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

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

## FORM 10-Q

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

Commission File Number 0-26589

### THE FIRST BANCORP, INC.

(Exact name of Registrant as specified in its charter)

MAINE

01-0404322

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

MAIN STREET, DAMARISCOTTA, MAINE 04543

(Address of principal executive offices) (Zip code)

(207) 563-3195

Registrant's telephone number, including area code

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

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

Large accelerated filer  Accelerated filer  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**

Indicate the number of shares outstanding of each of the registrant's classes of common stock as of November 1, 2018

**Common Stock: 10,860,334 shares**

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**Part I. Financial Information****Selected Financial Data (Unaudited)**

The First Bancorp, Inc. and Subsidiary

|   | As of and for the nine<br>months ended<br>September 30, |             | As of and for the<br>quarter ended<br>September 30, |             |   |
|---|---|-------------|---|-------------|---|
|   | 2018  | 2017        | 2018  | 2017        |   |
| <i>Dollars in thousands,</i>                            |   |             |   |             |   |
| <i>except for per share amounts</i>                     |   |             |   |             |   |
| <b><i>Summary of Operations</i></b>                     |   |             |   |             |   |
| Interest Income   | <b>\$51,742</b>   | \$45,010    | <b>\$18,086</b>                                     | \$15,517    |   |
| Interest Expense  | <b>14,528</b>   | 9,915       | <b>5,550</b>  | 3,563       |   |
| Net Interest Income                                     | <b>37,214</b>   | 35,095      | <b>12,536</b>                                       | 11,954      |   |
| Provision for Loan Losses                               | <b>1,333</b>  | 1,750       | <b>333</b>  | 750         |   |
| Non-Interest Income                                     | <b>9,347</b>  | 9,338       | <b>3,034</b>  | 3,493       |   |
| Non-Interest Expense                                    | <b>24,971</b>   | 23,351      | <b>8,216</b>  | 8,013       |   |
| Net Income  | <b>17,173</b>   | 14,502      | <b>5,933</b>  | 4,982       |   |
| <b><i>Per Common Share Data</i></b>                     |   |             |   |             |   |
| Basic Earnings per Share                                | <b>\$1.59</b>   | \$1.35      | <b>\$0.55</b>                                       | \$0.46      |   |
| Diluted Earnings per Share                              | <b>1.58</b>   | 1.34        | <b>0.55</b>   | 0.46        |   |
| Cash Dividends Declared                                 | <b>0.82</b>   | 0.71        | <b>0.29</b>   | 0.24        |   |
| Book Value per Common Share                             | <b>17.01</b>  | 16.62       | <b>17.01</b>  | 16.62       |   |
| Tangible Book Value per Common Share <sup>2</sup>       | <b>14.25</b>  | 13.84       | <b>14.25</b>  | 13.84       |   |
| Market Value  | <b>28.97</b>  | 30.31       | <b>28.97</b>  | 30.31       |   |
| <b><i>Financial Ratios</i></b>                          |   |             |   |             |   |
| Return on Average Equity <sup>1</sup>                   | <b>12.47</b>  | % 10.86     | <b>%12.63</b>                                       | % 10.91     | % |
| Return on Average Tangible Common Equity <sup>1,2</sup> | <b>14.90</b>  | % 13.06     | <b>%15.05</b>                                       | % 13.08     | % |
| Return on Average Assets <sup>1</sup>                   | <b>1.21</b>   | % 1.09      | <b>%1.21</b>  | % 1.09      | % |
| Average Equity to Average Assets                        | <b>9.72</b>   | % 10.03     | <b>%9.59</b>  | % 10.02     | % |
| Average Tangible Equity to Average Assets <sup>2</sup>  | <b>8.14</b>   | % 8.35      | <b>%8.05</b>  | % 8.36      | % |
| Net Interest Margin Tax-Equivalent <sup>1,2</sup>       | <b>2.90</b>   | % 3.03      | <b>%2.83</b>  | % 3.02      | % |
| Dividend Payout Ratio                                   | <b>51.57</b>  | % 52.59     | <b>%52.73</b>                                       | % 52.17     | % |
| Allowance for Loan Losses/Total Loans                   | <b>0.94</b>   | % 0.98      | <b>%0.94</b>  | % 0.98      | % |
| Non-Performing Loans to Total Loans                     | <b>1.14</b>   | % 1.46      | <b>%1.14</b>  | % 1.46      | % |
| Non-Performing Assets to Total Assets                   | <b>0.74</b>   | % 0.94      | <b>%0.74</b>  | % 0.94      | % |
| Efficiency Ratio <sup>2</sup>                           | <b>51.86</b>  | % 49.51     | <b>%50.82</b>                                       | % 49.88     | % |
| <b><i>At Period End</i></b>                             |   |             |   |             |   |
| Total Assets  | <b>\$1,981,854</b>                                      | \$1,781,701 | <b>\$1,981,854</b>                                  | \$1,781,701 |   |
| Total Loans   | <b>1,243,558</b>  | 1,121,086   | <b>1,243,558</b>                                    | 1,121,086   |   |
| Total Investment Securities                             | <b>574,425</b>  | 552,476     | <b>574,425</b>                                      | 552,476     |   |
| Total Deposits  | <b>1,514,911</b>  | 1,350,049   | <b>1,514,911</b>                                    | 1,350,049   |   |
| Total Shareholders' Equity                              | <b>184,661</b>  | 179,882     | <b>184,661</b>                                      | 179,882     |   |

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

**Item 1 – Financial Statements**

***Report of Independent Registered Public Accounting Firm***

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

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

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

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

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

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**Consolidated Balance Sheets (Unaudited)**

The First Bancorp, Inc. and Subsidiary

|   | <b>September 30,<br/>2018</b> | December 31,<br>2017 | September 30,<br>2017 |
|---|-------------------------------|----------------------|-----------------------|
| <b><u>Assets</u></b>  |                               |                      |                       |
| Cash and cash equivalents   | <b>\$ 21,649,000</b>          | \$ 19,207,000        | \$ 22,375,000         |
| Interest bearing deposits in other banks  | <b>51,045,000</b>             | 860,000              | 584,000               |
| Securities available for sale   | <b>305,444,000</b>            | 300,172,000          | 298,999,000           |
| Securities to be held to maturity (fair value of \$249,890,000 at September 30, 2018, \$259,655,000 at December 31, 2017 and \$245,021,000 at September 30, 2017) | <b>257,395,000</b>            | 256,567,000          | 242,679,000           |
| Restricted equity securities, at cost   | <b>11,586,000</b>             | 10,358,000           | 10,798,000            |
| Loans held for sale   | <b>1,134,000</b>              | 386,000              | 434,000               |
| Loans   | <b>1,243,558,000</b>          | 1,164,139,000        | 1,121,086,000         |
| Less allowance for loan losses  | <b>11,682,000</b>             | 10,729,000           | 11,012,000            |
| Net loans   | <b>1,231,876,000</b>          | 1,153,410,000        | 1,110,074,000         |
| Accrued interest receivable   | <b>7,095,000</b>              | 5,867,000            | 5,820,000             |
| Premises and equipment, net   | <b>21,451,000</b>             | 22,502,000           | 21,731,000            |
| Other real estate owned   | <b>584,000</b>                | 1,012,000            | 320,000               |
| Goodwill  | <b>29,805,000</b>             | 29,805,000           | 29,805,000            |
| Other assets  | <b>42,790,000</b>             | 42,784,000           | 38,082,000            |
| <b>Total assets</b>   | <b>\$ 1,981,854,000</b>       | \$ 1,842,930,000     | \$ 1,781,701,000      |
| <b><u>Liabilities</u></b>   |                               |                      |                       |
| Demand deposits   | <b>\$ 170,728,000</b>         | \$ 145,332,000       | \$ 158,797,000        |
| NOW deposits  | <b>357,834,000</b>            | 318,043,000          | 325,695,000           |
| Money market deposits   | <b>129,516,000</b>            | 163,898,000          | 134,257,000           |
| Savings deposits  | <b>237,424,000</b>            | 232,605,000          | 234,456,000           |
| Certificates of deposit   | <b>619,409,000</b>            | 559,001,000          | 496,844,000           |
| Total deposits  | <b>1,514,911,000</b>          | 1,418,879,000        | 1,350,049,000         |
| Borrowed funds – short term   | <b>200,160,000</b>            | 113,638,000          | 119,207,000           |
| Borrowed funds – long term  | <b>65,114,000</b>             | 115,120,000          | 115,121,000           |
| Other liabilities   | <b>17,008,000</b>             | 13,972,000           | 17,442,000            |
| <b>Total liabilities</b>  | <b>1,797,193,000</b>          | 1,661,609,000        | 1,601,819,000         |
| <b><u>Shareholders' equity</u></b>  |                               |                      |                       |
| Common stock, one cent par value per share  | <b>109,000</b>                | 108,000              | 108,000               |
| Additional paid-in capital  | <b>62,497,000</b>             | 61,747,000           | 61,446,000            |
| Retained earnings   | <b>129,247,000</b>            | 121,144,000          | 118,360,000           |
| Accumulated other comprehensive income (loss)   |                               |                      |                       |
| Net unrealized loss on securities available for sale  | <b>(9,133,000)</b>            | (2,901,000)          | (825,000)             |
| Net unrealized loss on securities transferred from available for sale to held to maturity   | <b>(194,000)</b>              | (174,000)            | (140,000)             |
| Net unrealized gain on cash flow hedging derivative instruments   | <b>2,282,000</b>              | 1,544,000            | 1,035,000             |
| Net unrealized loss on postretirement benefit costs   | <b>(147,000)</b>              | (147,000)            | (102,000)             |
| <b>Total shareholders' equity</b>   | <b>184,661,000</b>            | 181,321,000          | 179,882,000           |
| <b>Total liabilities &amp; shareholders' equity</b>   | <b>\$ 1,981,854,000</b>       | \$ 1,842,930,000     | \$ 1,781,701,000      |
| <b><u>Common Stock</u></b>  |                               |                      |                       |
| Number of shares authorized   | <b>18,000,000</b>             | 18,000,000           | 18,000,000            |
| Number of shares issued and outstanding   | <b>10,857,116</b>             | 10,829,918           | 10,824,724            |
| Book value per common share   | <b>\$ 17.01</b>               | \$ 16.74             | \$ 16.62              |
| Tangible book value per common share  | <b>\$ 14.25</b>               | \$ 13.97             | \$ 13.84              |

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



**Consolidated Statements of Income and Comprehensive Income (Unaudited)**

The First Bancorp, Inc. and Subsidiary

|   | <b>For the nine months ended</b> |              | <b>For the quarter ended</b> |              |
|---|----------------------------------|--------------|------------------------------|--------------|
|   | <b>September 30,</b>             |              | <b>September 30,</b>         |              |
|   | <b>2018</b>                      | 2017         | <b>2018</b>                  | 2017         |
| <b>Interest income</b>  |                                  |              |                              |              |
| Interest and fees on loans (includes tax-exempt income of \$822,000 as of September 30, 2018 and \$589,000 as of September 30, 2017)                | <b>\$39,164,000</b>              | \$33,415,000 | <b>\$13,735,000</b>          | \$11,648,000 |
| Interest on deposits with other banks   | <b>132,000</b>                   | 46,000       | <b>115,000</b>               | 23,000       |
| Interest and dividends on investments (includes tax-exempt income of \$5,208,000 as of September 30, 2018 and \$4,890,000 as of September 30, 2017) | <b>12,446,000</b>                | 11,549,000   | <b>4,236,000</b>             | 3,846,000    |
| Total interest income   | <b>51,742,000</b>                | 45,010,000   | <b>18,086,000</b>            | 15,517,000   |
| <b>Interest expense</b>   |                                  |              |                              |              |
| Interest on deposits  | <b>11,131,000</b>                | 6,769,000    | <b>4,274,000</b>             | 2,473,000    |
| Interest on borrowed funds  | <b>3,397,000</b>                 | 3,146,000    | <b>1,276,000</b>             | 1,090,000    |
| Total interest expense  | <b>14,528,000</b>                | 9,915,000    | <b>5,550,000</b>             | 3,563,000    |
| Net interest income   | <b>37,214,000</b>                | 35,095,000   | <b>12,536,000</b>            | 11,954,000   |
| Provision for loan losses   | <b>1,333,000</b>                 | 1,750,000    | <b>333,000</b>               | 750,000      |
| Net interest income after provision for loan losses   | <b>35,881,000</b>                | 33,345,000   | <b>12,203,000</b>            | 11,204,000   |
| <b>Non-interest income</b>  |                                  |              |                              |              |
| Investment management and fiduciary income  | <b>2,285,000</b>                 | 1,995,000    | <b>743,000</b>               | 655,000      |
| Service charges on deposit accounts   | <b>1,624,000</b>                 | 1,562,000    | <b>527,000</b>               | 511,000      |
| Net securities gains  | <b>137,000</b>                   | 471,000      | <b>1,000</b>                 | 468,000      |
| Mortgage origination and servicing income, net of amortization  | <b>1,042,000</b>                 | 1,260,000    | <b>350,000</b>               | 499,000      |
| Other operating income  | <b>4,259,000</b>                 | 4,050,000    | <b>1,413,000</b>             | 1,360,000    |
| Total non-interest income   | <b>9,347,000</b>                 | 9,338,000    | <b>3,034,000</b>             | 3,493,000    |
| <b>Non-interest expense</b>   |                                  |              |                              |              |
| Salaries and employee benefits  | <b>13,230,000</b>                | 12,110,000   | <b>4,460,000</b>             | 4,267,000    |
| Occupancy expense   | <b>1,871,000</b>                 | 1,816,000    | <b>574,000</b>               | 589,000      |
| Furniture and equipment expense   | <b>2,816,000</b>                 | 2,702,000    | <b>972,000</b>               | 942,000      |
| FDIC insurance premiums   | <b>950,000</b>                   | 762,000      | <b>337,000</b>               | 259,000      |
| Amortization of identified intangibles  | <b>32,000</b>                    | 32,000       | <b>10,000</b>                | 10,000       |
| Other operating expense   | <b>6,072,000</b>                 | 5,929,000    | <b>1,863,000</b>             | 1,946,000    |
| Total non-interest expense  | <b>24,971,000</b>                | 23,351,000   | <b>8,216,000</b>             | 8,013,000    |
| Income before income taxes  | <b>20,257,000</b>                | 19,332,000   | <b>7,021,000</b>             | 6,684,000    |
| Income tax expense  | <b>3,084,000</b>                 | 4,830,000    | <b>1,088,000</b>             | 1,702,000    |
| <b>NET INCOME</b>   | <b>\$17,173,000</b>              | \$14,502,000 | <b>\$5,933,000</b>           | \$4,982,000  |
| Basic earnings per common share   | <b>\$1.59</b>                    | \$1.35       | <b>\$0.55</b>                | \$0.46       |
| Diluted earnings per common share   | <b>\$1.58</b>                    | \$1.34       | <b>\$0.55</b>                | \$0.46       |
| <b>Other comprehensive income (loss) net of tax</b>   |                                  |              |                              |              |
| Net unrealized gain (loss) on securities available for sale   | <b>(6,232,000)</b>               | 110,000      | <b>(1,888,000)</b>           | (240,000)    |
| Net unrealized loss on securities transferred from available for sale to held to maturity, net of amortization                                      | <b>(20,000)</b>                  | (11,000)     | <b>(5,000)</b>               | (3,000)      |
| Net unrealized gain (loss) on cash flow hedging derivative instruments  | <b>738,000</b>                   | (128,000)    | <b>216,000</b>               | (20,000)     |
| Other comprehensive loss  | <b>(5,514,000)</b>               | (29,000)     | <b>(1,677,000)</b>           | (263,000)    |
| <b>Comprehensive income</b>   | <b>\$11,659,000</b>              | \$14,473,000 | <b>\$4,256,000</b>           | \$4,719,000  |

See Report of Independent Registered Public Accounting Firm.

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



**Consolidated Statements of Changes in Shareholders' Equity (Unaudited)**

The First Bancorp, Inc. and Subsidiary

|  | Common stock and<br>additional paid-in capital |                     | Retained<br>earnings | Accumulated<br>other<br>comprehensive<br>income (loss) | Total<br>shareholders'<br>equity |
|--|--|---------------------|----------------------|--|----------------------------------|
|  | Shares   | Amount              |                      |  |                                  |
| <b>Balance at December 31, 2016</b>  | <b>10,793,946</b>                              | <b>\$60,831,000</b> | <b>\$111,693,000</b> | <b>\$ (3,000)</b>                                      | <b>\$172,521,000</b>             |
| Net income   | —  | —                   | 14,502,000           | —  | 14,502,000                       |
| Net unrealized gain on securities available for sale, net of tax   | —  | —                   | —                    | 110,000  | 110,000                          |
| Net unrealized loss on cash flow hedging derivative instruments,<br>net of tax                           | —  | —                   | —                    | (128,000)  | (128,000)                        |
| Net unrealized loss on securities transferred from available for sale<br>to held to maturity, net of tax | —  | —                   | —                    | (11,000)   | (11,000)                         |
| Comprehensive income   | —  | —                   | 14,502,000           | (29,000)   | 14,473,000                       |
| Cash dividends declared (\$0.71 per share)   | —  | —                   | (7,682,000)          | —  | (7,682,000)                      |
| Equity compensation expense  | —  | 247,000             | —                    | —  | 247,000                          |
| Payment to repurchase common stock   | (5,560)  | —                   | (153,000)            | —  | (153,000)                        |
| Issuance of restricted stock   | 18,850   | —                   | —                    | —  | —                                |
| Proceeds from sale of common stock   | 17,488   | 476,000             | —                    | —  | 476,000                          |
| <b>Balance at September 30, 2017</b>   | <b>10,824,724</b>                              | <b>\$61,554,000</b> | <b>\$118,360,000</b> | <b>\$ (32,000)</b>                                     | <b>\$179,882,000</b>             |
| <b>Balance at December 31, 2017</b>  | <b>10,829,918</b>                              | <b>\$61,855,000</b> | <b>\$121,144,000</b> | <b>\$ (1,678,000)</b>                                  | <b>\$181,321,000</b>             |
| Net income   | —  | —                   | 17,173,000           | —  | 17,173,000                       |
| Net unrealized loss on securities available for sale, net of tax   | —  | —                   | —                    | (6,232,000)  | (6,232,000)                      |
| Net unrealized gain on cash flow hedging derivative instruments,<br>net of tax                           | —  | —                   | —                    | 738,000  | 738,000                          |
| Net unrealized loss on securities transferred from available for sale<br>to held to maturity, net of tax | —  | —                   | —                    | (20,000)   | (20,000)                         |
| Comprehensive income   | —  | —                   | 17,173,000           | (5,514,000)  | 11,659,000                       |
| Cash dividends declared (\$0.82 per share)   | —  | —                   | (8,902,000)          | —  | (8,902,000)                      |
| Equity compensation expense  | —  | 285,000             | —                    | —  | 285,000                          |
| Payment to repurchase common stock   | (5,725)  | —                   | (168,000)            | —  | (168,000)                        |
| Issuance of restricted stock   | 16,795   | —                   | —                    | —  | —                                |
| Proceeds from sale of common stock   | 16,128   | 466,000             | —                    | —  | 466,000                          |
| <b>Balance at September 30, 2018</b>   | <b>10,857,116</b>                              | <b>\$62,606,000</b> | <b>\$129,247,000</b> | <b>\$ (7,192,000)</b>                                  | <b>\$184,661,000</b>             |

See Report of Independent Registered Public Accounting Firm.

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

**Consolidated Statements of Cash Flows (Unaudited)**

The First Bancorp, Inc. and Subsidiary

|   | <b>For the nine months ended</b> |                      |
|---|----------------------------------|----------------------|
|   | <b>September 30,</b>             | <b>September 30,</b> |
|   | <b>2018</b>                      | <b>2017</b>          |
| <b>Cash flows from operating activities</b>   |                                  |                      |
| Net income  | <b>\$ 17,173,000</b>             | \$ 14,502,000        |
| <b>Adjustments to reconcile net income to net cash provided by operating activities</b> |                                  |                      |
| Depreciation  | <b>1,347,000</b>                 | 1,378,000            |
| Change in deferred taxes  | <b>(591,000)</b>                 | ) 98,000             |
| Provision for loan losses   | <b>1,333,000</b>                 | 1,750,000            |
| Loans originated for resale   | <b>(6,343,000)</b>               | ) (29,422,000 )      |
| Proceeds from sales and transfers of loans  | <b>5,895,000</b>                 | 30,323,000           |
| Net gain on sales of loans  | <b>(300,000)</b>                 | ) (553,000 )         |
| Net gain on sale or call of securities  | <b>(137,000)</b>                 | ) (471,000 )         |
| Net amortization of premiums on investments   | <b>1,556,000</b>                 | 2,651,000            |
| Net gain on sale of other real estate owned   | <b>(312,000)</b>                 | ) (74,000 )          |
| Provision for losses on other real estate owned   | <b>—</b>                         | 17,000               |
| Equity compensation expense   | <b>285,000</b>                   | 247,000              |
| Net increase in other assets and accrued interest                                       | <b>(289,000)</b>                 | ) (2,677,000 )       |
| Net increase in other liabilities   | <b>4,368,000</b>                 | 61,000               |
| Net loss on disposal of premises and equipment  | <b>137,000</b>                   | 7,000                |
| Amortization of investment in limited partnership                                       | <b>133,000</b>                   | 134,000              |
| Net acquisition amortization  | <b>32,000</b>                    | 32,000               |
| Net cash provided by operating activities   | <b>24,287,000</b>                | 18,003,000           |
| <b>Cash flows from investing activities</b>   |                                  |                      |
| Increase in interest-bearing deposits in other banks                                    | <b>(50,185,000)</b>              | ) (291,000 )         |
| Proceeds from sales of securities available for sale                                    | <b>459,000</b>                   | 15,587,000           |
| Proceeds from maturities, payments and calls of securities available for sale           | <b>40,515,000</b>                | 141,967,000          |
| Proceeds from maturities, payments and calls of securities to be held to maturity       | <b>10,171,000</b>                | 11,693,000           |
| Proceeds from sales of other real estate owned  | <b>904,000</b>                   | 336,000              |
| Purchases of securities available for sale  | <b>(55,591,000)</b>              | ) (158,330,000)      |
| Purchases of securities to be held to maturity  | <b>(10,987,000)</b>              | ) (27,379,000 )      |
| Redemption of restricted equity securities  | <b>—</b>                         | 1,132,000            |
| Purchase of restricted equity securities  | <b>(1,228,000)</b>               | ) —                  |
| Net increase in loans   | <b>(79,963,000)</b>              | ) (50,660,000 )      |
| Capital expenditures  | <b>(433,000)</b>                 | ) (914,000 )         |
| Net cash used by investing activities   | <b>(146,338,000)</b>             | ) (66,859,000 )      |
| <b>Cash flows from financing activities</b>   |                                  |                      |
| Net increase in demand, savings, and money market accounts                              | <b>35,624,000</b>                | 86,868,000           |
| Net increase in certificates of deposit   | <b>60,408,000</b>                | 20,224,000           |
| Net increase (decrease) in short-term borrowings  | <b>116,516,000</b>               | ) (94,538,000 )      |
| Advances on long-term borrowings  | <b>—</b>                         | 50,000,000           |
| Repayment on long-term borrowings   | <b>(80,000,000)</b>              | ) (35,000 )          |
| Payment to repurchase common stock  | <b>(168,000)</b>                 | ) (153,000 )         |
| Proceeds from sale of common stock  | <b>466,000</b>                   | 476,000              |
| Dividends paid  | <b>(8,353,000)</b>               | ) (8,977,000 )       |
| Net cash provided by financing activities   | <b>124,493,000</b>               | 53,865,000           |
| Net increase in cash and cash equivalents   | <b>2,442,000</b>                 | 5,009,000            |

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|  |                     |              |
|--|---------------------|--------------|
| Cash and cash equivalents at beginning of period   | <b>19,207,000</b>   | 17,366,000   |
| <b>Cash and cash equivalents at end of period</b>  | <b>\$21,649,000</b> | \$22,375,000 |
| Interest paid                                      | <b>\$14,349,000</b> | \$9,789,000  |
| Income taxes paid                                  | <b>1,762,000</b>    | 3,950,000    |
| <b>Non-cash transactions</b>                       |                     |              |
| Net transfer from loans to other real estate owned | <b>\$164,000</b>    | \$224,000    |

See Report of Independent Registered Public Accounting Firm.

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

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**Notes to Consolidated Financial Statements**

The First Bancorp, Inc. and Subsidiary

**Note 1 – Basis of Presentation**

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

**Subsequent Events**

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

**Note 2 – Investment Securities**

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

|  | <b>Amortized<br/>Cost</b> | <b>Unrealized<br/>Gains</b> | <b>Unrealized<br/>Losses</b> | <b>Fair Value<br/>(Estimated)</b> |
|--|---------------------------|-----------------------------|------------------------------|-----------------------------------|
| <b>Securities available for sale</b>     |                           |                             |                              |                                   |
| U.S. government-sponsored agencies       | \$5,000,000               | \$ —                        | \$(21,000)                   | \$4,979,000                       |
| Mortgage-backed securities               | 303,793,000               | 77,000                      | (11,300,000)                 | 292,570,000                       |
| State and political subdivisions         | 4,955,000                 | —                           | (317,000)                    | 4,638,000                         |
| Other equity securities                  | 3,257,000                 | —                           | —                            | 3,257,000                         |
|  | \$317,005,000             | \$ 77,000                   | \$(11,638,000)               | \$305,444,000                     |
| <b>Securities to be held to maturity</b> |                           |                             |                              |                                   |
| U.S. Government-sponsored agencies       | \$11,155,000              | \$ —                        | \$(767,000)                  | \$10,388,000                      |
| Mortgage-backed securities               | 19,244,000                | 326,000                     | (460,000)                    | 19,110,000                        |
| State and political subdivisions         | 222,696,000               | 639,000                     | (7,243,000)                  | 216,092,000                       |
| Corporate securities                     | 4,300,000                 | —                           | —                            | 4,300,000                         |
|  | \$257,395,000             | \$ 965,000                  | \$(8,470,000)                | \$249,890,000                     |
| <b>Restricted equity securities</b>      |                           |                             |                              |                                   |
| Federal Home Loan Bank Stock             | \$10,549,000              | \$ —                        | \$—                          | \$10,549,000                      |
| Federal Reserve Bank Stock               | 1,037,000                 | —                           | —                            | 1,037,000                         |
|  | \$11,586,000              | \$ —                        | \$—                          | \$11,586,000                      |

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

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

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

|  | <b>Amortized<br/>Cost</b> | <b>Unrealized<br/>Gains</b> | <b>Unrealized<br/>Losses</b> | <b>Fair Value<br/>(Estimated)</b> |
|--|---------------------------|-----------------------------|------------------------------|-----------------------------------|
| <b>Securities available for sale</b>     |                           |                             |                              |                                   |
| Mortgage-backed securities               | \$290,151,000             | \$1,339,000                 | \$(2,701,000)                | \$288,789,000                     |
| State and political subdivisions         | 6,860,000                 | 28,000                      | (46,000)                     | 6,842,000                         |
| Other equity securities                  | 3,257,000                 | 113,000                     | (2,000)                      | 3,368,000                         |
|  | \$300,268,000             | \$1,480,000                 | \$(2,749,000)                | \$298,999,000                     |
| <b>Securities to be held to maturity</b> |                           |                             |                              |                                   |
| U.S. Government-sponsored agencies       | \$11,154,000              | \$—                         | \$(197,000)                  | \$10,957,000                      |
| Mortgage-backed securities               | 24,993,000                | 731,000                     | (40,000)                     | 25,684,000                        |
| State and political subdivisions         | 202,232,000               | 3,640,000                   | (1,792,000)                  | 204,080,000                       |
| Corporate securities                     | 4,300,000                 | —                           | —                            | 4,300,000                         |
|  | \$242,679,000             | \$4,371,000                 | \$(2,029,000)                | \$245,021,000                     |
| <b>Restricted equity securities</b>      |                           |                             |                              |                                   |
| Federal Home Loan Bank Stock             | \$9,761,000               | \$—                         | \$—                          | \$9,761,000                       |
| Federal Reserve Bank Stock               | 1,037,000                 | —                           | —                            | 1,037,000                         |
|  | \$10,798,000              | \$—                         | \$—                          | \$10,798,000                      |

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

|                       | Securities available for sale |                        | Securities to be held to maturity |                        |
|-----------------------|-------------------------------|------------------------|-----------------------------------|------------------------|
|                       | Amortized Cost                | Fair Value (Estimated) | Amortized Cost                    | Fair Value (Estimated) |
| Due in 1 year or less | \$—                           | \$—                    | \$ 1,796,000                      | \$ 1,800,000           |
| Due in 1 to 5 years   | 13,961,000                    | 13,886,000             | 21,463,000                        | 21,468,000             |
| Due in 5 to 10 years  | 69,317,000                    | 67,434,000             | 155,997,000                       | 152,154,000            |
| Due after 10 years    | 230,470,000                   | 220,867,000            | 78,139,000                        | 74,468,000             |
| Equity securities     | 3,257,000                     | 3,257,000              | —                                 | —                      |
|                       | \$317,005,000                 | \$305,444,000          | \$257,395,000                     | \$249,890,000          |

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

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

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

|                       | Securities available for sale |                        | Securities to be held to maturity |                        |
|-----------------------|-------------------------------|------------------------|-----------------------------------|------------------------|
|                       | Amortized Cost                | Fair Value (Estimated) | Amortized Cost                    | Fair Value (Estimated) |
| Due in 1 year or less | \$ 176,000                    | \$ 179,000             | \$ 552,000                        | \$ 559,000             |
| Due in 1 to 5 years   | 856,000                       | 859,000                | 17,241,000                        | 17,485,000             |
| Due in 5 to 10 years  | 33,550,000                    | 33,987,000             | 37,218,000                        | 37,963,000             |
| Due after 10 years    | 262,429,000                   | 260,606,000            | 187,668,000                       | 189,014,000            |
| Equity securities     | 3,257,000                     | 3,368,000              | —                                 | —                      |
|                       | \$300,268,000                 | \$298,999,000          | \$242,679,000                     | \$245,021,000          |

At September 30, 2018, securities with a fair value of \$302,129,000 were pledged to secure public deposits, repurchase agreements, and for other purposes as required by law. This compares to securities with a fair value of \$231,516,000 as of December 31, 2017 and \$233,733,000 at September 30, 2017, pledged for the same purposes. Gains and losses on the sale of securities available for sale are computed by subtracting the amortized cost at the time of sale from the security's selling price, net of accrued interest to be received. The following table shows securities gains and losses for the nine months and quarters ended September 30, 2018 and 2017:

|                                   | For the nine months ended |                    | For the quarter ended |                    |
|-----------------------------------|---------------------------|--------------------|-----------------------|--------------------|
|                                   | September 30, 2018        | September 30, 2017 | September 30, 2018    | September 30, 2017 |
| Proceeds from sales of securities | \$459,000                 | \$15,587,000       | \$—                   | \$15,584,000       |
| Gross realized gains              | 137,000                   | 471,000            | 1,000                 | 468,000            |
| Gross realized losses             | —                         | —                  | —                     | —                  |
| Net gain                          | \$137,000                 | \$471,000          | \$1,000               | \$468,000          |
| Related income taxes              | \$29,000                  | \$165,000          | \$—                   | \$164,000          |



Management reviews securities with unrealized losses for other than temporary impairment. As of September 30, 2018, there were 596 securities with unrealized losses held in the Company's portfolio. These securities were temporarily impaired as a result of changes in interest rates reducing their fair value, of which 185 had been temporarily impaired for 12 months or more. At September 30, 2018, there were no material changes in the credit quality of these securities resulting in other than temporary impairment, and in Management's opinion, no additional write-down for other-than-temporary impairment is warranted. Information regarding securities temporarily impaired as of September 30, 2018 is summarized below:

|                                  | <b>Less than 12 months</b> |                      | <b>12 months or more</b>  |                      | <b>Total</b>              |                      |
|----------------------------------|----------------------------|----------------------|---------------------------|----------------------|---------------------------|----------------------|
|                                  | Fair Value<br>(Estimated)  | Unrealized<br>Losses | Fair Value<br>(Estimated) | Unrealized<br>Losses | Fair Value<br>(Estimated) | Unrealized<br>Losses |
| U.S.                             |                            |                      |                           |                      |                           |                      |
| Government-sponsored agencies    | \$7,753,000                | \$(247,000)          | \$7,614,000               | \$(541,000)          | \$15,367,000              | \$(788,000)          |
| Mortgage-backed securities       | 154,611,000                | (4,333,000)          | 143,771,000               | (7,427,000)          | 298,382,000               | (11,760,000)         |
| State and political subdivisions | 105,233,000                | (3,255,000)          | 38,491,000                | (4,305,000)          | 143,724,000               | (7,560,000)          |
|                                  | \$267,597,000              | \$(7,835,000)        | \$189,876,000             | \$(12,273,000)       | \$457,473,000             | \$(20,108,000)       |

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

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

As of September 30, 2017, there were 229 securities with unrealized losses held in the Company's portfolio. These securities were temporarily impaired as a result of changes in interest rates reducing their fair value, of which 61 had been temporarily impaired for 12 months or more. Information regarding securities temporarily impaired as of September 30, 2017 is summarized below:

|                                    | <b>Less than 12 months</b> |                      | <b>12 months or more</b>  |                      | <b>Total</b>              |                      |
|------------------------------------|----------------------------|----------------------|---------------------------|----------------------|---------------------------|----------------------|
|                                    | Fair Value<br>(Estimated)  | Unrealized<br>Losses | Fair Value<br>(Estimated) | Unrealized<br>Losses | Fair Value<br>(Estimated) | Unrealized<br>Losses |
| U.S. Government-sponsored agencies | \$7,958,000                | \$(197,000)          | \$—                       | \$—                  | \$7,958,000               | \$(197,000)          |
| Mortgage-backed securities         | 147,326,000                | (1,635,000)          | 48,015,000                | (1,106,000)          | 195,341,000               | (2,741,000)          |
| State and political subdivisions   | 39,407,000                 | (1,186,000)          | 12,583,000                | (652,000)            | 51,990,000                | (1,838,000)          |
| Other equity securities            | —                          | —                    | 10,000                    | (2,000)              | 10,000                    | (2,000)              |
|                                    | \$194,691,000              | \$(3,018,000)        | \$60,608,000              | \$(1,760,000)        | \$255,299,000             | \$(4,778,000)        |

During the third quarter of 2014, the Company transferred securities with a total amortized cost of \$89,780,000 with a corresponding fair value of \$89,757,000 from available for sale to held to maturity. The net unrealized loss, net of

taxes, on these securities at the date of the transfer was \$15,000. The net unrealized holding loss at the time of transfer continues to be reported in accumulated other comprehensive income (loss), net of tax and is amortized over the remaining lives of the

securities as an adjustment of the yield. The amortization of the net unrealized loss reported in accumulated other comprehensive income (loss) will offset the effect on interest income of the discount for the transferred securities. The remaining unamortized balance of the net unrealized losses for the securities transferred from available for sale to held to maturity was \$194,000 at September 30, 2018. These securities were transferred as a part of the Company's overall investment and balance sheet strategies.

The Bank is a member of the Federal Home Loan Bank ("FHLB") of Boston, a cooperatively owned wholesale bank for housing and finance in the six New England States. As a requirement of membership in the FHLB, the Bank must own a minimum required amount of FHLB stock, calculated periodically based primarily on its level of borrowings from the FHLB. The Bank uses the FHLB for a portion of its wholesale funding needs. As of September 30, 2018 and 2017, and December 31, 2017, the Bank's investment in FHLB stock totaled \$10,549,000, \$9,761,000 and \$9,321,000, respectively. FHLB stock is a non-marketable equity security and therefore is reported at cost, which equals par value. The Company periodically evaluates its investment in FHLB stock for impairment based on, among other factors, the capital adequacy of the FHLB and its overall financial condition. No impairment losses have been recorded through September 30, 2018. The Company will continue to monitor its investment in FHLB stock.

### **Note 3 – Loans**

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

|                            | <b>September 30, 2018</b> |              | December 31, 2017 |       | September 30, 2017 |         |
|----------------------------|---------------------------|--------------|-------------------|-------|--------------------|---------|
| Commercial                 |                           |              |                   |       |                    |         |
| Real estate                | <b>\$366,390,000</b>      | <b>29.5</b>  | % \$323,809,000   | 27.8  | % \$301,227,000    | 26.9 %  |
| Construction               | <b>23,889,000</b>         | <b>1.9</b>   | % 38,056,000      | 3.3   | % 32,893,000       | 2.9 %   |
| Other                      | <b>188,128,000</b>        | <b>15.1</b>  | % 181,528,000     | 15.6  | % 172,986,000      | 15.4 %  |
| Municipal                  | <b>56,704,000</b>         | <b>4.6</b>   | % 33,391,000      | 2.9   | % 33,311,000       | 3.0 %   |
| Residential                |                           |              |                   |       |                    |         |
| Term                       | <b>459,449,000</b>        | <b>36.8</b>  | % 432,661,000     | 37.1  | % 429,572,000      | 38.3 %  |
| Construction               | <b>18,166,000</b>         | <b>1.5</b>   | % 17,868,000      | 1.5   | % 15,495,000       | 1.4 %   |
| Home equity line of credit | <b>105,213,000</b>        | <b>8.5</b>   | % 111,302,000     | 9.6   | % 110,178,000      | 9.8 %   |
| Consumer                   | <b>25,619,000</b>         | <b>2.1</b>   | % 25,524,000      | 2.2   | % 25,424,000       | 2.3 %   |
| Total                      | <b>\$1,243,558,000</b>    | <b>100.0</b> | % \$1,164,139,000 | 100.0 | % \$1,121,086,000  | 100.0 % |

Loan balances include net deferred loan costs of \$6,428,000 as of September 30, 2018, \$5,748,000 as of December 31, 2017, and \$5,560,000 as of September 30, 2017. Pursuant to collateral agreements, qualifying first mortgage loans and commercial real estate loans, which totaled \$311,152,000 at September 30, 2018, were used to collateralize borrowings from the FHLB. This compares to qualifying first mortgages loans which totaled \$239,805,000 at December 31, 2017, and \$245,000,000 at September 30, 2017. In addition, commercial, construction and home equity loans totaling \$229,769,000 at September 30, 2018, \$290,247,000 at December 31, 2017, and \$297,712,000 at September 30, 2017, were used to collateralize a standby line of credit at the Federal Reserve Bank of Boston that is currently unused.

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

|                            | 30-59 Days<br>Past Due | 60-89 Days<br>Past Due | 90+ Days<br>Past Due | All<br>Past Due | Current          | Total            | 90+ Days<br>&<br>Accruing |
|----------------------------|------------------------|------------------------|----------------------|-----------------|------------------|------------------|---------------------------|
| Commercial                 |                        |                        |                      |                 |                  |                  |                           |
| Real estate                | \$ 305,000             | \$—                    | \$ 503,000           | \$ 808,000      | \$ 365,582,000   | \$ 366,390,000   | \$—                       |
| Construction               | —                      | —                      | —                    | —               | 23,889,000       | 23,889,000       | —                         |
| Other                      | 440,000                | 526,000                | 416,000              | 1,382,000       | 186,746,000      | 188,128,000      | —                         |
| Municipal                  | —                      | —                      | —                    | —               | 56,704,000       | 56,704,000       | —                         |
| Residential                |                        |                        |                      |                 |                  |                  |                           |
| Term                       | 838,000                | 2,701,000              | 1,566,000            | 5,105,000       | 454,344,000      | 459,449,000      | 199,000                   |
| Construction               | —                      | —                      | —                    | —               | 18,166,000       | 18,166,000       | —                         |
| Home equity line of credit | 1,883,000              | 403,000                | 565,000              | 2,851,000       | 102,362,000      | 105,213,000      | —                         |
| Consumer                   | 161,000                | 14,000                 | 52,000               | 227,000         | 25,392,000       | 25,619,000       | 50,000                    |
| Total                      | \$ 3,627,000           | \$ 3,644,000           | \$ 3,102,000         | \$ 10,373,000   | \$ 1,233,185,000 | \$ 1,243,558,000 | \$ 249,000                |

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

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

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

|                            | 30-59 Days<br>Past Due | 60-89 Days<br>Past Due | 90+ Days<br>Past Due | All<br>Past Due | Current          | Total            | 90+ Days<br>&<br>Accruing |
|----------------------------|------------------------|------------------------|----------------------|-----------------|------------------|------------------|---------------------------|
| Commercial                 |                        |                        |                      |                 |                  |                  |                           |
| Real estate                | \$ 415,000             | \$ 169,000             | \$ 1,387,000         | \$ 1,971,000    | \$ 299,256,000   | \$ 301,227,000   | \$—                       |
| Construction               | —                      | —                      | —                    | —               | 32,893,000       | 32,893,000       | —                         |
| Other                      | 345,000                | 265,000                | 567,000              | 1,177,000       | 171,809,000      | 172,986,000      | —                         |
| Municipal                  | —                      | —                      | —                    | —               | 33,311,000       | 33,311,000       | —                         |
| Residential                |                        |                        |                      |                 |                  |                  |                           |
| Term                       | 295,000                | 3,668,000              | 1,941,000            | 5,904,000       | 423,668,000      | 429,572,000      | 344,000                   |
| Construction               | —                      | —                      | —                    | —               | 15,495,000       | 15,495,000       | —                         |
| Home equity line of credit | 645,000                | 130,000                | 986,000              | 1,761,000       | 108,417,000      | 110,178,000      | 167,000                   |
| Consumer                   | 195,000                | 6,000                  | 18,000               | 219,000         | 25,205,000       | 25,424,000       | —                         |
| Total                      | \$ 1,895,000           | \$ 4,238,000           | \$ 4,899,000         | \$ 11,032,000   | \$ 1,110,054,000 | \$ 1,121,086,000 | \$ 511,000                |

For all classes, loans are placed on non-accrual status when, based on current information and events, it is probable

that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement or when principal

and interest is 90 days or more past due unless the loan is both well secured and in the process of collection (in which case the loan may continue to accrue interest in spite of its past due status). A loan is "well secured" if it is secured (1) by collateral in the form of liens on or pledges of real or personal property, including securities, that have a realizable value sufficient to discharge the debt (including accrued interest) in full, or (2) by the guarantee of a financially responsible party. A loan is "in the process of collection" if collection of the loan is proceeding in due course either (1) through legal action, including judgment enforcement procedures, or, (2) in appropriate circumstances, through collection efforts not involving legal action which are reasonably expected to result in repayment of the debt or in its restoration to a current status in the near future.

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

|                            | September 30,<br>2018 | December 31,<br>2017 | September 30,<br>2017 |
|----------------------------|-----------------------|----------------------|-----------------------|
| Commercial                 |                       |                      |                       |
| Real estate                | <b>\$964,000</b>      | \$752,000            | \$1,929,000           |
| Construction               | —                     | —                    | —                     |
| Other                      | <b>9,330,000</b>      | 9,357,000            | 9,520,000             |
| Municipal                  | —                     | —                    | —                     |
| Residential                |                       |                      |                       |
| Term                       | <b>3,042,000</b>      | 3,778,000            | 3,875,000             |
| Construction               | —                     | —                    | —                     |
| Home equity line of credit | <b>834,000</b>        | 833,000              | 1,001,000             |
| Consumer                   | <b>2,000</b>          | 16,000               | 51,000                |
| Total                      | <b>\$14,172,000</b>   | \$14,736,000         | \$16,376,000          |

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

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

|  | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Recorded<br>Investment                  | Recognized<br>Interest<br>Income               | Average<br>Recorded<br>Investment | Recognized<br>Interest<br>Income |
|--|------------------------|--------------------------------|----------------------|--|--|-----------------------------------|----------------------------------|
|  |                        |                                |                      | For the nine<br>months ended<br>September 30, 2018 | For the quarter<br>ended September<br>30, 2018 |                                   |                                  |
| <b><u>With No Related Allowance</u></b>  |                        |                                |                      |  |  |                                   |                                  |
| Commercial                               |                        |                                |                      |  |  |                                   |                                  |
| Real estate                              | \$ 5,954,000           | \$ 6,275,000                   | \$ —                 | \$ 5,099,000                                       | \$ 194,000                                     | \$ 5,966,000                      | \$ 84,000                        |
| Construction                             | 741,000                | 741,000                        | —                    | 773,000  | 32,000   | 741,000                           | 11,000                           |
| Other                                    | 1,926,000              | 2,044,000                      | —                    | 2,146,000  | 25,000   | 1,865,000                         | 8,000                            |
| Municipal                                | —                      | —                              | —                    | —  | —  | —                                 | —                                |
| Residential                              |                        |                                |                      |  |  |                                   |                                  |
| Term                                     | 9,019,000              | 10,201,000                     | —                    | 9,515,000  | 222,000  | 9,200,000                         | 71,000                           |
| Construction                             | —                      | —                              | —                    | —  | —  | —                                 | —                                |
| Home equity line of credit               | 1,068,000              | 1,128,000                      | —                    | 1,014,000  | 15,000   | 1,033,000                         | 6,000                            |
| Consumer                                 | —                      | —                              | —                    | 14,000   | —  | 10,000                            | —                                |
|  | \$ 18,708,000          | \$ 20,389,000                  | \$ —                 | \$ 18,561,000                                      | \$ 488,000                                     | \$ 18,815,000                     | \$ 180,000                       |
| <b><u>With an Allowance Recorded</u></b> |                        |                                |                      |  |  |                                   |                                  |
| Commercial                               |                        |                                |                      |  |  |                                   |                                  |
| Real estate                              | \$ 3,456,000           | \$ 3,474,000                   | \$ 265,000           | \$ 3,700,000                                       | \$ 97,000                                      | \$ 3,461,000                      | \$ 30,000                        |
| Construction                             | —                      | —                              | —                    | —  | —  | —                                 | —                                |
| Other                                    | 7,923,000              | 8,231,000                      | 1,890,000            | 7,345,000  | —  | 7,682,000                         | —                                |
| Municipal                                | —                      | —                              | —                    | —  | —  | —                                 | —                                |
| Residential                              |                        |                                |                      |  |  |                                   |                                  |
| Term                                     | 1,909,000              | 2,085,000                      | 238,000              | 2,054,000  | 70,000   | 2,108,000                         | 22,000                           |
| Construction                             | —                      | —                              | —                    | —  | —  | —                                 | —                                |
| Home equity line of credit               | 100,000                | 100,000                        | 7,000                | 92,000   | —  | 100,000                           | —                                |
| Consumer                                 | 2,000                  | 15,000                         | 2,000                | —  | —  | 1,000                             | —                                |
|  | \$ 13,390,000          | \$ 13,905,000                  | \$ 2,402,000         | \$ 13,191,000                                      | \$ 167,000                                     | \$ 13,352,000                     | \$ 52,000                        |
| <b><u>Total</u></b>                      |                        |                                |                      |  |  |                                   |                                  |
| Commercial                               |                        |                                |                      |  |  |                                   |                                  |
| Real estate                              | \$ 9,410,000           | \$ 9,749,000                   | \$ 265,000           | \$ 8,799,000                                       | \$ 291,000                                     | \$ 9,427,000                      | \$ 114,000                       |
| Construction                             | 741,000                | 741,000                        | —                    | 773,000  | 32,000   | 741,000                           | 11,000                           |
| Other                                    | 9,849,000              | 10,275,000                     | 1,890,000            | 9,491,000  | 25,000   | 9,547,000                         | 8,000                            |
| Municipal                                | —                      | —                              | —                    | —  | —  | —                                 | —                                |
| Residential                              |                        |                                |                      |  |  |                                   |                                  |
| Term                                     | 10,928,000             | 12,286,000                     | 238,000              | 11,569,000   | 292,000  | 11,308,000                        | 93,000                           |
| Construction                             | —                      | —                              | —                    | —  | —  | —                                 | —                                |
| Home equity line of credit               | 1,168,000              | 1,228,000                      | 7,000                | 1,106,000  | 15,000   | 1,133,000                         | 6,000                            |
| Consumer                                 | 2,000                  | 15,000                         | 2,000                | 14,000   | —  | 11,000                            | —                                |
|  | \$ 32,098,000          | \$ 34,294,000                  | \$ 2,402,000         | \$ 31,752,000                                      | \$ 655,000                                     | \$ 32,167,000                     | \$ 232,000                       |

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

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

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

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

|  | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | For the nine<br>months ended<br>September 30, 2017<br>Average<br>Recorded<br>Investment | For the nine<br>months ended<br>September 30, 2017<br>Recognized<br>Interest<br>Income | For the quarter<br>ended September<br>30, 2017<br>Average<br>Recorded<br>Investment | For the quarter<br>ended September<br>30, 2017<br>Recognized<br>Interest<br>Income |
|--|------------------------|--------------------------------|----------------------|---|--|---|--|
| <b><u>With No Related Allowance</u></b>  |                        |                                |                      |   |  |   |  |
| Commercial                               |                        |                                |                      |   |  |   |  |
| Real estate                              | \$ 5,281,000           | \$ 5,634,000                   | \$—                  | \$ 5,418,000  | \$ 149,000   | \$ 5,398,000  | \$ 55,000  |
| Construction                             | —                      | —                              | —                    | —   | —  | —   | —  |
| Other                                    | 2,862,000              | 2,955,000                      | —                    | 1,631,000   | 37,000   | 1,879,000   | 12,000   |
| Municipal                                | —                      | —                              | —                    | —   | —  | —   | —  |
| Residential                              |                        |                                |                      |   |  |   |  |
| Term                                     | 10,133,000             | 11,358,000                     | —                    | 11,110,000  | 236,000  | 10,645,000  | 75,000   |
| Construction                             | —                      | —                              | —                    | —   | —  | —   | —  |
| Home equity line of credit               | 1,495,000              | 1,807,000                      | —                    | 1,417,000   | 18,000   | 1,479,000   | 4,000  |
| Consumer                                 | 51,000                 | 102,000                        | —                    | 8,000   | —  | 23,000  | —  |
|  | \$ 19,822,000          | \$ 21,856,000                  | \$—                  | \$ 19,584,000   | \$ 440,000   | \$ 19,424,000   | \$ 146,000   |
| <b><u>With an Allowance Recorded</u></b> |                        |                                |                      |   |  |   |  |
| Commercial                               |                        |                                |                      |   |  |   |  |
| Real estate                              | \$ 4,555,000           | \$ 4,891,000                   | \$ 347,000           | \$ 4,549,000  | \$ 125,000   | \$ 4,360,000  | \$ 40,000  |
| Construction                             | 763,000                | 763,000                        | 108,000              | 763,000   | 28,000   | 763,000   | 10,000   |
| Other                                    | 7,388,000              | 7,392,000                      | 1,130,000            | 991,000   | —  | 2,618,000   | —  |
| Municipal                                | —                      | —                              | —                    | —   | —  | —   | —  |
| Residential                              |                        |                                |                      |   |  |   |  |
| Term                                     | 2,508,000              | 2,726,000                      | 307,000              | 2,078,000   | 66,000   | 2,293,000   | 25,000   |
| Construction                             | —                      | —                              | —                    | —   | —  | —   | —  |
| Home equity line of credit               | 24,000                 | 27,000                         | 24,000               | 25,000  | —  | 25,000  | —  |
| Consumer                                 | —                      | —                              | —                    | —   | —  | —   | —  |
|  | \$ 15,238,000          | \$ 15,799,000                  | \$ 1,916,000         | \$ 8,406,000  | \$ 219,000   | \$ 10,059,000   | \$ 75,000  |
| <b><u>Total</u></b>                      |                        |                                |                      |   |  |   |  |
| Commercial                               |                        |                                |                      |   |  |   |  |
| Real estate                              | \$ 9,836,000           | \$ 10,525,000                  | \$ 347,000           | \$ 9,967,000  | \$ 274,000   | \$ 9,758,000  | \$ 95,000  |
| Construction                             | 763,000                | 763,000                        | 108,000              | 763,000   | 28,000   | 763,000   | 10,000   |
| Other                                    | 10,250,000             | 10,347,000                     | 1,130,000            | 2,622,000   | 37,000   | 4,497,000   | 12,000   |
| Municipal                                | —                      | —                              | —                    | —   | —  | —   | —  |
| Residential                              |                        |                                |                      |   |  |   |  |
| Term                                     | 12,641,000             | 14,084,000                     | 307,000              | 13,188,000  | 302,000  | 12,938,000  | 100,000  |
| Construction                             | —                      | —                              | —                    | —   | —  | —   | —  |
| Home equity line of credit               | 1,519,000              | 1,834,000                      | 24,000               | 1,442,000   | 18,000   | 1,504,000   | 4,000  |
| Consumer                                 | 51,000                 | 102,000                        | —                    | 8,000   | —  | 23,000  | —  |
|  | \$ 35,060,000          | \$ 37,655,000                  | \$ 1,916,000         | \$ 27,990,000   | \$ 659,000   | \$ 29,483,000   | \$ 221,000   |



*Troubled Debt Restructured*

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

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

As of September 30, 2018, the Company had 71 loans with a balance of \$25,661,000 that have been classified as TDRs. This compares to 62 loans with a balance of \$17,801,000 and 67 loans with a balance of \$19,760,000 classified as TDRs as of December 31, 2017 and September 30, 2017, respectively. The impairment carried as a specific reserve in the allowance for loan losses is calculated by present valuing the expected cash flows on the loan at the original interest rate, or, for collateral-dependent loans, using the fair value of the collateral less costs to sell.

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

|                            | <b>Number<br/>of<br/>Loans</b> | <b>Balance</b> | <b>Specific<br/>Reserves</b> |
|----------------------------|--------------------------------|----------------|------------------------------|
| Commercial                 |                                |                |                              |
| Real estate                | 16                             | \$8,542,000    | \$138,000                    |
| Construction               | 1                              | 741,000        | —                            |
| Other                      | 5                              | 7,007,000      | 1,100,000                    |
| Municipal                  | —                              | —              | —                            |
| Residential                |                                |                |                              |
| Term                       | 46                             | 8,869,000      | 238,000                      |
| Construction               | —                              | —              | —                            |
| Home equity line of credit | 3                              | 502,000        | —                            |
| Consumer                   | —                              | —              | —                            |
|                            | 71                             | \$25,661,000   | \$1,476,000                  |

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

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



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

|                            | <b>Number<br/>of<br/>Loans</b> | <b>Balance</b> | <b>Specific<br/>Reserves</b> |
|----------------------------|--------------------------------|----------------|------------------------------|
| Commercial                 |                                |                |                              |
| Real estate                | 9                              | \$7,908,000    | \$65,000                     |
| Construction               | 1                              | 763,000        | 108,000                      |
| Other                      | 5                              | 730,000        | —                            |
| Municipal                  | —                              | —              | —                            |
| Residential                |                                |                |                              |
| Term                       | 49                             | 9,842,000      | 283,000                      |
| Construction               | —                              | —              | —                            |
| Home equity line of credit | 3                              | 517,000        | —                            |
| Consumer                   | —                              | —              | —                            |
|                            | 67                             | \$19,760,000   | \$456,000                    |

As of September 30, 2018, 10 of the loans classified as TDRs with a total balance of \$1,271,000 were more than 30 days past due. Of these loans, one had been placed on TDR status in the previous 12 months. The following table shows these TDRs by class and the associated specific reserves included in the allowance for loan losses as of September 30, 2018:

|                            | <b>Number<br/>of<br/>Loans</b> | <b>Balance</b> | <b>Specific<br/>Reserves</b> |
|----------------------------|--------------------------------|----------------|------------------------------|
| Commercial                 |                                |                |                              |
| Real estate                | —                              | \$—            | \$—                          |
| Construction               | —                              | —              | —                            |
| Other                      | 1                              | 138,000        | —                            |
| Municipal                  | —                              | —              | —                            |
| Residential                |                                |                |                              |
| Term                       | 8                              | 966,000        | 5,000                        |
| Construction               | —                              | —              | —                            |
| Home equity line of credit | 1                              | 167,000        | —                            |
| Consumer                   | —                              | —              | —                            |
|                            | 10                             | \$1,271,000    | \$5,000                      |



As of September 30, 2017, 14 of the loans classified as TDRs with a total balance of \$1,849,000 were more than 30 days past due. Of these loans, none had been placed on TDR status in the previous 12 months. The following table shows these TDRs by class and the associated specific reserves included in the allowance for loan losses as of September 30, 2017:

|                            | <b>Number<br/>of<br/>Loans</b> | <b>Balance</b> | <b>Specific<br/>Reserves</b> |
|----------------------------|--------------------------------|----------------|------------------------------|
| Commercial                 |                                |                |                              |
| Real estate                | —                              | \$—            | \$—                          |
| Construction               | —                              | —              | —                            |
| Other                      | 1                              | 6,000          | —                            |
| Municipal                  | —                              | —              | —                            |
| Residential                |                                |                |                              |
| Term                       | 12                             | 1,676,000      | 65,000                       |
| Construction               | —                              | —              | —                            |
| Home equity line of credit | 1                              | 167,000        | —                            |
| Consumer                   | —                              | —              | —                            |
|                            | 14                             | \$1,849,000    | \$65,000                     |

For the nine months ended September 30, 2018, 11 loans were placed on TDR status. The following table shows these TDRs by class and the associated specific reserves included in the allowance for loan losses as of September 30, 2018:

|                            | <b>Number<br/>of<br/>Loans</b> | <b>Pre-Modification<br/>Outstanding<br/>Recorded<br/>Investment</b> | <b>Post-Modification<br/>Outstanding<br/>Recorded<br/>Investment</b> | <b>Specific<br/>Reserves</b> |
|----------------------------|--------------------------------|---|--|------------------------------|
| Commercial                 |                                |   |  |                              |
| Real estate                | 8                              | \$ 1,608,000  | \$ 1,606,000   | \$42,000                     |
| Construction               | —                              | —   | —  | —                            |
| Other                      | 1                              | 6,727,000   | 6,487,000  | 1,100,000                    |
| Municipal                  | —                              | —   | —  | —                            |
| Residential                |                                |   |  |                              |
| Term                       | 2                              | 441,000   | 436,000  | 26,000                       |
| Construction               | —                              | —   | —  | —                            |
| Home equity line of credit | —                              | —   | —  | —                            |
| Consumer                   | —                              | —   | —  | —                            |
|                            | 11                             | \$ 8,776,000  | \$ 8,529,000   | \$1,168,000                  |



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

|                            | Number<br>of<br>Loans | Pre-Modification<br>Outstanding<br>Recorded<br>Investment | Post-Modification<br>Outstanding<br>Recorded<br>Investment | Specific<br>Reserves |
|----------------------------|-----------------------|---|--|----------------------|
| Commercial                 |                       |   |  |                      |
| Real estate                | 1                     | \$ 552,000  | \$ 552,000   | \$ —                 |
| Construction               | —                     | —   | —  | —                    |
| Other                      | —                     | —   | —  | —                    |
| Municipal                  | —                     | —   | —  | —                    |
| Residential                |                       |   |  |                      |
| Term                       | —                     | —   | —  | —                    |
| Construction               | —                     | —   | —  | —                    |
| Home equity line of credit | —                     | —   | —  | —                    |
| Consumer                   | —                     | —   | —  | —                    |
|                            | 1                     | \$ 552,000  | \$ 552,000   | \$ —                 |

For the nine months and quarter ended September 30, 2017, no loans were placed on TDR status.

As of September 30, 2018, Management is aware of four loans classified as TDRs that are involved in bankruptcy with an outstanding balance of \$676,000. There were also twelve loans with an outstanding balance of \$7,735,000 that were classified as TDRs and on non-accrual status, of which four loans with an outstanding balance of \$504,000 were in the process of foreclosure.

#### *Residential Mortgage Loans in Process of Foreclosure*

As of September 30, 2018, there were 14 mortgage loans collateralized by residential real estate in the process of foreclosure with a total balance of \$1,337,000. This compares to 14 mortgage loans collateralized by residential real estate in the process of foreclosure with a total balance of \$1,861,000 as of September 30, 2017.

#### **Note 4. Allowance for Loan Losses**

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

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

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

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

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

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

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

*Home Equity Line of Credit* - The overall health of the economy, including unemployment rates and housing prices, has an impact on the credit quality of this segment.

*Consumer* -The overall health of the economy, including unemployment rates, has an impact on the credit quality of this segment.

The appropriate level of the allowance is evaluated continually based on a review of significant loans, with a particular emphasis on nonaccruing, past due, and other loans that may require special attention. Other factors include general conditions in local and

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

| <i>As of September 30, 2018</i> | Specific Reserves on Loans Evaluated Individually for Impairment | General Reserves on Loans Based on Historical Loss Experience | Reserves for Qualitative Factors | Unallocated Reserves | Total Reserves |
|---------------------------------|--|---|----------------------------------|----------------------|----------------|
| Commercial                      |  |   |                                  |                      |                |
| Real estate                     | \$265,000  | \$758,000   | \$2,566,000                      | \$—                  | \$3,589,000    |
| Construction                    | —  | 49,000  | 165,000                          | —                    | 214,000        |
| Other                           | 1,890,000  | 388,000   | 1,313,000                        | —                    | 3,591,000      |
| Municipal                       | —  | —   | 23,000                           | —                    | 23,000         |
| Residential                     |  |   |                                  |                      |                |
| Term                            | 238,000  | 313,000   | 541,000                          | —                    | 1,092,000      |
| Construction                    | —  | 13,000  | 23,000                           | —                    | 36,000         |
| Home equity line of credit      | 7,000  | 280,000   | 432,000                          | —                    | 719,000        |
| Consumer                        | 2,000  | 397,000   | 341,000                          | —                    | 740,000        |
| Unallocated                     | —  | —   | —                                | 1,678,000            | 1,678,000      |
|                                 | \$2,402,000  | \$2,198,000   | \$5,404,000                      | \$1,678,000          | \$11,682,000   |
| <i>As of December 31, 2017</i>  | Specific Reserves on Loans Evaluated Individually for Impairment | General Reserves on Loans Based on Historical Loss Experience | Reserves for Qualitative Factors | Unallocated Reserves | Total Reserves |
| Commercial                      |  |   |                                  |                      |                |
| Real estate                     | \$224,000  | \$1,285,000   | \$2,363,000                      | \$—                  | \$3,872,000    |
| Construction                    | —  | 153,000   | 281,000                          | —                    | 434,000        |
| Other                           | 1,309,000  | 723,000   | 1,326,000                        | —                    | 3,358,000      |
| Municipal                       | —  | —   | 20,000                           | —                    | 20,000         |
| Residential                     |  |   |                                  |                      |                |
| Term                            | 255,000  | 311,000   | 564,000                          | —                    | 1,130,000      |
| Construction                    | —  | 13,000  | 23,000                           | —                    | 36,000         |
| Home equity line of credit      | 24,000   | 297,000   | 371,000                          | —                    | 692,000        |
| Consumer                        | —  | 251,000   | 294,000                          | —                    | 545,000        |
| Unallocated                     | —  | —   | —                                | 642,000              | 642,000        |
|                                 | \$1,812,000  | \$3,033,000   | \$5,242,000                      | \$642,000            | \$10,729,000   |



| <i>As of September 30, 2017</i> | Specific Reserves on Loans Evaluated Individually for Impairment | General Reserves on Loans Based on Historical Loss Experience | Reserves for Qualitative Factors | Unallocated Reserves | Total Reserves |
|---------------------------------|--|---|----------------------------------|----------------------|----------------|
| Commercial                      |  |   |                                  |                      |                |
| Real estate                     | \$347,000  | \$1,315,000   | \$2,342,000                      | \$—                  | \$4,004,000    |
| Construction                    | 108,000  | 142,000   | 253,000                          | —                    | 503,000        |
| Other                           | 1,130,000  | 752,000   | 1,341,000                        | —                    | 3,223,000      |
| Municipal                       | —  | —   | 20,000                           | —                    | 20,000         |
| Residential                     |  |   |                                  |                      |                |
| Term                            | 307,000  | 300,000   | 550,000                          | —                    | 1,157,000      |
| Construction                    | —  | 11,000  | 20,000                           | —                    | 31,000         |
| Home equity line of credit      | 24,000   | 297,000   | 366,000                          | —                    | 687,000        |
| Consumer                        | —  | 247,000   | 288,000                          | —                    | 535,000        |
| Unallocated                     | —  | —   | —                                | 852,000              | 852,000        |
|                                 | \$1,916,000  | \$3,064,000   | \$5,180,000                      | \$852,000            | \$11,012,000   |

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

General economic conditions.

- Credit quality trends with emphasis on loan delinquencies, nonaccrual levels and classified loans.

Recent loss experience in particular segments of the portfolio.

Loan volumes and concentrations, including changes in mix.

Other factors, including changes in quality of the loan origination; loan policy changes; changes in credit risk management processes; Bank regulatory and external loan review examination results.

The qualitative portion of the allowance for loan losses was 0.43% of related loans as of September 30, 2018, compared to 0.45% of related loans as of December 31, 2017. The qualitative portion increased \$162,000 between December 31, 2017 and September 30, 2018 due to a mix of factors.

The unallocated component of the allowance totaled \$1,678,000 at September 30, 2018, or 14.4% of the total reserve. This compares to \$642,000 or 6.0% as of December 31, 2017. The change supported general imprecision related to portfolio growth.

The allowance for loan losses as a percent of total loans stood at 0.94% as of September 30, 2018, compared to 0.92% as of December 31, 2017 and 0.98% as of September 30, 2017.

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

Commercial real estate loans consist of mortgage loans to finance investments in real property such as multi-family residential, commercial/retail, office, industrial, hotels, educational and other specific or mixed use properties.

Commercial real estate loans are typically written with amortizing payment structures. Collateral values are determined based on appraisals and evaluations in accordance with established policy and regulatory guidelines.

Commercial real estate loans typically have a loan-to-value ratio of up to 80% based upon current valuation information at the time the loan is made. Commercial real estate loans are primarily paid by the cash flow generated from the real property, such as operating leases, rents, or other operating cash flows from the borrower.

Commercial construction loans consist of loans to finance construction in a mix of owner- and non-owner occupied commercial real estate properties. Commercial construction loans typically have maturities of less than two years.

Payment structures during the construction period are typically on an interest only basis, although principal payments may be established depending on the type of construction project being financed. During the construction phase, commercial construction loans are primarily paid by cash flow generated from the construction project or other

operating cash flows from the borrower or guarantors, if applicable. At the end of the construction period, loan repayment typically comes from a third party source in the event that the Company will not be providing permanent term financing. Collateral valuation and loan-to-value guidelines follow those for commercial real estate loans. Other commercial loans consist of revolving and term loan obligations extended to business and corporate enterprises for the purpose of financing working capital and or capital investment. Collateral generally consists of pledges of business assets including, but not limited to, accounts receivable, inventory, plant and equipment, and/or real estate, if applicable. Commercial loans are primarily paid by the operating cash flow of the borrower. Commercial loans may be secured or unsecured.

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

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

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

Residential construction loans typically consist of loans for the purpose of constructing single family residences to be owned and occupied by the borrower. Borrower qualifications include favorable credit history combined with supportive income requirements and loan-to-value ratios within established policy and regulatory guidelines.

Residential construction loans normally have construction terms of one year or less and payment during the construction term is typically on an interest only basis from sources including interest reserves, borrower liquidity and/or income. Residential construction loans will typically convert to permanent financing from the Company or have another financing commitment in place from an acceptable mortgage lender. Collateral valuation and loan-to-value guidelines are consistent with those for residential term loans.

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

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

Construction, land and land development loans, both commercial and residential, comprise a small portion of the portfolio, and at 24.4% of capital are below the regulatory guidance limit of 100.0% of capital at September 30, 2018. Construction loans and non-owner-occupied commercial real estate loans are at 123.1% of total capital, below the regulatory limit of 300.0% of capital at September 30, 2018.

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



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

**1 Strong**

Credits rated "1" are characterized by borrowers fully responsible for the credit with excellent capacity to pay principal and interest. Loans rated "1" may be secured with acceptable forms of liquid collateral.

**2 Above Average**

Credits rated "2" are characterized by borrowers that have better than average liquidity, capitalization, earnings and/or cash flow with a consistent record of solid financial performance.

**3 Satisfactory**

Credits rated "3" are characterized by borrowers with favorable liquidity, profitability and financial condition with adequate cash flow to pay debt service.

**4 Average**

Credits rated "4" are characterized by borrowers that present risk more than 1, 2 and 3 rated loans and merit an ordinary level of ongoing monitoring. Financial condition is on par or somewhat below industry averages while cash flow is generally adequate to meet debt service requirements.

**5 Watch**

Credits rated "5" are characterized by borrowers that warrant greater monitoring due to financial condition or unresolved and identified risk factors.

**6 Other Assets Especially Mentioned (OAEM)**

Loans in this category are currently protected but are potentially weak and constitute an undue and unwarranted credit risk, but not to the point of justifying a classification of substandard. OAEM have potential weaknesses which may, if not checked or corrected, weaken the asset or inadequately protect the Company's credit position at some future date.

**7 Substandard**

Loans in this category are inadequately protected by the paying capacity of the borrower or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Substandard loans are characterized by the distinct possibility that the Company may sustain some loss if the deficiencies are not corrected.

**8 Doubtful**

Loans classified "Doubtful" have the same weaknesses as those classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, based on currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is high, but because of certain important and reasonably specific pending factors which may work to the advantage and strengthening of the asset, its classification as an estimated loss is deferred until its more exact status may be determined.

The following table summarizes the risk ratings for the Company's commercial real estate, commercial construction, commercial other, and municipal loans as of September 30, 2018:

|                 | Commercial<br>Real Estate | Commercial<br>Construction | Commercial<br>Other | Municipal<br>Loans | All Risk-<br>Rated Loans |
|-----------------|---------------------------|----------------------------|---------------------|--------------------|--------------------------|
| 1 Strong        | \$—                       | \$—                        | \$2,558,000         | \$—                | \$2,558,000              |
| 2 Above Average | 10,710,000                | 38,000                     | 4,845,000           | 55,553,000         | 71,146,000               |
| 3 Satisfactory  | 78,794,000                | 1,810,000                  | 44,888,000          | 552,000            | 126,044,000              |
| 4 Average       | 196,883,000               | 16,331,000                 | 80,171,000          | 599,000            | 293,984,000              |
| 5 Watch         | 62,036,000                | 5,424,000                  | 39,176,000          | —                  | 106,636,000              |
| 6 OAEM          | 1,387,000                 | —                          | 1,368,000           | —                  | 2,755,000                |
| 7 Substandard   | 16,457,000                | 286,000                    | 15,122,000          | —                  | 31,865,000               |
| 8 Doubtful      | 123,000                   | —                          | —                   | —                  | 123,000                  |
| Total           | \$366,390,000             | \$23,889,000               | \$188,128,000       | \$56,704,000       | \$635,111,000            |

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

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

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

|                 | Commercial<br>Real Estate | Commercial<br>Construction | Commercial<br>Other | Municipal<br>Loans | All Risk-<br>Rated Loans |
|-----------------|---------------------------|----------------------------|---------------------|--------------------|--------------------------|
| 1 Strong        | \$—                       | \$—                        | \$868,000           | \$—                | \$868,000                |
| 2 Above Average | 13,051,000                | 43,000                     | 7,501,000           | 32,560,000         | 53,155,000               |
| 3 Satisfactory  | 76,533,000                | 3,763,000                  | 49,886,000          | 751,000            | 130,933,000              |
| 4 Average       | 146,424,000               | 18,685,000                 | 79,410,000          | —                  | 244,519,000              |
| 5 Watch         | 44,773,000                | 10,402,000                 | 18,190,000          | —                  | 73,365,000               |
| 6 OAEM          | 2,738,000                 | —                          | 4,625,000           | —                  | 7,363,000                |
| 7 Substandard   | 17,585,000                | —                          | 12,506,000          | —                  | 30,091,000               |
| 8 Doubtful      | 123,000                   | —                          | —                   | —                  | 123,000                  |
| Total           | \$301,227,000             | \$32,893,000               | \$172,986,000       | \$33,311,000       | \$540,417,000            |

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

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

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

value of the collateral with any outstanding loan balance in excess of the fair value of the property, less costs to sell, written down or charged-off.

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

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

|   | Commercial     |               |                | Municipal     | Residential<br>Term | Residential<br>Construction | Home Equity<br>Line of Credit | Consumer      | Unallocated  | Total            |
|---|----------------|---------------|----------------|---------------|---------------------|-----------------------------|-------------------------------|---------------|--------------|------------------|
|   | Real Estate    | Construction  | Other          |               |                     |                             |                               |               |              |                  |
| <b>For the nine months ended September 30, 2018</b>       |                |               |                |               |                     |                             |                               |               |              |                  |
| Beginning balance   | \$ 3,872,000   | \$ 434,000    | \$ 3,358,000   | \$ 20,000     | \$ 1,130,000        | \$ 36,000                   | \$ 692,000                    | \$ 545,000    | \$ 642,000   | \$ 10,729,000    |
| Charge offs   | —              | —             | 68,000         | —             | 212,000             | —                           | 121,000                       | 195,000       | —            | 596,000          |
| Recoveries  | 52,000         | —             | 33,000         | —             | 45,000              | —                           | 13,000                        | 73,000        | —            | 216,000          |
| Provision (credit)  | (335,000)      | (220,000)     | 268,000        | 3,000         | 129,000             | —                           | 135,000                       | 317,000       | 1,036,000    | 1,333,000        |
| Ending balance  | \$ 3,589,000   | \$ 214,000    | \$ 3,591,000   | \$ 23,000     | \$ 1,092,000        | \$ 36,000                   | \$ 719,000                    | \$ 740,000    | \$ 1,678,000 | \$ 11,682,000    |
| <b>For the three months ended September 30, 2018</b>      |                |               |                |               |                     |                             |                               |               |              |                  |
| Beginning balance   | \$ 3,732,000   | \$ 399,000    | \$ 3,475,000   | \$ 21,000     | \$ 1,138,000        | \$ 29,000                   | \$ 678,000                    | \$ 575,000    | \$ 1,425,000 | \$ 11,472,000    |
| Charge offs   | —              | —             | 51,000         | —             | 116,000             | —                           | 6,000                         | 50,000        | —            | 223,000          |
| Recoveries  | 52,000         | —             | 23,000         | —             | 3,000               | —                           | —                             | 22,000        | —            | 100,000          |
| Provision (credit)  | (195,000)      | (185,000)     | 144,000        | 2,000         | 67,000              | 7,000                       | 47,000                        | 193,000       | 253,000      | 333,000          |
| Ending balance  | \$ 3,589,000   | \$ 214,000    | \$ 3,591,000   | \$ 23,000     | \$ 1,092,000        | \$ 36,000                   | \$ 719,000                    | \$ 740,000    | \$ 1,678,000 | \$ 11,682,000    |
| <b>Allowance for loan losses as of September 30, 2018</b> |                |               |                |               |                     |                             |                               |               |              |                  |
| Ending balance specifically evaluated for impairment      | \$ 265,000     | \$ —          | \$ 1,890,000   | \$ —          | \$ 238,000          | \$ —                        | \$ 7,000                      | \$ 2,000      | \$ —         | \$ 2,402,000     |
| Ending balance collectively evaluated for impairment      | \$ 3,324,000   | \$ 214,000    | \$ 1,701,000   | \$ 23,000     | \$ 854,000          | \$ 36,000                   | \$ 712,000                    | \$ 738,000    | \$ 1,678,000 | \$ 9,280,000     |
| <b>Related loan balances as of September 30, 2018</b>     |                |               |                |               |                     |                             |                               |               |              |                  |
| Ending balance  | \$ 366,390,000 | \$ 23,889,000 | \$ 188,128,000 | \$ 56,704,000 | \$ 459,449,000      | \$ 18,166,000               | \$ 105,213,000                | \$ 25,619,000 | \$ —         | \$ 1,243,558,000 |
| Ending balance specifically evaluated for impairment      | \$ 9,410,000   | \$ 741,000    | \$ 9,849,000   | \$ —          | \$ 10,928,000       | \$ —                        | \$ 1,168,000                  | \$ 2,000      | \$ —         | \$ 32,098,000    |
| Ending balance collectively evaluated for impairment      | \$ 356,980,000 | \$ 23,148,000 | \$ 178,279,000 | \$ 56,704,000 | \$ 448,521,000      | \$ 18,166,000               | \$ 104,045,000                | \$ 25,617,000 | \$ —         | \$ 1,211,460,000 |

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

|   | Commercial     |               | Municipal      | Residential   |                | Home Equity<br>Line of Credit | Consumer       | Unallocated   | Total        |                  |
|---|----------------|---------------|----------------|---------------|----------------|-------------------------------|----------------|---------------|--------------|------------------|
|   | Real Estate    | Construction  |                | Other         | Term           |                               |                |               |              | Construction     |
| Beginning balance   | \$ 3,988,000   | \$ 396,000    | \$ 1,780,000   | \$ 18,000     | \$ 1,288,000   | \$ 44,000                     | \$ 807,000     | \$ 559,000    | \$ 1,258,000 | \$ 10,138,000    |
| Charge offs   | 587,000        | —             | 212,000        | —             | 456,000        | —                             | 28,000         | 335,000       | —            | 1,618,000        |
| Recoveries  | —              | —             | 49,000         | —             | 40,000         | —                             | 11,000         | 109,000       | —            | 209,000          |
| Provision (credit)  | 471,000        | 38,000        | 1,741,000      | 2,000         | 258,000        | (8,000)                       | (98,000)       | (212,000)     | (616,000)    | (2,000,000)      |
| Ending balance  | \$ 3,872,000   | \$ 434,000    | \$ 3,358,000   | \$ 20,000     | \$ 1,130,000   | \$ 36,000                     | \$ 692,000     | \$ 545,000    | \$ 642,000   | \$ 10,729,000    |
| Ending balance<br>specifically evaluated<br>for impairment    | \$ 224,000     | \$ —          | \$ 1,309,000   | \$ —          | \$ 255,000     | \$ —                          | \$ 24,000      | \$ —          | \$ —         | \$ 1,812,000     |
| Ending balance<br>collectively<br>evaluated for<br>impairment | \$ 3,648,000   | \$ 434,000    | \$ 2,049,000   | \$ 20,000     | \$ 875,000     | \$ 36,000                     | \$ 668,000     | \$ 545,000    | \$ 642,000   | \$ 8,917,000     |
| Ending balance  | \$ 323,809,000 | \$ 38,056,000 | \$ 181,528,000 | \$ 33,391,000 | \$ 432,661,000 | \$ 17,868,000                 | \$ 111,302,000 | \$ 25,524,000 | \$ —         | \$ 1,164,139,000 |
| Ending balance<br>specifically evaluated<br>for impairment    | \$ 7,790,000   | \$ 741,000    | \$ 9,918,000   | \$ —          | \$ 11,748,000  | \$ —                          | \$ 1,179,000   | \$ 16,000     | \$ —         | \$ 31,392,000    |
| Ending balance<br>collectively<br>evaluated for<br>impairment | \$ 316,019,000 | \$ 37,315,000 | \$ 171,610,000 | \$ 33,391,000 | \$ 420,913,000 | \$ 17,868,000                 | \$ 110,123,000 | \$ 25,508,000 | \$ —         | \$ 1,132,747,000 |

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

|   | Commercial     |               |                | Municipal     | Residential    |               | Home Equity<br>Line of Credit | Consumer      | Unallocated  | Total            |
|---|----------------|---------------|----------------|---------------|----------------|---------------|-------------------------------|---------------|--------------|------------------|
|   | Real Estate    | Construction  | Other          |               | Term           | Construction  |                               |               |              |                  |
| <b>For the nine months ended September 30, 2017</b>       |                |               |                |               |                |               |                               |               |              |                  |
| Beginning balance   | \$ 3,988,000   | \$ 396,000    | \$ 1,780,000   | \$ 18,000     | \$ 1,288,000   | \$ 44,000     | \$ 807,000                    | \$ 559,000    | \$ 1,258,000 | \$ 10,138,000    |
| Charge offs   | 305,000        | —             | 58,000         | —             | 351,000        | —             | 28,000                        | 276,000       | —            | 1,018,000        |
| Recoveries  | —              | —             | 25,000         | —             | 29,000         | —             | 4,000                         | 84,000        | —            | 142,000          |
| Provision (credit)  | 321,000        | 107,000       | 1,476,000      | 2,000         | 191,000        | (13,000)      | (96,000)                      | 168,000       | (406,000)    | 1,750,000        |
| Ending balance  | \$ 4,004,000   | \$ 503,000    | \$ 3,223,000   | \$ 20,000     | \$ 1,157,000   | \$ 31,000     | \$ 687,000                    | \$ 535,000    | \$ 852,000   | \$ 11,012,000    |
| <b>For the three months ended September 30, 2017</b>      |                |               |                |               |                |               |                               |               |              |                  |
| Beginning balance   | \$ 3,996,000   | \$ 517,000    | \$ 2,171,000   | \$ 19,000     | \$ 999,000     | \$ 26,000     | \$ 684,000                    | \$ 529,000    | \$ 1,670,000 | \$ 10,611,000    |
| Charge offs   | —              | —             | —              | —             | 281,000        | —             | —                             | 120,000       | —            | 401,000          |
| Recoveries  | —              | —             | 7,000          | —             | 10,000         | —             | 1,000                         | 34,000        | —            | 52,000           |
| Provision (credit)  | 8,000          | (14,000)      | 1,045,000      | 1,000         | 429,000        | 5,000         | 2,000                         | 92,000        | (818,000)    | 750,000          |
| Ending balance  | \$ 4,004,000   | \$ 503,000    | \$ 3,223,000   | \$ 20,000     | \$ 1,157,000   | \$ 31,000     | \$ 687,000                    | \$ 535,000    | \$ 852,000   | \$ 11,012,000    |
| <b>Allowance for loan losses as of September 30, 2017</b> |                |               |                |               |                |               |                               |               |              |                  |
| Ending balance specifically evaluated for impairment      | \$ 347,000     | \$ 108,000    | \$ 1,130,000   | \$ —          | \$ 307,000     | \$ —          | \$ 24,000                     | \$ —          | \$ —         | \$ 1,916,000     |
| Ending balance collectively evaluated for impairment      | \$ 3,657,000   | \$ 395,000    | \$ 2,093,000   | \$ 20,000     | \$ 850,000     | \$ 31,000     | \$ 663,000                    | \$ 535,000    | \$ 852,000   | \$ 9,096,000     |
| <b>Related loan balances as of September 30, 2017</b>     |                |               |                |               |                |               |                               |               |              |                  |
| Ending balance  | \$ 301,227,000 | \$ 32,893,000 | \$ 172,986,000 | \$ 33,311,000 | \$ 429,572,000 | \$ 15,495,000 | \$ 110,178,000                | \$ 25,424,000 | \$ —         | \$ 1,121,086,000 |
| Ending balance specifically evaluated for impairment      | \$ 9,836,000   | \$ 763,000    | \$ 10,250,000  | \$ —          | \$ 12,641,000  | \$ —          | \$ 1,519,000                  | \$ 51,000     | \$ —         | \$ 35,060,000    |
| Ending balance collectively evaluated for impairment      | \$ 291,391,000 | \$ 32,130,000 | \$ 162,736,000 | \$ 33,311,000 | \$ 416,931,000 | \$ 15,495,000 | \$ 108,659,000                | \$ 25,373,000 | \$ —         | \$ 1,086,026,000 |

### **Note 5 – Stock-Based Compensation**

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

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

| Year<br>Granted | Vesting Term<br>(In Years) | Shares | Remaining Term<br>(In Years) |
|-----------------|----------------------------|--------|------------------------------|
| 2014            | 5.0                        | 10,422 | 0.4                          |
| 2015            | 5.0                        | 12,023 | 1.3                          |
| 2016            | 5.0                        | 15,015 | 2.3                          |
| 2017            | 3.0                        | 4,902  | 1.4                          |
| 2017            | 5.0                        | 9,972  | 3.3                          |
| 2018            | 1.0                        | 300    | 0.4                          |
| 2018            | 2.0                        | 932    | 1.3                          |
| 2018            | 3.0                        | 2,400  | 2.4                          |
| 2018            | 4.0                        | 2,068  | 3.3                          |
| 2018            | 5.0                        | 9,655  | 4.3                          |
|                 |                            | 67,689 | 2.1                          |

The compensation cost related to these restricted stock grants is \$1,489,000 and is recognized over the vesting terms of each grant. In the nine months ended September 30, 2018, \$285,000 of expense was recognized for these restricted shares, leaving \$774,000 in unrecognized expense as of September 30, 2018. In the nine months ended September 30, 2017, \$247,000 of expense was recognized for restricted shares, leaving \$745,000 in unrecognized expense as of September 30, 2017.

#### **Note 6 – Preferred and Common Stock**

##### *Preferred Stock*

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

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

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

##### *Common Stock*

Proceeds from sale of common stock totaled \$466,000 and \$476,000 for the nine months ended September 30, 2018 and 2017, respectively.

**Note 7 – Earnings Per Share**

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

|   | Income<br>(Numerator) | Shares<br>(Denominator) | Per-Share<br>Amount |
|---|-----------------------|-------------------------|---------------------|
| <b>For the nine months ended September 30, 2018</b>                           |                       |                         |                     |
| Net income as reported  | \$ 17,173,000         |                         |                     |
| Basic EPS: Income available to common shareholders                            | 17,173,000            | 10,780,277              | \$ 1.59             |
| Effect of dilutive securities: restricted stock                               |                       | 69,515                  |                     |
| Diluted EPS: Income available to common shareholders plus assumed conversions | \$ 17,173,000         | 10,849,792              | \$ 1.58             |
| <b>For the nine months ended September 30, 2017</b>                           |                       |                         |                     |
| Net income as reported  | \$ 14,502,000         |                         |                     |
| Basic EPS: Income available to common shareholders                            | 14,502,000            | 10,744,155              | \$ 1.35             |
| Effect of dilutive securities: restricted stock                               |                       | 71,923                  |                     |
| Diluted EPS: Income available to common shareholders plus assumed conversions | \$ 14,502,000         | 10,816,078              | \$ 1.34             |

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

|   | Income<br>(Numerator) | Shares<br>(Denominator) | Per-Share<br>Amount |
|---|-----------------------|-------------------------|---------------------|
| <b>For the quarter ended September 30, 2018</b>                               |                       |                         |                     |
| Net income as reported  | \$ 5,933,000          |                         |                     |
| Basic EPS: Income available to common shareholders                            | 5,933,000             | 10,785,528              | \$ 0.55             |
| Effect of dilutive securities: restricted stock                               |                       | 69,515                  |                     |
| Diluted EPS: Income available to common shareholders plus assumed conversions | \$ 5,933,000          | 10,855,043              | \$ 0.55             |
| <b>For the quarter ended September 30, 2017</b>                               |                       |                         |                     |
| Net income as reported  | \$ 4,982,000          |                         |                     |
| Basic EPS: Income available to common shareholders                            | 4,982,000             | 10,751,630              | \$ 0.46             |
| Effect of dilutive securities: restricted stock                               |                       | 71,086                  |                     |
| Diluted EPS: Income available to common shareholders plus assumed conversions | \$ 4,982,000          | 10,822,716              | \$ 0.46             |

**Note 8 – Employee Benefit Plans****401(k) Plan**

The Bank has a defined contribution plan available to substantially all employees who have completed 3 months of service. Employees may contribute up to Internal Revenue Service ("IRS") determined limits and the Bank may match employee contributions not to exceed 3.0% of compensation depending on contribution level. Subject to a vote of the Board of Directors, the Bank may also make a profit-sharing contribution to the Plan. Such contribution equaled 2.0% of each eligible employee's compensation in 2017. The amount for 2018 has not been established. The expense related to the 401(k) plan was \$414,000 and \$364,000 for the nine months ended September 30, 2018 and 2017, respectively.

### Deferred Compensation and Supplemental Retirement Benefits

The Bank also provides unfunded supplemental retirement benefits for certain officers, payable in installments over 20 years upon retirement or death. The agreements consist of individual contracts with differing characteristics that, when taken together, do not constitute a postretirement plan. The costs for these benefits are recognized over the service periods of the participating officers in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 712 "Compensation – Nonretirement Postemployment Benefits". The expense of these supplemental retirement benefits was \$129,000 for the nine months ended September 30, 2018 and \$161,000 for the the same period in 2017. As of September 30, 2018, the associated accrued liability included in other liabilities in the balance sheet was \$2,973,000 compared to \$3,060,000 and \$3,040,000 at December 31, 2017 and September 30, 2017, respectively.

### Post-Retirement Benefit Plans

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

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

|   | At or for the nine months ended<br>September 30, |               |
|---|--|---------------|
|   | 2018   | 2017          |
| <b>Change in benefit obligation</b>     |  |               |
| Benefit obligation at beginning of year | \$1,874,000                                      | \$1,870,000   |
| Interest cost                           | 57,000   | 57,000        |
| Benefits paid                           | (84,000)   | (96,000)      |
| Benefit obligation at end of period     | \$1,847,000                                      | \$1,831,000   |
| <b>Funded status</b>                    |  |               |
| Benefit obligation at end of period     | \$(1,847,000)                                    | \$(1,831,000) |
| Unamortized loss                        | 186,000  | 156,000       |
| Accrued benefit cost at end of period   | \$(1,661,000)                                    | \$(1,675,000) |

The following table sets forth the net periodic pension cost:

|  | For the nine months ended September 30, |          | For the quarter ended September 30, |          |
|--|---|----------|-------------------------------------|----------|
|  | 2018                                    | 2017     | 2018                                | 2017     |
| <b>Components of net periodic benefit cost</b> |   |          |                                     |          |
| Interest cost                                  | \$57,000                                | \$57,000 | \$19,000                            | \$19,000 |
| Net periodic benefit cost                      | \$57,000                                | \$57,000 | \$19,000                            | \$19,000 |

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

|   | September 30,<br>2018 | December 31,<br>2017 | September 30,<br>2017 |
|---|-----------------------|----------------------|-----------------------|
| Unamortized net actuarial loss  | \$(186,000)           | \$(186,000)          | \$(156,000)           |
| Deferred tax benefit at 21% (for September 30, 2018 and December 31, 2017) and 35% (for September 30, 2017) | 39,000                | 39,000               | 54,000                |

|  |                     |             |             |
|--|---------------------|-------------|-------------|
| Net unrecognized postretirement benefits included in accumulated other comprehensive income (loss) | <b>\$(147,000 )</b> | \$(147,000) | \$(102,000) |
|--|---------------------|-------------|-------------|

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

**Note 9 - Other Comprehensive Income (Loss)**

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

|  | For the nine months ended<br>September 30,<br>2018 |             | For the quarter ended<br>September 30,<br>2017 |             |
|--|--|-------------|--|-------------|
| Balance at beginning of period   | <b>\$(2,901,000)</b>                               | \$(935,000) | <b>\$(7,245,000)</b>                           | \$(585,000) |
| Unrealized gains (losses) arising during the period  | <b>(7,753,000)</b>                                 | 640,000     | <b>(2,390,000)</b>                             | 99,000      |
| Reclassification of realized gains during the period   | <b>(137,000)</b>                                   | (471,000)   | <b>(1,000)</b>                                 | (468,000)   |
| Related deferred taxes (at a Federal Income Tax rate of 21% for September 30, 2018 and 35% for September 30, 2017) | <b>1,658,000</b>                                   | (59,000)    | <b>503,000</b>                                 | 129,000     |
| Net change   | <b>(6,232,000)</b>                                 | 110,000     | <b>(1,888,000)</b>                             | (240,000)   |
| Balance at end of period   | <b>\$(9,133,000)</b>                               | \$(825,000) | <b>\$(9,133,000)</b>                           | \$(825,000) |

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

|  | For the nine months ended<br>September 30,<br>2018 |             | For the quarter ended<br>September 30,<br>2017 |             |
|--|--|-------------|--|-------------|
| Balance at beginning of period   | <b>\$(174,000)</b>                                 | \$(129,000) | <b>\$(189,000)</b>                             | \$(137,000) |
| Amortization of net unrealized losses  | <b>(25,000)</b>                                    | (17,000)    | <b>(6,000)</b>                                 | (5,000)     |
| Related deferred taxes (at a Federal Income Tax rate of 21% for September 30, 2018 and 35% for September 30, 2017) | <b>5,000</b>                                       | 6,000       | <b>1,000</b>                                   | 2,000       |
| Net change   | <b>(20,000)</b>                                    | (11,000)    | <b>(5,000)</b>                                 | (3,000)     |
| Balance at end of period   | <b>\$(194,000)</b>                                 | \$(140,000) | <b>\$(194,000)</b>                             | \$(140,000) |

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

|  | For the nine months ended<br>September 30,<br>2018 |             | For the quarter ended<br>September 30,<br>2017 |             |
|--|--|-------------|--|-------------|
| Balance at beginning of period   | <b>\$1,544,000</b>                                 | \$1,163,000 | <b>\$2,066,000</b>                             | \$1,055,000 |
| Unrealized gains, (losses) on cash flow hedging derivatives arising during the period                              | <b>934,000</b>                                     | (198,000)   | <b>273,000</b>                                 | (31,000)    |
| Related deferred taxes (at a Federal Income Tax rate of 21% for September 30, 2018 and 35% for September 30, 2017) | <b>(196,000)</b>                                   | 70,000      | <b>(57,000)</b>                                | 11,000      |

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|                          |                    |             |                    |             |
|--------------------------|--------------------|-------------|--------------------|-------------|
| Net change               | <b>738,000</b>     | (128,000 )  | <b>216,000</b>     | (20,000 )   |
| Balance at end of period | <b>\$2,282,000</b> | \$1,035,000 | <b>\$2,282,000</b> | \$1,035,000 |

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

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

**Note 10 - Financial Derivative Instruments**

As part of its overall asset and liability management strategy, the Company periodically uses derivative instruments to minimize significant unplanned fluctuations in earnings and cash flows caused by interest rate volatility. The Company's interest rate risk management strategy involves modifying the re-pricing characteristics of certain assets or liabilities so that changes in interest rates do not have a significant effect on net interest income.

The Company recognizes its derivative instruments in the consolidated balance sheet at fair value. On the date the derivative instrument is entered into, the Company designates whether the derivative is part of a hedging relationship (i.e., cash flow or fair value hedge). The Company formally documents relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking hedge transactions. The Company also assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives used in hedging transactions are highly effective in offsetting the changes in cash flows or fair values of hedged items. Changes in fair value of derivative instruments that are highly effective and qualify as cash flow hedges are recorded in other comprehensive income or loss. Any ineffective portion is recorded in earnings. The Company discontinues hedge accounting when it is determined that the derivative is no longer highly effective in offsetting changes of the hedged risk on the hedged item, or management determines that the designation of the derivative as a hedging instrument is no longer appropriate.

In 2016, then again in 2018, interest rate swaps were contracted to limit the Company's exposure to rising interest rates on short-term liabilities indexed to one-month London Inter-bank Offered Rates (LIBOR). The interest rate swaps were designated as cash flow hedges.

The details of the interest rate swap agreements are as follows:

| Notional Amount | Effective Date | Maturity Date    | Variable Index Received | Fixed Rate Paid | September 30, 2018        | December 31, 2017         | September 30, 2017        |
|-----------------|----------------|------------------|-------------------------|-----------------|---------------------------|---------------------------|---------------------------|
|                 |                |                  |                         |                 | Fair Value <sup>(1)</sup> | Fair Value <sup>(1)</sup> | Fair Value <sup>(1)</sup> |
| \$30,000,000    | June 28, 2016  | June 28, 2021    | 1-Month USD LIBOR       | 0.940%          | <b>\$1,552,000</b>        | \$1,154,000               | \$934,000                 |
| 20,000,000      | June 27, 2016  | June 27, 2021    | 1-Month USD LIBOR       | 0.893%          | <b>1,059,000</b>          | 801,000                   | 658,000                   |
| 25,000,000      | June 5, 2018   | December 5, 2019 | 1-Month USD LIBOR       | 2.466%          | <b>59,000</b>             | —                         | —                         |
| 25,000,000      | June 5, 2018   | June 5, 2020     | 1-Month USD LIBOR       | 2.547%          | <b>94,000</b>             | —                         | —                         |
| 25,000,000      | June 5, 2018   | December 5, 2020 | 1-Month USD LIBOR       | 2.603%          | <b>124,000</b>            | —                         | —                         |
| \$125,000,000   |                |                  |                         |                 | <b>\$2,888,000</b>        | \$1,955,000               | \$1,592,000               |

<sup>(1)</sup> Presented within other assets in the consolidated balance sheet.

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

**Note 11 – Mortgage Servicing Rights**

FASB ASC Topic 860 "Transfers and Servicing" requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable. The Company's servicing assets and servicing liabilities are reported using the amortization method and carried at the lower of amortized cost or fair value by strata. In evaluating the carrying values of mortgage servicing rights, the Company obtains third party valuations based on loan level data including note rate, type and term of the underlying loans. The model utilizes several assumptions, the most significant of which is loan prepayments, calculated using a three-months moving average of weekly prepayment data published by the Public Securities Association (PSA) and modeled against the serviced loan portfolio, and the discount rate to discount future cash flows. As of September 30, 2018, the prepayment assumption using the PSA model was 127, which translates into an anticipated prepayment rate of 7.65%. The discount rate is 9.50%. Other assumptions include delinquency rates, foreclosure rates, servicing cost inflation, and annual unit loan cost. All assumptions are adjusted periodically to reflect current circumstances. Amortization of mortgage servicing rights, as well as write-offs due to prepayments of the related mortgage loans, are recorded as a charge against mortgage servicing fee income.

For the nine months ended September 30, 2018 and 2017, servicing rights capitalized totaled \$184,000 and \$339,000, respectively. Servicing rights amortized for the nine-month periods ended September 30, 2018 and 2017 were \$152,000 and \$274,000, respectively. The fair value of servicing rights was \$2,572,000, \$2,321,000 and \$1,888,000 at September 30, 2018, December 31, 2017 and September 30, 2017, respectively. The Bank serviced loans for others totaling \$257,584,000, \$260,258,000 and \$256,530,000 at September 30, 2018, December 31, 2017, and September 30, 2017, respectively.

Mortgage servicing rights are included in other assets and detailed in the following table:

|                           | September 30,<br>2018 | December 31,<br>2017 | September 30,<br>2017 |
|---------------------------|-----------------------|----------------------|-----------------------|
| Mortgage servicing rights | <b>\$5,611,000</b>    | \$5,428,000          | \$5,199,000           |
| Accumulated amortization  | <b>(4,312,000)</b>    | (4,160,000)          | (4,072,000)           |
| Impairment reserve        | —                     | —                    | (18,000)              |
|                           | <b>\$1,299,000</b>    | \$1,268,000          | \$1,109,000           |

**Note 12 – Income Taxes**

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

**Note 13 - Certificates of Deposit**

The following table represents the breakdown of certificates of deposit at September 30, 2018 and 2017, and at December 31, 2017:

|                                     | September 30,<br>2018 | December 31,<br>2017 | September 30,<br>2017 |
|-------------------------------------|-----------------------|----------------------|-----------------------|
| Certificates of deposit < \$100,000 | <b>\$389,317,000</b>  | \$284,066,000        | \$250,865,000         |
| Certificates \$100,000 to \$250,000 | <b>168,402,000</b>    | 232,759,000          | 202,722,000           |
| Certificates \$250,000 and over     | <b>61,690,000</b>     | 42,176,000           | 43,257,000            |
|                                     | <b>\$619,409,000</b>  | \$559,001,000        | \$496,844,000         |

***Note 14 – Reclassifications***

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

***Note 15 – Fair Value***

Certain assets and liabilities are recorded at fair value to provide additional insight into the Company's quality of earnings. Some of these assets and liabilities are measured on a recurring basis while others are measured on a nonrecurring basis, with the determination based upon applicable existing accounting pronouncements. For example, securities available for sale are recorded at fair value on a recurring basis. Other assets, such as, other real estate owned and impaired loans, are recorded at fair value on a nonrecurring basis using the lower of cost or market methodology to determine impairment of individual assets. The Company groups assets and liabilities which are recorded at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement (with level 1 considered highest and level 3 considered lowest). A brief description of each level follows:

**Level 1** - Valuation is based upon quoted prices for identical instruments in active markets.

**Level 2** - Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

**Level 3** - Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates that market participants would use in pricing the asset or liability. Valuation includes use of discounted cash flow models and similar techniques.

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

***Cash, Cash Equivalents and Interest-Bearing Deposits in Other Banks***

The carrying values of cash equivalents, due from banks and federal funds sold approximate their relative fair values. As such, the Company classifies these financial instruments as Level 1.

***Investment Securities***

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

***Loans Held for Sale***

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

***Loans***

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

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

***Other Real Estate Owned***

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

***Mortgage Servicing Rights***

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

***Accrued Interest Receivable***

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

***Deposits***

The fair value of deposits is based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar remaining maturities. As such, the Company classifies deposits as Level 2. The fair value estimates do not include the benefit that results from the low-cost funding provided by the deposits compared to the cost of borrowing funds in the market. If that value were considered, the fair value of the Company's net assets could increase.

***Borrowed Funds***

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

***Derivatives***

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

***Accrued Interest Payable***

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

***Off-Balance-Sheet Instruments***

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

***Limitations***

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

**Assets Recorded at Fair Value on a Recurring Basis**

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

| <b>At September 30, 2018</b>               |                    |                      |                          |
|--|--------------------|----------------------|--------------------------|
|  | <b>Level<br/>1</b> | <b>Level 2</b>       | <b>Level 3<br/>Total</b> |
| <b>Securities available for sale</b>       |                    |                      |                          |
| U.S. Government-sponsored agencies         | \$—                | \$4,979,000          | \$—                      |
| Mortgage-backed securities                 | —                  | 292,570,000          | —                        |
| State and political subdivisions           | —                  | 4,638,000            | —                        |
| Other equity securities                    | —                  | 3,257,000            | —                        |
| <b>Total securities available for sale</b> | <b>—</b>           | <b>305,444,000</b>   | <b>—</b>                 |
| Interest rate swap agreements              | —                  | 2,888,000            | —                        |
| <b>Total assets</b>                        | <b>\$—</b>         | <b>\$308,332,000</b> | <b>\$—</b>               |

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

| <b>At September 30, 2017</b>               |                    |                      |                          |
|--|--------------------|----------------------|--------------------------|
|  | <b>Level<br/>1</b> | <b>Level 2</b>       | <b>Level 3<br/>Total</b> |
| <b>Securities available for sale</b>       |                    |                      |                          |
| Mortgage-backed securities                 | \$—                | \$288,789,000        | \$—                      |
| State and political subdivisions           | —                  | 6,842,000            | —                        |
| Other equity securities                    | —                  | 3,368,000            | —                        |
| <b>Total securities available for sale</b> | <b>—</b>           | <b>298,999,000</b>   | <b>—</b>                 |
| Interest rate swap agreements              | —                  | 1,592,000            | —                        |
| <b>Total assets</b>                        | <b>\$—</b>         | <b>\$300,591,000</b> | <b>\$—</b>               |

**Assets Recorded at Fair Value on a Non-Recurring Basis**

The following tables include assets measured at fair value on a nonrecurring basis that have had a fair value adjustment since their initial recognition. Other real estate owned is presented net of an allowance of \$53,000 at December 31, 2017 and September 30, 2017. There was no allowance at September 30, 2018. Only collateral-dependent impaired loans with a related specific allowance for loan losses or a partial charge off are included in impaired loans for purposes of fair value disclosures. Impaired loans below are presented net of specific allowances of \$2,109,000, \$1,531,000 and \$1,553,000 at September 30, 2018, December 31, 2017, and September 30, 2017, respectively.

| <b>At September 30, 2018</b> |                    |                |                          |
|------------------------------|--------------------|----------------|--------------------------|
|                              | <b>Level<br/>1</b> | <b>Level 2</b> | <b>Level 3<br/>Total</b> |
| Other real estate owned      | \$—                | \$584,000      | \$—                      |

|                     |            |                    |            |                    |
|---------------------|------------|--------------------|------------|--------------------|
| Impaired loans      | —          | 7,024,000          | —          | 7,024,000          |
| <b>Total assets</b> | <b>\$—</b> | <b>\$7,608,000</b> | <b>\$—</b> | <b>\$7,608,000</b> |

**At December 31, 2017**

|                         | <b>Level<br/>1</b>    | <b>Level 2</b> | <b>Level<br/>3</b> | <b>Total</b>        |
|-------------------------|-----------------------|----------------|--------------------|---------------------|
| Other real estate owned | \$-\$1,012,000        |                | \$                 | -\$1,012,000        |
| Impaired loans          |                       | —6,521,000     | —                  | 6,521,000           |
| <b>Total assets</b>     | <b>\$-\$7,533,000</b> |                | <b>\$</b>          | <b>-\$7,533,000</b> |

**At September 30, 2017**

|                         | <b>Level<br/>1</b>    | <b>Level 2</b> | <b>Level<br/>3</b> | <b>Total</b>        |
|-------------------------|-----------------------|----------------|--------------------|---------------------|
| Other real estate owned | \$-\$320,000          |                | \$                 | -\$320,000          |
| Impaired loans          |                       | —7,334,000     | —                  | 7,334,000           |
| <b>Total assets</b>     | <b>\$-\$7,654,000</b> |                | <b>\$</b>          | <b>-\$7,654,000</b> |

**Fair Value of Financial Instruments**

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

Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company.

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

|  | Carrying<br>value | Estimated fair<br>value | Level 1      | Level 2       | Level 3       |
|--|-------------------|-------------------------|--------------|---------------|---------------|
| <b>Financial assets</b>                  |                   |                         |              |               |               |
| Cash and cash equivalents                | \$21,649,000      | \$21,649,000            | \$21,649,000 | \$—           | \$—           |
| Interest bearing deposits in other banks | 51,045,000        | 51,045,000              | 51,045,000   | —             | —             |
| Securities available for sale            | 305,444,000       | 305,444,000             | —            | 305,444,000   | —             |
| Securities to be held to maturity        | 257,395,000       | 249,890,000             | —            | 249,890,000   | —             |
| Restricted equity securities             | 11,586,000        | 11,586,000              | —            | 11,586,000    | —             |
| Loans held for sale                      | 1,134,000         | 1,134,000               | —            | 1,134,000     | —             |
| Loans (net of allowance for loan losses) |                   |                         |              |               |               |
| Commercial                               |                   |                         |              |               |               |
| Real estate                              | 362,199,000       | 359,421,000             | —            | 423,000       | 358,998,000   |
| Construction                             | 23,639,000        | 23,458,000              | —            | —             | 23,458,000    |
| Other                                    | 183,935,000       | 184,116,000             | —            | 6,033,000     | 178,083,000   |
| Municipal                                | 56,677,000        | 56,981,000              | —            | —             | 56,981,000    |
| Residential                              |                   |                         |              |               |               |
| Term                                     | 458,174,000       | 459,561,000             | —            | 475,000       | 459,086,000   |
| Construction                             | 18,124,000        | 18,095,000              | —            | —             | 18,095,000    |
| Home equity line of credit               | 104,373,000       | 103,209,000             | —            | 93,000        | 103,116,000   |
| Consumer                                 | 24,755,000        | 24,126,000              | —            | —             | 24,126,000    |
| Total loans                              | 1,231,876,000     | 1,228,967,000           | —            | 7,024,000     | 1,221,943,000 |
| Mortgage servicing rights                | 1,299,000         | 2,572,000               | —            | 2,572,000     | —             |
| Interest rate swap agreements            | 2,888,000         | 2,888,000               | —            | 2,888,000     | —             |
| Accrued interest receivable              | 7,095,000         | 7,095,000               | —            | 7,095,000     | —             |
| <b>Financial liabilities</b>             |                   |                         |              |               |               |
| Demand deposits                          | \$170,728,000     | \$169,751,000           | \$—          | \$169,751,000 | \$—           |
| NOW deposits                             | 357,834,000       | 346,851,000             | —            | 346,851,000   | —             |
| Money market deposits                    | 129,516,000       | 123,865,000             | —            | 123,865,000   | —             |
| Savings deposits                         | 237,424,000       | 216,051,000             | —            | 216,051,000   | —             |
| Local certificates of deposit            | 252,440,000       | 253,014,000             | —            | 253,014,000   | —             |
| National certificates of deposit         | 366,969,000       | 368,127,000             | —            | 368,127,000   | —             |
| Total deposits                           | 1,514,911,000     | 1,477,659,000           | —            | 1,477,659,000 | —             |
| Repurchase agreements                    | 95,160,000        | 90,311,000              | —            | 90,311,000    | —             |
| Federal Home Loan Bank advances          | 170,114,000       | 170,058,000             | —            | 170,058,000   | —             |
| Total borrowed funds                     | 265,274,000       | 260,369,000             | —            | 260,369,000   | —             |
| Accrued interest payable                 | 943,000           | 943,000                 | —            | 943,000       | —             |



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

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



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

|  | Carrying<br>value | Estimated fair<br>value | Level 1      | Level 2       | Level 3       |
|--|-------------------|-------------------------|--------------|---------------|---------------|
| <b>Financial assets</b>                  |                   |                         |              |               |               |
| Cash and cash equivalents                | \$22,375,000      | \$22,375,000            | \$22,375,000 | \$—           | \$—           |
| Interest bearing deposits in other banks | 584,000           | 584,000                 | 584,000      | —             | —             |
| Securities available for sale            | 298,999,000       | 298,999,000             | —            | 298,999,000   | —             |
| Securities to be held to maturity        | 242,679,000       | 245,021,000             | —            | 245,021,000   | —             |
| Restricted equity securities             | 10,798,000        | 10,798,000              | —            | 10,798,000    | —             |
| Loans held for sale                      | 434,000           | 434,000                 | —            | 434,000       | —             |
| Loans (net of allowance for loan losses) |                   |                         |              |               |               |
| Commercial                               |                   |                         |              |               |               |
| Real estate                              | 296,888,000       | 290,475,000             | —            | 351,000       | 290,124,000   |
| Construction                             | 32,348,000        | 31,649,000              | —            | —             | 31,649,000    |
| Other                                    | 169,493,000       | 167,710,000             | —            | 6,259,000     | 161,451,000   |
| Municipal                                | 33,289,000        | 33,466,000              | —            | —             | 33,466,000    |
| Residential                              |                   |                         |              |               |               |
| Term                                     | 428,318,000       | 431,112,000             | —            | 724,000       | 430,388,000   |
| Construction                             | 15,461,000        | 15,307,000              | —            | —             | 15,307,000    |
| Home equity line of credit               | 109,433,000       | 107,891,000             | —            | —             | 107,891,000   |
| Consumer                                 | 24,844,000        | 24,416,000              | —            | —             | 24,416,000    |
| Total loans                              | 1,110,074,000     | 1,102,026,000           | —            | 7,334,000     | 1,094,692,000 |
| Mortgage servicing rights                | 1,109,000         | 1,888,000               | —            | 1,888,000     | —             |
| Interest rate swap agreements            | 1,592,000         | 1,592,000               | —            | 1,592,000     | —             |
| Accrued interest receivable              | 5,820,000         | 5,820,000               | —            | 5,820,000     | —             |
| <b>Financial liabilities</b>             |                   |                         |              |               |               |
| Demand deposits                          | \$158,797,000     | \$154,034,000           | \$—          | \$154,034,000 | \$—           |
| NOW deposits                             | 325,695,000       | 306,947,000             | —            | 306,947,000   | —             |
| Money market deposits                    | 134,257,000       | 126,541,000             | —            | 126,541,000   | —             |
| Savings deposits                         | 234,456,000       | 207,813,000             | —            | 207,813,000   | —             |
| Local certificates of deposit            | 220,702,000       | 220,047,000             | —            | 220,047,000   | —             |
| National certificates of deposit         | 276,142,000       | 276,078,000             | —            | 276,078,000   | —             |
| Total deposits                           | 1,350,049,000     | 1,291,460,000           | —            | 1,291,460,000 | —             |
| Repurchase agreements                    | 75,412,000        | 72,948,000              | —            | 72,948,000    | —             |
| Federal Home Loan Bank advances          | 158,916,000       | 158,424,000             | —            | 158,424,000   | —             |
| Total borrowed funds                     | 234,328,000       | 231,372,000             | —            | 231,372,000   | —             |
| Accrued interest payable                 | 605,000           | 605,000                 | —            | 605,000       | —             |

**Note 16 – Impact of Recently Issued Accounting Standards**

The FASB issued Accounting Standards Update (“ASU”) No. 2014-09, Revenue from Contracts with Customers, in 2014 to replace the current plethora of industry-specific rules with a broad, principles-based framework for recognizing and measuring revenue. Due to the complexity of the new pronouncement and the anticipated effort required by entities in many industries to implement ASU No. 2014-09, FASB delayed the effective date. Public business entities, certain not-for-profit entities, and certain employee benefit plans should apply the guidance to annual reporting periods beginning after December 15, 2017, and all other entities should apply the guidance to annual reporting periods beginning after December 15, 2018. FASB formed a Transition Resource Group to assist it in identifying implementation issues that may require further clarification or amendment to ASU No. 2014-09. As a

result of that group's deliberations, FASB has issued the following amendments, which will be effective concurrently with ASU No. 2014-09: ASU No. 2016-08, Principal versus Agent Considerations, which clarifies whether an entity should record the gross amount of revenue or only its ultimate share when a third party is also involved in

providing goods or services to a customer; ASU No. 2016-10, Identifying Performance Obligations and Licensing, which clarifies and simplifies the process for determining whether performance obligations to a customer should be segregated and accounted for individually, and clarifies how the new revenue rules apply to licenses of intellectual property; and ASU No. 2016-12, Narrow-Scope Improvements and Practical Expedients, which clarifies and simplifies the process of assessing collectability of consideration under a contract, presentation of sales taxes, accounting for noncash consideration received, and certain transitional issues. The new standard does not apply to revenue associated with financial instruments, including loans and securities that are accounted for under other U.S. GAAP. The Company has reviewed its various other revenue streams and concluded that the new standard will have minimal impact upon its consolidated financial statements. Adoption of ASU No. 2014-09 was made on January 1, 2018 utilizing the modified retrospective approach.

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

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

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

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

In March 2017, the FASB issued ASU No. 2017-08, Premium Amortization on Purchased Callable Debt Securities. This ASU shortens the amortization period for the premium on certain purchased callable debt securities to the earliest call date. Today, many entities amortize the premium over the contractual life of the security. The new guidance does

not change the accounting for purchased callable debt securities held at a discount; the discount continues to be accreted to maturity. The ASU is effective for interim and annual reporting periods beginning after December 15, 2018; early adoption is permitted. The guidance calls for a modified retrospective transition approach under which a cumulative-effect adjustment will be made to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. The Company's current practice aligns with the ASU therefore Management believes there will be no impact on the Company's consolidated financial statements.

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

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

In July 2018, the FASB issued ASU No. 2018-11, Leases - Targeted Improvements to provide entities with relief from the costs of implementing certain aspects of the new leasing standard, ASU No. 2016-02. Specifically, under the amendments in ASU 2018-11: (1) entities may elect not to recast the comparative periods presented when transitioning to the new leasing standard, and (2) lessors may elect not to separate lease and non-lease components when certain conditions are met. The amendments have the same effective date as ASU 2016-02. The Company expects to elect both transition options. The adoption of ASU 2018-11 is not expected to have a material effect on the Company's consolidated financial statements.

In August 2018, the FASB issued ASU No. 2018-13, Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement. This ASU eliminates, adds and modifies certain disclosure requirements for fair value measurements. Among the changes, entities will no longer be required to disclose the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, but will be required to disclose the range and weighted average used to develop significant unobservable inputs for Level 3 fair value measurements. ASU No. 2018-13 is effective for interim and annual reporting periods beginning after December 15, 2019; early adoption is permitted. Entities are also allowed to elect early adoption the eliminated or modified disclosure requirements and delay adoption of the new disclosure requirements until their effective date. As ASU No. 2018-13 only revises disclosure requirements, it will not have a material impact on the Company's consolidated financial statements.

In August 2018, the FASB issued ASU No. 2018-14, Disclosure Framework - Changes to the Disclosure Requirements for Defined Benefit Plans. This ASU makes minor changes to the disclosure requirements for employers that sponsor defined benefit pension and/or other postretirement benefit plans. ASU 2018-14 is effective for fiscal years ending after December 15, 2020; early adoption is permitted. As ASU 2018-14 only revises disclosure requirements, it will not have a material impact on the Company's consolidated financial statements.

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

The First Bancorp, Inc. and Subsidiary

***Forward-Looking Statements***

This report contains statements that are "forward-looking statements." We may also make written or oral forward-looking statements in other documents we file with the Securities and Exchange Commission ("SEC"), in our annual reports to shareholders, in press releases and other written materials, and in oral statements made by our officers, directors or employees. You can identify forward-looking statements by the use of the words "believe," "expect," "anticipate," "intend," "estimate," "assume," "outlook," "will," "should," and other expressions that predict or indicate future events and trends and which do not relate to historical matters. You should not rely on forward-looking statements, because they involve known and unknown risks, uncertainties and other factors, some of which are beyond the control of the Company. These risks, uncertainties and other factors may cause the actual results, performance or achievements of the Company to be materially different from the anticipated future results, performance or achievements expressed or implied by the forward-looking statements.

Some of the factors that might cause these differences include the following: changes in general national, regional or international economic conditions or conditions affecting the banking or financial services industries or financial capital markets, volatility and disruption in national and international financial markets, government intervention in the U.S. financial system, reductions in net interest income resulting from interest rate volatility as well as changes in the balance and mix of loans and deposits, reductions in the market value of wealth management assets under administration, changes in the value of securities and other assets, reductions in loan demand, changes in loan collectability, default and charge-off rates, changes in the size and nature of the Company's competition, changes in legislation or regulation and accounting principles, policies and guidelines, and changes in the assumptions used in making such forward-looking statements. In addition, the factors described under "Risk Factors" in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2017, as filed with the SEC, may result in these differences. You should carefully review all of these factors, and you should be aware that there may be other factors that could cause these differences. These forward-looking statements were based on information, plans and estimates at the date of this quarterly report, and we assume no obligation to update any forward-looking statements to reflect changes in underlying assumptions or factors, new information, future events or other changes.

Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, actual results may differ materially from the results discussed in these forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. The Company undertakes no obligation to republish revised forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. Readers are also urged to carefully review and consider the various disclosures made by the Company, which attempt to advise interested parties of the facts that affect the Company's business.

***Critical Accounting Policies***

Management's discussion and analysis of the Company's financial condition is based on the consolidated financial statements which are prepared in accordance with GAAP. The preparation of such financial statements requires Management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On an ongoing basis, Management evaluates its estimates, including those related to the allowance for loan losses, goodwill, the valuation of mortgage servicing rights, and other-than-temporary impairment on securities. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis in making judgments about the carrying values of assets that are not readily apparent from other sources. Actual results could differ from the amount derived from Management's estimates and assumptions under different assumptions or conditions.

**Allowance for Loan Losses.** Management believes the allowance for loan losses requires the most significant estimates and assumptions used in the preparation of the consolidated financial statements. The allowance for loan losses is based on Management's evaluation of the level of the allowance required in relation to the estimated loss

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

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

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

**Other-Than-Temporary Impairment on Securities.** One of the significant estimates related to investment securities is the evaluation of other-than-temporary impairments. The evaluation of securities for other-than-temporary impairments is a quantitative and qualitative process, which is subject to risks and uncertainties and is intended to determine whether declines in the fair value of investments should be recognized in current period earnings. The risks and uncertainties include changes in general economic conditions, the issuer's financial condition and/or future prospects, the effects of changes in interest rates or credit spreads and the expected recovery period of unrealized losses. Securities that are in an unrealized loss position are reviewed at least quarterly to determine if other-than-temporary impairment is present based on certain quantitative and qualitative factors and measures. The primary factors considered in evaluating whether a decline in value of securities is other-than-temporary include: (a) the length of time and extent to which the fair value has been less than cost or amortized cost and the expected recovery period of the security, (b) the financial condition, credit rating and future prospects of the issuer, (c) whether the debtor is current on contractually obligated interest and principal payments, (d) the volatility of the securities' market price, (e) the intent and ability of the Company to retain the investment for a period of time sufficient to allow for recovery, which may be at maturity and (f) any other information and observable data considered relevant in determining whether other-than-temporary impairment has occurred, including the expectation of receipt of all principal and interest when due.

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

***Use of Non-GAAP Financial Measures***

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

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

|                                     | <b>For the nine months ended</b> |          | <b>For the quarter ended</b> |          |
|-------------------------------------|----------------------------------|----------|------------------------------|----------|
|                                     | <b>September 30,</b>             |          | <b>September 30,</b>         |          |
| <i>Dollars in thousands</i>         | <b>2018</b>                      | 2017     | <b>2018</b>                  | 2017     |
| Net interest income as presented    | <b>\$37,214</b>                  | \$35,095 | <b>\$12,536</b>              | \$11,954 |
| Effect of tax-exempt income         | <b>1,603</b>                     | 2,953    | <b>557</b>                   | 1,003    |
| Net interest income, tax equivalent | <b>\$38,817</b>                  | \$38,048 | <b>\$13,093</b>              | \$12,957 |

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

|   | <b>For the nine months ended</b> |          | <b>For the quarter ended</b> |          |
|---|----------------------------------|----------|------------------------------|----------|
|   | <b>September 30,</b>             |          | <b>September 30,</b>         |          |
| <i>Dollars in thousands</i>                           | <b>2018</b>                      | 2017     | <b>2018</b>                  | 2017     |
| Non-interest expense, as presented                    | <b>\$24,971</b>                  | \$23,351 | <b>\$8,216</b>               | \$8,013  |
| Net interest income, as presented                     | <b>37,214</b>                    | 35,095   | <b>12,536</b>                | 11,954   |
| Effect of tax-exempt interest income                  | <b>1,603</b>                     | 2,953    | <b>557</b>                   | 1,003    |
| Non-interest income, as presented                     | <b>9,347</b>                     | 9,338    | <b>3,034</b>                 | 3,493    |
| Effect of non-interest tax-exempt income              | <b>124</b>                       | 248      | <b>41</b>                    | 83       |
| Net securities gains                                  | <b>(137)</b>                     | (471)    | <b>(1)</b>                   | (468)    |
| Adjusted net interest income plus non-interest income | <b>\$48,151</b>                  | \$47,163 | <b>\$16,167</b>              | \$16,065 |
| Non-GAAP efficiency ratio                             | <b>51.86</b>                     | % 49.51  | <b>50.82</b>                 | % 49.88  |
| GAAP efficiency ratio                                 | <b>53.63</b>                     | % 52.55  | <b>52.77</b>                 | % 51.87  |

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



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

| <i>Dollars in thousands</i>                  | <b>For the nine months ended September 30, 2018</b> |           |                  |           | <b>For the quarter ended September 30, 2017</b> |      |             |      |
|--|---|-----------|------------------|-----------|---|------|-------------|------|
|  | <b>2018</b>   | 2017      | <b>2018</b>      | 2017      | <b>2018</b>                                     | 2017 | <b>2018</b> | 2017 |
| Average shareholders' equity as presented    | <b>\$184,132</b>                                    | \$178,482 | <b>\$186,399</b> | \$181,153 |   |      |             |      |
| Less average intangible assets               | <b>(30,006 )</b>                                    | (30,049 ) | <b>(30,021 )</b> | (30,064 ) |   |      |             |      |
| Average tangible shareholders' common equity | <b>\$154,126</b>                                    | \$148,433 | <b>\$156,378</b> | \$151,089 |   |      |             |      |

### ***Executive Summary***

Net income for the nine months ended September 30, 2018 was \$17.2 million, up \$2.7 million or 18.4% from the same period in 2017. Earnings per common share on a fully diluted basis were \$1.58 for the nine months ended September 30, 2018, up \$0.24 or 17.9% from the \$1.34 posted for the same period in 2017. For the quarter ended September 30, 2018, net income was \$5.9 million, up \$951,000 or 19.1% from the same period in 2017. Earnings per common share on a fully diluted basis were \$0.55 for the quarter ended September 30, 2018, up \$0.09 or 19.6% from the \$0.46 posted in 2017. Compared to the previous quarter, net income was up \$199,000 or 3.5% and earnings per common share on a fully diluted basis were up \$0.02 or 3.8%.

This was the best quarter in the Company's history, including another quarter of record earnings. Continued growth in earning assets resulted in increased net interest income despite tighter margins. The Company's fee-based business lines continue to generate year-over-year revenue growth, led by First Advisors, the Bank's trust and investment management division, where revenues are up 15% over the first nine months of last year. Based upon the strength of the Company's earnings, a dividend of 29 cents per share was declared in the third quarter, representing a payout to our shareholders of 52.73% of net income for the period.

Net interest income on a tax-equivalent basis was up \$769,000 or 2.0% in the nine months ended September 30, 2018 compared to the same period in 2017, with the increase primarily attributable to growth in earning assets. This growth offset a year-over-year decline in our net interest margin from 3.03% in the first nine months of 2017 to 2.90% in the first nine months of 2018. For the quarter ended September 30, 2018, net interest income on a tax-equivalent basis increased \$136,000 or 1.0% compared to the same period in 2017, despite a decline in the net interest margin period to period from 3.02% to 2.83%. The quarterly and year-to-date margin declines are due to higher funding costs and a reduced benefit from tax-exempt assets.

Non-interest income for the nine months ended September 30, 2018 was up \$9,000 or 0.1%, from the nine months ended September 30, 2017. Revenue growth from First Advisors and deposit-based charges offset a period to period decline in mortgage banking income and net securities gains. Non-interest expense for the nine months ended September 30, 2018 was up \$1.6 million or 6.9%, from the same period in 2017, primarily due to higher employee costs as we continue to invest in the people and technology to sustain growth.

Credit quality is stable and remains solid. Non-performing assets stood at 0.74% of total assets as of September 30, 2018 - down from 0.94% of total assets as of September 30, 2017 and 0.86% as of December 31, 2017. Total past-due loans were 0.83% of total loans as of September 30, 2018, down from 1.60% of total loans as of December 31, 2017 and 0.98% as of September 30, 2017.

The provision for loan losses for the first nine months of 2018 was \$1.3 million, down \$417,000 from the amount provisioned in the same period in 2017. Net loan chargeoffs for the nine months ended September 30, 2018 were \$380,000 or 0.04% of average loans on an annualized basis. This was down \$496,000 from net chargeoffs of \$876,000 or 0.11% of average loans on an annualized basis for the nine months ended September 30, 2017. The allowance for loan losses increased \$953,000 between December 31, 2017 and September 30, 2018, and is 0.94% of loans outstanding as of September 30, 2018, up slightly from 0.92% as of as of December 31, 2017 and down slightly from 0.98% of total loans as of September 30, 2017.

The strong growth on both sides of the balance sheet experienced in 2017 continued into the first nine months of 2018. Total assets have increased \$138.9 million or 7.5% year-to-date. The loan portfolio increased \$79.4 million or 6.8% in the nine months ended September 30, 2018 and \$122.5 million or 10.9% from a year ago. The majority of the loan

growth has been in commercial and municipal loans, with modest growth in residential term mortgage loans. The investment portfolio has increased \$7.3 million year-to-date and increased \$21.9 million or 4.0% from a year ago. On the liability side of the balance sheet, low-cost deposits have increased \$70.0 million or 10.1% year-to-date, in-line with our normal seasonal deposit flow pattern. Year-over-year low-cost deposits increased \$47.0 million or 6.5%. Local certificates of deposit ("CDs") decreased \$36.5 million and wholesale CDs increased \$159.1 million year-to-date.

Remaining well capitalized remains a top priority for The First Bancorp, Inc. Since December 31, 2008, the Company's total risk-based capital ratio has increased from 11.13% to 14.84%, well above the well-capitalized threshold of 10.0% set by the Federal Deposit Insurance Corporation, the Federal Reserve Board, and the Office of the Comptroller of the Currency.

The Company's operating ratios remain good, with a return on average tangible common equity of 14.90% for the nine months ended September 30, 2018 compared to 13.06% for the same period in 2017. Based upon June 30, 2018 data, our return on average tangible common equity was in the top 21% of all banks in the UBPR peer group, which had an average return on equity of 11.71%. Our efficiency ratio continues to be an important component in our overall performance and stood at 51.86% for the nine months ended September 30, 2018 compared to 49.51% for the same period in 2017. The increase being attributable to increased operating expenses and a reduction in tax equivalent revenue from the Company's tax exempt assets, as a result of the Tax Cuts and Jobs Act of 2017 ("the TCJA"). This ratio remains well below the UBPR peer group average of 61.87% as of June 30, 2018.

#### **Net Interest Income**

Total interest income of \$51.7 million for the nine months ended September 30, 2018 was an increase of \$6.7 million or 15.0% compared to total interest income of \$45.0 million for the same period of 2017. Total interest expense of \$14.5 million for the nine months ended September 30, 2018 was an increase of \$4.6 million or 46.5% compared to total interest expense for the nine months ended September 30, 2017. As a result, net interest income of \$37.2 million for the nine months ended September 30, 2018 was an increase of \$2.1 million or 6.0% compared to net interest income of \$35.1 million for the same period ended September 30, 2017. The Company's net interest margin on a tax-equivalent basis decreased from 3.03% for the nine months ended September 30, 2017 to 2.90% for the nine months ended September 30, 2018. Tax-exempt interest income amounted to \$6.0 million for the nine months ended September 30, 2018 and \$5.5 million for the same period of 2017.

Total interest income of \$18.1 million for the quarter ended September 30, 2018 is a 16.6% increase from total interest income of \$15.5 million in the comparable period of 2017. Total interest expense of \$5.6 million for the quarter ended September 30, 2018 is a 55.8% increase from total interest expense of \$3.6 million for the comparable period of 2017. As a result, net interest income increased 4.9% or \$582,000 to \$12.5 million for the quarter ended September 30, 2018, from the \$12.0 million reported for the same period in 2017. The Company's net interest margin on a tax-equivalent basis decreased from 3.02% for the quarter ended September 30, 2017 to 2.83% for the quarter ended September 30, 2018. Tax-exempt interest income amounted to \$2.1 million for the quarters ended September 30, 2018 and \$1.9 million for the same period of 2017.

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

|                                   | <b>For the nine months ended</b> |                           |                    |                    |   |
|-----------------------------------|----------------------------------|---------------------------|--------------------|--------------------|---|
|                                   | <b>September 30, 2018</b>        |                           | September 30, 2017 |                    |   |
| <i>Dollars in thousands</i>       | <b>Amount of interest</b>        | <b>Average Yield/Rate</b> | Amount of interest | Average Yield/Rate |   |
| <b>Interest on earning assets</b> |                                  |                           |                    |                    |   |
| Interest-bearing deposits         | \$132                            | 1.95                      | % \$46             | 0.92               | % |
| Investments                       | 13,831                           | 3.22                      | % 14,185           | 3.36               | % |
| Loans held for sale               | 5                                | 2.08                      | % 20               | 3.72               | % |
| Loans                             | 39,377                           | 4.37                      | % 33,712           | 4.08               | % |
| Total interest income             | 53,345                           | 3.99                      | % 47,963           | 3.82               | % |
| <b>Interest expense</b>           |                                  |                           |                    |                    |   |
| Deposits                          | 11,131                           | 1.16                      | % 6,769            | 0.79               | % |
| Other borrowings                  | 3,397                            | 1.69                      | % 3,146            | 1.63               | % |
| Total interest expense            | 14,528                           | 1.25                      | % 9,915            | 0.95               | % |
| <b>Net interest income</b>        | <b>\$38,817</b>                  |                           | \$38,048           |                    |   |
| Interest rate spread              |                                  | 2.74                      | %                  | 2.87               | % |
| Net interest margin               |                                  | 2.90                      | %                  | 3.03               | % |



| <i>Dollars in thousands</i>       | <b>For the quarters ended</b> |                           |                           |                           |   |
|-----------------------------------|-------------------------------|---------------------------|---------------------------|---------------------------|---|
|                                   | <b>September 30, 2018</b>     |                           | <b>September 30, 2017</b> |                           |   |
|                                   | <b>Amount of interest</b>     | <b>Average Yield/Rate</b> | <b>Amount of interest</b> | <b>Average Yield/Rate</b> |   |
| <b>Interest on earning assets</b> |                               |                           |                           |                           |   |
| Interest-bearing deposits         | \$ 115                        | 1.97                      | % \$ 23                   | 1.52                      | % |
| Investments                       | 4,700                         | 3.23                      | % 4,736                   | 3.31                      | % |
| Loans held for sale               | 7                             | 8.07                      | % 8                       | 3.57                      | % |
| Loans                             | 13,821                        | 4.45                      | % 11,753                  | 4.13                      | % |
| Total interest-earning assets     | 18,643                        | 4.04                      | % 16,520                  | 3.85                      | % |
| <b>Interest expense</b>           |                               |                           |                           |                           |   |
| Deposits                          | 4,274                         | 1.30                      | % 2,473                   | 0.86                      | % |
| Other borrowings                  | 1,276                         | 1.86                      | % 1,090                   | 1.58                      | % |
| Total interest expense            | 5,550                         | 1.39                      | % 3,563                   | 1.00                      | % |
| <b>Net interest income</b>        | <b>\$ 13,093</b>              |                           | <b>\$ 12,957</b>          |                           |   |
| Interest rate spread              |                               | 2.65                      | %                         | 2.85                      | % |
| Net interest margin               |                               | 2.83                      | %                         | 3.02                      | % |

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

**For the nine months ended September 30, 2018 compared to 2017**

| <i>Dollars in thousands</i>       | Volume   | Rate      | Rate/Volume <sup>1</sup> | Total  |
|-----------------------------------|----------|-----------|--------------------------|--------|
| <b>Interest on earning assets</b> |          |           |                          |        |
| Interest-bearing deposits         | \$ 16    | \$ 52     | \$ 18                    | \$ 86  |
| Investment securities             | 220      | (565 )    | ( 9 )                    | (354 ) |
| Loans held for sale               | (3 )     | 5         | (3 )                     | (1 )   |
| Loans                             | 3,026    | 2,409     | 216                      | 5,651  |
| Change in interest income         | 3,259    | 1,901     | 222                      | 5,382  |
| <b>Interest expense</b>           |          |           |                          |        |
| Deposits                          | 818      | 3,162     | 382                      | 4,362  |
| Other borrowings                  | 125      | 121       | 5                        | 251    |
| Change in interest expense        | 943      | 3,283     | 387                      | 4,613  |
| Change in net interest income     | \$ 2,316 | \$(1,382) | \$ (165 )                | \$ 769 |

<sup>1</sup> Represents the change attributable to a combination of change in rate and change in volume.

**For the quarter ended September 30, 2018 compared to 2017**

| <i>Dollars in thousands</i>       | Volume | Rate   | Rate/Volume <sup>1</sup> | Total |
|-----------------------------------|--------|--------|--------------------------|-------|
| <b>Interest on earning assets</b> |        |        |                          |       |
| Interest-bearing deposits         | \$ 66  | \$ 7   | \$ 19                    | \$ 92 |
| Investment securities             | 85     | (119 ) | (2 )                     | (36 ) |
| Loans held for sale               | (5 )   | 10     | (6 )                     | (1 )  |
| Loans                             | 1,084  | 901    | 83                       | 2,068 |
| Change in interest income         | 1,230  | 799    | 94                       | 2,123 |
| <b>Interest expense</b>           |        |        |                          |       |
| Deposits                          | 358    | 1,260  | 183                      | 1,801 |
| Other borrowings                  | (3 )   | 190    | (1 )                     | 186   |

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|                               |       |         |          |       |
|-------------------------------|-------|---------|----------|-------|
| Change in interest expense    | 355   | 1,450   | 182      | 1,987 |
| Change in net interest income | \$875 | \$(651) | \$ (88 ) | \$136 |

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**Average Daily Balance Sheets**

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

| <i>Dollars in thousands</i>   | <b>For the nine months ended</b> |                           | <b>For the quarters ended</b> |                           |
|---|----------------------------------|---------------------------|-------------------------------|---------------------------|
|   | <b>September 30, 2018</b>        | <b>September 30, 2017</b> | <b>September 30, 2018</b>     | <b>September 30, 2017</b> |
| <b>Assets</b>   |                                  |                           |                               |                           |
| Cash and cash equivalents   | <b>\$18,443</b>                  | \$17,096                  | <b>\$22,244</b>               | \$20,763                  |
| Interest-bearing deposits in other banks  | <b>9,038</b>                     | 6,697                     | <b>23,145</b>                 | 6,007                     |
| Securities available for sale   | <b>304,038</b>                   | 311,488                   | <b>307,029</b>                | 311,462                   |
| Securities to be held to maturity   | <b>257,798</b>                   | 240,355                   | <b>258,282</b>                | 243,187                   |
| Restricted equity securities, at cost   | <b>11,603</b>                    | 12,849                    | <b>11,890</b>                 | 12,370                    |
| Loans held for sale   | <b>321</b>                       | 719                       | <b>344</b>                    | 889                       |
| Loans   | <b>1,204,327</b>                 | 1,105,168                 | <b>1,232,252</b>              | 1,128,199                 |
| Allowance for loan losses   | <b>(11,207)</b>                  | (10,475)                  | <b>(11,605)</b>               | (10,734)                  |
| Net loans   | <b>1,193,120</b>                 | 1,094,693                 | <b>1,220,647</b>              | 1,117,465                 |
| Accrued interest receivable   | <b>6,785</b>                     | 6,327                     | <b>6,790</b>                  | 6,255                     |
| Premises and equipment  | <b>21,952</b>                    | 21,707                    | <b>21,593</b>                 | 21,459                    |
| Other real estate owned   | <b>812</b>                       | 341                       | <b>401</b>                    | 326                       |
| Goodwill  | <b>29,805</b>                    | 29,805                    | <b>29,805</b>                 | 29,805                    |
| Other assets  | <b>40,312</b>                    | 36,616                    | <b>41,067</b>                 | 37,319                    |
| <b>Total Assets</b>   | <b>\$1,894,027</b>               | \$1,778,693               | <b>\$1,943,237</b>            | \$1,807,307               |
| <b>Liabilities &amp; Shareholders' Equity</b>   |                                  |                           |                               |                           |
| Demand deposits   | <b>\$147,083</b>                 | \$185,093                 | <b>\$161,795</b>              | \$196,037                 |
| NOW deposits  | <b>304,032</b>                   | 262,213                   | <b>309,979</b>                | 257,035                   |
| Money market deposits   | <b>116,084</b>                   | 134,469                   | <b>117,973</b>                | 139,545                   |
| Savings deposits  | <b>232,314</b>                   | 224,993                   | <b>232,926</b>                | 230,933                   |
| Certificates of deposit   | <b>629,064</b>                   | 521,687                   | <b>646,999</b>                | 514,915                   |
| Total deposits  | <b>1,428,577</b>                 | 1,328,455                 | <b>1,469,672</b>              | 1,338,465                 |
| Borrowed funds – short term   | <b>203,448</b>                   | 258,279                   | <b>207,513</b>                | 273,451                   |
| Borrowed funds – long term  | <b>65,114</b>                    | —                         | <b>65,114</b>                 | —                         |
| Dividends payable   | <b>1,073</b>                     | 993                       | <b>1,131</b>                  | 901                       |
| Other liabilities   | <b>11,683</b>                    | 12,484                    | <b>13,408</b>                 | 13,337                    |
| Total Liabilities   | <b>1,709,895</b>                 | 1,600,211                 | <b>1,756,838</b>              | 1,626,154                 |
| Shareholders' Equity:   |                                  |                           |                               |                           |
| Common stock  | <b>108</b>                       | 108                       | <b>109</b>                    | 108                       |
| Additional paid-in capital  | <b>62,095</b>                    | 61,079                    | <b>62,342</b>                 | 61,310                    |
| Retained earnings   | <b>126,990</b>                   | 116,841                   | <b>129,710</b>                | 119,072                   |
| Net unrealized loss on securities available for sale                                      | <b>(6,697)</b>                   | (357)                     | <b>(7,531)</b>                | (26)                      |
| Net unrealized loss on securities transferred from available for sale to held to maturity | <b>(184)</b>                     | (134)                     | <b>(191)</b>                  | (138)                     |
| Net unrealized gain on cash flow hedging derivative instruments                           | <b>1,967</b>                     | 1,047                     | <b>2,107</b>                  | 929                       |
| Net unrealized loss on postretirement benefit costs                                       | <b>(147)</b>                     | (102)                     | <b>(147)</b>                  | (102)                     |
| Total Shareholders' Equity  | <b>184,132</b>                   | 178,482                   | <b>186,399</b>                | 181,153                   |
| <b>Total Liabilities &amp; Shareholders' Equity</b>                                       | <b>\$1,894,027</b>               | \$1,778,693               | <b>\$1,943,237</b>            | \$1,807,307               |



***Non-Interest Income***

Non-interest income of \$9.3 million for the nine months ended September 30, 2018 is an increase of \$9,000 compared to the same period in 2017. Revenue growth from First Advisors and deposit-based charges offset a period to period decline in mortgage banking income and net securities gains. Non-interest income of \$3.0 million for the quarter ended September 30, 2018 is a decrease of \$459,000 compared to the same period in 2017, due to a decrease in net securities gains and mortgage origination and servicing income.

***Non-Interest Expense***

Non-interest expense of \$25.0 million for the nine months ended September 30, 2018 is an increase of 6.9% or \$1.6 million compared to non-interest expense of \$23.4 million for the same period in 2017, primarily due to higher employee costs as we continue to invest in the people and technology to sustain growth. The Company's efficiency ratio stood at 51.86% for the nine months ended September 30, 2018, up from 49.51% for the same period in 2017, primarily due to TCJA and higher operating costs. Noninterest expense of \$8.2 million for the quarter ended September 30, 2018 is an increase of 2.5% compared to noninterest expense of \$8.0 million for the same period in 2017 due to the reasons mentioned above.

***Income Taxes***

Income taxes on operating earnings were \$3.1 million for the nine months ended September 30, 2018, down \$1.7 million from the same period in 2017. As expected, the TCJA resulted in a significant income tax expense savings from the prior year.

***Investments***

The Company's investment portfolio increased by \$7.3 million between December 31, 2017 and September 30, 2018. As of September 30, 2018, mortgage-backed securities had a carrying value of \$311.8 million and a fair value of \$311.7 million. Of this total, securities with a fair value of \$127.0 million or 40.8% of the mortgage-backed portfolio were issued by the Government National Mortgage Association and securities with a fair value of \$184.7 million or 59.2% of the mortgage-backed portfolio were issued by the Federal Home Loan Mortgage Corporation ("Freddie Mac") and the Federal National Mortgage Association ("Fannie Mae").

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

All investment securities are managed in accordance with a written investment policy adopted by the Board of Directors. It is the Company's general policy that investments for either portfolio be limited to government debt obligations, time deposits, and corporate bonds or commercial paper with one of the three highest ratings given by a nationally recognized rating agency. The portfolio is currently invested primarily in U.S. Government agency securities and tax-exempt obligations of states and political subdivisions. The individual securities have been selected to enhance the portfolio's overall yield while not materially adding to the Company's level of interest rate risk. During the third quarter of 2014, the Company transferred securities with a total amortized cost of \$89,780,000 and a corresponding fair value of \$89,757,000 from available for sale to held to maturity. The net unrealized loss, net of taxes, on these securities at the date of the transfer was \$15,000. The net unrealized holding loss at the time of transfer continues to be reported in accumulated other comprehensive income (loss), net of tax and is amortized over the remaining lives of the securities as an adjustment of the yield. The amortization of the net unrealized loss reported in accumulated other comprehensive income (loss) will offset the effect on interest income of the discount for the transferred securities. The remaining unamortized balance of the net unrealized losses for the securities transferred from available for sale to held to maturity was \$194,000 at September 30, 2018. These securities were transferred as a part of the Company's overall investment and balance sheet strategies.



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

| <i>Dollars in thousands</i>              | <b>September 30,<br/>2018</b> | December 31,<br>2017 | September 30,<br>2017 |
|--|-------------------------------|----------------------|-----------------------|
| <b>Securities available for sale</b>     |                               |                      |                       |
| U.S. government-sponsored agencies       | <b>\$ 4,979</b>               | \$ —                 | \$ —                  |
| Mortgage-backed securities               | <b>292,570</b>                | 289,989              | 288,789               |
| State and political subdivisions         | <b>4,638</b>                  | 6,769                | 6,842                 |
| Other equity securities                  | <b>3,257</b>                  | 3,414                | 3,368                 |
|  | <b>\$ 305,444</b>             | \$ 300,172           | \$ 298,999            |
| <b>Securities to be held to maturity</b> |                               |                      |                       |
| U.S. government-sponsored agencies       | <b>\$ 11,155</b>              | \$ 11,155            | \$ 11,154             |
| Mortgage-backed securities               | <b>19,244</b>                 | 23,284               | 24,993                |
| State and political subdivisions         | <b>222,696</b>                | 217,828              | 202,232               |
| Corporate securities                     | <b>4,300</b>                  | 4,300                | 4,300                 |
|  | <b>\$ 257,395</b>             | \$ 256,567           | \$ 242,679            |
| <b>Restricted equity securities</b>      |                               |                      |                       |
| Federal Home Loan Bank Stock             | <b>\$ 10,549</b>              | \$ 9,321             | \$ 9,761              |
| Federal Reserve Bank Stock               | <b>1,037</b>                  | 1,037                | 1,037                 |
|  | <b>\$ 11,586</b>              | \$ 10,358            | \$ 10,798             |
| Total securities                         | <b>\$ 574,425</b>             | \$ 567,097           | \$ 552,476            |

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

| <i>Dollars in thousands</i>               | <u>Available For Sale</u> |                   | <u>Held to Maturity</u> |                   |   |
|---|---------------------------|-------------------|-------------------------|-------------------|---|
|   | Fair Value                | Yield to maturity | Amortized Cost          | Yield to maturity |   |
| <b>U.S. Government-Sponsored Agencies</b> |                           |                   |                         |                   |   |
| Due in 1 year or less                     | \$—                       | 0.00              | % \$—                   | 0.00              | % |
| Due in 1 to 5 years                       | 4,979                     | 3.38              | % —                     | 0.00              | % |
| Due in 5 to 10 years                      | —                         | 0.00              | % 7,255                 | 3.03              | % |
| Due after 10 years                        | —                         | 0.00              | % 3,900                 | 3.05              | % |
| Total                                     | 4,979                     | 3.38              | % 11,155                | 3.04              | % |
| <b>Mortgage-Backed Securities</b>         |                           |                   |                         |                   |   |
| Due in 1 year or less                     | —                         | 0.00              | % 20                    | 2.01              | % |
| Due in 1 to 5 years                       | 8,532                     | 3.15              | % 3,573                 | 2.75              | % |
| Due in 5 to 10 years                      | 63,171                    | 3.10              | % 11,529                | 3.29              | % |
| Due after 10 years                        | 220,867                   | 2.46              | % 4,122                 | 4.98              | % |
| Total                                     | 292,570                   | 2.62              | % 19,244                | 3.55              | % |
| <b>State &amp; Political Subdivisions</b> |                           |                   |                         |                   |   |
| Due in 1 year or less                     | —                         | 0.00              | % 1,476                 | 5.55              | % |
| Due in 1 to 5 years                       | 375                       | 5.67              | % 17,890                | 5.72              | % |
| Due in 5 to 10 years                      | 4,263                     | 4.40              | % 133,213               | 4.71              | % |
| Due after 10 years                        | —                         | 0.00              | % 70,117                | 4.64              | % |
| Total                                     | 4,638                     | 4.50              | % 222,696               | 4.77              | % |
| <b>Corporate Securities</b>               |                           |                   |                         |                   |   |
| Due in 1 year or less                     | —                         | 0.00              | % 300                   | 1.50              | % |
| Due in 1 to 5 years                       | —                         | 0.00              | % —                     | 0.00              | % |
| Due in 5 to 10 years                      | —                         | 0.00              | % 4,000                 | 5.50              | % |
| Due after 10 years                        | —                         | 0.00              | % —                     | 0.00              | % |
| Total                                     | —                         | 0.00              | % 4,300                 | 5.22              | % |
| <b>Equity Securities</b>                  |                           |                   |                         |                   |   |
|   | 3,257                     | 0.01              | % —                     | 0.00              | % |
|   | \$305,444                 | 2.58              | % \$257,395             | 4.61              | % |

### ***Impaired Securities***

The securities portfolio contains certain securities where the amortized cost of which exceeds fair value, which at September 30, 2018 amounted to \$20.1 million, or 3.58% of the amortized cost of the total securities portfolio. At December 31, 2017 this amount was \$5.9 million, or 1.08% of the amortized cost of total securities portfolio. As a part of the Company's ongoing security monitoring process, the Company identifies securities in an unrealized loss position that could potentially be other-than-temporarily impaired. If a decline in the fair value of a debt security is judged to be other-than-temporary, the decline related to credit loss is recorded in net realized securities losses while the decline attributable to other factors is recorded in other comprehensive income or loss.

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

securities market price, (e) the intent and ability of the Company to retain the investment for a period of time sufficient to allow for recovery, which may be at maturity, and (f) any other information and observable data considered relevant in determining whether other-than-temporary impairment has occurred.

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

As of September 30, 2018, the Company had temporarily impaired securities with a fair value of \$457.5 million and unrealized losses of \$20.1 million, as identified in the table below. The level of temporary impairment was up from December 31, 2017 as a result of a shift in the yield curve and a corresponding decrease in value of investment securities. Securities in a continuous unrealized loss position more than twelve months amounted to \$189.9 million as of September 30, 2018, compared with \$144.4 million at December 31, 2017. The Company has concluded that these securities were not other-than-temporarily impaired. This conclusion was based on the issuer's continued satisfaction of the securities obligations in accordance with their contractual terms and the expectation that the issuer will continue to do so, Management's intent and ability to hold these securities for a period of time sufficient to allow for any anticipated recovery in fair value which may be at maturity, the expectation that the Company will receive 100% of future contractual cash flows, as well as the evaluation of the fundamentals of the issuer's financial condition and other objective evidence. The following table summarizes temporarily impaired securities and their approximate fair values at September 30, 2018:

| <i>Dollars in thousands</i>        | <b>Less than 12 months</b> |                   | <b>12 months or more</b> |                   | <b>Total</b>           |                   |
|------------------------------------|----------------------------|-------------------|--------------------------|-------------------|------------------------|-------------------|
|                                    | Fair Value (Estimated)     | Unrealized Losses | Fair Value (Estimated)   | Unrealized Losses | Fair Value (Estimated) | Unrealized Losses |
| U.S. Government-sponsored agencies | \$7,753                    | \$(247 )          | \$7,614                  | \$(541 )          | \$15,367               | \$(788 )          |
| Mortgage-backed securities         | 154,611                    | (4,333 )          | 143,771                  | (7,427 )          | 298,382                | (11,760 )         |
| State and political subdivisions   | 105,233                    | (3,255 )          | 38,491                   | (4,305 )          | 143,724                | (7,560 )          |
|                                    | \$267,597                  | \$(7,835)         | \$189,876                | \$(12,273)        | \$457,473              | \$(20,108)        |

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

**Securities issued by U.S. Government-sponsored agencies and enterprises.** As of September 30, 2018, there were \$788,000 unrealized losses on these securities compared to \$180,000 unrealized losses as of December 31, 2017. All of these securities were credit rated "AAA" or "AA+" by the major credit rating agencies. Management believes that securities issued by U.S. Government-sponsored agencies and enterprises have minimal credit risk, as these agencies and enterprises play a vital role in the nation's financial markets and does not consider these securities to be other-than-temporarily impaired at September 30, 2018.

**Mortgage-backed securities issued by U.S. Government agencies and U.S. Government-sponsored enterprises.** As of September 30, 2018, there were \$11.8 million of unrealized losses on these securities compared with \$4.6 million at December 31, 2017. All of these securities were credit rated "AAA" or "AA+" by the major credit rating agencies. Management believes that securities issued by U.S. Government agencies bear no credit risk because they are backed by the full faith and credit of the United States and that securities issued by U.S. Government-sponsored enterprises have minimal credit risk, as these agencies and enterprises play a vital role in the nation's financial markets. Management believes that the unrealized losses at September 30, 2018 were attributable to changes in current market yields and spreads since the date the underlying securities were purchased, and does not consider these securities to be other-than-temporarily impaired at September 30, 2018. The Company also has the ability and intent to hold these securities until a recovery of their amortized cost, which may be at maturity.

**Obligations of state and political subdivisions.** As of September 30, 2018, there were \$7.6 million of unrealized losses on these securities compared to \$1.2 million at December 31, 2017. Municipal securities are supported by the general taxing authority of the municipality and, in the cases of school districts, are generally supported by state aid.

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

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

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

#### ***Federal Home Loan Bank Stock***

The Bank is a member of the Federal Home Loan Bank ("FHLB") of Boston, a cooperatively owned wholesale bank for housing and finance in the six New England States. As a requirement of membership in the FHLB, the Bank must own a minimum required amount of FHLB stock, calculated periodically based primarily on its level of borrowings from the FHLB. The Bank uses the FHLB for much of its wholesale funding needs. As of September 30, 2018, 2017 and December 31, 2017, the Bank's investment in FHLB stock totaled \$10.5 million, \$9.8 million and \$9.3 million, respectively. FHLB stock is a non-marketable equity security and therefore is reported at cost, which equals par value. The Company periodically evaluates its investment in FHLB stock for impairment based on, among other factors, the capital adequacy of the FHLB and its overall financial condition. No impairment losses have been recorded through September 30, 2018. The Company will continue to monitor its investment in FHLB stock.

#### ***Loans Held for Sale***

Loans held for sale are carried at the lower of cost or market value. As of September 30, 2018, the Bank had \$1,134,000 in loans held for sale. This compares to \$386,000 in loans held for sale at December 31, 2017 and \$434,000 in loans held for sale at September 30, 2017. The Bank participates in FHLB's Mortgage Partnership Finance Program ("MPF"), selling loans with recourse. The volume of loans sold to date through the MPF program is de minimis; therefore, there was minimum impact on the reserve.

#### ***Loans***

The loan portfolio increased during the first nine months of 2018, with total loans at \$1.24 billion at September 30, 2018, up \$79.4 million or 6.8% from total loans of \$1.16 billion at December 31, 2017. Commercial loans increased \$35.0 million or 6.4% between December 31, 2017 and September 30, 2018, municipal loans increased \$23.3 million or 69.8%, residential term loans increased \$26.8 million and home equity lines of credit decreased \$6.1 million. Commercial loans are comprised of three major classes: commercial real estate loans, commercial construction loans and other commercial loans.

Commercial real estate loans consist of mortgage loans to finance investments in real property such as multi-family residential, commercial/retail, office, industrial, hotels, educational and other specific or mixed use properties.

Commercial real estate loans are typically written with amortizing payment structures. Collateral values are determined based on appraisals and evaluations in accordance with established policy and regulatory guidelines.

Commercial real estate loans typically have a loan-to-value ratio of up to 80% based upon current valuation information at the time the loan is made. Commercial real estate loans are primarily paid by the cash flow generated from the real property, such as operating leases, rents, or other operating cash flows from the borrower.

Commercial construction loans consist of loans to finance construction in a mix of owner- and non-owner occupied commercial real estate properties. Commercial construction loans typically have maturities of less than two years.

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

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

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

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

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

established policy and regulatory guidelines. Residential loans typically have a loan-to-value ratio of up to 80% based on appraisal information at the time the loan is made. Collateral consists of mortgage liens on one- to four-family residential properties. Loans are offered with fixed or adjustable rates with amortization terms of up to thirty years. Residential construction loans typically consist of loans for the purpose of constructing single family residences to be owned and occupied by the borrower. Borrower qualifications include favorable credit history combined with supportive income requirements and loan-to-value ratios within established policy and regulatory guidelines. Residential construction loans normally have construction terms of one year or less and payment during the construction term is typically on an interest only basis from sources including interest reserves, borrower liquidity and/or income. Residential construction loans will typically convert to permanent financing from the Company or have another financing commitment in place from an acceptable mortgage lender. Collateral valuation and loan-to-value guidelines are consistent with those for residential term loans.

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

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

Construction loans, both commercial and residential, at 24.4% of capital are well under the regulatory guidance of 100.0% of capital at September 30, 2018. Construction loans and non-owner-occupied commercial real estate loans are at 123.1% of total capital, well under the regulatory guidance of 300.0% of capital at September 30, 2018.

The following table summarizes the loan portfolio, by class, at September 30, 2018 and 2017 and December 31, 2017.

| <i>Dollars in thousands</i> | <b>September 30, 2018</b> |                | December 31, 2017 |         | September 30, 2017 |         |
|-----------------------------|---------------------------|----------------|-------------------|---------|--------------------|---------|
| Commercial                  |                           |                |                   |         |                    |         |
| Real estate                 | <b>\$366,390</b>          | <b>29.5 %</b>  | \$323,809         | 27.8 %  | \$301,227          | 26.9 %  |
| Construction                | <b>23,889</b>             | <b>1.9 %</b>   | 38,056            | 3.3 %   | 32,893             | 2.9 %   |
| Other                       | <b>188,128</b>            | <b>15.1 %</b>  | 181,528           | 15.6 %  | 172,986            | 15.4 %  |
| Municipal                   | <b>56,704</b>             | <b>4.6 %</b>   | 33,391            | 2.9 %   | 33,311             | 3.0 %   |
| Residential                 |                           |                |                   |         |                    |         |
| Term                        | <b>459,449</b>            | <b>36.8 %</b>  | 432,661           | 37.1 %  | 429,572            | 38.3 %  |
| Construction                | <b>18,166</b>             | <b>1.5 %</b>   | 17,868            | 1.5 %   | 15,495             | 1.4 %   |
| Home equity line of credit  | <b>105,213</b>            | <b>8.5 %</b>   | 111,302           | 9.6 %   | 110,178            | 9.8 %   |
| Consumer                    | <b>25,619</b>             | <b>2.1 %</b>   | 25,524            | 2.2 %   | 25,424             | 2.3 %   |
| Total loans                 | <b>\$1,243,558</b>        | <b>100.0 %</b> | \$1,164,139       | 100.0 % | \$1,121,086        | 100.0 % |



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

| <i>Dollars in thousands</i> | < 1 Year        | 1 - 5 Years      | 5 - 10<br>Years  | > 10 Years       | Total              |
|-----------------------------|-----------------|------------------|------------------|------------------|--------------------|
| <b>Commercial</b>           |                 |                  |                  |                  |                    |
| Real estate                 | \$5,067         | \$30,058         | \$40,375         | \$290,890        | \$366,390          |
| Construction                | 2,133           | 3,829            | 2,173            | 15,754           | 23,889             |
| Other                       | 12,736          | 67,561           | 45,445           | 62,386           | 188,128            |
| <b>Municipal</b>            | 33,099          | 6,484            | 13,280           | 3,841            | 56,704             |
| <b>Residential</b>          |                 |                  |                  |                  |                    |
| Term                        | 1,857           | 7,541            | 28,782           | 421,269          | 459,449            |
| Construction                | 170             | —                | —                | 17,996           | 18,166             |
| Home equity line of credit  | 765             | 318              | 644              | 103,486          | 105,213            |
| <b>Consumer</b>             | 7,922           | 4,889            | 2,829            | 9,979            | 25,619             |
| <b>Total loans</b>          | <b>\$63,749</b> | <b>\$120,680</b> | <b>\$133,528</b> | <b>\$925,601</b> | <b>\$1,243,558</b> |

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

| <i>Dollars in thousands</i> | <u>Fixed-Rate</u> |             | <u>Adjustable-Rate</u> |             | <u>Total</u>        |              |          |  |
|-----------------------------|-------------------|-------------|------------------------|-------------|---------------------|--------------|----------|--|
|                             | Amount            | % of total  | Amount                 | % of total  | Amount              | % of total   |          |  |
| <b>Commercial</b>           |                   |             |                        |             |                     |              |          |  |
| Real estate                 | \$68,234          | 5.5         | %\$298,156             | 24.0        | %\$366,390          | 29.5         | %        |  |
| Construction                | 8,780             | 0.7         | %15,109                | 1.2         | %23,889             | 1.9          | %        |  |
| Other                       | 69,855            | 5.6         | %118,273               | 9.5         | %188,128            | 15.1         | %        |  |
| <b>Municipal</b>            | 55,354            | 4.5         | %1,350                 | 0.1         | %56,704             | 4.6          | %        |  |
| <b>Residential</b>          |                   |             |                        |             |                     |              |          |  |
| Term                        | 331,369           | 26.5        | %128,080               | 10.3        | %459,449            | 36.8         | %        |  |
| Construction                | 17,895            | 1.5         | %271                   | 0.0         | %18,166             | 1.5          | %        |  |
| Home equity line of credit  | 670               | 0.1         | %104,543               | 8.4         | %105,213            | 8.5          | %        |  |
| <b>Consumer</b>             | 19,043            | 1.6         | %6,576                 | 0.5         | %25,619             | 2.1          | %        |  |
| <b>Total loans</b>          | <b>\$571,200</b>  | <b>46.0</b> | <b>%\$672,358</b>      | <b>54.0</b> | <b>%\$1,243,558</b> | <b>100.0</b> | <b>%</b> |  |

### ***Loan Concentrations***

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

### ***Credit Risk Management and Allowance for Loan Losses***

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

We provide for loan losses through the establishment of an allowance for loan losses which represents an estimated reserve for existing losses in the loan portfolio. We deploy a systematic methodology for determining our allowance that includes a quarterly review process, risk rating, and adjustment to our allowance. We classify our portfolios as either commercial or residential and consumer and monitor credit risk separately as discussed below. We evaluate the

appropriateness of our

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allowance continually based on a review of all significant loans, with a particular emphasis on nonaccruing, past due, and other loans that we believe require special attention.

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

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

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

#### *Commercial*

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

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

*Residential, Home Equity and Consumer*

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

*Unallocated*

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

The allowance for loan losses includes reserve amounts assigned to individual loans on the basis of loan impairment. Certain loans are evaluated individually and are judged to be impaired when Management believes it is probable that the Company will not collect all of the contractual interest and principal payments as scheduled in the loan agreement. Under this method, loans are selected for evaluation based on internal risk ratings or non-accrual status. A specific reserve is allocated to an individual loan when that loan has been deemed impaired and when the amount of a probable loss is estimable on the basis of its collateral value, the present value of anticipated future cash flows, or its net realizable value. At September 30, 2018, impaired loans with specific reserves totaled \$13.4 million and the amount of such reserves was \$2.4 million. This compares to impaired loans with specific reserves of \$13.4 million at December 31, 2017 and the amount of such reserves was \$1.8 million.

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

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

| <i>Dollars in thousands</i> | <b>September 30,<br/>2018</b> |              | December 31,<br>2017 |       | September 30,<br>2017 |       |   |
|-----------------------------|-------------------------------|--------------|----------------------|-------|-----------------------|-------|---|
| Commercial                  |                               |              |                      |       |                       |       |   |
| Real estate                 | <b>\$3,589</b>                | <b>29.5</b>  | % \$3,872            | 27.8  | % \$4,004             | 26.9  | % |
| Construction                | <b>214</b>                    | <b>1.9</b>   | % 434                | 3.3   | % 503                 | 2.9   | % |
| Other                       | <b>3,591</b>                  | <b>15.1</b>  | % 3,358              | 15.6  | % 3,223               | 15.4  | % |
| Municipal                   | <b>23</b>                     | <b>4.6</b>   | % 20                 | 2.9   | % 20                  | 3.0   | % |
| Residential                 |                               |              |                      |       |                       |       |   |
| Term                        | <b>1,092</b>                  | <b>36.8</b>  | % 1,130              | 37.1  | % 1,157               | 38.3  | % |
| Construction                | <b>36</b>                     | <b>1.5</b>   | % 36                 | 1.5   | % 31                  | 1.4   | % |
| Home equity line of credit  | <b>719</b>                    | <b>8.5</b>   | % 692                | 9.6   | % 687                 | 9.8   | % |
| Consumer                    | <b>740</b>                    | <b>2.1</b>   | % 545                | 2.2   | % 535                 | 2.3   | % |
| Unallocated                 | <b>1,678</b>                  | <b>—</b>     | % 642                | —     | % 852                 | —     | % |
| Total                       | <b>\$11,682</b>               | <b>100.0</b> | % \$10,729           | 100.0 | % \$11,012            | 100.0 | % |

The allowance for loan losses totaled \$11.7 million at September 30, 2018, compared to \$10.7 million as of December 31, 2017 and \$11.0 million as of September 30, 2017. Management's ongoing application of methodologies

to establish the allowance include an evaluation of impaired loans for specific reserves. These specific reserves increased \$590,000 in the first nine months of 2018 from \$1.8 million at December 31, 2017 to \$2.4 million at September 30, 2018. The specific loans that make up those categories change from period to period. Impairment on those loans, which would be reflected in the allowance for loan losses, might or might not exist, depending on the specific circumstances of each loan. The portion of the reserve based upon homogeneous pools of loans decreased by \$835,000 in the first nine months of 2018. The portion of the reserve based on qualitative factors increased nominally, or \$162,000 in the first nine months of 2018 due to a mix of factors. After consideration of the shifts in specific, pooled and qualitative reserves, Management determined that the change in unallocated reserves from\$

642,000, or 6.0% of the total reserve at December 31, 2017, to \$1.7 million, or 14.4% as of September 30, 2018, supported general imprecision related to portfolio growth.

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

| <i>Dollars in thousands</i> | Specific<br>Reserves on<br>Loans<br>Evaluated<br>Individually<br>for<br>Impairment | General<br>Reserves<br>on Loans<br>Based on<br>Historical<br>Loss<br>Experience | Reserves<br>for<br>Qualitative<br>Factors | Unallocated<br>Reserves | Total<br>Reserves |
|-----------------------------|--|---|---|-------------------------|-------------------|
| Commercial                  |  |   |   |                         |                   |
| Real estate                 | \$ 265   | \$ 758  | \$ 2,566                                  | \$ —                    | \$3,589           |
| Construction                | —  | 49  | 165                                       | —                       | 214               |
| Other                       | 1,890  | 388   | 1,313                                     | —                       | 3,591             |
| Municipal                   | —  | —   | 23  | —                       | 23                |
| Residential                 |  |   |   |                         |                   |
| Term                        | 238  | 313   | 541                                       | —                       | 1,092             |
| Construction                | —  | 13  | 23  | —                       | 36                |
| Home equity line of credit  | 7  | 280   | 432                                       | —                       | 719               |
| Consumer                    | 2  | 397   | 341                                       | —                       | 740               |
| Unallocated                 | —  | —   | —   | 1,678                   | 1,678             |
|                             | \$ 2,402   | \$ 2,198  | \$ 5,404                                  | \$ 1,678                | \$11,682          |

Based upon Management's evaluation, provisions are made to maintain the allowance as a best estimate of inherent losses within the portfolio. The provision for loan losses to maintain the allowance was \$1.3 million for the first nine months of 2018 and \$1.8 million the first nine months of 2017. Net chargeoffs were \$380,000 in the first nine months of 2018, down from \$876,000 in the first nine months of 2017. Our allowance as a percentage of outstanding loans was 0.94% as of September 30, 2018, up from 0.92% reported as of December 31, 2017, and down from 0.98% as of September 30, 2017.

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

| <i>Dollars in thousands</i>  | <b>September<br/>30, 2018</b> | December 31,<br>2017 | September<br>30, 2017 |   |
|--|-------------------------------|----------------------|-----------------------|---|
| Balance at the beginning of year   | <b>\$ 10,729</b>              | \$ 10,138            | \$ 10,138             |   |
| Loans charged off:   |                               |                      |                       |   |
| Commercial   |                               |                      |                       |   |
| Real estate  | —                             | 587                  | 305                   |   |
| Construction   | —                             | —                    | —                     |   |
| Other  | <b>68</b>                     | 212                  | 58                    |   |
| Municipal  | —                             | —                    | —                     |   |
| Residential  |                               |                      |                       |   |
| Term   | <b>212</b>                    | 456                  | 351                   |   |
| Construction   | —                             | —                    | —                     |   |
| Home equity line of credit   | <b>121</b>                    | 28                   | 28                    |   |
| Consumer   | <b>195</b>                    | 335                  | 276                   |   |
| Total  | <b>596</b>                    | 1,618                | 1,018                 |   |
| Recoveries on loans previously charged off                               |                               |                      |                       |   |
| Commercial   |                               |                      |                       |   |
| Real estate  | <b>52</b>                     | —                    | —                     |   |
| Construction   | —                             | —                    | —                     |   |
| Other  | <b>33</b>                     | 49                   | 25                    |   |
| Municipal  | —                             | —                    | —                     |   |
| Residential  |                               |                      |                       |   |
| Term   | <b>45</b>                     | 40                   | 29                    |   |
| Construction   | —                             | —                    | —                     |   |
| Home equity line of credit   | <b>13</b>                     | 11                   | 4                     |   |
| Consumer   | <b>73</b>                     | 109                  | 84                    |   |
| Total  | <b>216</b>                    | 209                  | 142                   |   |
| Net loans charged off  | <b>380</b>                    | 1,409                | 876                   |   |
| Provision for loan losses  | <b>1,333</b>                  | 2,000                | 1,750                 |   |
| Balance at end of period   | <b>\$ 11,682</b>              | \$ 10,729            | \$ 11,012             |   |
| Ratio of net loans charged off to average loans outstanding <sup>1</sup> | <b>0.04</b>                   | % 0.13               | % 0.11                | % |
| Ratio of allowance for loan losses to total loans outstanding            | <b>0.94</b>                   | % 0.92               | % 0.98                | % |

<sup>1</sup> Annualized using a 365-day basis for both 2018 and 2017.

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

### ***Nonperforming Loans***

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



procedures, or, (2) in appropriate circumstances, through collection efforts not involving legal action which are reasonably expected to result in repayment of the debt or in its restoration to a current status in the near future. When a loan becomes nonperforming (generally 90 days past due), it is evaluated for collateral dependency based upon the most recent appraisal or other evaluation method. If the collateral value is lower than the outstanding loan balance plus accrued interest and estimated selling costs, the loan is placed on non-accrual status, all accrued interest is reversed from interest income, and a specific reserve is established for the difference between the loan balance and the collateral value less selling costs, or, in certain situations, the difference between the loan balance and the collateral value less selling costs is written off. Concurrently, a new appraisal or valuation may be ordered, depending on collateral type, currency of the most recent valuation, the size of the loan, and other factors appropriate to the loan. Upon receipt and acceptance of the new valuation, the loan may have an additional specific reserve or write down based on the updated collateral value. On an ongoing basis, appraisals or valuations may be done periodically on collateral dependent non-performing loans and an additional specific reserve or write down will be made, if appropriate, based on the new collateral value.

Once a loan is placed on nonaccrual, it remains in nonaccrual status until the loan is current as to payment of both principal and interest and the borrower demonstrates the ability to pay and remain current. All payments made on nonaccrual loans are applied to the principal balance of the loan.

Nonperforming loans, expressed as a percentage of total loans, totaled 1.14% at September 30, 2018 compared to 1.27% at December 31, 2017 and 1.46% at September 30, 2017. The following table shows the distribution of nonperforming loans by class as of September 30, 2018 and 2017 and December 31, 2017:

| <i>Dollars in thousands</i> | <b>September 30,<br/>2018</b> | December 31,<br>2017 | September 30,<br>2017 |
|-----------------------------|-------------------------------|----------------------|-----------------------|
| Commercial                  |                               |                      |                       |
| Real estate                 | <b>\$ 964</b>                 | \$ 752               | \$ 1,929              |
| Construction                | —                             | —                    | —                     |
| Other                       | <b>9,330</b>                  | 9,357                | 9,520                 |
| Municipal                   | —                             | —                    | —                     |
| Residential                 |                               |                      |                       |
| Term                        | <b>3,042</b>                  | 3,778                | 3,875                 |
| Construction                | —                             | —                    | —                     |
| Home equity line of credit  | <b>834</b>                    | 833                  | 1,001                 |
| Consumer                    | <b>2</b>                      | 16                   | 51                    |
| Total nonperforming loans   | <b>\$ 14,172</b>              | \$ 14,736            | \$ 16,376             |

The amounts shown for total nonperforming loans do not include loans 90 or more days past due and still accruing interest. These are loans for which we expect to collect all amounts due, including past-due interest. As of September 30, 2018, loans 90 or more days past due and still accruing interest totaled \$249,000, compared to \$445,000 at December 31, 2017 and \$511,000 at September 30, 2017.

### ***Troubled Debt Restructured***

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

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

As of September 30, 2018, we had 71 loans with a balance of \$25.7 million that have been restructured. This compares to 62 loans with a balance of \$17.8 million and 67 loans with a balance of \$19.8 million classified as TDRs as of December 31, 2017 and September 30, 2017, respectively.



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

| <i>Balance in Thousands of Dollars</i>     | Number<br>of<br>Loans | Aggregate<br>Balance |
|--|-----------------------|----------------------|
| Total at December 31, 2017                 | 62                    | \$ 17,801            |
| Added in 2018                              | 11                    | 8,576                |
| Principal reduction on loans added in 2018 | (47                   | )                    |
| Net added in 2018                          |                       | 8,529                |
| Loans paid off in 2018                     | (2                    | ) (340               |
| Repayments in 2018                         | —                     | (329                 |
| Total at September 30, 2018                | 71                    | \$ 25,661            |

As of September 30, 2018, 56 loans with an aggregate balance of \$17.4 million were performing under the modified terms, three loans with an aggregate balance of \$501,000 were more than 30 days past due and accruing and 12 loans with an aggregate balance of \$7.7 million were on nonaccrual. As a percentage of aggregate outstanding balance, 67.9% were performing under the modified terms, 2.0% were more than 30 days past due and accruing and 30.1% were on nonaccrual. The performance status of all TDRs as of September 30, 2018, as well as the associated specific reserve in the allowance for loan losses, is summarized by type of loan in the following table.

| <i>In thousands of dollars</i> | Performing<br>As<br>Modified | 30+ Days<br>Past Due<br>and<br>Accruing | On<br>Nonaccrual | All<br>TDRs |
|--------------------------------|------------------------------|---|------------------|-------------|
| Commercial                     |                              |   |                  |             |
| Real estate                    | \$ 8,445                     | \$ —                                    | \$ 97            | \$ 8,542    |
| Construction                   | 741                          | —                                       | —                | 741         |
| Other                          | 382                          | 138                                     | 6,487            | 7,007       |
| Municipal                      | —                            | —                                       | —                | —           |
| Residential                    |                              |   |                  |             |
| Term                           | 7,522                        | 363                                     | 984              | 8,869       |
| Construction                   | —                            | —                                       | —                | —           |
| Home equity line of credit     | 335                          | —                                       | 167              | 502         |
| Consumer                       | —                            | —                                       | —                | —           |
|                                | \$ 17,425                    | \$ 501                                  | \$ 7,735         | \$ 25,661   |
| Percent of balance             | 67.9                         | % 2.0                                   | % 30.1           | % 100.0     |
| Number of loans                | 56                           | 3                                       | 12               | 71          |
| Associated specific reserve    | \$ 371                       | \$ —                                    | \$ 1,105         | \$ 1,476    |

Residential TDRs (including home equity lines of credit) as of September 30, 2018 included 49 loans with an aggregate balance of \$9.4 million, and the modifications granted fell into five major categories. Loans totaling \$6.1 million had an extension of term, allowing the borrower to repay over an extended number of years and lowering the monthly payment to a level the borrower can afford. Loans totaling \$3.4 million had interest capitalized, allowing the borrower to become current after unpaid interest was added to the balance of the loan and re-amortized over the remaining life of the loan. Loans with an aggregate balance of \$533,000 were converted from interest-only to regular principal-and-interest payments based on the borrowers' ability to service the higher payment amount. Rate concessions were granted on loans totaling \$2.2 million. Loans with an aggregate balance of \$1.9 million were involved in bankruptcy. Certain residential TDRs had more than one modification.

Commercial TDRs as of September 30, 2018 were comprised of 22 loans with a balance of \$16.3 million. Of this total, 10 loans with an aggregate balance of \$5.4 million had an extended period of interest-only payments, deferring

the start of principal repayment. Two loans with an aggregate balance of \$1.7 million had an extension of term, allowing the borrower to repay over an extended number of years and lowering the monthly payment to a level the borrower can afford. Seven loans with an aggregate balance of \$7.5 million had a deferral of payment. The remaining three loans with an aggregate balance of \$1.7 million had several different modifications.

In each case when a loan was modified, Management determined it was in the Bank's best interest to work with the borrower with modified terms rather than to proceed to foreclosure. Once a loan is classified as a TDR it remains classified as such until the balance is fully repaid, despite whether the loan is performing under the modified terms. As of September 30, 2018, Management is aware of four loans classified as TDRs that are involved in bankruptcy with an outstanding balance of

\$676,000. There were also 12 loans with an outstanding balance of \$7.7 million that were classified as TDRs and on non-accrual status, of which four loans with an outstanding balance of \$504,000 were in the process of foreclosure.

### ***Impaired Loans***

Impaired loans include restructured loans and loans placed on non-accrual status. These loans are measured at the present value of expected future cash flows discounted at the loan's effective interest rate or at the fair value of the collateral less estimated selling costs if the loan is collateral dependent. If the measure of an impaired loan is lower than the recorded investment in the loan, a specific reserve is established for the difference. Impaired loans totaled \$32.1 million at September 30, 2018, and have increased \$706,000 from December 31, 2017. There were 138 impaired loans at September 30, 2018, up from 128 loans at December 31, 2017. Impaired commercial loans increased \$1.6 million between December 31, 2017 and September 30, 2018. The specific allowance for impaired commercial loans increased from \$1.5 million at December 31, 2017 to \$2.2 million as of September 30, 2018, which represented the fair value deficiencies for loans where the fair value of the collateral or net present value of expected cash flows was estimated at less than our carrying amount of the loan. From December 31, 2017 to September 30, 2018, impaired residential loans decreased \$820,000 and impaired home equity lines of credit decreased \$11,000.

The following table sets forth impaired loans as of September 30, 2018 and 2017 and December 31, 2017:

| <i>Dollars in thousands</i> | <b>September 30,<br/>2018</b> | December 31,<br>2017 | September 30,<br>2017 |
|-----------------------------|-------------------------------|----------------------|-----------------------|
| Commercial                  |                               |                      |                       |
| Real estate                 | <b>\$ 9,410</b>               | \$ 7,790             | \$ 9,836              |
| Construction                | <b>741</b>                    | 741                  | 763                   |
| Other                       | <b>9,849</b>                  | 9,918                | 10,250                |
| Municipal                   | —                             | —                    | —                     |
| Residential                 |                               |                      |                       |
| Term                        | <b>10,928</b>                 | 11,748               | 12,641                |
| Construction                | —                             | —                    | —                     |
| Home equity line of credit  | <b>1,168</b>                  | 1,179                | 1,519                 |
| Consumer                    | <b>2</b>                      | 16                   | 51                    |
| Total                       | <b>\$ 32,098</b>              | \$ 31,392            | \$ 35,060             |

**Past Due Loans**

The Bank's overall loan delinquency ratio was 0.83% at September 30, 2018 compared to 1.60% at December 31, 2017 and 0.98% at September 30, 2017. Loans 90 days delinquent and accruing decreased from \$445,000 at December 31, 2017 to \$249,000 as of September 30, 2018. The following table sets forth loan delinquencies as of September 30, 2018 and 2017 and December 31, 2017:

| <i>Dollars in thousands</i>                           | <b>September 30,<br/>2018</b> | December 31,<br>2017 | September 30,<br>2017 |   |
|---|-------------------------------|----------------------|-----------------------|---|
| Commercial  |                               |                      |                       |   |
| Real estate   | <b>\$ 808</b>                 | \$ 874               | \$ 1,971              |   |
| Construction  | —                             | —                    | —                     |   |
| Other   | <b>1,382</b>                  | 7,779                | 1,177                 |   |
| Municipal   | —                             | —                    | —                     |   |
| Residential   |                               |                      |                       |   |
| Term  | <b>5,105</b>                  | 7,659                | 5,904                 |   |
| Construction  | —                             | 471                  | —                     |   |
| Home equity line of credit                            | <b>2,851</b>                  | 1,707                | 1,761                 |   |
| Consumer  | <b>227</b>                    | 186                  | 219                   |   |
| Total   | <b>\$ 10,373</b>              | \$ 18,676            | \$ 11,032             |   |
| Loans 30-89 days past due to total loans              | <b>0.58</b>                   | % 1.28               | % 0.55                | % |
| Loans 90+ days past due and accruing to total loans   | <b>0.02</b>                   | % 0.04               | % 0.05                | % |
| Loans 90+ days past due on non-accrual to total loans | <b>0.23</b>                   | % 0.29               | % 0.39                | % |
| Total past due loans to total loans                   | <b>0.83</b>                   | % 1.60               | % 0.98                | % |

**Potential Problem Loans and Loans in Process of Foreclosure**

Potential problem loans consist of classified, accruing commercial and commercial real estate loans that were between 30 and 89 days past due. Such loans are characterized by weaknesses in the financial condition of borrowers or collateral deficiencies. Based on historical experience, the credit quality of some of these loans may improve due to improvements in the economy as well as changes in collateral values or the financial condition of the borrowers, while the credit quality of other loans may deteriorate, resulting in some amount of loss. At September 30, 2018, there were two potential problem loans with a balance of \$40,000 or 0.003% of total loans. This compares to 11 loans with a balance of \$902,000 or 0.08% of total loans at December 31, 2017.

As of September 30, 2018, there were 19 loans in the process of foreclosure with a total balance of \$1.8 million. The Bank's residential foreclosure process begins when a loan becomes 75 days past due at which time a Demand/Breach Letter is sent to the borrower. If the loan becomes 120 days past due, copies of the promissory note and mortgage deed are forwarded to the Bank's attorney for review and a complaint for foreclosure is then prepared. An authorized Bank officer signs the affidavit certifying the validity of the documents and verification of the past due amount which is then forwarded to the court. Once a Motion for Summary Judgment is granted, a Period of Redemption (POR) begins which gives the customer 90 days to cure the default. A foreclosure auction date is then set 30 days from the POR expiration date if the default is not cured.

The Bank's commercial foreclosure process begins when a loan becomes 60 days past due, at which time a default letter is issued. At expiration of the period to cure default, which lasts 12 days after the issuing of the default letter, copies of the promissory note and mortgage deed are forwarded to the Bank's attorney for review. A Notice of Statutory Power of Sale is then prepared. This notice must be published for three consecutive weeks in a newspaper located in the county in which the property is located. A notice also must be issued to the mortgagor and all parties of interest 21 days prior to the sale. The foreclosure auction occurs and the Affidavit of Sale is recorded within the appropriate county within 30 days of the sale.

The Bank's written policies and procedures for foreclosures, along with implementation of same, are subject to annual review by its internal audit provider. The scope of this review includes loans held in portfolio and loans serviced for

others. There were no issues requiring management attention in the most recent review. Servicing for others includes loans sold to Freddie Mac, Fannie Mae, and the Federal Home Loan Bank of Boston through its Mortgage Partnership Finance (MPF) program. The Bank follows the published guidelines of each investor. Loans serviced for Freddie Mac and Fannie Mae have been sold without recourse, and the Bank has no liability for these loans in the event of foreclosure. A de minimis volume of

has been sold to and serviced for MPF to date. The Bank retains a second loss layer credit enhancement obligation; no losses have been recorded on this credit enhancement obligation since the Bank started selling loans to MPF in 2013.

### **Other Real Estate Owned**

Other real estate owned and repossessed assets ("OREO") are comprised of properties or other assets acquired through a foreclosure proceeding, or acceptance of a deed or title in lieu of foreclosure. Real estate acquired through foreclosure is carried at the lower of fair value less estimated cost to sell or the cost of the asset and is not included as part of the allowance for loan loss totals. At September 30, 2018, there were five properties owned with an OREO balance of \$584,000, compared to December 31, 2017 when there were six properties owned with a net OREO balance of \$1.0 million, net of an allowance for losses of \$53,000 and September 30, 2017 when there were six properties owned with a net OREO balance of \$320,000, net of an allowance for losses of \$53,000.

The following table presents the composition of other real estate owned:

| <i>Dollars in thousands</i> | <b>September 30,<br/>2018</b> | December 31,<br>2017 | September 30,<br>2017 |
|-----------------------------|-------------------------------|----------------------|-----------------------|
| <b>Carrying Value</b>       |                               |                      |                       |
| Commercial                  |                               |                      |                       |
| Real estate                 | \$ —                          | \$ —                 | \$ —                  |
| Construction                | —                             | 28                   | 28                    |
| Other                       | —                             | 511                  | —                     |
| Municipal                   | —                             | —                    | —                     |
| Residential                 |                               |                      |                       |
| Term                        | <b>584</b>                    | 526                  | 345                   |
| Construction                | —                             | —                    | —                     |
| Home equity line of credit  | —                             | —                    | —                     |
| Consumer                    | —                             | —                    | —                     |
| <b>Total</b>                | <b>\$ 584</b>                 | <b>\$ 1,065</b>      | <b>\$ 373</b>         |
| <b>Related Allowance</b>    |                               |                      |                       |
| Commercial                  |                               |                      |                       |
| Real estate                 | \$ —                          | \$ —                 | \$ —                  |
| Construction                | —                             | 28                   | 28                    |
| Other                       | —                             | —                    | —                     |
| Municipal                   | —                             | —                    | —                     |
| Residential                 |                               |                      |                       |
| Term                        | —                             | 25                   | 25                    |
| Construction                | —                             | —                    | —                     |
| Home equity line of credit  | —                             | —                    | —                     |
| Consumer                    | —                             | —                    | —                     |
| <b>Total</b>                | <b>\$ —</b>                   | <b>\$ 53</b>         | <b>\$ 53</b>          |
| <b>Net Value</b>            |                               |                      |                       |
| Commercial                  |                               |                      |                       |
| Real estate                 | \$ —                          | \$ —                 | \$ —                  |
| Construction                | —                             | —                    | —                     |
| Other                       | —                             | 511                  | —                     |
| Municipal                   | —                             | —                    | —                     |
| Residential                 |                               |                      |                       |
| Term                        | <b>584</b>                    | 501                  | 320                   |
| Construction                | —                             | —                    | —                     |
| Home equity line of credit  | —                             | —                    | —                     |

|          |        |          |        |
|----------|--------|----------|--------|
| Consumer | —      | —        | —      |
| Total    | \$ 584 | \$ 1,012 | \$ 320 |

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### ***Liquidity Management***

As of September 30, 2018, the Bank had primary sources of liquidity of \$539.4 million. It is Management's opinion this is sufficient to meet liquidity needs under a broad range of scenarios. The Bank has an additional \$274.2 million in contingent sources of liquidity, including the Federal Reserve Borrower in Custody program, municipal and corporate securities, and correspondent bank lines of credit. The Asset/Liability Committee ("ALCO") establishes guidelines for liquidity in its Asset/Liability policy and monitors internal liquidity measures to manage liquidity exposure. Based on its assessment of the liquidity considerations described above, Management believes the Company's sources of funding will meet anticipated funding needs.

Liquidity is the ability of a financial institution to meet maturing liability obligations and customer loan demand. The Bank's primary source of liquidity is deposits, which funded 75.4% of total average assets in the first nine months of 2018. While the generally preferred funding strategy is to attract and retain low-cost deposits, the ability to do so is affected by competitive interest rates and terms in the marketplace. Other sources of funding include discretionary use of purchased liabilities (e.g., FHLB term advances and other borrowings), cash flows from the securities portfolios and loan repayments. Securities designated as available for sale may also be sold in response to short-term or long-term liquidity needs although Management has no intention to do so at this time.

The Bank has a detailed liquidity funding policy and a contingency funding plan that provide for the prompt and comprehensive response to unexpected demands for liquidity. Management has developed quantitative models to estimate needs for contingent funding that could result from unexpected outflows of funds in excess of "business as usual" cash flows. In Management's estimation, risks are concentrated in two major categories: runoff of in-market deposit balances and the inability to renew wholesale sources of funding. Of the two categories, potential runoff of deposit balances would have the most significant impact on contingent liquidity. Our modeling attempts to quantify deposits at risk over selected time horizons. In addition to these unexpected outflow risks, several other "business as usual" factors enter into the calculation of the adequacy of contingent liquidity including payment proceeds from loans and investment securities, maturing debt obligations and maturing time deposits. The Bank has established collateralized borrowing capacity with the Federal Reserve Bank of Boston and also maintains additional collateralized borrowing capacity with the FHLB in excess of levels used in the ordinary course of business as well as Fed Funds lines with two correspondent banks and availability through the Federal Reserve Bank Borrower in Custody program.

### ***Deposits***

During the first nine months of 2018, total deposits increased by \$96.0 million or 6.8% from December 31, 2017 levels. Low-cost deposits (demand, NOW, and savings accounts) increased by \$70.0 million or 10.1% in the first nine months of 2018, money market deposits decreased \$34.4 million or 21.0%, and certificates of deposit increased \$60.4 million or 10.8%. Between September 30, 2017 and September 30, 2018, total deposits increased by \$164.9 million or 12.2%. Low-cost deposits increased by \$47.0 million or 6.5%, money market accounts decreased \$4.7 million or 3.5%, and certificates of deposit increased \$122.6 million or 24.7%. The increase in low-cost deposits year-to-date is consistent with our normal seasonal fluctuation. The majority of the change in certificates of deposit both year-to-date and year-over-year resulted from funding of asset growth and a shift in funding between money market deposits and certificates of deposit.

### ***Borrowed Funds***

The Company uses funding from the FHLB of Boston, the Federal Reserve Bank of Boston and repurchase agreements enabling it to grow its balance sheet and its revenues. This funding may also be used to balance seasonal deposit flows or to carry out interest rate risk management strategies, and is increased to replace or supplement other sources of funding, including core deposits and certificates of deposit. During the nine months ended September 30, 2018, borrowed funds increased \$36.5 million or 16.0% from December 31, 2017. Between September 30, 2017 and September 30, 2018, borrowed funds increased by \$30.9 million or 13.2%. This is due primarily to asset growth.

### ***Shareholders' Equity***

Shareholders' equity as of September 30, 2018 was \$184.7 million, compared to \$181.3 million as of December 31, 2017 and \$179.9 million as of September 30, 2017. The Company's earnings in the first nine months of 2018, net of

dividends paid, added to shareholders' equity. The net unrealized loss on available-for-sale securities, presented in accordance with FASB ASC Topic 320 "Investments – Debt and Equity Securities", was up from December 31, 2017 and now stands at \$9.1 million.

A cash dividend of \$0.29 per share was declared in the third quarter of 2018. The dividend payout ratio, which is calculated by dividing dividends declared per share by diluted earnings per share, was 51.57% for the first nine months of 2018 compared to 52.59% for the same period in 2017. In determining future dividend payout levels, the Board of Directors carefully analyzes capital requirements and earnings retention, as set forth in the Company's Dividend Policy. The ability of the Company to pay cash dividends to its shareholders depends on receipt of dividends from its subsidiary, the Bank. The subsidiary may pay dividends to its parent out of so much of its net profits as the Bank's directors deem appropriate, subject to the limitation that the total of all dividends declared by the Bank in any calendar year may not exceed the total of its net profits

of that year combined with its retained net profits of the preceding two years. The amount available for dividends in 2018 is this year's net income plus \$15.8 million.

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

Incident to such issuance of the CPP shares, the Company issued to the Treasury warrants (the "Warrants") to purchase up to 225,904 shares of the Company's common stock at a price per share of \$16.60 (subject to adjustment). The Warrants (and any shares of common stock issuable pursuant to the Warrants) are freely transferable by Treasury to third parties. The Warrants have a term of ten years and could be exercised by Treasury or a subsequent holder at any time or from time to time during their term. To the extent they had not previously been exercised, the Warrants will expire after ten years. The Warrants were unchanged as a result of the CPP Shares repurchase transactions. In May 2015, the Treasury sold the Warrants to private parties. In accordance with the contractual terms of the Warrants, the number of shares issuable upon exercise and strike price were adjusted at the time of the sale. As a result of this transaction, the aggregate number of shares of common stock issuable under the Warrants were adjusted to 226,819 shares with a strike price of \$16.53 per share. In November 2016, the Company repurchased all of the outstanding Warrants for an aggregate purchase price of \$1,750,000.

Financial institution regulators have established guidelines for minimum capital ratios for banks and bank holding companies. The net unrealized gain or loss on available-for-sale securities is generally not included in computing regulatory capital. During the first quarter of 2015, the Company adopted the new Basel III regulatory capital framework as approved by the federal banking agencies. The adoption of this new framework modified the calculation of the various capital ratios, added a new ratio, common equity tier 1, and revised the adequately and well capitalized thresholds. Additionally, under the new rule, in order to avoid limitations on capital distributions, including dividend payments, the Company must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer is being phased in from 0.0% for 2015 to 2.50% by 2019. The amounts shown below as the adequately capitalized ratio plus capital conservation buffer include the fully phased-in 2.50% buffer. The Company met each of the well-capitalized ratio guidelines at September 30, 2018. The following tables indicate the capital ratios for the Bank and the Company at September 30, 2018 and December 31, 2017.

| <i>As of September 30, 2018</i>                               | Leverage | Tier<br>1 | Common<br>Equity<br>Tier 1 | Total<br>Risk-Based |   |
|---|----------|-----------|----------------------------|---------------------|---|
| Bank  | 8.39     | % 13.75   | % 13.75                    | % 14.76             | % |
| Company   | 8.44     | % 13.84   | % 13.84                    | % 14.84             | % |
| Adequately capitalized ratio                                  | 4.00     | % 6.00    | % 4.50                     | % 8.00              | % |
| Adequately capitalized ratio plus capital conservation buffer | 4.00     | % 8.50    | % 7.00                     | % 10.50             | % |
| Well capitalized ratio (Bank only)                            | 5.00     | % 8.00    | % 6.50                     | % 10.00             | % |

| <i>As of December 31, 2017</i>                                | Leverage | Tier<br>1 | Common<br>Equity<br>Tier 1 | Total<br>Risk-Based |   |
|---|----------|-----------|----------------------------|---------------------|---|
| Bank  | 8.49     | % 14.09   | % 14.09                    | % 15.09             | % |
| Company   | 8.57     | % 14.23   | % 14.23                    | % 15.24             | % |
| Adequately capitalized ratio                                  | 4.00     | % 6.00    | % 4.50                     | % 8.00              | % |
| Adequately capitalized ratio plus capital conservation buffer | 4.00     | % 8.50    | % 7.00                     | % 10.50             | % |
| Well capitalized ratio (Bank only)                            | 5.00     | % 8.00    | % 6.50                     | % 10.00             | % |



**Off-Balance Sheet Financial Instruments and Contractual Obligations****Derivative Financial Instruments Designated as Hedges**

As part of its overall asset and liability management strategy, the Company periodically uses derivative instruments to minimize significant unplanned fluctuations in earnings and cash flows caused by interest rate volatility. The Company's interest rate risk management strategy involves modifying the re-pricing characteristics of certain assets and/or liabilities so that change in interest rates does not have a significant adverse effect on net interest income. Derivative instruments that Management periodically uses as part of its interest rate risk management strategy may include interest rate swap agreements, interest rate floor agreements, and interest rate cap agreements.

At September 30, 2018, the Company had five outstanding, off-balance sheet, derivative instruments. These derivative instruments were interest rate swap agreements, with notional principal amounts totaling \$125.0 million and an unrealized gain of \$2.3 million, net of taxes. The notional amounts and net unrealized gain (loss) of the financial derivative instruments do not represent exposure to credit loss. The Company is exposed to credit loss only to the extent the counter-party defaults in its responsibility to pay interest under the terms of the agreements. The credit risk in derivative instruments is mitigated by entering into transactions with highly-rated counterparties that Management believes to be creditworthy and by limiting the amount of exposure to each counter-party. At September 30, 2018, the Company's derivative instrument counterparties were credit rated "A" by the major credit rating agencies. The interest rate swap agreements were entered into by the Company to limit its exposure to rising interest rates and were designated as cash flow hedges.

**Contractual Obligations**

The following table sets forth the contractual obligations of the Company as of September 30, 2018:

| <i>Dollars in thousands</i>                       | <b>Total</b>     | <b>Less than<br/>1 year</b> | <b>1-3 years</b> | <b>3-5 years</b> | <b>More<br/>than<br/>5<br/>years</b> |
|---|------------------|-----------------------------|------------------|------------------|--------------------------------------|
| Borrowed funds                                    | <b>\$265,274</b> | \$200,160                   | \$—              | \$65,000         | \$114                                |
| Operating leases                                  | <b>169</b>       | 94                          | 33               | 33               | 9                                    |
| Certificates of deposit                           | <b>619,409</b>   | 456,833                     | 99,926           | 62,650           | —                                    |
| Total   | <b>\$884,852</b> | \$657,087                   | \$99,959         | \$127,683        | \$123                                |
| Total loan commitments and unused lines of credit | <b>\$183,596</b> | \$183,596                   | \$—              | \$—              | \$—                                  |

**Item 3 – Quantitative and Qualitative Disclosures About Market Risk****Market-Risk Management**

Market risk is the risk of loss arising from adverse changes in the fair value of financial instruments due to changes in interest rates. The First Bancorp, Inc.'s market risk is composed primarily of interest rate risk. The Bank's Asset/Liability Committee (ALCO) is responsible for reviewing the interest rate sensitivity position of the Company and establishing policies to monitor and limit exposure to interest rate risk. All guidelines and policies established by ALCO have been approved by the Board of Directors.

**Asset/Liability Management**

The primary goal of asset/liability management is to maximize net interest income within the interest rate risk limits set by ALCO. Interest rate risk is monitored through the use of two complementary measures: static gap analysis and earnings simulation modeling. While each measurement has limitations, taken together they represent a reasonably comprehensive view of the magnitude of interest rate risk in the Company, the level of risk through time, and the amount of exposure to changes in certain interest rate relationships.

Static gap analysis measures the amount of repricing risk embedded in the balance sheet at a point in time. It does so by comparing the differences in the repricing characteristics of assets and liabilities. A gap is defined as the difference between the principal amount of assets and liabilities that reprice within a specified time period. The Company's cumulative one-year gap at September 30, 2018 was 0.92% of total assets compared to -3.13% of total assets at December 31, 2017. Core deposits with non-contractual maturities are presented based upon historical patterns of balance attrition and pricing behavior, which are reviewed at least annually.

The gap repricing distributions include principal cash flows from residential mortgage loans and mortgage-backed securities in the time frames in which they are expected to be received. Mortgage prepayments are estimated by applying industry median projections of prepayment speeds to portfolio segments based on coupon range and loan age.

A summary of the Company's static gap, as of September 30, 2018, is presented in the following table:

|  | <b>0-90</b>      | <b>90-365</b>     | <b>1-5</b>       | <b>5+</b>          |
|--|------------------|-------------------|------------------|--------------------|
| <i>Dollars in thousands</i>  | <b>Days</b>      | <b>Days</b>       | <b>Years</b>     | <b>Years</b>       |
| Investment securities at amortized cost (HTM) and fair value (AFS) | \$33,636         | \$42,515          | \$174,422        | \$312,266          |
| Restricted stock, at cost  | 10,549           | —                 | —                | 1,037              |
| Loans held for sale  | —                | —                 | —                | 1,134              |
| Loans  | 407,962          | 166,835           | 475,252          | 193,509            |
| Other interest-earning assets                                      | —                | 23,365            | —                | —                  |
| Non-rate-sensitive assets  | 62,976           | —                 | —                | 76,396             |
| <b>Total assets</b>  | <b>515,123</b>   | <b>232,715</b>    | <b>649,674</b>   | <b>584,342</b>     |
| Interest-bearing deposits  | 363,304          | 283,541           | 162,549          | 536,580            |
| Borrowed funds   | 170,160          | 30,000            | 65,000           | 114                |
| Non-rate-sensitive liabilities and equity                          | (123,100 )       | 5,700             | 32,350           | 270,995            |
| <b>Total liabilities and equity</b>                                | <b>410,364</b>   | <b>319,241</b>    | <b>259,899</b>   | <b>807,689</b>     |
| <b>Period gap</b>  | <b>\$104,759</b> | <b>\$(86,526)</b> | <b>\$389,775</b> | <b>\$(223,347)</b> |
| Percent of total assets  | 5.29             | %(4.37 )          | %19.67           | %(11.27 )%         |
| Cumulative gap (current)   | \$104,759        | \$18,233          | \$408,008        | \$184,661          |
| Percent of total assets  | 5.29             | %0.92             | %20.59           | %9.32 %            |

The earnings simulation model forecasts capture the impact of changing interest rates on one-year and two-year net interest income. The modeling process calculates changes in interest income received and interest expense paid on all interest-earning assets and interest-bearing liabilities reflected on the Company's balance sheet. None of the assets used in the simulation are held for trading purposes. The modeling is done for a variety of scenarios that incorporate changes in the absolute level of interest rates as well as basis risk, as represented by changes in the shape of the yield curve and changes in interest rate relationships. Management evaluates the effects on income of alternative interest

rate scenarios against earnings in a stable interest rate environment. This analysis is also most useful in determining the short-run earnings exposures to changes in customer behavior involving loan payments and deposit additions and withdrawals.

The Company's most recent simulation model projects net interest income would remain the same if short-term rates affected by Federal Open Market Committee actions fall gradually by one percentage point over the next year, and decrease by approximately 3.40% if rates rise gradually by two percentage points. Both scenarios are well within ALCO's policy limit of a decrease in net interest income of no more than 10.0% given a 2.0% move in interest rates, up or down. Management believes this reflects a reasonable interest rate risk position. In year two, and assuming no additional movement in rates, the model forecasts that net interest income would be lower than that earned in a stable rate environment by 0.31% in a falling-rate scenario, and lower than that earned in a stable rate environment by 7.47% in a rising rate scenario, when compared to the year-one base scenario. A summary of the Bank's interest rate risk simulation modeling, as of September 30, 2018 and December 31, 2017 is presented in the following table:

**Changes in Net Interest Income** **September 30, 2018** December 31, 2017

**Year 1**

|  |               |        |
|--|---------------|--------|
| Projected change if rates decrease by 1.0% | <b>-1.03%</b> | 0.97%  |
| Projected change if rates increase by 2.0% | <b>-3.40%</b> | -5.10% |

**Year 2**

|  |               |        |
|--|---------------|--------|
| Projected change if rates decrease by 1.0% | <b>-0.31%</b> | 1.08%  |
| Projected change if rates increase by 2.0% | <b>-7.47%</b> | -7.09% |

This dynamic simulation model includes assumptions about how the balance sheet is likely to evolve through time and in different interest rate environments. Loans and deposits are projected to maintain stable balances. All maturities, calls and prepayments in the securities portfolio are assumed to be reinvested in similar assets. Mortgage loan prepayment assumptions are developed from industry median estimates of prepayment speeds for portfolios with similar coupon ranges and seasoning. Non-contractual deposit volatility and pricing are assumed to follow historical patterns. The sensitivities of key assumptions are analyzed annually and reviewed by ALCO.

This sensitivity analysis does not represent a Company forecast and should not be relied upon as being indicative of expected operating results. These hypothetical estimates are based upon numerous assumptions including, among others, the nature and timing of interest rate levels, yield curve shape, prepayments on loans and securities, pricing decisions on loans and deposits, and reinvestment/ replacement of asset and liability cash flows. While assumptions are developed based upon current economic and local market conditions, the Company cannot make any assurances as to the predictive ability of these assumptions, including how customer preferences or competitor influences might change.

***Interest Rate Risk Management***

A variety of financial instruments can be used to manage interest rate sensitivity. These may include investment securities, interest rate swaps, and interest rate caps and floors. Frequently called interest rate derivatives, interest rate swaps, caps and floors have characteristics similar to securities but possess the advantages of customization of the risk-reward profile of the instrument, minimization of balance sheet leverage and improvement of liquidity. As of September 30, 2018, the Company was using interest rate swaps for interest rate risk management.

The Company engages an independent consultant to periodically review its interest rate risk position, as well as the effectiveness of simulation modeling and reasonableness of assumptions used. As of September 30, 2018, there were no significant differences between the views of the independent consultant and Management regarding the Company's interest rate risk exposure. As a result of recent statements made by the Federal Open Market Committee, Management expects that short-term interest rates may continue to increase sometime in the next one-to-three quarters and believes that the current level of interest rate risk is acceptable.

**Item 4: Controls and Procedures**

As required by Rule 13a-15 under the Securities Exchange Act of 1934, as of September 30, 2018, the end of the quarter covered by this report, 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 the design and operation of the Company's disclosure controls and procedures. In designing and evaluating the Company's disclosure controls and procedures, the Company and its management recognize that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and the Company's management necessarily was required to apply its judgment in evaluating and implementing possible controls and procedures. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective at the reasonable assurance level to ensure that information required to be disclosed by the Company in the reports it files or submits 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. There was no change in the Company's internal control over financial reporting that occurred during the quarter ended September 30, 2018 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting. The Company reviews its disclosure controls and procedures, which may include its internal controls over financial reporting on an ongoing basis, and may from time to time make changes aimed at enhancing their effectiveness and to ensure that the Company's systems evolve with its business.

**Part II – Other Information****Item 1 – Legal Proceedings**

The Company was not involved in any legal proceedings requiring disclosure under Item 103 of Regulation S-K during the reporting period.

**Item 1A – Risk Factors**

There have been no material changes from the risk factors previously disclosed in the Company's Form 10-K for the year ended December 31, 2017.

**Item 2 – Unregistered Sales of Equity Securities and Use of Proceeds**

a. None

b. None

c. The Company made the following repurchases of its common stock in the nine months ended September 30, 2018:

| Month          | Shares Purchased | Average Price Per Share | Total shares purchased as part of publicly announced repurchase plans | Maximum number of shares that may be purchased under the plans |
|----------------|------------------|-------------------------|---|--|
| January 2018   | 5,134            | 29.47                   | —   | —  |
| February 2018  | 168              | 27.21                   | —   | —  |
| March 2018     | 423              | 27.98                   | —   | —  |
| April 2018     | —                | —                       | —   | —  |
| May 2018       | —                | —                       | —   | —  |
| June 2018      | —                | —                       | —   | —  |
| July 2018      | —                | —                       | —   | —  |
| August 2018    | —                | —                       | —   | —  |
| September 2018 | —                | —                       | —   | —  |
|                | 5,725            | 29.18                   | —   | —  |

**Item 3 – Default Upon Senior Securities**

None.

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**Item 4 – Other Information**

- A. None.
- B. None.

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**Item 5 – Exhibits**

Exhibit 3.2 Amendment to the Registrant's Articles of Incorporation (incorporated by reference to Exhibit 3.1 to the Company's Form 8-K filed under item 5.03 on May 1, 2008).

Exhibit 3.3 Amendment to the Registrant's Articles of Incorporation (incorporated by reference to the Definitive Proxy Statement for the Company's 2008 Annual Meeting filed on March 14, 2008).

Exhibit 3.4 Amendment to the Registrant's Articles of Incorporation authorizing issuance of preferred stock (incorporated by reference to Exhibit 3.1 to Current Report on Form 8-K filed on December 29, 2008).

Exhibit 3.5 Conformed Copy of the Company's Bylaws (incorporated by reference to Exhibit 3.5 to the Company's Form 10-K filed March 10, 2017).

Exhibit 10.1 Director Split Dollar Insurance Plan and Specimen Agreement dated January 1, 2016, attached as Exhibit 10.1 to the Company's Form 8-K filed under item 1.01 on October 25, 2017.

Exhibit 10.2 Executive Split Dollar Insurance Plan and Specimen Agreement dated January 1, 2016, attached as Exhibit 10.2 to the Company's Form 8-K filed under item 1.01 on October 25, 2017.

Exhibit 14.1 Code of Ethics for Senior Financial Officers, adopted by the Board of Directors on September 19, 2003. Incorporated by reference to Exhibit 14.1 to the Company's Annual Report on Form 10-K filed on March 15, 2006.

Exhibit 14.2 Code of Business Conduct and Ethics, adopted by the Board of Directors on April 15, 2004. Incorporated by reference to Exhibit 14.2 to the Company's Annual Report on Form 10-K filed on March 15, 2006.

Exhibit 31.1 Certification of Chief Executive Officer Pursuant to Rule 13A-14(A) of The Securities Exchange Act of 1934

Exhibit 31.2 Certification of Chief Financial Officer Pursuant to Rule 13A-14(A) of The Securities Exchange Act of 1934

Exhibit 32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of The Sarbanes-Oxley Act of 2002

Exhibit 32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of The Sarbanes-Oxley Act of 2002

Exhibit 101.INS XBRL Instance Document

Exhibit 101.SCH XBRL Taxonomy Extension Schema Document

Exhibit 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document

Exhibit 101.LAB XBRL Taxonomy Extension Label Linkbase Document

Exhibit 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

Exhibit 101.DEF XBRL Taxonomy Extension Definitions Linkbase

**Signatures**

Pursuant to the requirements 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.

THE FIRST BANCORP, INC.

/s/ Tony C. McKim  
Tony C. McKim  
President & Chief Executive Officer

Date: November 9, 2018

/s/ Richard M. Elder  
Richard M. Elder  
Executive Vice President & Chief Financial Officer

Date: November 9, 2018