NORTHEAST BANCORP /ME/
Form 10-Q
February 09, 2017
Table of Contents

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

FORM 10-Q

Quarterly report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934

For the quarterly period ended December 31, 2016

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)**

(207) 786-3245

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 subjected to such filing requirements for the past 90 days. Yes   No ___

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, 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   No ___

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 definition of "accelerated filer", "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (check one): Large accelerated filer __ Accelerated filer
Non-accelerated filer __ Smaller Reporting Company __

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. As of February 2, 2017, the registrant had outstanding 7,518,705 shares of voting common stock, $1.00 par value per share and 1,312,530 shares of non-voting common stock, $1.00 par value per share.

Table of Contents

Part I.	**Financial Information**		3
	Item 1.	**Financial Statements (unaudited)**	3
		Consolidated Balance Sheets December 31, 2016 and June 30, 2016	3
		Consolidated Statements of Income Three Months Ended December 31, 2016 and 2015 Six Months Ended December 31, 2016 and 2015	4
		Consolidated Statements of Comprehensive Income Three Months Ended December 31, 2016 and 2015 Six Months Ended December 31, 2016 and 2015	5
		Consolidated Statements of Changes in Shareholders' Equity Six Months Ended December 31, 2016 and 2015	6
		Consolidated Statements of Cash Flows Six Months Ended December 31, 2016 and 2015	7
		Notes to Consolidated Financial Statements	8
	Item 2.	**Management's Discussion and Analysis of Financial Condition and Results of Operations**	29
	Item 3.	**Quantitative and Qualitative Disclosure about Market Risk**	44
	Item 4.	**Controls and Procedures**	45
Part II.	**Other Information**		45
	Item 1.	**Legal Proceedings**	45
	Item 1A.	**Risk Factors**	45
	Item 2.	**Unregistered Sales of Equity Securities and Use of Proceeds**	46
	Item 3.	**Defaults Upon Senior Securities**	46
	Item 4.	**Mine Safety Disclosures**	46
	Item 5.	**Other Information**	46
	Item 6.	**Exhibits**	46

2

Table of Contents

PART 1- FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

NORTHEAST BANCORP AND SUBSIDIARY CONSOLIDATED BALANCE SHEETS
(Unaudited)
(Dollars in thousands, except share and per share data)

	December 31, 2016	June 30, 2016
Assets		
Cash and due from banks	$2,586	$2,459
Short-term investments	109,610	148,698
Total cash and cash equivalents	112,196	151,157
Available-for-sale securities, at fair value	90,533	100,572
Residential real estate loans held for sale	5,217	6,449
SBA loans held for sale	3,762	1,070
Total loans held for sale	8,979	7,519
Loans		
Commercial real estate	503,448	426,568
Residential real estate	106,949	113,962
Commercial and industrial	151,228	145,956
Consumer	5,313	5,950
Total loans	766,938	692,436
Less: Allowance for loan losses	3,107	2,350
Loans, net	763,831	690,086
Premises and equipment, net	7,179	7,801
Real estate owned and other repossessed collateral, net	3,145	1,652
Federal Home Loan Bank stock, at cost	1,938	2,408
Intangible assets, net	1,514	1,732
Bank owned life insurance	15,953	15,725
Other assets	7,391	7,501

Total assets	$1,012,659	$986,153
Liabilities and Shareholders' Equity		
Liabilities		
Deposits		
Demand	$76,721	$66,686
Savings and interest checking	107,386	107,218
Money market	319,933	275,437
Time	335,531	351,091
Total deposits	839,571	800,432
Federal Home Loan Bank advances	20,024	30,075
Subordinated debt	23,469	23,331
Capital lease obligation	1,003	1,128
Other liabilities	13,650	14,596
Total liabilities	897,717	869,562
Commitments and contingencies	-	-
Shareholders' equity		
Preferred stock, $1.00 par value, 1,000,000 shares authorized; no shares issued and outstanding at December 31, 2016 and June 30, 2016	-	-
Voting common stock, $1.00 par value, 25,000,000 shares authorized; 7,487,552 and 8,089,790 shares issued and outstanding at December 31, 2016 and June 30, 2016, respectively	7,487	8,089
Non-voting common stock, $1.00 par value, 3,000,000 shares authorized; 1,343,683 and 1,227,683 shares issued and outstanding at December 31, 2016 and June 30, 2016, respectively	1,344	1,228
Additional paid-in capital	77,046	83,020
Retained earnings	30,830	26,160
Accumulated other comprehensive loss	(1,765)	(1,906)
Total shareholders' equity	114,942	116,591
Total liabilities and shareholders' equity	$1,012,659	$986,153

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

Table of Contents

NORTHEAST BANCORP AND SUBSIDIARY CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)
(Dollars in thousands, except share and per share data)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2016	2015	2016	2015
Interest and dividend income:				
Interest and fees on loans	$13,913	$11,719	$25,716	$22,509
Interest on available-for-sale securities	247	236	486	464
Other interest and dividend income	172	80	387	176
Total interest and dividend income	14,332	12,035	26,589	23,149
Interest expense:				
Deposits	1,798	1,425	3,553	2,789
Federal Home Loan Bank advances	220	259	475	519
Wholesale repurchase agreements	-	-	-	67
Short-term borrowings	-	5	-	13
Junior subordinated debentures issued to affiliated trusts	468	158	927	312
Obligation under capital lease agreements	13	16	27	33
Total interest expense	2,499	1,863	4,982	3,733
Net interest and dividend income before provision for loan losses	11,833	10,172	21,607	19,416
Provision for loan losses	628	896	820	1,065
Net interest and dividend income after provision for loan losses	11,205	9,276	20,787	18,351
Noninterest income:				
Fees for other services to customers	481	428	889	836
Gain on sales of residential loans held for sale	337	398	878	957
Gain on sales of portfolio loans	1,734	679	2,476	1,354
Loss recognized on real estate owned and other repossessed collateral, net	3	(14)	(11)	(74)
Bank-owned life insurance income	114	112	228	224
Other noninterest income	21	21	38	29
Total noninterest income	2,690	1,624	4,498	3,326

Noninterest expense:				
Salaries and employee benefits	5,161	4,854	10,475	9,110
Occupancy and equipment expense	1,252	1,320	2,481	2,610
Professional fees	399	264	895	694
Data processing fees	410	366	832	714
Marketing expense	97	66	184	136
Loan acquisition and collection expense	547	219	774	663
FDIC insurance premiums	22	116	146	229
Intangible asset amortization	109	131	218	262
Other noninterest expense	959	860	1,577	1,589
Total noninterest expense	8,956	8,196	17,582	16,007
Income before income tax expense	4,939	2,704	7,703	5,670
Income tax expense	1,839	960	2,852	2,059
Net income	3,100	1,744	4,851	3,611
Weighted-average shares outstanding:				
Basic	8,831,235	9,559,369	8,968,690	9,560,913
Diluted	8,864,618	9,569,585	8,999,062	9,567,138
Earnings per common share:				
Basic	$0.35	$0.18	$0.54	$0.38
Diluted	0.35	0.18	0.54	0.38
Cash dividends declared per common share	$0.01	$0.01	$0.02	$0.02

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

Table of Contents

NORTHEAST BANCORP AND SUBSIDIARY CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)
(Dollars in thousands)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2016	2015	2016	2015
Net income	$3,100	$1,744	$4,851	$3,611
Other comprehensive income, before tax:				
Available-for-sale securities:				
Change in net unrealized loss on available-for-sale securities	(1,336)	(692)	(1,414)	(226)
Derivatives and hedging activities:				
Change in accumulated gain (loss) on effective cash flow hedges	1,486	284	1,633	(554)
Reclassification adjustments included in net income	8	-	14	-
Total derivatives and hedging activities	1,494	284	1,647	(554)
Total other comprehensive income (loss), before tax	158	(408)	233	(780)
Income tax expense (benefit) related to other comprehensive (loss) income	62	(155)	92	(296)
Other comprehensive income (loss), net of tax	96	(253)	141	(484)
Comprehensive income	$3,196	$1,491	$4,992	$3,127

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

Table of Contents

NORTHEAST BANCORP AND SUBSIDIARY CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(Unaudited)
(Dollars in thousands, except share and per share data)

	Preferred Stock		Voting Common Stock		Non-voting Common Stock		Additional Paid-in	Retained	Accumulated Other Comprehensive	Total Shareholders'
	Shares	Amount	Shares	Amount	Shares	Amount	Capital	Earnings	Loss	Equity
Balance at June 30, 2015	-	$ -	8,575,144	$ 8,575	1,012,739	$ 1,013	$ 85,506	$ 18,921	$ (1,288)	$ 112,727
Net income	-	-	-	-	-	-	-	3,611	-	3,611
Other comprehensive loss, net of tax	-	-	-	-	-	-	-	-	(484)	(484)
Common stock repurchased	-	-	(125,100)	(125)	-	-	(1,204)	-	-	(1,329)
Conversion of voting common stock to non-voting common stock	-	-	(16,371)	(16)	16,371	16	-	-	-	-
Dividends on common stock at $0.02 per share	-	-	-	-	-	-	-	(192)	-	(192)
Stock-based compensation	-	-	-	-	-	-	280	-	-	280
Issuance of restricted common stock	-	-	100,000	100	-	-	(100)	-	-	-
	-	-	(43,054)	(43)	-	-	43	-	-	-

Cancellation and forfeiture of restricted common stock										
Balance at December 31, 2015	-	$ -	8,490,619	$ 8,491	1,029,110	$ 1,029	$ 84,525	$ 22,340	$ (1,772)	$ 114,613
Balance at June 30, 2016	-	-	8,089,790	$ 8,089	1,227,683	$ 1,228	$ 83,020	$ 26,160	$ (1,906)	$ 116,591
Net income	-	-	-	-	-	-	-	4,851	-	4,851
Other comprehensive loss, net of tax	-	-	-	-	-	-	-	-	141	141
Common stock repurchased	-	-	(645,238)	(645)	-	-	(6,298)	-	-	(6,943)
Conversion of voting common stock to non-voting common stock	-	-	(116,000)	(116)	116,000	116	-	-	-	-
Dividends on common stock at $0.02 per share	-	-	-	-	-	-	-	(181)	-	(181)
Stock-based compensation	-	-	-	-	-	-	483	-	-	483
Issuance of restricted common stock	-	-	160,000	160	-	-	(160)	-	-	-
Cancellation and forfeiture of restricted common stock	-	-	(1,000)	(1)	-	-	1	-	-	-
Balance at December 31, 2016	-	$ -	7,487,552	$ 7,487	1,343,683	$ 1,344	$ 77,046	$ 30,830	$ (1,765)	$ 114,942

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

6

Table of Contents

NORTHEAST BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)
(Dollars in thousands)

	Six Months Ended December 31,	
	2016	2015
Operating activities:		
Net income	$4,851	$3,611
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	820	1,065
(Gain) loss on sale and impairment of real estate owned and other repossessed collateral, net	(70)	68
Loss on sale and disposal of premises and equipment, net	82	6
Accretion of fair value adjustments on loans, net	(5,640)	(5,600)
Accretion of fair value adjustments on deposits, net	(2)	(4)
Accretion of fair value adjustments on borrowings, net	(51)	3
Amortization of subordinated debt issuance costs	138	-
Originations of loans held for sale	(66,778)	(49,640)
Net proceeds from sales of loans held for sale	71,100	64,525
Gain on sales of residential loans held for sale	(878)	(957)
Gain on sales of SBA loans held for sale	(2,476)	(1,354)
Amortization of intangible assets	218	262
Bank-owned life insurance income, net	(228)	(224)
Depreciation of premises and equipment	769	824
Stock-based compensation	483	280
Amortization of available-for-sale securities, net	555	490
Changes in other assets and liabilities:		
Other assets	18	165
Other liabilities	701	(1,027)
Net cash provided by operating activities	3,612	12,493
Investing activities:		
Purchases of available-for-sale securities	(9,056)	(17,548)
Proceeds from maturities and principal payments on available-for-sale securities	17,126	14,400
Loan purchases	(59,886)	(59,311)
Loan originations, principal collections, and purchased loan paydowns, net	(13,413)	(15,424)
Purchases and disposals of premises and equipment, net	(229)	(1,038)
Redemption of Federal Home Loan Bank stock	470	1,531
Proceeds from sales of real estate owned and other repossessed collateral	523	959
Net cash used in investing activities	(64,465)	(76,431)
Financing activities:		
Net increase in deposits	39,141	52,011
Net increase in short-term borrowings	-	77

Repurchase of common stock	(6,943)	(1,329)
Dividends paid on common stock	(181)	(192)
Repayment of wholesale repurchase agreements	-	(10,000)
Repayment of Federal Home Loan Bank advances	(10,000)	-
Repayment of capital lease obligation	(125)	(116)
Net cash provided by financing activities	21,892	40,451
Net decrease in cash and cash equivalents	(38,961)	(23,487)
Cash and cash equivalents, beginning of period	151,157	89,850
Cash and cash equivalents, end of period	$112,196	$66,363
Supplemental schedule of noncash investing activities:		
Transfers from loans to real estate owned and other repossessed collateral	$1,946	$614

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

Table of Contents

NORTHEAST BANCORP AND SUBSIDIARY

Notes to Unaudited Consolidated Financial Statements

December 31, 2016

1. Basis of Presentation

The accompanying unaudited condensed and consolidated interim financial statements include the accounts of Northeast Bancorp ("Northeast" or the "Company") and its wholly-owned subsidiary, Northeast Bank (the "Bank").

These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, the accompanying consolidated financial statements contain all adjustments (consisting principally of normal recurring accruals) considered necessary for a fair presentation of the Company's financial position, results of operations, and cash flows for the interim periods presented. These financial statements and notes should be read in conjunction with the audited consolidated financial statements and notes thereto for the fiscal year ended June 30, 2016 ("Fiscal 2016") included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission.

2. Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)* ("ASU 2014-09"). ASU 2014-09 implements a common revenue standard that clarifies the principles for recognizing revenue. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps: (i) identify the contract(s) with a customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract and (v) recognize revenue when (or as) the entity satisfies a performance obligation. ASU 2015-14, *Revenue from Contracts with Customers (Topic 606)* ("ASU 2014-09") was issued in August 2015 which defers adoption to annual reporting periods beginning after December 15, 2017. The Company is currently evaluating the impact of the adoption of ASU 2014-09 on its consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities* (“ASU 2016-01”). This guidance changes how entities account for equity investments that do not result in consolidation and are not accounted for under the equity method of accounting. Entities will be required to measure these investments at fair value at the end of each reporting period and recognize changes in fair value in net income. A practicability exception will be available for equity investments that do not have readily determinable fair values, however; the exception requires the Company to adjust the carrying amount for impairment and observable price changes in orderly transactions for the identical or a similar investment of the same issuer. This guidance also changes certain disclosure requirements and other aspects of current US GAAP. This guidance is effective for fiscal years beginning after December 15, 2017, including interim periods within the fiscal year. Early adoption is permitted for only one of the six amendments. The Company is currently evaluating the impact of the adoption of ASU 2016-01 on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)* (“ASU 2016-02”). The new guidance establishes the principles to report transparent and economically neutral information about the assets and liabilities that arise from leases. Entities will be required to recognize the lease assets and lease liabilities that arise from leases in the statement of financial position and to disclose qualitative and quantitative information about lease transactions, such as information about variable lease payments and options to renew and terminate leases. This guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within the fiscal year. The Company is currently evaluating the impact of the adoption of ASU 2016-02 on its consolidated financial statements.

In March 2016, the FASB issued ASU 2016-05, *Derivatives and Hedging (Topic 815): Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships* (“ASU 2016-05”). The new guidance clarifies that a change in the counterparty to a derivative instrument that has been designated as the hedging instrument under Topic 815 does not, in and of itself, require de-designation of that hedging relationship provided that all other hedge accounting criteria continue to be met. This guidance is effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. The adoption of this guidance is not expected to have a significant impact on the Company’s financial statements.

In March 2016, the FASB issued ASU 2016-09, *Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting* (“ASU 2016-09”). The new guidance simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. Entities will be required to recognize the income tax effects of awards in the income statement when the awards vest or are settled. This guidance is effective for fiscal years beginning after December 15, 2016, and interim periods within those annual periods. The adoption of this guidance is not expected to have a significant impact on the Company’s financial statements.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326)* (“ASU 2016-13”). This update is intended to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. To achieve this objective, the amendments in this update replace the incurred loss impairment methodology in current US GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. This ASU will be effective for fiscal years beginning after December 15, 2019. Early adoption is available as of the fiscal year beginning after December 15, 2018. The Company is currently evaluating the impact of the adoption of ASU 2016-13 on its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230)* (“ASU 2016-15”). This update clarifies and provides guidance on several cash receipt and cash payment classification issues, including debt prepayment and extinguishment costs, settlement of zero-coupon debt instruments, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies, distributions received from equity method investees, beneficial interests in securitization transactions, and separately identifiable cash flows and application of the predominance principle. The amendments in this update are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. The adoption of this guidance is not expected to have a significant impact on the Company’s financial statements.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230)* (“ASU 2016-18”). This update requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The amendments in this update are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. The Company is currently evaluating the impact of the adoption of ASU 2016-18 on its consolidated financial statements.

Table of Contents

3. Securities Available-for-Sale

The following presents a summary of the amortized cost, gross unrealized holding gains and losses, and fair value of securities available for sale.

	December 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
U.S. Government agency securities	$48,711	$ 5	$ (216)	$48,500
Agency mortgage-backed securities	37,882	-	(882)	37,000
Other investment measured at net asset value	5,157	-	(124)	5,033
	$91,750	$ 5	$ (1,222)	$90,533

	June 30, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
U.S. Government agency securities	$51,948	$ 98	$ -	$52,046
Agency mortgage-backed securities	43,330	90	(52)	43,368
Other investment measured at net asset value	5,097	61	-	5,158
	$100,375	$ 249	$ (52)	$100,572

When securities are sold, the adjusted cost of the specific security sold is used to compute the gain or loss on sale. There were no securities sold during the three and six months ended December 31, 2016 or 2015. At December 31, 2016, no investment securities were pledged as collateral to secure outstanding borrowings.

The following summarizes the Company’s gross unrealized losses and fair values aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position.

December 31, 2016					
Less than 12 Months		More than 12 Months		Total	
Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses

	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)					
U.S. Government agency securities	$42,493	$ (216)	$-	$ -	$42,493	$ (216)
Agency mortgage-backed securities	22,574	(375)	14,425	(507)	36,999	(882)
Other investment measured at net asset value	5,033	(124)	-	-	5,033	(124)
	$70,100	$ (715)	$14,425	$ (507)	$84,525	$ (1,222)

	June 30, 2016					
	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)					
U.S. Government agency securities	$-	$ -	$-	$ -	$-	$ -
Agency mortgage-backed securities	-	-	25,350	(52)	25,350	(52)
Other investment measured at net asset value	-	-	-	-	-	-
	$-	$ -	$25,350	$ (52)	$25,350	$ (52)

There were no other-than-temporary impairment losses on securities during the three and six months ended December 31, 2016 or 2015.

At December 31, 2016, the Company had seven securities in a continuous loss position for greater than twelve months. At December 31, 2016, all of the Company’s available-for-sale securities were issued or guaranteed by either government agencies or government-sponsored enterprises. The decline in fair value of the Company’s available-for-sale securities at December 31, 2016 is attributable to changes in interest rates.

In addition to considering current trends and economic conditions that may affect the quality of individual securities within the Company’s investment portfolio, management of the Company also considers the Company’s ability and intent to hold such securities to maturity or recovery of cost. At December 31, 2016, the Company does not intend to sell and it is not more likely than not that the Company will be required to sell the investment securities before recovery of its amortized cost. As such, management does not believe any of the Company’s available-for-sale securities are other-than-temporarily impaired at December 31, 2016.

The investment measured at net asset value is a fund that seeks to invest in securities either issued or guaranteed by the U.S. government or its agencies. The underlying composition of the fund is primarily government agencies or other investment-grade investments. As of December 31, 2016, the effective duration of the investments is 5.32 years.

Table of Contents

The amortized cost and fair values of available-for-sale debt securities by contractual maturity are shown below as of December 31, 2016. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
	(Dollars in thousands)	
Due within one year	$9,230	$9,224
Due after one year through five years	39,481	39,277
Due after five years through ten years	16,669	16,491
Due after ten years	21,213	20,508
Total	$86,593	$85,500

4. Loans, Allowance for Loan Losses and Credit Quality

Loans are carried at the principal amounts outstanding, or amortized acquired fair value in the case of acquired loans, adjusted by partial charge-offs and net of deferred loan costs or fees. Loan fees and certain direct origination costs are deferred and amortized into interest income over the expected term of the loan using the level-yield method. When a loan is paid off, the unamortized portion is recognized in interest income. Interest income is accrued based upon the daily principal amount outstanding except for loans on nonaccrual status.

Loans purchased by the Company are accounted for under ASC 310-30, Receivables—Loans and Debt Securities Acquired with Deteriorated Credit Quality ("ASC 310-30"). At acquisition, the effective interest rate is determined based on the discount rate that equates the present value of the Company's estimate of cash flows with the purchase price of the loan. Prepayments are not assumed in determining a purchased loan's effective interest rate and income accretion. The application of ASC 310-30 limits the yield that may be accreted on the purchased loan, or the "accretable yield," to the excess of the Company's estimate, at acquisition, of the expected undiscounted principal, interest, and other cash flows over the Company's initial investment in the loan. The excess of contractually required payments receivable over the cash flows expected to be collected on the loan represents the purchased loan's "nonaccretable difference." Subsequent improvements in expected cash flows of loans with nonaccretable differences result in a prospective increase to the loan's effective yield through a reclassification of some, or all, of the nonaccretable difference to accretable yield. The effect of subsequent credit-related declines in expected cash flows of purchased loans are recorded through a specific allocation in the allowance for loan losses.

Loans are generally placed on nonaccrual status when they are past due 90 days as to either principal or interest, or when in management's judgment the collectability of interest or principal of the loan has been significantly impaired. Loans accounted for under ASC 310-30 are placed on nonaccrual when it is not possible to reach a reasonable expectation of the timing and amount of cash flows to be collected on the loan. When a loan has been placed on nonaccrual status, previously accrued and uncollected interest is reversed against interest on loans. Interest on nonaccrual loans is accounted for on a cash-basis or using the cost-recovery method when collectability is doubtful. A loan is returned to accrual status when collectability of principal is reasonably assured and the loan has performed for a reasonable period of time.

In cases where a borrower experiences financial difficulties and the Company makes certain concessionary modifications to contractual terms, the loan is classified as a troubled debt restructuring ("TDR"), and therefore by definition is an impaired loan. Concessionary modifications may include adjustments to interest rates, extensions of maturity, and other actions intended to minimize economic loss and avoid foreclosure or repossession of collateral. For loans accounted for under ASC 310-30, the Company evaluates whether it has granted a concession by comparing the restructured debt terms to the expected cash flows at acquisition plus any additional cash flows expected to be collected arising from changes in estimate after acquisition. As a result, if an ASC 310-30 loan is modified to be consistent with, or better than, the Company's expectations at acquisition, the modified loan would not qualify as a TDR. Nonaccrual loans that are restructured generally remain on nonaccrual status for a minimum period of six

months to demonstrate that the borrower can meet the restructured terms. If the restructured loan is on accrual status prior to being modified, it is reviewed to determine if the modified loan should remain on accrual status. If the borrower's ability to meet the revised payment schedule is not reasonably assured, the loan is classified as a nonaccrual loan. With limited exceptions, loans classified as TDRs remain classified as such until the loan is paid off.
The composition of the Company’s loan portfolio is as follows on the dates indicated.

	December 31, 2016			June 30, 2016		
	Originated	Purchased	Total	Originated	Purchased	Total
	(Dollars in thousands)					
Residential real estate	$87,900	$3,085	$90,985	$93,391	$2,559	$95,950
Home equity	15,964	-	15,964	18,012	-	18,012
Commercial real estate	253,601	249,847	503,448	189,616	236,952	426,568
Commercial and industrial	150,087	1,141	151,228	145,758	198	145,956
Consumer	5,313	-	5,313	5,950	-	5,950
Total loans	$512,865	$254,073	$766,938	$452,727	$239,709	$692,436

Total loans include net deferred loan origination costs of $463 thousand and net deferred loan origination fees of $58 thousand as of December 31, 2016 and June 30, 2016, respectively.

Table of Contents

Past Due and Nonaccrual Loans

The following is a summary of past due and non-accrual loans:

	December 31, 2016							
	30-59 Days	60-89 Days	Past Due 90 Days or More-Still Accruing	Past Due 90 Days or More-Nonaccrual	Total Past Due	Total Current	Total Loans	Non-Accrual Loans
	(Dollars in thousands)							
Originated portfolio:								
Residential real estate	$1,052	$823	$ -	$ 1,596	$3,471	$84,429	$87,900	$2,827
Home equity	-	-	-	48	48	15,916	15,964	48
Commercial real estate	882	522	-	137	1,541	252,060	253,601	396
Commercial and industrial	48	-	-	677	725	149,362	150,087	2,659
Consumer	128	28	-	19	175	5,138	5,313	48
Total originated portfolio	2,110	1,373	-	2,477	5,960	506,905	512,865	5,978
Purchased portfolio:								
Residential real estate	1	-	-	-	1	3,084	3,085	1,066
Commercial and industrial	219	56	-	35	310	831	1,141	98
Commercial real estate	12,150	713	-	2,721	15,584	234,263	249,847	3,055
Total purchased portfolio	12,370	769	-	2,756	15,895	238,178	254,073	4,219
Total loans	$14,480	$2,142	$ -	$ 5,233	$21,855	$745,083	$766,938	$10,197

	June 30, 2016							
	30-59 Days	60-89 Days	Past Due 90 Days or More-Still Accruing	Past Due 90 Days or More-Nonaccrual	Total Past Due	Total Current	Total Loans	Non-Accrual Loans
	(Dollars in thousands)							
Originated portfolio:								
Residential real estate	$302	$910	$ -	$ 1,555	$2,767	$90,624	$93,391	$2,613

Home equity	146	-	-	48	194	17,818	18,012	48
Commercial real estate	132	-	-	188	320	189,296	189,616	474
Commercial and industrial	-	-	-	15	15	145,743	145,758	17
Consumer	73	56	-	74	203	5,747	5,950	163
Total originated portfolio	653	966	-	1,880	3,499	449,228	452,727	3,315
Purchased portfolio:								
Residential real estate	-	-	-	-	-	2,559	2,559	1,125
Commercial and industrial	-	-	-	-	-	198	198	-
Commercial real estate	-	19	-	3,387	3,406	233,546	236,952	3,387
Total purchased portfolio	-	19	-	3,387	3,406	236,303	239,709	4,512
Total loans	$653	$985	$ -	$ 5,267	$6,905	$685,531	$692,436	$7,827

Allowance for Loan Losses and Impaired Loans

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. For residential and consumer loans, a charge-off is recorded no later than the point at which a loan is 180 days past due if the loan balance exceeds the fair value of the collateral, less costs to sell. For commercial loans, a charge-off is recorded on a case-by-case basis when all or a portion of the loan is deemed to be uncollectible. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses consists of general, specific, and unallocated reserves and reflects management's estimate of probable loan losses inherent in the loan portfolio at the balance sheet date. Management uses a consistent and systematic process and methodology to evaluate the appropriateness of the allowance for loan losses on a quarterly basis. The calculation of the allowance for loan losses is segregated by portfolio segments, which include: commercial real estate, commercial and industrial, consumer, residential real estate, and purchased loans. Risk characteristics relevant to each portfolio segment are as follows:

Residential real estate: All loans in this segment are collateralized by residential real estate and repayment is primarily dependent on the credit quality, loan-to-value ratio and income of the individual borrower. The overall health of the economy, particularly unemployment rates and housing prices, has a significant effect on the credit quality in this segment. For purposes of the Company's allowance for loan loss calculation, home equity loans and lines of credit are included in residential real estate.

Commercial real estate: Loans in this segment are primarily income-producing properties. For owner-occupied properties, the cash flows are derived from an operating business, and the underlying cash flows may be adversely affected by deterioration in the financial condition of the operating business. The underlying cash flows generated by non-owner occupied properties may be adversely affected by increased vacancy rates. Management periodically obtains rent rolls, with which it monitors the cash flows of these loans. Adverse developments in either of these areas will have an adverse effect on the credit quality of this segment. For purposes of the allowance for loan losses, this segment also includes construction loans.

13

Table of Contents

Commercial and industrial: Loans in this segment are made to businesses and are generally secured by the assets of the business. Repayment is expected from the cash flows of the business. Weakness in national or regional economic conditions, and a corresponding weakness in consumer or business spending, will have an adverse effect on the credit quality of this segment.

Consumer: Loans in this segment are generally secured, and repayment is dependent on the credit quality of the individual borrower. Repayment of consumer loans is generally based on the earnings of individual borrowers, which may be adversely impacted by regional labor market conditions.

Purchased: Loans in this segment are typically secured by commercial real estate, multi-family residential real estate, or business assets and have been acquired by the Bank's Loan Acquisition and Servicing Group ("LASG"). Loans acquired by the LASG are, with limited exceptions, performing loans at the date of purchase. Repayment of loans in this segment is largely dependent on cash flow from the successful operation of the property, in the case of non-owner occupied property, or operating business, in the case of owner-occupied property. Loan performance may be adversely affected by factors affecting the general economy or conditions specific to the real estate market, such as geographic location or property type. Loans in this segment are evaluated for impairment under ASC 310-30. The Company reviews expected cash flows from purchased loans on a quarterly basis. The effect of a decline in expected cash flows subsequent to the acquisition of the loan is recognized through a specific allocation in the allowance for loan losses

The general component of the allowance for loan losses for originated loans is based on historical loss experience adjusted for qualitative factors stratified by loan segment. The Company does not weight periods used in that analysis to determine the average loss rate in each portfolio segment. This historical loss factor is adjusted for the following qualitative factors:

Levels and trends in delinquencies;

Trends in the volume and nature of loans;

Trends in credit terms and policies, including underwriting standards, procedures and practices, and the experience and ability of lending management and staff;

Trends in portfolio concentration;

National and local economic trends and conditions;

Effects of changes or trends in internal risk ratings; and

Other effects resulting from trends in the valuation of underlying collateral.

The allocated component of the allowance for loan losses relates to loans that are classified as impaired. Impairment is measured on a loan-by-loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. An allowance is established when the discounted cash flows or collateral value of the impaired loan is lower than the carrying value of that loan.

For all portfolio segments, except loans accounted for under ASC 310-30, a loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. For the purchased loan segment, a loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to realize cash flows as expected at acquisition. For loans accounted for under ASC 310-30 for which cash flows can reasonably be estimated, loan impairment is measured based on the decrease in expected cash flows from those estimated at acquisition, excluding changes due to changes in interest rate indices and other non-credit related factors, discounted at the loan's effective rate assumed at acquisition. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting the scheduled principal and interest payments when due.

Table of Contents

The following table sets forth activity in the Company's allowance for loan losses.

	Three Months Ended December 31, 2016						
	Residential Real Estate	Commercial Real Estate	Commercial and Industrial	Consumer	Purchased	Unallocated	Total
	(Dollars in thousands)						
Beginning balance	$541	$ 1,421	$ 318	$ 68	$ 158	$ -	$2,506
Provision	6	351	207	40	24	-	628
Recoveries	27	19	6	21	-	-	73
Charge-offs	-	(41)	-	(59)	-	-	(100)
Ending balance	$574	$ 1,750	$ 531	$ 70	$ 182	$ -	$3,107

	Three Months Ended December 31, 2015						
	Residential Real Estate	Commercial Real Estate	Commercial and Industrial	Consumer	Purchased	Unallocated	Total
	(Dollars in thousands)						
Beginning balance	$732	$ 733	$ 134	$ 46	$ 364	$ 56	$2,065
Provision	147	125	42	(6)	644	(56)	896
Recoveries	1	-	4	3	-	-	8
Charge-offs	(19)	(14)	(1)	(7)	(799)	-	(840)
Ending balance	$861	$ 844	$ 179	$ 36	$ 209	$ -	$2,129

	Six Months Ended December 31, 2016						
	Residential Real Estate	Commercial Real Estate	Commercial and Industrial	Consumer	Purchased	Unallocated	Total
	(Dollars in thousands)						
Beginning balance	$663	$ 1,195	$ 297	$ 62	$ 133	$ -	$2,350
Provision	(93)	577	224	63	49	-	820
Recoveries	29	19	11	32	-	-	91
Charge-offs	(25)	(41)	(1)	(87)	-	-	(154)
Ending balance	$574	$ 1,750	$ 531	$ 70	$ 182	$ -	$3,107

	Six Months Ended December 31, 2015						
	Residential	Commercial	Commercial	Consumer	Purchased	Unallocated	Total

	Real Estate	Real Estate	and Industrial				
	(Dollars in thousands)						
Beginning balance	$741	$ 694	$ 117	$ 35	$ 283	$ 56	$1,926
Provision	126	187	58	25	725	(56)	1,065
Recoveries	13	5	5	5	-	-	28
Charge-offs	(19)	(42)	(1)	(29)	(799)	-	(890)
Ending balance	$861	$ 844	$ 179	$ 36	$ 209	$ -	$2,129

The following table sets forth information regarding the allowance for loan losses by portfolio segment and impairment methodology.

	December 31, 2016						
	Residential Real Estate	Commercial Real Estate	Commercial and Industrial	Consumer	Purchased	Unallocated	Total
	(Dollars in thousands)						
Allowance for loan losses:							
Individually evaluated	$366	$ 64	$ 164	$ 6	$ -	$ -	$600
Collectively evaluated	208	1,686	367	64	-	-	2,325
ASC 310-30	-	-	-	-	182	-	182
Total	$574	$ 1,750	$ 531	$ 70	$182	$ -	$3,107
Loans:							
Individually evaluated	$5,573	$ 1,594	$ 2,820	$ 254	$ -	$ -	$10,241
Collectively evaluated	98,291	252,007	147,267	5,059	-	-	502,624
ASC 310-30	-	-	-	-	254,073	-	254,073
Total	$103,864	$ 253,601	$ 150,087	$ 5,313	$254,073	$ -	$766,938

Table of Contents

	June 30, 2016						
	Residential Real Estate	Commercial Real Estate	Commercial and Industrial	Consumer	Purchased	Unallocated	Total
	(Dollars in thousands)						
Allowance for loan losses:							
Individually evaluated	$386	$ 59	$ 2	$ 23	$ -	$ -	$470
Collectively evaluated	277	1,136	295	39	-	-	1,747
ASC 310-30	-	-	-	-	133	-	133
Total	$663	$ 1,195	$ 297	$ 62	$133	$ -	$2,350
Loans:							
Individually evaluated	$5,039	$ 1,686	$ 17	$ 362	$ -	$ -	$7,104
Collectively evaluated	106,364	187,930	145,741	5,588	-	-	445,623
ASC 310-30	-	-	-	-	239,709	-	239,709
Total	$111,403	$ 189,616	$ 145,758	$ 5,950	$239,709	$ -	$692,436

The following table sets forth information regarding impaired loans. Loans accounted for under ASC 310-30 that have performed based on cash flow and accretable yield expectations determined at date of acquisition are not considered impaired assets and have been excluded from the tables below.

	December 31, 2016			June 30, 2016		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(Dollars in thousands)					
Impaired loans without a valuation allowance:						
Originated:						
Residential real estate	$3,191	$3,264	$ -	$3,192	$3,299	$ -
Consumer	171	179	-	257	282	-
Commercial real estate	487	489	-	451	453	-
Commercial and industrial	1,815	1,815	-	15	15	-
Purchased:						
Residential real estate	1,066	1,108	-	1,125	1,125	-
Commercial real estate	4,513	6,049	-	4,574	4,886	-
Commercial and industrial	16	34	-	-	-	-
Total	11,259	12,938	-	9,614	10,060	-
Impaired loans with a valuation allowance:						
Originated:						
Residential real estate	2,382	2,340	366	1,847	1,802	386
Consumer	83	92	6	105	112	23

Commercial real estate	1,107	1,098	64	1,235	1,223	59
Commercial and industrial	1,005	1,005	164	2	2	2
Purchased:						
Commercial real estate	1,272	1,660	100	1,484	1,812	66
Commercial and industrial	56	322	57	-	-	-
Total	5,905	6,517	757	4,673	4,951	536
Total impaired loans	$17,164	$19,455	$ 757	$14,287	$15,011	$ 536

Table of Contents

The following tables set forth information regarding interest income recognized on impaired loans.

	Three Months Ended December 31,			
	2016		2015	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)			
Impaired loans without a valuation allowance:				
Originated:				
Residential real estate	$3,730	$ 62	$3,157	$ 37
Consumer	200	8	354	8
Commercial real estate	466	15	885	7
Commercial and industrial	1,080	33	2	-
Purchased:				
Residential real estate	1,087	-	-	-
Commercial real estate	4,705	47	6,844	50
Commercial and industrial	32	-	-	-
Total	11,300	165	11,242	102
Impaired loans with a valuation allowance:				
Originated:				
Residential real estate	1,952	73	1,968	22
Consumer	93	2	44	1
Commercial real estate	1,115	31	930	19
Commercial and industrial	504	12	-	-
Purchased:				
Commercial real estate	1,423	7	1,481	3
Commercial and industrial	28	2	-	-
Total	5,115	127	4,423	45
Total impaired loans	$16,415	$ 292	$15,665	$ 147

	Six Months Ended December 31,			
	2016		2015	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)			
Impaired loans without a valuation allowance:				
Originated:				
Residential real estate	$3,550	$ 111	$2,613	$ 76
Consumer	219	11	316	13
Commercial real estate	461	23	1,190	14
Commercial and industrial	725	36	2	-

Purchased:				
Residential real estate	1,100	3	-	-
Commercial real estate	4,661	99	6,674	64
Commercial and industrial	21	-	-	-
Total	10,737	283	10,795	167
Impaired loans with a valuation allowance:				
Originated:				
Residential real estate	1,917	89	2,024	45
Consumer	97	4	20	2
Commercial real estate	1,155	49	883	31
Commercial and industrial	336	12	-	-
Purchased:				
Commercial real estate	1,443	24	713	39
Commercial and industrial	19	2	-	-
Total	4,967	180	3,640	117
Total impaired loans	$15,704	$ 463	$14,435	$ 284

Table of Contents

Credit Quality

The Company utilizes a ten-point internal loan rating system for commercial real estate, construction, commercial and industrial, and certain residential loans as follows:

Loans rated 1 – 6: Loans in these categories are considered “pass” rated loans. Loans in categories 1-5 are considered to have low to average risk. Loans rated 6 are considered marginally acceptable business credits and have more than average risk.

Loans rated 7: Loans in this category are considered “special mention.” These loans show signs of potential weakness and are being closely monitored by management.

Loans rated 8: Loans in this category are considered “substandard.” Loans classified as substandard are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified have a well-defined weakness or weaknesses that jeopardize the orderly repayment of the debt.

Loans rated 9: Loans in this category are considered “doubtful.” Loans classified as doubtful have all the weaknesses inherent in one graded 8 with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable.

Loans rated 10: Loans in this category are considered “loss” and of such little value that their continuance as loans is not warranted.

On an annual basis, or more often if needed, the Company formally reviews the ratings of all loans subject to risk ratings. Semi-annually, the Company engages an independent third-party to review a significant portion of loans within these segments. Management uses the results of these reviews as part of its annual review process. Risk ratings on purchased loans, with and without evidence of credit deterioration at acquisition, are determined relative to the Company’s recorded investment in that loan, which may be significantly lower than the loan’s unpaid principal balance.

The following tables present the Company’s loans by risk rating.

	December 31, 2016				
	Originated Portfolio				
	Commercial Real Estate	Commercial and Industrial	Residential[1]	Purchased Portfolio	Total
	(Dollars in thousands)				
Loans rated 1- 6	$249,552	$ 148,674	$ 8,226	$243,364	$649,816
Loans rated 7	3,230	560	495	7,147	11,432
Loans rated 8	819	853	508	3,562	5,742
Loans rated 9	-	-	23	-	23
Loans rated 10	-	-	-	-	-
	$253,601	$ 150,087	$ 9,252	$254,073	$667,013

	June 30, 2016				
	Originated Portfolio				
	Commercial Real Estate	Commercial and Industrial	Residential[1]	Purchased Portfolio	Total
	(Dollars in thousands)				
Loans rated 1- 6	$186,165	$ 142,451	$ 7,659	$227,895	$564,170
Loans rated 7	2,493	3,290	431	7,147	13,361
Loans rated 8	958	17	537	4,667	6,179
Loans rated 9	-	-	23	-	23
Loans rated 10	-	-	-	-	-
	$189,616	$ 145,758	$ 8,650	$239,709	$583,733

(1) Certain of the Company’s loans made for commercial purposes, but secured by residential collateral, are rated under the Company’s risk-rating system.

The Company had consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceedings were in process according to local requirements of the applicable jurisdictions totaling $823 thousand at December 31, 2016, compared to $882 thousand at June 30, 2016.

Table of Contents

Troubled Debt Restructurings

The following table shows the Company's post-modification balance of TDRs by type of modification.

	Three Months Ended December 31,				Six Months Ended December 31,			
	2016		2015		2016		2015	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
	(Dollars in thousands)							
Extended maturity	1	$ 154	-	$ -	1	$ 154	-	$ -
Adjusted interest rate	2	135	-	-	3	144	-	-
Rate and maturity	-	-	3	208	1	334	3	208
Principal deferment	1	161	-	-	1	161	-	-
Court ordered concession	-	-	-	-	-	-	-	-
	4	$ 450	3	$ 208	6	$ 793	3	$ 208

The following table shows loans modified in a TDR and the change in the recorded investment subsequent to the modifications occurring.

	Three Months Ended December 31,					
	2016			2015		
	Number of Contracts	Recorded Investment Pre-Modification	Recorded Investment Post-Modification	Number of Contracts	Recorded Investment Pre-Modification	Recorded Investment Post-Modification
	(Dollars in thousands)					
Originated portfolio:						
Residential real estate	3	$ 266	$ 289	3	$ 208	$ 208
Home equity	-	-	-	-	-	-
Commercial real estate	-	-	-	-	-	-
Commercial and industrial	1	91	161	-	-	-
Consumer	-	-	-	-	-	-
Total originated portfolio	4	357	450	3	208	208

Purchased portfolio:

Residential real estate	-	-	-	-	-	-
Commercial real estate	-	-	-	-	-	-
Total purchased portfolio	-	-	-	-	-	-
Total	4	$ 357	$ 450	3	$ 208	$ 208

	Six Months Ended December 31, 2016			2015		
	Number of Contracts	Recorded Investment Pre-Modification	Recorded Investment Post-Modification	Number of Contracts	Recorded Investment Pre-Modification	Recorded Investment Post-Modification
	(Dollars in thousands)					
Originated portfolio:						
Residential real estate	4	$ 275	$ 298	3	$ 208	$ 208
Home equity	-	-	-	-	-	-
Commercial real estate	-	-	-	-	-	-
Commercial and industrial	1	91	161	-	-	-
Consumer	-	-	-	-	-	-
Total originated portfolio	5	366	459	3	208	208
Purchased portfolio:						
Residential real estate	-	-	-	-	-	-
Commercial real estate	1	334	334	-	-	-
Total purchased portfolio	1	334	334	-	-	-
Total	6	$ 700	$ 793	3	$ 208	$ 208

The Company considers TDRs past due 90 days or more to be in payment default. No loans modified in a TDR in the last twelve months defaulted during the three and six months ended December 31, 2016. As of December 31, 2016, there were no further commitments to lend to borrowers associated with loans modified in a TDR.

Table of Contents

ASC 310-30 Loans

The following tables present a summary of loans accounted for under ASC 310-30 that were acquired by the Company during the period indicated.

	Three Months Ended December 31, 2016	Three Months Ended December 31, 2015
	(Dollars in thousands)	
Contractually required payments receivable	$68,466	$60,153
Nonaccretable difference	(977)	(491)
Cash flows expected to be collected	67,489	59,662
Accretable yield	(21,456)	(23,807)
Fair value of loans acquired	$46,033	$35,855

	Six Months Ended December 31, 2016	Six Months Ended December 31, 2015
	(Dollars in thousands)	
Contractually required payments receivable	$94,720	$91,427
Nonaccretable difference	(3,494)	(782)
Cash flows expected to be collected	91,226	90,645
Accretable yield	(31,340)	(31,334)
Fair value of loans acquired	$59,886	$59,311

Certain of the loans accounted for under ASC 310-30 that were acquired by the Company are not accounted for using the income recognition model because the Company cannot reasonably estimate cash flows expected to be collected. These loans when acquired are placed on non-accrual. The carrying amounts of such loans are as follows.

As of and for	As of and for the

	the Three Months Ended December 31, 2016	Six Months Ended December 31, 2016
	(Dollars in thousands)	
Loans acquired during the period	$ -	$ 1,010
Loans at end of period	3,917	3,917

The following tables summarize the activity in the accretable yield for loans accounted for under ASC 310-30.

	Three Months Ended December 31, 2016	Three Months Ended December 31, 2015
	(Dollars in thousands)	
Beginning balance	$ 124,023	$ 109,615
Acquisitions	21,456	23,807
Accretion	(4,656)	(3,885)
Reclassifications from non-accretable difference to accretable yield	973	2,764
Disposals and other changes	(13,373)	(8,208)
Ending balance	$ 128,423	$ 124,093

	Six Months Ended December 31, 2016	Six Months Ended December 31, 2015
	(Dollars in thousands)	
Beginning balance	$ 124,151	$ 111,449
Acquisitions	31,340	31,334
Accretion	(9,308)	(7,640)
Reclassifications from non-accretable difference to accretable yield	1,131	3,041
Disposals and other changes	(18,891)	(14,091)
Ending balance	$ 128,423	$ 124,093

The following table provides information related to the unpaid principal balance and carrying amounts of ASC 310-30 loans.

	December 31, 2016 (1)	June 30, 2016 (1)
	(Dollars in thousands)	
Unpaid principal balance	$284,637	$267,985
Carrying amount	252,040	237,054

(1) Balances include loans held for sale of $975 thousand at December 31, 2016 and $0 at June 30, 2016.

Table of Contents

5. **Transfers and Servicing of Financial Assets**

The Company sells loans in the secondary market and for certain loans, retains the servicing responsibility. Consideration for the sale includes the cash received as well as the related servicing rights asset. The Company receives fees for the services provided.

Capitalized servicing rights as of December 31, 2016 totaled $2.3 million, compared to $1.8 million as of June 30, 2016, included in other assets on the consolidated balance sheets.

Mortgage loans sold in the quarter ended December 31, 2016 totaled $17.7 million, compared to $20.5 million in the quarter ended December 31, 2015. Mortgage loans sold in the six months ended December 31, 2016 totaled $42.7 million, compared to $49.4 million in the six months ended December 31, 2015. Mortgage loans serviced for others totaled $11.9 million at December 31, 2016 and $12.9 million at June 30, 2016. Additionally, the Company was servicing commercial loans participated out to various other institutions amounting to $33.3 million and $32.9 million at December 31, 2016 and June 30, 2016, respectively.

SBA loans sold during the quarter ended December 31, 2016 totaled $17.5 million, compared to $7.5 million in the quarter December 31, 2015. SBA loans sold in the six months ended December 31, 2016 totaled $24.8 million, compared to $13.0 million in the six months ended December 31, 2015. SBA loans serviced for others totaled $121.0 million at December 31, 2016 and $83.8 million at June 30, 2016.

Mortgage and SBA loans serviced for others are accounted for as sales and therefore are not included in the accompanying consolidated balance sheets. The risks inherent in mortgage servicing assets and SBA servicing assets relate primarily to changes in prepayments that result from shifts in interest rates.

Contractually specified servicing fees were $248 thousand and $167 thousand for the quarters ended December 31, 2016 and 2015, respectively, and were included as a component of loan related fees within non-interest income. Contractually specified servicing fees were $408 thousand and $316 thousand for the six months ended December 31, 2016 and 2015, respectively.

The significant assumptions used in the valuation for mortgage servicing rights as of December 31, 2016 included a weighted average discount rate of 7.8% and a weighted average prepayment speed assumption of 16.0%. For the SBA servicing rights, the significant assumptions used in the valuation included a range of discount rates from 8.8% to

13.9% and a weighted average prepayment speed assumption of 7.5%

6. Earnings Per Share (EPS)

EPS is computed by dividing net income allocated to common shareholders by the weighted average common shares outstanding (including participating securities). The Company's only participating securities are unvested restricted stock awards that contain non-forfeitable rights to dividends. The following table shows the weighted average number of shares outstanding for the periods indicated. Shares issuable relative to stock options granted have been reflected as an increase in the shares outstanding used to calculate diluted EPS, after applying the treasury stock method. The number of shares outstanding for basic and diluted EPS is presented as follows:

	Three months Ended December 31,		Six months Ended December 31,	
	2016	2015	2016	2015
	(Dollars in thousands, except share and per share data)			
Net income	$3,100	$1,744	$4,851	$3,611
Weighted average shares used in calculation of basic EPS	8,831,235	9,559,369	8,968,690	9,560,913
Incremental shares from assumed exercise of dilutive securities	33,383	10,216	30,372	6,225
Weighted average shares used in calculation of diluted EPS	8,864,618	9,569,585	8,999,062	9,567,138
Basic earnings per common share	$0.35	$0.18	$0.54	$0.38
Diluted earnings per common share	$0.35	$0.18	$0.54	$0.38

For the three and six months ended December 31, 2016 and 2015, the following stock options were excluded from the calculation of diluted EPS due to the exercise price of these options exceeding the average market price of the Company's common stock for the period. These options, which were not dilutive at that date, may potentially dilute EPS in the future.

	Three Months Ended December 31,		Six Months Ended December 31,	
	2016	2015	2016	2015
Stock options	714,545	714,545	714,545	714,545

Table of Contents

7. Derivatives and Hedging Activities

The Company has stand-alone derivative financial instruments in the form of interest rate caps that derive their value from a fee paid and are adjusted to fair value based on index and strike rate, and swap agreements that derive their value from the underlying interest rate. These transactions involve both credit and market risk. The notional amounts are amounts on which calculations, payments and the value of the derivative are based. Notional amounts do not represent direct credit exposures. Direct credit exposure arises in the event of nonperformance by the counterparties to these agreements, and is limited to the net difference between the calculated amounts to be received and paid, if any. Such differences, which represent the fair value of the derivative instruments, are reflected on the Company's balance sheet as derivative assets and derivative liabilities. The Company controls the credit risk of its financial contracts through credit approvals, limits and monitoring procedures, and does not expect any counterparties to fail to meet their obligations.

The Company currently holds derivative instruments that contain credit-risk related features that are in a net liability position, which may require that collateral be assigned to dealer banks. At December 31, 2016, the Company had posted cash collateral totaling $1.5 million with dealer banks related to derivative instruments in a net liability position.

The Company does not offset fair value amounts recognized for derivative instruments. The Company does not net the amount recognized for the right to reclaim cash collateral against the obligation to return cash collateral arising from derivative instruments executed with the same counterparty under a master netting arrangement.

Risk Management Policies—Derivative Instruments

The Company evaluates the effectiveness of entering into any derivative instrument agreement by measuring the cost of such an agreement in relation to the reduction in net income volatility within an assumed range of interest rates.

Interest Rate Risk Management—Cash Flow Hedging Instruments

The Company uses variable rate debt as a source of funds for use in the Company's lending and investment activities and other general business purposes. These debt obligations expose the Company to variability in interest payments due to changes in interest rates. If interest rates increase, interest expense increases. Conversely, if interest rates decrease, interest expense decreases. Management believes it is prudent to limit the variability of a portion of its

interest payments and, therefore, generally hedges a portion of its variable-rate interest payments.

Information pertaining to outstanding interest rate caps and swap agreements used to hedge variable rate debt is as follows.

December 31, 2016

Notional Amount	Inception Date	Termination Date	Index	Receive Rate	Pay Rate	Strike Rate	Unrealized Loss	Fair Value	Balance Sheet Location
(Dollars in thousands)									
Interest rate swaps:									
$5,000	July 2013	July 2033	3 Mo. LIBOR	0.98 %	3.38 %	n/a	$ (634)	$ (634)	Other Liabilities
5,000	July 2013	July 2028	3 Mo. LIBOR	0.98 %	3.23 %	n/a	(451)	(451)	Other Liabilities
5,000	July 2013	July 2023	3 Mo. LIBOR	0.98 %	2.77 %	n/a	(215)	(215)	Other Liabilities
Interest rate caps:									
6,000	October 2014	September 2019	3 Mo. LIBOR	n/a	n/a	2.50 %	(159)	17	Other Assets
10,000	March 2015	February 2020	3 Mo. LIBOR	n/a	n/a	2.50 %	(170)	46	Other Assets
$31,000							$ (1,629)	$ (1,237)	

June 30, 2016

Notional Amount	Inception Date	Termination Date	Index	Receive Rate	Pay Rate	Strike Rate	Unrealized Loss	Fair Value	Balance Sheet Location
(Dollars in thousands)									
Interest rate swaps:									
$5,000	July 2013	July 2033	3 Mo. LIBOR	0.65 %	3.38 %	n/a	$ (1,352)	$ (1,352)	Other Liabilities
5,000	July 2013	July 2028	3 Mo. LIBOR	0.65 %	3.23 %	n/a	(1,005)	(1,005)	Other Liabilities
5,000	July 2013	July 2023	3 Mo. LIBOR	0.65 %	2.77 %	n/a	(560)	(560)	Other Liabilities
Interest rate caps:									
6,000	October 2014	September 2019	3 Mo. LIBOR	n/a	n/a	2.50 %	(167)	10	Other Assets
10,000	March 2015	February 2020	3 Mo. LIBOR	n/a	n/a	2.50 %	(192)	25	Other Assets
$31,000							$ (3,276)	$ (2,882)	

During the three and six months ended December 31, 2016 and 2015, no interest rate cap or swap agreements were terminated prior to maturity. Changes in the fair value of interest rate caps and swaps designated as hedging instruments of the variability of cash flows associated with variable rate debt are reported in other comprehensive income. These amounts subsequently are reclassified into interest expense as a yield adjustment in the same period in which the related interest on the debt affects earnings. Risk management results for the three and six months ended December 31, 2016 and 2015 related to the balance sheet hedging of variable rate debt indicates that the hedges were effective.

Table of Contents

8. Other Comprehensive Income

The components of other comprehensive income are as follows:

	Three Months Ended December 31,					
	2016			2015		
	Pre-tax Amount	Tax Expense (Benefit)	After-tax Amount	Pre-tax Amount	Tax Expense (Benefit)	After-tax Amount
	(Dollars in thousands)					
Change in net unrealized loss on available-for-sale securities	$(1,336)	$ (507)	$ (829)	$(692)	$ (263)	$ (429)
				-	-	-
Change in accumulated gain on effective cash flow hedges	1,486	566	920	284	108	176
Reclassification adjustment for net gains included in net income	8	3	5	-	-	-
Total derivatives and hedging activities	1,494	569	925	284	108	176
Total other comprehensive gain (loss)	$158	$ 62	$ 96	$(408)	(155)	(253)

	Six Months Ended December 31,					
	2016			2015		
	Pre-tax Amount	Tax Expense (Benefit)	After-tax Amount	Pre-tax Amount	Tax Expense (Benefit)	After-tax Amount
	(Dollars in thousands)					
Change in net unrealized gain or loss on available-for-sale securities	$(1,414)	$ (537)	$ (877)	$(226)	$ (85)	$ (141)
				-	-	-
Change in accumulated loss on effective cash flow hedges	1,633	624	1,009	(554)	(211)	(343)
Reclassification adjustment for net gains included in net income	14	5	9	-	-	-
Total derivatives and hedging activities	1,647	629	1,018	(554)	(211)	(343)
Total other comprehensive gain (loss)	$233	$ 92	$ 141	$(780)	(296)	(484)

Accumulated other comprehensive loss is comprised of the following:

	December 31,	June 30,

	2016	2016
	(Dollars in thousands)	
Unrealized loss on available-for-sale securities	$(1,217)	$197
Tax effect	462	(75)
Net-of-tax amount	$(755)	$122
Unrealized loss on cash flow hedges	$(1,629)	$(3,276)
Tax effect	619	1,248
Net-of-tax amount	$(1,010)	$(2,028)
Accumulated other comprehensive loss	$(1,765)	$(1,906)

Table of Contents

9. Commitments and Contingencies

Commitments

The Company 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 reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit, standby letters of credit, and commitments to fund investments. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The contract amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Financial instruments with contract amounts which represent credit risk are as follows:

	December 31, 2016	June 30, 2016
	(Dollars in thousands)	
Commitments to grant loans	$24,187	$44,684
Unfunded commitments under lines of credit	76,317	58,412
Standby letters of credit	3,810	3,822
Commitment to fund investment	2,500	2,500

Commitments to extend credit are agreements to lend to a customer as long as there is no violation 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 many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the counter party. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, and income-producing commercial properties. The Company has recorded an allowance for possible losses on commitments and unfunded loans totaling

$63 thousand and $81 thousand recorded in other liabilities at December 31, 2016 and June 30, 2016, respectively.

The Company committed $2.5 million to a fund that acquires CRA qualified investments in loans for the Company's portfolio. The Fund Manager will call the funds from the Company when an investment is successfully acquired. Through the three and six months ended December 31, 2016, the fund has not called any funds from the Company.

Contingencies

The Company and its subsidiary are parties to litigation and claims arising in the normal course of business. Management believes that the liabilities, if any, arising from such litigation and claims will not be material to the Company's consolidated financial position or results of operations.

10. Stock-Based Compensation

A summary of restricted share activity for the six months ended December 31, 2016 follows:

	Shares	Weighted Average Grant Date Fair Value
Unvested at beginning of period	251,859	$ 9.93
Granted	160,000	11.20
Vested	-	-
Forfeited	(1,000)	9.47
Unvested at end of period	410,859	10.43

A summary of the vesting schedule for the shares granted in the six months ended December 31, 2016 follows:

15,000 restricted shares vest in full on August 25, 2019;
50,000 restricted shares are subject to performance-based vesting over a three year period (the "performance shares"). The performance shares include an absolute metric and a sliding metric within the performance period. The absolute metric requires that the Company be in compliance with the regulatory commitments made to the Federal Reserve Bank and Maine Bureau of Financial Institutions. The sliding metric is based on reaching certain thresholds in regards to the company's return on equity ("ROE"). The performance shares shall vest in certain defined increments for

such periods if the ROE is at least 70% of such targeted returns. This performance will be measured on both a year-by-year basis for three years, and an average basis over the three year performance period; and,
95,000 restricted shares vest in three equal installments, commencing on August 25, 2019.

Table of Contents

11. Fair Value Measurements

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. The Company uses prices and inputs that are current as of the measurement date, including during periods of market dislocation. In periods of market dislocation, the observability of prices and inputs may be reduced for many instruments. This condition could cause an instrument to be reclassified from one level to another. When market assumptions are not readily available, the Company's own assumptions are set to reflect those that market participants would use in pricing the asset or liability at the measurement date. If there has been a significant decrease in the volume and level of activity for the asset or liability, regardless of the valuation technique(s) used, the objective of a fair value measurement remains the same.

ASC 820 defines fair value and establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under ASC 820 are described below:

Level 1 — Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 — Valuations based on significant observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 — Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable.

To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. Accordingly, the degree of judgment exercised by the Company in determining fair value is greatest for instruments categorized in Level 3. A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

Valuation techniques - There have been no changes in the valuation techniques used during the current period.

Transfers- There were no transfers of assets and liabilities measured at fair value on a recurring or nonrecurring basis during the current period.

Assets and Liabilities Measured at Fair Value on a Recurring Basis:

Available-for-sale securities - Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Examples of such instruments include publicly-traded common and preferred stocks. If quoted prices are not available, then fair values are estimated by using pricing models (*i.e.*, matrix pricing) and market interest rates and credit assumptions or quoted prices of securities with similar characteristics and are classified within Level 2 of the valuation hierarchy. Examples of such instruments include government agency and government sponsored agency mortgage-backed securities, as well as certain preferred and trust preferred stocks. Level 3 securities are securities for which significant unobservable inputs are utilized.

Certain investments are measured at fair value using the net asset value per share as a practical expedient. The fund seeks to invest in securities either issued or guaranteed by the U.S. government or its agencies. The Company’s investments can be redeemed daily at the closing net asset value per share. In accordance with ASU 2015-07, these investments have not been included in the fair value hierarchy.

Derivative financial instruments - The valuation of the Company’s interest rate swaps and caps are determined using widely accepted valuation techniques including discounted cash flow analyses on the expected cash flows of derivatives. These analyses reflect the contractual terms of the derivatives, including the period to maturity, and use observable market-based inputs, including forward interest rate curves and implied volatilities. Unobservable inputs, such as credit valuation adjustments are insignificant to the overall valuation of the Company’s derivative financial instruments. Accordingly, the Company has determined that its interest rate derivatives fall within Level 2 of the fair value hierarchy.

The fair value of derivative loan commitments and forward loan sale agreements are estimated using the anticipated market price based on pricing indications provided from syndicate banks. These commitments and agreements are categorized as Level 2. The fair value of such instruments was nominal at each date presented.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis:

Collateral Dependent Impaired Loans- Valuations of impaired loans measured at fair value are determined by a review of collateral values. Certain inputs used in appraisals are not always observable, and therefore impaired loans are generally categorized as Level 3 within the fair value hierarchy.

Real Estate Owned and Other Repossessed collateral - The fair values of real estate owned and other repossessed collateral are estimated based upon appraised values less estimated costs to sell. Certain inputs used in appraisals are not always observable, and therefore may be categorized as Level 3 within the fair value hierarchy. When inputs used in appraisals are primarily observable, they are classified as Level 2.

Loan servicing rights— The fair value of the SBA and mortgage servicing rights is based on a valuation model that calculates the present value of estimated future net servicing income. Adjustments are only recorded when the discounted cash flows derived from the valuation model are less than the carrying value of the asset. Certain inputs are not observable, and therefore loan servicing rights are generally categorized as Level 3 within the fair value hierarchy.

Fair Value of other Financial Instruments:

Cash and cash equivalents - The fair value of cash, due from banks, interest bearing deposits and Federal Home Loan Bank of Boston (“FHLBB”) overnight deposits approximates their relative book values, as these financial instruments have short maturities.

FHLBB stock - The carrying value of FHLBB stock approximates fair value based on redemption provisions of the FHLBB.

Loans- Fair values are estimated for portfolios of loans with similar financial characteristics. The fair value of performing loans is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan. The estimates of maturity are based on the Company’s historical experience with repayments for each loan classification, modified, as required, by an estimate of the effect of current economic conditions, lending conditions and the effects of estimated prepayments.

Loans held for sale - The fair value of loans held-for-sale is estimated based on bid quotations received from loan dealers.

Interest receivable - The fair value of this financial instrument approximates the book value as this financial instrument has a short maturity. It is the Company's policy to stop accruing interest on loans past due by more than 90 days. Therefore, this financial instrument has been adjusted for estimated credit loss.

Deposits - The fair value of deposits with no stated maturity, such as noninterest-bearing demand deposits, savings, NOW accounts and money market accounts, is equal to the amount payable on demand. The fair values of time deposits are based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar remaining maturities. The fair value estimates do not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market. If that value were considered, the fair value of the Company's net assets could increase.

Borrowings - The fair value of the Company's borrowings with the FHLBB is estimated by discounting the cash flows through maturity or the next re-pricing date based on current rates available to the Company for borrowings with similar maturities. The fair value of the Company's short-term borrowings, capital lease obligations, wholesale repurchase agreements and other borrowings is estimated by discounting the cash flows through maturity based on current rates available to the Company for borrowings with similar maturities.

Off-Balance Sheet Credit-Related Instruments -Fair values for off-balance-sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The fair value of such instruments was nominal at each date presented.

Table of Contents

Assets and liabilities measured at fair value on a recurring basis are summarized below.

	December 31, 2016			
	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)			
Assets				
Securities available-for-sale:				
U.S. Government agency securities	$48,500	$ -	$48,500	$ -
Agency mortgage-backed securities	37,000	-	37,000	-
Other investment measured at net asset value[(1)]	5,033	-	-	-
Other assets – interest rate caps	63	-	63	-
Liabilities				
Other liabilities – interest rate swaps	$1,300	$ -	$1,300	$ -

	June 30, 2016			
	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)			
Assets				
Securities available-for-sale:				
U.S. Government agency securities	$52,046	$ -	$52,046	$ -
Agency mortgage-backed securities	43,368	-	43,368	-
Other investment measured at net asset value[(1)]	5,158	-	-	-
Other assets – interest rate caps	35	-	35	-
Liabilities				
Other liabilities – interest rate swap	$2,917	$ -	$2,917	$ -

(1) In accordance with ASU 820-10, certain investments that are measured at fair value using the net asset value per share (or its equivalent) as a practical expedient have not been classified in the fair value hierarchy. The fair value amount presented in the table are intended to permit reconciliation of the fair value amount to the consolidated financial statements.

Assets measured at fair value on a nonrecurring basis are summarized below.

	December 31, 2016			
	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)			
Collateral dependent impaired loans	$2,099	$ -	$ -	$2,099

Real estate owned and other repossessed collateral	3,145	-	-	3,145
Loan servicing rights	2,342	-	-	2,342

	June 30, 2016			
	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)			
Collateral dependent impaired loans	$922	$ -	$ -	$922
Real estate owned and other repossessed collateral	1,652	-	-	1,652
Loan servicing rights	1,771	-	-	1,771

The table below presents quantitative information about significant unobservable inputs (Level 3) for assets measured at fair value on a nonrecurring basis at the dates indicated.

	Fair Value		
	December 31, 2016	June 30, 2016	Valuation Technique
	(Dollars in thousands)		
Collateral dependent impaired loans	$2,099	$922	Appraisal of collateral(1)
Real estate owned and other repossessed collateral	3,145	1,652	Appraisal of collateral(1)
Loan servicing rights	2,342	1,771	Discounted cash flow(2)

(1) Fair value is generally determined through independent appraisals of the underlying collateral. The Company may also use another available source of collateral assessment to determine a reasonable estimate of the fair value of the collateral. Appraisals may be adjusted by management for qualitative factors such as economic factors and estimated liquidation expenses. The range of these possible adjustments was 6% to 30%.

(2) Fair value is determined using a discounted cash flow model. The unobservable inputs include anticipated rate of loan prepayments and discount rates. The range of prepayment assumptions used was 7.5% to 16.0%. For discount rates, the range was 7.8% to 14.0%.

Table of Contents

The following table presents the estimated fair value of the Company's financial instruments.

	Carrying	Fair Value Measurements at December 31, 2016			
	Amount	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)				
Financial assets:					
Cash and cash equivalents	$112,196	$112,196	$112,196	$-	$-
Available-for-sale securities	85,500	85,500	-	85,500	-
Other investment measured at net asset value[1]	5,033	5,033	-	-	-
Federal Home Loan Bank stock	1,938	1,938	-	1,938	-
Loans held for sale	8,979	8,979	-	8,979	-
Loans, net	763,831	769,998	-	-	769,998
Accrued interest receivable	1,722	1,722	-	1,722	-
Interest rate caps	63	63	-	63	-
Financial liabilities:					
Deposits	839,571	840,073	-	840,073	-
FHLBB advances	20,024	20,143	-	20,143	-
Capital lease obligation	1,003	1,059	-	1,059	-
Subordinated debentures	23,469	25,285	-	-	25,285
Interest rate swaps	1,300	1,300	-	1,300	-

	Carrying	Fair Value Measurements at June 30, 2016			
	Amount	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)				
Financial assets:					
Cash and cash equivalents	$151,157	$151,157	$151,157	$-	$-
Available-for-sale securities	95,414	95,414	-	95,414	-
Other investment measured at net asset value[1]	5,158	5,158	-	-	-
Federal Home Loan Bank stock	2,408	2,408	-	2,408	-
Loans held for sale	7,519	7,519	-	7,519	-
Loans, net	690,086	695,830	-	-	695,830
Accrued interest receivable	1,579	1,579	-	1,579	-
Interest rate caps	35	35	-	35	-
Financial liabilities:					
Deposits	800,432	801,045	-	801,045	-
FHLBB advances	30,075	30,396	-	30,396	-
Capital lease obligation	1,128	1,219	-	1,219	-
Subordinated debentures	23,331	25,664	-	-	25,664
Interest rate swaps	2,917	2,917	-	2,917	-

(1) In accordance with ASU 820-10, certain investments that are measured at fair value using the net asset value per share (or its equivalent) as a practical expedient have not been classified in the fair value hierarchy. The fair value amount presented in the table are intended to permit reconciliation of the fair value amount to the consolidated financial statements.

Table of Contents

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

The following discussion should be read in conjunction with the consolidated financial statements, notes and tables included in Northeast Bancorp's Annual Report on Form 10-K for the fiscal year ended June 30, 2016, filed with the Securities and Exchange Commission.

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 the Company's 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 and 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", "approximate "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". 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 its expectations will, in fact, occur or that its 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, changes in interest rates and real estate values; competitive pressures from other financial institutions; weakness 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 the Company's 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 the Company may not be successful in the implementation of its business strategy; the risk of compromises or breaches of the company's security systems; the risk that intangibles recorded in the Company's financial statements will become impaired; changes in assumptions used in making such forward-looking statements; and the other risks and uncertainties detailed in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2016 as updated in the Company's Quarterly Reports on Form 10-Q and other filings submitted to the Securities and Exchange Commission. 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 or to reflect the occurrence of unanticipated events.

Description of Business and Strategy

Business Overview

Northeast Bancorp ("we," "our," "us," "Northeast" or the "Company"), incorporated under Maine law in 1987, is a bank holdin company registered with the Board of Governors of the Federal Reserve System (the "Federal Reserve"). As a bank holding company registered under the Bank Holding Company Act of 1956, as amended (the "BHCA"), the Company is subject to regulation and supervision by the Federal Reserve. 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. As a Federal Deposit Insurance Corporation ("FDIC") insured Maine-chartered bank, the Bank is subject to regulation and supervision by the Maine Bureau of Financial Institutions (the "Bureau") and the FDIC.

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.

Table of Contents

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 to exclude owner-occupied commercial real estate loans from the commitment to hold commercial real estate loans to within 300% of total risk-based capital. 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. The Company's compliance ratios at December 31, 2016 follow:

Condition	Ratios as of December 31, 2016	
(i) Tier 1 leverage capital ratio	12.60	%
(ii) Total capital ratio	18.31	%
(iii) Ratio of purchased loans to total loans, including loans held for sale	32.91	%
(iv) Ratio of loans to core deposits (1)	92.04	%
(v) Ratio of commercial real estate loans to total risk-based capital (2)	197.11	%

(1) Core deposits include all non-maturity deposits and maturity deposits less than $250 thousand

(2) For purposes of calculating this ratio, commercial real estate includes all non-owner occupied commercial real estate loans defined as such by regulatory guidance, including all land development and construction loans.

As of December 31, 2016, the Company, on a consolidated basis, had total assets of $1.0 billion, total deposits of $839.6 million, and shareholders' equity of $114.9 million. The Company gathers retail deposits through its banking offices in Maine and the Bank's online affinity deposit program, ableBanking; originates loans through the Bank's Community Banking Division; originates Small Business Administration ("SBA") loans through the Bank's national SBA group ("SBA Division"); and purchases and originates commercial loans through the Bank's Loan Acquisition and Servicing Group ("LASG"). The Community Banking Division, with ten full-service branches and two loan production offices, operates from the Bank's headquarters in Lewiston, Maine. LASG, ableBanking, and the SBA Division operate from the Company's offices in Boston, Massachusetts.

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:

Continuing our community banking tradition. With a history that dates to 1872, our Community Banking Division maintains its focus on sales and service, with the goal of attracting and retaining deposits, and serving the lending needs of retail and commercial customers within our core markets.

Growing LASG's national originated and purchased loan business. We purchase commercial real estate loans nationally, at prices that on average have produced yields significantly higher than those available on our originated loan portfolio. We also originate loans nationally, taking advantage of our core expertise in underwriting and servicing national credits.

Growing our national SBA origination business. We originate loans on a national basis to small businesses, primarily through the SBA 7(a) program, which provides the partial guarantee of the SBA.

Generating deposits to fund our business. We offer a full line of deposit products through our ten-branch network located in the Community Banking Division's market. ableBanking is a direct savings platform providing an additional channel to raise core deposits to fund our asset strategy.

Critical Accounting Policies

Critical accounting policies are those that involve significant judgments and assessments by management, and which could potentially result in materially different results under different assumptions and conditions. The reader is encouraged to review each of the policies included in Form 10-K for the year ended June 30, 2016 to gain a better understanding of how Northeast's financial performance is measured and reported. There has been no material change in critical accounting policies during the three and six months ended December 31, 2016.

Overview

Net income was $3.1 million, or $0.35 per diluted common share, for the quarter ended December 31, 2016, compared to $1.7 million, or $0.18 per diluted common share, for the quarter ended December 31, 2015. Net income was $4.9 million, or $0.54 per diluted common share, for the six months ended December 31, 2016, compared to $3.6 million, or $0.38 per diluted common share, for the six months ended December 31, 2015.

Table of Contents

Net interest and dividend income before provision for loan losses increased by $1.7 million for the quarter ended December 31, 2016, compared to the quarter ended December 31, 2015. The increase is primarily due to higher average balances in the total loan portfolio and higher transactional income on purchased loans. This increase was partially offset by higher rates and volume in our deposit portfolio and the effect of the issuance of subordinated debt.

Noninterest income increased by $1.1 million for the quarter ended December 31, 2016, compared to the quarter ended December 31, 2015, due to an increase in gains realized on sale of SBA loans of $1.1 million.

Noninterest expense increased by $760 thousand for the quarter ended December 31, 2016, compared to the quarter ended December 31, 2015, primarily due to the following:

- An increase in loan expense of $328 thousand, largely driven by the expense related to loan collection in the period;
- An increase in salaries and employee benefits of $307 thousand, primarily due to increased incentive compensation and severance in the three months ended December 31, 2016, offset by higher deferred salaries due to an increase in loan originations;
- An increase in professional fees of $135 thousand, largely attributable to increased consulting costs, increased audit costs relating to the Company’s conversion to accelerated filer status and core system projects; and
- An increase in other noninterest expense of $99 thousand, largely attributable to $220 thousand of expense related to the quarterly valuation of SBA servicing rights.
- The increases in noninterest expense were partially offset by a decrease in FDIC deposit insurance premiums of $94 thousand, resulting from changes in the reserve ratio requirements.

Financial Condition

Overview

Total assets increased by $26.5 million, or 2.7%, to $1.0 billion at December 31, 2016, compared to June 30, 2016. The principal components of the change in the balance sheet were as follows:

- The loan portfolio – excluding loans held for sale – grew by $74.5 million, or 10.8%, compared to June 30, 2016, principally on the strength of $70.7 million of net growth in commercial loans purchased or originated by the Bank’s LASG and net growth of $13.2 million in originations by the Bank’s SBA Division. This net growth was offset by a $9.4 million decrease in the Bank’s Community Banking Division loan portfolio.

Loans generated by the LASG totaled $91.7 million for the quarter ended December 31, 2016. The growth in LASG loans consisted of $46.0 million of purchased loans, at an average price of 90.1% of unpaid principal balance, and $45.7 million of originated loans. SBA loans closed during the quarter totaled $25.3 million, of which $24.7 million were fully funded in the quarter. In addition, the Company sold $17.5 million of the guaranteed portion of SBA loans in the secondary market, of which $9.3 million were originated in the current quarter and $8.2 million were originated or purchased in prior quarters. Residential loan production sold in the secondary market totaled $17.7 million for the quarter.

As noted above in the "*Business Overview*" section, the Company made certain commitments to the Board of Governors of the Federal Reserve System in connection with the merger of FHB Formation LLC with and into the Company in December 2010. The Company's loan purchase and commercial real estate loan availability under these conditions follow.

Basis for Regulatory Condition	Condition	Availability at December 31, 2016 (Dollars in millions)
Total Loans	Purchased loans may not exceed 40% of total loans	$ 91.5
Regulatory Capital	Non-owner occupied commercial real estate loans may not exceed 300% of total capital	$ 146.2

Table of Contents

An overview of the Bank's LASG portfolio follows:

LASG Portfolio

	Three Months Ended December 31, 2016				2015			
	Purchased (1)	Originated	Secured Loans to Broker-Dealers	Total LASG	Purchased	Originated	Secured Loans to Broker-Dealers	Total LASG
	(Dollars in thousands)							
Loans purchased or originated during the period:								
Unpaid principal balance	$51,112	$45,647	$ -	$96,759	$40,145	$39,512	$ -	$79,657
Net investment basis	46,033	45,647	-	91,680	35,855	39,512	-	75,367
Loan returns during the period:								
Yield	13.01 %	5.89 %	0.99 %	8.76 %	12.74 %	5.69 %	0.50 %	8.55 %
Total Return (2)	13.01 %	5.89 %	0.99 %	8.76 %	12.74 %	5.69 %	0.50 %	8.55 %

	Six Months Ended December 31, 2016				2015			
	Purchased (1)	Originated	Secured Loans to Broker-Dealers	Total LASG	Purchased	Originated	Secured Loans to Broker-Dealers	Total LASG
	(Dollars in thousands)							
Loans purchased or originated during the period:								
Unpaid principal balance	$67,903	$88,025	$ -	$155,928	$63,728	$50,907	$ -	$114,635
Net investment basis	59,886	88,025	-	147,911	59,311	50,907	-	110,218
Loan returns during the								

period:								
Yield	11.71 %	5.88 %	0.74 %	8.19 %	12.41 %	5.68 %	0.50 %	8.40 %
Total Return (2)	11.73 %	5.88 %	0.74 %	8.19 %	12.43 %	5.68 %	0.50 %	8.41 %
Total loans as of period end:								
Unpaid principal balance	$288,455	$231,278	$ 48,000	$567,733	$258,049	$155,728	$ 60,000	$473,777
Net investment basis	255,048	231,278	48,000	534,326	226,014	155,728	60,000	441,742

(1) Purchased loan balances include loans held for sale of $975 thousand.

(2) The total return on purchased loans represents scheduled accretion, accelerated accretion, gains on asset sales, and other noninterest income recorded during the period divided by the average invested balance, which includes loans held for sale, on an annualized basis. The total return does not include the effect of purchased loan charge-offs or recoveries in the quarter. Total return is a non-GAAP financial measure.

Assets

Cash, Short-term Investments and Securities

Cash and short-term investments were $112.2 million as of December 31, 2016, a decrease of $39.0 million, or 25.8%, from $151.2 million at June 30, 2016. The decrease is primarily due to the increase in loans and the maturity of a $10.0 million FHLBB advance during the quarter ended December 31, 2016, offset by the increase in deposits in the period.

Available-for-sale securities totaled $90.5 million as of December 31, 2016, compared to $100.6 million as of June 30, 2016, representing a decrease of $10.0 million, or 10.0% due to the maturity of securities issued by government agencies as well as principal payments on mortgage backed securities. Included in available-for-sale securities are securities issued by government agencies and government-sponsored enterprises, as well as an investment of approximately $5.0 million in a CRA qualified fund that seeks to invest in securities either issued or guaranteed by the U.S. government or its agencies. At December 31, 2016, no securities were pledged for outstanding borrowings.

Table of Contents

Loans

The Company's loan portfolio (excluding loans held-for-sale) by lending division follows:

	December 31, 2016				
	Community Banking Division	LASG	SBA Division	Total	Percent of Total
	(Dollars in thousands)				
Originated loans:					
Residential real estate	$87,768	$-	$132	$87,900	11.46 %
Home equity	15,964	-	-	15,964	2.08 %
Commercial real estate: non-owner occupied	50,467	73,041	13,539	137,047	17.87 %
Commercial real estate: owner occupied	19,274	78,937	18,343	116,554	15.20 %
Commercial and industrial	15,206	127,300	7,581	150,087	19.57 %
Consumer	5,313	-	-	5,313	0.69 %
Subtotal	193,992	279,278	39,595	512,865	66.87 %
Purchased loans:					
Residential real estate	-	3,085	-	3,085	0.40 %
Commercial real estate: non-owner occupied	-	144,213	-	144,213	18.81 %
Commercial real estate: owner occupied	-	105,634	-	105,634	13.77 %
Commercial and industrial	-	1,141	-	1,141	0.15 %
Subtotal	-	254,073	-	254,073	33.13 %
Total	$193,992	$533,351	$39,595	$766,938	100.00 %

	June 30, 2016				
	Community Banking Division	LASG	SBA Division	Total	Percent of Total
	(Dollars in thousands)				
Originated loans:					
Residential real estate	$93,258	$-	$133	$93,391	13.49 %
Home equity	18,012	-	-	18,012	2.60 %
Commercial real estate: non-owner occupied	49,514	52,744	5,639	107,897	15.58 %
Commercial real estate: owner occupied	20,578	46,727	14,414	81,719	11.80 %
Commercial and industrial	16,069	123,447	6,242	145,758	21.05 %
Consumer	5,950	-	-	5,950	0.86 %
Subtotal	203,381	222,918	26,428	452,727	65.38 %
Purchased loans:					
Residential real estate	-	2,559	-	2,559	0.37 %

Commercial real estate: non-owner occupied	-	142,286	-	142,286	20.55 %
Commercial real estate: owner occupied	-	94,666	-	94,666	13.67 %
Commercial and industrial	-	198	-	198	0.03 %
Subtotal	-	239,709	-	239,709	34.62 %
Total	$203,381	$462,627	$26,428	$692,436	100.00%

Classification of Assets

Loans are classified as non-performing when 90 or more days past due, unless a loan is well-secured and in the process of collection. Loans less than 90 days past due, for which collection of principal or interest is considered doubtful, also may be designated as non-performing. In both situations, accrual of interest ceases. The Company typically maintains such loans as non-performing until the respective borrowers have demonstrated a sustained period of payment performance.

In cases where a borrower experiences financial difficulties and the Company makes certain concessionary modifications, the loan is classified as a troubled debt restructuring (“TDR”). Concessionary modifications may include adjustments to interest rates, extensions of maturity, or other actions intended to minimize economic loss and avoid foreclosure or repossession of collateral. Nonaccrual loans that are restructured generally remain on nonaccrual status for a minimum period of six months to demonstrate that the borrower can meet the restructured terms. If the restructured loan is on accrual status prior to being modified, it is reviewed to determine if the modified loan should remain on accrual status. If the borrower’s ability to meet the revised payment schedule is not reasonably assured, the loan is classified as a nonaccrual loan. With limited exceptions, loans classified as TDRs remain classified as such until the loan is paid off.

Other nonperforming assets include other real estate owned (“OREO”) and other personal property securing loans repossessed by the Bank. The real estate and personal property collateral for commercial and consumer loans is written down to its estimated realizable value upon repossession. Revenues and expenses are recognized in the period when received or incurred on OREO and in substance foreclosures. Gains and losses on disposition are recognized in noninterest income.

Table of Contents

The following table details the Company's nonperforming assets and other credit quality indicators as of December 31, 2016 and June 30, 2016. Management believes that, based on their carrying amounts, nonperforming assets are well secured based on the estimated fair value of underlying collateral.

	Non-Performing Assets at December 31, 2016		
	Originated	Purchased	Total
	(Dollars in thousands)		
Loans:			
Residential real estate	$2,827	$ 1,066	$3,893
Home equity	48	-	48
Commercial real estate	396	3,055	3,451
Commercial and industrial	2,659	98	2,757
Consumer	48	-	48
Subtotal	5,978	4,219	10,197
Real estate owned and other repossessed collateral	135	3,010	3,145
Total	$6,113	$ 7,229	$13,342
Ratio of nonperforming loans to total loans			1.33 %
Ratio of nonperforming assets to total assets			1.32 %
Ratio of loans past due to total loans			2.85 %
Nonperforming loans that are current			$4,499
Commercial loans risk rated substandard or worse			$4,700
Troubled debt restructurings:			
On accrual status			$6,953
On nonaccrual status			$1,200

	Non-Performing Assets at June 30, 2016		
	Originated	Purchased	Total
	(Dollars in thousands)		
Loans:			
Residential real estate	$2,613	$ 1,125	$3,738
Home equity	48	-	48
Commercial real estate	474	3,387	3,861
Commercial and industrial	17	-	17
Consumer	163	-	163
Subtotal	3,315	4,512	7,827
Real estate owned and other repossessed collateral	830	822	1,652
Total	$4,145	$ 5,334	$9,479
Ratio of nonperforming loans to total loans			1.13 %
Ratio of nonperforming assets to total assets			0.96 %
Ratio of loans past due to total loans			1.00 %

Nonperforming loans that are current	$2,271
Commercial loans risk rated substandard or worse	$4,518
Troubled debt restructurings:	
On accrual status	$7,036
Nonaccrual status	$1,152

At December 31, 2016, nonperforming assets totaled $13.3 million, or 1.32% of total assets, as compared to $9.5 million, or 0.96% of total assets, at June 30, 2016. The increase is largely due to one loan added to OREO during the period.

Allowance for Loan Losses

In connection with the application of the acquisition method of accounting for the merger on December 29, 2010, the allowance for loan losses was reduced to zero when the loan portfolio was marked to its then current fair value. Since that date, the Company has provided for an allowance for loan losses as new loans are originated or in the event that credit exposure in the pre-merger loan portfolio or other acquired loans exceeds the exposure estimated when initial fair values were determined.

The Company's allowance for loan losses was $3.1 million as of December 31, 2016, which represents an increase of $757 thousand from $2.4 million as of June 30, 2016. The increase during the period was principally due to loan growth.

The following table details ratios related to the allowance for loan losses for the periods indicated.

	December 31, 2016	June 30, 2016	December 31, 2015
Allowance for loan losses to nonperforming loans	30.47%	30.02%	34.90%
Allowance for loan losses to total loans	0.41%	0.34%	0.31%
Last twelve months of net-charge offs to average loans	0.06%	0.18%	0.15%

While management believes that it uses the best information available to make its determinations with respect to the allowance, there can be no assurance that the Company will not have to increase its provision for loan losses in the future as a result of changing economic conditions, adverse markets for real estate or other factors.

Table of Contents

Other Assets

The cash surrender value of the Company's bank-owned life insurance ("BOLI") assets increased $228 thousand, or 1.4% to $16.0 million at December 31, 2016, compared to $15.7 million at June 30, 2016. Increases in cash surrender value are recognized in other income and are not subject to income taxes. Borrowing on, or surrendering a policy, may subject the Company to income tax expense on the increase in cash surrender value. For these reasons, management considers BOLI an illiquid asset. BOLI represented 11.2% of the Company's total capital at December 31, 2016.

Intangible assets totaled $1.5 million and $1.7 million at December 31, 2016 and June 30, 2016, respectively. The $218 thousand decrease was the result of core deposit intangible asset amortization during the period.

Deposits, Borrowed Funds, Subordinated Debt, Liquidity, Capital, and Stock Repurchases

Deposits

The Company's principal source of funding is its core deposit accounts. At December 31, 2016, non-maturity accounts, and certificates of deposit with balances less than $250 thousand represented 99.9% of total deposits.

Total deposits increased $39.1 million to $839.6 million as of December 31, 2016 from $800.4 million as of June 30, 2016. The increase, which funded growth in the Company's loan portfolio, was centered mainly in money market accounts attracted through the Bank's Community Banking Division.

The composition of total deposits at December 31, 2016 and June 30, 2016 is as follows:

	December 31, 2016		June 30, 2016	
	Amount	Percent of Total	Amount	Percent of Total
	(Dollars in thousands)			

Demand deposits	$76,721	9.14	%	$66,686	8.33	%
NOW accounts	71,415	8.51	%	71,148	8.89	%
Regular and other savings	35,971	4.28	%	36,070	4.51	%
Money market deposits	319,933	38.11	%	275,437	34.41	%
Total non-certificate accounts	504,040	60.04	%	449,341	56.14	%
Term certificates less than $250 thousand	334,526	39.84	%	351,091	43.86	%
Term certificates of $250 thousand or more	1,005	0.12	%	-	0.00	%
Total certificate accounts	335,531	39.96	%	351,091	43.86	%
Total deposits	$839,571	100.00	%	$800,432	100.00	%

FHLBB Advances

Advances from the FHLBB were $20.0 million at December 31, 2016, as compared to $30.1 million at June 30, 2016. The decrease of $10.1 million was due to the maturity of one FHLBB advance. At December 31, 2016, the Company had pledged certain residential real estate loans and commercial real estate loans to secure outstanding advances and provide additional borrowing capacity. At December 31, 2016, no securities were pledged for outstanding borrowings.

Subordinated Debt

On June 29, 2016, the Company entered into a Subordinated Note Purchase Agreement with certain institutional accredited investors pursuant to which the Company issued subordinated notes equal to $15.05 million in aggregate principal amount with an interest rate of 6.75% fixed-to-floating maturing in 2026 (“subordinated notes”). The subordinated notes, net of issuance costs, totaled $14.6 million and $14.5 million at December 31, 2016 and June 30, 2016, respectively.

The Company had junior subordinated debentures issued to affiliated trusts totaling $8.9 million and $8.8 million at December 31, 2016 and June 30, 2016, respectively.

Table of Contents

Liquidity

The following table is a summary of unused borrowing capacity of the Company at December 31, 2016, in addition to traditional retail deposit products (dollars in thousands):

Brokered time deposits	$252,160	Subject to policy limitation of 25% of total assets
Federal Home Loan Bank of Boston	81,085	Unused advance capacity subject to eligible and qualified collateral
Federal Discount Window Borrower-in-Custody	1,641	Unused credit line subject to the pledge of loans
Other available lines	17,500	
Total unused borrowing capacity	352,386	

Retail deposits and other core deposit sources including deposit listing services are used by the Bank to manage its overall liquidity position. While we currently do not seek wholesale funding such as FHLBB advances and brokered deposits, the ability to raise them remains an important part of our liquidity contingency planning. While we closely monitor and forecast our liquidity position, it is affected by asset growth, deposit withdrawals and meeting other contractual obligations and commitments. The accuracy of our forecast assumptions may increase or decrease our overall available liquidity. To utilize the FHLBB advance capacity, the purchase of additional capital stock in the Federal Home Loan Bank of Boston may be required.

At December 31, 2016, the Company had $425.4 million of immediately accessible liquidity, defined as cash that the Bank reasonably believes could be raised within seven days through collateralized borrowings, brokered deposits or security sales. This position represented 42.0% of total assets. The Company also had $112.2 million of cash and cash equivalents at December 31, 2016.

Management believes that there are adequate funding sources to meet its liquidity needs for the foreseeable future. Primary funding sources are the repayment of principal and interest on loans, the renewal of time deposits, the potential for growth in the deposit base, and the credit availability from the FHLBB. Management does not believe that the terms and conditions that will be present at the renewal of these funding sources will significantly impact the Company’s operations, due to its management of the maturities of its assets and liabilities.

Capital

The unpaid principal balance and carrying amount of junior subordinated debentures totaled $16.5 million and $8.9 million, respectively, as of December 31, 2016. This debt represents qualifying Tier 1 capital for the Company, up to a maximum of 25% of total Tier 1 capital. At December 31, 2016, the carrying amounts of the junior subordinated notes, net of the Company’s $496 thousand investment in the affiliated trusts, qualified as Tier 1 capital.

At December 31, 2016, shareholders’ equity was $114.9 million, a decrease of $1.6 million, or 1.4% from June 30, 2016. Book value per outstanding common share was $13.02 at December 31, 2016 and $12.51 at June 30, 2016. Tier 1 capital to total average assets of the Company was 12.60% as of December 31, 2016 and 13.27% at June 30, 2016.

Under the capital rules, risk-based capital ratios are calculated by dividing Tier 1 and total capital, respectively, by risk-weighted assets. Assets and off-balance sheet credit equivalents are assigned to one of several risk-weight categories, based primarily on relative risk. The rules require banks and bank holding companies to maintain a minimum common equity Tier 1 capital ratio of 4.5%, a minimum Tier 1 capital ratio of 6%, a total capital ratio of 8% and a leverage ratio of 4%. Additionally, subject to a transition schedule, the capital rules require a bank holding company to establish a capital conservation buffer of Tier 1 capital in an amount above the minimum risk-based capital requirements for "adequately capitalized" institutions equal to 2.5% of total risk weighted assets, or face restrictions on the ability to pay dividends, pay discretionary bonuses, and to engage in share repurchases.

A bank holding company, such as the Company, is considered "well capitalized" if the bank holding company (i) has a total capital ratio of at least 10%, (ii) has a Tier 1 risk-based capital ratio of at least 6%, and (iii) is not subject to any written agreement order, capital directive or prompt corrective action directive to meet and maintain a specific capital level for any capital measure. In addition, the FDIC has amended its prompt corrective action rules to reflect the revisions made by the revised capital rules described above. Under the FDIC's revised rules, which became effective January 1, 2015, an insured state nonmember bank is considered "well capitalized" if it (i) has a total capital ratio of 10.0% or greater; (ii) a Tier 1 risk-based capital ratio of 8.0% or greater; (iii) a common Tier 1 equity ratio of 6.5% or greater, (iv) a leverage capital ratio of 5.0% or greater; and (iv) is not subject to any written agreement, order, capital directive, or prompt corrective action directive to meet and maintain a specific capital level for any capital measure.

Table of Contents

The Company and the Bank are considered "well capitalized" under all regulatory definitions. The Company's and the Bank's regulatory capital ratios are set forth below.

	Actual		Minimum Capital Requirements		Minimum To Be Well Capitalized Under Prompt Correction Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)					
December 31, 2016:						
Common equity tier 1 capital to risk weighted assets:						
Company	$115,971	14.94%	$37,461	≥4.5%	$N/A	N/A
Bank	131,054	16.87%	34,949	>4.5%	50,482	≥6.5%
Total capital to risk weighted assets:						
Company	142,114	18.31%	62,089	≥8.0%	N/A	N/A
Bank	134,347	17.30%	62,132	≥8.0%	77,665	≥10.0%
Tier 1 capital to risk weighted assets:						
Company	124,391	14.94%	49,947	≥6.0%	N/A	N/A
Bank	131,054	16.87%	46,599	>6.0%	62,132	≥8.0%
Tier 1 capital to average assets:						
Company	124,391	12.60%	39,501	≥4.0%	N/A	N/A
Bank	131,054	13.27%	39,512	≥4.0%	49,390	≥5.0%
June 30, 2016:						
Common equity tier 1 capital to risk weighted assets:						
Company	$126,046	17.97%	31,559	≥4.5%	N/A	N/A
Bank	117,212	16.69%	31,611	≥4.5%	45,660	≥6.5%
Total capital to risk weighted assets:						
Company	142,988	20.39%	56,105	≥8.0%	N/A	N/A
Bank	119,971	17.08%	56,197	≥8.0%	70,246	≥10.0%
Tier 1 capital to risk weighted assets:						
Company	126,046	17.97%	42,079	≥6.0%	N/A	N/A
Bank	117,212	16.69%	42,148	≥6.0%	56,197	≥8.0%
Tier 1 capital to average assets:						
Company	126,046	13.27%	38,006	≥4.0%	N/A	N/A
Bank	117,212	12.33%	38,022	≥4.0%	47,528	≥5.0%

Stock Repurchases

On August 22, 2016, the Company purchased 645,238 shares at a price of $10.75 per share.

On October 21, 2016, the Board of Directors voted to amend the existing stock repurchase program to authorize the Company to purchase an additional 500,000 shares of its common stock, representing 5.7% of the Company's outstanding common shares. Under the existing program, implemented in April 2014, the Company has purchased 1,970,000 shares through October 25, 2016 and no shares remained available for repurchase under the program on that date, prior to the 500,000 share increase in the repurchase plan. The amended stock repurchase program will expire on October 21, 2018.

Off-balance Sheet Financial Instruments

The Company 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. These financial instruments include commitments to extend credit, unused lines of credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest-rate risk in excess of the amounts recognized in the condensed consolidated balance sheet. The contract or notional amounts of these instruments reflect the extent of the Company's involvement in particular classes of financial instruments.

See Part I. Item I. "Notes to Unaudited Consolidated Financial Statements – Note 9: Commitments and Contingencies" for further discussion.

Table of Contents

Results of Operations

General

Net income increased by $1.4 million to $3.1 million for the quarter ended December 31, 2016, compared to $1.7 million for the quarter ended December 31, 2015.

The following table details the “Total Return” on purchased loans, which includes transactional interest income of $2.9 million for the quarter ended December 31, 2016. The yield on purchased loans for the quarter ended December 31, 2016 was 13.0% as compared to 12.7% in the quarter ended December 31, 2015, primarily due to higher regularly scheduled income and transactional income in the quarter. The following table details the total return on purchased loans:

	Total Return on Purchased Loans Three Months Ended December 31,			
	2016		2015	
	Income	Return (1)	Income	Return (1)
	(Dollars in thousands)			
Regularly scheduled interest and accretion	$4,716	8.01 %	$4,122	7.80 %
Transactional income:				
Gain on loan sales	-	0.00 %	-	0.00 %
Gain on sale of real estate owned	-	0.00 %	-	0.00 %
Other noninterest income	-	0.00 %	-	0.00 %
Accelerated accretion and loan fees	2,943	5.00 %	2,612	4.94 %
Total transactional income	2,943	5.00 %	2,612	4.94 %
Total	$7,659	13.01 %	$6,734	12.74 %

	Total Return on Purchased Loans Six Months Ended December 31,			
	2016		2015	
	Income	Return (1)	Income	Return (1)
	(Dollars in thousands)			
Regularly scheduled interest and accretion	$9,470	8.07 %	$8,009	7.75 %
Transactional income:				
Gain on loan sales	-	0.00 %	-	0.00 %

Gain on sale of real estate owned	19	0.02 %	22	0.02 %
Other noninterest income	-	0.00 %	(1)	0.00 %
Accelerated accretion and loan fees	4,270	3.64 %	4,820	4.66 %
Total transactional income	4,289	3.66 %	4,841	4.68 %
Total	$13,759	11.73%	$12,850	12.43%

(1) The total return on purchased loans represents scheduled accretion, accelerated accretion, gains on asset sales, gains on real estate owned and other noninterest income recorded during the period divided by the average invested balance, which includes loans held for sale, on an annualized basis. The total return does not include the effect of purchased loan charge-offs or recoveries in the quarter. Total return is a non-GAAP financial measure.

Net Interest Income

Three Months Ended December 31, 2016 and 2015

Net interest and dividend income before provision for loan losses increased by $1.7 million for the quarter ended December 31, 2016, compared to the quarter ended December 31, 2015. The increase is primarily due to higher average balances in the total loan portfolio and higher transactional income on purchased loans. This increase was partially offset by higher rates and volume in our deposit portfolio and the effect of the issuance of subordinated debt.

	Interest Income and Yield on Loans					
	Three Months Ended December 31,					
	2016			2015		
	Average Balance (1)	Interest Income	Yield	Average Balance (1)	Interest Income	Yield
	(Dollars in thousands)					
Community Banking	$203,963	$2,350	4.57 %	$217,470	$2,604	4.75 %
SBA	41,038	574	5.55 %	23,037	328	5.65 %
LASG:						
Originated	216,353	3,210	5.89 %	137,959	1,978	5.69 %
Purchased	233,502	7,659	13.01%	209,605	6,734	12.74%
Secured Loans to Broker-Dealers	48,000	120	0.99 %	60,004	75	0.50 %
Total LASG	497,855	10,989	8.76 %	407,568	8,787	8.55 %
Total	$742,856	$13,913	7.43 %	$648,075	$11,719	7.17 %

(1) Includes loans held for sale.

Table of Contents

The Company’s interest rate spread increased by 4 basis points and net interest margin increased by 6 basis points for the quarter ended December 31, 2016 compared to the quarter ended December 31, 2015. The increase was principally due to higher transactional interest income in the purchased portfolio, offset by the effect of the issuance of the subordinated debt in June 2016.

The following sets forth the average balance sheets, interest income and interest expense, and average yields and costs for the three months ended December, 2016 and 2015.

	Three Months Ended December 31,							
	2016				2015			
	Average Balance	Interest Income/ Expense	Average Yield/ Rate		Average Balance	Interest Income/ Expense	Average Yield/ Rate	
Assets:								
Interest-earning assets:								
Investment securities	$92,750	$247	1.06	%	$105,502	$236	0.89	%
Loans (1) (2) (3)	742,856	13,931	7.44	%	648,075	11,737	7.19	%
Federal Home Loan Bank stock	2,398	23	3.81	%	2,588	34	5.21	%
Short-term investments (4)	114,276	149	0.52	%	72,299	46	0.25	%
Total interest-earning assets	952,280	14,350	5.98	%	828,464	12,053	5.77	%
Cash and due from banks	2,764				3,353			
Other non-interest earning assets	35,213				35,558			
Total assets	$990,257				$867,375			
Liabilities & Stockholders' Equity:								
Interest-bearing liabilities:								
NOW accounts	$71,795	$52	0.29	%	$65,617	$42	0.25	%
Money market accounts	312,911	753	0.95	%	199,766	429	0.85	%
Savings accounts	35,206	12	0.14	%	35,269	11	0.12	%
Time deposits	317,318	981	1.23	%	334,925	943	1.12	%
Total interest-bearing deposits	737,230	1,798	0.97	%	635,577	1,425	0.89	%
Short-term borrowings	-	-	0.00	%	2,002	5	0.99	%
Borrowed funds	27,099	220	3.22	%	30,145	259	3.41	%
Subordinated debt	23,430	468	7.92	%	8,699	158	7.21	%
Capital lease obligations	1,024	13	5.04	%	1,272	16	4.99	%
Total interest-bearing liabilities	788,783	2,499	1.26	%	677,695	1,863	1.09	%
Non-interest bearing liabilities:								
Demand deposits and escrow accounts	80,538				69,464			
Other liabilities	8,299				6,302			
Total liabilities	877,620				753,461			
Stockholders' equity	112,637				113,914			
Total liabilities and stockholders' equity	$990,257				$867,375			

Net interest income (5)	$11,851			$10,190		
Interest rate spread		4.72	%		4.68	%
Net interest margin (6)		4.94	%		4.88	%

(1) Interest income and yield are stated on a fully tax-equivalent basis using a 34% tax rate.
(2) Includes loans held for sale.
(3) Nonaccrual loans are included in the computation of average, but unpaid interest has not been included for purposes of determining interest income.
(4) Short term investments include FHLBB overnight deposits and other interest-bearing deposits.
(5) Includes tax exempt interest income of $18 thousand for the three months ended December 31, 2016 and December 31, 2015.
(6) Net interest margin is calculated as net interest income divided by total interest-earning assets.

Table of Contents

The following table presents the extent to which changes in volume and interest rates of interest earning assets and interest bearing liabilities have affected the Company's interest income and interest expense during the periods indicated. Information is provided in each category with respect to (i) changes attributable to changes in volume (changes in volume multiplied by prior period rate), (ii) changes attributable to changes in rates (changes in rates multiplied by prior period volume) and (iii) change attributable to a combination of changes in rate and volume (change in rates multiplied by the changes in volume). Changes attributable to the combined impact of volume and rate have been allocated proportionately to the changes due to volume and the changes due to rate.

	Three Months Ended December 31, 2016 compared to 2015		
	Change Due to Volume	Change Due to Rate	Total Change
	(Dollars in thousands)		
Interest earning assets:			
Investment securities	$(31)	$ 42	$ 11
Loans	1,765	429	2,194
Regulatory stock	(2)	(9)	(11)
Short-term investments	37	66	103
Total interest-earning assets	1,769	528	2,297
Interest-bearing liabilities:			
Interest-bearing deposits	211	162	373
Short-term borrowings	(5)	-	(5)
Borrowed funds	(25)	(14)	(39)
Subordinated debt	293	17	310
Capital lease obligations	(3)	-	(3)
Total interest-bearing liabilities	471	165	636
Total change in net interest income	$1,298	$ 363	$ 1,661

Six Months Ended December 31, 2016 and 2015

Net interest and dividend income before provision for the six months ended December 31, 2016 and 2015 was $21.6 million and $19.4 million, respectively. The increase of $2.2 million was largely attributable to higher loan volume and interest income in the originated loan portfolio. The following table summarizes interest income and related yields recognized on the Company's loans for the six months ended December 31, 2016 and 2015.

Six Months Ended December 31,	
2016	2015

	Average Balance (1)	Interest Income	Yield	Average Balance (1)	Interest Income	Yield
	(Dollars in thousands)					
Community Banking	$204,864	$4,754	4.60 %	$221,400	$5,312	4.76 %
SBA	36,093	1,093	6.01 %	18,289	545	5.91 %
LASG:						
Originated	200,731	5,949	5.88 %	128,267	3,673	5.68 %
Purchased	232,751	13,740	11.71 %	204,995	12,829	12.41 %
Secured Loans to Broker-Dealers	48,000	180	0.74 %	60,006	150	0.50 %
Total LASG	481,482	19,869	8.19 %	393,268	16,652	8.40 %
Total	$722,439	$25,716	7.06 %	$632,957	$22,509	7.05 %

(1) Includes loans held for sale.

Table of Contents

The Company’s interest rate spread and net interest margin decreased by 19 basis points and 16 basis points, respectively, for the six months ended December 31, 2016 compared to the six months ended December 31, 2015. These decreases were principally the result of lower total return on purchased loans and the effect of the issuance of the subordinated debt in June 2016. The following sets forth the average balance sheets, interest income and interest expense, and average yields and costs for the six months ended December 31, 2016 and 2015.

	Six Months Ended December 31,					
	2016			2015		
	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate
Assets:						
Interest-earning assets:						
Investment securities	$93,825	$486	1.03 %	$103,872	$464	0.89 %
Loans (1) (2) (3)	722,439	25,752	7.07 %	632,957	22,545	7.07 %
Federal Home Loan Bank stock	2,403	46	3.80 %	3,345	68	4.03 %
Short-term investments (4)	134,334	341	0.50 %	85,974	108	0.25 %
Total interest-earning assets	953,001	26,625	5.54 %	826,148	23,185	5.57 %
Cash and due from banks	2,852			3,190		
Other non-interest earning assets	33,012			35,986		
Total assets	$988,865			$865,324		
Liabilities & Stockholders' Equity:						
Interest-bearing liabilities:						
NOW accounts	$71,323	$103	0.29 %	$67,617	$88	0.26 %
Money market accounts	302,323	1,435	0.94 %	185,166	782	0.84 %
Savings accounts	35,488	25	0.14 %	35,816	23	0.13 %
Time deposits	326,794	1,990	1.21 %	342,896	1,896	1.10 %
Total interest-bearing deposits	735,928	3,553	0.96 %	631,495	2,789	0.88 %
Short-term borrowings	-	-	0.00 %	1,976	13	1.31 %
Borrowed funds	28,580	475	3.30 %	34,734	586	3.35 %
Subordinated debt	23,395	927	7.86 %	8,674	312	7.14 %
Capital lease obligations	1,056	27	5.07 %	1,302	33	5.03 %
Total interest-bearing liabilities	788,959	4,982	1.25 %	678,181	3,733	1.09 %
Non-interest bearing liabilities:						
Demand deposits and escrow accounts	78,104			66,736		
Other liabilities	8,255			6,868		
Total liabilities	875,318			751,785		
Stockholders' equity	113,547			113,539		
Total liabilities and stockholders' equity	$988,865			$865,324		
Net interest income (5)		$21,643			$19,452	
Interest rate spread			4.29 %			4.48 %

Net interest margin (6)	4.51 %	4.67 %

(1) Interest income and yield are stated on a fully tax-equivalent basis using a 34% tax rate.
(2) Includes loans held for sale.
(3) Nonaccrual loans are included in the computation of average, but unpaid interest has not been included for purposes of determining interest income.
(4) Short term investments include FHLBB overnight deposits and other interest-bearing deposits.
(5) Includes tax exempt interest income of $36 thousand for the six months ended December 31, 2016 and December 31, 2015.

(6) Net interest margin is calculated as net interest income divided by total interest-earning assets.

Table of Contents

The following table presents the extent to which changes in volume and interest rates of interest earning assets and interest bearing liabilities have affected the Company's interest income and interest expense during the periods indicated. Information is provided in each category with respect to (i) changes attributable to changes in volume (changes in volume multiplied by prior period rate), (ii) changes attributable to changes in rates (changes in rates multiplied by prior period volume) and (iii) changes attributable to a combination of changes in rate and volume (change in rates multiplied by the changes in volume). Changes attributable to the combined impact of volume and rate have been allocated proportionately to the changes due to volume and the changes due to rate.

	Six Months Ended December 31, 2016 compared to 2015		
	Change Due to Volume	Change Due to Rate	Total Change
	(Dollars in thousands)		
Interest earning assets:			
Investment securities	$(48)	$ 70	$ 22
Loans	3,190	17	3,207
Regulatory stock	(18)	(4)	(22)
Short-term investments	83	150	233
Total interest-earning assets	3,207	233	3,440
Interest-bearing liabilities:			
Interest-bearing deposits	441	323	764
Short-term borrowings	(6)	(7)	(13)
Borrowed funds	(111)	-	(111)
Subordinated debt	580	35	615
Capital lease obligations	(6)	-	(6)
Total interest-bearing liabilities	898	351	1,249
Total change in net interest income	$2,309	$ (118)	$ 2,191

Provision for Loan Losses

Quarterly, the Company determines the amount of the allowance for loan losses that is appropriate to provide for losses inherent in the Company's loan portfolios, with the provision for loan losses determined by the net change in the allowance for loan losses. For loans accounted for under ASC 310-30, a provision for loan loss is recorded when estimates of future cash flows are lower than had been previously expected. See Part I. Item I. "Notes to Unaudited Consolidated Financial Statements — Note 4: Loans, Allowance for Loan losses and Credit Quality" for further discussion.

The provision for loan losses for periods subsequent to the merger with FHB Formation LLC reflects the impact of adjusting loans to their then fair values, as well as the elimination of the allowance for loan losses in accordance with the acquisition method of accounting. Subsequent to the merger, the provision for loan losses has been recorded based on estimates of inherent losses in newly originated loans and for incremental reserves required for pre-merger loans based on estimates of deteriorated credit quality post-merger.

Three Months Ended December 31, 2016 and 2015

The provision for loan losses for the quarter ended December 31, 2016 and 2015 was $628 thousand and $896 thousand, respectively. The decrease in the Company’s loan loss provision was primarily due to two loans which were provided for in the quarter ended December 31, 2015, offset by the increase in the allowance as a result of loan volume in the LASG originated portfolio, the effect of changes in the qualitative factors, and updates to the specific reserve on impaired loans.

Six Months Ended December 31, 2016 and 2015

The provision for loan losses for the six months ended December 31, 2016 and 2015 was $820 thousand and $1.1 million, respectively. The decrease in the Company’s loan loss provision was due to two loans which were provided for in the quarter ended December 31, 2015.

Noninterest Income

Three Months Ended December 31, 2016 and 2015

Noninterest income increased by $1.1 million for the quarter ended December 31, 2016, compared to the quarter ended December 31, 2015, due to an increase in gains realized on sale of SBA loans of $1.1 million.

Six Months Ended December 31, 2016 and 2015

Noninterest income increased by $1.2 million for the six months ended December 31, 2016, compared to the six months ended December 31, 2015, principally due to an increase of $1.1 million in gains realized on sale of SBA loans.

42

Table of Contents

Noninterest Expense

Three Months Ended December 31, 2016 and 2015

Noninterest expense increased by $760 thousand for the quarter ended December 31, 2016, compared to the quarter ended December 31, 2015, primarily due to the following:

- An increase in loan expense of $328 thousand, largely driven by the expense related to loan collection in the period;
- An increase in salaries and employee benefits of $307 thousand, primarily due to increased incentive compensation and severance in the three months ended December 31, 2016, offset by higher deferred salaries due to an increase in loan originations;
- An increase in professional fees of $135 thousand, largely attributable to increased consulting costs, increased audit costs relating to the Company's conversion to accelerated filer status and core system projects; and
- An increase in other noninterest expense of $99 thousand, largely attributable to $220 thousand of expense related to the quarterly valuation of SBA servicing rights.
- The increases in noninterest expense were partially offset by a decrease in FDIC deposit insurance premiums of $94 thousand, resulting from changes in the reserve ratio requirements.

Six Months Ended December 31, 2016 and 2015

Noninterest expense increased by $1.6 million for the six months ended December 31, 2016, compared to the six months ended December 31, 2015, principally due to the following:

- An increase in salaries and employee benefits of $1.4 million, primarily due to increased incentive compensation and severance, as well as higher employee headcount;
- An increase in professional fees of $201 thousand, largely attributable to increased audit costs relating to the Company's transition to accelerated filer status, increased compensation and cyber security consulting costs, increased loan review service costs and costs associated with core system projects;
- An increase in loan expense of $111 thousand, largely driven by the expense related to loan collection in the period;
- An increase in data processing fees of $118 thousand, primarily due to an increase in computer services fees.
- The increases in noninterest expense were partially offset by a decrease in occupancy and equipment expense of $129 thousand, primarily due to a decrease in IT-related equipment expense and computer equipment depreciation expense.

Income Taxes

Three Months Ended December 31, 2016 and 2015

The Company’s income tax expense was $1.8 million or an effective rate of 37.2%, for the three months ended December 31, 2016, as compared to $960 thousand, or an effective rate of 35.5%, for the three months ended December 31, 2015. The increase in effective tax rate was primarily due to an increase in federal taxes and state apportionment changes, as well as no expected changes in permanent items.

Six Months Ended December 31, 2016 and 2015

The Company’s income tax expense was $2.9 million or an effective rate of 37.0%, for the six months ended December 31, 2016, as compared to $2.1 million, or an effective rate of 36.3%, for the six months ended December 31, 2015. The increase in effective tax rate was primarily due to an increase in federal taxes and state apportionment changes, as well as no expected changes in permanent items.

Table of Contents

Item 3. Quantitative and Qualitative Disclosure about Market Risk

Market Risk

Market risk is the risk of loss due to adverse changes in market prices and rates, and typically encompasses exposures such as sensitivity to changes in market interest rates, foreign currency exchange rates, and commodity prices. The Company has no exposure to foreign currency exchange or commodity price movements. Because net interest income is our primary source of revenue, interest rate risk is a significant market risk to which the Company is exposed.

Interest Rate Risk

Interest rate risk can be defined as the exposure of future net interest income to adverse movements in interest rates. Net interest income is affected by changes in interest rates as well as by fluctuations in the level, mix and duration of the Company's assets and liabilities. Over and above the influence that interest rates have on net interest income, changes in rates also affect the volume of lending activity, the ability of borrowers to repay loans, the volume of loan prepayments, the flow and mix of deposits, and the market value of the Company's assets and liabilities.

Asset/Liability Management

The Company's management has established an Asset Liability Management Committee ("ALCO"), which is responsible for managing the Company's interest rate risk in accordance with policies and limits approved by the Board of Directors. With regard to management of market risk, the ALCO is charged with managing the Company's mix of assets and funding sources to produce results that are consistent with the Company's liquidity, capital adequacy, growth, and profitability goals.

Exposure to interest rate risk is managed by Northeast through periodic evaluations of the current interest rate risk inherent in its rate-sensitive assets and liabilities, coupled with determinations of the level of risk considered appropriate given the Company's capital and liquidity requirements, business strategy, and performance objectives. Through such management, Northeast seeks to mitigate the potential volatility in its net interest income due to changes in interest rates in a manner consistent with the risk appetite established by the Board of Directors.

The ALCO's primary tool for measuring, evaluating, and managing interest rate risk is income simulation analysis. Income simulation analysis measures the interest rate risk inherent in the Company's balance sheet at a given point in time by showing the effect of interest rate shifts on net interest income over defined time horizons. These simulations take into account the specific repricing, maturity, prepayment and call options of financial instruments that vary under different interest rate scenarios. The ALCO reviews simulation results to determine whether the 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. The Company considers a variety of specified rate scenarios, including instantaneous rate shocks, against static (or flat) rates when measuring interest rate risk, and evaluates results over two consecutive twelve-month periods. All changes are measured in comparison to the projected net interest income that would result from an "unchanged" scenario, where interest rates remain stable over the measured time horizon(s).

While the ALCO reviews simulation assumptions to ensure they are reasonable, and back-tests simulation results on a periodic basis as a monitoring tool, income simulation analysis may not always prove to be an accurate indicator of the Company's interest rate risk or future earnings. There are inherent shortcomings in income simulation, given the number and variety of assumptions that must be made to perform it. For example, the projected level of future market interest rates and the shape of future interest rate yield curves have a major impact on income simulation results. Many assumptions concerning the repricing of financial instruments, the degree to which non-maturity deposits react to changes in market rates, and the expected prepayment rates on loans, mortgage-backed securities, and callable debt securities are also inherently uncertain. In addition, as income simulation analysis assumes that the Company's balance sheet will remain static over the simulation horizon, the results do not reflect the Company's expectations for future balance sheet growth, nor changes in business strategy that the Company could implement in response to rate shifts to mitigate its loss exposures. As such, although the analysis described above provides an indication of the Company's sensitivity to interest rate changes at a point in time, these estimates are not intended to and do not provide a precise forecast of the effect of changes in market interest rates on the Company's net interest income and will differ from actual results.

Measuring Interest Rate Risk

The Company can be subject to margin compression depending on the economic environment and the shape of the yield curve. Under the Company's current balance sheet position, the Company's margin generally performs slightly better over time in a rising rate environment, while it generally decreases in a declining rate environment and when the yield curve is flattening or inverted.

Under a flattening yield curve scenario, margin compression occurs as the spread between the cost of funding and the yield on interest earning assets narrows. Under this scenario the degree of margin compression is highly dependent on the Company's ability to fund asset growth through lower cost deposits. However, if the curve is flattening, while short-term rates are rising, the adverse impact on margin may be somewhat delayed, as increases in the Prime Rate will initially result in the Company's asset yields re-pricing more quickly than funding costs.

Under an inverted yield curve situation, shorter-term rates exceed longer-term rates, and the impact on margin is similar but more adverse than the flat curve scenario. Again, however, the extent of the impact on margin is highly dependent on the Company's balance sheet mix.

In a declining rate environment, margin compression will eventually occur as the yield on interest earning assets decreases more rapidly than decreases in funding costs. The primary causes would be the impact of interest rate decreases (including decreases in the Prime Rate) on adjustable rate loans and the fact that decreases in deposit rates may be limited or lag decreases in the Prime Rate.

There have been no material changes in the results of the Company's net interest income sensitivity analysis as reported in the Company's 2016 Annual Report on Form 10-K. At December 31, 2016, management continues to consider the Company's primary interest rate risk exposure to be margin compression that may result from changes in interest rates and/or changes in the mix of the Company's balance sheet components. This would include the mix of fixed versus variable rate loans and investments on the asset side, and higher cost versus lower cost deposits and overnight borrowings versus term borrowings and certificates of deposit on the liability side.

Item 4. Controls and Procedures

The Company maintains controls and procedures designed to ensure that information required to be disclosed in the reports the Company files or submits under the Securities Exchange Act of 1934 (“Exchange Act”) is recorded,

processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, and that such information is accumulated and communicated to the Company’s management, including the Chief Executive Officer and Chief Financial Officer (the Company’s principal executive officer and principal financial officer, respectively), as appropriate to allow for timely decisions regarding timely disclosure. In designing and evaluating disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost/benefit relationship of possible controls and procedures.

The Company’s management, with the participation of the Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of its disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this Quarterly Report on Form 10-Q.

Based on this evaluation of the Company’s disclosure controls and procedures, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures were effective as of December 31, 2016.

There were no changes in the Company’s internal controls over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) that occurred during the quarter ended December 31, 2016 that have materially affected, or is reasonably likely to materially affect, the Company’s internal controls over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

None.

Item 1A. Risk Factors

There have been no material changes to the risk factors disclosed in Item 1A of the Company’s Form 10-K

for the year
ended
December
31, 2016.

Table of Contents

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Period	Total Number of Shares Purchased (1)	Average Price Per share	Total Number of Shares Purchased as Part of Publicly Announced Programs	Maximum Number of Shares that May Yet Be Purchased Under the Program
Oct. 1- Oct. 31	-	-	1,970,000	500,000
Nov. 1- Nov. 30	-	-	1,970,000	500,000
Dec. 1- Dec. 31	-	-	1,970,000	500,000

(1) Based on trade date, not settlement date

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibits No.	Description
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(a)). *

31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(a)). *
32.1	Certificate of the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(b)). **
32.2	Certificate of the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(b)). **
101	The following materials from Northeast Bancorp's Quarterly Report on Form 10-Q for the quarter ended December 31, 2016 formatted in XBRL: (i) Consolidated Balance Sheets at December 31, 2016 and June 30, 2016; (ii) Consolidated Statements of Income for the three and six months ended December 31, 2016 and 2015; (iii) Consolidated Statements of Comprehensive Income for the three and six months ended December 31, 2016 and 2015; (iv) Consolidated Statements of Changes in Shareholders' Equity for the six months ended December 31, 2016 and 2015; (v) Consolidated Statements of Cash Flows for the six months ended December 31, 2016 and 2015; and (v) Notes to Unaudited Consolidated Financial Statements. *

* Filed herewith

** Furnished herewith

Table of Contents

SIGNATURES

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

Date: February 9, 2017 **NORTHEAST BANCORP**

By: /s/ Richard Wayne
Richard Wayne
President and Chief Executive Officer

By: /s/ Brian Shaughnessy
Brian Shaughnessy
Chief Financial Officer

Table of Contents

NORTHEAST BANCORP

Index to Exhibits

Exhibits No.	Description
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(a)). *
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(a)). *
32.1	Certificate of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(b)). **
32.2	Certificate of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(b)). **
101	The following materials from Northeast Bancorp's Quarterly Report on Form 10-Q for the quarter ended December 31, 2016 formatted in XBRL: (i) Consolidated Balance Sheets at December 31, 2016 and June 30, 2016; (ii) Consolidated Statements of Income for the three and six months ended December 31, 2016 and 2015; (iii) Consolidated Statements of Comprehensive Income for the three and six months ended December 31, 2016 and 2015; (iv) Consolidated Statements of Changes in Shareholders' Equity for the six months ended December 31, 2016 and 2015; (v) Consolidated Statements of Cash Flows for the three and six months ended December 31, 2016 and 2015; and (v) Notes to Unaudited Consolidated Financial Statements. *

* Filed herewith

** Furnished herewith