NORTHEAST BANCORP /ME/
Form 10-Q
November 09, 2018

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

FORM 10-Q

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

For the quarterly period ended September 30, 2018

Commission File Number: 1-14588

Northeast Bancorp

(Exact name of registrant as specified in its charter)

Maine	**01-0425066**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
500 Canal Street, Lewiston, Maine	**04240**
(Address of Principal executive offices)	**(Zip Code)**

(207) 786-3245

Registrant's telephone number, including area code

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or an emerging growth company. See definition of “accelerated filer,” and “large accelerated filer”, “smaller reporting company” and “emerging growth 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 by Rule 12b-2 of the Exchange Act).
Yes_ No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. As of November 2, 2018, the registrant had outstanding 8,235,943 shares of voting common stock, $1.00 par value per share and 811,946 shares of non-voting common stock, $1.00 par value per share.

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PART 1- FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

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

	September 30, 2018	June 30, 2018
Assets		
Cash and due from banks	$2,668	$3,889
Short-term investments	203,049	153,513
Total cash and cash equivalents	205,717	157,402
Available-for-sale debt securities, at fair value	79,157	81,068
Equity securities, at fair value	6,620	6,619
Total investment securities	85,777	87,687
Residential real estate loans held for sale	1,940	3,405
SBA loans held for sale	1,350	3,750
Total loans held for sale	3,290	7,155
Loans		
Commercial real estate	599,624	579,450
Commercial and industrial	191,286	188,852
Residential real estate	93,308	100,256
Consumer	2,978	3,244
Total loans	887,196	871,802
Less: Allowance for loan losses	5,288	4,807
Loans, net	881,908	866,995
Premises and equipment, net	6,314	6,591
Real estate owned and other repossessed collateral, net	1,549	2,233
Federal Home Loan Bank stock, at cost	1,652	1,652

Intangible assets, net	758	867
Servicing rights, net	3,010	2,970
Bank-owned life insurance	16,729	16,620
Other assets	7,013	7,564
Total assets	$1,213,717	$1,157,736
Liabilities and Shareholders' Equity		
Deposits		
Demand	$67,500	$72,272
Savings and interest checking	109,564	109,637
Money market	398,423	420,886
Time	440,020	352,145
Total deposits	1,015,507	954,940
Federal Home Loan Bank advances	15,000	15,000
Subordinated debt	24,043	23,958
Capital lease obligation	536	605
Other liabilities	15,240	24,803
Total liabilities	1,070,326	1,019,306
Commitments and contingencies	-	-
Shareholders' equity		
Preferred stock, $1.00 par value, 1,000,000 shares authorized; no shares issued and outstanding at September 30, 2018 and June 30, 2018	-	-
Voting common stock, $1.00 par value, 25,000,000 shares authorized; 8,226,648 and 8,056,527 shares issued and outstanding at September 30, 2018 and June 30, 2018, respectively	8,226	8,057
Non-voting common stock, $1.00 par value, 3,000,000 shares authorized; 820,742 and 882,314 shares issued and outstanding at September 30, 2018 and June 30, 2018, respectively	821	882
Additional paid-in capital	77,075	77,016
Retained earnings	58,501	54,236
Accumulated other comprehensive loss	(1,232)	(1,761)
Total shareholders' equity	143,391	138,430
Total liabilities and shareholders' equity	$1,213,717	$1,157,736

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

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

	Three Months Ended September 30,	
	2018	2017
Interest and dividend income:		
Interest and fees on loans	$17,525	$15,383
Interest on investment securities	362	266
Other interest and dividend income	880	529
Total interest and dividend income	18,767	16,178
Interest expense:		
Deposits	3,682	2,176
Federal Home Loan Bank advances	118	172
Subordinated debt	601	508
Obligation under capital lease agreements	7	11
Total interest expense	4,408	2,867
Net interest and dividend income before provision for loan losses	14,359	13,311
Provision for loan losses	532	354
Net interest and dividend income after provision for loan losses	13,827	12,957
Noninterest income:		
Fees for other services to customers	492	526
Gain on sales of SBA loans	851	1,019
Gain on sales of residential loans held for sale	174	291
Net unrealized loss on equity securities	(40)	-
Loss on real estate owned, other repossessed collateral and premises and equipment, net	(40)	-
Bank-owned life insurance income	110	112
Other noninterest income	7	10
Total noninterest income	1,554	1,958
Noninterest expense:		
Salaries and employee benefits	5,509	5,254
Occupancy and equipment expense	1,127	1,109
Professional fees	534	442
Data processing fees	601	604

Marketing expense	124	87
Loan acquisition and collection expense	439	365
FDIC insurance premiums	81	80
Intangible asset amortization	109	109
Other noninterest expense	831	664
Total noninterest expense	9,355	8,714
Income before income tax expense	6,026	6,201
Income tax expense	1,492	1,615
Net income	$4,534	$4,586
Weighted-average common shares outstanding:		
Basic	8,995,925	8,841,511
Diluted	9,183,729	9,089,936
Earnings per common share:		
Basic	$0.50	$0.52
Diluted	0.49	0.50
Cash dividends declared per common share	$0.01	$0.01

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

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

	Three Months Ended September 30,	
	2018	2017
Net income	$4,534	$4,586
Other comprehensive income, before tax:		
Available-for-sale debt securities:		
Change in net unrealized loss on available-for-sale debt securities	(74)	122
Derivatives and hedging activities:		
Change in accumulated loss on effective cash flow hedges	482	22
Reclassification adjustments included in interest expense	70	23
Total derivatives and hedging activities	552	45
Total other comprehensive income, before tax	478	167
Income tax expense related to other comprehensive income	129	63
Other comprehensive income, net of tax	349	104
Comprehensive income	$4,883	$4,690

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

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

	Preferred Stock		Voting Common Stock		Non-voting Common Stock		Additional	Retained	Accumulated Other Comprehensive	Total Shareholders'
	Shares	Amount	Shares	Amount	Shares	Amount	Paid-in Capital	Earnings	Loss	Equity
Balance at June 30, 2017	-	-	7,840,460	$ 7,841	991,194	$ 991	$ 77,455	$ 38,142	$ (1,632)	$ 122,797
Net income	-	-	-	-	-	-	-	4,586	-	4,586
Other comprehensive income, net of tax	-	-	-	-	-	-	-	-	104	104
Conversions between voting common stock and non- voting common stock, net	-	-	-	-	-	-	-	-	-	-
Dividends on common stock at $0.01 per share	-	-	-	-	-	-	-	(87)	-	(87)
Stock-based compensation	-	-	-	-	-	-	220	-	-	220
Issuance of restricted common stock	-	-	10,000	10	-	-	(10)	-	-	-
Cancellation and forfeiture of restricted common stock	-	-	(15,089)	(15)	-	-	(39)	-	-	(54)
Stock options exercised, net	-	-	63,788	63	-	-	(917)	-	-	(854)

Balance at September 30, 2017	-	$ -	7,899,159	$ 7,899	991,194	$ 991	$ 76,709	$ 42,641	$ (1,528)	$ 126,712
Balance at June 30, 2018	-	-	8,056,527	$ 8,057	882,314	$ 882	$ 77,016	$ 54,236	$ (1,761)	$ 138,430
Net income	-	-	-	-	-	-	-	4,534	-	4,534
Other comprehensive income, net of tax	-	-	-	-	-	-	-	-	349	349
Conversions between voting common stock and non- voting common stock, net	-	-	61,572	61	(61,572)	(61)	-	-	-	-
Dividends on common stock at $0.01 per share	-	-	-	-	-	-	-	(89)	-	(89)
Stock-based compensation	-	-	-	-	-	-	299	-	-	299
Issuance of restricted common stock	-	-	114,925	114	-	-	(114)	-	-	-
Cancellation and forfeiture of restricted common stock	-	-	(6,376)	(6)	-	-	(126)	-	-	(132)
Stock options exercised, net	-	-	-	-	-	-	-	-	-	-
Adjustment for adoption of ASU 2016-01	-	-	-	-	-	-	-	(180)	180	-
Balance at September 30, 2018	-	$ -	8,226,648	$ 8,226	820,742	$ 821	$ 77,075	$ 58,501	$ (1,232)	$ 143,391

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

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NORTHEAST BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)
(Dollars in thousands)

	Three Months Ended September 30,	
	2018	2017
Operating activities:		
Net income	$4,534	$4,586
Adjustments to reconcile net income to net cash used in operating activities:		
Provision for loan losses	532	354
Loss on sale and impairment of real estate owned and other repossessed collateral, net	40	-
Net unrealized loss on equity securities	40	-
Accretion of fair value adjustments on loans, net	(1,592)	(2,938)
Accretion of fair value adjustments on borrowings, net	57	50
Amortization of subordinated debt issuance costs	28	28
Originations of loans held for sale	(25,271)	(30,545)
Net proceeds from sales of loans held for sale	26,523	29,450
Gain on sales of residential loans held for sale	(174)	(291)
Gain on sales of SBA and other loans held for sale	(851)	(1,019)
Net increase in servicing rights	(40)	(109)
Amortization of intangible assets	109	109
Bank-owned life insurance income, net	(110)	(112)
Depreciation of premises and equipment	333	292
Stock-based compensation	299	220
Amortization of available-for-sale debt securities, net	109	240
Changes in other assets and liabilities:		
Other assets	496	(990)
Other liabilities	(9,085)	(3,992)
Net cash used in operating activities	(4,023)	(4,667)
Investing activities:		
Purchases of available-for-sale debt securities	(15,992)	-
Proceeds from maturities and principal payments on investment securities, net	17,680	2,067
Loan purchases	(34,803)	(3,651)
Loan originations, principal collections, and purchased loan paydowns, net	24,538	22,599
Purchases and disposals of premises and equipment, net	(56)	(629)
Proceeds from sales of real estate owned and other repossessed collateral	694	-
Net cash (used in) provided by investing activities	(7,939)	20,386
Financing activities:		
Net increase (decrease) in deposits	60,567	(27,127)
Dividends paid on common stock	(89)	(87)
Repayment of capital lease obligation	(69)	(65)
Repurchases for tax withholdings on restricted common stock	(132)	(54)
Stock options exercised, net	-	(854)

Net cash provided by (used in) financing activities	60,277	(28,187)
Net increase (decrease) in cash and cash equivalents	48,315	(12,468)
Cash and cash equivalents, beginning of period	157,402	163,283
Cash and cash equivalents, end of period	$205,717	$150,815
Supplemental schedule of noncash investing activities:		
Transfers from loans to real estate owned and other repossessed collateral, net	$50	$1,214

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

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NORTHEAST BANCORP AND SUBSIDIARY

Notes to Unaudited Consolidated Financial Statements

September 30, 2018

1. Basis of Presentation

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

These 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 notes required by GAAP for complete financial statements. In the opinion of management, the accompanying consolidated financial statements contain all adjustments (consisting principally of normal recurring accruals) considered necessary for a fair presentation of the Company's financial position, results of operations, and cash flows for the interim periods presented. These accompanying unaudited financial statements and notes should be read in conjunction with the audited consolidated financial statements and notes thereto for the fiscal year ended June 30, 2018 ("Fiscal 2018") included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission.

2. Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, *Revenue from Contracts with Customers (Topic 606)* ("ASU 2014-09"). ASU 2014-09 implements a common revenue standard that clarifies the principles for recognizing revenue. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps: (i) identify the contract(s) with a customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract and (v) recognize revenue when (or as) the entity satisfies a performance obligation. ASU 2015-14, *Revenue from Contracts with Customers (Topic 606)* ("ASU 2015-14") was issued in August 2015 which deferred adoption to annual reporting periods beginning after December 15, 2017, which was adopted during the three months ended September 30, 2018. The timing of the Company's revenue recognition did not change. The Company's largest portions of revenue, interest and fees on loans, interest and dividend income on securities and short-term investments, bank-owned life insurance income, and gain on sales of loans, are specifically excluded from

the scope of the guidance. Additionally, fees for other services to customers includes loan servicing fee income which is accounted for under ASC Topic 860, *Transfers and Servicing*, ("Topic 860"), and is not subject to Topic 606. The other component of fees for other services to customers is deposit fees. The majority of the Company's deposit fees are specifically related to a customer accessing its funds, in which case the revenue is currently recognized in a consistent manner with Topic 606. Revenue that is not specifically related to a customer accessing its funds (i.e. account maintenance fees), can be waived; however, the amount of waived fees is not considered material, and thus the revenue is consistently recognized with Topic 606. All other revenue is also recognized in a manner consistent with Topic 606. Because of the above, management believes that revenue recognized under the new guidance approximates revenue recognized under current GAAP.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities* ("ASU 2016-01"). This guidance changes how entities account for equity investments that do not result in consolidation and are not accounted for under the equity method of accounting. Entities will be required to measure these investments at fair value at the end of each reporting period and recognize changes in fair value in net income. A practicability exception will be available for equity investments that do not have readily determinable fair values; however, the exception requires the Company to adjust the carrying amount for impairment and observable price changes in orderly transactions for the identical or a similar investment of the same issuer. This guidance also changes certain disclosure requirements and other aspects of current GAAP. The Company adopted this guidance during the three months ended September 30, 2018. This adoption resulted in a reclassification of $180 thousand from accumulated other comprehensive loss to retained earnings in the consolidated financial statements, with no net effect on shareholders' equity. In addition, the disclosure of the fair value of "Loans, net" in "Notes to Unaudited Consolidated Financial Statements – Note 11: Fair Value Measurements" is now calculated based on an exit pricing strategy versus an entry pricing strategy.

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

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In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326)* (“ASU 2016-13”). This guidance is intended to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. To achieve this objective, the amendments in this guidance replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. This ASU will be effective for fiscal years beginning after December 15, 2019. Early adoption is available as of the fiscal year beginning after December 15, 2018. The Company is evaluating the provisions of the guidance, and will closely monitor developments and additional guidance to determine the potential impact on the Company’s consolidated financial statements. Management is in the process of identifying the methodologies and the additional data requirements necessary to implement the guidance and has engaged an existing third-party service provider to assist in implementation.

In May 2017, the FASB issued ASU 2017-09, *Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting* (“ASU 2017-09”) which amends the scope of modification accounting for share-based payment arrangements. This update provides guidance on the types of changes to the terms or conditions of share-based payment awards to which an entity would be required to apply modification accounting. Specifically, an entity would not apply modification accounting if the fair value, vesting conditions, and classification of the awards are the same immediately before and after the modification. This update was adopted during the three months ended September 30, 2018 and did not have an impact on the Company’s consolidated financial statements.

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

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

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurements (Topic 820)* (“ASU 2018-13”). This update modifies disclosure requirements on fair value measurements in Topic 820, Fair Value Measurement. This includes

removing requirements related to transfers between Level 1 and Level 2, the policy of timing of transfers between levels, and the valuation process for Level 3 fair value measurements, modifying disclosure requirements related to investments in certain entities that calculate net asset value, and adding disclosure requirements for changes in unrealized gains and losses for recurring Level 3 fair value measurements and the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements. The amendments in this guidance are effective for public business entities for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted. The adoption of this guidance is not expected to have a significant impact on the Company’s consolidated financial statements.

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3. Investment Securities

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

	September 30, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
U.S. Government agency securities	$57,085	$ -	$ (264)	$56,821
Agency mortgage-backed securities	23,483	-	(1,147)	22,336
Equity investments measured at net asset value	6,907	-	(287)	6,620
Total investment securities	$87,475	$ -	$ (1,698)	$85,777

	June 30, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
U.S. Government agency securities	$57,129	$ -	$ (242)	$56,887
Agency mortgage-backed securities	25,276	-	(1,095)	24,181
Equity investments measured at net asset value	6,866	-	(247)	6,619
Total investment securities	$89,271	$ -	$ (1,584)	$87,687

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

When securities are sold, the adjusted cost of the specific security sold is used to compute the gain or loss on sale. There were no securities sold during the three months ended September 30, 2018 or 2017. At September 30, 2018, no investment securities were pledged as collateral to secure outstanding borrowings.

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

	September 30, 2018					
	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)					
U.S. Government agency securities	$41,873	$ (213)	$14,948	$ (51)	$56,821	$ (264)
Agency mortgage-backed securities	554	(15)	21,782	(1,132)	22,336	(1,147)
Equity investments measured at net asset value	-	-	5,067	(287)	5,067	(287)
Total investment securities	$42,427	$ (228)	$41,797	$ (1,470)	$84,224	$ (1,698)

	June 30, 2018					
	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)					
U.S. Government agency securities	$57,168	$ (233)	$-	$ -	$57,168	$ (233)
Agency mortgage-backed securities	19,571	(298)	13,332	(322)	32,903	(620)
Equity investments measured at net asset value	5,115	(95)	-	-	5,115	(95)
Total investment securities	$81,854	$ (626)	$13,332	$ (322)	$95,186	$ (948)

There were no other-than-temporary impairment losses on securities during the three months ended September 30, 2018 or 2017.

At September 30, 2018, the Company had 41 securities in an unrealized loss position. At September 30, 2018, all of the Company's available-for-sale securities were issued or guaranteed by either government agencies or government-sponsored enterprises. The decline in fair value of the Company's investment securities at September 30, 2018 is attributable to changes in interest rates.

In addition to considering current trends and economic conditions that may affect the quality of individual securities within the Company's investment portfolio, management of the Company also considers the Company's ability and intent to hold such securities to maturity or recovery of cost. At September 30, 2018, the Company does not intend to sell and it is not more likely than not that the Company will be required to sell the investment securities before recovery of its amortized cost. As such, management does not believe any of the Company's investment securities are other-than-temporarily impaired at September 30, 2018.

The investments measured at net asset value include a fund that seeks to invest in securities either issued or guaranteed by the U.S. government or its agencies, as well as a fund that primarily invests in the federally guaranteed portion of SBA 7(a) loans that adjust quarterly or monthly and are indexed to the Prime Rate. The underlying

composition of these funds is primarily government agencies, other investment-grade investments, or the guaranteed portion of SBA 7(a) loans, as applicable. As of September 30, 2018, the effective duration of the fund that seeks to invest in securities either issued or guaranteed by the U.S. government or its agencies is 4.58 years.

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ASU 2016-01, *Recognition and Measurements of Financial Assets and Financial Liabilities*, was adopted on July 1, 2018, and a cumulative effect adjustment of $180 thousand was recorded to reclassify the amount of accumulated unrealized losses, net, related to equity securities from accumulated other comprehensive loss to retained earnings. For the three months ended September 30, 2018, there were $40 thousand of net unrealized losses on equity securities recognized in the consolidated statement of income.

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

	Amortized Cost	Fair Value
	(Dollars in thousands)	
Due within one year	$16,992	$16,938
Due after one year through five years	40,093	39,883
Due after five years through ten years	-	-
Due after ten years	-	-
Total U.S. Government agency securities	57,085	56,821
Agency mortgage-backed securities	23,483	22,336
Total available-for-sale debt securities	$80,568	$79,157

4. Loans, Allowance for Loan Losses and Credit Quality

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

Loans purchased by the Company are accounted for under ASC 310-30, *Receivables—Loans and Debt Securities Acquired with Deteriorated Credit Quality* ("ASC 310-30"). At acquisition, the effective interest rate is determined based on the discount rate that equates the present value of the Company's estimate of cash flows with the purchase price of the loan. Prepayments are not assumed in determining a purchased loan's effective interest rate and income accretion. The application of ASC 310-30 limits the yield that may be accreted on the purchased loan, or the "accretable yield," to the excess of the Company's estimate, at acquisition, of the expected undiscounted principal,

interest, and other cash flows over the Company's initial investment in the loan. The excess of contractually required payments receivable over the cash flows expected to be collected on the loan represents the purchased loan's "nonaccretable difference." Subsequent improvements in expected cash flows of loans with nonaccretable differences result in a prospective increase to the loan's effective yield through a reclassification of some, or all, of the nonaccretable difference to accretable yield. The effect of subsequent credit-related declines in expected cash flows of purchased loans are recorded through a specific allocation in the allowance for loan losses.

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

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

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

	September 30, 2018			June 30, 2018		
	Originated	Purchased	Total	Originated	Purchased	Total
	(Dollars in thousands)					
Residential real estate	$69,776	$14,398	$84,174	$75,873	$13,926	$89,799
Home equity	9,134	-	9,134	10,457	-	10,457
Commercial real estate	314,394	285,230	599,624	303,399	276,051	579,450
Commercial and industrial	190,366	920	191,286	187,857	995	188,852
Consumer	2,978	-	2,978	3,244	-	3,244
Total loans	$586,648	$300,548	$887,196	$580,830	$290,972	$871,802

Total loans include deferred loan origination costs, net, of $339 thousand and $223 thousand as of September 30, 2018 and June 30, 2018, respectively.

Past Due and Nonaccrual Loans

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

	September 30, 2018							
	Past Due 30-59 Days	Past Due 60-89 Days	Past Due 90 Days or More-Still Accruing	Past Due 90 Days or More-Nonaccrual	Total Past Due	Total Current	Total Loans	Nonaccrual Loans
	(Dollars in thousands)							
Originated portfolio:								
Residential real estate	$351	$220	$ -	$ 1,536	$2,107	$67,669	$69,776	$ 2,633
Home equity	-	-	-	10	10	9,124	9,134	152
Commercial real estate	854	-	-	1,244	2,098	312,296	314,394	1,703
Commercial and industrial	100	-	-	807	907	189,459	190,366	1,453
Consumer	53	-	-	100	153	2,825	2,978	185
Total originated portfolio	1,358	220	-	3,697	5,275	581,373	586,648	6,126
Purchased portfolio:								

Residential real estate	421	-	-	202	623	13,775	14,398	202
Commercial real estate	1,074	16	-	2,395	3,485	281,745	285,230	4,815
Commercial and industrial	149	5	-	104	258	662	920	358
Total purchased portfolio	1,644	21	-	2,701	4,366	296,182	300,548	5,375
Total loans	$3,002	$241	$ -	$ 6,398	$9,641	$877,555	$887,196	$ 11,501

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

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Allowance for Loan Losses and Impaired Loans

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

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

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

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

Commercial and industrial: Loans in this segment are made to businesses and are generally secured by the assets of the business. Repayment is expected from the cash flows of the business. This segment also includes loans to non-bank lenders, which are generally secured by a collateral assignment of the notes and mortgages on loans originated by the non-bank lenders. Weakness in national or regional economic conditions, and a corresponding weakness in consumer or business spending, will have an adverse effect on the credit quality of this segment.

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

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

SBA: Loans in this segment are comprised of both commercial real estate and commercial and industrial loans to small businesses, underwritten and originated by the Bank's national SBA group ("SBA Division"). Loans are underwritten and originated primarily in accordance with SBA 7(a) guidelines, and are partially guaranteed by the SBA. Loans are primarily secured by income-producing properties and/or assets of the businesses. Adverse developments in national or regional economic conditions, and a corresponding weakness in consumer or business spending, will have an adverse effect on the credit quality of this segment.

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

- Levels and trends in delinquencies;
- Trends in the volume and nature of loans;
- Trends in credit terms and policies, including underwriting standards, procedures and practices, and the experience and ability of lending management and staff;

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Trends in portfolio concentration;

National and local economic trends and conditions;

Effects of changes or trends in internal risk ratings; and

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

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

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

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

	Three Months Ended September 30, 2018						
	Residential Real Estate	Commercial Real Estate	Commercial and Industrial	Consumer	Purchased	SBA	Total
	(Dollars in thousands)						
Beginning balance	$605	$ 1,527	$ 620	$ 39	$ 587	$1,429	$4,807
Provision (credit)	99	93	164	(12)	10	178	532
Recoveries	2	7	7	18	-	-	34

Charge-offs	(81)	-	(2)	(2)	-	-	(85)
Ending balance	$625	$ 1,627	$ 789	$ 43	$ 597	$1,607	$5,288

	Three Months Ended September 30, 2017						
	Residential Real Estate	Commercial Real Estate	Commercial and Industrial	Consumer	Purchased	SBA	Total
	(Dollars in thousands)						
Beginning balance	$472	$ 1,219	$ 394	$ 53	$ 303	$1,224	$3,665
Provision (credit)	41	29	184	(14)	7	107	354
Recoveries	7	-	18	6	-	-	31
Charge-offs	(12)	-	-	(4)	-	-	(16)
Ending balance	$508	$ 1,248	$ 596	$ 41	$ 310	$1,331	$4,034

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

	September 30, 2018						
	Residential Real Estate	Commercial Real Estate	Commercial and Industrial	Consumer	Purchased	SBA	Total
	(Dollars in thousands)						
Allowance for loan losses:							
Individually evaluated	$337	$ 128	$ 3	$ 22	$-	$342	$832
Collectively evaluated	288	1,499	786	21	-	1,265	3,859
ASC 310-30	-	-	-	-	597	-	597
Total	$625	$ 1,627	$ 789	$ 43	$597	$1,607	$5,288
Loans:							
Individually evaluated	$5,137	$ 2,541	$ 47	$ 340	$-	$3,585	$11,650
Collectively evaluated	73,773	250,588	184,372	2,638	-	63,627	574,998
ASC 310-30	-	-	-	-	300,548	-	300,548
Total	$78,910	$ 253,129	$ 184,419	$ 2,978	$300,548	$67,212	$887,196

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	June 30, 2018						
	Residential Real Estate	Commercial Real Estate	Commercial and Industrial	Consumer	Purchased	SBA	Total
	(Dollars in thousands)						
Allowance for loan losses:							
Individually evaluated	$322	$ 139	$ 8	$ 6	$-	$112	$587
Collectively evaluated	283	1,388	612	33	-	1,317	3,633
ASC 310-30	-	-	-	-	587	-	587
Total	$605	$ 1,527	$ 620	$ 39	$587	$1,429	$4,807
Loans:							
Individually evaluated	$5,682	$ 2,687	$ 33	$ 292	$-	$3,170	$11,864
Collectively evaluated	80,520	246,742	181,767	2,952	-	56,985	568,966
ASC 310-30	-	-	-	-	290,972	-	290,972
Total	$86,202	$ 249,429	$ 181,800	$ 3,244	$290,972	$60,155	$871,802

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

	September 30, 2018			June 30, 2018		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(Dollars in thousands)					
Impaired loans without a valuation allowance:						
Originated:						
Residential real estate	$3,031	$3,024	$ -	$3,162	$3,154	$ -
Commercial real estate	1,458	1,453	-	1,641	1,634	-
Commercial and industrial	1,659	1,659	-	2,401	2,401	-
Consumer	279	302	-	271	296	-
Purchased:						
Residential real estate	202	217	-	202	217	-
Commercial real estate	6,381	9,064	-	6,601	9,330	-
Commercial and industrial	95	173	-	108	186	-
Total	13,105	15,892	-	14,386	17,218	-
Impaired loans with a valuation allowance:						
Originated:						
Residential real estate	2,106	2,086	337	2,520	2,497	322
Commercial real estate	1,621	1,612	191	1,241	1,233	139
Commercial and industrial	1,435	1,434	282	607	607	120
Consumer	61	62	22	21	22	6
Purchased:						

Residential real estate	-	-	-	-	-	-
Commercial real estate	4,401	4,950	298	4,748	5,362	280
Commercial and industrial	357	415	299	349	407	307
Total	9,981	10,559	1,429	9,486	10,128	1,174
Total impaired loans	$23,086	$26,451	$ 1,429	$23,872	$27,346	$ 1,174

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

	Three Months Ended September 30,			
	2018		2017	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)			
Impaired loans without a valuation allowance:				
Originated:				
Residential real estate	$3,097	$ 19	$4,095	$ 36
Commercial real estate	1,550	10	1,393	93
Commercial and industrial	2,030	33	1,850	37
Consumer	275	2	272	6
Purchased:				
Residential real estate	202	-	1,067	-
Commercial real estate	6,491	59	8,868	80
Commercial and industrial	102	-	30	-
Total	13,747	123	17,575	252
Impaired loans with a valuation allowance:				
Originated:				
Residential real estate	2,313	23	1,614	21
Commercial real estate	1,431	27	1,396	22
Commercial and industrial	1,021	1	845	4
Consumer	41	-	35	1
Purchased:				
Residential real estate	-	-	-	-
Commercial real estate	4,575	31	3,534	27
Commercial and industrial	353	-	94	-
Total	9,734	82	7,518	75
Total impaired loans	$23,481	$ 205	$25,093	$ 327

Credit Quality

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

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

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

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

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

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

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

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

	September 30, 2018				
	Originated Portfolio				
	Commercial Real Estate	Commercial and Industrial	Residential[1]	Purchased Portfolio	Total
	(Dollars in thousands)				
Loans rated 1- 6	$307,933	$ 186,460	$ 14,543	$289,445	$798,381
Loans rated 7	4,620	2,212	96	5,505	12,433
Loans rated 8	1,841	1,694	815	5,598	9,948
Loans rated 9	-	-	-	-	-
Loans rated 10	-	-	-	-	-
Total	$314,394	$ 190,366	$ 15,454	$300,548	$820,762

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

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

Troubled Debt Restructurings

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

	Three Months Ended September 30,			
	2018		2017	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
	(Dollars in thousands)			
Extended maturity	-	$ -	1	$ 18
Adjusted interest rate	-	-	-	-
Rate and maturity	3	170	-	-
Principal deferment	-	-	1	655
Court ordered concession	-	-	-	-
Total	3	$ 170	2	$ 673

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

	Three Months Ended September 30,					
	2018			2017		
	Number of Contracts	Recorded Investment Pre-Modification	Recorded Investment Post-Modification	Number of Contracts	Recorded Investment Pre-Modification	Recorded Investment Post-Modification
	(Dollars in thousands)					
Originated portfolio:						
Residential real estate	3	$ 170	$ 170	1	$ 18	$ 18
Home equity	-	-	-	-	-	-
Commercial real estate	-	-	-	-	-	-
Commercial and industrial	-	-	-	1	655	655
Consumer	-	-	-	-	-	-
Total originated portfolio	3	170	170	2	673	673
Purchased portfolio:						
Residential real estate	-	-	-	-	-	-
Commercial real estate	-	-	-	-	-	-
Total purchased portfolio	-	-	-	-	-	-
Total	3	$ 170	$ 170	2	$ 673	$ 673

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The Company considers TDRs past due 90 days or more to be in payment default. Two loans modified in a TDR in the last twelve months totaling $1.5 million defaulted during the three months ended September 30, 2018. As of September 30, 2018, there were no further commitments to lend to borrowers associated with loans modified in a TDR.

ASC 310-30 Loans

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

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017
	(Dollars in thousands)	
Contractually required payments receivable	$61,540	$ 5,912
Nonaccretable difference	(174)	(157)
Cash flows expected to be collected	61,366	5,755
Accretable yield	(26,563)	(2,104)
Fair value of loans acquired	$34,803	$ 3,651

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

	As of and for the Three Months Ended September 30, 2018	As of and for the Three Months Ended September 30, 2017

	(Dollars in thousands)	
Loans acquired during the period	$ -	$ -
Loans at end of period	4,915	6,032

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

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017
	(Dollars in thousands)	
Beginning balance	$ 138,178	$ 131,197
Acquisitions	26,563	2,104
Accretion	(5,533)	(4,425)
Reclassifications from non-accretable difference to accretable yield	578	3,428
Disposals and other changes	(6,992)	(9,381)
Ending balance	$ 152,794	$ 122,923

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

	September 30, 2018	June 30, 2018
	(Dollars in thousands)	
Unpaid principal balance	$ 329,242	$ 318,876
Carrying amount	294,106	284,317

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5. Transfers and Servicing of Financial Assets

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

Capitalized servicing rights as of September 30, 2018 and June 30, 2018 totaled $3.0 million, and are classified as servicing rights, net, on the consolidated balance sheets.

Mortgage loans sold during the quarter ended September 30, 2018 totaled $13.2 million, compared to $19.2 million during the quarter ended September 30, 2017. Mortgage loans serviced for others totaled $8.1 million at September 30, 2018 and $8.7 million at June 30, 2018. Additionally, the Company was servicing commercial loans participated out to various other institutions amounting to $25.8 million and $32.2 million at September 30, 2018 and June 30, 2018, respectively.

SBA loans sold during the quarter ended September 30, 2018 totaled $12.3 million, compared to $9.1 million during the quarter ended September 30, 2017. SBA loans serviced for others totaled $171.1 million at September 30, 2018 and $162.0 million at June 30, 2018.

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

Contractually specified servicing fees were $247 thousand and $262 thousand for the quarters ended September 30, 2018 and 2017, respectively, and were included as a component of loan-related fees within noninterest income.

The significant assumptions used in the valuation of the servicing rights included a range of discount rates from 9.0% to 23.3% and a weighted average prepayment speed assumption of 11.5%.

6. Earnings Per Share (EPS)

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

	Three months Ended September 30,	
	2018	2017
	(Dollars in thousands, except share and per share data)	
Net income	$4,534	$4,586
Weighted average shares used in calculation of basic EPS	8,995,925	8,841,511
Incremental shares from assumed exercise of dilutive securities	187,804	248,425
Weighted average shares used in calculation of diluted EPS	9,183,729	9,089,936
Basic earnings per common share	$0.50	$0.52
Diluted earnings per common share	0.49	0.50

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

	Three Months Ended September 30,	
	2018	2017
Stock options	-	81,004

7. Derivatives and Hedging Activities

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

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

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

Risk Management Policies—Derivative Instruments

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

Interest Rate Risk Management—Cash Flow Hedging Instruments

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

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

September 30, 2018

Notional Amount	Inception Date	Termination Date	Index	Receive Rate	Pay Rate	Strike Rate	Unrealized Loss	Fair Value	Balance Sheet Location
(Dollars in thousands)									
Interest rate swaps:									
$5,000	July 2013	July 2033	3 Mo. LIBOR	2.29 %	3.38%	n/a	$ (181)	$(181)	Other Liabilities

5,000	July 2013	July 2028	3 Mo. LIBOR	2.29 %	3.23%	n/a	(76)	(76)	Other Liabilities
5,000	July 2013	July 2023	3 Mo. LIBOR	2.29 %	2.77%	n/a	54	54	Other Assets
Forward-starting interest rate swaps:									
6,000	February 2018	September 2029	3 Mo. LIBOR	5.20 %	5.88%	n/a	13	13	Other Assets
10,000	February 2018	February 2030	3 Mo. LIBOR	4.29 %	4.98%	n/a	15	15	Other Assets
Interest rate caps:									
6,000	October 2014	September 2019	3 Mo. LIBOR	n/a	n/a	2.50 %	(40)	16	Other Assets
10,000	March 2015	February 2020	3 Mo. LIBOR	n/a	n/a	2.50 %	(60)	52	Other Assets
$47,000							$ (275)	$ (107)	

June 30, 2018

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

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

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8. Other Comprehensive Income

The components of other comprehensive income are as follows:

	Three Months Ended September 30,					
	2018			2017		
	Pre-tax Amount	Tax Expense (Benefit)	After-tax Amount	Pre-tax Amount	Tax Expense (Benefit)	After-tax Amount
	(Dollars in thousands)					
Change in net unrealized loss on available-for-sale debt securities	$(74)	$ (20)	$ (54)	$122	$ 45	$ 77
Change in accumulated loss on effective cash flow hedges	482	130	352	22	9	13
Reclassification adjustment for losses included in net income	70	19	51	23	9	14
Total derivatives and hedging activities	552	149	403	45	18	27
Total other comprehensive (loss) income	$478	$ 129	$ 349	$167	$ 63	$ 104

Accumulated other comprehensive loss is comprised of the following:

	September 30, 2018	June 30, 2018
	(Dollars in thousands)	
Unrealized loss on investment securities	$(1,411)	$(1,584)
Tax effect	381	428
After tax amount	(1,030)	(1,156)
Unrealized loss on cash flow hedges	(275)	(827)
Tax effect	73	222
After tax amount	(202)	(605)
Accumulated other comprehensive loss	$(1,232)	$(1,761)

9. Commitments and Contingencies

Commitments

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

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

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

	September 30, 2018	June 30, 2018
	(Dollars in thousands)	
Commitments to grant loans	$22,957	$20,431
Unfunded commitments under lines of credit	32,862	29,478
Standby letters of credit	3,183	3,183

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the counter party. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, and income-producing commercial properties. The Company has recorded an allowance for possible losses on commitments and unfunded loans totaling $62 thousand and $52 thousand recorded in other liabilities at September 30, 2018 and June 30, 2018, respectively.

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Contingencies

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

10. Stock-Based Compensation

A summary of restricted share activity for the quarter ended September 30, 2018 follows:

	Shares	Weighted Average Grant Date Fair Value
Unvested at beginning of period	318,334	$ 11.71
Granted	114,925	22.40
Vested	(53,453)	10.30
Forfeited	(6,377)	10.20
Unvested at end of period	373,429	15.23

A summary of the vesting schedule for the shares granted in the quarter ended September 30, 2018 follows:

89,925 restricted shares vest in three equal installments, commencing on August 14, 2021; and,
25,000 restricted shares are subject to performance-based vesting over a three year period (the "performance shares"). The performance shares include an absolute metric and a sliding metric within the performance period. The absolute metric requires that the Company be in compliance with the regulatory commitments made to the Federal Reserve Bank and Maine Bureau of Financial Institutions. The sliding metric is based on reaching certain thresholds in regards to the company's return on equity ("ROE"). The performance shares shall vest in certain defined increments for such periods if the ROE is at least 70% of such targeted returns. This performance will be measured on both a year-by-year basis for three years, and an average basis over the three year performance period.

11. Fair Value Measurements

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Fair Value of other Financial Instruments:

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

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

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

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

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

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