted to $699 thousand and $2.0 million, respectively, for the three and nine months ended September 30, 2013, compared to $690 thousand and $2.1 million, respectively, for the same periods in 2012. Rental expense is recorded as a component of net occupancy expense in the accompanying Consolidated Statements of Income.

As of September 30, 2013, the minimum annual lease payments under the terms of these leases, exclusive of renewal provisions, are as follows:

(Dollars in thousands)	
October 1, 2013 to December 31, 2013	$597
2014	2,431
2015	1,913
2016	1,618
2017	1,450
Thereafter	14,612
Total minimum lease payments	$22,621

Lease expiration date ranges have not changed significantly since December 31, 2012.

Other Contingencies

Litigation

The Corporation is involved in various claims and legal proceedings arising out of the ordinary course of business. Management is of the opinion, based on its review with counsel of the development of such matters to date, that the ultimate disposition of such matters will not materially affect the consolidated financial position or results of operations of the Corporation.

Other

When selling a residential real estate mortgage loan or acting as originating agent on behalf of a third party, Washington Trust generally makes various representations and warranties. The specific representations and warranties depend on the nature of the transaction and the requirements of the buyer. Contractual liability may arise when the representations and warranties are breached. In the event of a breach of these representations and warranties, Washington Trust may be required to either repurchase the residential real estate mortgage loan (generally at unpaid principal balance plus accrued interest) with the identified defects or indemnify ("make-whole") the investor for its losses.

In the case of a repurchase, Washington Trust will bear any subsequent credit loss on the residential real estate mortgage loan. Washington Trust has experienced an insignificant number of repurchase demands over a period of many years. As of September 30, 2013 and December 31, 2012, the unpaid principal balance of loans repurchased due to representation and warranty claims was $683 thousand and $843 thousand, respectively. Washington Trust has recorded a reserve for its exposure to losses from the obligation to repurchase previously sold residential real estate mortgage loans. The reserve balance amounted to $250 thousand at September 30, 2013 and December 31, 2012 and is included in other liabilities in the Consolidated Balance Sheets. Any change in the estimate is recorded in net gains on loan sales and commissions on loans originated for others in the Consolidated Statements of Income.

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the Corporation's consolidated financial statements and notes thereto included in the Annual Report on Form 10-K for the year ended December 31, 2012, and in conjunction with the condensed unaudited consolidated financial statements and notes thereto included in Item 1 of this report. Operating results for the three and nine months ended September 30, 2013 are not necessarily indicative of the results for the full-year ended December 31, 2013 or any future period.

Forward-Looking Statements

This report contains statements that are "forward-looking statements." We may also make written or oral forward-looking statements in other documents we file with the SEC, in our annual reports to shareholders, in press releases and other written materials, and in oral statements made by our officers, directors or employees. You can identify forward-looking statements by the use of the words "believe," "expect," "anticipate," "intend," "estimate," "assume," "outlook," "will," "should," and other expressions that predict or indicate future events and trends and which do not relate to historical matters. You should not rely on forward-looking statements, because they involve known and unknown risks, uncertainties and other factors, some of which are beyond the control of the Corporation. These risks, uncertainties and other factors may cause the actual results, performance or achievements of the Corporation to be materially different from the anticipated future results, performance or achievements expressed or implied by the forward-looking statements.

Some of the factors that might cause these differences include the following: continued weakness in national, regional or international economic conditions or conditions affecting the banking or financial services industries or financial capital markets; volatility and disruption in national and international financial markets; additional government intervention in the U.S. financial system; reductions in net interest income resulting from interest rate volatility as well as changes in the balance and mix of loans and deposits; reductions in the market value of wealth management assets under administration; changes in the value of securities and other assets; reductions in loan demand; changes in loan collectibility, default and charge-off rates; changes in the size and nature of the Corporation's competition; changes in legislation or regulation and accounting principles, policies and guidelines and changes in the assumptions used in making such forward-looking statements. In addition, the factors described under "Risk Factors" in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2012, as updated by our Quarterly Reports on Form 10-Q and other filings submitted to the SEC, may result in these differences. You should carefully review all of these factors and you should be aware that there may be other factors that could cause these differences. These forward-looking statements were based on information, plans and estimates at the date of this report, and we assume no obligation to update any forward-looking statements to reflect changes in underlying assumptions or factors, new information, future events or other changes.

Critical Accounting Policies and Estimates

Accounting policies involving significant judgments, estimates and assumptions by management, which have, or could have, a material impact on the carrying value of certain assets and impact income are considered critical accounting policies. The Corporation considers the following to be its critical accounting policies: allowance for loan losses, review of goodwill and intangible assets for impairment and valuation of investment securities for impairment. There have been no significant changes in the Corporation's critical accounting policies and estimates from those disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

Recently Issued Accounting Pronouncements

See Note 2 to the Unaudited Consolidated Financial Statements for details of recently issued accounting pronouncements and their expected impact on the Corporation's consolidated financial position, results of operations or cash flows.

Overview

Washington Trust offers a comprehensive product line of financial services to individuals and businesses including commercial, residential and consumer lending, retail and commercial deposit products, and wealth management services through its offices in Rhode Island, eastern Massachusetts and Connecticut, its ATM networks, and its Internet website at www.washtrust.com.

Our largest source of operating income is net interest income, the difference between interest earned on loans and securities and interest paid on deposits and other borrowings. In addition, we generate noninterest income from a number of sources, including wealth management services, loan sales and commissions on loans originated for others, merchant credit card processing and deposit services and bank-owned life insurance ("BOLI"). Our principal noninterest expenses include salaries and employee benefits, occupancy and facility-related costs, merchant processing costs, technology and other administrative expenses.

Our financial results are affected by interest rate volatility, changes in economic and market conditions, competitive conditions within our market area and changes in legislation, regulation and/or accounting principles. While the regional economic climate has been improving in recent quarters, uncertainty surrounding future economic growth, consumer confidence, credit availability and corporate earnings remains. Management believes that overall credit quality continues to be affected by weaknesses in national and regional economic conditions, including high unemployment levels, particularly in Rhode Island.

Washington Trust opened its fourth mortgage lending office in March 2012 and a new full-service branch in July 2012. We believe the Corporation's financial strength and stability, capital resources and reputation as the largest independent bank headquartered in Rhode Island, were key factors in the expansion of our retail and mortgage banking business and in delivering solid results in the third quarter of 2013. We will continue to leverage our strong, statewide brand to build market share in Rhode Island whenever possible and bring select business lines to new markets with high-growth potential while remaining steadfast in our commitment to provide superior service. In the first quarter of 2014, Washington Trust plans to open a new full-service branch in Johnston, Rhode Island, in Providence County. This branch will be the Washington Trust's nineteenth branch office and its first in Johnston.

Composition of Earnings

Net income for the third quarter of 2013 amounted to $10.0 million, or 59 cents per diluted share, up from $8.9 million, or 54 cents per diluted share, reported for the third quarter of 2012. Third quarter 2013 net income and earnings per share results were record quarterly highs for Washington Trust. The returns on average equity and average assets for the third quarter of 2013 were 12.82% and 1.29%, respectively, compared to 12.02% and 1.17%, respectively, for the same quarter in 2012.

For the nine months ended September 30, 2013, net income amounted to $26.4 million, or $1.58 per diluted share, compared to $26.1 million, or $1.58 per diluted share, reported for the same period in 2012. The returns on average equity and average assets for the first nine months of 2013 were 11.54% and 1.15%, respectively, compared to 11.95% and 1.15%, respectively, for the same period in 2012.

Results for the first nine months of 2013 reflected solid mortgage banking results (net gains on loan sales and commissions on loans originated for others) and higher wealth management revenues, partially offset by an increase in salaries and employee benefit costs. Also included in the year-to-date results were the following:

- Residential mortgage portfolio loans totaling $48.7 million were sold in September 2013 at a gain of $977 thousand, including $456 thousand attributable to mortgage servicing rights retained. This gain was included in the net gains on loan sales and commissions on loans originated for others line item in the Consolidated Statements of Income.
- Other-than-temporary impairment ("OTTI") charges of $2.8 million in 2013 and $209 thousand in 2012; both of which were recognized in the first quarter of each year.
- Debt prepayment penalty expense of $1.1 million and $2.1 million, respectively, in 2013 and 2012.

Net interest income for the three and nine months ended September 30, 2013 amounted to $23.4 million and $68.3 million, respectively, up by $652 thousand, or 3%, and $732 thousand, or 1%, respectively, from the amounts recognized in the same periods in 2012. The net interest margin (fully taxable equivalent net interest income as a percentage of average interest-earnings assets) was 3.29% for both the three and nine months ended September 30, 2013, compared to 3.28% for each of the same periods in 2012.

The loan loss provision charged to earnings for the three and nine months ended September 30, 2013 amounted to $700 thousand and $2.0 million, respectively. Comparable amounts for the same periods in 2012 were $600 thousand and $2.1 million, respectively. Net charge-offs for the three and nine months ended September 30, 2013 totaled $576 thousand and $4.9 million, respectively, compared to $296 thousand and $1.2 million, respectively, for the same periods a year earlier. The higher level of net charge-offs in 2013 was primarily due to a $4.0 million charge-off recognized in the second quarter on one commercial mortgage loan.

Revenue from wealth management services is our largest source of noninterest income. For the three and nine months ended September 30, 2013, wealth management revenues totaled $7.6 million and $23.0 million, respectively, up by 6% and 5%, respectively, from the same periods in 2012 due to an increase in asset-based wealth management revenues. Wealth management assets under administration totaled $4.60 billion at September 30, 2013, compared to $4.20 billion at December 31, 2012 and $4.24 billion at September 30, 2012, largely reflecting net investment appreciation and income.

Mortgage banking revenues, which are dependent on mortgage origination volume and are sensitive to interest rates and the condition of the housing markets, amounted to $3.9 million and $11.5 million, respectively, for the three and nine months ended

September 30, 2013, up by 11% and 20%, respectively, from the same periods in 2012. Excluding the third quarter 2013 portfolio loan sale mentioned above:

- Mortgage banking revenues for the third quarter of 2013 declined by $598 thousand, or 17%, from the same quarter in 2012. On a year-to-date basis, this revenue source was up by $941 thousand, or 10%, from the same period last year.
- Residential real estate loans sold to the secondary market, including brokered loans, totaled $114.4 million and $399.3 million, respectively, for the three and nine months ended September 30, 2013. Comparable amounts for the same periods in 2012 were $140.5 million and $384.9 million, respectively.
- While the year-to-date level of mortgage banking activity has increased in 2013 compared to 2012, in the latter portion of the second quarter of 2013 mortgage loan refinancing and sales activity began to decline due to an increase in market interest rates.

Noninterest expenses for the three and nine months ended September 30, 2013 amounted to $25.5 million and $74.7 million, respectively, down by $742 thousand and $180 thousand, respectively, from the comparable 2012 periods. Excluding the above mentioned debt prepayment penalty expenses, noninterest expenses for the third quarter of 2013 decreased by $694 thousand, or 3%, from the same quarter a year earlier, largely due to a decline in salaries and employee benefit costs. On a year-to-date basis, noninterest expenses were up by $829 thousand, or 1%,which included a $554 thousand increase in employee severance related costs.

Income tax expense amounted to $4.6 million and $12.1 million, respectively, for the three and nine months ended September 30, 2013. Comparable amounts for the same periods a year earlier were $3.9 million and $11.8 million, respectively. The effective tax rate for the three months ended September 30, 2013 and 2012 was 31.5% and 30.3%, respectively. The lower effective tax rate for the third quarter of 2012 reflected a non-taxable gain related to the receipt of BOLI proceeds in that quarter. For the first nine months of 2013, the effective tax rate was 31.5%, up slightly from 31.2% for the same period in 2012.

Results of Operations

Segment Reporting

Washington Trust manages its operations through two business segments, Commercial Banking and Wealth Management Services. Activity not related to the segments, such as the investment securities portfolio, wholesale funding activities, income from BOLI and administrative expenses not allocated to the business lines are considered Corporate. The Corporate unit also includes the residual impact of methodology allocations such as funds transfer pricing offsets. Methodologies used to allocate income and expenses to business lines are periodically reviewed and revised. See Note 14 to the Unaudited Consolidated Financial Statements for additional disclosure related to business segments. The Corporate unit's net income for the three and nine months ended September 30, 2013 decreased by $349 thousand and $1.0 million, respectively, compared to the same periods a year ago. On a year-to-date basis, the decline in the Corporate unit's net income largely reflected the higher level of OTTI charges recognized on investment securities in 2013.

The Commercial Banking segment reported net income of $7.6 million and $21.3 million, respectively, for the three and nine months ended September 30, 2013, compared to $7.2 million and $20.4 million for the same periods in 2012. Net interest income for this segment for the three and nine months ended September 30, 2013 increased by $418 thousand and $480 thousand, respectively, from the same periods in 2012. The provision for loan losses for both the three and nine months ended September 30, 2013 increased by $100 thousand, compared to each corresponding period a year ago. Noninterest income derived from the Commercial Banking segment totaled $8.3 million and $24.2 million, respectively, for the three and nine months ended September 30, 2013, down by $381 thousand, or 4%, and up by $1.3 million, or 6%, respectively, from the comparable 2012 periods. The quarter to quarter decline in Commercial Banking's noninterest income reflected lower levels of mortgage refinancing and sales activity in recent months due to higher interest rates. On a year-to-date basis, the increase in noninterest income for the Commercial Banking segment largely reflected higher mortgage banking revenues. Commercial Banking noninterest expenses for the three and nine months ended September 30, 2013 were down by $672 thousand, or 4%, and up by $166 thousand, or 4%, respectively, from the same periods in 2012. The quarter to quarter decline in Commercial Banking’s noninterest expenses reflected decreases in salaries and employee benefit expenses primarily in the Mortgage Banking area.

The Wealth Management Services segment reported net income of $1.5 million and $4.3 million, respectively, for the three and nine months ended September 30, 2013, compared to $1.3 million and $3.9 million, respectively, for the same periods in 2012. Noninterest income derived from the Wealth Management Services segment was $7.6 million and $23.0 million for the three and nine months ended September 30, 2013, up by 6% and 5%, respectively, compared to the same periods in 2012, primarily due to higher asset-based wealth management revenues. Noninterest expenses for the Wealth Management Services segment totaled $5.3 million and $16.0 million, respectively, for the three and nine months ended September 30, 2013, up by

$85 thousand, or 2%, and $439 thousand, or 3%, respectively, from the same periods a year ago, largely reflecting an increase in salaries and employee benefit expenses.

Net Interest Income

Net interest income continues to be the primary source of Washington Trust's operating income. Net interest income is affected by the level of interest rates, changes in interest rates and changes in the amount and composition of interest-earning assets and interest-bearing liabilities. Included in interest income are loan prepayment fees and certain other fees, such as late charges. The following discussion presents net interest income on a fully taxable equivalent ("FTE") basis by adjusting income and yields on tax-exempt loans and securities to be comparable to taxable loans and securities. For more information, see the section entitled "Average Balances / Net Interest Margin - Fully Taxable Equivalent (FTE) Basis" below.

FTE net interest income for the three and nine months ended September 30, 2013 amounted to $24.0 million and $69.9 million, respectively, compared to $23.2 million and $69.0 million, respectively, for the same periods in 2012. The net interest margin was 3.29% for both the three and nine months ended September 30, 2013, compared to 3.28% for each of the same periods in 2012. Included in net interest income were:

- Loan prepayment fees and other fee income of $559 thousand and $806 thousand, respectively, for the three and nine months ended September 30, 2013. Comparable amounts for the same periods in 2012 were $75 thousand and $269 thousand, respectively.
- Accelerated amortization of $244 thousand in debt issuance costs, which was classified as interest expense in the second quarter of 2013, resulting from the redemption of $10.3 million of junior subordinated debentures. The rate on this debt was approximately 5.69% at the time of redemption, which included the cost of a related interest rate swap that matured upon the redemption event. There was no such expense incurred in 2012.
- The impact of both of these items to net interest margin for the three and nine months ended September 30, 2013 was an increase of 7 basis points and 2 basis points, respectively. The impact of loan prepayment fees and other fees on the net interest margin for both the three and nine months ended September 30, 2012 was an increase of 1 basis point.

In the recent interest rate environment, market yields on new loan originations have been below the average yield of the existing loan portfolio. Due to the combined effect of new loan growth and the runoff of higher yielding loan balances, interest rates on total earning assets may continue to decline. The impact of this trend is likely to exceed the benefit to be realized in reduced funding costs, with the resulting effect of modestly lower net interest margin results in the remainder of 2013.

Average interest-earning assets for the three and nine months ended September 30, 2013 were up by $67.6 million and $28.6 million, respectively, from the average balances for the same periods in 2012. Total average loans for the three and nine months ended September 30, 2013 increased by $148.2 million and $162.1 million, respectively, compared to the average balances for the comparable 2012 periods, led by growth in the commercial loan portfolio. The yield on total loans for the three and nine months ended September 30, 2013 decreased by 24 basis points and 29 basis points, respectively, from the comparable 2012 periods. These changes are net of an increase of 8 basis points and 2 basis points, respectively, due to the contribution of loan prepayment fees and other fee income to the yield on total loans. The decline in yield reflects the impact of a sustained low interest rate environment on loan yields.

Total average securities for the three and nine months ended September 30, 2013 decreased by $124.0 million and $151.9 million, respectively, from the average balances for the same periods a year earlier, primarily due to principal payments received on mortgage-backed securities. The FTE rate of return on securities for the three and nine months ended September 30, 2013 increased slightly compared to the same periods in 2012, reflecting maturities and pay-downs of lower yielding mortgage-backed securities.

Average interest-bearing liabilities for the three and nine months ended September 30, 2013 decreased by $2.6 million and $34.0 million, respectively, from the comparable periods in 2012, reflecting declines in average FHLBB advance balances, time deposits and junior subordinated debentures, partially offset by growth in lower-cost deposit categories. The weighted average cost of funds for the three and nine months ended September 30, 2013 declined by 26 basis points and 25 basis points, respectively, compared to the same periods in 2012, largely reflecting declines in the rate paid on time deposits.

The average balances of FHLBB advances for the three and nine months ended September 30, 2013 were down by $137.4 million and $161.1 million, respectively, compared to the average balances for the same periods in 2012. The average rate paid on such advances for the three and nine months ended September 30, 2013 increased 7 basis points and decreased 6 basis points, respectively, from the comparable periods in 2012. See additional discussion regarding the prepayment of FHLBB advances under “Sources of Funds” below.

Total average interest-bearing deposits for the three and nine months ended September 30, 2013 increased by $145.1 million and $137.2 million, respectively, compared to the average balances for the same periods in 2012. This increase reflected growth in lower-cost deposit balances, partially offset by a decrease in time deposits. The average rate paid on interest-bearing deposits for the three and nine months ended September 30, 2013 decreased by 12 basis points and 11 basis points, respectively, compared to the same periods in 2012, reflecting lower rates on time deposits. The average balance of noninterest-bearing demand deposits for the three and nine months ended September 30, 2013 increased by $47.1 million, or 14%, and $40.5 million, or 12%, respectively, compared to the average balances for the same period in 2012.

Average Balances / Net Interest Margin - Fully Taxable Equivalent (FTE) Basis

The following tables present average balance and interest rate information. Tax-exempt income is converted to a FTE basis using the statutory federal income tax rate adjusted for applicable state income taxes net of the related federal tax benefit. For dividends on corporate stocks, the 70% federal dividends received deduction is also used in the calculation of tax equivalency. Average balances and yields for securities available for sale are based on amortized cost. Nonaccrual and renegotiated loans, as well as interest earned on these loans (to the extent recognized in the Consolidated Statements of Income) are included in amounts presented for loans.

Three months ended September 30,	2013				2012			
(Dollars in thousands)	Average Balance	Interest	Yield/ Rate		Average Balance	Interest	Yield/ Rate	
Assets:								
Commercial loans	$1,297,705	$15,274	4.67	%	$1,193,006	$14,814	4.94	%
Residential real estate loans, including mortgage loans held for sale	780,323	7,991	4.06	%	739,744	8,041	4.32	%
Consumer loans	323,398	3,083	3.78	%	320,431	3,133	3.89	%
Total loans	2,401,426	26,348	4.35	%	2,253,181	25,988	4.59	%
Cash, federal funds sold and short-term investments	87,048	47	0.21	%	40,984	27	0.26	%
FHLBB stock	37,730	36	0.38	%	40,418	52	0.51	%
Taxable debt securities	297,532	2,582	3.44	%	417,525	3,672	3.50	%
Nontaxable debt securities	64,836	960	5.87	%	68,815	1,008	5.83	%
Corporate stocks	—	—	—	%	—	—	—	%
Total securities	362,368	3,542	3.88	%	486,340	4,680	3.83	%
Total interest-earning assets	2,888,572	29,973	4.12	%	2,820,923	30,747	4.34	%
Noninterest-earning assets	209,656				224,280			
Total assets	$3,098,228				$3,045,203			
Liabilities and Shareholders' Equity:								
Interest-bearing demand deposits	$6,688	$—	—	%	$—	$—	—	%
NOW accounts	293,634	45	0.06	%	260,829	41	0.06	%
Money market accounts	591,860	456	0.31	%	429,538	283	0.26	%
Savings accounts	295,821	47	0.06	%	267,614	74	0.11	%
Time deposits	811,850	2,516	1.23	%	896,770	2,993	1.33	%
FHLBB advances	328,705	2,693	3.25	%	466,135	3,726	3.18	%
Junior subordinated debentures	22,681	241	4.22	%	32,991	393	4.74	%
Other	353	4	4.50	%	314	5	6.33	%
Total interest-bearing liabilities	2,351,592	6,002	1.01	%	2,354,191	7,515	1.27	%
Demand deposits	384,665				337,547			
Other liabilities	51,186				57,315			
Shareholders' equity	310,785				296,150			
Total liabilities and shareholders' equity	$3,098,228				$3,045,203			
Net interest income		$23,971				$23,232		
Interest rate spread			3.11	%			3.07	%
Net interest margin			3.29	%			3.28	%

Interest income amounts presented in the preceding table include the following adjustments for taxable equivalency:
(Dollars in thousands)

Three months ended September 30,	2013	2012
Commercial loans	$252	$148
Nontaxable debt securities	331	348
Corporate stocks	—	—
Total	$583	$496

Nine months ended September 30,	2013				2012			
(Dollars in thousands)	Average Balance	Interest	Yield/ Rate		Average Balance	Interest	Yield/ Rate	
Assets:								
Commercial loans	$1,277,753	$44,443	4.65	%	$1,160,531	$43,702	5.03	%
Residential real estate loans, including mortgage loans held for sale	766,162	23,805	4.15	%	724,922	23,925	4.41	%
Consumer loans	323,871	9,226	3.81	%	320,274	9,297	3.88	%
Total loans	2,367,786	77,474	4.37	%	2,205,727	76,924	4.66	%
Cash, federal funds sold and short-term investments	61,945	99	0.21	%	41,125	64	0.21	%
FHLBB stock	38,409	113	0.39	%	40,812	158	0.52	%
Taxable debt securities	304,854	8,003	3.51	%	451,602	12,118	3.58	%
Nontaxable debt securities	66,444	2,949	5.93	%	70,389	3,107	5.90	%
Corporate stocks	—	—	—	%	1,215	66	7.26	%
Total securities	371,298	10,952	3.94	%	523,206	15,291	3.90	%
Total interest-earning assets	2,839,438	88,638	4.17	%	2,810,870	92,437	4.39	%
Noninterest-earning assets	211,108				222,387			
Total assets	$3,050,546				$3,033,257			
Liabilities and Shareholders' Equity:								
Interest-bearing demand deposits	$2,299	$—	—	%	$—	$—	—	%
NOW accounts	288,871	135	0.06	%	253,895	127	0.07	%
Money market accounts	541,160	1,189	0.29	%	415,661	740	0.24	%
Savings accounts	287,360	139	0.06	%	258,464	215	0.11	%
Time deposits	841,418	7,891	1.25	%	895,864	9,128	1.36	%
FHLBB advances	333,544	8,109	3.25	%	494,615	11,809	3.19	%
Junior subordinated debentures	28,988	1,243	5.73	%	32,991	1,176	4.76	%
Other	565	12	2.84	%	6,706	244	4.86	%
Total interest-bearing liabilities	2,324,205	18,718	1.08	%	2,358,196	23,439	1.33	%
Demand deposits	370,508				329,983			
Other liabilities	51,250				54,456			
Shareholders' equity	304,583				290,622			
Total liabilities and shareholders' equity	$3,050,546				$3,033,257			
Net interest income		$69,920				$68,998		
Interest rate spread			3.09	%			3.06	%
Net interest margin			3.29	%			3.28	%

Interest income amounts presented in the preceding table include the following adjustments for taxable equivalency:

(Dollars in thousands)		
Nine months ended September 30,	2013	2012
Commercial loans	$642	$377
Nontaxable debt securities	1,014	1,072
Corporate stocks	—	17
Total	$1,656	$1,466

Volume / Rate Analysis - Interest Income and Expense (Fully Taxable Equivalent Basis)

The following table presents certain information on a FTE basis regarding changes in our interest income and interest expense for the period indicated. The net change attributable to both volume and rate has been allocated proportionately.

(Dollars in thousands)	Three months September 30, 2013 vs. 2012 Increase (Decrease) Due to			Nine months September 30, 2013 vs. 2012 Increase (Decrease) Due to		
	Volume	Rate	Net Change	Volume	Rate	Net Change
Interest on Interest-Earning Assets:						
Commercial loans	$1,257	($797)	$460	$4,224	($3,483)	$741
Residential real estate loans, including mortgage loans held for sale	427	(477)	(50)	1,337	(1,457)	(120)
Consumer loans	29	(79)	(50)	105	(176)	(71)
Cash, federal funds sold and other short-term investments	26	(6)	20	35	—	35
FHLBB stock	(3)	(13)	(16)	(9)	(36)	(45)
Taxable debt securities	(1,038)	(52)	(1,090)	(3,871)	(244)	(4,115)
Nontaxable debt securities	(58)	10	(48)	(171)	13	(158)
Corporate stocks	—	—	—	(33)	(33)	(66)
Total interest income	640	(1,414)	(774)	1,617	(5,416)	(3,799)
Interest on Interest-Bearing Liabilities:						
Interest-bearing demand deposits	—	—	—	—	—	—
NOW accounts	4	—	4	23	(15)	8
Money market accounts	114	59	173	266	183	449
Savings accounts	8	(35)	(27)	23	(99)	(76)
Time deposits	(270)	(207)	(477)	(528)	(709)	(1,237)
FHLBB advances	(1,123)	90	(1,033)	(3,908)	208	(3,700)
Junior subordinated debentures	(113)	(39)	(152)	(153)	220	67
Other	1	(2)	(1)	(160)	(72)	(232)
Total interest expense	(1,379)	(134)	(1,513)	(4,437)	(284)	(4,721)
Net interest income	$2,019	($1,280)	$739	$6,054	($5,132)	$922

Provision and Allowance for Loan Losses

The provision for loan losses is based on management's periodic assessment of the adequacy of the allowance for loan losses which, in turn, is based on such interrelated factors as the composition of the loan portfolio and its inherent risk characteristics; the level of nonperforming loans and net charge-offs, both current and historic; local economic and credit conditions; the direction of real estate values; and regulatory guidelines. The provision for loan losses is charged against earnings in order to maintain an allowance for loan losses that reflects management's best estimate of probable losses inherent in the loan portfolio at the balance sheet date.

The provision for loan losses charged to earnings for the three and nine months ended September 30, 2013 amounted to $700 thousand and $2.0 million, respectively, compared to $600 thousand and $2.1 million for the same periods in September 30, 2012. Net charge-offs for the three and nine months ended September 30, 2013 totaled $576 thousand and $4.9 million, respectively, compared to $296 thousand and $1.2 million, respectively, for the same periods a year earlier. Net charge-offs in 2013 included a $4.0 million charge-off recognized in the second quarter on one commercial mortgage loan.

The allowance for loan losses was $28.0 million, or 1.19% of total loans, at September 30, 2013, compared to $30.9 million, or 1.35% of total loans, at December 31, 2012. The decline in the ratio of the allowance for loan losses to total loans reflects charge-offs and a decrease in specific reserves on impaired loans. The decline in this ratio also reflects a decrease in estimated loss exposure on loans collectively evaluated for impairment, as evidenced by improvement in commercial loan portfolio credit quality indicators. See additional discussion under the caption “Asset Quality” below for further information on the Allowance for Loan Losses.

Noninterest Income

Noninterest income is an important source of revenue for Washington Trust. For the three and nine months ended September 30, 2013, noninterest income represented 43% and 41% of total revenues, respectively. The principal categories of noninterest income are shown in the following table:

(Dollars in thousands)	Three months				Nine months			
			Incr (Decr)				Incr (Decr)	
Periods ended September 30,	2013	2012	$	%	2013	2012	$	%
Wealth management services:								
Trust and investment advisory fees	$6,291	$5,877	$414	7%	$18,587	$17,474	$1,113	6%
Mutual fund fees	1,075	1,024	51	5%	3,174	3,051	123	4%
Financial planning, commissions & other service fees	263	292	(29)	(10)%	1,254	1,326	(72)	(5)%
Wealth management services	7,629	7,193	436	6%	23,015	21,851	1,164	5%
Merchant processing fees	3,359	3,207	152	5%	7,949	7,927	22	—%
Net gains on loan sales and commissions on loans originated for others	3,883	3,504	379	11%	11,534	9,616	1,918	20%
Service charges on deposit accounts	855	833	22	3%	2,436	2,356	80	3%
Card interchange fees	731	675	56	8%	2,013	1,844	169	9%
Income from bank-owned life insurance	464	1,006	(542)	(54)%	1,392	1,969	(577)	(29)%
Net realized gains on securities	—	—	—	—%	—	299	(299)	(100)%
Net gains on interest rate swap contracts	54	63	(9)	(14)%	225	87	138	159%
Equity in earnings (losses) of unconsolidated subsidiaries	(47)	27	(74)	(274)%	(65)	114	(179)	(157)%
Other income	472	413	59	14%	1,233	1,473	(240)	(16)%
Noninterest income, excluding other-than-temporary impairment losses	17,400	16,921	479	3%	49,732	47,536	2,196	5%
Total other-than-temporary impairment losses on securities	—	—	—	—%	(613)	(85)	(528)	(621)%
Portion of loss recognized in other comprehensive income (before tax)	—	—	—	—%	(2,159)	(124)	(2,035)	(1,641)%
Net impairment losses recognized in earnings	—	—	—	—%	(2,772)	(209)	(2,563)	(1,226)%
Total noninterest income	$17,400	$16,921	$479	3%	$46,960	$47,327	($367)	(1)%

Revenue from wealth management services is our largest source of noninterest income. A substantial portion of wealth management revenues is largely dependent on the value of wealth management assets under administration and is closely tied to the performance of the financial markets. The following table presents the changes in wealth management assets under administration for the periods indicated:

(Dollars in thousands)		
	Three months	Nine months

Periods ended September 30,	2013	2012	2013	2012
Balance at the beginning of period	$4,433,574	$4,079,913	$4,199,640	$3,900,061
Net investment appreciation (depreciation) & income	190,931	155,427	383,954	321,686
Net client cash flows	(28,911)	7,180	12,000	20,773
Balance at the end of period	$4,595,594	$4,242,520	$4,595,594	$4,242,520

Noninterest Income Analysis

Wealth management revenues for the three and nine months ended September 30, 2013 increased by $436 thousand, or 6%, and $1.2 million, or 5%, respectively, from the comparable periods in 2012, reflecting higher asset-based wealth management revenues. Wealth management assets under administration totaled $4.60 billion at September 30, 2013, up by $396.0 million, or 9%, from December 31, 2012, largely due to net investment appreciation and income.

Net gains on loan sales and commissions on loans originated for others are dependent on mortgage origination volume and are sensitive to interest rates and the condition of housing markets. For the three and nine months ended September 30, 2013, this revenue source increased by $379 thousand, or 11%, and $1.9 million, or 20%, respectively, compared to the same periods in 2012. In September 2013, residential mortgage portfolio loans totaling $48.7 million, with a weighted average rate of 3.94% and a weighted average contractual maturity of 24 years, were sold at a gain of $977 thousand. The primary purpose of this sale was principally to reduce the interest rate risk exposure associated with holding longer term fixed rate assets in a rising rate environment. We do not have a practice of selling loans from portfolio and except for this sale we have not sold any packages of loans from our portfolio in many years. Excluding this portfolio sale:

- Mortgage banking revenues for the third quarter of 2013 decreased by $598 thousand, or 17%, from the comparable 2012 quarter, reflecting a decline of $18 million, or 14%, of residential mortgages sold to the secondary market.
- On a year-to-date basis, mortgage banking revenues increased by $941 thousand, or 10%, from 2012. Residential mortgages sold to the secondary market for the nine months ended September 30, 2013 and 2012 amounted to $399.3 million and $384.9 million, respectively.
- While the year-to-date level of mortgage banking activity has increased in 2013 compared to 2012, in the latter portion of the second quarter of 2013 mortgage loan refinancing and sales activity began to decline due to an increase in market interest rates. Residential mortgages sold to the secondary market amounted to $114 million in the third quarter of 2013, compared to $132 million in the second quarter of 2013.

BOLI income for the three and nine months ended September 30, 2013 decreased by $542 thousand and $577 thousand, respectively, from the same periods in 2012. This decrease was due to a $528 thousand non-taxable gain resulting from the receipt of tax-exempt life insurance proceeds in the third quarter of 2012.

Net realized gains on securities for the first nine months of 2012 totaled $299 thousand. These gains were primarily recognized on the sale of mortgage-backed securities associated with balance sheet management transactions executed in 2012. There were no sales of securities in 2013.

Net gains on interest rate swap contracts for the three and nine months ended September 30, 2013 decreased by $9 thousand and increased by $138 thousand, respectively, from the comparable periods in 2012. The increase in revenue in the year-to-date period was largely due to new customer-related interest rate swap contracts executed in 2013.

For the three and nine months ended September 30, 2013, equity in losses of unconsolidated subsidiaries (primarily generated by two real estate limited partnerships) amounted to $47 thousand and $65 thousand, respectively, compared to equity in earnings of $27 thousand and $114 thousand, respectively, for the same periods in 2012. Washington Trust has investments in two real estate limited partnerships that renovate, own and operate two low-income housing complexes. These investments are accounted for under the equity method of accounting and tax credits generated by the partnerships are recorded as a reduction of income tax expense.

Other income for the three and nine months ended September 30, 2013 increased by $59 thousand and decreased by$240 thousand, respectively, from the same periods in 2012, largely due to a gain of $348 thousand recognized on the sale of bank property in the second quarter of 2012. There were no such sales in 2013.

For the nine months ended September 30, 2013 and 2012, net impairment losses recognized in earnings on investment securities totaled $2.8 million and $209 thousand, respectively. There were no impairment losses recognized in the quarters ended September 30, 2013 and 2012. See additional discussion in the “Financial Condition” section under the caption “Securities” below.

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Noninterest Expense

The following table presents a noninterest expense comparison for the periods indicated:

(Dollars in thousands)	Three months				Nine months			
			Incr (Decr)				Incr (Decr)	
Periods ended September 30,	2013	2012	$	%	2013	2012	$	%
Salaries and employee benefits	$14,640	$15,214	($574)	(4)%	$45,624	$44,125	$1,499	3 %
Net occupancy	1,404	1,468	(64)	(4)%	4,282	4,521	(239)	(5)%
Equipment	1,222	1,168	54	5 %	3,658	3,418	240	7 %
Merchant processing costs	2,862	2,707	155	6 %	6,746	6,690	56	1 %
Outsourced services	878	845	33	4 %	2,590	2,660	(70)	(3)%
Legal, audit and professional fees	529	598	(69)	(12)%	1,691	1,599	92	6 %
FDIC deposit insurance costs	448	427	21	5 %	1,330	1,311	19	1 %
Advertising and promotion	312	445	(133)	(30)%	1,143	1,295	(152)	(12)%
Amortization of intangibles	170	182	(12)	(7)%	516	555	(39)	(7)%
Foreclosed property costs	38	136	(98)	(72)%	222	604	(382)	(63)%
Debt prepayment penalties	1,125	1,173	(48)	(4)%	1,125	2,134	(1,009)	(47)%
Other	1,920	1,927	(7)	— %	5,810	6,005	(195)	(3)%
Total noninterest expense	$25,548	$26,290	($742)	(3)%	$74,737	$74,917	($180)	— %

Noninterest Expense Analysis

For the three and nine months ended September 30, 2013, salaries and employee benefit expense amounted to $14.6 million and $45.6 million, respectively, and included $283 thousand and $593 thousand, respectively, in employee severance costs. Salaries and employee benefit expense for the same periods in 2012 totaled $15.2 million and $44.1 million, respectively, and included $75 thousand of employee severance costs in each of the three and nine month periods. The year over year decline in third quarter salaries and employee benefit expense reflected decreases in transaction-based compensation in the mortgage banking area and lower incentive compensation accruals as compared to the third quarter of 2012. The decline in transaction-based compensation in the mortgage banking area reflects a reduction in mortgage refinancing activity due to to rising market interest rates. The year-to-date increase in salaries and employee benefit expense largely reflects increased staffing levels to support growth and an increase in employee severance costs. See discussion regarding the pension plan amendment and remeasurement in the Section “Sources of Funds” under the caption “Other Liabilities.”

Net occupancy expense for the three and nine months ended September 30, 2013 decreased by $64 thousand and $239 thousand, respectively, compared to the same periods in 2012, largely due to a second quarter 2012 charge of $131 thousand for the termination of an operating lease associated with a branch closure in September 2012.

Equipment expense for the three and nine months ended September 30, 2013 increased by $54 thousand and $240 thousand, respectively, compared to the same periods a year earlier, due to additional investments in technology and other equipment.

Foreclosed property costs for the three and nine months ended September 30, 2013 decreased by $98 thousand and $382 thousand, respectively, from the same periods in 2012, reflecting declines in foreclosure activity.

Debt prepayment penalties for the three and nine months ended September 30, 2013, decreased by $48 thousand and $1.0 million, respectively, compared to the same periods in 2012. These charges were incurred as a result of the prepayment of FHLBB advances associated with balance sheet management transactions executed in each year.

Other noninterest expense for the three and nine months ended September 30, 2013 decreased by $7 thousand and $195 thousand, respectively, compared to same periods in 2012. The decrease on a year-to-date basis was largely due to a decline in credit and collection costs.

Income Taxes

Income tax expense amounted to $4.6 million and $12.1 million, respectively, for the three and nine months ended September 30, 2013, compared to $3.9 million and $11.8 million, respectively, for the same periods in 2012. The Corporation's effective tax rate for both the three and nine months ended September 30, 2013 was 31.5%, compared to 30.3% and 31.2%, respectively, for the comparable 2012 periods. The lower effective tax rate for the third quarter of 2012 reflected a non-taxable gain related to the receipt of BOLI proceeds in that quarter. The effective tax rates differed from the federal rate of 35%, due largely to the benefits of tax-exempt income, income from BOLI and federal tax credits.

Financial Condition

Summary

Total assets amounted to $3.13 billion at September 30, 2013, an increase of $60.1 million from the end of 2012. This increase reflected net loan growth of $59.8 million, or 3%, and an increase of $63.3 million in cash and due from banks resulting from strong deposit inflows. These increases were offset, in part, by a decrease of $16.0 million in short-term investments, a decrease of $37.0 million in mortgage loans held for sale and a decrease of $13.2 million in other assets.

Nonperforming assets as a percent of total assets amounted to 0.66% at September 30, 2013, down by 17 basis points from the end of 2012, largely due to charge-offs and payoffs on commercial loans. Overall credit quality continues to be affected by relatively weak economic conditions.

Total liabilities decreased by $32.1 million from the balance at December 31, 2012, reflecting a decline in pension plan liabilities, resulting from a pension plan amendment and remeasurement that is described in “Sources of Funds” under the caption “Other liabilities.” The decrease in total liabilities also reflected the June 2013 redemption of $10.3 million of junior subordinated debentures, which is described in the “Results of Operations” section under the caption “Net Interest Income.” Total FHLBB advances decreased by $72.7 million, or 20%, from the balance at December 31, 2012, while total deposits increased by $142.2 million, or 6%, in the first nine months of 2013.

Shareholders’ equity totaled $323.6 million at September 30, 2013, up by $27.9 million from the balance at the end of 2012, including an $11.2 million after tax beneficial impact of the change in pension plan liabilities described in “Sources of Funds” under the caption “Other Liabilities.” Capital levels continue to exceed the regulatory minimum levels to be considered well-capitalized, with a total risk-based capital ratio of 13.44% at September 30, 2013, compared to 13.26% at December 31, 2012. The increase we in the total risk-based capital ratio reflected the redemption of junior subordinated debentures, which were included in Tier 1 capital.

Securities

Washington Trust’s securities portfolio is managed to generate interest income, to implement interest rate risk management strategies, and to provide a readily available source of liquidity for balance sheet management. Securities are designated as either available for sale, held to maturity or trading at the time of purchase. The Corporation does not currently maintain a portfolio of trading securities. Securities available for sale may be sold in response to changes in market conditions, prepayment risk, rate fluctuations, liquidity, or capital requirements. Securities available for sale are reported at fair value, with any unrealized gains and losses excluded from earnings and reported as a separate component of shareholders’ equity, net of tax, until realized. Securities held to maturity are reported at amortized cost.

Determination of Fair Value

The Corporation uses an independent pricing service to obtain quoted prices. The prices provided by the independent pricing service are generally based on observable market data in active markets. The determination of whether markets are active or inactive is based upon the level of trading activity for a particular security class. The Corporation reviews the independent pricing service’s documentation to gain an understanding of the appropriateness of the pricing methodologies. The Corporation also reviews the prices provided by the independent pricing service for reasonableness based upon current trading levels for similar securities. If the prices appear unusual they are re-examined and the value is either confirmed or revised. In addition, the Corporation periodically performs independent price tests of a sample of securities to ensure proper valuation and to verify our understanding of how securities are priced. As of September 30, 2013 and December 31, 2012, the Corporation did not make any adjustments to the prices provided by the pricing service.

A majority of our fair value measurements utilize Level 2 inputs, which utilize quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in inactive markets, and model-derived valuations in which all significant input assumptions are observable in active markets. Our Level 2 financial instruments consist primarily of available for sale debt securities.

Level 3 financial instruments utilize valuation techniques in which one or more significant input assumptions are unobservable in the markets and which reflect the Corporation's market assumptions. As of September 30, 2013 and December 31, 2012, our Level 3 financial instruments consisted of available for sale pooled trust preferred securities, which were not actively traded.

See Notes 4 and 11 to the Unaudited Consolidated Financial Statements for additional information regarding the determination of fair value of investment securities.

Securities Portfolio

The carrying amounts of securities as of the dates indicated are presented in the following tables:

(Dollars in thousands)	September 30, 2013			December 31, 2012		
	Amount	%		Amount	%	
Securities Available for Sale:						
Obligations of U.S. government-sponsored enterprises	$55,669	14	%	$31,670	8	%
Mortgage-backed securities issued by U.S. government agencies and U.S. government-sponsored enterprises	228,505	59		231,233	62	
States and political subdivisions	67,340	17		72,620	19	
Trust preferred securities:						
Individual name issuers	24,775	6		24,751	7	
Collateralized debt obligations	425	—		843	—	
Corporate bonds	11,371	3		14,381	4	
Total securities available for sale	$388,085	100	%	$375,498	100	%

(Dollars in thousands)	September 30, 2013			December 31, 2012		
	Amount	%		Amount	%	
Securities Held to Maturity:						
Mortgage-backed securities issued by U.S. government agencies and U.S. government-sponsored enterprises	$31,264	100	%	$40,381	100	%
Total securities held to maturity	$31,264	100	%	$40,381	100	%

As of September 30, 2013, the investment portfolio totaled $419.3 million, down by $3.5 million from the balance at December 31, 2012, reflecting $92.0 million in purchases of mortgage-backed securities and U.S. government agency debt securities, mostly offset by maturities and principal payments received on mortgage-backed securities. Most of the purchases were made during the third quarter of 2013 to redeploy excess liquidity from deposit growth, add to on-balance sheet liquidity and to provide a source of collateralization for public and institutional deposits.

At September 30, 2013 and December 31, 2012, the net unrealized gain position on securities available for sale and held to maturity amounted to $7.8 million and $13.1 million, respectively, and included gross unrealized losses of $6.8 million and $9.1 million, respectively. These gross unrealized losses were temporary in nature and concentrated in variable rate trust preferred securities issued by financial services companies.

State and Political Subdivision Holdings

The carrying amount of state and political subdivision holdings included in our securities portfolio at September 30, 2013 totaled $67.3 million. The following table presents state and political subdivision holdings by geographic location.

(Dollars in thousands)

September 30, 2013	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
New Jersey	$30,864	$1,453	$—	$32,317
New York	11,441	449	—	11,890
Pennsylvania	7,460	217	—	7,677
Illinois	9,453	178	—	9,631
Other	5,616	209	—	5,825
Total	$64,834	$2,506	$—	$67,340

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The following table presents state and political subdivision holdings by category.
(Dollars in thousands)

September 30, 2013	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
School districts	$23,183	$860	$—	$24,043
General obligation	34,567	1,449	—	36,016
Revenue obligations (a)	7,084	197	—	7,281
Total	$64,834	$2,506	$—	$67,340

(a) Includes water and sewer districts, tax revenue obligations and other.

The Bank owns trust preferred security holdings of seven individual name issuers in the financial industry and one pooled trust preferred security in the form of collateralized debt obligations. The pooled trust preferred holding consists of trust preferred obligations of banking industry companies and, to a lesser extent, insurance industry companies. The following tables present information concerning the individual named issuers and pooled trust preferred obligations, including credit ratings. The Corporation's Investment Policy contains rating standards that specifically reference ratings issued by Moody's and S&P.

Individual Issuer Trust Preferred Securities

(Dollars in thousands)	September 30, 2013				Credit Ratings September 30, 2013			Form 10-Q Filing Date		
Named Issuer (parent holding company)	(a)	Amortized Cost	Fair Value	Unrealized Loss	Moody's	S&P		Moody's	S&P	
JPMorgan Chase & Co.	2	$9,754	$7,560	($2,194)	Baa2	BBB		Baa2	BBB	
Bank of America Corporation	3	5,759	4,700	(1,059)	Ba2	BB+	(b)	Ba2	BB+	(b)
Wells Fargo & Company	2	5,132	4,253	(879)	A3/Baa1	A-/BBB+		A3/Baa1	A-/BBB+	
SunTrust Banks, Inc.	1	4,171	3,402	(769)	Baa3	BB+	(b)	Baa3	BB+	(b)
Northern Trust Corporation	1	1,984	1,670	(314)	A3	A-		A3	A-	
State Street Corporation	1	1,974	1,560	(414)	A3	BBB+		A3	BBB+	
Huntington Bancshares Incorporated	1	1,931	1,629	(302)	Baa3	BB+	(b)	Baa3	BB+	(b)
Totals	11	$30,705	$24,774	($5,931)						

(a) Number of separate issuances, including issuances of acquired institutions.
(b) Rating is below investment grade.

The Corporation's evaluation of the impairment status of individual name trust preferred securities includes various considerations in addition to the degree of impairment and the duration of impairment. We review the reported regulatory capital ratios of the issuer and, in all cases, the regulatory capital ratios were deemed to be in excess of the regulatory minimums. Credit ratings were also taken into consideration, including ratings in effect as of the reporting period date as well as credit rating changes between the reporting period date and the filing date of this report. We noted no additional downgrades to below investment grade between the reporting period date and the filing date of this report. Where available, credit ratings from multiple rating agencies are obtained and rating downgrades are specifically analyzed. Our review process for these credit-sensitive holdings also includes a periodic review of relevant financial information for each issuer, such as quarterly financial reports, press releases and analyst reports. This information is used to evaluate the current and prospective financial condition of the issuer in order to assess the issuer’s ability to meet its debt obligations. Through the filing date of this report, each of the individual name issuer securities was current with respect to interest payments. Based on our evaluation of the facts and circumstances relating to each issuer, management concluded that all principal and interest payments for these individual issuer trust preferred securities would be collected according to their contractual terms and it expects to recover the entire amortized cost basis of these securities. Furthermore, Washington Trust does not intend to sell these securities and it is not more likely than not that Washington Trust will be required to sell these securities before recovery of their cost basis, which may be at maturity. Therefore, management does not consider these investments to be other-than-temporarily impaired at September 30, 2013.

Pooled Trust Preferred Obligations
The Bank has invested in two pooled trust preferred securities, Tropic CDO 1, tranche A4L ("Tropic") and PreTSL XXV, tranche C1 ("PreTSL").

On March 22, 2013, the trustee for the Tropic CDO I security issued a notice that liquidation of the CDO entity would take place at the direction of holders of the CDO tranches senior to the subordinate tranche interest held by Washington Trust. Accordingly, Washington Trust recognized an OTTI charge in the first quarter of 2013 on the entire $2.8 million carrying value of this security, based on the expectation that proceeds from the liquidation would be insufficient to satisfy the amount owed to the subordinate tranche. The liquidation was conducted in August 2013 and was insufficient to satisfy any amount owed on the subordinate tranche.

Valuations of pooled trust preferred holdings are dependent in part on cash flows from underlying issuers. Unexpected cash flow disruptions could have an adverse impact on the fair value and performance of pooled trust preferred securities. Management believes the unrealized losses on its pooled trust preferred holdings primarily reflects investor concerns about global economic growth and how it will affect the recent and potential future losses in the financial services industry and the possibility of further incremental deferrals of or defaults on interest payments on trust preferred debentures by financial institutions participating in these pools. These concerns have resulted in a substantial decrease in market liquidity and increased risk premiums for securities in this sector. Credit spreads for issuers in this sector have remained wide during recent months, causing prices to remain at low levels.

The following table provides information regarding the PreTSL pooled trust preferred security:

(Dollars in thousands)	September 30, 2013					Credit Ratings					
						September 30, 2013			Form 10-Q Filing Date		
Deal Name	Amortized Cost	Fair Value	Unrealized Loss	No. of Cos. in Issuance	Deferrals & Defaults (a)	Moody's		S&P	Moody's		S&P
Preferred Term Securities [PreTSL] XXV, tranche C1	$1,264	$425	($839)	68	33%	C	(c)	(b)	C	(c)	(b)
Totals	$1,264	$425	($839)								

(a) Percentage of pool collateral in deferral or default status.
(b) Not rated by S&P.
(c) Rating is below investment grade.

Washington Trust's investment in PreTSL is subordinate to two senior tranche levels. This investment security has been on nonaccrual status and has been deferring interest payments since December 2008. The September 30, 2013 amortized cost was net of $1.2 million of credit-related impairment losses previously recognized in earnings reflective of payment deferrals and credit deterioration of the underlying collateral. As of September 30, 2013, this security had unrealized losses of $839 thousand and a below investment grade rating of "C" by Moody's. Through the filing date of this report, there have been no additional rating changes on this security. This credit rating status has been considered by management in its assessment of the impairment status of this security. Based on information available through the filing date of this report, there have been no additional adverse changes in deferral or default status of the underlying issuer institutions. Based on cash flow forecasts for this security, management expects to recover the remaining amortized cost of this security. Furthermore, Washington Trust does not intend to sell this security and it is not more likely than not that Washington Trust will be required to sell this security before recovery of its cost basis, which may be at maturity. Therefore, management does not consider the unrealized losses on this security to be other-than-temporary at September 30, 2013.

Further deterioration in credit quality of the companies backing the trust preferred securities, further deterioration in the condition of the financial services industry, a continuation or worsening of the current economic downturn, or additional declines in real estate values may further affect the fair value of these securities and increase the potential that certain unrealized losses be designated as other-than-temporary in future periods and the Corporation may incur additional write-downs.

Loans

Total loans amounted to $2.35 billion at September 30, 2013, up by $59.8 million, or 3%, in the first nine months of 2013, due primarily to growth in the commercial loans and residential mortgages.

Commercial Loans
Commercial loans fall into two major categories, commercial real estate and other commercial loans (commercial and industrial). A significant portion of the Bank's commercial and industrial loans are also collateralized by real estate, but are not classified as commercial real restate loans because such loans are not made for the purpose of acquiring, developing, constructing, improving or refinancing the real estate securing the loan, nor is the repayment source income generated directly from such real property.

Commercial Real Estate Loans
Commercial real estate loans amounted to $779.3 million at September 30, 2013, an increase of $40.7 million, or 6%, from the $738.7 million balance at December 31, 2012. Included in these amounts were commercial construction loans of $52.0 million and $27.8 million, respectively. The growth in commercial real estate loans was in large part due to enhanced business development efforts with new borrowers.

Commercial real estate loans are secured by a variety of property types, with approximately 83% of the total composed of retail facilities, office buildings, commercial mixed use, lodging, multi-family dwellings and industrial and warehouse properties.

The following table presents a geographic summary of commercial real estate loans, including commercial construction, by property location.

(Dollars in thousands)	September 30, 2013			December 31, 2012		
	Amount	% of Total		Amount	% of Total	
Rhode Island, Connecticut, Massachusetts	$748,013	96	%	$707,068	96	%
New York	22,533	3	%	22,081	3	%
New Hampshire	8,780	1	%	9,290	1	%
Other	—	—	%	216	—	%
Total	$779,326	100	%	$738,655	100	%

Other Commercial Loans
Commercial and industrial loans amounted to $518.6 million at September 30, 2013, an increase of $4.8 million from the balance at December 31, 2012. This portfolio includes loans to a variety of business types. Approximately 72% of the total is composed of health care/social assistance, owner occupied and other real estate, retail trade, manufacturing, accommodation and food services, public administration, entertainment and recreation and construction businesses.

Residential Real Estate Loans
The residential real estate mortgage loan portfolio amounted to $731.7 million at September 30, 2013, up by $14.0 million, or 2.0%, from the balance at December 31, 2012. See discussion regarding the September 2013 sale of $48.7 million of residential mortgage portfolio loans in the "Results of Operations" section under the caption "Noninterest Income."

Washington Trust originates residential real estate mortgages within our general market area of Southern New England for portfolio and for sale in the secondary market. Loans originated for sale are sold with servicing retained or released. Washington Trust also originates residential real estate mortgages for various investors in a broker capacity, including conventional mortgages and reverse mortgages. Total residential real estate loan originations for retention in portfolio were $220 million and $162 million, respectively, for the nine months ended September 30, 2013 and 2012. Total residential real estate loan originations for sale into the secondary market, including loans originated in a broker capacity, were $399 million and $385 million, respectively, for the nine months ended September 30, 2013 and 2012.

Prior to March 2009, Washington Trust had periodically purchased one- to four-family residential mortgages originated in other states as well as southern New England from other financial institutions. All residential mortgage loans purchased from other financial institutions were individually underwritten using standards similar to those employed for Washington Trust’s self-originated loans. Purchased residential mortgage balances totaled $48.2 million and $56.0 million, respectively, as of September 30, 2013 and December 31, 2012.

The following is a geographic summary of residential mortgages by property location.

(Dollars in thousands)	September 30, 2013			December 31, 2012		
	Amount	% of Total		Amount	% of Total	
Rhode Island, Connecticut, Massachusetts	$709,595	96.9	%	$697,814	97.2	%
New York, Virginia, New Jersey, Maryland, Pennsylvania, District of Columbia	9,371	1.3	%	9,591	1.3	%
New Hampshire	6,750	0.9	%	3,903	0.5	%
Ohio	2,600	0.4	%	2,953	0.4	%
Washington and Oregon	1,362	0.2	%	1,379	0.2	%
Georgia	1,088	0.1	%	1,101	0.2	%
New Mexico	470	0.1	%	476	0.1	%
Other	456	0.1	%	464	0.1	%
Total residential mortgages	$731,692	100.0	%	$717,681	100.0	%

Consumer Loans

Consumer loans amounted to $324.2 million at September 30, 2013, an increase of $279 thousand from December 31, 2012. Our consumer portfolio is predominantly home equity lines and home equity loans, representing 83% of the total consumer portfolio at September 30, 2013. Consumer loans also include personal installment loans and loans to individuals secured by general aviation aircraft and automobiles.

Asset Quality

Nonperforming Assets

Nonperforming assets include nonaccrual loans, nonaccrual investment securities and property acquired through foreclosure or repossession.

The following table presents nonperforming assets and additional asset quality data for the dates indicated:

(Dollars in thousands)	Sep 30, 2013		Dec 31, 2012	
Nonaccrual loans:				
Commercial mortgages	$8,956		$10,681	
Commercial construction and development	—		—	
Other commercial	1,248		4,412	
Residential real estate mortgages	8,095		6,158	
Consumer	1,204		1,292	
Total nonaccrual loans	19,503		22,543	
Nonaccrual investment securities	425		843	
Property acquired through foreclosure or repossession, net	594		2,047	
Total nonperforming assets	$20,522		$25,433	
Nonperforming assets to total assets	0.66	%	0.83	%
Nonperforming loans to total loans	0.83	%	0.98	%
Total past due loans to total loans	1.02	%	1.22	%
Accruing loans 90 days or more past due	$—		$—	

Nonperforming assets decreased to $20.5 million, or 0.66% of total assets, at September 30, 2013, from $25.4 million, or 0.83% of total assets, at December 31, 2012. The decrease in nonperforming assets reflects charge-offs and payoffs on commercial loans, as well as dispositions of properties acquired through foreclosure in the nine months ended September 30, 2013.

Nonaccrual loans totaled $19.5 million at September 30, 2013, down by $3.0 million from the balance at December 31, 2012. Property acquired through foreclosure or repossession amounted to $594 thousand at September 30, 2013, compared to $2.0 million at December 31, 2012. The balance at September 30, 2013 consisted of seven commercial properties and one residential property.

Nonaccrual investment securities at September 30, 2013 and December 31, 2012 were comprised of pooled trust preferred securities. See additional information herein under the caption "Securities" above.

Nonaccrual Loans

During the nine months ended September 30, 2013, the Corporation made no changes in its practices or policies concerning the placement of loans or investment securities into nonaccrual status. There were no significant commitments to lend additional funds to borrowers whose loans were on nonaccrual status at September 30, 2013.

The following table presents additional detail on nonaccrual loans as of the dates indicated:

(Dollars in thousands)	September 30, 2013					December 31, 2012				
	Days Past Due					Days Past Due				
	Over 90	Under 90	Total	% (1)		Over 90	Under 90	Total	% (1)	
Commercial:										
Mortgages	$8,226	$730	$8,956	1.23	%	$10,300	$381	$10,681	1.50	%
Construction and development	—	—	—	—		—	—	—	—	
Other commercial	929	319	1,248	0.24	%	3,647	765	4,412	0.86	%
Residential real estate mortgages	4,843	3,252	8,095	1.11	%	3,658	2,500	6,158	0.86	%
Consumer	693	511	1,204	0.37	%	844	448	1,292	0.40	%
Total nonaccrual loans	$14,691	$4,812	$19,503	0.83	%	$18,449	$4,094	$22,543	0.98	%

(1) Percentage of nonaccrual loans to the total loans outstanding within the respective category.

Commercial mortgage loans in nonaccrual status decreased by a net $1.7 million from the balance at the end of 2012. As of September 30, 2013, 95% of nonaccrual commercial mortgage loans consisted of four relationships. The September 30, 2013 balance of nonaccrual commercial mortgage loans is net of charge-offs of $5.3 million and has a remaining loss allocation of $889 thousand. All of the nonaccrual commercial mortgage loans were located in Rhode Island, Massachusetts and Connecticut.

The largest nonaccrual relationship in the commercial mortgage category totaled $4.9 million at September 30, 2013, down from $5.9 million at December 31, 2012, due to a payoff received in the second quarter of 2013 on one of the loans in this relationship. This relationship is secured by several properties, including office, light industrial and retail space and is collateral dependent. Based on the estimated fair value of the underlying collateral, a $589 thousand loss allocation was deemed necessary at September 30, 2013. The Bank has additional accruing residential mortgage loans, which are related to the borrower by common guarantor, totaling $827 thousand at September 30, 2013. These additional loans have performed in accordance with the terms of the loans and were not past due at September 30, 2013. The second largest nonaccrual relationship in the commercial mortgage category totaled $2.3 million at September 30, 2013 and is secured by an office building. This relationship is collateral dependent and based on the estimated fair value of the underlying collateral, a $300 thousand loss allocation on this relationship was deemed necessary at September 30, 2013. The third largest commercial mortgage nonaccrual relationship at September 30, 2013 is a commercial mortgage loan with a carrying value of $686 thousand, down from $5.1 million at December 31, 2012, reflecting a $4.0 million charge-off recognized in the second quarter of 2013. This loan is secured by a distribution facility and is collateral dependent. This loan had been identified as a potential problem loan prior to 2013 and was placed on nonaccrual status in the first quarter of 2013. While this loan was 60 days past due at September 30, 2013, it was paid off on October 1, 2013, resulting in a recovery of $143 thousand.

Other commercial loans (commercial and industrial loans) in nonaccrual status amounted to $1.2 million at September 30, 2013, down by a net $3.2 million from the balance at December 31, 2012, reflecting the payoff of $2.0 million received in the second quarter of 2013 on a commercial and industrial loan relationship. The loss allocation on the balance of nonaccrual commercial and industrial loans was $326 thousand at September 30, 2013.

Nonaccrual residential mortgage loans increased by $1.9 million from the balance at the end of 2012. As of September 30, 2013, the $8.1 million balance of nonaccrual residential mortgage loans consisted of 34 loans, with $7.7 million located in Rhode Island and Massachusetts. The loss allocation on total nonaccrual residential mortgages was $1.5 million at September 30, 2013. Included in total nonaccrual residential mortgages at September 30, 2013 were 15 loans purchased for portfolio and serviced by others amounting to

$3.7 million. Management monitors the collection efforts of its third party servicers as part of its assessment of the collectibility of nonperforming loans.

Nonaccrual consumer loans decreased by $88 thousand thousand from the balance at the end of 2012.

Past Due Loans

The following table presents past due loans by category as of the dates indicated:

(Dollars in thousands)	September 30, 2013			December 31, 2012		
	Amount	% (1)		Amount	% (1)	
Commercial:						
Mortgages	$8,956	1.23	%	$11,081	1.56	%
Construction and development	—	—	%	—	—	%
Other commercial loans	3,585	0.69	%	4,203	0.82	%
Residential real estate mortgages	9,427	1.29	%	10,449	1.46	%
Consumer loans	2,034	0.63	%	2,363	0.73	%
Total past due loans	$24,002	1.02	%	$28,096	1.22	%

(1)Percentage of past due loans to the total loans outstanding within the respective category.

As of September 30, 2013, total past due loans amounted to $24.0 million, or 1.02% of total loans, down by $4.1 million from December 31, 2012.

All loans 90 days or more past due at September 30, 2013 and December 31, 2012 were classified as nonaccrual.

Troubled Debt Restructurings

Loans are considered restructured in a troubled debt restructuring when the Corporation has granted concessions to a borrower due to the borrower’s financial condition that it otherwise would not have considered. These concessions include modifications of the terms of the debt such as reduction of the stated interest rate other than normal market rate adjustments, extension of maturity dates, or reduction of principal balance or accrued interest. The decision to restructure a loan, versus aggressively enforcing the collection of the loan, may benefit the Corporation by increasing the ultimate probability of collection.

Restructured loans are classified as accruing or non-accruing based on management’s assessment of the collectibility of the loan. Loans which are already on nonaccrual status at the time of the restructuring generally remain on nonaccrual status for approximately six months before management considers such loans for return to accruing status. Accruing restructured loans are placed into nonaccrual status if and when the borrower fails to comply with the restructured terms and management deems it unlikely that the borrower will return to a status of compliance in the near term.

Troubled debt restructurings are reported as such for at least one year from the date of the restructuring. In years after the restructuring, troubled debt restructured loans are removed from this classification if the restructuring did not involve a below market rate concession and the loan is not deemed to be impaired based on the terms specified in the restructuring agreement. As of September 30, 2013, there were no significant commitments to lend additional funds to borrowers whose loans had been restructured.

The following table sets forth information on troubled debt restructured loans as of the dates indicated. The carrying amounts below consist of unpaid principal balance, net of charge-offs and unamortized deferred loan origination fees and costs. Accrued interest is not included in the carrying amounts set forth below.

(Dollars in thousands)	Sep 30, 2013	Dec 31, 2012
Accruing troubled debt restructured loans:		
Commercial mortgages	$23,892	$9,569
Other commercial	1,576	6,577
Residential real estate mortgages	870	1,123
Consumer	239	154
Accruing troubled debt restructured loans	26,577	17,423
Nonaccrual troubled debt restructured loans:		
Commercial mortgages	—	—
Other commercial	547	2,063
Residential real estate mortgages	—	688
Consumer	40	44
Nonaccrual troubled debt restructured loans	587	2,795
Total troubled debt restructured loans	$27,164	$20,218

As of September 30, 2013, loans classified as troubled debt restructurings totaled $27.2 million, up by $6.9 million from the balance at December 31, 2012.

The largest troubled debt restructured relationship at September 30, 2013 consisted of an accruing commercial mortgage relationship with a carrying value of $9.5 million, secured by mixed use properties. The restructuring took place in the second quarter of 2013 and included a modification of certain payment terms and a below market rate concession for a temporary period. At September 30, 2013, the second largest troubled debt restructured relationship consisted of an accruing commercial mortgage relationship with a carrying value of $8.1 million, secured by a hotel industry property. The restructuring took place in the third quarter of 2012 and included a modification of certain payment terms and a below market interest rate reduction for a temporary period on approximately $3.1 million of the total balance. In connection with this restructuring, additional collateral was also provided by the borrower during the third quarter of 2012. The third largest troubled debt restructured relationship [NS PROPERTIES] consisted of a commercial mortgage with a carrying value of $4.9 million, secured by commercial property. The restructuring took place in the third quarter of 2013 and included a modification of certain payment terms and a below market rate concession for a temporary period. In connection with this restructuring, a principal pay-down of $1.2 million was provided by the borrower during the third quarter of 2013.

During the second quarter of 2013, a payoff was received on an accruing troubled debt restructured commercial and industrial loan relationship with a carrying value of $4.7 million at December 31, 2012.

Potential Problem Loans

The Corporation classifies certain loans as "substandard," "doubtful," or "loss" based on criteria consistent with guidelines provided by banking regulators. Potential problem loans consist of classified accruing commercial loans that were less than 90 days past due at September 30, 2013 and other loans for which known information about possible credit problems of the related borrowers causes management to have doubts as to the ability of such borrowers to comply with the present loan repayment terms and which may result in disclosure of such loans as nonperforming at some time in the future. These loans are not included in the amounts of nonaccrual or restructured loans presented above. Management cannot predict the extent to which economic conditions or other factors may impact borrowers and the potential problem loans. Accordingly, there can be no assurance that other loans will not become 90 days or more past due, be placed on nonaccrual, become restructured, or require increased allowance coverage and provision for loan losses. The Corporation has identified approximately $2.0 million in potential problem loans at

September 30, 2013, compared to $6.4 million at December 31, 2012. The decrease from the end of 2012 was largely attributable to the reclassification to nonaccrual status in 2013 of the third largest nonaccrual commercial mortgage relationship described above under the caption “Nonaccrual Loans.” Potential problem loans are assessed for loss exposure using the methods described in Note 5 to the Unaudited Consolidated Financial Statements under the caption “Credit Quality Indicators.”

Allowance for Loan Losses
Establishing an appropriate level of allowance for loan losses necessarily involves a high degree of judgment. The Corporation uses a methodology to systematically measure the amount of estimated loan loss exposure inherent in the loan portfolio for purposes of establishing a sufficient allowance for loan losses. For a more detailed discussion on the allowance for loan losses, see additional information in Item 7 under the caption "Critical Accounting Policies and Estimates" of Washington Trust's Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

The allowance for loan losses is management's best estimate of probable loan losses inherent in the loan portfolio as of the balance sheet date. The allowance is increased by provisions charged to earnings and by recoveries of amounts previously charged off, and is reduced by charge-offs on loans. The status of nonaccrual loans, delinquent loans and performing loans were all taken into consideration in the assessment of the adequacy of the allowance for loans losses. In addition, the balance and trends of credit quality indicators, including the commercial loan categories of Pass, Special Mention and Classified, are integrated into the process used to determine the allocation of loss exposure. See Note 5 to the Unaudited Consolidated Financial Statements for additional information under the caption "Credit Quality Indicators." While management believes that the level of allowance for loan losses at September 30, 2013 is adequate and consistent with asset quality and delinquency indicators, management will continue to assess the adequacy of the allowance for loan losses in accordance with its established policies.

The Bank's general practice is to identify problem credits early and recognize full or partial charge-offs as promptly as practicable when it is determined that the collection of loan principal is unlikely. The Bank recognizes full or partial charge-offs on collateral dependent impaired loans when the collateral is deemed to be insufficient to support the carrying value of the loan. The Bank does not recognize a recovery when an updated appraisal indicates a subsequent increase in value.

The estimation of loan loss exposure inherent in the loan portfolio includes, among other procedures, (1) identification of loss allocations for individual loans deemed to be impaired in accordance with GAAP, (2) loss allocation factors for non-impaired loans based on credit grade, loss experience, delinquency factors and other similar economic indicators, and (3) general loss allocations, classified as an "unallocated" portion of the total allowance, for measurement imprecision attributable to uncertainty in the economic environment and ever changing conditions, as well as qualitative and quantitative assessments of other environmental factors. We periodically reassess and revise the loss allocation factors used in the assignment of loss exposure to appropriately reflect our analysis of migrational loss experience. We analyze historical loss experience in the various portfolios over periods deemed to be relevant to the inherent risk of loss in the respective portfolios as of the balance sheet date. Revisions to loss allocation factors are not retroactively applied.

The methodology to measure the amount of estimated loan loss exposure includes an analysis of individual loans deemed to be impaired. Impaired loans are loans for which it is probable that the Bank will not be able to collect all amounts due according to the contractual terms of the loan agreements and all loans restructured in a troubled debt restructuring. Impaired loans do not include large groups of smaller-balance homogeneous loans that are collectively evaluated for impairment, which consist of most residential mortgage loans and consumer loans. Impairment is measured on a discounted cash flow method based upon the loan's contractual effective interest rate, or at the loan's observable market price, or if the loan is collateral dependent, at the fair value of the collateral less costs to sell. For collateral dependent loans, management may adjust appraised values to reflect estimated market value declines or apply other discounts to appraised values for unobservable factors resulting from its knowledge of circumstances associated with the property.

The following is a summary of impaired loans by measurement type:

(Dollars in thousands)	Sep 30, 2013	Dec 31, 2012

Collateral dependent impaired loans (1)	$21,170	$23,359
Impaired loans measured on discounted cash flow method (2)	18,534	12,188
Total impaired loans	$39,704	$35,547

(1) Net of partial charge-offs of $5.8 million and $2.3 million, respectively, at September 30, 2013 and December 31, 2012.

(2) Net of partial charge-offs of $123 thousand and $92 thousand, respectively, at September 30, 2013 and December 31, 2012.

Impaired loans consist of nonaccrual commercial loans, troubled debt restructured loans and other loans classified as impaired. The loss allocation on impaired loans amounted to $2.0 million and $2.9 million, respectively, at September 30, 2013 and December 31, 2012. Various loan loss allowance coverage ratios are affected by the timing and extent of charge-offs, particularly with respect to impaired collateral dependent loans. For such loans, the Bank generally recognizes a partial charge-off equal to the identified loss exposure; therefore, the remaining allocation of loss is minimal.

Other individual commercial loans and commercial mortgage loans not deemed to be impaired are evaluated using the internal rating system and the application of loss allocation factors. The loan rating system is described under the caption “Credit Quality Indicators” in Note 5 to the Unaudited Consolidated Financial Statements. The loan rating system and the related loss allocation factors take into consideration parameters including the borrower’s financial condition, the borrower’s performance with respect to loan terms, and the adequacy of collateral. Portfolios of more homogeneous populations of loans including residential mortgages and consumer loans are analyzed as groups taking into account delinquency ratios and other indicators, as well as our historical loss experience for each type of credit product. We continue to periodically reassess and revise the loss allocation factors and estimates used in the assignment of loss exposure to appropriately reflect our analysis of migrational loss experience.

Appraisals are generally obtained with values determined on an “as is” basis from independent appraisal firms for real estate collateral dependent commercial loans in the process of collection or when warranted by other deterioration in the borrower’s credit status. Updates to appraisals are generally obtained for troubled or nonaccrual loans or when management believes it is warranted. The Corporation has continued to maintain appropriate professional standards regarding the professional qualifications of appraisers and has an internal review process to monitor the quality of appraisals.

For residential mortgages and real estate collateral dependent consumer loans that are in the process of collection, valuations are obtained from independent appraisal firms with values determined on an “as is” basis.

The provision for loan losses charged to earnings for the three and nine months ended September 30, 2013 amounted to $700 thousand and $2.0 million, compared to $600 thousand and $2.1 million for the same periods in 2012. Net charge-offs for the three and nine months ended September 30, 2013 totaled $576 thousand and $4.9 million, respectively, compared to $296 thousand and $1.2 million, respectively, for the same periods a year earlier. Net charge-offs in 2013 included a $4.0 million charge-off recognized in the second quarter on one commercial mortgage loan. The remaining carrying value of this loan was $686 thousand at September 30, 2013.

As of September 30, 2013, the allowance for loan losses was $28.0 million, or 1.19% of total loans, compared to $30.9 million, or 1.35% of total loans at December 31, 2012. The decline in the ratio of the allowance for loan losses to total loans reflects charge-offs and a decrease in specific reserves on impaired loans. The decline in this ratio also reflects a decrease in estimated loss exposure on loans collectively evaluated for impairment, as evidenced by improvement in commercial loan portfolio credit quality indicators. See Note 5 to the Unaudited Consolidated Financial Statements for additional information under the caption “Credit Quality Indicators.”

The following table presents additional detail on the Corporation’s loan portfolio and associated allowance for loan losses as of the dates indicated.

(Dollars in thousands)	September 30, 2013				December 31, 2012			
	Loans	Related Allowance	Allowance / Loans		Loans	Related Allowance	Allowance / Loans	
Impaired loans individually evaluated for impairment	$39,704	$2,013	5.07	%	$35,547	$2,880	8.10	%
Loans collectively evaluated for impairment	2,314,062	17,812	0.77	%	2,258,456	19,700	0.87	%
Unallocated	—	8,183	—		—	8,293	—	
Total	$2,353,766	$28,008	1.19	%	$2,294,003	$30,873	1.35	%

The following table presents the allocation of the allowance for loan losses as of the dates indicated:

(Dollars in thousands)	September 30, 2013			December 31, 2012		
	Amount	% (1)		Amount	% (1)	
Commercial:						
Mortgages	$6,639	31	%	$9,407	31	%
Construction and development	441	2		224	1	
Other	5,570	22		5,996	23	
Residential real estate:						
Mortgage	4,580	30		4,132	30	
Homeowner construction	100	1		137	1	
Consumer	2,495	14		2,684	14	
Unallocated	8,183			8,293		
Balance at end of period	$28,008	100	%	$30,873	100	%

(1) Percentage of loans within the respective category to the total loans outstanding.

Sources of Funds

Our sources of funds include deposits, brokered certificates of deposit, FHLBB borrowings, other borrowings and proceeds from the sales, maturities and payments of loans and investment securities. Washington Trust uses funds to originate and purchase loans, purchase investment securities, conduct operations, expand the branch network and pay dividends to shareholders.

Management’s preferred strategy for funding asset growth is to grow low-cost deposits, including demand deposit, NOW and savings accounts. Asset growth in excess of low-cost deposits is typically funded through higher-cost deposits (including certificates of deposit and money market accounts), brokered certificates of deposit, FHLBB borrowings, and securities portfolio cash flow.

Deposits

Washington Trust offers a wide variety of deposit products to consumer and business customers. Deposits provide an important source of funding for the Bank as well as an ongoing stream of fee revenue.

Washington Trust is a participant in the Insured Cash Sweep (“ICS”) program, a low-cost reciprocal deposit sweep service, and in the Certificate of Deposit Account Registry Service (“CDARS”) program. Washington Trust uses ICS to place customer funds into money market accounts issued by other participating banks and CDARS to place customer funds into certificate of deposit accounts issued by other participating banks. These transactions occur in amounts that are less than FDIC insurance limits to ensure that depositor customers are eligible for full FDIC insurance. We receive reciprocal amounts of deposits from other participating banks who do the same with their customer deposits. ICS and CDARS deposits are considered to be brokered deposits for bank regulatory purposes. We consider these reciprocal deposit balances to be in-market deposits as distinguished from traditional out-of-market brokered deposits.

Total deposits amounted to $2.45 billion at September 30, 2013, up by $142.2 million, or 6%, from the balance at December 31, 2012.

Demand deposits totaled $420.1 million at September 30, 2013, up by $40.2 million, or 11%, from December 31, 2012. NOW account balances increased by $10.1 million, or 3%, and totaled $301.3 million at September 30, 2013. Savings accounts totaled $292.8 million at September 30, 2013, up by $17.8 million, or 6%, from December 31, 2012.

Money market accounts (including brokered money market deposits) totaled $623.6 million at September 30, 2013, up by $127.2 million, or 26%, from the balance at December 31, 2012. Included in total money market deposits were ICS reciprocal money market deposits totaling $190.1 million at September 30, 2013, up by $47.3 million from the balance at December 31, 2012.

Time deposits (including brokered certificates of deposit) amounted to $817.1 million at September 30, 2013, down by $53.1 million, or 6%, from the balance at December 31, 2012. The Corporation utilizes out-of-market brokered time deposits as part of its overall funding program along with other sources. Excluding out-of-market brokered certificates of deposits, in-market time deposits totaled $710.9 million and $767.6 million, respectively, at September 30, 2013 and December 31, 2012. Included in in-market time deposits at September 30, 2013 were CDARS reciprocal time deposits of $162.9 million, down by $4.0 million from the balance at December 31, 2012.

Borrowings
The Corporation utilizes advances from the FHLBB as well as other borrowings as part of its overall funding strategy. FHLBB advances are used to meet short-term liquidity needs, to purchase securities and to purchase loans from other institutions. FHLBB advances amounted to $288.5 million at September 30, 2013, down by $72.7 million from the balance at the end of 2012.

In the third quarter of 2013, $24.5 million of FHLBB advances with a weighted average interest rate of 2.48% and a weighted average remaining maturity of 42 months were prepaid and as a result, debt prepayment penalty expense of $1.1 million was recognized.

In February 2013, the Corporation modified the terms to extend the maturity dates of $72.5 million of its FHLBB advances with original maturity dates in 2015. The original weighted average interest rate was 3.68% and was revised to 3.09% with maturities ranging from 2017 to 2019.

Redemption of Certain Trust Preferred Securities and Related Junior Subordinated Debentures
The Bancorp is the sponsor of the Washington Preferred Capital Trust (“WPCT”), a statutory trust created for the sole purpose of the April 7, 2008 issuance of trust preferred securities, the proceeds of which were invested in junior subordinated debentures of the Bancorp. On June 17, 2013, the Bancorp redeemed in whole at par the outstanding trust preferred securities and related subordinated debentures totaling $10.0 million in trust preferred securities at an interest rate of three-month LIBOR plus 3.50%. The source of funds used for the redemption was made available from our balance sheet liquidity. The Bancorp also had a related interest rate swap contract designated as a cash flow hedge, which matured at redemption or June 17, 2013. In connection with the redemption, unamortized debit issuance costs of $244 thousand were expensed and classified as interest expense in June 2013.

Other Liabilities
Other liabilities decreased by $26.6 million from December 31, 2012, largely reflecting a decline in pension plan liabilities. Effective September 19, 2013, the Corporation amended its defined benefit pension plan to freeze benefit accruals after a ten-year transition period ending in December 2023. Due to the amendment, a remeasurement of the value of pension plan liabilities was conducted and as a result, pension plan liabilities were reduced by $17.5 million and the accumulated other comprehensive income component of shareholders' equity was increased by $11.2 million, after tax. The remeasurement impact also reflected an increase in the discount rates used to measure the present value of pension plan liabilities as a result of an increase in market rates of interest and continued asset performance. Also as a result of the amendment and remeasurement, pension plan expense in the third quarter of 2013 was reduced by $124 thousand and fourth quarter 2013 pension plan expense is expected to be approximately $500 thousand lower than pre-amendment quarterly expense levels.

Liquidity and Capital Resources
Liquidity Management
Liquidity is the ability of a financial institution to meet maturing liability obligations and customer loan demand. Washington Trust’s primary source of liquidity is deposits, which funded approximately 76% of total average assets in the nine months ended September 30, 2013. While the generally preferred funding strategy is to attract and retain low cost deposits, the ability to do so is affected by competitive interest rates and terms in the marketplace. Other sources of funding include discretionary use of purchased liabilities (e.g., FHLBB term advances and other borrowings), cash flows from the Corporation’s securities portfolios and loan repayments. Securities designated as available for sale may also be sold in response to short-term or long-term liquidity needs although management has no intention to do so at this time. For a more detailed discussion on Washington Trust’s detailed liquidity funding policy and contingency

funding plan, see additional information in Item 7 under the caption “Liquidity and Capital Resources” of Washington Trust’s Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

Liquidity remained well within target ranges established by the Corporation’s Asset/Liability Committee (“ALCO”) during the nine months ended September 30, 2013. Based on its assessment of the liquidity considerations described above, management believes the Corporation’s sources of funding will meet anticipated funding needs.

For the nine months ended September 30, 2013, net cash used in financing activities amounted to $50.2 million. FHLBB advances decreased by $72.7 million, while total deposits increased by $142.2 million in the first nine months of 2013. See discussion regarding the redemption of $10.3 million in junior subordinated debentures in the second quarter of 2013 in the

"Sources of Funds" section under the caption "Borrowings." Net cash used in investing activities totaled $69.0 million for the nine months ended September 30, 2013. The most significant elements of cash flow within investment activities were net outflows related to growth in the loan portfolio, offset by cash received from the sale of residential mortgage portfolio loans during the third quarter of 2013. Net cash provided by operating activities amounted to $66.0 million for the nine months ended September 30, 2013. Net income totaled $26.4 million in the first nine months of 2013 and the most significant adjustments to reconcile net income to net cash provided by operating activities pertained to mortgage banking activities and a reduction of pension plan liabilities. See the Corporation's Consolidated Statements of Cash Flows for further information about sources and uses of cash.

Capital Resources

Total shareholders' equity amounted to $323.6 million at September 30, 2013, up by $27.9 million from December 31, 2012, including $26.4 million of earnings retention, the $11.2 million after tax beneficial impact of the change in pension plan liabilities described above in "Other Liabilities" and a reduction of $12.7 million for dividend declarations.

The ratio of total equity to total assets amounted to 10.33% at September 30, 2013. This compares to a ratio of 9.62% at December 31, 2012. Book value per share at September 30, 2013 and December 31, 2012 amounted to $19.51 and $18.05, respectively.

The Bancorp and the Bank are subject to various regulatory capital requirements. As of September 30, 2013, the Bancorp and the Bank are categorized as "well-capitalized" under the regulatory framework for prompt corrective action. As indicated under the caption "Borrowings" in the "Sources of Funds" section above, the Bancorp redeemed junior subordinated debentures issued to Washington Preferred Capital Trust on June 17, 2013. This transaction reduced the regulatory capital levels of total capital and Tier 1 capital in the Bancorp and the Bank by approximately $10.0 million.

See Note 9 to the Unaudited Consolidated Financial Statements for additional discussion of capital requirements.

Contractual Obligations and Commitments

The Corporation has entered into numerous contractual obligations and commitments. The following tables summarize our contractual cash obligations and other commitments at September 30, 2013:

(Dollars in thousands)	Payments Due by Period				
	Total	Less Than 1 Year (1)	1-3 Years	4-5 Years	After 5 Years
Contractual Obligations:					
FHLBB advances (2)	$288,485	$2,534	$79,666	$155,364	$50,921
Junior subordinated debentures	22,681	—	—	—	22,681
Operating lease obligations	22,621	2,437	3,745	2,767	13,672
Software licensing arrangements	4,697	2,213	2,381	103	—
Other borrowings	797	652	99	46	—
Total contractual obligations	$339,281	$7,836	$85,891	$158,280	$87,274

(1) Maturities or contractual obligations are considered by management in the administration of liquidity and are routinely refinanced in the ordinary course of business.

(2) All FHLBB advances are shown in the period corresponding to their scheduled maturity. Some FHLBB advances are callable at earlier dates.

(Dollars in thousands)	Amount of Commitment Expiration – Per Period				
	Total	Less Than 1 Year	1-3 Years	4-5 Years	After 5 Years
Other Commitments:					
Commercial loans	$253,400	$149,846	$56,486	$17,792	$29,276
Home equity lines	196,281	—	—	—	196,281
Other loans	33,622	25,668	4,322	3,632	—
Standby letters of credit	1,361	1,114	247	—	—
Forward loan commitments to:					
Originate loans	20,750	20,750	—	—	—
Sell loans	33,521	33,521	—	—	—
Customer related derivative contracts:					
Interest rate swaps with customers	64,898	19,261	22,205	14,978	8,454
Mirror swaps with counterparties	64,898	19,261	22,205	14,978	8,454
Interest rate risk management contract:					
Interest rate swap contracts	22,681	—	22,681	—	—
Total commitments	$691,412	$269,421	$128,146	$51,380	$242,465

Off-Balance Sheet Arrangements

For information on financial instruments with off-balance sheet risk and derivative financial instruments see Notes 10 and 17 to the Unaudited Consolidated Financial Statements.

Asset/Liability Management and Interest Rate Risk

Interest rate risk is the primary market risk category associated with the Corporation's operations. The ALCO is responsible for establishing policy guidelines on liquidity and acceptable exposure to interest rate risk. Periodically, the ALCO reports on the status of liquidity and interest rate risk matters to the Bank's Board of Directors. Interest rate risk is the risk of loss to future earnings due to changes in interest rates. The objective of the ALCO is to manage assets and funding sources to produce results that are consistent with Washington Trust's liquidity, capital adequacy, growth, risk and profitability goals.

The ALCO manages the Corporation's interest rate risk using income simulation to measure interest rate risk inherent in the Corporation's on-balance sheet and off-balance sheet financial instruments at a given point in time by showing the effect of interest rate shifts on net interest income over a 12-month horizon, the 13- to 24-month horizon and a 60-month horizon. The simulations assume that the size and general composition of the Corporation's balance sheet remain static over the simulation horizons, with the exception of certain deposit mix shifts from low-cost core savings to higher-cost time deposits in selected interest rate scenarios. Additionally, the simulations take into account the specific repricing, maturity, call options, and prepayment characteristics of differing financial instruments that may vary under different interest rate scenarios. The characteristics of financial instrument classes are reviewed periodically by the ALCO to ensure their accuracy and consistency.

The ALCO reviews simulation results to determine whether the Corporation's exposure to a decline in net interest income remains within established tolerance levels over the simulation horizons and to develop appropriate strategies to manage this exposure. As of September 30, 2013 and December 31, 2012, net interest income simulations indicated that exposure to changing interest rates over the simulation horizons remained within tolerance levels established by the Corporation. The Corporation defines maximum unfavorable net interest income exposure to be a change of no more than 5% in net interest income over the first 12 months, no more than 10% over the second 12 months, and no more than 10% over the full 60-month simulation horizon. All changes are measured in comparison to the projected net interest income that would result from an "unchanged" rate scenario where both interest rates and the composition of the Corporation's balance sheet remain stable for a 60-month period. In addition to measuring the change in net interest income as compared to an unchanged interest rate scenario, the ALCO also measures the trend of both net interest income and net interest margin over a 60-month horizon to ensure the stability and adequacy of this source of earnings in different interest rate scenarios.

The ALCO regularly reviews a wide variety of interest rate shift scenario results to evaluate interest risk exposure, including scenarios showing the effect of steepening or flattening changes in the yield curve of up to 500 basis points as well as parallel changes in interest rates of up to 400 basis points. Because income simulations assume that the Corporation's balance sheet will remain static over the simulation horizon, the results do not reflect adjustments in strategy that the ALCO could implement in response to rate shifts.

The following table sets forth the estimated change in net interest income from an unchanged interest rate scenario over the periods indicated for parallel changes in market interest rates using the Corporation's on- and off-balance sheet financial instruments as of September 30, 2013 and December 31, 2012. Interest rates are assumed to shift by a parallel 100, 200 or 300 basis points upward or 100 basis points downward over a 12-month period, except for core savings deposits, which are assumed to shift by lesser amounts due to their relative historical insensitivity to market interest rate movements. Further, deposits are assumed to have certain minimum rate levels below which they will not fall. It should be noted that the rate scenarios shown do not necessarily reflect the ALCO's view of the "most likely" change in interest rates over the periods indicated.

	September 30, 2013		December 31, 2012	
	Months 1 - 12	Months 13 - 24	Months 1 - 12	Months 13 - 24
100 basis point rate decrease	(1.75)%	(6.36)%	(2.33)%	(7.33)%
100 basis point rate increase	2.18%	3.50%	3.11%	5.86%
200 basis point rate increase	3.99%	6.51%	6.36%	10.98%
300 basis point rate increase	4.97%	6.58%	8.34%	13.19%

The ALCO estimates that the negative exposure of net interest income to falling rates as compared to an unchanged rate scenario results from a more rapid decline in earning asset yields compared to rates paid on deposits. If market interest rates were to fall from their already low levels and remain lower for a sustained period, certain core savings and time deposit rates could decline more slowly and by a lesser amount than other market rates. Asset yields would likely decline more rapidly than deposit costs as current asset holdings mature or reprice, since cash flow from mortgage-related prepayments and redemption of callable securities would increase as market rates fall.

The positive exposure of net interest income to rising rates as compared to an unchanged rate scenario results from a more rapid projected relative rate of increase in asset yields than funding costs over the near term. For simulation purposes, deposit rate changes are anticipated to lag other market rates in both timing and magnitude. The ALCO's estimate of interest rate risk exposure to rising rate environments, including those involving changes to the shape of the yield curve, incorporates certain assumptions regarding the shift in deposit balances from low-cost core savings categories to higher-cost deposit categories, which has characterized a shift in funding mix during the past rising interest rate cycles. The relative decrease in positive exposure of net interest income to rising rates from December 31, 2012 to September 30, 2013 was largely attributable to changes in balance sheet composition and a steepening of the yield curve.

While the ALCO reviews and updates simulation assumptions and also periodically back-tests the simulation results to ensure that the assumptions are reasonable and current, income simulation may not always prove to be an accurate indicator of interest rate risk or future net interest margin. Over time, the repricing, maturity and prepayment characteristics of financial instruments and the composition of the Corporation's balance sheet may change to a different degree than estimated. Simulation modeling assumes a static balance sheet, with the exception of certain modeled deposit mix shifts from low-cost core savings deposits to higher-cost time deposits in rising rate scenarios as noted above. Due to the current low level of market interest rates, the banking industry has experienced relatively strong growth in low-cost core deposits over the past several years. The ALCO recognizes that a portion of these increased levels of low-cost balances could shift into higher yielding alternatives in the future, particularly if interest rates rise and as confidence in financial markets strengthens, and has modeled increased amounts of deposit shifts out of these low-cost categories into higher-cost alternatives in the rising rate simulation scenarios presented above. Deposit balances may also be subject to possible outflow to non-bank alternatives in a rising rate environment, which may cause interest rate sensitivity to differ from the results as presented. Another significant simulation assumption is the sensitivity of core savings deposits to fluctuations in interest rates. Income simulation results assume that changes in both core savings deposit rates and balances are related to changes in short-term interest rates. The relationship between short-term interest rate changes and core deposit rate and balance changes may differ from the ALCO's estimates used in income simulation. It should be noted that the static balance sheet assumption does not necessarily reflect the Corporation's expectation for future balance sheet growth, which is a function of the business environment and customer behavior. Lastly, mortgage-backed securities and mortgage loans involve a level of risk that unforeseen changes in prepayment speeds may cause related cash flows to vary significantly in differing rate environments. Such changes could affect the level of reinvestment risk associated with cash flow from these instruments, as well as their market value. Changes in prepayment speeds could also increase or decrease the amortization of premium or accretion of discounts related to such instruments, thereby affecting interest income.

The Corporation also monitors the potential change in market value of its available for sale debt securities in changing interest rate environments. The purpose is to determine market value exposure that may not be captured by income simulation, but which might result in changes to the Corporation's capital position. Results are calculated using industry-standard analytical techniques and securities data.

The following table summarizes the potential change in market value of the Corporation's available for sale debt securities as of September 30, 2013 and December 31, 2012 resulting from immediate parallel rate shifts:
(Dollars in thousands)

Security Type	Down 100 Basis Points	Up 200 Basis Points
U.S. government-sponsored enterprise securities (noncallable)	$214	($420)
U.S. government sponsored enterprise securities (callable)	497	(2,230)
States and political subdivisions	1,335	(2,684)
Mortgage-backed securities issued by U.S. government agencies and U.S. government-sponsored enterprises	4,622	(15,284)
Trust preferred debt and other corporate debt securities	62	831
Total change in market value as of September 30, 2013	$6,730	($19,787)
Total change in market value as of December 31, 2012	$4,700	($12,824)

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

Information regarding quantitative and qualitative disclosures about market risk appears under Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations," under the caption "Asset/Liability Management and Interest Rate Risk."

ITEM 4. Controls and Procedures

Disclosure Controls and Procedures

As required by Rule 13a-15 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), the Corporation carried out an evaluation under the supervision and with the participation of the Corporation's management, including the Corporation's principal executive officer and principal financial officer, of the Corporation's disclosure controls and procedures as of the periods ended September 30, 2013. Based upon that evaluation, the principal executive officer and principal financial officer concluded that the Corporation's disclosure controls and procedures are effective and designed to ensure that information required to be disclosed by the Corporation in the reports it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and (ii) accumulated and communicated to the Corporation's management including its Chief Executive Officer and Chief Financial Officer as appropriate to allow timely decisions regarding required disclosures. The Corporation will continue to review and document its disclosure controls and procedures and consider such changes in future evaluations of the effectiveness of such controls and procedures, as it deems appropriate.

Internal Control Over Financial Reporting

The Corporation's management is responsible for establishing and maintaining adequate internal control over financial reporting as such term is defined by the Exchange Act Rule 13a-15(f). The Corporation's internal control system was designed to provide reasonable assurance to its management and the Board of Directors regarding the preparation and fair presentation of published financial statements. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. The Corporation's management assessed the effectiveness of its internal control over financial reporting as of the end of the period covered by this report.

There has been no change in our internal control over financial reporting during the period ended September 30, 2013 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II
Other Information

Item 1. Legal Proceedings
The Corporation is involved in various claims and legal proceedings arising out of the ordinary course of business. Management is of the opinion, based on its review with counsel of the development of such matters to date, that the ultimate disposition of such matters will not materially affect the consolidated financial position or results of operations of the Corporation.

Item 1A. Risk Factors
In addition to the risk factor discussed below and other information set forth in this report, you should carefully consider the factors discussed in Item 1A to Part I of Washington Trust's Annual Report on Form 10-K for the year ended December 31, 2012 and as updated by our Quarterly Reports on Form 10-Q and other filings submitted to the SEC.

We will become subject to more stringent capital requirements.
The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") required the federal banking agencies to establish minimum leverage and risk-based capital requirements for insured banks and their holding companies. The federal banking agencies issued a joint final rule, or the "Final Capital Rule," that implements the Basel III capital standards and establishes the minimum capital levels required under the Dodd-Frank Act. We must comply with the Final Capital Rule by January 1, 2015. The Final Capital Rule establishes a minimum common equity Tier I capital ratio of 6.5% of risk-weighted assets for a "well capitalized" institution and increases the minimum Tier I capital ratio for a "well capitalized" institution from 6% to 8%. Additionally, the Final Capital Rule requires an institution to maintain a 2.5% common equity Tier I capital conservation buffer to avoid restrictions on the ability to pay dividends, discretionary bonuses, and engage in share repurchases. The Final Capital Rule permanently grandfathers trust preferred securities issued before May 19, 2010 for institutions with less than $15 billion in total assets as of December 31, 2009, subject to a limit of 25% of Tier I capital. The Final Capital Rule increases the required capital for certain categories of assets, including high volatility construction real estate loans and certain exposures related to securitizations; however, the Final Capital Rule retains the current capital treatment of residential mortgages. Under the Final Capital Rule, we may make a one-time, permanent election to continue to exclude accumulated other comprehensive income from capital. If we do not make this election, unrealized gains and losses will be included in the calculation of our regulatory capital. Implementation of these standards, or any other new regulations, may adversely affect our ability to pay dividends, or require us to reduce business levels or raise capital, including in ways that may adversely affect our results of operations or financial condition.

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Item 6. Exhibits

(a) Exhibits. The following exhibits are included as part of this Form 10-Q:

Exhibit Number	
10.1	Employment and Compensatory Agreement with a certain executive officer, dated September 19, 2013 - Filed as Exhibit 10.1 to the Registrant's Current Report of Form 8-K, as filed with the Securities and Exchange Commission on September 25, 2013. (1) (2)
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 – Filed herewith.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 – Filed herewith.
32.1	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 – Furnished herewith. (3)
101	The following materials from Washington Trust Bancorp, Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2013 formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Changes in Shareholders' Equity, (v) the Consolidated Statements of Cash Flows, and (vi) related notes to these financial statements - Furnished herewith. (4)

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(1) Not filed herewith. In accordance with Rule 12b-32 promulgated pursuant to the Exchange Act, reference is made to the documents previously filed with the Securities and Exchange Commission, which are incorporated by reference herein.

(2) Management contract or compensatory plan or arrangement.

(3) These certifications are not "filed" for purposes of Section 18 of the Exchange Act or incorporated by reference into any filing under the Securities Act or the Securities Exchange Act.

(4) Pursuant to Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	WASHINGTON TRUST BANCORP, INC. (Registrant)
Date: November 7, 2013	By: /s/ Joseph J. MarcAurele Joseph J. MarcAurele Chairman, President and Chief Executive Officer (principal executive officer)
Date: November 7, 2013	By: /s/ David V. Devault David V. Devault Vice Chairman, Secretary and Chief Financial Officer (principal financial and accounting officer)

Exhibit Index

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