First Bancorp, Inc /ME/
Form 10-Q
August 09, 2018

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

[X] Quarterly Report Pursuant to Section 13 or 15(d) of The Securities Exchange Act of 1934
For the quarterly period ended June 30, 2018

Commission File Number 0-26589

THE FIRST BANCORP, INC.
(Exact name of Registrant as specified in its charter)

MAINE	01-0404322
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

MAIN STREET, DAMARISCOTTA, MAINE	04543
(Address of principal executive offices)	(Zip code)

(207) 563-3195
Registrant's telephone number, including area code

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, 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. (Check one):

Large accelerated filer [_] Accelerated filer [X] Non-accelerated filer [_] Smaller reporting company [_]
Emerging growth company [_]
If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. [_]

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

Indicate the number of shares outstanding of each of the registrant's classes of common stock as of August 1, 2018
Common Stock: 10,854,862 shares

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Part I. Financial Information
Selected Financial Data (Unaudited)
The First Bancorp, Inc. and Subsidiary

Dollars in thousands,	As of and for the six months ended June 30,		As of and for the quarters ended June 30,	
except for per share amounts	2018	2017	2018	2017
Summary of Operations				
Interest Income	$33,656	$29,493	$17,205	$15,002
Interest Expense	8,978	6,352	4,936	3,337
Net Interest Income	24,678	23,141	12,269	11,665
Provision for Loan Losses	1,000	1,000	500	500
Non-Interest Income	6,313	5,845	3,181	3,002
Non-Interest Expense	16,755	15,338	8,176	7,640
Net Income	11,240	9,520	5,734	4,883
Per Common Share Data				
Basic Earnings per Share	$1.04	$0.89	$0.53	$0.45
Diluted Earnings per Share	1.04	0.88	0.53	0.45
Cash Dividends Declared	0.53	0.47	0.29	0.24
Book Value per Common Share	16.89	16.41	16.89	16.41
Tangible Book Value per Common Share[2]	14.13	13.63	14.13	13.63
Market Value	28.22	27.06	28.22	27.06
Financial Ratios				
Return on Average Equity[1]	12.39%	10.84%	12.51%	10.96%
Return on Average Tangible Common Equity[1,2]	14.82%	13.05%	14.95%	13.18%
Return on Average Assets[1]	1.21%	1.09%	1.22%	1.10%
Average Equity to Average Assets	9.79%	10.04%	9.75%	10.05%
Average Tangible Equity to Average Assets[2]	8.18%	8.34%	8.16%	8.36%
Net Interest Margin Tax-Equivalent[1,2]	2.94%	3.04%	2.88%	3.03%
Dividend Payout Ratio	50.96%	52.81%	54.72%	53.33%
Allowance for Loan Losses/Total Loans	0.94%	0.95%	0.94%	0.95%
Non-Performing Loans to Total Loans	1.17%	0.66%	1.17%	0.66%
Non-Performing Assets to Total Assets	0.78%	0.44%	0.78%	0.44%
Efficiency Ratio[2]	52.39%	49.32%	51.02%	48.50%
At Period End				
Total Assets	$1,913,961	$1,795,651	$1,913,961	$1,795,651
Total Loans	1,224,440	1,120,665	1,224,440	1,120,665
Total Investment Securities	577,488	564,580	577,488	564,580
Total Deposits	1,416,646	1,319,259	1,416,646	1,319,259
Total Shareholders' Equity	183,304	177,537	183,304	177,537

[1]Annualized using a 365-day basis for both 2018 and 2017.
[2]These ratios use non-GAAP financial measures. See Management's Discussion and Analysis of Financial Condition and Results of Operations for additional disclosures and information.

Item 1 – Financial Statements

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
The First Bancorp, Inc.

We have reviewed the accompanying interim consolidated financial information of The First Bancorp, Inc. and Subsidiary as of June 30, 2018 and 2017 and for the three-month and six-month periods then ended. These financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit in accordance with standards of the Public Company Accounting Oversight Board (United States), the objective of which is to express an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying interim consolidated financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

/s/ Berry Dunn McNeil & Parker, LLC
Bangor, Maine
August 9, 2018

Consolidated Balance Sheets (Unaudited)
The First Bancorp, Inc. and Subsidiary

	June 30, 2018	December 31, 2017	June 30, 2017
Assets			
Cash and cash equivalents	$21,056,000	$19,207,000	$20,189,000
Interest bearing deposits in other banks	1,616,000	860,000	3,820,000
Securities available for sale	305,048,000	300,172,000	308,146,000
Securities to be held to maturity (fair value of $256,316,000 at June 30, 2018, $259,655,000 at December 31, 2017 and $246,238,000 at June 30, 2017)	260,077,000	256,567,000	244,123,000
Restricted equity securities, at cost	12,363,000	10,358,000	12,311,000
Loans held for sale	481,000	386,000	865,000
Loans	1,224,440,000	1,164,139,000	1,120,665,000
Less allowance for loan losses	11,472,000	10,729,000	10,611,000
Net loans	1,212,968,000	1,153,410,000	1,110,054,000
Accrued interest receivable	7,723,000	5,867,000	7,192,000
Premises and equipment, net	21,682,000	22,502,000	21,367,000
Other real estate owned	609,000	1,012,000	324,000
Goodwill	29,805,000	29,805,000	29,805,000
Other assets	40,533,000	42,784,000	37,455,000
Total assets	$1,913,961,000	$1,842,930,000	$1,795,651,000
Liabilities			
Demand deposits	$146,964,000	$145,332,000	$137,061,000
NOW deposits	282,449,000	318,043,000	293,553,000
Money market deposits	100,378,000	163,898,000	134,760,000
Savings deposits	229,464,000	232,605,000	226,391,000
Certificates of deposit	657,391,000	559,001,000	527,494,000
Total deposits	1,416,646,000	1,418,879,000	1,319,259,000
Borrowed funds – short term	232,339,000	113,638,000	157,154,000
Borrowed funds – long term	65,116,000	115,120,000	125,123,000
Other liabilities	16,556,000	13,972,000	16,578,000
Total liabilities	1,730,657,000	1,661,609,000	1,618,114,000
Shareholders' equity			
Common stock, one cent par value per share	109,000	108,000	108,000
Additional paid-in capital	62,246,000	61,747,000	61,218,000
Retained earnings	126,464,000	121,144,000	115,980,000
Accumulated other comprehensive income (loss)			
Net unrealized loss on securities available for sale	(7,245,000)	(2,901,000)	(585,000)
Net unrealized loss on securities transferred from available for sale to held to maturity	(189,000)	(174,000)	(137,000)
Net unrealized gain on cash flow hedging derivative instruments	2,066,000	1,544,000	1,055,000
Net unrealized loss on postretirement benefit costs	(147,000)	(147,000)	(102,000)
Total shareholders' equity	183,304,000	181,321,000	177,537,000
Total liabilities & shareholders' equity	$1,913,961,000	$1,842,930,000	$1,795,651,000
Common Stock			
Number of shares authorized	18,000,000	18,000,000	18,000,000
Number of shares issued and outstanding	10,851,917	10,829,918	10,819,443
Book value per common share	$16.89	$16.74	$16.41

Tangible book value per common share	$14.13	$13.97	$13.63

See Report of Independent Registered Public Accounting Firm. The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Income and Comprehensive Income (Unaudited)
The First Bancorp, Inc. and Subsidiary

	For the six months ended June 30,		For the quarter ended June 30,	
	2018	2017	2018	2017
Interest income				
Interest and fees on loans (includes tax-exempt income of $473,000 as of June 30, 2018 and $380,000 as of June 30, 2017)	$25,429,000	$21,767,000	$13,038,000	$11,115,000
Interest on deposits with other banks	17,000	23,000	6,000	8,000
Interest and dividends on investments (includes tax-exempt income of $3,462,000 as of June 30, 2018 and $3,238,000 as of June 30, 2017)	8,210,000	7,703,000	4,161,000	3,879,000
Total interest income	33,656,000	29,493,000	17,205,000	15,002,000
Interest expense				
Interest on deposits	6,857,000	4,296,000	3,758,000	2,302,000
Interest on borrowed funds	2,121,000	2,056,000	1,178,000	1,035,000
Total interest expense	8,978,000	6,352,000	4,936,000	3,337,000
Net interest income	24,678,000	23,141,000	12,269,000	11,665,000
Provision for loan losses	1,000,000	1,000,000	500,000	500,000
Net interest income after provision for loan losses	23,678,000	22,141,000	11,769,000	11,165,000
Non-interest income				
Investment management and fiduciary income	1,542,000	1,340,000	802,000	709,000
Service charges on deposit accounts	1,097,000	1,051,000	570,000	549,000
Net securities gains	136,000	3,000	—	—
Mortgage origination and servicing income, net of amortization	692,000	761,000	361,000	429,000
Other operating income	2,846,000	2,690,000	1,448,000	1,315,000
Total non-interest income	6,313,000	5,845,000	3,181,000	3,002,000
Non-interest expense				
Salaries and employee benefits	8,770,000	7,843,000	4,280,000	3,873,000
Occupancy expense	1,297,000	1,227,000	598,000	603,000
Furniture and equipment expense	1,844,000	1,760,000	915,000	890,000
FDIC insurance premiums	613,000	503,000	334,000	263,000
Amortization of identified intangibles	22,000	22,000	11,000	11,000
Other operating expense	4,209,000	3,983,000	2,038,000	2,000,000
Total non-interest expense	16,755,000	15,338,000	8,176,000	7,640,000
Income before income taxes	13,236,000	12,648,000	6,774,000	6,527,000
Income tax expense	1,996,000	3,128,000	1,040,000	1,644,000
NET INCOME	$11,240,000	$9,520,000	$5,734,000	$4,883,000
Basic earnings per common share	$1.04	$0.89	$0.53	$0.45
Diluted earnings per common share	$1.04	$0.88	$0.53	$0.45
Other comprehensive income (loss) net of tax				
Net unrealized gain (loss) on securities available for sale	(4,344,000)	350,000	(1,035,000)	349,000
Net unrealized loss on securities transferred from available for sale to held to maturity, net of amortization	(15,000)	(8,000)	(7,000)	(4,000)
Net unrealized gain (loss) on cash flow hedging derivative instruments	522,000	(108,000)	138,000	(171,000)
Other comprehensive income (loss)	(3,837,000)	234,000	(904,000)	174,000

Comprehensive income	$7,403,000	$9,754,000	$4,830,000	$5,057,000

See Report of Independent Registered Public Accounting Firm.
The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Changes in Shareholders' Equity (Unaudited)
The First Bancorp, Inc. and Subsidiary

	Common stock and additional paid-in capital		Retained earnings	Accumulated other comprehensive income (loss)	Total shareholders' equity
	Shares	Amount			
Balance at December 31, 2016	10,793,946	$60,831,000	$111,693,000	$(3,000)	$172,521,000
Net income	—	—	9,520,000	—	9,520,000
Net unrealized gain on securities available for sale, net of tax	—	—	—	350,000	350,000
Net unrealized loss on cash flow hedging derivative instruments, net of tax	—	—	—	(108,000)	(108,000)
Net unrealized loss on securities transferred from available for sale to held to maturity, net of tax	—	—	—	(8,000)	(8,000)
Comprehensive income	—	—	9,520,000	234,000	9,754,000
Cash dividends declared ($0.47 per share)	—	—	(5,085,000)	—	(5,085,000)
Equity compensation expense	—	166,000	—	—	166,000
Payment to repurchase common stock	(5,333)	—	(148,000)		(148,000)
Issuance of restricted stock	18,850	—	—	—	—
Proceeds from sale of common stock	11,980	329,000	—	—	329,000
Balance at June 30, 2017	10,819,443	$61,326,000	$115,980,000	$231,000	$177,537,000
Balance at December 31, 2017	10,829,918	$61,855,000	$121,144,000	$(1,678,000)	$181,321,000
Net income	—	—	11,240,000	—	11,240,000
Net unrealized loss on securities available for sale, net of tax	—	—	—	(4,344,000)	(4,344,000)
Net unrealized gain on cash flow hedging derivative instruments, net of tax	—	—	—	522,000	522,000
Net unrealized loss on securities transferred from available for sale to held to maturity, net of tax	—	—	—	(15,000)	(15,000)
Comprehensive income	—	—	11,240,000	(3,837,000)	7,403,000
Cash dividends declared ($0.53 per share)	—	—	(5,754,000)	—	(5,754,000)
Equity compensation expense	—	190,000	—	—	190,000
Payment to repurchase common stock	(5,725)	—	(166,000)	—	(166,000)
Issuance of restricted stock	16,795	—	—	—	—
Proceeds from sale of common stock	10,929	310,000	—	—	310,000
Balance at June 30, 2018	10,851,917	$62,355,000	$126,464,000	$(5,515,000)	$183,304,000

See Report of Independent Registered Public Accounting Firm.
The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Cash Flows (Unaudited)
The First Bancorp, Inc. and Subsidiary

	For the six months ended	
	June 30, 2018	June 30, 2017
Cash flows from operating activities		
Net income	$11,240,000	$9,520,000
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	910,000	908,000
Change in deferred taxes	(402,000)	98,000
Provision for loan losses	1,000,000	1,000,000
Loans originated for resale	(10,480,000)	(17,070,000)
Proceeds from sales and transfers of loans	10,577,000	17,280,000
Net gain on sales of loans	(192,000)	(293,000)
Net gain on sale or call of securities	(136,000)	(3,000)
Net amortization of premiums on investments	1,068,000	1,808,000
Net gain on sale of other real estate owned	(183,000)	(74,000)
Equity compensation expense	190,000	166,000
Net (increase) decrease in other assets and accrued interest	1,056,000	(3,338,000)
Net increase (decrease) in other liabilities	3,350,000	(943,000)
Net loss on disposal of premises and equipment	127,000	7,000
Amortization of investment in limited partnership	86,000	89,000
Net acquisition amortization	22,000	22,000
Net cash provided by operating activities	18,233,000	9,180,000
Cash flows from investing activities		
Increase in interest-bearing deposits in other banks	(756,000)	(3,527,000)
Proceeds from sales of securities available for sale	459,000	3,000
Proceeds from maturities, payments and calls of securities available for sale	28,886,000	123,896,000
Proceeds from maturities, payments and calls of securities to be held to maturity	6,500,000	7,022,000
Proceeds from sales of other real estate owned	815,000	336,000
Purchases of securities available for sale	(40,677,000)	(133,056,000)
Purchases of securities to be held to maturity	(10,004,000)	(24,169,000)
Purchase of restricted equity securities	(2,005,000)	(381,000)
Net increase in loans	(60,787,000)	(49,880,000)
Capital expenditures	(217,000)	(80,000)
Net cash used by investing activities	(77,786,000)	(79,836,000)
Cash flows from financing activities		
Net increase (decrease) in demand, savings, and money market accounts	(100,623,000)	25,428,000
Net increase in certificates of deposit	98,390,000	50,874,000
Net increase (decrease) in short-term borrowings	138,697,000	(21,624,000)
Advances on long-term borrowings	—	50,000,000
Repayment on long-term borrowings	(70,000,000)	(25,000,000)
Payment to repurchase common stock	(166,000)	(148,000)
Proceeds from sale of common stock	310,000	329,000
Dividends paid	(5,206,000)	(6,380,000)
Net cash provided by financing activities	61,402,000	73,479,000
Net increase in cash and cash equivalents	1,849,000	2,823,000
Cash and cash equivalents at beginning of period	19,207,000	17,366,000
Cash and cash equivalents at end of period	$21,056,000	$20,189,000
Interest paid	$8,677,000	$6,228,000

Income taxes paid	441,000	2,470,000
Non-cash transactions		
Net transfer from loans to other real estate owned	$229,000	$214,000

See Report of Independent Registered Public Accounting Firm.
The accompanying notes are an integral part of these consolidated financial statements.

Notes to Consolidated Financial Statements
The First Bancorp, Inc. and Subsidiary

Note 1 – Basis of Presentation

The First Bancorp, Inc. ("the Company") is a financial holding company that owns all of the common stock of First National Bank ("the Bank"). The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("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 footnotes required by GAAP for complete financial statements. In the opinion of Management, all adjustments (consisting of normally recurring accruals) considered necessary for a fair presentation have been included. All significant intercompany transactions and balances are eliminated in consolidation. The income reported for the 2018 period is not necessarily indicative of the results that may be expected for the year ending December 31, 2018. For further information, refer to the consolidated financial statements and notes included in the Company's annual report on Form 10-K for the year ended December 31, 2017.

Subsequent Events

Events occurring subsequent to June 30, 2018, have been evaluated as to their potential impact to the financial statements.

Note 2 – Investment Securities

The following table summarizes the amortized cost and estimated fair value of investment securities at June 30, 2018:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value (Estimated)
Securities available for sale				
Mortgage-backed securities	$306,286,000	$144,000	$(9,052,000)	$297,378,000
State and political subdivisions	4,955,000	$—	(263,000)	4,692,000
Other equity securities	2,978,000	—	—	2,978,000
	$314,219,000	$144,000	$(9,315,000)	$305,048,000
Securities to be held to maturity				
U.S. Government-sponsored agencies	$11,155,000	$—	$(584,000)	$10,571,000
Mortgage-backed securities	20,585,000	404,000	(365,000)	20,624,000
State and political subdivisions	224,037,000	1,274,000	(4,490,000)	220,821,000
Corporate securities	4,300,000	—	—	4,300,000
	$260,077,000	$1,678,000	$(5,439,000)	$256,316,000
Restricted equity securities				
Federal Home Loan Bank Stock	$11,326,000	$—	$—	$11,326,000
Federal Reserve Bank Stock	1,037,000	—	—	1,037,000
	$12,363,000	$—	$—	$12,363,000

The following table summarizes the amortized cost and estimated fair value of investment securities at December 31, 2017:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value (Estimated)
Securities available for sale				
Mortgage-backed securities	$293,689,000	$722,000	$(4,422,000)	$289,989,000
State and political subdivisions	6,860,000	16,000	(107,000)	6,769,000
Other equity securities	3,296,000	121,000	(3,000)	3,414,000
	$303,845,000	$859,000	$(4,532,000)	$300,172,000
Securities to be held to maturity				
U.S. Government-sponsored agencies	$11,155,000	$—	$(180,000)	$10,975,000
Mortgage-backed securities	23,284,000	568,000	(128,000)	23,724,000
State and political subdivisions	217,828,000	3,931,000	(1,103,000)	220,656,000
Corporate securities	4,300,000	—	—	4,300,000
	$256,567,000	$4,499,000	$(1,411,000)	$259,655,000
Restricted equity securities				
Federal Home Loan Bank Stock	$9,321,000	$—	$—	$9,321,000
Federal Reserve Bank Stock	1,037,000	—	—	1,037,000
	$10,358,000	$—	$—	$10,358,000

The following table summarizes the amortized cost and estimated fair value of investment securities at June 30, 2017:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value (Estimated)
Securities available for sale				
Mortgage-backed securities	$290,379,000	$1,381,000	$(2,769,000)	$288,991,000
State and political subdivisions	15,401,000	486,000	(59,000)	15,828,000
Other equity securities	3,266,000	65,000	(4,000)	3,327,000
	$309,046,000	$1,932,000	$(2,832,000)	$308,146,000
Securities to be held to maturity				
U.S. Government-sponsored agencies	$11,152,000	$—	$(181,000)	$10,971,000
Mortgage-backed securities	27,224,000	820,000	(41,000)	28,003,000
State and political subdivisions	201,447,000	3,573,000	(2,056,000)	202,964,000
Corporate securities	4,300,000	—	—	4,300,000
	$244,123,000	$4,393,000	$(2,278,000)	$246,238,000
Restricted equity securities				
Federal Home Loan Bank Stock	$11,274,000	$—	$—	$11,274,000
Federal Reserve Bank Stock	1,037,000	—	—	1,037,000
	$12,311,000	$—	$—	$12,311,000

The following table summarizes the contractual maturities of investment securities at June 30, 2018:

	Securities available for sale		Securities to be held to maturity	
	Amortized Cost	Fair Value (Estimated)	Amortized Cost	Fair Value (Estimated)
Due in 1 year or less	$34,000	$34,000	$1,327,000	$1,329,000
Due in 1 to 5 years	9,349,000	9,341,000	23,621,000	23,698,000
Due in 5 to 10 years	71,309,000	69,745,000	155,096,000	153,240,000
Due after 10 years	230,549,000	222,950,000	80,033,000	78,049,000
Equity securities	2,978,000	2,978,000	—	—
	$314,219,000	$305,048,000	$260,077,000	$256,316,000

The following table summarizes the contractual maturities of investment securities at December 31, 2017:

	Securities available for sale		Securities to be held to maturity	
	Amortized Cost	Fair Value (Estimated)	Amortized Cost	Fair Value (Estimated)
Due in 1 year or less	$111,000	$112,000	$635,000	$637,000
Due in 1 to 5 years	841,000	842,000	18,059,000	18,164,000
Due in 5 to 10 years	29,003,000	29,177,000	37,182,000	37,719,000
Due after 10 years	270,594,000	266,627,000	200,691,000	203,135,000
Equity securities	3,296,000	3,414,000	—	—
	$303,845,000	$300,172,000	$256,567,000	$259,655,000

The following table summarizes the contractual maturities of investment securities at June 30, 2017:

	Securities available for sale		Securities to be held to maturity	
	Amortized Cost	Fair Value (Estimated)	Amortized Cost	Fair Value (Estimated)
Due in 1 year or less	$26,000	$26,000	$707,000	$710,000
Due in 1 to 5 years	1,722,000	1,758,000	14,536,000	14,813,000
Due in 5 to 10 years	34,382,000	35,099,000	41,373,000	42,251,000
Due after 10 years	269,650,000	267,936,000	187,507,000	188,464,000
Equity securities	3,266,000	3,327,000	—	—
	$309,046,000	$308,146,000	$244,123,000	$246,238,000

At June 30, 2018, securities with a fair value of $203,196,000 were pledged to secure public deposits, repurchase agreements, and for other purposes as required by law. This compares to securities with a fair value of $231,516,000 as of December 31, 2017 and $188,448,000 at June 30, 2017, pledged for the same purposes.

Gains and losses on the sale of securities available for sale are computed by subtracting the amortized cost at the time of sale from the security's selling price, net of accrued interest to be received. The following table shows securities gains and losses for the six months and quarters ended June 30, 2018 and 2017:

	For the six months ended June 30,		For the quarter ended June 30,	
	2018	2017	2018	2017
Proceeds from sales of securities	$459,000	$3,000	$ —	$ —
Gross realized gains	136,000	3,000	—	—
Gross realized losses	—	—	—	—

Net gain	$136,000	$3,000	$ —	$ —
Related income taxes	$29,000	$1,000	$ —	$ —

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Management reviews securities with unrealized losses for other than temporary impairment. As of June 30, 2018, there were 480 securities with unrealized losses held in the Company's portfolio. These securities were temporarily impaired as a result of changes in interest rates reducing their fair value, of which 160 had been temporarily impaired for 12 months or more. At June 30, 2018, there were no material changes in the credit quality of these securities resulting in other than temporary impairment, and in Management's opinion, no additional write-down for other-than-temporary impairment is warranted. Information regarding securities temporarily impaired as of June 30, 2018 is summarized below:

	Less than 12 months		12 months or more		Total	
	Fair Value (Estimated)	Unrealized Losses	Fair Value (Estimated)	Unrealized Losses	Fair Value (Estimated)	Unrealized Losses
U.S. Government-sponsored agencies	$6,882,000	$(373,000)	$3,689,000	$(211,000)	$10,571,000	$(584,000)
Mortgage-backed securities	202,673,000	(5,660,000)	91,977,000	(3,757,000)	294,650,000	(9,417,000)
State and political subdivisions	70,674,000	(1,728,000)	36,909,000	(3,025,000)	107,583,000	(4,753,000)
	$280,229,000	$(7,761,000)	$132,575,000	$(6,993,000)	$412,804,000	$(14,754,000)

As of December 31, 2017, there were 241 securities with unrealized losses held in the Company's portfolio. These securities were temporarily impaired as a result of changes in interest rates reducing their fair value, of which 157 had been temporarily impaired for 12 months or more. Information regarding securities temporarily impaired as of December 31, 2017 is summarized below:

	Less than 12 months		12 months or more		Total	
	Fair Value (Estimated)	Unrealized Losses	Fair Value (Estimated)	Unrealized Losses	Fair Value (Estimated)	Unrealized Losses
U.S. Government-sponsored agencies	$7,161,000	$(94,000)	$3,814,000	$(86,000)	$10,975,000	$(180,000)
Mortgage-backed securities	132,025,000	(1,857,000)	101,707,000	(2,693,000)	233,732,000	(4,550,000)
State and political subdivisions	9,425,000	(149,000)	38,864,000	(1,061,000)	48,289,000	(1,210,000)
Other equity securities	—	—	9,000	(3,000)	9,000	(3,000)
	$148,611,000	$(2,100,000)	$144,394,000	$(3,843,000)	$293,005,000	$(5,943,000)

As of June 30, 2017, there were 235 securities with unrealized losses held in the Company's portfolio. These securities were temporarily impaired as a result of changes in interest rates reducing their fair value, of which 15 had been temporarily impaired for 12 months or more. Information regarding securities temporarily impaired as of June 30, 2017 is summarized below:

	Less than 12 months		12 months or more		Total	
	Fair Value (Estimated)	Unrealized Losses	Fair Value (Estimated)	Unrealized Losses	Fair Value (Estimated)	Unrealized Losses
U.S. Government-sponsored agencies	$7,972,000	$(181,000)	$—	$—	$7,972,000	$(181,000)
Mortgage-backed securities	170,966,000	(2,613,000)	7,643,000	(197,000)	178,609,000	(2,810,000)
State and political subdivisions	55,952,000	(2,115,000)	—	—	55,952,000	(2,115,000)
Other equity securities	69,000	(1,000)	9,000	(3,000)	78,000	(4,000)
	$234,959,000	$(4,910,000)	$7,652,000	$(200,000)	$242,611,000	$(5,110,000)

During the third quarter of 2014, the Company transferred securities with a total amortized cost of $89,780,000 with a corresponding fair value of $89,757,000 from available for sale to held to maturity. The net unrealized loss, net of taxes, on these securities at the date of the transfer was $15,000. The net unrealized holding loss at the time of transfer continues to be reported in accumulated other comprehensive income (loss), net of tax and is amortized over the remaining lives of the

securities as an adjustment of the yield. The amortization of the net unrealized loss reported in accumulated other comprehensive income (loss) will offset the effect on interest income of the discount for the transferred securities. The remaining unamortized balance of the net unrealized losses for the securities transferred from available for sale to held to maturity was $189,000 at June 30, 2018. These securities were transferred as a part of the Company's overall investment and balance sheet strategies.

The Bank is a member of the Federal Home Loan Bank ("FHLB") of Boston, a cooperatively owned wholesale bank for housing and finance in the six New England States. As a requirement of membership in the FHLB, the Bank must own a minimum required amount of FHLB stock, calculated periodically based primarily on its level of borrowings from the FHLB. The Bank uses the FHLB for a portion of its wholesale funding needs. As of June 30, 2018 and 2017, and December 31, 2017, the Bank's investment in FHLB stock totaled $11,326,000, $11,274,000 and $9,321,000, respectively. FHLB stock is a non-marketable equity security and therefore is reported at cost, which equals par value. The Company periodically evaluates its investment in FHLB stock for impairment based on, among other factors, the capital adequacy of the FHLB and its overall financial condition. No impairment losses have been recorded through June 30, 2018. The Company will continue to monitor its investment in FHLB stock.

Note 3 – Loans

The following table shows the composition of the Company's loan portfolio as of June 30, 2018 and 2017 and at December 31, 2017:

	June 30, 2018		December 31, 2017		June 30, 2017	
Commercial						
Real estate	$350,114,000	28.6 %	$323,809,000	27.8 %	$306,490,000	27.4 %
Construction	40,308,000	3.3 %	38,056,000	3.3 %	33,605,000	3.0 %
Other	184,718,000	15.1 %	181,528,000	15.6 %	173,691,000	15.5 %
Municipal	48,717,000	4.0 %	33,391,000	2.9 %	28,695,000	2.6 %
Residential						
Term	453,588,000	37.0 %	432,661,000	37.1 %	427,171,000	38.1 %
Construction	14,583,000	1.2 %	17,868,000	1.5 %	15,056,000	1.3 %
Home equity line of credit	107,666,000	8.8 %	111,302,000	9.6 %	110,328,000	9.8 %
Consumer	24,746,000	2.0 %	25,524,000	2.2 %	25,629,000	2.3 %
Total	$1,224,440,000	100.0%	$1,164,139,000	100.0%	$1,120,665,000	100.0%

Loan balances include net deferred loan costs of $6,307,000 as of June 30, 2018, $5,748,000 as of December 31, 2017, and $5,469,000 as of June 30, 2017. Pursuant to collateral agreements, qualifying first mortgage loans and commercial real estate loans, which totaled $317,053,000 at June 30, 2018, were used to collateralize borrowings from the FHLB. This compares to qualifying first mortgages loans which totaled $239,805,000 at December 31, 2017, and $249,329,000 at June 30, 2017. In addition, commercial, construction and home equity loans totaling $227,084,000 at June 30, 2018, $290,247,000 at December 31, 2017, and $294,315,000 at June 30, 2017, were used to collateralize a standby line of credit at the Federal Reserve Bank of Boston that is currently unused.

For all loan classes, loans over 30 days past due are considered delinquent. Information on the past-due status of loans by class of financing receivable as of June 30, 2018, is presented in the following table:

	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	All Past Due	Current	Total	90+ Days & Accruing
Commercial							
Real estate	$137,000	$75,000	$503,000	$715,000	$349,399,000	$350,114,000	$ —
Construction	—	—	—	—	40,308,000	40,308,000	—
Other	459,000	42,000	294,000	795,000	183,923,000	184,718,000	—
Municipal	—	—	—	—	48,717,000	48,717,000	—
Residential							
Term	531,000	2,014,000	1,730,000	4,275,000	449,313,000	453,588,000	—
Construction	—	—	—	—	14,583,000	14,583,000	—
Home equity line of credit	915,000	38,000	575,000	1,528,000	106,138,000	107,666,000	—
Consumer	70,000	37,000	18,000	125,000	24,621,000	24,746,000	3,000
Total	$2,112,000	$2,206,000	$3,120,000	$7,438,000	$1,217,002,000	$1,224,440,000	$ 3,000

Information on the past-due status of loans by class of financing receivable as of December 31, 2017, is presented in the following table:

	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	All Past Due	Current	Total	90+ Days & Accruing
Commercial							
Real estate	$574,000	$80,000	$220,000	$874,000	$322,935,000	$323,809,000	$—
Construction	—	—	—	—	38,056,000	38,056,000	—
Other	542,000	6,663,000	574,000	7,779,000	173,749,000	181,528,000	—
Municipal	—	—	—	—	33,391,000	33,391,000	—
Residential							
Term	1,031,000	4,372,000	2,256,000	7,659,000	425,002,000	432,661,000	436,000
Construction	101,000	370,000	—	471,000	17,397,000	17,868,000	—
Home equity line of credit	537,000	445,000	725,000	1,707,000	109,595,000	111,302,000	—
Consumer	159,000	18,000	9,000	186,000	25,338,000	25,524,000	9,000
Total	$2,944,000	$11,948,000	$3,784,000	$18,676,000	$1,145,463,000	$1,164,139,000	$445,000

Information on the past-due status of loans by class of financing receivable as of June 30, 2017, is presented in the following table:

	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	All Past Due	Current	Total	90+ Days & Accruing
Commercial							
Real estate	$88,000	$—	$1,387,000	$1,475,000	$305,015,000	$306,490,000	$—
Construction	—	—	—	—	33,605,000	33,605,000	—
Other	29,000	259,000	515,000	803,000	172,888,000	173,691,000	—
Municipal	—	—	—	—	28,695,000	28,695,000	—
Residential							
Term	533,000	3,343,000	1,507,000	5,383,000	421,788,000	427,171,000	—
Construction	99,000	—	—	99,000	14,957,000	15,056,000	—
	440,000	406,000	751,000	1,597,000	108,731,000	110,328,000	—

Home equity line of credit							
Consumer	282,000	118,000	29,000	429,000	25,200,000	25,629,000	29,000
Total	$1,471,000	$4,126,000	$4,189,000	$9,786,000	$1,110,879,000	$1,120,665,000	$ 29,000

For all classes, loans are placed on non-accrual status when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement or when principal and interest is 90 days or more past due unless the loan is both well secured and in the process of collection (in which case the loan may continue to accrue interest in spite of its past due status). A loan is "well secured" if it is secured (1) by collateral in the form of liens on or pledges of real or personal property, including securities, that have a realizable value sufficient to discharge the debt (including accrued interest) in full, or (2) by the guarantee of a financially responsible party. A loan is "in the process of collection" if collection of the loan is proceeding in due course either (1) through legal action, including judgment enforcement procedures, or, (2) in appropriate circumstances, through collection efforts not involving legal action which are reasonably expected to result in repayment of the debt or in its restoration to a current status in the near future.

Cash payments received on non-accrual loans, which are included in impaired loans, are applied to reduce the loan's principal balance until the remaining principal balance is deemed collectible, after which interest is recognized when collected. As a general rule, a loan may be restored to accrual status when payments are current for a substantial period of time, generally six months, and repayment of the remaining contractual amounts is expected, or when it otherwise becomes well secured and in the process of collection. Information on nonaccrual loans as of June 30, 2018 and 2017 and at December 31, 2017 is presented in the following table:

	June 30, 2018	December 31, 2017	June 30, 2017
Commercial			
Real estate	$981,000	$752,000	$1,814,000
Construction	286,000	—	—
Other	8,900,000	9,357,000	885,000
Municipal	—	—	—
Residential			
Term	3,509,000	3,778,000	3,852,000
Construction	—	—	—
Home equity line of credit	689,000	833,000	883,000
Consumer	16,000	16,000	—
Total	$14,381,000	$14,736,000	$7,434,000

Impaired loans include troubled debt restructured ("TDR") and loans placed on non-accrual. These loans are measured at the present value of expected future cash flows discounted at the loan's effective interest rate or at the fair value of the collateral if the loan is collateral dependent. If the measure of an impaired loan is lower than the recorded investment in the loan and estimated selling costs, a specific reserve is established for the difference, or, in certain situations, if the measure of an impaired loan is lower than the recorded investment in the loan and estimated selling costs, the difference is written off.

A breakdown of impaired loans by class of financing receivable as of and for the period ended June 30, 2018 is presented in the following table:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	For the six months ended June 30, 2018 Average Recorded Investment	For the six months ended June 30, 2018 Recognized Interest Income	For the quarter ended June 30, 2018 Average Recorded Investment	For the quarter ended June 30, 2018 Recognized Interest Income
With No Related Allowance							
Commercial							
Real estate	$5,438,000	$5,749,000	$—	$4,666,000	$ 110,000	$5,169,000	$ 56,000
Construction	1,027,000	1,027,000	—	789,000	21,000	837,000	11,000
Other	2,265,000	2,349,000	—	2,287,000	17,000	2,272,000	11,000
Municipal	—	—	—	—	—	—	—
Residential							
Term	9,613,000	10,808,000	—	9,671,000	151,000	9,642,000	80,000
Construction	—	—	—	—	—	—	—
Home equity line of credit	928,000	1,021,000	—	1,004,000	9,000	918,000	4,000
Consumer	16,000	29,000	—	16,000	—	16,000	—
	$19,287,000	$20,983,000	$—	$18,433,000	$ 308,000	$18,854,000	$ 162,000
With an Allowance Recorded							
Commercial							
Real estate	$3,470,000	$3,488,000	$270,000	$3,819,000	$ 67,000	$3,749,000	$ 28,000
Construction	—	—	—	—	—	—	—
Other	7,174,000	7,388,000	1,647,000	7,176,000	—	7,170,000	—
Municipal	—	—	—	—	—	—	—
Residential							
Term	2,161,000	2,378,000	286,000	2,027,000	48,000	2,086,000	24,000
Construction	—	—	—	—	—	—	—
Home equity line of credit	100,000	100,000	2,000	88,000	—	107,000	—
Consumer	—	—	—	—	—	—	—
	$12,905,000	$13,354,000	$2,205,000	$13,110,000	$ 115,000	$13,112,000	$ 52,000
Total							
Commercial							
Real estate	$8,908,000	$9,237,000	$270,000	$8,485,000	$ 177,000	$8,918,000	$ 84,000
Construction	1,027,000	1,027,000	—	789,000	21,000	837,000	11,000
Other	9,439,000	9,737,000	1,647,000	9,463,000	17,000	9,442,000	11,000
Municipal	—	—	—	—	—	—	—
Residential							
Term	11,774,000	13,186,000	286,000	11,698,000	199,000	11,728,000	104,000
Construction	—	—	—	—	—	—	—
Home equity line of credit	1,028,000	1,121,000	2,000	1,092,000	9,000	1,025,000	4,000
Consumer	16,000	29,000	—	16,000	—	16,000	—
	$32,192,000	$34,337,000	$2,205,000	$31,543,000	$ 423,000	$31,966,000	$ 214,000

Substantially all interest income recognized on impaired loans for all classes of financing receivables was recognized on a cash basis as received.

A breakdown of impaired loans by class of financing receivable as of and for the year ended December 31, 2017 is presented in the following table:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Recognized Interest Income
With No Related Allowance					
Commercial					
Real estate	$3,791,000	$3,996,000	$—	$5,124,000	$ 164,000
Construction	741,000	741,000	—	62,000	38,000
Other	2,591,000	2,671,000	—	1,908,000	36,000
Municipal	—	—	—	—	—
Residential					
Term	9,769,000	10,909,000	—	10,770,000	297,000
Construction	—	—	—	—	—
Home equity line of credit	1,115,000	1,429,000	—	1,351,000	18,000
Consumer	16,000	29,000	—	12,000	—
	$18,023,000	$19,775,000	$—	$19,227,000	$ 553,000
With an Allowance Recorded					
Commercial					
Real estate	$3,999,000	$4,116,000	$224,000	$4,460,000	$ 152,000
Construction	—	—	—	699,000	—
Other	7,327,000	7,371,000	1,309,000	2,584,000	—
Municipal	—	—	—	—	—
Residential					
Term	1,979,000	2,144,000	255,000	2,106,000	79,000
Construction	—	—	—	—	—
Home equity line of credit	64,000	67,000	24,000	32,000	—
Consumer	—	—	—	—	—
	$13,369,000	$13,698,000	$1,812,000	$9,881,000	$ 231,000
Total					
Commercial					
Real estate	$7,790,000	$8,112,000	$224,000	$9,584,000	$ 316,000
Construction	741,000	741,000	—	761,000	38,000
Other	9,918,000	10,042,000	1,309,000	4,492,000	36,000
Municipal	—	—	—	—	—
Residential					
Term	11,748,000	13,053,000	255,000	12,876,000	376,000
Construction	—	—	—	—	—
Home equity line of credit	1,179,000	1,496,000	24,000	1,383,000	18,000
Consumer	16,000	29,000	—	12,000	—
	$31,392,000	$33,473,000	$1,812,000	$29,108,000	$ 784,000

A breakdown of impaired loans by class of financing receivable as of and for the period ended June 30, 2017 is presented in the following table:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	For the six months ended June 30, 2017 Average Recorded Investment	Recognized Interest Income	For the quarter ended June 30, 2017 Average Recorded Investment	Recognized Interest Income
With No Related Allowance							
Commercial							
Real estate	$5,686,000	$6,171,000	$ —	$5,429,000	$ 94,000	$5,414,000	$ 46,000
Construction	—	—	—	—	—	—	—
Other	1,405,000	1,449,000	—	1,507,000	19,000	1,418,000	12,000
Municipal	—	—	—	—	—	—	—
Residential							
Term	11,065,000	12,152,000	—	11,343,000	161,000	11,283,000	73,000
Construction	—	—	—	—	—	—	—
Home equity line of credit	1,380,000	1,731,000	—	1,387,000	14,000	1,397,000	7,000
Consumer	—	—	—	—	—	—	—
	$19,536,000	$21,503,000	$ —	$19,666,000	$ 288,000	$19,512,000	$ 138,000
With an Allowance Recorded							
Commercial							
Real estate	$4,167,000	$4,356,000	$ 221,000	$4,644,000	$ 85,000	$4,549,000	$ 43,000
Construction	763,000	763,000	103,000	763,000	18,000	763,000	9,000
Other	228,000	268,000	36,000	177,000	6,000	230,000	4,000
Municipal	—	—	—	—	—	—	—
Residential							
Term	1,925,000	2,067,000	209,000	1,971,000	41,000	1,864,000	21,000
Construction	—	—	—	—	—	—	—
Home equity line of credit	25,000	27,000	25,000	26,000	—	25,000	—
Consumer	—	—	—	—	—	—	—
	$7,108,000	$7,481,000	$ 594,000	$7,581,000	$ 150,000	$7,431,000	$ 77,000
Total							
Commercial							
Real estate	$9,853,000	$10,527,000	$ 221,000	$10,073,000	$ 179,000	$9,963,000	$ 89,000
Construction	763,000	763,000	103,000	763,000	18,000	763,000	9,000
Other	1,633,000	1,717,000	36,000	1,684,000	25,000	1,648,000	16,000
Municipal	—	—	—	—	—	—	—
Residential							
Term	12,990,000	14,219,000	209,000	13,314,000	202,000	13,147,000	94,000
Construction	—	—	—	—	—	—	—
Home equity line of credit	1,405,000	1,758,000	25,000	1,413,000	14,000	1,422,000	7,000
Consumer	—	—	—	—	—	—	—
	$26,644,000	$28,984,000	$ 594,000	$27,247,000	$ 438,000	$26,943,000	$ 215,000

Troubled Debt Restructured

A "TDR" constitutes a restructuring of debt if the Company, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower that it would not otherwise consider. To determine whether or not a loan should be classified as a TDR, Management evaluates a loan based upon the following criteria:

- The borrower demonstrates financial difficulty; common indicators include past due status with bank obligations, substandard credit bureau reports, or an inability to refinance with another lender, and
- The Company has granted a concession; common concession types include maturity date extension, interest rate adjustments to below market pricing, and deferment of payments.

As of June 30, 2018, the Company had 72 loans with a balance of $25,606,000 that have been classified as TDRs. This compares to 62 loans with a balance of $17,801,000 and 68 loans with a balance of $20,301,000 classified as TDRs as of December 31, 2017 and June 30, 2017, respectively. The impairment carried as a specific reserve in the allowance for loan losses is calculated by present valuing the expected cash flows on the loan at the original interest rate, or, for collateral-dependent loans, using the fair value of the collateral less costs to sell.

The following table shows TDRs by class and the specific reserve as of June 30, 2018:

	Number of Loans	Balance	Specific Reserves
Commercial			
Real estate	15	$8,026,000	$143,000
Construction	1	741,000	—
Other	5	7,071,000	1,100,000
Municipal	—	—	—
Residential			
Term	48	9,263,000	287,000
Construction	—	—	—
Home equity line of credit	3	505,000	—
Consumer	—	—	—
	72	$25,606,000	$1,530,000

The following table shows TDRs by class and the specific reserve as of December 31, 2017:

	Number of Loans	Balance	Specific Reserves
Commercial			
Real estate	8	$7,038,000	$90,000
Construction	1	741,000	—
Other	4	561,000	—
Municipal	—	—	—
Residential			
Term	46	8,948,000	233,000
Construction	—	—	—
Home equity line of credit	3	513,000	—
Consumer	—	—	—
	62	$17,801,000	$323,000

The following table shows TDRs by class and the specific reserve as of June 30, 2017:

	Number of Loans	Balance	Specific Reserves
Commercial			
Real estate	9	$8,040,000	$93,000
Construction	1	763,000	103,000
Other	5	749,000	1,000
Municipal	—	—	—
Residential			
Term	50	10,227,000	209,000
Construction	—	—	—
Home equity line of credit	3	522,000	—
Consumer	—	—	—
	68	$20,301,000	$406,000

As of June 30, 2018, eight of the loans classified as TDRs with a total balance of $893,000 were more than 30 days past due. None of these loans had been placed on TDR status in the previous 12 months. The following table shows these TDRs by class and the associated specific reserves included in the allowance for loan losses as of June 30, 2018:

	Number of Loans	Balance	Specific Reserves
Commercial			
Real estate	—	$—	$—
Construction	—	—	—
Other	—	—	—
Municipal	—	—	—
Residential			
Term	7	726,000	33,000
Construction	—	—	—
Home equity line of credit	1	167,000	—
Consumer	—	—	—
	8	$893,000	$33,000

As of June 30, 2017, 10 of the loans classified as TDRs with a total balance of $1,336,000 were more than 30 days past due. Of these loans, none had been placed on TDR status in the previous 12 months. The following table shows these TDRs by class and the associated specific reserves included in the allowance for loan losses as of June 30, 2017:

	Number of Loans	Balance	Specific Reserves
Commercial			
Real estate	—	$—	$—
Construction	—	—	—
Other	—	—	—
Municipal	—	—	—
Residential			
Term	9	1,169,000	10,000
Construction	—	—	—
Home equity line of credit	1	167,000	—
Consumer	—	—	—
	10	$1,336,000	$10,000

For the six months ended June 30, 2018, 10 loans were placed on TDR status. The following table shows these TDRs by class and the associated specific reserves included in the allowance for loan losses as of June 30, 2018:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Specific Reserves
Commercial				
Real estate	7	$ 1,056,000	$ 1,056,000	$42,000
Construction	—	—	—	—
Other	1	6,727,000	6,532,000	1,100,000
Municipal	—	—	—	—
Residential				
Term	2	441,000	436,000	26,000
Construction	—	—	—	—
Home equity line of credit	—	—	—	—
Consumer	—	—	—	—
	10	$ 8,224,000	$ 8,024,000	$1,168,000

For the quarter ended June 30, 2018, three loans were placed on TDR status. The following table shows these TDRs by class and the associated specific reserves included in the allowance for loan losses as of June 30, 2018:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Specific Reserves
Commercial				
Real estate	—	$ —	$ —	$—
Construction	—	—	—	—
Other	1	6,727,000	6,532,000	1,100,000
Municipal	—	—	—	—
Residential				
Term	2	441,000	436,000	26,000
Construction	—	—	—	—
Home equity line of credit	—	—	—	—
Consumer	—	—	—	—
	3	$ 7,168,000	$ 6,968,000	$1,126,000

For the six months and quarter ended June 30, 2017, no loans were placed on TDR status.
As of June 30, 2018, Management is aware of four loans classified as TDRs that are involved in bankruptcy with an outstanding balance of $681,000. There were also twelve loans with an outstanding balance of $7,795,000 that were classified as TDRs and on non-accrual status, of which four loans with an outstanding balance of $504,000 were in the process of foreclosure.

Residential Mortgage Loans in Process of Foreclosure

As of June 30, 2018, there were 14 mortgage loans collateralized by residential real estate in the process of foreclosure with a total balance of $1,524,000. This compares to 12 mortgage loans collateralized by residential real estate in the process of foreclosure with a total balance of $1,919,000 as of June 30, 2017.

Note 4. Allowance for Loan Losses

The Company provides for loan losses through the establishment of an allowance for loan losses which represents an estimated reserve for existing losses in the loan portfolio. A systematic methodology is used for determining the allowance that includes a quarterly review process, risk rating changes, and adjustments to the allowance. The loan portfolio is classified in eight classes and credit risk is evaluated separately in each class. Major risk characteristics relevant to each portfolio segment are as follows:

Commercial Real Estate - Commercial real estate loans are impacted by factors such as competitive market forces, vacancy rates, cap rates, net operating incomes, lease renewals and overall economic demand. In addition, loans in the recreational and tourism sector can be affected by weather conditions, such as unseasonably low winter snowfalls. Commercial real estate lending also carries a higher degree of environmental risk than other real estate lending.

Commercial Construction - Commercial construction loans are impacted by factors similar to those for commercial real estate loans in addition to risks related to contractor financial capacity and ability to complete a project within acceptable time frames and within budget.

Commercial Other - A weakened economy, soft consumer spending, and the rising cost of labor or raw materials are examples of issues that can impact the credit quality in this segment.

Municipal Loans - The overall health of the economy, including unemployment rates and housing prices, has an impact on the credit quality of this segment.

Residential Real Estate Term - The overall health of the economy, including unemployment rates and housing prices, has an impact on the credit quality of this segment.

Residential Real Estate Construction - Residential construction are impacted by factors similar to those for residential real estate term in addition to risks related to contractor financial capacity and ability to complete a project within acceptable time frames and within budget.

Home Equity Line of Credit - The overall health of the economy, including unemployment rates and housing prices, has an impact on the credit quality of this segment.
Consumer -The overall health of the economy, including unemployment rates, has an impact on the credit quality of this segment.
The appropriate level of the allowance is evaluated continually based on a review of significant loans, with a particular emphasis on nonaccruing, past due, and other loans that may require special attention. Other factors include general conditions in local and

national economies; loan portfolio composition and asset quality indicators; and internal factors such as changes in underwriting policies, credit administration practices, experience, ability and depth of lending management, among others. The allowance consists of four elements: (1) specific reserves for loans evaluated individually for impairment; (2) general reserves for each portfolio segment based on historical loan loss experience, (3) qualitative reserves judgmentally adjusted for local and national economic conditions, concentrations, portfolio composition, volume and severity of delinquencies and nonaccrual loans, trends of criticized and classified loans, changes in credit policies and underwriting standards, credit administration practices, and other factors as applicable for each portfolio segment; and (4) unallocated reserves. All outstanding loans are considered in evaluating the appropriateness of the allowance.
A breakdown of the allowance for loan losses as of June 30, 2018, December 31, 2017, and June 30, 2017, by class of financing receivable and allowance element, is presented in the following tables:

As of June 30, 2018	Specific Reserves on Loans Evaluated Individually for Impairment	General Reserves on Loans Based on Historical Loss Experience	Reserves for Qualitative Factors	Unallocated Reserves	Total Reserves
Commercial					
Real estate	$ 270,000	$ 1,067,000	$ 2,395,000	$ —	$ 3,732,000
Construction	—	123,000	276,000	—	399,000
Other	1,647,000	563,000	1,265,000	—	3,475,000
Municipal	—	—	21,000	—	21,000
Residential					
Term	286,000	311,000	541,000	—	1,138,000
Construction	—	10,000	19,000	—	29,000
Home equity line of credit	2,000	287,000	389,000	—	678,000
Consumer	—	269,000	306,000	—	575,000
Unallocated	—	—	—	1,425,000	1,425,000
	$ 2,205,000	$ 2,630,000	$ 5,212,000	$ 1,425,000	$ 11,472,000

As of December 31, 2017	Specific Reserves on Loans Evaluated Individually for Impairment	General Reserves on Loans Based on Historical Loss Experience	Reserves for Qualitative Factors	Unallocated Reserves	Total Reserves
Commercial					
Real estate	$ 224,000	$ 1,285,000	$ 2,363,000	$ —	$ 3,872,000
Construction	—	153,000	281,000	—	434,000
Other	1,309,000	723,000	1,326,000	—	3,358,000
Municipal	—	—	20,000	—	20,000
Residential					
Term	255,000	311,000	564,000	—	1,130,000
Construction	—	13,000	23,000	—	36,000
Home equity line of credit	24,000	297,000	371,000	—	692,000
Consumer	—	251,000	294,000	—	545,000
Unallocated	—	—	—	642,000	642,000
	$ 1,812,000	$ 3,033,000	$ 5,242,000	$ 642,000	$ 10,729,000

As of June 30, 2017	Specific Reserves on Loans Evaluated Individually for Impairment	General Reserves on Loans Based on Historical Loss Experience	Reserves for Qualitative Factors	Unallocated Reserves	Total Reserves
Commercial					
Real estate	$ 221,000	$1,467,000	$2,308,000	$—	$3,996,000
Construction	103,000	161,000	253,000	—	517,000
Other	36,000	829,000	1,306,000	—	2,171,000
Municipal	—	—	19,000	—	19,000
Residential					
Term	209,000	249,000	541,000	—	999,000
Construction	—	8,000	18,000	—	26,000
Home equity line of credit	25,000	300,000	359,000	—	684,000
Consumer	—	245,000	284,000	—	529,000
Unallocated	—	—	—	1,670,000	1,670,000
	$ 594,000	$3,259,000	$5,088,000	$1,670,000	$10,611,000

Qualitative adjustment factors are taken into consideration when determining reserve estimates. These adjustment factors are based upon Management's evaluation of various current conditions, including those listed below.

- General economic conditions.
- Credit quality trends with emphasis on loan delinquencies, nonaccrual levels and classified loans.
- Recent loss experience in particular segments of the portfolio.
- Loan volumes and concentrations, including changes in mix.
- Other factors, including changes in quality of the loan origination; loan policy changes; changes in credit risk management processes; Bank regulatory and external loan review examination results.

The qualitative portion of the allowance for loan losses was 0.43% of related loans as of June 30, 2018, compared to 0.45% of related loans as of December 31, 2017. The qualitative portion declined nominally, or $30,000 between December 31, 2017 and June 30, 2018 due to a mix of factors.

The unallocated component of the allowance totaled $1,425,000 at June 30, 2018, or 12.4% of the total reserve. This compares to $642,000 or 6.0% as of December 31, 2017. The change supported general imprecision related to portfolio growth.

The allowance for loan losses as a percent of total loans stood at 0.94% as of June 30, 2018, compared to 0.92% as of December 31, 2017 and 0.95% as of June 30, 2017.

Commercial loans are comprised of three major classes, commercial real estate loans, commercial construction loans and other commercial loans.

Commercial real estate loans consist of mortgage loans to finance investments in real property such as multi-family residential, commercial/retail, office, industrial, hotels, educational and other specific or mixed use properties. Commercial real estate loans are typically written with amortizing payment structures. Collateral values are determined based on appraisals and evaluations in accordance with established policy and regulatory guidelines. Commercial real estate loans typically have a loan-to-value ratio of up to 80% based upon current valuation information at the time the loan is made. Commercial real estate loans are primarily paid by the cash flow generated from the real property, such as operating leases, rents, or other operating cash flows from the borrower.

Commercial construction loans consist of loans to finance construction in a mix of owner- and non-owner occupied commercial real estate properties. Commercial construction loans typically have maturities of less than two years. Payment structures during the construction period are typically on an interest only basis, although principal payments may be established depending on the type of construction project being financed. During the construction phase, commercial construction loans are primarily paid by cash flow generated from the construction project or other operating cash flows from the borrower or guarantors, if applicable. At the end of the construction period, loan repayment typically comes from a third party source in the event that the Company will not be providing permanent term financing. Collateral valuation and loan-to-value guidelines follow those for commercial real estate loans.

Other commercial loans consist of revolving and term loan obligations extended to business and corporate enterprises for the purpose of financing working capital and or capital investment. Collateral generally consists of pledges of business assets including, but not limited to, accounts receivable, inventory, plant and equipment, and/or real estate, if applicable. Commercial loans are primarily paid by the operating cash flow of the borrower. Commercial loans may be secured or unsecured.

Municipal loans are comprised of loans to municipalities in Maine for capitalized expenditures, construction projects or tax anticipation notes. All municipal loans are considered general obligations of the municipality and are collateralized by the taxing ability of the municipality for repayment of debt.

Residential loans are comprised of two classes: term loans and construction loans.

Residential term loans consist of residential real estate loans held in the Company's loan portfolio made to borrowers who demonstrate the ability to make scheduled payments with full consideration to underwriting factors. Borrower qualifications include favorable credit history combined with supportive income requirements and loan-to-value ratios within established policy and regulatory guidelines. Collateral values are determined based on appraisals and evaluations in accordance with established policy and regulatory guidelines. Residential loans typically have a loan-to-value ratio of up to 80% based on appraisal information at the time the loan is made. Collateral consists of mortgage liens on one- to four-family residential properties. Loans are offered with fixed or adjustable rates with amortization terms of up to thirty years.

Residential construction loans typically consist of loans for the purpose of constructing single family residences to be owned and occupied by the borrower. Borrower qualifications include favorable credit history combined with supportive income requirements and loan-to-value ratios within established policy and regulatory guidelines. Residential construction loans normally have construction terms of one year or less and payment during the construction term is typically on an interest only basis from sources including interest reserves, borrower liquidity and/or income. Residential construction loans will typically convert to permanent financing from the Company or have another financing commitment in place from an acceptable mortgage lender. Collateral valuation and loan-to-value guidelines are consistent with those for residential term loans.

Home equity lines of credit are made to qualified individuals and are secured by senior or junior mortgage liens on owner occupied one- to four-family homes, condominiums, or vacation homes. The home equity line of credit typically has a variable interest rate and is billed as interest-only payments during the draw period. At the end of the draw period, the home equity line of credit is billed as a percentage of the principal balance plus all accrued interest. Loan maturities are normally 300 months. Borrower qualifications include favorable credit history combined with supportive income requirements and combined loan-to- value ratios usually not exceeding 80% inclusive of priority liens. Collateral valuation guidelines follow those for residential real state loans.

Consumer loan products including personal lines of credit and amortizing loans made to qualified individuals for various purposes such as auto, recreational vehicles, debt consolidation, personal expenses or overdraft protection. Borrower qualifications include favorable credit history combined with supportive income and collateral requirements within established policy guidelines. Consumer loans may be secured or unsecured.

Construction, land and land development loans, both commercial and residential, comprise a small portion of the portfolio, and at 32.5% of capital are below the regulatory guidance limit of 100.0% of capital at June 30, 2018. Construction loans and non-owner-occupied commercial real estate loans are at 129.9% of total capital, below the regulatory limit of 300.0% of capital at June 30, 2018.

The process of establishing the allowance with respect to the commercial loan portfolio begins when a Loan Officer or Senior Officer (or designate) initially assigns each loan a risk rating, using established credit criteria. Approximately 60% of a trailing four quarter average gross commercial portfolio is subject to review and validation annually by an independent consulting firm. Additionally, commercial loan relationships with exposure greater than or equal to $500,000 and lines of credit greater than $250,000 are subject to review annually by the Company's internal credit review function. The methodology employs Management's judgment as to the level of losses on existing loans based on internal review of the loan portfolio, including an analysis of a borrower's current financial position, and the consideration of current and anticipated economic conditions and their potential effects on specific borrowers and or lines of business.

In determining the Company's ability to collect certain loans, Management also considers the fair value of underlying collateral. The risk rating system has eight levels, defined as follows:

1 Strong
Credits rated "1" are characterized by borrowers fully responsible for the credit with excellent capacity to pay principal and interest. Loans rated "1" may be secured with acceptable forms of liquid collateral.
2 Above Average
Credits rated "2" are characterized by borrowers that have better than average liquidity, capitalization, earnings and/or cash flow with a consistent record of solid financial performance.
3 Satisfactory
Credits rated "3" are characterized by borrowers with favorable liquidity, profitability and financial condition with adequate cash flow to pay debt service.
4 Average
Credits rated "4" are characterized by borrowers that present risk more than 1, 2 and 3 rated loans and merit an ordinary level of ongoing monitoring. Financial condition is on par or somewhat below industry averages while cash flow is generally adequate to meet debt service requirements.
5 Watch
Credits rated "5" are characterized by borrowers that warrant greater monitoring due to financial condition or unresolved and identified risk factors.
6 Other Assets Especially Mentioned (OAEM)
Loans in this category are currently protected but are potentially weak and constitute an undue and unwarranted credit risk, but not to the point of justifying a classification of substandard. OAEM have potential weaknesses which may, if not checked or corrected, weaken the asset or inadequately protect the Company's credit position at some future date.
7 Substandard
Loans in this category are inadequately protected by the paying capacity of the borrower or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Substandard loans are characterized by the distinct possibility that the Company may sustain some loss if the deficiencies are not corrected.
8 Doubtful
Loans classified "Doubtful" have the same weaknesses as those classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, based on currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is high, but because of certain important and reasonably specific pending factors which may work to the advantage and strengthening of the asset, its classification as an estimated loss is deferred until its more exact status may be determined.
The following table summarizes the risk ratings for the Company's commercial real estate, commercial construction, commercial other, and municipal loans as of June 30, 2018:

	Commercial Real Estate	Commercial Construction	Commercial Other	Municipal Loans	All Risk-Rated Loans
1 Strong	$—	$—	$1,404,000	$—	$1,404,000
2 Above Average	12,404,000	39,000	5,500,000	44,997,000	62,940,000
3 Satisfactory	73,164,000	3,027,000	40,950,000	603,000	117,744,000
4 Average	195,119,000	18,081,000	81,255,000	3,117,000	297,572,000
5 Watch	50,088,000	18,875,000	38,705,000	—	107,668,000
6 OAEM	1,410,000	—	1,373,000	—	2,783,000
7 Substandard	17,806,000	286,000	15,531,000	—	33,623,000
8 Doubtful	123,000	—	—	—	123,000
Total	$350,114,000	$40,308,000	$184,718,000	$48,717,000	$623,857,000

The following table summarizes the risk ratings for the Company's commercial real estate, commercial construction, commercial other, and municipal loans as of December 31, 2017:

	Commercial Real Estate	Commercial Construction	Commercial Other	Municipal Loans	All Risk-Rated Loans
1 Strong	$—	$—	$1,586,000	$—	$1,586,000
2 Above Average	12,534,000	40,000	5,776,000	32,673,000	51,023,000
3 Satisfactory	73,899,000	2,856,000	38,151,000	718,000	115,624,000
4 Average	173,956,000	22,446,000	84,360,000	—	280,762,000
5 Watch	41,652,000	12,714,000	33,934,000	—	88,300,000
6 OAEM	3,442,000	—	2,765,000	—	6,207,000
7 Substandard	18,203,000	—	14,956,000	—	33,159,000
8 Doubtful	123,000	—	—	—	123,000
Total	$323,809,000	$38,056,000	$181,528,000	$33,391,000	$576,784,000

The following table summarizes the risk ratings for the Company's commercial real estate, commercial construction, commercial other, and municipal loans as of June 30, 2017:

	Commercial Real Estate	Commercial Construction	Commercial Other	Municipal Loans	All Risk-Rated Loans
1 Strong	$2,000	$—	$1,004,000	$—	$1,006,000
2 Above Average	13,737,000	45,000	7,700,000	27,895,000	49,377,000
3 Satisfactory	84,550,000	2,827,000	52,024,000	800,000	140,201,000
4 Average	140,826,000	20,849,000	80,537,000	—	242,212,000
5 Watch	46,158,000	9,884,000	16,402,000	—	72,444,000
6 OAEM	3,283,000	—	3,920,000	—	7,203,000
7 Substandard	17,811,000	—	12,104,000	—	29,915,000
8 Doubtful	123,000	—	—	—	123,000
Total	$306,490,000	$33,605,000	$173,691,000	$28,695,000	$542,481,000

Commercial loans are generally charged off when all or a portion of the principal amount is determined to be uncollectible. This determination is based on circumstances specific to a borrower including repayment ability, analysis of collateral and other factors as applicable.

Residential loans are comprised of two classes: term loans, which include traditional amortizing home mortgages, and construction loans, which include loans for owner-occupied residential construction. Residential loans typically have a 75% to 80% loan to value based upon current appraisal information at the time the loan is made. Home equity loans and lines of credit are typically written to the same underwriting standards. Consumer loans are primarily amortizing loans to individuals collateralized by automobiles, pleasure craft and recreation vehicles, typically with a maximum loan to value of 80% to 90% of the purchase price of the collateral. Consumer loans also include a small amount of unsecured short-term time notes to individuals.

Residential loans, consumer loans and home equity lines of credit are segregated into homogeneous pools with similar risk characteristics. Trends and current conditions are analyzed and historical loss experience is adjusted accordingly. Quantitative and qualitative adjustment factors for these segments are consistent with those for the commercial and municipal classes. Certain loans in the residential, home equity lines of credit and consumer classes identified as having the potential for further deterioration are analyzed individually to confirm impairment status, and to determine the need for a specific reserve; however there is no formal rating system used for these classes. Consumer loans greater than 120 days past due are generally charged off. Residential loans 90 days or more past due are placed on non-accrual status unless the loans are both well secured and in the process of collection. One- to four-family residential real estate loans and home equity loans are written down or charged-off no later than 180 days past due, or for residential real estate secured loans having a borrower in bankruptcy, within 60 days of receipt of notification of filing from the bankruptcy court, whichever is sooner. This is subject to completion of a current assessment of the value of the collateral with any outstanding loan balance in excess of the fair value of the property, less costs to sell, written down or charged-off.

There were no changes to the Company's accounting policies or methodology used to estimate the allowance for loan losses during the six months ended June 30, 2018.

The following table presents allowance for loan losses activity by class for the six months and quarter ended June 30, 2018, and allowance for loan loss balances by class and related loan balances by class as of June 30, 2018:

	Commercial			Municipal	Residential		Home Equity Line of Credit	Consumer
	Real Estate	Construction	Other		Term	Construction		
For the six months ended June 30, 2018								
Beginning balance	$3,872,000	$434,000	$3,358,000	$20,000	$1,130,000	$36,000	$692,000	$545,000
Charge offs	—	—	17,000	—	96,000	—	115,000	145,000
Recoveries	—	—	10,000	—	42,000	—	13,000	51,000
Provision (credit)	(140,000)	(35,000)	124,000	1,000	62,000	(7,000)	88,000	124,000
Ending balance	$3,732,000	$399,000	$3,475,000	$21,000	$1,138,000	$29,000	$678,000	$575,000
For the three months ended June 30, 2018								
Beginning balance	$3,732,000	$396,000	$3,540,000	$21,000	$1,129,000	$31,000	$716,000	$581,000
Charge offs	—	—	—	—	15,000	—	—	40,000
Recoveries	—	—	4,000	—	38,000	—	2,000	26,000
Provision (credit)	—	3,000	(69,000)	—	(14,000)	(2,000)	(40,000)	8,000
Ending balance	$3,732,000	$399,000	$3,475,000	$21,000	$1,138,000	$29,000	$678,000	$575,000
Allowance for loan losses as of June 30, 2018								
Ending balance specifically evaluated for impairment	$270,000	$—	$1,647,000	$—	$286,000	$—	$2,000	$—
Ending balance collectively evaluated for impairment	$3,462,000	$399,000	$1,828,000	$21,000	$852,000	$29,000	$676,000	$575,000
Related loan balances as of June 30, 2018								
Ending balance	$350,114,000	$40,308,000	$184,718,000	$48,717,000	$453,588,000	$14,583,000	$107,666,000	$24,746,000
Ending balance specifically evaluated for impairment	$8,908,000	$1,027,000	$9,439,000	$—	$11,774,000	$—	$1,028,000	$16,000
Ending balance collectively evaluated	$341,206,000	$39,281,000	$175,279,000	$48,717,000	$441,814,000	$14,583,000	$106,638,000	$24,730,000

for
impairment

The following table presents allowance for loan losses activity by class for the year ended December 31, 2017 and allowance for loan loss balances by class and related loan balances by class as of December 31, 2017:

	Commercial			Municipal	Residential		Home Equity Line of Credit	Consumer	Una
	Real Estate	Construction	Other		Term	Construction			
Beginning balance	$3,988,000	$396,000	$1,780,000	$18,000	$1,288,000	$44,000	$807,000	$559,000	$1,
Charge offs	587,000	—	212,000	—	456,000	—	28,000	335,000	—
Recoveries	—	—	49,000	—	40,000	—	11,000	109,000	—
Provision (credit)	471,000	38,000	1,741,000	2,000	258,000	(8,000)	(98,000)	212,000	(61
Ending balance	$3,872,000	$434,000	$3,358,000	$20,000	$1,130,000	$36,000	$692,000	$545,000	$64
Ending balance specifically evaluated for impairment	$224,000	$—	$1,309,000	$—	$255,000	$—	$24,000	$—	$—
Ending balance collectively evaluated for impairment	$3,648,000	$434,000	$2,049,000	$20,000	$875,000	$36,000	$668,000	$545,000	$64
Ending balance	$323,809,000	$38,056,000	$181,528,000	$33,391,000	$432,661,000	$17,868,000	$111,302,000	$25,524,000	$—
Ending balance specifically evaluated for impairment	$7,790,000	$741,000	$9,918,000	$—	$11,748,000	$—	$1,179,000	$16,000	$—
Ending balance collectively evaluated for impairment	$316,019,000	$37,315,000	$171,610,000	$33,391,000	$420,913,000	$17,868,000	$110,123,000	$25,508,000	$—

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The following table presents allowance for loan losses activity by class for the six months and quarter ended June 30, 2017, and allowance for loan loss balances by class and related loan balances by class as of June 30, 2017:

	Commercial			Municipal	Residential		Home Equity Line of Credit	Consumer	U
	Real Estate	Construction	Other		Term	Construction			
For the six months ended June 30, 2017									
Beginning balance	$3,988,000	$396,000	$1,780,000	$18,000	$1,288,000	$44,000	$807,000	$559,000	$
Charge offs	305,000	—	58,000	—	70,000	—	28,000	156,000	—
Recoveries	—	—	18,000	—	19,000	—	3,000	50,000	—
Provision (credit)	313,000	121,000	431,000	1,000	(238,000)	(18,000)	(98,000)	76,000	4
Ending balance	$3,996,000	$517,000	$2,171,000	$19,000	$999,000	$26,000	$684,000	$529,000	$
For the three months ended June 30, 2017									
Beginning balance	$4,015,000	$441,000	$1,925,000	$18,000	$969,000	$24,000	$811,000	$573,000	$
Charge offs	141,000	—	58,000	—	17,000	—	21,000	53,000	—
Recoveries	—	—	7,000	—	5,000	—	3,000	19,000	—
Provision (credit)	122,000	76,000	297,000	1,000	42,000	2,000	(109,000)	(10,000)	79
Ending balance	$3,996,000	$517,000	$2,171,000	$19,000	$999,000	$26,000	$684,000	$529,000	$
Allowance for loan losses as of June 30, 2017									
Ending balance specifically evaluated for impairment	$221,000	$103,000	$36,000	$—	$209,000	$—	$25,000	$—	$-
Ending balance collectively evaluated for impairment	$3,775,000	$414,000	$2,135,000	$19,000	$790,000	$26,000	$659,000	$529,000	$
Related loan balances as of June 30, 2017									
Ending balance	$306,490,000	$33,605,000	$173,691,000	$28,695,000	$427,171,000	$15,056,000	$110,328,000	$25,629,000	$-
Ending balance specifically evaluated for impairment	$9,853,000	$763,000	$1,633,000	$—	$12,990,000	$—	$1,405,000	$—	$-
Ending balance collectively	$296,637,000	$32,842,000	$172,058,000	$28,695,000	$414,181,000	$15,056,000	$108,923,000	$25,629,000	$-

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Note 5 – Stock-Based Compensation

At the 2010 Annual Meeting, shareholders approved the 2010 Equity Incentive Plan (the "2010 Plan"). This reserves 400,000 shares of common stock for issuance in connection with stock options, restricted stock awards and other equity based awards to attract and retain the best available personnel, provide additional incentive to officers, employees and non-employee Directors and promote the success of our business. Such grants and awards will be structured in a manner that does not encourage the recipients to expose the Company to undue or inappropriate risk. Options issued under the 2010 Plan will qualify for treatment as incentive stock options for purposes of Section 422 of the Internal Revenue Code. Other compensation under the 2010 Plan will qualify as performance-based for purposes of Section 162(m) of the Internal Revenue Code, and will satisfy NASDAQ guidelines relating to equity compensation.

As of June 30, 2018, 144,355 shares of restricted stock had been granted under the 2010 Plan, of which 67,689 shares remain restricted as of June 30, 2018 as detailed in the following table:

Year Granted	Vesting Term (In Years)	Shares	Remaining Term (In Years)
2014	5.0	10,422	0.6
2015	5.0	12,023	1.6
2016	5.0	15,015	2.5
2017	3.0	4,902	1.6
2017	5.0	9,972	3.5
2018	1.0	300	0.6
2018	2.0	932	1.5
2018	3.0	2,400	2.6
2018	4.0	2,068	3.5
2018	5.0	9,655	4.5
		67,689	2.3

The compensation cost related to these restricted stock grants is $1,489,000 and is recognized over the vesting terms of each grant. In the six months ended June 30, 2018, $190,000 of expense was recognized for these restricted shares, leaving $869,000 in unrecognized expense as of June 30, 2018. In the six months ended June 30, 2017, $166,000 of expense was recognized for restricted shares, leaving $828,000 in unrecognized expense as of June 30, 2017.

Note 6 – Preferred and Common Stock

Preferred Stock

On January 9, 2009, the Company issued $25,000,000 in Fixed Rate Cumulative Perpetual Preferred Stock, Series A, to the U.S. Treasury ("Treasury') under the Capital Purchase Program ("the CPP Shares"). The CPP Shares qualified as Tier 1 capital on the Company's books for regulatory purposes and ranked senior to the Company's common stock and senior or at an equal level in the Company's capital structure to any other shares of preferred stock the Company may issue in the future. In three separate transactions in 2012 and 2013, the Company repurchased all of the CPP shares from the Treasury.

Incident to such issuance of the CPP shares, the Company issued to the Treasury warrants (the "Warrants") to purchase up to 225,904 shares of the Company's common stock at a price per share of $16.60 (subject to adjustment). The Warrants (and any shares of common stock issuable pursuant to the Warrants) are freely transferable by the Treasury to third parties. The Warrants have a term of ten years and could be exercised by the Treasury or a subsequent holder at any time or from time to time during their term. To the extent they had not previously been exercised, the Warrants will expire after ten years. The Warrants were unchanged as a result of the CPP Shares repurchase transactions.

In May 2015, the Treasury sold the Warrants to private parties. In accordance with the contractual terms of the Warrants, the number of shares issuable upon exercise and strike price were adjusted at the time of the sale. As a result of this transaction, the aggregate number of shares of common stock issuable under the Warrants were adjusted to 226,819 shares with a strike price of $16.53 per share. In November 2016, the Company repurchased all of the outstanding Warrants for an aggregate purchase price of $1,750,000.

Common Stock

Proceeds from sale of common stock totaled $310,000 and $329,000 for the six months ended June 30, 2018 and 2017, respectively.

Note 7 – Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share (EPS) for the six months ended June 30, 2018 and 2017:

	Income (Numerator)	Shares (Denominator)	Per-Share Amount
For the six months ended June 30, 2018			
Net income as reported	$11,240,000		
Basic EPS: Income available to common shareholders	11,240,000	10,776,680	$ 1.04
Effect of dilutive securities: restricted stock		70,443	
Diluted EPS: Income available to common shareholders plus assumed conversions	$11,240,000	10,847,123	$ 1.04
For the six months ended June 30, 2017			
Net income as reported	$9,520,000		
Basic EPS: Income available to common shareholders	9,520,000	10,740,355	$ 0.89
Effect of dilutive securities: restricted stock		72,348	
Diluted EPS: Income available to common shareholders plus assumed conversions	$9,520,000	10,812,703	$ 0.88

The following table sets forth the computation of basic diluted EPS for the quarters ended June 30, 2018 and 2017:

	Income (Numerator)	Shares (Denominator)	Per-Share Amount
For the quarter ended June 30, 2018			
Net income as reported	$5,734,000		
Basic EPS: Income available to common shareholders	5,734,000	10,779,275	$ 0.53
Effect of dilutive securities: restricted stock		70,443	
Diluted EPS: Income available to common shareholders plus assumed conversions	$5,734,000	10,849,718	$ 0.53
For the quarter ended June 30, 2017			
Net income as reported	$4,883,000		
Basic EPS: Income available to common shareholders	4,883,000	10,746,363	$ 0.45
Effect of dilutive securities: restricted stock		71,086	
Diluted EPS: Income available to common shareholders plus assumed conversions	$4,883,000	10,817,449	$ 0.45

Note 8 – Employee Benefit Plans

401(k) Plan

The Bank has a defined contribution plan available to substantially all employees who have completed 3 months of service. Employees may contribute up to Internal Revenue Service ("IRS") determined limits and the Bank may match employee contributions not to exceed 3.0% of compensation depending on contribution level. Subject to a vote of the Board of Directors, the Bank may also make a profit-sharing contribution to the Plan. Such contribution equaled 2.0% of each eligible employee's compensation in 2017. The amount for 2018 has not been established. The expense related to the 401(k) plan was $288,000 and $243,000 for the six months ended June 30, 2018 and 2017, respectively.

Deferred Compensation and Supplemental Retirement Benefits

The Bank also provides unfunded supplemental retirement benefits for certain officers, payable in installments over 20 years upon retirement or death. The agreements consist of individual contracts with differing characteristics that, when taken together, do not constitute a postretirement plan. The costs for these benefits are recognized over the service periods of the participating officers in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 712 "Compensation – Nonretirement Postemployment Benefits". The expense of these supplemental retirement benefits was $86,000 for the six months ended June 30, 2018 and $108,000 for the the same period in 2017. As of June 30, 2018, the associated accrued liability included in other liabilities in the balance sheet was $3,003,000 compared to $3,060,000 and $3,042,000 at December 31, 2017 and June 30, 2017, respectively.

Post-Retirement Benefit Plans

The Bank sponsors two post-retirement benefit plans. One plan currently provides a subsidy for health insurance premiums to certain retired employees and a future subsidy for six active employees who were age 50 and over in 1996. These subsidies are based on years of service and range between $40 and $1,200 per month per person. The other plan provides life insurance coverage to certain retired employees and health insurance for retired directors. None of these plans are pre-funded. The Company utilizes FASB ASC Topic 712 to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its balance sheet and to recognize changes in the funded status in the year in which the changes occur through comprehensive income (loss).

The following table sets forth the accumulated postretirement benefit obligation and funded status:

	At or for the six months ended June 30,	
	2018	2017
Change in benefit obligation		
Benefit obligation at beginning of year	$1,874,000	$1,870,000
Interest cost	38,000	38,000
Benefits paid	(56,000)	(64,000)
Benefit obligation at end of period	$1,856,000	$1,844,000
Funded status		
Benefit obligation at end of period	$(1,856,000)	$(1,844,000)
Unamortized loss	186,000	102,000
Accrued benefit cost at end of period	$(1,670,000)	$(1,742,000)

The following table sets forth the net periodic pension cost:

	For the six months ended June 30,		For the quarter ended June 30,	
	2018	2017	2018	2017
Components of net periodic benefit cost				
Interest cost	$38,000	$38,000	$19,000	$19,000
Net periodic benefit cost	$38,000	$38,000	$19,000	$19,000

Amounts not yet reflected in net periodic benefit cost and included in accumulated other comprehensive income (loss) are as follows:

	June 30, 2018	December 31, 2017	June 30, 2017
Unamortized net actuarial loss	$(186,000)	$(186,000)	$(156,000)
Deferred tax benefit at 21% (for June 30, 2018 and December 31, 2017) and 35% (for June 30, 2017)	39,000	39,000	54,000
	$(147,000)	$(147,000)	$(102,000)

Net unrecognized postretirement benefits included in accumulated other comprehensive income (loss)

A weighted average discount rate of 4.25% was used in determining the accumulated benefit obligation and the net periodic benefit cost. The assumed health care cost trend rate is 7.0%. The measurement date for benefit obligations was as of year-end for prior years presented. The expected benefit payments for all of 2018 are $128,000. Plan expense for 2018 is estimated to be $77,000. A 1% change in trend assumptions would create an approximate change in the same direction of $100,000 in the accumulated benefit obligation, $7,000 in the interest cost and $1,000 in the service cost.

Note 9 - Other Comprehensive Income (Loss)

The following table summarizes activity in the unrealized gain or loss on available for sale securities included in other comprehensive income (loss) for the six months and quarter ended June 30, 2018 and 2017.

	For the six months ended June 30,		For the quarter ended June 30,	
	2018	2017	2018	2017
Balance at beginning of period	$(2,901,000)	$(935,000)	$(6,210,000)	$(934,000)
Unrealized gains (losses) arising during the period	(5,363,000)	541,000	(1,311,000)	536,000
Reclassification of realized gains during the period	(136,000)	(3,000)	—	—
Related deferred taxes (at a Federal Income Tax rate of 21% for June 30, 2018 and 35% for June 30, 2017)	1,155,000	(188,000)	276,000	(187,000)
Net change	(4,344,000)	350,000	(1,035,000)	349,000
Balance at end of period	$(7,245,000)	$(585,000)	$(7,245,000)	$(585,000)

The reclassification of realized gains is included in the net securities gains line of the consolidated statements of income and comprehensive income and the tax effect is included in the income tax expense line of the same statement. The following table summarizes activity in the unrealized loss on securities transferred from available for sale to held to maturity included in other comprehensive income (loss) for the six months and quarter ended June 30, 2018 and 2017.

	For the six months ended June 30,		For the quarter ended June 30,	
	2018	2017	2018	2017
Balance at beginning of period	$(174,000)	$(129,000)	$(182,000)	$(133,000)
Amortization of net unrealized losses	(19,000)	(12,000)	(9,000)	(6,000)
Related deferred taxes (at a Federal Income Tax rate of 21% for June 30, 2018 and 35% for June 30, 2017)	4,000	4,000	2,000	2,000
Net change	(15,000)	(8,000)	(7,000)	(4,000)
Balance at end of period	$(189,000)	$(137,000)	$(189,000)	$(137,000)

The following table presents the effect of the Company's derivative financial instruments included in other comprehensive income (loss) for the six months and quarter ended June 30, 2018 and 2017.

	For the six months ended June 30,		For the quarter ended June 30,	
	2018	2017	2018	2017
Balance at beginning of period	$1,544,000	$1,163,000	$1,928,000	$1,226,000
Unrealized gains, (losses) on cash flow hedging derivatives arising during the period	661,000	(167,000)	175,000	(263,000)
Related deferred taxes (at a Federal Income Tax rate of 21% for June 30, 2018 and 35% for June 30, 2017)	(139,000)	59,000	(37,000)	92,000
Net change	522,000	(108,000)	138,000	(171,000)

Balance at end of period	$2,066,000	$1,055,000	$2,066,000	$1,055,000

The following table summarizes activity in the unrealized gain or loss on postretirement benefits included in other comprehensive income (loss) for the six months and quarter ended June 30, 2018 and 2017.

	For the six months ended June 30,		For the quarter ended June 30,	
	2018	2017	2018	2017
Unrecognized postretirement benefits at beginning of period	$(147,000)	$(102,000)	$(147,000)	$(102,000)
Amortization of unrecognized transition obligation	—	—	—	—
Change in unamortized net actuarial gain (loss)	—	—	—	—
Related deferred taxes (at a Federal Income Tax rate of 21% for June 30, 2018 and 35% for June 30, 2017)	—	—	—	—
Unrecognized postretirement benefits at end of period	$(147,000)	$(102,000)	$(147,000)	$(102,000)

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Note 10 - Financial Derivative Instruments

As part of its overall asset and liability management strategy, the Company periodically uses derivative instruments to minimize significant unplanned fluctuations in earnings and cash flows caused by interest rate volatility. The Company's interest rate risk management strategy involves modifying the re-pricing characteristics of certain assets or liabilities so that changes in interest rates do not have a significant effect on net interest income.
The Company recognizes its derivative instruments in the consolidated balance sheet at fair value. On the date the derivative instrument is entered into, the Company designates whether the derivative is part of a hedging relationship (i.e., cash flow or fair value hedge). The Company formally documents relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking hedge transactions. The Company also assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives used in hedging transactions are highly effective in offsetting the changes in cash flows or fair values of hedged items. Changes in fair value of derivative instruments that are highly effective and qualify as cash flow hedges are recorded in other comprehensive income or loss. Any ineffective portion is recorded in earnings. The Company discontinues hedge accounting when it is determined that the derivative is no longer highly effective in offsetting changes of the hedged risk on the hedged item, or management determines that the designation of the derivative as a hedging instrument is no longer appropriate.
In 2016, then again in 2018, interest rate swaps were contracted to limit the Company's exposure to rising interest rates on short-term liabilities indexed to one-month London Inter-bank Offered Rates (LIBOR). The interest rate swaps were designated as cash flow hedges.
The details of the interest rate swap agreements are as follows:

					June 30, 2018	December 31, 2017	June 30, 2017
Notional Amount	Effective Date	Maturity Date	Variable Index Received	Fixed Rate Paid	Fair Value(1)	Fair Value(1)	Fair Value(1)
$30,000,000	June 28, 2016	June 28, 2021	1-Month USD LIBOR	0.940%	$1,521,000	$1,154,000	$952,000
20,000,000	June 27, 2016	June 27, 2021	1-Month USD LIBOR	0.893%	1,041,000	801,000	671,000
25,000,000	June 5, 2018	December 5, 2019	1-Month USD LIBOR	2.466%	11,000	—	—
25,000,000	June 5, 2018	June 5, 2020	1-Month USD LIBOR	2.547%	19,000	—	—
25,000,000	June 5, 2018	December 5, 2020	1-Month USD LIBOR	2.603%	24,000	—	—
$125,000,000					$2,616,000	$1,955,000	$1,623,000

(1) Presented within other assets in the consolidated balance sheet.

The Company would reclassify unrealized gains or losses accounted for within accumulated other comprehensive income (loss) into earnings if the interest rate swaps were to become ineffective or the swaps were to terminate. In the next 12 months, the Company does not believe it will be required to reclassify any unrealized gains or losses accounted for within accumulated other comprehensive income (loss) into earnings as a result of ineffectiveness or swap termination. Amounts paid or received under the swaps are reported in interest expense in the statement of income, and in interest paid in the statement of cash flows.

Note 11 – Mortgage Servicing Rights

FASB ASC Topic 860 "Transfers and Servicing" requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable. The Company's servicing assets and servicing liabilities are reported using the amortization method and carried at the lower of amortized cost or fair value by strata. In evaluating the carrying values of mortgage servicing rights, the Company obtains third party valuations based on loan level data including note rate, type and term of the underlying loans. The model utilizes several assumptions, the most significant of which is loan prepayments, calculated using a three-months moving average of weekly prepayment data published by the Public Securities Association (PSA) and modeled against the serviced loan portfolio, and the discount rate to discount future cash flows. As of June 30, 2018, the prepayment assumption using the PSA model was 126, which translates into an anticipated prepayment rate of 7.56%. The discount rate is 9.50%. Other assumptions include delinquency rates, foreclosure rates, servicing cost inflation, and annual unit loan cost. All assumptions are adjusted periodically to reflect current circumstances. Amortization of mortgage servicing rights, as well as write-offs due to prepayments of the related mortgage loans, are recorded as a charge against mortgage servicing fee income. For the six months ended June 30, 2018 and 2017, servicing rights capitalized totaled $119,000 and $339,000, respectively. Servicing rights amortized for the six-month periods ended June 30, 2018 and 2017 were $102,000 and $274,000, respectively. The fair value of servicing rights was $2,581,000, $2,321,000 and $1,888,000 at June 30, 2018, December 31, 2017 and June 30, 2017, respectively. The Bank serviced loans for others totaling $259,105,000, $260,258,000 and $252,152,000 at June 30, 2018, December 31, 2017, and June 30, 2017, respectively.
Mortgage servicing rights are included in other assets and detailed in the following table:

	June 30, 2018	December 31, 2017	June 30, 2017
Mortgage servicing rights	$5,546,000	$5,428,000	$5,199,000
Accumulated amortization	(4,261,000)	(4,160,000)	(4,072,000)
Impairment reserve	—	—	(18,000)
	$1,285,000	$1,268,000	$1,109,000

Note 12 – Income Taxes
FASB ASC Topic 740 "Income Taxes" defines the criteria that an individual tax position must satisfy for some or all of the benefits of that position to be recognized in a company's financial statements. Topic 740 prescribes a recognition threshold of more-likely-than-not, and a measurement attribute for all tax positions taken or expected to be taken on a tax return, in order for those tax positions to be recognized in the financial statements. The Company is currently open to audit under the statute of limitations by the IRS for the years ended December 31, 2015 through 2017.

Note 13 - Certificates of Deposit
The following table represents the breakdown of certificates of deposit at June 30, 2018 and 2017, and at December 31, 2017:

	June 30, 2018	December 31, 2017	June 30, 2017
Certificates of deposit < $100,000	$400,680,000	$284,066,000	$270,875,000
Certificates $100,000 to $250,000	204,311,000	232,759,000	212,063,000
Certificates $250,000 and over	52,400,000	42,176,000	44,556,000
	$657,391,000	$559,001,000	$527,494,000

Note 14 – Reclassifications
Certain items from the prior year were reclassified in the financial statements to conform with the current year presentation. These do not have a material impact on the consolidated balance sheet or statement of income and comprehensive income presentations.

Note 15 – Fair Value
Certain assets and liabilities are recorded at fair value to provide additional insight into the Company's quality of earnings. Some of these assets and liabilities are measured on a recurring basis while others are measured on a nonrecurring basis, with the determination based upon applicable existing accounting pronouncements. For example, securities available for sale are recorded at fair value on a recurring basis. Other assets, such as, other real estate owned and impaired loans, are recorded at fair value on a nonrecurring basis using the lower of cost or market methodology to determine impairment of individual assets. The Company groups assets and liabilities which are recorded at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement (with level 1 considered highest and level 3 considered lowest). A brief description of each level follows:
Level 1 - Valuation is based upon quoted prices for identical instruments in active markets.
Level 2 - Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.
Level 3 - Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates that market participants would use in pricing the asset or liability. Valuation includes use of discounted cash flow models and similar techniques.

The fair value methods and assumptions for the Company's financial instruments and other assets measured at fair value are set forth below.

Cash, Cash Equivalents and Interest-Bearing Deposits in Other Banks
The carrying values of cash equivalents, due from banks and federal funds sold approximate their relative fair values. As such, the Company classifies these financial instruments as Level 1.

Investment Securities
The fair values of investment securities are estimated by independent providers using a market approach with observable inputs, including matrix pricing and recent transactions. In obtaining such valuation information from third parties, the Company has evaluated their valuation methodologies used to develop the fair values in order to determine whether the valuations are representative of an exit price in the Company's principal markets. The Company's principal markets for its securities portfolios are the secondary institutional markets, with an exit price that is predominantly reflective of bid level pricing in those markets. Fair values are calculated based on the value of one unit without regard to any premium or discount that may result from concentrations of ownership of a financial instrument, possible tax ramifications, or estimated transaction costs. If these considerations had been incorporated into the fair value estimates, the aggregate fair value could have been changed. The carrying values of restricted equity securities approximate fair values. As such, the Company classifies investment securities as Level 2.

Loans Held for Sale
Loans held for sale are recorded at the lower of aggregate carrying value or fair value. The fair value of mortgage loans held for sale is based on what secondary markets are currently offering for portfolios with similar characteristics. As such, the Company classifies mortgage loans held for sale as Level 2.

Loans
Fair values are estimated for portfolios of loans with similar financial characteristics. The fair values of performing loans are calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest 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 and lending conditions, and the effects of estimated prepayments. Assumptions

regarding credit risk, cash flows, and discount rates are judgmentally determined using available market information and specific borrower information. Management has made estimates of fair value using discount rates that it believes to be reasonable. However, because there is no market for many of these financial instruments, Management has no basis to determine whether the fair value presented above would be indicative of the value negotiated in an actual sale. As such, the Company classifies loans as Level 3, except for certain collateral-dependent impaired loans. Fair values of impaired loans are based on estimated cash flows and are discounted using a rate commensurate with the risk associated with the estimated cash flows, or if collateral dependent, discounted to the appraised value of the collateral as determined by reference to sale prices of similar properties, less costs to sell. As such, the Company classifies collateral dependent impaired loans for which a specific reserve results in a fair value measure as Level 2. All other impaired loans are classified as Level 3.

Other Real Estate Owned
Real estate acquired through foreclosure is initially recorded at fair value. The fair value of other real estate owned is based on property appraisals and an analysis of similar properties currently available. As such, the Company records other real estate owned as nonrecurring Level 2.

Mortgage Servicing Rights
Mortgage servicing rights represent the value associated with servicing residential mortgage loans. Servicing assets and servicing liabilities are reported using the amortization method and compared to fair value for impairment. In evaluating the fair values of mortgage servicing rights, the Company obtains third party valuations based on loan level data including note rate, type and term of the underlying loans. As such, the Company classifies mortgage servicing rights as Level 2.

Accrued Interest Receivable
The fair value estimate of this financial instrument approximates the carrying value as this financial instrument has a short maturity. It is the Company's policy to stop accruing interest on loans for which it is probable that the interest is not collectible. Therefore, this financial instrument has been adjusted for estimated credit loss. As such, the Company classifies accrued interest receivable as Level 2.

Deposits
The fair value of deposits is 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. As such, the Company classifies deposits as Level 2. The fair value estimates do not include the benefit that results from the low-cost funding provided by the deposits 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.

Borrowed Funds
The fair value of borrowed funds is based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently available for borrowings of similar remaining maturities. As such, the Company classifies borrowed funds as Level 2.

Derivatives
The fair value of interest rate swaps is determined using inputs that are observable in the market place obtained from third parties including yield curves, publicly available volatilities, and floating indexes and, accordingly, are classified as Level 2 inputs. The credit value adjustments associated with derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by the Company and its counterparties. As of June 30, 2018 and 2017, and December 31, 2017, the Company has assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and has determined that the credit valuation adjustments are not significant to the overall valuation of its derivatives due to collateral postings.

Accrued Interest Payable
The fair value estimate approximates the carrying amount as this financial instrument has a short maturity. The Company classifies accrued interest payable as Level 2.

Off-Balance-Sheet Instruments
Off-balance-sheet instruments include loan commitments. Fair values for loan commitments have not been presented as the future revenue derived from such financial instruments is not significant.

Limitations

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These values do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on Management's judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates. Fair value estimates are based on existing on- and off-balance-sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Other significant assets and liabilities that are not considered financial instruments include the deferred tax asset, premises and equipment, and other real estate owned. In addition, tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of the estimates.

Assets Recorded at Fair Value on a Recurring Basis

The following tables present the balances of assets that were measured at fair value on a recurring basis as of June 30, 2018, December 31, 2017 and June 30, 2017.

	At June 30, 2018			
	Level 1	Level 2	Level 3	Total
Securities available for sale				
Mortgage-backed securities	$—	$297,378,000	$ —	$297,378,000
State and political subdivisions	—	4,692,000	—	4,692,000
Other equity securities	—	2,978,000	—	2,978,000
Total securities available for sale	—	305,048,000	—	305,048,000
Interest rate swap agreements	—	2,616,000	—	2,616,000
Total assets	$—	$307,664,000	$ —	$307,664,000

	At December 31, 2017			
	Level 1	Level 2	Level 3	Total
Securities available for sale				
Mortgage-backed securities	$—	$289,989,000	$ —	$289,989,000
State and political subdivisions	—	6,769,000	—	6,769,000
Other equity securities	—	3,414,000	—	3,414,000
Total securities available for sale	—	300,172,000	—	300,172,000
Interest rate swap agreements	—	1,955,000	—	1,955,000
Total assets	$—	$302,127,000	$ —	$302,127,000

	At June 30, 2017			
	Level 1	Level 2	Level 3	Total
Securities available for sale				
Mortgage-backed securities	$—	$288,991,000	$ —	$288,991,000
State and political subdivisions	—	15,828,000	—	15,828,000
Other equity securities	—	3,327,000	—	3,327,000
Total securities available for sale	—	308,146,000	—	308,146,000
Interest rate swap agreements	—	1,623,000	—	1,623,000
Total assets	$—	$309,769,000	$ —	$309,769,000

Assets Recorded at Fair Value on a Non-Recurring Basis

The following tables include assets measured at fair value on a nonrecurring basis that have had a fair value adjustment since their initial recognition. Other real estate owned is presented net of an allowance of $53,000 and $39,000 at December 31, 2017, and June 30, 2017, respectively. There was no allowance at June 30, 2018. Only collateral-dependent impaired loans with a related specific allowance for loan losses or a partial charge off are included in impaired loans for purposes of fair value disclosures. Impaired loans below are presented net of specific allowances of $1,893,000, $1,531,000 and $202,000 at June 30, 2018, December 31, 2017, and June 30, 2017, respectively.

	At June 30, 2018			
	Level 1	Level 2	Level 3	Total
Other real estate owned	$—	$609,000	$ —	$609,000
Impaired loans	—	6,387,000	—	6,387,000
Total assets	$—	$6,996,000	$ —	$6,996,000

	At December 31, 2017			
	Level 1	Level 2	Level 3	Total
Other real estate owned	$—	$1,012,000	$ —	$1,012,000
Impaired loans	—	6,521,000	—	6,521,000
Total assets	$—	$7,533,000	$ —	$7,533,000

	At June 30, 2017			
	Level 1	Level 2	Level 3	Total
Other real estate owned	$—	$324,000	$ —	$324,000
Impaired loans	—	269,000	—	269,000
Total assets	$—	$593,000	$ —	$593,000

Fair Value of Financial Instruments

FASB ASC Topic 825 "Financial Instruments" requires disclosures of fair value information about financial instruments, whether or not recognized in the balance sheet, if the fair values can be reasonably determined. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques using observable inputs when available. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. Topic 825 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company.

The carrying amount and estimated fair values for financial instruments as of June 30, 2018 were as follows:

	Carrying value	Estimated fair value	Level 1	Level 2	Level 3
Financial assets					
Cash and cash equivalents	$21,056,000	$21,056,000	$21,056,000	$—	$ —
Interest bearing deposits in other banks	1,616,000	1,616,000	1,616,000	—	—
Securities available for sale	305,048,000	305,048,000	—	305,048,000	—
Securities to be held to maturity	260,077,000	256,316,000	—	256,316,000	—
Restricted equity securities	12,363,000	12,363,000	—	12,363,000	—
Loans held for sale	481,000	481,000	—	481,000	—
Loans (net of allowance for loan losses)					
Commercial					
Real estate	345,853,000	338,784,000	—	423,000	338,361,000
Construction	39,852,000	39,037,000	—	—	39,037,000
Other	180,750,000	178,904,000	—	5,527,000	173,377,000
Municipal	48,693,000	47,790,000	—	—	47,790,000
Residential					
Term	452,289,000	441,029,000	—	339,000	440,690,000
Construction	14,550,000	14,443,000	—	—	14,443,000
Home equity line of credit	106,892,000	105,264,000	—	98,000	105,166,000
Consumer	24,089,000	23,322,000	—	—	23,322,000
Total loans	1,212,968,000	1,188,573,000	—	6,387,000	1,182,186,000
Mortgage servicing rights	1,285,000	2,581,000	—	2,581,000	—
Interest rate swap agreements	2,616,000	2,616,000	—	2,616,000	—
Accrued interest receivable	7,723,000	7,723,000	—	7,723,000	—
Financial liabilities					
Demand deposits	$146,964,000	$136,167,000	$—	$136,167,000	$ —
NOW deposits	282,449,000	254,619,000	—	254,619,000	—
Money market deposits	100,378,000	93,978,000	—	93,978,000	—
Savings deposits	229,464,000	194,141,000	—	194,141,000	—
Local certificates of deposit	267,932,000	263,342,000	—	263,342,000	—
National certificates of deposit	389,459,000	389,062,000	—	389,062,000	—
Total deposits	1,416,646,000	1,331,309,000	—	1,331,309,000	—
Repurchase agreements	91,764,000	88,560,000	—	88,560,000	—
Federal Home Loan Bank advances	205,691,000	204,476,000	—	204,476,000	—
Total borrowed funds	297,455,000	293,036,000	—	293,036,000	—
Accrued interest payable	943,000	943,000	—	943,000	—

The carrying amounts and estimated fair values for financial instruments as of December 31, 2017 were as follows:

	Carrying value	Estimated fair value	Level 1	Level 2	Level 3
Financial assets					
Cash and cash equivalents	$19,207,000	$19,207,000	$19,207,000	$—	$ —
Interest bearing deposits in other banks	860,000	860,000	860,000	—	—
Securities available for sale	300,172,000	300,172,000	—	300,172,000	—
Securities to be held to maturity	256,567,000	259,655,000	—	259,655,000	—
Restricted equity securities	10,358,000	10,358,000	—	10,358,000	—
Loans held for sale	386,000	386,000	—	386,000	—
Loans (net of allowance for loan losses)					
Commercial					
Real estate	319,691,000	311,321,000	—	72,000	311,249,000
Construction	37,594,000	36,610,000	—	—	36,610,000
Other	177,956,000	175,455,000	—	6,018,000	169,437,000
Municipal	33,370,000	33,280,000	—	—	33,280,000
Residential					
Term	431,459,000	431,028,000	—	391,000	430,637,000
Construction	17,830,000	17,613,000	—	—	17,613,000
Home equity line of credit	110,566,000	109,012,000	—	40,000	108,972,000
Consumer	24,944,000	24,408,000	—	—	24,408,000
Total loans	1,153,410,000	1,138,727,000	—	6,521,000	1,132,206,000
Mortgage servicing rights	1,268,000	2,321,000	—	2,321,000	—
Interest rate swap agreements	1,955,000	1,955,000	—	1,955,000	—
Accrued interest receivable	5,867,000	5,867,000	—	5,867,000	—
Financial liabilities					
Demand deposits	$145,332,000	$139,350,000	$—	$139,350,000	$ —
NOW deposits	318,043,000	295,775,000	—	295,775,000	—
Money market deposits	163,898,000	153,497,000	—	153,497,000	—
Savings deposits	232,605,000	203,799,000	—	203,799,000	—
Local certificates of deposit	223,074,000	220,734,000	—	220,734,000	—
National certificates of deposit	335,927,000	335,775,000	—	335,775,000	—
Total deposits	1,418,879,000	1,348,930,000	—	1,348,930,000	—
Repurchase agreements	70,564,000	67,976,000	—	67,976,000	—
Federal Home Loan Bank advances	158,194,000	156,396,000	—	156,396,000	—
Total borrowed funds	228,758,000	224,372,000	—	224,372,000	—
Accrued interest payable	642,000	642,000	—	642,000	—

The carrying amount and estimated fair values for financial instruments as of June 30, 2017 were as follows:

	Carrying value	Estimated fair value	Level 1	Level 2	Level 3
Financial assets					
Cash and cash equivalents	$20,189,000	$20,189,000	$20,189,000	$—	$ —
Interest bearing deposits in other banks	3,820,000	3,820,000	3,820,000	—	—
Securities available for sale	308,146,000	308,146,000	—	308,146,000	—
Securities to be held to maturity	244,123,000	246,238,000	—	246,238,000	—
Restricted equity securities	12,311,000	12,311,000	—	12,311,000	—
Loans held for sale	865,000	865,000	—	865,000	—
Loans (net of allowance for loan losses)					
Commercial					
Real estate	301,722,000	295,339,000	—	—	295,339,000
Construction	32,989,000	32,291,000	—	—	32,291,000
Other	171,099,000	169,509,000	—	33,000	169,476,000
Municipal	28,672,000	28,902,000	—	—	28,902,000
Residential					
Term	425,985,000	428,556,000	—	236,000	428,320,000
Construction	15,025,000	14,983,000	—	—	14,983,000
Home equity line of credit	109,516,000	107,855,000	—	—	107,855,000
Consumer	25,046,000	24,654,000	—	—	24,654,000
Total loans	1,110,054,000	1,102,089,000	—	269,000	1,101,820,000
Mortgage servicing rights	1,109,000	1,888,000	—	1,888,000	—
Interest rate swap agreements	1,623,000	1,623,000	—	1,623,000	—
Accrued interest receivable	7,192,000	7,192,000	—	7,192,000	—
Financial liabilities					
Demand deposits	$137,061,000	$133,002,000	$—	$133,002,000	$ —
NOW deposits	293,553,000	274,476,000	—	274,476,000	—
Money market deposits	134,760,000	126,402,000	—	126,402,000	—
Savings deposits	226,391,000	200,712,000	—	200,712,000	—
Local certificates of deposit	217,495,000	217,021,000	—	217,021,000	—
National certificates of deposit	309,999,000	309,853,000	—	309,853,000	—
Total deposits	1,319,259,000	1,261,466,000	—	1,261,466,000	—
Repurchase agreements	67,154,000	64,852,000	—	64,852,000	—
Federal Home Loan Bank advances	215,123,000	214,893,000	—	214,893,000	—
Total borrowed funds	282,277,000	279,745,000	—	279,745,000	—
Accrued interest payable	603,000	603,000	—	603,000	—

Note 16 – Impact of Recently Issued Accounting Standards

The FASB issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers, in 2014 to replace the current plethora of industry-specific rules with a broad, principles-based framework for recognizing and measuring revenue. Due to the complexity of the new pronouncement and the anticipated effort required by entities in many industries to implement ASU No. 2014-09, FASB delayed the effective date. Public business entities, certain not-for-profit entities, and certain employee benefit plans should apply the guidance to annual reporting periods beginning after December 15, 2017, and all other entities should apply the guidance to annual reporting periods beginning after December 15, 2018. FASB formed a Transition Resource Group to assist it in identifying implementation issues that may require further clarification or amendment to ASU No. 2014-09. As a result of that group's deliberations, FASB has issued the following amendments, which will be effective concurrently with ASU No. 2014-09: ASU No. 2016-08, Principal versus Agent Considerations, which clarifies whether an entity should record the gross amount of revenue or only its ultimate share when a third party is also involved in providing goods or services to a customer; ASU No. 2016-10, Identifying Performance Obligations and Licensing, which clarifies and simplifies the process for determining whether performance obligations to a customer should be segregated and accounted for individually, and clarifies how the new revenue rules apply to licenses of intellectual property; and ASU No. 2016-12, Narrow-Scope Improvements and Practical Expedients, which clarifies and simplifies the process of assessing collectability of consideration under a contract, presentation of sales taxes, accounting for noncash consideration received, and certain transitional issues. The new standard does not apply to revenue associated with financial instruments, including loans and securities that are accounted for under other U.S. GAAP. The Company has reviewed its various other revenue streams and concluded that the new standard will have minimal impact upon its consolidated financial statements. Adoption of ASU No. 2014-09 was made on January 1, 2018 utilizing the modified retrospective approach.

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments - Overall: Recognition and Measurement of Financial Assets and Financial Liabilities. The ASU was issued to enhance the reporting model for financial instruments to provide users of financial statements with more decision-useful information. This ASU changes how entities account for equity investments that do not result in consolidation and are not accounted for under the equity method of accounting. The ASU also changes certain disclosure requirements and other aspects of U.S. GAAP, including a requirement for public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. The ASU became effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The adoption of the ASU did not have a material effect on the Company's consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). The ASU was issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The ASU is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2018. Management is reviewing the guidance in the ASU to determine whether it will have a material effect on the Company’s consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. Under the new guidance, which will replace the existing incurred loss model for recognizing credit losses, banks and other lending institutions will be required to recognize the full amount of expected credit losses. The new guidance, which is referred to as the current expected credit loss model, requires that expected credit losses for financial assets held at the reporting date that are accounted for at amortized cost be measured and recognized based on historical experience and current and reasonably supportable forecasted conditions to reflect the full amount of expected credit losses. A modified version of these requirements also applies to debt securities classified as available for sale. The ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted for fiscal years beginning after December 15, 2018, including interim periods within such years. The Company is currently evaluating the impact of the adoption of the ASU on its consolidated financial statements, and anticipates it may have a material impact. The Bank has formed an implementation committee for ASU No. 2016-13. To date, committee members have participated in educational seminars on the new standards, begun the process of identifying the historical data sets that will be necessary to implement the new standard, and have chosen a third-party vendor who provides software solutions for ASU No. 2016-13 modeling and calculation. Implementation of this software is in process.

In January 2017, the FASB issued ASU No. 2017-04, Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. The ASU was issued to reduce the cost and complexity of the goodwill impairment test. To simplify the subsequent measurement of goodwill, step two of the goodwill impairment test was eliminated. Instead, a Company will recognize an impairment of goodwill should the carrying value of a reporting unit exceed its fair value (i.e. step one). The ASU will be effective for the Company on January 1, 2020 and will be applied prospectively. The Company does not expect the implementation to have a material effect on the Company's consolidated financial statements.

In March 2017, the FASB issued ASU No. 2017-08, Premium Amortization on Purchased Callable Debt Securities. This ASU shortens the amortization period for the premium on certain purchased callable debt securities to the earliest call date. Today, many entities amortize the premium over the contractual life of the security. The new guidance does not change the accounting for purchased callable debt securities held at a discount; the discount continues to be accreted to maturity. The ASU is effective for interim and annual reporting periods beginning after December 15, 2018; early adoption is permitted. The guidance calls for a modified retrospective transition approach under which a cumulative-effect adjustment will be made to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. The Company's current practice aligns with the ASU therefore Management believes there will be no impact on the Company's consolidated financial statements.

In May 2017, the FASB issued ASU No. 2017-09, Compensation-Stock Compensation (Topic 718): Scope of Modification Accounting. The ASU was issued to provide clarity and reduce both 1) diversity in practice and 2) cost and complexity when applying the guidance in Topic 718, Compensation-Stock Compensation, to a change to the terms or conditions of a shared-based payment award. The ASU includes guidance on determining which changes to the terms and conditions of share-based payment awards require and entity to apply modification accounting under Topic 718. The ASU is effective for the annual period, and interim periods within the annual periods, beginning after December 15, 2017. Early adoption is permitted, including adoption in any interim period. The ASU should be applied prospectively to an award modified on or after the adoption date. Adoption of the ASU did not have a material effect on the Company's consolidated financial statements.

In August 2017, the FASB issued ASU 2017-12, Derivatives and Hedging (Topic 815). The amendments in this ASU improve the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements. In addition, this ASU makes certain targeted improvements to simplify the application of the hedge accounting guidance in current US GAAP. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early application is permitted in any interim period after issuance of the ASU. Management is reviewing the guidance in this ASU to determine whether it will have a material effect on the Company's consolidated financial statements.
In February 2018, the FASB issued ASU No. 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income (Loss). This ASU was issued to allow a reclassification from accumulated other comprehensive income (loss) to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. Consequently, the amendments eliminate the stranded tax effects resulting from the Tax Cuts and Jobs Act and will improve the usefulness of information reported to financial statement users. However, because the amendments only relate to the reclassification of the income tax effects of the Tax Cuts and Jobs Act, the underlying guidance that requires that the effect of a change in tax laws or rates be included in income from continuing operations is not affected. The ASU is effective for fiscal years beginning after December 15, 2018, with early adoption permitted for financial statements which have not yet been issued. The Company adopted the ASU for the December 31, 2017 consolidated financial statements, which resulted in a reclassification adjustment on the Consolidated Statements of Changes in Shareholders' Equity of $297,000 from accumulated other comprehensive income (loss) to retained earnings. Refer to Note 9, Income Taxes, in the Company's December 31, 2017 Form 10-K for additional information.

Item 2 – Management's Discussion and Analysis of Financial Condition
and Results of Operations
The First Bancorp, Inc. and Subsidiary
Forward-Looking Statements
This report contains statements that are "forward-looking statements." We may also make written or oral forward-looking statements in other documents we file with the Securities and Exchange Commission ("SEC"), in our annual reports to shareholders, in press releases and other written materials, and in oral statements made by our officers, directors or employees. You can identify forward-looking statements by the use of the words "believe," "expect," "anticipate," "intend," "estimate," "assume," "outlook," "will," "should," and other expressions that predict or indicate future events and trends and which do not relate to historical matters. You should not rely on forward-looking statements, because they involve known and unknown risks, uncertainties and other factors, some of which are beyond the control of the Company. These risks, uncertainties and other factors may cause the actual results, performance or achievements of the Company to be materially different from the anticipated future results, performance or achievements expressed or implied by the forward-looking statements.
Some of the factors that might cause these differences include the following: changes in general national, regional or international economic conditions or conditions affecting the banking or financial services industries or financial capital markets, volatility and disruption in national and international financial markets, government intervention in the U.S. financial system, reductions in net interest income resulting from interest rate volatility as well as changes in the balance and mix of loans and deposits, reductions in the market value of wealth management assets under administration, changes in the value of securities and other assets, reductions in loan demand, changes in loan collectability, default and charge-off rates, changes in the size and nature of the Company's competition, changes in legislation or regulation and accounting principles, policies and guidelines, and changes in the assumptions used in making such forward-looking statements. In addition, the factors described under "Risk Factors" in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2017, as filed with the SEC, may result in these differences. You should carefully review all of these factors, and you should be aware that there may be other factors that could cause these differences. These forward-looking statements were based on information, plans and estimates at the date of this quarterly report, and we assume no obligation to update any forward-looking statements to reflect changes in underlying assumptions or factors, new information, future events or other changes.
Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, actual results may differ materially from the results discussed in these forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. The Company undertakes no obligation to republish revised forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. Readers are also urged to carefully review and consider the various disclosures made by the Company, which attempt to advise interested parties of the facts that affect the Company's business.
Critical Accounting Policies
Management's discussion and analysis of the Company's financial condition is based on the consolidated financial statements which are prepared in accordance with GAAP. The preparation of such financial statements requires Management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On an ongoing basis, Management evaluates its estimates, including those related to the allowance for loan losses, goodwill, the valuation of mortgage servicing rights, and other-than-temporary impairment on securities. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis in making judgments about the carrying values of assets that are not readily apparent from other sources. Actual results could differ from the amount derived from Management's estimates and assumptions under different assumptions or conditions.
Allowance for Loan Losses. Management believes the allowance for loan losses requires the most significant estimates and assumptions used in the preparation of the consolidated financial statements. The allowance for loan losses is based on Management's evaluation of the level of the allowance required in relation to the estimated loss

exposure in the loan portfolio. Management believes the allowance for loan losses is a significant estimate and therefore regularly evaluates it to determine the appropriate level by taking into consideration factors such as prior loan loss experience, the character and size of the loan portfolio, business and economic conditions and Management's estimation of potential losses. The use of different estimates or assumptions could produce different provisions for loan losses.

Goodwill. Management utilizes numerous techniques to estimate the value of various assets held by the Company, including methods to determine the appropriate carrying value of goodwill as required under FASB ASC Topic 350 "Intangibles – Goodwill and Other." In addition, goodwill from a purchase acquisition is subject to ongoing periodic impairment tests, which include an evaluation of the ongoing assets, liabilities and revenues from the acquisition and an estimation of the impact of business conditions.

Mortgage Servicing Rights. The valuation of mortgage servicing rights is a critical accounting policy which requires significant estimates and assumptions. The Bank often sells mortgage loans it originates and retains the ongoing servicing of such loans, receiving a fee for these services, generally 0.25% of the outstanding balance of the loan per annum. Mortgage servicing rights are recognized at fair value when they are acquired through the sale of loans, and are reported in other assets. They are amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. The rights are subsequently carried at the lower of amortized cost or fair value. Management uses an independent firm which specializes in the valuation of mortgage servicing rights to determine the fair value which is recorded on the balance sheet. The most important assumption is the anticipated loan prepayment rate, and increases in prepayment speed results in lower valuations of mortgage servicing rights. The valuation also includes an evaluation for impairment based upon the fair value of the rights, which can vary depending upon current interest rates and prepayment expectations, as compared to amortized cost. Impairment is determined by stratifying rights by predominant characteristics, such as interest rates and terms. The use of different assumptions could produce a different valuation. All of the assumptions are based on standards the Company believes would be utilized by market participants in valuing mortgage servicing rights and are consistently derived and/or benchmarked against independent public sources.

Other-Than-Temporary Impairment on Securities. One of the significant estimates related to investment securities is the evaluation of other-than-temporary impairments. The evaluation of securities for other-than-temporary 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 investments 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. Securities that are in an unrealized loss position are reviewed at least quarterly to determine if other-than-temporary impairment 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 length of time and extent to which the fair value has been less than cost or amortized cost and the expected recovery period of the security, (b) the financial condition, credit rating and future prospects of the issuer, (c) whether the debtor is current on contractually obligated interest and principal payments, (d) the volatility of the securities' market price, (e) the intent and ability of the Company to retain the investment for a period of time sufficient to allow for recovery, which may be at maturity and (f) any other information and observable data considered relevant in determining whether other-than-temporary impairment has occurred, including the expectation of receipt of all principal and interest when due.

Derivative Financial Instruments Designated as Hedges. The Company recognizes all derivatives in the consolidated balance sheets at fair value. On the date the Company enters into the derivative contract, the Company designates the derivative as a hedge of either a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability (“cash flow hedge”), a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment (“fair value hedge”), or a held for trading instrument (“trading instrument”). The Company formally documents relationships between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedge transactions. The Company also assesses, both at the hedge’s inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are effective in offsetting changes in cash flows or fair values of hedged items. Changes in fair value of a derivative that is effective and that qualifies as a cash flow hedge are recorded in other comprehensive income (loss) and are reclassified into earnings when the forecasted transaction or related cash flows affect earnings. Changes in fair value of a derivative that qualifies as a fair value hedge and the change in fair value of the hedged item are both recorded in earnings and offset each other when the transaction is effective. Those derivatives that are classified as trading instruments are recorded at fair value with changes in fair value recorded in earnings. The Company discontinues hedge accounting when it determines that the derivative is no longer effective in offsetting changes in the cash flows of the hedged item, that it is unlikely that the forecasted transaction will occur, or that the designation of the derivative as a hedging instrument is no longer appropriate.

Use of Non-GAAP Financial Measures

Certain information in Management's Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this Report contains financial information determined by methods other than in accordance with GAAP. Management uses these "non-GAAP" measures in its analysis of the Company's performance and believes that these non-GAAP financial measures provide a greater understanding of ongoing operations and enhance comparability of results with prior periods as well as demonstrating the effects of significant gains and charges in the current period. The Company believes that a meaningful analysis of its financial performance requires an understanding of the factors underlying that performance. Management believes that investors may use these non-GAAP financial measures to analyze financial performance without the impact of unusual items that may obscure trends in the Company's underlying performance. These disclosures should not be viewed as a substitute for operating results determined in accordance with GAAP, nor are they necessarily comparable to non-GAAP performance measures that may be presented by other companies.

In several places net interest income is presented on a fully taxable-equivalent basis. Specifically included in interest income was tax-exempt interest income from certain investment securities and loans. An amount equal to the tax benefit derived from this tax exempt income has been added back to the interest income total which, as adjusted, increased net interest income accordingly. Management believes the disclosure of tax-equivalent net interest income information improves the clarity of financial analysis, and is particularly useful to investors in understanding and evaluating the changes and trends in the Company's results of operations. Other financial institutions commonly present net interest income on a tax-equivalent basis. This adjustment is considered helpful in the comparison of one financial institution's net interest income to that of another, as each will have a different proportion of tax-exempt interest from its earning assets. Moreover, net interest income is a component of a second financial measure commonly used by financial institutions, net interest margin, which is the ratio of net interest income to average earning assets. For purposes of this measure as well, other financial institutions generally use tax-equivalent net interest income to provide a better basis of comparison from institution to institution. The Company follows these practices. The following table provides a reconciliation of tax-equivalent financial information to the Company's consolidated financial statements prepared in accordance with GAAP. A Federal Income Tax rate of 21.0% was used in 2018 and a 35.0% tax rate was used in 2017.

	For the six months ended June 30,		For the quarter ended June 30,	
Dollars in thousands	2018	2017	2018	2017
Net interest income as presented	$24,678	$23,141	$12,269	$11,665
Effect of tax-exempt income	1,046	1,951	533	1,004
Net interest income, tax equivalent	$25,724	$25,092	$12,802	$12,669

The Company presents its efficiency ratio using non-GAAP information which is most commonly used by financial institutions. The GAAP-based efficiency ratio is noninterest expenses divided by net interest income plus noninterest income from the Consolidated Statements of Income and Comprehensive Income (Loss). The non-GAAP efficiency ratio excludes securities losses and other-than-temporary impairment charges from noninterest expenses, excludes securities gains from noninterest income, and adds the tax-equivalent adjustment to net interest income. The following table provides a reconciliation between the GAAP and non-GAAP efficiency ratio:

	For the six months ended June 30,		For the quarter ended June 30,	
Dollars in thousands	2018	2017	2018	2017
Non-interest expense, as presented	$16,755	$15,338	$8,176	$7,640
Net interest income, as presented	24,678	23,141	12,269	11,665
Effect of tax-exempt interest income	1,046	1,951	533	1,004
Non-interest income, as presented	6,313	5,845	3,181	3,002
Effect of non-interest tax-exempt income	83	165	41	83
Net securities gains	(136)	(3)	—	—
Adjusted net interest income plus non-interest income	$31,984	$31,099	$16,024	$15,754
Non-GAAP efficiency ratio	52.39%	49.32%	51.02%	48.50%
GAAP efficiency ratio	54.06%	52.92%	52.92%	52.09%

The Company presents certain information based upon average tangible shareholders' common equity instead of total average shareholders' equity. The difference between these measures is the Company's intangible assets, specifically goodwill from prior acquisitions. Management, banking regulators and many stock analysts use the tangible common equity ratio and the tangible book value per common share in conjunction with more traditional bank capital ratios to compare the capital adequacy of banking organizations with significant amounts of goodwill or other intangible assets, typically stemming from the use of the purchase accounting method in accounting for mergers and acquisitions.

The following table provides a reconciliation of average tangible shareholders' common equity to the Company's consolidated financial statements, which have been prepared in accordance with GAAP:

Dollars in thousands	For the six months ended June 30, 2018	2017	For the quarter ended June 30, 2018	2017
Average shareholders' equity as presented	$182,979	$177,122	$183,898	$178,628
Less average intangible assets	(30,011)	(30,055)	(30,021)	(30,060)
Average tangible shareholders' common equity	$152,968	$147,067	$153,877	$148,568

Executive Summary

Net income for the six months ended June 30, 2018 was $11.2 million, up $1.7 million or 18.1% from the same period in 2017. Earnings per common share on a fully diluted basis were $1.04 for the six months ended June 30, 2018, up $0.16 or 18.2% from the $0.88 posted for the same period in 2017. For the quarter ended June 30, 2018, net income was $5.7 million, up $851,000 or 17.4% from the same period in 2017. Earnings per common share on a fully diluted basis were $0.53 for the quarter ended June 30, 2018, up $0.08 or 17.8% from the $0.45 posted in 2017. Compared to the previous quarter, net income was up $228,000 or 4.1% and earnings per common share on a fully diluted basis were up $0.02 or 3.9%.

This was the best quarter in the Company's history, including another quarter of record earnings. Continued growth in earning assets resulted in increased net interest income despite the headwinds of higher funding costs. The Company's fee-based business lines continue to generate year-over-year revenue growth, led by First Advisors, the Bank's trust and investment management division, where revenues are up 15% over the first six months of last year. Based upon the strength of the Company's earnings, the dividend was increased to 29 cents per share in the second quarter, representing a payout to our shareholders of 54.72% of net income for the period.

Net interest income on a tax-equivalent basis was up $632,000 or 2.5% in the six months ended June 30, 2018 compared to the same period in 2017, with the increase primarily attributable to growth in earning assets. This growth fully offset a year-over-year decline in our net interest margin from 3.04% in the first six months of 2017 to 2.94% in the first six months of 2018. For the quarter ended June 30, 2018, net interest income on a tax-equivalent basis increased $133,000 or 1.0% compared to the same period in 2017, again primarily attributable to earning asset growth. The net interest margin for the second quarter of 2018 was 2.88%, down from 3.03% in the second quarter of 2017.

Non-interest income for the six months ended June 30, 2018 was up $468,000 or 8.0%, from the six months ended June 30, 2017, led by revenue growth at First Advisors, the Bank’s trust and investment management division.

Non-interest expense for the six months ended June 30, 2018 was up $1.4 million or 9.2%, from the same period in 2017, primarily due to higher employee costs as we continue to invest in the people and technology to sustain growth.

Credit quality remains solid. Non-performing assets stood at 0.78% of total assets as of June 30, 2018 - up from the 0.44% level of non-performing assets as of June 30, 2017 and down from 0.86% as of December 31, 2017. Total past-due loans were 0.61% of total loans as of June 30, 2018, down from 1.60% of total loans as of December 31, 2017 and 0.87% as of June 30, 2017.

The provision for loan losses for the first six months of 2018 was $1.0 million, level with the amount provisioned in the same period in 2017. Net loan chargeoffs for the six months ended June 30, 2018 were $257,000 or 0.04% of average loans on an annualized basis. This was down $270,000 from net chargeoffs of $527,000 or 0.10% of average loans on an annualized basis for the six months ended June 30, 2017. The allowance for loan losses increased $743,000 between December 31, 2017 and June 30, 2018, and is 0.94% of loans outstanding as of June 30, 2018, up slightly from 0.92% as of as of December 31, 2017 and down slightly from 0.95% of total loans as of June 30, 2017.

The strong growth on both sides of the balance sheet experienced in 2017 continued into the first six months of 2018. Total assets have increased $71.0 million or 3.9% year-to-date. The loan portfolio increased $60.3 million or 5.2% in the six months ended June 30, 2018 and $103.8 million or 9.3% from a year ago. The majority of the loan growth has been in commercial and municipal loans, with modest growth in residential term mortgage loans. The investment portfolio has increased $10.4 million year-to-date and increased $12.9 million or 2.3% from a year ago. On the liability side of the balance sheet, low-cost deposits have decreased $37.1 million or 5.3% year-to-date, in-line with our normal seasonal deposit flow pattern. Year-over-year low-cost deposits increased $1.9 million or 0.3%. Local certificates of deposit ("CDs") decreased $2.1 million and wholesale CDs increased $96.3 million year-to-date. Remaining well capitalized remains a top priority for The First Bancorp, Inc. Since December 31, 2008, the Company's total risk-based capital ratio has increased from 11.13% to 14.98%, well above the well-capitalized threshold of 10.0% set by the Federal Deposit Insurance Corporation, the Federal Reserve Board, and the Office of the Comptroller of the Currency.

The Company's operating ratios remain good, with a return on average tangible common equity of 14.82% for the six months ended June 30, 2018 compared to 13.05% for the same period in 2017. Based upon March 31, 2018 data, our return on average tangible common equity was in the top 23% of all banks in the UBPR peer group, which had an average return on equity of 11.60%. Our efficiency ratio continues to be an important component in our overall performance and stood at 52.39% for the six months ended June 30, 2018 compared to 49.32% for the same period in 2017. The increase being attributable to increased operating expenses and a reduction in tax equivalent revenue from the Company's tax exempt assets, as as a result of the Tax Cuts and Jobs Act of 2017 ("the TCJA"). This ratio remains well below the UBPR peer group average of 62.16% as of March 31, 2018.

Net Interest Income

Total interest income of $33.7 million for the six months ended June 30, 2018 was an increase of $4.2 million or 14.1% compared to total interest income of $29.5 million for the same period of 2017. Total interest expense of $9.0 million for the six months ended June 30, 2018 was an increase of $2.6 million or 41.3% compared to total interest expense for the six months ended June 30, 2017. As a result, net interest income of $24.7 million for the six months ended June 30, 2018 was an increase of $1.5 million or 6.6% compared to net interest income of $23.1 million for the same period ended June 30, 2017. The Company's net interest margin on a tax-equivalent basis decreased from 3.04% for the six months ended June 30, 2017 to 2.94% for the six months ended June 30, 2018. Tax-exempt interest income amounted to $3.9 million for the six months ended June 30, 2018 and $3.6 million for the same period of 2017.

Total interest income of $17.2 million for the quarter ended June 30, 2018 is a 14.7% increase from total interest income of $15.0 million in the comparable period of 2017. Total interest expense of $4.9 million for the quarter ended June 30, 2018 is a 47.9% increase from total interest expense of $3.3 million for the comparable period of 2017. As a result, net interest income increased 5.2% or $604,000 to $12.3 million for the quarter ended June 30, 2018, from the $11.7 million reported for the same period in 2017. The Company's net interest margin on a tax-equivalent basis decreased from 3.03% for the quarter ended June 30, 2017 to 2.88% for the quarter ended June 30, 2018. Tax-exempt interest income amounted to $2.0 million for the quarters ended June 30, 2018 and and $1.9 million for the same period of 2017.

The following tables present the amount of interest earned or paid, as well as the average yield or rate on an annualized basis, for each major category of assets or liabilities for the six months and quarters ended June 30, 2018 and 2017. Tax-exempt income is calculated on a tax-equivalent basis, using a 21.0% Federal Income Tax rate in 2018, and a 35.0% rate in 2017.

	For the six months ended					
	June 30, 2018			June 30, 2017		
Dollars in thousands	Amount of interest	Average Yield/Rate		Amount of interest	Average Yield/Rate	
Interest on earning assets						
Interest-bearing deposits	$17	1.84	%	$23	0.88	%
Investments	9,130	3.22	%	9,449	3.38	%
Loans held for sale	5	3.26	%	12	3.82	%
Loans	25,550	4.33	%	21,959	4.05	%
Total interest income	34,702	3.97	%	31,443	3.81	%
Interest expense						
Deposits	6,857	1.09	%	4,296	0.76	%
Other borrowings	2,121	1.60	%	2,056	1.65	%
Total interest expense	8,978	1.18	%	6,352	0.92	%
Net interest income	$25,724			$25,091		
Interest rate spread		2.79	%		2.89	%
Net interest margin		2.94	%		3.04	%

	For the quarters ended			
	June 30, 2018		June 30, 2017	
Dollars in thousands	Amount of interest	Average Yield/Rate	Amount of interest	Average Yield/Rate
Interest on earning assets				
Interest-bearing deposits	$6	1.72%	$8	1.08%
Investments	4,624	3.24%	4,779	3.38%
Loans held for sale	8	13.15%	7	3.86%
Loans	13,100	4.36%	11,212	4.07%
Total interest-earning assets	17,738	4.00%	16,006	3.83%
Interest expense				
Deposits	3,758	1.18%	2,302	0.80%
Other borrowings	1,178	1.73%	1,035	1.65%
Total interest expense	4,936	1.28%	3,337	0.95%
Net interest income	$12,802		$12,669	
Interest rate spread		2.72%		2.88%
Net interest margin		2.88%		3.03%

The following tables present changes in interest income and expense attributable to changes in interest rates and volume for interest-earning assets and liabilities for the six months and quarters ended June 30, 2018 compared to 2017. Tax-exempt income is calculated on a tax-equivalent basis, using a 21% tax rate in 2018 and 35% in 2017.

For the six months ended June 30, 2018 compared to 2017				
Dollars in thousands	Volume	Rate	Rate/Volume[1]	Total
Interest on earning assets				
Interest-bearing deposits	$(15)	$25	$ (16)	$(6)
Investment securities	134	(447)	(6)	(319)
Loans held for sale	(3)	4	(2)	(1)
Loans	1,942	1,510	133	3,585
Change in interest income	2,058	1,092	109	3,259
Interest expense				
Deposits	468	1,888	205	2,561
Other borrowings	131	(62)	(4)	65
Change in interest expense	599	1,826	201	2,626
Change in net interest income	$1,459	$(734)	$ (92)	$633

[1] Represents the change attributable to a combination of change in rate and change in volume.

For the quarter ended June 30, 2018 compared to 2017				
Dollars in thousands	Volume	Rate	Rate/Volume[1]	Total
Interest on earning assets				
Interest-bearing deposits	$ (4)	$5	$ (3)	$(2)
Investment securities	44	(197)	(2)	(155)
Loans held for sale	(5)	17	(11)	1
Loans	1,034	782	72	1,888
Change in interest income	1,069	607	56	1,732
Interest expense				
Deposits	238	1,103	115	1,456
Other borrowings	86	53	4	143
Change in interest expense	324	1,156	119	1,599

Change in net interest income	$ 745	$ (549)	$ (63)	$ 133

Average Daily Balance Sheets

The following table shows the Company's average daily balance sheets for the six months and quarters ended ended June 30, 2018 and 2017.

	For the six months ended		For the quarters ended	
Dollars in thousands	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Assets				
Cash and cash equivalents	$16,511	$16,323	$16,455	$16,683
Interest-bearing deposits in other banks	1,868	5,958	1,398	3,899
Securities available for sale	302,517	311,502	302,684	310,785
Securities to be held to maturity	257,552	238,915	258,640	244,332
Restricted equity securities, at cost	11,458	13,092	11,541	12,516
Loans held for sale	309	633	244	727
Loans	1,190,132	1,093,463	1,205,976	1,104,134
Allowance for loan losses	(11,005)	(10,344)	(11,138)	(10,447)
Net loans	1,179,127	1,083,119	1,194,838	1,093,687
Accrued interest receivable	6,782	6,364	7,256	6,839
Premises and equipment	22,134	21,833	21,927	21,615
Other real estate owned	1,020	348	947	351
Goodwill	29,805	29,805	29,805	29,805
Other assets	39,928	36,258	40,540	36,584
Total Assets	$1,869,011	$1,764,150	$1,886,275	$1,777,823
Liabilities & Shareholders' Equity				
Demand deposits	$139,358	$179,525	$141,863	$178,244
NOW deposits	301,009	264,845	296,951	261,261
Money market deposits	115,124	131,889	103,603	128,662
Savings deposits	232,002	221,974	229,818	224,045
Certificates of deposit	620,194	525,135	644,829	541,577
Total deposits	1,407,687	1,323,368	1,417,064	1,333,789
Borrowed funds – short term	201,380	125,445	207,853	157,154
Borrowed funds – long term	65,116	125,123	65,116	94,922
Dividends payable	1,044	1,040	933	795
Other liabilities	10,805	12,052	11,411	12,535
Total Liabilities	1,686,032	1,587,028	1,702,377	1,599,195
Shareholders' Equity:				
Common stock	108	108	108	108
Additional paid-in capital	61,969	60,961	62,092	61,082
Retained earnings	125,608	115,707	127,125	116,801
Net unrealized loss on securities available for sale	(6,273)	(525)	(7,058)	(207)
Net unrealized loss on securities transferred from available for sale to held to maturity	(181)	(133)	(184)	(134)
Net unrealized gain on cash flow hedging derivative instruments	1,895	1,106	1,962	1,080
Net unrealized loss on postretirement benefit costs	(147)	(102)	(147)	(102)
Total Shareholders' Equity	182,979	177,122	183,898	178,628
Total Liabilities & Shareholders' Equity	$1,869,011	$1,764,150	$1,886,275	$1,777,823

Non-Interest Income

Non-interest income of $6.3 million for the six months ended June 30, 2018 is an increase of $468,000 compared to the same period in 2017, led by revenue growth at First Advisors, the Bank's trust and investment management division. Non-interest income of $3.2 million for the quarter ended June 30, 2018 is an increase of $179,000 compared to the same period in 2017, primarily due the reasons mentioned above.

Non-Interest Expense

Non-interest expense of $16.8 million for the six months ended June 30, 2018 is an increase of 9.2% or $1.4 million compared to non-interest expense of $15.3 million for the same period in 2017, primarily due to higher employee costs as we continue to invest in the people and technology to sustain growth. The Company's efficiency ratio stood at 52.39% for the six months ended June 30, 2018, up from 49.32% for the same period in 2017, primarily due to TCJA and higher operating costs. Noninterest expense of $8.2 million for the quarter ended June 30, 2018 is an increase of 7.0% compared to noninterest expense of $7.6 million for the same period in 2017 due to the reasons mentioned above.

Income Taxes

Income taxes on operating earnings were $2.0 million for the six months ended June 30, 2018, down $1.1 million from the same period in 2017. As expected, the TCJA resulted in a significant income tax expense savings from the prior year.

Investments

The Company's investment portfolio increased by $10.4 million between December 31, 2017 and June 30, 2018. As of June 30, 2018, mortgage-backed securities had a carrying value and a fair value of $318.0 million. Of this total, securities with a fair value of $135.0 million or 42.5% of the mortgage-backed portfolio were issued by the Government National Mortgage Association and securities with a fair value of $183.0 million or 57.5% of the mortgage-backed portfolio were issued by the Federal Home Loan Mortgage Corporation ("Freddie Mac") and the Federal National Mortgage Association ("Fannie Mae").

The Company's investment securities are classified into two categories: securities available for sale and securities to be held to maturity. Securities available for sale consist primarily of debt securities which Management intends to hold for indefinite periods of time. They may be used as part of the Company's funds management strategy, and may be sold in response to changes in interest rates, prepayment risk and liquidity needs, to increase capital ratios, or for other similar reasons. Securities to be held to maturity consist primarily of debt securities that the Company has acquired solely for long-term investment purposes, rather than potential future sale. For securities to be categorized as held to maturity Management must have the intent and the Company must have the ability to hold such investments until their respective maturity dates. The Company does not hold trading account securities.

All investment securities are managed in accordance with a written investment policy adopted by the Board of Directors. It is the Company's general policy that investments for either portfolio be limited to government debt obligations, time deposits, and corporate bonds or commercial paper with one of the three highest ratings given by a nationally recognized rating agency. The portfolio is currently invested primarily in U.S. Government agency securities and tax-exempt obligations of states and political subdivisions. The individual securities have been selected to enhance the portfolio's overall yield while not materially adding to the Company's level of interest rate risk.

During the third quarter of 2014, the Company transferred securities with a total amortized cost of $89,780,000 and a corresponding fair value of $89,757,000 from available for sale to held to maturity. The net unrealized loss, net of taxes, on these securities at the date of the transfer was $15,000. The net unrealized holding loss at the time of transfer continues to be reported in accumulated other comprehensive income (loss), net of tax and is amortized over the remaining lives of the securities as an adjustment of the yield. The amortization of the net unrealized loss reported in accumulated other comprehensive income (loss) will offset the effect on interest income of the discount for the transferred securities. The remaining unamortized balance of the net unrealized losses for the securities transferred from available for sale to held to maturity was $189,000 at June 30, 2018. These securities were transferred as a part of the Company's overall investment and balance sheet strategies.

The following table sets forth the Company's investment securities at their carrying amounts as of June 30, 2018 and 2017 and December 31, 2017.

Dollars in thousands	June 30, 2018	December 31, 2017	June 30, 2017
Securities available for sale			
Mortgage-backed securities	$297,378	$ 289,989	$288,991
State and political subdivisions	4,692	6,769	15,828
Other equity securities	2,978	3,414	3,327
	$305,048	$ 300,172	$308,146
Securities to be held to maturity			
U.S. government-sponsored agencies	$11,155	$ 11,155	$11,152
Mortgage-backed securities	20,585	23,284	27,224
State and political subdivisions	224,037	217,828	201,447
Corporate securities	4,300	4,300	4,300
	$260,077	$ 256,567	$244,123
Restricted equity securities			
Federal Home Loan Bank Stock	$11,326	$ 9,321	$11,274
Federal Reserve Bank Stock	1,037	1,037	1,037
	$12,363	$ 10,358	$12,311
Total securities	$577,488	$ 567,097	$564,580

The following table sets forth yields and contractual maturities of the Company's investment securities as of June 30, 2018. Yields on tax-exempt securities have been computed on a tax-equivalent basis using a tax rate of 21%. Mortgage-backed securities are presented according to their final contractual maturity date, while the calculated yield takes into effect the intermediate cash flows from repayment of principal which results in a much shorter average life.

Dollars in thousands	Available For Sale Fair Value	Yield to maturity		Held to Maturity Amortized Cost	Yield to maturity	
U.S. Government-Sponsored Agencies						
Due in 1 year or less	$—	0.00	%	$—	0.00	%
Due in 1 to 5 years	—	0.00	%	—	0.00	%
Due in 5 to 10 years	—	0.00	%	7,255	3.03	%
Due after 10 years	—	0.00	%	3,900	3.05	%
Total	—	0.00	%	11,155	3.04	%
Mortgage-Backed Securities						
Due in 1 year or less	34	4.43	%	—	0.00	%
Due in 1 to 5 years	8,966	3.17	%	3,410	2.67	%
Due in 5 to 10 years	65,428	3.08	%	12,572	3.26	%
Due after 10 years	222,950	2.46	%	4,603	4.96	%
Total	297,378	2.62	%	20,585	3.55	%
State & Political Subdivisions						
Due in 1 year or less	—	0.00	%	1,027	5.25	%
Due in 1 to 5 years	375	5.67	%	20,211	5.80	%
Due in 5 to 10 years	4,317	4.40	%	131,269	4.72	%
Due after 10 years	—	0.00	%	71,530	4.60	%
Total	4,692	4.50	%	224,037	4.78	%
Corporate Securities						
Due in 1 year or less	—	0.00	%	300	1.50	%
Due in 1 to 5 years	—	0.00	%	—	0.00	%
Due in 5 to 10 years	—	0.00	%	4,000	5.50	%
Due after 10 years	—	0.00	%	—	0.00	%
Total	—	0.00	%	4,300	5.22	%
Equity Securities	2,978	0.01	%	—	0.00	%
	$305,048	2.62	%	$260,077	4.62	%

Impaired Securities

The securities portfolio contains certain securities where the amortized cost of which exceeds fair value, which at June 30, 2018 amounted to $14.8 million, or 2.62% of the amortized cost of the total securities portfolio. At December 31, 2017 this amount was $5.9 million, or 1.08% of the amortized cost of total securities portfolio. As a part of the Company's ongoing security monitoring process, the Company identifies securities in an unrealized loss position that could potentially be other-than-temporarily impaired. If a decline in the fair value of a debt security is judged to be other-than-temporary, the decline related to credit loss is recorded in net realized securities losses while the decline attributable to other factors is recorded in other comprehensive income or loss.

The Company's evaluation of securities for impairment is a quantitative and qualitative process intended to determine whether declines in the fair value of investment securities should be recognized in current period earnings. The primary factors considered in evaluating whether a decline in the fair value of securities is other-than-temporary include: (a) the length of time and extent to which the fair value has been less than cost or amortized cost and the expected recovery period of the security, (b) the financial condition, credit rating and future prospects of the issuer, (c) whether the debtor is current on contractually obligated interest and principal payments, (d) the volatility of the securities market price, (e) the intent and ability of the Company to retain the investment for a period of time sufficient to allow for recovery, which may be at maturity, and (f) any other information and observable data considered relevant in determining whether other-than-temporary impairment has occurred.

The Company's best estimate of cash flows uses severe economic recession assumptions due to market uncertainty. The Company's assumptions include but are not limited to delinquencies, foreclosure levels and constant default rates on the underlying collateral, loss severity ratios, and constant prepayment rates. If the Company does not expect to receive 100% of future contractual principal and interest, an other-than-temporary impairment charge is recognized. Estimating future cash flows is a quantitative and qualitative process that incorporates information received from third party sources along with certain internal assumptions and judgments regarding the future performance of the underlying collateral.

As of June 30, 2018, the Company had temporarily impaired securities with a fair value of $412.8 million and unrealized losses of $14.8 million, as identified in the table below. The level of temporary impairment was up from December 31, 2017 as a result of a shift in the yield curve and a corresponding decrease in value of investment securities. Securities in a continuous unrealized loss position more than twelve months amounted to $132.6 million as of June 30, 2018, compared with $144.4 million at December 31, 2017. The Company has concluded that these securities were not other-than-temporarily impaired. This conclusion was based on the issuer's continued satisfaction of the securities obligations in accordance with their contractual terms and the expectation that the issuer will continue to do so, Management's intent and ability to hold these securities for a period of time sufficient to allow for any anticipated recovery in fair value which may be at maturity, the expectation that the Company will receive 100% of future contractual cash flows, as well as the evaluation of the fundamentals of the issuer's financial condition and other objective evidence. The following table summarizes temporarily impaired securities and their approximate fair values at June 30, 2018:

	Less than 12 months		12 months or more		Total	
Dollars in thousands	Fair Value (Estimated)	Unrealized Losses	Fair Value (Estimated)	Unrealized Losses	Fair Value (Estimated)	Unrealized Losses
U.S. Government-sponsored agencies	$6,882	$ (373)	$3,689	$ (211)	$10,571	$ (584)
Mortgage-backed securities	202,673	(5,660)	91,977	(3,757)	294,650	(9,417)
State and political subdivisions	70,674	(1,728)	36,909	(3,025)	107,583	(4,753)
	$280,229	$ (7,761)	$132,575	$ (6,993)	$412,804	$ (14,754)

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

Securities issued by U.S. Government-sponsored agencies and enterprises. As of June 30, 2018, there were $584,000 unrealized losses on these securities compared to $180,000 unrealized losses as of December 31, 2017. All of these securities were credit rated "AAA" or "AA+" by the major credit rating agencies. Management believes that securities issued by U.S. Government-sponsored agencies and enterprises have minimal credit risk, as these agencies and enterprises play a vital role in the nation's financial markets and does not consider these securities to be other-than-temporarily impaired at June 30, 2018.

Mortgage-backed securities issued by U.S. Government agencies and U.S. Government-sponsored enterprises. As of June 30, 2018, there were $9.4 million of unrealized losses on these securities compared with $4.6 million at December 31, 2017. All of these securities were credit rated "AAA" or "AA+" by the major credit rating agencies. Management believes that securities issued by U.S. Government agencies bear no credit risk because they are backed by the full faith and credit of the United States and that securities issued by U.S. Government-sponsored enterprises have minimal credit risk, as these agencies and enterprises play a vital role in the nation's financial markets. Management believes that the unrealized losses at June 30, 2018 were attributable to changes in current market yields and spreads since the date the underlying securities were purchased, and does not consider these securities to be other-than-temporarily impaired at June 30, 2018. The Company also has the ability and intent to hold these securities until a recovery of their amortized cost, which may be at maturity.

Obligations of state and political subdivisions. As of June 30, 2018, there were $4.8 million of unrealized losses on these securities compared to $1.2 million at December 31, 2017. Municipal securities are supported by the general taxing authority of the municipality and, in the cases of school districts, are generally supported by state aid. At

June 30, 2018, all municipal bond issuers were current on contractually obligated interest and principal payments. The Company attributes the unrealized losses at June 30, 2018 to changes in prevailing market yields and pricing spreads since the date the underlying securities were purchased, combined with current market liquidity conditions and the disruption in the financial markets in general. Accordingly, the Company does not consider these municipal securities to be other-than-temporarily impaired at June 30, 2018. The Company also has the ability and intent to hold these securities until a recovery of their amortized cost, which may be at maturity.

Corporate securities. There were no unrealized losses on corporate securities as of June 30, 2018, or at December 31, 2017. Corporate securities are dependent on the operating performance of the issuers. At June 30, 2018, all corporate bond issuers were current on contractually obligated interest and principal payments.

Other equity securities. As of June 30, 2018, there were no unrealized losses on other equity securities compared with $3,000 at December 31, 2017. Other equity securities is comprised of common and preferred stock holdings. The unrealized losses were the result of normal market fluctuations for equity securities.

Federal Home Loan Bank Stock

The Bank is a member of the Federal Home Loan Bank ("FHLB") of Boston, a cooperatively owned wholesale bank for housing and finance in the six New England States. As a requirement of membership in the FHLB, the Bank must own a minimum required amount of FHLB stock, calculated periodically based primarily on its level of borrowings from the FHLB. The Bank uses the FHLB for much of its wholesale funding needs. As of June 30, 2018, 2017 and December 31, 2017, the Bank's investment in FHLB stock totaled $11.3 million, $11.3 million and $9.3 million, respectively. FHLB stock is a non-marketable equity security and therefore is reported at cost, which equals par value. The Company periodically evaluates its investment in FHLB stock for impairment based on, among other factors, the capital adequacy of the FHLB and its overall financial condition. No impairment losses have been recorded through June 30, 2018. The Company will continue to monitor its investment in FHLB stock.

Loans Held for Sale

Loans held for sale are carried at the lower of cost or market value. As of June 30, 2018, the Bank had $481,000 in loans held for sale. This compares to $386,000 in loans held for sale at December 31, 2017 and $865,000 in loans held for sale at June 30, 2017. The Bank participates in FHLB's Mortgage Partnership Finance Program ("MPF"), selling loans with recourse. The volume of loans sold to date through the MPF program is de minimis; therefore, there was minimum impact on the reserve.

Loans

The loan portfolio increased during the first six months of 2018, with total loans at $1.22 billion at June 30, 2018, up $60.3 million or 5.2% from total loans of $1.16 billion at December 31, 2017. Commercial loans increased $31.7 million or 5.8% between December 31, 2017 and June 30, 2018, municipal loans increased $15.3 million or 45.9%, residential term loans increased $20.9 million and home equity lines of credit decreased $3.6 million.

Commercial loans are comprised of three major classes: commercial real estate loans, commercial construction loans and other commercial loans.

Commercial real estate loans consist of mortgage loans to finance investments in real property such as multi-family residential, commercial/retail, office, industrial, hotels, educational and other specific or mixed use properties. Commercial real estate loans are typically written with amortizing payment structures. Collateral values are determined based on appraisals and evaluations in accordance with established policy and regulatory guidelines. Commercial real estate loans typically have a loan-to-value ratio of up to 80% based upon current valuation information at the time the loan is made. Commercial real estate loans are primarily paid by the cash flow generated from the real property, such as operating leases, rents, or other operating cash flows from the borrower.

Commercial construction loans consist of loans to finance construction in a mix of owner- and non-owner occupied commercial real estate properties. Commercial construction loans typically have maturities of less than two years. Payment structures during the construction period are typically on an interest only basis, although principal payments may be established depending on the type of construction project being financed. During the construction phase, commercial construction loans are primarily paid by cash flow generated from the construction project or other operating cash flows from the borrower or guarantors, if applicable. At the end of the construction period, loan repayment typically comes from a third party source in the event that the Company will not be providing permanent term financing. Collateral valuation and loan-to-value guidelines follow those for commercial real estate loans.

Other commercial loans consist of revolving and term loan obligations extended to business and corporate enterprises for the purpose of financing working capital and or capital investment. Collateral generally consists of pledges of business assets including, but not limited to, accounts receivable, inventory, plant and equipment, and/or real estate, if applicable. Commercial loans are primarily paid by the operating cash flow of the borrower. Commercial loans may be secured or unsecured.

Municipal loans are comprised of loans to municipalities in Maine for capitalized expenditures, construction projects or tax-anticipation notes. All municipal loans are considered general obligations of the municipality and are collateralized by the taxing ability of the municipality for repayment of debt.

Residential loans are comprised of two classes: term loans and construction loans.

Residential term loans consist of residential real estate loans held in the Company's loan portfolio made to borrowers who demonstrate the ability to make scheduled payments with full consideration to underwriting factors. Borrower qualifications include favorable credit history combined with supportive income requirements and loan-to-value ratios within established policy and regulatory guidelines. Collateral values are determined based on appraisals and evaluations in accordance with established policy and regulatory guidelines. Residential loans typically have a loan-to-value ratio of up to 80% based on

appraisal information at the time the loan is made. Collateral consists of mortgage liens on one- to four-family residential properties. Loans are offered with fixed or adjustable rates with amortization terms of up to thirty years.
Residential construction loans typically consist of loans for the purpose of constructing single family residences to be owned and occupied by the borrower. Borrower qualifications include favorable credit history combined with supportive income requirements and loan-to-value ratios within established policy and regulatory guidelines. Residential construction loans normally have construction terms of one year or less and payment during the construction term is typically on an interest only basis from sources including interest reserves, borrower liquidity and/or income. Residential construction loans will typically convert to permanent financing from the Company or have another financing commitment in place from an acceptable mortgage lender. Collateral valuation and loan-to-value guidelines are consistent with those for residential term loans.
Home equity lines of credit are made to qualified individuals and are secured by senior or junior mortgage liens on owner-occupied one- to four-family homes, condominiums, or vacation homes. The home equity line of credit typically has a variable interest rate and is billed as interest-only payments during the draw period. At the end of the draw period, the home equity line of credit is billed as a percentage of the principal balance plus all accrued interest. Loan maturities are normally 300 months. Borrower qualifications include favorable credit history combined with supportive income requirements and combined loan-to-value ratios usually not exceeding 80% inclusive of priority liens. Collateral valuation guidelines follow those for residential real estate loans.
Consumer loan products including personal lines of credit and amortizing loans made to qualified individuals for various purposes such as auto, recreational vehicles, debt consolidation, personal expenses or overdraft protection. Borrower qualifications include favorable credit history combined with supportive income and collateral requirements within established policy guidelines. Consumer loans may be secured or unsecured.
Construction loans, both commercial and residential, at 32.5% of capital are well under the regulatory guidance of 100.0% of capital at June 30, 2018. Construction loans and non-owner-occupied commercial real estate loans are at 129.9% of total capital, well under the regulatory guidance of 300.0% of capital at June 30, 2018.
The following table summarizes the loan portfolio, by class, at June 30, 2018 and 2017 and December 31, 2017.

Dollars in thousands	June 30, 2018		December 31, 2017		June 30, 2017	
Commercial						
Real estate	$350,114	28.6 %	$323,809	27.8 %	$306,490	27.4 %
Construction	40,308	3.3 %	38,056	3.3 %	33,605	3.0 %
Other	184,718	15.1 %	181,528	15.6 %	173,691	15.5 %
Municipal	48,717	4.0 %	33,391	2.9 %	28,695	2.6 %
Residential						
Term	453,588	37.0 %	432,661	37.1 %	427,171	38.1 %
Construction	14,583	1.2 %	17,868	1.5 %	15,056	1.3 %
Home equity line of credit	107,666	8.8 %	111,302	9.6 %	110,328	9.8 %
Consumer	24,746	2.0 %	25,524	2.2 %	25,629	2.3 %
Total loans	$1,224,440	100.0%	$1,164,139	100.0%	$1,120,665	100.0%

The following table sets forth certain information regarding the contractual maturities of the Bank's loan portfolio as of June 30, 2018.

Dollars in thousands	< 1 Year	1 - 5 Years	5 - 10 Years	> 10 Years	Total
Commercial					
Real estate	$6,271	$29,341	$40,182	$274,320	$350,114
Construction	1,760	5,368	2,259	30,921	40,308
Other	15,681	63,474	46,150	59,413	184,718
Municipal	24,238	6,300	13,946	4,233	48,717
Residential					
Term	1,929	7,799	27,105	416,755	453,588
Construction	207	17	47	14,312	14,583
Home equity line of credit	770	365	391	106,140	107,666
Consumer	8,266	4,526	2,666	9,288	24,746
Total loans	$59,122	$117,190	$132,746	$915,382	$1,224,440

The following table provides a listing of loans by class, between variable and fixed rates as of June 30, 2018.

	Fixed-Rate			Adjustable-Rate			Total		
Dollars in thousands	Amount	% of total		Amount	% of total		Amount	% of total	
Commercial									
Real estate	$68,505	5.6	%	$281,609	23.0	%	$350,114	28.6	%
Construction	9,289	0.8	%	31,019	2.5	%	40,308	3.3	%
Other	70,318	5.7	%	114,400	9.3	%	184,718	15.1	%
Municipal	47,322	3.9	%	1,395	0.1	%	48,717	4.0	%
Residential									
Term	325,689	26.6	%	127,899	10.4	%	453,588	37.0	%
Construction	14,413	1.2	%	170	0.0	%	14,583	1.2	%
Home equity line of credit	615	0.1	%	107,051	8.7	%	107,666	8.8	%
Consumer	18,321	1.5	%	6,425	0.5	%	24,746	2.0	%
Total loans	$554,472	45.4	%	$669,968	54.6	%	$1,224,440	100.0	%

Loan Concentrations

As of June 30, 2018, the Bank did not have any concentration of loans in one particular industry that exceeded 10% of its total loan portfolio.

Credit Risk Management and Allowance for Loan Losses

Credit risk is the risk of loss arising from the inability of a borrower to meet its obligations. We manage credit risk by evaluating the risk profile of the borrower, repayment sources, the nature of the underlying collateral, and other support given current events, conditions, and expectations. We attempt to manage the risk characteristics of our loan portfolio through various control processes, such as credit evaluation of borrowers, establishment of lending limits, and application of lending procedures, including the holding of adequate collateral and the maintenance of compensating balances. However, we seek to rely primarily on the cash flow of our borrowers as the principal source of repayment. Although credit policies and evaluation processes are designed to minimize our risk, Management recognizes that loan losses will occur and the amount of these losses will fluctuate depending on the risk characteristics of our loan portfolio, as well as general and regional economic conditions.

We provide for loan losses through the establishment of an allowance for loan losses which represents an estimated reserve for existing losses in the loan portfolio. We deploy a systematic methodology for determining our allowance that includes a quarterly review process, risk rating, and adjustment to our allowance. We classify our portfolios as either commercial or residential and consumer and monitor credit risk separately as discussed below. We evaluate the appropriateness of our allowance continually based on a review of all significant loans, with a particular emphasis on nonaccruing, past due, and other loans that we believe require special attention.

The allowance consists of four elements: (1) specific reserves for loans evaluated individually for impairment; (2) general reserves for types or portfolios of loans based on historical loan loss experience; (3) qualitative reserves judgmentally adjusted for local and national economic conditions, concentrations, portfolio composition, volume and severity of delinquencies and nonaccrual loans, trends of criticized and classified loans, changes in credit policies, and underwriting standards, credit administration practices, and other factors as applicable; and (4) unallocated reserves. All outstanding loans are considered in evaluating the appropriateness of the allowance.

Appropriateness of the allowance for loan losses is determined using a consistent, systematic methodology, which analyzes the risk inherent in the loan portfolio. In addition to evaluating the collectability of specific loans when determining the appropriateness of the allowance for loan losses, Management also takes into consideration other factors such as changes in the mix and size of the loan portfolio, historic loss experience, the amount of delinquencies and loans adversely classified, economic trends, changes in credit policies, and experience, ability and depth of lending management. The appropriateness of the allowance for loan losses is assessed by an allocation process whereby specific reserve allocations are made against certain adversely classified loans, and general reserve allocations are made against segments of the loan portfolio which have similar attributes. The Company's historical loss experience, industry trends, and the impact of the local and regional economy on the Company's borrowers, are considered by Management in determining the appropriateness of the allowance for loan losses.

The allowance for loan losses is increased by provisions charged against current earnings. Loan losses are charged against the allowance when Management believes that the collectability of the loan principal is unlikely. Recoveries on loans previously charged off are credited to the allowance. While Management uses available information to assess possible losses on loans, future additions to the allowance may be necessary based on increases in non-performing loans, changes in economic conditions, growth in loan portfolios, or for other reasons. Any future additions to the allowance would be recognized in the period in which they were determined to be necessary. In addition, various regulatory agencies periodically review the Company's allowance for loan losses as an integral part of their examination process. Such agencies may require the Company to record additions to the allowance based on judgments different from those of Management.

Commercial

Our commercial portfolio includes all secured and unsecured loans to borrowers for commercial purposes, including commercial lines of credit and commercial real estate. Our process for evaluating commercial loans includes performing updates on loans that we have rated for risk. Our non-performing commercial loans are generally reviewed individually to determine impairment, accrual status, and the need for specific reserves. Our methodology incorporates a variety of risk considerations, both qualitative and quantitative. Quantitative factors include our historical loss experience by loan type, collateral values, financial condition of borrowers, and other factors. Qualitative factors include judgments concerning general economic conditions that may affect credit quality, credit concentrations, the pace of portfolio growth, and delinquency levels; these qualitative factors are also considered in connection with our unallocated portion of our allowance for loan losses.

The process of establishing the allowance with respect to the commercial loan portfolio begins when a Loan Officer or Senior Officer (or designate) initially assigns each loan a risk rating, using established credit criteria. Approximately 60% of a trailing four quarter average gross commercial portfolio is subject to review and validation annually by an independent consulting firm. Additionally, commercial loan relationships with exposure greater than or equal to $500,000 and lines of credit greater than $250,000 are subject to review annually by the Company's internal credit review function. Our methodology employs Management's judgment as to the level of losses on existing loans based on our internal review of the loan portfolio, including an analysis of the borrowers' current financial position, and the consideration of current and anticipated economic conditions and their potential effects on specific borrowers and or lines of business. In determining our ability to collect certain loans, we also consider the fair value of any underlying collateral. We also evaluate credit risk concentrations, including trends in large dollar exposures to related borrowers, industry and geographic concentrations, and economic and environmental factors.

Residential, Home Equity and Consumer

Consumer, home equity and residential mortgage loans are generally segregated into homogeneous pools with similar risk characteristics. Trends and current conditions in these pools are analyzed and historical loss experience is adjusted accordingly. Quantitative and qualitative adjustment factors for the consumer, home equity and residential mortgage portfolios are consistent with those for the commercial portfolios. Certain loans in the consumer and residential portfolios identified as having the potential for further deterioration are analyzed individually to confirm the appropriate risk status and accrual status, and to determine the need for a specific reserve. Consumer loans that are greater than 120 days past due are generally charged off. Residential loans and home equity lines of credit that are greater than 90 days past due are evaluated for collateral adequacy and if deficient are placed on non-accrual status.

Unallocated

The unallocated portion of the allowance is intended to provide for losses that are not identified when establishing the specific and general portions of the allowance and is based upon Management's evaluation of various conditions that are not directly measured in the determination of the portfolio and loan specific allowances. Such conditions may include general economic and business conditions affecting our lending area, credit quality trends (including trends in delinquencies and nonperforming loans expected to result from existing conditions), loan volumes and concentrations, duration of the current business cycle, bank regulatory examination results, findings of external loan review examiners, and Management's judgment with respect to various other conditions including loan administration and management and the quality of risk identification systems. Management reviews these conditions quarterly. We have risk management practices designed to ensure timely identification of changes in loan risk profiles; however, undetected losses may exist inherently within the loan portfolio. The judgmental aspects involved in applying the risk grading criteria, analyzing the quality of individual loans, and assessing collateral values can also contribute to undetected, but probable, losses. Consequently, there maybe underlying credit risks that have not yet surfaced in the loan- specific or qualitative metrics the Company uses to estimate its allowance for loan losses.

The allowance for loan losses includes reserve amounts assigned to individual loans on the basis of loan impairment. Certain loans are evaluated individually and are judged to be impaired when Management believes it is probable that the Company will not collect all of the contractual interest and principal payments as scheduled in the loan agreement. Under this method, loans are selected for evaluation based on internal risk ratings or non-accrual status. A specific reserve is allocated to an individual loan when that loan has been deemed impaired and when the amount of a probable loss is estimable on the basis of its collateral value, the present value of anticipated future cash flows, or its net realizable value. At June 30, 2018, impaired loans with specific reserves totaled $12.9 million and the amount of such reserves was $2.2 million. This compares to impaired loans with specific reserves of $13.4 million at December 31, 2017 and the amount of such reserves was $1.8 million.

All of these analyses are reviewed and discussed by the Directors' Loan Committee, and recommendations from these processes provide Management and the Board of Directors with independent information on loan portfolio condition. Our total allowance at June 30, 2018 is considered by Management to be appropriate to address the credit losses inherent in the loan portfolio at that date. However, our determination of the appropriate allowance level is based upon a number of assumptions we make about future events, which we believe are reasonable, but which may or may not prove valid. Thus, there can be no assurance that our charge-offs in future periods will not exceed our allowance for loan losses or that we will not need to make additional increases in our allowance for loan losses.

The following table summarizes our allocation of allowance by loan class as of June 30, 2018 and 2017 and December 31, 2017. The percentages are the portion of each loan class to total loans.

Dollars in thousands	June 30, 2018			December 31, 2017			June 30, 2017		
Commercial									
Real estate	$3,732	28.6	%	$3,872	27.8	%	$4,019	27.4	%
Construction	399	3.3	%	434	3.3	%	519	3.0	%
Other	3,475	15.1	%	3,358	15.6	%	2,184	15.5	%
Municipal	21	4.0	%	20	2.9	%	19	2.6	%
Residential									
Term	1,138	37.0	%	1,130	37.1	%	999	38.1	%
Construction	29	1.2	%	36	1.5	%	26	1.3	%
Home equity line of credit	678	8.8	%	692	9.6	%	684	9.8	%
Consumer	575	2.0	%	545	2.2	%	491	2.3	%
Unallocated	1,425	—	%	642	—	%	1,670	—	%
Total	$11,472	100.0	%	$10,729	100.0	%	$10,611	100.0	%

The allowance for loan losses totaled $11.5 million at June 30, 2018, compared to $10.7 million as of December 31, 2017 and $10.6 million as of June 30, 2017. Management's ongoing application of methodologies to establish the allowance include an evaluation of impaired loans for specific reserves. These specific reserves increased $393,000 in the first six months of 2018 from $1.8 million at December 31, 2017 to $2.2 million at June 30, 2018. The specific loans that make up those categories change from period to period. Impairment on those loans, which would be reflected in the allowance for loan losses, might or might not exist, depending on the specific circumstances of each loan. The portion of the reserve based upon homogeneous pools of loans decreased by $403,000 in the first six months of 2018. The portion of the reserve based on qualitative factors declined nominally, or $30,000 in the first six months of 2018 due to a mix of factors. After consideration of the shifts in specific, pooled and qualitative reserves, Management determined that the change in unallocated reserves from $642,000, or 6.0% of the total reserve at December 31, 2017, to $1.4 million, or 12.4% as of June 30, 2018, supported general imprecision related to portfolio growth.

A breakdown of the allowance for loan losses as of June 30, 2018, by loan class and allowance element, is presented in the following table:

Dollars in thousands	Specific Reserves on Loans Evaluated Individually for Impairment	General Reserves on Loans Based on Historical Loss Experience	Reserves for Qualitative Factors	Unallocated Reserves	Total Reserves
Commercial					
Real estate	$ 270	$ 1,067	$ 2,395	$ —	$ 3,732
Construction	—	123	276	—	399
Other	1,647	563	1,265	—	3,475
Municipal	—	—	21	—	21
Residential					
Term	286	311	541	—	1,138
Construction	—	10	19	—	29
Home equity line of credit	2	287	389	—	678
Consumer	—	269	306	—	575
Unallocated	—	—	—	1,425	1,425
	$ 2,205	$ 2,630	$ 5,212	$ 1,425	$ 11,472

Based upon Management's evaluation, provisions are made to maintain the allowance as a best estimate of inherent losses within the portfolio. The provision for loan losses to maintain the allowance was $1.0 million for the first six months of 2018 and the first six months of 2017. Net chargeoffs were $257,000 in the first six months of 2018, down from $527,000 in the first six months of 2017. Our allowance as a percentage of outstanding loans was 0.94% as of June 30, 2018, up from 0.92% reported as of December 31, 2017, and down from 0.95% as of June 30, 2017.

The following table summarizes the activities in our allowance for loan losses for the six months ended June 30, 2018 and 2017 and for the year ended December 31, 2017:

Dollars in thousands	June 30, 2018	December 31, 2017	June 30, 2017
Balance at the beginning of year	$10,729	$ 10,138	$10,138
Loans charged off:			
Commercial			
Real estate	—	587	305
Construction	—	—	—
Other	17	212	58
Municipal	—	—	—
Residential			
Term	96	456	70
Construction	—	—	—
Home equity line of credit	115	28	28
Consumer	145	335	156
Total	373	1,618	617
Recoveries on loans previously charged off			
Commercial			
Real estate	—	—	—
Construction	—	—	—
Other	10	49	18
Municipal	—	—	—
Residential			
Term	42	40	19
Construction	—	—	—
Home equity line of credit	13	11	3
Consumer	51	109	50
Total	116	209	90
Net loans charged off	257	1,409	527
Provision for loan losses	1,000	2,000	1,000
Balance at end of period	$11,472	$ 10,729	$10,611
Ratio of net loans charged off to average loans outstanding[1]	0.04 %	0.13 %	0.10 %
Ratio of allowance for loan losses to total loans outstanding	0.94 %	0.92 %	0.95 %

[1] Annualized using a 365-day basis for both 2018 and 2017.

In Management's opinion, the level of the provision for loan losses is directionally consistent with the overall credit quality of our loan portfolio and corresponding levels of nonperforming loans, as well as with the performance of the national and local economies.

Nonperforming Loans

Nonperforming loans are comprised of loans, for which based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement or when principal and interest is 90 days or more past due unless the loan is both well secured and in the process of collection (in which case the loan may continue to accrue interest in spite of its past due status). A loan is "well secured" if it is secured (1) by collateral in the form of liens on or pledges of real or personal property, including securities, that have a realizable value sufficient to discharge the debt including accrued interest) in full, or (2) by the guarantee of a financially responsible party. A loan is "in the process of collection" if collection of the loan is proceeding in due course either (1) through legal action, including judgment enforcement

procedures, or, (2) in appropriate circumstances, through collection efforts not involving legal action which are reasonably expected to result in repayment of the debt or in its restoration to a current status in the near future.
When a loan becomes nonperforming (generally 90 days past due), it is evaluated for collateral dependency based upon the most recent appraisal or other evaluation method. If the collateral value is lower than the outstanding loan balance plus accrued interest and estimated selling costs, the loan is placed on non-accrual status, all accrued interest is reversed from interest income, and a specific reserve is established for the difference between the loan balance and the collateral value less selling costs, or, in certain situations, the difference between the loan balance and the collateral value less selling costs is written off. Concurrently, a new appraisal or valuation may be ordered, depending on collateral type, currency of the most recent valuation, the size of the loan, and other factors appropriate to the loan. Upon receipt and acceptance of the new valuation, the loan may have an additional specific reserve or write down based on the updated collateral value. On an ongoing basis, appraisals or valuations may be done periodically on collateral dependent non-performing loans and an additional specific reserve or write down will be made, if appropriate, based on the new collateral value.
Once a loan is placed on nonaccrual, it remains in nonaccrual status until the loan is current as to payment of both principal and interest and the borrower demonstrates the ability to pay and remain current. All payments made on nonaccrual loans are applied to the principal balance of the loan.
Nonperforming loans, expressed as a percentage of total loans, totaled 1.17% at June 30, 2018 compared to 1.27% at December 31, 2017 and 0.66% at June 30, 2017. The following table shows the distribution of nonperforming loans by class as of June 30, 2018 and 2017 and December 31, 2017:

Dollars in thousands	June 30, 2018	December 31, 2017	June 30, 2017
Commercial			
Real estate	$981	$ 752	$ 1,814
Construction	286	—	—
Other	8,900	9,357	885
Municipal	—	—	—
Residential			
Term	3,509	3,778	3,852
Construction	—	—	—
Home equity line of credit	689	833	883
Consumer	16	16	—
Total nonperforming loans	$14,381	$ 14,736	$ 7,434

The amounts shown for total nonperforming loans do not include loans 90 or more days past due and still accruing interest. These are loans for which we expect to collect all amounts due, including past-due interest. As of June 30, 2018, loans 90 or more days past due and still accruing interest totaled $3,000, compared to $445,000 at December 31, 2017 and $29,000 at June 30, 2017.

Troubled Debt Restructured

A troubled debt restructured ("TDR") constitutes a restructuring of debt if the Company, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower that it would not otherwise consider. To determine whether or not a loan should be classified as a TDR, Management evaluates a loan based upon the following criteria:

- The borrower demonstrates financial difficulty; common indicators include past due status with bank obligations, substandard credit bureau reports, or an inability to refinance with another lender, and
- The Company has granted a concession; common concession types include maturity date extension, interest rate adjustments to below market pricing, and deferment of payments.

As of June 30, 2018, we had 72 loans with a balance of $25.6 million that have been restructured. This compares to 62 loans with a balance of $17.8 million and 68 loans with a balance of $20.3 million classified as TDRs as of December 31, 2017 and June 30, 2017, respectively.

The following table shows the activity in loans classified as TDRs between December 31, 2017 and June 30, 2018:

Balance in Thousands of Dollars	Number of Loans	Aggregate Balance
Total at December 31, 2017	62	$ 17,801
Added in 2018	10	8,024
Loans paid off in 2018	—	—
Repayments in 2018	—	(219)
Total at June 30, 2018	72	$ 25,606

As of June 30, 2018, 59 loans with an aggregate balance of $17.7 million were performing under the modified terms, one loan with an aggregate balance of $118,000 was more than 30 days past due and accruing and 12 loans with an aggregate balance of $7.8 million were on nonaccrual. As a percentage of aggregate outstanding balance, 69.1% were performing under the modified terms, 0.5% were more than 30 days past due and accruing and 30.4% were on nonaccrual. The performance status of all TDRs as of June 30, 2018, as well as the associated specific reserve in the allowance for loan losses, is summarized by type of loan in the following table.

In thousands of dollars	Performing As Modified	30+ Days Past Due and Accruing	On Nonaccrual	All TDRs
Commercial				
Real estate	$ 7,928	$ —	$ 98	$ 8,026
Construction	741	—	—	741
Other	539	—	6,532	7,071
Municipal	—	—	—	—
Residential				
Term	8,147	118	998	9,263
Construction	—	—	—	—
Home equity line of credit	338	—	167	505
Consumer	—	—	—	—
	$ 17,693	$ 118	$ 7,795	$ 25,606
Percent of balance	69.1 %	0.5 %	30.4 %	100.0 %
Number of loans	59	1	12	72
Associated specific reserve	$ 397	$ 16	$ 1,117	$ 1,530