First Bancorp, Inc /ME/
Form 10-K
March 10, 2017

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K

[X] Annual Report Pursuant to Section 13 or 15(d) of The Securities Exchange Act of 1934
For the Fiscal Year ended December 31, 2016

Commission File Number 0-26589

THE FIRST BANCORP, INC.
(Exact name of Registrant as specified in its charter)

MAINE	01-0404322
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
MAIN STREET, DAMARISCOTTA, MAINE 04543	
(Address of principal executive offices) (Zip code)	

(207) 563-3195
Registrant's telephone number, including area code

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

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

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

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

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).
Yes [_]   No [X]

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter.
Common Stock: $217,289,000

Indicate the number of shares outstanding of each of the registrant's classes of common stock as of March 1, 2017
Common Stock: 10,815,445 shares

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ITEM 1. Discussion of Business

The First Bancorp, Inc. (the "Company") was incorporated under the laws of the State of Maine on January 15, 1985, for the purpose of becoming the parent holding company of The First National Bank of Damariscotta, which was chartered as a national bank under the laws of the United States on May 30, 1864. At the Company's Annual Meeting of Shareholders on April 30, 2008, the Company's name was changed from First National Lincoln Corporation to The First Bancorp, Inc.

On January 14, 2005, the acquisition of FNB Bankshares ("FNB") of Bar Harbor, Maine, was completed, adding seven banking offices and one investment management office in Hancock and Washington counties of Maine. FNB's subsidiary, The First National Bank of Bar Harbor, was merged into The First National Bank of Damariscotta at closing, and from January 31, 2005, until January 28, 2016, the combined banks operated under the name: The First, N.A. On January 28, 2016, the Board of Directors voted to change the Bank's name to First National Bank (the "Bank").

On October 26, 2012, the Bank completed the purchase of a branch at 63 Union Street in Rockland, Maine, from Camden National Bank "Camden National". The branch is one of 15 Maine branches Camden National acquired from Bank of America, and this branch was divested by Camden National to resolve competitive concerns in that market raised by the U.S. Department of Justice's Antitrust Division. As part of the transaction, the Bank acquired approximately $32.3 million in deposits as well as a small volume of loans. On the same date, the Bank completed the purchase of a full-service bank building at 145 Exchange Street in Bangor, Maine, also from Camden National, and opened a full-service branch in this building in February of 2013. The total value of the transaction was $6.6 million, which included the premises and equipment for the two locations, the premium paid for the Rockland deposits, a small amount of loans, plus core deposit intangible and goodwill.

As of December 31, 2016, the Company's securities consisted of one class of common stock. At that date, there were 10,793,946 shares of common stock outstanding. On January 9, 2009, the Company issued $25,000,000 in Fixed Rate Cumulative Perpetual Preferred Stock, Series A, having a liquidation preference of $1,000 per share, to the U.S. Treasury under the Capital Purchase Program ("the CPP Shares"). As of May 8, 2013, the Company had repurchased all of the CPP Shares. Incident to such issuance of the CPP Shares, the Company issued to the Treasury warrants (the "Warrants") to purchase up to 225,904 shares of the Company's common stock at a price per share of $16.60 (subject to adjustment). The Warrants (and any shares of common stock issuable pursuant to the Warrants) are freely transferable by Treasury to third parties. The Warrants have a term of ten years and could be exercised by Treasury or a subsequent holder at any time or from time to time during their term. To the extent they had not previously been exercised, the Warrants will expire after ten years. The Warrants were unchanged as a result of the CPP Shares repurchase transactions.

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

The common stock of the Bank is the principal asset of the Company, which has no other subsidiaries. The Bank's capital stock consists of one class of common stock of which 290,069 shares, par value $2.50 per share, are authorized and outstanding. All of the Bank's common stock is owned by the Company.

The Bank emphasizes personal service, and its customers are primarily small businesses and individuals to whom the Bank offers a wide variety of services, including deposit accounts and consumer, commercial and mortgage loans. The Bank has not made any material changes in its mode of conducting business during the past five years. The banking business in the Bank's market area is seasonal with lower deposits in the winter and spring and higher deposits in the summer and fall. This swing is predictable and has not had a materially adverse effect on the Bank.

In addition to traditional banking services, the Company provides investment management and private banking services through First Advisors, which is an operating division of the Bank. First Advisors is focused on taking advantage of opportunities created as the larger banks have altered their personal service commitment to clients not meeting established account criteria. First Advisors is able to offer a comprehensive array of private banking, financial

planning, investment management and trust services to individuals, businesses, non-profit organizations and municipalities of varying asset size, and to provide the highest level of personal service. The staff includes investment and trust professionals with extensive experience.

The financial services landscape has changed considerably over the past five years in the Bank's primary market area. Two large out-of-state banks have continued to experience local change as a result of mergers and acquisitions at the regional and national level. Credit unions have continued to expand their membership and the scope of banking services offered. Non-banking entities such as brokerage houses, mortgage companies and insurance companies are offering very competitive products. Many of these entities and institutions have resources substantially greater than those available to the Bank and are not subject to the same regulatory restrictions as the Company and the Bank.

The Company believes that there will continue to be a need for a bank in the Bank's primary market area with local management having decision-making power and emphasizing loans to small and medium-sized businesses and to individuals. The Bank has concentrated on extending business loans to such customers in the Bank's primary market area and to extending investment and trust services to clients with accounts of all sizes. The Bank's Management also makes decisions based upon, among other things, the knowledge of the Bank's employees regarding the communities and customers in the Bank's primary market area. The individuals employed by the Bank, to a large extent, reside near the branch offices and thus are generally

familiar with their communities and customers. This is important in local decision-making and allows the Bank to respond to customer questions and concerns on a timely basis and fosters quality customer service.
The Bank has worked and will continue to work to position itself to be competitive in its market area. The Bank's ability to make decisions close to the marketplace, Management's commitment to providing quality banking products, the caliber of the professional staff, and the community involvement of the Bank's employees are all factors affecting the Bank's ability to be competitive.

Supervision and Regulation

The Company is a financial holding company within the meaning of the Bank Holding Company Act of 1956, as amended (the "BHC Act"), and section 225.82 of Regulation Y issued by the Board of Governors of the Federal Reserve System (the "Federal Reserve Board" or "FRB"), and is required to file with the Federal Reserve Board an annual report and other information required pursuant to the BHC Act. The Company is subject to examination by the Federal Reserve Board. Virtually all of the Company's cash revenues are generally derived from dividends paid to the Company by the Bank. These dividends are subject to various legal and regulatory restrictions which are summarized in Note 18 to the accompanying financial statements. The Bank is regulated by the Office of the Comptroller of the Currency (the "OCC") and is subject to the provisions of the National Bank Act. As a result, it must meet certain liquidity and capital requirements, which are discussed in the following sections.

General
As a financial holding company, the Company is subject to regulation under the BHC Act and to inspection, examination and supervision by its primary regulator, the FRB. The Company is also subject to the disclosure and regulatory requirements of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, both as administered by the Securities and Exchange Commission (the "SEC"). As a company with securities listed on the NASDAQ, the Company is subject to the rules of the NASDAQ for listed companies. The Bank is subject to regulation and examination primarily by the OCC and is subject to regulations of the Federal Deposit Insurance Corporation (the "FDIC").

Bank Holding Company Activities
As a bank holding company ("BHC") that has elected to become a financial holding company pursuant to the BHC Act, we may affiliate with securities firms and insurance companies and engage in other activities that are financial in nature or incidental or complementary to activities that are financial in nature. "Financial in nature" activities include securities underwriting, dealing and market making; sponsoring mutual funds and investment companies; insurance underwriting and agency; merchant banking; and activities that the FRB, in consultation with the Secretary of the U.S. Treasury, determines to be financial in nature or incidental to such financial activity. "Complementary activities" are activities that the FRB determines upon application to be complementary to a financial activity and do not pose a safety and soundness risk.
FRB approval is not generally required for us to acquire a company (other than a bank holding company, bank or savings association) engaged in activities that are financial in nature or incidental to activities that are financial in nature, as determined by the FRB. Prior notice to the FRB may be required, however, if the company to be acquired has total consolidated assets of $10 billion or more. Prior FRB approval is required before we may acquire the beneficial ownership or control of more than 5% of the voting shares or substantially all of the assets of a bank holding company, bank or savings association.
Because we are a financial holding company, if the Bank receives a rating under the Community Reinvestment Act of 1977, as amended (the "CRA"), of less than satisfactory, the Bank and/or the Company will be prohibited, until the rating is raised to satisfactory or better, from engaging in new activities or acquiring companies other than bank holding companies, banks or savings associations, except that we could engage in new activities, or acquire companies engaged in activities, that are closely related to banking under the BHC Act. In addition, if the FRB finds that the Bank is not well capitalized or well managed, we would be required to enter into an agreement with the FRB to comply with all applicable capital and management requirements and which may contain additional limitations or

conditions. Until corrected, we could be prohibited from engaging in any new activity or acquiring companies engaged in activities that are not closely related to banking under the BHC Act without prior FRB approval. If we fail to correct any such condition within a prescribed period, the FRB could order us to divest our banking subsidiaries or, in the alternative, to cease engaging in activities other than those closely related to banking under the BHC Act.

In determining whether to approve a proposed bank acquisition, federal bank regulators will consider, among other factors, the effect of the acquisition on competition, financial condition, and future prospects including current and projected capital ratios and levels, the competence, experience, and integrity of management and record of compliance with laws and regulations, the convenience and needs of the communities to be served, including the acquiring institution's record of compliance under the CRA, the effectiveness of the acquiring institution in combating money laundering activities and the risk to the stability of the United States banking system.

The Company is a legal entity separate and distinct from the Bank. The primary source of funds to pay dividends on our common stock is dividends from the Bank. Various federal and state statutory provisions and regulations limit the amount of dividends the Bank may pay without regulatory approval. Federal bank regulatory agencies have the authority to prohibit the Bank from engaging in unsafe or unsound practices in conducting its business. The payment of dividends, depending on the

financial condition of the Bank, could be deemed an unsafe or unsound practice. The ability of the Bank to pay dividends in the future is currently, and could be further, influenced by bank regulatory policies and capital guidelines.
The Bank is subject to restrictions under federal law that limit the transfer of funds or other items of value from a subsidiary to the Company and any nonbank subsidiaries (including affiliates) in so-called "covered transactions." In general, covered transactions include loans and other extensions of credit, investments and asset purchases, as well as certain other transactions involving the transfer of value from a subsidiary bank to an affiliate or for the benefit of an affiliate. Unless an exemption applies, covered transactions by a subsidiary bank with a single affiliate are limited to 10% of the subsidiary bank's capital and surplus and, with respect to all covered transactions with affiliates in the aggregate, to 20% of the subsidiary bank's capital and surplus. Also, loans and extensions of credit to affiliates generally are required to be secured by qualifying collateral. A bank's transactions with its nonbank affiliates are also generally required to be on arm's-length terms.
The FRB has a policy that a BHC is expected to act as a source of financial and managerial strength to each of its subsidiary banks and, under appropriate circumstances, to commit resources to support each such subsidiary bank. This support may be required at times when the BHC may not have the resources to provide the support. The OCC may order an assessment of the BHC if the capital of one of its national bank subsidiaries were to become impaired. If the BHC failed to pay the assessment within three months, the OCC could order the sale of the BHC's holdings of stock in the national bank to cover the deficiency.
In the event of the "liquidation or other resolution" of an insured depository institution, the claims of deposits payable in the United States (including the claims of the FDIC as subrogee of insured depositors) and certain claims for administrative expenses of the FDIC as a receiver will have priority over other general unsecured claims against the institution. If an insured depository institution fails, claims of insured and uninsured U.S. depositors, along with claims of the FDIC, will have priority in payment ahead of unsecured creditors, including the BHC, and depositors whose deposits are solely payable at such insured depository institution's non-U.S. offices.

Dodd-Frank Wall Street Reform and Consumer Protection Act
The Dodd-Frank Act, enacted on July 21, 2010, is resulting in broad changes to the U.S. financial system and is the most significant financial reform legislation enacted since the 1930s. Financial regulatory agencies have issued numerous rulemakings to implement its provision, but other rules have yet to be promulgated or to take effect. As a result, the ultimate impact of the Dodd-Frank Act is not yet known, but it has affected, and we expect it will continue to affect, most of our businesses in some way, either directly through regulation of specific activities or indirectly through regulation of concentration risks, capital or liquidity.
Federal regulatory agencies issued numerous other rulemakings in 2012 and 2013 to implement various other requirements of the Dodd-Frank Act. Agencies have proposed rules establishing a comprehensive framework for the regulation of derivatives, restricting banking entities from engaging in proprietary trading or owning interests in or sponsoring hedge funds or private equity funds (the "Volcker Rule"), and requiring sponsors of asset-backed securities ("ABS") to retain an ownership stake in the ABS. In November 2012, the Financial Stability Oversight Council proposed new regulations for addressing perceived risks that money market mutual funds may pose to the financial stability of the United States. Once final recommendations are issued, the SEC is required to adopt the recommendations or explain its reasons for not implementing the recommendations. Although we have analyzed these and other proposed rules, the absence of final rules and the complexity of some of the proposed rules make it difficult for the Company to estimate the financial, compliance or operational impacts of the proposals.
The Dodd-Frank Act also established the Consumer Financial Protection Bureau (the "CFPB") to ensure consumers receive clear and accurate disclosures regarding financial products and to protect consumers from hidden fees and unfair or abusive practices. The CFPB has begun exercising supervisory review of banks under its jurisdiction and has concentrated much of its initial rulemaking efforts on a variety of mortgage-related topics required under the Dodd-Frank Act, including ability-to-repay and qualified mortgage standards, mortgage servicing standards, loan originator compensation standards, high-cost mortgage requirements, appraisal and escrow standards and requirements for higher-priced mortgages. During 2017, we expect the CFPB will focus its rulemaking efforts on integrating disclosure requirements for lenders and settlement agents and expanding the scope of information lenders must report in connection with mortgage and other housing-related loan applications. In addition to the exercise of its

rulemaking authority, the CFPB is continuing its on-going examination activities with respect to a number of consumer focused businesses and financial products.

Customer Information Security

The FDIC, the OCC and other bank regulatory agencies have published guidelines (the "Guidelines") establishing standards for safeguarding nonpublic personal information about customers that implement provisions of the Gramm-Leach-Bliley Act (the "GLBA"). Among other things, the Guidelines require each financial institution, under the supervision and ongoing oversight of its Board of Directors or an appropriate committee thereof, to develop, implement and maintain a comprehensive written information security program designed to ensure the security and confidentiality of customer information, to protect against any anticipated threats or hazards to the security or integrity of such information, and to protect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any customer.

Privacy
The FDIC, the OCC and other regulatory agencies have published privacy rules pursuant to provisions of the GLBA ("Privacy Rules"). The Privacy Rules, which govern the treatment of nonpublic personal information about consumers by financial institutions, require a financial institution to provide notice to customers (and other consumers in some circumstances) about its privacy policies and practices, describe the conditions under which a financial institution may disclose nonpublic personal information to nonaffiliated third parties, and provide a method for consumers to prevent a financial institution from disclosing that information to most nonaffiliated third parties by "opting-out" of that disclosure, subject to certain exceptions.

USA Patriot Act
The USA Patriot Act of 2001, designed to deny terrorists and others the ability to obtain anonymous access to the U.S. financial system, has significant implications for depository institutions, broker-dealers and other businesses involved in the transfer of money. The USA Patriot Act, together with the implementing regulations of various federal regulatory agencies, have caused financial institutions, including the Bank, to adopt and implement additional or amend existing policies and procedures with respect to, among other things, anti-money laundering compliance, suspicious activity and currency transaction reporting, customer identity verification and customer risk analysis. The statute and its underlying regulations also permit information sharing for counter-terrorist purposes between federal law enforcement agencies and financial institutions, as well as among financial institutions, subject to certain conditions, and require the Federal Reserve Board (and other federal banking regulatory agencies) to evaluate the effectiveness of an applicant in combating money laundering activities when considering applications filed under Section 3 of the BHC Act or under the Bank Merger Act.

The Bank Secrecy Act
The Bank Secrecy Act (the "BSA") requires all financial institutions, including banks and securities broker-dealers, to, among other things, establish a risk-based system of internal controls reasonably designed to prevent money laundering and the financing of terrorism. It includes a variety of recordkeeping and reporting requirements (such as cash and suspicious activity reporting) as well as due diligence/know-your-customer documentation requirements. The Bank has established an anti-money laundering program to comply with the BSA requirements.

The Sarbanes-Oxley Act
The Sarbanes-Oxley Act of 2002 ("SOX") implements a broad range of corporate governance and accounting measures for public companies (including publicly-held bank holding companies such as the Company) designed to promote honesty and transparency in corporate America and better protect investors from the type of corporate wrongdoings that occurred at Enron and WorldCom, among other companies. SOX's principal provisions, many of which have been implemented through regulations released and policies and rules adopted by the securities exchanges in 2003 and 2004, provide for and include, among other things:

- The creation of an independent accounting oversight board;
- Auditor independence provisions which restrict non-audit services that accountants may provide to clients;
- Additional corporate governance and responsibility measures, including the requirement that the chief executive officer and chief financial officer of a public company certify financial statements;
- The forfeiture of bonuses or other incentive-based compensation and profits from the sale of an issuer's securities by directors and senior officers in the twelve-month period following initial publication of any financial statements that later require restatement;
- An increase in the oversight of, and enhancement of certain requirements relating to, audit committees of public companies and how they interact with the public company's independent auditors;
- Requirements that audit committee members must be independent and are barred from accepting consulting, advisory or other compensatory fees from the issuer;
- Requirements that companies disclose whether at least one member of the audit committee is a 'financial expert' (as such term is defined by the SEC, and if not, why not;

- Expanded disclosure requirements for corporate insiders, including accelerated reporting of stock transactions by insiders and a prohibition on insider trading during pension blackout periods;
- A prohibition on personal loans to directors and officers, except certain loans made by insured financial institutions, such as the Bank, on nonpreferential terms and in compliance with bank regulatory requirements;
- Disclosure of a code of ethics and filing a Form 8-K in the event of a change or waiver of such code; and
- A range of enhanced penalties for fraud and other violations.

The Company complies with the provisions of SOX and its underlying regulations. Management believes that such compliance efforts have strengthened the Company's overall corporate governance structure and does not expect that such compliance has to date had, or will in the future have, a material impact on the Company's results of operations or financial condition.

Capital Requirements
The OCC has established guidelines with respect to the maintenance of appropriate levels of capital by FDIC-insured banks. The Federal Reserve Board has established substantially identical guidelines with respect to the maintenance of appropriate levels of capital, on a consolidated basis, by BHCs. If a banking organization's capital levels fall below the minimum requirements established by such guidelines, a bank or BHC will be expected to develop and implement a plan acceptable to the FDIC or the Federal Reserve Board, respectively, to achieve adequate levels of capital within a reasonable period, and may be denied approval to acquire or establish additional banks or non-bank businesses, merge with other institutions or open branch facilities until such capital levels are achieved. Federal regulations require federal bank regulators to take "prompt corrective action" with respect to insured depository institutions that fail to satisfy minimum capital requirements and impose significant restrictions on such institutions. See "Prompt Corrective Action" below.

Leverage Capital Ratio
The regulations of the OCC require national banks to maintain a minimum "Leverage Capital Ratio" or "Tier 1 Capital" (as defined in the Risk-Based Capital Guidelines discussed in the following paragraphs) to Total Assets of 4.0%. Any bank experiencing or anticipating significant growth is expected to maintain capital well above the minimum levels. The Federal Reserve Board's guidelines impose substantially similar leverage capital requirements on bank holding companies on a consolidated basis. It is possible that banking regulators may increase minimum capital requirements for banks should economic conditions worsen.

Risk-Based Capital Requirements
OCC regulations also require national banks to maintain minimum capital levels as a percentage of a bank's risk-adjusted assets. A bank's qualifying total capital ("Total Capital") for this purpose may include two components: "Core" (Tier 1) Capital and "Supplementary" (Tier 2) Capital. Core Capital consists primarily of common stockholders' equity, which generally includes common stock, related surplus and retained earnings, certain non-cumulative perpetual preferred stock and related surplus, and minority interests in the equity accounts of consolidated subsidiaries, and (subject to certain limitations) mortgage servicing rights and purchased credit card relationships, less all other intangible assets (primarily goodwill). Supplementary Capital elements include, subject to certain limitations, a portion of the allowance for loan losses, perpetual preferred stock that does not qualify for inclusion in Tier 1 capital, long-term preferred stock with an original maturity of at least 20 years and related surplus, certain forms of perpetual debt and mandatory convertible securities, and certain forms of subordinated debt and intermediate-term preferred stock.
The risk-based capital rules assign the majority of a bank's balance sheet assets and the credit equivalent amounts of the bank's off-balance sheet obligations to one of four risk categories, weighted at 0%, 20%, 50% or 100%, as applicable. A small amount of assets and off-balance sheet obligations are assigned a risk weight above 100%. Applying these risk-weights to each category of the bank's balance sheet assets and to the credit equivalent amounts of the bank's off-balance sheet obligations and summing the totals results in the amount of the bank's total Risk-Adjusted Assets for purposes of the risk-based capital requirements. Risk-Adjusted Assets can either exceed or be less than reported balance sheet assets, depending on the risk profile of the banking organization. Risk-Adjusted Assets for institutions such as the Bank will generally be less than reported balance sheet assets because its retail banking activities include proportionally more residential mortgage loans, many of its investment securities have a low risk weighting and there is a relatively small volume of off-balance sheet obligations.
The risk-based capital regulations require all banks to maintain a minimum ratio of Total Capital to Risk-Adjusted Assets of 8.0%, of which at least one-half (4.0%) must be Core (Tier 1) Capital. For the purpose of calculating these ratios: (i) a banking organization's Supplementary Capital eligible for inclusion in Total Capital is limited to no more than 100% of Core Capital; and (ii) the aggregate amount of certain types of Supplementary Capital eligible for inclusion in Total Capital is further limited. For example, the regulations limit the portion of the allowance for loan losses eligible for inclusion in Total Capital to 1.25% of Risk-Adjusted Assets. The Federal Reserve Board has established substantially identical risk-based capital requirements, which are applied to bank holding companies on a

consolidated basis. The risk-based capital regulations explicitly provide for the consideration of interest rate risk in the overall evaluation of a bank's capital adequacy to ensure that banks effectively measure and monitor their interest rate risk, and that they maintain capital adequate for that risk. A bank deemed by its federal banking regulator to have excessive interest rate risk exposure may be required to maintain additional capital (that is, capital in excess of the minimum ratios discussed above). The Bank believes, based on its level of interest rate risk exposure, that this provision will not have a material adverse effect on it.

On December 31, 2016, the Company's consolidated Total and Tier 1 Risk-Based Capital Ratios were 15.69% and 14.64%, respectively, and its Leverage Capital Ratio was 8.71%. Based on the above figures and accompanying discussion, the Company exceeds all regulatory capital requirements and is considered well capitalized.

Basel III Capital Requirements

In December 2010, the Basel Committee on Bank Supervision (the "BCBS") finalized a set of international guidelines for determining regulatory capital known as "Basel III." These guidelines were developed in response to the financial crisis of 2008 and 2009 and were intended to address many of the weaknesses identified in the banking sector as contributing to the crisis including excessive leverage, inadequate and low quality capital and insufficient liquidity buffers. The Basel III guidelines will:

- raise the quality of capital as that banks will be better able to absorb losses on both a going concern basis; and
- increase the risk coverage of the capital framework, specifically for trading activities, securitizations, exposures to off-balance sheet vehicles, and counterparty credit exposures arising from derivatives;
- raise the level of minimum capital requirements;
- establish an international leverage ratio;
- develop capital buffers;
- raise standards for the supervisory review process (Pillar 2) and public disclosures (Pillar 3).

On June 2013, the U.S. banking regulators finalized rulemaking to implement the BCBS capital guidelines for U.S. banks, including, among other things:

- implement in the United States the Basel III regulatory capital reforms including those that revise the definition of capital, increase minimum capital ratios, and introduce a minimum Tier 1 common equity ratio of 4.5% and a capital conservation buffer of 2.5% (for a total minimum Tier 1 common equity ratio of 7.0%) and a potential countercyclical buffer of up to 2.5%, which would be imposed by regulators at their discretion if it is determined that a period of excessive credit growth is contributing to an increase in systemic risk;
- revise "Basel I" rules for calculating risk-weighted assets to enhance risk sensitivity;
- modify the existing Basel II advanced approaches rules for calculating risk-weighted assets to implement Basel III;
- comply with the Dodd-Frank Act provision prohibiting the reliance on external credit ratings.

The U.S. banking regulators also approved a final rule to implement changes to the market risk capital rule, which requires banking organizations with significant trading activities to adjust their capital requirements to better account for the market risks of those activities.

The Company has evaluated the impact of Basel III on its capital ratios based on our interpretation of the capital requirements, and our Tier 1 common equity ratio of 14.64% exceeded the fully phased-in minimum of ratio of 7.0% by 7.6% at December 31, 2016.

From time to time, the OCC, the FRB and the Federal Financial Institutions Examination Council (the "FFIEC") propose changes and amendments to, and issue interpretations of, risk-based capital guidelines and related reporting instructions. In addition, the FRB has closely monitored capital levels of the institutions it supervises during the ongoing financial disruption, and may require such institutions to modify capital levels based on FRB determinations. Such determinations, proposals or interpretations could, if implemented in the future, affect our reported capital ratios and net risk-adjusted assets.

Prompt Corrective Action

The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") requires, among other things, that the federal banking regulators take "prompt corrective action" with respect to, and imposes significant restrictions on, any bank that fails to satisfy its applicable minimum capital requirements. FDICIA establishes five capital categories consisting of "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized" and "critically undercapitalized." Under applicable regulations, a bank that has a Total Risk-Based Capital Ratio of 10.0% or greater, a Tier 1 Risk-Based Capital Ratio of 8.0% or greater and a Leverage Capital Ratio of 5.0% or greater, and 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, is deemed to be "well capitalized." A bank that has a Total Risk-Based Capital Ratio of 8.0% or greater, a Tier 1 Risk-Based Capital Ratio of 6.0% or greater and a Leverage Capital Ratio of 4.0% (or 3% for banks with the highest regulatory examination rating that are not experiencing or anticipating significant growth or expansion) or greater and does not meet the definition of a well-capitalized bank is considered to be "adequately capitalized." A bank that has a Total Risk-Based Capital Ratio of less than 8.0% or has a Tier 1 Risk-Based Capital Ratio that is less than 4.0%, except as noted above, or a Leverage Capital Ratio of less than

4.0% is considered "undercapitalized." A bank that has a Total Risk-Based Capital Ratio of less than 6.0%, or a Tier 1 Risk-Based Capital Ratio that is less than 3.0% or a Leverage Capital Ratio that is less than 3.0% is considered to be "significantly undercapitalized," and a bank that has a ratio of tangible equity to total assets equal to or less than 2% is deemed to be "critically undercapitalized." A bank may be deemed to be in a capital category lower than is indicated by its actual capital position if it is determined to be in an unsafe or unsound condition or receives an unsatisfactory examination rating. FDICIA generally prohibits a bank from making capital distributions (including payment of dividends) or paying management fees to controlling stockholders or their affiliates if, after such payment, the bank would be undercapitalized.

Under FDICIA and the applicable implementing regulations, an undercapitalized bank will be (i) subject to increased monitoring by its primary federal banking regulator; (ii) required to submit to its primary federal banking regulator an acceptable capital restoration plan (guaranteed, subject to certain limits, by the bank's holding company) within 45 days of being classified as undercapitalized; (iii) subject to strict asset growth limitations; and (iv) required to obtain prior regulatory approval for certain acquisitions, transactions not in the ordinary course of business, and entries into new lines of business. In addition to the foregoing, the primary federal banking regulator may issue a "prompt corrective action directive" to any

undercapitalized institution. Such a directive may (i) require sale or re-capitalization of the bank; (ii) impose additional restrictions on transactions between the bank and its affiliates; (iii) limit interest rates paid by the bank on deposits; (iv) limit asset growth and other activities; (v) require divestiture of subsidiaries; (vi) require replacement of directors and officers; and (vii) restrict capital distributions by the bank's parent holding company. In addition to the foregoing, a significantly undercapitalized institution may not award bonuses or increases in compensation to its senior executive officers until it has submitted an acceptable capital restoration plan and received approval from its primary federal banking regulator.

No later than 90 days after an institution becomes critically undercapitalized, the primary federal banking regulator for the institution must appoint a receiver or, with the concurrence of the FDIC, a conservator, unless the agency, with the concurrence of the FDIC, determines that the purpose of the prompt corrective action provisions would be better served by another course of action. FDICIA requires that any alternative determination be "documented" and reassessed on a periodic basis. Notwithstanding the foregoing, a receiver must be appointed after 270 days unless the appropriate federal banking agency and the FDIC certify that the institution is viable and not expected to fail.

Deposit Insurance Assessments

The Bank is a member of the Deposit Insurance Fund ("DIF") maintained by the FDIC. Through the DIF, the FDIC insures the deposits of the Bank up to prescribed limits for each depositor. The DIF was formed March 31, 2006, upon the merger of the Bank Insurance Fund and the Savings Insurance Fund in accordance with the Federal Deposit Insurance Reform Act of 2005 (the "FDIR Act"). The FDIR Act established a range of 1.15% to 1.50% within which the FDIC Board of Directors may set the Designated Reserve Ratio (the "reserve ratio" or "DRR"). The FDIR Act also granted the FDIC Board the discretion to price deposit insurance according to risk for all insured institutions regardless of the level of the reserve ratio.

In 2009, the FDIC undertook several measures in an effort to replenish the DIF. On February 27, 2009, the FDIC adopted a final rule modifying the risk-based assessment system and set new initial base assessment rates beginning April 1, 2009. Annual rates ranged from a minimum of 12 cents per $100 of domestic deposits for well-managed, well-capitalized institutions with the highest credit ratings, to 45 cents per $100 for those institutions posing the most risk to the DIF. Risk-based adjustments to the initial assessment rate could have lowered the rate to 7 cents per $100 of domestic deposits for well-managed, well-capitalized banks with the highest credit ratings or raised the rate to 77.5 cents per $100 for depository institutions posing the most risk to the DIF. On May 22, 2009, the FDIC adopted a final rule imposing a 5 basis point special assessment on each insured depository institution's assets minus Tier 1 capital as of June 30, 2009. The amount of the special assessment for any institution was limited to 10 basis points times the institution's assessment base for the second quarter 2009. On November 17, 2009, the FDIC amended its regulations to require insured institutions to prepay their estimated quarterly risk-based assessments for fourth quarter 2009, and all of 2010, 2011, 2012 and 2013. For purposes of determining the prepayment, the FDIC used the institution's assessment rate in effect on September 30, 2009. The unused portion of the prepaid assessment was refunded on June 28, 2013.

The Dodd-Frank Act gave the FDIC greater discretion to manage the DIF, raised the minimum DRR to 1.35% and removed the upper limit of the range. In October 2010, the FDIC Board adopted a Restoration Plan to ensure that the DIF reserve ratio reaches 1.35% by September 30, 2020, as required by the Dodd-Frank Act. At the same time, the FDIC Board proposed a comprehensive, long-range plan for DIF management. In December 2010, as part of the comprehensive plan, the FDIC Board adopted a final rule to set the DRR at 2%, and in February 2011, the FDIC Board approved the remainder of the comprehensive plan. The Restoration Plan eliminated a 3 basis point increase in the annual assessment rates that was to take effect January 1, 2011.

On February 7, 2011, the FDIC Board approved a final rule on assessments, dividends, assessment base and large bank pricing that took effect on April 1, 2011. To maintain the DIF, member institutions are assessed an insurance premium based on an assessment base and an assessment rate. Generally, the assessment base is an institution's average consolidated total assets minus average tangible equity. For large and highly complex institutions (those that are very large and are structurally and operationally complex or that pose unique challenges and risks in the case of failure), the assessment rate is determined by combining supervisory ratings and certain financial measures into scorecards. The score received by an institution will be converted into an assessment rate for the institution. The FDIC

retains the ability to adjust the total score of large and highly complex institutions based upon quantitative or qualitative measures not adequately captured in the scorecards.

All FDIC-insured depository institutions must also pay a quarterly assessment towards interest payments on bonds issued by the Financing Corporation, a federal corporation chartered under the authority of the Federal Housing Finance Board. The bonds (commonly referred to as FICO bonds) were issued to capitalize the Federal Savings and Loan Insurance Corporation. FDIC-insured depository institutions paid approximately 1.00 to 1.02 cents per $100 of assessable deposits during the first nine months of 2011. To coincide with Dodd-Frank Act mandated changes to the insurance assessment base, the FDIC established lower FICO assessment rates, 0.66 cents per $100 of assessment base for 2012, 0.64 cents per $100 of assessment base for 2013, 0.62 cents per $100 of assessment base for 2014 and 0.60 cents per $100 of assessment base for 2015 and on.

The FDIC may terminate a depository institution's deposit insurance upon a finding that the institution's financial condition is unsafe or unsound or that the institution has engaged in unsafe or unsound practices or has violated any applicable rule, regulation, order or condition enacted or imposed by the institution's regulatory agency. The termination of deposit insurance for the Bank could have a material adverse effect on our earnings.

Brokered Deposits and Pass-Through Deposit Insurance Limitations

Under FDICIA, a bank cannot accept brokered deposits unless it either (i) is "Well Capitalized" or (ii) is "Adequately Capitalized" and has received a written waiver from its primary federal banking regulator. For this purpose, "Well Capitalized" and "Adequately Capitalized" have the same definitions as in the Prompt Corrective Action regulations. See "Prompt Corrective Action" above. Banks that are not in the "Well Capitalized" category are subject to certain limits on the rates of interest they may offer on any deposits (whether or not obtained through a third-party deposit broker). Pass-through insurance coverage is not available in banks that do not satisfy the requirements for acceptance of brokered deposits, except that pass-through insurance coverage will be provided for employee benefit plan deposits in institutions which at the time of acceptance of the deposit meet all applicable regulatory capital requirements and send written notice to their depositors that their funds are eligible for pass-through deposit insurance. The Bank currently accepts brokered deposits.

Real Estate Lending Standards

FDICIA requires the federal bank regulatory agencies to adopt uniform real estate lending standards. The FDIC and the OCC have adopted regulations which establish supervisory limitations on Loan-to-Value ("LTV") ratios in real estate loans by FDIC-insured banks, including national banks. The regulations require banks to establish LTV ratio limitations within or below the prescribed uniform range of supervisory limits. The CFPB amended Regulation Z effective January 10, 2014 to implement Ability to Repay and Qualified Mortgage Standards for residential mortgage lending. The Bank is considered a large bank under the rule. The Bank follows the Ability to Repay rule by making a good faith determination of an applicant’s ability to repay under the terms of the transaction; loans meeting the outlined standards for Qualified Mortgages are identified as such in the Bank’s records. The CFPB further amended Regulation Z along with amending Regulation X to combine certain disclosures consumers receive when applying for and closing on a mortgage loan under the Truth in Lending Act and Real Estate Settlement Procedures Act. These amendments became effective October 3, 2015.

Standards for Safety and Soundness

Pursuant to FDICIA the federal bank regulatory agencies have prescribed, by regulation, standards and guidelines for all insured depository institutions and depository institution holding companies relating to: (i) internal controls, information systems and internal audit systems; (ii) loan documentation; (iii) credit underwriting; (iv) interest rate risk exposure; (v) asset growth; and (vi) compensation, fees and benefits. The compensation standards prohibit employment contracts, compensation or benefit arrangements, stock option plans, fee arrangements or other compensatory arrangements that would provide "excessive" compensation, fees or benefits, or that could lead to material financial loss. In addition, the federal bank regulatory agencies are required by FDICIA to prescribe standards specifying: (i) maximum classified assets to capital ratios; (ii) minimum earnings sufficient to absorb losses without impairing capital; and (iii) to the extent feasible, a minimum ratio of market value to book value for publicly-traded shares of depository institutions and depository institution holding companies.

Consumer Protection Provisions

FDICIA also includes provisions requiring advance notice to regulators and customers for any proposed branch closing and authorizing (subject to future appropriation of the necessary funds) reduced insurance assessments for institutions offering "lifeline" banking accounts or engaged in lending in distressed communities. FDICIA also includes provisions requiring depository institutions to make additional and uniform disclosures to depositors with respect to the rates of interest, fees and other terms applicable to consumer deposit accounts.

FDIC Waiver of Certain Regulatory Requirements

The FDIC issued a rule, effective on September 22, 2003, that includes a waiver provision which grants the FDIC Board of Directors extremely broad discretionary authority to waive FDIC regulatory provisions that are not specifically mandated by statute or by a separate regulation.

Future Legislation or Regulation

In light of recent conditions in the U.S. and global financial markets and the U.S. and global economy, legislators, the presidential administration and regulators have continued their increased focus on regulation of the financial services industry. Legislative changes and additional regulations have the potential to change our operating environment in substantial and unpredictable ways. Such legislation and regulations could increase our cost of doing business, affect our compensation structure, restrict or expand the activities in which we may engage or affect the competitive balance among banks, savings associations, credit unions, and other financial institutions. We cannot predict whether future legislative proposals will be enacted and, if enacted, the effect that they, or any implementing regulations, would have on our business, results of operations or financial condition.

Impact of Monetary Policy

Our business and earnings are affected significantly by the fiscal and monetary policies of the federal government and its agencies. We are particularly affected by the policies of the FRB, which regulates the supply of money and credit in the United States. Among the instruments of monetary policy available to the FRB are (a) conducting open market operations in United

States government securities, (b) changing the discount rates of borrowings of depository institutions, (c) imposing or changing reserve requirements against depository institutions' deposits, and (d) imposing or changing reserve requirements against certain borrowings by banks and their affiliates. These methods are used in varying degrees and combinations to directly affect the availability of bank loans and deposits, as well as the interest rates charged on loans and paid on deposits. The policies of the FRB may have a material effect on our business, results of operations and financial condition. The nature of future monetary policies and the effect of such policies on the future business and earnings of the Company and the Bank cannot be predicted. See Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations, regarding the Bank's net interest margin and the effect of interest rate volatility on future earnings.

Employees

At December 31, 2016, the Company had 235 employees and full-time equivalency of 218 employees. The Company enjoys good relations with its employees. A variety of employee benefits, including health, group life and disability income, a defined contribution retirement plan, and an incentive bonus plan, are available to qualifying officers and other employees.

Company Website

The Company maintains a website at www.thefirstbancorp.com where it makes available, free of charge, its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as well as all Section 16 reports on Forms 3, 4, and 5, as soon as reasonably practicable after such reports are electronically filed with, or furnished to, the SEC. The Company's reports filed with, or furnished to, the SEC are also available at the SEC's website at www.sec.gov. Information contained on the Company's website does not constitute a part of this report. Interactive reports for our 10-K and 10-Q filings are available in XBRL format at the Company's website.

ITEM 1A. Risk Factors

The risks and uncertainties described below are not the only ones the Company faces. Additional risks and uncertainties that we are unaware of, or that we currently deem immaterial, also may become important factors that affect us and our business. If any of these risks were to occur, our business, financial condition or results of operations could be materially and adversely affected.

Risk Associated With Our Business

We are subject to credit risk and may incur losses if loans are not repaid.

There are inherent risks associated with our lending activities. These risks include, among other things, the impact of changes in interest rates and changes in the economic conditions in the markets where we operate as well as those across the United States and abroad. Increases in interest rates and/or weakening economic conditions could adversely impact the ability of borrowers to repay outstanding loans or the value of the collateral securing these loans. We seek to mitigate the risks inherent in our loan portfolio by adhering to specific underwriting practices. Although we believe that our underwriting criteria are appropriate for the various kinds of loans we make, we may incur losses on loans that meet our underwriting criteria, and these losses may exceed the amounts set aside as reserves in our allowance for loan losses.

Our loan portfolio includes commercial and commercial real estate loans that may have higher risks than other types of loans.

Our commercial, commercial real estate, and commercial construction loans at December 31, 2016 and 2015 were $478.7 million and $422.7 million, or 44.7% and 42.8% of total loans, respectively. Commercial and commercial real estate loans generally carry larger loan balances and can involve a greater degree of financial and credit risk than other loans. As a result, banking regulators continue to give greater scrutiny to lenders with a high concentration of commercial real estate loans in their portfolios, and such lenders are expected to implement stricter underwriting criteria, internal controls, risk management policies and portfolio stress testing, as well as higher capital levels and loss allowances. The increased financial and credit risk associated with these types of loans are a result of several factors, including the concentration of principal in a limited number of loans and borrowers, the size of loan balances, the effects of general economic conditions on income-producing properties and the increased difficulty of evaluating and monitoring these types of loans.

Regulators have the right to require banks to maintain elevated levels of capital or liquidity due to commercial real estate loan concentrations, and could do so, especially if there is a downturn in our local real estate markets. In addition, when underwriting a commercial or industrial loan, we may take a security interest in commercial real estate, and, in some instances upon a default by the borrower, we may foreclose on and take title to the property, which may lead to potential financial risks for us under applicable environmental laws. If hazardous substances were discovered on any of these properties, we may be liable to governmental agencies or third parties for the costs of remediation of the hazard, as well as for personal injury and property damage. Many environmental laws can impose liability regardless of whether the Bank knew of, or had been responsible for, the contamination.

Furthermore, the repayment of loans secured by commercial real estate is typically dependent upon the successful operation of the related real estate or commercial project. If the cash flows from the project are reduced, a borrower's ability to repay the loan may be impaired. This cash flow shortage may result in the failure to make loan payments. In such cases, we may be compelled to modify the terms of the loan. In addition, the nature of these loans is such that they are generally less predictable and more difficult to evaluate and monitor. As a result, repayment of these loans may, to a greater extent than residential loans, be subject to adverse conditions in the real estate market or the broader economy.

Our allowance for loan losses may be insufficient and require additional provision from earnings.

The Bank maintains an allowance for loan losses based on, among other things, national and regional economic conditions, historical loss experience and delinquency trends. We make various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of borrowers and the value of the real estate and other assets serving as collateral for the repayment of loans. In determining the size of the allowance for loan losses, we rely on our experience and our evaluation of economic conditions. However, we cannot predict loan losses with certainty, and we cannot provide assurance that charge-offs in future periods will not exceed the allowance for loan losses. If, as a result of general economic conditions, previously incorrect assumptions or an increase in defaulted loans, we determine that additional increases in the allowance for loan losses are necessary, we will incur additional provision expenses. In addition, regulatory agencies review the Bank's allowance for loan losses and may require additions to the allowance based on their judgment about information available to them at the time of their examination. Management could also decide that the allowance for loan losses should be increased. If charge-offs in future periods exceed the allowance for loan losses, we will need additional provisions to increase the allowance for loan losses. Furthermore, growth in the loan portfolio would generally lead to an increase in the provision for loan losses. Any increases in the allowance for loan losses will result in a decrease in net income and capital, and may have a material adverse effect on our financial condition, results of operations and cash flows. See the section captioned "Credit Risk

Management and Allowance for Loan Losses" in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, located elsewhere in this report, for further discussion related to our process for determining the appropriate level of the allowance for loan losses.
The Maine foreclosure process can be lengthy and add additional losses for the Bank.
Residential foreclosures in Maine occur through the judicial system. Under ideal circumstances, it can take as little as six months to foreclose on a Maine property; however, if the borrower contests the foreclosure or the court delays the foreclosure, the process may take as long as two years. In 2009, the Maine Legislature passed "An Act to Preserve Home Ownership and Stabilize the Economy by Preventing Unnecessary Foreclosures." This law provides for mediation of foreclosure of residential mortgages and borrowers may choose mediation in which parties must attend mediation sessions and evaluate foreclosure alternatives in good faith. This law also provides that issues such as reinstatement of the mortgage, modification of the loan and restructuring of the mortgage debt are to be addressed at these mediations. Given the uncertain timeframe related to foreclosure in Maine, the Bank can incur additional legal fees and other costs, such as payment of property taxes and insurance, if the foreclosure process is extended. In addition, the value of the property may further decline if the borrower fails to maintain the property in good order.
Our level of troubled debt restructured ("TDR") remains elevated.
Our efforts between 2011 and 2015 to assist homeowners and other borrowers increased our overall level of TDRs. In each case when a loan was modified, Management determined it was in the Bank's best interest to work with the borrower with modified terms rather than to proceed to foreclosure. Once a loan is classified as a TDR, however, it remains classified as a TDR until the balance is fully repaid, whether or not the loan is performing under the modified terms. As of December 31, 2016 there were 71 loans with an outstanding balance of $21.5 million that have been restructured. This compares to 84 loans with a value of $23.9 million as of December 31, 2015.
As of December 31, 2016, 57 loans with an aggregate balance of $18.9 million were performing under the modified terms, five loans with an aggregate balance $876,000 were more than 30 days past due and accruing and nine loans with an aggregate balance of $1.7 million were on nonaccrual. As a percentage of aggregate outstanding balances, 87.9% were performing under the modified terms, 4.1% were more than 30 days past due and accruing and 8.0% were on nonaccrual. Although a large percentage of TDRs continue to be performing, as a group our TDRs are relatively unseasoned and the full collection of principal and interest on some TDRs may not occur, which could adversely affect our financial condition and results of operations.
Changes in interest rates could adversely affect our net interest income and profitability.
Our earnings and cash flows are largely dependent upon our net interest income. Net interest income is the difference between interest income earned on interest-earning assets, such as loans and securities, and interest expense paid on interest-bearing liabilities, such as deposits and borrowed funds. Interest rates are highly sensitive to many factors that are beyond our control, including general economic conditions, demand for loans, securities and deposits, and policies of various governmental and regulatory agencies and, in particular, the Board of Governors of the Federal Reserve System. Changes in monetary policy, including changes in interest rates, could influence not only the interest we receive on loans and securities and the amount of interest we pay on deposits and borrowings, but such changes could also affect

- our ability to originate loans and obtain deposits;
- the fair value of our financial assets and liabilities; and
- the average duration of our loans and securities that are collateralized by mortgages.

If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and other investments, our net interest income, and therefore earnings, could be adversely affected. Earnings could also be adversely affected if the interest rates received on loans and other investments fall more quickly than the interest rates paid on deposits and other borrowings. If interest rates decline, our higher-rate loans and investments may be subject to prepayment risk, which could negatively impact our net interest margin. Conversely, if interest rates increase, our loans and investments may be subject to extension risk, which could negatively impact our net interest

margin as well. Any substantial, unexpected or prolonged change in market interest rates could have a material adverse effect on our financial condition, results of operations and cash flows. See Item 7A. Quantitative and Qualitative Disclosures about Market Risk located elsewhere in this report for further discussion related to our management of interest rate risk.

The value of our investment portfolio may be negatively affected by changes in interest rates and disruptions in securities markets.

The market for some of the investment securities held in our portfolio has become volatile over the past several years. Volatile market conditions may detrimentally affect the value of these securities due to the perception of heightened credit and liquidity risks. There can be no assurance that the declines in market value associated with these disruptions will not result in other than temporary impairments of these assets, which would lead to accounting charges that could have a material adverse effect on our

net income and capital levels. Our mortgage-backed bond portfolio may be subject to extension risk as interest rates rise and borrowers are unable to refinance their current mortgages into lower rate mortgages, extending the average life of the bonds. As of December 31, 2016, we had $300.4 million and $226.8 million in available for sale and held to maturity investment securities, respectively. Numerous factors, including lack of liquidity for re-sales of certain investment securities, absence of reliable pricing information for investment securities, adverse changes in business climate, adverse actions by regulators, or unanticipated changes in the competitive environment could have a negative effect on our investment portfolio in future periods. If an impairment charge is significant enough it could affect the ability of the Bank to renew funding. This could have a material adverse effect on our liquidity and the Bank's ability to upstream dividends to the Company and for the Company to then pay dividends to shareholders. It could also negatively impact our regulatory capital ratios and result in our not being classified as "well-capitalized" for regulatory purposes.

Illiquidity could impair our ability to fund operations and jeopardize our financial condition.

Liquidity is essential to our business. An inability to raise funds through traditional deposits, brokered deposit renewals or rollovers, secured or unsecured borrowings, the sale of securities or loans and other sources could have a substantial negative effect on our liquidity. Our access to funding sources in amounts adequate to finance our activities could be impaired by factors that affect us specifically or the financial services industry or the economy in general, or could be available only under terms which are unacceptable to us. We rely primarily on commercial and retail deposits and, to a lesser extent, brokered deposit renewals and rollovers, advances from the Federal Home Loan Bank of Boston (the "FHLB") and other secured and unsecured borrowings to fund our operations. Factors that could detrimentally impact our access to liquidity sources include a decrease in the level of our business activity as a result of a downturn in the markets in which our loans are concentrated, adverse regulatory action against us, changes in market interest rates or increased competition for funding within our market. Disruptions in the capital markets or interest rate changes may make the terms of wholesale funding sources less favorable and may make it difficult to sell securities when needed to provide additional liquidity. In addition, if we fall below the FDIC's thresholds to be considered "well capitalized", we will be unable to continue to roll over or renew brokered funds, and the interest rate paid on deposits would be subject to restrictions. As a result, there is a risk that our cost of funding will increase or we will not have sufficient funds to meet our obligations when they become due.

Loss of lower-cost funding sources could lead to margin compression and decrease net interest income.

Checking and savings, NOW, and money market deposit account balances and other forms of customer deposits can decrease when customers perceive alternative investments, such as the stock market, as providing a better risk/return tradeoff. If customers move money out of bank deposits and into other investments, we could lose a relatively low-cost source of funds, increasing our funding costs and reducing our net interest income and net income. Advances from the FHLB are currently a relatively low-cost source of funding. The availability of qualified collateral on the Bank's balance sheet determines the level of advances available from FHLB and a deterioration in quality in the Bank's loan portfolio can adversely impact the availability of this source of funding, which could increase our funding costs and reduce our net interest income.

The soundness of other financial institutions could adversely affect us.

Financial institutions in particular have been subject to increased volatility and an overall loss in investor confidence. Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services companies are interrelated as a result of trading, clearing, counterparty, or other relationships. We have exposure to many different industries and counterparties, and we routinely execute transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, mutual and hedge funds, and other institutional clients. As a result, defaults by, or even rumors or questions about, one or more financial services companies, or the financial services industry generally, have led to market-wide liquidity problems and could lead to losses or defaults by us or by other institutions. In addition, many of these transactions expose us to credit risk in the event of default of our counterparty

or client. Further, our credit risk may be exacerbated when the collateral held by us cannot be realized or is liquidated at prices not sufficient to recover the full amount of the loan or derivative exposure due us. There is no assurance that any such losses would not materially and adversely affect our business, financial condition or results of operations.

Lack of loan demand may adversely impact net interest income.

Loan demand in the Bank's market area may be limited during periods of weak economic conditions. This could have the greatest impact on the commercial loan portfolio. In addition, in order to reduce the Bank's exposure to interest rate risk, the Bank may sell residential mortgages to the secondary market that have been refinanced by borrowers seeking to take advantage of lower interest rates. Should this happen, net interest income may be negatively impacted if loans are replaced by lower-yielding investment securities or if the balance sheet is allowed to shrink.

A decline in real estate values in our primary market area could adversely impact results of operations and financial condition.

Most of the Bank's lending is in Mid-Coast and Down East Maine. As a result of this geographic concentration, a significant broad-based deterioration in economic conditions in this area of Northern New England could have a material adverse impact on the quality of the Bank's loan portfolio, and could result in a decline in the demand for our products and services and, accordingly, could negatively impact our results of operations. Such a decline in economic conditions could impair borrowers' ability to pay outstanding principal and interest on loans when due and, consequently, adversely affect the cash flows of our business. The Bank's loan portfolio is largely secured by real estate collateral. A substantial portion of the real and personal property securing the loans in the Bank's portfolio is located in Mid-Coast and Down East Maine. Conditions in the real estate market in which the collateral for the Bank's loans is located strongly influence the level of the Bank's non-performing loans and results of operations.

Our investment management activities are dependent on the value of investment securities which may lead to revenue fluctuations.

First Advisors is the investment management arm of the Bank, operating under trust powers granted by the OCC in the Bank's charter. First Advisors provides trustee, investment management and custody services for individual, municipal and business clients, predominantly in the Bank's market area. First Advisors' revenues are directly tied to the asset values of the investments it manages for clients, and these may be adversely affected by a decline in the market value of these investments caused by normal fluctuations in the bond and stock markets.

We are dependent upon the services of our management team and if we are unable to retain the services of our management team, our business may suffer.

Our future success and profitability are substantially dependent upon the management and banking abilities of our senior executives. Changes in key personnel may be disruptive to our business and could have a material adverse effect on our business, financial condition and results of operations. We believe that our future results will also depend in part upon our attracting and retaining highly skilled and qualified management. Competition for the best people in most activities in which we are engaged can be intense, and we may not be able to retain or hire the people we want and/or need. In order to attract and retain qualified employees, we must compensate such employees at market levels. Typically, those levels have caused employee compensation to be our greatest expense. If we are unable to continue to attract and retain qualified employees, or do so at rates necessary to maintain our competitive position, our performance, including our competitive position, could suffer, and, in turn, have a material adverse effect on us. Although we have incentive compensation plans aimed, in part, at long-term employee retention, the unexpected loss of services of one or more of our key personnel could still occur, and such events may have a material adverse effect on us because of the loss of the employee's skills, knowledge of our market, and years of industry experience, and the difficulty of promptly finding qualified replacement personnel for our talented executives and/or relationship managers.

Other restrictions on executive compensation were imposed under the Recovery Act, the Dodd-Frank Act and other legislation or regulations. Our ability to attract and/or retain talented executives and/or relationship managers may be negatively affected by these developments or any new executive compensation limits.

Our internal control systems are inherently limited and may fail or be circumvented.

We face the risk that the design of our controls and procedures, including those intended to mitigate the risk of fraud by employees or outsiders, may prove to be inadequate or may be circumvented, thereby causing delays in detection of errors or inaccuracies in data and information. Although Management regularly reviews and updates our internal controls, disclosure controls and procedures, and corporate governance policies and procedures, the Company's systems of internal controls, disclosure controls and corporate governance policies and procedures are inherently limited. The inherent limitations of our system of internal controls include the use of judgment in decision-making that can be faulty; breakdowns can occur because of human error; and controls can be circumvented by individual acts or by collusion of two or more people. The design of any system of controls is based in part upon certain assumptions

about the likelihood of future events, and any design may not succeed in achieving its stated goals under all potential future conditions. Because of the inherent limitations of a cost-effective control system, misstatements due to error or fraud may occur and may not be detected, which may have an adverse effect on the Company's business, results of operations or financial condition. Additionally, any plans for remediation of any identified limitations may be ineffective in improving internal controls.

We continually encounter technological change that may be difficult (costly) to keep up with.

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. Our future success depends, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in our operations. Our largest competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services or be successful in

marketing these products and services to our customers. Failure to successfully keep pace with technological change affecting the financial services industry and increased costs due to efforts to keep pace with change, could have a material adverse effect on us.

We are subject to security, transactional and operational risks relating to the use of technology that could damage our reputation and our business.

We rely heavily on communications and information systems to conduct our business serving both internal and customer constituencies. Any failure, interruption or breach in security of these systems could result in failures or disruptions in our customer relationship management, general ledger, deposit, loan, and other systems. While we have in place policies and procedures, security applications and fraud mitigation applications, designed to prevent or limit the effect of the failure, interruption, fraud attacks or security breach of or affecting our information systems, there can be no assurance that any such failures, interruptions, fraud attacks or security breaches will not occur or, if they do occur, that they will be adequately addressed. Fraud attacks targeting customer-controlled devices, plastic payment card terminals, and merchant data collection points provide another source of potential loss, again through no fault of our own. The occurrence of any failures, interruptions or security breaches of information systems used to process customer transactions could damage our reputation, result in a loss of customer business, subject us to additional regulatory scrutiny, or expose us to civil litigation and possible financial liability, any of which could have a material adverse effect on our financial condition, results of operations and cash flows.

Our information systems may experience an interruption or breach in security.

We rely heavily on communications, information systems (both internal and provided by third parties) and the internet to conduct our business. Our business is dependent on our ability to process and monitor large numbers of daily transactions in compliance with legal, regulatory and internal standards and specifications. In addition, a significant portion of our operations relies heavily on the secure processing, storage and transmission of personal and confidential information, such as the personal information of our customers and clients. The risks associated with such operations may increase in the future as we continue to increase mobile payments and other internet-based product offerings and expand our internal usage of web-based products and applications.

In the event of a failure, interruption or breach of our information systems, we may be unable to avoid impact to our customers. Other U.S. financial service institutions and companies have reported breaches in the security of their websites or other systems and have experienced significant distributed denial-of-service attacks, some of which involved sophisticated and targeted attacks intended to disable or degrade service, or sabotage systems. Other potential attacks have attempted to obtain unauthorized access to confidential information or destroy data, often through the introduction of computer viruses or malware, cyberattacks and other means. To date, none of these efforts has had a material adverse effect on our business or operations. Such security attacks can originate from a wide variety of sources, including persons who are involved with organized crime or who may be linked to terrorist organizations or hostile foreign governments. Those same parties may also attempt to fraudulently induce employees, customers or other users of our systems to disclose sensitive information in order to gain access to our data or funds or those of our customers or clients. Our security systems may not be able to protect our information systems from similar attacks due to the rapid evolution and creation of sophisticated cyberattacks. We are also subject to the risk that our employees may intercept and transmit unauthorized confidential or proprietary information. An interception, misuse or mishandling of personal, confidential or proprietary information being sent to or received from a customer or third party could result in legal liability, remediation costs, regulatory action and reputational harm.

We also have risk related to data or security breaches affecting other companies. Under Federal banking regulations, if a consumer's debit card is compromised, the liability for unauthorized transactions falls primarily to the issuing financial institution, not to the consumer or the company which experienced the data or security breach. In the normal course of business the Bank issues debit cards to its customers, creating potential risk for this type of liability.

We are subject to claims and litigation that may impact our earnings and/or our reputation.

From time to time, customers, vendors or other parties may make claims and take legal action against us. Whether any particular claims and legal actions are founded or unfounded, if such claims and legal actions are not resolved in a manner favorable to us, they may result in financial liability and/or adversely affect the market perception of the Bank and its products and services. Any financial liability or reputational damage could have a material adverse effect on our business, which, in turn, could have a material adverse effect on our financial condition and results of operations. We maintain reserves for certain claims when deemed appropriate based upon our assessment that a loss is probable, consistent with applicable accounting guidance. At any given time we may have legal actions asserted against us in various stages of litigation. Resolution of a legal action can often take years. We are also involved, from time to time, in other reviews, investigations and proceedings (both formal and informal) by governmental and self-regulatory agencies regarding our business, including, among other things, accounting and operational matters, certain of which may result in adverse judgments, settlements, fines, penalties, injunctions or other relief. The number and risk of these investigations and proceedings has increased in recent years with regard to many firms in the financial services industry due to legal changes to the consumer protection laws provided for by the Dodd-Frank

Act, the creation of the CFPB, and the uncertainty as to whether federal preemption of certain state consumer laws remains intact for federally chartered financial institutions like the Bank. A weakening of federal pre-emption would potentially increase our compliance and operational costs and risks since the Bank is national bank and we would potentially face new state and local enforcement activity. There have also been a number of highly publicized cases involving fraud or misconduct by employees in the financial services industry in recent years, and we face the risk that employee misconduct could occur. It is not always possible to deter or prevent employee misconduct, and the precautions we take to prevent and detect this activity may not be effective in all cases. Any financial liability for which we have not adequately maintained reserves or insurance coverage, and/or any damage to our reputation from such claims and legal actions, could have a material adverse effect on us.

Damage to our reputation could significantly harm our businesses.

Our ability to attract and retain customers, clients, investors and highly-skilled management and employees is impacted by our reputation. Public perception of the financial services industry declined since the recent downturn in the U.S. economy. We continue to face increased public and regulatory scrutiny resulting from the financial crisis and economic downturn. Significant harm to our reputation can also arise from other sources, including employee misconduct, actual or perceived unethical behavior, litigation or regulatory outcomes, failing to deliver minimum or required standards of service and quality, compliance failures, disclosure of confidential information, and the activities of our clients, customers and counterparties, including vendors. Actions by the financial services industry generally or by certain members or individuals in the industry can also significantly adversely affect our reputation. We could also suffer significant reputational harm if we fail to properly identify and manage potential conflicts of interest. The actual or perceived failure to adequately address conflicts of interest could affect the willingness of clients to deal with us, which could adversely affect our businesses. Our actual or perceived failure to address these and other issues gives rise to reputational risk that could cause significant harm to us and our business prospects, and may have a material adverse effect on us.

Our recent results may not be indicative of our future results.

We may not be able to sustain our historical rate of growth or may not even be able to grow our business at all. In addition, our recent growth may distort some of our historical financial ratios and statistics. Various factors, such as economic conditions, regulatory and legislative considerations and competition, may also impede our ability to expand our market presence. If we experience a significant decrease in our historical rate of growth, our results of operations and financial condition may be adversely affected due to a high percentage of our operating costs being fixed expenses.

Risks Associated With Our Industry

Our business has been and may continue to be adversely affected by conditions in the financial markets and economic conditions generally and by increased regulation.

Negative developments in 2008 and 2009 in the financial services industry resulted in uncertainty in the financial markets in general and a related general economic downturn, which lasted for several years. In addition, as a consequence of the recent U.S. recession, businesses across a wide range of industries faced serious difficulties due to the decrease in consumer spending, reduced consumer confidence brought on by deflated home values, among other things, and reduced liquidity in the credit markets. Unemployment also increased significantly during that period.

As a result of these financial and economic crises, during this period, many lending institutions, including us, experienced declines in the performance of their loans, including construction, land development and land loans, commercial real estate loans and other commercial and consumer loans (see "Credit Risk Management and Allowance for Loan Losses" in ITEM 7: Management's Discussion and Analysis of Financial Condition and Results of Operations). Moreover, competition among depository institutions for core deposits and quality loans has increased significantly. As a result, bank regulatory agencies have been and are expected to continue to be very aggressive in responding to concerns and trends identified in examinations, including the issuance of formal or informal enforcement actions or orders. New legislation responding to these developments may negatively impact us by restricting our business operations, including our ability to originate or sell loans, and adversely impact our financial performance or our stock price.

In addition, further negative market developments may affect consumer confidence levels and may cause adverse changes in payment patterns, causing increases in delinquencies and default rates, which may impact our charge-offs and provision for credit losses. A worsening of these conditions would likely exacerbate the adverse effects of these difficult market conditions on us and others in the financial services industry.

Europe's debt crisis could have a material adverse effect on our business, financial condition and liquidity.

The possibility that certain European Union ("EU") member states will default on their debt obligations, or that recessionary conditions will reappear or deepen in parts of the EU, has negatively impacted economic conditions and global markets. The continued uncertainty over the outcome of international and the EU's financial support programs and the possibility that other EU member states may experience similar financial troubles could further disrupt global markets. The negative impact on economic conditions and global markets could also have a material adverse effect on our liquidity, financial condition and results of operations, or result in failure to meet regulatory requirements. Great Britain’s pending departure from the EU has continued to create additional economic uncertainty, as does the possible unwinding of the North America Free Trade Agreement.

We operate in a highly regulated environment and may be adversely affected by changes in law and regulations.

Bank holding companies and nationally chartered banks operate in a highly regulated environment and are subject to supervision and examination by various regulatory agencies. The cost of compliance with regulatory requirements may adversely affect our results of operations or financial condition. Federal and state laws and regulations govern numerous matters including: changes in the ownership or control of banks and bank holding companies; maintenance of adequate capital and the financial condition of a financial institution; permissible types, amounts and terms of extensions of credit and investments; permissible non-banking activities; the required level of reserves against deposits; and restrictions on dividend payments. These and other restrictions limit the manner in which we may conduct our business and obtain financing. If we fail to meet minimum regulatory capital guidelines and other regulatory requirements, our financial condition would be materially and adversely affected. Our failure to maintain the status of "well-capitalized" under our regulatory framework could affect the confidence of our customers in us, thus compromising our competitive position, or could cause our regulators to take corrective or other supervisory action.

The Dodd-Frank Act created a new Consumer Financial Protection Bureau, tightened capital standards and will continue to result in new laws and regulations that are expected to increase our costs of operations.

The Dodd-Frank Act is significantly changing the current bank regulatory structure and affecting the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. Many of the details and the impacts of the Dodd-Frank Act may not be known for many months or years. However, it is expected that the legislation and implementing regulations may materially increase our operating and compliance costs.

The CFPB has broad rule-making authority for a wide range of consumer protection matters that apply to all banks and savings institutions, including the authority to prohibit "unfair, deceptive or abusive" acts and practices. The CFPB's authority to prescribe rules governing the provision of consumer financial products and services could result in rules and regulations that reduce the profitability of such products or services, or impose new disclosure or substantive requirements on us that could increase the cost to us of providing such products and services. The Dodd-Frank Act also weakens the federal preemption rules that have been applicable to national banks and federal savings associations, and gives state attorneys general the ability to enforce federal consumer protection laws, which could increase our operating costs.

Effective July 21, 2011, the Dodd-Frank Act eliminated the federal prohibitions on paying interest on demand deposits, thus allowing businesses to have interest bearing checking accounts, which could result in an increase in our interest expense.

The short-term and long-term impact of changing regulatory capital requirements and new capital rules is uncertain.

In June 2013, the Federal Reserve Board finalized rules that will substantially amend the regulatory risk-based capital rules applicable to us. These rules implement the Basel III regulatory capital reforms and changes required by the Dodd-Frank Act. In addition, in a weak economic environment, bank regulators may impose capital requirements that are more stringent than those required by applicable existing regulations.

The application of more stringent capital requirements could, among other things, result in lower returns on equity, require the raising of additional capital, and result in adverse regulatory actions if we were to be unable to comply with such requirements. Furthermore, the imposition of liquidity requirements in connection with the implementation of Basel III could result in our having to lengthen the term of our funding, restructure our business models, and/or increase our holdings of liquid assets. Implementation of changes to asset risk weightings for risk based capital calculations, items included or deducted in calculating regulatory capital or additional capital conservation buffers, could result in management modifying our business strategy and could limit our ability to make distributions, including paying dividends or buying back our shares.

Significant competition in the financial services industry may impact our results.

We face substantial competition in all areas of our operations from a variety of different competitors, many of which are larger and have more financial resources than we do. We compete with other providers of financial services such as commercial and savings banks, savings and loan associations, credit unions, money market and mutual funds, mortgage companies, asset managers, insurance companies and a wide array of other local, regional and national institutions which offer financial services. Mergers between financial institutions within Maine and in neighboring states have added competitive pressure. If we are unable to compete effectively, we will lose market share and our income generated from loans, deposits, and other financial products will decline.

Risks Associated With Our Common Stock

There may not be a robust trading market for our common stock.

Although our common stock is traded on the NASDAQ Global Select market, the trading volume of the common stock has historically not been substantial. For the year ended December 31, 2016, the average monthly trading volume of our common stock was 332,085 shares, or approximately 3.08% of the average number of our outstanding common shares. Due to the limited trading volume in our common stock, the intraday spread between bid and ask prices of the shares can be quite high. There can be no assurance that a more robust, active or economical trading market for our common stock will develop. The market value and liquidity of our common stock may, as a result, be adversely affected.

The price of our common stock may fluctuate.

The price of our common stock on the NASDAQ Global Select Market constantly changes and recently, given the uncertainty in the financial markets, has fluctuated widely. We expect the market price of our common stock will continue to fluctuate. Holders of our common stock will be subject to the risk of volatility and changes in prices. Our common stock price can fluctuate as a result of many factors which are beyond our control, including:

- quarterly fluctuations in our operating and financial results;
- operating results that vary from the expectations of investors;
- changes in expectations as to our future financial performance, including financial estimates;
- events negatively impacting the financial services industry which result in a general decline for the industry;
- announcements of material developments affecting our operations or our dividend policy;
- future sales of our equity securities;

- new laws or regulations or new interpretations of existing laws or regulations applicable to our business;
- changes in accounting standards, policies, guidance, interpretations or principles;
- general domestic economic and market conditions; and
- declines in bank stock prices driven by macro-economic concerns.

In addition, recently the stock market generally has experienced extreme price and volume fluctuations, and industry factors and general economic and political conditions and events, such as economic slowdowns or recessions, interest rate changes or credit loss trends, could also cause our stock price to decrease regardless of our operating results.

The inability to receive dividends from the Bank would negatively affect our ability to pay dividends to shareholders.
The Company is a legal entity separate and distinct from the Bank. With the exception of cash raised from debt and equity issuances, we receive substantially all of our cash flow from dividends from the Bank. These dividends are the principal source of funds to pay dividends on our equity securities. Federal banking law and regulations limit the amount of dividends that the Bank can pay. For further information on the regulatory restrictions on the payment of dividends by the Bank, see "Supervision and Regulation" in Item 1. In the event the Bank is unable to pay dividends to the Company or such dividends were to be restricted or reduced, we may not be able to service debt, pay obligations or pay dividends on our equity securities. Our right to participate in a distribution of assets upon the Bank's liquidation or reorganization is subject to the prior claims of the Bank's creditors.
If we do not manage our capital position strategically, our return on equity could be lower compared to our competitors as a result of our high level of capital.
If we are unable to use strategically our excess capital, or to successfully continue capital management programs, such as stock repurchase programs or quarterly dividends to our shareholders, then our goal of generating a return on average equity that is competitive and increasing earnings per share and book value per share without assuming undue risk, could be delayed or may not be attained. Failure to achieve a competitive return on average equity might decrease investments in our common stock and might cause our common stock to trade at lower prices.
We may issue additional equity securities or engage in other transactions which dilute our book value or affect the priority of the common stock, which may adversely affect the market price of our common stock.
Our Board of Directors may determine from time to time that we need to raise additional capital by issuing additional shares of our common stock or other securities. Except pursuant to the rules of the NASDAQ Stock Market, we are not restricted from issuing additional shares of common stock, including securities that are convertible into or exchangeable for, or that represent the right to receive, common stock. Because our decision to issue securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of any future offerings, or the prices at which such offerings may be affected. Such offerings could be dilutive to common shareholders or reduce the market price of our common stock. Holders of our common stock are not entitled to preemptive rights or protection against dilution. New investors also may have rights, preferences and privileges that are senior to, and that adversely affect, our then-current common shareholders. We may attempt to increase our capital resources or, if our or the Bank's capital ratios fall below the required minimums, we could be forced to raise additional capital, by making offerings of debt or preferred equity securities, including medium-term notes, trust preferred securities, senior or subordinated notes and preferred stock. Upon liquidation, holders of our shares of preferred stock and lenders with respect to other borrowings will receive distributions of our available assets prior to the holders of our common stock. Our Board of Directors is authorized to issue one or more series of preferred stock from time to time without any action on the part of our shareholders. Our Board of Directors also has the power, without shareholder approval, to set the terms of any such series of preferred stock that may be issued, including voting rights, dividend rights and preferences over our common stock with respect to dividends or upon our dissolution, winding-up and liquidation and other terms. If we issue preferred stock in the future that has a preference over our common stock with respect to the payment of dividends or upon our liquidation, dissolution or winding up, or if we issue preferred stock with voting rights that dilute the voting power of our common stock, the rights of holders of our common stock or the market price of our common stock could be adversely affected.
Potential acquisitions may disrupt our business and dilute shareholder value.
Acquiring other banks, businesses, or branches involves various risks commonly associated with acquisitions, including:

- potential exposure to unknown or contingent liabilities of the target;
- exposure to potential asset quality issues of the target;

- difficulty and expense of integrating the operations and personnel of the target;
- potential disruption to our business;
- potential diversion of Management's time and attention;
- the possible loss of key employees and customers of the target;
- difficulty in estimating the value of the assets and liabilities of the target;
- potential changes in banking or tax laws or regulations that may affect the target.

Merger or acquisition discussions and, in some cases, negotiations may take place and future mergers or acquisitions involving cash, debt or equity securities may occur at any time. Acquisitions typically involve the payment of a premium over book and market values, and, therefore, some dilution of our tangible book value and net income per common share may occur in connection with any future transaction. Furthermore, failure to realize the expected revenue increases, cost savings, increases in geographic or product presence, and/or other projected benefits from an acquisition could have a material adverse effect on us.

ITEM 1B. Unresolved Staff Comments

None

ITEM 2. Properties

The principal office of the Company and the Bank is located in Damariscotta, Maine. The Bank operates 16 full-service banking offices in five counties in the Mid-Coast, Eastern and Down East regions of Maine:

Lincoln County	Knox County	Hancock County	Washington County
Boothbay Harbor	Camden	Bar Harbor	Eastport
Damariscotta	Rockland Park Street	Blue Hill	Calais
Waldoboro	Rockland Union Street	Ellsworth	
Wiscasset	Rockport	Northeast Harbor	Penobscot County
		Southwest Harbor	Bangor

First Advisors, the investment management and trust division of the Bank, operates from four offices in Bangor, Bar Harbor, Ellsworth and Damariscotta. The Bank also maintains Operations Centers in Damariscotta and Edgecomb. The Company owns all of its facilities except for the land on which the Ellsworth branch is located, and except for the Camden office and the Southwest Harbor drive-up facility, for which the Bank has entered into long-term leases. Management believes that the Bank's current facilities are suitable and adequate in light of its current needs and its anticipated needs over the near term.

ITEM 3. Legal Proceedings

There are no material pending legal proceedings to which the Company or the Bank is a party or to which any of its property is subject, other than routine litigation incidental to the business of the Bank. None of these proceedings is expected to have a material effect on the financial condition of the Company or of the Bank.

ITEM 4. Mine Safety Disclosures

Not applicable.

ITEM 5. Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities

The common stock of The First Bancorp, Inc., (ticker symbol FNLC) trades on the NASDAQ Global Select Market System. As of December 31, 2016, there were 10,793,946 shares outstanding and held of record by approximately 4,766 shareholders. The following table reflects the high and low prices of actual sales in each quarter of 2016 and 2015. Such quotations do not reflect retail mark-ups, mark-downs or brokers' commissions.

	2016		2015	
	High	Low	High	Low
1st Quarter	$20.50	$17.37	$18.25	$16.20
2nd Quarter	21.79	18.50	19.74	16.41
3rd Quarter	24.66	20.27	20.00	17.50
4th Quarter	33.21	22.53	22.56	18.61

The last transaction in the Company's stock on NASDAQ during 2016 was on December 31 at $33.10 per share. There are no warrants outstanding with respect to the Company's common stock and the Company has no securities outstanding which are convertible into common equity.

The ability of the Company to pay cash dividends depends on receipt of dividends from the Bank. Dividends may be declared by the Bank out of its net profits as the directors deem appropriate, subject to the limitation that the total of all dividends declared by the Bank in any calendar year may not exceed the total of its net profits of that year plus retained net profits of the preceding two years. The amount available for dividends in 2017 will be that year's net income plus $13.6 million.
The payment of dividends from the Bank to the Company may be additionally restricted if the payment of such dividends would result in the Bank failing to meet regulatory capital requirements. The Bank is also required to maintain minimum amounts of capital-to-total-risk-weighted-assets, as defined by banking regulators. At December 31, 2016, the Bank was required to have minimum Tier 1 and Tier 2 risk-based capital ratios of 6.00% and 8.00%, respectively. The Bank's actual ratios were 14.50% and 15.55%, respectively, as of December 31, 2016. The table below sets forth the cash dividends declared in the last two fiscal years:

Date Declared	Amount Per Share	Date Payable
March 19, 2015	$ 0.210	April 30, 2015
June 17, 2015	$ 0.220	July 31, 2015
September 16, 2015	$ 0.220	October 30, 2015
December 17, 2015	$ 0.220	January 29, 2016
March 24, 2016	$ 0.220	April 29, 2016
June 23, 2016	$ 0.230	July 29, 2016
September 22, 2016	$ 0.230	October 28, 2016
December 22, 2016	$ 0.230	January 31, 2017
December 22, 2016	$ 0.120	January 31, 2017

Repurchase of Shares and Use of Proceeds

During the year ended December 31, 2016, the Company repurchased 7,156 shares of common stock with payments totaling $129,000.

Unregistered Sales of Equity Securities

None

Securities Authorized for Issuance Under Equity Compensation Plans

The following table lists the amount and weighted-average exercise price of securities authorized for issuance under equity compensation plans:

	Number of securities to be issued upon exercise of outstanding options, warrants	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation

	and rights		plans (excluding securities reflected in column)
Plan category			
Equity compensation plans approved by security holders	—	$ —	291,290
Equity compensation plans not approved by security holders	—	—	—
Total	—	$ —	291,290

Performance Graph

Set forth below is a line graph comparing the five-year cumulative total return of $100.00 invested in the Company's common stock ("FNLC"), assuming reinvestment of all cash dividends and retention of all stock dividends, with a comparable amount invested in the Standard & Poor's 500 Index ("S&P 500") and the NASDAQ Combined Bank Index ("NASD Bank"). The NASD Bank index is a capitalization-weighted index designed to measure the performance of all NASDAQ stocks in the banking sector.

	2011	2012		2013		2014		2015		2016
FNLC	100.00	102.79	111.15	115.51	138.20	127.81	108.13	149.75	124.90	252.75
S&P 500	100.00	102.11	117.48	118.44	180.40	156.79	115.06	158.95	136.28	177.94
NASD Bank	100.00	89.50	102.16	106.23	171.85	150.55	114.15	163.86	121.26	226.08

ITEM 6. Selected Financial Data
The First Bancorp, Inc. and Subsidiary

Dollars in thousands, except for per share amounts	Years ended December 31, 2016	2015	2014	2013	2012
Summary of Operations					
Interest Income	$53,759	$50,810	$51,022	$49,936	$51,825
Interest Expense	10,812	9,874	11,425	12,496	12,938
Net Interest Income	42,947	40,936	39,597	37,440	38,887
Provision for Loan Losses	1,600	1,550	1,150	4,200	7,835
Non-Interest Income	12,499	12,230	11,048	12,087	11,278
Non-Interest Expense	29,383	29,896	30,220	28,937	26,271
Net Income	18,009	16,206	14,709	12,965	12,688
Per Common Share Data					
Basic Earnings per Share	$1.68	$1.52	$1.38	$1.20	$1.22
Diluted Earnings per Share	1.66	1.51	1.37	1.20	1.22
Cash Dividends Declared per Common Share	1.030	0.870	0.830	0.785	0.780
Book Value per Common Share	15.98	15.58	15.06	13.69	14.60
Tangible Book Value per Common Share	13.20	12.78	12.25	10.83	14.47
Market Value per Common Share	33.10	20.47	18.09	17.42	16.47
Financial Ratios					
Return on Average Equity[1]	10.28%	9.74%	9.34%	8.72%	8.84%
Return on Average Tangible Equity[1,2]	12.42%	11.90%	11.57%	10.66%	10.40%
Return on Average Assets[1]	1.12%	1.07%	0.99%	0.90%	0.89%
Average Equity to Average Assets	10.86%	11.00%	10.63%	10.62%	10.96%
Average Tangible Equity to Average Assets[2]	9.00%	9.01%	8.58%	8.49%	8.96%
Net Interest Margin Tax-Equivalent[1,2]	3.05%	3.10%	3.10%	3.05%	3.14%
Dividend Payout Ratio	61.31%	57.24%	60.14%	65.42%	63.93%
Allowance for Loan Losses/Total Loans	0.95%	1.00%	1.13%	1.31%	1.44%
Non-Performing Loans to Total Loans	0.73%	0.75%	1.15%	1.86%	2.20%
Non-Performing Assets to Total Assets	0.48%	0.57%	0.97%	1.44%	1.89%
Efficiency Ratio[2]	50.43%	54.26%	56.86%	55.44%	51.01%
At Year End					
Total Assets	$1,712,875	$1,564,810	$1,482,131	$1,463,963	$1,414,999
Total Loans	1,071,526	988,638	917,564	876,367	869,284
Total Investment Securities	539,174	477,319	475,092	489,013	449,382
Total Deposits	1,242,957	1,043,189	1,024,819	1,024,399	958,850
Total Borrowings	278,901	337,457	279,916	279,125	282,905
Total Shareholders' Equity	172,521	167,498	161,554	146,098	156,323

	High	Low
Market price per common share of stock during 2016	$33.21	$22.53

[1]Annualized using a 365-day basis in all years except 2012 and 2016, in which a 366-day basis was used.
[2]These ratios use non-GAAP financial measures. See Management's Discussion and Analysis of Financial Condition and Results of Operations for additional disclosures and information.

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

The First Bancorp, Inc. (the "Company" or "The First Bancorp") was incorporated in the State of Maine on January 15, 1985, and is the parent holding company of First National Bank (the "Bank"). On January 28, 2016, the Board of Directors voted to change the Bank's name to First National Bank from The First, N.A.
The Company generates almost all of its revenues from the Bank, which was chartered as a national bank under the laws of the United States on May 30, 1864. The Bank, which has sixteen offices along coastal and eastern Maine, emphasizes personal service to the communities it serves, concentrating primarily on small businesses and individuals. The Bank offers a wide variety of traditional banking services and derives the majority of its revenues from net interest income – the spread between what it earns on loans and investments and what it pays for deposits and borrowed funds. While net interest income typically increases as earning assets grow, the spread can vary up or down depending on the level and direction of movements in interest rates. Management believes the Bank has modest exposure to changes in interest rates, as discussed in "Interest Rate Risk Management" elsewhere in Management's Discussion.
The banking business in the Bank's market area historically has been seasonal with lower deposits in the winter and spring and higher deposits in the summer and fall. This seasonal swing is fairly predictable and has not had a materially adverse effect on the Bank.
Non-interest income is the Bank's secondary source of revenue and includes fees and service charges on deposit accounts, income from the sale and servicing of mortgage loans, and income from investment management and private banking services through First Advisors, a division of the Bank.

Forward-Looking Statements

This report contains statements that are "forward-looking statements." We may also make forward-looking statements in other documents we file with the SEC, in our annual reports to Shareholders, in press releases and other written materials, and in oral statements made by our officers, directors or employees. You can identify forward-looking statements by the use of the words "believe", "expect", "anticipate", "intend", "estimate", "assume", "outlook", "will", "should", "may", "might, "could", and other expressions that predict or indicate future events or trends and which do not relate to historical matters. You should not rely on forward-looking statements, because they involve known and unknown risks, uncertainties and other factors, some of which are beyond the control of the Company. These risks, uncertainties and other factors may cause the actual results, performance or achievements of the Company to be materially different from the anticipated future results, performance or achievements expressed or implied by the forward-looking statements.
Some of the factors that might cause these differences include the following: changes in general national, regional or international economic conditions or conditions affecting the banking or financial services industries or financial capital markets, volatility and disruption in national and international financial markets, government intervention in the U.S. financial system, reductions in net interest income resulting from interest rate volatility as well as changes in the balance and mix of loans and deposits, reductions in the market value of wealth management assets under administration, changes in the value of securities and other assets, reductions in loan demand, changes in loan collectibility, default and charge-off rates, changes in the size and nature of the Company's competition, changes in legislation or regulation and accounting principles, policies and guidelines, and changes in the assumptions used in making such forward-looking statements. In addition, the factors described under "Risk Factors" in Item 1A of this Annual Report on Form 10-K may result in these differences. You should carefully review all of these factors, and you should be aware that there may be other factors that could cause these differences. These forward-looking statements were based on information, plans and estimates at the date of this annual report, and we assume no obligation to update any forward-looking statements to reflect changes in underlying assumptions or factors, new information, future events or other changes.

Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, actual results may differ materially from the results discussed in these forward-looking statements. Readers are also urged to carefully review and consider the various disclosures made by the Company, which attempt to advise interested parties of the factors that affect the Company's business.

Critical Accounting Policies

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

Allowance for Loan Losses. Management believes the allowance for loan losses requires the most significant estimates and assumptions used in the preparation of the consolidated financial statements. The allowance for loan losses is based on Management's evaluation of the level of the allowance required in relation to the estimated loss exposure in the loan portfolio. Management believes the allowance for loan losses is a significant estimate and therefore regularly evaluates it to determine the appropriate level by taking into consideration factors such as prior loan loss experience, the character and size of the loan portfolio, business and economic conditions and Management's estimation of potential losses. The use of different estimates or assumptions could produce different provisions for loan losses.

Goodwill. Management utilizes numerous techniques to estimate the value of various assets held by the Company, including methods to determine the appropriate carrying value of goodwill as required under Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 350 "Intangibles – Goodwill and Other." Goodwill from purchase acquisitions is subject to ongoing periodic evaluation for impairment.

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

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

Derivative Financial Instruments Designated as Hedges. The Company recognizes all derivatives in the consolidated balance sheets at fair value. On the date the Company enters into the derivative contract, the Company designates the derivative as a hedge of either a forecasted transaction or the variability of cash flows to be received or paid related to

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

Use of Non-GAAP Financial Measures

Certain information in Management's Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this Report contains financial information determined by methods other than in accordance with accounting principles generally accepted in the United States of America ("GAAP"). Management uses these "non-GAAP" measures in its analysis of the Company's performance and believes that these non-GAAP financial measures provide a greater understanding of ongoing operations and enhance comparability of results with prior periods as well as demonstrating the effects of significant gains and charges in the current period. The Company believes that a meaningful analysis of its financial performance requires an understanding of the factors underlying that performance. Management believes that investors may use these non-GAAP financial measures to analyze financial performance without the impact of unusual items that may obscure trends in the Company's underlying performance. These disclosures should not be viewed as a substitute for operating results determined in accordance with GAAP, nor are they necessarily comparable to non-GAAP performance measures that may be presented by other companies.
In several places in this report, net interest income is presented on a fully taxable equivalent basis. Specifically included in interest income was tax-exempt interest income from certain investment securities and loans. An amount equal to the tax benefit derived from this tax exempt income has been added back to the interest income total, which adjustments increased net interest income accordingly. Management believes the disclosure of tax-equivalent net interest income information improves the clarity of financial analysis, and is particularly useful to investors in understanding and evaluating the changes and trends in the Company's results of operations. Other financial institutions commonly present net interest income on a tax-equivalent basis. This adjustment is considered helpful in the comparison of one financial institution's net interest income to that of another institution, as each will have a different proportion of tax-exempt interest from its earning assets. Moreover, net interest income is a component of a second financial measure commonly used by financial institutions, net interest margin, which is the ratio of net interest income to average earning assets. For purposes of this measure as well, other financial institutions generally use tax-equivalent net interest income to provide a better basis of comparison from institution to institution. The Company follows these practices. The following table provides a reconciliation of tax-equivalent financial information to the Company's consolidated financial statements, which have been prepared in accordance with GAAP. A 35.0% tax rate was used in 2016, 2015 and 2014.

	Years ended December 31,		
Dollars in thousands	2016	2015	2014
Net interest income as presented	$42,947	$40,936	$39,597
Effect of tax-exempt income	3,150	3,092	3,475
Net interest income, tax equivalent	$46,097	$44,028	$43,072

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

	Years ended December 31,		
Dollars in thousands	2016	2015	2014
Non-interest expense, as presented	$29,383	$29,896	$30,220

Net interest income, as presented	42,947	40,936	39,597
Effect of tax-exempt income	3,150	3,092	3,475
Non-interest income, as presented	12,499	12,230	11,048
Effect of non-interest tax-exempt income	345	236	185
Net securities gains	(673)	(1,399)	(1,155)
Adjusted net interest income plus non-interest income	$58,268	$55,095	$53,150
Non-GAAP efficiency ratio	50.43%	54.26%	56.86%
GAAP efficiency ratio	52.99%	56.23%	59.67%

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

	Years ended December 31,		
Dollars in thousands	2016	2015	2014
Average shareholders' equity as presented	$175,119	$166,319	$157,465
Less intangible assets (average)	(30,087)	(30,131)	(30,338)
Average tangible common shareholders' equity	$145,032	$136,188	$127,127

Executive Summary

This was the best annual performance in The First Bancorp, Inc.'s history, surpassing our previous best year in 2015. The Company's 2016 performance was driven by increased net interest income, the result of continued strong growth in earning assets. The Company also saw a modest drop in operating expense in 2016 compared to 2015. The Company also increased the quarterly dividend by one cent in the second quarter to 23 cents per share, and also declared a special cash dividend of 12 cents per share during the fourth quarter of 2016.

Net income for the year ended December 31, 2016 was $18.0 million, up $1.8 million or 11.1% from the $16.2 million posted for the year ended December 31, 2015. Earnings per common share on a fully diluted basis were $1.66 for the year ended December 31, 2016, up $0.15 or 9.9% from the $1.51 posted for the year ended December 31, 2015. Net interest income on a tax-equivalent basis increased $2.1 million or 4.7% for the year ended December 31, 2016 compared to the year ended December 31, 2015, with growth in earning assets responsible for the increase. The Company's net interest margin was 3.05% in 2016, compared to 3.10% in 2015.

Non-interest income for the year ended December 31, 2016 was $12.5 million or 2.2% higher than non-interest income posted for the year ended December 31, 2015. This was primarily due to a $634,000 increase in mortgage origination and servicing income and a $153,000 increase in First Advisors income offsetting the strategic decision to not take gains from sale of securities at the level taken in 2015. Non-interest expense for the year ended December 31, 2016 was $29.4 million or 1.7% lower than non-interest expense posted for the year ended December 31, 2015, primarily due to a reduction in other credit-related costs outside of the provision for loan losses.

During 2016, total assets increased $148.1 million or 9.5%. The loan portfolio increased $82.9 million or 8.4% in 2016, ending the year at $1.07 billion. The investment portfolio was up $61.9 million or 13.0% for the year. On the liability side of the balance sheet, low-cost deposits increased $61.6 million or 10.6%, totaling $640.8 million as of December 31, 2016. Certificates of deposit increased $105.6 million or 28.5% from the end of 2015. Local certificates of deposit (CDs) increased $8.9 million and wholesale CDs increased $96.7 million at December 31, 2016 compared to December 31, 2015.

Continued improvement in credit quality was another contributor to the Company's 2016 results. Non-performing assets stood at 0.48% of total assets as of December 31, 2016 - well below the 0.57% level of non-performing assets a year ago. This compares to non-performing loans at 0.66% for our Uniform Bank Performance Report peer group ("UBPR peer group") as of December 31, 2016. Net chargeoffs were $1.4 million or 0.13% of average loans in 2016 compared to net chargeoffs of $2.0 million or 0.21% of average loans in 2015. Net chargeoffs for the UBPR peer

group in 2016 were 0.10% of average loans. The provision for loan losses in 2016 was $1.6 million, $50,000 or 3.2% higher than in 2015. The allowance as a percentage of loans outstanding stood at 0.95% in 2016, down from 1.00% at December 31, 2015.

Remaining well capitalized remains a top priority for The First Bancorp, Inc. Since December 31, 2008, the Company's total risk-based capital ratio has increased from 11.13% to 15.69%, well above the well-capitalized threshold of 10.0% set by the Federal Deposit Insurance Corporation.

The Company's operating ratios remain good, with a return on average tangible common equity of 12.42% for the year ended December 31, 2016 compared to 11.90% and 11.57% for the years ended December 31, 2015 and 2014, respectively. Our return on average tangible equity was in the top 18% of all banks in the UBPR peer group, which had an average return of 9.55% for the year. Our efficiency ratio continues to be an important component in our overall performance and at 50.43%, dropped 3.83% in 2016, well below the 54.26% and 56.86% posted for 2015 and 2014, respectively. As of December 31, 2016, the average efficiency ratio for our UBPR peer group was 63.70%, which put us in the top 7% of all banks in the UBPR peer group.

Results of Operations

Net Interest Income

Net interest income on a tax-equivalent basis increased 4.7% or $2.1 million to $46.1 million for the year ended December 31, 2016 from the $44.0 million reported for the year ended December 31, 2015, with growth in earning assets responsible for the increase. The Company's net interest margin was 3.05% in 2016, compared to 3.10% in 2015.
Total interest income on a tax-equivalent basis in 2016 was $56.9 million, an increase of $3.0 million or 5.6% from the $53.9 million posted by the Company in 2015. Total interest expense in 2016 was $10.8 million, an increase of $938,000 or 9.5% from the $9.9 million posted by the Company in 2015. Tax-exempt interest income amounted to $5.8 million for the year ended December 31, 2016, $5.7 million for the year ended December 31, 2015 and $6.4 million for the year ended December 31, 2014.
Net interest income on a tax-equivalent basis increased 2.2% or $956,000 to $44.0 million for the year ended December 31, 2015 from the $43.1 million reported for the year ended December 31, 2014. A $1.5 million increase in loan income and a $1.6 million decrease in funding costs more than offset the $2.1 million drop in investment income resulting from a lower level of investment securities. The Company's net interest margin was 3.10% in 2015, the same as in 2014.
Total interest income on a tax-equivalent basis in 2015 was $53.9 million, a decrease of $595,000 or 1.1% from the $54.5 million posted by the Company in 2014.
The following tables present changes in interest income and expense attributable to changes in interest rates, volume, and rate/volume[1] for interest-earning assets and interest-bearing liabilities. Tax-exempt income is calculated on a tax-equivalent basis, using a 35.0% tax rate.

Year ended December 31, 2016 compared to 2015

Dollars in thousands	Volume	Rate	Rate/Volume[1]	Total
Interest on earning assets				
Interest-bearing deposits	$(8)	$20	$ (9)	$3
Investment securities	817	(1,182)	(57)	(422)
Loans held for sale	11	—	1	12
Loans	2,764	605	45	3,414
Total interest income	3,584	(557)	(20)	3,007
Interest expense				
Deposits	389	330	24	743
Borrowings	95	98	2	195
Total interest expense	484	428	26	938
Change in net interest income	$3,100	$(985)	$ (46)	$2,069

Year ended December 31, 2015 compared to 2014

Dollars in thousands	Volume	Rate	Rate/Volume[1]	Total
Interest on earning assets				
Interest-bearing deposits	$ 15	$—	$ (1)	$ 14
Investment securities	(1,401)	(774)	56	(2,119)
Loans held for sale	6	(1)	—	5
Loans	2,429	(865)	(59)	1,505
Total interest income	1,049	(1,640)	(4)	(595)
Interest expense				
Deposits	(113)	(1,717)	28	(1,802)
Borrowings	417	(151)	(15)	251
Total interest expense	304	(1,868)	13	(1,551)
Change in net interest income	$ 745	$ 228	$ (17)	$ 956

[1] Represents the change attributable to a combination of change in rate and change in volume.

The following table presents the interest earned on or paid for each major asset and liability category, respectively, for the years ended December 31, 2016, 2015, and 2014, as well as the average yield for each major asset and liability category, and the net yield between assets and liabilities. Tax-exempt income has been calculated on a tax-equivalent basis using a 35% rate. Unrecognized interest on non-accrual loans is not included in the amount presented, but the average balance of non-accrual loans is included in the denominator when calculating yields.

Dollars in thousands	2016 Amount of interest	Average Yield/Rate	2015 Amount of interest	Average Yield/Rate	2014 Amount of interest	Average Yield/Rate
Interest-earning assets						
Interest-bearing deposits	$ 22	0.51 %	$ 19	0.25 %	$ 5	0.27 %
Investment securities	16,530	3.42 %	16,952	3.68 %	19,071	3.84 %
Loans held for sale	29	3.95 %	17	3.85 %	12	4.07 %
Loans	40,328	3.94 %	36,914	3.87 %	35,409	3.97 %
Total interest-earning assets	56,909	3.76 %	53,902	3.79 %	54,497	3.92 %
Interest-bearing liabilities						
Deposits	6,028	0.61 %	5,285	0.57 %	7,087	0.75 %
Borrowings	4,784	1.62 %	4,589	1.59 %	4,338	1.64 %
Total interest-bearing liabilities	10,812	0.84 %	9,874	0.81 %	11,425	0.95 %
Net interest income	$ 46,097		$ 44,028		$ 43,072	
Interest rate spread		2.91 %		2.98 %		2.97 %
Net interest margin		3.05 %		3.10 %		3.10 %

Average Daily Balance Sheets

The following table shows the Company's average daily balance sheets for the years ended December 31, 2016, 2015 and 2014.

	Years ended December 31,		
Dollars in thousands	2016	2015	2014
Assets			
Cash and cash equivalents	$18,742	$15,446	$15,674
Interest-bearing deposits in other banks	4,302	7,573	1,883
Securities available for sale	251,714	192,330	261,155
Securities to be held to maturity	216,640	254,396	221,938
Restricted equity securities, at cost	14,327	13,757	13,912
Loans held for sale (fair value approximates cost)	734	441	295
Loans	1,024,777	953,396	892,189
Allowance for loan losses	(10,229)	(9,997)	(11,659)
Net loans	1,014,548	943,399	880,530
Accrued interest receivable	5,213	4,949	5,071
Premises and equipment, net	21,475	22,097	22,600
Other real estate owned	1,171	2,275	4,663
Goodwill	29,805	29,805	29,805
Other assets	33,315	25,120	24,409
Total Assets	$1,611,986	$1,511,588	$1,481,935
Liabilities & Shareholders' Equity			
Demand deposits	$132,726	$116,151	$106,609
NOW deposits	259,462	220,815	178,335
Money market deposits	82,563	99,507	94,017
Savings deposits	210,540	187,379	154,938
Certificates of deposit	441,341	418,092	513,461
Total deposits	1,126,632	1,041,944	1,047,360
Borrowed funds – short term	158,774	135,220	173,905
Borrowed funds – long term	136,611	154,199	90,141
Dividends payable	943	1,103	1,014
Other liabilities	13,907	12,803	12,050
Total Liabilities	1,436,867	1,345,269	1,324,470
Shareholders' Equity:			
Common stock	108	107	107
Additional paid-in capital	60,262	59,458	58,792
Retained earnings	112,405	105,009	98,303
Net unrealized gain on securities available for sale	2,525	1,950	89
Net unrealized gain on cash flow hedging derivative instruments	100	—	—
Net unrealized loss on securities transferred from available for sale to held to maturity	(125)	(80)	(12)
Net unrealized loss on postretirement benefit costs	(156)	(125)	186
Total Shareholders' Equity	175,119	166,319	157,465
Total Liabilities & Shareholders' Equity	$1,611,986	$1,511,588	$1,481,935

Non-Interest Income

Non-interest income in 2016 was $12.5 million, an increase of $269,000 or 2.2% from the $12.2 million reported in 2015, with a $634,000 increase in mortgage origination income and a $153,000 increase in First Advisors income offsetting the strategic decision to not take gains from sale of securities at the level taken in 2015.
Non-interest income in 2015 was $12.2 million, an increase of $1.2 million or 10.7% from the $11.0 million reported in 2014. This was primarily due to increases in securities gains and mortgage origination and servicing income.

Non-Interest Expense

Non-interest expense in 2016 was $29.4 million, a decrease of $513,000 or 1.7% from the $29.9 million reported in 2015, primarily due to a reduction in other-credit-related costs outside of the provision for loan losses.
Non-interest expense in 2015 was $29.9 million, a decrease of $324,000 or 1.1% from the $30.2 million reported in 2014, primarily due to a decrease in other credit-related costs - including expenses for collections, foreclosure and foreclosed properties.

Provision to the Allowance for Loan Losses

The Company's provision to the allowance for loan losses was $1.6 million in 2016 compared to $1.6 million in 2015. This was 0.10% of average assets in 2016, compared to 0.12% of average assets for our peer group. The allowance for loan losses stood at 0.95% of total loans as of December 31, 2016, compared to 1.00% a year ago.
Credit quality continued to improve in 2016. Net loan chargeoffs were $1.4 million or 0.13% of average loans, down $599,000 from net chargeoffs of $2.0 million or 0.21% of average loans in 2015. Non-performing assets stood at 0.48% of total assets as of December 31, 2016 compared to 0.57% of total assets at December 31, 2015. Past-due loans were 1.18% of total loans as of December 31, 2016, up from 0.84% of total loans as of December 31, 2015.
The Company's provision to the allowance for loan losses was $1.6 million in 2015 compared to $1.2 million in 2014. This was 0.10% of average assets in 2015, compared to 0.09% of average assets for our peer group. The allowance for loan losses stood at 1.00% of total loans as of December 31, 2015, compared to 1.13% at December 31, 2014.
Credit quality improved significantly in 2015. Net loan chargeoffs were $2.0 million or 0.21% of average loans, down $342,000 from net chargeoffs of $2.3 million or 0.26% of average loans in 2014. Non-performing assets stood at 0.57% of total assets as of December 31, 2015 compared to 0.97% of total assets at December 31, 2014. Past-due loans were 0.84% of total loans as of December 31, 2015, down significantly from 1.29% of total loans as of December 31, 2014.

Income Taxes
Income taxes on operating earnings were $6.5 million for the year ended December 31, 2016, up $940,000 from the same period in 2015. This is in line with the increase in the Company's level of income before taxes.
Income taxes on operating earnings were $5.5 million for the year ended December 31, 2015, up $948,000 from the same period in 2014. This is in line with the increase in the Company's level of income before taxes.

Net Income

Net income for 2016 was $18.0 million, up 11.1% or $1.8 million from net income of $16.2 million that was posted in 2015. Earnings per share on a fully diluted basis were $1.66, up $0.15 or 9.9% from the $1.51 reported for the year ended December 31, 2015.

Net income for 2015 was $16.2 million, up 10.2% or $1.5 million from net income of $14.7 million that was posted in 2014. Earnings per share on a fully diluted basis were $1.51, up $0.14 or 10.2% from the $1.37 reported for the year ended December 31, 2014.

Key Ratios

Return on average assets in 2016 was 1.12%, up from the 1.07% and the 0.99% posted in 2015 and 2014, respectively. Return on average tangible common equity was 12.42% in 2016, compared to 11.90% in 2015 and 11.57% in 2014. In 2016, the Company's dividend payout ratio (dividends declared per share divided by earnings per share) was 61.31%, compared to 57.24% in 2015 and 60.14% in 2014. The Company's efficiency ratio – a benchmark measure of the amount spent to generate a dollar of income – was 50.43% in 2016 compared to 63.70% for the Bank's peer group, on average. In 2015, the Company's efficiency ratio was 54.26% compared to 65.23% for the Bank's peer group, on average.

Investment Management and Fiduciary Activities

As of December 31, 2016, First Advisors, the Bank's private banking and investment management division, had assets under management with a market value of $851.0 million, consisting of 1,031 trust accounts, estate accounts, agency accounts, and self-directed individual retirement accounts. This compares to December 31, 2015, when 1,041 accounts with a market value of $762.0 million were under management.

Assets and Asset Quality

Total assets of $1.713 billion at December 31, 2016 increased 9.5% or $148.1 million from $1.565 billion at December 31, 2015. The investment portfolio increased $61.9 million or 13.0% over December 31, 2015, and the loan portfolio increased $82.9 million or 8.4%. Year-over-year, average assets were up $100.4 million in 2016 over 2015. Average loans in 2016 were $71.4 million higher than in 2015, and average investments in 2016 were $22.2 million higher than in 2015.

Credit quality continued to improve in 2016. Non-performing assets to total assets stood at 0.48% at December 31, 2016, below 0.57% of total assets at December 31, 2015 and 0.97% of total assets at December 31, 2014. In Management's opinion, the Company's long-standing approach to working with borrowers and ethical loan underwriting standards helps alleviate some of the payment problems on customers' loans and minimizes actual loan losses.

Net chargeoffs in 2016 were $1.4 million or 0.13% of average loans outstanding. This compares to net chargeoffs in 2015 of $2.0 million or 0.21% of average loans outstanding and net charge offs for our UBPR peer group in 2016 of 0.10% of average loans. Residential real estate term loans represent 38.4% of the total loan portfolio, and this loan category generally has a lower level of losses in comparison to other loan types. In 2016, the loss ratio for residential mortgages was 0.08% compared to 0.13% for the entire loan portfolio. The Company does not have a credit card portfolio or offer dealer consumer loans which generally carry more risk and potentially higher losses.

The allowance for loan losses ended 2016 at $10.1 million and stood at 0.95% of total loans outstanding compared to $9.9 million and 1.00% of total loans outstanding at December 31, 2015. A $1.6 million provision for losses was made in 2016 and net charge offs totaled $1.4 million, resulting in the allowance for loan losses increasing $222,000 or 2.2% from December 31, 2015. Management believes the allowance for loan losses is appropriate as of December 31, 2016. In Management's opinion, the level of the provision for loan losses in 2016 was directionally consistent with the improvement in overall credit quality of our loan portfolio and corresponding levels of nonperforming loans, as well as with the performance of the national and local economies, current levels of unemployment and the outlook for future economic conditions.

Investment Activities

During 2016, the investment portfolio increased 13.0% to end the year at $539.2 million compared to $477.3 million at December 31, 2015. Average investments in 2016 were $22.2 million higher than in 2015. As of December 31, 2016, mortgage-backed securities had a carrying value of $311.8 million and a fair value of $312.6 million. Of this total, securities with a fair value of $199.0 million or 63.7% of the mortgage-backed portfolio were issued by the Government National Mortgage Association and securities with a fair value of $113.6 million or 36.3% of the mortgage-backed portfolio were issued by the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association.

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

All investment securities are managed in accordance with a written investment policy adopted by the Board of Directors. It is the Company's general policy that investments for either portfolio be limited to government debt obligations, time deposits, and corporate bonds or commercial paper with one of the three highest ratings given by a nationally recognized rating agency. The portfolio is currently invested primarily in U.S. Government sponsored agency securities and tax-exempt obligations of states and political subdivisions. The individual securities have been selected to enhance the portfolio's overall yield while not materially adding to the Company's level of interest rate risk.

During the third quarter of 2014, the Company transferred securities with a total amortized cost of $89,780,000 with a corresponding fair value of $89,757,000 from available for sale to held to maturity. The net unrealized loss, net of taxes, on these securities at the date of the transfer was $15,000. The net unrealized holding loss at the time of transfer continues to be reported in accumulated other comprehensive income (loss), net of tax and is amortized over the remaining lives of the securities as an adjustment of the yield. The amortization of the net unrealized loss reported in accumulated other

comprehensive income (loss) will offset the effect on interest income of the discount for the transferred securities. The remaining unamortized balance of the net unrealized losses for the securities transferred from available for sale to held to maturity was $129,000 at December 31, 2016. These securities were transferred as a part of the Company's overall investment and balance sheet strategies.
The following table sets forth the Company's investment securities at their carrying amounts as of December 31, 2016, 2015, and 2014.

Dollars in thousands	2016	2015	2014
Securities available for sale			
Mortgage-backed securities	$280,604	$195,110	$151,855
State and political subdivisions	16,482	24,506	30,855
Other equity securities	3,330	3,423	2,551
	300,416	223,039	185,261
Securities to be held to maturity			
U.S. Government sponsored agencies	11,943	71,000	92,341
Mortgage-backed securities	31,201	42,193	57,003
State and political subdivisions	179,384	122,530	126,275
Corporate securities	4,300	4,300	300
	226,828	240,023	275,919
Restricted equity securities			
Federal Home Loan Bank Stock	10,893	13,220	12,875
Federal Reserve Bank Stock	1,037	1,037	1,037
	11,930	14,257	13,912
Total securities	$539,174	$477,319	$475,092

The following table sets forth information on the yields and expected maturities of the Company's investment securities as of December 31, 2016. Yields on tax-exempt securities have been computed on a tax-equivalent basis using a tax rate of 35%. Mortgage-backed securities are presented according to their contractual maturity date, while the yield takes into effect intermediate cashflows from repayment of principal which results in a much shorter average life.

Dollars in thousands	Available For Sale		Held to Maturity	
	Fair Value	Yield to maturity	Amortized Cost	Yield to maturity
U.S. Government Sponsored Agencies				
Due in 1 year or less	$—	0.00 %	$—	0.00 %
Due in 1 to 5 years	—	0.00 %	—	0.00 %
Due in 5 to 10 years	—	0.00 %	4,167	3.03 %
Due after 10 years	—	0.00 %	7,776	3.34 %
Total	—	0.00 %	11,943	3.23 %
Mortgage-Backed Securities				
Due in 1 year or less	253	2.41 %	6	0.16 %
Due in 1 to 5 years	1,734	2.88 %	5,584	2.41 %
Due in 5 to 10 years	19,236	2.93 %	9,601	3.01 %
Due after 10 years	259,381	1.93 %	16,010	3.92 %
Total	280,604	2.01 %	31,201	3.37 %
State & Political Subdivisions				
Due in 1 year or less	—	0.00 %	600	6.43 %
Due in 1 to 5 years	564	6.14 %	7,867	6.19 %
Due in 5 to 10 years	2,269	6.21 %	23,820	5.82 %
Due after 10 years	13,649	5.63 %	147,097	4.61 %
Total	16,482	5.73 %	179,384	4.85 %
Corporate Securities				
Due in 1 year or less	—	0.00 %	300	1.00 %
Due in 1 to 5 years	—	0.00 %	—	0.00 %
Due in 5 to 10 years	—	0.00 %	4,000	5.50 %
Due after 10 years	—	0.00 %	—	0.00 %
Total	—	0.00 %	4,300	5.19 %
Equity Securities	3,330	2.22 %	—	—
	$300,416	2.21 %	$226,828	4.56 %

Impaired Securities

The securities portfolio contains certain securities, the amortized cost of which exceeds fair value, which at December 31, 2016 amounted to an unrealized loss of $7.6 million, or 1.44% of the amortized cost of the total securities portfolio. At December 31, 2015 this amount represented an unrealized loss of $3.5 million, or 0.76% of the total securities portfolio. As a part of the Company's ongoing security monitoring process, the Company identifies securities in an unrealized loss position that could potentially be other-than-temporarily impaired. If a decline in the fair value of a debt security is judged to be other-than-temporary, the decline related to credit loss is recorded in net realized securities losses while the decline attributable to other factors is recorded in other comprehensive income or loss.

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

other information and observable data considered relevant in determining whether other-than-temporary impairment has occurred.
The Company's best estimate of cash flows uses severe economic recession assumptions to quantify potential market uncertainty. The Company's assumptions include but are not limited to delinquencies, foreclosure levels and constant default rates on the underlying collateral, loss severity ratios, and constant prepayment rates. If the Company does not expect to receive 100% of future contractual principal and interest, an other-than-temporary impairment charge is recognized. Estimating future cash flows is a quantitative and qualitative process that incorporates information received from third party sources along with certain internal assumptions and judgments regarding the future performance of the underlying collateral.
As of December 31, 2016, the Company had temporarily impaired securities with a fair value of $279.6 million and unrealized losses of $7.6 million, as identified in the table below. Securities in a continuous unrealized loss position twelve-months or more amounted to $3.0 million as of December 31, 2016, compared with $21.0 million at December 31, 2015. The Company has concluded that these securities were not other-than-temporarily impaired. This conclusion was based on the issuers' continued satisfaction of their obligations in accordance with their contractual terms and the expectation that the issuers will continue to do so, Management's intent and ability to hold these securities for a period of time sufficient to allow for any anticipated recovery in fair value which may be at maturity, the expectation that the Company will receive 100% of future contractual cash flows, as well as the evaluation of the fundamentals of the issuers' financial condition and other objective evidence. The following table summarizes temporarily impaired securities and their approximate fair values at December 31, 2016.

	Less than 12 months		12 months or more		Total	
Dollars in thousands	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government-sponsored agencies	$6,642	$ (233)	$—	$ —	$6,642	$ (233)
Mortgage-backed securities	197,528	(3,090)	2,905	(184)	200,433	(3,274)
State and political subdivisions	72,348	(4,060)	—	—	72,348	(4,060)
Other equity securities	—	—	128	(7)	128	(7)
	$276,518	$ (7,383)	$3,033	$ (191)	$279,551	$ (7,574)

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

Securities issued by U.S. Government-sponsored agencies. As of December 31, 2016, the total unrealized losses on these securities amounted to $233,000, compared with $2.3 million at December 31, 2015. All of these securities were credit rated "AAA" or "AA+" by the major credit rating agencies. Management believes that securities issued by U.S. Government-sponsored agencies and enterprises have minimal credit risk, as these agencies and enterprises play a vital role in the nation's financial markets, and does not consider these securities to be other-than-temporarily impaired at December 31, 2016.

Mortgage-backed securities issued by U.S. Government agencies and U.S. Government-sponsored enterprises. As of December 31, 2016, the total unrealized losses on these securities amounted to $3.3 million, compared with $1.1 million at December 31, 2015. All of these securities were credit rated "AAA" by the major credit rating agencies. Management believes that securities issued by U.S. Government agencies bear no credit risk because they are backed by the full faith and credit of the United States and that securities issued by U.S. Government-sponsored enterprises have minimal credit risk, as these agencies enterprises play a vital role in the nation's financial markets. Management believes that the unrealized losses at December 31, 2016 were attributable to changes in current market yields and

spreads since the date the underlying securities were purchased, and does not consider these securities to be other-than-temporarily impaired at December 31, 2016. The Company also has the ability and intent to hold these securities until a recovery of their amortized cost, which may be at maturity.

Obligations of state and political subdivisions. As of December 31, 2016, the total unrealized losses on municipal securities amounted to $4.1 million, compared with $87,000 at December 31, 2015. Municipal securities are supported by the general taxing authority of the municipality and, in the cases of school districts, are supported by state aid. At December 31, 2016, all municipal bond issuers were current on contractually obligated interest and principal payments. The Company monitors price changes and changes in credit quality of municipal issuers on a regular basis as a potential indicator of temporary impairment. The Company attributes the unrealized losses at December 31, 2016, however, to changes in prevailing market yields and pricing spreads since the dates the underlying securities were purchased, combined with current market liquidity conditions and the disruption in the financial markets in general. Accordingly, the Company does not consider these municipal securities to be other-than-temporarily impaired at December 31, 2016. The Company also has the ability and intent to hold these securities until a recovery of their amortized cost, which may be at maturity.

Corporate securities. As of December 31, 2016 and 2015, there were no unrealized losses on corporate securities. Corporate securities are dependent on the operating performance of the issuers. At December 31, 2016, all corporate bond issuers were current on contractually obligated interest and principal payments.

Other Equity Securities. As of December 31, 2016, the total unrealized losses on other equity securities amounted to $7,000, compared with $6,000 at December 31, 2015. Other equity securities is comprised of common and preferred stock holdings. The unrealized losses were the result of normal market fluctuations for equity securities. Accordingly, the Company does not consider other equity securities to be other-than-temporarily impaired at December 31, 2016.

Federal Home Loan Bank Stock

The Bank is a member of the Federal Home Loan Bank ("FHLB") of Boston, a cooperatively owned wholesale bank for housing and finance in the six New England States. As a requirement of membership in the FHLB, the Bank must own a minimum required amount of FHLB stock, calculated periodically based primarily on its level of borrowings from the FHLB. The Bank uses the FHLB for much of its wholesale funding needs. As of December 31, 2016 and 2015, the Bank's investment in FHLB stock totaled $10.9 million and $13.2 million, respectively. FHLB stock is a non-marketable equity security and therefore is reported at cost, which equals par value. The Company periodically evaluates its investment in FHLB stock for impairment based on, among other factors, the capital adequacy of the FHLB and its overall financial condition. No impairment losses have been recorded through December 31, 2016. The Bank will continue to monitor its investment in FHLB stock.

Lending Activities

The loan portfolio increased $82.9 million or 8.4% in 2016, with total loans at $1.1 billion at December 31, 2016, compared to $988.6 million at December 31, 2015. Commercial loans increased $56.0 million or 13.2% between December 31, 2015 and December 31, 2016. Residential term loans increased by $8.4 million or 2.1% and municipal loans increased by $7.3 million or 37.0% for the same period.
Commercial loans are comprised of three major classes: commercial real estate loans, commercial construction loans and other commercial loans.
Commercial real estate loans consist of mortgage loans to finance investments in real property such as multi-family residential, commercial/retail, office, industrial, hotels, educational and other specific or mixed use properties. Commercial real estate loans are typically written with amortizing payment structures. Collateral values are determined based on appraisals and evaluations in accordance with established policy and regulatory guidelines. Commercial real estate loans typically have a loan-to-value ratio of up to 80% based upon current valuation information at the time the loan is made. Commercial real estate loans are primarily paid by the cash flow generated from the real property, such as operating leases, rents, or other operating cash flows from the borrower.
Commercial construction loans consist of loans to finance construction in a mix of owner- and non-owner occupied commercial real estate properties. Commercial construction loans typically have maturities of less than two years. Payment structures during the construction period are typically on an interest only basis, although principal payments may be established depending on the type of construction project being financed. During the construction phase, commercial construction loans are primarily paid by cash flow generated from the construction project or other operating cash flows from the borrower or guarantors, if applicable. At the end of the construction period, loan repayment typically comes from a third party source in the event that the Company will not be providing permanent term financing. Collateral valuation and loan-to-value guidelines follow those for commercial real estate loans.

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

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

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

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

Residential construction loans typically consist of loans for the purpose of constructing single family residences to be owned and occupied by the borrower. Borrower qualifications include favorable credit history combined with supportive income requirements and loan-to-value ratios within established policy and regulatory guidelines. Residential construction loans normally have construction terms of one year or less and payment during the construction term is typically on an interest only basis from sources including interest reserves, borrower liquidity and/or income. Residential construction loans will typically convert to permanent financing from the Company or have another financing commitment in place from an acceptable mortgage lender. Collateral valuation and loan-to-value guidelines are consistent with those for residential term loans.

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

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

Construction loans, both commercial and residential, at 28.9% of capital are well under the regulatory guidance of 100.0% of capital at December 31, 2016. Construction loans and non-owner-occupied commercial real estate loans are at 109.4% of total capital, are below the regulatory limit of 300.0% of capital at December 31, 2016.

The following table summarizes the loan portfolio, by class as of December 31, 2016, 2015, 2014, 2013 and 2012.

Dollars in thousands	As of December 31, 2016			2015			2014			2013			2012		
Commercial															
Real estate	$302,506	28.2	%	$269,462	27.3	%	$242,311	26.4	%	$245,943	28.2	%	$251,335	28.9	%
Construction	25,406	2.4	%	24,881	2.5	%	30,932	3.4	%	20,382	2.3	%	22,417	2.6	%
Other	150,769	14.1	%	128,341	13.0	%	104,531	11.4	%	95,289	10.9	%	81,183	9.3	%
Municipal	27,056	2.5	%	19,751	2.0	%	20,424	2.2	%	19,117	2.2	%	14,704	1.7	%
Residential															
Term	411,469	38.4	%	403,030	40.7	%	384,032	41.9	%	377,218	43.0	%	379,447	43.7	%
Construction	18,303	1.7	%	8,451	0.9	%	12,160	1.3	%	11,803	1.3	%	6,459	0.7	%
Home equity line of credit	110,907	10.4	%	110,202	11.1	%	103,521	11.3	%	91,549	10.4	%	99,082	11.4	%
Consumer	25,110	2.3	%	24,520	2.5	%	19,653	2.1	%	15,066	1.7	%	14,657	1.7	%
Total loans	$1,071,526	100.0	%	$988,638	100.0	%	$917,564	100.0	%	$876,367	100.0	%	$869,284	100.0	%

The following table sets forth certain information regarding the contractual maturities of the Bank's loan portfolio as of December 31, 2016:

Dollars in thousands	< 1 Year	1 - 5 Years	5 - 10 Years	> 10 Years	Total
Commercial					
Real estate	$1,499	$10,743	$26,248	$264,016	$302,506
Construction	—	5,989	2,128	17,289	25,406
Other	3,466	39,493	33,952	73,858	150,769
Municipal	—	7,056	10,332	9,668	27,056
Residential					
Term	1	5,486	11,714	394,268	411,469
Construction	70	1,042	54	17,137	18,303
Home equity line of credit	100	396	1,750	108,661	110,907
Consumer	7,128	4,943	2,959	10,080	25,110
Total loans	$12,264	$75,148	$89,137	$894,977	$1,071,526

The following table provides a listing of loans by class, between variable and fixed rates as of December 31, 2016.

	Fixed-Rate		Adjustable-Rate		Total	
Dollars in thousands	Amount	% of total	Amount	% of total	Amount	% of total
Commercial						
Real estate	$32,731	3.1 %	$269,775	25.1 %	$302,506	28.2 %
Construction	5,979	0.6 %	19,427	1.8 %	25,406	2.4 %
Other	62,660	5.8 %	88,109	8.3 %	150,769	14.1 %
Municipal	25,345	2.3 %	1,711	0.2 %	27,056	2.5 %
Residential						
Term	287,397	26.8 %	124,072	11.6 %	411,469	38.4 %
Construction	17,735	1.6 %	568	0.1 %	18,303	1.7 %
Home equity line of credit	723	0.1 %	110,184	10.3 %	110,907	10.4 %
Consumer	19,434	1.8 %	5,676	0.5 %	25,110	2.3 %
Total loans	$452,004	42.1 %	$619,522	57.9 %	$1,071,526	100.0 %

Loan Concentrations

As of December 31, 2016, the Bank did not have any concentration of loans in one particular industry that exceeded 10% of its total loan portfolio.

Loans Held for Sale

As of December 31, 2016, the Bank had $782,000 in loans held for sale. This compares to $349,000 in loans held for sale at December 31, 2015. The Bank participates in FHLB's Mortgage Partnership Finance Program ("MPF"), selling loans with recourse. The volume of loans sold to date through the MPF program is de minimis; therefore, there was minimum impact on the reserve.

Credit Risk Management and Allowance for Loan Losses

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

processes are designed to minimize our risk, Management recognizes that loan losses will occur and the amount of these losses will fluctuate depending on the risk characteristics of our loan portfolio, as well as general and regional economic conditions.

We provide for loan losses through the establishment of an allowance for loan losses which represents an estimated reserve for existing losses in the loan portfolio. We deploy a systematic methodology for determining our allowance that includes a quarterly review process, risk rating, and adjustment to our allowance. We classify our portfolios as either commercial or residential and consumer and monitor credit risk separately as discussed below. We evaluate the appropriateness of our allowance continually based on a review of all significant loans, with a particular emphasis on nonaccruing, past due, and other loans that we believe require special attention.

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

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

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

Commercial

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

The process of establishing the allowance with respect to our commercial loan portfolio begins when a loan officer initially assigns each loan a risk rating, using established credit criteria. Approximately 50% of our outstanding loans and commitments are subject to review and validation annually by an independent consulting firm, as well as periodically by our internal credit review function. Our methodology employs Management's judgment as to the level of losses on existing loans based on our internal review of the loan portfolio, including an analysis of the borrowers' current financial position, and the consideration of current and anticipated economic conditions and their potential effects on specific borrowers and lines of business. In determining our ability to collect certain loans, we also consider the fair value of any underlying collateral. We also evaluate credit risk concentrations, including trends in large dollar exposures to related borrowers, industry and geographic concentrations, and economic and environmental factors.

Residential, Home Equity and Consumer

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

Unallocated
The unallocated portion of the allowance is intended to provide for losses that are not identified when establishing the specific and general portions of the allowance and is based upon Management's evaluation of various conditions that are not directly measured in the determination of the portfolio and loan specific allowances. Such conditions may include general economic and business conditions affecting our lending area, credit quality trends (including trends in delinquencies and nonperforming loans expected to result from existing conditions), loan volumes and concentrations, duration of the current business cycle, bank regulatory examination results, findings of external loan review examiners, and Management's judgment with respect to various other conditions including loan administration and management and the quality of risk identification systems. Management reviews these conditions quarterly. We have risk management practices designed to ensure timely identification of changes in loan risk profiles; however, undetected losses may exist inherently within the loan portfolio. The judgmental aspects involved in applying the risk grading criteria, analyzing the quality of individual loans, and assessing collateral values can also contribute to undetected, but probable, losses. Consequently, there maybe underlying credit risks that have not yet surfaced in the loan- specific or qualitative metrics the Company uses to estimate its allowance for loan losses.
The allowance for loan losses includes reserve amounts assigned to individual loans on the basis of loan impairment. Certain loans are evaluated individually and are judged to be impaired when Management believes it is probable that the Company will not collect all of the contractual interest and principal payments as scheduled in the loan agreement. Under this method, loans are selected for evaluation based on internal risk ratings or non-accrual status. A specific reserve is allocated to an individual loan when that loan has been deemed impaired and when the amount of a probable loss is estimable on the basis of its collateral value, the present value of anticipated future cash flows, or its net realizable value. At December 31, 2016, impaired loans with specific reserves totaled $7.9 million and the amount of such reserves was $974,000. This compares to impaired loans with specific reserves of $8.6 million at December 31, 2015, at which date the amount of such reserves was $754,000.
All of these analyses are reviewed and discussed by the Directors' Loan Committee, and recommendations from these processes provide Management and the Board of Directors with independent information on loan portfolio condition. Our total allowance at December 31, 2016 is considered by Management to be appropriate to address the credit losses inherent in the loan portfolio at that date. However, our determination of the appropriate allowance level is based upon a number of assumptions we make about future events, which we believe are reasonable, but which may or may not prove valid. Thus, there can be no assurance that our charge-offs in future periods will not exceed our allowance for loan losses or that we will not need to make additional increases in our allowance for loan losses.

The following table summarizes our allocation of allowance by loan class as of December 31, 2016, 2015, 2014, 2013 and 2012. The percentages are the portion of each loan type to total loans.

	As of December 31,														
Dollars in thousands	2016			2015			2014			2013			2012		
Commercial															
Real estate	$3,988	28.2	%	$3,120	27.3	%	$3,532	26.4	%	$4,602	28.2	%	$5,865	28.9	%
Construction	396	2.4	%	580	2.5	%	823	3.4	%	575	2.3	%	1,359	2.6	%
Other	1,780	14.1	%	1,452	13.0	%	1,505	11.4	%	2,276	10.9	%	2,050	9.3	%
Municipal	18	2.5	%	17	2.0	%	15	2.2	%	15	2.2	%	18	1.7	%
Residential															
Term	1,288	38.4	%	1,391	40.7	%	1,185	41.9	%	1,099	43.0	%	1,109	43.7	%
Construction	44	1.7	%	24	0.9	%	20	1.3	%	21	1.3	%	11	0.7	%
Home equity line of credit	807	10.4	%	893	11.1	%	1,060	11.3	%	675	10.4	%	654	11.4	%

Consumer	559	2.3 %	566	2.5 %	542	2.1 %	573	1.7 %	592	1.7 %
Unallocated	1,258	— %	1,873	— %	1,662	— %	1,678	— %	842	— %
Total	$10,138	100.0%	$9,916	100.0%	$10,344	100.0%	$11,514	100.0%	$12,500	100.0%

The allowance for loan losses totaled $10.1 million at December 31, 2016, compared to $9.9 million at December 31, 2015. Management's ongoing application of methodologies to establish the allowance include an evaluation of non-accrual loans and troubled debt restructured for specific reserves. These specific reserves increased $220,000 in 2016 from $754,000 at December

31, 2015 to $974,000 at December 31, 2016. The specific loans that make up those categories change from period to period. Impairment on those loans, which would be reflected in the allowance for loan losses, might or might not exist, depending on the specific circumstances of each loan. The portion of the reserve based upon homogeneous pools of loans increased by $833,000 in 2016. This increase was due to a growth in the loan portfolio and downgrades on a few larger credits that are performing under the terms of the loans. The portion of the reserve based on qualitative factors decreased by $216,000 during 2016 as a result of an improved U.S. economy. The unallocated reserves decreased $615,000 in 2016 from $1.9 million at December 31, 2015 to $1.3 million at December 31, 2016. The decrease in the unallocated portion is a result of charge offs on collateral dependent loans and the improvement in credit quality. Management feels the decrease in the unallocated portion is directionally consistent with local and national economic conditions.

A breakdown of the allowance for loan losses as of December 31, 2016, by loan class of financing receivable and allowance element, is presented in the following table:

Dollars in thousands	Specific Reserves on Loans Evaluated Individually for Impairment	General Reserves on Loans Based on Historical Loss Experience	Reserves for Qualitative Factors	Unallocated Reserves	Total Reserves
Commercial					
Real estate	$ 505	$ 1,471	$ 2,012	$ —	$ 3,988
Construction	100	125	171	—	396
Other	39	735	1,006	—	1,780
Municipal	—	—	18	—	18
Residential					
Term	304	563	421	—	1,288
Construction	—	25	19	—	44
Home equity line of credit	26	444	337	—	807
Consumer	—	328	231	—	559
Unallocated	—	—	—	1,258	1,258
	$ 974	$ 3,691	$ 4,215	$ 1,258	$ 10,138

Based upon Management's evaluation, provisions are made to maintain the allowance as a best estimate of inherent losses within the portfolio. The provision for loan losses to maintain the allowance at an appropriate level was $1.6 million in 2016 compared to $1.6 million in 2015. Net charge offs were $1.4 million in 2016 compared to net charge offs of $2.0 million in 2015. The allowance as a percentage of loans outstanding stood at 0.95% at December 31, 2016 compared to 1.00% at December 31, 2015.

The following table summarizes the activities in our allowance for loan losses as of December 31, 2016, 2015, 2014, 2013, and 2012:

	As of December 31,				
Dollars in thousands	2016	2015	2014	2013	2012
Balance at beginning of year	$9,916	$10,344	$11,514	$12,500	$13,000
Loans charged off:					
Commercial					
Real estate	294	280	1,205	150	1,394
Construction	75	9	—	963	928
Other	376	732	989	2,583	3,215
Municipal	—	—	—	—	—
Residential					
Term	379	420	699	1,118	1,911
Construction	—	—	—	—	389
Home equity line of credit	147	582	153	611	688
Consumer	450	350	449	430	555
Total	1,721	2,373	3,495	5,855	9,080
Recoveries on loans previously charged off					
Commercial					
Real estate	—	2	144	—	13
Construction	8	1	—	—	246
Other	129	88	758	359	113
Municipal	—	—	—	—	—
Residential					
Term	93	152	36	103	110
Construction	—	—	25	—	54
Home equity line of credit	5	31	16	24	1
Consumer	108	121	196	183	208
Total	343	395	1,175	669	745
Net loans charged off	1,378	1,978	2,320	5,186	8,335
Provision for loan losses	1,600	1,550	1,150	4,200	7,835
Balance at end of period	$10,138	$9,916	$10,344	$11,514	$12,500
Ratio of net loans charged off to average loans outstanding	0.13 %	0.21 %	0.26 %	0.60 %	0.95 %
Ratio of allowance for loan losses to total loans outstanding	0.95 %	1.00 %	1.13 %	1.31 %	1.44 %

Management believes the allowance for loan losses is appropriate as of December 31, 2016. In Management's opinion, the level of the provision for loan losses in 2016 was directionally consistent with the improvement in overall credit quality of our loan portfolio and corresponding levels of nonperforming loans, as well as with the performance of the national and local economies, current levels of unemployment and the outlook for economic recovery continuing for some time to come.

Nonperforming Loans

Nonperforming loans are comprised of loans for which, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement or when principal

and interest is 90 days or more past due unless the loan is both well secured and in the process of collection (in which case the loan may continue to accrue interest in spite of its past due status). A loan is "well secured" if it is secured (1) by collateral in the form of liens on or pledges of real or personal property, including securities, that have a realizable value sufficient to discharge the debt (including accrued interest) in full, or (2) by the guarantee of a financially responsible party. A loan is "in the process of

collection" if collection of the loan is proceeding in due course either (1) through legal action, including judgment enforcement procedures, or, (2) in appropriate circumstances, through collection efforts not involving legal action which are reasonably expected to result in repayment of the debt or in its restoration to a current status in the near future.

When a loan becomes nonperforming (generally 90 days past due), it is evaluated for collateral dependency based upon the most recent appraisal or other evaluation method. If the collateral value is lower than the outstanding loan balance plus accrued interest and estimated selling costs, the loan is placed on non-accrual status, all accrued interest is reversed from interest income, and a specific reserve is established for the difference between the loan balance and the collateral value less selling costs or, in certain situations, the difference between the loan balance and the collateral value less selling costs is written off. Concurrently, a new appraisal or valuation may be ordered, depending on collateral type, currency of the most recent valuation, the size of the loan, and other factors appropriate to the loan. Upon receipt and acceptance of the new valuation, the loan may have an additional specific reserve or write down based on the updated collateral value. On an ongoing basis, appraisals or valuations may be obtained periodically on collateral dependent non-performing loans and an additional specific reserve or write down will be made, if appropriate, based on the new collateral value.

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

Nonperforming loans, expressed as a percentage of total loans, totaled 0.73% at December 31, 2016 compared to 0.75% at December 31, 2015. The following table shows the distribution of nonperforming loans by class as of December 31, 2016, 2015, 2014, 2013, and 2012:

	As of December 31,				
Dollars in thousands	2016	2015	2014	2013	2012
Commercial					
Real estate	$1,907	$915	$2,088	$2,457	$4,603
Construction	—	238	208	—	101
Other	964	66	935	4,370	3,459
Municipal	—	—	—	—	—
Residential					
Term	4,060	5,260	6,421	8,484	10,333
Construction	—	—	—	—	—
Home equity line of credit	843	893	832	1,007	654
Consumer	—	—	26	—	—
Total non-performing loans	$7,774	$7,372	$10,510	$16,318	$19,150

Total nonperforming loans does not include loans 90 or more days past due and still accruing interest. These are loans in which we expect to collect all amounts due, including past-due interest. As of December 31, 2016, loans 90 or more days past due and still accruing interest totaled $777,000, compared to $136,000, $181,000, $1.0 million and $1.1 million at December 31, 2015, 2014, 2013 and 2012, respectively.

As of December 31, 2016, 9 loans with a balance of $1.7 million were non-performing and also classified as troubled-debt-restructured.

Troubled Debt Restructured

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

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

As of December 31, 2016 there were 71 loans with an aggregate outstanding balance of $21.5 million that have been restructured. This compares to 84 loans with amounts totaling $23.9 million as of December 31, 2015. The following table shows the activity in loans classified as TDRs between December 31, 2014 and December 31, 2016:

Balance in Thousands of Dollars	Number of Loans	Aggregate Balance
Total at December 31, 2014	94	$ 27,214
Added in 2015	2	218
Removed in 2015	(12)	(2,142)
Repayments in 2015	—	(1,367)
Total at December 31, 2015	84	$ 23,923
Added in 2016	—	—
Removed in 2016	(13)	(1,433)
Repayments in 2016	—	(964)
Total at December 31, 2016	71	$ 21,526

As of December 31, 2016, 57 loans with an aggregate balance of $18.9 million were performing under the modified terms, five loans with an aggregate balance of $876,000 were more than 30 days past due and nine loans with an aggregate balance of $1.7 million were on nonaccrual. As a percentage of aggregate outstanding balance, 87.9% were performing under the modified terms, 4.1% were more than 30 days past due and 8.0% were on nonaccrual. The performance status of all TDRs as of December 31, 2016, as well as the associated specific reserve in the allowance for loan losses, is summarized by class of loan in the following table.

In thousands of dollars	Performing As Modified	30+ Days Past Due and Accruing	On Nonaccrual	All TDRs
Commercial				
Real estate	$ 8,115	$ —	$ 822	$ 8,937
Construction	763	—	—	763
Other	779	—	—	779
Municipal	—	—	—	—
Residential				
Term	8,901	709	893	10,503
Construction	—	—	—	—
Home equity line of credit	377	167	—	544
Consumer	—	—	—	—
	$ 18,935	$ 876	$ 1,715	$ 21,526
Percent of balance	87.9 %	4.1 %	8.0 %	100.0 %
Number of loans	57	5	9	71
Associated specific reserve	$ 448	$ 10	$ 280	$ 738

Residential TDRs as of December 31, 2016 included 52 loans with an aggregate balance of $10.5 million and the modifications granted fell into five major categories. Loans totaling $6.8 million had an extension of term, allowing the borrower to repay over an extended number of years and lowering the monthly payment to a level the borrower

can afford. Loans totaling $3.9 million had interest capitalized, allowing the borrower to become current after unpaid interest was added to the balance of the loan and re-amortized over the remaining life of the loan. Loans with an aggregate balance of $246,000 were converted from interest-only to regular principal-and-interest payments based on the borrowers' ability to service the higher payment amount. Short-term rate concessions were granted on loans totaling $2.0 million, with a rate concession typically of 1.0% or less. Loans with an aggregate balance of $2.3 million were involved in bankruptcy. Certain residential TDRs had more than one modification.

Commercial TDRs as of December 31, 2016 were comprised of 16 loans with a balance of $10.5 million. Of this total, 12 loans with an aggregate balance of $7.5 million had an extended period of interest-only payments, deferring the start of

principal repayment. Two loans with an aggregate balance of $1.8 million had an extension of term, allowing the borrower to repay over an extended number of years and lowering the monthly payment to a level the borrower can afford. The remaining two loans with an aggregate balance of $1.2 million had several different modifications.
In each case when a loan was modified, Management determined it was in the Bank's best interest to work with the borrower with modified terms rather than to proceed to foreclosure. Once a loan is classified as a TDR, however, it remains classified as such until the balance is fully repaid, despite whether the loan is performing under the modified terms. As of December 31, 2016, Management is aware of six loans classified as TDRs that are involved in bankruptcy with an aggregate outstanding balance of $1.7 million. There were also nine loans with an outstanding balance of $1.7 million that were classified as TDRs and on non-accrual status. One loan with an outstanding balance of $46,000 was in the process of foreclosure.

Impaired Loans

Impaired loans include restructured loans and loans placed on non-accrual status when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. These loans are measured at the present value of expected future cash flows discounted at the loan's effective interest rate or at the fair value of the collateral less estimated selling costs if the loan is collateral dependent. If the measure of an impaired loan is lower than the recorded investment in the loan, a specific reserve is established for the difference. Impaired loans totaled $27.6 million at December 31, 2016, and have decreased $1.9 million from December 31, 2015. The number of impaired loans decreased by 11 loans from 145 to 134 during the same period. Impaired commercial loans decreased $450,000 from December 31, 2015 to December 31, 2016. The specific allowance for impaired commercial loans increased from $399,000 at December 31, 2015 to $644,000 as of December 31, 2016, which represented the fair value deficiencies for those loans for which the net fair value of the collateral was estimated at less than our carrying amount of the loan. From December 31, 2015 to December 31, 2016, impaired residential loans decreased $1.4 million and impaired home equity lines of credit decreased $79,000.
The following table sets forth impaired loans as of December 31, 2016, 2015, 2014, 2013 and 2012:

	As of December 31,				
Dollars in thousands	2016	2015	2014	2013	2012
Commercial					
Real estate	$10,021	$10,717	$13,304	$14,935	$15,774
Construction	763	1,026	1,380	1,284	3,354
Other	1,743	1,234	2,942	6,698	5,861
Municipal	—	—	—	—	—
Residential					
Term	13,669	15,088	16,123	17,786	19,444
Construction	—	—	—	—	—
Home equity line of credit	1,387	1,466	2,087	1,648	1,311
Consumer	—	—	26	—	—
Total	$27,583	$29,531	$35,862	$42,351	$45,744

Past Due Loans

The Bank's overall loan delinquency ratio was 1.18% at December 31, 2016, versus 0.84% at December 31, 2015. Loans 90 days delinquent and accruing increased from $136,000 at December 31, 2015 to $777,000 as of December 31, 2016. This total is made up of five loans, with the largest loan totaling $753,000. We expect to collect all amounts

due on these loans, including interest.

The following table sets forth loan delinquencies as of December 31, 2016, 2015, 2014, 2013 and 2012:

	As of December 31,				
Dollars in thousands	2016	2015	2014	2013	2012
Commercial					
Real estate	$3,476	$884	$860	$1,086	$4,898
Construction	—	273	249	—	64
Other	1,031	328	860	3,469	3,182
Municipal	—	—	—	—	136
Residential					
Term	6,403	5,187	7,003	9,144	12,784
Construction	—	368	—	47	188
Home equity line of credit	1,564	1,108	2,122	1,719	1,699
Consumer	184	139	769	527	216
Total	$12,658	$8,287	$11,863	$15,992	$23,167
Loans 30-89 days past due to total loans	0.65 %	0.46 %	0.38 %	0.46 %	0.92 %
Loans 90+ days past due and accruing to total loans	0.07 %	0.01 %	0.02 %	0.12 %	0.12 %
Loans 90+ days past due on non-accrual to total loans	0.46 %	0.37 %	0.89 %	1.24 %	1.63 %
Total past due loans to total loans	1.18 %	0.84 %	1.29 %	1.82 %	2.67 %

As of December 31, 2016, the UBPR peer group had loans 30-89 days past due to total loans of 0.40% and loans 90+ days past due on non-accrual to total loans of 0.66%.

Potential Problem Loans and Loans in Process of Foreclosure

Potential problem loans consist of classified accruing commercial and commercial real estate loans that were between 30 and 89 days past due. Such loans are characterized by weaknesses in the financial condition of borrowers or collateral deficiencies. Based on historical experience, the credit quality of some of these loans may improve due to changes in collateral values or the financial condition of the borrowers, while the credit quality of other loans may deteriorate, resulting in some amount of loss. At December 31, 2016, there were six potential problem loans with a balance of $1.1 million or 0.10% of total loans. This compares to six loans with a balance of $579,000 or 0.06% of total loans at December 31, 2015.

As of December 31, 2016, there were 23 loans in the process of foreclosure with a total balance of $4.0 million. The Bank's residential foreclosure process begins when a loan becomes 75 days past due at which time a Demand/Breach Letter is sent to the borrower. If the loan becomes 120 days past due, copies of the promissory note and mortgage deed are forwarded to the Bank's attorney for review and a complaint for foreclosure is then prepared. An authorized Bank officer signs the affidavit certifying the validity of the documents and verification of the past due amount which is then forwarded to the court. Once a Motion for Summary Judgment is granted, a Period of Redemption (POR) begins which gives the customer 90 days to cure the default. A foreclosure auction date is then set 30 days from the POR expiration date if the default is not cured.

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

appropriate county within 30 days of the sale.
In July 2016, the Bank conducted a self-audit of its loans in foreclosure and its foreclosure process and found there were no deficiencies or areas to improve. For loans sold to the secondary market on which servicing is retained, the Bank follows Freddie Mac's and Fannie Mae's published guidelines and regularly reviews these guidelines for updates and changes to process. All secondary market loans have been sold without recourse in a non-securitized, one-on-one basis. As a result, the Bank has no liability for these loans in the event of a foreclosure.

Other Real Estate Owned

Other real estate owned and repossessed assets ("OREO") are comprised of properties or other assets acquired through a foreclosure proceeding, or acceptance of a deed or title in lieu of foreclosure. Real estate acquired through foreclosure is carried at the lower of cost or fair value less estimated cost to sell. At December 31, 2016, there were six properties owned with a net OREO balance of $375,000, net of an allowance for losses of $205,000, compared to December 31, 2015 when there were 14 properties owned with a net OREO balance of $1.5 million, net of an allowance for losses of $162,000. The following table presents the composition of other real estate owned as of December 31, 2016, 2015, 2014, 2013 and 2012:

	As of December 31,				
Dollars in thousands	2016	2015	2014	2013	2012
Carrying Value					
Commercial					
Real estate	$—	$—	$145	$394	$—
Construction	28	28	151	295	3,406
Other	170	706	888	531	1,617
Municipal	—	—	—	—	—
Residential					
Term	382	960	3,255	3,917	2,943
Construction	—	—	—	—	—
Home equity line of credit	—	—	—	—	—
Consumer	—	—	—	—	—
Total	$580	$1,694	$4,439	$5,137	$7,966
Related Allowance					
Commercial					
Real estate	$—	$—	$75	$74	$—
Construction	11	11	17	8	—
Other	127	77	170	7	158
Municipal	—	—	—	—	—
Residential					
Term	67	74	392	241	215
Construction	—	—	—	—	—
Home equity line of credit	—	—	—	—	—
Consumer	—	—	—	—	—
Total	$205	$162	$654	$330	$373
Net Value					
Commercial					
Real estate	$—	$—	$70	$320	$—
Construction	17	17	134	287	3,406
Other	43	629	718	524	1,459
Municipal	—	—	—	—	—
Residential					
Term	315	886	2,863	3,676	2,728
Construction	—	—	—	—	—
Home equity line of credit	—	—	—	—	—

Consumer	—	—	—	—	—
Total	$375	$1,532	$3,785	$4,807	$7,593

Funding, Liquidity and Capital Resources

As of December 31, 2016, the Bank had primary sources of liquidity of $139.7 million or 8.3% of assets. It is Management's opinion that this is appropriate. In addition, the Bank has an additional $157.2 million in borrowing capacity under the Federal Reserve Bank of Boston's Borrower in Custody program, $48.0 million in credit lines with correspondent banks, and $169.3 million in unencumbered securities available as collateral for borrowing. These bring the Bank's primary sources of liquidity to $514.2 million or 30.5% of assets. The Asset/Liability Committee ("ALCO") establishes guidelines for liquidity in its Asset/Liability policy and monitors internal liquidity measures to manage liquidity exposure. Based on its assessment of the liquidity considerations described above, Management believes the Company's sources of funding will meet anticipated funding needs.
Liquidity is the ability of a financial institution to meet maturing liability obligations and customer loan demand. The Bank's primary source of liquidity is deposits, which funded 69.9% of total average assets in 2016. While the generally preferred funding strategy is to attract and retain low cost deposits, the ability to do so is affected by competitive interest rates and terms in the marketplace. Other sources of funding include discretionary use of purchased liabilities (e.g., FHLB term advances and other borrowings), cash flows from the securities portfolios and loan repayments. Securities designated as available for sale may also be sold in response to short-term or long-term liquidity needs, although Management has no intention to do so at this time.
The Bank has a detailed liquidity funding policy and a contingency funding plan that provide for prompt and comprehensive responses to unexpected demands for liquidity. Management has developed quantitative models to estimate needs for contingent funding that could result from unexpected outflows of funds in excess of "business as usual" cash flows. In Management's estimation, risks are concentrated in two major categories: runoff of in-market deposit balances and the inability to renew wholesale sources of funding. Of the two categories, potential runoff of deposit balances would have the most significant impact on contingent liquidity. Our modeling attempts to quantify deposits at risk over selected time horizons. In addition to these unexpected outflow risks, several other "business as usual" factors enter into the calculation of the adequacy of contingent liquidity including payment proceeds from loans and investment securities, maturing debt obligations and maturing time deposits. The Bank has established collateralized borrowing capacity with the Federal Reserve Bank of Boston and also maintains additional collateralized borrowing capacity with the FHLB in excess of levels used in the ordinary course of business as well as Fed Funds lines with three correspondent banks.

Deposits

During 2016, total deposits increased by $199.8 million, ending the year at $1.243 billion compared to $1.043 billion at December 31, 2015. Low-cost deposits (demand, NOW, and savings accounts) increased by $61.6 million or 10.6% during the year, money market deposits increased $32.6 million or 35.0%, and certificates of deposit increased $105.6 million or 28.5%. The majority of the change in certificates of deposit year-to-date was primarily from a shift in funding between borrowed funds and certificates of deposit. The increase in low-cost deposits resulted from an inflow of low-cost deposits due to the low interest rate environment. Average deposits increased $84.7 million in 2016, as shown in the following table which sets forth the average daily balance for the Bank's principal deposit categories for each period:

	Years ended December 31,			% change
Dollars in thousands	2016	2015	2014	2016 vs. 2015
Demand deposits	$132,726	$116,151	$106,609	14.27 %
NOW accounts	259,462	220,815	178,335	17.50 %

Money market accounts	82,563	99,507	94,017	(17.03)%
Savings	210,540	187,379	154,938	12.36 %
Certificates of deposit	441,341	418,092	513,461	5.56 %
Total deposits	$1,126,632	$1,041,944	$1,047,360	8.13 %

The average cost of deposits (including non-interest-bearing accounts) was 0.53% for the year ended December 31, 2016, compared to 0.51% for the year ended December 31, 2015 and 0.68% for the year ended December 31, 2014. The following table sets forth the average cost of each category of interest-bearing deposits for the periods indicated.

	Years ended December 31,		
	2016	2015	2014
NOW	0.44%	0.33%	0.28%
Money market	0.28%	0.28%	0.29%
Savings	0.23%	0.22%	0.20%
Certificates of deposit	0.96%	0.92%	1.17%
Total interest-bearing deposits	0.61%	0.57%	0.75%

Of all certificates of deposit, $321.5 million or 67.46% will mature by December 31, 2017. As of December 31, 2016, the Bank held a total of $281.5 million in certificate of deposit accounts with balances in excess of $100,000. The following table summarizes the time remaining to maturity for these certificates of deposit:

	As of December 31,	
Dollars in thousands	2016	2015
Within 3 Months	$159,791	$90,725
3 Months through 6 months	7,481	18,670
6 months through 12 months	21,452	24,284
Over 12 months	92,781	78,774
Total	$281,505	$212,453

Borrowed Funds

Borrowed funds consists mainly of advances from the FHLB which are secured by FHLB stock, funds on deposit with FHLB, U.S. agencies notes and mortgage-backed securities and qualifying first mortgage loans. As of December 31, 2016, advances totaled $194.7 million, with a weighted average interest rate of 1.67% and remaining maturities ranging from four days to 15 years. This compares to advances totaling $250.4 million, with a weighted average interest rate of 1.53% and remaining maturities ranging from two days to ten years, as of December 31, 2015, and advances totaling $205.2 million, with a weighted average interest rate of 1.71% and remaining maturities ranging from two days to ten years, as of December 31, 2014. The increase in the weighted average rate paid on borrowed funds in 2016 compared to 2015 is consistent with the interest rate policy and actions of the FOMC.
The Bank offers securities repurchase agreements to municipal and corporate customers as an alternative to deposits. The balance of these agreements as of December 31, 2016 was $84.2 million, compared to $87.1 million on December 31, 2015, and $74.7 million on December 31, 2014. The weighted average rates of these agreements were 1.06% as of December 31, 2016, compared to 0.80% as of December 31, 2015 and 0.79% as of December 31, 2014.
The maximum amount of borrowed funds outstanding at any month-end during each of the last three years was $388.5 million at the end of January in 2016, $337.5 million at the end of December in 2015, and $298.5 million at the end of June in 2014. The average amount outstanding during 2016 was $295.4 million with a weighted average interest rate of 1.62%. This compares to an average outstanding amount of $289.4 million with a weighted average interest rate of 1.53% in 2015, and an average outstanding amount of $264.0 million with a weighted average interest rate of 1.71% in 2014.

Capital Resources

Shareholders' equity as of December 31, 2016 was $172.5 million, compared to $167.5 million as of December 31, 2015. Capital at December 31, 2016 was sufficient to meet the requirements of regulatory authorities. Leverage capital of the Company, or total shareholders' equity divided by average total assets for the current quarter less goodwill and any net unrealized gain or loss on securities available for sale and postretirement benefits, stood at 8.71% on December 31, 2016 and 8.81% at December 31, 2015. To be rated "well-capitalized", regulatory requirements call for a minimum leverage capital ratio of 5.00%. At December 31, 2016, the Company had tier-one risk-based capital of 14.64% and tier-two risk-based capital of 15.69%, versus 14.70% and 15.78%, respectively, at December 31, 2015. To be rated "well-capitalized", regulatory requirements call for minimum tier-one and tier-two risk-based capital ratios of 8.00% and 10.00%, respectively. The

company's actual levels of capitalization were comfortably above the standards to be rated "well-capitalized" by regulatory authorities.

During 2016, the Company declared cash dividends of $0.22 per share in the first quarter and $0.23 per share in the remaining three quarters, as well as a special dividend of $0.12 per share in the fourth quarter or $1.03 per share for the year. The dividend payout ratio, which is calculated by dividing dividends declared per share by diluted earnings per share, was 61.31% for the year ended December 31, 2016 compared to 57.24% for the year ended December 31, 2015. In determining future dividend payout levels, the Board of Directors carefully analyzes capital requirements and earnings retention, as set forth in the Company's Dividend Policy. The ability of the Company to pay cash dividends to its shareholders depends on receipt of dividends from its subsidiary, the Bank. The subsidiary may pay dividends to its parent out of so much of its net profits as the Bank's directors deem appropriate, subject to the limitation that the total of all dividends declared by the Bank in any calendar year may not exceed the total of its net profits of that year combined with its retained net profits of the preceding two years. The amount available for dividends in 2017 is this year's net income plus $13.6 million.

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

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

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

In 2016, 47,247 shares were issued via employee stock programs, the dividend reinvestment plan, the exercise of stock options, and restricted stock grants. The Company received consideration totaling $531,000. The following table summarizes the Company's 2016 stock issuances:

Dividend reinvestment plan	10,889
Employee stock program	14,511
Net restricted stock grants	21,847
Total	47,247

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

below as the adequately capitalized ratio plus capital conservation buffer includes the fully phased-in 2.50% buffer. The Company met each of the well-capitalized ratio guidelines at December 31, 2016. The following tables indicate the capital ratios for the Bank and the Company at December 31, 2016 and December 31, 2015.

As of December 31, 2016	Leverage	Tier 1	Common Equity Tier 1	Total Risk-Based
Bank	8.63%	14.50%	14.50%	15.55%
Company	8.71%	14.64%	14.64%	15.69%
Adequately capitalized ratio	4.00%	6.00%	4.50%	8.00%
Adequately capitalized ratio plus capital conservation buffer	4.00%	8.50%	7.00%	10.50%
Well capitalized ratio (Bank only)	5.00%	8.00%	6.50%	10.00%

As of December 31, 2015	Leverage	Tier 1	Common Equity Tier 1	Total Risk-Based
Bank	8.82 %	14.45 %	14.45 %	15.53 %
Company	8.81 %	14.70 %	14.70 %	15.78 %
Adequately capitalized ratio	4.00 %	6.00 %	4.50 %	8.00 %
Adequately capitalized ratio plus capital conservation buffer	4.00 %	8.50 %	7.00 %	10.50 %
Well capitalized ratio (Bank only)	5.00 %	8.00 %	6.50 %	10.00 %

Except as identified in Item 1A, "Risk Factors", Management knows of no present trends, events or uncertainties that will have, or are reasonably likely to have, a material effect on capital resources, liquidity, or results of operations.

Contractual Obligations

The following table sets forth the contractual obligations and commitments to extend credit of the Company as of December 31, 2016:

Dollars in thousands	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Borrowed funds	$278,901	$158,774	$30,000	$65,000	$25,127
Operating leases	400	160	174	31	35
Certificates of deposit	476,620	321,537	76,130	78,376	577
Total	$755,921	$480,471	$106,304	$143,407	$25,739
Unused lines, collateralized by residential real estate	$76,646	$76,646	$—	$—	$—
Other unused commitments	57,738	57,738	—	—	—
Standby letters of credit	4,198	4,198	—	—	—
Commitments to extend credit	10,684	10,684	—	—	—
Total loan commitments and unused lines of credit	$149,266	$149,266	$—	$—	$—

The Company is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These include commitments to originate loans, commitments for unused lines of credit, and standby letters of credit. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated balance sheets. Commitments for unused lines are agreements to lend to a customer provided there is no violation of any condition established in the contract and generally have fixed expiration dates. Standby letters of credit are conditional commitments issued by the Bank to guarantee a customer's performance to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. As of December 31, 2016, the Company's off-balance-sheet activities consisted entirely of commitments to extend credit.

Off-Balance Sheet Financial Instruments

No material off-balance sheet risk exists that requires a separate liability presentation.

Capital Purchases

In 2016, the Company made capital purchases totaling $2,131,000 for real estate improvements for branch or operations premises and equipment related to technology. This cost will be amortized over an average of 16 years, adding approximately $130,000 to pre-tax operating costs per year.

Goodwill

On October 26, 2012, the Bank completed the purchase of a branch at 63 Union Street in Rockland, Maine, from Camden National Bank that was formerly operated by Bank of America. As part of the transaction, the Bank acquired approximately $32.3 million in deposits as well as a small volume of loans.

The excess of the purchase price over the fair value of the assets acquired, liabilities assumed, and the amount allocated for core deposit intangible totaled $2.1 million and was recorded as goodwill. The goodwill is not amortizable for GAAP but is amortizable for tax purposes.

On January 14, 2005, the Company acquired FNB Bankshares ("FNB") of Bar Harbor, Maine, and its subsidiary, The First National Bank of Bar Harbor. The total value of the transaction was $48.0 million, and all of the voting equity interest of FNB was acquired in the transaction. The transaction was accounted for as a purchase and the excess of purchase price over the fair value of net identifiable assets acquired equaled $27.6 million and was recorded as goodwill, none of which was deductible for tax purposes. The portion of the purchase price related to the core deposit intangible is being amortized over its expected economic life.

Goodwill is evaluated annually for possible impairment under the provisions of FASB ASC Topic 350, "Intangibles – Goodwill and Other". As of December 31, 2016, in accordance with Topic 350, the Company completed its annual review of goodwill and determined there has been no impairment. The Bank also carries $125,000 in goodwill for a de minimus transaction in 2001.

Effect of Future Interest Rates on Post-retirement Benefit Liabilities

In evaluating the Company's post-retirement benefit liabilities, Management believes changes in discount rates which have occurred pursuant to recently enacted Federal legislation will not have a significant impact on the Company's future operating results or financial condition.

ITEM 7A. Quantitative and Qualitative Disclosures about Market Risk

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

Asset/Liability Management

The primary goal of asset/liability management is to maximize net interest income within the interest rate risk limits set by ALCO. Interest rate risk is monitored through the use of two complementary measures: static gap analysis and earnings simulation modeling. While each measurement has limitations, taken together they present a reasonably comprehensive view of the magnitude of interest rate risk in the Company, the level of risk through time, and the amount of exposure to changes in certain interest rate relationships.
Static gap analysis measures the amount of repricing risk embedded in the balance sheet at a point in time. It does so by comparing the differences in the repricing characteristics of assets and liabilities. A gap is defined as the difference between the principal amount of assets and liabilities which reprice within a specified time period. The cumulative one-year gap, at December 31, 2016, was +0.77% of total assets, compared to +5.13% of assets at December 31, 2015. ALCO's policy limit for the one-year gap is plus or minus 20% of total assets. Core deposits with non-contractual maturities are presented based upon historical patterns of balance attrition which are reviewed at least annually.
The gap repricing distributions include principal cash flows from residential mortgage loans and mortgage-backed securities in the time frames in which they are expected to be received. Mortgage prepayments are estimated by applying industry median projections of prepayment speeds to portfolio segments based on coupon range and loan age.
The Company's summarized static gap, as of December 31, 2016, is presented in the following table:

Dollars in thousands	0-90 Days	90-365 Days	1-5 Years	5+ Years
Investment securities at amortized cost (HTM) and fair value (AFS)	$29,230	$56,147	$194,934	$246,933
Restricted equity securities, at cost	10,893	—	—	1,037
Loans held for sale	—	—	—	782
Loans	378,534	169,530	380,548	142,914
Other interest-earning assets	—	22,270	—	—
Non-rate-sensitive assets	6,607	—	—	72,516
Total assets	425,264	247,947	575,482	464,182
Interest-bearing deposits	388,596	80,108	154,493	479,278
Borrowed funds	128,774	55,000	95,000	127
Non-rate-sensitive liabilities and equity	1,900	5,700	32,350	291,549
Total liabilities and equity	519,270	140,808	281,843	770,954
Period gap	$(94,006)	$107,139	$293,639	$(306,772)
Percent of total assets	(5.49)%	6.25%	17.14%	(17.91)
Cumulative gap (current)	$(94,006)	$13,133	$306,772	—
Percent of total assets	(5.49)%	0.77%	17.91%	0.00%

The earnings simulation model forecasts capture the impact of changing interest rates on one-year and two-year net interest income. The modeling process calculates changes in interest income received and interest expense paid on all interest-earning assets and interest-bearing liabilities reflected on the Company's balance sheet. None of the assets used in the simulation are held for trading purposes. The modeling is done for a variety of scenarios that incorporate changes in the absolute level of interest rates as well as basis risk, as represented by changes in the shape of the yield curve and changes in interest rate relationships. Management evaluates the effects on income of alternative interest rate scenarios against earnings in a stable interest rate environment. This analysis is also most useful in determining the short-run earnings exposures to changes in customer behavior involving loan payments and deposit additions and withdrawals.

The Company's most recent simulation model projects net interest income would decrease by approximately 0.38% of stable-rate net interest income if short-term rates affected by Federal Open Market Committee actions fall gradually by one percentage point over the next year, and decrease by approximately 3.06% if rates rise gradually by two percentage points. Both scenarios are well within ALCO's policy limit of a decrease in net interest income of no more than 10.0% given a 2.0% move in

interest rates, up or down. Management believes this reflects a reasonable interest rate risk position. In year two, and assuming no additional movement in rates, the model forecasts that net interest income would be higher than that earned in a stable rate environment by 0.48% in a falling-rate scenario, and lower than that earned in a stable rate environment by 1.18% in a rising rate scenario, when compared to the year-one base scenario. A summary of the Bank's interest rate risk simulation modeling, as of December 31, 2016 and 2015 is presented in the following table:

Changes in Net Interest Income	2016	2015
Year 1		
Projected changes if rates decrease by 1.0%	-0.38%	-0.97%
Projected change if rates increase by 2.0%	-3.06%	-1.94%
Year 2		
Projected changes if rates decrease by 1.0%	0.48%	-2.80%
Projected change if rates increase by 2.0%	1.18%	-1.59%

This dynamic simulation model includes assumptions about how the balance sheet is likely to evolve through time and in different interest rate environments. Loans and deposits are projected to maintain stable balances. All maturities, calls and prepayments in the securities portfolio are assumed to be reinvested in similar assets. Mortgage loan prepayment assumptions are developed from industry median estimates of prepayment speeds for portfolios with similar coupon ranges and seasoning. Non-contractual deposit volatility and pricing are assumed to follow historical patterns. The sensitivities of key assumptions are analyzed annually and reviewed by ALCO.
This sensitivity analysis does not represent a Company forecast and should not be relied upon as being indicative of expected operating results. These hypothetical estimates are based upon numerous assumptions including, among others, the nature and timing of interest rate levels, yield curve shape, prepayments on loans and securities, pricing decisions on loans and deposits, and reinvestment/ replacement of asset and liability cash flows. While assumptions are developed based upon current economic and local market conditions, the Company cannot make any assurances as to the predictive ability of these assumptions, including how customer preferences or competitor influences might change.

Interest Rate Risk Management

A variety of financial instruments can be used to manage interest rate sensitivity. These may include investment securities, interest rate swaps, and interest rate caps and floors. Frequently called interest rate derivatives, interest rate swaps, caps and floors have characteristics similar to securities but possess the advantages of customization of the risk-reward profile of the instrument, minimization of balance sheet leverage and improvement of liquidity. As of December 31, 2016, the Company was using interest rate swaps for interest rate risk management.
The Company engages an independent consultant to periodically review its interest rate risk position, as well as the effectiveness of simulation modeling and reasonableness of assumptions used. As of December 31, 2016, there were no significant differences between the views of the independent consultant and Management regarding the Company's interest rate risk exposure. Management expects interest rates will remain relatively stable in the next year and believes that the current level of interest rate risk is acceptable.

ITEM 8. Financial Statements and Supplementary Data

Consolidated Balance Sheets

The First Bancorp, Inc. and Subsidiary

As of December 31,	2016	2015
Assets		
Cash and cash equivalents	$17,366,000	$14,299,000
Interest-bearing deposits in other banks	293,000	4,013,000
Securities available for sale	300,416,000	223,039,000
Securities to be held to maturity (fair value of $225,537,000 at December 31, 2016, and $243,123,000 at December 31, 2015)	226,828,000	240,023,000
Restricted equity securities, at cost	11,930,000	14,257,000
Loans held for sale	782,000	349,000
Loans	1,071,526,000	988,638,000
Less allowance for loan losses	10,138,000	9,916,000
Net loans	1,061,388,000	978,722,000
Accrued interest receivable	5,532,000	4,912,000
Premises and equipment, net	22,202,000	21,816,000
Other real estate owned	375,000	1,532,000
Goodwill	29,805,000	29,805,000
Other assets	35,958,000	32,043,000
Total assets	$1,712,875,000	$1,564,810,000
Liabilities		
Demand deposits	$140,482,000	$130,566,000
NOW deposits	282,971,000	242,638,000
Money market deposits	125,544,000	92,994,000
Savings deposits	217,340,000	206,009,000
Certificates of deposit	476,620,000	370,982,000
Total deposits	1,242,957,000	1,043,189,000
Borrowed funds – short term	158,774,000	222,323,000
Borrowed funds – long term	120,127,000	115,134,000
Other liabilities	18,496,000	16,666,000
Total liabilities	1,540,354,000	1,397,312,000
Commitments and contingent liabilities		
Shareholders' equity		
Common stock, one cent par value per share	108,000	108,000
Additional paid-in capital	60,723,000	59,862,000
Retained earnings	111,693,000	106,673,000
Accumulated other comprehensive income (loss)		
Net unrealized gain (loss) on securities available for sale	(935,000)	1,123,000
Net unrealized loss on securities transferred from available for sale to held to maturity	(129,000)	(112,000)
Net unrealized gain on cash flow hedging derivative instruments	1,163,000	—
Net unrecognized loss on postretirement benefit costs	(102,000)	(156,000)
Total shareholders' equity	172,521,000	167,498,000
Total liabilities and shareholders' equity	$1,712,875,000	$1,564,810,000
Common stock		

Number of shares authorized	18,000,000	18,000,000
Number of shares issued and outstanding	10,793,946	10,753,855
Book value per common share	$15.98	$15.58
Tangible book value per common share	$13.20	$12.78

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

Consolidated Statements of Income and Comprehensive Income
The First Bancorp, Inc. and Subsidiary

Years ended December 31,	2016	2015	2014
Interest and dividend income			
Interest and fees on loans (includes tax-exempt income of $670,000 in 2016, $578,000 in 2015, and $592,000 in 2014)	$39,996,000	$36,620,000	$35,102,000
Interest on deposits with other banks	22,000	19,000	5,000
Interest and dividends on investments (includes tax-exempt income of $5,168,000 in 2016, $5,157,000 in 2015, and $5,854,000 in 2014)	13,741,000	14,171,000	15,915,000
Total interest and dividend income	53,759,000	50,810,000	51,022,000
Interest expense			
Interest on deposits	6,028,000	5,285,000	7,087,000
Interest on borrowed funds	4,784,000	4,589,000	4,338,000
Total interest expense	10,812,000	9,874,000	11,425,000
Net interest income	42,947,000	40,936,000	39,597,000
Provision for loan losses	1,600,000	1,550,000	1,150,000
Net interest income after provision for loan losses	41,347,000	39,386,000	38,447,000
Non-interest income			
Fiduciary and investment management income	2,411,000	2,258,000	2,139,000
Service charges on deposit accounts	2,237,000	2,384,000	2,505,000
Net securities gains	673,000	1,399,000	1,155,000
Mortgage origination and servicing income	2,192,000	1,558,000	979,000
Other operating income	4,986,000	4,631,000	4,270,000
Total non-interest income	12,499,000	12,230,000	11,048,000
Non-interest expense			
Salaries and employee benefits	15,215,000	15,080,000	14,890,000
Occupancy expense	2,313,000	2,312,000	2,215,000
Furniture and equipment expense	3,305,000	3,171,000	2,940,000
FDIC insurance premiums	789,000	890,000	1,004,000
Amortization of identified intangibles	43,000	58,000	326,000
Other operating expense	7,718,000	8,385,000	8,845,000
Total non-interest expense	29,383,000	29,896,000	30,220,000
Income before income taxes	24,463,000	21,720,000	19,275,000
Applicable tax expense	6,454,000	5,514,000	4,566,000
Net income	$18,009,000	$16,206,000	$14,709,000
Basic earnings per common share	$1.68	$1.52	$1.38
Diluted earnings per common share	1.66	1.51	1.37
Other comprehensive income (loss), net of tax			
Net unrealized gain (loss) on securities available for sale	(2,058,000)	(1,399,000)	9,113,000
Net unrealized loss on securities transferred from available for sale to held to maturity, net of amortization	(17,000)	(64,000)	(48,000)
Net unrealized gain on cash flow hedging derivative instruments	1,163,000	—	—
Net unrecognized gain (loss) on postretirement benefits	54,000	(31,000)	(313,000)
Other comprehensive income (loss)	(858,000)	(1,494,000)	8,752,000
Comprehensive income	$17,151,000	$14,712,000	$23,461,000

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

Consolidated Statements of Changes in Shareholders' Equity
The First Bancorp, Inc. and Subsidiary

	Common stock and additional paid-in capital		Retained	Accumulated other comprehensive	Total shareholders'
	Shares	Amount	earnings	income (loss)	equity
Balance at December 31, 2013	10,671,192	$58,501,000	$94,000,000	$(6,403,000)	$146,098,000
Net income	—	—	14,709,000	—	14,709,000
Net unrealized gain on securities available for sale, net of tax	—	—	—	9,113,000	9,113,000
Net unrealized loss on securities transferred from available for sale to held to maturity, net of tax	—	—	—	(48,000)	(48,000)
Unrecognized loss for post-retirement benefits, net of tax	—	—	—	(313,000)	(313,000)
Comprehensive income	—	—	14,709,000	8,752,000	23,461,000
Cash dividends declared ($0.83 per share)	—	—	(8,893,000)	—	(8,893,000)
Equity compensation expense	—	431,000	—	—	431,000
Issuance of restricted stock	25,843	—	—	—	—
Proceeds from sale of common stock	27,324	457,000	—	—	457,000
Balance at December 31, 2014	10,724,359	$59,389,000	$99,816,000	$2,349,000	$161,554,000
Net income	—	—	16,206,000	—	16,206,000
Net unrealized loss on securities available for sale, net of tax	—	—	—	(1,399,000)	(1,399,000)
Net unrealized loss on securities transferred from available for sale to held to maturity, net of tax	—	—	—	(64,000)	(64,000)
Unrecognized loss for post-retirement benefits, net of tax	—	—	—	(31,000)	(31,000)
Comprehensive income	—	—	16,206,000	(1,494,000)	14,712,000
Cash dividends declared ($0.87 per share)	—	—	(9,349,000)	—	(9,349,000)
Equity compensation expense	—	296,000	—	—	296,000
Payment for repurchase of common stock	(10,138)	(180,000)	—	—	(180,000)
Issuance of restricted stock	14,179	—	—	—	—
Proceeds from sale of common stock	25,455	465,000	—	—	465,000
Balance at December 31, 2015	10,753,855	$59,970,000	$106,673,000	$855,000	$167,498,000

	Common stock and additional paid-in capital		Retained	Accumulated other comprehensive	Total shareholders'
	Shares	Amount	earnings	income (loss)	equity
Balance at December 31, 2015	10,753,855	$59,970,000	$106,673,000	$ 855,000	$167,498,000
Net income	—	—	18,009,000	—	18,009,000
Net unrealized loss on securities available for sale, net of tax	—	—	—	(2,058,000)	(2,058,000)
Net unrealized gain on cash flow hedging derivative instruments, net of tax	—	—	—	1,163,000	1,163,000
Net unrealized loss on securities transferred from available for sale to held to maturity, net of tax	—	—	—	(17,000)	(17,000)
Unrecognized gain for post-retirement benefits, net of tax	—	—	—	54,000	54,000
Comprehensive income	—	—	18,009,000	(858,000)	17,151,000
Cash dividends declared ($1.03 per share)	—	—	(11,110,000)	—	(11,110,000)
Equity compensation expense	—	298,000	—	—	298,000
Payment for repurchase of common stock	(7,156)	—	(129,000)	—	(129,000)
Repurchase of warrants	—	—	(1,750,000)	—	(1,750,000)
Tax benefit from vesting of restricted stock	—	32,000	—	—	32,000
Issuance of restricted stock	21,847	—	—	—	—
Proceeds from sale of common stock	25,400	531,000	—	—	531,000
Balance at December 31, 2016	10,793,946	$60,831,000	$111,693,000	$ (3,000)	$172,521,000

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

Consolidated Statements of Cash Flows
The First Bancorp, Inc. and Subsidiary

For the years ended December 31,	2016	2015	2014
Cash flows from operating activities			
Net income	$18,009,000	$16,206,000	$14,709,000
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	1,745,000	1,720,000	1,663,000
Change in deferred taxes	(139,000)	332,000	18,000
Provision for loan losses	1,600,000	1,550,000	1,150,000
Loans originated for resale	(54,257,000)	(31,306,000)	(21,758,000)
Proceeds from sales and transfers of loans	55,035,000	31,671,000	22,337,000
Net gain on sales of loans	(1,211,000)	(714,000)	(496,000)
Net gain on sale or call of securities	(673,000)	(1,399,000)	(1,155,000)
Net amortization of investment premiums	2,810,000	783,000	943,000
Net (gain) loss on sale of other real estate owned	(177,000)	5,000	32,000
Provision for losses on other real estate owned	132,000	311,000	637,000
Equity compensation expense	298,000	296,000	431,000
Tax benefit from vesting of restricted stock	32,000	—	—
Net (increase) decrease in other assets and accrued interest	(2,460,000)	(455,000)	676,000
Net increase in other liabilities	665,000	1,418,000	378,000
Net loss on disposal of premises and equipment	—	—	3,000
Amortization of investments in limited partnerships	194,000	266,000	569,000
Net acquisition amortization	43,000	58,000	326,000
Net cash provided by operating activities	21,646,000	20,742,000	20,463,000
Cash flows from investing activities			
(Increase) decrease in interest-bearing deposits in other banks	3,720,000	(454,000)	(997,000)
Proceeds from sales of securities available for sale	10,309,000	35,468,000	15,557,000
Proceeds from maturities, payments, calls of securities available for sale	79,223,000	36,588,000	30,226,000
Proceeds from maturities, payments, calls of securities held to maturity	88,899,000	45,688,000	18,085,000
Proceeds from sales of other real estate owned	1,786,000	3,260,000	2,624,000
Purchases of securities available for sale	(172,343,000)	(111,616,000)	(908,000)
Purchases of securities to be held to maturity	(75,573,000)	(9,644,000)	(34,881,000)
Investment in bank-owned life insurance	—	(10,000,000)	—
Purchase of Federal Home Loan Bank Stock	—	(345,000)	—
Redemption of restricted equity securities	2,327,000	—	—
Net increase in loans	(84,850,000)	(74,375,000)	(45,788,000)
Capital expenditures	(2,131,000)	(927,000)	(1,909,000)
Proceeds from sale of premises and equipment	—	10,000	1,240,000
Net cash used in investing activities	(148,633,000)	(86,347,000)	(16,751,000)

Cash flows from financing activities			
Net increase in demand, savings, and money market accounts	94,130,000	94,889,000	84,038,000
Net increase (decrease) in certificates of deposit	105,638,000	(76,519,000)	(83,618,000)
Advances on long-term borrowings	35,000,000	55,000,000	—
Repayment on long-term borrowings	(30,000,000)	(40,000,000)	(30,000,000)
Net increase (decrease) in short-term borrowings	(63,556,000)	42,541,000	30,791,000
Payment to repurchase common stock	(129,000)	(180,000)	—
Proceeds from sale of common stock	531,000	465,000	457,000
Repurchase of warrants	(1,750,000)	—	—
Dividends paid	(9,810,000)	(9,349,000)	(8,893,000)
Net cash provided by (used in) financing activities	130,054,000	66,847,000	(7,225,000)
Net increase (decrease) in cash and cash equivalents	3,067,000	1,242,000	(3,513,000)
Cash and cash equivalents at beginning of year	14,299,000	13,057,000	16,570,000
Cash and cash equivalents at end of year	$17,366,000	$14,299,000	$13,057,000
Interest paid	$10,767,000	$9,960,000	$11,503,000
Income taxes paid	6,367,000	4,235,000	5,150,000
Non-cash transactions:			
Net transfer from loans to other real estate owned	584,000	1,323,000	2,271,000
Transfer of securities from available for sale to held to maturity	$—	$—	$89,757,000

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

Notes to Consolidated Financial Statements

Nature of Operations

The First Bancorp, Inc. (the "Company") through its wholly-owned subsidiary, First National Bank ("the Bank"), provides a full range of banking services to individual and corporate customers from sixteen offices in coastal and eastern Maine. First Advisors, a division of the Bank, provides investment management, private banking and financial planning services. On January 28,
2016, the Board of Directors voted to change the Bank's name to First National Bank from The First, N.A.

Note 1. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and the Bank. All intercompany accounts and transactions have been eliminated in consolidation.

Subsequent Events

Events occurring subsequent to December 31, 2016, have been evaluated as to their potential impact to the financial statements.

Use of Estimates in Preparation of Financial Statements

In preparing the financial statements in accordance with accounting principles generally accepted in the United States of America ("GAAP"), Management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities as of the date of the balance sheet and revenues and expenses for the reporting period. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for loan losses, goodwill, the valuation of mortgage servicing rights, and other-than-temporary impairment of securities.

Investment Securities

Investment securities are classified as available for sale or held to maturity when purchased. There are no trading account securities. Securities available for sale consist primarily of debt securities which Management intends to hold for indefinite periods of time. They may be used as part of the Bank's funds management strategy, and may be sold in response to changes in interest rates or prepayment risk, changes in liquidity needs, or for other reasons. They are accounted for at fair value, with unrealized gains or losses adjusted through shareholders' equity, net of related income taxes. The cost basis is adjusted for the amortization of premiums and accretion of discounts. Securities to be held to maturity consist primarily of debt securities which Management has acquired solely for long-term investment purposes, rather than for purposes of trading or future sale. For securities to be held to maturity, Management has the intent and the Bank has the ability to hold such securities until their respective maturity dates. Such securities are carried at cost adjusted for the amortization of premiums and accretion of discounts. Investment securities transactions are accounted for on a settlement date basis; reported amounts would not be materially different from those accounted for on a trade date basis. Gains and losses on the sales of investment securities are determined using the amortized cost of the specifically identified security. For declines in the fair value of individual debt securities available for sale below their cost that are deemed to be other than temporary, where the Company does not intend to sell the security and it is more likely than not that the Company will not be required to sell the security before recovery of its amortized cost basis, the other-than-temporary decline in the fair value of the debt security related to 1) credit loss is recognized in earnings and 2) other factors is recognized in other comprehensive income or loss. Credit loss is deemed

to exist if the present value of expected future cash flows using the effective rate at acquisition is less than the amortized cost basis of the debt security. For individual debt securities where the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost, the other-than-temporary impairment is recognized in earnings equal to the entire difference between the security's cost basis and its fair value at the balance sheet date.

Derivative Financial Instruments Designated as Hedges

The Company recognizes all derivatives in the consolidated balance sheets at fair value. On the date the Company enters into the derivative contract, the Company designates the derivative as a hedge of either a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability ("cash flow hedge"), a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment ("fair value hedge"), or a held for trading instrument ("trading instrument"). The Company formally documents relationships between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedge transactions. The Company also assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are effective in offsetting changes in cash flows or fair values of hedged items. Changes in fair value of a derivative that is effective and that qualifies as a cash flow hedge are recorded in other comprehensive income (loss) and are reclassified into earnings when the forecasted transaction or related cash flows affect earnings. Changes in fair value of a derivative that qualifies as a fair value hedge and the change in fair value of the hedged item are both recorded in earnings and offset each other when the transaction is effective. Those derivatives that

are classified as trading instruments are recorded at fair value with changes in fair value recorded in earnings. The Company discontinues hedge accounting when it determines that the derivative is no longer effective in offsetting changes in the cash flows of the hedged item, that it is unlikely that the forecasted transaction will occur, or that the designation of the derivative as a hedging
instrument is no longer appropriate.

Loans Held for Sale
Loans held for sale consist of residential real estate mortgage loans and are carried at the lower of aggregate cost or fair value, as determined by current investor yield requirements.

Loans
Loans are generally reported at their outstanding principal balances, adjusted for chargeoffs, the allowance for loan losses and any deferred fees or costs to originate loans. Loan commitments are recorded when funded.

Loan Fees and Costs
Loan origination fees and certain direct loan origination costs are deferred and recognized in interest income as an adjustment to the loan yield over the life of the related loans. The unamortized net deferred fees and costs are included on the balance sheets with the related loan balances, and the amortization is included with the related interest income.

Allowance for Loan Losses
Loans considered to be uncollectible are charged against the allowance for loan losses. The allowance for loan losses is maintained at a level determined by Management to be appropriate to absorb probable losses. This allowance is increased by provisions charged to operating expenses and recoveries on loans previously charged off. Arriving at an appropriate level of allowance for loan losses necessarily involves a high degree of judgment. In determining the appropriate level of allowance for loan losses, Management takes into consideration several factors, including reviews of individual non-performing loans and performing loans listed on the watch report requiring periodic evaluation, loan portfolio size by category, recent loss experience, delinquency trends and current economic conditions. For all loan classes, loans over 30 days past due are considered delinquent. Impaired loans include restructured loans and loans placed on non-accrual status when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. These loans are measured at the present value of expected future cash flows discounted at the loan's effective interest rate or at the fair value of the collateral if the loan is collateral dependent. Management takes into consideration impaired loans in addition to the above mentioned factors in determining the appropriate level of allowance for loan losses.

Troubled Debt Restructured
A troubled debt restructured ("TDR") constitutes a restructuring of debt if the Bank, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower that it would not otherwise consider. To determine whether or not a loan should be classified as a TDR, Management evaluates a loan to first determine if the borrower demonstrates financial difficulty. Common indicators of this include past due status with bank obligations, substandard credit bureau reports, or an inability to refinance with another lender. If the borrower is experiencing financial difficulty and concessions are granted, such as maturity date extension, interest rate adjustments to below market pricing, or a deferment of payments, the loan will generally be classified as a TDR.

Accrual of Interest Income and Expense
Interest on loans and investment securities is taken into income using methods which relate the income earned to the balances of loans and investment securities outstanding. Interest expense on liabilities is derived by applying

applicable interest rates to principal amounts outstanding. For all classes of loans, recording of interest income on problem loans, which includes impaired loans, ceases when collectibility of principal and interest within a reasonable period of time becomes doubtful. Cash payments received on non-accrual loans, which includes impaired loans, are applied to reduce the loan's principal balance until the remaining principal balance is deemed collectible, after which interest is recognized when collected. As a general rule, a loan may be restored to accrual status when payments are current for a substantial period of time, generally six months, and repayment of the remaining contractual amounts is expected or when it otherwise becomes well secured and in the process of collection.

Premises and Equipment

Premises, furniture and equipment are stated at cost, less accumulated depreciation. Depreciation expense is computed by straight-line methods over the asset's estimated useful life.

Other Real Estate Owned ("OREO")

Real estate acquired by foreclosure or deed in lieu of foreclosure is transferred to OREO and recorded at fair value, less estimated costs to sell, based on appraised value at the date actually or constructively received. Loan losses arising from the acquisition of

such property are charged against the allowance for loan losses. Subsequent provisions to reduce the carrying value of a property are recorded to the allowance for OREO losses and a charge to operations on a specific property basis.

Goodwill and Identified Intangible Assets
Intangible assets include the excess of the purchase price over the fair value of net assets acquired (goodwill) from the acquisition of FNB Bankshares in 2005 as well as the core deposit intangible related to the same acquisition. The core deposit intangible is amortized on a straight-line basis over ten years. There was no annual amortization expense for 2016 as the expense is now fully amortized. For 2015 and 2014 the annual amortization expense was $15,000 and $283,000, respectfully. Intangible assets also include the goodwill and core deposit intangible from the 2012 acquisition of a bank branch in Rockland, Maine and a bank building in Bangor, Maine. The core deposit intangible will be amortized on a straight-line basis over ten years. Annual amortization expense for 2016, 2015 and 2014 was $43,000, and the amortization expense for each year until fully amortized will be $43,000. The straight-line basis is used because the Company does not expect significant run off in the core deposits acquired. The Company annually evaluates goodwill, and periodically evaluates other intangible assets, for impairment. At December 31, 2016, the Company determined goodwill and other intangible assets were not impaired.

Income Taxes
Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between financial statement carrying amounts of assets and liabilities and their respective tax bases, and for tax credits that are available to offset future taxable income. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period the change is enacted.

Loan Servicing
Servicing rights are recognized when they are acquired through sale of loans. Capitalized servicing rights are reported in other assets and are amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Servicing rights are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights by predominant characteristics, such as interest rates and terms. Impairment is recognized through a valuation allowance for an individual stratum, to the extent that fair value is less than the capitalized amount for the stratum.

Post-Retirement Benefits
The cost of providing post-retirement benefits is accrued during the active service period of the employee or director.

Earnings Per Share
Basic earnings per share data are based on the weighted average number of common shares outstanding during each year. Diluted earnings per share gives effect to restricted stock granted and stock options and warrants outstanding, determined by the treasury stock method.

Comprehensive Income (Loss)
Comprehensive income (loss) includes net income and other comprehensive income (loss), which is comprised of the change in unrealized gains and losses on securities available for sale, net of tax, change in unrealized losses on securities transferred from available for sale to held to maturity, net of amortization, change in unrealized gain on cash flow hedging derivative instruments, net of tax, and unrecognized gains and losses related to post-retirement benefit costs, net of tax.

Segments
The First Bancorp, Inc., through the branches of its subsidiary, First National Bank, provides a broad range of financial services to individuals and companies in coastal Maine. These services include demand, time, and savings deposits; lending; ATM processing; and investment management and trust services. Operations are managed and financial performance is evaluated on a corporate-wide basis. Accordingly, all of the Company's banking operations are considered by Management to be aggregated in one reportable operating segment.

Note 2. Cash and Cash Equivalents

For the purposes of reporting consolidated cash flows, cash and cash equivalents include cash on hand, amounts due from banks and federal funds sold. At December 31, 2016, the Company had a contractual clearing balance of $500,000 and a reserve balance requirement of $2,134,000 at the Federal Reserve Bank, which are satisfied by both cash on hand at branches and balances held at the Federal Reserve Bank of Boston. The Company maintains a portion of its cash in bank deposit accounts which, at times, may

exceed federally insured limits. The Company has not experienced any losses in such accounts. The Company believes it is not exposed to any significant risk with respect to these accounts.

Note 3. Investment Securities

The following tables summarize the amortized cost and estimated fair value of investment securities at December 31, 2016 and 2015:

As of December 31, 2016	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value (Estimated)
Securities available for sale				
Mortgage-backed securities	$282,397,000	$1,334,000	$(3,127,000)	$280,604,000
State and political subdivisions	16,183,000	475,000	(176,000)	16,482,000
Other equity securities	3,274,000	63,000	(7,000)	3,330,000
	$301,854,000	$1,872,000	$(3,310,000)	$300,416,000
Securities to be held to maturity				
U.S. Government-sponsored agencies	$11,943,000	$35,000	$(233,000)	$11,745,000
Mortgage-backed securities	31,201,000	967,000	(147,000)	32,021,000
State and political subdivisions	179,384,000	1,971,000	(3,884,000)	177,471,000
Corporate securities	4,300,000	—	—	4,300,000
	$226,828,000	$2,973,000	$(4,264,000)	$225,537,000
Restricted equity securities				
Federal Home Loan Bank Stock	$10,893,000	$—	$—	$10,893,000
Federal Reserve Bank Stock	1,037,000	—	—	1,037,000
	$11,930,000	$—	$—	$11,930,000

As of December 31, 2015	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value (Estimated)
Securities available for sale				
Mortgage-backed securities	$194,563,000	$1,509,000	$(962,000)	$195,110,000
State and political subdivisions	23,367,000	1,201,000	(62,000)	24,506,000
Other equity securities	3,381,000	48,000	(6,000)	3,423,000
	$221,311,000	$2,758,000	$(1,030,000)	$223,039,000
Securities to be held to maturity				
U.S. Government-sponsored agencies	$71,000,000	$40,000	$(2,284,000)	$68,756,000
Mortgage-backed securities	42,193,000	1,305,000	(136,000)	43,362,000
State and political subdivisions	122,530,000	4,200,000	(25,000)	126,705,000
Corporate securities	4,300,000	—	—	4,300,000
	$240,023,000	$5,545,000	$(2,445,000)	$243,123,000
Restricted equity securities				
Federal Home Loan Bank Stock	$13,220,000	$—	$—	$13,220,000
Federal Reserve Bank Stock	1,037,000	—	—	1,037,000
	$14,257,000	$—	$—	$14,257,000

The following table summarizes the contractual maturities of investment securities at December 31, 2016:

	Securities available for sale		Securities to be held to maturity	
	Amortized Cost	Fair Value (Estimated)	Amortized Cost	Fair Value (Estimated)
Due in 1 year or less	$253,000	$253,000	$906,000	$913,000
Due in 1 to 5 years	2,251,000	2,298,000	13,451,000	13,714,000
Due in 5 to 10 years	21,043,000	21,505,000	41,588,000	42,448,000
Due after 10 years	275,033,000	273,030,000	170,883,000	168,462,000
Equity securities	3,274,000	3,330,000	—	—
	$301,854,000	$300,416,000	$226,828,000	$225,537,000

The following table summarizes the contractual maturities of investment securities at December 31, 2015:

	Securities available for sale		Securities to be held to maturity	
	Amortized Cost	Fair Value (Estimated)	Amortized Cost	Fair Value (Estimated)
Due in 1 year or less	$527,000	$530,000	$1,814,000	$1,850,000
Due in 1 to 5 years	7,562,000	7,727,000	6,306,000	6,514,000
Due in 5 to 10 years	19,647,000	20,055,000	58,397,000	60,196,000
Due after 10 years	190,194,000	191,304,000	173,506,000	174,563,000
Equity securities	3,381,000	3,423,000	—	—
	$221,311,000	$223,039,000	$240,023,000	$243,123,000

At December 31, 2016, securities with a fair value of $222,328,000 were pledged to secure borrowings from the Federal Home Loan Bank of Boston, public deposits, repurchase agreements, and for other purposes as required by law. This compares to securities with a fair value of $201,879,000 as of December 31, 2015 pledged for the same purposes.

Gains and losses on the sale of securities available for sale are computed by subtracting the amortized cost at the time of sale from the security's selling price, net of accrued interest to be received.

The following table shows securities gains and losses for 2016, 2015 and 2014:

	2016	2015	2014
Proceeds from sales of securities	$10,309,000	$35,468,000	$15,557,000
Gross realized gains	673,000	1,399,000	1,155,000
Gross realized losses	—	—	—
Net gain	$673,000	$1,399,000	$1,155,000
Related income taxes	$236,000	$490,000	$404,000

Management reviews securities with unrealized losses for other than temporary impairment. As of December 31, 2016, there were 299 securities with unrealized losses held in the Company's portfolio. These securities were temporarily impaired as a result of changes in interest rates reducing their fair value, of which 15 had been temporarily impaired for 12 months or more. At the present time, there have been no material changes in the credit quality of these securities resulting in other than temporary impairment, and in Management's opinion, no additional write-down for

other-than-temporary impairment is warranted.

Information regarding securities temporarily impaired as of December 31, 2016 is summarized below:

	Less than 12 months		12 months or more		Total	
As of December 31, 2016	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government-sponsored agencies	$6,642,000	$(233,000)	$—	$—	$6,642,000	$(233,000)
Mortgage-backed securities	197,528,000	(3,090,000)	2,905,000	(184,000)	200,433,000	(3,274,000)
State and political subdivisions	72,348,000	(4,060,000)	—	—	72,348,000	(4,060,000)
Other equity securities	—	—	128,000	(7,000)	128,000	(7,000)
	$276,518,000	$(7,383,000)	$3,033,000	$(191,000)	$279,551,000	$(7,574,000)

As of December 31, 2015, there were 78 securities with unrealized losses held in the Company's portfolio. These securities were temporarily impaired as a result of changes in interest rates reducing their fair value, of which 15 had been temporarily impaired for 12 months or more. Information regarding securities temporarily impaired as of December 31, 2015 is summarized below:

	Less than 12 months		12 months or more		Total	
As of December 31, 2015	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government-sponsored agencies	$45,311,000	$(1,469,000)	$17,185,000	$(815,000)	$62,496,000	$(2,284,000)
Mortgage-backed securities	120,915,000	(1,027,000)	910,000	(71,000)	121,825,000	(1,098,000)
State and political subdivisions	2,528,000	(24,000)	2,901,000	(63,000)	5,429,000	(87,000)
Other equity securities	64,000	(5,000)	52,000	(1,000)	116,000	(6,000)
	$168,818,000	$(2,525,000)	$21,048,000	$(950,000)	$189,866,000	$(3,475,000)

During the third quarter of 2014, the Company transferred securities with a total amortized cost of $89,780,000 and a corresponding fair value of $89,757,000 from available for sale to held to maturity. The net unrealized loss, net of taxes, on these securities at the date of the transfer was $15,000. The net unrealized holding loss at the time of transfer continues to be reported in accumulated other comprehensive income (loss), net of tax and is amortized over the remaining lives of the securities as an adjustment of the yield. The amortization of the net unrealized loss reported in accumulated other comprehensive income (loss) will offset the effect on interest income of the discount for the transferred securities. The remaining unamortized balance of the net unrealized losses for the securities transferred from available for sale to held to maturity was $129,000 at December 31, 2016. These securities were transferred as a part of the Company's overall investment and balance sheet strategies.

The Bank is a member of the Federal Home Loan Bank ("FHLB") of Boston, a cooperatively owned wholesale bank for housing and finance in the six New England States. As a requirement of membership in the FHLB, the Bank must own a minimum required amount of FHLB stock, calculated periodically based primarily on its level of borrowings from the FHLB. The Bank uses the FHLB for much of its wholesale funding needs. As of December 31, 2016 and 2015, the Bank's investment in FHLB stock totaled $10,893,000 and $13,220,000, respectfully. FHLB stock is a restricted equity security and therefore is reported at cost, which equals par value.

The Company periodically evaluates its investment in FHLB stock for impairment based on, among other factors, the capital adequacy of the FHLB and its overall financial condition. No impairment losses have been recorded through December 31, 2016. The Bank will continue to monitor its investment in FHLB stock.

Note 4. Mortgage Servicing Rights

At December 31, 2016 and 2015, the Bank serviced loans for others totaling $250,083,000 and $223,610,000, respectively. Net gains from the sale of loans totaled $1,211,000 in 2016, $714,000 in 2015, and $496,000 in 2014. In 2016, mortgage servicing rights of $554,000 were capitalized and amortization for the year totaled $459,000. At December 31, 2016, mortgage servicing rights had a fair value of $1,696,000. In 2015, mortgage servicing rights of $487,000 were capitalized and amortization for the year totaled $449,000. At December 31, 2015, mortgage servicing rights had a fair value of $1,915,000.

The Financial Accounting Standards Board ("FASB") Accounting Standards Codification (the "Codification" or "ASC") Topic 860, "Transfers and Servicing", requires all separately recognized servicing assets and servicing liabilities to be initially measured at

fair value, if practicable. Servicing assets and servicing liabilities are reported using the amortization method or the fair value measurement method. In evaluating the carrying values of mortgage servicing rights, the Company obtains third party valuations based on loan level data including note rate, type and term of the underlying loans. The model utilizes several assumptions, the most significant of which is loan prepayments, calculated using a three-month moving average of weekly prepayment data published by the Public Securities Association (PSA) and modeled against the serviced loan portfolio, and the discount rate to discount future cash flows. As of December 31, 2016, the prepayment assumption using the PSA model was 250, which translates into an anticipated annual prepayment rate of 15.00%. The discount rate is the quarterly average ten-year U.S. Treasury interest rate plus 3.79%. Other assumptions include delinquency rates, foreclosure rates, servicing cost inflation, and annual unit loan cost. All assumptions are adjusted periodically to reflect current circumstances. Amortization of mortgage servicing rights, as well as write-offs due to prepayments of the related mortgage loans, are recorded as a charge against mortgage servicing fee income. Mortgage servicing rights are included in other assets and detailed in the following table:

As of December 31,	2016	2015
Mortgage servicing rights	$5,901,000	$5,747,000
Accumulated amortization	(4,680,000)	(4,619,000)
Impairment reserve	(108,000)	(35,000)
	$1,113,000	$1,093,000

Note 5. Loans

The following table shows the composition of the Company's loan portfolio as of December 31, 2016 and 2015:

	December 31, 2016		December 31, 2015	
Commercial				
Real estate	$302,506,000	28.2 %	$269,462,000	27.3 %
Construction	25,406,000	2.4 %	24,881,000	2.5 %
Other	150,769,000	14.1 %	128,341,000	13.0 %
Municipal	27,056,000	2.5 %	19,751,000	2.0 %
Residential				
Term	411,469,000	38.4 %	403,030,000	40.7 %
Construction	18,303,000	1.7 %	8,451,000	0.9 %
Home equity line of credit	110,907,000	10.4 %	110,202,000	11.1 %
Consumer	25,110,000	2.3 %	24,520,000	2.5 %
Total loans	$1,071,526,000	100.0%	$988,638,000	100.0%

Loan balances include net deferred loan costs of $4,921,000 in 2016 and $3,686,000 in 2015. Pursuant to collateral agreements, qualifying first mortgage loans, which were valued at $257,122,000 and $279,463,000 at December 31, 2016 and 2015, respectively, were used to collateralize borrowings from the Federal Home Loan Bank of Boston. In addition, commercial, construction and home equity loans totaling $261,463,000 at December 31, 2016 and $243,578,000 at December 2015, were used to collateralize a standby line of credit at the Federal Reserve Bank of Boston that is currently unused.

At December 31, 2016 and 2015, non-accrual loans were $7,774,000 and $7,372,000, respectively. For the years ended December 31, 2016, 2015 and 2014, interest income which would have been recognized on these loans, if interest had been accrued, was $288,000, $369,000, and $551,000, respectively. Loans more than 90 days past due accruing interest totaled $777,000 at December 31, 2016 and $136,000 at December 31, 2015. The Company continues to accrue interest on these loans because it believes collection of principal and interest is reasonably

assured.

Loans to directors, officers and employees totaled $34,889,000 at December 31, 2016 and $31,285,000 at December 31, 2015. A summary of loans to directors and executive officers is as follows:

For the years ended December 31,	2016	2015
Balance at beginning of year	$20,401,000	$14,856,000
New loans	6,278,000	7,382,000
Repayments	(3,386,000)	(1,837,000)
Balance at end of year	$23,293,000	$20,401,000

Information on the past-due status of loans as of December 31, 2016, is presented in the following table:

	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	All Past Due	Current	Total	90+ Days & Accruing
Commercial							
Real estate	$1,039,000	$22,000	$2,415,000	$3,476,000	$299,030,000	$302,506,000	$753,000
Construction	—	—	—	—	25,406,000	25,406,000	—
Other	202,000	33,000	796,000	1,031,000	149,738,000	150,769,000	20,000
Municipal	—	—	—	—	27,056,000	27,056,000	—
Residential							
Term	631,000	3,970,000	1,802,000	6,403,000	405,066,000	411,469,000	—
Construction	—	—	—	—	18,303,000	18,303,000	—
Home equity line of credit	704,000	157,000	703,000	1,564,000	109,343,000	110,907,000	—
Consumer	135,000	45,000	4,000	184,000	24,926,000	25,110,000	4,000
Total	$2,711,000	$4,227,000	$5,720,000	$12,658,000	$1,058,868,000	$1,071,526,000	$777,000

Information on the past-due status of loans as of December 31, 2015, is presented in the following table:

	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	All Past Due	Current	Total	90+ Days & Accruing
Commercial							
Real estate	$603,000	$—	$281,000	$884,000	$268,578,000	$269,462,000	$—
Construction	35,000	—	238,000	273,000	24,608,000	24,881,000	—
Other	303,000	—	25,000	328,000	128,013,000	128,341,000	25,000
Municipal	—	—	—	—	19,751,000	19,751,000	—
Residential							
Term	450,000	2,098,000	2,639,000	5,187,000	397,843,000	403,030,000	100,000
Construction	368,000	—	—	368,000	8,083,000	8,451,000	—
Home equity line of credit	261,000	255,000	592,000	1,108,000	109,094,000	110,202,000	—
Consumer	102,000	26,000	11,000	139,000	24,381,000	24,520,000	11,000
Total	$2,122,000	$2,379,000	$3,786,000	$8,287,000	$980,351,000	$988,638,000	$136,000

For all classes, loans are placed on non-accrual status when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement or

when principal and interest is 90 days or more past due unless the loan is both well secured and in the process of collection (in which case the loan may continue to accrue interest in spite of its past due status). A loan is "well secured" if it is secured (1) by collateral in the form of liens

on or pledges of real or personal property, including securities, that have a realizable value sufficient to discharge the debt (including accrued interest) in full, or (2) by the guarantee of a financially responsible party. A loan is "in the process of collection" if collection of the loan is proceeding in due course either (1) through legal action, including judgment enforcement procedures, or, (2) in appropriate circumstances, through collection efforts not involving legal action which are reasonably expected to result in repayment of the debt or in its restoration to a current status in the near future.

Information on nonaccrual loans as of December 31, 2016 and 2015 is presented in the following table:

As of December 31,	2016	2015
Commercial		
Real estate	$1,907,000	$915,000
Construction	—	238,000
Other	964,000	66,000
Municipal	—	—
Residential		
Term	4,060,000	5,260,000
Construction	—	—
Home equity line of credit	843,000	893,000
Consumer	—	—
Total	$7,774,000	$7,372,000

Information regarding impaired loans is as follows:

For the years ended December 31,	2016	2015	2014
Average investment in impaired loans	$28,217,000	$32,698,000	$38,404,000
Interest income recognized on impaired loans, all on cash basis	1,104,000	1,220,000	1,465,000

As of December 31,	2016	2015
Balance of impaired loans	$27,583,000	$29,531,000
Less portion for which no allowance for loan losses is allocated	(19,716,000)	(20,889,000)
Portion of impaired loan balance for which an allowance for loan losses is allocated	$7,867,000	$8,642,000
Portion of allowance for loan losses allocated to the impaired loan balance	$974,000	$754,000

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

A breakdown of impaired loans by category as of December 31, 2016, is presented in the following table:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Recognized Interest Income
With No Related Allowance					
Commercial					
Real estate	$5,201,000	$5,614,000	$—	$6,252,000	$220,000
Construction	—	—	—	32,000	—
Other	1,671,000	1,852,000	—	1,074,000	86,000
Municipal	—	—	—	—	—
Residential					
Term	11,483,000	12,654,000	—	11,025,000	442,000
Construction	—	—	—	—	—
Home equity line of credit	1,361,000	1,733,000	—	1,213,000	33,000
Consumer	—	—	—	9,000	—
	$19,716,000	$21,853,000	$—	$19,605,000	$781,000
With an Allowance Recorded					
Commercial					
Real estate	$4,820,000	$4,925,000	$ 505,000	$4,153,000	$186,000
Construction	763,000	763,000	100,000	816,000	36,000
Other	72,000	72,000	39,000	317,000	—
Municipal	—	—	—	—	—
Residential					
Term	2,186,000	2,328,000	304,000	3,209,000	101,000
Construction	—	—	—	—	—
Home equity line of credit	26,000	28,000	26,000	69,000	—
Consumer	—	—	—	48,000	—
	$7,867,000	$8,116,000	$ 974,000	$8,612,000	$323,000
Total					
Commercial					
Real estate	$10,021,000	$10,539,000	$ 505,000	$10,405,000	$406,000
Construction	763,000	763,000	100,000	848,000	36,000
Other	1,743,000	1,924,000	39,000	1,391,000	86,000
Municipal	—	—	—	—	—
Residential					
Term	13,669,000	14,982,000	304,000	14,234,000	543,000
Construction	—	—	—	—	—
Home equity line of credit	1,387,000	1,761,000	26,000	1,282,000	33,000
Consumer	—	—	—	57,000	—
	$27,583,000	$29,969,000	$ 974,000	$28,217,000	$1,104,000

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

A breakdown of impaired loans by category as of December 31, 2015, is presented in the following table:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Recognized Interest Income
With No Related Allowance					
Commercial					
Real estate	$7,173,000	$7,496,000	$—	$8,990,000	$301,000
Construction	30,000	30,000	—	3,000	1,000
Other	1,163,000	1,210,000	—	1,893,000	76,000
Municipal	—	—	—	—	—
Residential					
Term	11,122,000	12,157,000	—	10,480,000	415,000
Construction	—	—	—	—	—
Home equity line of credit	1,401,000	2,054,000	—	1,400,000	43,000
Consumer	—	—	—	42,000	3,000
	$20,889,000	$22,947,000	$—	$22,808,000	$839,000
With an Allowance Recorded					
Commercial					
Real estate	$3,544,000	$3,627,000	$ 89,000	$3,066,000	$149,000
Construction	996,000	996,000	302,000	1,153,000	44,000
Other	71,000	77,000	8,000	256,000	5,000
Municipal	—	—	—	—	—
Residential					
Term	3,966,000	4,193,000	326,000	5,228,000	180,000
Construction	—	—	—	—	—
Home equity line of credit	65,000	66,000	29,000	187,000	3,000
Consumer	—	—	—	—	—
	$8,642,000	$8,959,000	$ 754,000	$9,890,000	$381,000
Total					
Commercial					
Real estate	$10,717,000	$11,123,000	$ 89,000	$12,056,000	$450,000
Construction	1,026,000	1,026,000	302,000	1,156,000	45,000
Other	1,234,000	1,287,000	8,000	2,149,000	81,000
Municipal	—	—	—	—	—
Residential					
Term	15,088,000	16,350,000	326,000	15,708,000	595,000
Construction	—	—	—	—	—
Home equity line of credit	1,466,000	2,120,000	29,000	1,587,000	46,000
Consumer	—	—	—	42,000	3,000
	$29,531,000	$31,906,000	$ 754,000	$32,698,000	$1,220,000

A breakdown of impaired loans by category as of December 31, 2014, is presented in the following table:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Recognized Interest Income
With No Related Allowance					
Commercial					
Real estate	$11,687,000	$12,423,000	$—	$11,080,000	$488,000
Construction	—	—	—	30,000	—
Other	2,616,000	3,407,000	—	3,853,000	156,000
Municipal	—	—	—	—	—
Residential					
Term	10,820,000	11,824,000	—	10,505,000	402,000
Construction	—	—	—	—	—
Home equity line of credit	1,164,000	1,395,000	—	1,447,000	29,000
Consumer	26,000	28,000	—	11,000	3,000
	$26,313,000	$29,077,000	$—	$26,926,000	$1,078,000
With an Allowance Recorded					
Commercial					
Real estate	$1,617,000	$1,789,000	$346,000	$3,040,000	$62,000
Construction	1,380,000	1,380,000	413,000	1,279,000	56,000
Other	326,000	338,000	129,000	1,103,000	13,000
Municipal	—	—	—	—	—
Residential					
Term	5,303,000	5,513,000	519,000	5,738,000	239,000
Construction	—	—	—	—	—
Home equity line of credit	923,000	929,000	396,000	318,000	17,000
Consumer	—	—	—	—	—
	$9,549,000	$9,949,000	$1,803,000	$11,478,000	$387,000
Total					
Commercial					
Real estate	$13,304,000	$14,212,000	$346,000	$14,120,000	$550,000
Construction	1,380,000	1,380,000	413,000	1,309,000	56,000
Other	2,942,000	3,745,000	129,000	4,956,000	169,000
Municipal	—	—	—	—	—
Residential					
Term	16,123,000	17,337,000	519,000	16,243,000	641,000
Construction	—	—	—	—	—
Home equity line of credit	2,087,000	2,324,000	396,000	1,765,000	46,000
Consumer	26,000	28,000	—	11,000	3,000
	$35,862,000	$39,026,000	$1,803,000	$38,404,000	$1,465,000

Troubled Debt Restructured

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

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

The Company applies the same interest accrual policy to TDRs as it does for all classes of loans. As of December 31, 2016, the Company had 71 loans with a value of $21,526,000 that have been restructured. This compares to 84 loans with a value of $23,923,000 classified as TDRs as of December 31, 2015. The impairment carried as a specific reserve in the allowance for loan losses is calculated by present valuing the cashflow modification on the loan, or, for collateral-dependent loans, using the fair value of the collateral less costs to sell.

The following table shows TDRs by class and the specific reserve as of December 31, 2016:

	Number of Loans	Balance	Specific Reserves
Commercial			
Real estate	10	$8,937,000	$375,000
Construction	1	763,000	100,000
Other	5	779,000	—
Municipal	—	—	—
Residential			
Term	52	10,503,000	261,000
Construction	—	—	—
Home equity line of credit	3	544,000	—
Consumer	—	—	—
	71	$21,526,000	$736,000

The following table shows TDRs by class and the specific reserve as of December 31, 2015:

	Number of Loans	Balance	Specific Reserves
Commercial			
Real estate	15	$10,350,000	$85,000
Construction	1	788,000	94,000
Other	11	1,168,000	1,000
Municipal	—	—	—
Residential			
Term	53	10,875,000	275,000
Construction	—	—	—
Home equity line of credit	4	742,000	—
Consumer	—	—	—

84	$23,923,000	$455,000

As of December 31, 2016, 12 of the loans classified as TDRs with a total balance of $2,303,000 were more than 30 days past due. Of these loans, none had been placed on TDR status in the previous 12 months. The following table shows past-due TDRs by class and the associated specific reserves included in the allowance for loan losses as of December 31, 2016:

	Number of Loans	Balance	Specific Reserves
Commercial			
Real estate	1	$822,000	$264,000
Construction	—	—	—
Other	—	—	—
Municipal	—	—	—
Residential			
Term	10	1,314,000	26,000
Construction	—	—	—
Home equity line of credit	1	167,000	—
Consumer	—	—	—
	12	$2,303,000	$290,000

As of December 31, 2015, eight of the loans classified as TDRs with a total balance of $1,053,000 were more than 30 days past due. None of these loans had been placed on TDR status in the previous 12 months. The following table shows past-due TDRs by class and the associated specific reserves included in the allowance for loan losses as of December 31, 2015:

	Number of Loans	Balance	Specific Reserves
Commercial			
Real estate	—	$—	$—
Construction	—	—	—
Other	—	—	—
Municipal	—	—	—
Residential			
Term	8	1,053,000	46,000
Construction	—	—	—
Home equity line of credit	—	—	—
Consumer	—	—	—
	8	$1,053,000	$46,000

During the year ended December 31, 2016, no loans were placed on TDR status.

During the year ended December 31, 2015, two loans were placed on TDR status with a post-modification balance of $218,000. These were considered to be TDRs because concessions had been granted to borrowers experiencing financial difficulties. Concessions include reductions in interest rates, principal and/or interest forbearance, payment extensions, or combinations thereof.

The following table shows loans placed on TDR status in 2015 by type of loan and the associated specific reserve included in the allowance for loan losses as of December 31, 2015:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Specific Reserves
Commercial				
Real estate	—	$ —	$ —	$ —
Construction	—	—	—	—
Other	—	—	—	—
Municipal	—	—	—	—
Residential				
Term	2	221,000	218,000	—
Construction	—	—	—	—
Home equity line of credit	—	—	—	—
Consumer	—	—	—	—
	2	$ 221,000	$ 218,000	$ —

As of December 31, 2016, Management is aware of six loans classified as TDRs that are involved in bankruptcy with an outstanding balance of $1,693,000. As of December 31, 2016, there were nine loans with an outstanding balance of $1,715,000 that were classified as TDRs and were on non-accrual status, one of which, with an outstanding balance of $46,000, was in the process of foreclosure.

Residential Mortgage Loans in Process of Foreclosure

As of December 31, 2016, there were 15 mortgage loans collateralized by residential real estate in the process of foreclosure with a total balance of $2,058,000; this compares to 16 mortgage loans collateralized by residential real estate in the process of foreclosure with a total balance of $1,513,000 as of December 31, 2015.

Note 6. Allowance for Loan Losses

The Company provides for loan losses through the establishment of an allowance for loan losses which represents an estimated reserve for existing losses in the loan portfolio. A systematic methodology is used for determining the allowance that includes a quarterly review process, risk rating changes, and adjustments to the allowance. The loan portfolio is classified in eight classes and credit risk is evaluated separately in each class. The appropriate level of the allowance is evaluated continually based on a review of significant loans, with a particular emphasis on nonaccruing, past due, and other loans that may require special attention. Other factors include general conditions in local and national economies; loan portfolio composition and asset quality indicators; and internal factors such as changes in underwriting policies, credit administration practices, experience, ability and depth of lending management, among others.

The following table summarizes the composition of the allowance for loan losses, by class of financing receivable and allowance, as of December 31, 2016 and 2015:

As of December 31,	2016	2015
Allowance for Loans Evaluated Individually for Impairment		
Commercial		
Real estate	$505,000	$89,000
Construction	100,000	302,000
Other	39,000	8,000
Municipal	—	—
Residential		
Term	304,000	326,000
Construction	—	—
Home equity line of credit	26,000	29,000
Consumer	—	—
Total	$974,000	$754,000
Allowance for Loans Evaluated Collectively for Impairment		
Commercial		
Real estate	$3,483,000	$3,031,000
Construction	296,000	278,000
Other	1,741,000	1,444,000
Municipal	18,000	17,000
Residential		
Term	984,000	1,065,000
Construction	44,000	24,000
Home equity line of credit	781,000	864,000
Consumer	559,000	566,000
Unallocated	1,258,000	1,873,000
Total	$9,164,000	$9,162,000
Total Allowance for Loan Losses		
Commercial		
Real estate	$3,988,000	$3,120,000
Construction	396,000	580,000
Other	1,780,000	1,452,000
Municipal	18,000	17,000
Residential		
Term	1,288,000	1,391,000
Construction	44,000	24,000
Home equity line of credit	807,000	893,000
Consumer	559,000	566,000
Unallocated	1,258,000	1,873,000
Total	$10,138,000	$9,916,000

The allowance consists of four elements: (1) specific reserves for loans evaluated individually for impairment; (2) general reserves for each portfolio segment based on historical loan loss experience; (3) qualitative reserves judgmentally adjusted for local and national economic conditions, concentrations, portfolio composition, volume and severity of delinquencies and nonaccrual loans, trends of criticized and classified loans, changes in credit policies, and underwriting standards, credit administration practices, and other factors as applicable for each portfolio segment; and (4) unallocated reserves. All outstanding loans are considered in evaluating the appropriateness of the allowance.
A breakdown of the allowance for loan losses as of December 31, 2016 and 2015, by class of financing receivable and allowance element, is presented in the following tables:

As of December 31, 2016	Specific Reserves on Loans Evaluated Individually for Impairment	General Reserves on Loans Based on Historical Loss Experience	Reserves for Qualitative Factors	Unallocated Reserves	Total Reserves
Commercial					
Real estate	$ 505,000	$1,471,000	$2,012,000	$—	$3,988,000
Construction	100,000	125,000	171,000	—	396,000
Other	39,000	735,000	1,006,000	—	1,780,000
Municipal	—	—	18,000	—	18,000
Residential					
Term	304,000	563,000	421,000	—	1,288,000
Construction	—	25,000	19,000	—	44,000
Home equity line of credit	26,000	444,000	337,000	—	807,000
Consumer	—	328,000	231,000	—	559,000
Unallocated	—	—	—	1,258,000	1,258,000
	$ 974,000	$3,691,000	$4,215,000	$1,258,000	$10,138,000

As of December 31, 2015	Specific Reserves on Loans Evaluated Individually for Impairment	General Reserves on Loans Based on Historical Loss Experience	Reserves for Qualitative Factors	Unallocated Reserves	Total Reserves
Commercial					
Real estate	$ 89,000	$893,000	$2,138,000	$—	$3,120,000
Construction	302,000	82,000	196,000	—	580,000
Other	8,000	425,000	1,019,000	—	1,452,000
Municipal	—	—	17,000	—	17,000
Residential					
Term	326,000	613,000	452,000	—	1,391,000
Construction	—	14,000	10,000	—	24,000
Home equity line of credit	29,000	500,000	364,000	—	893,000
Consumer	—	331,000	235,000	—	566,000

Unallocated	—	—	—	1,873,000	1,873,000
	$ 754,000	$2,858,000	$4,431,000	$1,873,000	$9,916,000

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

- General economic conditions.
- Credit quality trends with emphasis on loan delinquencies, nonaccrual levels and classified loans.
- Recent loss experience in particular segments of the portfolio.
- Loan volumes and concentrations, including changes in mix.
- Other factors, including changes in quality of the loan origination; loan policy changes; changes in credit risk management processes; Bank regulatory and external loan review examination results.

The qualitative portion of the allowance for loan losses was 0.39% of related loans as of December 31, 2016, compared to 0.45% of related loans as of December 31, 2015. The qualitative portion decreased $216,000 between December 31, 2015 and December 31, 2016.

The unallocated component totaled $1,258,000 at December 31, 2016, or 12.4% of the total reserve. This compares to $1,873,000 or 18.9% as of December 31, 2015. The decrease in the unallocated portion is a result of charge offs on collateral-dependent loans and the improvement in credit quality. Management feels the decrease in the unallocated portion is directionally consistent with local and national economic conditions.

The allowance for loan losses as a percent of total loans stood at 0.95% as of December 31, 2016, compared to 1.00% of total loans as of December 31, 2015.

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

Commercial real estate loans consist of mortgage loans to finance investments in real property such as multi-family residential, commercial/retail, office, industrial, hotels, educational and other specific or mixed use properties. Commercial real estate loans are typically written with amortizing payment structures. Collateral values are determined based on appraisals and evaluations in accordance with established policy and regulatory guidelines. Commercial real estate loans typically have a loan-to-value ratio of up to 80% based upon current valuation information at the time the loan is made. Commercial real estate loans are primarily paid by the cash flow generated from the real property, such as operating leases, rents, or other operating cash flows from the borrower.

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

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

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

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

Residential term loans consist of residential real estate loans held in the Company's loan portfolio made to borrowers who demonstrate the ability to make scheduled payments with full consideration to underwriting factors. Borrower

qualifications include favorable credit history combined with supportive income requirements and loan-to-value ratios within established policy and regulatory guidelines. Collateral values are determined based on appraisals and evaluations in accordance with established policy and regulatory guidelines. Residential loans typically have a loan-to-value ratio of up to 80% based on appraisal information at the time the loan is made. Collateral consists of mortgage liens on one- to four-family residential properties. Loans are offered with fixed or adjustable rates with amortization terms of up to thirty years.

Residential construction loans typically consist of loans for the purpose of constructing single family residences to be owned and occupied by the borrower. Borrower qualifications include favorable credit history combined with supportive income requirements and loan-to-value ratios within established policy and regulatory guidelines. Residential construction loans normally have construction terms of one year or less and payment during the construction term is typically on an interest only basis from sources including interest reserves, borrower liquidity and/or income. Residential construction loans will typically convert to permanent financing from the Company or have another financing commitment in place from an acceptable mortgage lender. Collateral valuation and loan-to-value guidelines are consistent with those for residential term loans.

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

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

Construction loans, both commercial and residential, at 28.9% of capital are well under the regulatory guidance of 100.0% of capital at December 31, 2016. Construction loans and non-owner-occupied commercial real estate loans are at 109.4% of total capital, are below the regulatory limit of 300.0% of capital at December 31, 2016.

The process of establishing the allowance with respect to the commercial loan portfolio begins when a loan officer initially assigns each loan a risk rating, using established credit criteria. Approximately 50% of the outstanding loans and commitments are subject to review and validation annually by an independent consultant, as well as periodically by the Company's internal credit review function. The methodology employs Management's judgment as to the level of losses on existing loans based on internal review of the loan portfolio, including an analysis of a borrower's current financial position, and the consideration of current and anticipated economic conditions and their potential effects on specific borrowers and or lines of business. In determining the Company's ability to collect certain loans, Management also considers the fair value of underlying collateral.

The risk rating system has eight levels, defined as follows:

1 Strong
Credits rated "1" are characterized by borrowers fully responsible for the credit with excellent capacity to pay principal and interest. Loans rated "1" may be secured with acceptable forms of liquid collateral.
2 Above Average
Credits rated "2" are characterized by borrowers that have better than average liquidity, capitalization, earnings and/or cash flow with a consistent record of solid financial performance.
3 Satisfactory
Credits rated "3" are characterized by borrowers with favorable liquidity, profitability and financial condition with adequate cash flow to pay debt service.
4 Average
Credits rated "4" are characterized by borrowers that present risk more than 1, 2 and 3 rated loans and merit an ordinary level of ongoing monitoring. Financial condition is on par or somewhat below industry averages while cash flow is generally adequate to meet debt service requirements.
5 Watch
Credits rated "5" are characterized by borrowers that warrant greater monitoring due to financial condition or unresolved and identified risk factors.
6 Other Assets Especially Mentioned (OAEM)
Loans in this category are currently protected but are potentially weak and constitute an undue and unwarranted credit risk, but not to the point of justifying a classification of substandard. OAEM have potential weaknesses which may, if not checked or corrected, weaken the asset or inadequately protect the Bank's credit position at some future date.
7 Substandard
Loans in this category are inadequately protected by the current paying capacity of the borrower or of the collateral, if any. These loans have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Substandard loans are characterized by the distinct possibility that the Bank may sustain some loss if deficiencies are not corrected.
8 Doubtful
Loans classified "Doubtful" have the same weaknesses as those classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, based on currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is high, but because of certain important and reasonably specific pending factors which may work to the advantage and strengthening of the asset, its classification as an estimated loss is deferred until its more exact status may be determined.

The following table summarizes the risk ratings for the Company's commercial construction, commercial real estate, commercial other and municipal loans as of December 31, 2016:

	Commercial Real Estate	Commercial Construction	Commercial Other	Municipal Loans	All Risk-Rated Loans
1 Strong	$2,000	$—	$850,000	$—	$852,000
2 Above average	13,981,000	49,000	8,934,000	25,527,000	48,491,000
3 Satisfactory	81,286,000	1,345,000	48,212,000	1,529,000	132,372,000
4 Average	139,421,000	16,506,000	65,146,000	—	221,073,000
5 Watch	43,181,000	7,349,000	16,864,000	—	67,394,000
6 OAEM	4,569,000	—	1,587,000	—	6,156,000
7 Substandard	20,066,000	157,000	9,176,000	—	29,399,000
8 Doubtful	—	—	—	—	—

Total	$302,506,000	$25,406,000	$150,769,000	$27,056,000	$505,737,000

The following table summarizes the risk ratings for the Company's commercial construction, commercial real estate, commercial other and municipal loans as of December 31, 2015:

	Commercial Real Estate	Commercial Construction	Commercial Other	Municipal Loans	All Risk-Rated Loans
1 Strong	$6,000	$—	$1,256,000	$—	$1,262,000
2 Above average	29,176,000	56,000	7,506,000	18,321,000	55,059,000
3 Satisfactory	52,821,000	2,057,000	28,787,000	1,430,000	85,095,000
4 Average	122,071,000	18,070,000	67,301,000	—	207,442,000
5 Watch	36,075,000	4,490,000	18,135,000	—	58,700,000
6 OAEM	9,742,000	—	2,410,000	—	12,152,000
7 Substandard	19,571,000	208,000	2,946,000	—	22,725,000
8 Doubtful	—	—	—	—	—
Total	$269,462,000	$24,881,000	$128,341,000	$19,751,000	$442,435,000

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

Residential loans are comprised of two classes: term loans, which include traditional amortizing home mortgages, and construction loans, which include loans for owner-occupied residential construction. Residential loans typically have a 75% to 80% loan to value based upon current appraisal information at the time the loan is made. Home equity loans and lines of credit are typically written to the same underwriting standa