

NORTHEAST BANCORP /ME/

FORM 10-Q (Quarterly Report)

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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, 2017

Commission File Number: 1-14588

Northeast Bancorp

(Exact name of registrant as specified in its charter)

<u>Maine</u> (State or other jurisdiction of incorporation or organization)	<u>01-0425066</u> (I.R.S. Employer Identification No.)
<u>500 Canal Street, Lewiston, Maine</u> (Address of Principal executive offices)	<u>04240</u> (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 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, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller Reporting Company Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined 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, 2017, the registrant had outstanding 7,930,565 shares of voting common stock, \$1.00 par value per share and 996,823 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, 2017	June 30, 2017
Assets		
Cash and due from banks	\$ 3,528	\$ 3,582
Short-term investments	147,287	159,701
Total cash and cash equivalents	150,815	163,283
Available-for-sale securities, at fair value	94,508	96,693
Residential real estate loans held for sale	7,106	4,508
SBA loans held for sale	2,400	191
Total loans held for sale	9,506	4,699
Loans :		
Commercial real estate	471,846	498,004
Commercial and industrial	183,493	175,654
Residential real estate	100,124	101,168
Consumer	4,121	4,369
Total loans	759,584	779,195
Less: Allowance for loan losses	4,034	3,665
Loans, net	755,550	775,530
Premises and equipment, net	7,274	6,937
Real estate owned and other repossessed collateral, net	2,040	826
Federal Home Loan Bank stock, at cost	1,938	1,938
Intangible assets, net	1,191	1,300
Servicing rights, net	2,955	2,846
Bank owned life insurance	16,291	16,179
Other assets	7,569	6,643
Total assets	<u>\$ 1,049,637</u>	<u>\$ 1,076,874</u>
Liabilities and Shareholders' Equity		
Liabilities		
Deposits :		
Demand	\$ 74,731	\$ 69,827
Savings and interest checking	105,691	108,417
Money market	380,992	374,569
Time	301,309	337,037
Total deposits	862,723	889,850
Federal Home Loan Bank advances	20,004	20,011
Subordinated debt	23,705	23,620
Capital lease obligation	808	873
Other liabilities	15,685	19,723
Total liabilities	922,925	954,077
Commitments and contingencies	-	-
Shareholders' equity		
Preferred stock, \$1.00 par value, 1,000,000 shares authorized; no shares issued and outstanding at September 30, 2017 and June 30, 2017	-	-
Voting common stock, \$1.00 par value, 25,000,000 shares authorized; 7,899,159 and 7,840,460 shares issued and outstanding at September 30, 2017 and June 30, 2017, respectively	7,899	7,841
Non-voting common stock, \$1.00 par value, 3,000,000 shares authorized; 991,194 shares issued and outstanding at both September 30, 2017 and June 30, 2017	991	991
Additional paid-in capital	76,709	77,455
Retained earnings	42,641	38,142
Accumulated other comprehensive loss	(1,528)	(1,632)
Total shareholders' equity	126,712	122,797
Total liabilities and shareholders' equity	<u>\$ 1,049,637</u>	<u>\$ 1,076,874</u>

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CONSOLIDATED STATEMENTS OF INCOME**

(Unaudited)

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

	Three Months Ended September 30,	
	2017	2016
Interest and dividend income:		
Interest and fees on loans	\$ 15,383	\$ 11,803
Interest on available-for-sale securities	266	239
Other interest and dividend income	529	215
Total interest and dividend income	<u>16,178</u>	<u>12,257</u>
Interest expense:		
Deposits	2,176	1,754
Federal Home Loan Bank advances	172	255
Subordinated debt	508	459
Obligation under capital lease agreements	11	14
Total interest expense	<u>2,867</u>	<u>2,482</u>
Net interest and dividend income before provision for loan losses	13,311	9,775
Provision for loan losses	354	193
Net interest and dividend income after provision for loan losses	<u>12,957</u>	<u>9,582</u>
Noninterest income:		
Fees for other services to customers	526	408
Gain on sales of residential real estate loans held for sale	291	542
Gain on sales of SBA loans held for sale	1,019	743
Loss recognized on real estate owned and other repossessed collateral, net	-	(14)
Bank owned life insurance income	112	114
Other noninterest income	10	15
Total noninterest income	<u>1,958</u>	<u>1,808</u>
Noninterest expense:		
Salaries and employee benefits	5,254	5,314
Occupancy and equipment expense	1,109	1,229
Professional fees	442	496
Data processing fees	604	421
Marketing expense	87	87
Loan acquisition and collection expense	365	227
FDIC insurance premiums	80	124
Intangible asset amortization	109	109
Other noninterest expense	664	619
Total noninterest expense	<u>8,714</u>	<u>8,626</u>
Income before income tax expense	6,201	2,764
Income tax expense	1,615	1,013
Net income	<u>\$ 4,586</u>	<u>\$ 1,751</u>
Weighted-average shares outstanding:		
Basic	8,841,511	9,106,144
Diluted	9,089,936	9,133,383
Earnings per common share:		
Basic	\$ 0.52	\$ 0.19
Diluted	0.50	0.19
Cash dividends declared per common share	\$ 0.01	\$ 0.01

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

**NORTHEAST BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(Unaudited)

(Dollars in thousands)

	Three Months Ended September 30,	
	2017	2016
Net income	\$ 4,586	\$ 1,751
Other comprehensive income, before tax:		
Available-for-sale securities:		
Change in net unrealized loss on available-for-sale securities	122	(78)
Derivatives and hedging activities:		
Change in accumulated loss on effective cash flow hedges	22	154
Reclassification adjustments included in net income	23	-
Total derivatives and hedging activities	45	154
Total other comprehensive income, before tax	167	76
Income tax expense related to other comprehensive income	63	31
Other comprehensive income, net of tax	104	45
Comprehensive income	\$ 4,690	\$ 1,796

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

NORTHEAST BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN SHARE HOLDERS' EQUITY

(Unaudited)

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

	Preferred Stock		Voting Common Stock		Non-voting Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
	Shares	Amount	Shares	Amount	Shares	Amount				
Balance at June 30, 2016	-	\$ -	8,089,790	\$ 8,089	1,227,683	\$ 1,228	\$ 83,020	\$ 26,160	\$ (1,906)	\$ 116,591
Net income	-	-	-	-	-	-	-	1,751	-	1,751
Other comprehensive loss, net of tax	-	-	-	-	-	-	-	-	45	45
Common stock repurchased	-	-	(645,238)	(645)	-	-	(6,298)	-	-	(6,943)
Conversion of voting common stock to non-voting common stock	-	-	(116,000)	(116)	116,000	116	-	-	-	-
Dividends on common stock at \$0.01 per share	-	-	-	-	-	-	-	(93)	-	(93)
Stock-based compensation	-	-	-	-	-	-	202	-	-	202
Issuance of restricted common stock	-	-	160,000	160	-	-	(160)	-	-	-
Cancellation and forfeiture of restricted common stock	-	-	(1,000)	(1)	-	-	1	-	-	-
Balance at September 30, 2016	-	\$ -	7,487,552	\$ 7,487	1,343,683	\$ 1,344	\$ 76,765	\$ 27,818	\$ (1,861)	\$ 111,553
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 loss, net of tax	-	-	-	-	-	-	-	-	104	104
Conversion of voting common stock to non-voting common stock	-	-	-	-	-	-	-	-	-	-
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

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

NORTHEAST BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)
(Dollars in thousands)

	Three Months Ended September 30,	
	2017	2016
Operating activities:		
Net income	\$ 4,586	\$ 1,751
Adjustments to reconcile net income to net cash used in operating activities:		
Provision for loan losses	354	193
Loss recognized on real estate owned, other repossessed collateral and premises and equipment, net	-	14
Accretion of fair value adjustments on loans, net	(2,938)	(2,133)
Accretion of fair value adjustments on deposits, net	-	(1)
Accretion of fair value adjustments on borrowings, net	50	(29)
Amortization of subordinated debt issuance costs	28	62
Originations of loans held for sale	(30,545)	(33,459)
Net proceeds from sales of loans held for sale	29,450	33,758
Gain on sales of residential loans held for sale, net	(291)	(542)
Gain on sales of SBA and other loans held for sale, net	(1,019)	(743)
Amortization of intangible assets	109	109
Bank owned life insurance income, net	(112)	(114)
Depreciation of premises and equipment	292	395
Stock-based compensation	220	202
Amortization of available-for-sale securities, net	240	286
Changes in other assets and liabilities:		
Other assets	(1,099)	(15)
Other liabilities	(3,992)	(345)
Net cash used in operating activities	<u>(4,667)</u>	<u>(611)</u>
Investing activities:		
Purchases of available-for-sale securities	-	(9,056)
Proceeds from maturities and principal payments on available-for-sale securities	2,067	14,681
Loan purchases	(3,651)	(13,853)
Loan originations, principal collections, and purchased loan paydowns, net	22,599	(13,969)
Purchases of premises and equipment	(629)	(47)
Proceeds from sales of real estate owned and other repossessed collateral	-	67
Net cash provided by (used in) investing activities	<u>20,386</u>	<u>(22,177)</u>
Financing activities:		
Net (decrease) increase in deposits	(27,127)	4,978
Repurchase of common stock	-	(6,943)
Dividends paid on common stock	(87)	(93)
Repayment of capital lease obligation	(65)	(62)
Repurchases for tax withholdings on stock options and restricted common stock	(908)	-
Net cash used in financing activities	<u>(28,187)</u>	<u>(2,120)</u>
Net decrease in cash and cash equivalents	(12,468)	(24,908)
Cash and cash equivalents, beginning of period	163,283	151,157
Cash and cash equivalents, end of period	<u>\$ 150,815</u>	<u>\$ 126,249</u>
Supplemental schedule of noncash investing activities:		
Transfers from loans to real estate owned and other repossessed collateral	\$ 1,214	\$ 2,188

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

NORTHEAST BANCORP AND SUBSIDIARY
Notes to Unaudited Consolidated Financial Statements
September 30, 2017

1. Basis of Presentation

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

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

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities* (“ASU 2016-01”). This guidance changes how entities account for equity investments that do not result in consolidation and are not accounted for under the equity method of accounting. Entities will be required to measure these investments at fair value at the end of each reporting period and recognize changes in fair value in net income. A practicability exception will be available for equity investments that do not have readily determinable fair values; however, the exception requires the Company to adjust the carrying amount for impairment and observable price changes in orderly transactions for the identical or a similar investment of the same issuer. This guidance also changes certain disclosure requirements and other aspects of current US GAAP. This guidance is effective for fiscal years beginning after December 15, 2017, including interim periods within the fiscal year. Early adoption is permitted for only one of the six amendments. The Company is currently evaluating the impact of the adoption of ASU 2016-01 on its consolidated financial statements.

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.

In March 2016, the FASB issued ASU 2016-05, *Derivatives and Hedging (Topic 815): Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships* (“ASU 2016-05”). The new guidance clarifies that a change in the counterparty to a derivative instrument that has been designated as the hedging instrument under Topic 815 does not, in and of itself, require de-designation of that hedging relationship provided that all other hedge accounting criteria continue to be met. This guidance is effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. The adoption of this guidance did not have an impact on the Company's financial statements.

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In March 2016, the FASB issued ASU 2016-09, *Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting* (“ASU 2016-09”). The new guidance simplified several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. Entities are required to recognize the income tax effects of awards in the income statement when the awards vest or are settled. This guidance is effective for fiscal years beginning after December 15, 2016, and interim periods within those annual periods. For interim reporting purposes the excess tax benefits or deficiencies shall be recorded as discrete items in the period in which they occur. In addition to the excess tax benefit treatment, the amendment removed the assumed proceeds related to the excess tax benefit from the calculation of diluted shares.

Upon adoption, the most significant impact of this amendment resulted from the prospective application of current excess tax benefits and deficiencies being recognized in income tax expense, which would previously have been recognized in additional paid-in capital. In the three months ended September 30, 2017, this item reduced income tax expense and increased net income by approximately \$818 thousand, representing an income tax benefit arising from individuals who exercised non-qualified stock options and restricted stock awards that vested during the period. For the year ended June 30, 2017, the Company recognized \$27 thousand in additional paid-in-capital related to the excess tax benefit, which, if under the new ASU, would have been recognized as an income tax benefit in the income statement. These amounts, treated as discrete items in the period in which they occur, will vary from year to year as a function of the volume of share-based payments vested or exercised and the then fair market value of the Company's stock in comparison to the compensation cost recognized in the financial statements. In addition to the excess tax benefit treatment, the amendment removed the assumed proceeds related to the excess tax benefit from the calculation of diluted shares which increased diluted weighted average common shares outstanding by 40,966 shares to 9,089,936. This amendment is applied on a prospective basis, and no prior periods were adjusted. Additionally upon adoption, the Company made a policy election to record forfeitures as they occur rather than make use of an estimate. The other provisions did not have a material impact on the Company's financial statements upon adoption.

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

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230)* (“ASU 2016-15”). This guidance clarifies and provides guidance on several cash receipt and cash payment classification issues, including debt prepayment and extinguishment costs, settlement of zero-coupon debt instruments, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies, distributions received from equity method investees, beneficial interests in securitization transactions, and separately identifiable cash flows and application of the predominance principle. The amendments in this guidance are effective for public business entities for fiscal years beginning after December 15, 2017, 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 financial statements.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230)* (“ASU 2016-18”). This guidance requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The amendments in this guidance are effective for public business entities for fiscal years beginning after December 15, 2017, 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 financial statements.

In March 2017, the FASB issued ASU 2017-08, *Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20)* (“ASU 2017-08”). This guidance amends the amortization period for certain purchased callable debt securities held at a premium, and shortens the amortization period for the premium to the earliest call date. Under current GAAP, entities generally amortize the premium as an adjustment of yield over the contractual life of the instrument. 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 financial statements.

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

3. Securities Available-for-Sale

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

	September 30, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
U.S. Government agency securities	\$ 57,261	\$ -	\$ (192)	\$ 57,069
Agency mortgage-backed securities	31,318	3	(546)	30,775
Other investments measured at net asset value	6,755	-	(91)	6,664
	<u>\$ 95,334</u>	<u>\$ 3</u>	<u>\$ (829)</u>	<u>\$ 94,508</u>

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

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, 2017 or 2016. At September 30, 2017, 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, 2017					
	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)					
U.S. Government agency securities	\$ 20,961	\$ (38)	\$ 36,108	\$ (154)	\$ 57,069	\$ (192)
Agency mortgage-backed securities	14,565	(233)	14,404	(313)	28,969	(546)
Other investments measured at net asset value	5,149	(91)	-	-	5,149	(91)
	<u>\$ 40,675</u>	<u>\$ (362)</u>	<u>\$ 50,512</u>	<u>\$ (467)</u>	<u>\$ 91,187</u>	<u>\$ (829)</u>

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

There were no other-than-temporary impairment losses on securities during the three months ended September 30, 2017 or 2016.

At September 30, 2017, the Company had eighteen securities in a continuous loss position for greater than twelve months. At September 30, 2017, all of the Company's available-for-sale securities were issued or guaranteed by either government agencies or government-sponsored enterprises. The decline in fair value of the Company's available-for-sale securities at September 30, 2017 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, 2017, the Company does not intend to sell and it is not more likely than not that the Company will be required to sell the investment securities before recovery of its amortized cost. As such, management does not believe any of the Company's available-for-sale securities are other-than-temporarily impaired at September 30, 2017.

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, 2017, the effective duration of the fund that seeks to invest in securities either issued or guaranteed by the U.S. government or its

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The amortized cost and fair values of available-for-sale debt securities by contractual maturity are shown below as of September 30, 2017. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
	(Dollars in thousands)	
Due within one year	\$ 42,251	\$ 42,118
Due after one year through five years	24,251	24,078
Due after five years through ten years	22,077	21,648
Due after ten years	-	-
Total	<u>\$ 88,579</u>	<u>\$ 87,844</u>

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

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.

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

	September 30, 2017			June 30, 2017		
	Originated	Purchased	Total	Originated	Purchased	Total
	(Dollars in thousands)					
Residential real estate	\$ 83,864	\$ 3,208	\$ 87,072	\$ 83,759	\$ 3,377	\$ 87,136
Home equity	12,954	98	13,052	13,931	101	14,032
Commercial real estate	246,241	225,605	471,846	256,280	241,724	498,004
Commercial and industrial	182,390	1,103	183,493	174,468	1,186	175,654
Consumer	4,121	-	4,121	4,369	-	4,369
Total loans	<u>\$ 529,570</u>	<u>\$ 230,014</u>	<u>\$ 759,584</u>	<u>\$ 532,807</u>	<u>\$ 246,388</u>	<u>\$ 779,195</u>

Total loans include net deferred loan origination costs of \$286 thousand and \$507 thousand as of September 30, 2017 and June 30, 2017, respectively.

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Past Due and Nonaccrual Loans

The following is a summary of past due and non-accrual loans:

	September 30, 2017							
	30-59 Days	60-89 Days	Past Due 90 Days or More-Still Accruing	Past Due 90 Days or More- Nonaccrual	Total Past Due	Total Current	Total Loans	Non- Accrual Loans
(Dollars in thousands)								
Originated portfolio:								
Residential real estate	\$ 1,570	\$ 51	\$ -	\$ 2,073	\$ 3,694	\$ 80,170	\$ 83,864	\$ 3,667
Home equity	50	-	-	58	108	12,846	12,954	58
Commercial real estate	184	517	-	123	824	245,417	246,241	2,409
Commercial and industrial	40	-	-	-	40	182,350	182,390	2,629
Consumer	98	25	-	44	167	3,954	4,121	131
Total originated portfolio	1,942	593	-	2,298	4,833	524,737	529,570	8,894
Purchased portfolio:								
Residential real estate and home equity	95	-	-	1,064	1,159	2,147	3,306	1,078
Commercial and industrial	-	-	-	-	-	1,103	1,103	27
Commercial real estate	979	2,002	-	3,172	6,153	219,452	225,605	6,653
Total purchased portfolio	1,074	2,002	-	4,236	7,312	222,702	230,014	7,758
Total loans	\$ 3,016	\$ 2,595	\$ -	\$ 6,534	\$ 12,145	\$ 747,439	\$ 759,584	\$ 16,652

	June 30, 2017							
	30-59 Days	60-89 Days	Past Due 90 Days or More-Still Accruing	Past Due 90 Days or More- Nonaccrual	Total Past Due	Total Current	Total Loans	Non- Accrual Loans
(Dollars in thousands)								
Originated portfolio:								
Residential real estate	\$ 141	\$ 574	\$ -	\$ 1,398	\$ 2,113	\$ 81,646	\$ 83,759	\$ 3,337
Home equity	49	-	-	58	107	13,824	13,931	58
Commercial real estate	2,266	-	-	124	2,390	253,890	256,280	413
Commercial and industrial	-	-	-	2,433	2,433	172,035	174,468	2,600
Consumer	69	50	-	32	151	4,218	4,369	103
Total originated portfolio	2,525	624	-	4,045	7,194	525,613	532,807	6,511
Purchased portfolio:								
Residential real estate and home equity	-	1,082	-	16	1,098	2,380	3,478	1,056
Commercial and industrial	-	-	-	-	-	1,186	1,186	32
Commercial real estate	173	1,997	-	2,922	5,092	236,632	241,724	6,364
Total purchased portfolio	173	3,079	-	2,938	6,190	240,198	246,388	7,452
Total loans	\$ 2,698	\$ 3,703	\$ -	\$ 6,983	\$ 13,384	\$ 765,811	\$ 779,195	\$ 13,963

Allowance for Loan Losses and Impaired Loans

The 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 costs to sell. For commercial loans, a charge-off is recorded on a case-by-case basis when all or a portion of the loan is deemed to be uncollectible. Subsequent recoveries, if any, are credited to the allowance.

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

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

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

rent rolls and operating statements, with which it monitors the cash flows of these loans. Adverse developments in either of these areas will have an adverse effect on the credit quality of this segment. For purposes of the allowance for loan losses, this segment also includes construction loans.

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

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

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.

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

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

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.

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

	Three Months Ended September 30, 2017						
	Residential Real Estate	Commercial Real Estate	Commercial and Industrial	Consumer	Purchased	Unallocated	Total
	(Dollars in thousands)						
Beginning balance	\$ 477	\$ 2,312	\$ 520	\$ 53	\$ 303	\$ -	\$ 3,665
Provision	41	131	189	(14)	7	-	354
Recoveries	7	-	18	6	-	-	31
Charge-offs	(12)	-	-	(4)	-	-	(16)
Ending balance	<u>\$ 513</u>	<u>\$ 2,443</u>	<u>\$ 727</u>	<u>\$ 41</u>	<u>\$ 310</u>	<u>\$ -</u>	<u>\$ 4,034</u>

	Three Months Ended September 30, 2016						
	Residential Real Estate	Commercial Real Estate	Commercial and Industrial	Consumer	Purchased	Unallocated	Total
	(Dollars in thousands)						
Beginning balance	\$ 663	\$ 1,195	\$ 297	\$ 62	\$ 133	\$ -	\$ 2,350
Provision	(99)	226	17	24	25	-	193
Recoveries	2	-	5	11	-	-	18
Charge-offs	(25)	-	(1)	(29)	-	-	(55)
Ending balance	<u>\$ 541</u>	<u>\$ 1,421</u>	<u>\$ 318</u>	<u>\$ 68</u>	<u>\$ 158</u>	<u>\$ -</u>	<u>\$ 2,506</u>

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

	September 30, 2017						
	Residential Real Estate	Commercial Real Estate	Commercial and Industrial	Consumer	Purchased	Unallocated	Total
	(Dollars in thousands)						
Allowance for loan losses:							
Individually evaluated	\$ 280	\$ 142	\$ 153	\$ 1	\$ -	\$ -	\$ 576
Collectively evaluated	233	2,301	574	40	-	-	3,148
ASC 310-30	-	-	-	-	310	-	310
Total	<u>\$ 513</u>	<u>\$ 2,443</u>	<u>\$ 727</u>	<u>\$ 41</u>	<u>\$ 310</u>	<u>\$ -</u>	<u>\$ 4,034</u>

Loans:							
Individually evaluated	\$ 5,739	\$ 3,817	\$ 2,696	\$ 317	\$ -	\$ -	\$ 12,569
Collectively evaluated	91,079	242,424	179,694	3,804	-	-	517,001
ASC 310-30	-	-	-	-	230,014	-	230,014
Total	<u>\$ 96,818</u>	<u>\$ 246,241</u>	<u>\$ 182,390</u>	<u>\$ 4,121</u>	<u>\$ 230,014</u>	<u>\$ -</u>	<u>\$ 759,584</u>

	June 30, 2017						
	Residential Real Estate	Commercial Real Estate	Commercial and Industrial	Consumer	Purchased	Unallocated	Total
	(Dollars in thousands)						
Allowance for loan losses:							
Individually evaluated	\$ 252	\$ 147	\$ 149	\$ 4	\$ -	\$ -	\$ 552
Collectively evaluated	225	2,165	371	49	-	-	2,810
ASC 310-30	-	-	-	-	303	-	303
Total	<u>\$ 477</u>	<u>\$ 2,312</u>	<u>\$ 520</u>	<u>\$ 53</u>	<u>\$ 303</u>	<u>\$ -</u>	<u>\$ 3,665</u>

Loans:							
Individually evaluated	\$ 5,676	\$ 1,759	\$ 2,694	\$ 296	\$ -	\$ -	\$ 10,425
Collectively evaluated	92,014	254,521	171,774	4,073	-	-	522,382
ASC 310-30	-	-	-	-	246,388	-	246,388
Total	<u>\$ 97,690</u>	<u>\$ 256,280</u>	<u>\$ 174,468</u>	<u>\$ 4,369</u>	<u>\$ 246,388</u>	<u>\$ -</u>	<u>\$ 779,195</u>

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

	September 30, 2017			June 30, 2017		
	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	\$ 4,136	\$ 4,162	\$ -	\$ 4,052	\$ 4,084	\$ -
Consumer	293	321	-	250	271	-
Commercial real estate	2,426	2,420	-	359	354	-
Commercial and industrial	1,830	1,830	-	1,870	1,870	-
Purchased:						
Residential real estate	1,078	1,121	-	1,056	1,099	-
Commercial real estate	9,039	11,817	-	8,696	11,468	-
Commercial and industrial	27	60	-	32	65	-
Total	18,829	21,731	-	16,315	19,211	-
Impaired loans with a valuation allowance:						
Originated:						
Residential real estate	1,603	1,577	280	1,624	1,595	252
Consumer	24	27	1	46	55	4
Commercial real estate	1,391	1,380	142	1,400	1,388	147
Commercial and industrial	866	866	153	824	824	149
Purchased:						
Commercial real estate	3,540	3,914	182	3,528	3,929	176
Commercial and industrial	94	108	54	94	108	55
Total	7,518	7,872	812	7,516	7,899	783
Total impaired loans	\$ 26,347	\$ 29,603	\$ 812	\$ 23,831	\$ 27,110	\$ 783

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

	Three Months Ended September 30,			
	2017		2016	
	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	\$ 4,095	\$ 36	\$ 3,730	\$ 49
Consumer	272	6	243	3
Commercial real estate	1,393	93	447	8
Commercial and industrial	1,850	37	180	3
Purchased:				
Residential real estate	1,067	-	1,117	3
Commercial real estate	8,868	80	4,736	52
Commercial and industrial	30	-	24	-
Total	17,575	252	10,477	118
Impaired loans with a valuation allowance:				
Originated:				
Residential real estate	1,614	21	1,685	16
Consumer	35	1	104	2
Commercial real estate	1,396	22	1,179	18
Commercial and industrial	845	4	2	-
Purchased:				
Commercial real estate	3,534	27	1,529	17
Commercial and industrial	94	-	-	-
Total	7,518	75	4,499	\$ 53
Total impaired loans	\$ 25,093	\$ 327	\$ 14,976	\$ 171

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.

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

	September 30, 2017				
	Originated Portfolio			Purchased Portfolio	Total
	Commercial Real Estate	Commercial and Industrial	Residential ⁽¹⁾		
	(Dollars in thousands)				
Loans rated 1- 6	\$ 240,696	\$ 179,056	\$ 15,282	\$ 214,451	\$ 649,485
Loans rated 7	2,999	2,512	69	8,244	13,824
Loans rated 8	2,546	822	781	7,319	11,468
Loans rated 9	-	-	19	-	19
Loans rated 10	-	-	-	-	-
	<u>\$ 246,241</u>	<u>\$ 182,390</u>	<u>\$ 16,151</u>	<u>\$ 230,014</u>	<u>\$ 674,796</u>
	June 30, 2017				
	Originated Portfolio			Purchased Portfolio	Total
	Commercial Real Estate	Commercial and Industrial	Residential ⁽¹⁾		
	(Dollars in thousands)				
Loans rated 1- 6	\$ 253,041	\$ 171,160	\$ 10,039	\$ 229,980	\$ 664,220
Loans rated 7	2,686	2,483	71	9,622	14,862
Loans rated 8	554	825	803	6,786	8,968
Loans rated 9	-	-	19	-	19
Loans rated 10	-	-	-	-	-
	<u>\$ 256,281</u>	<u>\$ 174,468</u>	<u>\$ 10,932</u>	<u>\$ 246,388</u>	<u>\$ 688,069</u>

(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.

The Company had consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceedings were in process according to local requirements of the applicable jurisdictions totaling \$458 thousand at September 30, 2017, compared to \$543 thousand at June 30, 2017.

Troubled Debt Restructurings

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

	Three Months Ended September 30,			
	2017		2016	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
	(Dollars in thousands)			
Extended maturity	1	\$ 18	-	\$ -
Adjusted interest rate	-	-	1	9
Rate and maturity	-	-	1	334
Principal deferment	1	655	-	-
Court ordered concession	-	-	-	-
	<u>2</u>	<u>\$ 673</u>	<u>2</u>	<u>\$ 343</u>

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,					
	2017			2016		
	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	1	\$ 18	\$ 18	1	\$ 9	\$ 9
Home equity	-	-	-	-	-	-
Commercial real estate	-	-	-	-	-	-
Commercial and industrial	1	655	655	-	-	-
Consumer	-	-	-	-	-	-
Total originated portfolio	<u>2</u>	<u>673</u>	<u>673</u>	<u>1</u>	<u>9</u>	<u>9</u>
Purchased portfolio:						
Residential real estate	-	-	-	-	-	-
Commercial real estate	-	-	-	1	334	334
Total purchased portfolio	<u>-</u>	<u>-</u>	<u>-</u>	<u>1</u>	<u>334</u>	<u>334</u>
Total	<u>2</u>	<u>\$ 673</u>	<u>\$ 673</u>	<u>2</u>	<u>\$ 343</u>	<u>\$ 343</u>

The Company considers TDRs past due 90 days or more to be in payment default. No loans modified in a TDR in the last twelve months defaulted during the three months ended September 30, 2017. As of September 30, 2017, 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, 2017	Three Months Ended September 30, 2016
	(Dollars in thousands)	
Contractually required payments receivable	\$ 5,912	\$ 26,254
Nonaccretable difference	(157)	(2,517)
Cash flows expected to be collected	5,755	23,737
Accretable yield	(2,104)	(9,884)
Fair value of loans acquired	<u>\$ 3,651</u>	<u>\$ 13,853</u>

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 non-accrual. The carrying amounts of such loans are as follows.

	As of and for the Three Months Ended September 30, 2017	As of and for the Three Months Ended September 30, 2016
	(Dollars in thousands)	
Loans acquired during the period	\$ -	\$ 1,103
Loans at end of period	6,032	4,439



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

	Three Months Ended September 30, 2017	Three Months Ended September 30, 2016
	(Dollars in thousands)	
Beginning balance	\$ 131,197	\$ 124,151
Acquisitions	2,104	9,884
Accretion	(4,425)	(4,652)
Reclassifications from non-accretable difference to accretable yield	3,428	(1,105)
Disposals and other changes	(9,381)	(4,255)
Ending balance	<u>\$ 122,923</u>	<u>\$ 124,023</u>

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

	September 30, 2017 (1)	June 30, 2017 (1)
	(Dollars in thousands)	
Unpaid principal balance	\$ 252,516	\$ 271,709
Carrying amount	223,503	239,583

(1) Balances include loans held for sale of \$ 1.2 million at September 30, 2017 and \$0 at June 30, 2017.

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

Mortgage loans sold in the quarter ended September 30, 2017 totaled \$19.2 million, compared to \$25.0 million in the quarter ended September 30, 2016. Mortgage loans serviced for others totaled \$9.9 million at September 30, 2017 and \$10.7 million at June 30, 2017. Additionally, the Company was servicing commercial loans participated out to various other institutions amounting to \$27.3 million and \$25.2 million at September 30, 2017 and June 30, 2017, respectively.

SBA loans sold during the quarter ended September 30, 2017 totaled \$9.1 million, compared to \$7.4 million in the quarter ended September 30, 2016. SBA loans serviced for others totaled \$148.6 million at September 30, 2017 and \$144.4 million at June 30, 2017.

Mortgage and SBA loans serviced for others are accounted for as sales and therefore are not included in 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 \$262 thousand and \$160 thousand for the quarters ended September 30, 2017 and 2016, respectively, and were included as a component of loan related fees within non-interest income.

The significant assumptions used in the valuation for mortgage servicing rights as of September 30, 2017 included a weighted average discount rate of 7.3% and a weighted average prepayment speed assumption of 14.4%. For the SBA servicing rights, the significant assumptions used in the valuation included a range of discount rates from 10.1% to 14.9% and a weighted average prepayment speed assumption of 7.9%.

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,	
	2017	2016
	(Dollars in thousands, except share and per share data)	
Net income	\$ 4,586	\$ 1,751
Weighted average shares used in calculation of basic EPS	8,841,511	9,106,144
Incremental shares from assumed exercise of dilutive securities	248,425	27,239
Weighted average shares used in calculation of diluted EPS	9,089,936	9,133,383
Basic earnings per common share	\$ 0.52	\$ 0.19
Diluted earnings per common share	0.50	0.19

For the three months ended September 30, 2017 and 2016, the following stock options were excluded from the calculation of diluted EPS due to the exercise price of these options exceeding the average market price of the Company's common stock for the period.

	Three Months Ended September 30,	
	2017	2016
Stock options	81,004	714,545

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.

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, 2017, the Company had posted cash collateral totaling \$1.7 million 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.

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

September 30, 2017										
Notional Amount	Inception Date	Termination Date	Index	Receive Rate	Pay Rate	Strike Rate	Unrealized Loss	Fair Value	Balance Sheet Location	
(Dollars in thousands)										
<i>Interest rate swaps:</i>										
\$ 5,000	July 2013	July 2033	3 Mo. LIBOR	1.33%	3.38%	n/a	\$ (657)	\$ (657)	Other Liabilities	
5,000	July 2013	July 2028	3 Mo. LIBOR	1.33%	3.23%	n/a	(463)	(463)	Other Liabilities	
5,000	July 2013	July 2023	3 Mo. LIBOR	1.33%	2.77%	n/a	(205)	(205)	Other Liabilities	
<i>Interest rate caps:</i>										
6,000	October 2014	September 2019	3 Mo. LIBOR	n/a	n/a	2.50%	(131)	2	Other Assets	
10,000	March 2015	February 2020	3 Mo. LIBOR	n/a	n/a	2.50%	(182)	8	Other Assets	
<u>\$ 31,000</u>							<u>\$ (1,638)</u>	<u>\$ (1,315)</u>		

June 30, 2017										
Notional Amount	Inception Date	Termination Date	Index	Receive Rate	Pay Rate	Strike Rate	Unrealized Loss	Fair Value	Balance Sheet Location	
(Dollars in thousands)										
<i>Interest rate swaps:</i>										
\$ 5,000	July 2013	July 2033	3 Mo. LIBOR	1.30%	3.38%	n/a	\$ (666)	(666)	Other Liabilities	
5,000	July 2013	July 2028	3 Mo. LIBOR	1.30%	3.23%	n/a	(471)	(471)	Other Liabilities	
5,000	July 2013	July 2023	3 Mo. LIBOR	1.30%	2.77%	n/a	(218)	(218)	Other Liabilities	
<i>Interest rate caps:</i>										
6,000	October 2014	September 2019	3 Mo. LIBOR	n/a	n/a	2.50%	(142)	4	Other Assets	
10,000	March 2015	February 2020	3 Mo. LIBOR	n/a	n/a	2.50%	(186)	14	Other Assets	
<u>\$ 31,000</u>							<u>\$ (1,683)</u>	<u>\$ (1,337)</u>		

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

8. Other Comprehensive Income

The components of other comprehensive income are as follows:

	Three Months Ended September 30,					
	2017			2016		
	Pre-tax Amount	Tax Expense	After-tax Amount	Pre-tax Amount	Tax Expense (Benefit)	After-tax Amount
(Dollars in thousands)						
Change in net unrealized loss on available-for-sale securities	\$ 122	\$ 45	\$ 77	\$ (78)	\$ (30)	\$ (48)
Change in accumulated loss on effective cash flow hedges	22	9	13	154	61	93
Reclassification adjustments included in net income	23	9	14	-	-	-
Total derivatives and hedging activities	<u>45</u>	<u>18</u>	<u>27</u>	<u>154</u>	<u>61</u>	<u>93</u>
Total other comprehensive income	<u>\$ 167</u>	<u>\$ 63</u>	<u>\$ 104</u>	<u>\$ 76</u>	<u>\$ 31</u>	<u>\$ 45</u>

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Accumulated other comprehensive loss is comprised of the following:

	September 30, 2017	June 30, 2017
	(Dollars in thousands)	
Unrealized loss on available-for-sale securities	\$ (826)	\$ (948)
Tax effect	314	360
After- tax amount	(512)	(588)
Unrealized loss on cash flow hedges	(1,638)	(1,683)
Tax effect	622	639
After- tax amount	(1,016)	(1,044)
Accumulated other comprehensive loss	<u>\$ (1,528)</u>	<u>\$ (1,632)</u>

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 in the consolidated balance sheets. The contract amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

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

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

	September 30, 2017	June 30, 2017
	(Dollars in thousands)	
Commitments to grant loans	\$ 34,628	\$ 15,244
Unfunded commitments under lines of credit	44,078	31,858
Standby letters of credit	3,400	3,400
Commitment to fund investment	-	1,000

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the 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 \$74 thousand and \$39 thousand recorded in other liabilities at September 30, 2017 and June 30, 2017, respectively.

In the year ended June 30, 2016, the Company committed \$2.5 million to a fund that acquires Community Reinvestment Act ("CRA") qualified investments in loans for the Company's portfolio. The fund manager calls the funds from the Company when an investment is successfully acquired. During the prior year ended June 30, 2017, the fund called \$1.5 million from the Company. As of September 30, 2017, the Company no longer has a remaining commitment to fund these investments.

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

In March 2016, the FASB issued ASU 2016-09. The new guidance simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. Entities are now required to recognize the income tax effects of awards in the income statement when the awards vest or are settled.

The Company adopted ASU 2016-09 in the first quarter of fiscal 2018. Upon adoption, the most significant impact of this amendment resulted from the prospective application of current excess tax benefits and deficiencies being recognized in income tax expense, which previously would have been recognized in additional paid-in capital.

In addition to the excess tax benefit treatment, the amendment removed the assumed proceeds related to the excess tax benefit from the calculation of diluted shares. Additionally, dividends paid to employees for nonvested equity shares are also recognized through income tax expense.

For the three months ended September 30, 2017, in totality, the adoption of ASU 2016-09 reduced the Company's income tax expense by \$818 thousand. The

excess tax benefit under the new guidance is treated as a discrete item in the period in which it occurs, and will vary from quarter to quarter as a function of the volume of restricted stock that vests, the volume of options that are exercised and the market price of the Company's stock in comparison to the compensation cost recognized in the financial statements.

Upon adoption, the Company made a policy election to record forfeitures as they occur rather than make use of an estimate. The other provisions did not have a material impact on the Company's financial statements upon adoption.

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

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

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

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

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

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

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

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

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

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

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

Fair Value of other Financial Instruments:

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

FHL B B 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 of the Company’s net assets could increase .

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

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

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

	September 30, 2017			
	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)			
Assets				
Securities available-for-sale:				
U.S. Government agency securities	\$ 57,069	\$ -	\$ 57,069	\$ -
Agency mortgage-backed securities	30,775	-	30,775	-
Other investments measured at net asset value ⁽¹⁾	6,664	-	-	-
Other assets – interest rate caps	10	-	10	-
Liabilities				
Other liabilities – interest rate swaps	\$ 1,325	\$ -	\$ 1,325	\$ -

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

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

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

	September 30, 2017			
	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)			
Collateral dependent impaired loans	\$ 1,064	\$ -	\$ -	\$ 1,064
Real estate owned and other repossessed collateral	2,040	-	-	2,040
Loan servicing rights	2,955	-	-	2,955
	June 30, 2017			
	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)			
Collateral dependent impaired loans	\$ 1,011	\$ -	\$ -	\$ 1,011
Real estate owned and other repossessed collateral	826	-	-	826
Loan servicing rights	2,846	-	-	2,846

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

	Fair Value		Valuation Technique
	September 30, 2017	June 30, 2017	
	(Dollars in thousands)		
Collateral dependent impaired loans	\$ 1,064	\$ 1,011	Appraisal of collateral ⁽¹⁾
Real estate owned and other repossessed collateral	2,040	826	Appraisal of collateral ⁽¹⁾
Loan servicing rights	2,955	2,846	Discounted cash flow ⁽²⁾

(1) Fair value is generally determined through independent appraisals of the underlying collateral. The Company may also use another available source of collateral assessment to determine a reasonable estimate of the fair value of the collateral. Appraisals may be adjusted by management for qualitative factors such as economic factors and estimated liquidation expenses. The range of these possible adjustments was 8% to 75%.

(2) Fair value is determined using a discounted cash flow model. The unobservable inputs include anticipated rate of loan prepayments and discount rates. The range of prepayment assumptions used was 3.8% to 14.4%. For discount rates, the range was 7.3% to 14.9%.

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

	Carrying Amount	Fair Value Measurements at September 30, 2017			
		Total	Level 1	Level 2	Level 3
(Dollars in thousands)					
Financial assets:					
Cash and cash equivalents	\$ 150,815	\$ 150,815	\$ 150,815	\$ -	\$ -
Available-for-sale securities	87,844	87,844	-	87,844	-
Other investments measured at net asset value ⁽¹⁾	6,664	6,664	-	-	-
Federal Home Loan Bank stock	1,938	1,938	-	1,938	-
Loans held for sale	9,506	9,506	-	9,506	-
Loans, net	755,550	756,956	-	-	756,956
Accrued interest receivable	2,224	2,224	-	2,224	-
Interest rate caps	10	10	-	10	-

Financial liabilities:					
Deposits	862,723	862,900	-	862,900	-
Federal Home Loan Bank advances	20,004	20,021	-	20,021	-
Capital lease obligation	808	845	-	845	-
Subordinated debentures	23,705	25,928	-	-	25,928
Interest rate swaps	1,325	1,325	-	1,325	-

	Carrying Amount	Fair Value Measurements at June 30, 2017			
		Total	Level 1	Level 2	Level 3
(Dollars in thousands)					
Financial assets:					
Cash and cash equivalents	\$ 163,283	\$ 163,283	\$ 163,283	\$ -	\$ -
Available-for-sale securities	90,071	90,071	-	90,071	-
Other investments measured at net asset value ⁽¹⁾	6,622	6,622	-	-	-
Federal Home Loan Bank stock	1,938	1,938	-	1,938	-
Loans held for sale	4,699	4,699	-	4,699	-
Loans, net	775,530	776,579	-	-	776,579
Accrued interest receivable	2,111	2,111	-	2,111	-
Interest rate caps	18	18	-	18	-

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

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

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

The following discussion should be read in conjunction with the consolidated financial statements, notes and tables included in Northeast Bancorp's Annual Report on Form 10-K for the fiscal year ended June 30, 2017, filed with the Securities and Exchange Commission.

A Note about Forward Looking Statements

This report contains certain "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended, such as statements relating to Northeast Bancorp's financial condition, prospective results of operations, future performance or expectations, plans, objectives, prospects, loan loss allowance adequacy, simulation of changes in interest rates, capital spending and finance sources and revenue sources. These statements relate to expectations concerning matters that are not historical facts. Accordingly, statements that are based on management's projections, estimates, assumptions, and judgments constitute forward-looking statements. These forward-looking statements, which are based on various assumptions (some of which are beyond the Company's control), may be identified by reference to a future period or periods, or by the use of forward-looking terminology such as "believe", "expect", "estimate", "anticipate", "continue", "plan", "approximately", "intend", "objective", "goal", "project", or other similar terms or variations on those terms, or the future or conditional verbs such as "will", "may", "should", "could", and "would". Although the Company believes that these forward-looking statements are based on reasonable estimates and assumptions, they are not guarantees of future performance and are subject to known and unknown risks, uncertainties, contingencies, and other factors. Accordingly, the Company cannot give you any assurance that its expectations will, in fact, occur or that its estimates or assumptions will be correct. The Company cautions you that actual results could differ materially from those expressed or implied by such forward-looking statements as a result of, among other factors, changes in interest rates and real estate values; competitive pressures from other financial institutions; weakness in general economic conditions on a national basis or in the local markets in which the Company operates, including changes which adversely affect borrowers' ability to service and repay the Company's loans; changes in loan defaults and charge-off rates; changes in the value of securities and other assets, adequacy of loan loss reserves, or deposit levels necessitating increased borrowing to fund loans and investments; changes in government regulation; operational risks including, but not limited to, cybersecurity, fraud and natural disasters; the risk that the Company may not be successful in the implementation of its business strategy; the risk that intangibles recorded in the Company's financial statements will become impaired; changes in assumptions used in making such forward-looking statements; and the other risks and uncertainties detailed in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2017 as updated in the Company's Quarterly Reports on Form 10-Q and other filings submitted to the Securities and Exchange Commission. These forward-looking statements speak only as of the date of this report and the Company does not undertake any obligation to update or revise any of these forward-looking statements to reflect events or circumstances occurring after the date of this report or to reflect the occurrence of unanticipated events.

Description of Business and Strategy

Business Overview

Northeast Bancorp ("we," "our," "us," "Northeast" or the "Company"), incorporated under Maine law in 1987, is a bank holding company registered with the Board of Governors of the Federal Reserve System (the "Federal Reserve"). As a bank holding company registered under the Bank Holding Company Act of 1956, as amended (the "BHCA"), the Company is subject to regulation and supervision by the Federal Reserve. The Company's primary subsidiary and principal asset is its wholly-owned banking subsidiary, Northeast Bank (the "Bank" or "Northeast Bank"), a Maine state-chartered bank originally organized in 1872. As a Federal Deposit Insurance Corporation ("FDIC") insured Maine-chartered bank, the Bank is subject to regulation and supervision by the Maine Bureau of Financial Institutions (the "Bureau") and the FDIC.

On December 29, 2010, the merger of the Company and FHB Formation LLC, a Delaware limited liability company ("FHB"), was consummated. As a result of the merger, the surviving company received a capital contribution of \$16.2 million (in addition to the approximately \$13.1 million in cash consideration paid to former shareholders), and the former members of FHB collectively acquired approximately 60% of the Company's outstanding common stock. The Company applied the acquisition method of accounting, as described in Accounting Standards Codification ("ASC") 805, *Business Combinations* ("ASC 805") to the merger, which represents an acquisition by FHB of Northeast, with Northeast as the surviving company.

In connection with the transaction, as part of the regulatory approval process, the Company and the Bank made certain commitments to the Federal Reserve, the most significant of which are (i) to maintain a Tier 1 leverage ratio of at least 10%, (ii) to maintain a total risk-based capital ratio of at least 15%, (iii) to limit purchased loans to 40% of total loans, (iv) to fund 100% of the Company's loans with core deposits (defined as non-maturity deposits and non-brokered insured time deposits), and (v) to hold commercial real estate loans (including owner-occupied commercial real estate) to within 300% of total risk-based capital. On June 28, 2013, the Federal Reserve approved the amendment to exclude owner-occupied commercial real estate loans from the commitment to hold commercial real estate loans to within 300% of total risk-based capital. All other commitments made to the Federal Reserve in connection with the merger remain unchanged. The Company and the Bank are currently in compliance with all commitments to the Federal Reserve. The Company's compliance ratios at September 30, 2017 follow:

Condition	Ratios as of September 30, 2017
(i) Tier 1 leverage capital ratio	12.77%
(ii) Total capital ratio	20.04%
(iii) Ratio of purchased loans to total loans, including loans held for sale	30.11%
(iv) Ratio of loans to core deposits (1)	88.68%
(v) Ratio of non-owner occupied commercial real estate loans to total capital (2)	166.15%

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

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

As of September 30, 2017, the Company, on a consolidated basis, had total assets of \$1.0 billion, total deposits of \$862.7 million, and shareholders' equity of \$126.7 million. The Company gathers retail deposits through its banking offices in Maine and the Bank's online affinity deposit program, ableBanking; originates loans through the Bank's Community Banking Division; originates Small Business Administration ("SBA") and United States Department of Agriculture ("USDA") loans through the Bank's national SBA group ("SBA Division"); and purchases and originates commercial loans through the Bank's Loan Acquisition and Servicing Group ("LASG"). The Community Banking Division, with ten full-service branches and two loan production offices, operates from the Bank's headquarters in Lewiston, Maine. LASG, ableBanking, and the SBA Division operate from the Company's offices in Boston, Massachusetts.

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

Strategy

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

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

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

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

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

Critical Accounting Policies

Critical accounting policies are those that involve significant judgments and assessments by management, and which could potentially result in materially different results under different assumptions and conditions. The reader is encouraged to review each of the policies included in Form 10-K for the year ended June 30, 2017 to gain a better understanding of how Northeast's financial performance is measured and reported. There has been no material change in critical accounting policies during the three months ended September 30, 2017.

Overview

Net income was \$4.6 million, or \$0.50 per diluted common share, for the quarter ended September 30, 2017, compared to net income of \$1.8 million, or \$0.19 per diluted common share, for the quarter ended September 30, 2016.

Net interest and dividend income before provision for loan losses increased by \$3.5 million for the quarter ended September 30, 2017, compared to the quarter ended September 30, 2016. The increase is primarily due to higher transactional income on purchased loans and higher average balances in the total loan portfolio. This increase was partially offset by higher rates and higher average deposit balances.

Noninterest income increased by \$150 thousand for the quarter ended September 30, 2017, compared to the quarter ended September 30, 2016, principally due to the following:

- An increase in gain on sale of SBA loans of \$276 thousand, due to a higher dollar amount sold in the quarter; and
- An increase in fees for other services to customers of \$118 thousand, due to higher loan servicing fees on SBA loans sold.
- The increases in noninterest income were partially offset by a decrease in gain on sale of residential loans held for sale of \$251 thousand, due to a lower volume sold in the quarter.

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Noninterest expense increased by \$88 thousand for the quarter ended September 30, 2017, compared to the quarter ended September 30, 2016, primarily due to the following:

- An increase in data processing fees of \$183 thousand, primarily due to the outsourcing of data processing.
- The increase in data processing fees was partially offset by a decrease in occupancy and equipment expense of \$120 thousand, primarily due to lower computer equipment and software depreciation.

Income tax expense increased by \$602 thousand for the quarter ended September 30, 2017, compared to the quarter ended September 30, 2016, primarily due to the increase in income before income tax expense, offset by the effects of the adoption of ASU 2016-09, *Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting* (“ASU 2016-09”). For further information regarding the implementation of ASU 2016-09, see Part I, Item I. “Notes to Unaudited Consolidated Financial Statements — Note 2: Recent Accounting Pronouncements.”

Financial Condition

Overview

As of September 30, 2017, total assets were \$1.0 billion, a decrease of \$27.2 million, or 2.5%, from total assets of \$1.1 billion as of June 30, 2017. The principal components of the change in the balance sheet follow :

\$74.4 million of loans were originated or acquired during the quarter ended September 30, 2017. Loans generated by the Bank's LASG totaled \$44.5 million, which consisted of \$3.7 million of purchased loans, at an average price of 84.6% of unpaid principal balance, and \$40.8 million of originated loans. The Bank's SBA Division closed \$7.8 million of new loans during the quarter, of which \$5.9 million were funded. In addition, the Company sold \$9.1 million of the guaranteed portion of SBA loans in the secondary market, of which \$3.1 million were originated in the current quarter and \$6.0 million were originated or purchased in prior quarters. Residential loan production sold in the secondary market totaled \$19.2 million for the quarter.

In totality, the loan portfolio – excluding loans held for sale – decreased by \$19.6 million, or 2.5%, compared to June 30, 2017, primarily due to payoffs, pay-downs and sales in the portfolio, partially offset by originations.

The following table highlights the changes in the loan portfolio for the three months ended September 30, 2017:

	Three Months E nded September 30, 2017 (Dollars in thousands)
Loan Portfolio Changes:	
LASG originations and acquisitions	\$ 44,430
SBA and USDA funded originations	5,913
Community Banking Division originations	22,147
SBA loan sales	(9,135)
Residential loan sales	(19,153)
Transfer to real estate owned	(1,214)
P ayoffs, pay-downs and amortization, net	(62,599)
Net change	\$ (19,611)

As noted above in the “ *Business Overview* ” section, the Company made certain commitments to the Board of Governors of the Federal Reserve System in connection with the merger of FHB with and into the Company in December 2010. The Company’s loan purchase and commercial real estate loan availability under these conditions follow.

Basis for Regulatory Condition	Condition	Availability at September 30, 2017 (Dollars in millions)
Total Loans	Purchased loans may not exceed 40% of total loans	\$ 126.5
Regulatory Capital	Non-owner occupied c ommercial real estate loans may not exceed 300% of total capital	207.1

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An overview of the Bank 's LASG portfolio follows:

LASG Portfolio									
Three Months Ended September 30,									
2017					2016				
Secured Loans to Broker-Dealers					Secured Loans to Broker-Dealers				
Purchased	Originated		Total LASG	Purchased	Originated		Total LASG		
(Dollars in thousands)									
Loans purchased or originated during the period:									
Unpaid principal balance	\$ 4,318	\$ 40,779	\$ -	\$ 45,097	\$ 16,790	\$ 42,002	\$ -	\$ 58,792	
Net investment basis	3,651	40,779	-	44,430	13,853	42,002	-	55,855	
Loan returns during the period:									
Yield (1)	12.28%	6.35%	-	8.85%	10.40%	5.88%	0.50%	7.58%	
Total Return (1) (2)	12.28%	6.35%	-	8.85%	10.43%	5.88%	0.50%	7.59%	
Total loans as of period end:									
Unpaid principal balance	\$ 262,144	\$ 340,756	\$ -	\$ 602,900	\$ 269,462	\$ 206,748	\$ 48,000	\$ 524,210	
Net investment basis	231,232	340,756	-	571,988	237,103	206,748	48,000	491,851	

(1) Purchased loan balances include loans held for sale of \$1.2 million and \$789 thousand as of September 30, 2017 and 2016, respectively.

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

Assets

Cash and Due from Banks, Short-Term Investments and Available-for-Sale Securities

Cash and cash equivalents were \$150.8 million as of September 30, 2017, a decrease of \$12.5 million, or 7.6%, from \$163.3 million at June 30, 2017. The decrease is primarily due to the decrease in deposits, offset by the decrease in loans in the period.

Available-for-sale securities totaled \$94.5 million as of September 30, 2017, compared to \$96.7 million as of June 30, 2017, representing a decrease of \$2.2 million, or 2.3%, primarily due to principal payments on mortgage backed securities. Included in available-for-sale securities are securities issued by government agencies and government-sponsored enterprises, as well as an investment of approximately \$5.0 million in a CRA qualified fund that seeks to invest in securities either issued or guaranteed by the U.S. government or its agencies, as well as an investment of approximately \$1.5 million in a CRA qualified fund that primarily invests in the federally guaranteed portion of SBA 7(a) loans. At September 30, 2017, no securities were pledged for outstanding borrowings.

Loans

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

September 30, 2017						
	Community Banking Division	LASG		SBA Division	Total	Percent of Total
(Dollars in thousands)						
Originated loans:						
Residential real estate	\$ 76,433	\$ 7,302	\$ 129	\$ 83,864	11.04%	
Home equity	12,954	-	-	12,954	1.71%	
Commercial real estate: non-owner occupied	22,340	91,694	18,035	132,069	17.39%	
Commercial real estate: owner occupied	13,332	78,406	22,434	114,172	15.03%	
Commercial and industrial	11,764	163,354	7,272	182,390	24.01%	
Consumer	4,121	-	-	4,121	0.54%	
Subtotal	140,944	340,756	47,870	529,570	69.72%	
Purchased loans:						
Residential real estate	-	3,208	-	3,208	0.42%	
Home equity	-	98	-	98	0.01%	
Commercial real estate: non-owner occupied	-	125,185	-	125,185	16.48%	
Commercial real estate: owner occupied	-	100,420	-	100,420	13.22%	
Commercial and industrial	-	1,103	-	1,103	0.15%	
Subtotal	-	230,014	-	230,014	30.28%	

Total	<u>\$ 140,944</u>	<u>\$ 570,770</u>	<u>\$ 47,870</u>	<u>\$ 759,584</u>	<u>100.00%</u>
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June 30, 2017

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

Classification of Assets

Loans are classified as nonperforming when 90 or more days past due, unless a loan is well-secured and in the process of collection. Loans less than 90 days past due, for which collection of principal or interest is considered doubtful, also may be designated as nonperforming. In both situations, accrual of interest ceases. The Company typically maintains such loans as nonperforming until the respective borrowers have demonstrated a sustained period of payment performance.

In cases where a borrower experiences financial difficulties and the Company makes certain concessionary modifications, the loan is classified as a troubled debt restructuring (“TDR”). Concessionary modifications may include adjustments to interest rates, extensions of maturity, or other actions intended to minimize economic loss and avoid foreclosure or repossession of collateral. 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.

Other nonperforming assets include other real estate owned (“OREO”) and other personal property securing loans repossessed by the Bank. The real estate and personal property collateral for commercial and consumer loans is written down to its estimated realizable value upon repossession. Revenues and expenses are recognized in the period when received or incurred on OREO and in substance foreclosures. Gains and losses on disposition are recognized in noninterest income.

The following table details the Company's nonperforming assets and other credit quality indicators as of September 30, 2017 and June 30, 2017. Management believes that, based on their carrying amounts, nonperforming assets are well secured based on the estimated fair value of underlying collateral.

	Nonperforming Assets at September 30, 2017		
	Originated	Purchased	Total
(Dollars in thousands)			
Loans:			
Residential real estate	\$ 3,667	\$ 1,078	\$ 4,745
Home equity	58	-	58
Commercial real estate	2,409	6,653	9,062
Commercial and industrial	2,629	27	2,656
Consumer	131	-	131
Subtotal	8,894	7,758	16,652
Real estate owned and other repossessed collateral	4	2,036	2,040
Total	\$ 8,898	\$ 9,794	\$ 18,692

Ratio of nonperforming loans to total loans	2.19%
Ratio of nonperforming assets to total assets	1.78%
Ratio of loans past due to total loans	1.60%
Nonperforming loans that are current	\$ 8,268
Commercial loans risk rated substandard or worse	\$ 9,610
Troubled debt restructurings:	
On accrual status	\$ 9,624
On nonaccrual status	\$ 5,955

	Nonperforming Assets at June 30, 2017		
	Originated	Purchased	Total
	(Dollars in thousands)		
Loans:			
Residential real estate	\$ 3,337	\$ 1,056	\$ 4,393
Home equity	58	-	58
Commercial real estate	413	6,364	6,777
Commercial and industrial	2,600	32	2,632
Consumer	103	-	103
Subtotal	6,511	7,452	13,963
Real estate owned and other repossessed collateral	4	822	826
Total	\$ 6,515	\$ 8,274	\$ 14,789
Ratio of nonperforming loans to total loans			1.79%
Ratio of nonperforming assets to total assets			1.37%
Ratio of loans past due to total loans			1.72%
Nonperforming loans that are current		\$ 4,321	
Commercial loans risk rated substandard or worse		\$ 7,109	
Troubled debt restructurings:			
On accrual status		\$ 9,702	
Nonaccrual status		\$ 5,383	

As of September 30, 2017, nonperforming assets totaled \$18.7 million, or 1.78% of total assets, as compared to \$14.8 million, or 1.37% of total assets, as of June 30, 2017. The increase of \$3.9 million from June 30, 2017 is primarily due to three loans placed on non-accrual totaling \$3.4 million.

Allowance for Loan Losses

In connection with the application of the acquisition method of accounting for the merger on December 29, 2010, the allowance for loan losses was reduced to zero when the loan portfolio was marked to its then current fair value. Since that date, the Company has provided for an allowance for loan losses as new loans are originated or in the event that credit exposure in the pre-merger loan portfolio or other acquired loans exceeds the exposure estimated when initial fair values were determined.

The Company's allowance for loan losses was \$4.0 million as of September 30, 2017, compared to \$3.7 million as of June 30, 2017. The increase in the period is primarily the result of the effect of changes in the qualitative factors.

The following table details ratios related to the allowance for loan losses for the periods indicated.

	September 30, 2017	June 30, 2017	September 30, 2016
Allowance for loan losses to nonperforming loans	24.23%	26.25 %	28.08%
Allowance for loan losses to total loans	0.53%	0.47%	0.35%
Last twelve months of net-charge offs to average loans	0.03%	0.04%	0.18%

While management believes that it uses the best information available to make its determinations with respect to the allowance, there can be no assurance that the Company will not have to increase its provision for loan losses in the future as a result of changing economic conditions, adverse markets for real estate or other factors.

Other Assets

Premises and equipment, net, increased by \$337 thousand, or 4.9%, to \$7.3 million at September 30, 2017, compared to \$6.9 million at June 30, 2017. The increase was primarily due to fixed assets acquired during the period, offset by depreciation.

Real estate owned and other repossessed collateral, net, increased by \$1.2 million to \$2.0 million at September 30, 2017, compared to \$826 thousand at June 30, 2017. The increase was primarily due to the addition of one property into real estate owned during the period.

Intangible assets totaled \$1.2 million and \$1.3 million at September 30, 2017 and June 30, 2017, respectively. The \$109 thousand decrease was the result of core deposit intangible asset amortization during the period.

Servicing rights totaled \$3.0 million and \$2.8 million at September 30, 2017 and June 30, 2017, respectively. The \$109 thousand increase was the result of SBA loans sold during the quarter, offset by amortization.

The cash surrender value of the Company's bank-owned life insurance ("BOLI") assets increased \$112 thousand, or 0.7% to \$16.3 million at September 30, 2017, compared to \$16.2 million at June 30, 2017. Increases in cash surrender value are recognized in other income and are not subject to income taxes. Borrowing on, or surrendering a policy, may subject the Company to income tax expense on the increase in cash surrender value. For these reasons, management considers BOLI an illiquid asset. BOLI represented 10.5% of the Company's regulatory total capital at September 30, 2017.

Deposits, FHLBB Advances, Subordinated Debt, Liquidity, Capital, and Stock Repurchases

Deposits

The Company’s principal source of funding is its core deposit accounts. At September 30, 2017, non-maturity accounts, and non-brokered insured time deposits represented 100% of total deposits.

Total deposits decreased \$27.1 million to \$862.7 million as of September 30, 2017 from \$889.9 million as of June 30, 2017. The decrease was attributable primarily to a decrease in time deposits of \$35.7 million, or 10.6%, partially offset by growth in non-maturity (demand, savings and interest checking, and money market) accounts, which increased by \$8.6 million, or 1.6%.

The composition of total deposits at September 30, 2017 and June 30, 2017 is as follows:

	September 30, 2017		June 30, 2017	
	Amount	Percent of Total	Amount	Percent of Total
	(Dollars in thousands)			
Demand deposits	\$ 74,731	8.66%	\$ 69,827	7.84%
NOW accounts	68,003	7.88%	71,247	8.01%
Regular and other savings	37,688	4.37%	37,170	4.18%
Money market deposits	380,992	44.16%	374,569	42.09%
Total non-certificate accounts	561,414	65.07%	552,814	62.12%
Term certificates of \$250 thousand or less	301,309	34.93%	337,037	37.88%
Term certificates greater than \$250 thousand	-	0.00%	-	0.00%
Total certificate accounts	301,309	34.93%	337,037	37.88%
Total deposits	\$ 862,723	100.00%	\$ 889,850	100.00%

FHLBB Advances

Advances from the Federal Home Loan Bank of Boston (“FHLBB”) were \$20.0 million at both September 30, 2017 and June 30, 2017. As of September 30, 2017, the Company had pledged certain residential real estate loans and commercial real estate loans to secure outstanding advances and provide additional borrowing capacity. As of September 30, 2017, no securities were pledged for outstanding borrowings.

Subordinated Debt

On June 29, 2016, the Company entered into a Subordinated Note Purchase Agreement with certain institutional accredited investors pursuant to which the Company issued subordinated notes equal to \$15.05 million in aggregate principal amount with an interest rate of 6.75% fixed-to-floating maturing in 2026 (“subordinated notes”). The subordinated notes, net of issuance costs, totaled \$14.6 million at both September 30, 2017 and June 30, 2017.

The Company had junior subordinated debentures issued to affiliated trusts totaling \$9.1 million and \$9.0 million at September 30, 2017 and June 30, 2017, respectively.

Liquidity

The following table is a summary of unused borrowing capacity of the Company at September 30, 2017, in addition to traditional retail deposit products:

	As of September 30, 2017	
	(Dollars in thousands)	
Brokered time deposits	\$ 262,409	Subject to policy limitation of 25% of total assets
Federal Home Loan Bank of Boston	55,328	Unused advance capacity subject to eligible and qualified collateral
Federal Discount Window Borrower-in-Custody	1,325	Unused credit line subject to the pledge of loans
Other available lines	17,500	
Total unused borrowing capacity	<u>\$ 336,562</u>	

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

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At September 30, 2017, the Company had \$412.1 million of immediately accessible liquidity, defined as cash that the Bank reasonably believes could be raised within seven days through collateralized borrowings, brokered deposits or security sales. This position represented 39.3% of total assets. The Company also had \$150.8 million of cash and cash equivalents at September 30, 2017.

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

Capital

The unpaid principal balance and carrying amount of junior subordinated debentures totaled \$16.5 million and \$9.1 million, respectively, as of September 30, 2017. The unpaid principal balance and carrying amount of subordinated debt totaled \$15.1 million and \$14.6 million, respectively, as of September 30, 2017. The junior subordinated debt represents qualifying Tier I capital for the Company, up to a maximum of 25% of total Tier I capital, and the subordinated debt represents qualifying Tier II capital for the Company. At September 30, 2017, the carrying amounts of the junior subordinated debt, net of the Company's \$496 thousand investment in the affiliated trusts, qualified as Tier I capital, and the subordinated debt qualified as Tier II capital.

At September 30, 2017, shareholders' equity was \$126.7 million, an increase of \$3.9 million, or 3.2% from June 30, 2017. Book value per outstanding common share was \$14.25 at September 30, 2017 and \$13.90 at June 30, 2017. Tier I capital to total average assets of the Company was 12.77% as of September 30, 2017 and 12.81% at June 30, 2017.

Under the capital rules, risk-based capital ratios are calculated by dividing Tier I and total capital, respectively, by risk-weighted assets. Assets and off-balance sheet credit equivalents are assigned to one of several risk-weight categories, based primarily on relative risk. The rules require banks and bank holding companies to maintain a minimum common equity Tier I capital ratio of 4.5%, a minimum Tier I capital ratio of 6%, a total capital ratio of 8% and a leverage ratio of 4%. Additionally, subject to a transition schedule, the capital rules require a bank holding company to establish a capital conservation buffer of Tier I capital in an amount above the minimum risk-based capital requirements for "adequately capitalized" institutions equal to 2.5% of total risk weighted assets, or face restrictions on the ability to pay dividends, pay discretionary bonuses, and to engage in share repurchases.

A bank holding company, such as the Company, is considered "well capitalized" if the bank holding company (i) has a total capital ratio of at least 10%, (ii) has a Tier I risk-based capital ratio of at least 6%, and (iii) is not subject to any written agreement order, capital directive or prompt corrective action directive to meet and maintain a specific capital level for any capital measure. In addition, the FDIC has amended its prompt corrective action rules to reflect the revisions made by the revised capital rules described above. Under the FDIC's revised rules, which became effective January 1, 2015, an insured state nonmember bank is considered "well capitalized" if it (i) has a total capital ratio of 10.0% or greater; (ii) a Tier I risk-based capital ratio of 8.0% or greater; (iii) a common Tier I equity ratio of 6.5% or greater; (iv) a leverage capital ratio of 5.0% or greater; and (iv) is not subject to any written agreement, order, capital directive, or prompt corrective action directive to meet and maintain a specific capital level for any capital measure.

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The Company and the Bank are considered "well capitalized" under all regulatory definitions. The Company's and the Bank's regulatory capital ratios are set forth below.

	Actual		Minimum Capital Requirements		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions		Minimum Capital Ratio with Capital Conservation Buffer
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Ratio
(Dollars in thousands)							
September 30, 2017 :							
Common equity tier 1 capital to risk weighted assets:							
Company	\$ 127,390	16.50%	\$ 34,736	≥ 4.5%	\$ N/A	N/A	7.0%
Bank	143,851	18.63%	34,752	≥ 4.5%	50,198	≥ 6.5%	7.0%
Total capital to risk weighted assets:							
Company	154,706	20.04%	61,753	≥ 8.0%	N/A	N/A	10.5%
Bank	147,958	19.16%	61,782	≥ 8.0%	77,227	≥ 10.0%	10.5%
Tier 1 capital to risk weighted assets:							
Company	135,963	17.61%	46,315	≥ 6.0%	N/A	N/A	8.5%
Bank	143,851	18.63%	46,336	≥ 6.0%	61,782	≥ 8.0%	8.5%
Tier 1 capital to average assets:							
Company	135,963	12.77%	42,579	≥ 4.0%	N/A	N/A	4.0%
Bank	143,851	13.51%	42,585	≥ 4.0%	53,231	≥ 5.0%	4.0%
June 30, 2017 :							
Common equity tier 1 capital to risk weighted assets:							
Company	\$ 123,442	16.00%	\$ 34,714	≥ 4.5%	\$ N/A	N/A	7.0%
Bank	138,744	17.98%	34,727	≥ 4.5%	50,162	≥ 6.5%	7.0%
Total capital to risk weighted assets:							
Company	150,269	19.48%	61,715	≥ 8.0%	N/A	N/A	10.5%
Bank	142,447	18.46%	61,737	≥ 8.0%	77,172	≥ 10.0%	10.5%
Tier 1 capital to risk weighted assets:							
Company	131,958	17.11%	46,286	≥ 6.0%	N/A	N/A	8.5%
Bank	138,744	17.98%	46,303	≥ 6.0%	61,737	≥ 8.0%	8.5%
Tier 1 capital to average assets:							
Company	131,958	12.81%	41,215	≥ 4.0%	N/A	N/A	4.0%
Bank	138,744	13.46%	41,238	≥ 4.0%	51,547	≥ 5.0%	4.0%

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In addition to the minimum regulatory capital required for capital adequacy purposes included in the table above, the Company is required to maintain a capital conservation buffer, in the form of common equity, in order to avoid restrictions on capital distributions and discretionary bonuses. The required amount of the capital conservation buffer was 0.625% on January 1, 2016 and will increase by 0.625% each year until it reaches 2.5% on January 1, 2019. As of January 1, 2017, the capital conservation buffer is 1.25%.

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

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

Stock Repurchases

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

Off-Balance Sheet Financial Instruments

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

See Part I. Item I. "Notes to Unaudited Consolidated Financial Statements – Note 9: Commitments and Contingencies" for further discussion.

Results of Operations

General

Net income increased by \$2.8 million to \$4.6 million for the quarter ended September 30, 2017, compared to \$1.8 million for the quarter ended September 30, 2016.

The following table details the “Total Return” on purchased loans. When compared to the three months ended September 30, 2016, transactional income increased by \$1.5 million to \$2.8 million. The total return on purchased loans for the three months ended September 30, 2017 was 12.28% compared to 10.43% for the three months ended September 30, 2016. The increase over the prior comparable period was primarily due to higher average balances and transactional income in the three months ended September 30, 2017. The following table details the total return on purchased loans:

	Total Return on Purchased Loans			
	Three Months Ended September 30,			
	2017		2016	
	Income	Return (1)	Income	Return (1)
	(Dollars in thousands)			
Regularly scheduled interest and accretion	\$ 4,613	7.62%	\$ 4,754	8.13%
Transactional income:				
Gain on loan sales	-	0.00%	-	0.00%
Gain on sale of real estate owned	-	0.00%	19	0.03%
Other noninterest income	-	0.00%	-	0.00%
Accelerated accretion and loan fees	2,818	4.66%	1,327	2.27%
Total transactional income	2,818	4.66%	1,346	2.30%
Total	\$ 7,431	12.28%	\$ 6,100	10.43%

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

Net Interest Income

Net interest and dividend income before provision for loan losses increased by \$3.5 million for the quarter ended September 30, 2017, compared to the quarter ended September 30, 2016. The increase is primarily due to higher transactional income on purchased loans and higher average balances in the total loan portfolio. This increase was partially offset by higher rates and higher average deposit balances.

	Interest Income and Yield on Loans					
	Three Months Ended September 30,					
	2017			2016		
	Average Balance (1)	Interest Income (2)	Yield	Average Balance (1)	Interest Income (2)	Yield
	(Dollars in thousands)					
Community Banking Division	\$ 150,178	\$ 1,746	4.61%	\$ 205,765	\$ 2,401	4.63%
SBA	53,527	941	6.97%	31,148	519	6.61%
LASG:						
Originated	328,775	5,265	6.35%	185,109	2,742	5.88%
Purchased	240,136	7,431	12.28%	231,999	6,081	10.40%
Secured Loans to Broker-Dealers	-	-	0.00%	48,000	60	0.50%
Total LASG	568,911	12,696	8.85%	465,108	8,883	7.58%
Total	\$ 772,616	\$ 15,383	7.90%	\$ 702,021	\$ 11,803	6.67%

- (1) Includes loans held for sale.
(2) SBA interest income includes SBA fees of \$48 thousand and \$50 thousand for the quarters ended September 30, 2017 and 2016, respectively.

The Company’s interest rate spread increased by 103 basis points and net interest margin increased by 106 basis points for the quarter ended September 30, 2017 compared to the quarter ended September 30, 2016. The increase was principally due to higher transactional interest income in the purchased portfolio and higher yield and average balances in the loan portfolio, offset by higher rates and average deposit balances.

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The following sets forth the average balance sheets, interest income and interest expense, and average yields and costs for the three months ended September 30, 2017 and 2016.

	Three Months Ended September 30,					
	2017			2016		
	Average Balance	Interest Income/Expense	Average Yield/Rate	Average Balance	Interest Income/Expense	Average Yield/Rate
Assets:						
Interest-earning assets:						
Investment securities	\$ 95,827	\$ 266	1.10%	\$ 94,899	\$ 239	1.00%
Loans (1) (2) (3)	772,616	15,393	7.90%	702,021	11,821	6.68%
Federal Home Loan Bank stock	1,938	20	4.09%	2,408	23	3.79%
Short-term investments (4)	160,354	509	1.26%	154,392	192	0.49%
Total interest-earning assets	1,030,735	16,188	6.23%	953,720	12,275	5.11%
Cash and due from banks	3,134			2,941		
Other non-interest earning assets	30,887			30,812		
Total assets	\$ 1,064,756			\$ 987,473		
Liabilities & Share holders' Equity:						
Interest-bearing liabilities:						
NOW accounts	\$ 69,577	\$ 51	0.29%	\$ 70,850	\$ 51	0.29%
Money market accounts	387,632	1,097	1.12%	291,734	682	0.93%
Savings accounts	37,033	13	0.14%	35,769	12	0.13%
Time deposits	312,485	1,015	1.29%	336,271	1,009	1.19%
Total interest-bearing deposits	806,727	2,176	1.07%	734,624	1,754	0.95%
Federal Home Loan Bank advances	20,007	172	3.41%	30,061	255	3.37%
Subordinated debt	23,661	508	8.52%	23,360	459	7.80%
Capital lease obligation	830	11	5.26%	1,087	14	5.11%
Total interest-bearing liabilities	851,225	2,867	1.34%	789,132	2,482	1.25%
Non-interest bearing liabilities:						
Demand deposits and escrow accounts	80,565			75,672		
Other liabilities	8,464			8,213		
Total liabilities	940,254			873,017		
Share holders' equity	124,502			114,456		
Total liabilities and share holders' equity	\$ 1,064,756			\$ 987,473		
Net interest income (5)		\$ 13,321			\$ 9,793	
Interest rate spread			4.89%			3.86%
Net interest margin (6)			5.13%			4.07%

(1) Interest income and yield are stated on a fully tax-equivalent basis using a 34% tax rate.

(2) Includes loans held for sale.

(3) Nonaccrual loans are included in the computation of average, but unpaid interest has not been included for purposes of determining interest income.

(4) Short term investments include FHLBB overnight deposits and other interest-bearing deposits.

(5) Includes tax exempt interest income of \$10 thousand and \$18 thousand for the three months ended September 30, 2017 and 2016, respectively.

(6) Net interest margin is calculated as net interest income divided by total interest-earning assets.

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

	Three Months Ended September 30, 2017 compared to 2016		
	Change Due to	Change Due to Rate	Total Change
	Volume	(Dollars in thousands)	
Interest earning assets:			
Investment securities	\$ 2	\$ 25	\$ 27
Loans	1,266	2,306	3,572
Federal Home Loan Bank stock	(5)	2	(3)
Short-term investments	7	310	317
Total interest-earning assets	1,270	2,643	3,913
Interest-bearing liabilities:			
Interest-bearing deposits	170	252	422
Federal Home Loan Bank advances	(86)	3	(83)
Subordinated debt	6	43	49
Capital lease obligations	(3)	-	(3)
Total interest-bearing liabilities	87	298	385
Total change in net interest income	<u>\$ 1,183</u>	<u>\$ 2,345</u>	<u>\$ 3,528</u>

Provision for Loan Losses

Quarterly, the Company determines the amount of the allowance for loan losses that is appropriate to provide for losses inherent in the Company's loan portfolios, with the provision for loan losses determined by the net change in the allowance for loan losses. For loans accounted for under ASC 310-30, a provision for loan loss is recorded when estimates of future cash flows are lower than had been previously expected. See Part I. Item I. "Notes to Unaudited Consolidated Financial Statements — Note 4: Loans, Allowance for Loan Losses and Credit Quality" for further discussion.

The provision for loan losses for periods subsequent to the merger with FHB reflects the impact of adjusting loans to their then fair values, as well as the elimination of the allowance for loan losses in accordance with the acquisition method of accounting. Subsequent to the merger, the provision for loan losses has been recorded based on estimates of inherent losses in newly originated loans and for incremental reserves required for pre-merger loans based on estimates of deteriorated credit quality post-merger.

The provision for loan losses for the quarter ended September 30, 2017 and 2016 was \$354 thousand and \$193 thousand, respectively. The increase in the Company's loan loss provision was primarily the effect of changes in the qualitative factors and updates to the specific reserve on impaired loans.

Noninterest Income

Noninterest income increased by \$150 thousand for the quarter ended September 30, 2017, compared to the quarter ended September 30, 2016, principally due to the following:

- An increase in gain on sale of SBA loans of \$276 thousand, due to a higher dollar amount sold in the quarter; and
- An increase in fees for other services to customers of \$118 thousand, due to higher loan servicing fees on SBA loans sold.
- The increases in noninterest income were partially offset by a decrease in gain on sale of residential loans held for sale of \$251 thousand, due to a lower volume sold in the quarter.

Noninterest Expense

Noninterest expense increased by \$88 thousand for the quarter ended September 30, 2017, compared to the quarter ended September 30, 2016, primarily due to the following:

- An increase in data processing fees of \$183 thousand, primarily due to the outsourcing of data processing.
- The increase in data processing fees was partially offset by a decrease in occupancy and equipment expense of \$120 thousand, primarily due to lower computer equipment and software depreciation.

Income Taxes

The Company's income tax expense was \$1.6 million or a tax rate of 26.0%, for the three months ended September 30, 2017, as compared to \$1.0 million, or a tax rate of 36.7%, for the three months ended September 30, 2016. The decrease in the tax rate was primarily due to the Company's adoption of ASU 2016-09 in the current quarter. The most significant impact of this amendment resulted from the prospective application of current excess tax benefits and deficiencies being recognized in income tax expense, which previously would have been recognized in additional paid-in capital, in the reporting period in which they occur. For the three months ended September 30, 2017, the adoption of ASU 2016-09 reduced the Company's income tax expense by \$818 thousand. This excess tax benefit is treated as a discrete item in the period in which it occurs, and is not to be considered in determining the annual effective tax rate. The discrete item will vary from year to year as a function of the volume of restricted stock that is vested, the volume of options that are exercised and market price of the Company's stock in comparison to the compensation cost recognized in the financial statements. See Part I. Item I. "Notes to Unaudited Consolidated Financial Statements — Note 10: Stock-Based Compensation" for further discussion.

Item 3. Quantitative and Qualitative Disclosure about Market Risk

Market Risk

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

Interest Rate Risk

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

Asset/Liability Management

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

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

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

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

Measuring Interest Rate Risk

The Company can be subject to margin compression depending on the economic environment and the shape of the yield curve. Under the Company's current balance sheet position, the Company's margin generally performs slightly better over time in a rising rate environment, while it generally decreases in a declining rate environment and when the yield curve is flattening or inverted.

Under a flattening yield curve scenario, margin compression occurs as the spread between the cost of funding and the yield on interest earning assets narrows. Under this scenario the degree of margin compression is highly dependent on the Company's ability to fund asset growth through lower cost deposits. However, if the curve is flattening, while short-term rates are rising, the adverse impact on margin may be somewhat delayed, as increases in the Prime Rate will initially result in the Company's asset yields re-pricing more quickly than funding costs.

Under an inverted yield curve situation, shorter-term rates exceed longer-term rates, and the impact on margin is similar but more adverse than the flat curve scenario. Again, however, the extent of the impact on margin is highly dependent on the Company's balance sheet mix.

In a declining rate environment, margin compression will eventually occur as the yield on interest earning assets decreases more rapidly than decreases in funding costs. The primary causes would be the impact of interest rate decreases (including decreases in the Prime Rate) on adjustable rate loans and the fact that decreases in deposit rates may be limited or lag decreases in the Prime Rate.

There have been no material changes in the results of the Company's net interest income sensitivity analysis as reported in the Company's 2017 Annual Report on Form 10-K. At September 30, 2017, management continues to consider the Company's primary interest rate risk exposure to be margin compression that may result from changes in interest rates and/or changes in the mix of the Company's balance sheet components. This would include the mix of fixed versus variable rate loans and investments on the asset side, and higher cost versus lower cost deposits and overnight borrowings versus term borrowings and certificates of deposit on the liability side.

Item 4. Controls and Procedures

The Company maintains controls and procedures designed to ensure that information required to be disclosed in the reports the Company files or submits under the Securities Exchange Act of 1934 ("Exchange Act") is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, and that such information is accumulated and communicated to the Company's management, including the Chief Executive Officer and Chief Financial Officer (the Company's principal executive officer and principal financial officer, respectively), as appropriate to allow for timely decisions regarding timely disclosure. In designing and evaluating disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost/benefit relationship of possible controls and procedures.

The Company's management, with the participation of the Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of its disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this Quarterly Report on Form 10-Q.

Based on this evaluation of the Company's disclosure controls and procedures, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures were effective as of September 30, 2017.

There were no changes in the Company's internal controls over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) that occurred during the quarter ended September 30, 2017 that have materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

None.

Item 1A. Risk Factors

There have been no material changes to the risk factors disclosed in Item 1A of the Company's 2017 Annual Report on Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

There were no purchases made by the Company of its common stock during the three months ended September 30, 2017.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

<u>Exhibits No.</u>	<u>Description</u>
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(a)). *
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(a)). *
32.1	Certificate of the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(b)). **
32.2	Certificate of the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(b)). **
101	The following materials from Northeast Bancorp's Quarterly Report on Form 10-Q for the quarter ended September 30, 2017 formatted in XBRL: (i) Consolidated Balance Sheets at September 30, 2017 and June 30, 2017; (ii) Consolidated Statements of Income for the three months ended September 30, 2017 and 2016; (iii) Consolidated Statements of Comprehensive Income for the three months ended September 30, 2017 and 2016; (iv) Consolidated Statements of Changes in Shareholders' Equity for the three months ended September 30, 2017 and 2016; (v) Consolidated Statements of Cash Flows for the three months ended September 30, 2017 and 2016; and (v) Notes to Unaudited Consolidated Financial Statements. *

* Filed herewith

** Furnished herewith

SIGNATURES

Pursuant to the requirements of the Securities Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: November 9 , 2017

NORTHEAST BANCORP

By: /s/ Richard Wayne
Richard Wayne
President and Chief Executive Officer

By: /s/ Brian Pinheiro
Brian Pinheiro
Interim Chief Financial Officer and
Chief Risk Officer

NORTHEAST BANCORP
Index to Exhibits

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* Filed herewith

** Furnished herewith

Exhibit 31.1 Certification of the Chief Executive Officer

**Chief Executive Officer Certification
Pursuant To Section 302 Of
The Sarbanes-Oxley Act Of 2002**

I, Richard Wayne, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Northeast Bancorp;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

November 9 , 2017

/s/ Richard Wayne
Richard Wayne
Chief Executive Officer

**Chief Financial Officer Certification
Pursuant To Section 302 Of
The Sarbanes-Oxley Act Of 2002**

I, Brian Pinheiro, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Northeast Bancorp;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

November 9 , 2017

/s/ Brian Pinheiro

Brian Pinheiro

Interim Chief Financial Officer and Chief Risk Officer

Exhibit 32.1. Certificate of the Chief Executive Officer

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

In connection with the Quarterly Report of Northeast Bancorp. (the "Company") on Form 10-Q for the quarterly period ended September 30, 2017 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Richard Wayne, as Chief Executive Officer of the Company, hereby certify pursuant to 18 U.S.C. 1350, as adopted pursuant to 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company for the dates and the periods covered by the Report.

This certification shall not be deemed "filed" for any purpose, nor shall it be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934 regardless of any general incorporation language in such filing.

November 9, 2017

/s/ Richard Wayne
Richard Wayne
Chief Executive Officer

Exhibit 32.2. Certificate of the Chief Financial Officer

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

In connection with the Quarterly Report of Northeast Bancorp. (the "Company") on Form 10-Q for the quarterly period ended September 30, 2017 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Brian Pinheiro, as Interim Chief Financial Officer and Chief Risk Officer of the Company, hereby certify pursuant to 18 U.S.C. 1350, as adopted pursuant to 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company for the dates and the periods covered by the Report.

This certification shall not be deemed "filed" for any purpose, nor shall it be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934 regardless of any general incorporation language in such filing.

November 9, 2017

/s/ Brian Pinheiro
Brian Pinheiro
Interim Chief Financial Officer and Chief Risk Officer