BAR HARBOR BANKSHARES
Form 10-Q
August 08, 2016
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2016

OR

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

Commission File Number: **01-13349**

BAR HARBOR BANKSHARES

(Exact name of registrant as specified in its charter)

Maine	**01-0393663**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
PO Box 400 **82 Main Street, Bar Harbor, ME**	**04609-0400**
(Address of principal executive offices)	(Zip Code)

(207) 288-3314

(Registrant's telephone number, including area code)

Inapplicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES **þ** 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 **þ** 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 the definitions of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act: Large accelerated filer ¨ Accelerated filer **þ** Non-accelerated filer (do not check if a smaller reporting company) ¨ Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (As defined in Rule 12B-2 of the Exchange Act): YES: ¨ NO: **þ**

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date:

Class of Common Stock	**Number of Shares Outstanding August 1, 2016**
$2.00 Par Value	**6,032,894**

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PART I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

BAR HARBOR BANKSHARES AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

JUNE 30, 2016 AND DECEMBER 31, 2015

(in thousands, except share and per share data)

(*unaudited*)

	June 30, 2016	December 31, 2015
Assets		
Cash and cash equivalents	$ 25,867	$ 9,720
Securities available for sale, at fair value	532,590	504,969
Federal Home Loan Bank stock	26,713	21,479
Loans	1,049,022	990,070
Allowance for loan losses	(9,891)	(9,439)
Loans, net of allowance for loan losses	1,039,131	980,631
Premises and equipment, net	22,951	20,674
Goodwill	4,935	4,935
Bank owned life insurance	24,131	23,747
Other assets	11,231	13,900
TOTAL ASSETS	$1,687,549	$1,580,055
Liabilities		
Deposits:		
Demand and other non-interest bearing deposits	$ 84,123	$ 86,577
NOW accounts	159,015	160,394
Savings and money market deposits	289,820	299,087
Time deposits	456,858	396,729
Total deposits	989,816	942,787
Short-term borrowings	345,478	333,909
Long-term advances from Federal Home Loan Bank	174,624	135,882
Junior subordinated debentures	5,000	5,000
Other liabilities	7,400	8,325
TOTAL LIABILITIES	1,522,318	1,425,903
Shareholders' equity		
Capital stock, par value $2.00; authorized 20,000,000 and 10,000,000 shares;		

issued 6,788,407 shares at June 30, 2016 and December 31, 2015, respectively	13,577	13,577
Surplus	22,249	21,624
Retained earnings	127,672	122,260
Accumulated other comprehensive income:		
Prior service cost and unamortized net actuarial losses on employee benefit plans, net of tax of ($222) and ($249), at June 30, 2016 and December 31, 2015, respectively	(412)	(463)
Net unrealized appreciation on securities available for sale, net of tax of $6,020 and $2,828, at June 30, 2016 and December 31, 2015, respectively	11,180	5,251
Portion of OTTI attributable to non-credit gains, net of tax of $73 and $249, at June 30, 2016 and December 31, 2015, respectively	135	462
Net unrealized depreciation on derivative instruments, net of tax of ($1,299) and ($873), at June 30, 2016 and December 31, 2015, respectively	(2,412)	(1,621)
Total accumulated other comprehensive income	8,491	3,629
Less: cost of 758,722 and 778,196 shares of treasury stock at June 30, 2016 and December 31, 2015, respectively	(6,758)	(6,938)
TOTAL SHAREHOLDERS' EQUITY	165,231	154,152
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$1,687,549	$1,580,055

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

BAR HARBOR BANKSHARES AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2016 AND 2015

(in thousands, except per share data)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	**2015**	**2016**	**2015**
Interest and dividend income:				
Interest and fees on loans	$10,249	$ 9,645	$20,332	$19,322
Interest on securities	3,900	3,732	7,805	7,494
Dividend on FHLB stock	205	95	381	189
Total interest and dividend income	14,354	13,472	28,518	27,005
Interest expense:				
Deposits	1,599	1,460	3,176	2,913
Short-term borrowings	532	253	982	492
Long-term debt	841	873	1,642	1,716
Total interest expense	2,972	2,586	5,800	5,121
Net interest income	11,382	10,886	22,718	21,884
Provision for loan losses	150	400	615	895
Net interest income after provision for loan losses	11,232	10,486	22,103	20,989
Non-interest income:				
Trust and other financial services	955	985	1,903	1,930
Service charges on deposit accounts	252	255	463	453
Debit card income	430	402	830	768
Securities gains	1,699	587	3,135	1,206
Other operating income	278	274	611	488
Total non-interest income	3,614	2,503	6,942	4,845
Non-interest expense:				
Salaries and employee benefits	4,799	4,269	9,816	8,621
Occupancy expense	594	567	1,163	1,147
Furniture and equipment expense	558	580	1,147	1,145
Debit card expenses	120	112	237	208
FDIC insurance assessments	218	210	435	411
Other operating expense	2,442	1,863	3,930	3,402
Total non-interest expense	8,731	7,601	16,728	14,934
Income before income taxes	6,115	5,388	12,317	10,900

Income taxes	1,804	1,515	3,600	3,146
Net income	$ 4,311	$ 3,873	$ 8,717	$ 7,754
Per Common Share Data:				
Basic earnings per share	$ 0.72	$ 0.65	$ 1.45	$ 1.30
Diluted earnings per share	$ 0.71	$ 0.64	$ 1.43	$ 1.28

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

BAR HARBOR BANKSHARES AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2016 AND 2015

(in thousands)

(unaudited)

	Three Months Ended June 30, 2016	Three Months Ended June 30, 2015
Net income	$ 4,311	$ 3,873
Other comprehensive income:		
Net unrealized appreciation (depreciation) on securities available for sale, net of tax of $1,537 and ($2,308), respectively	2,854	(4,288)
Less reclassification adjustment for net gains related to securities available for sale included in net income, net of tax of ($595) and ($205), respectively	(1,105)	(382)
Net unrealized (depreciation) appreciation on interest rate derivatives, net of tax of ($176) and $122, respectively	(327)	227
Net amortization of prior service cost and actuarial loss for supplemental executive retirement plan, net of related tax of $2 and $3, respectively	4	6
Actuarial gains on supplemental executive retirement plan, net of related tax of $0 and $0, respectively	---	---
Total other comprehensive income (loss)	1,426	(4,437)
Total comprehensive income (loss)	$ 5,737	$ (564)

	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015
Net income	$ 8,717	$ 7,754
Other comprehensive income:		
Net unrealized appreciation (depreciation) on securities available for sale, net of tax of $4,114 and ($1,299), respectively	7,640	(2,414)
Less reclassification adjustment for net gains related to securities available for sale included in net income, net of tax of ($1,098) and ($422), respectively	(2,038)	(784)
Net unrealized depreciation on interest rate derivatives, net of tax of ($426) and ($87), respectively	(791)	(162)

Net amortization of prior service cost and actuarial loss for supplemental executive retirement plan, net of related tax of $5 and $5, respectively	9	13
Actuarial gains on supplemental executive retirement plan, net of related tax of $23 and $0, respectively	42	---
Total other comprehensive income (loss)	4,862	(3,347)
Total comprehensive income	$13,579	$ 4,407

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

BAR HARBOR BANKSHARES AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

FOR THE SIX MONTHS ENDED JUNE 30, 2016 AND 2015

(in thousands, except share and per share data)

(unaudited)

	Capital Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Shareholders' Equity
Balance December 31, 2014	$13,577	$20,905	$113,149	$ 6,691	$(8,035)	$146,287
Net income	---	---	7,754	---	---	7,754
Total other comprehensive loss	---	---	---	(3,347)	---	(3,347)
Dividend declared:						
Common stock ($0.495 per share)	---	---	(2,952)	---	---	(2,952)
Purchase of Treasury Stock (221 shares)	---	---	---	---	(8)	(8)
Stock options exercised (35,312 shares),						
including related tax effects	---	99	(1)	---	633	731
Recognition of stock based compensation expense	---	191	---	---	---	191
Restricted stock grants (3,540 shares)	---	(64)	---	---	64	---
Balance June 30, 2015	$13,577	$21,131	$117,950	$ 3,344	$(7,346)	$148,656

	Capital Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Shareholders' Equity
Balance December 31, 2015	$13,577	$21,624	$122,260	$ 3,629	$(6,938)	$154,152
Net income	---	---	8,717	---	---	8,717
Total other comprehensive income	---	---	---	4,862	---	4,862
Dividend declared:						
Common stock ($0.270 per share)	---	---	(3,219)	---	---	(3,219)
Purchase of Treasury Stock (14,950 shares)	---	---	---	---	(481)	(481)
Stock options exercised (14,804 shares)						
including related tax effects	---	92	(86)	---	349	355
Recognition of stock based compensation expense	---	845	---	---	---	845
Restricted and performance stock grants (19,620 shares)	---	(312)	---	---	312	---
Balance June 30, 2016	$13,577	$22,249	$127,672	$ 8,491	$(6,758)	$165,231

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

BAR HARBOR BANKSHARES AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE SIX MONTHS ENDED JUNE 30, 2016 AND 2015

(in thousands)

(unaudited)

	2016	2015
Cash flows from operating activities:		
Net income	$ 8,717	$ 7,754
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of premises and equipment	788	861
Amortization of core deposit intangible	46	46
Provision for loan losses	615	895
Net securities gains	(3,135)	(1,206)
Net amortization of bond premiums and discounts	1,273	1,302
Recognition of stock based compensation expense	845	191
Gains on sale of other real estate owned	---	(64)
Net income from bank owned life insurance	(384)	(270)
Net change in other assets	(1,133)	(30,306)
Net change in other liabilities	(925)	(891)
Net cash provided by (used in) operating activities	6,707	(21,688)
Cash flows from investing activities:		
Purchases of securities available for sale	(110,269)	(89,314)
Proceeds from maturities, calls and principal paydowns of mortgage-backed securities	48,472	54,257
Proceeds from sales of securities available for sale	44,656	20,428
Purchases of Bank Owned Life Insurance	---	15,000
Net increase in Federal Home Loan Bank stock	(5,234)	(2,239)
Net increase in total loans originated	(9,319)	(42,550)
Purchases of loans	(49,796)	(22,435)
Proceeds from sale of other real estate owned	---	110
Capital expenditures	(3,065)	(1,313)
Net cash used in investing activities	(84,555)	(68,056)
Cash flows from financing activities:		
Net increase in deposits	47,029	32,067
Net (decrease) increase in securities sold under repurchase agreements and fed funds purchased	(6,431)	11,654
Proceeds from Federal Home Loan Bank advances	63,750	66,493
Repayments of Federal Home Loan Bank advances	(7,008)	(11,003)
Purchases of Treasury Stock	(481)	(8)
Proceeds from stock option exercises, including excess tax benefits	355	731
Payments of dividends	(3,219)	(2,952)

Net cash provided by financing activities	93,995	96,982
Net increase in cash and cash equivalents	16,147	7,238
Cash and cash equivalents at beginning of period	9,720	9,800
Cash and cash equivalents at end of period	$ 25,867	$ 17,038
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$ 5,766	$ 5,146
Income taxes	$ 3,926	$ 2,495
Schedule of noncash investing activities:		
Transfers from loans to other real estate owned	$ ---	$ ---
Restricted stock grants	$ 312	$ 64

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

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BAR HARBOR BANKSHARES AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

JUNE 30, 2016

(Dollars in thousands, except share and per share data)

(*unaudited*)

Note 1: Basis of Presentation

The accompanying consolidated interim financial statements are unaudited. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. All inter-company transactions have been eliminated in consolidation. Amounts in the prior period financial statements are reclassified whenever necessary to conform to current period presentation. The net income reported for the three and six months ended June 30, 2016, is not necessarily indicative of the results that may be expected for the year ending December 31, 2016, or any other interim periods.

The consolidated balance sheet at December 31, 2015, has been derived from audited consolidated financial statements at that date. The accompanying unaudited interim consolidated financial statements have been prepared in accordance with United States (U.S.) generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X (17 CFR Part 210). Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. For further information, please refer to the consolidated financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2015, and notes thereto.

Note 2: Subsequent Event

On July 19, 2016, the Company's Board of Directors declared a third quarter 2016 regular cash dividend of 27.5 cents per share of Company common stock, representing an increase of 2.0 cents, or 7.8%, compared with the third quarter of 2015. The quarterly cash dividend is payable to all Company shareholders of record as of the close of business August 15, 2016, and will be paid on September 15, 2016. This represented the twenty-first consecutive quarter where the Company increased its quarterly cash dividend to shareholders.

Note 3: Merger and Acquisition Activity

On May 5, 2016, the Company announced the signing of a definitive agreement and plan of merger pursuant to which the Company will acquire Lake Sunapee Bank Group (LSBG) in an all-stock transaction valued at approximately $143 million (the Merger). The market expanding merger is expected to create efficiencies and strategic growth opportunities for both businesses through the leveraging of each other s platforms and capabilities, and will create the only community bank headquartered in New England with a market footprint in all three Northern New England states of Maine, New Hampshire and Vermont.

At closing, the combined institution is expected to have approximately $3.3 billion in assets, $2.4 billion in net loans, $2.2 billion in deposits and over $2.0 billion in assets under management. The Company will have a pro forma market cap of approximately $350 million and 49 branches serving customers and communities across three states. The merger is expected to be completed in the fourth quarter of 2016 or the first quarter of 2017. The consummation of the Merger is subject to receipt of the requisite approval of the Company's shareholders and LSBG shareholders, receipt of all required regulatory approvals, and other customary closing conditions.

Included in the Company s second quarter and year-to-date non-interest expense was $492 in non-recurring expenses related to the LSBG Merger, largely legal and other professional fees. The Company expects to continue to incur related non-recurring costs through the closing of the Merger.

Note 4: Recent Accounting Pronouncements

ASU 2015-01, Income Statement - Extraordinary and Unusual Items (Subtopic 225-20) Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items. ASU 2015-01 eliminates from U.S. GAAP the concept of extraordinary items, which, among other things, required an entity to segregate extraordinary items considered to be unusual and infrequent from the results of ordinary operations and show the item separately in the income statement, net of tax, after income from continuing operations. ASU 2015-01 became effective for us on January 1, 2016 and did not have a significant impact on the Company s financial statements.

ASU 2015-16, Business Combinations (Topic 805) Simplifying the Accounting for Measurement-Period Adjustments. ASU 2015-16 requires that adjustments to provisional amounts that are identified during the measurement period of a business combination be recognized in the reporting period in which the adjustment amounts are determined. Furthermore, the income statement effects of such adjustments, if any, must be calculated as if the accounting had been completed at the acquisition date. Any amounts that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date should be recorded in current-period earnings. Under previous guidance, adjustments to provisional amounts identified during the measurement period were to be recognized retrospectively. ASU 2015-16 became effective for us on January 1, 2016 and did not have a significant impact on the Company s financial statements.

ASU 2016-01 Financial Instruments Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, which updates certain aspects of recognition, measurement, presentation and disclosure of financial instruments. The new guidance requires equity investments to be measured at fair value with changes in fair value recognized in net income, excluding equity investments that are consolidated or accounted for under the equity method of accounting. The new guidance allows equity investments without readily determinable fair values to be measured at cost minus impairment, with a qualitative assessment required to identify impairment. The new guidance also requires public companies to use exit prices to measure the fair value of financial instruments, eliminates the disclosure requirements related to measurement assumptions for the fair value of instruments measured at amortized cost and requires separate presentation of financial assets and liabilities based on form and measurement category. In addition, for liabilities measured at fair value under the fair value option, the changes in fair value due to changes in instrument-specific credit risk should be recognized in OCI. This guidance is effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years. The Company is currently evaluating this guidance to determine the impact on its consolidated financial statements.

ASU 2016-02, Leases (Topic 842). The guidance in this ASU supersedes the leasing guidance in Topic 840, *Leases*. Under the new guidance, lessees are required to recognize lease assets and lease liabilities on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company is currently evaluating this guidance to determine the impact on its consolidated financial statements.

ASU 2016-05 Derivatives and Hedging (Topic 815) Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships. ASU 2016-05 clarifies that a change in the counterparty to a derivative instrument that has been designated as the hedging instrument under ASC Topic 815 does not, in and of itself, require dedesignation of that hedging relationship provided that all other hedge accounting criteria continue to be met. ASU 2016-05 will be effective for us on January 1, 2017 and is not expected to have a significant impact on the Company s our financial statements.

ASU 2016-07, Investments - Equity Method and Joint Ventures (Topic 323): Simplifying the Transition to the Equity Method of Accounting. The amendments affect all entities that have an investment that becomes qualified for the equity method of accounting as a result of an increase in the level of ownership interest or degree of influence. ASU 2016-07 simplifies the transition to the equity method of accounting by eliminating retroactive adjustment of the investment when an investment qualifies for use of the equity method, among other things. ASU 2016-07 will be effective for the Company on January 1, 2017 and is not expected to have a significant impact on our financial statements.

ASU 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. Under ASU 2016-09 all excess tax benefits and tax deficiencies related to share-based payment awards should be recognized as income tax expense or benefit in the income statement during the period in which they occur. Previously, such amounts were recorded in the pool of excess tax benefits included in additional paid-in capital, if such pool was available. Because excess tax benefits are no longer recognized in additional paid-in capital, the assumed proceeds from applying the treasury stock method when computing earnings per share should exclude the amount of excess tax benefits that would have previously been recognized in additional paid-in capital. Additionally, excess tax

benefits should be classified along with other income tax cash flows as an operating activity rather than a financing activity, as was previously the case. ASU 2016-09 also provides that an entity can make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest (current GAAP) or account for forfeitures when they occur. ASU 2016-09 changes the threshold to qualify for equity classification (rather than as a liability) to permit withholding up to the maximum statutory tax rates (rather than the minimum as was previously the case) in the applicable jurisdictions. ASU 2016-09 will be effective on January 1, 2017 and is not expected to have a significant impact on the Company s financial statements.

ASU 2016-13, Financial Instruments Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. ASU 2016-13, was issued to provide financial statement users with information about expected credit losses on financial instruments and other commitments to extend credit rather than the current incurred loss model. For public business entities, the new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is currently evaluating this guidance to determine the impact on its consolidated financial statements.

Note 5: Management s Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for loan losses, other-than-temporary impairments on securities, income tax estimates, and the valuation of intangible assets.

Allowance for Loan Losses: The allowance for loan losses (the allowance) is a significant accounting estimate used in the preparation of the Company s consolidated financial statements. The allowance is available to absorb losses inherent in the current loan portfolio and is maintained at a level that, in management s judgment, is appropriate for the amount of risk inherent in the loan portfolio, given past and present conditions. The allowance is increased by provisions charged to operating expense and by recoveries on loans previously charged off, and is decreased by loans charged off as uncollectible.

Arriving at an appropriate level of allowance for loan losses involves a high degree of judgment. The determination of the adequacy of the allowance and provisioning for estimated losses is evaluated regularly based on review of loans, with particular emphasis on non-performing and other loans that management believes warrant special consideration. The ongoing evaluation process includes a formal analysis, which considers among other factors: the character and size of the loan portfolio, business and economic conditions, real estate market conditions, collateral values, changes in product offerings or loan terms, changes in underwriting and/or collection policies, loan growth, previous charge-off experience, delinquency trends, non-performing loan trends, the performance of individual loans in relation to contract terms, and estimated fair values of collateral.

The allowance for loan losses consists of allowances established for specific loans including impaired loans; allowances for pools of loans based on historical charge-offs by loan types; and supplemental allowances that adjust historical loss experience to reflect current economic conditions, industry specific risks, and other observable data.

While management uses available information to recognize losses on loans, changing economic conditions and the economic prospects of the borrowers may necessitate future additions or reductions to the allowance. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank s allowance, which also may necessitate future additions or reductions to the allowance, based on information available to them at the time of their examination.

Other-Than-Temporary Impairments on Investment Securities: One of the significant estimates relating to securities is the evaluation of other-than-temporary impairment (OTTI). If a decline in the fair value of a security is judged to be other-than-temporary, and management does not intend to sell the security and believes it is more-likely-than-not the Company will not be required to sell the security prior to recovery of cost or amortized cost, the portion of the total impairment attributable to the credit loss is recognized in earnings, and the remaining difference between the security s amortized cost basis and its fair value is included in other comprehensive income.

For impaired available for sale debt securities that management intends to sell, or where management believes it is more-likely-than-not that the Company will be required to sell, an OTTI charge is recognized in earnings equal to the difference between fair value and cost or amortized cost basis of the security. The fair value of the OTTI security becomes its new cost basis.

The evaluation of securities for impairments is a quantitative and qualitative process, which is subject to risks and uncertainties and is intended to determine whether declines in the fair value of securities should be recognized in current period earnings. The risks and uncertainties include changes in general economic conditions, the issuer s financial condition and/or future prospects, the effects of changes in interest rates or credit spreads and the expected recovery period of unrealized losses. The Company has a security monitoring process that identifies securities that, due to certain characteristics, as described below, are subjected to an enhanced analysis on a quarterly basis.

Securities that are in an unrealized loss position are reviewed at least quarterly to determine if an OTTI is present based on certain quantitative and qualitative factors and measures. The primary factors considered in evaluating whether a decline in value of securities is other-than-temporary include: (a) the cause of the impairment; (b) the financial condition, credit rating and future prospects of the issuer; (c) whether the underlying debtor is current on contractually obligated interest and principal payments; (d) the volatility of the securities fair value; (e) performance indicators of the underlying assets in the security including default rates, delinquency rates, percentage of non-performing assets, loan to collateral value ratios, conditional payment rates, third party guarantees, current levels of subordination, vintage, and geographic concentration and; (f) any other information and observable data considered relevant in determining whether an OTTI has occurred, including the expectation of the receipt of all principal and interest due.

In addition, for securitized financial assets with contractual cash flows, such as private label mortgage-backed securities (MBS), the Company periodically updates its best estimate of cash flows over the life of the security. The Company s best estimate of cash flows is based upon assumptions consistent with the current economic environment, similar to those the Company believes market participants would use. Estimating future cash flows is a quantitative and qualitative process that incorporates information received from third party sources along with certain assumptions and judgments regarding the future performance of the underlying collateral. In addition, projections of expected future cash flows may change based upon new information regarding the performance of the underlying collateral.

Income Taxes: The Company uses the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. If current available information indicates that it is more-likely-than-not that deferred tax assets will not be realized, a valuation allowance is established. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Significant management judgment is required in determining income tax expense and deferred tax assets and liabilities. As of June 30, 2016 and December 31, 2015, there was no valuation allowance for deferred tax assets.

Goodwill and Identifiable Intangible Assets: In connection with acquisitions, the Company generally records as assets on its consolidated financial statements both goodwill and identifiable intangible assets, such as core deposit intangibles.

The Company evaluates whether the carrying value of its goodwill has become impaired, in which case the value is reduced through a charge to its earnings. Goodwill is evaluated for impairment at least annually, or upon a triggering event using certain fair value techniques. Goodwill impairment testing is performed at the segment (or reporting unit) level. Goodwill is assigned to reporting units at the date the goodwill is initially recorded. Once goodwill has been assigned to the reporting units, it no longer retains its association with a particular acquisition, and all of the activities within a reporting unit, whether acquired or organically grown, are available to support the value of the goodwill.

Goodwill represents the excess of the purchase price over the fair value of net assets acquired in accordance with the purchase method of accounting for business combinations. Goodwill is not amortized but, instead, is subject to impairment tests on at least an annual basis or more frequently if an event occurs or circumstances change that reduce the fair value of a reporting unit below its carrying amount. The Company completes its annual goodwill impairment test as of December 31 of each year. The impairment testing process is conducted by assigning assets and goodwill to each reporting unit. Currently, the Company s goodwill is evaluated at the entity level as there is only one reporting unit. The Company first assesses certain qualitative factors to determine if it is more-likely-than-not that the fair value of the reporting unit is less than its carrying value. If it is more-likely-than-not that the fair value of the reporting unit is less than the carrying value, then the fair value of each reporting unit is compared to the recorded book value (step one). If the fair value of the reporting unit exceeds its carrying value, goodwill is not considered impaired and step two is not considered necessary. If the carrying value of a reporting unit exceeds its fair value, the impairment test continues (step two) by comparing the carrying value of the reporting unit s goodwill to the implied fair value of goodwill. The implied fair value is computed by adjusting all assets and liabilities of the reporting unit to current fair value with the offset adjustment to goodwill. The adjusted goodwill balance is the implied fair value of the goodwill. An impairment charge is recognized if the carrying fair value of goodwill exceeds the implied fair value of goodwill. At December 31, 2015, there was no indication of impairment that led the Company to believe it needed to perform a two-step test.

Any changes in the estimates used by the Company to determine the carrying value of its goodwill, or which otherwise adversely affect their value or estimated lives, would adversely affect the Company s consolidated results of operations.

Note 6: Earnings Per Share

Basic earnings per share excludes dilution and is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company, such as the Company s dilutive stock options and awards.

The following is a reconciliation of basic and diluted earnings per share for the three and six months ended June 30, 2016, and 2015:

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2016	**2015**	**2016**	**2015**
Net income	$ 4,311	$ 3,873	$ 8,717	$ 7,754
Weighted average common shares outstanding				
Basic	6,021,316	5,973,758	6,015,257	5,963,704
Effect of dilutive employee stock options	64,985	90,655	68,110	86,418
Diluted	6,086,301	6,064,413	6,083,367	6,050,122
Anti-dilutive options excluded from earnings per share calculation	75,763	10,950	80,263	11,197
Per Common Share Data:				
Basic earnings per share	$ 0.72	$ 0.65	$ 1.45	$ 1.30
Diluted earnings per share	$ 0.71	$ 0.64	$ 1.43	$ 1.28

Note 7: Securities Available For Sale

The following tables summarize the securities available for sale portfolio as of June 30, 2016, and December 31, 2015:

June 30, 2016 **Available for Sale:**	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Estimated Fair Value**
Mortgage-backed securities:				
US Government-sponsored enterprises	$323,684	$ 9,693	$ 397	$332,980
US Government agency	80,472	1,993	97	82,368
Private label	1,128	218	19	1,327
Obligations of states and political subdivisions thereof	109,898	6,108	91	115,915
Total	$515,182	$18,012	$ 604	$532,590

December 31, 2015 **Available for Sale:**	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Estimated Fair Value**
Mortgage-backed securities:				
US Government-sponsored enterprises	$304,106	$ 5,042	$2,155	$306,993
US Government agency	78,408	1,269	547	79,130
Private label	2,713	762	11	3,464
Obligations of states and political subdivisions thereof	110,952	4,758	328	115,382
Total	$496,179	$11,831	$3,041	$504,969

Securities Maturity Distribution: The following table summarizes the maturity distribution of the amortized cost and estimated fair value of securities available for sale as of June 30, 2016. Actual maturities may differ from the final maturities noted below because issuers may have the right to prepay or call certain securities. In the case of MBS, actual maturities may also differ from expected maturities due to the amortizing nature of the underlying mortgage collateral, and the fact that borrowers have the right to prepay.

Securities Available for Sale	**Amortized Cost**	**Estimated Fair Value**
Due one year or less	$ 167	$ 168
Due after one year through five years	5,592	5,732
Due after five years through ten years	13,889	14,762

Due after ten years	495,534	511,928
Total	$515,182	$532,590

Securities Impairment: As a part of the Company s ongoing security monitoring process, the Company identifies securities in an unrealized loss position that could potentially be OTTI. For the three and six months ended June 30, 2016 and 2015, the Company did not have any OTTI losses recognized in earnings (before taxes).

Upon initial impairment of a security, total OTTI losses represent the excess of the amortized cost over the fair value. For subsequent impairments of the same security, total OTTI losses represent additional credit losses and or declines in fair value subsequent to the previously recorded OTTI losses, if applicable. Unrealized OTTI losses recognized in accumulated other comprehensive income (OCI) represent the non-credit component of OTTI losses on debt securities. Net impairment losses recognized in earnings represent the credit component of OTTI losses on debt securities.

As of June 30, 2016, the Company held four private label MBS (debt securities) with a total amortized cost (i.e. carrying value) of $48 for which OTTI losses have previously been recognized in pre-tax earnings dating back to the fourth quarter of 2008. For all of these securities, the Company previously recognized credit losses in excess of the unrealized losses currently in accumulated OCI, creating an unrealized gain of $135, net of tax, as included in accumulated OCI as of June 30, 2016, compared with a net unrealized gain of $462, net of tax, at December 31, 2015.

The OTTI losses previously recognized in earnings represented management s best estimate of credit losses inherent in the securities based on discounted, bond-specific future cash flow projections using assumptions about cash flows associated with the pools of mortgage loans underlying each security. In estimating those cash flows the Company takes a variety of factors into consideration including, but not limited to, loan level credit characteristics, current delinquency and non-performing loan rates, current levels of subordination and credit support, recent default rates and future constant default rate estimates, original and current loan to collateral value ratios, recent collateral loss severities and future collateral loss severity estimates, recent and historical conditional prepayment rates and future conditional prepayment rate assumptions, and other estimates of future collateral performance.

Despite elevated levels of delinquencies, defaults and losses in the underlying residential mortgage loan collateral, given credit enhancements resulting from the structures of the individual securities, the Company expects that as of June 30, 2016, it will recover the amortized cost basis of its private label MBS as depicted in the continuously unrealized loss table below and has therefore concluded that such securities were not OTTI as of that date. Nevertheless, given recent market conditions, it is possible that adverse changes in repayment performance and fair value could occur in future periods that would change the Company s current best estimates.

The following table displays the beginning balance of OTTI related to historical credit losses on debt securities held by the Company at the beginning of the current reporting period, as well as changes in credit losses recognized in pre-tax earnings for the three and six months ended June 30, 2016, and 2015.

	2016	**2015**
Estimated credit losses as of March 31,	$2,793	$3,413
Additions for credit losses for securities on which OTTI has been previously recognized	---	---
Additions for credit losses for securities on which OTTI has not been previously recognized	---	---
Reductions for securities sold or paid off during the period	1,096	233
Estimated credit losses as of June 30,	$1,697	$3,180

Estimated credit losses as of prior year-end,	$3,180	$3,413
Additions for credit losses for securities on which OTTI has been previously recognized	---	---
Additions for credit losses for securities on which OTTI has not been previously recognized	---	---
Reductions for securities sold or paid off during the period	1,483	233
Estimated credit losses as of June 30,	$1,697	$3,180

As of June 30, 2016, based on a review of the remaining securities in the securities portfolio, the Company concluded that it expects to recover its amortized cost basis for such securities. This conclusion was based on the issuers continued satisfaction of the securities obligations in accordance with their contractual terms and the expectation that they will continue to do so through the maturity of the security, the expectation that the Company will receive the entire amount of future contractual cash flows, as well as the evaluation of the fundamentals of the issuers financial condition and other objective evidence. Accordingly, the Company concluded that any declines in the values of those securities were temporary and that any additional OTTI charges were not appropriate at June 30, 2016.

The following table summarizes the fair value of securities with continuous unrealized losses for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or longer as of June 30, 2016 and December 31, 2015. All securities referenced are debt securities.

	Less than 12 months			**12 months or longer**			**Total**		
June 30, 2016	**Estimated Fair Value**	**Number of Investments**	**Unrealized Losses**	**Estimated Fair Value**	**Number of Investments**	**Unrealized Losses**	**Estimated Fair Value**	**Number of Investments**	**Unrealized Losses**
Description of Securities:									
Mortgage-backed securities:									
US Government-sponsored enterprises	$35,865	42	$ 224	$ 9,678	22	$ 173	$ 45,543	64	$ 397
US Government agency	7,619	11	27	4,920	16	70	12,539	27	97
Private label	198	2	10	159	5	9	357	7	19
Obligations of states and political subdivisions thereof	2,426	5	7	5,077	11	84	7,503	16	91
Total	$46,108	60	$ 268	$19,834	54	$ 336	$ 65,942	114	$ 604

	Less than 12 months			**12 months or longer**			**Total**		
December 31, 2015	**Estimated Fair Value**	**Number of Investments**	**Unrealized Losses**	**Estimated Fair Value**	**Number of Investments**	**Unrealized Losses**	**Estimated Fair Value**	**Number of Investments**	**Unrealized Losses**
Description of Securities:									
Mortgage-backed securities:									
US Government-sponsored enterprises	$112,770	142	$1,342	$23,646	33	$ 813	$136,416	175	$2,155
US Government agency	20,201	30	326	11,232	22	221	31,433	52	547
Private label	235	2	2	178	5	9	413	7	11

Obligations of states and political subdivisions thereof	14,853	25	210	3,700	11	118	18,553	36	328
Total	$148,059	199	$1,880	$38,756	71	$1,161	$186,815	270	$3,041

For securities with unrealized losses, the following information was considered in determining that the impairments were not other-than-temporary:

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Mortgage-backed securities issued by U.S. Government-sponsored enterprises: As of June 30, 2016, the total unrealized losses on these securities amounted to $397, compared with $2,155 at December 31, 2015. All of these securities were credit rated AA+ by the major credit rating agencies. Company management believes these securities have minimal credit risk, as these Government-sponsored enterprises play a vital role in the nation s financial markets. Management s analysis indicates that the unrealized losses at June 30, 2016 were attributed to changes in current market yields and pricing spreads for similar securities since the date the underlying securities were purchased, and does not consider these securities to be OTTI at June 30, 2016.

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Mortgage-backed securities issued by U.S. Government agencies: As of June 30, 2016, the total unrealized losses on these securities amounted to $97, compared with $547 at December 31, 2015. All of these securities were credit rated AA+ by the major credit rating agencies. Management s analysis indicates that these securities bear little or no credit risk because they are backed by the full faith and credit of the United States. The Company attributes the unrealized losses at June 30, 2016 to changes in current market yields and pricing spreads for similar securities since the date the underlying securities were purchased, and does not consider these securities to be OTTI at June 30, 2016.

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Private label mortgage-backed securities: As of June 30, 2016, the total unrealized losses on the Bank s private label MBS amounted to $19, compared with $11 at December 31, 2015. The Company attributes the unrealized losses at June 30, 2016 to the current illiquid market for non-agency MBS, risk-related market pricing discounts for non-agency MBS and credit rating downgrades on certain private label MBS owned by the Company. Based upon the foregoing considerations and the expectation that the Company will receive all of the future contractual cash flows related to the amortized cost on these securities, the Company does not consider there to be any additional OTTI with respect to these securities at June 30, 2016.

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Obligations of states of the U.S. and political subdivisions thereof: As of June 30, 2016, the total unrealized losses on the Bank s municipal securities amounted to $91, compared with $328 at December 31, 2015. The Bank s municipal securities primarily consist of general obligation bonds and to a lesser extent, revenue bonds. General obligation bonds carry less risk, as they are supported by the full faith, credit and taxing authority of the issuing government and in the cases of school districts, are additionally supported by state aid. Revenue bonds are generally backed by municipal revenue streams generated through user fees or lease payments associated with specific municipal projects that have been financed.

Municipal bonds are frequently supported with insurance, which guarantees that, in the event the issuer experiences financial problems, the insurer will step in and assume payment of both principal and interest. Historically, insurance support has strengthened an issuer s underlying credit rating to AAA or AA status. Starting in 2008, many of the insurance companies providing municipal bond insurance experienced financial difficulties and, accordingly, were downgraded by at least one of the major credit rating agencies. Consequently, a portion of the Bank s municipal bond portfolio was downgraded by at least one of the major credit rating agencies. Notwithstanding the credit rating downgrades, at June 30, 2016, the Bank s municipal bond portfolio did not contain any below investment grade securities as reported by major credit rating agencies. In addition, at June 30, 2016, all municipal bond issuers were current on contractually obligated interest and principal payments.

The Company attributes the unrealized losses in municipal bonds at June 30, 2016 to changes in current market yields and pricing spreads for similar securities since the date the underlying securities were purchased and, to a lesser extent, changes in credit ratings on certain securities. The Company also attributes the unrealized losses to ongoing media attention and market concerns about municipal budget deficits and the prolonged recovery from the national economic recession and the impact it might have on the future financial stability of municipalities throughout the country. Notwithstanding the foregoing considerations, the Company does not consider these municipal securities to be other-than-temporarily impaired at June 30, 2016.

At June 30, 2016, the Company had no intent to sell nor believed it is more-likely-than-not that it would be required to sell any of its impaired securities as identified and discussed immediately above, and therefore did not consider these securities to be other than temporarily impaired as of that date.

Securities Gains and Losses: The following table summarizes realized gains and losses on securities available for sale for the three and six months ended June 30, 2016 and 2015.

	Proceeds from Sale of Securities Available for Sale	**Realized Gains**	**Realized Losses**	**Other Than Temporary Impairment Losses**	**Net**
Three months ended June 30,					
2016	$23,142	$1,699	$ ---	$ ---	$1,699
2015	$11,487	$ 587	$ ---	$ ---	$ 587
Six months ended June 30,					
2016	$44,655	$3,135	$ ---	$ ---	$3,135
2015	$20,428	$1,206	$ ---	$ ---	$1,206

Visa Class B Common Shares: The Bank was a member of the Visa USA payment network and was issued Class B shares in connection with the Visa Reorganization and the Visa Inc. initial public offering in March 2008. The Visa Class B shares are transferable only under limited circumstances until they can be converted into shares of the publicly traded class of Visa stock. This conversion cannot happen until the settlement of certain litigation, which is indemnified by Visa members. Since its initial public offering, Visa has funded a litigation reserve based upon a change in the conversion ratio of Visa Class B shares into Visa Class A shares. At its discretion, Visa may continue to increase the conversion rate in connection with any settlements in excess of amounts then in escrow for that purpose and reduce the conversion rate to the extent that it adds any funds to the escrow in the future. Based on the existing transfer restriction and the uncertainty of the litigation, the Company has recorded its Visa Class B shares on its statements of condition at zero value for all reporting periods since 2008.

At June 30, 2016, the Bank owned 11,623 of Visa Class B shares with a then current conversion ratio to Visa Class A shares of 1.648 (or 19,158 Visa Class A shares). Upon termination of the existing transfer restriction and settlement of the litigation, and to the extent that the Bank continues to own such Visa Class B shares in the future, the Company expects to record its Visa Class A shares at fair value.

Note 8: Loans and Allowance for Loan Losses

Loans are carried at the principal amounts outstanding adjusted by partial charge-offs and net deferred loan origination costs or fees.

Interest on loans is accrued and credited to income based on the principal amount of loans outstanding. Residential real estate and home equity loans are generally placed on non-accrual status when reaching 90 days past due, or in process of foreclosure, or sooner if judged appropriate by management. Consumer loans are generally placed on non-accrual status when reaching 90 days or more past due, or sooner if management determines there is a reason to doubt full collectability of all outstanding principal and interest. Secured consumer loans are written down to realizable value and unsecured consumer loans are charged-off upon reaching 120 days past due. Commercial real estate loans and commercial business loans that are 90 days or more past due are generally placed on non-accrual status, unless secured by sufficient cash or other assets immediately convertible to cash, and the loan is in the process of collection. Commercial real estate and commercial business loans may be placed on non-accrual status prior to the 90 days delinquency date if management determines there is a reason to doubt full collectability of all outstanding principal and interest. When a loan has been placed on non-accrual status, previously accrued and uncollected interest is reversed against interest on loans. A loan can be returned to accrual status when there is evidence of an ability to adhere to the required repayment schedule and the loan has performed for a period of time, generally six months.

Commercial real estate and commercial business loans are considered impaired when it becomes probable the Bank will not be able to collect all amounts due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status and collateral value. In considering loans for evaluation of impairment, management generally excludes smaller balance, homogeneous loans, residential mortgage loans, home equity loans, and all consumer loans, unless such loans were restructured in a troubled debt restructuring. These loans are collectively evaluated for risk of loss.

Loan origination, commitment fees and direct loan origination costs are deferred, and the net amount is amortized as an adjustment of the related loans yield, using the level yield method over the estimated lives of the related loans.

The Company s lending activities are principally conducted in downeast, midcoast and central Maine.

The following table summarizes the composition of the loan portfolio as of June 30, 2016, and December 31, 2015:

LOAN PORTFOLIO SUMMARY

	June 30, 2016	**December 31, 2015**
Commercial real estate mortgages	$ 390,033	$371,002
Commercial and industrial	80,749	79,911
Commercial construction and land development	25,467	24,926
Agricultural and other loans to farmers	33,081	31,003
Total commercial loans	529,330	506,842
Residential real estate mortgages	446,933	408,401
Home equity loans	49,330	51,530
Other consumer loans	6,946	7,949
Total consumer loans	503,209	467,880
Tax exempt loans	16,352	15,244
Net deferred loan costs and fees	131	104
Total loans	1,049,022	990,070
Allowance for loan losses	(9,891)	(9,439)
Total loans net of allowance for loan losses	$1,039,131	$980,631

Loan Origination/Risk Management: The Bank has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. The Bank s board of directors reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management and the board with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies and non-performing loans and potential problem loans. The Bank seeks to diversify the loan portfolio as a means of managing risk associated with fluctuations in economic conditions.

Commercial Real Estate Mortgages: The Bank s commercial real estate mortgage loans are collateralized by liens on real estate, typically have variable interest rates and amortize over a 15 to 20 year period. These loans are underwritten primarily as cash flow loans and secondarily as loans secured by real estate. Payments on loans secured by such properties are largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Accordingly, repayment of these loans may be subject to adverse economic conditions to a greater extent than other types of loans. The Bank seeks to minimize these risks in a variety of ways, including giving careful consideration to the property s operating history, future operating projections, current and projected occupancy, location and physical condition in connection with underwriting these loans. The underwriting analysis also includes credit verification, analysis of global cash flows, appraisals and a review of the financial condition of the borrower. Reflecting the Bank s business region, at June 30, 2016, approximately 31% of the commercial real estate mortgage portfolio was represented by loans to the lodging industry. The Bank underwrites lodging industry loans as operating businesses, lending primarily to seasoned establishments with stabilized cash flows.

Commercial and Industrial Loans: Commercial and industrial loans are underwritten after evaluating and understanding the borrower s ability to operate profitably, and prudently expand its business. Commercial and industrial loans are primarily made in the Bank s market areas and are underwritten on the basis of the borrower s ability to service the debt from income. These loans typically have variable interest rates and amortize over a period of less than 10 years. As a general practice, the Bank takes as collateral a lien on available real estate, equipment or other assets owned by the borrower and obtains a personal guaranty of the borrower(s) or principal(s). Working capital loans are primarily collateralized by short-term assets whereas term loans are primarily collateralized by long-term assets. The risk in commercial and industrial loans is principally due to the type of collateral securing these loans. The increased risk also derives from the expectation that commercial and industrial loans generally will be serviced principally from the operations of the business, and, if not successful, these loans are primarily secured by tangible, non-real estate collateral.

Construction and Land Development Loans: The Bank makes loans to finance the construction of residential and non-residential properties. Construction loans generally are collateralized by first liens on real estate with terms of six to twenty-four months. The Bank conducts periodic inspections, either directly or through an agent, prior to approval of periodic draws on these loans. Underwriting guidelines similar to those described immediately above are also used in the Bank s construction lending activities. Construction loans involve additional risks attributable to the fact that loan funds are advanced against a project under construction and the project is of uncertain value prior to its completion. Because of uncertainties inherent in estimating construction costs, the market value of the completed project and the effects of governmental regulation on real property, it can be difficult to accurately evaluate the total funds required to complete a project and the related loan to value ratio. As a result of these uncertainties, construction lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project rather than the ability of a borrower or guarantor to repay the loan. In many cases the success of the project can also depend upon the financial support/strength of the sponsorship. If the Bank is forced to foreclose on a project prior to completion, there is no assurance that the Bank will be able to recover the entire unpaid portion of the loan. In addition, the Bank may be required to fund additional amounts to complete a project and may have to hold the property for an indeterminate period of time. While the Bank has underwriting procedures designed to identify what it believes to be acceptable levels of risks in construction lending, no assurance can be given that these procedures will prevent losses from the risks described above.

Residential Real Estate Mortgage Loans: The Bank originates and purchases first-lien, adjustable-rate and fixed-rate, one-to-four-family residential real estate loans for the construction, purchase or refinancing of residential property. These loans are principally collateralized by owner-occupied properties, and to a lesser extent second homes and vacation properties, and are amortized over 10 to 30 years. From time-to- time the Bank will sell longer-term, low rate, residential mortgage loans to the Federal Home Loan Mortgage Corporation (FHLMC) with servicing rights retained. This practice allows the Bank to better manage interest rate risk and liquidity risk. In an effort to manage risk of loss and strengthen secondary market liquidity opportunities, management typically uses secondary market underwriting, appraisal, and servicing guidelines for all loans, including those held in its portfolio. Loans on one-to-four-family residential real estate are mostly originated in amounts of no more than 80% of appraised value or have private mortgage insurance. Mortgage title insurance and hazard insurance is required.

Home Equity Loans: The Bank originates home equity lines of credit and second mortgage loans (loans which are secured by a junior lien position on one-to-four-family residential real estate). Home equity loans are mostly originated in amounts of no more than 85% of the combined loan-to-value ratio (first and second liens), or have private mortgage insurance. These loans carry a higher risk than first mortgage residential loans as they are in a second position relating to collateral. Risk is reduced through underwriting criteria, which include credit verification, appraisals and evaluations, a review of the borrower's financial condition, and personal cash flows. A security interest, with title insurance when necessary, is taken in the underlying real estate.

Non-performing Loans: The following table sets forth information regarding non-accruing loans and accruing loans 90 days or more overdue at June 30, 2016, and December 31, 2015.

TOTAL NON-PERFORMING LOANS

	June 30, 2016	**December 31, 2015**
Commercial real estate mortgages	$1,087	$1,279
Commercial and industrial loans	190	292
Commercial construction and land development	813	1,111
Agricultural and other loans to farmers	---	16
Total commercial loans	2,090	2,698
Residential real estate mortgages	3,157	3,452
Home equity loans	134	820
Other consumer loans	91	10
Total consumer loans	3,382	4,282
Total non-accrual loans	5,472	6,980
Accruing loans contractually past due 90 days or more	81	28
Total non-performing loans	$5,553	$7,008

Troubled Debt Restructures: A Troubled Debt Restructure (TDR) results from a modification of a loan to a borrower who is experiencing financial difficulty in which the Bank grants a concession to the debtor that it would not otherwise consider but for the debtor s financial difficulties. Financial difficulty arises when a debtor is bankrupt or contractually past due, or is likely to become so, based upon its ability to pay. A concession represents an accommodation not generally available to other customers, which may include a below-market interest rate, deferment of principal payments, extension of maturity dates, etc. Such accommodations extended to customers who are not experiencing financial difficulty do not result in TDR classification.

Troubled debt restructurings and related delinquency trends in general are considered in management s evaluation of the allowance for loan losses and the related determination of the provision for loan losses.

Summary information pertaining to the TDRs that occurred during the three and six months ended June 30, 2016 and 2015 follows:

	For the Three Months Ended June 30, 2016			For the Six Months Ended June 30, 2016		
	Number of Loans	**Pre-Modification Outstanding Recorded Investment**	**Post-Modification Outstanding Recorded Investment**	**Number of Loans**	**Pre-Modification Outstanding Recorded Investment**	**Post-Modification Outstanding Recorded Investment**
Commercial real estate mortgages	1	$30	$30	3	$ 425	$ 418
Agricultural and other loans to farmers	---	---	---	2	30	25
Total commercial loans	1	30	30	5	455	443
Total	1	$30	$30	5	$ 455	$ 443

	For the Three Months Ended June 30, 2015			For the Six Months Ended June 30, 2015		
	Number of Loans	**Pre-Modification Outstanding Recorded Investment**	**Post-Modification Outstanding Recorded Investment**	**Number of Loans**	**Pre-Modification Outstanding Recorded Investment**	**Post-Modification Outstanding Recorded Investment**
Agricultural and other loans to farmers	---	$---	$---	1	$ 18	$ 17
Total commercial loans	---	---	---	1	18	17
Residential real estate mortgages	2	$795	$794	3	$1,267	$1,266
Total consumer loans	2	795	794	3	1,267	1,266
Total	2	$795	$794	4	$1,285	$1,283

The following tables show the Bank s post-modification balance of TDRs listed by type of modification for TDRs that occurred during the three and six months ended June 30, 2016 and 2015:

	June 30, 2016		June 30, 2015	
	Three Months Ended	**Six Months Ended**	**Three Months Ended**	**Six Months Ended**

Extended maturity and adjusted interest rate	$---	$ ---	$ ---	$ 489
Extended maturity and adjusted payment	---	413	---	---
Adjusted payment	---	---	607	607
Adjusted payment and capitalized interest	---	---	187	187
Other concessions	30	30	---	---
Total	$30	$443	$794	$1,283

As of June 30, 2016, the Bank had $3,387 of loans outstanding to 21 relationships that were classified as TDRs. These loans consisted of ten commercial real estate loans, eight real estate secured loans, four commercial and industrial loans, four agricultural loans, and one other consumer loan. At June 30, 2016, six of these TDRs totaling $879 were classified as non-accrual, and none were past due 30 days or more and still accruing.

As of December 31, 2015, the Bank had $3,162 of loans outstanding to 17 relationships that were classified as TDRs. These loans consisted of seven commercial real estate loans, eight real estate secured loans, four commercial and industrial loans, two agricultural loans, and one other consumer loan. At December 31, 2015, six of these TDRs totaling $826 were classified as non-accrual, and none were past due 30 days or more and still accruing.

During the six months ended June 30, 2016, one CRE loan for $40 that had been modified as a TDR within the previous twelve months defaulted, compared with none during the same period in 2015. A default for purposes of this disclosure is a TDR in which the borrower is 90 days or more past due or results in foreclosure and repossession of the applicable collateral.

Past due loans: Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. The following tables set forth information regarding past due loans at June 30, 2016 and December 31, 2015. Amounts shown exclude deferred loan origination fees and costs.

June 30, 2016	**30-59 Days Past Due**	**60-89 Days Past Due**	**90 Days or Greater**	**Total Past Due**	**Current**	**Total Loans**	**Non-Accrual**	**>90 Days Past Due and Accruing**
Commercial real estate mortgages	$ 844	$ 103	$ 333	$1,280	388,753	$ 390,033	$1,087	$---
Commercial and industrial	4	30	190	224	80,525	80,749	190	---
Commercial construction	---	---	813	813	24,654	25,467	813	---

and land development								
Agricultural and other loans to farmers	13	---	81	94	32,987	33,081	---	81
Residential real estate mortgages	1,488	753	991	3,232	443,701	446,933	3,157	---
Home equity	31	15	10	56	49,274	49,330	134	---
Other consumer loans	34	1	2	37	6,909	6,946	91	---
Tax exempt	---	---	---	---	16,352	16,352	---	---
Total	$2,414	$ 902	$2,420	$5,736	$1,043,155	$1,048,891	$5,472	$81

December 31, 2015	**30-59 Days Past Due**	**60-89 Days Past Due**	**90 Days or Greater**	**Total Past Due**	**Current**	**Total Loans**	**Non-Accrual**	**>90 Days Past Due and Accruing**
Commercial real estate mortgages	$ 99	$ 287	$ 241	$ 627	$ 370,375	$ 371,002	$1,279	$---
Commercial and industrial	9	1	271	281	79,630	79,911	292	---
Commercial construction and land development	---	---	1,111	1,111	23,815	24,926	1,111	---
Agricultural and other loans to farmers	12	70	3	85	30,918	31,003	16	3
Residential real estate mortgages	1,313	452	1,299	3,064	403,588	406,652	3,452	25
Home equity	245	---	797	1,042	50,488	51,530	820	---
Other consumer loans	66	---	---	66	9,632	9,698	10	---
Tax exempt	---	---	---	---	15,244	15,244	---	---
Total	$1,744	$ 810	$3,722	$6,276	$ 983,690	$ 989,966	$6,980	$28

Impaired Loans: Impaired loans are all commercial loans for which the Company believes it is probable that it will be unable to collect all amounts due according to the contractual terms of the loan agreement, as well as all loans modified into a TDR, if any. Allowances for losses on impaired loans are determined by the lower of the present value of the expected cash flows related to the loan, using the original contractual interest rate, and its recorded value, or in the case of collateral dependent loans, the lower of the fair value of the collateral, less estimated costs to dispose, and the recorded amount of the loans. When foreclosure is probable, impairment is measured based on the fair value of the collateral less estimated cost to sell.

Details of impaired loans as of June 30, 2016 and December 31, 2015 follows:

	June 30, 2016			December 31, 2015		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance:						
Commercial real estate mortgages	$1,900	$1,900	$---	$1,692	$1,736	$---
Commercial and industrial	89	89	---	202	352	---
Commercial construction and land development	---	---	---	---	---	---
Agricultural and other loans to farmers	127	127	---	106	106	---
Residential real estate loans	1,214	1,330	---	1,332	1,362	---
Home equity loans	17	17	---	18	18	---
Other consumer	---	---	---	---	---	---
Subtotal	$3,347	$3,463	$---	$3,350	$3,574	$---
With an allowance:						
Commercial real estate mortgages	$ 536	$ 536	$ 43	$ 531	$ 531	$ 43
Commercial and industrial	220	370	175	224	374	175
Commercial construction and land development						