

NORTHEAST BANCORP /ME/  
Form 10-K  
September 13, 2018

Table of Contents

---

---

**United States**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

---

**FORM 10-K**

**(Mark One)**

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

**For the fiscal year ended June 30, 2018**

**OR**

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

**For the transition period from                      to**

**Commission file number (1-14588)**

---

**NORTHEAST BANCORP**

**(Exact name of registrant as specified in its charter)**

**Maine  
(State or other jurisdiction of  
incorporation or organization)**

**01-0425066  
(I.R.S. Employer  
Identification No.)**

**500 Canal Street, Lewiston, Maine 04240**  
**(Address of principal executive offices) (Zip Code)**  
**Registrant's telephone number, including area code:**

**(207) 786-3245**

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

<b><u>Title of each class:</u></b>	<b><u>Name of each exchange on which registered:</u></b>
Voting Common Stock, \$1.00 par value	The NASDAQ Stock Market LLC

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

**None**

---

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

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

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 No

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated

filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer      Accelerated filer

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

The aggregate market value of the registrant’s voting and non-voting common stock held by non-affiliates, computed by reference to the last reported sales price of the registrant’s voting common stock on the NASDAQ Global Market on December 31, 2017 was approximately \$190,494,104.

As of September 7, 2018, the registrant had outstanding 8,230,417 shares of voting common stock, \$1.00 par value per share, and 820,742 shares of non-voting common stock, \$1.00 par value per share.

---

#### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant’s proxy statement for the 2018 Annual Meeting of Shareholders to be held on November 16, 2018 are incorporated by reference in Items 10, 11, 12, 13 and 14 of Part III of this Annual Report on Form 10-K. The registrant intends to file such proxy statement with the Securities and Exchange Commission no later than 120 days after the end of its fiscal year ended June 30, 2018.

---

---

Table of Contents

Table of Contents

Part I.

<u>Item 1. Business</u>	<u>4</u>
<u>Item 1A. Risk Factors</u>	<u>17</u>
<u>Item 1B. Unresolved Staff Comments</u>	<u>26</u>
<u>Item 2. Properties</u>	<u>26</u>
<u>Item 3. Legal Proceedings</u>	<u>26</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>26</u>

Part II

<u>Item 5. Market for Registrant’s Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities</u>	<u>27</u>
<u>Item 6. Selected Financial Data</u>	<u>29</u>
<u>Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>30</u>
<u>Item 7A. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>50</u>
<u>Item 8. Financial Statements and Supplementary Data</u>	<u>51</u>
<u>Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	<u>95</u>
<u>Item 9A. Controls and Procedures</u>	<u>95</u>
<u>Item 9B. Other Information</u>	<u>97</u>

Part III

<u>Item 10. Directors, Executive Officers and Corporate Governance</u>	<u>97</u>
<u>Item 11. Executive Compensation</u>	<u>97</u>

<u>Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters</u>	<u>97</u>
--	-----------

<u>Item 13. Certain Relationships and Related Transactions, and Director Independence</u>	<u>97</u>
---	-----------

<u>Item 14. Principal Accounting Fees and Services</u>	<u>97</u>
--	-----------

Part IV

<u>Item 15. Exhibits, Financial Statement Schedules</u>	<u>98</u>
---	-----------

Table of Contents

**A Note About Forward-Looking Statements**

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

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

Table of Contents

**PART I**

**Item 1. Business**

**Overview**

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

On December 29, 2010, the merger of the Company and FHB Formation LLC (the "Merger"), a Delaware limited liability company ("FHB"), was consummated. In connection with the transaction, as part of the regulatory approval process, the Company and the Bank made certain commitments to the Federal Reserve, the most significant of which are (i) to maintain a Tier 1 leverage ratio of at least 10%, (ii) to maintain a total capital ratio of at least 15%, (iii) to limit purchased loans to 40% of total loans, (iv) to fund 100% of the Company's loans with core deposits (defined as non-maturity deposits and non-brokered insured time deposits), and (v) to hold commercial real estate loans (including owner-occupied commercial real estate) to within 300% of total capital. On June 28, 2013, the Federal Reserve approved the amendment of the commitment to hold commercial real estate loans to within 300% of total capital to exclude owner-occupied commercial real estate loans. All other commitments made to the Federal Reserve in connection with the Merger remain unchanged. The Company and the Bank are currently in compliance with all commitments to the Federal Reserve.

As of June 30, 2018, the Company, on a consolidated basis, had total assets of \$1.2 billion, total deposits of \$954.9 million, and shareholders' equity of \$138.4 million. We gather retail deposits through the Community Banking Division's ten full-service branches in Maine and through our online deposit program, ableBanking; originate loans through the Community Banking Division; purchase and originate commercial loans on a nationwide basis through the Bank's Loan Acquisition and Servicing Group ("LASG"); and originate Small Business Administration and United States Department of Agriculture ("SBA") loans on a nationwide basis through the Bank's national SBA group ("SBA Division").

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

**Strategy**

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

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

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

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

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

## **Market Area and Competition**

The LASG and SBA Division activities are nationwide. The LASG competes primarily with community banks, regional banks and private equity funds operating nationwide in its bid to acquire primarily commercial real estate loans. We believe that we often have a competitive advantage in bidding against private equity funds on performing loans because those funds generally have higher funding costs and, therefore, higher expectations for return on investment than we do. Furthermore, private equity funds typically do not compete for small balance commercial loans and typically pursue larger, bulk transactions. Due to improving credit quality over the past several years and the low interest rate environment, the supply of loans available for purchase has declined, competition has increased, and spreads have tightened. Despite these trends, we believe that the LASG continues to have a competitive advantage in bidding against other banks because we have a specialized group with experience in purchasing commercial real estate loans. Additionally, most banks we compete against are community banks looking to acquire loans in their market; these banks usually have specific criteria for their acquisition activities and do not pursue pools with collateral or geographic diversity.





Table of Contents

The SBA Division competes primarily with community banks, regional banks, national/global banks, and non-bank licensed lenders on a nationwide basis. Capitalizing on our LASG origination loan infrastructure, the SBA Division is in a position to review and act quickly on a variety of lending opportunities. Risk management, approvals, underwriting and other due diligence for these loans is similar to that for the LASG loans. We believe that the SBA Division has an advantage in originating commercial real estate loans because of its ability to utilize in-house staff to quickly and accurately screen loan opportunities, which accelerates the underwriting process.

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

**Lending Activities**

*General*

We conduct our loan-related activities through three primary channels: the LASG, the SBA Division, and the Community Banking Division. The LASG purchases primarily performing commercial real estate loans, on a nationwide basis, typically at a discount from their unpaid principal balances, producing yields higher than those normally achieved on the Company's originated loan portfolio. The LASG also originates commercial real estate and commercial and industrial loans on a nationwide basis. The SBA Division originates loans to small businesses, primarily through the SBA 7(a) program, which provides the partial guarantee of the SBA. The Community Banking Division originates loans directly to consumers and businesses located in its market area. At June 30, 2018, our total loan portfolio (excluding loans held for sale) was \$871.8 million, of which \$688.3 million, or 79.0%, was purchased or originated by the LASG, \$60.2 million, or 6.9%, was originated by the SBA Division, and \$123.3 million, or 14.1%, was originated by the Community Banking Division.

The following table sets forth certain information concerning our portfolio loan purchases and originations for the periods indicated (including loans held for sale):

Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-K

	Years Ended June 30,	
	2018	2017
	(Dollars in thousands)	
Loans, including loans held for sale, beginning of year	\$783,894	\$699,955
Additions:		
LASG Purchases and Originations:		
Originations	224,546	237,691
Purchases	124,111	112,807
Subtotal	348,657	350,498
SBA Division Funded Originations	42,368	81,996
Community Bank Originations:		
Residential mortgages held for sale	63,321	72,571
Residential mortgages held for investment	1,094	3,785
Home equity	315	201
Commercial real estate	209	6,565
Commercial and industrial	1,670	980
Consumer	72	145
Subtotal	66,681	84,247
Total originations and purchases	457,706	516,741
Reductions:		
Sales of residential loans held for sale	(63,005 )	(74,662 )
Sales of SBA and portfolio loans	(32,088 )	(72,052 )
Charge-offs	(347 )	(387 )
Pay-downs and amortization, net	(267,203)	(285,701)
Total reductions	(362,643)	(432,802)
Loans, including loans held for sale, end of year	\$878,957	\$783,894
Annual percentage increase in loans	12.13 %	11.99 %

Table of Contents

We individually underwrite all loans that we originate and purchase. Our loan underwriting policies are reviewed and approved annually by our Board of Directors (the “Board”). Each loan, regardless of whether it is originated or purchased, must meet underwriting criteria set forth in our lending policies and the requirements of applicable federal and state regulations. All loans are subject to approval procedures and amount limitations, and the Board approves loan relationships exceeding certain prescribed dollar limits. We supplement our own supervision of the loan underwriting and approval process with periodic loan audits by internal personnel and outside professionals experienced in loan review. As of June 30, 2018, the Bank’s legal lending limit was \$32.4 million.

We typically retain servicing rights for all loans that we originate or purchase, except for residential loans that we originate and sell servicing released in the secondary market.

***LASG Purchases and Originations***

*General.* Loans originated or purchased by the LASG were \$688.3 million as of June 30, 2018, which consisted of \$495.4 million of commercial real estate loans, \$171.9 million of commercial and industrial loans, and \$21.0 million of one- to four-family residential loans. The following table summarizes the LASG loan portfolio as of June 30, 2018:

	Purchased	Originated	Total
	(Dollars in thousands)		
Non-owner occupied commercial real estate	\$ 150,805	\$ 137,463	\$ 288,268
Owner occupied commercial real estate	125,246	81,916	207,162
Commercial and industrial	995	170,873	171,868
1-4 family residential	13,926	7,111	21,037
Total	\$ 290,972	\$ 397,363	\$ 688,335

Since the inception of the LASG through June 30, 2018, we have purchased loans with an aggregate investment of \$723 million, of which \$124.1 million was purchased during fiscal 2018. We have also originated LASG loans totaling \$809 million, of which \$224.5 million was originated in fiscal 2018. As of June 30, 2018, the unpaid principal balance of loans purchased or originated by the LASG ranged from \$2 thousand to \$10.0 million and have an average balance of \$735 thousand. The real estate loans were secured principally by retail, industrial, hospitality, multi-family and office properties in 41 states.

The following table shows the LASG loan portfolio stratified by book value as of June 30, 2018, excluding deferred fees and costs:

Range	Amount	Percent of Total
(Dollars in thousands)		
\$0 - \$1,000	\$ 188,663	27.46 %
\$1,000 - \$3,000	272,846	39.72 %
\$3,000 - \$6,000	114,092	16.61 %
\$6,000 - \$9,000	92,329	13.44 %
Greater than \$9,000	18,999	2.77 %
Total	\$ 686,929	100.00 %

The following tables show the LASG loan portfolio by location and type of collateral as of June 30, 2018, excluding deferred fees and costs:

Collateral Type	Amount	Percent of Total	State	Amount	Percent of Total
	(Dollars in thousands)			(Dollars in thousands)	
Multifamily	\$ 59,697	8.69 %	NY	\$ 124,065	18.06 %
Office	68,984	10.04 %	CA	131,134	19.09 %
Hospitality	51,630	7.52 %	NJ	24,564	3.58 %
Retail	141,020	20.53 %	IL	29,075	4.23 %
Industrial	81,830	11.91 %	AZ	23,468	3.42 %
Portfolio finance	166,783	24.28 %	TX	35,736	5.20 %
Other real estate	63,750	9.28 %	FL	26,331	3.83 %
All other	53,235	7.75 %	Non-real estate	149,198	21.72 %
Total	\$ 686,929	100.00 %	All other states	143,358	20.87 %
			Total	\$ 686,929	100.00 %

*Loan Purchase Strategies.* The LASG's loan purchasing strategy involves the acquisition of commercial loans, typically secured by real estate or other business assets located throughout the United States.

Table of Contents

We acquire commercial loans typically at a discount to their unpaid principal balances. While we acquire loans on a nationwide basis, we seek to avoid significant concentration in any geographic region or in any one collateral type. We do not seek acquisition opportunities for which the primary collateral is land, construction, or one- to four-family residential property, although in a very limited number of cases, loans secured by such collateral may be included in a pool of otherwise desirable loans. Purchased loans are sourced on a nationwide basis from banks, insurance companies, investment funds and government agencies, either directly or indirectly through advisors.

We focus on servicing released, whole loan or lead participation transactions so that we can control the management of the portfolio through our experienced asset management professionals. Purchased loans can be acquired as a single relationship or combined with other borrowers in a larger pool. Loans are bid to a minimal acceptable yield to maturity based on the overall risk of the loan, including expected repayment terms and the underlying collateral value. Updated loan-to-value ratios and loan terms both influence the amount of discount the Bank requires in determining whether a loan meets the Bank's guidelines. We often achieve actual results in excess of our minimal acceptable yield to maturity when a loan is prepaid.

At June 30, 2018, purchased loans had an unpaid principal balance of \$326.9 million and a book value of \$291.0 million, representing a total discount of 11.0%.

The following table shows the purchased loan portfolio as of June 30, 2018 by original purchase price percentage:

Initial Investment as a % of	Amount	Percent
Unpaid Principal Balance	(Dollars in thousands)	of Total
0% - 60%	\$ 4,658	1.60 %
60% - 70%	7,463	2.57 %
70% - 80%	19,527	6.71 %
80% - 90%	83,307	28.63 %
>90%	176,017	60.49 %
Total	\$ 290,972	100.00 %

*Secondary Market for Commercial Loans.* Commercial whole loans are typically sold either directly by sellers or through loan sale advisors. Because a central database for commercial whole loan transactions does not exist, we attempt to compile our own statistics by both polling major loan sale advisors to obtain their aggregate trading volume and tracking the deal flow that we see directly via a proprietary database. This data reflects only a portion of the total market, as commercial whole loans that are sold in private direct sales or through other loan sale advisors are not included in our surveys. In recent years, the ratio of performing loans to total loans in the market has increased, in

part, because sellers have worked through their most troubled, non-performing loans or are looking to minimize the discount they would receive in a secondary market transaction. While the 2008-2010 economic crisis led to a high level of trading volume, we also expect the market to remain active in times of economic prosperity, as sellers tend to have additional reserve capacity to sell their unwanted assets. Furthermore, we believe that the continued consolidation of the banking industry will create secondary market activity as acquirers often sell non-strategic borrowing relationships or assets that create excess loan concentrations.

*Underwriting of Purchased Loans.* We review many loan purchase opportunities and commence underwriting on a relatively small percentage of loans. Purchased loans are underwritten by a team of in-house, seasoned analysts before being considered for approval. Prior to commencing underwriting, loans are analyzed for performance characteristics, loan terms, collateral quality, and price expectations. We also consider whether the loans would make our total purchased loan portfolio more or less diverse with respect to geography, loan type and collateral type. The opportunity is underwritten once it has been identified as fitting our investment parameters. While the extent of underwriting may vary based on investment size, procedures generally include the following:

- A loan analyst reviews and analyzes the seller credit file and our own internal and third party research in order to assess credit risk;

- With the assistance of local counsel, where appropriate, an in-house attorney makes a determination regarding the quality of loan documentation and enforceability of loan terms;

- An in-house real estate specialist performs real estate collateral evaluations, which includes conducting original market research for trends and sale and lease comparables, and develops a valuation based on current data reflecting what we believe are recent trends;

- An environmental assessment is performed on real estate collateral where appropriate;

Table of Contents

A property inspection is generally performed on all real estate collateral securing a loan, focusing on several characteristics, including, among other things, the physical quality of the property, current occupancy, general quality and occupancy within the neighborhood, market position and nearby property listings; and

An underwriting package containing the analysis and results is reviewed and submitted for approval by the LASG Credit Committee.

*Collateral Valuation.* The estimated value of the real property collateralizing the loan is determined by the LASG's in-house real estate group, which considers, among other factors, the type of property, its condition, location and its highest and best use in its marketplace. An inspection is conducted for the real property securing all loans bid upon. For loans that exceed a certain dollar threshold as prescribed in our credit policy, members of the LASG typically conduct an in-person site inspection.

We generally view cash flow from operations as the primary source of repayment on purchased loans. The LASG analyzes the current and likely future cash flows generated by the collateral to repay the loan. Also considered are minimum debt service coverage ratios, consisting of the ratio of net operating income to total scheduled principal and interest payments. Consideration of the debt service coverage ratio is critical to the pricing and rating of purchased and originated loans, and is analyzed carefully. For purchased loans, care is taken to ensure that, unless significantly offset by other factors in the credit, the purchase price results in an adjusted debt service coverage ratio that is within the Bank's lending limits. Moreover, if the debt service coverage ratio based on the contractual payments, regardless of the Bank's exposure, is significantly below 1.0x, then steps are taken to document alternative sources of repayment or develop a realistic plan to ensure continued performance of the loan.

*Loan Pricing.* In determining the amount that we are willing to bid to acquire individual loans or loan pools, the LASG considers the following:

• Collateral securing the loan;

• Geographic location;

• Financial resources of the borrower or guarantors, if any;

• Recourse nature of the loan;

• Age and performance of the loan;



•Length of time during which the loan has performed in accordance with its repayment term;

•Yield expected to be earned; and

•Servicing restrictions, if any.

In addition to the factors listed above and despite the fact that purchased loans are typically performing loans, the LASG also estimates the amount that we may realize through collection efforts or foreclosure and sale of the collateral, net of expenses, and the length of time and costs required to complete the collection or foreclosure process in the event a loan becomes non-performing or is non-performing at the time of purchase.

*Loan Originations.* In addition to purchasing loans, the LASG also originates commercial loans on a nationwide basis. Capitalizing on our purchased loan infrastructure, the LASG is in a position to review and act quickly on a variety of lending opportunities. Risk management, approvals, underwriting and other due diligence for these loans is similar to that for purchased loans, other than the appraisal and documentation process, which mirrors the Community Banking Division's practice of employing local attorneys and real estate appraisers to assist in the process. We believe that the LASG has an advantage in originating commercial loans because of its ability to utilize in-house staff to quickly and accurately screen loan opportunities and accelerate the underwriting process.

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

Table of Contents***SBA Division***

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

The following table summarizes the SBA Division loan portfolio as of June 30, 2018:

	SBA Division (Dollars in thousands)
Non-owner occupied commercial real estate	\$ 29,488
Owner occupied commercial real estate	24,483
Commercial and industrial	6,057
1-4 family residential	128
Total	\$ 60,156

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

In addition to the loans held in the SBA Division loan portfolio, as of June 30, 2018, \$3.8 million in the loans held for sale portfolio were attributable to the SBA Division, consisting of the guaranteed portion of the SBA Division loans that we expect to sell in the secondary market.

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

*Underwriting of SBA Division Loans.* Our loan policies and procedures establish guidelines governing our SBA lending program. Generally, these guidelines address the types of loans that we seek, target markets, underwriting and

collateral requirements, terms, interest rate and yield considerations and compliance with laws and regulations. All loans or credit lines are subject to approval procedures and amount limitations. Our policies are reviewed and approved at least annually by our Board to ensure that we are following SBA underwriting guidelines.

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

### ***Community Banking Division Originations***

*Loan Portfolio.* The Community Banking Division's loan portfolio consists primarily of loans to businesses and consumers in the Community Banking Division's market area.

*Residential Mortgage Loans.* We originate residential mortgage loans secured by one- to four-family properties primarily throughout Maine. Such loans may be originated for sale in the secondary market or to be held on the Bank's balance sheet. We also offer home equity loans and home equity lines of credit, which are secured by first or second mortgages on one- to four-family owner-occupied properties and are held on our balance sheet. At June 30, 2018, portfolio residential loans totaled \$79.1 million, or 9.1% of total loans. Of the residential loans we held for investment at June 30, 2018, approximately 54.5% were adjustable rate. Included in residential loans are home equity lines of credit and other second mortgage loans aggregating approximately \$10.5 million.

*Commercial Real Estate Loans.* We originate multi-family and other commercial real estate loans secured by property located primarily in the Community Banking Division's market area. At June 30, 2018, commercial real estate loans outstanding were \$30.1 million, or 3.4% of total loans. Although the largest commercial real estate loan originated by the Community Banking Division had a principal balance of \$1.7 million at June 30, 2018, the majority of the commercial real estate loans originated by the Community Banking Division had principal balances less than \$500 thousand.

## Table of Contents

*Commercial and industrial Loans.* We originate commercial and industrial loans, including term loans, lines of credit and equipment and receivables financing to businesses located primarily in the Community Banking Division's market area. At June 30, 2018, commercial and industrial loans outstanding were \$10.9 million, or 1.3% of total loans. At June 30, 2018, there were 98 commercial and industrial loans outstanding with an average principal balance of \$112 thousand. The largest of these commercial and industrial loans had a principal balance of \$1.9 million at June 30, 2018.

*Consumer Loans.* We originate, on a direct basis, automobile, boat and recreational vehicle loans. At June 30, 2018, consumer loans outstanding were \$3.2 million, or 0.4% of total loans.

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

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

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

## **Investment Activities**

Our securities portfolio and short-term investments provide and maintain liquidity, assist in managing the interest rate sensitivity of our balance sheet, and serve as collateral for certain of our obligations. Individual investment decisions are made based on the credit quality of the investment, liquidity requirements, potential returns, cash flow targets, and consistency with our asset/liability management objectives.

## **Sources of Funds**

Deposits have traditionally been the primary source of the Bank's funds for lending and other investment purposes. In addition to deposits, the Bank obtains funds from the amortization and prepayment of loans and mortgage-backed securities, the sale, call or maturity of securities, advances from the Federal Home Loan Bank of Boston (the "FHLBB"), other term borrowings and cash flows generated by operations.

### ***Deposits***

We offer a full line of deposit products to customers in western and south-central Maine through our ten-branch network. Our deposit products consist of demand deposit, NOW, money market, savings and certificate of deposit accounts. Our customers access their funds through ATMs, MasterCard® Debit Cards, Automated Clearing House funds (electronic transfers) and checks. We also offer telephone banking, online banking and bill payment, mobile banking and remote deposit capture services. Interest rates on our deposits are based upon factors that include prevailing loan demand, deposit maturities, alternative costs of funds, interest rates offered by competing financial institutions and other financial service firms, and general economic conditions. At June 30, 2018, we had core deposits of \$954.9 million, representing 100% of total deposits. We define core deposits as non-maturity deposits and non-brokered insured time deposits.

Our online deposit program, ableBanking, provides an additional channel through which to obtain core deposits to support our growth. ableBanking, which was launched in late fiscal 2012 as a division of Northeast Bank, had \$323.5 million in money market and time deposits as of June 30, 2018. We also use deposit listing services to gather deposits from time to time, in support of our liquidity and asset/liability management objectives. At June 30, 2018, listing service deposits totaled \$181.5 million, bearing a weighted-average remaining term of 0.98 years.

### ***Borrowings***

While we currently consider core deposits (defined as non-maturity deposits and non-brokered insured time deposits) as our primary source of funding to support asset growth, advances from the FHLBB and other sources of wholesale funding remain an important part of our liquidity contingency planning. Northeast Bank may borrow up to 50% of its total assets from the FHLBB, and borrowings are typically collateralized by mortgage loans and securities pledged to the FHLBB. At June 30, 2018, we had \$48.7 million of available borrowing capacity based on collateral. Northeast Bank can also borrow from the Federal Reserve Bank of Boston, with any such borrowing collateralized by consumer loans pledged to the Federal Reserve.

## Table of Contents

For the foreseeable future, we expect to rely less on borrowings than other banks of similar size, because of our regulatory commitment to fund 100% of our loans with core deposits, although the availability of FHLBB and Federal Reserve Bank of Boston advances and other sources of wholesale funding remain an important part of our liquidity contingency planning.

## **Employees**

As of June 30, 2018, the Company employed 167 full-time and 18 part-time employees. The Company's employees are not represented by any collective bargaining unit. The Company believes that its relations with its employees are good.

## **Other Subsidiaries**

As of June 30, 2018, the Bank had three wholly-owned non-bank subsidiaries:

• 200 Elm Realty, LLC, which was established to hold commercial real estate acquired as a result of loan workouts.

• 500 Pine Realty, LLC, which was established to hold residential real estate acquired as a result of loan workouts.

• 17 Dogwood Realty, LLC, which was established to hold commercial real estate acquired as a result of loan workouts.

## **Supervision and Regulation**

### ***General***

The following discussion addresses elements of the regulatory framework applicable to bank holding companies and their subsidiaries. This regulatory framework is intended primarily to protect the safety and soundness of depository institutions, the federal deposit insurance fund, and depositors, rather than the shareholders of a bank holding company such as the Company. This summary is not a comprehensive analysis of all applicable laws, and is qualified by reference to the applicable statutes and regulations.

*Regulation of the Company*

As a bank holding company, the Company is subject to regulation, supervision and examination by the Federal Reserve, which has the authority, among other things, to order bank holding companies to cease and desist from unsafe or unsound banking practices; to assess civil money penalties; and to order termination of non-banking activities or termination of ownership and control of a non-banking subsidiary by a bank holding company.

*Source of Strength.* Under the Federal Deposit Insurance Act (the “FDIA”), as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), the Company is required to serve as a source of financial strength for the Bank in the event of the financial distress of the Bank. This provision codifies the longstanding policy of the Federal Reserve. In addition, any capital loans by a bank holding company to any of its bank subsidiaries are subordinate to the payment of deposits and to certain other indebtedness. In the event of a bank holding company’s bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a bank subsidiary will be assumed by the bankruptcy trustee and entitled to a priority of payment.

*Acquisitions and Activities.* The Bank Holding Company Act of 1956 (the “BHCA”) prohibits a bank holding company, without prior approval of the Federal Reserve, from acquiring all or substantially all the assets of a bank; acquiring control of a bank; merging or consolidating with another bank holding company; or acquiring direct or indirect ownership or control of any voting shares of another bank or bank holding company if, after such acquisition, the acquiring bank holding company would control more than 5% of any class of the voting shares of such other bank or bank holding company.

The BHCA also prohibits a bank holding company from engaging directly or indirectly in activities other than those of banking, managing or controlling banks or furnishing services to its subsidiary banks. However, a bank holding company may engage in and may own shares of companies engaged in certain activities that the Federal Reserve has determined to be closely related to banking or managing and controlling banks as to be a proper incident thereto.

## Table of Contents

*Limitations on Acquisitions of Company Common Stock.* The Change in Bank Control Act prohibits a person or group of persons from acquiring “control” of a bank holding company unless the Federal Reserve has been notified and has not objected to the transaction. Under a rebuttable presumption established by the Federal Reserve, the acquisition of 10% or more of a class of voting securities of a bank holding company with a class of securities registered under Section 12 of the Securities Exchange Act of 1934, as amended, would constitute the acquisition of control of a bank holding company.

In addition, the BHCA prohibits any company from acquiring control of a bank or bank holding company without first having obtained the approval of the Federal Reserve. Among other circumstances, under the BHCA, a company has control of a bank or bank holding company if the company owns, controls or holds with power to vote 25% or more of a class of voting securities of the bank or bank holding company; controls in any manner the election of a majority of directors or trustees of the bank or bank holding company; or the Federal Reserve has determined, after notice and opportunity for hearing, that the company has the power to exercise a controlling influence over the management or policies of the bank or bank holding company.

## ***Regulation of the Bank***

As a Maine-chartered bank, the Bank is subject to supervision, regulation and examination by the Maine Bureau of Financial Institutions (the “Bureau”) and the Federal Deposit Insurance Corporation (the “FDIC”). The Federal Reserve may directly examine the subsidiaries of the Company, including the Bank. The enforcement powers available to federal and state banking regulators include, among other things, the ability to issue cease and desist or removal orders, to terminate insurance of deposits, to assess civil money penalties, to issue directives to increase capital, to place the bank into receivership, and to initiate injunctive actions against banking organizations and institution-affiliated parties.

*Deposit Insurance.* The deposit obligations of the Bank are insured up to applicable limits by the FDIC’s Deposit Insurance Fund (“DIF”) and are subject to deposit insurance assessments to maintain the DIF. The Dodd-Frank Act permanently increased the FDIC deposit insurance limit to \$250,000 per depositor for deposits maintained in the same right and capacity at a particular insured depository institution. On March 15, 2016, the FDIC’s Board of Directors approved a final rule to increase the DIF’s reserve ratio to the statutorily required minimum ratio of 1.35% of estimated insured deposits. Small banks, which are generally those banks with under \$10 billion in assets, will receive credits to offset the portion of their assessments that help to raise the reserve ratio from 1.15 percent to 1.35%. After the reserve ratio reaches 1.38%, the FDIC will automatically apply a small bank’s credits to reduce its regular assessment up to the entire amount of the assessment.

Deposit insurance assessments are based on assets. To determine its deposit insurance assessment, the Bank computes the base amount of its average consolidated assets less its average tangible equity (defined as the amount of Tier 1 capital) and the applicable assessment rate. On April 26, 2016, the FDIC’s Board of Directors adopted a final rule that



changed the manner in which deposit insurance assessment rates are calculated for established small banks, generally those banks with less than \$10 billion of assets that have been insured for at least five years. Under the final rule, beginning the first assessment period after June 30, 2016, assessments for established small banks with a CAMELS rating of 1 or 2 will range from 1.5 to 16 basis points, after adjustments, while assessment rates for established small institutions with a CAMELS composite rating of 4 or 5 may range from 11 to 30 basis points, after adjustments. Assessments for established banks with a CAMELS rating of 3 will range from 3 to 30 basis points.

The FDIC has the power to adjust deposit insurance assessment rates at any time. In addition, under the Federal Deposit Insurance Act (the “FDIA”), the FDIC may terminate deposit insurance upon a finding that the institution has engaged in unsafe and unsound practices; is in an unsafe or unsound condition to continue operations; or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC. For the year ended June 30, 2018, the FDIC insurance expense for the Bank was \$317 thousand.

*Acquisitions and Branching.* Prior approval from the Bureau and the FDIC is required in order for the Bank to acquire another bank or establish a new branch office. Well-capitalized and well-managed banks may acquire other banks in any state, subject to certain deposit concentration limits and other conditions, pursuant to the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, as amended by the Dodd-Frank Act. In addition, the Dodd-Frank Act authorizes a state-chartered bank, such as the Bank, to establish new branches on an interstate basis to the same extent a bank chartered by the host state may establish branches.

*Activities and Investments of Insured State-Chartered Banks.* Section 24 of the FDIA generally limits the types of equity investment an FDIC-insured state-chartered bank, such as the Bank, may make and the kinds of activities in which such a bank may engage, as a principal, to those that are permissible for national banks. Further, the Gramm-Leach-Bliley Act of 1999 (“GLBA”) permits national banks and state banks, to the extent permitted under state law, to engage—via financial subsidiaries—in certain activities that are permissible for subsidiaries of a financial holding company. In order to form a financial subsidiary, a state-chartered bank must be well capitalized, and such banks would be subject to certain capital deduction, risk management and affiliate transaction rules, among other things.

Table of Contents

*Lending Restrictions.* Federal law limits a bank's authority to extend credit to its directors, executive officers and 10% or more shareholders, as well as to entities controlled by such persons. Among other things, extensions of credit to insiders are required to be made on terms that are substantially the same as, and follow credit underwriting procedures that are not less stringent than, those prevailing for comparable transactions with unaffiliated persons. The terms of such extensions of credit may not involve more than the normal risk of repayment or present other unfavorable features and may not exceed certain limitations on the amount of credit extended to such persons, individually and in the aggregate, which limits are based, in part, on the amount of the bank's capital. The Dodd-Frank Act explicitly provides that an extension of credit to an insider includes credit exposure arising from a derivatives transaction, repurchase agreement, reverse repurchase agreement, securities lending transaction or securities borrowing transaction. Additionally, the Dodd-Frank Act requires that asset sale transactions with insiders must be on market terms, and if the transaction represents more than 10% of the capital and surplus of the bank, approved by a majority of the disinterested directors of the bank.

*Brokered Deposits.* Section 29 of the FDIA and FDIC regulations generally limit the ability of an insured depository institution to accept, renew or roll over any brokered deposit unless the institution's capital category is "well capitalized" or, with the FDIC's approval, "adequately capitalized." Depository institutions that have brokered deposits in excess of 10% of total assets will be subject to increased FDIC deposit insurance assessments. However, for institutions that are well capitalized and have a CAMELS composite rating of 1 or 2, reciprocal deposits are deducted from brokered deposits. In addition, the Economic Growth, Regulatory Relief, and Consumer Protection Act provides that reciprocal deposits are not treated as brokered deposits in the case of a "well capitalized" institution that received a "outstanding" or "good" rating on its most recent examination to the extent the amount of such deposits does not exceed the lesser of \$5 billion or 20% of the bank's total liabilities.

*Community Reinvestment Act.* The Community Reinvestment Act ("CRA") requires the FDIC to evaluate the Bank's performance in helping to meet the credit needs of the entire communities it serves, including low- and moderate-income neighborhoods, consistent with its safe and sound banking operations, and to take this record into consideration when evaluating certain applications. The FDIC's CRA regulations are generally based upon objective criteria of the performance of institutions under three key assessment tests: (i) a lending test, to evaluate the institution's record of making loans in its service areas; (ii) an investment test, to evaluate the institution's record of investing in community development projects, affordable housing, and programs benefiting low or moderate income individuals and businesses; and (iii) a service test, to evaluate the institution's delivery of services through its branches, ATMs, and other offices. The Bank's most recent performance evaluation from the FDIC was a "satisfactory" rating.

***Capital Adequacy and Safety and Soundness***

*Regulatory Capital Requirements.* The Federal Reserve and the FDIC have issued substantially similar risk-based and leverage capital rules applicable to U.S. banking organizations such as the Company and the Bank. These rules are intended to reflect the relationship between the banking organization's capital and the degree of risk associated with its operations based on transactions recorded on-balance sheet, as well as off-balance sheet. The Federal Reserve and the FDIC may from time to time require that a banking organization maintain capital above the minimum levels discussed

below, due to the banking organization's financial condition or actual or anticipated growth.

The capital adequacy rules define qualifying capital instruments and specify minimum amounts of capital as a percentage of assets that banking organizations are required to maintain. Common equity Tier 1 capital for banks and bank holding companies consists of common shareholders' equity and related surplus. Tier 1 capital for banks and bank holding companies generally consists of the sum of common shareholders' equity, non-cumulative perpetual preferred stock, and related surplus and, in certain cases and subject to limitations, minority interest in consolidated subsidiaries, less goodwill, other non-qualifying intangible assets and certain other deductions. Tier 2 capital generally consists of hybrid capital instruments, perpetual debt and mandatory convertible debt securities, cumulative perpetual preferred stock, term subordinated debt and intermediate-term preferred stock, and, subject to limitations, allowances for loan losses. The sum of Tier 1 and Tier 2 capital, less certain required deductions, represents qualifying total capital. Prior to the effectiveness of certain provisions of the Dodd-Frank Act, bank holding companies were permitted to include trust preferred securities and cumulative perpetual preferred stock in Tier 1 capital, subject to limitations. However, the Federal Reserve's capital rule applicable to bank holding companies permanently grandfathers nonqualifying capital instruments, including trust preferred securities, issued before May 19, 2010 by depository institution holding companies with less than \$15 billion in total assets as of December 31, 2009, subject to a limit of 25% of Tier 1 capital. In addition, under rules that became effective January 1, 2016, accumulated other comprehensive income (positive or negative) must be reflected in Tier 1 capital; however, the Company was permitted to make a one-time, permanent election to continue to exclude accumulated other comprehensive income from capital. The Company has made this election.

Table of Contents

Under the Federal Reserve’s capital rules applicable to the Company and the FDIC’s capital rules applicable to the Bank, the Company and the Bank are each required to maintain a minimum common equity Tier 1 capital to risk-weighted assets ratio of 4.5%, a minimum total Tier 1 capital to risk-weighted assets ratio of 6.0%, a minimum total capital to risk-weighted assets ratio of 8.0% and a minimum leverage ratio of 4.0%. Additionally, subject to a transition schedule, these rules require an institution to establish a capital conservation buffer of common equity Tier 1 capital above the minimum risk-based capital requirements for “adequately capitalized” institutions that is greater than 2.5% of total risk weighted assets, or face restrictions on the ability to pay dividends, pay discretionary bonuses, and to engage in share repurchases. The capital conservation buffer will be fully phased in on January 1, 2019.

Under the FDIC’s rules, an FDIC supervised institution, such as the Bank, is considered “well capitalized” if it (i) has a total risk-based capital ratio of 10.0% or greater; (ii) a Tier 1 risk-based capital ratio of 8.0% or greater; (iii) a common Tier 1 equity ratio of at least 6.5% or greater, (iv) a leverage capital ratio of 5.0% or greater; and (v) is not subject to any written agreement, order, capital directive, or prompt corrective action directive to meet and maintain a specific capital level for any capital measure.

Generally, a bank, upon being notified that it is not adequately capitalized (i.e., that it is “undercapitalized”), becomes subject to the prompt corrective action provisions of Section 38 of the FDIA that, for example, (i) restrict payment of capital distributions and management fees, (ii) require that its federal bank regulatory agency, which is the FDIC in the case of the Bank, monitor the condition of the institution and its efforts to restore its capital, (iii) require submission of a capital restoration plan, (iv) restrict the growth of the institution’s assets and (v) require prior regulatory approval of certain expansion proposals. A bank that is required to submit a capital restoration plan must concurrently submit a performance guarantee by each company that controls the bank. A bank that is “critically undercapitalized” (i.e., has a ratio of tangible equity to total assets that is equal to or less than 2.0%) will be subject to further restrictions, and generally will be placed in conservatorship or receivership within 90 days.

The Bank is currently considered “well capitalized” under all regulatory definitions. Current capital rules do not establish standards for determining whether a bank holding company is well capitalized. However, for purposes of processing regulatory applications and notices, the Federal Reserve Board’s Regulation Y provides that a bank holding company is considered “well capitalized” if (i) on a consolidated basis, the bank holding company maintains a total risk-based capital ratio of 10.0% or greater; (ii) on a consolidated basis, the bank holding company maintains a tier 1 risk-based capital ratio of 6.0% or greater; and (iii) the bank holding company is not subject to any written agreement, order, capital directive, or prompt corrective action directive issued by the Federal Reserve Board to meet and maintain a specific capital level for any capital measure.

*Safety and Soundness Standard.* The FDIA requires the federal bank regulatory agencies to prescribe standards, by regulations or guidelines, relating to internal controls, information systems and internal audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, asset quality, earnings, stock valuation and compensation, fees and benefits, and such other operational and managerial standards as the agencies deem appropriate. Guidelines adopted by the federal bank regulatory agencies establish general standards relating to internal controls and information systems, internal audit systems, loan documentation, credit underwriting, interest rate

exposure, asset growth and compensation, fees and benefits. In general, these guidelines require, among other things, appropriate systems and practices to identify and manage the risk and exposures specified in the guidelines. The guidelines prohibit excessive compensation as an unsafe and unsound practice and describe compensation as excessive when the amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director or principal shareholder. In addition, the federal banking agencies adopted regulations that authorize, but do not require, an agency to order an institution that has been given notice by an agency that it is not satisfying any of such safety and soundness standards to submit a compliance plan. If, after being so notified, an institution fails to submit an acceptable compliance plan or fails in any material respect to implement an acceptable compliance plan, the agency must issue an order directing action to correct the deficiency and may issue an order directing other actions of the types to which an undercapitalized institution is subject under the “prompt corrective action” provisions of FDIA. See “—*Regulatory Capital Requirements*” above. If an institution fails to comply with such an order, the agency may seek to enforce such order in judicial proceedings and to impose civil money penalties.

### ***Dividend Restrictions***

The Company is a legal entity separate and distinct from the Bank. The revenue of the Company (on a parent company only basis) is derived primarily from interest and dividends from the Bank. The right of the Company, and consequently the right of shareholders of the Company, to participate in any distribution of the assets or earnings of the Bank through the payment of such dividends or otherwise is necessarily subject to the prior claims of creditors of the Bank (including depositors), except to the extent that certain claims of the Company in a creditor capacity may be recognized.

*Restrictions on Bank Holding Company Dividends.* It is the policy of the Federal Reserve that a bank holding company should eliminate, defer or significantly reduce dividends if the organization’s net income available to shareholders for the past four quarters is not sufficient to fully fund the dividends, the prospective rate of earnings retention is not consistent with the organization’s capital needs, asset quality and overall financial condition, or the bank holding company will not meet or is in danger of not meeting its minimum regulatory capital adequacy ratios. The Federal Reserve has the authority to prohibit a bank holding company, such as the Company, from paying dividends if it deems such payment to be an unsafe or unsound practice.

Table of Contents

*Restrictions on Bank Dividends.* The FDIC has the authority to use its enforcement powers to prohibit a bank from paying dividends if, in its opinion, the payment of dividends would constitute an unsafe or unsound practice. Federal law also prohibits the payment of dividends by a bank that will result in the bank failing to meet its applicable capital requirements on a pro forma basis. Maine law requires the approval of the Bureau for any dividend that would reduce a bank's capital below prescribed limits.

***Certain Transactions by Bank Holding Companies with their Affiliates***

There are various statutory restrictions on the extent to which bank holding companies and their non-bank subsidiaries may borrow, obtain credit from or otherwise engage in "covered transactions" with their insured depository institution subsidiaries. In general, an "affiliate" of an insured depository institution includes the depository institution's parent holding company and any subsidiary of the parent holding company. However, an "affiliate" does not generally include an operating subsidiary of an insured depository institution. The Dodd-Frank Act amended the definition of affiliate to include any investment fund for which the depository institution or one of its affiliates is an investment adviser. An insured depository institution (and its subsidiaries) may not lend money to, or engage in other covered transactions with, its non-depository institution affiliates if the aggregate amount of covered transactions outstanding involving the bank, plus the proposed transaction, exceeds the following limits: (a) in the case of any one such affiliate, the aggregate amount of covered transactions of the insured depository institution and its subsidiaries cannot exceed 10% of the capital stock and surplus of the insured depository institution; and (b) in the case of all affiliates, the aggregate amount of covered transactions of the insured depository institution and its subsidiaries cannot exceed 20% of the capital stock and surplus of the insured depository institution. For this purpose, "covered transactions" are defined by statute to include a loan or extension of credit to an affiliate, a purchase of or investment in securities issued by an affiliate, a purchase of assets from an affiliate, the acceptance of securities issued by an affiliate as collateral for a loan or extension of credit to any person or company, the issuance of a guarantee, acceptance or letter of credit on behalf of an affiliate, securities borrowing or lending transactions with an affiliate that creates a credit exposure to such affiliate, or a derivatives transaction with an affiliate that creates a credit exposure to such affiliate. Certain covered transactions are also subject to collateral security requirements. Covered transactions as well as other types of transactions between a bank and a bank holding company must be on market terms, which means that the transaction must be conducted on terms and under circumstances that are substantially the same, or at least as favorable to the bank, as those prevailing at the time for comparable transactions with or involving nonaffiliates or, in the absence of comparable transactions, that in good faith would be offered to or would apply to nonaffiliates. Moreover, Section 106 of the Bank Holding Company Act Amendments of 1970 provides that, to further competition, a bank holding company and its subsidiaries are prohibited from engaging in certain tying arrangements in connection with any extension of credit, lease or sale of property of any kind, or furnishing of any service.

***Consumer Protection Regulation***

The Company and the Bank are subject to a number of federal and state laws designed to protect consumers and prohibit unfair or deceptive business practices. These laws include the Equal Credit Opportunity Act, the Fair Housing Act, Home Ownership Protection Act, the Fair Credit Reporting Act, as amended by the Fair and Accurate Credit

Transactions Act of 2003 (“FACT Act”), GLBA, the Truth in Lending Act, CRA, the Home Mortgage Disclosure Act, the Real Estate Settlement Procedures Act, the National Flood Insurance Act, the Electronic Funds Transfer Act, the Truth-in-Savings Act, the Secure and Fair Enforcement Act, the Expedited Funds Availability Act, and various state law counterparts. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must interact with customers when taking deposits, making loans, collecting loans and providing other services. Further, the Dodd-Frank Act established the Consumer Financial Protection Bureau (“CFPB”), which has the responsibility for making rules and regulations under the federal consumer protection laws relating to financial products and services. The CFPB also has a broad mandate to prohibit unfair or deceptive acts and practices and is specifically empowered to require certain disclosures to consumers and draft model disclosure forms. Failure to comply with consumer protection laws and regulations can subject financial institutions to enforcement actions, fines and other penalties. The FDIC examines the Bank for compliance with CFPB rules and enforces CFPB rules with respect to the Bank.

*Mortgage Reform.* The Dodd-Frank Act prescribes certain standards that mortgage lenders must consider before making a residential mortgage loan, including verifying a borrower’s ability to repay such mortgage loan. The Dodd-Frank Act also allows borrowers to assert violations of certain provisions of the Truth-in-Lending Act as a defense to foreclosure proceedings. Under the Dodd-Frank Act, prepayment penalties are prohibited for certain mortgage transactions and creditors are prohibited from financing insurance policies in connection with a residential mortgage loan or home equity line of credit. The Dodd-Frank Act requires mortgage lenders to make additional disclosures prior to the extension of credit, in each billing statement and for negative amortization loans and hybrid adjustable-rate mortgages. Additionally, the Dodd-Frank Act prohibits mortgage originators from receiving compensation based on the terms of residential mortgage loans and generally limits the ability of a mortgage originator to be compensated by others if compensation is received from a consumer.

Table of Contents

*Privacy and Customer Information Security.* GLBA requires financial institutions to implement policies and procedures regarding the disclosure of nonpublic personal information about consumers to nonaffiliated third parties. In general, the Bank must provide its customers with an annual disclosure that explains its policies and procedures regarding the disclosure of such nonpublic personal information and, except as otherwise required or permitted by law, the Bank is prohibited from disclosing such information, except as provided in such policies and procedures. However, as a result of amendments made by the Fixing America's Surface Transportation Act, a financial institution is not required to send an annual privacy notice if the institution only discloses nonpublic personal information in accordance with certain exceptions from GLBA that do not require an opt-out to be provided and if the institution has not changed its policies and practices since the most recent privacy disclosure provided to consumers. GLBA also requires that the Bank develop, implement and maintain a comprehensive written information security program designed to ensure the security and confidentiality of customer information (as defined under GLBA), to protect against anticipated threats or hazards to the security or integrity of such information; and to protect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any customer. The Bank is also required to send a notice to customers whose "sensitive information" has been compromised if unauthorized use of this information has occurred or is "reasonably possible." Most states, including Maine, have enacted legislation concerning breaches of data security and the duties of the Bank in response to a data breach. Congress continues to consider federal legislation that would require consumer notice of data security breaches. Pursuant to the FACT Act, the Bank must also develop and implement a written identity theft prevention program to detect, prevent, and mitigate identity theft in connection with the opening of certain accounts or certain existing accounts. Additionally, the FACT Act amends the Fair Credit Reporting Act to generally prohibit a person from using information received from an affiliate to make a solicitation for marketing purposes to a consumer, unless the consumer is given notice and a reasonable opportunity and a reasonable and simple method to opt out of the making of such solicitations.

*Anti-Money Laundering*

*The Bank Secrecy Act.* Under the Bank Secrecy Act ("BSA"), a financial institution is required to have systems in place to detect certain transactions, based on the size and nature of the transaction. Financial institutions are generally required to report to the United States Treasury any cash transactions involving more than \$10,000. In addition, financial institutions are required to file suspicious activity reports for transactions that involve more than \$5,000 and which the financial institution knows, suspects or has reason to suspect involves illegal funds, is designed to evade the requirements of the BSA or has no lawful purpose. The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the "USA PATRIOT Act"), which amended the BSA, is designed to deny terrorists and others the ability to obtain anonymous access to the U.S. financial system. The USA PATRIOT Act has significant implications for financial institutions and businesses of other types involved in the transfer of money. The USA PATRIOT Act, together with the implementing regulations of various federal regulatory agencies, has caused financial institutions, such as the Bank, to adopt and implement additional policies or amend existing policies and procedures with respect to, among other things, anti-money laundering compliance, suspicious activity, currency transaction reporting, customer identity verification and customer risk analysis. In evaluating an application under Section 3 of the BHCA to acquire a bank or an application under the Bank Merger Act to merge banks or affect a purchase of assets and assumption of deposits and other liabilities, the applicable federal banking regulator must consider the anti-money laundering compliance record of both the applicant and the target.



*OFAC.* The United States has imposed economic sanctions that affect transactions with designated foreign countries, nationals and others. These sanctions, which are administered by the U.S. Treasury Department's Office of Foreign Assets Control ("OFAC"), take many different forms. Generally, however, they contain one or more of the following elements: (i) restrictions on trade with or investment in a sanctioned country, including prohibitions against direct or indirect imports from and exports to a sanctioned country and prohibitions on "U.S. persons" engaging in financial transactions relating to making investments in, or providing investment-related advice or assistance to, a sanctioned country; (ii) a blocking of assets in which the government or specially designated nationals of the sanctioned country have an interest, by prohibiting transfers of property subject to U.S. jurisdiction (including property in the possession or control of U.S. persons); and (iii) restrictions on transactions with or involving certain persons or entities. Blocked assets (for example, property and bank deposits) cannot be paid out, withdrawn, set off or transferred in any manner without a license from OFAC.

### **Available Information**

The Company's Investor Relations information can be obtained through our Internet address, [investor.northeastbank.com](http://investor.northeastbank.com). The Company makes available on or through its Investor Relations page, without charge, its annual reports on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K and amendments to those reports filed with, or furnished to, the SEC as soon as reasonably practicable after such reports have been filed or furnished to the SEC. The Company's reports filed with, or furnished to, the SEC are also available at the SEC's website at [www.sec.gov](http://www.sec.gov). In addition, the Company makes available, free of charge, its press releases and Code of Ethics through the Company's Investor Relations page. Information on our website is not incorporated by reference into this document and should not be considered part of this report.

Table of Contents

**Item 1A. Risk Factors**

Investing in our common stock involves a high degree of risk. You should carefully consider the following risks and uncertainties, together with all other information in this report, including our consolidated financial statements and related notes, before investing in our common stock. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also affect our business. If any of these known or unknown risks or uncertainties actually occurs, our business, financial condition and results of operations could be impaired. In that event, the market price for our common stock could decline and you may lose your investment. Certain statements below are forward-looking statements. See "A Note About Forward-Looking Statements."

**Risks Associated With Our Business**

*We are subject to regulatory conditions that could constrain our ability to grow our business.*

In conjunction with the regulatory approvals received for the Merger with FHB Formation LLC, we committed to maintain a Tier 1 leverage ratio of at least 10%, maintain a total capital ratio of at least 15%, fund 100% of our loans with core deposits, limit purchased loans to 40% of total loans and hold non-owner occupied commercial real estate loans to within 300% of total capital. Core deposits, for purposes of this commitment, are defined as non-brokered non-maturity deposits and non-brokered insured time deposits. At June 30, 2018, the ratio of our purchased loans to total loans was 33.1%. Our continued ability to purchase loans will be dependent on our ability to maintain the growth of our originated loan portfolio. To the extent that our ability to originate loans is constrained by market forces or for any other reason, our ability to execute our loan acquisition strategy would be similarly constrained.

*A significant portion of loans held in our loan portfolio were originated by third parties, and such loans may not have been subject to the same level of due diligence that the Bank would have conducted had it originated the loans.*

At June 30, 2018, 33.1% of the loans held in our loan portfolio were originated by third parties, and therefore may not have been subject to the same level of due diligence that the Bank would have conducted had it originated the loans. Although the LASG conducts a comprehensive review of all loans that it purchases, loans originated by third parties may lack current financial information and may have incomplete legal documentation and outdated appraisals. As a result, the LASG may not have information with respect to an acquired loan which, if known at the time of acquisition, would have caused it to reduce its bid price or not bid for the loan at all. This may adversely affect our yield on loans or cause us to increase our allowance for loan losses.

***Our experience with loans held in our loan portfolio that were originated by third parties is limited.***

At June 30, 2018, the loans held in our loan portfolio that were originated by third parties had been held by us for approximately 1.8 years, calculated on a weighted average basis. Consequently, we have had only a relatively short period of time to evaluate the performance of those loans and the price at which we purchased them. Further experience with these loans may provide us with information that could cause us to increase our allowance for loan losses.

***Our loan portfolio includes commercial real estate and commercial and industrial loans, which are generally riskier than other types of loans.***

At June 30, 2018, our commercial real estate mortgage and commercial and industrial loan portfolios comprised 88.1% of total loans. Commercial loans generally carry larger loan balances and involve a higher risk of nonpayment or late payment than residential mortgage loans. These loans, and purchased loans in particular, may lack standardized terms and may include a balloon payment feature. The ability of a borrower to make or refinance a balloon payment may be affected by a number of factors, including the financial condition of the borrower, prevailing economic conditions and prevailing interest rates. Repayment of these loans is generally more dependent on the economy and the successful operation of a business. Because of the risks associated with commercial loans, we may experience higher rates of default than if the portfolio were more heavily weighted toward residential mortgage loans. Higher rates of default could have an adverse effect on our financial condition and results of operations.

***If our allowance for loan losses is not sufficient to absorb actual losses or if we are required to increase our allowance, our financial condition and results of operations could be adversely affected.***

We are exposed to the risk that our borrowers may default on their obligations. A borrower's default on its obligations under one or more loans of the Bank may result in lost principal and interest income and increased operating expenses as a result of the allocation of management time and resources to the collection and work-out of the loan. In certain situations, where collection efforts are unsuccessful or acceptable work-out arrangements cannot be reached, the Bank may have to write off the loan in whole or in part. In such situations, the Bank may acquire real estate or other assets, if any, that secure the loan through foreclosure or other similar available remedies, and often the amount owed under the defaulted loan exceeds the value of the assets acquired.

Table of Contents

We periodically make a determination of an allowance for loan losses based on available information, including, but not limited to, our historical loss experience, the quality of the loan portfolio, certain economic conditions, the value of the underlying collateral, expected cash flows from purchased loans, and the level of nonaccruing and criticized loans. We rely on our loan quality reviews, our experience and our evaluation of economic conditions, among other factors, in determining the amount of provision required for the allowance for loan losses. Provisions to this allowance result in an expense for the period. If, as a result of general economic conditions, previously incorrect assumptions, or an increase in defaulted loans, we determine that additional increases in the allowance for loan losses are necessary, we will incur additional expenses.

Determining the allowance for loan losses inherently involves a high degree of subjectivity and requires us to make significant estimates of current credit risks and future trends, all of which may undergo material changes. At any time, there are likely to be loans in our portfolio that will result in losses, but that have not been identified as nonperforming or potential problem credits. We cannot be sure that we will be able to identify deteriorating credits before they become nonperforming assets or that we will be able to limit losses on those loans that are identified. We have in the past been, and in the future may be, required to increase our allowance for loan losses for any of several reasons. State and federal regulators, in reviewing our loan portfolio as part of a regulatory examination, may request that we increase our allowance for loan losses. Changes in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of our control, may require an increase in our allowance for loan losses. In addition, if charge-offs in future periods exceed those estimated in the determination of our allowance for loan losses, we will need additional increases in our allowance for loan losses. Any increases in our allowance for loan losses will result in a decrease in our net income and, possibly, our capital, and could have an adverse effect on our financial condition and results of operations.

***Environmental liability associated with our lending activities could result in losses.***

In the course of business, we may acquire, through foreclosure, properties securing loans we have originated or purchased that are in default. Particularly in commercial real estate lending, there is a risk that hazardous substances could be discovered on these properties. In this event, we might be required to remove these substances from the affected properties at our sole cost and expense or we may be held liable to a government entity or to third parties for property damage, personal injury, investigation and cleanup costs incurred by these parties in connection with environmental contamination or may be required to investigate or clean up hazardous or toxic substances or chemical releases at a property. The costs associated with investigation or remediation activities could substantially exceed the value of the affected properties. We may not have adequate remedies against the prior owner or other responsible parties and could find it difficult or impossible to sell the affected properties. If we become subject to significant environmental liabilities, our business, financial condition and results of operations could be adversely affected.

***The performance of our securities portfolio in difficult market conditions could have adverse effects on our results of operations.***

We maintain a diversified securities portfolio, which includes obligations of U.S. government agencies and government-sponsored enterprises, including mortgage-backed securities. Under applicable accounting standards, we are required to review our securities portfolio periodically for the presence of other-than-temporary impairment, taking into consideration current market conditions, the extent and nature of changes in fair value, issuer rating changes and trends, volatility of earnings, current analysts' evaluations, our ability and intent to hold securities until a recovery of fair value, as well as other factors. Adverse developments with respect to one or more of the foregoing factors may require us to deem particular securities to be other-than-temporarily impaired, with the credit related portion of the reduction in the fair value recognized as a charge to the results of operations in the period in which the impairment occurs. Market volatility may make it difficult to value certain securities. Subsequent valuations, in light of factors prevailing at that time, may result in significant changes in the values of these securities in future periods. Any of these factors could require us to recognize further impairments in the value of our securities portfolio, which may have an adverse effect on our results of operations in future periods.

***Loss of deposits or a change in deposit mix could increase our cost of funding.***

Deposits are a low-cost and stable source of funding. We compete with banks and other financial institutions for deposits. Funding costs may increase if we lose deposits and are forced to replace them with more expensive sources of funding, if clients shift their deposits into higher-cost products or if we need to raise interest rates to avoid losing deposits. Higher funding costs reduce our net interest margin, net interest income and net income.

Table of Contents

***We are subject to liquidity risk.***

Liquidity is the ability to meet cash-flow needs on a timely basis by converting assets into cash or cash equivalents and by increasing liabilities at a reasonable cost. Liquidity sources include the amount of unencumbered or “free” investment portfolio securities that the Bank owns, borrowings, cash flow from loan and investment principal payments and pre-payments and residential mortgage loan sales. Our liquidity is used principally to originate or purchase loans, to repay deposit liabilities and other liabilities when they come due, and to fund operating costs. The Company also requires funds for dividends to shareholders, repurchases of shares, and for general corporate purposes. Customer demand for non-maturity deposits can be difficult to predict. Changes in market interest rates, increased competition within our markets, and other factors may make deposit gathering more difficult. Disruptions in the capital markets or interest rate changes may make the terms of wholesale funding sources—which include Federal Home Loan Bank advances, the Federal Reserve's Borrower-in-Custody program, securities sold under repurchase agreements, federal funds purchased and brokered certificates of deposit—less favorable and may make it difficult to sell securities when needed to provide additional liquidity. As a result, there is a risk that the cost of funding will increase or that we will not have sufficient funds to meet our obligations when they come due.

***We may not be able to attract and retain qualified key employees, which could adversely affect our business prospects, including our competitive position and results of operations.***

Our success is dependent upon our ability to attract and retain highly-skilled individuals. There is significant competition for those individuals with the experience and skills required to conduct many of our business activities. We may not be able to hire or retain the key personnel that we depend upon for success. The unexpected loss of services of one or more of these or other key personnel could have a material adverse impact on our business because of their skills, knowledge of the markets in which we operate, years of industry experience and the difficulty of promptly finding qualified replacement personnel.

***We face continuing and growing security risks to our information base, including the information we maintain relating to our customers.***

In the ordinary course of business, we rely on electronic communications and information systems to conduct our business and to store sensitive data, including financial information regarding customers. Our electronic communications and information systems infrastructure could be susceptible to cyberattacks, hacking, identity theft or terrorist activity. We have implemented and regularly review and update extensive systems of internal controls and procedures as well as corporate governance policies and procedures intended to protect our business operations, including the security and privacy of all confidential customer information. In addition, we rely on the services of a variety of vendors to meet our data processing and communication needs. No matter how well designed or implemented our controls are, we cannot provide an absolute guarantee to protect our business operations from every type of problem in every situation. A failure or circumvention of these controls could have a material adverse effect on

our business operations and financial condition.

We regularly assess and test our security systems and disaster preparedness, including back-up systems, but the risks are substantially escalating. As a result, cybersecurity and the continued enhancement of our controls and processes to protect our systems, data and networks from attacks, unauthorized access or significant damage remain a priority. Accordingly, we may be required to expend additional resources to enhance our protective measures or to investigate and remediate any information security vulnerabilities or exposures. Any breach of our system security could result in disruption of our operations, unauthorized access to confidential customer information, significant regulatory costs, litigation exposure and other possible damages, loss or liability. Such costs or losses could exceed the amount of available insurance coverage, if any, and would adversely affect our earnings. Also, any failure to prevent a security breach or to quickly and effectively deal with such a breach could negatively impact customer confidence, damaging our reputation and undermining our ability to attract and keep customers.

***We may not be able to successfully implement future information technology system enhancements, which could adversely affect our business operations and profitability.***

We invest significant resources in information technology system enhancements in order to provide functionality and security at an appropriate level. We may not be able to successfully implement and integrate future system enhancements, which could adversely impact the ability to provide timely and accurate financial information in compliance with legal and regulatory requirements, which could result in sanctions from regulatory authorities. Such sanctions could include fines and suspension of trading in our stock, among others. In addition, future system enhancements could have higher than expected costs and/or result in operating inefficiencies, which could increase the costs associated with the implementation as well as ongoing operations.

Failure to properly utilize system enhancements that are implemented in the future could result in impairment charges that adversely impact our financial condition and results of operations and could result in significant costs to remediate or replace the defective components. In addition, we may incur significant training, licensing, maintenance, consulting and amortization expenses during and after systems implementations, and any such costs may continue for an extended period of time.

Table of Contents

***We rely on other companies to provide key components of our business infrastructure.***

Third-party vendors provide key components of our business infrastructure such as internet connections, network access and core application processing. While we have selected these third-party vendors carefully, we do not control their actions. Any problems caused by these third parties, including as a result of their not providing us their services for any reason or their performing their services poorly, could adversely affect our ability to deliver products and services to our customers or otherwise conduct our business efficiently and effectively. Replacing these third-party vendors could also entail significant delay and expense.

***Natural disasters, acts of terrorism and other external events could harm our business.***

Natural disasters can disrupt our operations, result in damage to our properties, reduce or destroy the value of the collateral for our loans and negatively affect the economies in which we operate, which could have a material adverse effect on our results of operations and financial condition. A significant natural disaster, such as a tornado, hurricane, earthquake, fire or flood, could have a material adverse impact on our ability to conduct business, and our insurance coverage may be insufficient to compensate for losses that may occur. Acts of terrorism, war, civil unrest, violence or human error could cause disruptions to our business or the economy as a whole. While we have established and regularly test disaster recovery procedures, the occurrence of any such event could have a material adverse effect on our business, operations and financial condition.

***Damage to our reputation could significantly harm our business, including our competitive position and business prospects.***

We are dependent on our reputation within our market area, as a trusted and responsible financial company, for all aspects of our relationships with customers, employees, vendors, third-party service providers, and others, with whom we conduct business or potential future business. Our ability to attract and retain customers and employees could be adversely affected if our reputation is damaged. Our actual or perceived failure to address various issues, including our ability to (a) identify and address potential conflicts of interest, ethical issues, money-laundering, or privacy issues; (b) meet legal and regulatory requirements applicable to the Bank and to the Company; (c) maintain the privacy of customer and accompanying personal information; (d) maintain adequate record keeping; (e) engage in proper sales and trading practices; and (f) identify the legal, reputational, credit, liquidity and market risks inherent in our products, could give rise to reputational risk that could cause harm to us and our business prospects. Failure to appropriately address any of these issues could also give rise to additional regulatory restrictions and legal risks, which could, among other consequences, increase the size and number of litigation claims and damages asserted or subject us to enforcement actions, fines and penalties and cause us to incur related costs and expenses. Furthermore, any damage to our reputation could affect our ability to retain and develop the business relationships necessary to conduct business, which in turn could negatively impact our financial condition, results of operations, and the market price of our common stock.



***Internal controls may fail or be circumvented.***

Effective controls over financial reporting are necessary to help ensure reliable financial reporting and prevent fraud. Management is responsible for maintaining an effective system of internal control and assessing system effectiveness. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of the system of internal control could have an adverse effect on our business, profitability, financial condition and operations, and could further result in regulatory actions and loss of investor confidence.

***Our future growth, if any, may require us to raise additional capital, but that capital may not be available when we need it.***

As a bank holding company, we are required by regulatory authorities to maintain adequate levels of capital to support our operations. In addition, in conjunction with the regulatory approvals received for the merger with FHB Formation LLC, we committed to maintain a Tier 1 leverage ratio of at least 10% and a total capital ratio of at least 15%. We may need to raise additional capital in the future to provide us with sufficient capital resources and liquidity to support our operations or our growth. Our ability to raise additional capital will depend, in part, on conditions in the capital markets at that time, which are outside of our control, and our financial performance. Accordingly, we may be unable to raise additional capital, if and when needed, on acceptable terms, or at all. If we cannot raise additional capital when needed, our ability to further expand our operations through internal growth and acquisitions could be materially impaired. In addition, if we decide to raise additional equity capital, investors' interests could be diluted. Our failure to meet any applicable regulatory guideline related to our lending activities or any capital requirement otherwise imposed upon us or to satisfy any other regulatory requirement could subject us to certain activity restrictions or to a variety of enforcement remedies available to the regulatory authorities, including limitations on our ability to pay dividends or pursue acquisitions, the issuance by regulatory authorities of a capital directive to increase capital and the termination of deposit insurance by the FDIC.

Table of Contents

***The soundness of other financial institutions could adversely affect us.***

Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services institutions are interrelated as a result of trading, clearing, counterparty and other relationships. We have exposure to many different counterparties, and we routinely execute transactions with counterparties in the financial industry, including brokers and dealers, other commercial banks, investment banks, mutual and hedge funds, and other financial institutions. As a result, defaults by, or even rumors or questions about, one or more financial services institutions, or the financial services industry generally, could lead to market-wide liquidity problems and losses or defaults by us or by other institutions and organizations. Many of these transactions expose us to credit risk in the event of default of our counterparty or client. In addition, our credit risk may be exacerbated when the collateral held by us cannot be liquidated or is liquidated at prices not sufficient to recover the full amount of the financial instrument exposure due to us. There is no assurance that any such losses would not materially and adversely affect our results of operations.

***Weakness or deterioration in economic conditions, both in our market area and more generally, could adversely affect our financial condition and results of operations.***

Our financial performance generally, and in particular, the ability of borrowers to pay interest on and repay principal of outstanding loans and the value of collateral securing those loans, is highly dependent upon the business environment in the markets where we operate and in the United States as a whole. Our Community Banking Division primarily serves individuals and businesses located in western and south-central Maine. As a result, a significant portion of our earnings are closely tied to the economy of Maine. In addition, our loan portfolio includes commercial loans acquired or originated by the LASG and the SBA Division that are secured by assets located nationwide. Deterioration in the economic conditions of the Community Banking Division's market area in western and south-central Maine, and deterioration of the economy nationally could result in the following consequences:

Loan delinquencies may increase;

Problem assets and foreclosures may increase;

Demand for our products and services may decline;

Collateral for our loans may decline in value, in turn reducing a customer's borrowing power and reducing the value of collateral securing a loan; and

The net worth and liquidity of loan guarantors may decline, impairing their ability to honor commitments to us.

*We are subject to claims and litigation.*

From time to time, customers, vendors or other parties may make claims and take legal action against us. We maintain reserves for certain claims when deemed appropriate based upon our assessment that a loss is probable, estimable, and consistent with applicable accounting guidance. At any given time, we have a variety of legal actions asserted against us in various stages of litigation. Resolution of a legal action can often take years. We are also involved, from time to time, in other reviews, investigations and proceedings (both formal and informal) by governmental and self-regulatory agencies regarding our business, including, among other things, accounting and operational matters, certain of which may result in adverse judgments, settlements, fines, penalties, injunctions or other relief. The number and risk of these investigations and proceedings has increased in recent years with regard to many firms in the financial services industry due to legal changes to the consumer protection laws provided for by the Dodd-Frank Act. There have also been a number of highly publicized legal claims against financial institutions involving fraud or misconduct by employees, and we run the risk that employee misconduct could occur. It is not always possible to deter or prevent employee misconduct, and the precautions we take to prevent and detect this activity may not be effective in all cases.

Table of Contents

**Risks Associated With the Industry**

*Competition in the financial services industry is intense and could result in us losing business or experiencing reduced margins.*

We compete with community, regional, national and global banks, non-bank licensed lenders and private equity funds in purchasing or originating loans, attracting deposits, and selling other customer products and services. Many of our primary competitors there have substantially greater resources, larger established customer bases, higher lending limits, extensive branch networks, numerous ATMs and greater advertising and marketing budgets. They may also offer services that we do not currently provide. Additionally, due to their size, many competitors may be able to achieve economies of scale and, as a result, may offer a broader range of products and services, as well as better pricing for those products and services than we can. Technology has lowered barriers to entry and made it possible for non-banks to offer products and services traditionally provided by banks, such as automated transfer and automatic payment systems. Our long-term success depends on the ability of the Bank to compete successfully with other financial institutions in the Bank's service areas.

*Changes in interest rates could adversely affect our net interest income and profitability.*

The majority of our assets and liabilities are monetary in nature. As a result, our earnings and growth are significantly affected by interest rates, which are subject to the influence of economic conditions generally, both domestic and foreign, to events in the capital markets and also to the monetary and fiscal policies of the United States and its agencies, particularly the Federal Reserve. The nature and timing of any changes in such policies or general economic conditions and their effect on us cannot be controlled and are extremely difficult to predict. Changes in interest rates can affect our net interest income as well as the value of our assets and liabilities. Net interest income is the difference between (i) interest income on interest-earning assets, such as loans and securities, and (ii) interest expense on interest-bearing liabilities, such as deposits and borrowings. Changes in market interest rates, changes in the relationships between short-term and long-term market interest rates, or the yield curve, or changes in the relationships between different interest rate indices can affect the interest rates charged on interest-earning assets differently than the interest rates paid on interest-bearing liabilities. This difference could result in an increase in interest expense relative to interest income, and therefore reduce our net interest income. Further, declines in market interest rates may trigger loan prepayments, which in many cases are within our customers' discretion, and which in turn may serve to reduce our net interest income if we are unable to lend those funds to other borrowers or invest the funds at the same or higher interest rates.

*We operate in a highly regulated industry, and laws and regulations, or changes in them, could limit or restrict our activities and could have an adverse impact in our operations.*

We are subject to regulation and supervision by the Federal Reserve, and our banking subsidiary, Northeast Bank, is subject to regulation and supervision by the FDIC and the Bureau. Federal and state laws and regulations govern numerous matters, including changes in the ownership or control of banks and bank holding companies, maintenance of adequate capital and the financial condition of a financial institution, permissible types, amounts and terms of extensions of credit and investments, permissible non-banking activities, the level of reserves against deposits and restrictions on dividend payments. The Federal Reserve, the FDIC and the Bureau have the power to issue cease and desist orders to prevent or remedy unsafe or unsound practices or violations of law by banks subject to their regulation, and the Federal Reserve possesses similar powers with respect to bank holding companies. These and other restrictions limit the manner in which we and the Bank may conduct business and obtain financing.

Because our business is highly regulated, the laws, rules, regulations, and supervisory guidance and policies applicable to us are subject to regular modification and change. Such changes may, among other things, increase the cost of doing business, limit permissible activities, or affect the competitive balance between banks and other financial institutions. Failure to comply with laws, regulations, or policies could result in enforcement and other legal actions by federal and state authorities, including criminal and civil penalties, the loss of FDIC insurance, revocation of a banking charter, other sanctions by regulatory agencies, civil money penalties, and/or reputation damage, which could have a material adverse effect on our business, financial condition, and results of operations. See "Supervision and Regulation" in Item 1, "Business."

***We are subject to capital and liquidity standards that require banks and bank holding companies to maintain more and higher quality capital and greater liquidity than has historically been the case.***

We became subject to new capital requirements in 2015 that will be fully phased-in on January 1, 2019, which will force bank holding companies and their bank subsidiaries to maintain substantially higher levels of capital as a percentage of their assets, with a greater emphasis on common equity as opposed to other components of capital. The need to maintain more and higher quality capital, as well as greater liquidity, and generally increased regulatory scrutiny with respect to capital levels, may at some point limit our business activities, including lending, and our ability to expand. It could also result in our being required to take steps to increase our regulatory capital and may dilute shareholder value or limit our ability to pay dividends or otherwise return capital to our investors through stock repurchases. Pursuant to the Dodd-Frank Act, we were permitted to make a one-time, permanent election to continue to exclude accumulated other comprehensive income from capital. We made this election.

Table of Contents

***We are subject to numerous laws designed to protect consumers, including the Community Reinvestment Act and fair lending laws, and failure to comply with these laws could lead to a wide variety of sanctions.***

The Community Reinvestment Act, the Equal Credit Opportunity Act, the Fair Housing Act and other fair lending laws and regulations impose community investment and nondiscriminatory lending requirements on financial institutions. The CFPB, the Department of Justice and other federal agencies are responsible for enforcing these laws and regulations. A successful regulatory challenge to an institution's performance under the Community Reinvestment Act, the Equal Credit Opportunity Act, the Fair Housing Act or other fair lending laws and regulations could result in a wide variety of sanctions, including damages and civil money penalties, injunctive relief, restrictions on mergers and acquisitions, restrictions on expansion and restrictions on entering new business lines. Private parties may also have the ability to challenge an institution's performance under fair lending laws in private class action litigation. Such actions could have a material adverse effect on our business, financial condition and results of operations.

***We may incur fines, penalties and other negative consequences from regulatory violations, possibly even inadvertent or unintentional violations.***

We maintain systems and procedures designed to ensure that we comply with applicable laws and regulations. However, some legal/regulatory frameworks provide for the imposition of fines or penalties for noncompliance even though the noncompliance was inadvertent or unintentional and even though there was in place at the time systems and procedures designed to ensure compliance. For example, we are subject to regulations issued by the Office of Foreign Assets Control, or "OFAC," that prohibit financial institutions from participating in the transfer of property belonging to the governments of certain foreign countries and designated nationals of those countries and certain other persons or entities whose interest in property is blocked by OFAC-administered sanctions. OFAC may impose penalties for inadvertent or unintentional violations even if reasonable processes are in place to prevent the violations. There may be other negative consequences resulting from a finding of noncompliance, including restrictions on certain activities. Such a finding may also damage our reputation as described below and could restrict the ability of institutional investment managers to invest in our securities.

***The FDIC's assessment rates could adversely affect our financial condition and results of operations.***

The FDIC insures deposits at FDIC-insured depository institutions, such as the Bank, up to applicable limits. As a result of recent economic conditions, the FDIC has decreased deposit insurance assessment rates. If these decreases are insufficient for the deposit insurance fund of the FDIC to meet its funding requirements, there may need to be further special assessments or increases in deposit insurance premiums. We are generally unable to control the amount of premiums that we are required to pay for FDIC insurance. If there is an increase in bank or financial institution failures, we may be required to pay even higher FDIC premiums than the recently increased levels. Any future additional assessments, increases or required prepayments in FDIC insurance premiums may materially adversely affect results of operations, including by reducing our profitability or limiting our ability to pursue certain business

opportunities.

***Changes in accounting standards can materially impact our financial statements.***

Our accounting policies and methods are fundamental to how we record and report our financial condition and results of operations. From time to time, the Financial Accounting Standards Board or regulatory authorities change the financial accounting and reporting standards that govern the preparation of our financial statements. These changes can be hard to predict and can materially impact how we record and report our financial condition and results of operations. In some cases, we could be required to apply a new or revised standard retroactively, resulting in our restating prior period financial statements.

***Changes in tax laws and regulations and differences in interpretation of tax laws and regulations may adversely impact our financial statements.***

Local, state or federal tax authorities may interpret tax laws and regulations differently than we do and challenge tax positions that we have taken on tax returns. This may result in differences in the treatment of revenues, deductions, credits and/or differences in the timing of these items. The differences in treatment may result in payment of additional taxes, interest or penalties that could have a material adverse effect on our results.

Table of Contents

**Risks Associated With Our Common Stock**

*Market volatility has affected and may continue to affect the value of our common stock.*

The price of our common stock can fluctuate widely in response to a variety of factors. In addition, the trading volume in our common stock may fluctuate and cause significant price variations to occur. We cannot assure you that the market price of our common stock will not fluctuate or decline significantly. Some of the factors that could cause fluctuations or declines in the price of our common stock include, but are not limited to, actual or anticipated variations in reported operating results, recommendations by securities analysts, the level of trading activity in our common stock, new services or delivery systems offered by competitors, business combinations involving our competitors, operating and stock price performance of companies that investors deem to be comparable to the Bank, news reports relating to trends or developments in the credit, mortgage and housing markets as well as the financial services industry, and changes in government regulations.

*Our common stock trading volume may not provide adequate liquidity for investors.*

Our voting common stock is listed on the NASDAQ Global Market. The average daily trading volume for Northeast voting common stock is less than the corresponding trading volume for larger financial institutions. Due to this relatively low trading volume, significant sales of Northeast voting common stock, or the expectation of these sales, may place significant downward pressure on the market price of Northeast voting common stock. No assurance can be given that a more active trading market in our common stock will develop in the foreseeable future or can be maintained. There can also be no assurance that the offering will result in a material increase in the "float" for our common stock, which we define as the aggregate market value of our voting common stock held by shareholders who are not affiliates of Northeast, because our affiliates may purchase shares of voting common stock in the offering.

*There is a limited market for and restrictions on the transferability of our non-voting common stock.*

Our non-voting common stock is not and will not be listed on any exchange. Additionally, the non-voting common stock can only be transferred in certain limited circumstances set forth in our articles of incorporation. Accordingly, holders of our non-voting common stock may be required to bear the economic consequences of holding such non-voting common stock for an indefinite period of time.

*If we defer payments of interest on our outstanding junior subordinated debt securities or if certain defaults relating to those debt securities or our outstanding subordinated notes occur, we will be prohibited from declaring*



*or paying dividends or distributions on, and from making liquidation payments with respect to, our common stock.*

As of June 30, 2018, we had outstanding \$16.5 million in aggregate principal amount of junior subordinated debt securities issued in connection with the sale of trust preferred securities by affiliates of ours that are statutory business trusts. We have also guaranteed those trust preferred securities. The indenture under which the junior subordinated debt securities were issued, together with the guarantee, prohibits us, subject to limited exceptions, from declaring or paying any dividends or distributions on, or redeeming, repurchasing, acquiring or making any liquidation payments with respect to, any of our capital stock at any time when (i) there shall have occurred and be continuing an event of default under the indenture; (ii) we are in default with respect to payment of any obligations under the guarantee; or (iii) we have elected to defer payment of interest on the junior subordinated debt securities. In that regard, we are entitled, at our option but subject to certain conditions, to defer payments of interest on the junior subordinated debt securities from time to time for up to five years.

Events of default under the indenture generally consist of our failure to pay interest on the junior subordinated debt securities under certain circumstances, our failure to pay any principal of or premium on such junior subordinated debt securities when due, our failure to comply with certain covenants under the indenture, and certain events of bankruptcy, insolvency or liquidation relating to us.

As a result of these provisions, if we were to elect to defer payments of interest on the junior subordinated debt securities, or if any of the other events described in clause (i) or (ii) of the first paragraph of this risk factor were to occur, we would be prohibited from declaring or paying any dividends on our capital stock, from redeeming, repurchasing or otherwise acquiring any of our capital stock, and from making any payments to holders of our capital stock in the event of our liquidation, which would likely have a material adverse effect on the market value of our common stock.

As of June 30, 2018, we had outstanding \$15.05 million in aggregate principal amount of 6.75% fixed-to-floating subordinated notes due in 2026. If we were to be in default with respect to payment of any obligation under the notes, we would be prohibited from declaring or paying any dividends. We would also be prohibited from paying any distributions on, redeeming, purchasing, acquiring, or making a liquidation payment with respect to any of the Company's capital stock, which would likely have a material adverse effect on the market value of our common stock.

Table of Contents

***We are dependent upon our subsidiaries for dividends, distributions and other payments.***

We are a separate and distinct legal entity from the Bank, and depend on dividends, distributions and other payments from the Bank to fund dividend payments on our common stock and to fund all payments on our other obligations. We and the Bank are subject to laws that authorize regulatory authorities to block or reduce the flow of funds from the Bank to us. The FDIC has the authority to use its enforcement powers to prohibit a bank from paying dividends if, in its opinion, the payment of dividends would constitute an unsafe or unsound practice. Regulatory action of that kind could impede access to the funds that we need in order to make payments on its obligations or dividend payments. In addition, if the Bank does not maintain sufficient capital levels or its earnings are not sufficient to make dividend payments to us, we may not be able to make dividend payments to our common and preferred shareholders. Further, our right to participate in a distribution of assets upon a subsidiary's liquidation or reorganization is subject to the prior claims of the Bank's creditors. Additionally, our ability to pay dividends would be restricted if we do not maintain a capital conservation buffer. A reduction or elimination of dividends could adversely affect the market price of our common stock.

***We may not be able to pay dividends and, if we pay dividends, we cannot guarantee the amount and frequency of such dividends.***

The continued payment of dividends on shares of our common stock will depend upon our debt and equity structure, earnings and financial condition, need for capital in connection with possible future acquisitions, growth and other factors, including economic conditions, regulatory restrictions, and tax considerations. We cannot guarantee that we will pay dividends or, if we pay dividends, the amount and frequency of these dividends.

***We may issue additional shares of common or preferred stock in the future, which could dilute a shareholder's ownership of common stock.***

Our articles of incorporation authorize our Board of Directors, generally without shareholder approval, to, among other things, issue additional shares of common or preferred stock. The issuance of any additional shares of common or preferred stock could be dilutive to a shareholder's ownership of our common stock. To the extent that we issue options or warrants to purchase common stock in the future and the options or warrants are exercised, our shareholders may experience further dilution. Holders of shares of our common stock have no preemptive rights that entitle holders to purchase their pro rata share of any offering of shares of any class or series and, therefore, shareholders may not be permitted to invest in future issuances of Northeast common or preferred stock. We are required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations. Accordingly, regulatory requirements and/or deterioration in our asset quality may require us to sell common stock to raise capital under circumstances and at prices that result in substantial dilution.

***We may issue debt and equity securities that are senior to our common stock as to distributions and in liquidation, which could negatively affect the value of our common stock.***

In the future, we may increase our capital resources by entering into debt or debt-like financing or issuing debt or equity securities, which could include issuances of senior notes, subordinated notes, preferred stock or common stock. In the event of our liquidation, our lenders and holders of its debt or preferred securities would receive a distribution of our available assets before distributions to the holders of Northeast common stock. Our decision to incur debt and issue securities in future offerings will depend on market conditions and other factors beyond our control. We cannot predict or estimate the amount, timing or nature of our future offerings and debt financings. Future offerings could reduce the value of shares of our common stock and dilute a shareholder's interest in Northeast.

***Our common stock is not insured by any governmental entity.***

Our common stock is not a deposit account or other obligation of any bank and is not insured by the FDIC or any other governmental entity.

***Anti-takeover provisions could negatively impact our shareholders.***

Federal law imposes restrictions, including regulatory approval requirements, on persons seeking to acquire control over Northeast. Provisions of Maine law and provisions of our articles of incorporation and by-laws could make it more difficult for a third party to acquire control of us or have the effect of discouraging a third party from attempting to acquire control of us. We have a classified Board of Directors, meaning that approximately one-third of our directors are elected annually. Additionally, our articles of organization authorize our Board of Directors to issue preferred stock without shareholder approval and such preferred stock could be issued as a defensive measure in response to a takeover proposal. Other provisions that could make it more difficult for a third party to acquire us even if an acquisition might be in the best interest of our shareholders include supermajority voting requirements to remove a director from office without cause; restrictions on shareholders calling a special meeting; a requirement that only directors may fill a Board vacancy; and provisions regarding the timing and content of shareholder proposals and nominations.

Table of Contents

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

At June 30, 2018, the Company conducted its business from its headquarters in Lewiston, Maine, an office in Boston, Massachusetts, and an office in Portland, Maine. The Company also conducts business from its ten full-service bank branches. The Company believes that all of its facilities are well maintained and suitable for the purpose for which they are used.

In addition to its Lewiston, Maine, Boston, Massachusetts and Portland, Maine offices, the Company leases three of its other locations. For information regarding the Company's lease commitments, please refer to "Lease Obligations" under Note 15 of the Notes to the Consolidated Financial Statements in Item 8 of this Annual Report.

**Item 3. Legal Proceedings**

From time to time, the Company and its subsidiary are subject to certain legal proceedings and claims in the ordinary course of business. Management presently believes that the ultimate outcome of these proceedings, individually and in the aggregate, will not be material to the Company or its consolidated financial position. The Company establishes reserves for specific legal matters when it determines that the likelihood of an unfavorable outcome is probable and the loss is reasonably estimable. Legal proceedings are subject to inherent uncertainties, and unfavorable rulings could occur that could cause the Company to establish litigation reserves or could have, individually or in the aggregate, a material adverse effect on its business, financial condition, or operating results.

**Item 4. Mine Safety Disclosures**

Not applicable.

Table of Contents**PART II****Item 5. Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities**

The Company's voting common stock currently trades on the NASDAQ under the symbol "NBN." There is no established public trading market for the Company's non-voting common stock. As of the close of business on September 7, 2018, there were approximately 453 registered shareholders of record.

The following table sets forth the high and low closing sale prices of the Company's voting common stock, as reported on NASDAQ, and quarterly dividends paid on the Company's voting and non-voting common stock during the periods indicated:

Fiscal year ended June 30, 2018	High	Low	Dividend Paid
Jul 1 – Sep 30	\$26.95	\$20.05	\$ 0.01
Oct 1 – Dec 31	29.25	23.15	0.01
Jan 1 – Mar 31	24.90	20.45	0.01
Apr 1 – Jun 30	23.90	19.25	0.01

Fiscal year ended June 30, 2017	High	Low	Dividend Paid
Jul 1 – Sep 30	\$11.55	\$10.29	\$ 0.01
Oct 1 – Dec 31	13.08	10.88	0.01
Jan 1 – Mar 31	15.74	13.24	0.01
Apr 1 – Jun 30	20.75	14.99	0.01

Holders of the Company's voting and non-voting common stock are entitled to receive dividends when and if declared by the Board of Directors out of funds legally available. The amount and timing of future dividends payable on the Company's voting and non-voting common stock will depend on, among other things, the financial condition of the Company, regulatory considerations, and other factors. The Company is a legal entity separate from the Bank, but its revenues are derived primarily from the Bank. Accordingly, the ability of the Company to pay cash dividends on its stock in the future generally will be dependent upon the earnings of the Bank and the Bank's ability to pay dividends to the Company. The payment of dividends by the Bank will depend on a number of factors, including capital requirements, regulatory limitations, the Bank's results of operations and financial condition, tax considerations, and general economic conditions. National banking laws regulate and restrict the ability of the Bank to pay dividends to the Company. See "Item 1. Business—Supervision and Regulation."

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

There were no common stock purchases during the fiscal year ended June 30, 2018.

Table of Contents**Stock Performance Graph**

Below is a line graph comparing the yearly percentage change in the cumulative total shareholder return on the Company's voting common stock, based on the market price of the Company's voting common stock, with the total return on companies within the NASDAQ Composite Index and companies within the SNL \$1B-\$5B Bank Index. The calculation of cumulative return assumes a \$100 investment in the Company's common stock, the NASDAQ Composite Index, and the SNL \$1B-\$5B Bank Index on June 30, 2013. It also assumes that all dividends are reinvested during the relevant periods.

<b>Index</b>	<b>6/30/2013</b>	<b>6/30/2014</b>	<b>6/30/2015</b>	<b>6/30/2016</b>	<b>6/30/2017</b>	<b>6/30/2018</b>
Northeast Bancorp	\$ 100.00	\$ 99.27	\$ 103.22	\$ 116.70	\$ 211.10	\$ 226.14
NASDAQ Composite Index	100.00	128.35	145.20	141.00	178.79	218.67
SNL Bank \$1B - \$5B Index	100.00	123.60	137.71	143.81	210.02	223.37

Table of Contents**Item 6. Selected Financial Data**

The following table sets forth our selected financial and operating data on a historical basis. The data set forth below does not purport to be complete. It should be read in conjunction with, and is qualified in its entirety by, the more detailed information, including the Company's Consolidated Financial Statements and related notes, appearing elsewhere herein.

	As of and for the Twelve Months Ended June 30,				
	2018	2017	2016	2015	2014
	(Dollars in thousands, except per share data)				
Selected operations data:					
Interest and dividend income	\$65,893	\$57,921	\$47,235	\$44,588	\$38,371
Interest expense	12,584	10,096	7,855	7,220	6,653
Net interest income	53,309	47,825	39,380	37,368	31,718
Provision for loan losses	1,410	1,594	1,618	717	531
Noninterest income	7,028	9,696	7,773	7,089	4,869
Net securities gains	-	-	-	-	-
Noninterest expense	35,730	35,789	33,812	32,604	31,777
Income before income taxes	23,197	20,138	11,723	11,136	4,279
Income tax expense	7,031	7,779	4,104	3,995	1,579
Net income from continuing operations	16,166	12,359	7,619	7,141	2,700
Net (loss) income from discontinued operations	-	-	-	-	(8 )
Net income	\$16,166	\$12,359	\$7,619	\$7,141	\$2,692
Consolidated per share data:					
Earnings:					
Basic:					
Continuing operations	\$1.81	\$1.39	\$0.80	\$0.72	\$0.26
Discontinued operations	0.00	0.00	0.00	0.00	0.00
Total	\$1.81	\$1.39	\$0.80	\$0.72	\$0.26
Diluted:					
Continuing operations	\$1.77	\$1.38	\$0.80	\$0.72	\$0.26
Discontinued operations	0.00	0.00	0.00	0.00	0.00
Total	\$1.77	\$1.38	\$0.80	\$0.72	\$0.26
Cash dividends	\$0.04	\$0.04	\$0.04	\$0.04	\$0.28
Book value	15.49	13.90	12.51	11.77	11.05
Selected balance sheet data:					
Total assets	\$1,157,736	\$1,076,874	\$986,153	\$850,718	\$761,931
Loans	871,802	779,195	692,436	612,137	516,416
Deposits	954,940	889,850	800,432	674,759	574,329
Borrowings and capital lease obligations	39,563	44,504	54,534	52,568	66,005
Total shareholders' equity	138,430	122,797	116,591	112,727	112,066



Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-K

Other ratios:

Return on average assets	1.49	%	1.22	%	0.85	%	0.89	%	0.37	%
Return on average equity	12.47	%	10.62	%	6.66	%	6.35	%	2.39	%
Efficiency ratio	59.22	%	62.22	%	71.71	%	73.34	%	86.85	%
Average equity to average total assets	11.94	%	11.52	%	12.71	%	14.00	%	15.38	%
Common dividend payout ratio	2.26	%	2.90	%	5.00	%	5.56	%	107.69	%
Tier 1 leverage capital ratio	13.12	%	12.81	%	13.27	%	14.49	%	15.90	%
Total capital ratio	19.28	%	19.48	%	20.39	%	20.14	%	23.69	%

Table of Contents

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

Northeast Bancorp is a Maine corporation and a bank holding company registered with the Federal Reserve under the Bank Holding Company Act of 1956. The Company also is a registered Maine financial institution holding company, and is subject to regulation by both the Bureau and the Federal Reserve. The Company's principal asset is the capital stock of Northeast Bank, a Maine state-chartered universal bank, which is regulated by the FDIC and the Bureau. The Company's results of operations are primarily dependent on the results of the operations of the Bank.

The Management's Discussion and Analysis of Financial Condition and Results of Operations, which follows, presents a review of the consolidated operating results of the Company for the fiscal year ended June 30, 2018 ("fiscal 2018") and the fiscal year ended June 30, 2017 ("fiscal 2017"). This discussion and analysis is intended to assist you in understanding the results of our operations and financial condition. You should read this discussion together with your review of the Company's Consolidated Financial Statements and related notes and other statistical information included in this report. Certain amounts in the periods prior to fiscal 2018 have been reclassified to conform to the fiscal 2018 presentation.

**Overview**

On December 29, 2010, the Merger of the Company and FHB Formation LLC, a Delaware limited liability company ("FHB"), was consummated. In connection with the transaction, as part of the regulatory approval process the Company made certain commitments to the Federal Reserve, the most significant of which are, (i) maintain a Tier 1 leverage ratio of at least 10%, (ii) maintain a total capital ratio of at least 15%, (iii) limit purchased loans to 40% of total loans, (iv) fund 100% of the Company's loans with core deposits (defined as non-maturity deposits and non-brokered insured time deposits), and (v) hold commercial real estate loans (including owner-occupied commercial real estate) to within 300% of total capital.

On June 28, 2013, the Federal Reserve approved the amendment of the commitment to hold commercial real estate loans to within 300% of total capital to exclude owner-occupied commercial real estate loans. All other commitments made to the Federal Reserve in connection with the Merger remain unchanged. The Company and the Bank are currently in compliance with all commitments to the Federal Reserve.

The Company's compliance ratios at June 30, 2018 are as follows:

Condition	Ratio
(i) Tier 1 leverage ratio	13.12 %

(ii) Total capital ratio	19.28 %
(iii) Ratio of purchased loans to total loans	33.10 %
(iv) Ratio of loans to core deposits (1)	91.54 %
(v) Ratio of non-owner occupied commercial real estate loans to total capital (2)	200.74 %

(1) Core deposits include all non-maturity deposits and non-brokered insured time deposits

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

### ***Fiscal 2018 Financial Highlights***

The Company's financial and strategic highlights for fiscal 2018 include the following:

Earned net income of \$16.2 million, or \$1.77 per diluted common share, compared to \$12.3 million, or \$1.38 per diluted common share, for the year ended June 30, 2017.

Generated loans of \$460.4 million, growing the portfolio on a net basis by \$92.6 million, or 11.9%.

LASG purchased loans totaling \$124.1 million and originated loans totaling \$224.5 million, earning average portfolio yields of 11.4% and 6.8%, respectively. The purchased loan yield of 11.4% includes regularly scheduled interest and accretion, and accelerated accretion and fees recognized on loan payoffs. The Company also monitors the "total return" on its purchased loan portfolio, a measure that includes gains on asset sales, gains on real estate owned, as well as interest, scheduled accretion and accelerated accretion and fees. On this basis, the purchased loan portfolio earned a total return of 11.7% for fiscal 2018.

Table of Contents

An overview of the LASG portfolio follows:

	Years Ended June 30, 2018				2017			
	Purchased	Originated	Secured Loans to Broker-Dealers	Total LASG	Purchased	Originated	Secured Loans to Broker-Dealers	Total LASG
	(Dollars in thousands)							
Loans purchased or originated during the period: Unpaid principal balance	\$ 137,249	\$ 224,546	\$ -	\$ 361,795	\$ 126,713	\$ 237,691	\$ -	\$ 364,404
Net investment basis	124,111	224,546	-	348,657	112,807	237,691	-	350,498
Loan returns during the period: Yield	11.35 %	6.80 %	0.00 %	8.66 %	12.24 %	6.21 %	0.82 %	8.69 %
Total Return (1)	11.73 %	6.80 %	0.00 %	8.82 %	12.30 %	6.21 %	0.82 %	8.72 %
Total loans as of period end: Unpaid principal balance	\$ 326,855	\$ 397,363	\$ -	\$ 724,218	\$ 279,854	\$ 330,515	\$ -	\$ 610,369
Net investment basis	290,972	397,363	-	688,335	246,388	330,515	-	576,903

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

Increased the Company's deposit base by \$65.1 million, primarily the result of growth in non-maturity accounts of \$50.0 million, or 9.0%, and growth in time deposits of \$15.1 million, or 4.5%.

Originated \$45.1 million in SBA guaranteed loans through June 30, 2018, and sold \$29.2 million of loans, for a gain on sale of \$3.0 million.

## Results of Operations

### General

Net income for the year ended June 30, 2018 increased by \$3.9 million to \$16.2 million, compared to \$12.3 million for the year ended June 30, 2017.

Items of significance affecting the Company's earnings included:

An increase in net interest and dividend income before provision for loan losses, which grew to \$53.3 million as compared to \$47.8 million for the year ended June 30, 2017. The increase was primarily due to higher average balances in the LASG originated portfolio, partially offset by higher rates paid on deposits and higher average balances in the deposit portfolio.

The following table summarizes interest income and related yields recognized on the Company's loans:

	Years Ended June 30,			2017		
	Average Balance (1)	Interest Income	Yield	Average Balance (1)	Interest Income (2)	Yield
	(Dollars in thousands)					
Community Banking Division	\$139,239	\$6,871	4.93 %	\$190,704	\$9,102	4.77 %
SBA	53,030	3,888	7.33 %	42,946	2,619	6.10 %
LASG:						
Originated	350,427	23,834	6.80 %	239,796	14,883	6.21 %
Purchased	242,652	27,553	11.35 %	236,937	28,997	12.24 %
Secured Loans to Broker-Dealers	-	-	0.00 %	31,085	256	0.82 %
Total LASG	593,079	51,387	8.66 %	507,818	44,136	8.69 %
Total	\$785,348	\$62,146	7.91 %	\$741,468	\$55,857	7.53 %

(1) Includes loans held for sale.



Table of Contents

The yield on purchased loans is affected by unscheduled loan payoffs, which result in immediate recognition of the prepaid loans' discount in interest income. The following table details the "total return" on purchased loans, which includes total transactional income of \$9.7 million for the year ended June 30, 2018, a decrease of \$439 thousand from the year ended June 30, 2017. The following table summarizes the total return recognized on the purchased loan portfolio:

	Years Ended June 30,			
	2018		2017	
	Income	Return (1)	Income	Return (1)
	(Dollars in thousands)			
Regularly scheduled interest and accretion	\$18,752	7.73 %	\$18,975	8.01 %
Transactional income:				
Gain on loan sales	918	0.38 %	-	0.00 %
Gain on sale of real estate owned	-	0.00 %	148	0.06 %
Other noninterest income	-	0.00 %	(12 )	0.00 %
Accelerated accretion and loan fees	8,801	3.62 %	10,022	4.23 %
Total transactional income	9,719	4.00 %	10,158	4.29 %
Total	\$28,471	11.73 %	\$29,133	12.30 %

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

A decrease of \$2.7 million in noninterest income, principally resulting from a decrease of \$2.3 million in gains realized on the sale of SBA loans. The year ended June 30, 2018 includes gains realized on the sale of SBA loans of \$3.0 million. Additionally, there was a decrease in gain on sale of residential loans held for sale of \$521 thousand, and a decrease in other noninterest income of \$135 thousand, due to an increased loss recognized on real estate owned and other repossessed collateral. These increases were offset by an increase in gain on the sale of other loans of \$553 thousand, due to the sale of four LASG purchased loans for a total gain of \$918 thousand, as compared to the sale of a Community Banking Division commercial loan portfolio for a total gain of \$365 thousand in fiscal 2017.

A decrease of \$59 thousand in noninterest expense, principally due to a decrease of \$417 thousand in occupancy and equipment expense, due to decreased computer equipment repairs and maintenance expense and computer and software depreciation expense, and a decrease of \$380 thousand in loan acquisition and collection expense, due to lower loan workout expenses. These decreases were offset by an increase of \$703 thousand in data processing fees, primarily due to the increased cost associated with the outsourcing of data processing.

Table of Contents**Net Interest Income**

The following table sets forth average balance sheets, average yields and costs, and certain other information for the periods indicated:

	Years Ended June 30, 2018			2017			2016		
	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate
(Dollars in thousands)									
Assets:									
Interest-earning assets:									
Investment securities	\$92,599	\$1,111	1.20 %	\$95,624	\$1,018	1.06 %	\$100,503	\$930	0.93 %
Loans (1) (2) (3)	785,348	62,156	7.91 %	741,468	55,928	7.54 %	664,902	45,921	6.91 %
FHLBB stock	1,803	89	4.94 %	2,172	90	4.14 %	2,960	113	3.82 %
Short-term investments (4)	171,360	2,547	1.49 %	133,599	956	0.72 %	91,563	343	0.37 %
Total interest-earning assets	1,051,110	65,903	6.27 %	972,863	57,992	5.96 %	859,928	47,307	5.50 %
Cash and due from banks	2,889			2,833			3,596		
Other non-interest earning assets	31,550			32,394			35,607		
Total assets	\$1,085,549			\$1,008,090			\$899,131		
Liabilities & Shareholders' Equity:									
Interest-bearing liabilities:									
NOW accounts	\$70,486	\$210	0.30 %	\$70,912	\$204	0.29 %	\$68,304	\$182	0.27 %
Money market accounts	407,680	5,145	1.26 %	322,011	3,120	0.97 %	212,102	1,845	0.87 %
Savings accounts	37,514	57	0.15 %	36,438	50	0.14 %	36,062	48	0.13 %
Time deposits	311,544	4,485	1.44 %	326,601	3,983	1.22 %	349,978	3,952	1.13 %
Total interest-bearing deposits	827,224	9,897	1.20 %	755,962	7,357	0.97 %	666,446	6,027	0.90 %
Short-term borrowings	-	-	0.00 %	-	-	0.00 %	1,634	20	1.22 %



Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-K

FHLBB advances	16,947	547	3.23 %	24,334	800	3.29 %	32,432	1,094	3.37 %
Subordinated debt	23,787	2,102	8.84 %	23,468	1,888	8.04 %	8,762	651	7.43 %
Capital lease obligations	730	38	5.21 %	992	51	5.14 %	1,242	63	5.07 %
Total interest-bearing liabilities	868,688	12,584	1.45 %	804,756	10,096	1.25 %	710,516	7,855	1.11 %
Non-interest bearing liabilities:									
Demand deposits and escrow accounts	79,767			79,560			67,041		
Other liabilities	7,472			7,599			7,252		
Total liabilities	955,927			891,915			784,809		
Shareholders' equity	129,622			116,175			114,322		
Total liabilities and shareholders' equity	\$1,085,549			\$1,008,090			\$899,131		
Net interest income (5)		\$53,319			\$47,896			\$39,452	
Interest rate spread (5)			4.82 %			4.71 %			4.39 %
Net interest margin (6)			5.07 %			4.92 %			4.59 %

- (1) Interest income and yield are stated on a fully tax-equivalent basis using the statutory tax rate.
- (2) Includes loans held for sale.
- (3) Nonaccrual loans are included in the computation of average, but unpaid interest has not been included for purposes of determining interest income.
- (4) Short-term investments include FHLBB and FRB overnight deposits and other interest-bearing deposits.
- (5) Includes tax-exempt interest income of \$10 thousand, \$71 thousand, and \$72 thousand for the years ended June 30, 2018, 2017, and 2016, respectively.
- (6) Net interest margin is calculated as net interest income divided by total interest-earning assets.

Table of Contents

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

## Year Ended June 30, 2018

Compared to the Year  
Ended June 30, 2017  
Change Change Total  
Due to Due to Change  
Volume Rate  
(Dollars in thousands)

Interest earning assets:			
Investment securities	\$(33 )	\$ 126	\$ 93
Loans	3,399	2,829	6,228
FHLBB stock	(16 )	15	(1 )
Short-term investments	330	1,261	1,591
Total increase in interest income	3,680	4,231	7,911
Interest-bearing liabilities:			
Interest-bearing deposits	707	1,833	2,540
Short-term borrowings	(238 )	(15 )	(253 )
Subordinated debt	26	188	214
Capital lease obligations	(14 )	1	(13 )
Total increase in interest expense	481	2,007	2,488
Total increase in net interest and dividend income	\$3,199	\$2,224	\$5,423

## Year Ended June 30, 2017

Compared to the Year  
Ended June 30, 2016  
Change Change Total  
Due to Due to Change  
Volume Rate  
(Dollars in thousands)

Interest earning assets:			
Investment securities	\$(47 )	\$ 135	\$ 88
Loans	5,559	4,448	10,007

FHLBB stock	(32 )	9	(23 )
Short-term investments	205	408	613
Total increase in interest income	5,685	5,000	10,685
Interest bearing liabilities:			
Interest bearing deposits	750	580	1,330
Short-term borrowings	(10 )	(10 )	(20 )
FHLBB advances	(275 )	(19 )	(294 )
Subordinated debt	1,179	58	1,237
Capital lease obligations	(13 )	1	(12 )
Total increase in interest expense	1,631	610	2,241
Total increase in net interest and dividend income	\$4,054	\$4,390	\$8,444

For the year ended June 30, 2018, the \$3.2 million volume-related change in net interest income was mainly the result of the significant increase in loans, which grew by \$43.9 million on average compared to fiscal 2017. The rate-related change in fiscal 2018 compared to fiscal 2017 was principally due to the increase in yields on the originated loan portfolios. For fiscal 2018, the net interest margin earned of 5.07% was 15 basis points higher than that earned for fiscal 2017, primarily due to higher average balances and rates in the LASG originated portfolio, partially offset by higher rates paid on deposits and higher average balances in the deposit portfolio.

The Company's total cost of funds increased to 1.33% in fiscal 2018, from 1.14% in fiscal 2017, due to higher rates paid on deposits and higher volume in the deposit portfolio.

### ***Provision for Loan Losses***

Quarterly, the Company determines the amount of its allowance for loan losses adequate to provide for losses inherent in the Company's loan portfolios, with the provision for loan losses determined by the net periodic change in the allowance for loan losses. For acquired loans accounted for under ASC 310-30, *Receivables—Loans and Debt Securities Acquired with Deteriorated Credit Quality* ("ASC 310-30"), a provision for loan loss is recorded when estimates of future cash flows decrease due to credit deterioration.

The provision for loan losses has been recorded based on estimates of inherent losses in newly originated loans and for incremental reserves required for pre-merger loans based on estimates of deteriorated credit quality post-merger.

Table of Contents

The provision for loan losses for the fiscal year ended June 30, 2018 was \$1.4 million, a decrease from the provision for loan losses of \$1.6 million for the year ended June 30, 2017. At June 30, 2018 and 2017, the allowance for loan losses was \$4.8 million and \$3.7 million, respectively, and the ratio of allowance for loan losses to total loans was 0.55% and 0.47%, respectively.

Net charge-offs for fiscal 2018 totaled \$268 thousand, representing approximately 0.03% of the Company's average portfolio loan balance during the fiscal year. This compares to \$279 thousand, or 0.04%, in fiscal 2017, representing a decrease of \$11 thousand in fiscal 2018.

For additional information on the allowance for loan losses, see "Asset Quality."

***Noninterest Income***

Noninterest income for fiscal 2018 totaled \$7.0 million, a decrease of \$2.7 million, or 27.5%, from fiscal 2017. When compared to fiscal 2017, the decrease was principally due to the following:

- A decrease of \$2.3 million in gains realized on the sale of SBA loans. Fiscal 2018 includes gains realized on the sale of SBA loans of \$3.0 million, compared to a \$5.3 million gain on the sale of SBA loans in fiscal 2017; and
  - A decrease in gain on the sale of residential loans held for sale of \$521 thousand.
- The decreases in noninterest income were partially offset by an increase in gain on the sale of other loans of \$553 thousand. Fiscal 2018 includes gains realized on the sale of four LASG purchased loans of \$918 thousand, compared to a \$365 thousand gain on sale of a Community Banking Division commercial loan portfolio in the year ended June 30, 2017.

***Noninterest Expense***

Noninterest expense for fiscal 2018 totaled \$35.7 million, a decrease of \$59 thousand, or 0.2%, from fiscal 2017. When compared to fiscal 2017, the decrease was principally due to the following:

- A decrease of \$417 thousand in occupancy and equipment expense, due to decreased computer equipment repairs and maintenance expense, and computer and software depreciation expense; and
- A decrease of \$380 thousand in loan acquisition and collection expense, due to lower loan workout expenses.
-

The decreases in noninterest expense were partially offset by an increase of \$703 thousand in data processing fees, primarily due to the increased cost associated with the outsourcing of data processing.

### *Income Taxes*

Income tax expense for fiscal 2018 totaled \$7.0 million, representing 30.3% of pretax income, as compared to \$7.8 million, or 38.7% of pretax income, in fiscal 2017. The decrease in the Company's effective tax rate was principally due to the change in the federal corporate income tax rate as a result of the Tax Cuts and Jobs Act signed into law on December 22, 2017, along with benefits resulting from the Company's adoption of ASU 2016-09, *Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*, arising from the exercise of stock options and vesting of restricted stock awards.

Table of Contents

**Financial Condition**

*Overview*

The Company's total assets grew to \$1.2 billion at June 30, 2018, representing an increase of \$80.9 million, or 7.5%, compared to \$1.1 billion at June 30, 2017. Significant changes in the Company's balance sheet components include:

The loan portfolio, excluding loans held for sale, increased by \$92.6 million, or 11.9%, compared to June 30, 2017. The increase was principally due to \$348.7 million of LASG originations and purchases, \$3.4 million of Community Bank originations and \$45.1 million of SBA originations. The increase in loan volume was partially offset by SBA loan sales of \$29.2 million, as well as purchased and originated loan runoff in the portfolio.

Deposits increased by \$65.1 million, or 7.3%, from June 30, 2017 due to growth in non-maturity accounts of \$50.0 million, or 9.0%, and growth in time deposits of \$15.1 million, or 4.5%; and

Shareholders' equity increased by \$15.6 million from June 30, 2017, primarily due to earnings of \$16.2 million. Additionally, there was stock-based compensation of \$870 thousand, an increase in accumulated other comprehensive loss of \$129 thousand and \$355 thousand in dividends paid on common stock.

*Cash and Cash Equivalents*

Cash and cash equivalents decreased \$5.9 million, or 3.6%, to \$157.4 million at June 30, 2018, as compared to \$163.3 million at June 30, 2017. This decrease was principally the result of net loan growth, including loans held for sale, of \$95.1 million, offset by net deposit growth of \$65.1 million and a net decrease in available-for-sale securities of \$9.0 million.

*Available-for-sale Securities*

The available-for-sale securities portfolio totaled \$87.7 million and \$96.7 million at June 30, 2018 and 2017, respectively. The Company's investment portfolio was comprised primarily of U.S. Government-sponsored enterprise bonds and mortgage-backed securities guaranteed by government agencies. The composition of the Company's securities portfolio at the dates indicated follows.

	June 30, 2018		June 30, 2017		June 30, 2016	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)					
U.S. Government agency securities	\$57,129	\$56,887	\$57,401	\$57,168	\$51,948	\$52,046
Agency mortgage-backed securities	25,276	24,181	33,523	32,903	43,330	43,368
Other investments measured at net asset value	6,866	6,619	6,717	6,622	5,097	5,158
Total available-for-sale securities	\$89,271	\$87,687	\$97,641	\$96,693	\$100,375	\$100,572

The table below sets forth certain information regarding the contractual maturities and weighted average yields of the Company's debt securities portfolio at June 30, 2018. Actual maturities of mortgage-backed securities will differ from contractual maturities due both to scheduled amortization and prepayments.

	Within One Year		After One Year Through Five Years		After Five Years Through Ten Years		After Ten Years		Total	
	Fair Value	Yield	Fair Value	Yield	Fair Value	Yield	Fair Value	Yield	Fair Value	Yield
	(Dollars in thousands)									
U.S. Government agency securities	\$32,887	1.05 %	\$23,999	2.20 %	\$-	0.00 %	\$-	0.00 %	\$56,886	1.54 %
Agency mortgage-backed securities	-	0.00 %	9,101	0.89 %	15,080	1.46 %	-	0.00 %	24,181	1.25 %
Total available-for-sale securities	\$32,887	1.05 %	\$33,100	1.84 %	\$15,080	1.46 %	\$-	0.00 %	\$81,067	1.45 %

The other investments measured at net asset value have no scheduled maturity date. However, the Company's investments can be redeemed quarterly and daily at the closing net asset value.

Management reviews the portfolio of investments on an ongoing basis to determine if there have been any other-than-temporary declines in value. No other-than-temporary impairment expense was recognized during fiscal 2018 or fiscal 2017.

Table of Contents**Loans**

Loans, including loans held for sale, totaled \$879.0 million at June 30, 2018, compared to \$783.9 million at June 30, 2017 and \$700.0 million at June 30, 2016. The increase of \$95.1 million, or 12.1%, at June 30, 2018 was principally due to net increases of \$81.4 million in commercial real estate loans, \$13.2 million in commercial and industrial loans, and \$2.5 million in loans held for sale, offset by a net decrease of \$912 thousand in residential real estate loans and \$1.1 million in consumer loans. During fiscal 2018, the LASG originated \$224.5 million in loans and the LASG purchased \$124.1 million in loans, consisting principally of commercial real estate loans.

The composition of the Company's loan portfolio (excluding loans held for sale) at the dates indicated is as follows:

	June 30, 2018		June 30, 2017		June 30, 2016		June 30, 2015		June 30, 2014		
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	
	(Dollars in thousands)										
Residential real estate	\$100,256	11.50 %	\$101,168	12.98 %	\$113,962	16.46 %	\$132,669	21.67 %	\$148,634	28.79 %	
Commercial real estate	579,450	66.47 %	498,004	63.91 %	426,568	61.60 %	348,676	56.96 %	316,098	61.21 %	
Commercial and industrial	188,852	21.66 %	175,654	22.54 %	145,956	21.08 %	123,133	20.12 %	41,800	8.09 %	
Consumer and other	3,244	0.37 %	4,369	0.57 %	5,950	0.86 %	7,659	1.25 %	9,884	1.91 %	
Total loans	871,802	100.00 %	779,195	100.00 %	692,436	100.00 %	612,137	100.00 %	516,416	100.00 %	
Less:											
Allowance for loan losses	4,807		3,665		2,350		1,926		1,367		
Loans, net	\$866,995		\$775,530		\$690,086		\$610,211		\$515,049		

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

June 30, 2018



Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-K

	Community Banking Division	LASG	SBA Division	Total	Percent of Total
(Dollars in thousands)					
Originated loans:					
Residential real estate	\$68,634	\$7,111	\$128	\$75,873	8.70 %
Home equity	10,457	-	-	10,457	1.20 %
Commercial real estate: non-owner occupied	18,698	137,463	29,488	185,649	21.29 %
Commercial real estate: owner occupied	11,351	81,916	24,483	117,750	13.51 %
Commercial and industrial	10,927	170,873	6,057	187,857	21.55 %
Consumer	3,244	-	-	3,244	0.37 %
Subtotal	123,311	397,363	60,156	580,830	66.62 %
Purchased loans:					
Residential real estate	-	13,926	-	13,926	1.60 %
Commercial real estate: non-owner occupied	-	150,805	-	150,805	17.30 %
Commercial real estate: owner occupied	-	125,246	-	125,246	14.37 %
Commercial and industrial	-	995	-	995	0.11 %
Subtotal	-	290,972	-	290,972	33.38 %
Total	\$123,311	\$688,335	\$60,156	\$871,802	100.00 %

Table of Contents

	June 30, 2017				
	Community Banking Division	LASG	SBA Division	Total	Percent of Total
	(Dollars in thousands)				
Originated loans:					
Residential real estate	\$81,538	\$2,092	\$129	\$83,759	10.75 %
Home equity	13,931	-	-	13,931	1.79 %
Commercial real estate: non-owner occupied	23,638	90,154	23,720	137,512	17.65 %
Commercial real estate: owner occupied	13,502	83,446	21,820	118,768	15.24 %
Commercial and industrial	12,349	154,823	7,296	174,468	22.39 %
Consumer	4,369	-	-	4,369	0.56 %
Subtotal	149,327	330,515	52,965	532,807	68.38 %
Purchased loans:					
Residential real estate	-	3,478	-	3,478	0.45 %
Commercial real estate: non-owner occupied	-	134,970	-	134,970	17.32 %
Commercial real estate: owner occupied	-	106,754	-	106,754	13.70 %
Commercial and industrial	-	1,186	-	1,186	0.15 %
Subtotal	-	246,388	-	246,388	31.62 %
Total	\$149,327	\$576,903	\$52,965	\$779,195	100.00 %

	June 30, 2016				
	Community Banking Division	LASG	SBA Division	Total	Percent of Total
	(Dollars in thousands)				
Originated loans:					
Residential real estate	\$93,258	\$-	\$133	\$93,391	13.49 %
Home equity	18,012	-	-	18,012	2.60 %
Commercial real estate: non-owner occupied	49,514	52,744	5,639	107,897	15.58 %
Commercial real estate: owner occupied	20,578	46,727	14,414	81,719	11.80 %
Commercial and industrial	16,069	123,447	6,242	145,758	21.05 %
Consumer	5,950	-	-	5,950	0.86 %
Subtotal	203,381	222,918	26,428	452,727	65.38 %
Purchased loans:					
Residential real estate	-	2,559	-	2,559	0.37 %
Commercial real estate: non-owner occupied	-	142,286	-	142,286	20.55 %
Commercial real estate: owner occupied	-	94,666	-	94,666	13.67 %
Commercial and industrial	-	198	-	198	0.03 %
Subtotal	-	239,709	-	239,709	34.62 %
Total	\$203,381	\$462,627	\$26,428	\$692,436	100.00 %

Table of Contents

The following table summarizes the scheduled maturity of the Company's loan portfolio at June 30, 2018. Demand loans, loans having no stated repayment schedule, and overdraft loans are reported as being due in less than one year.

Scheduled Loan Maturities					
	Within One Year	After One Year Through Five Years	After Five Years Through Ten Years	After Ten Years	Total
(Dollars in thousands)					
Mortgages:					
Residential:					
Originated	\$6,406	\$10,599	\$8,214	\$61,111	\$86,330
Purchased	1,550	6,676	271	5,429	13,926
Commercial:					
Originated	39,498	124,120	74,494	65,287	303,399
Purchased	30,060	83,817	38,555	123,619	276,051
Non-mortgage loans:					
Commercial:					
Originated	49,195	124,876	12,861	925	187,857
Purchased	-	555	346	94	995
Consumer and other	126	1,025	1,629	464	3,244
Total loans	\$126,835	\$351,668	\$136,370	\$256,929	\$871,802

Loans Due After One Year, by Interest Rate Type			
	Fixed rate	Floating or Adjustable	Total
(Dollars in thousands)			
Mortgages:			
Residential:			
Originated	\$36,345	\$43,579	\$79,924
Purchased	3,840	8,536	12,376
Commercial:			
Originated	15,709	248,192	263,901
Purchased	98,613	147,378	245,991
Non-mortgage loans:			
Commercial:			
Originated	5,942	132,720	138,662
Purchased	13	982	995
Consumer and other	3,118	-	3,118
Total	\$163,580	\$581,387	\$744,967

Approximately 77.4% of total portfolio loans at June 30, 2018 were variable rate products, compared to 74.9% at June 30, 2017.

Certain purchased loans have been identified as having evidence of credit deterioration since their origination, and it is probable that the Company will not collect all contractually required principal and interest payments. Purchased loans are accounted for using the measurement provisions set forth in ASC 310-30. The nonaccretable difference represents a loan's contractually required payments receivable in excess of the amount of cash flows expected to be collected. Improvements in expected cash flows result in prospective yield adjustments. The effect of a decrease in expected cash flows due to further credit deterioration are recorded through the allowance for loan losses.

### *Other Assets*

Premises and equipment, net, decreased by \$346 thousand, or 5.0%, to \$6.6 million at June 30, 2018, compared to \$6.9 million at June 30, 2017. The decrease was primarily due to depreciation of \$1.3 million in the year, offset by fixed assets acquired.

Real estate owned and other repossessed collateral, net, increased by \$1.4 million, or 170.3%, to \$2.2 million at June 30, 2018, compared to \$826 thousand at June 30, 2017. The increase was primarily due to the addition of one LASG purchased property into real estate owned during the period. The real estate and personal property collateral for commercial and consumer loans are written down to fair value less estimated costs to sell upon transfer to acquired assets.

The cash surrender value of the Company's BOLI assets increased \$441 thousand, or 2.7%, to \$16.6 million at June 30, 2018, compared to \$16.2 million at June 30, 2017. BOLI assets are invested in the general account of three insurance companies and in separate accounts of a fourth insurance company. A general account policy's cash surrender value is supported by the general assets of the insurance company. A separate account policy's cash surrender value is supported by assets segregated from the general assets of the insurance company. Standard and Poor's rated these companies A+ or better at June 30, 2018. Interest earnings, net of mortality costs, increase the cash surrender value. These interest earnings are based on interest rates that reset each year, and are subject to minimum guaranteed rates. These increases in cash surrender value are recognized in other income and are not subject to income taxes. Management considers BOLI an illiquid asset. BOLI represented 10.2% of the Company's total capital at June 30, 2018.

Table of Contents

Servicing rights totaled \$3.0 million and \$2.8 million at June 30, 2018 and 2017, respectively. The \$124 thousand increase was the result of SBA loans sold during the year, offset by amortization and impairment booked during fiscal 2018.

Intangible assets totaled \$867 thousand and \$1.3 million at June 30, 2018 and June 30, 2017, respectively. The \$433 thousand decrease was the result of core deposit intangible amortization during fiscal 2018.

***Deposits***

The Company's principal source of funding is its core deposit accounts. At June 30, 2018, core deposits, which the Company defines as non-maturity deposits and non-brokered insured time deposits, represented 100% of total deposits.

Total deposits increased \$65.1 million to \$954.9 million as of June 30, 2018 from \$889.9 million as of June 30, 2017. The increase was primarily due to the increase in money market accounts attracted through ableBanking, as well as the Community Banking Division.

The following tables set forth certain information relative to the composition of the Company's average deposit accounts and the weighted average interest rate on each category of deposits for the periods indicated:

	Year Ended June 30, 2018		
	Average Balance	Weighted Average Rate	Percent of Total Average Deposits
	(Dollars in thousands)		
Non-interest bearing demand deposits and escrow accounts	\$79,767	0.00 %	8.79 %
Regular savings	37,514	0.15 %	4.14 %
NOW accounts	70,486	0.30 %	7.77 %
Money market accounts	407,680	1.26 %	44.95 %
Time deposits	311,544	1.44 %	34.35 %
Total average deposits	\$906,991	1.09 %	100.00 %

	Year Ended June 30, 2017			Year Ended June 30, 2016		
	Average Balance	Weighted Average Rate	Percent of Total Average Deposits	Average Balance	Weighted Average Rate	Percent of Total Average Deposits
	(Dollars in thousands)					
Non-interest bearing demand deposits and escrow accounts	\$79,560	0.00 %	9.52 %	\$67,041	0.00 %	9.14 %
Regular savings	36,438	0.14 %	4.36 %	36,062	0.13 %	4.92 %
NOW accounts	70,912	0.29 %	8.49 %	68,304	0.27 %	9.31 %
Money market accounts	322,011	0.97 %	38.54 %	212,102	0.87 %	28.92 %
Time deposits	326,601	1.22 %	39.09 %	349,978	1.13 %	47.71 %
Total average deposits	\$835,522	0.88 %	100.00 %	\$733,487	0.82 %	100.00 %

There were no time deposits greater than \$250 thousand as of June 30, 2018, 2017, and 2016.

The scheduled maturity of deposits greater than or equal to \$100 thousand is set forth below:

	June 30, 2018 (Dollars in thousands)
3 months or less	\$ 24,282
Over 3 through 6 months	84,503
Over 6 through 12 months	97,514
Over 12 months	77,500
Total time certificates greater than or equal to \$100 thousand	\$ 283,799

### ***Borrowings***

FHLBB advances, subordinated debt, and junior subordinated debentures have been the Company's sources of funding other than deposits. In fiscal 2018, total borrowings decreased by \$4.7 million, or 10.7%, to \$39.0 million.

Advances from the FHLBB were \$15.0 million and \$20.0 million at June 30, 2018 and 2017, respectively. The decrease was the result of the payoff of a \$5.0 million FHLBB advance during the quarter ended December 31, 2017.



Table of Contents

Pledges of residential real estate loans, certain commercial real estate loans and certain FHLBB deposits free of liens or pledges are required to secure outstanding advances and available additional borrowing capacity from the FHLBB. At June 30, 2018 and 2017, the Company had no pledged investment securities.

On June 29, 2016, the Company entered into a Subordinated Note Purchase Agreement with certain institutional accredited investors pursuant to which the Company sold and issued \$15.05 million in aggregate principal amount of 6.75% fixed-to-floating subordinated notes due 2026.

There were no balances outstanding at June 30, 2018 and 2017, respectively, for advances under the Federal Reserve Discount Window Borrower-in-custody program. The available credit under the program was \$1.1 million and \$1.4 million at June 30, 2018 and 2017, respectively, with the decrease in fiscal 2018 attributable to payoffs of consumer loans pledged as collateral.

The Company had junior subordinated debentures issued to affiliated trusts totaling \$9.2 million and \$9.0 million at June 30, 2018 and 2017, respectively. See “Capital” below for more information on our junior subordinated debentures and affiliated trusts.

**Asset Quality**

*Allowance for Loan Losses*

The allowance for loan losses is maintained at a level that management considers adequate to provide for probable loan losses based upon evaluation of known and inherent risks in the loan portfolio. The allowance is increased by providing for loan losses through a charge to expense and by recoveries of loans previously charged-off and is reduced by loans being charged-off.



Table of Contents

At June 30, 2018, the allowance for loan losses totaled \$4.8 million, or 0.55% of total loans, as compared to \$3.7 million, or 0.47% of total loans, at June 30, 2017 and \$2.4 million, or 0.34% of total loans, at June 30, 2016. The year over year increase in the Company's allowance for losses was principally the result of loan growth and the increase of qualitative factors. The following table sets forth activity in Company's allowance for loan losses for the periods indicated.

	Year Ended June 30, 2018	Year Ended June 30, 2017	Year Ended June 30, 2016	Year Ended June 30, 2015	Year Ended June 30, 2014
	(Dollars in thousands)				
Allowance at beginning of period	\$3,665	\$2,350	\$1,926	\$1,367	\$1,143
Loans charged-off during the period:					
Residential real estate	183	186	134	207	267
Commercial real estate	111	44	988	-	26
Commercial and industrial	-	56	77	3	43
Consumer and other	53	101	66	28	69
Total loans charged-off	347	387	1,265	238	405
Recoveries on loans previously charged-off:					
Residential real estate	14	33	35	24	63
Commercial real estate	-	21	5	1	2
Commercial and industrial	25	16	14	34	8
Consumer and other	40	38	17	21	25
Total recoveries	79	108	71	80	98
Net loans charged off during the period	268	279	1,194	158	307
Provision for loan losses	1,410	1,594	1,618	717	531
Allowance at end of period	\$4,807	\$3,665	\$2,350	\$1,926	\$1,367
Total loans at end of period <sup>(1)</sup>	\$871,802	\$779,195	\$692,436	\$612,137	\$516,416
Average loans outstanding during the period <sup>(1)</sup>	780,854	737,860	659,995	555,073	488,172
Allowance as a percentage of total loans	0.55 %	0.47 %	0.34 %	0.31 %	0.26 %
Ratio of net charge-offs to average loans outstanding	0.03 %	0.04 %	0.18 %	0.03 %	0.06 %
Allowance as a percentage of non-performing loans	40.02 %	26.25 %	30.02 %	18.41 %	18.66 %

(1) Amounts and resulting ratios exclude loans held for sale

The following table allocates the allowance for loan losses by loan category and the percent of loans in each category to total loans at the dates indicated below.

June 30, 2018	June 30, 2017	June 30, 2016	June 30, 2015	June 30, 2014
Percent of	Percent of	Percent of	Percent of	Percent of

Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-K

	Amount	Loans to Total Loans	Amount	Loans to Total Loans	Amount	Loans to Total Loans	Amount	Loans to Total Loans	Amount	Loans to Total Loans	
	(Dollars in thousands)										
Residential real estate	\$610	12.69 %	\$478	12.98 %	\$663	16.46 %	\$741	21.67 %	\$580	28.79 %	
Commercial real estate	3,136	65.24 %	2,549	63.91 %	1,328	61.60 %	976	56.96 %	625	61.21 %	
Commercial and industrial	1,022	21.26 %	585	22.54 %	297	21.08 %	118	20.12 %	48	8.09 %	
Consumer	39	0.81 %	53	0.57 %	62	0.86 %	35	1.25 %	79	1.91 %	
Unallocated	-	0.00 %	-	0.00 %	-	0.00 %	56	0.00 %	35	0.00 %	
Total	\$4,807	100.00 %	\$3,665	100.00 %	\$2,350	100.00 %	\$1,926	100.00 %	\$1,367	100.00 %	

Table of Contents

The following table reflects the annual trend of total loans 30 days or more past due, as a percentage of total loans. The decrease in the current year is primarily due to a decrease in delinquent LASG originated and SBA division loans.

	As of June 30,				
	2018	2017	2016	2015	2014
Past due loans to total loans	0.89%	1.72%	1.00%	1.08%	1.14%

***Non-performing Assets***

The table below sets forth the amounts and categories of the Company's non-performing assets at the dates indicated:

	June 30, 2018	June 30, 2017	June 30, 2016	June 30, 2015	June 30, 2014
	(Dollars in thousands)				
Nonperforming loans:					
Originated portfolio:					
Residential real estate	\$2,914	\$3,337	\$2,613	\$3,021	\$1,743
Commercial real estate	1,499	413	474	994	1,162
Home equity	298	58	48	11	160
Commercial and industrial	1,368	2,600	17	2	5
Consumer	134	103	163	190	139
Total originated portfolio	6,213	6,511	3,315	4,218	3,209
Purchased portfolio:					
Residential real estate	202	1,056	1,125	-	-
Commercial and industrial	363	32	-	-	-
Commercial real estate	5,180	6,364	3,387	6,532	4,116
Total purchased portfolio	5,745	7,452	4,512	6,532	4,116
Total nonperforming loans	11,958	13,963	7,827	10,750	7,325
Real estate owned and other repossessed collateral	2,233	826	1,652	1,651	1,991
Total nonperforming assets	\$14,191	\$14,789	\$9,479	\$12,401	\$9,316
Nonperforming loans that are current	\$4,897	\$4,321	\$2,271	\$484	\$651
Non-performing loans to total loans	1.37 %	1.79 %	1.13 %	1.76 %	1.42 %
Non-performing assets to total assets	1.23 %	1.37 %	0.96 %	1.46 %	1.22 %

At June 30, 2018, the Company had \$14.2 million of nonperforming assets, or 1.23% of total assets, compared to

\$14.8 million of nonperforming assets, or 1.37% of total assets at June 30, 2017 and \$9.5 million of nonperforming assets, or 0.96% of total assets, as of June 30, 2016. The decrease in nonperforming assets in fiscal 2018 was principally associated with a decrease in LASG purchased nonperforming loans of \$1.7 million in the year, offset by an increase in real estate owned and other repossessed collateral of \$1.4 million.

Troubled debt restructurings (“TDRs”) represent loans for which concessions (such as extension of repayment terms or reductions of interest rates to below market rates) are granted due to a borrower's financial condition. Such concessions may include reductions of interest rates to below-market terms and/or extension of repayment terms. The balances and payment status of TDRs are as follows:

	June 30, 2018	June 30, 2017	June 30, 2016
	(Dollars in thousands)		
Nonaccrual	\$3,543	\$5,383	\$1,152
Accrual	11,915	9,702	7,036
Total TDRs	\$15,458	\$15,085	\$8,188

At June 30, 2018, the Company had real estate owned and other repossessed collateral of \$2.2 million, compared to \$826 thousand at June 30, 2017. The increase in the period was primarily due to the addition of one LASG purchased property into real estate owned during the year. The real estate and personal property collateral for commercial and consumer loans are written down to fair value upon transfer to acquired assets. Revenues and expenses are recognized in the period when received or incurred on other real estate and in substance foreclosures. Gains and losses on disposition are recognized in noninterest income.

We continue to focus on asset quality and allocate significant resources to credit policy, loan review, asset management, collection, and workout functions. Despite this ongoing effort, there can be no assurance that adverse changes in the real estate markets and economic conditions will not result in higher non-performing assets levels in the future and negatively impact our results of operations through higher provision for loan losses, net loan charge-offs, decreased accrual of income and increased noninterest expenses.

Table of Contents**Potential Problem Loans**

Commercial real estate and commercial loans are periodically evaluated under a ten-point rating system. These ratings are guidelines in assessing the risk of a particular loan. The Company had \$10.1 million, \$9.0 million and \$6.2 million of loans rated substandard or worse at June 30, 2018, 2017 and 2016, respectively, an increase primarily attributable to downgraded purchased loans during the year. The following tables present the Company's loans by risk rating:

	June 30, 2018				
	Originated Portfolio				
	Commercial Real Estate (Dollars in thousands)	Commercial and Industrial	Residential Real Estate <sup>(1)</sup>	Purchased Portfolio	Total
Pass (1- 6)	\$298,200	\$ 184,024	\$ 13,531	\$279,111	\$774,866
Special mention (7)	3,505	2,198	100	5,899	11,702
Substandard (8)	1,694	1,635	823	5,962	10,114
Doubtful (9)	-	-	-	-	-
Loss (10)	-	-	-	-	-
Total	\$303,399	\$ 187,857	\$ 14,454	\$290,972	\$796,682

	June 30, 2017				
	Originated Portfolio				
	Commercial Real Estate (Dollars in thousands)	Commercial and Industrial	Residential Real Estate <sup>(1)</sup>	Purchased Portfolio	Total
Pass (1- 6)	\$253,041	\$ 171,160	\$ 10,039	\$229,980	\$664,220
Special mention (7)	2,686	2,483	71	9,622	14,862
Substandard (8)	554	825	803	6,786	8,968
Doubtful (9)	-	-	19	-	19
Loss (10)	-	-	-	-	-
Total	\$256,281	\$ 174,468	\$ 10,932	\$246,388	\$688,069

	June 30, 2016				
	Originated Portfolio				
	Commercial Real Estate (Dollars in thousands)	Commercial and Industrial	Residential Real Estate <sup>(1)</sup>	Purchased Portfolio	Total

Pass (1- 6)	\$186,165	\$ 142,451	\$ 7,659	\$227,895	\$564,170
Special mention (7)	2,493	3,290	431	7,147	13,361
Substandard (8)	958	17	537	4,667	6,179
Doubtful (9)	-	-	23	-	23
Loss (10)	-	-	-	-	-
Total	\$189,616	\$ 145,758	\$ 8,650	\$239,709	\$583,733

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

## **Risk Management**

Management and the Board of Directors of the Company recognize that taking and managing risk is fundamental to the business of banking. Through the development, implementation and monitoring of its policies with respect to risk management, the Company strives to measure, evaluate and control the risks it faces. The Board and management understand that an effective risk management system is critical to the Company's safety and soundness. Chief among the risks faced by us are credit risk, market risk (including interest rate risk), liquidity risk, and operational (transaction) risk.

### ***Credit Risk***

The Company considers credit risk to be the most significant risk that it faces, in that it has the greatest potential to affect the financial condition and operating results of the Company. Credit risk is managed through a combination of policies and limits established by the Board, the monitoring of compliance with these policies and limits, and the periodic evaluation of loans in the portfolio, including those with problem characteristics. The Company also utilizes the services of independent third parties to provide loan review services, which consist of a variety of monitoring techniques after a loan is purchased or originated.

In general, the Bank's policies establish limits on the maximum amount of credit that may be granted to a single borrower (including affiliates), the aggregate amount of loans outstanding by type in relation to total assets and capital, and concentrations of loans by size, property type, and geography. Underwriting criteria, such as collateral and debt service coverage ratios and approval limits are also specified in loan policies. The Company's policies also address the performance of periodic credit reviews, the risk rating of loans, when loans should be placed on non-performing status and factors that should be considered in establishing the Bank's allowance for loan losses. For additional information, refer to "Asset Quality" above and Item 1, "Business—Lending Activities."



Table of Contents

***Market Risk***

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

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

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

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

The ALCO's primary tool for measuring, evaluating, and managing interest rate risk is income simulation analysis. Income simulation analysis measures the interest rate risk inherent in the Company's balance sheet at a given point in time by showing the effect of interest rate shifts on net interest income over defined time horizons. These simulations take into account the specific repricing, maturity, prepayment and call options of financial instruments that vary under different interest rate scenarios. The ALCO reviews simulation results to determine whether the exposure to a decline in net interest income remains within established tolerance levels over the simulation horizons and to develop appropriate strategies to manage this exposure. The Company considers a variety of specified rate scenarios, including instantaneous rate shocks, against static (or flat) rates when measuring interest rate risk, and evaluates results over two consecutive twelve-month periods. All changes are measured in comparison to the projected net interest income that would result from an "unchanged" scenario, where interest rates remain stable over the measured time horizon(s). As of June 30, 2018, the income simulation analysis (as noted in the table below) for the first twelve-month period indicated that exposure to changing interest rates fell within the Company's policy levels of tolerance.



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

Assuming a 200 basis point increase and 100 basis point decrease in interest rates starting on June 30, 2018, we estimate that our net interest income in the following 12 months would increase by 2.7% if rates increased by 200 basis points and decrease by 1.1% if rates declined by 100 basis points. These results indicate a modest level of asset sensitivity in our balance sheet. An asset-sensitive position indicates that there are more rate-sensitive assets than rate-sensitive liabilities repricing or maturing within specific time horizons, which would generally imply a favorable impact on net interest income in periods of rising interest rates and a negative impact in periods of falling rates. A liability-sensitive position would generally imply a negative impact on net interest income in periods of rising rates and a positive impact in periods of falling rates.

Table of Contents

	Up 200 Basis Points		Down 100 Basis Points	
June 30, 2018	2.7	%	-1.1	%
June 30, 2017	0.5	%	-1.8	%
June 30, 2016	0.4	%	-1.6	%

***Liquidity Risk***

Liquidity risk is defined as the risk associated with an organization's ability to meet current and future financial obligations of a short-term nature. The Company uses its liquidity on a regular basis to fund existing and future loan commitments, to pay interest on deposits and on borrowings, to fund maturing certificates of deposit and borrowings, to fund other deposit withdrawals, to invest in other interest-earning assets, to make dividend payments to shareholders, and to meet operating expenses. The Company's primary sources of liquidity consist of deposit inflows, FHLBB advances, and the amortization, prepayment and maturities of loans and securities. While scheduled payments from the amortization and maturities of loans and securities are relatively predictable sources of funds, deposit flows and loan and investment prepayments can be greatly influenced by general interest rates, economic conditions and competition. In addition to these regular sources of funds, the Company may choose to sell portfolio loans and securities to meet liquidity demands.

We monitor and forecast our liquidity position. There are several interdependent methods used by us for this purpose, including daily review of Federal Funds positions, monthly review of balance sheet changes, monthly review of liquidity ratios, quarterly review of liquidity forecasts and periodic review of contingent funding plans. Using these methods, the Company actively manages its liquidity position under the direction of the ALCO.

The following is a summary of the unused borrowing capacity of the Company at June 30, 2018 available to meet our short-term funding needs:

	As of June 30, 2018 (Dollars in thousands)	
Brokered time deposits	\$ 289,434	Subject to policy limitation of 25% of total assets
Federal Home Loan Bank of Boston	48,656	Unused advance capacity subject to eligible and qualified collateral
Federal Discount Window Borrower-in-Custody	1,146	Unused credit line subject to the pledge of loans
Other available lines	17,500	

Total unused borrowing capacity                      \$ 356,736

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

At June 30, 2018, the Company had \$425.4 million of immediately accessible liquidity, defined as cash that the Bank reasonably believes could be raised within seven days through collateralized borrowings, brokered deposits or security sales. This position represented 36.7% of total assets. The Company also had \$157.4 million of cash and cash equivalents at June 30, 2018.

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

On a parent company only basis, commitments and debt service requirements at June 30, 2018 consisted of junior subordinated debentures issued to NBN Capital Trust II, NBN Capital Trust III and NBN Capital Trust IV with a principal balance of \$16.5 million as well as subordinated debt issued in June 2016 with a principal balance of \$15.05 million. See Note 9 of the Notes to the Consolidated Financial Statements for carrying values, maturity dates and the use of purchased interest rate caps and swaps to hedge the interest expense in periods of rising interest rates. Based on the interest rates at June 30, 2018, the annual aggregate payments to meet the debt service of the junior subordinated debentures is approximately \$754 thousand. In addition, for the year ended June 30, 2018, total annual interest expense on subordinated notes issued in June 2016 was \$1.0 million.

## Table of Contents

The principal sources of funds for the Company to meet parent-only obligations are dividends from the Bank, which are subject to regulatory limitations, and borrowings from public and private sources. For information on the restrictions on the payment of dividends by Northeast Bank, see Note 10 of the Notes to the Company's Consolidated Financial Statements in this Annual Report.

### ***Operational Risk***

Operational risk, which we define as the risk of loss from failed internal processes, people and systems, and external events, is inherent in all of our business activities. The principal ways in which we manage operational risk include the establishment of departmental and business-specific policies and procedures, internal controls and monitoring requirements. Some specific examples include our information security program, business continuity planning and testing, our vendor management program, reconciliation processes, our enterprise risk assessment process, and new product and/or system introduction processes. Periodic internal audits provide an important independent check on adherence to policies, procedures and controls designed to mitigate risk exposure.

To address these risks, management has a Senior Management Risk and Compliance Committee ("SMRCC"), whose responsibility is to proactively identify, accurately measure, and adequately monitor and control the risks assumed by the Bank in its various products and lines of business to ensure safe and sound operations and that the risks assumed by the Bank are consistent with the risk appetite established by the Board of Directors.

### **Off-Balance Sheet Arrangements and Aggregate Contractual Obligations**

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, unused lines of credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest-rate risk in excess of the amounts recognized on the condensed consolidated balance sheet. The contract or notional amounts of these instruments reflect the extent of the Company's involvement in particular classes of financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit, unused lines of credit and standby letters of credit is represented by the contractual amount of those instruments. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total committed amounts do not necessarily represent future cash requirements. To control the credit risk associated with entering into commitments and issuing letters of credit, the Company uses the same credit

quality, collateral policies, and monitoring controls in making commitments and letters of credit as it does with its lending activities.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers.

Unused lines of credit and commitments to extend credit typically result in loans with a market interest rate.

A summary of the amounts of the Company's contractual obligations and other commitments with off-balance sheet risk as of June 30, 2018 follows:

	Payments Due - By Period				
	Total	Less Than 1 Year	1-3 Years	4-5 Years	After 5 Years
(Dollars in thousands)					
Contractual obligations:					
Federal Home Loan Bank advances	\$15,000	\$15,000	\$-	\$-	\$-
Junior subordinated debentures	16,496	-	-	-	16,496
Subordinated debt	15,050	-	15,050	-	-
Capital lease obligation	637	306	331	-	-
Total debt obligations	47,183	15,306	15,381	-	16,496
Operating lease obligations	7,054	1,257	2,492	1,944	1,361
Total contractual obligations	\$54,237	\$16,563	\$17,873	\$1,944	\$17,857

Table of Contents

	Amount of Commitment Expiring - By Period				
	Total	Less Than 1 Year	1-3 Years	4-5 Years	After 5 Years
(Dollars in thousands)					
Commitments with off-balance sheet risk:					
Commitments to extend credit	\$20,431	\$20,431	\$-	\$-	\$-
Unused lines of credit	29,478	13,004	9,730	3,069	3,675
Standby letters of credit	3,183	3,183	-	-	-
Commitment to fund investment	1,000	1,000	-	-	-
Total commitments	\$54,092	\$37,618	\$9,730	\$3,069	\$3,675

**Capital**

Shareholders' equity was \$138.4 million at June 30, 2018, an increase of \$15.6 million from June 30, 2017. The increase was primarily due to earnings of \$16.2 million. Additionally, there was stock-based compensation of \$870 thousand, an increase in accumulated other comprehensive loss of \$129 thousand and \$355 thousand in dividends paid on common stock.

See Note 10 of the Notes to the Consolidated Financial Statements for information on the Company's capital ratios. Regulatory capital ratios for the Company and the Bank currently exceed all applicable requirements, including the commitments made to the Federal Reserve and the Bureau in connection with the Merger with FHB Formation LLC to maintain minimum Tier 1 leverage and total capital ratios of 10% and 15%, respectively.

**Impact of Inflation**

The consolidated financial statements and related notes have been presented in terms of historic dollars without considering changes in the relative purchasing power of money over time due to inflation. Unlike industrial companies, nearly all of the assets and virtually all of the liabilities of the Company are monetary in nature. As a result, interest rates have a more significant impact on the Company's performance than the general level of inflation. Over short periods of time, interest rates may not necessarily move in the same direction or in the same magnitude as inflation.

**Impact of New Accounting Standards**

Note 1 of the Notes to the Consolidated Financial Statement includes the Financial Accounting Standards Board (“FASB”) and the U.S. Securities and Exchange Commission (“SEC”) issued statements and interpretations affecting the Company.

### **Critical Accounting Policies**

Critical accounting policies are those that involve significant judgments and assessments by management, and that could potentially result in materially different results under different assumptions and conditions. The Company considers the following to be its critical accounting policies:

#### *Allowance for Loan Losses*

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

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

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

Table of Contents

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

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

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

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

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

• Levels and trends in delinquencies;

• Trends in the volume and nature of loans;



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

• Trends in portfolio concentration;

• National and local economic trends and conditions;

• Effects of changes or trends in internal risk ratings; and

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

There were no significant changes in the Company's policies or methodology pertaining to the general component of the allowance for loan losses during the years ended June 30, 2018 or 2017.

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

Table of Contents

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

Purchased Loans

Loans that the Company purchases are initially recorded at fair value with no carryover of the related allowance for loan and lease losses. Determining the fair value of the purchased loans involves estimating the amount and timing of principal and interest cash flows initially expected to be collected on the loans and discounting those cash flows at an appropriate market rate of interest. The Company continues to evaluate the reasonableness of expectations for the timing and the amount of cash to be collected. Subsequent decreases in expected cash flows may result in changes in the amortization or accretion of fair market value adjustments, and in some cases may result in a loan being considered impaired.

**Item 7A. Quantitative and Qualitative Disclosures about Market Risk**

See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations—Risk Management" and accompanying table set forth therein for quantitative and qualitative disclosures about market risk.

Table of Contents

**Item 8. Financial Statements and Supplementary Data**

Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors  
of Northeast Bancorp

**Opinion on the Financial Statements**

We have audited the accompanying consolidated balance sheets of Northeast Bancorp and subsidiary (the “Company”) as of June 30, 2018 and 2017, the related consolidated statements of income, comprehensive income, changes in shareholders’ equity and cash flows for each of the three years in the period ended June 30, 2018, and the related notes to the consolidated financial statements (collectively, the financial statements). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of June 30, 2018 and 2017, and the results of its operations and its cash flows for each of the three years in the period ended June 30, 2018, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company’s internal control over financial reporting as of June 30, 2018, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013, and our report dated September 13, 2018 expressed an unqualified opinion on the effectiveness of the Company’s internal control over financial reporting.

**Basis for Opinion**

These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with U.S. federal

securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ RSM US LLP

We have served as the Company's auditor since 2015.

Boston, Massachusetts

September 13, 2018

Table of Contents

**NORTHEAST  
BANCORP AND  
SUBSIDIARY  
CONSOLIDATED  
BALANCE  
SHEETS**

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

	June 30, 2018	June 30, 2017
Assets		
Cash and due from banks	\$3,889	\$3,582
Short-term investments	153,513	159,701
Total cash and cash equivalents	157,402	163,283
Available-for-sale securities, at fair value	87,687	96,693
Residential real estate loans held for sale	3,405	4,508
SBA loans held for sale	3,750	191
Total loans held for sale	7,155	4,699
Loans:		
Commercial real estate	579,450	498,004
Residential real estate	100,256	101,168
Commercial and industrial	188,852	175,654
Consumer	3,244	4,369
Total loans	871,802	779,195
Less: Allowance for loan losses	4,807	3,665
Loans, net	866,995	775,530
Premises and equipment, net	6,591	6,937
Real estate owned and other repossessed collateral, net	2,233	826
Federal Home Loan Bank stock, at cost	1,652	1,938
Intangible assets, net	867	1,300
Servicing rights, net	2,970	2,846
Bank-owned life insurance	16,620	16,179
Other assets	7,564	6,643
Total assets	\$1,157,736	\$1,076,874
Liabilities and Shareholders' Equity		
Liabilities		

Deposits:		
Demand	\$72,272	\$69,827
Savings and interest checking	109,637	108,417
Money market	420,886	374,569
Time	352,145	337,037
Total deposits	954,940	889,850
Federal Home Loan Bank advances	15,000	20,011
Subordinated debt	23,958	23,620
Capital lease obligation	605	873
Other liabilities	24,803	19,723
Total liabilities	1,019,306	954,077
Commitments and contingencies (Note 15)	-	-
Shareholders' equity		
Preferred stock, \$1.00 par value, 1,000,000 shares authorized; no shares issued and outstanding at June 30, 2018 and June 30, 2017	-	-
Voting common stock, \$1.00 par value, 25,000,000 shares authorized; 8,056,527 and 7,840,460 shares issued and outstanding at June 30, 2018 and June 30, 2017, respectively	8,057	7,841
Non-voting common stock, \$1.00 par value, 3,000,000 shares authorized; 882,314 and 991,194 shares issued and outstanding at June 30, 2018 and June 30, 2017, respectively	882	991
Additional paid-in capital	77,016	77,455
Retained earnings	54,236	38,142
Accumulated other comprehensive loss	(1,761 )	(1,632 )
Total shareholders' equity	138,430	122,797
Total liabilities and shareholders' equity	\$1,157,736	\$1,076,874

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

Table of Contents

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

	Years Ended June 30,		
	2018	2017	2016
Interest and dividend income:			
Interest and fees on loans	\$62,146	\$55,857	\$45,849
Interest on available-for-sale securities	1,111	1,018	930
Other interest and dividend income	2,636	1,046	456
Total interest and dividend income	65,893	57,921	47,235
Interest expense:			
Deposits	9,897	7,357	6,027
Federal Home Loan Bank advances	547	800	1,027
Wholesale repurchase agreements	-	-	67
Short-term borrowings	-	-	20
Subordinated debt	2,102	1,888	651
Obligation under capital lease agreements	38	51	63
Total interest expense	12,584	10,096	7,855
Net interest and dividend income before provision for loan losses	53,309	47,825	39,380
Provision for loan losses	1,410	1,594	1,618
Net interest and dividend income after provision for loan losses	51,899	46,231	37,762
Noninterest income:			
Fees for other services to customers	1,822	1,952	1,657
Gain on sales of residential loans held for sale	931	1,452	1,684
Gain on sales of SBA loans	2,955	5,277	4,178
Gain on sale of other loans	918	365	-
Loss recognized on real estate owned and other repossessed collateral and premises and equipment, net	(123)	(23)	(255)
Bank-owned life insurance income	441	454	449
Other noninterest income	84	219	60
Total noninterest income	7,028	9,696	7,773
Noninterest expense:			
Salaries and employee benefits	21,565	21,706	19,548
Occupancy and equipment expense	4,585	5,002	5,227
Professional fees	1,749	1,666	1,463
Data processing fees	2,447	1,744	1,487
Marketing expense	472	392	285
Loan acquisition and collection expense	1,354	1,734	1,368
FDIC insurance premiums	317	303	489
Intangible asset amortization	433	432	477

Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-K

Other noninterest expense	2,808	2,810	3,468
Total noninterest expense	35,730	35,789	33,812
Income before income tax expense	23,197	20,138	11,723
Income tax expense	7,031	7,799	4,104
Net income	\$16,166	\$12,339	\$7,619
Weighted-average shares outstanding:			
Basic	8,906,710	8,898,448	9,474,999
Diluted	9,129,152	8,952,614	9,484,635
Earnings per common share:			
Basic	\$1.81	\$1.39	\$0.80
Diluted	1.77	1.38	0.80
Cash dividends declared per common share	\$0.04	\$0.04	\$0.04

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



Table of Contents**NORTHEAST BANCORP AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(Dollars in thousands)

	Years Ended June 30,		
	2018	2017	2016
Net income	\$16,166	\$12,339	\$7,619
Other comprehensive income (loss), before tax:			
Available-for-sale securities:			
Change in net unrealized (loss) gain on available-for-sale securities	(636 )	(1,145 )	1,033
Derivatives and hedging activities:			
Change in accumulated gain (loss) on effective cash flow hedges	750	1,550	(2,032)
Reclassification adjustments included in net income	106	43	(3 )
Total derivatives and hedging activities	856	1,593	(2,035)
Total other comprehensive income (loss), before tax	220	448	(1,002)
Income tax expense (benefit) related to other comprehensive income (loss)	66	174	(384 )
Other comprehensive income (loss), net of tax	154	274	(618 )
Comprehensive income	\$16,320	\$12,613	\$7,001

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

Table of Contents
**NORTHEAST BANCORP AND SUBSIDIARY  
 CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**

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

	Preferred Stock Shares	Voting Stock Shares	Common Amount	Non-voting Common Stock Shares	Common Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity	
Balance at June 30, 2015	-	\$ -	8,575,144	\$8,575	1,012,739	\$1,013	\$85,506	\$18,921	\$(1,288)	\$112,727
Net income	-	-	-	-	-	-	7,619	-	7,619	
Other comprehensive loss, net of tax	-	-	(322,900)	-	-	-	-	(618)	(618)	
Common stock repurchased	-	-	-	(323)	-	(3,036)	-	-	(3,359)	
Conversion of voting common stock to non-voting common stock	-	-	(214,944)	(215)	214,944	215	-	-	-	
Dividends on common stock at \$0.04 per share	-	-	-	-	-	-	(380)	-	(380)	
Stock-based compensation	-	-	-	-	-	613	-	-	613	
Issuance of restricted common stock	-	-	100,000	100	-	(100)	-	-	-	
Cancellations and forfeiture of restricted common stock	-	-	(47,510)	(48)	-	37	-	-	(11)	
Balance at June 30, 2016	-	-	8,089,790	8,089	1,227,683	1,228	83,020	26,160	(1,906)	116,591
Net income	-	-	-	-	-	-	12,339	-	12,339	
Other comprehensive loss, net of tax	-	-	-	-	-	-	-	274	274	
Common stock repurchased	-	-	(645,238)	(645)	-	(6,298)	-	-	(6,943)	
Conversion of non-voting common stock to	-	-	236,489	237	(236,489)	(237)	-	-	-	

voting common stock										
Dividends on common stock at \$0.04 per share	-	-	-	-	-	-	-	(357 )	-	(357 )
Stock-based compensation	-	-	-	-	-	-	945	-	-	945
Issuance of restricted common stock	-	-	170,000	170	-	-	(170 )	-	-	-
Cancellations and forfeiture of restricted common stock	-	-	(16,956 )	(17 )	-	-	4	-	-	(13 )
Stock options exercised, net	-	-	6,375	7	-	-	(67 )	-	-	(60 )
Other	-	-	-	-	-	-	21	-	-	21
Balance at June 30, 2017	-	-	7,840,460	7,841	991,194	991	77,455	38,142	(1,632 )	122,797
Net income	-	-	-	-	-	-	-	16,166	-	16,166
Other comprehensive income, net of tax	-	-	-	-	-	-	-	-	154	154
Conversion of non-voting common stock to voting common stock	-	-	108,880	109	(108,880 )	(109 )	-	-	-	-
Dividends on common stock at \$0.04 per share	-	-	-	-	-	-	-	(355 )	-	(355 )
Stock-based compensation	-	-	-	-	-	-	870	-	-	870
Issuance of restricted common stock	-	-	22,000	22	-	-	(22 )	-	-	-
Cancellations and forfeiture of restricted common stock	-	-	(40,003 )	(40 )	-	-	(69 )	-	-	(109 )
Stock options exercised, net	-	-	125,190	125	-	-	(1,218 )	-	-	(1,093 )
Adjustment for adoption of ASU 2018-02	-	-	-	-	-	-	-	283	(283 )	-
Balance at June 30, 2018	-	\$ -	8,056,527	\$8,057	882,314	\$882	\$77,016	\$54,236	\$(1,761 )	\$138,430

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



Table of Contents**NORTHEAST BANCORP AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Dollars in thousands)

	Years Ended June 30,		
	2018	2017	2016
<b>Operating activities:</b>			
Net income	\$16,166	\$12,339	\$7,619
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	1,410	1,594	1,618
Loss recognized on real estate owned and other repossessed collateral and premises and equipment, net	123	23	255
Accretion of fair value adjustments on loans, net	(8,694 )	(12,093 )	(9,384 )
Accretion of fair value adjustments on deposits, net	-	(5 )	(6 )
Accretion of fair value adjustments on borrowings, net	217	115	43
Amortization of subordinated debt issuance costs	110	110	-
Originations of loans held for sale	(91,975 )	(122,924)	(130,010)
Net proceeds from sales of loans held for sale	99,112	153,939	134,522
Gain on sales of residential loans held for sale, net	(931 )	(1,452 )	(1,684 )
Gain on sales of SBA and other loans held for sale, net	(3,873 )	(5,642 )	(4,178 )
Net (decrease) increase in loan servicing rights	(124 )	1,075	657
Amortization of intangible assets	433	432	477
Bank-owned life insurance income, net	(441 )	(454 )	(449 )
Depreciation of premises and equipment	1,300	1,449	1,631
Deferred income tax expense (benefit)	498	(1,025 )	2,122
Stock-based compensation	870	945	613
Amortization of available-for-sale securities, net	802	1,055	1,025
Changes in other assets and liabilities:			
Other assets	(1,331 )	(2,206 )	(1,659 )
Other liabilities	5,782	6,715	1,882
Net cash provided by operating activities	19,454	33,990	5,094
<b>Investing activities:</b>			
Purchases of available-for-sale securities	(26,174 )	(19,526 )	(45,160 )
Proceeds from maturities and principal payments on available-for-sale securities	33,742	21,204	46,504
Loan purchases	(124,111)	(112,807)	(99,999 )
Loan originations, principal collections, and purchased loan paydowns, net	32,372	16,915	28,975
Purchases and disposals of premises and equipment, net	(981 )	(695 )	(1,190 )
Proceeds from sales of real estate owned and other repossessed collateral	1,266	759	1,537
Redemption of Federal Home Loan Bank stock	286	470	1,694
Net cash used in investing activities	(83,600 )	(93,680 )	(67,639 )
<b>Financing activities:</b>			
Issuance of subordinated debt, net of debt issuance costs	-	-	14,512
Net increase in deposits	65,090	89,423	125,679
Net decrease in short-term borrowings	-	-	(2,349 )

Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-K

Dividends paid on common stock	(355 )	(357 )	(380 )
Repurchase of common stock	-	(6,943 )	(3,359 )
Repayment of FHLBB borrowings and wholesale repurchase agreements	(5,000 )	(10,000 )	(10,000 )
Repayment of capital lease obligation	(268 )	(255 )	(240 )
Repurchases for tax withholdings on restricted common stock	(109 )	8	(11 )
Stock options exercised, net	(1,093 )	(60 )	-
Net cash provided by financing activities	58,265	71,816	123,852
Net (decrease) increase in cash and cash equivalents	(5,881 )	12,126	61,307
Cash and cash equivalents, beginning of year	163,283	151,157	89,850
Cash and cash equivalents, end of year	\$157,402	\$163,283	\$151,157
Supplemental schedule of cash flow information:			
Interest paid	\$12,171	\$9,502	\$7,773
Income taxes paid, net	5,341	7,670	2,166
Supplemental schedule of noncash investing and financing activities:			
Transfers from loans to real estate owned and other repossessed collateral, net	\$2,769	\$2,959	\$1,781

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

Table of Contents

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. Summary of Significant Accounting Policies**

The accounting and reporting policies of Northeast Bancorp and Subsidiary (the "Company" or "Northeast") conform to accounting principles generally accepted in the United States of America ("US GAAP") and conform to practices within the financial services industry.

Business

The Company is a Maine corporation and a bank holding company registered with the Federal Reserve Bank of Boston ("FRB") under the Bank Holding Company Act of 1956. As a bank holding company, the Company is subject to the regulation and supervision of the FRB. The Company provides a full range of banking services to individual and corporate customers throughout south-central and western Maine and conducts loan purchasing and origination activities nationwide through its wholly-owned subsidiary, Northeast Bank (the "Bank"), a Maine state-chartered bank. The Bank is subject to supervision and regulation by applicable state and federal banking agencies, including the Bureau, the Federal Deposit Insurance Corporation ("FDIC"), and the FRB. The Bank faces competition from banks and other financial institutions.

Business Combination Accounting

On *December 29, 2010*, the Company merged with FHB Formation LLC (the "Merger"). The Company applied the acquisition method of accounting to this business combination, which represented an acquisition by FHB Formation LLC ("FHB") of Northeast, with Northeast as the surviving company. Under the acquisition method, the acquiring entity in a business combination recognizes the assets acquired and liabilities assumed at their acquisition date fair values. Management utilizes valuation techniques appropriate for the asset or liability being measured in determining these fair values. Any excess of the purchase price over amounts allocated to assets acquired, including identifiable intangible assets, and liabilities assumed is recorded as goodwill. In the Merger, amounts allocated to assets acquired and liabilities assumed were greater than the purchase price, which resulted in the recognition of a bargain purchase gain. Acquisition-related costs were expensed as incurred.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Northeast Bancorp, and its wholly-owned subsidiary, Northeast Bank (including the Bank's wholly-owned subsidiaries). All significant intercompany transactions and balances have been eliminated in consolidation.

NBN Capital Trust II, NBN Capital Trust III and NBN Capital Trust IV are considered affiliates and are deconsolidated pursuant to criteria established by Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 810, *Consolidation* ("ASC 810"). The investments in these affiliates were \$496 thousand in aggregate and are included in other assets.

### Reclassifications

Certain previously reported amounts have been reclassified to conform to the current year's presentation.

### Use of Estimates

The consolidated financial statements have been prepared in conformity with US GAAP. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the balance sheet and reported amounts of revenue and expenses during the reporting period. Actual results could differ significantly from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses, the determination of fair values in conjunction with the application of loan acquisition accounting, and the on-going evaluation of assets for potential impairment.



Table of Contents

Concentrations of Credit Risk

Most of the Community Banking Division's business activity is with customers located within the State of Maine. However, the business activities of the Bank's Loan Acquisition and Servicing Group ("LASG") and the SBA Division are diversified across the country. In all regions, the Company's focus is to originate and purchase commercial real estate loans. Repayment of loans is expected from cash flows of the borrower. Losses on secured loans are limited by the value of the collateral upon default of the borrowers. The Company does *not* have any significant concentrations to any *one* industry or customer.

Cash and Cash Equivalents

For purposes of presentation in the consolidated statements of cash flows, cash and cash equivalents consist of cash and due from banks and short-term investments. The Company is required to maintain a certain reserve balance in the form of cash or deposits with other financial institutions. At *June 30, 2018* and *2017*, such reserve balances totaled *\$1.5 million* and *\$2.7 million*, respectively.

Available-for-Sale Securities

Securities for which the Company has the positive intent and ability to hold to maturity are classified as held to maturity and carried at amortized cost. Those securities held for indefinite periods of time, but *not* necessarily to maturity are classified as available for sale. Securities held for indefinite periods of time include securities that management intends to use as part of its asset/liability, liquidity, or capital management strategies and *may* be sold in response to changes in interest rates, maturities, asset/liability mix, liquidity needs, regulatory capital needs or other business factors. Securities available for sale are carried at estimated fair value with unrealized gains and losses reported on an after-tax basis in shareholders' equity as accumulated other comprehensive income or loss.

Interest and dividends on securities are recorded on the accrual method. Premiums and discounts on securities are amortized or accreted into interest income by the level-yield method over the remaining period to contractual maturity, adjusted for the effect of actual prepayments in the case of mortgage-backed securities. These estimates of prepayment assumptions are made based upon the actual performance of the underlying security, current interest rates, the general market consensus regarding changes in mortgage interest rates, the contractual repayment terms of the underlying loans, the priority rights of the investors to the cash flows from the mortgage securities and other economic conditions. When differences arise between anticipated prepayments and actual prepayments, the effective yield is recalculated to reflect actual payments to date and anticipated future payments. Unamortized premium or discount is adjusted to the amount that would have existed had the new effective yield been applied since purchase, with a corresponding charge or credit to interest income.

Security transactions are recorded on the trade date. Realized gains and losses are determined using the specific identification method and are recorded in noninterest income.

Management evaluates securities for other-than-temporary impairment on a periodic basis. Factors considered in determining whether an impairment is other than temporary include: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer and (3) the intent and ability of the Company to hold the investment for a period of time sufficient to allow for any anticipated recovery in fair value. If the Company intends to sell an impaired security, the Company records an other-than-temporary loss in an amount equal to the entire difference between the fair value and amortized cost. If a security is determined to be other-than-temporarily impaired, but the Company does *not* intend to sell the security, only the credit portion of the estimated loss is recognized in earnings, with the other portion of the loss recognized in other comprehensive income.

*Federal Home Loan Bank Stock*

During the periods presented, the Company has owned investments in the stock of the Federal Home Loan Bank of Boston ("FHLBB"). *No* readily-available market exists for these stocks, and they have *no* quoted market values. The Bank, as a member of the FHLBB, is required to maintain investments in the capital stock of the FHLBB equal to their membership base investments plus an activity-based investment determined according to the Bank's level of outstanding FHLBB advances. The Company reviews its investments in FHLBB stock periodically to determine if other-than-temporary impairment exists. The Company reviews recent public filings, rating agency analysis and other factors, when making the determination. As of *June 30, 2018*, *no* impairment has been recognized.

Table of Contents

Loans Held for Sale and Loan Servicing

Residential real estate mortgage loans are designated as held for sale or held to maturity based on intent, which is determined when loans are underwritten. Loans originated and held for sale in the secondary market are carried at the lower of cost or fair value. The SBA Division loans are designated as held for sale based on intent to sell, which is determined on a quarterly basis. The guaranteed portions of the loans are transferred to held for sale and are carried at the lower of cost or fair value. Realized gains and losses on sales of residential loans are determined using the specific identification method, and realized gains and losses on sales of SBA loans are determined using the allocation of participating interests sold and retained. Direct loan origination costs and fees related to loans held for sale are deferred upon origination and are recognized as an adjustment to the gain or loss on the date of sale.

In connection with the mortgage loans to be held for sale, the Company often offers interest rate lock commitments to prospective borrowers. The Company manages this interest rate risk by entering into offsetting forward sale agreements with *third* party investors for certain funded loans and loan commitments. The Company uses "best efforts" forward loan sale commitments to mitigate the risk of potential decreases in the values of loans that would result from the exercise of the derivative loan commitments. The gross effect of the derivative loan commitments and forward sale agreements is nominal at each date presented.

In its SBA Division activities, the Company recognizes the SBA servicing rights as separate assets, which is classified as servicing rights, net, on the consolidated balance sheet. The Company capitalizes SBA servicing rights at the net present value of the fee income and servicing cost spread upon the sale of the related loans. The Company uses the amortization method to subsequently measure servicing assets. The SBA servicing rights are amortized over the estimated weighted average life of the loans. The Company's assumptions with respect to prepayments, which affect the estimated average life of the loans, are adjusted quarterly and as necessary to reflect current circumstances. The Company evaluates the estimated life and fair value of its servicing portfolio based on data that is disaggregated to reflect note rate, type, and term on the underlying loans. The Company performs an assessment of capitalized SBA servicing rights for impairment based on the current fair value of those rights. Fair value of the servicing rights is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, prepayment speeds and default rates and losses. Impairment is recognized through a valuation allowance to the extent that fair value is less than the capitalized amount. If the Company later determines that all or a portion of the impairment *no* longer exists, a reduction of the allowance *may* be recorded as an increase to income.

Loans

Loans are carried at the principal amounts outstanding, or amortized acquired fair value in the case of acquired loans, adjusted by partial charge-offs and net of deferred loan costs or fees. Loan fees and certain direct origination costs are

deferred and amortized into interest income over the expected term of the loan using the level-yield method. When a loan is paid off, any unamortized discount or premium is recognized in interest income. Interest income is accrued based upon the daily principal amount outstanding except for loans on nonaccrual status.

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

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

## Table of Contents

In cases where a borrower experiences financial difficulties and the Company makes certain concessionary modifications to contractual terms, the loan is classified as a TDR, and therefore, by definition, is an impaired loan. Concessionary modifications *may* include adjustments to interest rates, extensions of maturity, and other actions intended to minimize economic loss and avoid foreclosure or repossession of collateral. For loans accounted for under ASC 310-30, the Company evaluates whether it has granted a concession by comparing the restructured debt terms to the expected cash flows at acquisition plus any additional cash flows expected to be collected arising from changes in estimate after acquisition. As a result, if an ASC 310-30 loan is modified to be consistent with, or better than, the Company's expectations at acquisition, the modified loan would generally *not* qualify as a TDR. Nonaccrual loans that are restructured generally remain on nonaccrual status for a minimum period of *six* months to demonstrate that the borrower can meet the restructured terms. If the restructured loan is on accrual status prior to being modified, it is reviewed to determine if the modified loan should remain on accrual status. If the borrower's ability to meet the revised payment schedule is *not* reasonably assured, the loan is classified as a nonaccrual loan. With limited exceptions, loans classified as TDRs remain classified as such until the loan is paid off.

## Allowance for Loan Losses

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

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

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

**Commercial real estate:** Loans in this segment are primarily income-producing properties. For owner-occupied properties, the cash flows are derived from an operating business, and the underlying cash flows *may* be adversely affected by deterioration in the financial condition of the operating business. The underlying cash flows generated by

non-owner occupied properties *may* be adversely affected by increased vacancy rates. Management periodically obtains rent rolls and operating statements, with which it monitors the cash flows of these loans. Adverse developments in either of these areas will have an adverse effect on the credit quality of this segment. For purposes of the allowance for loan losses, this segment also includes construction loans.

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

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

Table of Contents

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

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

- Levels and trends in delinquencies and non-performing loans;
- Trends in the volume and nature of loans;
- Trends in credit terms and policies, including underwriting standards, procedures and practices, and the experience and ability of lending management and staff;
- Trends in portfolio concentration;
- National and local economic trends and conditions;
- Effects of changes or trends in internal risk ratings; and
- Other effects resulting from trends in the valuation of underlying collateral.

There were *no* significant changes in the Company's policies or methodology pertaining to the general component of the allowance for loan losses during the years ended *June 30, 2018* or *2017*.

The allocated component of the allowance for loan losses relates to loans that are classified as impaired. Impairment is measured on a loan-by-loan basis by either the present value of expected future cash flows discounted at the loan's

effective interest rate or the fair value of the collateral if the loan is collateral dependent. An allowance is established when the discounted cash flows or collateral value of the impaired loan is lower than the carrying value of the loan.

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

#### Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are computed by the straight-line method over the estimated useful lives of the assets or the respective lease terms. Premises and equipment under capital leases are amortized over the estimated useful lives of the assets or the respective lease terms, whichever is shorter. Maintenance and repairs are charged to expense as incurred and the cost of major renewals and betterments are capitalized.



Table of Contents

Intangible Assets

Identifiable intangible assets subject to amortization are amortized over the estimated lives of the intangibles using a method that approximates the amount of economic benefits that are realized by the Company. Identifiable intangible assets are reviewed for impairment annually and whenever events or changes in circumstances indicate that the carrying amount of the assets *may not* be recoverable.

Real Estate Owned and Other Repossessed Collateral

Assets in control of the Company or acquired through foreclosure or repossession are held for sale and are initially recorded at fair value less estimated costs to sell at the date control is established, resulting in a new cost basis. The amount by which the recorded investment in the loan exceeds the fair value (net of estimated cost to sell) of the foreclosed asset is charged to the allowance for loan losses. Subsequent declines in the fair value of the foreclosed asset below the new cost basis are recorded through the use of a valuation allowance or through a direct write-off. Subsequent increases in the fair value *may* only be recorded to the extent of any previously recognized valuation allowance. Rental revenue received and gains and losses recognized on foreclosed assets is included in other noninterest income, whereas operating expenses and changes in the valuation allowance relating to foreclosed assets are included in other noninterest expense.

Impairment of Long-Lived Assets

The Company reviews long-lived assets, including premises and equipment, for impairment whenever events or changes in business circumstances indicate that the remaining useful life *may* warrant revision or that the carrying amount of the long-lived asset *may not* be fully recoverable. The Company performs undiscounted cash flow analyses to determine if impairment exists. If impairment is determined to exist, any related impairment loss is calculated based on fair value. Impairment losses on assets to be disposed of, if any, are based on the estimated proceeds to be received, less costs of disposal.

Bank-Owned Life Insurance

Increases in the cash surrender value of bank-owned life insurance policies, as well as death benefits received net of any cash surrender value, are recorded in noninterest income, and are *not* subject to income taxes. The cash surrender value of the policies *not* previously endorsed to participants are recorded as assets of the Company. Any amounts owed to participants relating to these policies are recorded as liabilities of the Company. The Company reviews the

financial strength of the insurance carriers prior to the purchase of life insurance policies and *no* less than annually thereafter.

### Income Taxes

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the period that includes the enactment date. Accordingly, changes resulting from the Tax Cuts and Jobs Act (the “Act”) enacted on *December 22, 2017* have been recognized in the consolidated financial statements as of and for the year ended *June 30, 2018*. The Company's policy is to recognize interest and penalties assessed on uncertain tax positions in income tax expense. See Note 12 to the consolidated financial statements. The Company exercises significant judgment in evaluating the amount and timing of recognition of the resulting tax assets and liabilities.

There was *no* reserve for uncertain tax positions as of *June 30, 2018* or *2017*.

Effective *July 1, 2017*, with the application of ASU 2016-09, Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting, the Company *no* longer records the excess tax benefits or deficiencies related to share-based compensation in additional paid-in capital. Instead, excess tax benefits or deficiencies are recorded in the income statement as part of the income tax expense on a prospective basis. For interim reporting purposes, the excess tax benefits or deficiencies are recorded as discrete items in the period in which they arise. Excess tax benefits are now presented as an operating activity in the consolidated statement of cash flows. In addition, under the new guidance, when calculating incremental shares for earnings per share, entities exclude from assumed proceeds excess tax benefits that previously would have been recorded in additional paid-in capital. The total income tax benefit recorded in income tax expense relating to excess tax benefits on stock-based compensation for the year ended *June 30, 2018* was *\$1.3* million.

Table of Contents

Stock-Based Compensation

The Company's stock-based compensation plans provide for awards of stock options, restricted stock and other stock-based compensation to directors, officers and employees. The cost of employee services received in exchange for awards of equity instruments is based on the grant-date fair value of those awards. Compensation cost is recognized over the requisite service period as a component of compensation expense. For awards with graded-vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award. The Company uses the Black-Scholes model to estimate the fair value of stock options, while the market price of the Company's common stock at the date of grant is used for restricted stock awards.

Comprehensive Income

Comprehensive income consists of net income and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains and losses on securities available for sale, unrealized losses related to factors other than credit on debt securities, unrealized gains and losses on cash flow hedges and deferred gains on hedge accounting transactions.

Earnings Per Share

Basic earnings per share is calculated using the *two*-class method. The *two*-class method is an earnings allocation formula under which earnings per share is calculated from common stock and participating securities according to dividends declared and participation rights in undistributed earnings. Under this method, all earnings distributed and undistributed, are allocated to participating securities and common shares based on their respective rights to receive dividends. Unvested share-based payment awards that contain non-forfeitable rights to dividends are considered participating securities (i.e. unvested restricted stock), *not* subject to performance-based measures. Basic earnings per share is calculated by dividing net income available to common shareholders by the weighted-average number of common shares outstanding (inclusive of participating securities). Diluted earnings per share have been calculated in a manner similar to that of basic earnings per share, except that the weighted-average number of common shares outstanding is increased to include the number of additional common shares that would have been outstanding if all potentially dilutive common shares (such as those resulting from the exercise of stock options or the attainment of performance measures) were issued during the period, computed using the treasury stock method.

Derivatives

Derivative instruments are carried at fair value in the Company's consolidated financial statements. The accounting for changes in the fair value of a derivative instrument is determined by whether it has been designated and qualifies as part of a hedging relationship, and further, by the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, the Company designates the hedging instrument, based upon the exposure being hedged, as either a fair value hedge or a cash flow hedge. For derivative instruments that are designated and qualify as a cash flow hedge (i.e., hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income, net of related tax, and reclassified into earnings in the same period or periods during which the hedged transactions affect earnings. The remaining gain or loss on the derivative instrument in excess of the cumulative change in the present value of future cash flows of the hedged item (i.e., the ineffective portion), if any, is recognized in current earnings during the period. For derivative instruments designated and qualifying as a fair value hedge (i.e., hedging the exposure to changes in the fair value of an asset or liability or an identified portion thereof that is attributable to the hedged risk), the gain or loss on the derivative instrument, as well as the offsetting gain or loss on the hedged item attributable to the hedged risk, are recognized in current earnings during the period of the change in fair values. At the inception of a hedge, the Company documents certain items, including but *not* limited to the following: the relationship between hedging instruments and hedged items, Company risk management objectives, hedging strategies, and the evaluation of hedge transaction effectiveness. Documentation includes linking all derivatives designated as fair value or cash flow hedges to specific assets and liabilities on the balance sheet or to specific forecasted transactions.

Hedge accounting is discontinued prospectively when (1) a derivative is *no* longer highly effective in offsetting changes in the fair value or cash flow of a hedged item, (2) a derivative expires or is sold, (3) a derivative is de-designated as a hedge, because it is unlikely that a forecasted transaction will occur, or (4) it is determined that designation of a derivative as a hedge is *no* longer appropriate. For derivative instruments *not* designated as hedging instruments, the gain or loss on the derivative is recognized in current earnings during the period of change.

## Table of Contents

### Transfer of Financial Assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does *not* maintain effective control over the transferred assets. There are *no* agreements to repurchase before their maturity.

Transfers of a portion of a loan must meet the criteria of a participating interest. If it does *not* meet the criteria of a participating interest, the transfer must be accounted for as a secured borrowing. In order to meet the criteria for a participating interest, all cash flows from the loan must be divided proportionately, the rights of each loan holder must have the same priority, and the loan holders must have *no* recourse to the transferor other than standard representations and warranties and *no* loan holder has the right to pledge or exchange the entire loan.

The Company sells financial assets in the normal course of business, the majority of which are related to the SBA-guaranteed portion of loans, as well as residential mortgage loan sales through established programs, commercial loan sales through participation agreements, and other individual or portfolio loan and securities sales. In accordance with accounting guidance for asset transfers, the Company considers any ongoing involvement with transferred assets in determining whether the assets can be derecognized from the balance sheet. With the exception of servicing and certain performance-based guarantees, the Company's continuing involvement with financial assets sold is minimal and generally limited to market customary representation and warranty clauses.

When the Company sells financial assets, it *may* retain servicing rights and/or other interests in the financial assets. The gain or loss on sale depends on the previous carrying amount of the transferred financial assets, the servicing right recognized, and the consideration received and any liabilities incurred in exchange for the transferred assets. Upon transfer, any servicing assets and other interests held by the Company are carried at the lower of cost or fair value.

### Advertising Costs

Advertising costs are expensed as incurred.

### Segment Reporting

All of the Company's operations are considered by management to be *one* operating segment.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)* (“ASU 2014-09”). ASU 2014-09 implements a common revenue standard that clarifies the principles for recognizing revenue. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps: (i) identify the contract(s) with a customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract and (v) recognize revenue when (or as) the entity satisfies a performance obligation. ASU 2015-14, *Revenue from Contracts with Customers (Topic 606)* (“ASU 2015-14”) was issued in August 2015 which defers adoption to annual reporting periods beginning after December 15, 2017. The timing of the Company’s revenue recognition is *not* expected to materially change. The Company’s largest portions of revenue, interest and fees on loans and gain on sales of loans, are specifically excluded from the scope of the guidance, and the Company currently recognizes the majority of the remaining revenue sources in a manner that management believes is consistent with the new guidance. Because of this, management believes that revenue recognized under the new guidance will generally approximate revenue recognized under current US GAAP. These observations are subject to change as the evaluation is completed.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities* (“ASU 2016-01”). This guidance changes how entities account for equity investments that do *not* result in consolidation and are *not* accounted for under the equity method of accounting. Entities will be required to measure these investments at fair value at the end of each reporting period and recognize changes in fair value in net income. A practicability exception will be available for equity investments that do *not* have readily determinable fair values; however, the exception requires the Company to adjust the carrying amount for impairment and observable price changes in orderly transactions for the identical or a similar investment of the same issuer. This guidance also changes certain disclosure requirements and other aspects of current US GAAP. This guidance is effective for fiscal years beginning after December 15, 2017, including interim periods within the fiscal year. Early adoption is permitted for only *one* of the *six* amendments. The impact of the change in equity investments will depend on market conditions, but if applied in fiscal 2018, would have resulted in a loss related to changes in fair value of equity investments of \$152 thousand (pre-tax) being recognized in net income versus other comprehensive income. The disclosure of the fair value of “Loans, net” in “Note 18: Fair Value Measurements” is subject to change at adoption of the guidance based on an exit pricing strategy versus an entry pricing strategy when determining the fair value. The Company is currently evaluating the amount of expected change in the disclosure, but the adoption does *not* impact the operations of the Company.

Table of Contents

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)* (“ASU 2016-02”). The new guidance establishes the principles to report transparent and economically neutral information about the assets and liabilities that arise from leases. Entities will be required to recognize the lease assets and lease liabilities that arise from leases in the statement of financial position and to disclose qualitative and quantitative information about lease transactions, such as information about variable lease payments and options to renew and terminate leases. This guidance is effective for fiscal years beginning after *December 15, 2018*, including interim periods within the fiscal year. The Company is currently evaluating the impact of the adoption of ASU 2016-02 to determine the potential impact it will have on its consolidated financial statements. The Company’s assets and liabilities will increase based on the present value of the remaining lease payments for leases in place at the adoption date; however, this is *not* expected to be material to the Company’s consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, *Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting* (“ASU 2016-09”). The new guidance simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. Entities are required to recognize the income tax effects of awards in the income statement when the awards vest or are settled. This guidance became effective for the Company for the fiscal year beginning *July 1, 2017*. For reporting purposes the excess tax benefits or deficiencies shall be recorded as discrete items in the period in which they occur. In addition to the excess tax benefit treatment, the amendment removed the assumed proceeds related to the excess tax benefit from the calculation of diluted shares.

Upon adoption, the most significant impact of this amendment resulted from the prospective application of current excess tax benefits and deficiencies being recognized in income tax expense, which would previously have been recognized in additional paid-in capital. For the year ended *June 30, 2018*, this item reduced income tax expense and increased net income by approximately \$1.3 million, representing an income tax benefit arising from individuals who exercised non-qualified stock options and restricted stock awards that vested during the period. For the year ended *June 30, 2017*, the Company recognized \$27 thousand in additional paid-in-capital related to the excess tax benefit, which, if under the new ASU, would have been recognized as an income tax benefit in the income statement. These amounts, treated as discrete items in the period in which they occur, will vary from year to year as a function of the volume of share-based payments vested or exercised and the then fair market value of the Company's stock in comparison to the compensation cost recognized in the financial statements. In addition to the excess tax benefit treatment, the amendment removed the assumed proceeds related to the excess tax benefit from the calculation of diluted shares which increased diluted weighted average common shares outstanding by 40,966 shares to 9,089,936. This amendment is applied on a prospective basis, and *no* prior periods were adjusted. Additionally upon adoption, the Company made a policy election to record forfeitures as they occur rather than make use of an estimate. The other provisions did *not* have a material impact on the Company's consolidated financial statements upon adoption.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326)* (“ASU 2016-13”). This guidance is intended to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. To achieve this objective, the amendments in this guidance replace the incurred loss impairment methodology in current US GAAP with a methodology that reflects expected credit losses and requires consideration

of a broader range of reasonable and supportable information to inform credit loss estimates. This ASU will be effective for fiscal years beginning after *December 15, 2019*. Early adoption is available as of the fiscal year beginning after *December 15, 2018*. The Company is evaluating the provisions of the guidance, and will closely monitor developments and additional guidance to determine the potential impact on the Company's consolidated financial statements. Management is in the process of identifying the methodologies and the additional data requirements necessary to implement the guidance and has engaged an existing *third* party service provider to assist in implementation.

In *May 2017*, the FASB issued ASU 2017-09, *Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting* (“ASU 2017-09”) which amends the scope of modification accounting for share-based payment arrangements. This update provides guidance on the types of changes to the terms or conditions of share-based payment awards to which an entity would be required to apply modification accounting. Specifically, an entity would *not* apply modification accounting if the fair value, vesting conditions, and classification of the awards are the same immediately before and after the modification. This update is effective for public business entities for annual periods being after *December 15, 2017*, including interim periods within those annual periods. Early adoption is permitted including adopting in any interim period. This update will be applied prospectively to awards modified on or after the effective date. The adoption of this guidance is *not* expected to have an impact on the Company's consolidated financial statements.



Table of Contents

In August 2017, the FASB issued ASU 2017-12, *Derivatives and Hedging (Topic 815)* (“ASU 2017-12”). This guidance permits hedge accounting for risk components in hedging relationships involving nonfinancial risk and interest rate risk, and improves the financial reporting of hedging relationships to better portray the economic results of an entity’s risk management activities in its financial statements. The amendments in this guidance are effective for public business entities for fiscal years beginning after *December 15, 2018*, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. The adoption of this guidance is *not* expected to have a significant impact on the Company’s consolidated financial statements.

In February 2018, the FASB issued ASU 2018-02, *Income Statement- Reporting Comprehensive Income (Topic 220)* (“ASU 2018-02”). This guidance allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the “Tax Cuts and Jobs Act,” which was signed into law in *December 2017*. The amendments in this guidance are effective for all entities for fiscal years beginning after *December 15, 2018*, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. The Company adopted this guidance during the *three* months ended *March 31, 2018*. This adoption resulted in a reclassification of \$283 thousand to accumulated other comprehensive income from retained earnings in the consolidated financial statements, with *no* net effect on shareholders' equity.

In July 2018, the FASB issued ASU 2018-10, *Codification Improvements to Topic 842, Leases* (“ASU 2018-10”) and ASU 2018-11, *Leases (Topic 842)* (“ASU 2018-11”). The guidance provides clarification on the application of ASU 2016-02, specifically on certain narrow aspects of the guidance issued under ASU 2016-02, including comparative reporting requirements for initial adoption and, for lessors only, separating lease and non-lease components in a contract and allocating the consideration in the contract to the separate components. For entities that have *not* adopted ASU 2016-02 before the issuance of these updates, the amendments in this guidance are the same as the effective date and transition requirements in ASU 2016-02. The adoption of this guidance is *not* expected to have an impact on the Company’s consolidated financial statements.

## 2. Securities Available for Sale

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

	June 30, 2018			
	Amortized	Gross Unrealized	Gross Unrealized	Fair
	Cost	Gains	Losses	Value
	(Dollars in thousands)			
U.S. Government agency securities	\$57,129	\$ -	\$ (242	) \$56,887

Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-K

Agency mortgage-backed securities	25,276	-	(1,095	)	24,181
Other investments measured at net asset value	6,866	-	(247	)	6,619
Total	\$89,271	\$	-	\$ (1,584	) \$87,687

	June 30, 2017			
	Amortized	Gross Unrealized	Gross Unrealized	Fair
	Cost	Gains	Losses	Value
	(Dollars in thousands)			
U.S. Government agency securities	\$57,401	\$ -	\$ (233	) \$57,168
Agency mortgage-backed securities	33,523	-	(620	) 32,903
Other investments measured at net asset value	6,717	-	(95	) 6,622
Total	\$97,641	\$ -	\$ (948	) \$96,693

At *June 30, 2018*, the Company held *no* securities of any single issuer (excluding the U. S. Government and federal agencies) with a book value that exceeded *10%* of shareholders' equity.

When securities are sold, the adjusted cost of the specific security sold is used to compute the gain or loss on sale. There were *no* securities sold during the years ending *June 30, 2018* or *2017*. At *June 30, 2018*, *no* investment securities were pledged as collateral to secure outstanding FHLBB advances.

Table of Contents

	June 30, 2018					
	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)					
U.S. Government agency securities	\$25,988	\$ (126 )	\$30,899	\$ (116 )	\$56,887	\$ (242 )
Agency mortgage-backed securities	1,265	(27 )	22,916	(1,068 )	24,181	(1,095 )
Other investments measured at net asset value	-	-	5,076	(247 )	5,076	(247 )
Total	\$27,253	\$ (153 )	\$58,891	\$ (1,431 )	\$86,144	\$ (1,584 )

	June 30, 2017					
	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)					
U.S. Government agency securities	\$57,168	\$ (233 )	\$-	\$ -	\$57,168	\$ (233 )
Agency mortgage-backed securities	19,571	(298 )	13,332	(322 )	32,903	(620 )
Other investments measured at net asset value	5,115	(95 )	-	-	5,115	(95 )
Total	\$81,854	\$ (626 )	\$13,332	\$ (322 )	\$95,186	\$ (948 )

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

There were *no* other-than-temporary impairment losses on securities during the years ended *June 30, 2018, 2017, and 2016*.

At *June 30, 2018*, the Company had *thirty* securities in a continuous loss position for greater than *twelve* months. At *June 30, 2018*, all of the Company's available-for-sale securities were issued or guaranteed by either government agencies or government-sponsored enterprises. The decline in fair value of the Company's available-for-sale securities at *June 30, 2018* is attributable to changes in interest rates.

In addition to considering current trends and economic conditions that *may* affect the quality of individual securities within the Company's investment portfolio, management of the Company also considers the Company's ability and intent to hold such securities to maturity or recovery of cost. At *June 30, 2018*, the Company does *not* intend to sell

and it is *not* more likely than *not* that the Company will be required to sell the investment securities before recovery of its amortized cost. As such, management does *not* believe any of the Company's available-for-sale securities are other-than-temporarily impaired at *June 30, 2018*.

The investments measured at net asset value include a fund that seeks to invest in securities either issued or guaranteed by the U.S. government or its agencies, as well as a fund that primarily invests in the federally guaranteed portion of SBA 7(a) loans that adjust quarterly or monthly and are indexed to the Prime Rate. The underlying composition of these funds is primarily government agencies, other investment-grade investments, or the guaranteed portion of SBA 7(a) loans, as applicable. As of *June 30, 2018*, the effective duration of the fund that seeks to invest in securities either issued or guaranteed by the U.S. government or its agencies is *4.60* years.

The amortized cost and fair values of available-for-sale debt securities by contractual maturity are shown below as of *June 30, 2018*. Actual maturities *may* differ from contractual maturities because borrowers *may* have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
	(Dollars in thousands)	
Due within one year	\$33,004	\$32,887
Due after one year through five years	33,485	33,101
Due after five years through ten years	15,916	15,080
Due after ten years	-	-
Total	\$82,405	\$81,068

Table of Contents**3. Loans, Allowance for Loan Losses and Credit Quality**

The composition of the Company's loan portfolio is as follows on the dates indicated.

	June 30, 2018			June 30, 2017		
	Originated	Purchased	Total	Originated	Purchased	Total
	(Dollars in thousands)					
Residential real estate	\$75,873	\$13,926	\$89,799	\$83,759	\$3,377	\$87,136
Home equity	10,457	-	10,457	13,931	101	14,032
Commercial real estate	303,399	276,051	579,450	256,280	241,724	498,004
Commercial and industrial	187,857	995	188,852	174,468	1,186	175,654
Consumer	3,244	-	3,244	4,369	-	4,369
Total loans	\$580,830	\$290,972	\$871,802	\$532,807	\$246,388	\$779,195

Total loans include deferred loan origination costs, net, of \$223 thousand as of *June 30, 2018* and \$507 thousand as of *June 30, 2017*.

Loans pledged as collateral with the FHLBB for outstanding borrowings and additional borrowing capacity totaled \$128.3 million and \$163.5 million at *June 30, 2018* and *2017*, respectively.

During the years ended *June 30, 2018* and *2017*, the Company sold *four* LASG purchased loans with a total principal balance of \$2.8 million for a gain of \$918 thousand, and a commercial loan portfolio of \$18.3 million for a gain of \$365 thousand, respectively.

Related Party Loans

Certain of the Company's related parties are credit customers of the Company in the ordinary course of business. All loans and commitments included in such transactions are on such terms, including interest rates, repayment terms and collateral, as those prevailing at the time for comparable transactions with persons who are *not* affiliated with the Bank and do *not* involve more than a normal risk of collectability or present other features unfavorable to the Bank.

As of *June 30, 2018* and *2017*, the outstanding loan balances to directors, officers, principal shareholders and their associates were *\$129* thousand and *\$208* thousand, respectively. All loans to these related parties were current and accruing at those dates.

Past Due and Nonaccrual Loans

The following is a summary of past due and nonaccrual loans:

	June 30, 2018			Past Due 90 Days or More-Still Accruing	Past Due 90 Days or More- Nonaccrual	Total Past Due	Total Current	Total Loans	Non- Accrual Loans
	30-59 Days	60-89 Days							
(Dollars in thousands)									
Originated portfolio:									
Residential real estate	\$404	\$181	\$-	\$1,201	\$1,786	\$74,087	\$75,873	\$2,914	
Home equity	89	-	-	154	243	10,214	10,457	298	
Commercial real estate	27	210	-	169	406	302,993	303,399	1,499	
Commercial and industrial	-	-	-	792	792	187,065	187,857	1,368	
Consumer	77	82	-	19	178	3,066	3,244	134	
Total originated portfolio	597	473	-	2,335	3,405	577,425	580,830	6,213	
Purchased portfolio:									
Residential real estate	-	-	-	202	202	13,724	13,926	202	
Commercial real estate	659	274	-	3,086	4,019	272,032	276,051	5,180	
Commercial and industrial	17	-	-	91	108	887	995	363	
Total purchased portfolio	676	274	-	3,379	4,329	286,643	290,972	5,745	
Total loans	\$1,273	\$747	\$-	\$5,714	\$7,734	\$864,068	\$871,802	\$11,958	

Table of Contents

June 30, 2017

	30-59 Days	60-89 Days	Past Due 90 Days or More-Still Accruing	Past Due 90 Days or More- Nonaccrual	Total Past Due	Total Current	Total Loans	Non- Accrual Loans
(Dollars in thousands)								
Originated portfolio:								
Residential real estate	\$141	\$574	\$ -	\$ 1,398	\$2,113	\$81,646	\$83,759	\$3,337
Home equity	49	-	-	58	107	13,824	13,931	58
Commercial real estate	2,266	-	-	124	2,390	253,890	256,280	413
Commercial and industrial	-	-	-	2,433	2,433	172,035	174,468	2,600
Consumer	69	50	-	32	151	4,218	4,369	103
Total originated portfolio	2,525	624	-	4,045	7,194	525,613	532,807	6,511
Purchased portfolio:								
Residential real estate	-	1,082	-	16	1,098	2,380	3,478	1,056
Commercial real estate	173	1,997	-	2,922	5,092	236,632	241,724	6,364
Commercial and industrial	-	-	-	-	-	1,186	1,186	32
Total purchased portfolio	173	3,079	-	2,938	6,190	240,198	246,388	7,452
Total loans	\$2,698	\$3,703	\$ -	\$ 6,983	\$13,384	\$765,811	\$779,195	\$13,963

Allowance for Loan Losses and Impaired Loans

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

	Year Ended June 30, 2018						
	Residential Real Estate	Commercial Real Estate	Commercial and Industrial	Consumer	Purchased	Unallocated	Total
(Dollars in thousands)							
Beginning balance	\$477	\$ 2,312	\$ 520	\$ 53	\$ 303	\$ -	\$3,665
Provision	302	544	170	(1 )	395	-	1,410
Recoveries	14	-	25	40	-	-	79
Charge-offs	(183)	-	-	(53 )	(111 )	-	(347 )
Ending balance	\$610	\$ 2,856	\$ 715	\$ 39	\$ 587	\$ -	\$4,807

Year Ended June 30, 2017

	Residential Real Estate	Commercial Real Estate	Commercial and Industrial	Consumer	Purchased	Unallocated	Total
--	-------------------------------	---------------------------	---------------------------------	----------	-----------	-------------	-------

Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-K

(Dollars in thousands)

Beginning balance	\$663	\$ 1,195	\$ 297	\$ 62	\$ 133	\$ -	\$2,350
Provision	(33 )	1,099	207	54	267	-	1,594
Recoveries	33	21	16	38	-	-	108
Charge-offs	(186)	(3 )	-	(101 )	(97 )	-	(387 )
Ending balance	\$477	\$ 2,312	\$ 520	\$ 53	\$ 303	\$ -	\$3,665

Year Ended June 30, 2016

	Residential Real Estate	Commercial Real Estate	Commercial and Industrial	Consumer	Purchased	Unallocated	Total
(Dollars in thousands)							
Beginning balance	\$741	\$ 694	\$ 117	\$ 35	\$ 283	\$ 56	\$1,926
Provision	21	547	243	76	787	(56 )	1,618
Recoveries	35	5	14	17	-	-	71
Charge-offs	(134)	(51 )	(77 )	(66 )	(937 )	-	(1,265)
Ending balance	\$663	\$ 1,195	\$ 297	\$ 62	\$ 133	\$ -	\$2,350



Table of Contents

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

	June 30, 2018						
	Residential Real Estate	Commercial Real Estate	Commercial and Industrial	Consumer	Purchased	Unallocated	Total
	(Dollars in thousands)						
Allowance for loan losses:							
Individually evaluated	\$ 322	\$ 139	\$ 120	\$ 6	\$ -	\$ -	\$ 587
Collectively evaluated	288	2,717	595	33	-	-	3,633
ASC 310-30	-	-	-	-	587	-	587
Total	\$ 610	\$ 2,856	\$ 715	\$ 39	\$ 587	\$ -	\$ 4,807
Loans:							
Individually evaluated	\$ 5,682	\$ 2,882	\$ 3,008	\$ 292	\$ -	\$ -	\$ 11,864
Collectively evaluated	80,648	300,517	184,849	2,952	-	-	568,966
ASC 310-30	-	-	-	-	290,972	-	290,972
Total	\$ 86,330	\$ 303,399	\$ 187,857	\$ 3,244	\$ 290,972	\$ -	\$ 871,802
	June 30, 2017						
	Residential Real Estate	Commercial Real Estate	Commercial and Industrial	Consumer	Purchased	Unallocated	Total
	(Dollars in thousands)						
Allowance for loan losses:							
Individually evaluated	\$ 252	\$ 147	\$ 149	\$ 4	\$ -	\$ -	\$ 552
Collectively evaluated	225	2,165	371	49	-	-	2,810
ASC 310-30	-	-	-	-	303	-	303
Total	\$ 477	\$ 2,312	\$ 520	\$ 53	\$ 303	\$ -	\$ 3,665
Loans:							
Individually evaluated	\$ 5,676	\$ 1,759	\$ 2,694	\$ 296	\$ -	\$ -	\$ 10,425
Collectively evaluated	92,014	254,521	171,774	4,073	-	-	522,382
ASC 310-30	-	-	-	-	246,388	-	246,388
Total	\$ 97,690	\$ 256,280	\$ 174,468	\$ 4,369	\$ 246,388	\$ -	\$ 779,195

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

June 30, 2018

June 30, 2017

Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-K

	Unpaid			Unpaid		
	Recorded Investmen	Principal Balance	Related Allowance	Recorded Investmen	Principal Balance	Related Allowance
(Dollars in thousands)						
Impaired loans without a valuation allowance:						
Originated:						
Residential real estate	\$3,162	\$3,154	\$ -	\$4,052	\$4,084	\$ -
Commercial real estate	1,641	1,634	-	359	354	-
Commercial and industrial	2,401	2,401	-	1,870	1,870	-
Consumer	271	296	-	250	271	-
Purchased:						
Residential real estate	202	420	-	1,056	1,099	-
Commercial real estate	6,601	11,276	-	8,696	11,468	-
Commercial and industrial	108	1,420	-	32	65	-
Total	14,386	20,601	-	16,315	19,211	-
Impaired loans with a valuation allowance:						
Originated:						
Residential real estate	2,520	2,497	322	1,624	1,595	252
Commercial real estate	1,241	1,233	139	1,400	1,388	147
Commercial and industrial	607	607	120	824	824	149
Consumer	21	22	6	46	55	4
Purchased:						
Commercial real estate	4,748	5,362	280	3,528	3,929	176
Commercial and industrial	349	407	307	94	108	55
Total	9,486	10,128	1,174	7,516	7,899	783
Total impaired loans	\$23,872	\$30,729	\$ 1,174	\$23,831	\$27,110	\$ 783

Table of Contents

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

	Year Ended June 30, 2018		Years Ended June 30, 2017		2016	
	Average	Interest	Average	Interest	Average	Interest
	Recorded	Recorded	Recorded	Recorded	Recorded	Recorded
	Income	Income	Income	Income	Income	Income
	Investmen	Investmen	Investmen	Investmen	Investmen	Investmen
	Recognized	Recognized	Recognized	Recognized	Recognized	Recognized
	(Dollars in thousands)					
Impaired loans without a valuation allowance:						
Originated:						
Residential real estate	\$3,697	\$ 94	\$3,775	\$ 106	\$2,584	\$ 151
Commercial real estate	2,054	183	454	19	978	31
Commercial and industrial	1,904	105	1,195	33	9	-
Consumer	271	18	225	14	255	27
Purchased:						
Residential real estate	489	-	66	1		
Commercial real estate	8,754	275	4,266	186		
Commercial and industrial	42	-	251	3		
Total	17,211	675	8,868	449		
Impaired loans with a valuation allowance:						
Originated:						
Residential real estate	2,120	159				
Commercial real estate	1,379	92				
Commercial and industrial	753	6				
Consumer	33	2				
Purchased:						
Residential real estate	66	1				
Commercial real estate	4,266	186				
Commercial and industrial	251	3				
Total	8,868	449				
Total impaired loans	\$26,079	\$ 1,124				

Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-K

Residential real estate	1,086	1	563	51
Commercial real estate	6,474	267	6,123	140
Commercial and industrial	28	-	-	-
Total	13,237	440	10,512	400
Impaired loans with a valuation allowance:				
Originated:				
Residential real estate	1,798	117	1,984	96
Commercial real estate	1,219	100	1,056	63
Commercial and industrial	532	13	1	-
Consumer	77	7	53	3
Purchased:				
Commercial real estate	1,636	86	1,346	83
Commercial and industrial	35	2	-	-
Total	5,297	325	4,440	245
Total impaired loans	\$18,534	\$ 765	\$14,952	\$ 645

Table of Contents

Credit Quality

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

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

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

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

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

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

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

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

June 30, 2018

Originated Portfolio

	Commercial Real Estate (Dollars in thousands)	Commercial and Industrial	Residential Real Estate <sup>(1)</sup>	Purchased Portfolio	Total
Pass (1- 6)	\$298,200	\$184,024	\$13,531	\$279,111	\$774,866
Special mention (7)	3,505	2,198	100	5,899	11,702
Substandard (8)	1,694	1,635	823	5,962	10,114
Doubtful (9)	-	-	-	-	-
Loss (10)	-	-	-	-	-
Total	\$303,399	\$187,857	\$14,454	\$290,972	\$796,682

June 30, 2017

Originated Portfolio

	Commercial Real Estate (Dollars in thousands)	Commercial and Industrial	Residential Real Estate <sup>(1)</sup>	Purchased Portfolio	Total
Pass (1- 6)	\$253,041	\$171,160	\$10,039	\$229,980	\$664,220
Special mention (7)	2,686	2,483	71	9,622	14,862
Substandard (8)	554	825	803	6,786	8,968
Doubtful (9)	-	-	19	-	19
Loss (10)	-	-	-	-	-
Total	\$256,281	\$174,468	\$10,932	\$246,388	\$688,069

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

Table of ContentsTroubled Debt Restructurings

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

	Years Ended June 30,		2017	
	2018		2017	
	Number	Recorded	Number	Recorded
	of	Investment	of	Investment
	Contracts	(Dollars in thousands)	Contracts	(Dollars in thousands)
Extended maturity	3	\$ 73	9	\$ 4,537
Adjusted interest rate	1	15	6	424
Rate and maturity	4	2,302	5	1,317
Principal deferment	8	3,362	3	1,978
Court ordered concession	1	94	-	-
Total	17	\$ 5,846	23	\$ 8,256

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

	Years Ended June 30,		2017		2017	
	2018		2017		2017	
	Number	Recorded	Number	Recorded	Number	Recorded
	of	Investment	of	Investment	of	Investment
	Contracts	Post-Modification	Contracts	Post-Modification	Contracts	Post-Modification
	(Dollars in thousands)	(Dollars in thousands)	(Dollars in thousands)	(Dollars in thousands)	(Dollars in thousands)	(Dollars in thousands)
<b>Originated portfolio:</b>						
Residential real estate	8	\$ 707	\$ 709	9	\$ 964	\$ 1,084
Home equity	-	-	-	-	-	-
Commercial real estate	5	3,303	3,370	2	195	195
Commercial and industrial	1	655	655	2	1,867	1,937
Consumer	-	-	-	-	-	-
Total originated portfolio	14	4,665	4,734	13	3,026	3,216
<b>Purchased portfolio:</b>						
Commercial real estate	2	820	844	9	4,895	4,946
Commercial and industrial	1	269	268	1	94	94
Total purchased portfolio	3	1,089	1,112	10	4,989	5,040
Total	17	\$ 5,754	\$ 5,846	23	\$ 8,015	\$ 8,256

As of *June 30, 2018*, there were *no* further commitments to lend to borrowers associated with loans modified in a TDR.

The Company considers TDRs past due *90* days or more to be in payment default. *No* loans modified in a TDR in the last *twelve* months defaulted during the years ended *June 30, 2018* and *2017*.

ASC 310-30 Loans

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

	Years Ended June 30,		
	2018	2017	2016
	(Dollars in thousands)		
Contractually required payments receivable	\$179,726	\$175,274	\$148,394
Nonaccretable difference	(4,321 )	(4,518 )	(2,050 )
Cash flows expected to be collected	175,405	170,756	146,344
Accretable yield	(51,294 )	(57,949 )	(46,345 )
Fair value of loans acquired	\$124,111	\$112,807	\$99,999



Table of Contents

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

	As of and for the Years Ended June 30,		
	2018	2017	2016
	(Dollars in thousands)		
Loans acquired during the period	\$820	\$1,850	\$424
Loans at end of period	5,278	6,582	4,512

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

	Years Ended June 30,		
	2018	2017	2016
	(Dollars in thousands)		
Beginning balance	\$131,197	\$124,151	\$111,449
Acquisitions	51,294	57,949	46,345
Accretion	(17,947)	(18,468)	(16,900)
Reclassifications from nonaccretable difference to accretable yield	5,827	6,109	7,079
Disposals and other changes	(32,193)	(38,544)	(23,822)
Ending balance	\$138,178	\$131,197	\$124,151

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

	June 30, 2018	June 30, 2017
Unpaid principal balance	\$318,876	\$271,709
Carrying amount	284,317	239,583

#### **4. Transfers and Servicing of Financial Assets**

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

Capitalized servicing rights as of *June 30, 2018* totaled \$3.0 million, compared to \$2.8 million as of *June 30, 2017*, and are classified as servicing rights, net, on the consolidated balance sheets.

Mortgage loans sold in the year ended *June 30, 2018* totaled \$63.8 million, compared to \$74.7 million in the year ended *June 30, 2017*. Mortgage loans serviced for others totaled \$8.7 million at *June 30, 2018* and \$10.7 million at *June 30, 2017*. Additionally, the Company was servicing commercial loans participated out to various other institutions amounting to \$32.2 million and \$25.2 million at *June 30, 2018* and *2017*, respectively.

SBA loans sold during the year ended *June 30, 2018* totaled \$29.2 million, compared to \$53.8 million in the year ended *June 30, 2017*. SBA loans serviced for others totaled \$162.0 million at *June 30, 2018* and \$144.4 million at *June 30, 2017*.

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

Contractually specified servicing fees were \$817 thousand, \$988 thousand, and \$649 thousand for the years ended *June 30, 2018, 2017* and *2016*, respectively, and were included as a component of fees for other services to customers within noninterest income.

The significant assumptions used in the valuation for loan servicing rights as of *June 30, 2018* included a discount rate, ranging from 9.0% to 16.0% and a weighted average prepayment speed assumption of 10.6 %.

Table of Contents

SBA servicing rights activity was as follows:

	(Dollars in thousands)
Balance, June 30, 2015	\$ 1,077
Additions	1,230
Disposals	(38 )
Amortization	(52 )
Impairment	(463 )
Balance, June 30, 2016	1,754
Additions	1,529
Amortization	(224 )
Impairment	(220 )
Balance, June 30, 2017	2,839
Additions	931
Amortization	(769 )
Impairment	(31 )
Balance, June 30, 2018	\$ 2,970

**5. Premises and Equipment**

Premises and equipment consists of the following:

	June 30, 2018 (Dollars in thousands)	June 30, 2017	Estimated Useful Life (In years)
Land	\$767	\$767	n/a
Buildings	1,702	1,755	39
Assets recorded under capital lease	1,850	1,850	Term of lease (or term
Leasehold and building improvements	3,646	3,150	5 - 39 of lease, if shorter)
Furniture, fixtures and equipment	8,749	8,274	3 - 7
Total	16,714	15,796	
Less accumulated depreciation	10,123	8,859	
Net premises and equipment	\$6,591	\$6,937	

Depreciation and amortization of premises and equipment included in occupancy and equipment expense was \$1.3 million for the year ended *June 30, 2018*, \$1.4 million for the year ended *June 30, 2017* and \$1.6 million for the year ended *June 30, 2016*.

## 6. Intangible Assets

At *June 30, 2018* and *2017*, intangible assets consisted of a core deposit intangible. The Company's core deposit intangible is being amortized on an accelerated basis over 9.5 years, with an estimated remaining life of 2 years.

The changes in the carrying amount of the core deposit intangible follow:

	(Dollars in thousands)
June 30, 2015	\$ 2,209
Amortization	(477 )
June 30, 2016	\$ 1,732
Amortization	(432 )
June 30, 2017	\$ 1,300
Amortization	(433 )
June 30, 2018	\$ 867

The components of core deposit intangible follow:

	June 30, 2018	June 30, 2017
	(Dollars in thousands)	
Core Deposit Intangible:		
Gross carrying amount	\$6,348	\$6,348
Accumulated amortization	(5,481)	(5,048)
Intangible asset, net	\$867	\$1,300



Table of Contents

Expected annual amortization expense associated with the core deposit intangible over the period of estimated economic benefit is as follows:

Fiscal Year	Expected Amortization Expense (Dollars in thousands)
2019	\$ 433
2020	434
Total	\$ 867

**7. Deposits**

The composition of deposits is as follows:

	June 30, 2018	June 30, 2017
	(Dollars in thousands)	
Demand	\$72,272	\$69,827
NOW	73,347	71,247
Money market	420,886	374,569
Regular savings	36,290	37,170
Time certificates	352,145	337,037
Total deposits	\$954,940	\$889,850

There were *no* time deposits greater than \$250 thousand as of *June 30, 2018* and *2017*.

The scheduled maturities of time certificates by fiscal year are as follows:

Fiscal Year	June 30, 2018 (Dollars in thousands)
2019	\$ 248,119

2020	63,986
2021	22,263
2022	12,606
2023	5,171
Thereafter	-
Total	\$ 352,145

## 8. Borrowings

### Federal Home Loan Bank Advances

A summary of advances from the Federal Home Loan Bank of Boston follows:

Maturity	Unpaid Principal Balance		Carrying Amount <sup>(1)</sup>		Weighted Average Interest Rate	
	2018	2017	2018	2017	2018	2017
By Fiscal Year	(Dollars in thousands)					
2018	\$-	\$20,000	\$-	\$20,011	0.00%	1.94%
2019	15,000	-	15,000	-	2.05%	0.00%
	\$15,000	\$20,000	\$15,000	\$20,011	2.05%	1.94%

- (1) The difference between the carrying amount and the unpaid principal balance is the result of purchase accounting. The premium or discount is being amortized or accreted as interest expense over the instrument's contractual life.

At June 30, 2018, no FHLBB advances were subject to call provisions and as such, *may not* be called prior to the stated maturity.

Certain mortgage loans, free of liens, pledges and encumbrances have been pledged under a blanket agreement to secure these advances. The Company is required to own stock in the Federal Home Loan Bank of Boston in order to borrow from the FHLBB.

At June 30, 2018, the Company had approximately \$48.7 million of additional capacity to borrow from the FHLBB.





Table of ContentsCapital Lease Obligation

In fiscal 2006, the Company recognized a capital lease obligation for its Lewiston, Maine, headquarters. The present value of the lease payments over *fifteen* years exceeded *90%* of the fair value of the property.

The outstanding capital lease obligations are as follows for years ending *June 30*:

	Capital Lease Obligation (Dollars in thousands)
2019	\$ 306
2020	306
2021	25
Total	637
Imputed interest	(32 )
Capital lease obligation	\$ 605

**9. Subordinated Debt**Trust Preferred Securities and Junior Subordinated Debentures

NBN Capital Trust II and NBN Capital Trust III were created in *December 2003*. NBN Capital Trust IV was created in *December 2004*. Each such trust is a Delaware statutory trust (together, the "Private Trusts"). The exclusive purpose of the Private Trusts was (i) issuing and selling common securities and preferred securities in a private placement offering (the "Private Trust Securities"), (ii) using the proceeds of the sale of the Private Trust Securities to acquire Junior Subordinated Deferrable Interest Notes ("Junior Subordinated Debentures"); and (iii) engaging only in those other activities necessary, convenient or incidental thereto. Accordingly, the Junior Subordinated Debentures are the sole assets of each of the Private Trusts.

The following table summarizes the Junior Subordinated Debentures issued by the Company to each affiliated trust and the Private Trust Securities issued by each affiliated trust as of *June 30, 2018* and *June 30, 2017*. Amounts include the junior subordinated debentures acquired by the affiliated trusts from the Company with the capital contributed by

the Company in exchange for the common securities of such trust, which were \$93 thousand each for NBN Capital Trust II and III and \$310 thousand for NBN Capital Trust IV. The trust preferred securities (the "Preferred Securities") were sold in *two* separate private placement offerings. The Company has the right to redeem the Junior Subordinated Debentures, in whole or in part, on or after *March 30, 2009*, for NBN Capital Trust II and III, and on or after *February 23, 2010*, for NBN Capital Trust IV, at the redemption price specified in the associated Indenture, plus accrued but unpaid interest to the redemption date.

	Maturity Date	Unpaid Principal Balance		Carrying Amount <sup>(1)</sup>	
		2018	2017	2018	2017
(Dollars in thousands)					
NBN Capital Trust II	March 30, 2034	\$3,093	\$3,093	\$1,940	\$1,901
NBN Capital Trust III	March 30, 2034	3,093	3,093	1,940	1,901
NBN Capital Trust IV	February 23, 2035	10,310	10,310	5,358	5,209
		\$16,496	\$16,496	\$9,238	\$9,011

The difference between the carrying amount and the unpaid principal balance is the result of purchase (I) accounting. The premium or discount is being amortized or accreted as interest expense over the instrument's contractual life.

NBN Capital Trust II and III pay a variable rate based on *three* month LIBOR plus 2.80%, and NBN Capital Trust IV pays a variable rate based on *three* month LIBOR plus 1.89%. Accordingly, the Preferred Securities of the Private Trusts currently pay quarterly distributions at an annual rate of 3.45% for the stated liquidation amount of \$1,000 per Preferred Security for NBN Capital Trust II and III and an annual rate of 2.54% for the stated liquidation amount of \$1,000 per Preferred Security for NBN Capital Trust IV. The Company has fully and unconditionally guaranteed all of the obligations of each trust. The guaranty covers the quarterly distributions and payments on liquidation or redemption of the Private Trust Securities, but only to the extent of funds held by the trusts.

The Junior Subordinated Debentures each have variable rates indexed to *three*-month LIBOR. During the fiscal year ended *June 30, 2015*, the Company purchased *two* interest rate caps to hedge the interest rate risk on notional amounts of \$6 million and \$10 million, respectively, of the Company's Junior Subordinated Debentures. Each is a cash flow hedge used to manage the risk to net interest income in a period of rising rates.

## Table of Contents

The interest rate caps hedge the junior subordinated debt resulting from the issuance of trust preferred securities by our affiliates NBN Capital Trust II, NBN Capital Trust III and NBN Capital Trust IV. The notional amount of \$6 million and \$10 million for each interest rate cap represents the outstanding junior subordinated debt from each trust. The strike rate is 2.50%. The Company will recognize higher interest expense on the junior subordinated debt for the *first 200* basis points increase in *three*-month LIBOR. Once the *three*-month LIBOR rate exceeds 2.50% on a quarterly reset date, there will be a payment by the counterparty to the Company at the following quarter end. The effective date of the purchased interest rate caps were *October 2014* and *March 2015*, respectively, and mature *five* years after.

## Subordinated Notes

On *June 29, 2016*, the Company entered into a Subordinated Note Purchase Agreement with certain institutional accredited investors (the "Purchasers") whereby the Company sold and issued \$15.05 million in aggregate principal amount of 6.75% fixed-to-floating subordinated notes due 2026 (the "Notes"). The Notes were issued by the Company to the Purchasers at a price equal to 100% of their face amount. Issuance costs were \$552 thousand and have been netted against Subordinated Debt on the consolidated balance sheet. These costs are being amortized over *five* years, which represents the period from issuance to the *first* redemption date of *July 1, 2021*. Total amortization expense for both years ended *June 30, 2018* and *2017* was \$110 thousand, with \$331 thousand remaining to be amortized as of *June 30, 2018*.

The Notes mature on *July 1, 2026*, with a fixed interest rate of 6.75% payable semiannually in arrears for *five* years until *July 1, 2021*. Subsequently, the Company will be obligated to pay 3-month LIBOR plus 557 basis points quarterly in arrears until either the early redemption date or the maturity date. The Notes are *not* convertible into or exchangeable for any other securities or assets of the Company or any of its subsidiaries. The Notes are redeemable by the Company, in whole or in part, on or after *July 1, 2021* and at any time upon the occurrence of certain events. Any redemption by the Company would be at a redemption price equal to 100% of the outstanding principal amount of the Notes being redeemed, including any accrued and unpaid interest.

## **10. Capital and Regulatory Matters**

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Company's and the Bank's capital amounts and classification are also subject to qualitative judgments by the

regulators about components, risk weightings and other factors.

The prompt corrective action regulations define specific capital categories based on an institution's capital ratios. The capital categories, in declining order, are "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized" and "critically undercapitalized."

As of *June 30, 2018* and *2017*, the most recent notification from the Company's and the Bank's regulator categorized the Company and the Bank as "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well capitalized," the Company and the Bank must maintain minimum Common equity tier 1 capital, total capital, Tier 1 capital and Tier 1 leverage ratios as set forth in the table below. There are *no* conditions or events since that notification that management believes have changed the institution's regulatory designation as "well-capitalized" under the regulatory framework for prompt corrective action.

Table of Contents

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios as set forth in the table below. At *June 30, 2018* and *2017*, the Company's and the Bank's ratios exceeded the regulatory requirements. Management believes that the Company and the Bank met all capital adequacy requirements to which they were subject as of *June 30, 2018* and *2017*. The Company's and the Bank's regulatory capital ratios are set forth below.

	Actual		Minimum Capital Requirements		Minimum To Be Well		Minimum Capital Ratio with Capital Conservation Buffer	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Ratio	
(Dollars in thousands)								
June 30, 2018:								
Common equity tier 1 capital to risk weighted assets:								
Company	\$139,247	16.02%	\$39,113	≥4.5%	N/A	N/A	7.0	%
Bank	156,856	18.04%	39,120	≥4.5%	\$56,506	≥6.5%	7.0	%
Total capital to risk weighted assets:								
Company	167,567	19.28%	69,535	≥8.0%	N/A	N/A	10.5	%
Bank	161,714	18.60%	69,546	≥8.0%	86,933	≥10.0%	10.5	%
Tier 1 capital to risk weighted assets:								
Company	147,990	17.03%	52,151	≥6.0%	N/A	N/A	8.5	%
Bank	156,856	18.04%	52,160	≥6.0%	69,546	≥8.0%	8.5	%
Tier 1 capital to average assets:								
Company	147,990	13.12%	45,102	≥4.0%	N/A	N/A	4.0	%
Bank	156,856	13.92%	45,075	≥4.0%	56,344	≥5.0%	4.0	%
June 30, 2017:								
Common equity tier 1 capital to risk weighted assets:								
Company	\$123,442	16.00%	\$34,714	≥4.5%	N/A	N/A	7.0	%
Bank	138,744	17.98%	34,727	≥4.5%	\$50,162	≥6.5%	7.0	%
Total capital to risk weighted assets:								
Company	150,269	19.48%	61,715	≥8.0%	N/A	N/A	10.5	%

Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-K

Bank	142,447	18.46%	61,737	≥8.0%	77,172	≥10.0%	10.5	%
Tier 1 capital to risk weighted assets:								
Company	131,958	17.11%	46,286	≥6.0%	N/A	N/A	8.5	%
Bank	138,744	17.98%	46,303	≥6.0%	61,737	≥8.0%	8.5	%
Tier 1 capital to average assets:								
Company	131,958	12.81%	41,215	≥4.0%	N/A	N/A	4.0	%
Bank	138,744	13.46%	41,238	≥4.0%	51,547	≥5.0%	4.0	%

In addition to the minimum regulatory capital required for capital adequacy purposes included in the table above, the Company is required to maintain a capital conservation buffer, in the form of common equity, in order to avoid restrictions on capital distributions and discretionary bonuses. The required amount of the capital conservation buffer was 0.625% on January 1, 2016 and will increase by 0.625% each year until it reaches 2.5% on January 1, 2019.

The Bank *may not* declare or pay a cash dividend on, or repurchase, any of its capital stock from the Company if the effect thereof would cause the capital of the Bank to be reduced below the capital requirements imposed by the regulatory authorities or if such amount exceeds the otherwise allowable amount under FRB rules.

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

Table of Contents**11. Earnings Per Common Share (“EPS”)**

EPS is computed by dividing net income allocated to common shareholders by the weighted-average common shares outstanding. The following table shows the weighted-average number of common shares outstanding for the periods indicated. Shares issuable relative to stock options granted have been reflected as an increase in the shares outstanding used to calculate diluted EPS, after applying the treasury stock method. The number of shares outstanding for basic and diluted EPS is presented as follows:

	Years ended June 30,		
	2018	2017	2016
	(Dollars in thousands, except share and per share data)		
Net income	\$16,166	\$12,339	\$7,619
Weighted average shares used in calculation of basic earnings per share	8,906,710	8,898,448	9,474,999
Incremental shares from assumed exercise of dilutive securities	222,442	54,166	9,636
Weighted average shares used in calculation of diluted earnings per share	9,129,152	8,952,614	9,484,635
Earnings per common share:	\$1.81	\$1.39	\$0.80
Diluted earnings per common share:	\$1.77	\$1.38	\$0.80

For the years ended *June 30, 2018, 2017, and 2016*, the following stock options were excluded from the calculation of diluted EPS due to the exercise price of these options exceeding the average market price of the Company's common stock for the period. These options, which were *not* dilutive at that date, *may* potentially dilute EPS in the future.

	Years ended June 30,	
	2018	2017
Stock options	642,641	714,545

**12. Income Taxes**

The current and deferred components of income tax expense follows:

	Years Ended June 30,		
	2018	2017	2016
	(Dollars in thousands)		
Current provision			
Federal	\$4,133	\$7,071	\$1,544
State	1,606	1,753	438
Total current provision	5,739	8,824	1,982
Deferred expense (benefit)			
Federal	1,189	(792 )	1,761
State	103	(233 )	361
Total deferred expense (benefit)	1,292	(1,025)	2,122
Total tax provision	\$7,031	\$7,799	\$4,104

The reconciliation between the statutory federal income tax rate of 28% for fiscal 2018 and 35% for fiscal 2017 and 2016, and the effective tax rate on income follows:

	Years Ended June 30,		
	2018	2017	2016
	(Dollars in thousands)		
Expected income tax expense at federal tax rate	\$6,509	\$7,048	\$3,986
State tax, net of federal tax benefit	1,231	988	527
Non-taxable BOLI income	(124 )	(159 )	(153 )
Low-income housing tax credit, net of adoption of ASU 2014-01	(37 )	(40 )	(42 )
Tax exempt interest income	(5 )	(76 )	(76 )
Stock compensation excess tax benefits (ASU 2016-09)	(1,266)	-	-
Statutory rate change	497	-	-
Other	226	38	(138 )
Total tax provision	\$7,031	\$7,799	\$4,104



Table of Contents

The tax effect of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at *June 30* follows:

	June 30,	
	2018	2017
	(1)	(2)
	(Dollars in thousands)	
Deferred tax assets		
Allowance for loan losses	\$1,315	\$1,462
Loan basis differential	931	1,242
Capital lease	166	348
Compensation and benefits	252	1,425
Stock-based compensation	863	1,651
Unrealized loss on derivatives	224	640
Unrealized loss on available for sale securities	428	360
Interest on nonperforming loans	349	418
Derivative basis differential	41	-
Other	406	585
Gross deferred tax asset	4,975	8,131
Less: valuation allowance	-	-
Total deferred tax assets	4,975	8,131
Deferred tax liabilities		
Intangible assets	237	519
Prepaid expenses	433	385
Premises and equipment	707	926
Borrowings basis differential	1,939	2,943
Other	812	1,135
Total deferred tax liability	4,128	5,908
Net deferred tax asset	\$847	\$2,223

(1) 2018 balances reflect a statutory rate of 21%

(2) 2017 balances reflect a statutory rate of 35%

The net deferred tax asset was included in other assets in the accompanying consolidated balance sheets as of *June 30, 2018* and *June 30, 2017*.

On *December 22, 2017*, the Act became law. The Act amends the Internal Revenue Code to reduce tax rates and modify policies, credits, and deductions for individuals and businesses. For businesses, the Act reduced the corporate tax rate from a maximum of 35% to 21%. However, as the Company is a fiscal year *June 30* year end, the blended corporate tax rate for the year ended *June 30, 2018* was 28%. The corporate tax rate reduction to 21% is effective *July 1, 2018*.

In accordance with ASC 740, *Income Taxes*, deferred tax assets are to be reduced by a valuation allowance if, based on the weight of available evidence, it is more likely than *not* that some portion or all of the deferred tax assets will *not* be realized. The realization of the tax benefit depends upon the existence of sufficient taxable income within the carry-back and future periods. The Company believes that it is more likely than *not* that the net deferred tax asset as of *June 30, 2018* will be realized, based upon the ability to generate future taxable income as well as the availability of current and historical taxable income.

For federal tax purposes, the Company has a \$2.0 million reserve for loan losses which remains subject to recapture. If any portion of the reserve is used for purposes other than to absorb the losses for which it was established, approximately *130%* of the amount actually used (limited to the amount of the reserve) would be subject to taxation in the year in which used. As the Company intends to use the reserve only to absorb loan losses, *no* provision has been made for potential liability that would result if *100%* of the reserve were recaptured.

The Company made adjustments amounting to \$97 thousand to deferred tax assets representing future deductions for accrued compensation that are subject to new limitations under Internal Revenue Code Section *162(m)* which, generally, limits the annual deduction for certain compensation paid to certain employees to \$1 million.

Table of Contents

From time to time, the Internal Revenue Service (the "IRS") and state tax authorities *may* review or challenge specific tax positions taken by the Company in its ordinary course of business. The Company accounts for uncertainties in income taxes by reserving for tax positions that *may not* be upheld under examination. Increases to the Company's unrealized tax positions occur as a result of accruing for the unrecognized tax benefit as well the accrual of interest and penalties related to prior year positions. Decreases in the Company's unrealized tax positions occur as a result of the statute of limitation lapsing on prior year positions or settlements relating to outstanding positions. The Company reserves for uncertain tax positions, as well as related interest and penalties, as a component of income tax expense therefore affecting the effective tax rate. The following is a reconciliation of the beginning and ending amounts of the Company's uncertain tax positions:

	Tax Position	Interest and Penalties	Total
	(Dollars in thousands)		
Balance at June 30, 2015	\$109	\$ 18	\$127
Reduction of tax positions for prior years	(42 )	(4 )	(46 )
Increase for prior year tax position	-	-	-
Increase for current year tax position	-	-	-
Balance at June 30, 2016	\$67	\$ 14	\$81
Reduction of tax positions for prior years	(67 )	(14 )	(81 )
Increase for prior year tax position	-	-	-
Increase for current year tax position	-	-	-
Balance at June 30, 2017	\$-	\$ -	\$-
Reduction of tax positions for prior years	-	-	-
Increase for prior year tax position	-	-	-
Increase for current year tax position	-	-	-
Balance at June 30, 2018	\$-	\$ -	\$-

The Company is currently open to audit under the statute of limitations by the IRS and state taxing authorities for the fiscal 2015 tax return and forward.

**13. Employee Benefit Plans**401(k) Plan

The Company offers a contributory 401(k) plan that is available to all full-time salaried and hourly-paid employees who have attained age 18, and completed 90 days of employment. Employees *may* contribute up to 100% of their base compensation, subject to IRS limitations. The Company will match 50% of each employee's contribution up to the

*first 6%* contributed. For the years ended *June 30, 2018, 2017, and 2016*, the Company contributed \$340 thousand, \$355 thousand and \$331 thousand, respectively.

#### Deferred Compensation

The Company has individual deferred compensation agreements with *five* former senior officers. The Company recognized deferred compensation expense of \$31 thousand for each of the years ended *June 30, 2018, 2017, and 2016*, respectively. At *June 30, 2018, 2017 and 2016*, the Company's deferred compensation liability was \$526 thousand, \$540 thousand and \$541 thousand, respectively.

#### **14. Stock-Based Compensation**

At the *2017* annual meeting of shareholders, the Company's shareholders ratified the Northeast Bancorp Amended and Restated *2010* Stock Option and Incentive Plan (the "Restated Plan"). The Restated Plan amends and restates the Northeast Bancorp *2010* Option and Incentive Plan (the "*2010* Plan"). The key material differences between the *2010* Plan and the Restated Plan are:

The maximum number of shares of common stock to be issued under the Restated Plan is increased by *600,000* shares, from *810,054* shares to *1,410,054* shares;

The method by which shares subject to previously granted awards are added back to the Restated Plan has been revised so that the only shares added back to the Restated Plan are those subject to awards that are forfeited, canceled or otherwise terminated. The following shares shall *not* be added back to the Restated Plan: (i) shares tendered or held back upon exercise of an option or settlement of an award to cover the exercise price or tax withholding, and (ii) shares subject to a stock appreciation right that are *not* issued in connection with the stock settlement of the stock appreciation right upon exercise thereof.

Minimum vesting periods are required for grants of restricted stock, restricted stock units and performance share awards; and

The term of the Restated Plan will now expire on *November 28, 2022*, while grants of incentive options under the Restated Plan *may* be made until *September 21, 2022*.

Table of Contents

A summary of stock option activity for the year ended *June 30, 2018* follows:

	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	890,866	\$ 12.43
Granted	-	-
Exercised	(373,634)	12.86
Forfeited	(81,006 )	14.52
Outstanding at end of year	436,226	12.46
Exercisable	436,226	12.46

	Shares	Weighted Average Grant Date Fair Value
Exercisable, beginning of year	506,911	\$ 3.18
Vested	302,949	2.33
Exercised	(373,634)	2.89
Forfeited or expired	-	-
Exercisable, end of year	436,226	2.89

There were *no* options granted in the year ended *June 30, 2018* or *2017*.

The expected volatility is based on historical volatility. The risk-free interest rate is for periods within the expected life of the awards, and is based on the U.S. Treasury yield curve in effect at the time of the grant. The expected life is based on expected exercise experience.

The following table summarizes information about stock options outstanding at *June 30, 2018*:

Options Outstanding (Dollars in thousands, except per share data)			Options Exercisable		
Weighted	Weighted	Aggregate	Weighted	Weighted	Aggregate
Average	Average	Intrinsic	Average	Average	Intrinsic

Exercise Price	Number	Remaining Life		Exercise Price	Number	Remaining Life	
		(in years)	Value			(in years)	Value
\$9.38	139,607	4.59	\$ 1,734	\$9.38	139,607	4.59	\$ 1,734
12.63	5,000	3.58	45	12.63	5,000	3.58	45
13.93	291,619	2.50	2,295	13.93	291,619	2.50	2,295
12.46	436,226	3.18	\$ 4,074	12.46	436,226	3.18	\$ 4,074

A summary of restricted stock activity for the year ended *June 30, 2018* follows:

	Shares	Weighted Average Grant Date Fair Value
Unvested at beginning of period	395,430	\$ 10.69
Granted	22,000	22.41
Vested	(59,093 )	9.65
Forfeited	(40,003 )	10.54
Unvested at end of period	318,334	11.71

A summary of the vesting schedule for the shares granted in the year ended *June 30, 2018* follows:

- 10,000 restricted shares vest in *three* equal annual installments, commencing on *August 31, 2020*;
- 2,000 restricted shares vest in *three* equal annual installments, commencing on *November 10, 2020*; and,
- 10,000 restricted shares vest in *three* equal annual installments, commencing on *January 5, 2021*.

Table of Contents

Stock-based compensation totaled \$870 thousand for the year ended *June 30, 2018*, \$945 thousand for the year ended *June 30, 2017*, and \$613 thousand for the year ended *June 30, 2016*. The tax benefit related to stock-based compensation expensed totaled \$264 thousand for the year ended *June 30, 2018*, \$366 thousand for the year ended *June 30, 2017* and \$215 thousand for the year ended *June 30, 2016*. The estimated amount and timing of future pre-tax stock-based compensation expense to be recognized are as follows.

	Years Ended June 30,					
	2019	2020	2021	2022	2023	Total
	(Dollars in thousands)					
Stock options	\$-	\$-	\$-	\$-	\$-	\$-
Restricted stock	939	575	355	165	37	2,071
	\$939	\$575	\$355	\$165	\$37	\$2,071

**15. Commitments, Contingent Liabilities and Other Off-Balance Sheet Risks**

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The contract amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

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

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

	June 30,	
	2018	2017
	(Dollars in thousands)	
Commitments to originate loans	\$20,431	\$15,244

Unused lines of credit	29,478	31,858
Standby letters of credit	3,183	3,400
Commitment to fund investment	1,000	1,000

Commitments to extend credit are agreements to lend to a customer as long as there is *no* violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and *may* require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do *not* necessarily represent future cash requirements. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies but *may* include accounts receivable, inventory, property, plant and equipment, and income-producing commercial properties. The Company has recorded an allowance for possible losses on commitments and unfunded loans totaling \$52 thousand and \$39 thousand recorded in other liabilities at *June 30, 2018* and *2017*, respectively.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a *third* party. Those guarantees are issued to support private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. As of *June 30, 2018* and *2017*, the maximum potential amount of the Company's obligation was \$3.2 million and \$3.4 million, respectively, for financial and standby letters of credit. The Company's outstanding letters of credit generally have a term of less than *one* year. If a letter of credit is drawn upon, the Company *may* seek recourse through the customer's underlying line of credit. If the customer's line of credit is also in default, the Company *may* take possession of the collateral, if any, securing the line of credit.

In the year ended *June 30, 2016*, the Company committed \$2.5 million to a fund that acquires CRA qualified investments in loans for the Company's portfolio. The fund manager calls the funds from the Company when an investment is successfully acquired. During the year ended *June 30, 2017*, the fund called \$1.5 million from the Company. The Company has a remaining commitment of \$1.0 million as of *June 30, 2018* to a fund that invests in the federally guaranteed portion of SBA 7(a) loans.



Table of ContentsLease Obligations

The Company leases certain properties used in operations under terms of various non-cancelable operating leases, most of which include renewal options. The leases contain renewal options and escalation clauses which provide for increased rental expense as these leases expire. Rental expense under leases totaled \$1.2 million for each of the years ended *June 30, 2018, 2017, and 2016*.

Approximate future minimum lease payments over the remaining terms of the Company's leases at *June 30, 2018* are as follows:

	Minimum lease  payments (Dollars in thousands)
2019	\$ 1,257
2020	1,256
2021	1,236
2022	1,255
2023	689
Thereafter	1,361
Total	\$ 7,054

Legal Proceedings

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

**16. Other Comprehensive Income (Loss)**

The components of other comprehensive income (loss) follows:

	Years Ended June 30,					
	2018			2017		
	Pre-tax Amount	Tax Expense (Benefit)	After-tax Amount	Pre-tax Amount	Tax Expense (Benefit)	After-tax Amount
	(Dollars in thousands)					
Change in net unrealized loss on available-for-sale securities	\$(636)	\$ (171 )	\$ (465 )	\$(1,145)	\$ (434 )	\$ (711 )
Change in accumulated gain on effective cash flow hedges	750	203	547	1,550	592	958
Reclassification adjustment included in net income	106	34	72	43	16	27
Total derivatives and hedging activities	856	237	619	1,593	608	985
Adoption of ASU 2018-02	-	283	(283 )	-	-	-
Total other comprehensive (loss) income	\$220	\$ 349	\$ (129 )	\$448	\$ 174	\$ 274

	Year Ended June 30,		
	2016		
	Pre-tax Amount	Tax Expense (Benefit)	After-tax Amount
	(Dollars in thousands)		
Change in net unrealized gain on available-for-sale securities	\$1,033	\$ 393	\$ 640
Change in accumulated loss on effective cash flow hedges	(2,032)	(776 )	(1,256 )
Reclassification adjustment included in net income	(3 )	(1 )	(2 )
Total derivatives and hedging activities	(2,035)	(777 )	(1,258 )
Total other comprehensive loss	\$(1,002)	\$ (384 )	\$ (618 )

Table of Contents

Accumulated other comprehensive loss is comprised of the following components:

	June 30, 2018	June 30, 2017	June 30, 2016
	(Dollars in thousands)		
Unrealized (loss) gain on available-for-sale securities	\$(1,584)	\$(948 )	\$197
Tax effect	428	360	(75 )
Net-of-tax amount	(1,156)	(588 )	122
Unrealized loss on cash flow hedges	(827 )	(1,683)	(3,276)
Tax effect	222	639	1,248
Net-of-tax amount	(605 )	(1,044)	(2,028)
Accumulated other comprehensive loss	\$(1,761)	\$(1,632)	\$(1,906)

**17. Derivatives**

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

The Company currently holds derivative instruments that contain credit-risk related features that are in a net liability position, which *may* require that collateral be assigned to dealer banks. At *June 30, 2018* and *2017*, the Company had posted cash collateral totaling \$800 thousand and \$1.7 million, respectively, with dealer banks related to derivative instruments in a net liability position.

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

*Risk Management Policies—Derivative Instruments*

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

*Interest Rate Risk Management—Cash Flow Hedging Instruments*

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

Table of Contents

Information pertaining to outstanding interest rate caps and swap agreements used to hedge junior subordinated debt and FHLBB advances is as follows:

June 30, 2018

Notional Amount	Inception Date	Termination Date	Index	Receive Rate	Pay Rate	Strike Rate	Unrealized Loss	Fair Value	Balance Sheet Location
(Dollars in thousands)									
<i>Interest rate swaps on FHLB advances:</i>									
\$5,000	July 2013	July 2033	3 Mo. LIBOR	2.05 %	3.38%	n/a	\$ (293 )	\$(293 )	Other Liabilities
5,000	July 2013	July 2028	3 Mo. LIBOR	2.05 %	3.23%	n/a	(154 )	(154 )	Other Liabilities
5,000	July 2013	July 2023	3 Mo. LIBOR	2.05 %	2.77%	n/a	15	15	Other Assets
<i>Forward-starting interest rate swaps on Trust Preferred Securities:</i>									
6,000	February 2018	September 2029	3 Mo. LIBOR	5.14 %	5.88%	n/a	(81 )	(81 )	Other Liabilities
10,000	February 2018	February 2030	3 Mo. LIBOR	4.23 %	4.98%	n/a	(140 )	(140 )	Other Liabilities
<i>Interest rate caps:</i>									
6,000	October 2014	September 2019	3 Mo. LIBOR	n/a	n/a	2.50 %	(91 )	15	Other Assets
10,000	March 2015	February 2020	3 Mo. LIBOR	n/a	n/a	2.50 %	(83 )	49	Other Assets
\$47,000							\$ (827 )	\$(589 )	

June 30, 2017

Notional Amount	Inception Date	Termination Date	Index	Receive Rate	Pay Rate	Strike Rate	Unrealized Loss	Fair Value	Balance Sheet Location
(Dollars in thousands)									
<i>Interest rate swaps on FHLB advances:</i>									
\$5,000	July 2013	July 2033	3 Mo. LIBOR	1.30 %	3.38%	n/a	\$ (666 )	\$(666 )	Other Liabilities
5,000	July 2013	July 2028	3 Mo. LIBOR	1.30 %	3.23%	n/a	(471 )	(471 )	Other Liabilities
5,000	July 2013	July 2023	3 Mo. LIBOR	1.30 %	2.77%	n/a	(218 )	(218 )	Other Liabilities
<i>Interest rate caps:</i>									
6,000	October 2014	September 2019	3 Mo. LIBOR	n/a	n/a	2.50 %	(142 )	4	Other Assets
10,000	March 2015	February 2020	3 Mo. LIBOR	n/a	n/a	2.50 %	(186 )	14	Other Assets
\$31,000							\$ (1,683 )	\$(1,337 )	

During the years ended *June 30, 2018, 2017* and *2016*, *no* interest rate cap or swap agreements were terminated prior to maturity. Changes in the fair value of interest rate caps and swaps designated as hedging instruments of the variability of cash flows associated with variable rate debt are reported in other comprehensive income. These amounts subsequently are reclassified into interest expense as a yield adjustment in the same period in which the related interest on the debt affects earnings. Risk management results for the years ended *June 30, 2018, 2017* and *2016* related to the balance sheet hedging of variable rate debt indicates that the hedges were effective.

Amounts recognized in income related to amounts excluded from effectiveness testing resulted from amortization of the acquisition price of interest rate caps. For the years ended *June 30, 2018* and *2017*, amounts recognized in income related to the amortization of the interest rate caps. The table below presents amounts recognized in income related to interest rate cap amortization, hedge ineffectiveness and amounts excluded from effectiveness testing.

	Years Ended June 30, 2018 2017 2016 (Dollars in thousands)		
Interest income (expense):			
Interest rate caps	\$(106)	\$(43)	\$ 3
Interest rate swap	-	-	-
Total	\$(106)	\$(43)	\$ 3

The Company does *not* expect to record interest income or interest expense related to interest rate swap or interest rate cap ineffectiveness in the next *twelve* months.

## **18. Fair Value Measurements**

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



Table of Contents

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

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

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

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

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

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

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

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

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



government sponsored enterprise mortgage-backed securities, as well as certain preferred and trust preferred stocks. Level 3 securities are securities for which significant unobservable inputs are utilized.

Certain investments are measured at fair value using the net asset value per share as a practical expedient. These investments include a fund that seeks to invest in securities either issued or guaranteed by the U.S. government or its agencies, as well as a fund that primarily invests in the federally guaranteed portion of SBA 7(a) loans. The Company's investment in securities either issued or guaranteed by the U.S. government or its agencies can be redeemed daily at the closing net asset value per share. The Company's investment in SBA 7(a) loans can be redeemed quarterly with *sixty days'* notice. In accordance with ASU 2015-07, these investments have *not* been included in the fair value hierarchy.

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

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

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

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

Table of Contents

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

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

*Fair Value of other Financial Instruments:*

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

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

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

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

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

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

*FHLBB advances, capital lease obligations and subordinated debentures* - The fair value of the Company's borrowings with the FHLBB is estimated by discounting the cash flows through maturity or the next re-pricing date based on current rates available to the Company for borrowings with similar maturities. The fair value of the Company's capital lease obligations and subordinated debentures are estimated by discounting the cash flows through maturity based on current rates available to the Company for borrowings with similar maturities.

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

Table of Contents

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

	June 30, 2018			
	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)			
<u>Assets</u>				
Securities available-for-sale:				
U.S. Government agency securities	\$56,887	\$ -	\$56,887	\$ -
Agency mortgage-backed securities	24,181	-	24,181	-
Other investments measured at net asset value <sup>(1)</sup>	6,619	-	-	-
Other assets – interest rate caps	64	-	64	-
Other assets – interest rate swaps	15	-	15	-
<u>Liabilities</u>				
Other liabilities – interest rate swaps	\$668	\$ -	\$668	\$ -

	June 30, 2017			
	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)			
<u>Assets</u>				
Securities available-for-sale:				
U.S. Government agency securities	\$57,168	\$ -	\$57,168	\$ -
Agency mortgage-backed securities	32,903	-	32,903	-
Other investments measured at net asset value <sup>(1)</sup>	6,622	-	-	-
Other assets – interest rate caps	18	-	18	-
<u>Liabilities</u>				
Other liabilities – interest rate swap	\$1,355	\$ -	\$1,355	\$ -

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

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

	June 30, 2018		
Total	Level 1	Level 2	Level 3

	(Dollars in thousands)			
Collateral dependent impaired loans	\$1,917	\$ -	\$ -	\$1,917
Real estate owned and other repossessed collateral	2,233	-	-	2,233
Loan servicing rights	2,970	-	-	2,970

	June 30, 2017			
	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)			
Collateral dependent impaired loans	\$1,011	\$ -	\$ -	\$1,011
Real estate owned and other repossessed collateral	826	-	-	826
Loan servicing rights	2,846	-	-	2,846

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

	Fair Value		
	June 30, 2018	June 30, 2017	Valuation Technique
	(Dollars in thousands)		
Collateral dependent impaired loans	\$1,917	\$1,011	Appraisal of collateral <sup>(1)</sup>
Real estate owned and other repossessed collateral	2,233	826	Appraisal of collateral <sup>(1)</sup>
Loan servicing rights	2,970	2,846	Discounted cash flow <sup>(2)</sup>

(1) Fair value is generally determined through independent appraisals of the underlying collateral. The Company *may* also use another available source of collateral assessment to determine a reasonable estimate of the fair value of the collateral. Appraisals *may* be adjusted by management for qualitative factors such as economic factors and estimated liquidation expenses. The range of these possible adjustments was 20% to 100%.

(2) Fair value is determined using a discounted cash flow model. The unobservable inputs include anticipated rate of loan prepayments and discount rates. The range of prepayment assumptions used was 7.9% to 14.5%. For discount rates, the range was 7.3% to 16.0%.

Table of Contents

The table below summarizes the total gains (losses) on assets measured at fair value on a non-recurring basis for the years ended *June 30, 2018* and *2017* and *2016*.

	Years Ended June 30,		
	2018	2017	2016
	(Dollars in thousands)		
Collateral dependent impaired loans	\$(519)	\$(294)	\$(129)
Real estate owned and other repossessed collateral	(96 )	87	(243)
Loan servicing rights	(31 )	(220)	(463)
Total	\$(646)	\$(427)	\$(835)

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

	Carrying Amount	Fair Value Measurements at June 30, 2018			
	Total	Level 1	Level 2	Level 3	
	(Dollars in thousands)				
<u>Financial assets:</u>					
Cash and cash equivalents	\$157,402	\$157,402	\$157,402	\$-	\$-
Available-for-sale securities	81,068	81,068	-	81,068	-
Other investments measured at net asset value <sup>(1)</sup>	6,619	6,619	-	-	-
Federal Home Loan Bank stock	1,652	1,652	-	1,652	-
Loans held for sale	7,155	7,155	-	7,155	-
Loans, net	866,995	868,730	-	-	868,730
Accrued interest receivable	2,528	2,528	-	2,528	-
Interest rate caps	64	64	-	64	-
Interest rate swaps	15	15	-	15	-
<u>Financial liabilities:</u>					
Deposits	954,940	953,216	-	953,216	-
Federal Home Loan Bank advances	15,000	15,000	-	15,000	-
Capital lease obligation	605	619	-	619	-
Subordinated debt	23,958	25,961	-	-	25,961
Interest rate swaps	668	668	-	668	-

	Carrying Amount	Fair Value Measurements at June 30, 2017			
	Total	Level 1	Level 2	Level 3	
	(Dollars in thousands)				
<u>Financial assets:</u>					
Cash and cash equivalents	\$163,283	\$163,283	\$163,283	-	\$-
Available-for-sale securities	90,071	90,071	-	90,071	-

Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-K

Other investments measured at net asset value <sup>(1)</sup>	6,622	6,622	-	-	-
Federal Home Loan Bank stock	1,938	1,938	-	1,938	-
Loans held for sale	4,699	4,699	-	4,699	-
Loans, net	775,530	776,579	-	-	776,579
Accrued interest receivable	2,111	2,111	-	2,111	-
Interest rate caps	18	18	-	18	-

Financial liabilities:

Deposits	889,850	889,877	-	889,877	-
Federal Home Loan Bank advances	20,011	20,057	-	20,057	-
Capital lease obligation	873	918	-	918	-
Subordinated debt	23,620	25,677	-	-	25,677
Interest rate swaps	1,355	1,355	-	1,355	-

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

Table of Contents**19. Condensed Parent Information**

Condensed financial information for Northeast Bancorp follows:

	June 30, 2018	June 30, 2017
	(Dollars in thousands)	
<u>Balance Sheets</u>		
Assets:		
Cash	\$6,658	\$8,165
Investment in subsidiary	156,764	138,920
Investment in common securities of affiliated trusts	496	496
Other assets	618	193
Total assets	\$164,536	\$147,774
Liabilities and Shareholders' Equity:		
Subordinated debt	\$23,958	\$23,620
Other liabilities	2,148	1,357
Total liabilities	26,106	24,977
Shareholders' equity	138,430	122,797
Total liabilities and shareholders' equity	\$164,536	\$147,774

	Years Ended June 30,		
	2018	2017	2016
	(Dollars in thousands)		
<u>Statements of Income</u>			
Income:			
Other income	\$446	\$563	\$62
Expenses:			
Interest expense	2,102	1,888	651
Noninterest expense	1,221	1,324	954
Total expense	3,323	3,212	1,605
Loss before income tax benefit and equity in undistributed net income of subsidiary	(2,877)	(2,649)	(1,543)
Income tax benefit	(1,408)	(1,548)	(579)
Loss before equity in undistributed net income of subsidiary	(1,469)	(1,101)	(964)
Equity in undistributed net income of subsidiary	17,635	13,440	8,583
Net income	\$16,166	\$12,339	\$7,619





Table of Contents

	Years Ended June 30,		
	2018	2017	2016
	(Dollars in thousands)		
<u>Statements of Cash Flows</u>			
Operating activities:			
Net income	\$16,166	\$12,339	\$7,619
Adjustments to reconcile net income to net cash (used in) provided by operating activities:			
Amortization of fair value adjustment for borrowings	338	289	193
Stock-based compensation	870	945	613
Undistributed earnings of subsidiary	(17,635)	(13,440)	(8,583)
(Decrease) increase in other assets and liabilities	311	(1,144)	673
Net cash (used in) provided by operating activities	50	(1,011)	515
Investing activities:			
Increase in investment of bank subsidiary	-	-	-
Net cash used in investing activities	-	-	-
Financing activities:			
Capital contribution	-	(8,000)	-
Issuance of subordinated debt, net of debt issuance costs	-	-	14,512
Repurchases for tax withholdings on restricted common stock	(109)	8	(11)
Stock options exercised, net	(1,093)	(60)	-
Repurchase of common stock	-	(6,943)	(3,359)
Dividends paid to shareholders	(355)	(357)	(380)
Net cash (used in) provided by financing activities	(1,557)	(15,352)	10,762
Net (decrease) increase in cash	(1,507)	(16,363)	11,277
Cash, beginning of year	8,165	24,528	13,251
Cash, end of year	\$6,658	\$8,165	\$24,528

**20. Quarterly Results of Operations (Unaudited)**

	2018			
	First	Second	Third	Fourth
(Dollars in thousands, except share data)	Quarter	Quarter	Quarter	Quarter
Interest and dividend income	\$16,178	\$15,260	\$16,483	\$17,972
Interest expense	2,867	2,803	3,349	3,564
Net interest income	13,311	12,457	13,134	14,408
Provision for loan losses	354	437	364	254

Edgar Filing: NORTHEAST BANCORP /ME/ - Form 10-K

Net interest income after provision for loan losses	<i>12,957</i>	<i>12,020</i>	<i>12,770</i>	<i>14,154</i>
Non-interest income	<i>1,958</i>	<i>1,228</i>	<i>1,882</i>	<i>1,959</i>
Non-interest expense	<i>8,714</i>	<i>8,563</i>	<i>8,975</i>	<i>9,478</i>
Income before income tax expense	<i>6,201</i>	<i>4,685</i>	<i>5,677</i>	<i>6,635</i>
Income tax expense	<i>1,615</i>	<i>1,381</i>	<i>1,745</i>	<i>2,291</i>
Net income	<i>\$4,586</i>	<i>\$3,304</i>	<i>\$3,932</i>	<i>\$4,344</i>
Basic earnings per share	<i>\$0.52</i>	<i>\$0.37</i>	<i>\$0.44</i>	<i>\$0.49</i>
Diluted earnings per share	<i>\$0.50</i>	<i>\$0.36</i>	<i>\$0.43</i>	<i>\$0.48</i>

Table of Contents

	<b>2017</b>			
	<b>First</b>	<b>Second</b>	<b>Third</b>	<b>Fourth</b>
<b>(Dollars in thousands, except share data)</b>	<b>Quarter</b>	<b>Quarter</b>	<b>Quarter</b>	<b>Quarter</b>
Interest and dividend income	\$12,257	\$14,332	\$14,960	\$16,371
Interest expense	2,482	2,499	2,501	2,614
Net interest income	9,775	11,833	12,459	13,757
Provision for loan losses	193	628	384	389
Net interest income after provision for loan losses	9,582	11,205	12,075	13,368
Non-interest income	1,808	2,690	2,308	2,890
Non-interest expense	8,626	8,956	8,842	9,364
Income before income tax expense	2,764	4,939	5,541	6,894
Income tax expense	1,013	1,839	2,080	2,867
Net income	\$1,751	\$3,100	\$3,461	\$4,027
Basic earnings per share	\$0.19	\$0.35	\$0.39	\$0.46
Diluted earnings per share	\$0.19	\$0.35	\$0.39	\$0.45

	<b>2016</b>			
	<b>First</b>	<b>Second</b>	<b>Third</b>	<b>Fourth</b>
<b>(Dollars in thousands, except share data)</b>	<b>Quarter</b>	<b>Quarter</b>	<b>Quarter</b>	<b>Quarter</b>
Interest and dividend income	\$11,113	\$12,035	\$11,259	\$12,828
Interest expense	1,872	1,863	2,005	2,115
Net interest income	9,241	10,172	9,254	10,713
Provision for loan losses	169	896	236	317
Net interest income after provision for loan losses	9,072	9,276	9,018	10,396
Non-interest income	1,705	1,624	2,035	2,411
Non-interest expense	7,810	8,196	8,412	9,396
Income before income tax expense	2,967	2,704	2,641	3,411
Income tax expense	1,100	960	832	1,212
Net income	\$1,867	\$1,744	\$1,809	\$2,199
Basic earnings per share	\$0.20	\$0.18	\$0.19	\$0.24
Diluted earnings per share	\$0.20	\$0.18	\$0.19	\$0.24

Table of Contents

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None

**Item 9A. Controls and Procedures**

*Evaluation of Disclosure Controls and Procedures*

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of its disclosure controls and procedures, as defined in Exchange Act Rules 13a-15(e) and 15d-15(e). Based upon the evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that as of June 30, 2018, the Company's disclosure controls and procedures are effective. Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be disclosed in the Company's reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. In addition, no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) occurred during the fourth quarter of our fiscal year ended June 30, 2018 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

An evaluation was performed under the supervision and with the participation of the Company's management, including its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our internal controls and procedures over financial reporting (as defined in Rule 13a-15(e) of the Exchange Act) as of the end of the period covered by this annual report.

*Management Report on Internal Control over Financial Reporting*

Management is responsible for establishing and maintaining adequate internal controls over financial reporting. The standard measures adopted by management in making its evaluation are the measures in *Interest Control—Integrated Framework (2013)* published by the Committee of Sponsoring Organizations of the Treadway Commission. We do not expect that our disclosure controls and procedures will prevent all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objective will be met. Further, the design of a control system must reflect the fact that there are resource constraints,

and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues, errors, and instances of fraud, if any, within the Company have been or will be detected. The inherent limitations include, among other things, the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Controls and procedures also can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management or employee override of the controls and procedures. The design of any system of controls and procedures is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls and procedures may become inadequate because of changes in conditions or deterioration in the degree of compliance with its policies or procedures. Because of the inherent limitation in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Based on their evaluation of disclosure controls and procedures, our Chief Executive Officer and Chief Financial Officer concluded, subject to the limitations described above, that our internal controls and procedures over financial reporting as of the end of the period covered by this report were effective and that there were no material weaknesses.

Table of Contents

Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors of

Northeast Bancorp

**Opinion on the Internal Control Over Financial Reporting**

We have audited Northeast Bancorp and subsidiary's (the "Company") internal control over financial reporting as of June 30, 2018, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013. In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of June 30, 2018, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets as of June 30, 2018 and 2017, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for each of the three years in the period ended June 30, 2018, and the related notes to the consolidated financial statements of the Company and our report dated September 13, 2018 expressed an unqualified opinion.

**Basis for Opinion**

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting in the accompanying "Management Report on Internal Control over Financial Reporting." Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating

effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

### **Definition and Limitations of Internal Control Over Financial Reporting**

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ RSM US LLP

Boston, Massachusetts

September 13, 2018



Table of Contents

*Changes in Internal Control over Financial Reporting*

There have been no significant changes in our internal controls, or in other factors that could significantly affect our internal controls, subsequent to the date the Chief Executive Officer and Chief Financial Officer completed their evaluation, including any corrective actions with regard to significant deficiencies or material weaknesses.

**Item 9B. Other Information.**

None.

**PART III**

**Item 10. Directors, Executive Officers and Corporate Governance.**

The information required by Item 10 shall be included in the Proxy Statement and is incorporated herein by reference.

**Item 11. Executive Compensation**

The information required by Item 11 shall be included in the Proxy Statement and is incorporated herein by reference.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters**

The information required by Item 12 shall be included in the Proxy Statement and is incorporated herein by reference.

**Item 13. Certain Relationships and Related Transactions, and Director Independence**

The information required by Item 13 shall be included in the Proxy Statement and is incorporated herein by reference.

**Item 14. Principal Accounting Fees and Services**

The information required by Item 14 shall be included in the Proxy Statement and is incorporated herein by reference.

97

---

Table of Contents

**PART IV**

**Item 15. Exhibits, Financial Statement Schedules**

(a) Financial Statements and Financial Statement Schedules

Consolidated Balance Sheets as of June 30, 2018 and 2017

Consolidated Statements of Income for the years ended June 30, 2018, 2017, and 2016

Consolidated Statements of Comprehensive Income for the years ended June 30, 2018, 2017, and 2016

Consolidated Statements of Changes in Shareholders' Equity for the years ended June 30, 2018, 2017, and 2016

Consolidated Statements of Cash Flows for the years ended June 30, 2018, 2017, and 2016

Notes to Consolidated Financial Statements

(b) Exhibits

- 3.1 Amended and Restated Articles of Incorporation of Northeast Bancorp (incorporated by reference to Exhibit 3.1 of Northeast Bancorp's Current Report on Form 8-K filed on January 5, 2011).
- 3.2 Articles of Amendment to the Amended and Restated Articles of Incorporation of Northeast Bancorp (incorporated by reference to Exhibit 3.1 of Northeast Bancorp's Current Report on Form 8-K filed on March 22, 2011).
- 3.3 Articles of Amendment to the Amended and Restated Articles of Incorporation of Northeast Bancorp (incorporated by reference to Exhibit 3.1 of Northeast Bancorp's Current Report on Form 8-K filed on November 29, 2012).
- 3.4

- Amended and Restated Bylaws of Northeast Bancorp (incorporated by reference to Exhibit 3.2 of Northeast Bancorp's Current Report on Form 8-K filed on January 5, 2011).
- 4.1 Registration Rights Schedule to the Agreement and Plan of Merger, dated as of March 30, 2010, by and between Northeast Bancorp and FHB Formation LLC (incorporated by reference to Amendment No. 1 on Form 10-K/A of Northeast Bancorp filed on March 19, 2012).
- 4.2 Form of 6.75% Fixed-to-Floating Subordinated Note due 2026 (incorporated by reference to Exhibit 4.1 of Northeast Bancorp's Current Report on Form 8-K filed on June 29, 2016).
- 10.1+ Northeast Bancorp Amended and Restated 2010 Stock Option and Incentive Plan (incorporated by reference to Exhibit 10.1 of Northeast Bancorp's Form 10-K filed on September 13, 2017).
- 10.2a+ Form of Restricted Stock Award Agreement under the Northeast Bancorp Amended and Restated 2010 Stock Option and Incentive Plan (issued on or after May 25, 2017) (incorporated by reference to Exhibit 10.2a of Northeast Bancorp's Form 10-K filed on September 13, 2017).
- 10.2b+ Form of Restricted Stock Award Agreement under the Northeast Bancorp Amended and Restated 2010 Stock Option and Incentive Plan (issued before May 25, 2017) (incorporated by reference to Exhibit 10.2b of Northeast Bancorp's Form 10-K filed on September 13, 2017).
- 10.3+ Form of Non-Qualified Stock Option Agreement for Company Employees under the Northeast Bancorp Amended and Restated 2010 Stock Option and Incentive Plan (incorporated by reference to Exhibit 10.3 of Northeast Bancorp's Form 10-K filed on September 13, 2017).
- 10.4+ Non-Qualified Time-Based Stock Option Agreement, dated December 29, 2010, by and between Northeast Bancorp and Richard Wayne (incorporated by reference to Exhibit 10.5 of Northeast Bancorp's Current Report on Form 8-K filed on January 5, 2011).
- 10.5+ Non-Qualified Performance-Based Stock Option Agreement, dated March 22, 2013, by and between Northeast Bancorp and Richard Wayne (incorporated by reference to Exhibit 10.1 of Northeast Bancorp's Current Report on Form 8-K filed on March 26, 2013).
- 10.6+ Non-Qualified Stock Option Agreement, dated December 30, 2010, by and between Northeast Bancorp and Robert Glauber (incorporated by reference to Exhibit 10.11 of Northeast Bancorp's Current Report on Form 8-K filed on January 5, 2011).
- 10.7+ Amended and Restated Performance-Based Stock Appreciation Rights Agreement, dated March 24, 2011, by and between Northeast Bancorp and Matthew Botein (incorporated by reference to Exhibit 10.1 of Northeast Bancorp's Current Report on Form 8-K filed on March 30, 2011).
- 10.8+ Non-Qualified Time-Based Stock Option Agreement, dated March 24, 2011, by and between Northeast Bancorp and Matthew Botein (incorporated by reference to Exhibit 10.2 of Northeast Bancorp's Current Report on Form 8-K filed on March 30, 2011).

Table of Contents

10.9+	<u>Non-Qualified Performance-Based Stock Option Agreement, dated March 24, 2011, by and between Northeast Bancorp and Matthew Botein (incorporated by reference to Exhibit 10.3 of Northeast Bancorp's Current Report on Form 8-K filed on March 30, 2011).</u>
10.10+	<u>Form of Indemnification Agreement, dated as of December 29, 2010, by and between Northeast Bancorp and each of the members of the Board (incorporated by reference to Exhibit 10.1 of Northeast Bancorp's Current Report on Form 8-K filed on January 5, 2011).</u>
10.11+	<u>Employment Agreement, dated December 30, 2010, by and between Northeast Bancorp and Richard Wayne (incorporated by reference to Exhibit 10.2 of Northeast Bancorp's Current Report on Form 8-K filed on January 5, 2011).</u>
10.12	<u>Subordinated Note Purchase Agreement, dated June 29, 2016, by and among Northeast Bancorp and the Purchasers identified therein (incorporated by reference to Exhibit 10.1 of Northeast Bancorp's Current Report on Form 8-K filed on June 29, 2016).</u>
21	<u>Subsidiaries of Northeast Bancorp</u>
23.1	<u>Consent of RSM US LLP</u>
31.1	<u>Rule 13a-14(a)/15d-14(a) Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*</u>
31.2	<u>Rule 13a-14(a)/15d-14(a) Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*</u>
32.1	<u>Rule 13a-14(b) Certifications of the Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**</u>
101.INS	XBRL Instance Document*
101.SCH	XBRL Taxonomy Extension Schema Document*
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document*
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document*
101.LAB	XBRL Taxonomy Extension Label Linkbase Document*
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document*

\* Filed herewith

\*\*Furnished herewith

+Management contract or compensatory plan or agreement

**Item 15. Form 10-K Summary**

None.



Table of Contents

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

## NORTHEAST BANCORP

Date: September 13, 2018 By: /s/ RICHARD WAYNE  
**Richard Wayne**  
**Chief Executive Officer**

**(Principal Executive Officer)**

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<b>Signature</b>	<b>Title</b>	<b>Date</b>
/s/ RICHARD WAYNE <b>Richard Wayne</b>	Chief Executive Officer and Director (Principal Executive Officer)	September 13, 2018
/s/ JEAN-PIERRE LAPOINTE <b>Jean-Pierre Lapointe</b>	Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)	September 13, 2018
/s/ ROBERT GLAUBER <b>Robert Glauber</b>	Chairman of the Board	September 13, 2018
/s/ MATTHEW BOTEIN <b>Matthew Botein</b>	Director	September 13, 2018
/s/ CHERYL DORSEY <b>Cheryl Dorsey</b>	Director	September 13, 2018
/s/ JOHN C. ORESTIS <b>John C. Orestis</b>	Director	September 13, 2018
/s/ DAVID TANNER <b>David Tanner</b>	Director	September 13, 2018
/s/ JUDITH E. WALLINGFORD <b>Judith E. Wallingford</b>	Director	September 13, 2018

