NORTHEAST BANCORP /ME/
Form 10-Q
February 09, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended December 31, 2017

Commission File Number: 1-14588

Northeast Bancorp

(Exact name of registrant as specified in its charter)

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

(207) 786-3245

Registrant's telephone number, including area code

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

Indicate by check mark whether the registrant has submitted electronically 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 or a smaller reporting company. See definition of "accelerated filer", "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (check one): Large accelerated filer __ Accelerated filer Non-accelerated filer __ Smaller Reporting Company __

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act). Yes_ No

Indicate by check mark whether the registrant is an emerging growth company as defined in Rule 405 of the Securities Act of 1933 (§230.405 of this chapter) or Rule 12b-2 of the Securities Exchange Act of 1934 (§240.12b-2 of this chapter).

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 the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. As of February 2, 2018, the registrant had outstanding 8,008,634 shares of voting common stock, $1.00 par value per share and 918,639 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)
(In thousands, except share and per share data)

	December 31, 2017	June 30, 2017
Assets		
Cash and due from banks	$2,515	$3,582
Short-term investments	125,708	159,701
Total cash and cash equivalents	128,223	163,283
Available-for-sale securities, at fair value	92,339	96,693
Residential real estate loans held for sale	5,515	4,508
SBA loans held for sale	818	191
Total loans held for sale	6,333	4,699
Loans		
Commercial real estate	493,954	498,004
Commercial and industrial	178,840	175,654
Residential real estate	97,593	101,168
Consumer	3,803	4,369
Total loans	774,190	779,195
Less: Allowance for loan losses	4,355	3,665
Loans, net	769,835	775,530
Premises and equipment, net	7,061	6,937
Real estate owned and other repossessed collateral, net	910	826
Federal Home Loan Bank stock, at cost	1,758	1,938
Intangible assets, net	1,082	1,300
Loan servicing rights, net	3,005	2,846
Bank-owned life insurance	16,402	16,179
Other assets	7,498	6,643
Total assets	$1,034,446	$1,076,874

Liabilities and Shareholders' Equity		
Deposits		
Demand	$71,054	$69,827
Savings and interest checking	107,750	108,417
Money market	352,237	374,569
Time	317,613	337,037
Total deposits	848,654	889,850
Federal Home Loan Bank advances	15,000	20,011
Subordinated debt	23,790	23,620
Capital lease obligation	741	873
Other liabilities	16,258	19,723
Total liabilities	904,443	954,077
Commitments and contingencies	-	-
Shareholders' equity		
Preferred stock, $1.00 par value, 1,000,000 shares authorized; no shares issued and outstanding at December 31, 2017 and June 30, 2017	-	-
Voting common stock, $1.00 par value, 25,000,000 shares authorized; 8,017,334 and 7,840,460 shares issued and outstanding at December 31, 2017 and June 30, 2017, respectively	8,017	7,841
Non-voting common stock, $1.00 par value, 3,000,000 shares authorized; 921,939 and 991,194 shares issued and outstanding at December 31, 2017 and June 30, 2017, respectively	922	991
Additional paid-in capital	76,805	77,455
Retained earnings	45,855	38,142
Accumulated other comprehensive loss	(1,596)	(1,632)
Total shareholders' equity	130,003	122,797
Total liabilities and shareholders' equity	$1,034,446	$1,076,874

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

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2017	2016	2017	2016
Interest and dividend income:				
Interest and fees on loans	$14,501	$13,913	$29,883	$25,716
Interest on available-for-sale securities	267	247	533	486
Other interest and dividend income	492	172	1,022	387
Total interest and dividend income	15,260	14,332	31,438	26,589
Interest expense:				
Deposits	2,129	1,798	4,305	3,553
Federal Home Loan Bank advances	148	220	319	475
Subordinated debt	517	468	1,025	927
Obligation under capital lease agreements	9	13	21	27
Total interest expense	2,803	2,499	5,670	4,982
Net interest and dividend income before provision for loan losses	12,457	11,833	25,768	21,607
Provision for loan losses	437	628	792	820
Net interest and dividend income after provision for loan losses	12,020	11,205	24,976	20,787
Noninterest income:				
Fees for other services to customers	475	481	1,002	889
Gain on sales of residential loans held for sale	255	337	545	878
Gain on sales of SBA loans	341	1,734	1,361	2,476
Gain on sales of other loans	21	-	21	-
Gain (loss) on real estate owned, other repossessed collateral and premises and equipment, net	11	3	11	(11)
Bank-owned life insurance income	111	114	223	228
Other noninterest income	14	21	23	38
Total noninterest income	1,228	2,690	3,186	4,498
Noninterest expense:				
Salaries and employee benefits	5,173	5,161	10,427	10,475
Occupancy and equipment expense	1,150	1,252	2,260	2,481
Professional fees	425	399	867	895
Data processing fees	624	410	1,227	832

Marketing expense	70	97	157	184
Loan acquisition and collection expense	368	547	733	774
FDIC insurance premiums	80	22	160	146
Intangible asset amortization	109	109	218	218
Other noninterest expense	564	959	1,228	1,577
Total noninterest expense	8,563	8,956	17,277	17,582
Income before income tax expense	4,685	4,939	10,885	7,703
Income tax expense	1,381	1,839	2,995	2,852
Net income	$3,304	$3,100	$7,890	$4,851
Weighted-average shares outstanding:				
Basic	8,924,495	8,831,235	8,883,003	8,968,690
Diluted	9,168,084	8,864,618	9,129,010	8,999,062
Earnings per common share:				
Basic	$0.37	$0.35	$0.89	$0.54
Diluted	0.36	0.35	0.86	0.54
Cash dividends declared per common share	$0.01	$0.01	$0.02	$0.02

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

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2017	2016	2017	2016
Net income	$3,304	$3,100	$7,890	$4,851
Other comprehensive income, before tax:				
Available-for-sale securities:				
Change in net unrealized loss on available-for-sale securities	(297)	(1,336)	(175)	(1,414)
Derivatives and hedging activities:				
Change in accumulated gain on effective cash flow hedges	160	1,486	181	1,633
Reclassification adjustments included in interest expense	26	8	49	14
Total derivatives and hedging activities	186	1,494	230	1,647
Total other comprehensive (loss) income, before tax	(111)	158	55	233
Income tax expense (benefit) related to other comprehensive (loss) income	(43)	62	19	92
Other comprehensive (loss) income, net of tax	(68)	96	36	141
Comprehensive income	$3,236	$3,196	$7,926	$4,992

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

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

	Preferred Stock		Voting Common Stock		Non-voting Common Stock		Additional	Retained	Accumulated Other	Total
	Shares	Amount	Shares	Amount	Shares	Amount	Paid-in Capital	Earnings	Comprehensive Loss	Shareholders' Equity
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	-	-	-	-	-	-	-	4,851	-	4,851
Other comprehensive loss, net of tax	-	-	-	-	-	-	-	-	141	141
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 $0.02 per share	-	-	-	-	-	-	-	(181)	-	(181)
Stock-based compensation	-	-	-	-	-	-	483	-	-	483
Issuance of restricted common stock	-	-	160,000	160	-	-	(160)	-	-	-
Cancellation and forfeiture of restricted common stock	-	-	(1,000)	(1)	-	-	1	-	-	-
	-	$ -	7,487,552	$ 7,487	1,343,683	$ 1,344	$ 77,046	$ 30,830	$ (1,765)	$ 114,942

Balance at December 31, 2016										
Balance at June 30, 2017	-	-	7,840,460	$ 7,841	991,194	$ 991	$ 77,455	$ 38,142	$ (1,632)	$ 122,797
Net income	-	-	-	-	-	-	-	7,890	-	7,890
Other comprehensive loss, net of tax	-	-	-	-	-	-	-	-	36	36
Conversion of non-voting common stock to voting common stock	-	-	69,255	69	(69,255)	(69)	-	-	-	-
Dividends on common stock at $0.02 per share	-	-	-	-	-	-	-	(177)	-	(177)
Stock-based compensation	-	-	-	-	-	-	485	-	-	485
Issuance of restricted common stock	-	-	12,000	12	-	-	(12)	-	-	-
Cancellation and forfeiture of restricted common stock	-	-	(15,756)	(16)	-	-	(39)	-	-	(55)
Stock options exercised, net	-	-	111,375	111	-	-	(1,084)	-	-	(973)
Balance at December 31, 2017	-	$ -	8,017,334	$ 8,017	921,939	$ 922	$ 76,805	$ 45,855	$ (1,596)	$ 130,003

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

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NORTHEAST BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)
(Dollars in thousands)

	Six Months Ended December 31,	
	2017	2016
Operating activities:		
Net income	$7,890	$4,851
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	792	820
(Gain) loss recognized on real estate owned, other repossessed collateral and premises and equipment, net	(11)	11
Accretion of fair value adjustments on loans, net	(4,830)	(5,640)
Accretion of fair value adjustments on deposits, net	-	(2)
Amortization (accretion) of fair value adjustments on borrowings, net	104	(51)
Amortization of subordinated debt issuance costs	55	138
Originations of loans held for sale	(49,309)	(66,778)
Net proceeds from sales of loans held for sale	50,946	71,100
Gain on sales of residential loans held for sale, net	(545)	(878)
Gain on sales of SBA and other loans held for sale, net	(1,382)	(2,476)
Net increase in loan servicing rights	(159)	(577)
Amortization of intangible assets	218	218
Bank-owned life insurance income	(223)	(228)
Depreciation and amortization of premises and equipment	636	769
Stock-based compensation	485	483
Deferred income tax expense	498	-
Amortization of available-for-sale securities, net	450	555
Net changes in other assets and liabilities:		
Other assets	(1,376)	595
Other liabilities	(3,231)	702
Net cash provided by operating activities	1,008	3,612
Investing activities:		
Purchases of available-for-sale securities	(9,222)	(9,056)
Proceeds from maturities and principal payments on available-for-sale securities	12,951	17,126
Loan purchases	(38,453)	(59,886)
Loan originations, principal collections, and purchased loan paydowns, net	45,540	(13,413)
Purchases of premises and equipment	(795)	(229)
Redemption of Federal Home Loan Bank stock	180	470
Proceeds from sales of real estate owned and other repossessed collateral	1,264	523
Net cash provided by (used in) investing activities	11,465	(64,465)
Financing activities:		
Net change in deposits	(41,196)	39,141
Repurchase of common stock	-	(6,943)
Dividends paid on common stock	(177)	(181)

Repayment of Federal Home Loan Bank advances	(5,000)	(10,000)
Repayment of capital lease obligation	(132)	(125)
Repurchases for tax withholdings on restricted common stock	(55)	-
Repurchases for tax withholdings on stock options	(973)	-
Net cash (used in) provided by financing activities	(47,533)	21,892
Net decrease in cash and cash equivalents	(35,060)	(38,961)
Cash and cash equivalents, beginning of period	163,283	151,157
Cash and cash equivalents, end of period	$128,223	$112,196
Supplemental schedule of noncash investing activities:		
Transfers from loans to real estate owned and other repossessed collateral	$1,302	$1,946

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

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NORTHEAST BANCORP AND SUBSIDIARY

Notes to Unaudited Consolidated Financial Statements

December 31, 2017

1. Basis of Presentation

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

These unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("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 accompanying unaudited financial statements and notes should be read in conjunction with the audited consolidated financial statements and notes thereto for the fiscal year ended June 30, 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 Accounting Standards Update ("ASU") 2014-09, *Revenue from Contracts with Customers (Topic 606)* ("ASU 2014-09"). ASU 2014-09 implements a common revenue standard that clarifies the principles for recognizing revenue. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps: (i) identify the contract(s) with a customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract and (v) recognize revenue when (or as) the entity satisfies a performance obligation. ASU 2015-14, *Revenue from Contracts with Customers (Topic 606)* ("ASU 2015-14") was issued in August 2015 which 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 2016-09, *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 became effective for the Company for the fiscal year beginning July 1, 2017. 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 six months ended December 31, 2017, this item reduced income tax expense and increased net income by approximately $1.1 million, representing an income tax benefit arising from individuals who exercised non-qualified stock options and restricted stock awards that vested during the period. For the year ended June 30, 2017, the Company recognized $27 thousand in additional paid-in-capital related to the excess tax benefit, which, if under the new ASU, would have been recognized as an income tax benefit in the income statement. These amounts, treated as discrete items in the period in which they occur, will vary from year to year as a function of the volume of share-based payments vested or exercised and the then fair market value of the Company's stock in comparison to the compensation cost recognized in the financial statements. In addition to the excess tax benefit treatment, the amendment removed the assumed proceeds related to the excess tax benefit from the calculation of diluted shares which increased diluted weighted average common shares outstanding by 40,966 shares to 9,089,936. This amendment is applied on a prospective basis, and no prior periods were adjusted. Additionally upon adoption, the Company made a policy election to record forfeitures as they occur rather than make use of an estimate. The other provisions did not have a material impact on the Company's consolidated financial statements upon adoption.

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

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

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

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3. Available-for-Sale Securities

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

	December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
U.S. Government agency securities	$57,365	$ -	$ (273)	$57,092
Agency mortgage-backed securities	29,306	-	(726)	28,580
Other investments measured at net asset value	6,791	-	(124)	6,667
	$93,462	$ -	$ (1,123)	$92,339

	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
	$97,641	$ -	$ (948)	$96,693

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 and six months ended December 31, 2017 or 2016. At December 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.

December 31, 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)					

	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government agency securities	$21,111	$ (86)	$35,981	$ (187)	$57,092	$ (273)
Agency mortgage-backed securities	1,627	(9)	26,953	(717)	28,580	(726)
Other investments measured at net asset value	-	-	5,142	(124)	5,142	(124)
	$22,738	$ (95)	$68,076	$ (1,028)	$90,814	$ (1,123)

	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)
	$81,854	$ (626)	$13,332	$ (322)	$95,186	$ (948)

There were no other-than-temporary impairment losses on securities during the three and six months ended December 31, 2017 or 2016.

At December 31, 2017, the Company had 31 securities in a continuous loss position for greater than twelve months. At December 31, 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 December 31, 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 December 31, 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 December 31, 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 December 31, 2017, the effective duration of the fund that seeks to invest in securities either issued or guaranteed by the U.S. government or its agencies is 4.66 years.

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The amortized cost and fair values of available-for-sale debt securities by contractual maturity are shown below as of December 31, 2017. Actual maturities may differ from contractual maturities because borrowers may have the right to prepay obligations with or without prepayment penalties.

	Amortized Cost	Fair Value
	(Dollars in thousands)	
Due within one year	$39,168	$38,981
Due after one year through five years	18,197	18,111
Due after five years through ten years	-	-
Due after ten years	-	-
Total U.S. Government agency securities	57,365	57,092
Agency mortgage-backed securities	29,306	28,580
Total debt securities	$86,671	$85,672

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 and interest is reasonably assured and the loan has performed for a reasonable period of time.

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

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

	December 31, 2017			June 30, 2017		
	Originated	Purchased	Total	Originated	Purchased	Total
	(Dollars in thousands)					
Residential real estate	$80,462	$4,723	$85,185	$83,759	$3,377	$87,136
Home equity	12,313	95	12,408	13,931	101	14,032
Commercial real estate	255,679	238,275	493,954	256,280	241,724	498,004
Commercial and industrial	177,756	1,084	178,840	174,468	1,186	175,654
Consumer	3,803	-	3,803	4,369	-	4,369
Total loans	$530,013	$244,177	$774,190	$532,807	$246,388	$779,195

Total loans include net deferred loan origination costs of $212 thousand and $507 thousand as of December 31, 2017 and June 30, 2017, respectively.

Past Due and Nonaccrual Loans

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

	December 31, 2017							
	Past Due 30-59 Days	Past Due 60-89 Days	Past Due 90 Days or More-Still Accruing	Past Due 90 Days or More-Nonaccrual	Total Past Due	Total Current	Total Loans	Nonaccrual Loans
	(Dollars in thousands)							
Originated portfolio:								
Residential real estate	$1,472	$618	$ -	$ 2,108	$4,198	$76,264	$80,462	$ 3,783
Home equity	-	148	-	108	256	12,057	12,313	107
Commercial real estate	1,870	288	-	123	2,281	253,398	255,679	2,537
Commercial and industrial	1,004	36	-	-	1,040	176,716	177,756	2,555
Consumer	55	53	-	36	144	3659	3,803	147
Total originated portfolio	4,401	1,143	-	2,375	7,919	522,094	530,013	9,129
Purchased portfolio:								
	-	-	-	220	220	4,598	4,818	220

Residential real estate and home equity								
Commercial and industrial	217	-	-	-	217	867	1,084	292
Commercial real estate	10,918	5,971	-	4,712	21,601	216,674	238,275	8,450
Total purchased portfolio	11,135	5,971	-	4,932	22,038	222,139	244,177	8,962
Total loans	$15,536	$7,114	$ -	$ 7,307	$29,957	$744,233	$774,190	$ 18,091

	June 30, 2017							
	Past Due 30-59 Days	Past Due 60-89 Days	Past Due 90 Days or More-Still Accruing	Past Due 90 Days or More-Nonaccrual	Total Past Due	Total Current	Total Loans	Nonaccrual Loans
	(Dollars in thousands)							
Originated portfolio:								
Residential real estate	$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

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Allowance for Loan Losses and Impaired Loans

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

The allowance for loan losses consists of general, specific, and unallocated reserves and reflects management's estimate of probable loan losses inherent in the loan portfolio at the balance sheet date. Management uses a consistent and systematic process and methodology to evaluate the appropriateness of the allowance for loan losses on a quarterly basis. The calculation of the allowance for loan losses is segregated by portfolio segments, which include: residential real estate, commercial real estate, commercial and industrial, consumer, 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. This segment also includes loans to non-bank lenders, which are generally secured by a collateral assignment of the notes and mortgages on loans originated by the non-bank lenders. Weakness in national or regional economic conditions, and a corresponding weakness in consumer or business spending, will have an adverse effect on the credit quality of this segment.

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

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

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.

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

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

	Three Months Ended December 31, 2017						
	Residential Real Estate	Commercial Real Estate	Commercial and Industrial	Consumer	Purchased	Unallocated	Total
	(Dollars in thousands)						
Beginning balance	$513	$ 2,443	$ 727	$ 41	$ 310	$ -	$4,034
Provision	176	74	(42)	19	210	-	437
Recoveries	1	-	5	25	-	-	31
Charge-offs	(112)	-	-	(35)	-	-	(147)
Ending balance	$578	$ 2,517	$ 690	$ 50	$ 520	$ -	$4,355

	Three Months Ended December 31, 2016						
	Residential Real Estate	Commercial Real Estate	Commercial and Industrial	Consumer	Purchased	Unallocated	Total
	(Dollars in thousands)						
Beginning balance	$541	$ 1,421	$ 318	$ 68	$ 158	$ -	$2,506
Provision	6	351	207	40	24	-	628
Recoveries	27	19	6	21	-	-	73
Charge-offs	-	(41)	-	(59)	-	-	(100)
Ending balance	$574	$ 1,750	$ 531	$ 70	$ 182	$ -	$3,107

	Six Months Ended December 31, 2017						
	Residential	Commercial Real Estate	Commercial	Consumer	Purchased	Unallocated	Total

	Real Estate		and Industrial				
	(Dollars in thousands)						
Beginning balance	$477	$ 2,312	$ 520	$ 53	$ 303	$ -	$3,665
Provision	217	205	147	6	217	-	792
Recoveries	8	-	23	31	-	-	62
Charge-offs	(124)	-	-	(40)	-	-	(164)
Ending balance	$578	$ 2,517	$ 690	$ 50	$ 520	$ -	$4,355

	Six Months Ended December 31, 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	(93)	577	224	63	49	-	820
Recoveries	29	19	11	32	-	-	91
Charge-offs	(25)	(41)	(1)	(87)	-	-	(154)
Ending balance	$574	$ 1,750	$ 531	$ 70	$ 182	$ -	$3,107

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

	December 31, 2017						
	Residential Real Estate	Commercial Real Estate	Commercial and Industrial	Consumer	Purchased	Unallocated	Total
	(Dollars in thousands)						
Allowance for loan losses:							
Individually evaluated	$307	$ 163	$ 144	$ 9	$-	$ -	$623
Collectively evaluated	271	2,354	546	41	-	-	3,212
ASC 310-30	-	-	-	-	520	-	520
Total	$578	$ 2,517	$ 690	$ 50	$520	$ -	$4,355
Loans:							
Individually evaluated	$6,053	$ 3,867	$ 2,592	$ 315	$-	$ -	$12,827
Collectively evaluated	86,722	251,812	175,164	3,488	-	-	517,186
ASC 310-30	-	-	-	-	244,177	-	244,177
Total	$92,775	$ 255,679	$ 177,756	$ 3,803	$244,177	$ -	$774,190

	June 30, 2017						
	Residential Real Estate	Commercial Real Estate	Commercial and Industrial	Consumer	Purchased	Unallocated	Total
	(Dollars in thousands)						
Allowance for loan losses:							
Individually evaluated	$252	$ 147	$ 149	$ 4	$-	$ -	$552
Collectively evaluated	225	2,165	371	49	-	-	2,810
ASC 310-30	-	-	-	-	303	-	303
Total	$477	$ 2,312	$ 520	$ 53	$303	$ -	$3,665
Loans:							
Individually evaluated	$5,676	$ 1,759	$ 2,694	$ 296	$-	$ -	$10,425
Collectively evaluated	92,014	254,521	171,774	4,073	-	-	522,382
ASC 310-30	-	-	-	-	246,388	-	246,388
Total	$97,690	$ 256,280	$ 174,468	$ 4,369	$246,388	$ -	$779,195

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

	December 31, 2017			June 30, 2017		
	Recorded	Unpaid Principal	Related	Recorded	Unpaid Principal	Related

	InvestmenBalance		Allowance	InvestmenBalance		Allowance
	(Dollars in thousands)					
Impaired loans without a valuation allowance:						
Originated:						
Residential real estate	$3,848	$3,840	$ -	$4,052	$4,084	$ -
Consumer	276	303	-	250	271	-
Commercial real estate	2,482	2,477	-	359	354	-
Commercial and industrial	1,758	1,758	-	1,870	1,870	-
Purchased:						
Residential real estate	54	54	-	1,056	1,099	-
Commercial real estate	10,589	13,408	-	8,696	11,468	-
Commercial and industrial	24	57	-	32	65	-
Total	19,031	21,897	-	16,315	19,211	-
Impaired loans with a valuation allowance:						
Originated:						
Residential real estate	2,205	2,186	307	1,624	1,595	252
Consumer	39	41	9	46	55	4
Commercial real estate	1,385	1,374	163	1,400	1,388	147
Commercial and industrial	834	834	144	824	824	149
Purchased:						
Residential real estate	166	180	4	-	-	-
Commercial real estate	4,676	5,102	190	3,528	3,929	176
Commercial and industrial	362	421	321	94	108	55
Total	9,667	10,138	1,138	7,516	7,899	783
Total impaired loans	$28,698	$32,035	$ 1,138	$23,831	$27,110	$ 783

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

	Three Months Ended December 31,			
	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	$3,992	$ 38	$3,730	$ 62
Consumer	285	7	200	8
Commercial real estate	2,454	1	466	15
Commercial and industrial	1,794	2	1,080	33
Purchased:				
Residential real estate	566	-	1,087	-
Commercial real estate	9,814	102	4,705	47
Commercial and industrial	26	-	32	-
Total	18,931	150	11,300	165
Impaired loans with a valuation allowance:				
Originated:				
Residential real estate	1,904	42	1,952	73
Consumer	32	1	93	2
Commercial real estate	1,388	27	1,115	31
Commercial and industrial	850	2	504	12
Purchased:				
Residential real estate	83	1	-	-
Commercial real estate	4,108	38	1,423	7
Commercial and industrial	228	3	28	2
Total	8,593	114	5,115	127
Total impaired loans	$27,524	$ 264	$16,415	$ 292

	Six Months Ended December 31,			
	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	$4,012	$ 74	$3,550	$ 111
Consumer	273	13	219	11
Commercial real estate	1,756	94	461	23
Commercial and industrial	1,819	39	725	36

Purchased:				
Residential real estate	729	-	1,100	3
Commercial real estate	9,441	182	4,661	99
Commercial and industrial	28	-	21	-
Total	18,058	402	10,737	283
Impaired loans with a valuation allowance:				
Originated:				
Residential real estate	1,811	63	1,917	89
Consumer	36	2	97	4
Commercial real estate	1,392	49	1,155	49
Commercial and industrial	841	6	336	12
Purchased:				
Residential real estate	55	1	-	-
Commercial real estate	3,915	65	1,443	24
Commercial and industrial	183	3	19	2
Total	8,233	189	4,967	180
Total impaired loans	$26,291	$ 591	$15,704	$ 463

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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.

	December 31, 2017				
	Originated Portfolio				
	Commercial Real Estate	Commercial and Industrial	Residential[1]	Purchased Portfolio	Total
	(Dollars in thousands)				
Loans rated 1- 6	$248,576	$ 174,482	$ 13,754	$231,544	$668,356
Loans rated 7	4,537	2,186	66	3,021	9,810
Loans rated 8	2,566	1,088	1,298	9,612	14,564
Loans rated 9	-	-	19	-	19
Loans rated 10	-	-	-	-	-
	$255,679	$ 177,756	$ 15,137	$244,177	$692,749

	June 30, 2017				
	Originated Portfolio				
	Commercial Real Estate	Commercial and Industrial	Residential[1]	Purchased Portfolio	Total
	(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	-	-	-	-	-
	$256,281	$ 174,468	$ 10,932	$246,388	$688,069

(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.

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Troubled Debt Restructurings

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

	Three Months Ended December 31,				Six Months Ended December 31,			
	2017		2016		2017		2016	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
	(Dollars in thousands)							
Extended maturity	-	$ -	1	$ 154	1	$ 18	1	$ 154
Adjusted interest rate	1	15	2	135	1	15	3	144
Rate and maturity	3	2,263	-	-	3	2,263	1	334
Principal deferment	2	283	1	161	3	938	1	161
Court ordered concession	-	-	-	-	-	-	-	-
	6	$ 2,561	4	$ 450	8	$ 3,234	6	$ 793

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

	Three Months Ended December 31,					
	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	2	$ 29	$ 30	3	$ 266	$ 289
Home equity	-	-	-	-	-	-
Commercial real estate	2	2,079	2,140	-	-	-
Commercial and industrial	-	-	-	1	91	161
Consumer	-	-	-	-	-	-
Total originated portfolio	4	2,108	2,170	4	357	450
Purchased portfolio:						
Residential real estate	-	-	-	-	-	-
Commercial real estate	1	123	123	-	-	-
Commercial and industrial	1	268	268	-	-	-
Total purchased portfolio	2	391	391	-	-	-
Total	6	$ 2,499	$ 2,561	4	$ 357	$ 450

	Six Months Ended December 31,							
	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	3	$	47	$ 48	4	$	275	$ 298
Home equity	-		-	-	-		-	-
Commercial real estate	2		2,079	2,140	-		-	-
Commercial and industrial	1		655	655	1		91	161
Consumer	-		-	-	-		-	-
Total originated portfolio	6		2,781	2,843	5		366	459
Purchased portfolio:								
Residential real estate	-		-	-	-		-	-
Commercial real estate	1		123	123	-		-	-
Commercial and industrial	1		268	268	1		334	334
Total purchased portfolio	2		391	391	1		334	334
Total	8	$	3,172	$ 3,234	6	$	700	$ 793

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 and six months ended December 31, 2017. As of December 31, 2016 and 2017, there were no further commitments to lend to borrowers associated with loans modified in a TDR.

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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 December 31, 2017	Three Months Ended December 31, 2016
	(Dollars in thousands)	
Contractually required payments receivable	$49,408	$68,466
Nonaccretable difference	(1,667)	(977)
Cash flows expected to be collected	47,741	67,489
Accretable yield	(12,939)	(21,456)
Fair value of loans acquired	$34,802	$46,033

	Six Months Ended December 31, 2017	Six Months Ended December 31, 2016
	(Dollars in thousands)	
Contractually required payments receivable	$55,320	$94,720
Nonaccretable difference	(1,824)	(3,494)
Cash flows expected to be collected	53,496	91,226
Accretable yield	(15,043)	(31,340)
Fair value of loans acquired	$38,453	$59,886

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

	As of and for the Three	As of and for the Six

	Months Ended December 31, 2017	Months Ended December 31, 2017
	(Dollars in thousands)	
Loans acquired during the period	$5	$ 5
Loans at end of period	6,901	6,901

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

	Three Months Ended December 31, 2017	Three Months Ended December 31, 2016
	(Dollars in thousands)	
Beginning balance	$122,923	$124,023
Acquisitions	12,939	21,456
Accretion	(4,244)	(4,656)
Reclassifications from non-accretable difference to accretable yield	1,095	973
Disposals and other changes	(7,810)	(13,373)
Ending balance	$124,903	$128,423

	Six Months Ended December 31, 2017	Six Months Ended December 31, 2016
	(Dollars in thousands)	
Beginning balance	$131,197	$124,151
Acquisitions	15,043	31,340
Accretion	(8,669)	(9,308)
Reclassifications from non-accretable difference to accretable yield	4,523	1,131
Disposals and other changes	(17,191)	(18,891)
Ending balance	$124,903	$128,423

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

	December 31, 2017	June 30, 2017
	(Dollars in thousands)	
Unpaid principal balance	$266,374	$271,709
Carrying amount	236,047	239,583

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5. Transfers and Servicing of Financial Assets

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

Capitalized servicing rights as of December 31, 2017 totaled $3.0 million, compared to $2.8 million as of June 30, 2017, and are classified as loan servicing rights, net, on the consolidated balance sheets.

Mortgage loans sold in the quarter ended December 31, 2017 totaled $17.6 million, compared to $17.7 million in the quarter ended December 31, 2016. Mortgage loans sold in the six months ended December 31, 2017 totaled $36.7 million, compared to $42.7 million in the six months ended December 31, 2016. Mortgage loans serviced for others totaled $9.3 million at December 31, 2017 and $10.7 million at June 30, 2017. Additionally, the Company was servicing commercial loans participated out to various other institutions amounting to $29.3 million and $25.2 million at December 31, 2017 and June 30, 2017, respectively.

SBA loans sold during the quarter ended December 31, 2017 totaled $3.4 million, compared to $17.5 million in the quarter ended December 31, 2016. SBA loans sold in the six months ended December 31, 2017 totaled $12.5 million, compared to $24.8 million in the six months ended December 31, 2016. SBA loans serviced for others totaled $146.8 million at December 31, 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 on the accompanying consolidated balance sheets. The risks inherent in mortgage servicing assets and SBA servicing assets relate primarily to changes in prepayments that result from shifts in interest rates.

Contractually specified servicing fees were $234 thousand and $248 thousand for the quarters ended December 31, 2017 and 2016, respectively, and were included as a component of loan-related fees within noninterest income. Contractually specified servicing fees were $497 thousand and $408 thousand for the six months ended December 31, 2017 and 2016, respectively.

The significant assumptions used in the valuation of the servicing rights included a range of discount rates from 9.6% to 15.8% and a weighted average prepayment speed assumption of 8.8%.

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 December 31,		Six months Ended December 31,	
	2017	2016	2017	2016
	(In thousands, except share and per share data)			
Net income	$3,304	$3,100	$7,890	$4,851
Weighted average shares used in calculation of basic EPS	8,924,495	8,831,235	8,883,003	8,968,690
Incremental shares from assumed exercise of dilutive securities	243,589	33,383	246,007	30,372
Weighted average shares used in calculation of diluted EPS	9,168,084	8,864,618	9,129,010	8,999,062
Basic earnings per common share	$0.37	$0.35	$0.89	$0.54
Diluted earnings per common share	$0.36	$0.35	$0.86	$0.54

For the three and six months ended December 31, 2017 and 2016, the following stock options were excluded from the calculation of diluted EPS due to the exercise price of these options exceeding the average market price of the Company’s common stock for the period. These options, which were not dilutive at that date, may potentially dilute EPS in the future.

	Three Months Ended December 31,		Six Months Ended December 31,	
	2017	2016	2017	2016
Stock options	-	714,545	-	714,545

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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 December 31, 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.

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

December 31, 2017

Notional Amount	Inception Date	Termination Date	Index	Receive Rate	Pay Rate	Strike Rate	Unrealized Loss	Fair Value	Balance Sheet Location
(Dollars in thousands)									
Interest rate swaps:									
$5,000	July 2013	July 2033	3 Mo. LIBOR	1.69 %	3.38%	n/a	$ (619)	$(619)	Other Liabilities
5,000	July 2013	July 2028	3 Mo. LIBOR	1.69 %	3.23%	n/a	(409)	(409)	Other Liabilities
5,000	July 2013	July 2023	3 Mo. LIBOR	1.69 %	2.77%	n/a	(144)	(144)	Other Liabilities
Interest rate caps:									
6,000	October 2014	September 2019	3 Mo. LIBOR	n/a	n/a	2.50 %	(116)	4	Other Assets
10,000	March 2015	February 2020	3 Mo. LIBOR	n/a	n/a	2.50 %	(165)	13	Other Assets
$31,000							$ (1,453)	$(1,155)	

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)									
Interest rate swaps:									
$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
Interest rate caps:									
6,000	October 2014	September 2019	3 Mo. LIBOR	n/a	n/a	2.50 %	(142)	4	Other Assets
10,000	March 2015	February 2020	3 Mo. LIBOR	n/a	n/a	2.50 %	(186)	14	Other Assets
$31,000							$ (1,683)	$(1,337)	

During the three and six months ended December 31, 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 and six months ended December 31, 2017 and 2016 related to the balance sheet hedging of variable rate debt indicates that the hedges were effective.

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8. Other Comprehensive Income

The components of other comprehensive income are as follows:

	Three Months Ended December 31,					
	2017			2016		
	Pre-tax Amount	Tax Expense (Benefit)	After-tax Amount	Pre-tax Amount	Tax Expense (Benefit)	After-tax Amount
	(Dollars in thousands)					
Change in net unrealized loss on available-for-sale securities	$(297)	$ (113)	$ (184)	$(1,336)	$ (507)	$ (829)
Change in accumulated loss on effective cash flow hedges	160	60	100	1,486	566	920
Reclassification adjustment for losses included in net income	26	10	16	8	3	5
Total derivatives and hedging activities	186	70	116	1,494	569	925
Total other comprehensive (loss) income	$(111)	$ (43)	$ (68)	$158	$ 62	$ 96

	Six Months Ended December 31,					
	2017			2016		
	Pre-tax Amount	Tax Expense (Benefit)	After-tax Amount	Pre-tax Amount	Tax Expense (Benefit)	After-tax Amount
	(Dollars in thousands)					
Change in net unrealized gain or loss on available-for-sale securities	$(175)	$ (68)	$ (107)	$(1,414)	$ (537)	$ (877)
Change in accumulated loss on effective cash flow hedges	181	68	113	1,633	624	1,009
Reclassification adjustment for losses included in net income	49	19	30	14	5	9
Total derivatives and hedging activities	230	87	143	1,647	629	1,018
Total other comprehensive income	$55	$ 19	$ 36	$233	$ 92	$ 141

Accumulated other comprehensive loss is comprised of the following:

	December 31, 2017	June 30, 2017

	(Dollars in thousands)	
Unrealized loss on available-for-sale securities	$(1,123)	$(948)
Tax effect	428	360
After tax amount	(695)	(588)
Unrealized loss on cash flow hedges	(1,453)	(1,683)
Tax effect	552	639
After tax amount	(901)	(1,044)
Accumulated other comprehensive loss	$(1,596)	$(1,632)

9. Commitments and Contingencies

Commitments

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

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

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

	December 31, 2017	June 30, 2017
	(Dollars in thousands)	
Commitments to grant loans	$40,537	$15,244
Unfunded commitments under lines of credit	33,757	31,858
Standby letters of credit	3,460	3,400
Commitment to fund investments	-	1,000

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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 $79 thousand and $39 thousand recorded in other liabilities at December 31, 2017 and June 30, 2017, respectively.

As of December 31, 2017, the Company does not have a commitment to fund 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 six months ended December 31, 2017, in totality, the adoption of ASU 2016-09 reduced the Company's income tax expense by $1.1 million. 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 consolidated 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 consolidated financial statements upon adoption.

11. Income Taxes

On December 22, 2017, President Donald Trump signed into law the "Tax Cuts and Jobs Act", which among other items reduces the federal corporate tax rate to 21% from the previous federal corporate tax rate of 35%. The change in federal tax rate resulted in a $762 thousand decrease in federal income tax expense during the quarter ended December 31, 2017. Of this total, $328 thousand was related to the decrease in the federal corporate income tax rate for the three months ended December 31, 2017 and $434 thousand was related to income tax expense previously recorded in the three months ended September 30, 2017, to arrive at the required blended federal corporate income tax rate of 28.0% for fiscal 2018.

The change in the federal corporate tax rate also required the Company to revalue its deferred tax assets at the new federal rate. The Company performed an analysis to determine the impact of the revaluation of the deferred tax asset, which included a forecast of the expected deferred tax asset as of June 30, 2018. The result was a write-down of the deferred tax asset of $498 thousand, which increased federal income tax expense in the quarter ended December 31, 2017.

Included in the deferred tax asset was the revaluation of the tax on the available-for-sale securities, interest rate swaps and interest rate caps. Currently, the effect of the revaluation is an adjustment to the income tax provision and would remain in accumulated other comprehensive income (“AOCI”) until the investments either mature or are sold or the interest rate swaps and caps mature or are terminated. The FASB is currently contemplating whether this “stranded” AOCI should be reclassified to retained earnings. Pending a ruling by the FASB on the financial reporting effects of the Tax Cuts and Jobs Act, the Company left the “stranded” AOCI in AOCI, and, if required, will reclassify the amount when the final ruling is announced. The effect would be a reclassification of $283 thousand from AOCI to retained earnings, with no net effect on shareholders' equity.

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12. 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 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.

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

Loans - Fair values are estimated for portfolios of loans with similar financial characteristics. The fair value of performing loans is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan. The estimates of maturity are based on the Company’s historical experience with repayments for