NORTHEAST BANCORP /ME/
Form 10-K
September 30, 2015

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United States
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended June 30, 2015

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 (1-14588)

NORTHEAST BANCORP

(Exact name of registrant as specified in its charter)

Maine	**01-0425066**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
500 Canal Street, Lewiston, Maine	**04240**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code:

(207) 786-3245

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

Title of each class:	Name of each exchange on which registered:
Voting Common Stock, $1.00 par value	The NASDAQ Stock Market LLC

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

None

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

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

Large Accelerated Filer o   Accelerated filer o   Non-accelerated filer o   Smaller Reporting Company ý

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

The aggregate market value of the registrant's voting and non-voting common stock held by non-affiliates, computed by reference to the last reported sales price of the registrant's voting common stock on the NASDAQ Global Market on December 31, 2014 was approximately $65,212,768.

As of September 18, 2015, the registrant had outstanding 8,523,666 shares of voting common stock, $1.00 par value per share, and 1,012,717 shares of non-voting common stock, $1.00 par value per share.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's proxy statement for the 2015 Annual Meeting of Shareholders to be held on November 20, 2015 are incorporated by reference in Items 10, 11, 12, 13 and 14 of Part III of this Annual Report on Form 10-K. The registrant intends to file such proxy statement with the Securities and Exchange Commission no later than 120 days after the end of its fiscal year ended June 30, 2015.

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A Note About Forward-Looking Statements

This report contains certain "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended, such as statements relating to our financial condition, prospective results of operations, future performance or expectations, plans, objectives, prospects, loan loss allowance adequacy, simulation of changes in interest rates, capital spending, finance sources and revenue sources. These statements relate to expectations concerning matters that are not historical facts. Accordingly, statements that are based on management's projections, estimates, assumptions, and judgments constitute forward-looking statements. These forward looking statements, which are based on various assumptions (some of which are beyond the Company's control), may be identified by reference to a future period or periods, or by the use of forward-looking terminology such as "believe", "expect", "estimate", "anticipate", "continue", "plan", "approximately", "intend", "objective", "goal", "project", or other similar terms or variations on those terms, or the future or conditional verbs such as "will", "may", "should", "could", and "would".

Such forward-looking statements reflect our current views and expectations based largely on information currently available to our management, and on our current expectations, assumptions, plans, estimates, judgments, and projections about our business and our industry, and they involve inherent risks and uncertainties. Although the Company believes that these forward-looking statements are based on reasonable estimates and assumptions, they are not guarantees of future performance and are subject to known and unknown risks, uncertainties, contingencies, and other factors. Accordingly, the Company cannot give you any assurance that our expectations will in fact occur or that our estimates or assumptions will be correct. The Company cautions you that actual results could differ materially from those expressed or implied by such forward-looking statements as a result of, among other factors, the factors referenced in this report under Item 1A. "Risk Factors"; changes in interest rates; competitive pressures from other financial institutions; the effects of a deterioration in general economic conditions on a national basis or in the local markets in which the Company operates, including changes which adversely affect borrowers' ability to service and repay our loans; changes in loan defaults and charge-off rates; changes in the value of securities and other assets, adequacy of loan loss reserves, or deposit levels necessitating increased borrowing to fund loans and investments; changes in government regulation; the risk that we may not be successful in the implementation of our business strategy; the risk that intangibles recorded in the Company's financial statements will become impaired; and changes in assumptions used in making such forward-looking statements. These forward-looking statements speak only as of the date of this report and the Company does not undertake any obligation to update or revise any of these forward-looking statements to reflect events or circumstances occurring after the date of this report.

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PART I

Item 1. Business

Overview

Northeast Bancorp ("we," "our," "us," "Northeast" or the "Company"), incorporated under Maine law in 1987, is a bank holding company, registered with the Board of Governors of the Federal Reserve System (the "Federal Reserve") under the Bank Holding Company Act of 1956, as amended. The Company's primary subsidiary and principal asset is its wholly-owned banking subsidiary, Northeast Bank (the "Bank" or "Northeast Bank"), a Maine state-chartered bank originally organized in 1872.

On December 29, 2010, the merger of the Company and FHB Formation LLC, a Delaware limited liability company ("FHB"), was consummated. As a result of the merger, the surviving company received a capital contribution of $16.2 million (in addition to the approximately $13.1 million in cash consideration paid to former shareholders), and the former members of FHB collectively acquired approximately 60% of the Company's outstanding common stock. The Company applied the acquisition method of accounting, as described in Accounting Standards Codification ("ASC") 805, *Business Combinations* ("ASC 805") to the merger, which represents an acquisition by FHB of Northeast, with Northeast as the surviving company.

In connection with the transaction, as part of the regulatory approval process, the Company and the Bank made certain commitments to the Federal Reserve, the most significant of which are (i) to maintain a Tier 1 leverage ratio of at least 10%, (ii) to maintain a total risk-based capital ratio of at least 15%, (iii) to limit purchased loans to 40% of total loans, (iv) to fund 100% of the Company's loans with core deposits (defined as non-maturity deposits and non-brokered insured time deposits), and (v) to hold commercial real estate loans (including owner-occupied commercial real estate) to within 300% of total risk-based capital. On June 28, 2013, the Federal Reserve approved the amendment of the commitment to hold commercial real estate loans to within 300% of total risk-based capital to exclude owner-occupied commercial real estate loans. All other commitments made to the Federal Reserve in connection with the merger remain unchanged. The Company and the Bank are currently in compliance with all commitments to the Federal Reserve.

As of June 30, 2015, the Company, on a consolidated basis, had total assets of $850.8 million, total deposits of $674.8 million, and stockholders' equity of $112.8 million. The Company gathers retail deposits through the Community Banking Division's ten full-service branches in Maine and through its online deposit program, ableBanking; originates loans through its Community Banking Division; purchases and originates commercial loans on a nationwide basis through its Loan Acquisition and Servicing Group ("LASG"); and originates Small Business Administration ("SBA") loans on a nationwide basis through the Small Business Administration National group ("SBA National").

Unless the context otherwise requires, references herein to the Company include the Company and its subsidiary on a consolidated basis.

Strategy

The Company's goal is to prudently grow its franchise, while maintaining sound operations and risk management, by implementing the following strategies:

Measured growth of our national commercial loan portfolio. The Company purchases performing commercial real estate loans, on a nationwide basis, typically at a discount from their outstanding principal balances, producing yields higher than those normally achieved on our originated loan portfolio. These loans are purchased from a variety of sources, including banks, insurance companies, investment funds and government agencies, either directly or indirectly through a broker. We also originate commercial real estate and commercial business loans on a nationwide basis, including loans partially guaranteed by the SBA.

Focus on core deposits. The Company offers a full line of deposit products to customers in the Community Banking Division's market area through its ten-branch network. In addition, in June 2012, we launched our online deposit program, ableBanking, a division of Northeast Bank, to provide an additional channel through which to raise core deposits to fund the Company's asset strategy.

Continuing our community banking tradition. The Community Banking Division retains a high degree of local autonomy and operational flexibility to better serve its customers. The Community Banking Division's focus on sales and service allows us to attract and retain core deposits in support of balance sheet growth, and to continue to generate new commercial and residential mortgage loans.

Market Area and Competition

Northeast Bancorp is the holding company for Northeast Bank, a full-service bank headquartered in Lewiston, Maine. We offer traditional banking services through the Community Banking Division, which operates ten full-service branches that serve customers located in western and central Maine. From our Maine and Boston locations, we also lend throughout the New England area. The LASG purchases and originates commercial loans on a nationwide basis. SBA National originates SBA loans on a nationwide basis for the Bank's portfolio, and sells the guaranteed portion on certain loans originated. ableBanking, a division of Northeast Bank, offers savings products to consumers online.

The Community Banking Division's market area covers the six New England states, with the majority of its activities centered in the western and central regions of the State of Maine. We encounter significant competition in the Community Banking Division market area in originating loans, attracting deposits, and selling other customer products and services. Our competitors include savings banks, commercial banks, credit unions, mutual funds, insurance companies, brokerage and investment banking companies, finance companies, and other financial intermediaries. Many of our primary competitors there have substantially greater resources, larger established customer bases, higher lending limits, extensive branch networks, numerous ATMs and greater advertising and marketing budgets. They may also offer services that we do not currently provide.

The LASG has a nationwide scope in its loan purchasing, origination, and servicing activities. It competes with regional banks, national private equity funds, and community banks in its bid to acquire performing commercial loans. SBA National has a national scope in its SBA loan origination activities, and competes with regional banks and community banks in its bid to originate loans. ableBanking also has nationwide scope in its deposit gathering activities and competes with banks and credit unions, as well as other, larger, online direct banks having a national reach.

Lending Activities

General

We conduct our loan-related activities through three primary channels: the Community Banking Division, the LASG, and SBA National. The Community Banking Division originates loans directly to consumers and businesses located in its market area. The LASG purchases primarily performing commercial real estate loans, on a nationwide basis, typically at a discount from their outstanding principal balances, producing yields higher than those normally achieved on the Company's originated loan portfolio. The LASG also originates commercial real estate and commercial business loans on a nationwide basis. Pursuant to commitments made to the Federal Reserve in connection with the merger, the Company is required to limit purchased loans to 40% of total loans. At June 30, 2015, the Company's ratio of purchased loans to total loans, including loans held for sale, was 32.6%. SBA National originates loans to small businesses, primarily through the SBA 7(a) program, which provides

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the partial guarantee of the SBA. At June 30, 2015, of our total loan portfolio of $612.1 million, $220.2 million, or 36.0%, was originated by the Community Banking Division, $380.9 million, or 62.2%, was purchased or originated by the LASG and $11.0 million, or 1.8%, was originated by SBA National, excluding loans held for sale.

The following table sets forth certain information concerning our portfolio loan purchases and originations for the periods indicated:

	Year Ended June 30,	
	2015	2014
	(Dollars in thousands)	
Loans, including loans held for sale, beginning of year	$ 528,361	$ 443,970
Additions:		
LASG Purchases and Originations:		
Originations	130,502	61,665
Purchases	82,654	79,823
Subtotal	213,156	141,488
SBA National Originations:		
Originations	34,544	4,613
Community Bank Originations:		
Residential mortgages held for sale	97,438	91,366
Residential mortgage held to maturity	7,857	45,525
Home equity	1,024	1,498
Commercial real estate	13,580	1,854
Commercial business	6,317	1,256
Consumer	211	191
Subtotal	126,427	141,690
Total originations and purchases	374,127	287,791
Reductions:		
Sales of residential loans held for sale	(106,045)	(88,015)
Sales of portfolio loans	(22,351)	(8,779)
Charge-offs	(238)	(405)
Pay-downs and amortization, net	(152,682)	(106,201)
Total reductions	(281,316)	(203,400)
Loans, including loans held for sale, end of year	$ 621,172	$ 528,361
Annual percentage increase in loans	17.57%	19.01%

We individually underwrite the loans that we originate and all loans that we purchase. Our loan underwriting policies are reviewed and approved annually by our board of directors. Each loan, regardless of whether it is originated or purchased, must meet underwriting criteria set forth in our lending policies and the requirements of applicable federal and state regulators. We typically retain servicing rights for all loans that we originate or purchase, except for residential loans that we originate and sell servicing released in the secondary market.

Community Bank Originations

Originated Loan Portfolio. Our Community Bank originated loan portfolio consists primarily of loans to consumers and businesses in the Community Banking Division's market area.

Residential Mortgage Loans. We originate residential mortgage loans secured by one- to four-family properties throughout Maine, southern New Hampshire, and Massachusetts. Such

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loans may be originated for sale in the secondary market or to be held on the Bank's balance sheet. We also offer home equity loans and home equity lines of credit, which are secured by first or second mortgages on one- to four-family owner-occupied properties and which are held on our balance sheet. At June 30, 2015, portfolio residential loans totaled $130.5 million, or 21.3% of total loans. Of the residential loans we held for investment at June 30, 2015, approximately 51.0% were adjustable rate. Included in residential loans are home equity lines of credit and other second mortgage loans aggregating approximately $24.3 million.

Commercial Real Estate Loans. We originate multi-family and other commercial real estate loans secured by property located primarily in the Community Banking Division's market area. At June 30, 2015, commercial real estate loans outstanding were $70.6 million, or 11.5% of total loans. Although the largest commercial real estate loan originated by the Community Banking Division had a principal balance of $3.2 million at June 30, 2015, the majority of the commercial real estate loans originated by the Community Banking Division had principal balances less than $500 thousand.

Commercial Business Loans. We originate commercial business loans, including term loans, lines of credit and equipment and receivables financing to businesses located primarily in the Community Banking Division's market area. At June 30, 2015, commercial business loans outstanding were $11.9 million, or 1.9% of total loans. At June 30, 2015, there were 122 commercial business loans outstanding with an average principal balance of $97 thousand. The largest of these commercial business loans had a principal balance of $2.7 million at June 30, 2015.

Consumer Loans. We originate, on a direct basis, automobile, boat and recreational vehicle loans. At June 30, 2015, consumer loans outstanding were $7.7 million, or 1.3% of total loans.

Underwriting of Originated Loans. Most residential loans, including those held for investment, are originated in accordance with the standards of the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, the Federal Housing Authority, or other third party correspondent lenders. Our underwriting and approval process for all other loans originated by the Community Banking Division is as follows:

Most of our Community Bank originated loans are sourced through relationships between loan officers and their third party referral sources or current or previous customers.

After a loan officer has taken basic information from the borrower, the request is submitted to the Community Banking Division's loan production department. The loan production department obtains comprehensive information from the borrower and third parties, and conducts verification and analysis of the borrower information, which is assembled into a single underwriting package that is submitted for final approval.

Loans of $500 thousand or more (determined on a relationship basis) require approval from the Community Banking Division Credit Committee, which is comprised of senior managers of the Bank. Loans of less than $500 thousand (determined on a relationship basis) require approval from two officers with appropriate lending authority.

SBA National

General. SBA National, launched in November 2014, originates loans to small businesses nationwide, most often through the SBA's 7(a) program, which provides a partial government guarantee. Our loans are typically secured by liens on business assets and mortgages on commercial properties, as well as the SBA guarantees. We seek to build a loan portfolio that is diverse with respect to geography, loan type and collateral type.

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The following table summarizes the SBA National loan portfolio as of June 30, 2015.

	SBA National (Dollars in thousands)	
Non-owner occupied commercial real estate	$	3,865
Owner occupied commercial real estate		4,461
Commercial business		2,637
1 - 4 family residential		
Total	$	10,963

The Company's SBA loan portfolio includes owner and non-owner occupied loans as defined under regulatory call report instructions. The regulatory call report instructions primarily consider the primary source of repayment on the loan for this determination. However, these loans meet the SBA requirements to be considered owner occupied as the owner or controlling entity are actively involved in the daily operations of the underlying core business.

In addition to the loans held in the SBA National loan portfolio, as of June 30, 2015, $1.9 million in the loans held for sale portfolio were attributable to SBA National, which relates to the guaranteed portion of the SBA National loans we expect to sell in the secondary market.

Secondary Market for SBA Guarantees. We typically sell the SBA-guaranteed portion of our variable-rate originations (generally 75% of the principal balance) at a premium in the secondary market. We generally retain a 25% unguaranteed interest and the accompanying servicing rights to the entire loan. We hold most fixed-rate SBA loan originations in portfolio.

Competition for SBA Loans. SBA National competes primarily with community banks and regional banks nationwide. Capitalizing on our LASG origination loan infrastructure, SBA National is in a position to review and act quickly on a variety of lending opportunities. Risk management, approvals, underwriting and other due diligence for these loans is similar to that for the LASG loans. We believe that SBA National has an advantage in originating commercial loans because of its ability to utilize in-house staff to quickly and accurately screen loan opportunities and accelerate the underwriting process.

Underwriting of SBA National Loans. Our loan policies and procedures establish guidelines governing our SBA lending program. Generally, these guidelines address the types of loans that we seek, target markets, underwriting and collateral requirements, terms, interest rate and yield considerations and compliance with laws and regulations. All loans or credit lines are subject to approval procedures and amount limitations. Our policies are reviewed and approved at least annually by our board of directors. We supplement our own supervision of the loan underwriting and approval process with periodic loan audits by internal personnel and outside professionals experienced in loan review.

Loan Servicing. We conduct all loan servicing for SBA National loans with an in-house team of experienced asset managers who actively manage the loan portfolio. Asset managers initiate and maintain regular borrower contact, and ensure that the loan credit analysis is accurate. Collateral valuations, property inspections, and other collateral characteristics are updated periodically as a result of our ongoing in-house real estate analysis. All asset management activity and analysis is contained within a central database.

LASG Purchases and Originations

General. The LASG purchases and originates commercial loans secured by income-producing collateral, and on a nationwide basis. Although the Bank's legal lending limit was $22.3 million at

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June 30, 2015, our credit policy currently requires prior Board approval for the purchase or origination of a loan with an initial investment greater than 10% of the Company's Tier 1 capital, determined on a relationship basis. We focus primarily on loans with balances between $1.0 million and $5.0 million. Purchased loans are sourced on a nationwide basis from banks, insurance companies, investment funds and government agencies, either directly or indirectly through advisors. We seek to build a loan portfolio that is diverse with respect to geography, loan type and collateral type. Of the loans originated or purchased by the LASG that were outstanding as of June 30, 2015, $269.8 million, or 70.8%, consisted of commercial real estate loans. The following table summarizes the LASG loan portfolio as of June 30, 2015.

	Purchased	Originated	Total
	(Dollars in thousands)		
Non-owner occupied commercial real estate	$ 128,182	$ 53,051	$ 181,233
Owner occupied commercial real estate	72,069	16,507	88,576
Commercial business	273	108,577	108,850
1 - 4 family residential	2,068	137	2,205
Total	$ 202,592	$ 178,272	$ 380,864

Since the inception of the LASG through June 30, 2015, we have purchased loans for an aggregate investment of $386.3 million, of which $82.7 million was purchased during fiscal 2015. We have also originated loans totaling $235.3 million, of which $130.5 million was originated in fiscal 2015. As of June 30, 2015, the unpaid principal balance of loans purchased or originated by the LASG ranged from $1 thousand to $12.0 million, with an average balance of $892 thousand. Included in the balance are non-real estate secured loans to broker-dealers, which have balances of $12.0 million each. The real estate loans were secured principally by retail, industrial, mixed use, multi-family a