BAR HARBOR BANKSHARES
Form 10-K
March 12, 2019
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K
ý ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2018
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number: 001-13349
BAR HARBOR BANKSHARES
(Exact name of registrant as specified in its charter)

Maine	01-0393663
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

PO Box 400 82 Main Street, Bar Harbor, ME	04609-0400
(Address of principal executive offices)	(Zip Code)

Registrant’s telephone number, including area code: (207) 288-3314
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common stock, par value $2.00 per share	NYSE American

Securities registered pursuant to Section 12(g) of the Act: None
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No ý
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 o No ý
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 ý No o
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ý No o
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. o

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definition of “large accelerated filer,” “accelerated filer”, “smaller reporting company”, or "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one)
Large Accelerated Filer o Accelerated Filer ý Non-Accelerated Filer o Smaller Reporting Company o
Emerging growth company o
If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)
Yes o No ý
The aggregate market value of the common stock held by non-affiliates of Bar Harbor Bankshares was $469,384,260 based on the closing sale price of the common stock on the NYSE American on June 30, 2018, the last trading day of the registrant’s most recently completed second quarter.
The Registrant had 15,523,628 shares of common stock, par value $2.00 per share, outstanding as of March 8, 2019.
DOCUMENTS INCORPORATED BY REFERENCE
Portions of the definitive Proxy Statement for the Annual Meeting of Stockholders to be held on May 21, 2019 are incorporated by reference into Part III, Items 10-14 of this Annual Report on Form 10-K.

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SIGNATURES

The Company conducts business operations principally through Bar Harbor Bank & Trust, which may be referred to as the Bank and which is a subsidiary of Bar Harbor Bankshares. Unless the context requires otherwise, references in this report to "our company, "our," "us," "we" and similar terms refer to Bar Harbor Bankshares and its subsidiaries, including the Bank, collectively.

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PART I

ITEM 1. BUSINESS

FORWARD-LOOKING STATEMENTS

Certain statements contained in this Annual Report on Form 10-K that are not historical facts may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 ("Securities Act") and Section 21E of the Securities Exchange Act of 1934 ("Exchange Act") and are intended to be covered by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. You can identify these statements from the use of the words “may,” “will,” “should,” “could,” “would,” “plan,” “potential,” “estimate,” “project,” “believe,” “intend,” “an “target” and similar expressions. These forward-looking statements are subject to significant risks, assumptions and uncertainties, including among other things, changes in general economic and business conditions, increased competitive pressures, changes in the interest rate environment, legislative and regulatory change, changes in the financial markets, and other risks and uncertainties disclosed from time to time in documents that Bar Harbor Bankshares files with the Securities and Exchange Commission. All risk factors set forth in Item 1A of this Annual Report on Form 10-K should be considered in evaluating forward-looking statements, which speak only as of the dates on which they were made. The Company is not undertaking an obligation to update forward-looking statements, even though its situation may change in the future, except as required under federal securities law. The Company qualifies all of its forward-looking statements by these cautionary statements.

GENERAL

Throughout this Annual Report on Form 10-K, Bar Harbor Bankshares is referred to as “BHB”, “the Company", “we”, “our”, or “us.” Bar Harbor Bank & Trust (“the Bank”) was established in 1887, and is the only community bank headquartered in Northern New England with branches in Maine, New Hampshire and Vermont. The Bank is a true community bank providing exceptional commercial, retail and wealth management banking services through a network of 48 full-service branches.

The Company’s corporate goal is to be among the most profitable banks in New England, and its business model is centered on the following:

- Employee and customer experience is the foundation of superior performance, which leads to significant financial benefit to shareholders
- Geography, heritage and performance are key while remaining true to a community culture
- Strong commitment to risk management while balancing growth and earnings
- Service and sales driven culture with a focus on core business growth
- Fee income is fundamental to the Company's profitability through trust and treasury management services, customer derivatives and secondary market mortgage sales
- Investment in processes, products, technology, training, leadership and infrastructure
- Expansion of the Company’s brand and business to deepen market presence
- Opportunity and growth for existing employees while adding catalyst recruits across all levels of the Company

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Shown below is a profile and geographical footprint of the Bank as of December 31, 2018:

The Bank serves affluent and growing markets in Maine, New Hampshire and Vermont. Within these markets, tourism, agriculture and fishing industries remain strong and continue to drive economic activity. These core markets have also maintained their strength through diversification into various service industries.

Maine
The Bank operates 14 full-service branches principally located in the regions of downeast, midcoast and central Maine, which can generally be characterized as rural areas. As previously announced, the Bank opened a new commercial loan office in Portland, Maine in December 2018. In Maine, the Bank considers its primary market areas to be Hancock, Knox, Washington, Kennebec and Sagadahoc counties. The economies in these counties are based primarily on tourism, healthcare, fishing and lobstering, agriculture, state government, and small local businesses and are also supported by a large contingent of retirees.

New Hampshire
The Bank operates 21 full-service branches and two stand-alone drive-up windows in New Hampshire located in the regions of the lake sunapee, upper valley and merrimack valley. There are several distinct markets within each of these regions. The towns or cities of Nashua, Manchester, and Concord are considered part of the merrimack valley. Nashua, New Hampshire is a regional commercial, entertainment and dining destination and with its board with Massachusetts, also enjoys a vibrant high-tech industry and a robust retail industry due in part to the state's absence of a sales tax. The upper valley region of New Hampshire includes the towns of Lebanon and Hanover, which are home to Dartmouth-Hitchcock Medical Center and Dartmouth College, respectively. The lake sunapee market is a popular year-round recreation and resort area that includes both Lake Sunapee and Mount Sunapee and includes the towns of Claremont, New London, and Newport.

Vermont
The Bank operates 13 full-service branches and one stand-alone drive-up window in Vermont. The branches are primarily located in central Vermont within the counties of Rutland, Windsor and Orange. These markets are home to many attractions, including Killington Mountain, Okemo Resort, and the city of Rutland. Popular vacation destinations in this region include Woodstock, Brandon, Ludlow and Quechee.

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SUBSIDIARY ACTIVITIES

Bar Harbor Bankshares is a legal entity separate and distinct from its first-tier bank subsidiary, Bar Harbor Bank & Trust and its second-tier subsidiaries, Bar Harbor Trust Services, Charter Trust Company and Cottage Street Corporation. Under Charter Trust Company are third-tier subsidiaries Charter Holding Corporation and Charter New England Agency.

The Company also owns all of the common stock of two Connecticut statutory trusts. These capital trusts are unconsolidated and their only material asset is a $20.6 million trust preferred security related to the junior subordinated debentures reported in Note 8 - Borrowed Funds of the Consolidated Financial Statements.

AVAILABLE INFORMATION

The Company is required to file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission, or SEC. The SEC maintains a website at www.sec.gov that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC.
The Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, proxy statements and amendments to those documents filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, are also available free of charge on the Company's website at www.bhbt.com under the Shareholders Relations link as soon as reasonably practicable after such reports are electronically filed with or furnished to the SEC.
Investors should note that the Company currently announces material information to investors and others using SEC filings, press releases and postings on the Company's website (www.bhbt.com), including news and announcements regarding the Company's financial performance, key personnel, brands and business strategy. Information that is posted on the corporate website could be deemed material to investors. The Company encourages investors to review the information posted on these channels. Updates may be made, from time to time, to the list of channels used to communicate information that could be deemed material and any such change will be posted on www.bhbt.com. The information on the website is not, and shall not be deemed to be, a part hereof or incorporated into this or any other filings with the SEC.

COMPETITION

Major competitors in the Company's market areas include local independent banks, local branches of large regional and national bank affiliates, thrift institutions, savings and loan institutions, mortgage companies, and credit unions.

The Company has generally been able to compete effectively with other financial institutions by emphasizing quality customer service, making decisions at the local level, maintaining long-term customer relationships, building customer loyalty, and providing products and services designed to address the specific needs of customers. However, no assurance can be provided regarding the Company’s ongoing ability to compete effectively with other financial institutions in the future.

No part of the Company’s business is materially dependent upon one, or a few customers, or upon a particular industry segment, the loss of which would have a material adverse impact on the operations of the Company.

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LENDING ACTIVITIES

General
The Bank originates loans in four basic portfolio categories, which are discussed below. These portfolio categories include construction and land development, commercial real estate, commercial and industrial, agricultural, tax exempt entities, residential mortgages, home equity and other consumer loans. Loan interest rates and other key loan terms are affected principally by the Bank's lending policy, asset/liability strategy, loan demand, competition, and the supply of money available for lending purposes. The Bank does not engage in subprime lending activities. The Bank monitors and manages the amount of long-term fixed-rate lending and adjustable-rate loan products according to its interest rate management policy. The Bank generally originates loans for investment except for certain residential mortgages that are underwritten with the intention to be sold in the secondary mortgage market.

Loan Portfolio Analysis. The following table sets forth the year-end composition of the Company's loan portfolio in dollar amounts and as a percentage of the portfolio for the five years indicated. Further information about the composition of the loan portfolio is contained in Note 3 - Loans of the Consolidated Financial Statements.

	2018		2017		2016		2015		2014	
(in thousands, except percentages)	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
Commercial real estate	$826,699	33 %	$826,746	34 %	$418,119	37 %	$396,032	40 %	$351,354	38 %
Commercial and industrial	404,870	16	379,423	15	151,240	13	126,158	13	121,057	13
Total commercial	1,231,569	49	1,206,169	49	569,359	50	522,190	53	472,411	51
Residential	1,144,698	46	1,155,682	46	506,612	45	408,401	41	382,678	42
Consumer	113,960	5	123,762	5	53,093	5	59,479	6	63,935	7
Total loans	2,490,227	100 %	2,485,613	100 %	1,129,064	100 %	990,070	100 %	919,024	100 %
Allowance for loan losses	(13,866)		(12,325)		(10,419)		(9,439)		(8,969)	
Net loans	$2,476,361		$2,473,288		$1,118,645		$980,631		$910,055	

Commercial Real Estate
Commercial real estate loans are secured primarily by multifamily dwellings, industrial/warehouse buildings, retail centers, office buildings and hospitality properties, primarily located in the Company's market area in New England. The Company's loans secured by commercial real estate are originated with either a fixed or an adjustable interest rate. Interest rates on adjustable rate loans are based on a variety of indices, generally determined through negotiations with borrowers. The Bank's commercial real estate underwriting guidelines call for loan-to-value (LTV) ratios not to exceed 80 percent of the appraised value of the underlying property securing the loan. Unless on some sort of seasonal pay basis, to match debt payments with seasonal cash flows. Loans typically require monthly payments containing balloon payments with maturities of 10 years or less based on 20 year amortization schedules for commercial real estate and 25 years for multifamily loans.

Commercial and Industrial Loans
Commercial and industrial loans are made to finance operations, provide working capital, finance the purchase of fixed assets, and business acquisitions. A borrower's cash flow from operations is generally the primary source of repayment. Accordingly, the Company's loan policy provides specific guidelines regarding debt service coverage and other financial ratios. Commercial and industrial loans include lines of credit, commercial term loans and owner-occupied commercial real estate loans. Commercial lines of credit are extended to businesses generally to

finance operations and working capital needs. Commercial term loans are typically made to finance the acquisition of fixed assets, refinance short-term debt originally used to purchase fixed assets or make business acquisitions. Commercial and industrial loans are extended based on the financial strength and integrity of the borrower and guarantor(s) and are generally collateralized by the borrower's assets such as accounts receivable, inventory, equipment or real estate, typically with a term based on the collateral's useful life of 1-10 years. The interest rates on these loans generally

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are adjustable and usually are indexed to The Wall Street Journal's prime rate (Prime Rate) or London Interbank Offered Rate (LIBOR) and the spread will vary based on market conditions and perceived credit risk.

In order to mitigate the risk of loss, the Company generally requires collateral and personal guarantees to support commercial and industrial loans. The Company attempts to mitigate risk by limiting advance rates against eligible collateral to no more than 80 percent, though appropriate advance rates can vary depending on asset class.

Commercial and industrial loans also attract multifaceted relationships, which include deposit and treasury management services. During 2018, the Company expanded its offering of treasury management services and introduced customer loan derivatives. The Company facilitates the risk management strategies for commercial banking customers by offering customer loan derivatives, which allows a customer to obtain a lower fixed-rate loan for an upfront fee. Offsetting loan swap arrangements with a highly-rated third-party financial institutions are then executed by the Company to mitigate the interest rate risk.

Residential Real Estate

The Company offers fixed-rate and adjustable-rate residential mortgage loans to individuals with maturities of up to 30 years that are fully amortizing with monthly loan payments. Certain loans are originated for sale with rate lock commitments which are recorded as derivative financial instruments. Mortgages are generally underwritten according to U.S. government sponsored enterprise guidelines designated as “A” or “A-” and referred to as “conforming loans”. The Company also originates jumbo loans above conforming loan amounts which generally are consistent with secondary market guidelines for these loans; however, these are typically held for investment. The Company does not offer a subprime mortgage lending program. Mortgage loans sold on the secondary market are sold on a servicing-retained basis.

Consumer Loans

The Company offers a variety of secured consumer loans, including second deed-of-trust home equity loans, home equity lines of credit ("HELOCs"), personal property and loans secured by deposits. The Company also offers a limited amount of unsecured loans. The Company originates consumer loans primarily in its market area. Consumer loans generally have shorter terms to maturity or variable interest rates, which reduce the Company's exposure to changes in interest rates, and carry higher rates of interest than do residential real estate loans. The Company believes that offering consumer loan products is critical to community banking by providing customer service at the holistic relationship level.

HELOCs have a ten or fifteen year draw period followed by a 20 year amortization and require either interest-only payments during the draw period or the payment of 1.0 percent or 1.5 percent of the outstanding loan balance per month (depending on the terms). Following receipt of payments, the available credit includes amounts repaid up to the credit limit. HELOCs with a ten year draw period have a balloon payment due at the end of the draw period and then amortize for the remaining term. For loans with shorter-term draw periods, once the draw period has lapsed, generally the payment is fixed based on the loan balance and prevailing market interest rates at that time.

Maturity and Sensitivity of the Loan Portfolio

The following table shows contractual final maturities of selected loan categories at December 31, 2018. The contractual maturities do not reflect premiums, discounts, deferred costs, or prepayments.

(in thousands)	1 Year or Less	1 to 5 Years	More than 5 Years	Total
Commercial real estate	$15,156	$85,239	$726,304	$826,699
Commercial and industrial	38,630	117,956	248,284	404,870
Total commercial	53,786	203,195	974,588	1,231,569
Residential	273	20,351	1,124,074	1,144,698

Consumer	7,643	25,977	80,340	113,960
Total	$61,702	$249,523	$2,179,002	$2,490,227

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Problem Assets

The Bank prefers to work with borrowers to resolve problems rather than proceeding to foreclosure. For commercial loans, this may result in a period of forbearance or restructuring of the loan, which is normally done at current market terms and does not result in a “troubled” loan designation. For residential mortgage loans, the Bank generally follows The Federal Deposit Insurance Corporation ("FDIC") guidelines to attempt a restructuring that will enable owner-occupants to remain in their home. However, if these processes fail to result in a performing loan, then the Bank generally will initiate foreclosure or other proceedings no later than the 90th day of a delinquency, as necessary, to minimize any potential loss. Management reports delinquent loans and non-performing assets to the Board monthly. Loans are generally removed from accruing status when they reach 90 days delinquent, except for certain loans which are well secured and in the process of collection. Loan collections are managed by a combination of the related business units and the Bank’s Managed Assets Group, which focuses on larger, riskier collections and the recovery of purchased credit impaired loans.

The following table presents the problem assets and accruing troubled debt restructurings ("TDRs") for the five years indicated:

(in thousands, except ratios)	2018	2017	2016	2015	2014
Non-accruing loans:					
Commercial real estate	$8,156	$8,343	$2,564	$2,390	$4,484
Commercial and industrial	2,331	1,209	315	308	708
Residential	7,210	4,266	3,419	3,452	6,051
Consumer	538	500	198	830	1,045
Total non-performing loans	18,235	14,318	6,496	6,980	12,288
Real estate owned	2,351	122	90	256	523
Total non-performing assets	$20,586	$14,440	$6,586	$7,236	$12,811
Troubled debt restructurings (accruing)	$1,657	$1,046	$2,713	$2,336	$1,092
Accruing loans 90+ days past due	246	510	—	28	—
Total non-performing loans/total loans	0.73 %	0.58 %	0.58 %	0.71 %	1.34 %
Total non-performing assets/total assets	0.57	0.41	0.38	0.46	0.88

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Allowance for Loan Losses

The Bank's loan portfolio is regularly reviewed by management to evaluate the adequacy of the allowance for loan losses. The allowance represents management's estimate of inherent losses that are probable and estimatable as of the date of the financial statements. The allowance includes a specific component for impaired loans (a "specific loan loss reserve") and a general component for portfolios of all outstanding loans (a "general loan loss reserve"). At the time of acquisition, no allowance for loan losses is assigned to loans acquired in business combinations. These loans are carried at fair value, including the impact of expected losses, as of the acquisition date. The loan loss allowance is discussed further in Note 1 - Summary of Significant Accounting Policies of the Consolidated Financial Statements.

The following table presents an analysis of the allowance for loan losses for the five years indicated:

(in thousands, except ratios)	2018	2017	2016	2015	2014
Balance at beginning of year	$12,325	$10,419	$9,439	$8,969	$8,475
Charged-off loans:					
Commercial real estate	553	275	133	667	238
Commercial and industrial	277	207	90	395	489
Residential	383	255	141	70	650
Consumer	694	289	47	487	243
Total charged-off loans	1,907	1,026	411	1,619	1,620
Recoveries on charged-off loans:					
Commercial real estate	318	50	40	98	85
Commercial and industrial	83	11	289	54	146
Residential	166	65	44	129	12
Consumer	101	18	39	23	38
Total recoveries on charged-off loans	668	144	412	304	281
Net charged-off	1,239	882	(1)	1,315	1,339
Provision for loan losses	2,780	2,788	979	1,785	1,833
Balance at end of year	$13,866	$12,325	$10,419	$9,439	$8,969
Ratios:					
Net charge-offs/average loans	0.05 %	0.04 %	— %	0.14 %	0.15 %
Recoveries/charged-off loans	35.03	14.04	100.24	18.78	17.35
Allowance for loan losses/total loans	0.56	0.50	0.92	0.95	0.98
Allowance for loan losses/non-accruing loans	76.04	86.08	160.39	135.23	72.99

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The following table presents year-end data for the approximate allocation of the allowance for loan losses by loan categories at the dates indicated. The table shows for each category the amount of the allowance allocated to that category as a percentage of the outstanding loans in that category. Management believes that the allowance can be allocated by category only on an approximate basis. The allocation of the allowance to each category is not indicative of future losses and does not restrict the use of any of the allowance to absorb losses in any category. Due to the impact of accounting standards for acquired loans, data in the accompanying tables may not be comparable between accounting periods.

(in thousands, except ratios)	2018 Amount Allocated	2018 Percent Allocated to Total Loans In Each Category	2017 Amount Allocated	2017 Percent Allocated to Total Loans In Each Category	2016 Amount Allocated	2016 Percent Allocated to Total Loans In Each Category	2015 Amount Allocated	2015 Percent Allocated to Total Loans In Each Category	2014 Amount Allocated	2014 Percent Allocated to Total Loans In Each Category
Commercial real estate	$6,984	0.84 %	$6,134	0.74 %	$5,145	1.23 %	$4,430	1.12 %	$4,613	1.31 %
Commercial and industrial	2,415	0.60	2,389	0.63	1,952	1.29	1,590	1.26	1,277	1.05
Residential	4,059	0.35	3,416	0.30	2,721	0.54	2,747	0.67	2,714	0.71
Consumer	408	0.36	386	0.31	601	1.13	672	1.13	365	0.57
Total	$13,866	0.56 %	$12,325	0.50 %	$10,419	0.92 %	$9,439	0.95 %	$8,969	0.98 %

INVESTMENT SECURITIES ACTIVITIES

The general objectives of the Company's investment portfolio are to provide liquidity when loan demand is high, and to absorb excess funds when demand is low. The securities portfolio also provides a medium for certain interest rate risk measures intended to maintain an appropriate balance between interest income from loans and total interest expense. For additional information, see Item 7A of this Annual Report on Form 10-K.

The Company only invests in high-quality investment-grade securities. Investment decisions are made in accordance with the Company’s investment policy and include consideration of risk, return, duration, and portfolio concentrations.

The following table presents the amortized cost and fair value of securities available for sale for the three years indicated:

(in thousands)	2018 Amortized Cost	2018 Fair Value	2017 Amortized Cost	2017 Fair Value	2016 Amortized Cost	2016 Fair Value
Obligations of US Government-sponsored enterprises	$—	$—	$6,967	$6,972	$—	$—
US Government-sponsored enterprises	413,492	404,952	447,081	443,003	330,635	328,452
US Government agency	111,938	110,512	96,357	95,596	76,722	76,906
Private label	20,353	20,382	529	674	936	1,132
Obligations of states and political subdivisions thereof	133,260	132,265	138,522	140,200	123,832	122,366
Corporate bonds	58,098	57,726	30,527	30,797	—	—
Total	$737,141	$725,837	$719,983	$717,242	$532,125	$528,856

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The following table presents the amortized cost and weighted average yields of securities at December 31, 2018:

	Available for sale		
(in thousands, except ratios)	Amortized Cost	Weighted Average Yield	
Within 1 year	$425	0.85	%
Over 1 year to 5 years	23,312	5.96	
Over 5 years to 10 years	62,111	3.76	
Over 10 years	105,510	3.80	
Total bonds and obligations	191,358	3.94	
Mortgage-backed securities	545,783	2.96	
Total securities available for sale	$737,141	3.20	%

DEPOSIT ACTIVITIES AND OTHER SOURCES OF FUNDS

The Company offers a variety of deposit products to consumers, businesses and institutional customers with a wide range of interest rates and terms. The Company's deposits consist of interest-bearing and non-interest-bearing demand accounts, savings accounts, money market deposit accounts, and certificates of deposit. The Company solicits deposits primarily in its market area, excluding brokered deposits. The Company primarily relies on competitive pricing policies, marketing and customer service to attract and retain deposits.

The Company manages pricing of deposits in keeping with the Company's asset/liability management, liquidity and profitability objectives, subject to market competitive factors. Based on the Company's experience, the Company believes that the Company's deposits are relatively stable sources of funds. Despite this stability, the Company's ability to attract and maintain these deposits and rates are significantly affected by market conditions.

The following table presents the average balances and weighted average rates for deposits for the three years indicated:

	2018					2017					2016				
(in thousands, except ratios)	Average Balance	Percent of Total Average Deposits		Weighted Average Rate		Average Balance	Percent of Total Average Deposits		Weighted Average Rate		Average Balance	Percent of Total Average Deposits		Weighted Average Rate	
Demand	$354,499	15	%	—	%	$339,303	15	%	—	%	$93,757	11	%	—	%
NOW	456,591	20		0.42		455,064	20		0.25		161,494	16		0.20	
Savings	354,453	15		0.17		367,785	17		0.16		72,657	7		0.09	
Money market	281,258	12		0.78		300,905	14		0.49		240,325	24		0.40	
Time deposits	902,507	38		1.64		760,544	34		1.07		414,347	42		1.29	
Total	$2,349,308	100	%	0.83	%	$2,223,601	100	%	0.51	%	$982,580	100	%	0.68	%

The following table presents the scheduled maturities of time deposits $100 thousand or greater at December 31, 2018:

(in thousands, except ratios)	Amount	Weighted Average Rate	
Three months or less	$118,778	1.40	%
Over 3 months through 6 months	70,788	1.90	
Over 6 months through 12 months	31,737	1.37	

Over 12 months	89,012	1.78	
Total	$310,315	1.62	%

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The Company may also utilize borrowings as an alternative source of funds which can be invested at a positive interest rate spread when the Company desires additional capacity to fund loan demand or when they meet the Company's asset/liability management goals to diversify funding sources and enhance interest rate risk management.

The Company's borrowings historically have included advances from the Federal Home Loan Bank of Boston ("FHLB"), securities sold under repurchase agreements, and an unsecured line of credit. The Company also has the ability to borrow from the Federal Reserve Bank of Boston ("FRB"), as well as through unsecured federal funds lines with correspondent banks. The Company may obtain advances from the FHLB by collateralizing the advances with certain loans and investment securities of the Company. These advances may be made pursuant to several different credit programs, each of which has its own interest rate, range of maturities and call features.

RETAIL BROKERAGE SERVICES

Bar Harbor Financial Services principally serves the brokerage needs of individuals ranging from first-time purchasers, to sophisticated investors. It also offers a line of life insurance, annuity, and retirement products, as well as financial planning services. These products are not deposits, are not insured by the FDIC or any other government agency, are not guaranteed by the Bank or any affiliate, and may be subject to investment risk, including possible loss of principal.

The Bank is a branch office of Infinex Investments, Inc., (“Infinex”) a full-service third-party broker-dealer, conducting business under the assumed business name “Bar Harbor Financial Services.” Infinex is an independent registered broker-dealer and is not affiliated with the Company or its subsidiaries. Infinex was formed by a group of member banks, and is one of the largest providers of third-party investment and insurance services to banks and their customers in New England. Through Infinex, the Bank is able to take advantage of the expertise, capabilities, and experience of a well-established third-party broker-dealer in a cost effective manner.

TRUST MANAGEMENT SERVICES

The Bank has two wholly-owned subsidiaries that provide a comprehensive array of trust and investment management services to individuals, businesses, not-for-profit organizations, and municipalities. Bar Harbor Trust Services is a Maine-chartered trust company, and Charter Trust is a New Hampshire-chartered trust company that was obtained through a 2017 business combination. As a New Hampshire-chartered trust company, Charter Trust is subject to New Hampshire laws applicable to trust companies and fiduciaries. Trust management services include trustee of both living trusts and trusts under wills, including revocable, irrevocable, charitable remainder and testamentary trusts, and in this capacity holds, accounts for and manages financial assets, real estate and special assets. Trust Services offers custody, estate settlement, and fiduciary tax services. The employees include credentialed investment and trust professionals with extensive experience. At December 31, 2018 and 2017, trust management services had total assets under management of $1.7 billion and $1.8 billion, respectively.

PERSONNEL

As of December 31, 2018, the Company had 445 full time equivalent employee positions compared to 423 full time equivalents at December 31, 2017. The Company has augmented the staff with targeted hires to deepen the overall employee skill set. The Company has never had a work stoppage, and no employees are represented by a labor organization or subject to any collective bargaining arrangements. The employee relations of the Company are considered to be good.

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REGULATION AND SUPERVISION

As a bank holding company, the Company is regulated under the Bank Holding Company Act (“BHC”) and is subject to inspection, examination and supervision by the Board of Governors of the Federal Reserve System, or the Federal Reserve Board. The Company is also under the jurisdiction of the Securities and Exchange Commission ("SEC") and is subject to the disclosure and regulatory requirements of the Securities Act and the Exchange Act. The Company’s common stock is listed on the NYSE American exchange under the trading symbol “BHB,” and is subject to the rules of NYSE American for listed companies.

As a Maine-chartered financial institution, the Bank is subject to supervision, periodic examination, and regulation by the Maine Bureau of Financial Institutions ("BFI") as its chartering authority and the Federal Deposit Insurance Corporation ("FDIC") as its primary federal regulator. The prior approval of the BFI and the FDIC is required, among other things, for the Bank to establish or relocate an additional branch office, assume deposits, or engage in any merger, consolidation, purchase or sale of all or substantially all of the assets of any bank.

As a New Hampshire-chartered trust company, Charter Trust Company and its affiliates (“Charter”) is subject to supervision and periodic examination and regulation by the New Hampshire Banking Department. Charter’s consolidated capital includes the following legal entities: Charter Holding Corporation, Charter Trust Company and Charter New England Agency.

In accordance with NH RSA 383-C:5-502, Charter’s Capital Plan requires minimum capital of $500 thousand to be held in accordance with NH RSA 564-B:9-902. As of December 31, 2018 Charter’s total capital was $10.1 million and had liquidation reserves of $501 thousand held in a savings account. Charter also had operating reserves of $10.4 million held in a U.S. Government money market fund. As of December 31, 2018, Charter had an appropriate liquidation reserve, minimum capital in excess of statutory requirements, and all funds were held in accordance with prudent investor standards of NH RSA 564-B:9-902.

Bank Holding Company Regulations Applicable to the Company

The BHC Act and other federal laws subject bank holding companies to particular restrictions on the types of activities in which the Company may engage, and to a range of supervisory requirements and activities, including regulatory enforcement actions for violations of laws and regulations.

Permitted Activities

Generally, bank holding companies are prohibited under the BHC Act from engaging in or acquiring direct or indirect control of more than 5% of the voting shares of any company engaged in any activity other than (i) banking or managing or controlling banks or (ii) an activity that the Federal Reserve Board determines to be so closely related to banking as to be a proper incident to the business of banking. The Federal Reserve Board has the authority to require a bank holding company to terminate an activity or terminate control of or liquidate or divest certain subsidiaries or affiliates when the Federal Reserve Board believes the activity or the control of the subsidiary or affiliate constitutes a significant risk to the financial safety, soundness, or stability of any of its banking subsidiaries.

A bank holding company that qualifies and elects to become a financial holding company is permitted to engage in additional activities that are financial in nature or incidental or complementary to financial activity. The Company currently has no plans to make a financial holding company election.

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Sound Banking Practices
Bank holding companies and their non-banking subsidiaries are prohibited from engaging in activities that represent unsafe and unsound banking practices. For example, under certain circumstances the Federal Reserve Board's Regulation Y requires a holding company to give the Federal Reserve Board prior notice of any redemption or repurchase of its own equity securities if the consideration to be paid, together with the consideration paid for any repurchases in the preceding year, is equal to 10% or more of the company's consolidated net worth. The Federal Reserve Board may oppose the transaction if it believes that the transaction would constitute an unsafe or unsound practice or would violate a regulation. As another example, a holding company is prohibited from impairing its subsidiary bank's soundness by causing the bank to make funds available to non-banking subsidiaries or their customers if the Federal Reserve Board believes it not prudent to do so. The Federal Reserve Board has the power to assess civil money penalties for knowing or reckless violations, if the activities leading to a violation caused a substantial loss to a depository institution. Potential penalties are as high as $1,000,000 for each day the activity continues.

Source of Strength
In accordance with Federal Reserve Board policy, the holding company is expected to act as a source of financial and managerial strength to the Bank. Section 616 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") codifies the requirement that bank holding companies serve as a source of financial strength to their subsidiary depository institutions. Under this policy, the holding company is expected to commit resources to support its bank subsidiary, including at times when the holding company may not be in a financial position to provide it. As discussed below, the holding company could be required to guarantee the capital plan of the Bank if it becomes undercapitalized for purposes of banking regulations. Any capital loans by a bank holding company to its subsidiary bank are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary bank. The BHC Act provides that, in the event of a bank holding company's bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a bank subsidiary will be assumed by the bankruptcy trustee and entitled to priority of payment.

Regulatory agencies have promulgated regulations to increase the capital requirements for bank holding companies to a level that matches those of banking institutions. See Capital Adequacy and Prompt Corrective Action included in Item I.

Anti-tying Restrictions
Bank holding companies and affiliates are prohibited from tying the provision of services, such as extensions of credit, to other services offered by a holding company or its affiliates.

Mergers & Acquisitions
The BHC Act, the Bank Merger Act, the laws of the State of Maine applicable to financial institutions and other federal and state statutes regulate acquisitions of banks and their holding companies. The BHC Act generally limits acquisitions by bank holding companies to banks and companies engaged in activities that the Federal Reserve Board has determined to be so closely related to banking as to be a proper incident thereto. The BHC Act requires every bank holding company to obtain the prior approval of the Federal Reserve before (i) acquiring more than 5% of the voting stock of any bank or other bank holding company, (ii) acquiring all or substantially all of the assets of any bank or bank holding company, or (iii) merging or consolidating with any other bank holding company.

In reviewing applications seeking approval of merger and acquisition transactions, the bank regulatory authorities generally consider, among other things, the competitive effect and public benefits of the transactions, the financial and managerial resources and future prospects of the combined organization (including the capital position of the combined organization), the applicant's performance record under the Community Reinvestment Act (see Community Reinvestment Act included in Item I), fair housing laws and the effectiveness of the subject organizations in

combating money laundering activities.

Limitations on Acquisitions of Bar Harbor Bankshares Common Stock

The Change in Bank Control Act prohibits a person or group of persons from acquiring “control” of a bank holding company unless the appropriate federal bank regulator has been notified and has not objected to the transaction. Under a rebuttable presumption established by the federal bank regulator, the acquisition of 10% or more of a class of voting securities of a bank holding company with a class of securities registered under Section 12 of the Exchange Act would constitute the acquisition of control of a bank holding company. In addition, the BHC Act prohibits any company from acquiring control of a bank or bank holding company without first having obtained the approval of the federal bank regulator. Among other circumstances, under the BHC Act, a company has control of a bank or bank holding company if the company owns, controls or holds with power to vote 25% or more of a class of voting securities of the bank or bank holding company, controls in any manner the election of a majority of directors or trustees of the bank or bank holding company, or the federal bank regulator has determined, after notice and opportunity for hearing, that the company has the power to exercise a controlling influence over the management or policies of the bank or bank holding company.

Dividends

Dividends from the Bank are the Company's principal source of cash revenues. The Company's earnings and activities are affected by legislation, by regulations and by local legislative and administrative bodies and decisions of courts in the jurisdictions in which business is conducted. These include limitations on the ability of the Bank to pay dividends to the holding company and the ability to pay dividends to stockholders. It is the policy of the Federal Reserve Board that bank holding companies should pay cash dividends on common stock only out of income available over the past year and only if prospective earnings retention is consistent with the organization’s expected future needs and financial condition. The policy provides that bank holding companies should not maintain a level of cash dividends that undermines the bank holding company’s ability to serve as a source of strength to its banking subsidiary. Consistent with such policy, a banking organization should have comprehensive policies on dividend payments that clearly articulate the organization’s objectives and approaches for maintaining a strong capital position and achieving the objectives of the policy statement.

The FDIC has the authority to use its enforcement powers to prohibit a bank from paying dividends if, in its opinion, the payment of dividends would constitute an unsafe or unsound practice. Federal law also prohibits the payment of dividends by a bank that will result in the bank failing to meet its applicable capital requirements on a pro forma basis. Maine law requires the approval of the BFI for any dividend that would reduce a bank's capital below prescribed limits.

Annual Reporting

The Company is required to file an annual report with the Federal Reserve Board, and such additional information as the Federal Reserve Board may require. The Federal Reserve Board may examine a bank holding company and any of its subsidiaries, and charge the Company for the cost of such an examination.

Imposition of Liability for Undercapitalized Subsidiaries: Pursuant to Section 38 of the Federal Deposit Insurance Act (“FDIA”) federal banking agencies are required to take “prompt corrective action” (“PCA”) should an insured depository institution fail to meet certain capital adequacy standards. In the event an institution becomes “undercapitalized,” it must submit a capital restoration plan. The capital restoration plan will not be accepted by the regulators unless each company “having control of” the undercapitalized institution “guarantees” the subsidiary’s compliance with the capital restoration plan until it becomes “adequately capitalized.” For purposes of this statute, the holding company has control of the Bank. Under FDIA, the aggregate liability of all companies controlling a particular institution is limited to the lesser of five percent of the depository institution’s total assets at the time it became undercapitalized or the amount necessary to bring the institution into compliance with applicable capital standards. FDIA grants greater powers to bank regulators in situations where an institution becomes “significantly” or “critically” undercapitalized or fails to submit a capital restoration plan. For example, a bank holding company controlling such an institution can be required to

obtain prior Federal Reserve Board approval of proposed distributions, or might be required to consent to a merger or to divest the troubled institution or other affiliates. See Capital Adequacy and Prompt Corrective Action included in Item I.

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Transactions with Affiliates

The holding company and the Bank are considered “affiliates” of each other under the Federal Reserve Act, and transactions between a bank and its affiliates are subject to certain restrictions, under Sections 23A and 23B of the Federal Reserve Act and the Federal Reserve Board's implementing Regulation W. Generally, Sections 23A and 23B: (1) limit the extent to which an insured depository or its subsidiaries may engage in covered transactions (a) with an affiliate (as defined in such sections) to an amount equal to 10% of such institution’s capital and surplus, and (b) with all affiliates, in the aggregate to an amount equal to 20% of such capital and surplus; and (2) require all transactions with an affiliate, whether or not covered transactions, to be on terms substantially the same, or at least as favorable to the institution or subsidiary, as the terms provided or that would be provided to a non-affiliate. The term “covered transaction” includes the making of loans, purchase of assets, issuance of a guarantee and other similar types of transactions.

State Law Restrictions

As a Maine corporation, the holding company is subject to certain limitations and restrictions under applicable Maine corporate law. For example, state law restrictions in Maine include limitations and restrictions relating to indemnification of directors, distributions and dividends to stockholders, transactions involving directors, officers or interested stockholders, maintenance of books, records, and minutes, and observance of certain corporate formalities.

As a New Hampshire-chartered trust company, Charter Trust Company and its affiliates (“Charter”) is subject to supervision and periodic examination and regulation by the New Hampshire Banking Department. Charter’s consolidated capital includes the following legal entities: Charter Holding Corporation, Charter Trust Company and Charter New England Agency.

Capital Adequacy and Prompt Corrective Action

In July 2013, the Federal Reserve Board, the FDIC and the Office of the Comptroller of the Currency (the “OCC”) issued final rules (the “Capital Rules”) that established a new capital framework for U.S. banking organizations. The Capital Rules generally implement the Basel Committee on Banking Supervision’s (the “Basel Committee”) December 2010 final capital framework referred to as “Basel III” for strengthening international capital standards. In addition, the Capital Rules implement certain provisions of the Dodd-Frank Act, including the requirements of Section 939A to remove references to credit ratings from the federal banking agencies’ rules. The Capital Rules substantially revised the risk-based capital requirements applicable to bank holding companies and their depository institution subsidiaries. The risk based capital guidelines are designed to make regulatory capital requirements sensitive to differences in risk profiles among banks and bank holding companies, to account for off-balance sheet exposures and to minimize disincentives for holding liquid, low-risk assets.

The Capital Rules: (i) require a capital measure called “Common Equity Tier 1” (“CET1”) and related regulatory capital ratio of CET1 to risk-weighted assets; (ii) specify that Tier 1 capital consists of CET1 and “Additional Tier 1 capital” instruments meeting certain revised requirements; (iii) mandate that most deductions/adjustments to regulatory capital measures be made to CET1 and not to the other components of capital; and (iv) expand the scope of the deductions from and adjustments to capital as compared to existing regulations. The Capital Rules revised the definitions and the components of regulatory capital and impacted the calculation of the numerator in banking institutions’ regulatory capital ratios. The Capital Rules became effective for the Company and the Bank on January 1, 2015, subject to phase-in periods for certain components and other provisions. Under the Capital Rules, for most banking organizations, the most common form of Additional Tier 1 capital is non-cumulative perpetual preferred stock and the most common forms of Tier 2 capital are subordinated notes and a portion of the allocation for loan losses, in each case, subject to the Capital Rules’ specific requirements. Pursuant to the Capital Rules, the minimum capital ratios plus additional capital conservation buffer for 2018 are as follows:

- 4.5% CET1 to risk-weighted assets;

- 6.0% Tier 1 capital (that is, CET1 plus Additional Tier 1 capital) to risk-weighted assets;
- 8.0% Total capital (that is, Tier 1 capital plus Tier 2 capital) to risk-weighted assets; and
- 4.0% Tier 1 capital to average consolidated assets as reported on consolidated financial statements (the "leverage ratio").

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The Capital Rules also require a “capital conservation buffer,” composed entirely of CET1, on top of these minimum risk-weighted asset ratios. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking organizations with a ratio of CET1 to risk-weighted assets above the minimum but below the capital conservation buffer will face constraints on dividends, equity and other capital instrument repurchases and compensation based on the amount of the shortfall. When fully phased-in on January 1, 2019, the capital standards applicable to the Company and the Bank will include an additional capital conservation buffer of 2.5% of CET1, effectively resulting in minimum ratios inclusive of the capital conservation buffer of (i) CET1 to risk-weighted assets of at least 7%, (ii) Tier 1 capital to risk-weighted assets of at least 8.5%, and (iii) Total capital to risk-weighted assets of at least 10.5%. The Capital Rules provide for a number of deductions from and adjustments to CET1. These include, for example, the requirement that mortgage servicing rights and deferred tax assets arising from temporary differences that could not be realized through net operating loss carrybacks and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such items, in the aggregate, exceed 15% of CET1.

In addition, under the prior general risk-based capital rules, the effects of accumulated other comprehensive income or loss (“AOCI”) items included in shareholders’ equity (for example, mark-to-market of securities held in the available-for-sale portfolio) under U.S. GAAP are reversed for the purposes of determining regulatory capital ratios. Under the Capital Rules, the effects of certain AOCI items are not excluded; however, banking organizations not using the advanced approaches, including the Company and the Bank, were permitted to make a one-time permanent election to continue to exclude these items in January 2015. The Capital Rules also preclude certain hybrid securities, such as trust preferred securities issued after May 19, 2010, from inclusion in bank holding companies’ Tier 1 capital.

Implementation of the deductions and other adjustments to CET1 began on January 1, 2015 and are being phased-in over a 4-year period (beginning at 40% on January 1, 2015 and an additional 20% per year thereafter). The implementation of the capital conservation buffer began on January 1, 2016, at the 0.625% level and increase by 0.625% on each subsequent January 1, until it reaches 2.5% on January 1, 2019.

The Capital Rules prescribe a standardized approach for risk weightings, generally ranging from 0% for U.S. government and agency securities to 600% for certain equity exposures, resulting in higher risk weights for a variety of asset classes.

Pursuant to Section 38 of the FDIA, federal banking agencies are required to take “prompt corrective action” should an insured depository institutions fail to meet certain capital adequacy standards. At each successive lower capital category, an insured depository institution is subject to more restrictions and prohibitions, including restrictions on growth, restrictions on interest rates paid on deposits, restrictions or prohibitions on payment of dividends and restrictions on the acceptance of brokered deposits. Furthermore, if an insured depository institution is classified in one of the undercapitalized categories, it is required to submit a capital restoration plan to the appropriate federal banking agency, and the holding company must guarantee the performance of that plan. Based upon its capital levels, a bank that is classified as well-capitalized, adequately capitalized, or undercapitalized may be treated as though it were in the next lower capital category if the appropriate federal banking agency, after notice and opportunity for hearing, determines that an unsafe or unsound condition, or an unsafe or unsound practice, warrants such treatment.

For purposes of PCA, to be: (i) well-capitalized, an insured depository institution must have a total risk-based capital ratio of at least 10%, a Tier 1 risk-based capital ratio of at least 8%, a CET1 risk-based capital ratio of at least 6.5%, and a Tier 1 leverage ratio of at least 5%; (ii) adequately capitalized, an insured depository institution must have a total risk-based capital ratio of at least 8%, a Tier 1 risk-based capital ratio of at least 6%, a CET1 risk-based capital ratio of at least 4.5%, and a Tier 1 leverage ratio of at least 4%; (iii) undercapitalized, an insured depository institution would have a total risk-based capital ratio of less than 8%, a Tier 1 risk-based capital ratio of less than 6%, a CET1 risk-based capital ratio of less than 4.5%, and a Tier 1 leverage ratio of less than 4%; (iv) significantly

undercapitalized, an insured depository institution would have a total risk-based capital ratio of less than 6%, a Tier 1 risk-based capital ratio of less than 4%, a CET1 risk-based capital ratio of less than 3%, and a Tier 1 leverage ratio of less than 3%. and (v) critically undercapitalized, an insured depository institution would have a ratio of tangible equity to total assets that is less than or equal to 2%.

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Both the Company and the Bank have always maintained the capital ratios and leverage ratio above the levels to be considered quantitatively well-capitalized. For information regarding the capital ratios and leverage ratio of the Company and the Bank as of December 31, 2018, and December 31, 2017, see the discussion under the section captioned Capital Resources included in Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations included in Item 7 and Note 13 - Stock-Based Compensation in the Notes to Consolidated Financial Statements, elsewhere in this report.

The Volker Rule

Section 619 of the Dodd-Frank Act, commonly known as the Volcker Rule, restricts the ability of banking entities, such as the Company, from: (i) engaging in "proprietary trading" and (ii) investing in or sponsoring certain types of funds ("Covered Funds"), subject to certain limited exceptions. Under the Volcker Rule, a Covered Fund is any issuer that would be an investment company under the Investment Company Act (the "ICA") but for the exemptions in section 3(c)(1) and 3(c)(7) of the ICA, which includes collateralized loan obligation ("CLO") and collateralized debt obligation securities. The regulation also provides, among other exemptions, an exemption for CLOs meeting certain requirements. The Bank is in compliance with these rules.

Significant Banking Regulations Applicable to the Bank

Deposit Insurance

The Bank's deposit accounts are fully insured by the Deposit Insurance Fund ("DIF") of the FDIC up to the deposit insurance limit of $250,000 per depositor, per FDIC insured institution, and per ownership category, all in accordance with applicable laws and regulations.

The FDIC uses a risk-based assessment system that imposes insurance premiums based upon a risk matrix that accounts for a bank's capital level and supervisory rating (CAMELS rating). The risk matrix uses different risk categories distinguished by capital levels and supervisory ratings. The base for deposit insurance assessments is consolidated average assets less average tangible equity. Assessment rates are calculated using formulas that take into account the risk of the institution being assessed. The FDIC may increase or decrease the assessment rate schedule in order to manage the DIF to prescribed statutory target levels. An increase in the risk category for the Bank or in the assessment rates could have an adverse effect on the Bank's and consequently the Company's earnings. The FDIC may terminate deposit insurance if it determines the institution involved has engaged in or is engaging in unsafe or unsound banking practices, is in an unsafe or unsound condition, or has violated applicable laws, regulations or orders.

In addition to deposit insurance assessments, the FDIA provides for additional assessments to be imposed on insured depository institutions to pay for the cost of Financing Corporation ("FICO") funding. The FICO is a mixed-ownership government corporation established by the Competitive Equality Banking Act of 1987, whose sole purpose was to function as a financing vehicle for the now defunct Federal Savings & Loan Insurance Corporation. The FICO assessments are adjusted quarterly to reflect changes in the assessment base of the DIF and do not vary depending upon a depository institution's capitalization or supervisory evaluation. The current annualized assessment rate is approximately six basis points and the rate is adjusted quarterly. These assessments will continue until the FICO bonds mature in 2019.

Depositor Preference

The FDIA provides that, in the event of the "liquidation or other resolution" of an insured depository institution, the claims of depositors of the institution, 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, insured and uninsured depositors, along with the FDIC, will have priority in payment ahead of unsecured, non-deposit creditors, including the parent bank holding company, with respect to any extensions of credit they have made to such insured depository institution.

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Consumer Financial Protection

The Company is subject to a number of federal and state consumer protection laws that govern its relationship with its customers. These laws include the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Truth in Lending Act, the Truth in Savings Act, the Electronic Fund Transfer Act, the Expedited Funds Availability Act, the Home Mortgage Disclosure Act, the Fair Housing Act, the Real Estate Settlement Procedures Act, the Fair Debt Collection Practices Act, the Right to Financial Privacy Act, the Service Members Civil Relief Act and these laws' respective state law counterparts, as well as state usury laws and laws regarding unfair and deceptive acts and practices. These and other federal laws, among other things, require disclosures of the cost of credit and terms of deposit accounts, provide substantive consumer rights, prohibit discrimination in credit transactions, regulate the use of credit report information, provide financial privacy protections, prohibit unfair, deceptive and abusive practices, restrict the Bank's ability to raise interest rates and subject the Bank to substantial regulatory oversight. Violations of applicable consumer protection laws can result in significant potential liability from litigation brought by customers, including actual damages, restitution and attorneys' fees.

Further, the Consumer Financial Protection Bureau ("CFPB") has broad rulemaking authority for a wide range of consumer financial laws that apply to all banks, including, among other things, the authority to prohibit "unfair, deceptive or abusive" acts and practices. Abusive acts or practices are defined as those that materially interfere with a consumer's ability to understand a term or condition of a consumer financial product or service or take unreasonable advantage of a consumer's: (i) lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service, (ii) inability of the consumer to protect its interests in selecting or using a consumer financial product or service, or (iii) reasonable reliance on a covered entity to act in the consumer's interests.

Neither the Dodd-Frank Act nor the individual consumer financial protection laws prevent states from adopting stricter consumer protection standards.

Brokered Deposit Restrictions

Under FDIC Improvement Act, banks may be restricted in their ability to accept brokered deposits, depending on their classification. "Well-capitalized" institutions are permitted to accept brokered deposits, but all banks that are not well-capitalized could be restricted from accepting such deposits. The Bank is currently well-capitalized and not restricted from accepting brokered deposits.

Community Reinvestment Act

The Community Reinvestment Act of 1977 ("CRA"), requires depository institutions to assist in meeting the credit needs of their market areas consistent with safe and sound banking practice. Under the CRA, each depository institution is required to help meet the credit needs of its market areas by, among other things, providing credit to low- and moderate-income individuals and communities. These factors are also considered in evaluating mergers, acquisitions and applications to open a branch or facility. The applicable federal regulators regularly conduct CRA examinations to assess the performance of financial institutions and assign one of four ratings to the institution's records of meeting the credit needs of its community. During its last examination, a rating of "satisfactory" was received by the Bank.

Insider Credit Transactions

Section 22(h) of the Federal Reserve Act ("FRA") and its implementing Regulation O, restricts loans to directors, executive officers, and principal stockholders ("insiders"). Under Section 22(h), loans to insiders and their related interests may not exceed, together with all other outstanding loans to such persons and affiliated entities, the institution's total capital and surplus. Loans to insiders above specified amounts must receive the prior approval of the Board of Directors. Further, under Section 22(h) of the FRA, loans to directors, executive officers and principal stockholders must be made on terms substantially the same as offered in comparable transactions to other persons, except that such insiders may receive preferential loans made under a benefit or compensation program that is widely

available to the bank's employees and does not give preference to the insider over the employees. Section 22(g) of the FRA places additional limitations on loans to executive officers. A violation of these restrictions may result in the assessment of substantial civil monetary penalties on the affected bank or any officer, director, employee, agent or other person participating in the conduct of the affairs of that bank, the imposition of a cease and desist order, and other regulatory sanctions.

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Safety and Soundness

Under the FDIA, each federal banking agency has prescribed, by regulation, non-capital safety and soundness standards for institutions under its authority. These standards cover internal controls, information and internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, such other operational and managerial standards as the agency determines to be appropriate, and standards for asset quality, earnings and stock valuation. An institution which fails to meet these standards must develop a plan acceptable to the agency, specifying the steps that the institution will take to meet the standards. Failure to submit or implement such a plan may subject the institution to regulatory sanctions.

Examinations

The Bank is examined from time-to-time by its primary federal banking regulator, the FDIC, and the BFI.

Financial Privacy

Section V of the Gramm-Leach-Bliley Act ("GLBA") and its implementing regulations require all financial institutions, including the Company and the Bank, to adopt privacy policies, restrict the sharing of nonpublic customer data with non-affiliated parties at the customer's request, limit the reuse of certain consumer information received from non-affiliated financial institutions, and establish procedures and practices to protect customer data from unauthorized access. In addition, the Fair Credit Reporting Act ("FCRA"), as amended by the Fair and Accurate Credit Transactions Act of 2003 (the "FACT Act"), includes many provisions affecting the Company, Bank, and/or their affiliates, including provisions concerning obtaining consumer reports, furnishing information to consumer reporting agencies, maintaining a program to prevent identity theft, sharing of certain information among affiliated companies, and other provisions. The FACT Act requires entities subject to FCRA to notify their customers if they report negative information about them to a credit bureau or if they are granted credit on terms less favorable than those generally available. The CFPB and the Federal Trade Commission ("FTC") have extensive rulemaking authority under the FACT Act, and the Company and the Bank are subject to the rules that have been promulgated under the FACT Act, including rules requiring financial institutions with covered accounts (e.g. consumer bank accounts and loans) to develop, implement, and administer an identity theft protection program, as well as rules regarding limitations on affiliate marketing and implementation of programs to identify, detect and mitigate certain identity theft red flags. The Company has developed policies and procedures for itself and its subsidiaries, including the Bank, and believes it is in compliance with all privacy, information sharing, and notification provisions of the GLBA and the FACT Act. The Bank is also subject to data security standards, privacy and data breach notice requirements, primarily those issued by the FDIC.

Anti-Money Laundering Initiatives and the USA Patriot Act

A major focus of governmental policy on financial institutions over the last two decades has been combating money laundering and terrorist financing. The USA PATRIOT Act of 2001 ("USA Patriot Act"), substantially broadened the scope of United States anti-money laundering laws and regulations by imposing significant new compliance and due diligence obligations, creating new crimes and penalties and expanding the extra-territorial jurisdiction of the United States. The U.S. Treasury Department has issued a number of regulations that apply various requirements of the USA Patriot Act to financial institutions such as the Bank. These regulations impose obligations on financial institutions to maintain appropriate policies, procedures and controls to detect, prevent and report money laundering and terrorist financing and to verify the identities of their customers. Financial institutions are also prohibited from entering into specified financial transactions and account relationships and must use enhanced due diligence procedures in their dealings with certain types of high-risk customers and implement a written customer identification program. Financial institutions must take certain steps to assist government agencies in detecting and preventing money laundering and report certain types of suspicious transactions. Regulatory authorities routinely examine financial institutions for compliance with these obligations, and failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing, or to comply with all of the relevant laws or regulations, can have serious legal and reputational consequences for the institution.

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Office of Foreign Assets Control Regulation

The United States has imposed economic sanctions that affect transactions with designated foreign countries, nationals and others. These are typically known as the “OFAC” rules based on their administration by the U.S. Treasury Department Office of Foreign Assets Control (“OFAC”). The OFAC-administered sanctions targeting countries take many different forms. Generally, however, they contain one or more of the following elements: (i) restrictions on trade with or investment in a sanctioned country, including prohibitions against direct or indirect imports from and exports to a sanctioned country and prohibitions on “U.S. persons” engaging in financial transactions relating to making investments in, or providing investment-related advice or assistance to, a sanctioned country; and (ii) a blocking of assets in which the government or specially designated nationals of the sanctioned country have an interest, by prohibiting transfers of property subject to U.S. jurisdiction (including property in the possession or control of U.S. persons). Blocked assets (e.g., property and bank deposits) cannot be paid out, withdrawn, set off or transferred in any manner without a license from OFAC. The Company is responsible for, among other things, blocking accounts of, and transactions with, such targets and countries, prohibiting unlicensed trade and financial transactions with them and reporting blocked transactions after their occurrence. Failure to comply with these sanctions could have serious legal and reputational consequences.

Other Laws and Regulations

The Company is not only subject to federal laws applicable to it, it is also subject to the rules and regulations of the various federal agencies charged with the responsibility of implementing these federal laws.

Guidance on Sound Compensation Policies

The Dodd-Frank Act requires publicly traded companies to give stockholders a non-binding vote on executive compensation at their first annual meeting taking place six months after the date of enactment and at least every three years thereafter and on so-called “golden parachute” payments in connection with approvals of mergers and acquisitions.

The Dodd-Frank Act also requires the federal banking agencies and the SEC to establish joint regulations or guidelines prohibiting incentive-based payment arrangements at specified regulated entities with at least $1 billion in total consolidated assets that encourage inappropriate risks by providing an executive officer, employee, director or principal shareholder with excessive compensation, fees, or benefits that could lead to material financial loss to the entity. The federal banking agencies and the SEC most recently proposed such regulations in 2016, but the regulations have not yet been finalized. If the regulations are adopted in the form initially proposed, they will restrict the manner in which executive compensation is structured.

Changing Regulatory Structure and Future Legislation and Regulation

Congress may enact further legislation that affects the regulation of the financial services industry, and the Maine or New Hampshire legislature may enact further legislation affecting the regulation of financial institutions chartered by the State of Maine or the State of New Hampshire. Federal and state regulatory agencies also periodically propose and adopt changes to their regulations or change the manner in which existing regulations are applied. The Company cannot predict the substance or impact of pending or future legislation or regulations, or the application thereof, although enactment of the proposed legislation could impact the regulatory structure under which the Company operates and may significantly increase costs, impede the efficiency of internal business processes, require an increase in regulatory capital, require modifications to the Company’s business strategy, and limit the Company’s ability to pursue business opportunities in an efficient manner. A change in statutes, regulations or regulatory policies applicable to the Company or any of its subsidiaries could have a material effect on its business.

Monetary Policy and Economic Environment

The earnings of the Company are significantly affected by the monetary and fiscal policies of governmental authorities, including the Federal Reserve Board. Among the instruments of monetary policy used by the Federal Reserve Board to implement these objectives are open-market operations in U.S. Government securities and federal

funds, changes in the discount rate on member bank borrowings, and changes in reserve requirements against member bank deposits. These instruments of monetary policy are used in varying combinations to influence the overall level of bank loans, investments, and deposits, and the interest rates charged on loans and paid for deposits. The Federal Reserve Board frequently uses these instruments of monetary policy, especially its open-market operations and the discount rate, to

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influence the level of interest rates, thereby affecting the strength of the economy, the level of inflation, or the price of the dollar in foreign exchange markets. The monetary policies of the Federal Reserve Board have had a significant effect on the operating results of banking institutions in the past and are expected to continue to do so in the future. It is not possible to predict the nature of future changes in monetary and fiscal policies, or the effect which they may have on the Company’s business and earnings.

Environmental Laws

The Company believes that it is in compliance with all federal, state and local environmental regulations. The cost of ongoing compliance with such regulations does not have a material effect on operations.

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ITEM 1A. RISK FACTORS

An investment in the Company involves risk, some of which, including market, liquidity, credit, operational, legal, compliance, reputational and strategic risks, could be substantial and is inherent in the Company's business. This risk also includes the possibility that the value of the investment could decrease considerably, and dividends or other distributions concerning the investment could be reduced or eliminated. Discussed below are risk factors that could adversely affect financial results and condition, as well as the value of, and return on investments made in the Company. Although the Company believes that these risks are the most important for you to consider, you should read this section in conjunction with the Consolidated Financial Statements, the notes to those Financial Statements and management's discussion and analysis of financial condition and results of operations.

Economic Risk Factors

Deterioration in local economies or real estate market may adversely affect financial performance.
The Company serves individuals and businesses located in the downeast, midcoast and central regions of Maine, the Cheshire, Grafton, Hillsborough, Merrimack and Sullivan counties in central and western New Hampshire, and the Rutland, Windsor and Orange counties in central Vermont. A substantial portion of the loan portfolio is secured by real estate in these areas and the value of the associated collateral is subject to local real estate market conditions. Furthermore, many customers in the hospitality industry rely upon a high number of tourists to vacation destinations and attractions within the Company's markets. The Company's success is largely dependent on the economic conditions, including employment levels, population growth, income levels, savings trends and government policies in those market areas. A downturn in the local economies may adversely affect collateral values, sources of funds, and demand for products, all of which could have a negative impact on results of operations, financial condition and business expansion.

Changes in the general economy or the financial markets could adversely affect financial performance.
The outlook for the U.S. economy remains uncertain amid concerns about short- and long-term interest rates, debt and equity capital markets and general financial market conditions. A deterioration of general economic conditions could adversely affect the markets of local economies and have a negative impact on results of operations and financial condition. Deterioration or defaults made by issuers of the underlying collateral of investment securities may cause additional credit-related other-than-temporary impairment charges to the income statement. The Company's ability to borrow from other financial institutions or to access the debt or equity capital markets on favorable terms or at all could be adversely affected by disruptions in the capital markets or other events, including actions by rating agencies or deteriorating investor expectations.

Interest rate volatility could significantly reduce the Company's profitability.
The Bank's earnings and cash flows are largely dependent upon its net interest income. Net interest income is the difference between interest income earned on interest-bearing 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 the Company's control, including general economic conditions, demand for loans, securities and deposits, 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, or the slope of the yield curve could influence not only the interest received on loans and securities and the amount of interest paid on deposits and borrowings, but such changes could also affect (i) the ability to originate loans and obtain deposits, (ii) the fair value of the Company's financial assets and liabilities, and (iii) the average duration of 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, 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, the Bank's

higher-rate loans and investments may be subject to prepayment risk, which could negatively impact its net interest margin. Conversely, if interest rates increase, the Bank's loans and investment securities may be subject to extension risk, which could negatively impact its net interest margin as well.

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Industry Risk Factors

Loss of deposits or a change in deposit mix could increase the cost of funding.
Deposits are a low cost and stable source of funding. The Company competes with banks and other financial institutions for deposits. Funding costs may increase if deposits are lost and are forced to replace them with more expensive sources of funding, if customers shift their deposits into higher cost products or if the Company needs to raise interest rates to avoid losing deposits. Higher funding costs reduce the net interest margin, net interest income and net income.

Wholesale funding sources may prove insufficient to replace deposits at maturity and support operations and future growth.
The Company and banking subsidiaries must maintain sufficient funds to respond to the needs of depositors and borrowers. To manage liquidity, the Company draws upon a number of funding sources in addition to core deposit growth and repayments and maturities of loans and investments. These sources include FHLB advances, proceeds from the sale of investments and loans, and liquidity resources at the holding company. The Company's ability to manage liquidity will be severely constrained if unable to maintain access to funding or if adequate financing is not available to accommodate future growth at acceptable costs. In addition, if the Company is required to rely more heavily on more expensive funding sources to support future growth, revenues may not increase proportionately to cover costs. In this case, operating margins and profitability would be adversely affected. Turbulence in the capital and credit markets may adversely affect liquidity and financial condition and the willingness of certain counterparties and customers to do business with the Company.

High concentrations of commercial loans may increase exposure to credit loss upon borrower default.
As of December 31, 2018, approximately 49% of the Banks's loan portfolio consisted of commercial real estate, commercial and industrial, construction and agricultural loans. Commercial loan portfolio concentration generally exposes lenders to greater risk of delinquency and loss than residential real estate loans because repayment of the loans often depends on the successful operation and income streams from the property. Additionally, commercial loans typically involve larger balances to single borrowers or groups of related borrowers compared to residential real estate loans. Because the Bank's loan portfolio contains a significant number of large commercial loans, the deterioration of one or a few of these loans could cause a significant increase in non-performing loans, provision for loan losses, and/or an increase in loan charge-offs, all of which could adversely affect the Company's financial condition and results of operations.

Greater than anticipated credit losses in the loan portfolios may adversely affect earnings.
Credit losses are inherent in the business of making loans and could have a material adverse affect on operating results. The Company makes various assumptions and judgments about the collectability of the loan portfolio and provide an allowance for loan losses based on a number of factors. The allowance for loan losses is evaluated on a periodic basis using current information, including the quality of the loan portfolio, economic conditions, the value of the underlying collateral and the level of non-accrual loans. Although the Company believes the allowance for loan losses is appropriate to absorb probable losses in the loan portfolio, this allowance may not be adequate. Increases in the allowance will result in an expense for the period, thereby reducing reported net income.

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Disruptions to the Company’s information systems and security breaches could adversely affect its business and reputation.

In the ordinary course of business, the Company relies on electronic communications and information systems to conduct its businesses and to store sensitive data, including financial information regarding its customers. The integrity of information systems are under significant threat from cyber-attacks by third parties, including through coordinated attacks sponsored by foreign nations and criminal organizations to disrupt business operations and other compromises to data and systems for political or criminal purposes. The Company employs an in-depth, layered, defense approach that leverages people, processes and technology to manage and maintain cyber security controls. Notwithstanding the strength of defensive measures, the threat from cyberattacks is severe, attacks are sophisticated and attackers respond rapidly to changes in defensive measures. Cyber security risks may also occur with the Company’s third-party service providers, and may interfere with their ability to fulfill their contractual obligations to us, with additional potential for financial loss or liability that could adversely affect the Company’s financial condition or results of operations. The Company offers its customers the ability to bank remotely and provide other technology-based products and services, which services include the secure transmission of confidential information over the Internet and other remote channels. To the extent that the Company’s customers’ systems are not secure or are otherwise compromised, its network could be vulnerable to unauthorized access, malicious software, phishing schemes and other security breaches. To the extent that the Company’s activities or the activities of its clients or third-party service providers involve the storage and transmission of confidential information, security breaches and malicious software could expose the Company to claims, regulatory scrutiny, litigation and other possible liabilities.

While to date the Company has not experienced a significant compromise, significant data loss or material financial losses related to cyber security attacks, the Company’s systems and those of its clients and third-party service providers, are under constant threat and may experience a significant event in the future. The Company may suffer material financial losses related to these risks in the future or it may be subject to liability for compromises to its client or third-party service provider systems. Any such losses or liabilities could adversely affect the Company’s financial condition or results of operations, and could expose us to reputation risk, the loss of client business, increased operational costs, as well as additional regulatory scrutiny, possible litigation, and related financial liability. These risks also include possible business interruption, including the inability to access critical information and systems.

The Company may be adversely affected by continuous technological change.

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. The Company’s future success depends, in part, upon its ability to address the needs of its customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional operational efficiencies. Many of the Company's larger competitors have substantially greater resources to invest in technological improvements. The Company may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to its customers.

The Company may be adversely affected by the soundness of other financial institutions.

The Company's ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Bank and non-bank financial services companies are interrelated as a result of trading, clearing, counterparty and other relationships. The Company has exposure to different industries and counterparties through transactions with counterparties in the bank and non-bank financial services industries, including brokers and dealers, commercial banks, investment banks and other institutional clients. As a result, defaults by, or even rumors or questions about, one or more bank or non-bank financial services companies, or the bank or non-bank financial services industries generally, have led to market-wide liquidity problems and could lead to losses or defaults by us or by other institutions. These losses or defaults could have an adverse affect on the Company's business, financial condition and results of operations.

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Prepayments of loans may negatively impact the Company's business. Generally, customers may prepay the principal amount of their outstanding loans at any time.
The speeds at which such prepayments occur, as well as the size of such prepayments, are within the customers' discretion. Fluctuations in interest rates, in certain circumstances, may also lead to high levels of loan prepayments, which may also have an adverse impact on net interest income. If customers prepay the principal amount of their loans, and the Company is unable to lend those funds to other borrowers or invest the funds at the same or higher interest rates, interest income will be reduced. A significant reduction in interest income could have a negative impact on results of operations and financial condition.

Business Risk Factors

Strong competition within the Company's markets may significantly impact profitability.
The Company competes with an ever-increasing array of financial service providers. See the section entitled "Competition" of Item 1 of this Annual Report on Form 10-K for additional competitor information. Competition from nationwide banks, as well as local institutions, continues to mount in the Company's markets. To compete, the Company focuses on quality customer service, making decisions at the local level, maintaining long-term customer relationships, building customer loyalty, and providing products and services designed to address the specific needs of customers. Failure to perform in any of these areas could significantly weaken the Company's competitive position, which could adversely affect growth and profitability.

Expansion, growth, and acquisitions could negatively impact earnings if not successful.
The Company may grow organically both by geographic expansion and through business line expansion, as well as through acquisitions. Success of these activities depends on the Company's ability to continue to maintain and develop an infrastructure appropriate to support and integrate such growth. Success may also depends on acceptance of the Bank by customers in these new markets and, in the case of expansion through acquisitions, these factors include the long-term recruitment and retention of key personnel and acquired customer relationships. Profitability depends on whether the marginal revenue generated in the new markets will offset the increased expenses of operating a larger entity, with more staff, more locations, and more product offerings. Failure to achieve any of these success factors may have a negative impact on the Company's financial condition and results of operations.

Market changes may adversely affect demand for services and impact revenue, costs, and earnings.
Channels for servicing the Company's customers are evolving rapidly, with less reliance on traditional branch facilities, increased use of e-commerce channels, and demand for universal bankers and other relationship managers who can service multiple product lines. The Company has an ongoing process for evaluating the profitability of its branch system and other office and operational facilities. The identification of unprofitable operations and facilities can lead to restructuring charges and introduce the risk of disruptions to revenues and customer relationships. The Company competes with larger financial institutions who are rapidly evolving their service channels and escalating the costs of evolving the service process.

The Company is subject to a variety of operational risks, including reputational risk, and the risk of fraud or theft by employees or outsiders, which may adversely affect the Company's business and results of operations.
The Company is exposed to many types of operational risks, including reputational risk, legal and compliance risk, the risk of fraud or theft by employees or outsiders, and unauthorized transactions by employees or operational errors, including clerical or record-keeping errors or those resulting from faulty or disabled computer or telecommunications systems. If personal, non-public, confidential, or proprietary information of customers in the Company's possession were to be mishandled or misused, the Company could suffer significant regulatory consequences, reputational damage, and financial loss.

Because the nature of the financial services business involves a high volume of transactions, certain errors may be repeated or compounded before they are discovered and successfully rectified. The Company's necessary dependence upon automated systems to record and process transactions and its large transaction volume may further increase the risk that technical flaws or employee tampering or manipulation of those systems will result in losses that are difficult to detect. The Company may also be subject to disruptions of its operating systems arising from events that are wholly

or partially beyond its control (i.e., computer viruses or electrical or telecommunications outages, natural disaster, disease pandemics, or other damage to property or physical assets), which may give rise to disruption of service to customers and to financial loss or liability. The Company is further exposed to the risk that its external vendors may be unable to fulfill their contractual obligations (or will be subject to the same risk of fraud or operational errors by their respective employees) and to the risk that the Company's vendors' business continuity and data security systems prove to be inadequate. The occurrence of any of these risks could result in a diminished ability to operate (i.e., by requiring the Company to expend significant resources to correct the defect), as well as potential liability to clients, reputational damage, and regulatory intervention.

Goodwill from acquisitions could become impaired.
Applicable accounting standards require that the purchase method of accounting be used for all business combinations. Under purchase accounting, if the purchase price of an acquired company exceeds the fair value of the acquired company's net assets, the excess is carried on the balance sheet as goodwill, by the acquirer. A significant decline in expected future cash flows, a continuing period of market disruption, market capitalization to book value deterioration, or slower growth rates may require the Company to record charges in the future related to the impairment of goodwill. If the Company concludes that a future write-down is necessary, the impact could have an adverse affect on financial condition and results of operations

The Company may be unable to attract and retain key personnel.
The Company's success depends, in large part, on its ability to attract and retain key personnel. Competition for qualified personnel in the financial services industry can be intense and the Company and its subsidiaries may not be able to hire or retain the key personnel that it depends upon for success. In addition, the Bank's rural geographic marketplace, combined with relatively expensive real estate purchase prices within the area of the Bank's principal office location in Bar Harbor, Maine, create additional risks for the Company and the Bank's ability to attract and retain key personnel. The unexpected loss of services of one or more of key personnel could have a material adverse impact on the Company's business because of their skills, knowledge of the markets in which the Company operates, years of industry experience and the difficulty of promptly finding qualified replacement personnel.

Severe weather, natural disasters, acts of war or terrorism, and other external events could significantly impact the Company's business and the business of its customers.
Severe weather, natural disasters, acts of war or terrorism, and other adverse external events could have a significant impact on the Company's ability to conduct business. Such events could affect the stability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue and/or cause us to incur additional expenses. In particular, such events may have a particularly negative impact upon the business of customers who are engaged in the hospitality and natural resource dependent industries in the Company's market area, which could have a direct negative impact on the Company's business and results of operations.

Regulatory Risk Factors

The Company is subject to extensive government regulation and supervision, which may interfere with the ability to conduct business and may negatively impact financial results.
The Company is subject to extensive federal and state regulation and supervision. Banking regulations are primarily intended to protect depositors' funds, the Federal Deposit Insurance Fund and the safety and soundness of the banking system as a whole, not stockholders. These regulations affect the Company's lending practices, capital structure, investment practices, dividend policy and growth, among other things. Congress and federal regulatory agencies continually review banking laws, regulations and policies for possible changes. Changes to statutes, regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulations or policies, could affect the Company in substantial and unpredictable ways. Such changes could subject the Company to additional

costs, limit the types of financial services and products the Company may offer, and/or limit the pricing the Company may charge on certain banking services, among other things. Compliance personnel and resources may increase costs of operations and adversely impact earnings.

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Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or reputation damage, which could have a material adverse affect on the Company's business, financial condition and results of operations. While the Company has policies and procedures designed to prevent any such violations, there can be no assurance that such violations will not occur.

The Company may elect or be compelled to seek additional capital in the future, but capital may not be available when it is needed.
The Company is required by federal and state regulatory authorities to maintain adequate levels of capital to support its operations. In addition, the Company may elect to raise additional capital to support its business or to finance acquisitions, if any, or the Company may otherwise elect to raise additional capital.

The Company’s ability to raise additional capital, if needed, will depend on conditions in the capital markets, economic conditions, and a number of other factors, many of which are outside the Company’s control, and on its financial performance. Accordingly, there is no assurance of the Company’s ability to raise additional capital if needed or on acceptable terms. If the Company cannot raise additional capital when needed, or on reasonable terms, it may have a material adverse affect on its financial condition and results of operations.

The Company is subject to possible claims and litigation pertaining to fiduciary responsibilities.
From time to time, customers make claims and take legal action pertaining to the Company’s performance of its fiduciary responsibilities. Whether customer claims and legal action related to the Company's performance of fiduciary responsibilities are founded or unfounded, if such claims and legal actions are not resolved in a favorable manner, they may result in significant financial liability and/or adversely affect the market perception of the Company and products and services as well as impact customer demand for products and services.

Changes in tax laws and regulations and differences in interpretation of tax laws and regulations may adversely impact the Company's financial statements.
Federal, state, and local tax authorities may change tax laws and regulations, which could result in a decrease or increase to net deferred tax assets. In December 2017, the Company recognized a write-down of $4.0 million in net deferred tax assets in connection with the adoption of the Tax Cuts and Jobs Act of 2017 ("TCJA"). Federal, state, and local tax authorities may interpret tax laws and regulations differently and challenge tax positions that the Company has taken on tax returns. This may result in differences in the treatment of revenues, deductions, credits and/or differences in the timing of these items. The differences in treatment may result in payment of additional taxes, interest or penalties that could have a material adverse affect on results.

The Company’s access to funds from subsidiaries may be restricted.
Bar Harbor Bankshares is a separate and distinct legal entity from the Bank and non-banking subsidiaries. Bar Harbor Bankshares depends on dividends, distributions and other payments from its banking and non-banking subsidiaries to fund dividend payments on its common stock and to fund all payments on its other obligations. The Company’s subsidiaries are subject to laws that authorize regulatory bodies to block or reduce the flow of funds from those subsidiaries to Bar Harbor Bankshares, which could impede access to funds it needs to make payments on its obligations or dividend payments.

A new accounting standard may require us to increase the allowance for loan losses.
The Financial Accounting Standards Board has issued Accounting Standards Update 2016-13, which will be effective for the Company for the first quarter of the year ending December 31, 2020. This standard, often referred to as CECL requires companies to recognize an allowance for credit losses using a new current expected credit loss model. The Company is currently evaluating the impact of adopting this standard on the consolidated financial statements. Any increase in the allowance for credit losses or expenses incurred to determine the appropriate level of the allowance for loan losses may have a material adverse affect on the Company's financial condition and results of operations.

The Bank is exposed to risk of environmental liabilities with respect to properties to which it takes title.
In the course of business, the Bank may own or foreclose and take title to real estate, and could be subject to environmental liabilities with respect to these properties. The Company may be held liable to a governmental entity or to third parties for property damage, personal injury, investigation and restoration costs incurred by these parties in connection with environmental contamination, or may be required to investigate or clean up hazardous or toxic substances, or chemical releases at a property. The cost associated with investigation or remediation activities could be substantial. In addition, as the owner or former owner of a contaminated site, the Company may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from the property.

ITEM 2. PROPERTIES

The Company’s principal executive offices and one branch are in a building owned by the Company located at 82 Main Street, Bar Harbor, Maine. The Bank provides full-banking services at an additional 48 locations throughout Maine, New Hampshire and Vermont of which 30 are owned and 18 are leased. The Bank also has two stand-alone drive-up windows in New Hampshire and one in Vermont. In addition to banking offices, the Company also has an Operations Center located in Ellsworth, Maine, that houses the Company’s operations and data processing centers, as well as leased space in Hampden, Maine and Bedford, New Hampshire, where back office support for multiple lines of business and related functions are located. In the opinion of management, the physical properties of the Company and the Bank are considered adequate to meet the needs of customers in the communities served.

ITEM 3. LEGAL PROCEEDINGS

From time to time the Company may become involved in legal proceedings or may be subject to claims arising in the ordinary course of business. Although the results of litigation and claims cannot be predicted with certainty, the Company currently believes that the final outcome of these ordinary course matters will not have a material adverse effect on business, operating results, financial condition or cash flows. Regardless of the outcome, litigation can have an adverse impact on the Company because of defense and settlement costs, diversion of management resources and other factors.

PART II

ITEM 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

The common stock of the Company is traded on the NYSE American, under the trading symbol "BHB". As of March 8, 2019, there were 15,523,628 shares of Bar Harbor Bankshares common stock, par value $2.00 per share, outstanding and approximately 1,616 shareholders of record, as obtained through the Company’s transfer agent.

Recent Sale of Unregistered Securities and Use of Proceeds from Registered Securities

No unregistered securities were sold by the Company during the year ended December 31, 2018.

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Common Stock Performance Graph

The following graph illustrates the estimated yearly change in value of the Company's cumulative total stockholder return on its common stock for each of the last five years. Total shareholder return is computed by taking the difference between the ending price of the common stock at the end of the previous year and the current year, plus any dividends paid divided by the ending price of the common stock at the end of the previous year. For purposes of comparison, the graph also matches Bar Harbor Bankshares' cumulative 5-Year total shareholder return on common stock with the cumulative total returns of the NYSE American Composite index, and the SNL Bank $1B to $5B Index. The graph tracks the performance of a $100 investment in the Company's common stock and in each index (with the reinvestment of all dividends) from December 31, 2013 to December 31, 2018.

	Period Ending					
Index	12/31/13	12/31/14	12/31/15	12/31/16	12/31/17	12/31/18
Bar Harbor Bankshares	100.00	124.18	137.60	195.35	171.80	146.72
NYSE American Composite Index	100.00	103.76	94.00	104.00	123.29	108.79
SNL Bank $1B - $5B Index	100.00	104.56	117.04	168.38	179.51	157.27

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ITEM 6. SELECTED FINANCIAL DATA

The following summary data is based in part on the Consolidated Financial Statements and accompanying notes, and other schedules appearing elsewhere in this Form 10-K. Historical data is also based in part on, and should be read in conjunction with, prior filings with the SEC.

	At or For the Years Ended December 31,				
(in millions, except ratios and per share data)	2018	2017	2016	2015	2014
Financial Condition Data:					
Total assets	$3,608	$3,565	$1,755	$1,580	$1,459
Total earning assets[(1)]	3,263	3,244	1,683	1,517	1,411
Total investments	761	755	554	526	492
Total loans	2,490	2,486	1,129	990	919
Allowance for loan losses	14	12	10	9	9
Total goodwill and intangible assets	108	108	5	5	5
Total deposits	2,483	2,352	1,050	943	858
Total borrowings	724	830	537	475	447
Total shareholders' equity	371	355	157	154	146
Operating Data:					
Total interest and dividend income	$127	$116	$57	$55	$54
Total interest expense	36	24	12	10	10
Net interest income	91	92	45	45	44
Non-interest income	28	26	13	9	8
Net Revenue[(2)]	119	118	58	54	52
Provision for loan losses	3	3	1	2	2
Total non-interest expense	75	72	36	31	29
Income tax expense[(3)]	8	17	6	6	6
Net income	33	27	15	15	15
Ratios and Other Data:					
Per Common Share Data					
Basic earnings	$2.13	$1.71	$1.65	$1.69	$1.64
Diluted earnings	2.12	1.70	1.63	1.67	1.63
Total book value	23.87	22.96	17.19	17.10	16.40
Dividends	0.79	0.75	0.73	0.67	0.60
Common stock price:					
High	30.95	33.41	33.25	25.32	21.91
Low	21.25	25.09	19.69	19.31	16.01
Close	22.43	27.01	31.55	22.95	21.33
Weighted average common shares outstanding:					
Basic	15,488	15,184	9,069	8,970	8,890
Diluted	15,564	15,290	9,143	9,090	8,964

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(in millions, except ratios and per share data)	At or For the Years Ended December 31, 2018	2017	2016	2015	2014
Performance Ratios:[4]					
Return on assets	0.90 %	0.75 %	0.89 %	0.98 %	1.03 %
Return on equity	9.22	7.41	9.21	10.01	10.69
Interest rate spread	2.68	2.99	2.86	3.09	3.23
Net interest margin (fully taxable equivalent)	2.87	3.10	2.96	3.19	3.33
Dividend payout ratio	36.99	44.26	44.04	39.86	36.69
Growth Ratios:					
Total commercial loans	1.42 %	23.83 %	9.24 %	11.21 %	0.04 %
Total loans	0.19	13.14	14.04	7.73	7.76
Total deposits	5.58	14.39	11.40	9.88	2.68
Asset Quality and Condition Ratios:					
Non-performing loans/total loans	0.73 %	0.58 %	0.58 %	0.71 %	1.34 %
Net charge-offs/average loans	0.05	0.04	—	0.14	0.15
Allowance for loan losses/total loans[5]	0.56	0.50	0.92	0.95	0.98
Loans/deposits	100.25	108.68	107.50	105.02	107.11
Capital Ratios:					
Tier 1 capital to average assets - Company	8.58 %	8.10 %	8.94 %	9.37 %	9.30 %
Tier 1 capital to risk-weighted assets - Company	12.61	12.19	15.01	15.55	15.60
Tier 1 capital to average assets - Bank	8.74	8.58	9.06	9.49	9.40
Tier 1 capital to risk-weighted assets - Bank	12.91	12.92	15.20	15.77	15.77
Shareholders equity to total assets	10.27	9.95	8.93	9.76	10.02

(1) Earning assets includes non-accruing loans and securities are valued at amortized cost.

(2) Net revenue is defined as net interest income plus non-interest income.

(3) In December 2017, the Tax Cuts and Jobs Act of 2017 was enacted, and the Company recognized a $4.0 million write-down of its deferred tax assets and liabilities upon revaluation using the lower federal corporate income tax rate of 21.0%

(4) All performance ratios are based on average balance sheet amounts.

(5) Generally accepted accounting principles require that loans acquired in a business combination be recorded at fair value, whereas loans from business activities are recorded at cost. The fair value of loans acquired in a business combination includes expected loan losses, and there is no loan loss allowance recorded for these loans at the time of acquisition. Accordingly, the ratio of the loan loss allowance to total loans is reduced as a result of the existence of such loans, and this measure is not directly comparable to prior periods. Similarly, net loan charge-offs are normally reduced for loans acquired in a business combination since these loans are recorded net of expected loan losses. Therefore, the ratio of net loan charge-offs to average loans is reduced as a result of the existence of such loans, and this measure is not directly comparable to prior periods. Other institutions may have loans acquired in a business combination, and therefore there may be no direct comparability of these ratios between and among other institutions.

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AVERAGE BALANCES AND AVERAGE YIELDS/RATES

The following table presents average balances and an analysis of average rates and yields on an annualized fully taxable equivalent basis for the periods included:

	2018			2017			2016		
(in millions, except ratios)	Average Balance	Interest[3]	Average Yield/Rate [3]	Average Balance	Interest[3]	Average Yield/Rate [3]	Average Balance	Interest[3]	Average Yield/Rate [3]
Assets									
Commercial real estate	$829.5	$ 37.8	4.56 %	$774.4	$ 32.9	4.24 %	$410.7	$ 15.2	3.71 %
Commercial and industrial	389.7	17.8	4.57	336.7	15.9	4.73	138.5	5.6	4.03
Residential real estate	1,132.8	43.6	3.85	1,158.6	43.9	3.79	450.6	18.3	4.06
Consumer	118.4	5.6	4.73	126.8	5.5	4.34	54.9	2.8	5.10
Total loans [1]	2,470.5	104.8	4.24	2,396.5	98.2	4.10	1,054.7	41.9	3.97
Securities and other [2]	762.1	24.6	3.23	757.4	23.5	3.10	546.7	17.7	3.24
Total earning assets	3,232.6	129.4	4.00 %	3,153.9	121.7	3.86 %	1,601.4	59.6	3.72 %
Cash and due from banks	58.2			66.5			5.4		
Allowance for loan losses	(13.3)			(11.5)			(10.0)		
Goodwill and other intangible assets	108.0			107.6			5.4		
Other assets	139.5			147.5			74.7		
Total assets	$3,525.0			$3,464.0			$1,676.9		
Liabilities									
NOW deposits	$456.6	$ 1.9	0.42 %	$455.1	$ 1.1	0.25 %	$161.5	$ 0.3	0.20 %
Savings deposits	354.5	0.6	0.17	367.8	0.6	0.16	72.7	0.1	0.09
Money market deposits	281.3	2.2	0.78	300.9	1.5	0.49	240.2	1.0	0.40
Time deposits	902.5	14.8	1.64	760.5	8.1	1.07	414.4	5.3	1.29
Total interest bearing deposits	1,994.9	19.5	0.98	1,884.3	11.3	0.60	888.8	6.7	0.75
Borrowings	790.3	17.0	2.16	862.5	12.6	1.46	524.9	5.4	1.03
Total interest bearing liabilities	2,785.2	36.5	1.31 %	2,746.8	23.9	0.87 %	1,413.7	12.1	0.86 %
Non-interest bearing demand deposits	354.5			339.3			93.8		
Other liabilities	28.3			27.2			7.3		
Total liabilities	3,167.9			3,113.3			1,514.8		
Total shareholders' equity	357.1			350.7			162.1		
Total liabilities and shareholders' equity	$3,525.0			$3,464.0			$1,676.9		
Net interest income		$ 92.9			$ 97.8			$ 47.5	
Net interest margin			2.87 %			3.10 %			2.96 %
Net interest spread			2.68			2.99			2.86

(1) The average balances of loans include non-accrual loans and unamortized deferred fees and costs.
(2) The average balance for securities available for sale is based on amortized cost.
(3)

Fully taxable equivalent considers the impact of tax-advantaged securities and loans.

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Rate/Volume Analysis

The following table presents the effects of rate and volume changes on the fully taxable equivalent net interest income. Tax exempt interest revenue is shown on a tax-equivalent basis for proper comparison. For each category of interest-earning assets and interest-bearing liabilities, information is provided with respect to changes attributable to (1) changes in rate (change in rate multiplied by prior year volume), (2) changes in volume (change in volume multiplied by prior year rate), and (3) changes in volume/rate (change in rate multiplied by change in volume) have been allocated proportionately based on the absolute value of the change due to the rate and the change due to volume.

	2018 Compared with 2017			2017 Compared with 2016		
	Increases (Decreases) due to			Increases (Decreases) due to		
(in thousands)	Rate	Volume	Net	Rate	Volume	Net
Interest income:						
Commercial real estate	$2,583	$2,295	$4,878	$2,444	$15,145	$17,589
Commercial and industrial[1]	(644)	2,553	1,909	1,122	9,236	10,358
Residential	655	(961)	(306)	(1,135)	26,802	25,667
Consumer	616	(486)	130	(347)	3,050	2,703
Total loans	3,210	3,401	6,611	2,084	54,233	56,317
Securities	818	323	1,141	(701)	6,488	5,787
Total interest income	$4,028	$3,724	$7,752	$1,383	$60,721	$62,104
Interest expense:						
NOW	$736	$4	$740	$99	$717	$816
Savings	113	(72)	41	82	426	508
Money market	842	(98)	744	243	274	517
Time deposits	5,163	1,525	6,688	(710)	3,477	2,767
Total deposits	6,854	1,359	8,213	(286)	4,894	4,608
Borrowings	5,507	(1,067)	4,440	2,830	4,363	7,193
Total interest expense	$12,361	$292	$12,653	$2,544	$9,257	$11,801
Change in net interest income	$(8,333)	$3,432	$(4,901)	$(1,161)	$51,464	$50,303

(1) Includes a lower tax equivalency adjustment due to a lower federal corporate tax rate of 21% in 2018 and 35% in 2017.

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NON-GAAP FINANCIAL MEASURES

To supplement the Company's Consolidated Financial Statements presented in accordance with U.S. generally accepted accounting principles, or GAAP, the Company monitors and considers certain non-GAAP financial measures. These measures are commonly used by management and investors as performance measures. They are not considered measures of financial performance under GAAP, and the items excluded from the measures are significant components in understanding and assessing financial performance. Each non-GAAP measure has limitations as an analytical tool, and should not be considered in isolation or as an alternative to such GAAP measures as net income, net interest income, non-interest expense or other financial statement data presented in the Company's Consolidated Financial Statements as an indicator of financial performance or liquidity. In addition, because they are not measures determined in accordance with GAAP and are susceptible to varying calculations, the non-GAAP measures presented below may not be comparable to other similarly titled measures of other banking entities.
The Company utilizes the non-GAAP measure of adjusted earnings in evaluating operating trends, including components for adjusted revenue and expense. These measures exclude amounts which the Company views as unrelated to its normalized operations, which can include securities gains/losses, acquisition costs, restructuring costs, legal settlements, and systems conversion costs. Non-GAAP adjustments are presented net of an adjustment for income tax expense.

The Company also calculates adjusted earnings per share based on its measure of adjusted earnings. The Company views these amounts as important to understanding its operating trends, particularly due to the impact of accounting standards related to acquisition activity. Analysts also rely on these measures in estimating and evaluating the Company's performance. Management also believes that the computation of non-GAAP adjusted earnings and adjusted earnings per share may facilitate the comparison of the Company to other companies in the financial services industry. The Company also adjusts certain equity related measures to exclude intangible assets due to the importance of these measures to the investment community.

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RECONCILIATION OF NON-GAAP FINANCIAL MEASURES

The following table summarizes the reconciliation of non-GAAP items for the time periods presented:

		At or For The Years Ended December 31,		
(in thousands, except ratios)		2018	2017	2016
GAAP net income		$32,937	$25,993	$14,933
Plus (less):				
Loss (gain) on sale of securities, net		924	(19)	(4,498)
Loss on sale of premises and equipment, net		—	94	248
Loss on other real estate owned		20	—	—
Acquisition, conversion and other expenses		1,728	3,302	2,650
Income tax (expense) benefit[1]		(635)	(1,269)	560
Tax reform charge		—	3,988	—
Total adjusted income[2]	(A)	$34,974	$32,089	$13,893
GAAP net interest income	(B)	$90,883	$92,155	$45,374
Plus: Non-interest income		27,935	25,982	12,349
Total Revenue[2]		118,818	118,137	57,723
Plus (less): Loss (gain) on sale of securities, net		924	(19)	(4,498)
Total adjusted revenue[2]	(C)	$119,742	$118,118	$53,225
GAAP total non-interest expense		$75,539	$72,726	$35,935
Less: Loss on sale of premises and equipment, net		—	(94)	(248)
Less: Loss on other real estate owned		(20)	—	—
Less: Acquisition, conversion and other expenses		(1,728)	(3,302)	(2,650)
Adjusted non-interest expense[2]	(D)	$73,791	$69,330	$33,037
(in millions)				
Average earning assets	(E)	$3,238	$3,154	$1,601
Average assets	(F)	3,525	3,464	1,677
Average shareholders' equity	(G)	357	351	162
Average tangible shareholders' equity[2][3]	(H)	249	243	157
Tangible shareholders' equity, period-end[2][3]	(I)	263	246	151
Tangible assets, period-end[2][3]	(J)	3,501	3,457	1,750
(in thousands)				
Common shares outstanding, period-end	(K)	15,523	15,443	9,116
Average diluted shares outstanding	(L)	15,564	15,290	9,143
Adjusted earnings per share, diluted[2]	(A/L)	$2.25	$2.10	$1.52
Tangible book value per share, period-end[2]	(I/K)	16.94	15.94	16.61
Securities adjustment, net of tax[2][4]	(M)	(8,663)	1,711	(2,125)
Tangible book value per share, excluding securities adjustment[2][4]	(I+M)/K	17.50	15.83	16.84
Tangible shareholders' equity/tangible assets[2]	(I/J)	7.51	7.12	8.65

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(in thousands, except ratios)		At or For The Years Ended December 31, 2018	2017	2016
Performance ratios				
GAAP return on assets		0.93 %	0.75 %	0.89 %
Adjusted return on assets[2]	(A/F)	0.99	0.93	0.83
GAAP return on equity		9.22	7.41	9.21
Adjusted return on equity[2]	(A/G)	9.79	9.15	8.57
Adjusted return on tangible equity[2][3][5]	(A/H)	14.29	13.40	8.90
Efficiency ratio[2][6]	(D-O-Q)/(C+N)	59.27	55.44	58.90
Net interest margin[2]	(B+P)/E	2.87	3.10	2.96
Supplementary data (in thousands)				
Taxable equivalent adjustment for efficiency ratio	(N)	$2,554	$4,391	$2,470
Franchise taxes included in non-interest expense	(O)	479	599	140
Tax equivalent adjustment for net interest margin	(P)	1,986	5,615	2,093
Intangible amortization	(Q)	828	812	92

(1) Assumes a marginal tax rate of 23.78% in 2018, 37.57% in 2017 and 35.00% in 2016.

(2) Non-GAAP financial measure.

(3) Tangible shareholders' equity is computed by taking total shareholders' equity less the intangible assets at period-end. Tangible assets is computed by taking total assets less the intangible assets at period-end.

(4) Securities adjustment, net of tax represents the total unrealized loss on available-for-sale securities recorded on the Company's consolidated balance sheets within total common shareholders' equity.

(5) Adjusted return on tangible equity is computed by dividing the total core income adjusted for the tax-effected amortization of intangible assets, assuming a marginal rate of 23.78% in 2018, 37.57% in 2017 and 35.00% in 2016, by tangible equity.

(6) Efficiency ratio is computed by dividing adjusted non-interest expense by the sum of net interest income on a fully taxable equivalent basis and adjusted non-interest income.

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ITEM 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

GENERAL

Management’s discussion and analysis of financial condition and results of operations is intended to assist in understanding the financial condition and results of operations of the Company. The following discussion and analysis should be read in conjunction with the Company’s Consolidated Financial Statements and the accompanying notes contained in this Annual Report on Form 10-K.

APPLICATION OF CRITICAL ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES, AND RECENT ACCOUNTING PRONOUNCEMENTS

The Company’s significant accounting policies are described in Note 1 - Summary of Significant Accounting Policies of the Consolidated Financial Statements in this Annual Report on Form 10-K. Please see those policies in conjunction with this discussion. The accounting and reporting policies followed by the Company conform, in all material respects, to accounting principles generally accepted in the United States and to general practices within the financial services industry. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. While the Company estimates are based on historical experience, current information and other factors deemed to be relevant, actual results could differ from those estimates.

The SEC defines “critical accounting policies” as those that require application of management’s most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in future periods. Please see those policies in conjunction with this discussion. Management believes that the following policies would be considered critical under the SEC’s definition:

Allowance for Loan Losses: The allowance for loan losses represents probable credit losses that are inherent in the loan portfolio at the financial statement date and which may be estimated. Management uses historical information, as well as current economic data, to assess the adequacy of the allowance for loan losses as it is affected by changing economic conditions and various external factors, which may impact the portfolio in ways currently unforeseen. Although management believes that it uses appropriate available information to establish the allowance for loan losses, future additions to the allowance may be necessary if certain future events occur that may cause actual results to differ from the assumptions used in making the evaluation. Conditions in the local economy and real estate values could require the Company to increase provisions for loan losses, which would negatively impact earnings.

Acquired Loans: Loans acquired in business combinations are initially recorded at fair value with no carryover of the related allowance for loan losses. Determining the fair value of the loans involves estimating the amount and timing of principal and interest cash flows initially expected to be collected on the loans and discounting those cash flows at an appropriate market rate of interest. The Company continues to reevaluate reasonableness of expectations for the timing and the amount of cash to be collected. Subsequent decreases in expected cash flows may result in changes in the amortization or accretion of fair market value adjustments, and in some cases may result in the loan being considered impaired. For collateral-dependent loans with deteriorated credit quality, the Company estimates the fair value of the underlying collateral. These values are discounted using market derived rates of return, with consideration given to the period of time and costs associated with the foreclosure and disposition of the collateral.

Income Taxes: Significant management judgment is required in determining income tax expense and deferred tax assets and liabilities. The Company uses the asset and liability method of accounting for income taxes in which deferred tax assets and liabilities are established for the temporary differences between the financial reporting basis

and the tax basis of the Company's assets and liabilities. The realization of the net deferred tax asset generally depends upon future levels of taxable income and future reversals of existing taxable temporary differences. A valuation allowance would be established for deferred tax assets that management estimates are more likely than not to be unrealizable based on available evidence at the time the estimate is made.

Goodwill and Identifiable Intangible Assets: Goodwill and identifiable intangible assets are recorded as a result of business acquisitions and combinations. These assets are evaluated for impairment annually or whenever events or changes in circumstances indicate the carrying value of these assets may not be recoverable. When these assets are evaluated for impairment, if the carrying amount exceeds fair value, an impairment charge is recorded to income. The fair value is based on observable market prices, when practicable. Other valuation techniques may be used when market prices are unavailable, including estimated discounted cash flows and analysis of market pricing multiples. These types of analyses contain uncertainties because they require management to make assumptions and to apply judgment to estimate industry economic factors and the profitability of future business strategies. In the event of future changes in fair value, the Company may be exposed to an impairment charge that could be material.

Determination of Other-Than-Temporary Impairment of Securities: The Company evaluates debt and equity securities within the Company's available for sale for other-than-temporary impairment ("OTTI"), at least quarterly. If the fair value of a debt security is below the amortized cost basis of the security, OTTI is required to be recognized if any of the following are met: (1) the Company intends to sell the security; (2) it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis; or (3) for debt securities, the present value of expected cash flows is not sufficient to recover the entire amortized cost basis. For all impaired debt securities that the Company intends to sell, or more likely than not will be required to sell, the full amount of the loss is recognized as OTTI through earnings. Credit-related OTTI for all other impaired debt securities is recognized through earnings. Non-credit-related OTTI for such debt securities is recognized in other comprehensive income, net of applicable taxes. In evaluating its marketable equity securities portfolios for OTTI, the Company considers its intent and ability to hold an equity security to recovery of its cost basis in addition to various other factors, including the length of time and the extent to which the fair value has been less than cost and the financial condition and near term prospects of the issuer. Any OTTI on marketable equity securities is recognized immediately through earnings. Should actual factors and conditions differ materially from those expected by management, the actual realization of gains or losses on investment securities could differ materially from the amounts recorded in the financial statements.

Fair Value of Financial Instruments: The Company uses fair value measurements to record fair value adjustments to certain financial instruments and to determine fair value disclosures. Trading assets, securities available for sale, and derivative instruments are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a non-recurring basis, or to establish a loss allowance or write-down based on the fair value of impaired assets. Further, the notes to financial statements include information about the extent to which fair value is used to measure assets and liabilities, the valuation methodologies used and its impact to earnings. For financial instruments not recorded at fair value, the notes to financial statements disclose the estimate of their fair value. Due to the judgments and uncertainties involved in the estimation process, the estimates could result in materially different results under different assumptions and conditions.

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SUMMARY

Bar Harbor Bankshares recorded 2018 net income of $32.9 million or $2.12 per share, a 27% increase compared to $26.0 million or $1.70 per share in 2017. The Company improved its key performance metrics in every consecutive quarter in 2018 while focusing on profitable organic growth by continuing to strengthen community and customer relationships.

Return on assets in 2018 was 0.93% as compared to 0.75% in 2017, while adjusted return on assets (non-GAAP measure) improved to 0.99% in 2018 from 0.93% in 2017. In a similar trend, return on equity was 9.22% for 2018 compared to 7.41% in 2017 and adjusted return on equity (non-GAAP measure) improved to 9.79% in 2018 from 9.15% in 2017. Credit quality remains strong with a ratio of net charge-offs to average loans of 0.05% in 2018 compared to 0.04% in 2017.

In December 2018, the Company opened a new branch in Manchester, New Hampshire and a commercial loan office in Portland, Maine. The new branch has already attracted market share given its anticipated arrival and the new commercial loan production office is expected to generate more opportunities for loan growth and fee income, including but not limited to customer loan derivatives. The Company also announced plans to further expand into Bedford, New Hampshire and Belfast, Maine during 2019. These additional markets are viewed by the Company as providing great opportunity to further grow its franchise while serving existing communities. Additionally, strategic recruits were hired in 2018 to complement existing teams. This foundation of talent is expected to drive revenue as the Company's grows across its New England footprint.

In 2018, the Company rolled out an expanded Treasury Management platform, which contributed to overall growth in loans and deposits and helped to drive the loan to deposit ratio to 100% at year-end. Given the volatile interest rate environment, active balance sheet management was prevalent in 2018. The Company continues to diligently explore various balance sheet strategies to efficiently use capital and enhance shareholder returns.

Total assets were $3.6 billion in 2018, increasing $43.3 million from 2017. Loans totaled $2.5 billion, increasing $4.6 million from 2017 primarily due to commercial and industrial loans which grew at a rate of 5.4%. Deposits were $2.5 billion at the end of 2018, increasing 5.6% from 2017 with growth in about equal parts of non-maturity and time deposits.

Shareholders' equity increased by 4.5% to $370.6 million in 2018 from $354.6 million in 2017. The Company continued to build shareholder value in 2018 with strong risk-based capital ratios and increasing tangible book value per share excluding security adjustments (non-GAAP measure) by 11% to $17.50 per share. The Company increased dividends to $0.79 per share in 2018 from $0.75 per share in 2017.

COMPARISON OF FINANCIAL CONDITION AT DECEMBER 31, 2018 AND 2017

Summary

In managing its asset portfolios, the Company utilizes funding and capital resources within well-defined credit, investment, interest rate, and liquidity risk guidelines. Loans and investment securities are the Company's primary earning assets with additional capacity invested in money market instruments. Net interest income from these products is the Company's primary source of revenue. Funding of the Company's earning assets is achieved through its management of liabilities, attempting to provide stable and flexible sources of funding within established liquidity and interest rate risk guidelines. The Company's objective is to optimize its balance sheet position and to enhance profitability through strategies promising sufficient reward for understood and controlled risk. The Company believes it maintains adequate liquidity under both prevailing and forecasted economic conditions, with an efficient and

appropriate mix of core deposits, brokered deposits, and borrowed funds.

Securities

The Company maintains a relatively high quality and liquid security portfolio consisting of mortgage-backed securities issued by U.S. Government agencies, U.S. Government-sponsored enterprises and, to a much lesser extent, other non-agency, and private-label issuers. The securities portfolio also includes obligations of state and political subdivisions thereof, as well as corporate bonds. Each investment is evaluated from a return on equity and interest rate risk perspective under policy guidelines established by the Company's Board of Directors. The yield and duration of each security are given careful consideration to the current interest rate environment. Overall, management has positioned the portfolio to provide flexibility in reacting to asset and liability changes as they arise. Included in the Company's total securities is FHLB stock which is a non-marketable equity security and, therefore, is reported at cost.

Securities available for sale in 2018 increased $8.6 million to $725.8 million from $717.2 million in 2017. As part of its ongoing balance sheet optimization strategy, the Company completed the sale of approximately $30.0 million of its lower yielding securities available-for-sale. The weighted average yield on the securities sold was 2.36% with an estimated duration of 3.2 years. Proceeds from the sales were reinvested in debt securities issued by U.S. government agencies at a weighted average yield of 5.30% with an estimated duration of 0.4 years.

In total, securities purchased were $146.8 million during 2018 and included $119.1 million of mortgage-backed securities guaranteed by US Government agency and US Government-sponsored enterprises and $27.7 million of corporate bonds. The increase was primarily offset by $95.6 million of maturities, calls, and pay-downs of amortizing securities and sale of $30.0 million in mortgage-backed securities. While the securities sale generated a $924 thousand realized loss, the mark-to-market on these securities had already been recognized in other comprehensive income thus resulting in no impact to tangible book value.

The weighted average yield on the Company's securities portfolio was 3.23% in 2018 compared to 3.10% in prior year. The weighted average life of the securities portfolio at December 31, 2018 was estimated to be 5.2 years, with a duration of approximately 3.9 years. These metrics compare with an estimated weighted average life of 5.1 years, with a duration of approximately 4.0 years for the portfolio at December 31, 2017.

Loans

The Company's loan portfolio is comprised of the following segments: commercial real estate, commercial and industrial, residential real estate, and consumer loans. Commercial real estate loans include multi-family, commercial construction and land, and other commercial real estate classes. Commercial and industrial loans include loans to commercial businesses, agricultural and tax exempt loans. Residential real estate loans consist of mortgages for 1-4 family housing. Consumer loans include home equity loans and lines of credit, auto and other installment lending.

At December 31, 2018, total loans were $2.5 billion with commercial loans comprising 49.4% of the total loan portfolio and residential real estate mortgage loans comprising 46.0% of total loans, remaining consistent with 2017. The remaining loan portfolio consists of consumer, home equity and tax exempt loans. Total commercial loans had a 1.41% growth rate led mostly by commercial and industrial loans which grew at a rate of 5.4%. The increase in commercial and industrial loans was influenced by the launch of a treasury management platform in 2018.

Allowance for loan losses

The determination of the allowance for loan losses is a critical accounting estimate. The Company considers the allowance for loan losses appropriate to cover probable losses which can be reasonably estimated in the loan portfolio as of the balance sheet date. Specific allowances for impaired loans are determined based upon a discounted cash flows analysis, or as appropriate, a collateral shortfall analysis. General allowances for loan losses account for the risk and estimated loss inherent in certain pools of homogeneous loans within the loan portfolio. Under accounting standards for business combinations, acquired loans are recorded at fair value with no loan loss allowance on the date of acquisition. An allowance for loan loss is recorded by the Company for the emergence of new probable and

estimable losses on acquired loans which were not impaired as of the acquisition date.

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During 2018, the allowance for loan losses increased $1.5 million to $13.9 million, largely as a result of the increase in business activity loans offset by lower net charge-off activity reflecting stable asset quality. The ratio of net charge-offs to total loans remain near zero at 0.05% in 2018 and 0.04% in 2017. The allowance to total loans ratio increased to 0.56% in 2018 from 0.50% in 2017, reflecting adequate coverage for future net charge-offs.

The credit risk of the Company’s loan portfolio is managed through loan officer authorities, loan policy, and oversight from the Company’s Chief Credit Officer, the Company's Management Loan Committee, the Directors’ Loan Committee and the Company's Board of Directors. Management follows a policy of continually identifying, analyzing and grading credit risk inherent in the loan portfolio. An ongoing independent review, subsequent to management's review, of individual credits is performed by an independent loan review consulting firm, which reports to the Audit Committee of the Board of Directors. The Company applies a risk grading system, which stratifies the portfolio and allows management to focus appropriate efforts on the highest risk components of the portfolio. The risk grades include ratings that correlate with regulatory definitions of “Pass,” “Special Mention,” “Substandard,” “Doubtful,” and “Loss.” The credit risk profile of the Company’s loan portfolio is described in Note 4 - Allowance for Loan Losses of the Consolidated Financial Statements.

Bank-Owned Life Insurance

Bank-owned life insurance (“BOLI”) represents life insurance on the lives of certain current and retired employees who have provided positive consent allowing the Company to be the beneficiary of such policies. Increases in the cash value of the policies, as well as insurance proceeds received in excess of the cash value, are recorded in other non-interest income, and are not subject to income taxes. The cash surrender value of the BOLI is included on the Company’s consolidated balance sheet.

At December 31, 2018, the cash surrender value of BOLI amounted to $73.8 million, compared with $58.0 million at the end of 2017. The increase in BOLI was primarily the result of $14.0 million in purchases of new policies in the second half of 2018.

Deposits

Historically, the Company's deposit market area exhibits some seasonality, with lower deposits in the winter and spring months and higher deposits in the summer and autumn months.

Total deposits increased to $2.5 billion in 2018 compared to $2.4 billion in 2017 with growth of $131 million. Core deposits remain the primary funding source for loan growth with FHLB borrowings supplementing funding needs. Deposit growth for 2018 was 5.6% with non-maturity deposits growing 4.4%. Excluding the impact of acquired balances, total deposits increased 14.4% in 2017. Non-maturity deposits saw the largest growth in non-interest bearing demand deposits and interest bearing money market deposits of 6.3% and 10.0% respectively. The Company improved its loan-to-deposit ratio to 100% at December 31, 2018 from 106% at December 31, 2017, which helped to mitigate the overall rising cost of funds.

Borrowings

Borrowed funds provide a means to help manage balance sheet interest rate risk, given the Company’s ability to select desired amounts, terms and maturities on a daily basis. These borrowed funds principally consist of advances from the FHLB and, to a lesser extent, securities sold under agreements to repurchase, Federal funds purchased and borrowings from the FRB Boston. Advances from the FHLB are secured by stock in the FHLB, investment securities, certain commercial real estate loans, and blanket liens on qualifying mortgage loans and home equity loans.

At December 31, 2018 total borrowings were $723.8 million with a weighted average rate of 2.56% at year-end. Overall borrowing decreased 13% from year-end 2017 due to deposit growth.

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Stockholders’ Equity

Total equity increased by $15.9 million, or 4.5%, during 2018. The increase reflects strong earnings of $32.9 million, net issuance of stock based compensation of $2.0 million offset by treasury shares of $300 thousand, implementation of revenue recognition of $200 thousand offset by dividends of $12.2 million and an increase in other accumulated comprehensive losses of $6.3 million.

The Company evaluates changes in tangible book value, a non-GAAP financial measure that is a commonly used valuation metric in the investment community, which parallels some regulatory capital measures. Tangible book value per share was $16.94 at year end 2018 compared to $15.94 at year end 2017. Lower long-term rates had a positive impact on the fair value adjustment to the Company’s securities portfolio recorded in accumulated other comprehensive income. Excluding the impact of security fair value adjustments, tangible book value per share (non-GAAP measure) was $17.50 for 2018, compared to $15.83 in 2017, representing a 11% increase.

The Company and the Bank remained well-capitalized under regulatory guidelines at period end as further described in Note 13 - Shareholders’ Equity and Earnings Per Common Share on the Consolidated Financial Statements.

Stock Repurchase Plan

In August 2008, the Company’s Board of Directors approved a 24 month program to repurchase up to 675,000 shares of the Company’s common stock. The Company’s Board of Directors authorized the continuance of this program for additional 24 month periods in August 2010, 2012 and 2014. On August 16, 2017, the Company’s Board of Directors authorized the continuance of this program through August 17, 2018.

As of August 17, 2018, the Company had repurchased 281,192 shares of stock under this plan, at a total cost of $4.07 million and an average price of $14.48 per share. During 2018, the Company repurchased 10,899 shares under the plan, at a total cost of $324 thousand and an average price of $29.78. The Company records repurchased shares as treasury stock.

Cash Dividends

The Company has historically paid regular quarterly cash dividends on its common stock. Each quarter, the Board of Directors may declare the payment of regular quarterly cash dividends, subject to adjustment from time to time, based on the Company’s earnings outlook, the strength of its balance sheet, its need for funds, and other relevant factors. There can be no assurance that dividends on the Company’s common stock will be paid in the future.

The Company’s principal source of funds to pay cash dividends and support its commitments is derived from Bank operations. During 2018, the Company declared and distributed regular cash dividends on its common stock in the aggregate amount of $12.2 million compared with $11.5 million in 2017. The Company’s 2018 dividend payout ratio amounted to 37.0% in 2018, compared with 44.3% in 2017. The decrease is due to higher acquisition, conversion and other expenses in 2017 that lowered net income in that year. The total cash dividends paid in 2018 amounted to $0.79 per common share of common stock, compared with $0.75 in 2017, representing an increase of $0.04 per share, or 5.3%.

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COMPARISON OF OPERATING RESULTS FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

Summary
Net income in 2018 was $32.9 million, up 27% compared to $26.0 million in 2017. Adjusted income increased to $35.0 million in 2018, up 9% from $32.1 million in 2017. The increase in net income reflects the positive organic growth during 2018.

Net Interest Income
Net interest income is the principal component of the Company's income stream and represents the difference or spread between interest generated from earning assets and the interest expense paid on deposits and borrowed funds. Fluctuations in market interest rates as well as volume and mix changes in earning assets and interest-bearing liabilities can materially impact net interest income.

Net interest income decreased year-over-year by $1.3 million to $90.9 million on a higher cost of funds while interest income increased 9.8% to $11.4 million as yields on earning assets expanded. Interest income increases are being driven by a focus on variable rate loan origination and shifts in the securities portfolio. These increases are partially offset by a lower tax equivalency adjustment from a lower 2018 federal tax rate and a lower contribution from purchased loan accretion. The Company executed an investment remix strategy in the fourth quarter of 2018 which is expected to be accretive starting in 2019 and improve overall liquidity and interest rate risk position. Net interest margin in 2018 decreased to 2.87% from 3.10% in 2017. Interest expense increases are being driven by short-term interest rate hikes through 2018, strategies continue to be implemented to shift funding mix and term to secure the Company's longer-term net interest margin goals and funding requirements. Excluding purchased loan accretion, net interest margin in 2018 was 2.76%.

Loan Loss Provision
The provision for loan losses is a charge to earnings in an amount sufficient to maintain the allowance for loan losses at a level deemed adequate by the Company as an estimate of the probable and estimable loan losses in the portfolio as of period-end. The level of the allowance is a critical accounting estimate, which is subject to uncertainty. The level of the allowance is included in the discussion of financial condition.

The provision for loan losses in 2018 remained consistent with 2017 at $2.8 million. The amount of the provision exceeded net charge-offs in all periods shown, as the amount of the allowance has risen gradually based on loan portfolio growth and offset in part by the ongoing improvement in loan performance and credit quality. The ratio of the allowance for loan losses to totals loans increased to 0.56% in 2018 from 0.50% in 2017.

Non-Interest Income
Non-interest income for 2018 increased to $27.9 million from $26.0 million in 2017. Income in 2018 included $2.1 million from the sale of Visa Class B shares, customer loan derivative income of $860 thousand, and an increase in customer service fees of $1.0 million. Income in 2018 was offset by a loss on security sales of $924 thousand and 2017 included a decrease of $1.1 million from insurance brokerage income after the sale of the business line in 2017. Other areas of non-interest income remained consistent year over year, which includes trust and investment management fee income and bank-owned life insurance income. Customer loan derivative income of $860 thousand resulted from fees earned in helping commercial customers to facilitate risk management strategies. The Company mitigates the risk by entering into equal and offsetting loan swap arrangements with highly rated third party financial institutions.

Income from customer service fees increased to $9.5 million in 2018 from $8.5 million in 2017. Customer service fees are principally derived from debit card interchange fees and customer deposit fees. The Company earns interchange fees from transaction fees that merchants pay whenever a customer uses a debit card to make a purchase. Customer

deposit fees are earned from a variety of deposit accounts with a range of interest rates, fee schedules and other terms, which are designed to meet the customer's financial needs. Additional depositor related services provided to customers include ATMs, bank remote deposit capture, ACH origination, and wire transfers-by-phone, internet banking, internet bill pay, mobile banking, and other cash management services.

Trust and investment management fee income represented 43% of total non-interest income in 2018 compared to 47% in 2017 due to the increase in customer service fees. Income from trust and investment management fees are principally derived from fee income through a range of fiduciary services including trust and estate administration, wealth advisory services, and investment management to individuals, businesses, not-for-profit organizations, and municipalities. Revenue from financial services is derived from retail brokerage services conducted through Bar Harbor Financial Services, an independent third-party broker.

Non-Interest Expense

Non-interest expense increased to $75.5 million from $72.7 million in 2017. Full time equivalent staff totaled 445 at the end of 2018 compared with 423 at the end of 2017, and increase of 5.2%. Salary and benefit expense increased proportionally to the amount of new hires and was offset by the revaluation of post-retirement liabilities at lower year-end discount rates. Acquisition, conversion and other expenses totaled $1.7 million in 2018 compared to $3.3 million in 2017. The charges in 2018 relate to debit card conversion from VISA to Mastercard and preliminary trust system conversion costs. In addition, there was a net benefit of $2.6 million in 2017, which reflected a gain on the sale of the Company's insurance subsidiary offset by other one-time charges. Other non-interest expenses increased to $14.9 million in 2018 from $11.9 million in 2017. The increase is due to various one-time charges related to brand consolidation and upgrades around the Company's automated teller machines and associated write-offs.

Income Tax Expense

The effective tax rate was 18.7% in 2018 compared to 39.0% in 2017. The decrease in the effective tax rate was a direct result of the Tax Cuts and Jobs Act of 2017. As previously mentioned, the tax reform resulted in a $4.0 million income tax charge in the fourth quarter of 2017 due to the revaluation of net deferred tax assets.

COMPARISON OF OPERATING RESULTS FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016

Summary

Results in 2017 include operations acquired on January 13, 2017 from a business combination. Therefore, many measures of revenue, expense, income, and average balances increased compared to prior periods. Additionally, per share measures were affected by the issuance of common shares as merger consideration.

Net income in 2017 was $26.0 million compared to $14.9 million in 2016. Adjusted income increased to $32.1 million in 2017 from $13.9 million in 2016. The improvement in results reflects operations acquired from a business combination, expanded operations and improved profitability. The Company's profitability in 2017 benefited from both a higher non-interest income as well as improved efficiency. Acquisition costs affected both years with an after-tax charge of $2.1 million in 2017 and $1.7 million in 2016. Net income in 2016 benefited from security gains totaling $2.9 million on an after-tax basis.

Operational enhancements in 2017 are reflected in the Company's efficiency ratio (non-GAAP) trend, which started 2017 at 59%, but then improved consecutively in each quarter ending 2017 at 55%. The efficiency ratio is a non-GAAP financial measure that compares adjusted expenses and revenues to assess how well the Company is managing its costs. Higher ratios in prior periods represent gradual investments made in infrastructure and key employees to support operations across a broader footprint and larger revenue producing institution.

Net Interest Income

Net interest income increased year-over-year by $46.8 million to $92.2 million. The increase was driven by a $1.6 billion increase in average earning assets, which includes organic growth and the benefit of the business combination. Net interest margin increased to 3.10% in 2017 compared to 2.96% in 2016. Net interest spread increased 13 basis points mostly from the addition of acquired loans but also reflecting higher yields on commercial loans. Weighted average yields for commercial real estate and commercial and industrial loans increased to 4.24% and 4.73% in 2017

from 3.71% and 4.03% in 2016, respectively. Net interest margin in 2017 also benefited from purchased loan accretion totaling $3.7 million in the year.

Lower costs of interest-bearing deposits acquired from the business combination were offset by increased rates on FHLB advances and repurchase agreements year over year as well as acquired subordinated borrowings. For short-term advances, weighted average rates increased to 1.49% from 0.97% in 2016 while advances greater than one year showed a 13 basis point increase in weighted average rates year-over-year. Higher wholesale funding costs resulted from federal funds rate hikes. Increases in overall cost of funds are expected to have a negative impact on net interest margin in the near-term as rates increase and the Company employs strategies to mitigate the impact.

Non-Interest Income

Non-interest income for the year increased to $26.0 million in 2017 from $12.3 million in 2016. Gains from sales of securities in 2016 increased non-interest income by $4.5 million. Non-interest income in 2017, excluding gains on securities, increased $18.1 million from 2016. Revenue from trust and investment management services as well as financial services on a year-to-date basis increased $8.4 million from 2016, which is principally due to the addition of Charter Trust Company as part of the business combination. Fee income from trust, investment management and financial services represented 47% of total non-interest income in 2017 compared to 31% in 2016.

Customer service fees increased $5.8 million compared to 2016 also as a result of the acquisition given the broader customer deposit base and higher number of ATM transactions. In 2017, the Company also benefited from $1.1 million in fees from its insurance subsidiary, which was acquired from the business combination. The Company sold the insurance subsidiary in October 2017.

Loan Loss Provision

The level of the allowance is included in the discussion of financial condition. The provision for loan losses in 2017 increased to $2.8 million from $1.0 million in 2016. The amount of the provision exceeded net charge-offs in all periods shown, as the amount of the allowance has risen gradually based on loan portfolio growth and offset in part by the ongoing improvement in loan performance and credit quality.

Non-Interest Expense

Non-interest expense increased to $72.7 million from $35.9 million in 2016. Salary and employee benefit costs increased by $19.8 million compared with 2016 principally due to the business combination. Full time equivalent staff totaled 423 at the end of 2017 compared with 186 at the end of 2016. Salary and employee benefit costs decreased on a quarterly basis in the second half of 2017 reflecting a positive trend of disciplined cost control and realized cost saves with the acquisition. Occupancy expenses increased $7.0 million as compared to 2016 due to the costs of operating additional branches from the business combination. Acquisition costs totaled $3.3 million in 2017 and $2.7 million in 2016. Acquisition costs in 2017 include severance, system conversion and professional costs, which were offset in part by a one-time benefit from the sale of the Company's insurance subsidiary.

Income Tax Expense

The effective tax rate was 39.0% in 2017 compared to 28.2% in 2016. The increase in the effective tax rate was a direct result of the Tax Cuts and Jobs Act of 2017. The tax reform resulted in a $4.0 million income tax charge in the fourth quarter due to the revaluation of net deferred tax assets.

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LIQUIDITY AND CASH FLOWS

Liquidity is measured by the Company's ability to meet short-term cash needs at a reasonable cost or minimal loss. The Company seeks to obtain favorable sources of liabilities and to maintain prudent levels of liquid assets in order to satisfy varied liquidity demands. Besides serving as a funding source for maturing obligations, liquidity provides flexibility in responding to customer initiated needs. Many factors affect the Company's ability to meet liquidity needs, including variations in the markets served by its network of offices, its mix of assets and liabilities, reputation and credit standing in the marketplace, and general economic conditions.

The Bank actively manages its liquidity position through target ratios established under its Asset Liability Management Policy. Continual monitoring of these ratios, by using historical data and through forecasts under multiple rate and stress scenarios, allows the Bank to employ strategies necessary to maintain adequate liquidity. The Bank's policy is to maintain a liquidity position of at least 4% of total assets. A portion of the Bank's deposit base has been historically seasonal in nature, with balances typically declining in the winter months through late spring, during which period the Bank's liquidity position tightens.

The Bank maintains a liquidity contingency plan approved by the Bank's Board of Directors. This plan addresses the steps that would be taken in the event of a liquidity crisis, and identifies other sources of liquidity available to the Company. Company management believes that the level of liquidity is sufficient to meet current and future funding requirements. However, changes in economic conditions, including consumer savings habits and availability or access to the brokered deposit market could potentially have a significant impact on the Company's liquidity position.

The Company believes the existing cash and cash equivalents (including an interest-bearing deposit at the FRB Boston), securities available for sale and cash flows from operating activities will be sufficient to meet anticipated cash needs for at least the next twelve months. Future working capital needs will depend on many factors, including the rate of business and revenue growth. To the extent cash and cash equivalents, securities available for sale and cash flows from operating activities are insufficient to fund future activities, the Company may need to raise additional funds through debt arrangements or public or private debt or equity financings. The Company also may need to raise additional funds in the event it is determined in the future to effect one or more acquisitions of banks or businesses. If additional funding is required, The Company may not be able to obtain debt arrangements or to effect an equity or debt financing on terms acceptable to the Company or at all.

Capital Resources

Consistent with its long-term goal of operating a sound and profitable organization, at December 31, 2018, the Company maintained its strong capital position and continued to be a "well-capitalized" financial institution according to applicable regulatory standards. Management believes this to be vital in promoting depositor and investor confidence and providing a solid foundation for future growth.

The Bank has capacity to borrow funds on a secured basis utilizing the Borrower in Custody program and the Discount Window at the FRB. At December 31, 2018, the Bank's available secured line of credit at the FRB stood at $118.6 million or 3.3% of the Bank's total assets. The Bank also has access to the national brokered deposit market, and has used this funding source to bolster its on balance sheet liquidity position.

Contractual Obligations

The Company is a party to certain contractual obligations under which it is obligated to make future payments. These principally include borrowings from the FHLB, consisting of short-term and long-term fixed rate borrowings, and collateralized by all stock in the FHLB; a blanket lien on qualified collateral consisting primarily of loans with first and second mortgages secured by one-to-four family properties; and certain pledged investment securities. The Company has an obligation to repay all borrowings from the FHLB.

In the normal course of conducting its banking and financial services business, and in connection with providing products and services to its customers, the Company has entered into a variety of traditional third-party contracts for support services. Examples of such contractual agreements include, but are not limited to: services providing core

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banking systems, ATM and debit card processing, trust services software, accounting software and the leasing of T-1 telecommunication lines and other technology infrastructure supporting the Company’s network.

The following table summarizes the Company’s contractual obligations at December 31, 2018:

(in thousands)	Total	Less than One Year	One to Three Years	Three to Five Years	After Five Years
FHLB Borrowings	$644,612	$611,683	$31,604	$1,000	$325
Subordinated Notes	42,973	—	—	—	42,973
Operating lease obligations	11,306	929	1,802	1,821	6,754
Purchase obligations	20,139	3,621	5,324	4,528	6,666
Total Contractual Obligations	$719,030	$616,233	$38,730	$7,349	$56,718

EFFECTS OF INFLATION

Inflation and changing prices have not had a material effect on the Company's business, and the Company does not expect that they will materially affect the business in the foreseeable future. Any impact of inflation on cost of revenue and operating expenses, especially employee compensation costs, may not be readily recoverable in the price of the Company product offerings.

OFF-BALANCE SHEET ARRANGEMENTS

The Company is a party to certain off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on the Company's financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources, that may be material to investors.

At December 31, 2018 and 2017, the Company’s off-balance sheet arrangements were limited to customer obligations, in the normal course of business to meet customer's financing needs. These financial arrangements include commitments to extend credit, unused or unadvanced loan funds, and letters of credit. The Company uses the same lending policies and procedures to make such commitments as it uses for other lending products. Customers' creditworthiness is evaluated on a case-by-case basis.

Commitments to originate loans, including unused or unadvanced loan funds, are agreements to lend to a customer provided there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require the customer to pay a fee. Since many of the commitments are expected to expire without being fully drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Standby letters of credit generally become payable upon the failure of the customer to perform according to the terms of the underlying contract with the third party, while commercial letters of credit are issued specifically to facilitate commerce and typically result in the commitment being drawn on when the underlying transaction is consummated between the customer and a third party. The contractual amount of these letters of credit represents the maximum potential future payments guaranteed by the Company. Typically these letters of credit expire if unused; therefore the total amounts do not necessarily represent future cash requirements.

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The following table summarizes the contractual amounts of commitments and contingent liabilities to customers as of December 31, 2018 and December 31, 2017:

(in thousands)	2018	2017
Commitments to originate new loans	$20,431	$52,438
Unused funds on commercial and other lines of credit	169,063	134,408
Unadvanced funds on home equity lines of credit	110,682	108,745
Unadvanced funds on construction and real estate loans	128,569	87,915
Commercial letters of credit	1,171	928
Standby letters of credit	486	486
Total	$430,402	$384,920

IMPACT OF NEW ACCOUNTING PRONOUNCEMENTS

Please refer to the notes on Recently Adopted Accounting Principles and Future Application of Accounting Pronouncements in Note 1 - Summary of Significant Accounting Policies of the Consolidated Financial Statements.

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ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market Risk

Market risk is the risk of loss in a financial instrument arising from adverse changes in market rates/prices, such as interest rates, foreign currency exchange rates, commodity prices and equity prices. Interest rate risk is the most significant market risk affecting the Company. Other types of market risk do not arise in the normal course of the Company’s business activities.

The responsibility for interest rate risk management oversight is the function of the Bank’s Asset and Liability Committee (“ALCO”), chaired by the Chief Financial Officer and composed of various members of senior management. ALCO meets regularly to review balance sheet structure, formulate strategies in light of current and expected economic conditions, adjust product prices as necessary, implement policy, monitor liquidity, and review performance against guidelines established to control exposure to the various types of inherent risk.

Interest Rate Risk: Interest rate risk can be defined as an exposure to movement in interest rates that could have an adverse impact on the Bank's net interest income. Interest rate risk arises from the imbalance in the re-pricing, maturity and or cash flow characteristics of assets and liabilities. Management's objectives are to measure, monitor and develop strategies in response to the interest rate risk profile inherent in the Bank's balance sheet. The objectives in managing the Bank's balance sheet are to preserve the sensitivity of net interest income to actual or potential changes in interest rates, and to enhance profitability through strategies that promote sufficient reward for understood and controlled risk.

The Bank's interest rate risk measurement and management techniques incorporate the re-pricing and cash flow attributes of balance sheet and off-balance sheet instruments as each relate to current and potential changes in interest rates. The level of interest rate risk, measured in terms of the potential future effect on net interest income, is determined through the use of modeling and other techniques under multiple interest rate scenarios. Interest rate risk is evaluated in depth on a quarterly basis and reviewed by ALCO and the Company’s Board of Directors.

The Bank's Asset Liability Management Policy, approved annually by the Bank’s Board of Directors, establishes interest rate risk limits in terms of variability of net interest income under rising, flat, and decreasing rate scenarios. It is the role of the ALCO to evaluate the overall risk profile and to determine actions to maintain and achieve a posture consistent with policy guidelines.

Interest Rate Sensitivity Modeling: The Bank utilizes an interest rate risk model widely recognized in the financial industry to monitor and measure interest rate risk. The model simulates the behavior of interest income and expense for all balance sheet and off-balance sheet instruments, under different interest rate scenarios together with a dynamic future balance sheet. Interest rate risk is measured in terms of potential changes in net interest income based upon shifts in the yield curve.

The interest rate risk sensitivity model requires that assets and liabilities be broken down into components as to fixed, variable, and adjustable interest rates, as well as other homogeneous groupings, which are segregated as to maturity and type of instrument. The model includes assumptions about how the balance sheet is likely to evolve through time and in different interest rate environments. The model uses contractual re-pricing dates for variable products, contractual maturities for fixed rate products, and product-specific assumptions for deposit accounts, such as money market accounts, that are subject to re-pricing based on current market conditions. Re-pricing margins are also determined for adjustable rate assets and incorporated in the model. Investment securities and borrowings with call provisions are examined on an individual basis in each rate environment to estimate the likelihood of a call. Prepayment assumptions for mortgage loans and mortgage-backed securities are developed from industry median estimates of prepayment speeds, based upon similar coupon ranges and degree of seasoning. Cash flows and maturities are then determined, and for certain assets, prepayment assumptions are estimated under different interest rate scenarios. Interest income and interest expense are then simulated under several hypothetical interest rate conditions including:

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A flat interest rate scenario in which current prevailing rates are locked in and the only balance sheet fluctuations that occur are due to cash flows, maturities, new volumes, and re-pricing volumes consistent with this flat rate assumption;

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- A 200 basis point rise or decline in interest rates applied against a parallel shift in the yield curve over a twelve-month horizon together with a dynamic balance sheet anticipated to be consistent with such interest rate changes;
- Various non-parallel shifts in the yield curve, including changes in either short-term or long-term rates over a twelve-month horizon, together with a dynamic balance sheet anticipated to be consistent with such interest rate changes; and
- An extension of the foregoing simulations to each of two, three, four and five year horizons to determine the interest rate risk with the level of interest rates stabilizing in years two through five. Even though rates remain stable during this two to five year time period, re-pricing opportunities driven by maturities, cash flow, and adjustable rate products will continue to change the balance sheet profile for each of the interest rate conditions.

Changes in net interest income based upon the foregoing simulations are measured against the flat interest rate scenario and actions are taken to maintain the balance sheet interest rate risk within established policy guidelines.
As of December 31, 2018, interest rate sensitivity modeling results indicate that the Bank's balance sheet was moderately liability sensitive over the one- and two-year horizons (i.e., moderately exposed to rising interest rates).
The following table presents the changes in sensitivities for the years ended December 31, 2018 and 2017:

Change in Interest Rates-Basis Points (Rate Ramp)	1 - 12 Months		13 - 24 Months	
(in thousands, except ratios)	$ Change	% Change	$ Change	% Change
At December 31, 2018				
-100	$1,471	1.7 %	$603	70 %
+200	(3,220)	(3.72)	(7,161)	(8.27)
At December 31, 2017				
-100	$130	0.14 %	$301	0.32 %
+200	(3,211)	(3.44)	(7,521)	(8.07)

Assuming short-term and long-term interest rates decline 100 basis points from current levels (i.e., a parallel yield curve shift) and the Bank's balance sheet structure and size remain at current levels, management believes net interest income will improve slightly over the one year horizon with a further modest improvement over the two-year horizon. Should the yield curve steepen as rates fall, the model suggests that accelerated earning asset prepayments will slow, resulting in a more stabilized level of net interest income. Management anticipates that moderate to strong earning asset growth will be needed to meaningfully increase the Bank's current level of net interest income should both long-term and short-term interest rates decline in parallel.
Assuming the Bank's balance sheet structure and size remain at current levels and the Federal Reserve increases short-term interest rates by 200 basis points with the balance of the yield curve shifting in parallel with these increases, management believes net interest income will decline moderately over the one and two-year horizons as increased funding costs outpace increases in earning asset yields. The interest rate sensitivity simulation model suggests that as interest rates rise, the Bank's funding costs will initially re-price disproportionately with earning asset yields to a moderate degree. As funding costs begin to stabilize early in the third year of the simulation, the model suggests that the earning asset portfolios will continue to re-price at prevailing interest rate levels and cash flows from the Bank's earning asset portfolios will be reinvested into higher yielding earning assets, resulting in a widening of spreads and a stabilization of net interest income over the three-year horizon and beyond. Management believes moderate to strong earning asset growth will be necessary to meaningfully increase the current level of net interest income over the one-year and two-year horizons should short-term and long-term interest rates rise in parallel.

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As compared to December 31, 2017, the year-one sensitivity in the down 100 basis points scenario improved year-over-year, while the year-two sensitivity in the down 100 basis points scenario also showed further improvement. In the year-one up 200 basis points scenario, results were modestly down versus the prior year, while year-two, up 200 basis points results were slightly more negative. On balance, the current aggregate position is consistent with the prior year's position.

Despite a consistent albeit patient path of rate hikes, the Federal Reserve continues to maintain short-term interest rates at relatively low levels, threatening net interest income. Net interest income exposure is also significantly effected by the shape and level of the U.S. Government securities and interest rate swap yield curve, and changes in the size and composition of the Bank's loan, investment and deposit portfolios.

The preceding 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: the nature and timing of interest rate levels and yield curve shape; prepayment speeds on loans and securities; deposit rates; pricing decisions on loans and deposits; reinvestment or replacement of asset and liability cash flows; and renegotiated loan terms with borrowers. While assumptions are developed based upon current economic and local market conditions, the Company cannot make any assurances as to the predictive nature of these assumptions including how customer preferences or competitor influences might change.

As market conditions vary from those assumed in the sensitivity analysis, actual results may also differ due to: prepayment and refinancing levels deviating from those assumed; the impact of interest rate changes, caps or floors on adjustable rate assets; the potential effect of changing debt service levels on customers with adjustable rate loans; depositor early withdrawals and product preference changes; and other such variables. The sensitivity analysis also does not reflect additional actions that the Bank's Senior Executive Team and Board of Directors might take in responding to or anticipation of changes in interest rates, and the anticipated impact on the Bank's net interest income.

The Bank engages an independent consultant to periodically review its interest rate risk position and the reasonableness of assumptions used, with periodic reports provided to the internal Asset-Liability Committee and the Bank's Board of Directors. At December 31, 2018, there were no significant differences between the views of the independent consultant and management regarding the Bank's interest rate risk exposure.

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ITEM 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

REPORT OF INDEPENDANT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and the Board of Directors of Bar Harbor Bankshares:

Opinion on the Financial Statements
We have audited the accompanying consolidated balance sheets of Bar Harbor Bankshares and its subsidiaries (the Company) as of December 31, 2018 and 2017, the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2018, and the related notes to the consolidated financial statements (collectively, the financial statements). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2018, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013, and our report dated March 12, 2019 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Basis for Opinion
These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ RSM US LLP

We have served as the Company's auditor since 2015.

Boston, Massachusetts
March 12, 2019

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BAR HARBOR BANKSHARES AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)	December 31, 2018	December 31, 2017
Assets		
Cash and due from banks	$ 35,208	$ 34,262
Interest-bearing deposit with the Federal Reserve Bank	63,546	56,423
Total cash and cash equivalents	98,754	90,685
Securities available for sale, at fair value	725,837	717,242
Federal Home Loan Bank stock	35,659	38,105
Total securities	761,496	755,347
Loans:		
Commercial real estate	826,699	826,746
Commercial and industrial	404,870	379,423
Residential real estate	1,144,698	1,155,682
Consumer	113,960	123,762
Total loans	2,490,227	2,485,613
Less: Allowance for loan losses	(13,866)	(12,325)
Net loans	2,476,361	2,473,288
Premises and equipment, net	48,804	47,708
Other real estate owned	2,351	122
Goodwill	100,085	100,085
Other intangible assets, net	7,459	8,383
Cash surrender value of bank-owned life insurance	73,810	57,997
Deferred tax assets, net	9,514	7,180
Other assets	29,853	24,389
Total assets	$ 3,608,487	$ 3,565,184
Liabilities		
Deposits:		
Demand	$ 370,889	$ 349,055
NOW	484,717	466,610
Savings	358,888	364,799
Money market	335,951	305,275
Time	932,793	866,346
Total deposits	2,483,238	2,352,085
Borrowings:		
Senior	680,823	786,688
Subordinated	42,973	43,033
Total borrowings	723,796	829,721
Other liabilities	30,874	28,737
Total liabilities	3,237,908	3,210,543
(continued)		
Shareholders’ equity		
Capital stock, par value $2.00; authorized 20,000,000 shares; issued 16,428,388 and 16,428,388 shares at December 31, 2018 and December 31, 2017, respectively	32,857	32,857
Additional paid-in capital	187,653	186,702
Retained earnings	166,526	144,977

Accumulated other comprehensive loss	(11,802)	(4,554)
Less: 905,201 and 985,462 shares of treasury stock at December 31, 2018 and December 31, 2017, respectively, at cost	(4,655)	(5,341)
Total shareholders' equity	370,579	354,641
Total liabilities and shareholders' equity	$ 3,608,487	$ 3,565,184

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

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BAR HARBOR BANKSHARES AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

	Years Ended December 31,		
(in thousands, except per share data)	2018	2017	2016
Interest and dividend income			
Loans	$104,015	$94,976	$41,653
Securities and other	23,436	21,093	15,834
Total interest and dividend income	127,451	116,069	57,487
Interest expense			
Deposits	19,521	11,307	6,699
Borrowings	17,047	12,607	5,414
Total interest expense	36,568	23,914	12,113
Net interest income	90,883	92,155	45,374
Provision for loan losses	2,780	2,788	979
Net interest income after provision for loan losses	88,103	89,367	44,395
Non-interest income			
Trust and investment management fee income	11,985	12,270	3,829
Insurance brokerage service income	—	1,097	—
Customer service fees	9,538	8,484	2,648
(Loss) gain on sales of securities, net	(924)	19	4,498
Bank-owned life insurance income	1,821	1,539	703
Other income	5,515	2,573	671
Total non-interest income	27,935	25,982	12,349
Non-interest expense			
Salaries and employee benefits	40,964	39,589	19,775
Occupancy and equipment	12,386	11,061	4,610
Loss on premises and equipment, net	—	94	248
Outside services	2,408	3,000	767
Professional services	1,474	1,655	1,489
Communication	804	1,289	586
Amortization of intangible assets	828	812	92
Acquisition, conversion and other expenses	1,728	3,302	2,650
Other expenses	14,947	11,924	5,718
Total non-interest expense	75,539	72,726	35,935
Income before income taxes	40,499	42,623	20,809
Income tax expense	7,562	16,630	5,876
Net income	$32,937	$25,993	$14,933
Earnings per share:			
Basic	$2.13	$1.71	$1.65
Diluted	$2.12	$1.70	$1.63
Weighted average common shares outstanding:			
Basic	15,488	15,184	9,069
Diluted	15,564	15,290	9,143

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

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BAR HARBOR BANKSHARES AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Years Ended December 31,		
(in thousands)	2018	2017	2016
Net income	$32,937	$25,993	$14,933
Other comprehensive income (loss), before tax:			
Changes in unrealized loss on securities available for sale	(8,563)	528	(12,059)
Changes in unrealized loss on derivative hedges	654	(838)	(272)
Changes in unrealized loss on post-retirement plans	(216)	(328)	90
Income taxes related to other comprehensive income (loss):			
Changes in unrealized loss on securities available for sale	1,978	(114)	4,221
Changes in unrealized loss on derivative hedges	(168)	386	95
Changes in unrealized loss on post-retirement plans	47	138	(30)
Total other comprehensive loss	(6,268)	(228)	(7,955)
Total comprehensive income	$26,669	$25,765	$6,978

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

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BAR HARBOR BANKSHARES AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(in thousands, except share data)	Common stock amount	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income (loss)	Treasury stock	Total
Balance at December 31, 2015	$13,577	$21,624	$122,260	$ 3,629	$(6,938)	$154,152
Comprehensive income:						
Net income	—	—	14,933	—	—	14,933
Other comprehensive loss	—	—	—	(7,955)	—	(7,955)
Total comprehensive income	—	—	14,933	(7,955)	—	6,978
Cash dividends declared ($0.73 per share)	—	—	(6,577)	—	—	(6,577)
Treasury stock purchased (23,072 shares)	—	—	—	—	(497)	(497)
Net issuance (123,349 shares) to employee stock plans, including related tax effects	—	125	(127)	—	1,408	1,406
Recognition of stock based compensation	—	1,278	—	—	—	1,278
Balance at December 31, 2016	$13,577	$23,027	$130,489	$ (4,326)	$(6,027)	$156,740
Comprehensive income:						
Net income	—	—	25,993	—	—	25,993
Other comprehensive loss	—	—	—	(228)	—	(228)
Total comprehensive income	—	—	25,993	(228)	—	25,765
Cash dividends declared ($0.75 per share)	—	—	(11,505)	—	—	(11,505)
Acquisition of Lake Sunapee Bank Group (6,245,780 shares)	8,328	173,591	—	—	—	181,919
Treasury stock purchased (9,603 shares)	—	—	—	—	(282)	(282)
Net issuance (91,517 shares) to employee stock plans, including related tax effects	—	(222)	—	—	968	746
Three-for-two stock split	10,952	(10,968)	—	—	—	(16)
Recognition of stock based compensation	—	1,274	—	—	—	1,274
Balance at December 31, 2017	$32,857	$186,702	$144,977	$ (4,554)	$(5,341)	$354,641
Comprehensive income:						
Net income	—	—	32,937	—	—	32,937
Other comprehensive loss	—	—	—	(6,268)	—	(6,268)
Total comprehensive income	—	—	32,937	(6,268)	—	26,669
Cash dividends declared ($0.79 per share)	—	—	(12,184)	—	—	(12,184)
Treasury stock purchased (10,899 shares)	—	—	—	—	(324)	(324)
Net issuance (101,460 shares) to employee stock plans, including related tax effects	—	(395)	—	—	1,010	615
Modified retrospective basis adoption of Revenue Recognition Accounting Codification Standard 606	—	—	(184)	—	—	(184)
Reclassification of the income tax effects of the Tax Cuts and Jobs Act from accumulated other comprehensive income for adoption of ASU 2018-02	—	—	980	(980)	—	—
Recognition of stock based compensation	—	1,346	—	—	—	1,346
Balance at December 31, 2018	$32,857	$187,653	$166,526	$ (11,802)	$(4,655)	$370,579

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

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BAR HARBOR BANKSHARES AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
(in thousands)	2018	2017	2016
Cash flows from operating activities:			
Net income	$32,937	$25,993	$14,933
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	2,780	2,788	979
Net amortization of securities	3,945	5,214	3,415
Deferred tax benefit	(443)	6,886	470
Change in unamortized net loan costs and premiums	(600)	(933)	(557)
Premises and equipment depreciation	3,704	3,553	1,551
Stock-based compensation expense	1,346	1,274	1,278
Accretion of purchase accounting entries, net	(3,512)	(3,337)	—
Amortization of other intangibles	828	812	92
Income from cash surrender value of bank-owned life insurance policies	(1,821)	(1,539)	(703)
Loss (gain) on sales of securities, net	924	(19)	(4,498)
Loss on premises and equipment, net	—	94	—
Net change in other assets and liabilities	(2,366)	(654)	(169)
Net cash provided by operating activities	37,722	40,132	16,791
Cash flows from investing activities:			
Proceeds from sales of securities available for sale	29,107	1,599	66,583
Proceeds from maturities, calls and prepayments of securities available for sale	95,629	121,583	109,377
Purchases of securities available for sale	(146,763)	(172,116)	(210,824)
Net change in loans	116,756	(126,828)	(10,042)
Purchase of loans	(121,914)	(18,621)	(128,951)
Purchase of Federal Home Loan Bank stock	(2,676)	(1,325)	(3,852)
Proceeds from sale of Federal Home Loan Bank stock	5,122	—	—
Purchase of premises and equipment, net	(4,793)	(3,157)	(4,296)
Purchase of bank-owned life insurance	(14,000)	—	—
Acquisitions, net of cash acquired	—	39,537	—
Net investment in tax credit limited partnerships	(585)	—	—
Proceeds from sale of other real estate owned	153	322	119
Net cash used in investing activities	(43,964)	(159,006)	(181,886)
Cash flows from financing activities:			
Net increase in deposits	131,981	151,900	107,513
Net change in short-term advances from the Federal Home Loan Bank	3,246	213,593	59,700
Net change in long-term advances from the Federal Home Loan Bank	(104,528)	(153,332)	1,234
Net change in short-term other borrowings	(4,495)	(222)	871
Exercise of stock options	615	968	1,570
Purchase of treasury stock	(324)	(282)	(497)
Cash dividends paid on common stock	(12,184)	(11,505)	(6,577)
Net cash provided by financing activities	14,311	201,120	163,814
Net change in cash and cash equivalents	8,069	82,246	(1,281)
Cash and cash equivalents at beginning of year	90,685	8,439	9,720
Cash and cash equivalents at end of year	$98,754	$90,685	$8,439

(continued)

Supplemental cash flow information:			
Interest paid	$36,511	$21,399	$11,944
Income taxes paid, net	9,891	9,084	6,286
Acquisition of non-cash assets and liabilities:			
Assets acquired	—	1,454,076	—
Liabilities assumed	—	1,406,672	—
Other non-cash changes:			
Real estate owned acquired in settlement of loans	2,380	32	—

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

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BAR HARBOR BANKSHARES AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation: The consolidated financial statements (the “financial statements”) of Bar Harbor Bankshares and its subsidiaries (the “Company” or “Bar Harbor”) have been prepared in conformity with accounting principles generally accepted in the United States of America (“U.S. GAAP”). Bar Harbor Bankshares is a Maine Financial Institution Holding Company for the purposes of the laws of the state of Maine, and as such, is subject to the jurisdiction of the Superintendent of the Maine Bureau of Financial Institutions. These financial statements include the accounts of the Company, its wholly-owned subsidiary Bar Harbor Bank & Trust (the "Bank") and the Bank’s consolidated subsidiaries. The results of operations of companies or assets acquired are included only from the dates of acquisition. All material wholly-owned and majority-owned subsidiaries are consolidated unless U.S. GAAP requires otherwise.

Consolidation: The accompanying consolidated financial statements have been prepared in accordance with GAAP. The consolidated financial statements include the accounts of Bar Harbor Bankshares and its wholly-owned subsidiary, Bar Harbor Bank & Trust. All significant inter-company balances and transactions have been eliminated in consolidation. Assets held in a fiduciary capacity are not assets of the Company, but assets of customers, and therefore, are not included in the consolidated balance sheets.

Reclassifications: Whenever necessary, amounts in the prior years’ financial statements are reclassified to conform to current presentation. The reclassifications had no impact on net income in the Company’s consolidated income statement.

Stock Split: On February 21, 2017, the Company's Board of Directors declared a three-for-two stock split payable on March 21, 2017 as a large stock dividend. Shares presented in prior years have been adjusted to conform to the same basis.

Use of estimates: In preparing financial statements in conformity with GAAP, management is required to make estimates and assumptions that affect the reported amount of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to change in the near term relate to the determination of the allowance for loan losses, other-than-temporary impairment on securities, income tax estimates, reviews of goodwill for impairment, and accounting for post-retirement plans.

Cash and Cash Equivalents: For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks, Federal Funds sold, and other short-term investments with maturities less than 90 days. The Federal Reserve Bank requires the Bank to maintain certain reserve requirements of vault cash and/or deposits. The reserve requirement, included in cash and equivalents, was $15.8 million and $12.7 million at year-end 2018 and 2017, respectively.

Investment Securities: All securities held at December 31, 2018 and 2017 were classified as available-for-sale (“AFS”). Available for sale securities primarily consist of mortgage-backed securities and obligations of state and political subdivisions there of, and are carried at estimated fair value. Changes in estimated fair value of AFS securities, net of applicable income taxes, are reported in accumulated other comprehensive income (loss) as a separate component of shareholders’ equity unless deemed to be other-than-temporarily impaired (“OTTI”) as discussed below. The Company does not have any securities classified as trading or held-to-maturity.

Premiums and discounts on securities are amortized and accreted over the term of the securities using the interest method. Gains and losses on the sale of securities are recognized at the trade date using the specific-identification method and are shown separately in the Consolidated Statements of Income.

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Other-Than-Temporary Impairments on Investment Securities: The Company conducts an OTTI analysis of investment securities on a quarterly basis or more often if a potential loss-triggering event occurs. A write-down of a debt security is recorded when fair value is below amortized cost in circumstances where: (1) the Company has the intent to sell a security; (2) it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis; or (3) the Company does not expect to recover the entire amortized cost basis of the security. If the Company intends to sell a security or if it is more likely than not that the Company will be required to sell the security before recovery, an OTTI write-down is recognized in earnings equal to the entire difference between the security's amortized cost basis and its fair value. If the Company does not intend to sell the security or it is not more likely than not that it will be required to sell the security before recovery, the OTTI write-down is separated into an amount representing credit loss, which is recognized in earnings, and an amount related to all other factors, which is recognized in other comprehensive income. To determine the amount related to credit loss on a debt security, the Company applies a methodology similar to that used for evaluating the impairment of loans.

Federal Home Loan Bank Stock: The Bank is a member of the Federal Home Loan Bank of Boston ("FHLB"). The Bank uses the FHLB for most of its wholesale funding needs. 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. FHLB stock is a non-marketable equity security and therefore is reported at cost, which generally equals par value. Shares held in excess of the minimum required amount are generally redeemable at par value.

The Company periodically evaluates its investment in FHLB stock for impairment based on, among other things, the capital adequacy of the FHLB and its overall financial condition. Based on the capital adequacy, liquidity position and sustained profitability of the FHLB, management believes there is no impairment related to the carrying amount of the Bank's FHLB stock as of December 31, 2018.

Loans Held for Sale: Loans originated with the intent to be sold in the secondary market are accounted for at the lower of cost or market (fair value). Fair value is primarily determined based on quoted prices for similar loans in active markets. Gains and losses on sales of residential mortgage loans (sales proceeds minus carrying value) are recorded in non-interest income. Non-refundable fees and direct loan origination costs related to residential mortgage loans held for sale are recognized in non-interest income or non-interest expense as earned or incurred.

Loans: Loans are reported at their outstanding unpaid principal balances adjusted for charge-offs, the allowance for loan losses, the unamortized balance of any deferred fees or costs on originated loans and the unamortized balance of any premiums or discounts on loans purchased or acquired through mergers.

Interest on loans is accrued and credited to income based on the principal amount of loans outstanding.
Loan origination and commitment fees and direct loan origination costs are deferred, and the net amount is amortized as an adjustment of the related loans' yield, using the level-yield method over the estimated lives of the related loans.

Acquired Loans: Loans acquired in acquisitions are initially recorded at fair value with no carryover of the related allowance for credit losses. Determining the fair value of the loans involves estimating the amount and timing of principal and interest cash flows initially expected to be collected on the loans and discounting those cash flows at an appropriate market rate of interest.

For loans that meet the criteria stipulated in ASC 310-30, "Loans and Debt Securities Acquired with Deteriorated Credit Quality," the Company recognizes the accretable yield, which is defined as the excess of all cash flows expected at acquisition over the initial fair value of the loan, as interest income on a level-yield basis over the expected remaining life of the loan. The excess of the loan's contractually required payments over the cash flows expected to be collected is the non-accretable difference. The non-accretable difference is not recognized as an adjustment of yield, a

loss accrual, or a valuation allowance. The Company evaluates quarterly whether the timing and cash to be collected are reasonably expected. Subsequent significant increases in cash flows the Company expects to collect will first reduce any previously recognized valuation allowance and then be reflected prospectively as an increase to the level yield. Subsequent decreases in expected cash flows may result in the loan being considered impaired. Interest income is not

recognized to the extent that the net investment in the loan would increase to an amount greater than the estimated payoff amount.

For loans that do not meet the ASC 310-30 criteria, the Company accretes interest income based on the contractually required cash flows. The Company subjects loans that do not meet the ASC 310-30 criteria to ASC 450, “Contingencies” by collectively evaluating these loans for an allowance for loan loss.

Acquired loans that met the criteria for non-accrual of interest prior to the acquisition are considered performing upon acquisition, regardless of whether the customer is contractually delinquent, if the Company can reasonably estimate the timing and amount of the expected cash flows on such loans and if the Company expects to fully collect the new carrying value of the loans. As such, the Company may no longer consider the loan to be non-accrual or nonperforming and may accrue interest on these loans, including the impact of any accretable yield.

Non-performing loans: Residential real estate and home equity loans are generally placed on non-accrual status when reaching 90 days past due, or in process of foreclosure, or sooner if considered appropriate by management. Consumer loans are generally placed on non-accrual when reaching 90 days or more past due, or sooner if considered appropriate by management. Secured consumer loans are written down to net realizable value and unsecured consumer loans are charged-off upon reaching 120 days past due. Commercial real estate loans and commercial business loans that are 90 days or more past due are generally placed on non-accrual status, unless secured by sufficient cash or other assets immediately convertible to cash, and the loan is in the process of collection. Commercial real estate and commercial business loans may be placed on non-accrual status prior to the 90 days delinquency date if considered appropriate by management.

When a loan has been placed on non-accrual status, previously accrued and uncollected interest is reversed against interest on the loan. The interest on non-accrual loans is accounted for using the cash-basis or cost-recovery method depending on corresponding credit risk, until qualifying for return to accrual status. A loan can be returned to accrual status when collectability of principal is reasonably assured and the loan has performed for a period of time, generally six months.

Impaired loans: A loan is considered impaired when, based on current information and events, it is probable that the Company will not be able to collect all amounts due from the borrower in accordance with the contractual terms of the loan, including scheduled interest payments.

Factors considered by management in determining impairment include payment status and collateral value. In considering loans for evaluation of impairment, management generally excludes smaller balance, homogeneous loans; residential mortgage loans, home equity loans, and all consumer loans, unless such loans were restructured in a troubled debt restructuring. These loans are collectively evaluated for risk of loss.

When a loan has been identified as being impaired, the amount of impairment is measured based on the present value of expected future cash flows discounted at the loan’s effective interest rate, the loan’s observable market price, or the estimated fair value of the collateral, less any selling costs, if the loan is collateral-dependent. If the measurement of the impaired loan is less than the recorded investment in the loan (including accrued interest, net of deferred loan fees or costs, and unamortized premiums or discounts), impairment is recognized by establishing or adjusting an existing allocation of the allowance for loan losses, or by recording a partial charge-off of the loan to its fair value. Interest payments made on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured, in which case, interest income may be accrued or recognized on a cash basis.

Loans Modified in a Troubled Debt Restructuring: Loans are considered to have been modified in a troubled debt restructuring when, due to a borrower’s financial difficulties, the Company makes certain concessions to the borrower

that it would not otherwise consider. Modifications may include interest rate reductions, principal or interest forgiveness, forbearance, and other actions intended to minimize economic loss and to avoid foreclosure or repossession of collateral. Generally, a non-accrual loan that has been modified in a troubled debt restructuring remains on non-accrual status for a period of at least 6 months to demonstrate that the borrower is able to meet the terms of the modified loan.

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However, performance prior to the modification, or significant events that coincide with the modification, are included in assessing whether the borrower can meet the new terms and may result in the loan being returned to accrual status at the time of loan modification or after a shorter performance period. If the borrower's ability to meet the revised payment schedule is uncertain, the loan remains on non-accrual status.

Allowance for Loan Losses: The allowance for loan losses (the "allowance") is a significant accounting estimate used in the preparation of the Company's consolidated financial statements. The allowance is available to absorb losses inherent in the current loan portfolio and is maintained at a level that, in management's judgment, is appropriate for the amount of risk inherent in the loan portfolio, given past and present conditions. The allowance is increased by provisions charged to operating expense and by recoveries on loans previously charged off, and is decreased by loans charged off as uncollectible.

The allowance is calculated in accordance with ASC 310 - Receivables and ASC 450 - Contingencies. Under the guidance of ASC 310, specific allowances are established in cases where management has identified significant conditions or circumstances related to individual loans where the probability of a loss may be incurred. Credit loss estimates for loans without specific allowances are determined under the guidance of ASC 450, which includes portfolio segmentation based on similar risk characteristics, determination of estimated historical loss rates, calculation of a time-based loss emergence and confirmation periods, and adjustments for certain qualitative risk factors.

Arriving at an appropriate level of allowance for loan losses involves a high degree of judgment. The determination of the adequacy of the allowance and provisioning for estimated losses is evaluated regularly based on review of loans, with particular emphasis on non-performing and other loans that management believes warrant special consideration.

While management uses available information to recognize losses on loans, changing economic conditions and the economic prospects of the borrowers may necessitate future additions or reductions to the allowance. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance, which also may necessitate future additions or reductions to the allowance, based on information available to them at the time of their examination.

Refer to Note 4 - Allowance for Loan Losses, for further information, including the Company's loan loss estimation methodology.

Reserve for Unfunded Commitments: The unfunded reserve is a component of other liabilities and represents the estimate for probable credit losses inherent in unfunded commitments to extend credit. Unfunded commitments to extend credit include banker's acceptances, and standby and commercial letters of credit. The process used to determine the unfunded reserve is consistent with the process for determining the allowance, as adjusted for estimated funding probabilities or loan and lease equivalency factors. The level of the unfunded reserve is adjusted by recording on an expense or recovery in other noninterest expense. Reserve for unfunded commitments are classified in other liabilities on the Company's Consolidated Balance Sheet.

Premises and Equipment: Premises and equipment and related improvements are stated at cost less accumulated depreciation. Depreciation is computed on the straight-line method over the lesser of the lease term or estimated useful lives of related assets; generally 25 to 39 years for premises and three to seven years for furniture and equipment. Software costs are stated at cost less accumulated depreciation within other assets on the Consolidated Statements of Condition. Amortization expense is calculated using the straight-line method over the estimated useful lives of the related assets.

Goodwill and Identifiable Intangible Assets: In connection with acquisitions, the Company generally records as assets on its consolidated financial statements both goodwill and identifiable intangible assets, such as core deposit intangibles.

Goodwill represents the excess of the purchase price over the fair value of net assets acquired in accordance with the purchase method of accounting for business combinations. Goodwill is not amortized but, instead, is subject to impairment tests on at least an annual basis, or more frequently, if an event occurs or circumstances change that reduce

the fair value of a reporting unit below its carrying amount. The impairment testing process is conducted by assigning assets and goodwill to each reporting unit. Currently, the Company's goodwill is evaluated at the entity level as there is only one reporting unit. The Company first assesses certain qualitative factors to determine if it is more likely than not that the fair value of the reporting unit is less than its carrying value. If it is more likely than not that the fair value of the reporting unit is less than the carrying value, then the fair value of each reporting unit is compared to the recorded book value "step one." If the fair value of the reporting unit exceeds its carrying value, goodwill is not considered impaired and "step two" is not considered necessary. If the carrying value of a reporting unit exceeds its fair value, the impairment test continues ("step two") by comparing the carrying value of the reporting unit's goodwill to the implied fair value of goodwill. The implied fair value is computed by adjusting all assets and liabilities of the reporting unit to current fair value with the offset adjustment to goodwill. The adjusted goodwill balance is the implied fair value of the goodwill. An impairment charge is recognized if the carrying fair value of goodwill exceeds the implied fair value of goodwill.

Identifiable intangible assets, included in other assets on the consolidated balance sheet, consist of core deposit intangibles amortized over their estimated useful lives on a straight-line method, which approximates the economic benefits to the Company. These assets are reviewed for impairment at least annually, or whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. The determination of which intangible assets have finite lives is subjective, as is the determination of the amortization period for such intangible assets.

Any negative changes in the estimates used by the Company to determine the carrying value of its goodwill and identifiable intangible assets, or which otherwise adversely affect their value or estimated lives, would adversely affect the Company's consolidated results of operations.

Bank-Owned Life Insurance: Bank-owned life insurance ("BOLI") represents life insurance on the lives of certain current and retired employees who had provided positive consent allowing the Bank to be the beneficiary of such policies. Increases in the cash value of the policies, as well as insurance proceeds received in excess of the cash value, are recorded in other non-interest income, and are not subject to income taxes. The cash surrender value is included in other assets on the Company's consolidated balance sheet.

Other Real Estate Owned: Other real estate owned consists of properties acquired through foreclosure proceedings or acceptance of a deed-in-lieu of foreclosure. These properties are recorded at fair value less estimated costs to sell the property. If the recorded investment in the loan exceeds the property's fair value at the time of acquisition, a charge-off is recorded against the allowance. If the fair value of the property at the time of acquisition exceeds the carrying amount of the loan, the excess is recorded either as a recovery to the allowance if a charge-off had previously been recorded, or as a gain on initial transfer in other non-interest income. Subsequent decreases in the property's fair value and operating expenses of the property are recognized through charges to other non-interest expense. The fair value of the property acquired is based on third-party appraisals, broker price opinions, recent sales activity, or a combination thereof, subject to management judgment.

Capitalized Servicing Rights: Capitalized servicing rights are recognized as assets when mortgage loans are sold and the rights to service those loans are retained.

The Company's capitalized servicing rights are accounted for under the amortization method and are initially recorded at fair value. Fair values are established by using a discounted cash flow model to calculate the present value of estimated future net servicing income. Changes in the fair value of capitalized servicing rights are primarily due to changes in valuation inputs, assumptions, and the collection and realization of expected cash flows. However, these capitalized servicing rights are amortized in proportion to and over the period of estimated net servicing income, which includes prepayment assumptions. An impairment analysis is prepared on a quarterly basis by estimating the

fair value of the capitalized servicing rights and comparing that value to the carrying amount. A valuation allowance is established when the carrying amount of these capitalized servicing rights exceeds fair value.

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Senior and Subordinated Borrowings: The Company's borrowings include retail and wholesale repurchase agreements, FHLB overnight and short-term borrowings, Federal Funds purchased, line of credit advances and subordinated notes. The Company is required to post collateral for certain borrowings, for which it, generally, posts loans and/or investment securities as collateral.

Derivative Financial Instruments: The Company recognizes all derivative instruments on the consolidated balance sheet at fair value. On the date the derivative instrument is entered into, the Company designates whether the derivative is part of a hedging relationship (i.e., cash flow or fair value hedge). The Company formally documents relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking hedge transactions. The Company also assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives used in hedging transactions are highly effective in offsetting the changes in cash flows or fair values of hedged items.

Changes in the fair value of derivative instruments that are highly effective and qualify as cash flow hedge are recorded in other comprehensive income/(loss). Any ineffective portion is recorded in earnings. For fair value hedges that are highly effective, the gain or loss on the derivative and the loss or gain on the hedged item attributable to the hedged risk are both recognized in earnings, with the differences (if any) representing hedge ineffectiveness. The Company discontinues hedge accounting when it is determined that the derivative is no longer highly effective in offsetting changes of the hedged risk on the hedged item, or management determines that the designation of the derivative as a hedging instrument is no longer appropriate.

Off-Balance Sheet Financial Instruments: In the ordinary course of business, the Company has entered into off-balance sheet financial instruments consisting of commitments to extend credit, unused or unadvanced loan funds and letters of credit. Such financial instruments are recorded in the consolidated financial statements when they are funded or related fees are incurred or received.

Stock Based Compensation: The Company has equity award plans that include stock option, restricted stock and performance stock, which are described more fully in Note 14 - Stock Based Compensation Plans of the Consolidated Financial Statements. The Company expenses the grant date fair value of equity awards granted. The expense is recognized over the vesting periods of the grants. The Company uses its treasury shares for issuing shares upon option exercises, restricted stock and performance stock vesting.

Accounting for Retirement Benefit Plans: The Company has non-qualified supplemental executive retirement agreements with certain retired officers. The agreements provide supplemental retirement benefits payable in installments over a period of years upon retirement or death. The Company recognized the net present value of payments associated with the agreements over the service periods of the participating officers. Interest costs continue to be recognized on the benefit obligations. The Company also has a supplemental executive retirement agreement with a certain current executive officer. This agreement provides a stream of future payments in accordance with individually defined vesting schedules upon retirement, termination, or in the event that the participating executive leaves the Company following a change of control event. The Company recognizes the net present value of payments associated with these agreements over the service periods of the participating executive officers. Upon retirement, interest costs will continue to be recognized on the benefit obligation.

The Company recognizes the over-funded or under-funded status of post-retirement benefit plans as a liability on the balance sheet in other liabilities and recognizes changes in that funded status through other comprehensive income/(loss). Gains and losses, prior service costs and credits, and any remaining transition amounts that have not yet been recognized through net periodic benefit costs are recognized in accumulated other comprehensive income/(loss), net of tax effects, until they are amortized as a component of net periodic cost. The measurement date, which is the date at which the benefit obligation and plan assets are measured, is the Company's fiscal year end.

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Income Taxes: The Company uses the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. If current available information indicates that it is more likely than not that deferred tax assets will not be realized, a valuation allowance is established. 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 on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Earnings Per Share: Basic earnings per share excludes dilution and is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflect the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company, such as the Company’s dilutive stock options.

Revenue Recognition: The Company recognizes revenue in accordance with ASC 606, "Revenue from Contracts with Customers." ASC 606 requires the Company to follow a five step process: (1) identify the contract(s) with a customer, (2) identify the performance obligations in the contract, (3) determine the transaction price, (4) allocate the transaction price to the performance obligations in the contract, and (5) recognize revenue when (or as) the Company satisfies a performance obligation. Revenue recognition under ASC 606 depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for the goods or service. See Note 16 - Non-Interest Income of the Company's Consolidated Financial Statements for additional information on revenue recognition.

Segment Reporting: An operating segment is defined as a component of a business for which separate financial information is available that is evaluated regularly by the chief operating decision-maker in deciding how to allocate resources and evaluate performance. The Company has determined that its operations are solely in the community banking industry and include traditional community banking services, including lending activities, acceptance of demand, savings and time deposits, business services, investment management, trust and third-party brokerage services. These products and services have similar distribution methods, types of customers and regulatory responsibilities. Accordingly, segment information is not presented in the Consolidated Financial Statements.

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Recent Accounting Pronouncements

The following table provides a brief description of accounting standards that could have a material impact to the Company's consolidated financial statements upon adoption:

Standard	Description	Required Date of Adoption	Effect on financial statements
Standards Adopted in 2018			
ASU 2014-09, Revenue from Contracts with Customers ASU 2015-14, Deferral of the Effective Date ASU 2016-08, Principal versus Agent Considerations ASU 2016-10, Identifying Performance Obligations and Licensing ASU 2016-12, Narrow-Scope Improvements and Practical Expedience ASU 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers	This ASU supersedes the revenue recognition requirements in ASC Topic 605, Revenue Recognition, and most industry-specific guidance throughout the Industry topics of the Codification. The core principle of the ASU is an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU may be adopted either retrospectively or on a modified retrospective basis.	January 1, 2018	The Company adopted this ASU as of January 1, 2018, upon completion of an analysis to identify all revenue streams within the scope of this accounting guidance. After reviewing the related contracts as prescribed by the five steps within this ASU, one contract resulted in recognition of a $241 thousand liability with a $184 thousand impact to retained earnings net of tax. The remaining changes had no material impact on the consolidated financial statements. See Note 11 for more detail and transitional disclosures.
ASU 2016-01, Recognition and Measurement of Financial Assets and Liabilities ASU-2018-03, Technical Corrections and Improvements to Financial Instruments	This ASU amends ASC Topic 825, Financial Instruments-Overall, and addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. Among other minor amendments applicable to the Company, the main provisions require investments in equity securities to be measured at fair value with changes in fair value recognized through net income unless they qualify for a practicability exception (excludes investments accounted for under the equity method of accounting or those that result in consolidation of the investee). Except for disclosure requirements that will be adopted	January 1, 2018	The Company adopted this ASU as of January 1, 2018, although it did not have any equity securities that would be in scope of this ASU. However, the Company is subject to the exit pricing notion required in fair value disclosures and after calculating the fair value, the Company had no material impact to its consolidated financial statements.

	prospectively, the ASU must be adopted on a modified retrospective basis.		
ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments	This ASU amends Topic 230, Statement of Cash Flows, and provides clarification with respect to classification within the statement of cash flows where current guidance is unclear or silent. The ASU should be adopted retrospectively. If it is impractical to apply the guidance retrospectively for an issue, the amendments related to the issue would be applied prospectively.	January 1, 2018	The Company adopted this ASU as of January 1, 2018, although it did not have a material impact on the Company's consolidated financial statements.

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Standard	Description	Required Date of Adoption	Effect on financial statements
Standards Adopted in 2018 (continued)			
ASU 2017-07, Compensation- Retirement Benefits	This ASU amends Topic 715, Retirement Benefits, and provides more prescriptive guidance around the presentation of net period pension and post-retirement benefit cost in the income statement. The amendment requires the service cost component be disaggregated from other components of net periodic benefit cost in the income statement.	January 1, 2018 Early adoption is permitted.	The Company adopted this ASU as of January 1, 2018, although it did not have a material impact on the Company's consolidated financial statements.
ASU 2017-09, Stock Compensation: Scope of Modification Accounting	This ASU amends Topic 718, Compensation- Stock Compensation, and clarifies when modification accounting should be applied to changes in terms or conditions of share-based payment awards. The amendments narrow the scope of modification accounting by clarifying that modification accounting should be applied to awards if the change affects the fair value, vesting conditions, or classification of the award. The amendments do not impact current disclosure requirements for modifications, regardless of whether modification accounting is required under the new guidance.	January 1, 2018	The Company adopted this ASU as of January 1, 2018, although it did not have a material impact on the Company's consolidated financial statements.
ASU 2018-02, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income ASU 2018-05, Income Taxes (Topic 740) SEC Amendments	The ASU amends Topic 220, Income Statement-Reporting Comprehensive Income, and is intended to help organizations reclassify certain stranded income tax effects in accumulated other comprehensive income resulting from the recently enacted Tax Reform. The guidance allows entities to reclassify stranded tax effects in accumulated other comprehensive income to retained earnings.	January 1, 2019 Early adoption is permitted.	The Company adopted this ASU as of March 31, 2018. The effect of the reclassification resulted in an increase to retained earnings and a decrease to accumulated other comprehensive income of $980 thousand with zero net effect on total stockholders' equity.
ASU 2018-06, Codification Improvements to Topic 942, Financial Services - Depository and Lending	Circular 202, issued on July 2, 1985, was rescinded by the Office of the Comptroller of the Currency. The circular limited the net deferred tax debits that could be carried on the Company's balance sheet for regulatory purposes to the amount that would be coverable by the net operating loss carrybacks. The language is no longer relevant and has been removed from the guidance.	May 2018	The Company adopted this ASU as of January 1, 2018, although it did not have a material impact on the Company's consolidated financial statements.

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Standard	Description	Required Date of Adoption	Effect on financial statements
Standards Not Yet Adopted			
ASU 2016-02, Leases ASU 2018-11 Practical Expedients to Topic 842, Leases ASU 2018-02 Scope Improvements for Lessors	This ASU creates ASU Topic 842, Leases, and supersedes Topic 840, Leases. The new guidance requires lessees to record a right-of-use asset and a corresponding liability equal to the present value of future rental payments on their balance sheets for all leases with a term greater than one year. There are not significant changes to lessor accounting; however, there are certain improvements made to align lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. This guidance expands both quantitative and qualitative required disclosures. This ASU is required to be adopted on a modified retrospective basis and allows for practical expedients and elections in conjunction with implementation. The Company may elect some of the expedients upon the adoption date, which may be applied prospectively or retrospectively.	January 1, 2019	The Company plans to elect the practical expedients, allowing for existing leases to be accounted for consistent with current guidance, with the exception of balance sheet recognition for lessees. A modified retrospective transition approach is required, applying the new standard to all leases existing at the date of initial application. The Company will use the effective date as the initial date of application. At adoption the Company expects to recognize a right-of-use asset and corresponding lease liability of $9.0 million. This estimate is based, primarily, on the present value of unpaid future minimum lease payments. Additionally, that amount is impacted by assumptions around renewals and/or extensions, and the interest rate used to discount those future lease obligations. Due to the limited size of the Company's leasing portfolio, many other items related to this standard don't apply, or have an immaterial impact on the Company's consolidated financial statements.
ASU 2016-13, Measurement of Credit Losses on Financial Instruments ASU 2018-19, Codification Improvements to ASU 2016-13	This ASU amends Topic 326, Financial Instruments- Credit Losses to replace the current incurred loss accounting model with a current expected credit loss approach (CECL) for financial instruments measured at amortized cost and other commitments to extend credit. The amendments require entities to consider all available relevant information when estimating current expected credit losses, including details about past events, current conditions, and reasonable and supportable forecasts. The resulting allowance for credit losses is to reflect the portion of the amortized cost basis that the entity does not expect to collect. The amendments also eliminate the current accounting model for purchased credit impaired loans and debt securities. Additional quantitative and qualitative disclosures are required upon adoption. While the CECL model does not apply to available for sale debt securities, the ASU	January 1, 2020	Adoption of this ASU is expected to primarily change how the Company estimates credit losses with the application of the expected credit loss model. In addition, the Company expects the ASU to change the presentation of credit losses for AFS debt securities through an allowance method rather than as a direct write-off. The Company is in the process of evaluating loan loss estimation models to comply with the guidance under this ASU, which may result in a higher credit loss estimate.

does require entities to record an allowance when recognizing credit losses for available for sale securities, rather than reduce the amortized cost of the securities by direct write-offs.	
The ASU should be adopted on a modified retrospective basis. Entities that have loans accounted for under ASC 310-30 at the time of adoption should prospectively apply the guidance in this amendment for purchase credit deteriorated assets.	Early adoption is permitted in 2019

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Standard	Description	Required Date of Adoption	Effect on financial statements
Standards Not Yet Adopted (continued)			
ASU 2017-04, Simplifying the Test for Goodwill Impairment	This ASU amends Topic 350, Intangibles-Goodwill and Other, and eliminates Step 2 from the goodwill impairment test.	January 1, 2020 Early adoption is permitted.	Adoption of this ASU is not expected to have a material impact on the Company's consolidated financial statements.
ASU 2017-12, Targeted Improvements to Accounting for Hedging Activities ASU 2018-16, Inclusion of Overnight Financing Rate or Overnight Swap Rate as a Benchmark for Hedge Accounting	This ASU amends ASC 815, Derivatives and Hedging to (1) improve the transparency and understandability of information conveyed to financial statement users about an entity's risk management activities by better aligning the entity's financial reporting for hedging relationships with those risk management activities and (2) reduce the complexity of and simplify the application of hedge accounting by preparers.	January 1, 2019	Adoption of this ASU is not expected to have a material impact on the Company's consolidated financial statements.
ASU 2018-07, Share Based Payment Accounting	This ASU expands the scope of Topic 718, Compensation- Stock Compensation to include share-based payments issued to non-employees for goods or services. Consequently, the accounting for share-based payments to non-employees and employees will be substantially aligned. The ASU supersedes Subtopic 505-50, Equity-Based Payments to non-employees.	January 1, 2019	Adoption of this ASU is not expected to have a material impact on the Company's consolidated financial statements as the Company does not participate in these types of arrangements in the normal course of business, except for board director compensation.
ASU 2018-13 Changes to Disclosure Requirements Fair Value Measurement, Topic 820	This ASU eliminates, adds and modifies certain disclosure requirements for fair value measurements. Among the changes, entities will no longer be required to disclose the amount and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, but will be required to disclose the range and weighted average used to develop significant unobservable inputs for Level 3 fair value measurements.	January 1, 2020 Early adoption is permitted.	The Company is currently evaluating this guidance to determine any impact on the Company's consolidated financial statements.
ASU 2018-14 Compensation- Disclosure Requirements for Defined Pension Plans Topic 715-20	This ASU makes minor changes to the disclosure requirements for employers that sponsor defined benefit pension and/or other post-retirement benefit plans.	January 1, 2021 Early adoption is permitted.	The Company is currently evaluating this guidance to determine any impact on the Company's consolidated financial statements.

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NOTE 2. SECURITIES AVAILABLE FOR SALE

The following is a summary of securities available for sale:

(in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2018				
Securities available for sale				
Debt securities:				
Mortgage-backed securities:				
US Government-sponsored enterprises	$ 413,492	$ 904	$ 9,444	$ 404,952
US Government agency	111,938	509	1,935	110,512
Private label	20,353	113	84	20,382
Obligations of states and political subdivisions thereof	133,260	1,081	2,076	132,265
Corporate bonds	58,098	264	636	57,726
Total securities available for sale	$ 737,141	$ 2,871	$ 14,175	$ 725,837
December 31, 2017				
Securities available for sale				
Debt securities:				
Obligations of US Government sponsored enterprises	$ 6,967	$ 5	$ —	$ 6,972
Mortgage-backed securities:				
US Government-sponsored enterprises	447,081	1,738	5,816	443,003
US Government agency	96,357	413	1,174	95,596
Private label	529	150	5	674
Obligations of states and political subdivisions thereof	138,522	2,407	729	140,200
Corporate bonds	30,527	323	53	30,797
Total securities available for sale	$ 719,983	$ 5,036	$ 7,777	$ 717,242

The amortized cost and estimated fair value of available for sale ("AFS") securities segregated by contractual maturity at December 31, 2018 are presented below. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. Mortgage-backed securities are shown in total, as their maturities are highly variable.

(in thousands)	Available for sale	
	Amortized Cost	Fair Value
Within 1 year	$425	$427
Over 1 year to 5 years	23,312	23,311
Over 5 years to 10 years	62,111	62,055
Over 10 years	105,510	104,198
Total bonds and obligations	191,358	189,991
Mortgage-backed securities	545,783	535,846
Total securities available for sale	$737,141	$725,837

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The following table summarizes proceeds from the sale of AFS securities and realized gains and losses:

(in thousands)	Proceeds from Sale of Securities Available for Sale	Realized Gains	Realized Losses	Net
2018	$ 29,107	$ —	$ 924	$ (924)
2017	1,599	19	—	19
2016	66,583	4,498	—	4,498

Securities with unrealized losses, segregated by the duration of their continuous unrealized loss positions, are summarized as follows:

	Less Than Twelve Months		Over Twelve Months		Total	
(in thousands)	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
December 31, 2018						
Securities available for sale						
Debt securities:						
Mortgage-backed securities:						
US Government-sponsored enterprises	$ 155	$ 19,367	$ 9,289	$ 297,569	$ 9,444	$ 316,936
US Government agency	16	2,570	1,919	68,266	1,935	70,836
Private label	79	10,393	5	47	84	10,440
Obligations of states and political subdivisions thereof	43	6,784	2,033	47,930	2,076	54,714
Corporate bonds	224	11,759	412	14,460	636	26,219
Total securities available for sale	$ 517	$ 50,873	$ 13,658	$ 428,272	$ 14,175	$ 479,145
December 31, 2017						
Securities available for sale						
Debt securities:						
Mortgage-backed securities:						
US Government-sponsored enterprises	$ 1,895	$ 189,486	$ 3,921	$ 117,156	$ 5,816	$ 306,642
US Government agency	559	45,221	615	30,155	1,174	75,376
Private label	—	8	5	130	5	138
Obligations of states and political subdivisions thereof	58	8,298	671	27,727	729	36,025
Corporate bonds	53	8,943	—	—	53	8,943
Total securities available for sale	$ 2,565	$ 251,956	$ 5,212	$ 175,168	$ 7,777	$ 427,124

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A summary of securities pledged as collateral for certain deposits and borrowing arrangements as of the years ended December 31, 2018 and December 31, 2017 is as follows:

(in thousands)	December 31, 2018 Carrying Value	December 31, 2018 Estimated Fair Value	December 31, 2017 Carrying Value	December 31, 2017 Estimated Fair Value
Securities pledged for deposits	$128,949	$126,649	$195,921	$194,681
Securities pledged for repurchase agreements	55,656	54,189	98,407	98,050
Securities pledged for other borrowings (1)	270,252	265,334	213,379	212,089
Total securities pledged	$454,857	$446,172	$507,707	$504,820

(1) The Bank pledged securities as collateral for certain borrowing arrangements with the Federal Home Loan Bank of Boston and Federal Reserve Bank of Boston.

Visa Class B Common Shares

The Company was a member of the Visa USA payment network and was issued Class B shares in connection with the Visa Reorganization and the Visa Inc. initial public offering ("IPO") in March 2008. The Visa Class B shares are transferable only under limited circumstances until they can be converted into shares of the publicly traded class of Visa stock. This conversion cannot happen until the settlement of certain litigation, which is indemnified by Visa members. Since its initial public offering, Visa has funded a litigation reserve based upon a change in the conversion ratio of Visa Class B shares into Visa Class A shares. At its discretion, Visa may continue to increase the conversion rate in connection with any settlements in excess of amounts then in escrow for that purpose and reduce the conversion rate to the extent it adds any funds to the escrow in the future. Based on the existing transfer restriction and uncertainty of the litigation, the Company has recorded its Visa Class B shares on its consolidated balance sheets at a zero value for all reporting periods since 2008.

In 2018, the Company sold all of its shares for a pre-tax gain of $2.1 million reflected in other income. As of December 31, 2017 the Company held 15,542 Visa Class B shares, which 11,623 were obtained through the original IPO and 3,919 were acquired through a business combination in early 2017.

Securities Impairment

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. For the twelve months ended December 31, 2018, 2017 and 2016. The Company did not record any other-than-temporary impairment (“OTTI”) losses.

The following table presents the remaining amount of historical credit losses on debt securities and changes reflected in the statement of income:

	Twelve Months Ended December 31,		
(in thousands)	2018	2017	2016
Estimated credit losses as of prior year-end,	$1,697	$1,697	$3,180
Reductions for securities paid off during the period	—	—	1,483
Estimated credit losses at end of the period	$1,697	$1,697	$1,697

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

The Company expects to recover its amortized cost basis on all debt securities in its AFS portfolio, as unrealized losses are the result of changes in the interest rate environment and other market factors. Furthermore, the Company

does not intend to sell nor does it anticipate that it will be required to sell any of its securities in an unrealized loss position as of December 31, 2018, prior to this recovery. The Company’s ability and intent to hold these securities until recovery is supported by the Company’s strong capital and liquidity positions as well as its historically low portfolio turnover.

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The following summarizes, by investment security type, the basis for the conclusion that the debt securities in an unrealized loss position within the Company’s AFS were not other-than-temporarily impaired at December 31, 2018:

US Government-sponsored enterprises
451 out of the total 759 securities in the Company’s portfolios of AFS US Government-sponsored enterprises were in unrealized loss positions. Aggregate unrealized losses represented 2.9% of the amortized cost of securities in unrealized loss positions.The FNMA and FHLMC guarantee the contractual cash flows of all of the Company’s US Government-sponsored enterprises. The securities are investment grade rated and there were no material underlying credit downgrades during the year. All securities are performing.

US Government agencies
117 out of the total 194 securities in the Company’s portfolios of AFS US Government agency securities were in unrealized loss positions. Aggregate unrealized losses represented 2.7% of the amortized cost of securities in unrealized loss positions. The Government National Mortgage Association (“GNMA”) guarantees the contractual cash flows of all of the Company’s US government agency securities. The securities are rated investment grade and there were no material underlying credit downgrades during the year. All securities are performing.

Private-label
15 of the total 23 securities in the Company’s portfolio of AFS private-label mortgage-backed securities were in unrealized loss positions. Aggregate unrealized losses represented 0.8% of the amortized cost of securities in unrealized loss positions. Based upon the foregoing considerations, and the expectation that the Company will receive all of the future contractual cash flows related to the amortized cost on these securities, the Company does not consider there to be any additional other-than-temporary impairment with respect to these securities.

Obligations of states and political subdivisions thereof
118 of the total 257 securities in the Company’s portfolio of AFS municipal bonds and obligations were in unrealized loss positions. Aggregate unrealized losses represented 3.7% of the amortized cost of securities in unrealized loss positions. The Company continually monitors the municipal bond sector of the market carefully and periodically evaluates the appropriate level of exposure to the market. At this time, the Company believes the bonds in this portfolio carry minimal risk of default and the Company is appropriately compensated for that risk. There were no material underlying credit downgrades during the year. All securities are performing.

Corporate bonds
10 of the total 21 securities in the Company’s portfolio of AFS corporate bonds were in an unrealized loss position. The aggregate unrealized loss represents 2.4% of the amortized cost of bonds in unrealized loss positions. The Company reviews the financial strength of all of these bonds and has concluded that the amortized cost remains supported by the expected future cash flows of these securities.

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NOTE 3. LOANS

The Company’s loan portfolio is comprised of the following segments: commercial real estate, commercial and industrial, residential real estate, and consumer loans. Commercial real estate loans include multi-family, commercial construction and land, and other commercial real estate classes. Commercial and industrial loans include loans to commercial businesses, agricultural and other loans to farmers, and tax exempt loans. Residential real estate loans consist of mortgages for 1-to-4 family housing. Consumer loans include home equity loans, auto and other installment loans.

The Company’s lending activities are principally conducted in Maine, New Hampshire, and Vermont.

Total loans include business activity loans and acquired loans. Acquired loans are those loans previously acquired from a business combination. The following is a summary of total loans as of December 31, 2018 and December 31, 2017:

	December 31, 2018			December 31, 2017		
(in thousands)	Business Activities Loans	Acquired Loans	Total	Business Activities Loans	Acquired Loans	Total
Commercial real estate:						
Construction and land development	$23,754	$2,890	$26,644	$28,892	$16,781	$45,673
Other commercial real estate	555,980	244,075	800,055	505,119	275,954	781,073
Total commercial real estate	579,734	246,965	826,699	534,011	292,735	826,746
Commercial and industrial:						
Other Commercial	234,757	52,470	287,227	198,051	68,069	266,120
Agricultural	22,317	—	22,317	27,588	—	27,588
Tax exempt	56,588	38,738	95,326	42,365	43,350	85,715
Total commercial and industrial	313,662	91,208	404,870	268,004	111,419	379,423
Total commercial loans	893,396	338,173	1,231,569	802,015	404,154	1,206,169
Residential real estate:						
Residential mortgages	670,189	474,509	1,144,698	591,411	564,271	1,155,682
Total residential real estate	670,189	474,509	1,144,698	591,411	564,271	1,155,682
Consumer:						
Home equity	57,898	45,291	103,189	51,376	62,217	113,593
Other consumer	9,414	1,357	10,771	7,828	2,341	10,169
Total consumer	67,312	46,648	113,960	59,204	64,558	123,762
Total loans	$1,630,897	$859,330	$2,490,227	$1,452,630	$1,032,983	$2,485,613

Total unamortized net premiums included in the year-end total for business activity loans were the following at December 31, 2018 and December 31, 2017:

(in thousands)	2018	2017
Unamortized net loan origination costs	$3,064	$2,445
Unamortized net premium on purchased loans	(127)	(123)
Total unamortized net costs and premiums	$2,937	$2,322

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For the year ended December 31, 2018, the Company had pledged loans with a collateral value totaling $96.3 million to the Federal Reserve Bank of Boston for certain borrowing arrangements. The Company also pledged residential first mortgage loans, home equity loans and certain commercial loans with collateral value totaling $986.2 million for FHLB borrowings for the year ended December 31, 2018. (See Note 8 - Borrowed Funds of the Company's Consolidated Financial Statements.)

The carrying amount of the acquired loans at December 31, 2018 totaled $859.3 million. A subset of these loans was determined to have evidence of credit deterioration at the acquisition date, which is accounted for in accordance with ASC 310-30. These purchased credit-impaired loans presently maintain a carrying value of $10.1 million (and a note balance of $14.0 million). These loans are evaluated for impairment through the periodic reforecasting of expected cash flows. Loans considered not impaired at acquisition date had a carrying amount of $849.2 million.

The following table summarizes activity in the accretable yield for the acquired loan portfolio that falls under the purview of ASC 310-30, Accounting for Certain Loans or Debt Securities Acquired in a Transfer:

	Twelve Months Ended December 31,	
(in thousands)	2018	2017
Balance at beginning of period	$3,509	$—
Acquisitions	—	3,398
Reclassification from nonaccretable difference for loans with improved cash flows	2,240	1,925
Changes in expected cash flows that do not affect the nonaccretable difference	—	—
Reclassification to TDR	(30)	—
Accretion	(1,342)	(1,814)
Balance at end of period	$4,377	$3,509

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The following is a summary of past due loans at December 31, 2018 and December 31, 2017:

Business Activities Loans

(in thousands)	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Current	Total Loans	Past Due > 90 days and Accruing
December 31, 2018							
Commercial real estate:							
Construction and land development	$ —	$ —	$ —	$—	$23,754	$23,754	$ —
Other commercial real estate	1,146	—	6,725	7,871	548,109	555,980	—
Total commercial real estate	1,146	—	6,725	7,871	571,863	579,734	—
Commercial and industrial:							
Other Commercial	395	60	402	857	233,900	234,757	50
Agricultural	65	6	25	96	22,221	22,317	—
Tax exempt	—	—	—	—	56,588	56,588	—
Total commercial and industrial	460	66	427	953	312,709	313,662	50
Total commercial loans	1,606	66	7,152	8,824	884,572	893,396	50
Residential real estate:							
Residential mortgages	3,565	641	1,309	5,515	664,674	670,189	—
Total residential real estate	3,565	641	1,309	5,515	664,674	670,189	—
Consumer:							
Home equity	72	—	—	72	57,826	57,898	—
Other consumer	17	—	11	28	9,386	9,414	—
Total consumer	89	—	11	100	67,212	67,312	—
Total loans	$ 5,260	$ 707	$ 8,472	$14,439	$1,616,458	$1,630,897	$ 50

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Acquired Loans

(in thousands)	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Acquired Credit Impaired	Total Loans	Past Due > 90 days and Accruing
December 31, 2018							
Commercial real estate:							
Construction and land development	$ —	$ —	$ —	$—	$ 164	$2,890	$ —
Other commercial real estate	631	99	211	941	6,143	244,075	—
Total commercial real estate	631	99	211	941	6,307	246,965	—
Commercial and industrial:							
Other commercial	149	26	494	669	679	52,470	—
Agricultural	—	—	—	—	—	—	—
Tax exempt	—	—	—	—	—	38,738	—
Total commercial and industrial	149	26	494	669	679	91,208	—
Total commercial loans	780	125	705	1,610	6,986	338,173	—
Residential real estate:							
Residential mortgages	3,419	254	1,792	5,465	3,095	474,509	—
Total residential real estate	3,419	254	1,792	5,465	3,095	474,509	—
Consumer:							
Home equity	198	—	66	264	22	45,291	7
Other consumer	17	—	—	17	3	1,357	189
Total consumer	215	—	66	281	25	46,648	196
Total loans	$ 4,414	$ 379	$ 2,563	$7,356	$ 10,106	$859,330	$ 196

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Business Activities Loans

(in thousands)	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Current	Total Loans	Past Due > 90 days and Accruing
December 31, 2017							
Commercial real estate:							
Construction and land development	$ —	$ —	$ 637	$637	$28,255	$28,892	$ —
Other commercial real estate	965	1,659	5,065	7,689	497,430	505,119	119
Total commercial real estate	965	1,659	5,702	8,326	525,685	534,011	119
Commercial and industrial:							
Other commercial	186	329	702	1,217	196,834	198,051	21
Agricultural	42	159	198	399	27,189	27,588	155
Tax exempt	—	—	—	—	42,365	42,365	—
Total commercial and industrial	228	488	900	1,616	266,388	268,004	176
Total commercial loans	1,193	2,147	6,602	9,942	792,073	802,015	295
Residential real estate:							
Residential mortgages	3,096	711	975	4,782	586,629	591,411	—
Total residential real estate	3,096	711	975	4,782	586,629	591,411	—
Consumer:							
Home equity	515	—	199	714	50,662	51,376	199
Other consumer	36	24	—	60	7,768	7,828	—
Total consumer	551	24	199	774	58,430	59,204	199
Total loans	$ 4,840	$ 2,882	$ 7,776	$15,498	$1,437,132	$1,452,630	$ 494

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Acquired Loans

(in thousands)	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Acquired Credit Impaired	Total Loans	Past Due > 90 days and Accruing
December 31, 2017							
Commercial real estate:							
Construction and land development	$ 124	$ 9	$ —	$ 133	$ 258	$ 16,781	$ —
Other commercial real estate	278	—	411	689	8,397	275,954	—
Total commercial real estate	402	9	411	822	8,655	292,735	—
Commercial and industrial:							
Other commercial	125	14	49	188	632	68,069	—
Agricultural	—	—	—	—	—	—	—
Tax exempt	—	—	—	—	—	43,350	—
Total commercial and industrial	125	14	49	188	632	111,419	—
Total commercial loans	527	23	460	1,010	9,287	404,154	—
Residential real estate:							
Residential mortgages	752	388	614	1,754	3,259	564,271	—
Total residential real estate	752	388	614	1,754	3,259	564,271	—
Consumer:							
Home equity	125	117	80	322	38	62,217	16
Other consumer	2	—	—	2	3	2,341	—
Total consumer	127	117	80	324	41	64,558	16
Total loans	$ 1,406	$ 528	$ 1,154	$ 3,088	$ 12,587	$ 1,032,983	$ 16

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Non-Accrual Loans

The following is summary information pertaining to non-accrual loans at December 31, 2018 and December 31, 2017:

	December 31, 2018			December 31, 2017		
(in thousands)	Business Activities Loans	Acquired Loans	Total	Business Activities Loans	Acquired Loans	Total
Commercial real estate:						
Construction and land development	$1	$ —	$1	$637	$ —	$637
Other commercial real estate	7,873	282	8,155	7,146	560	7,706
Total commercial real estate	7,874	282	8,156	7,783	560	8,343
Commercial and industrial:						
Other commercial	1,423	643	2,066	703	463	1,166
Agricultural	265	—	265	43	—	43
Tax exempt	—	—	—	—	—	—
Total commercial and industrial	1,688	643	2,331	746	463	1,209
Total commercial loans	9,562	925	10,487	8,529	1,023	9,552
Residential real estate:						
Residential mortgages	4,213	2,997	7,210	3,408	858	4,266
Total residential real estate	4,213	2,997	7,210	3,408	858	4,266
Consumer:						
Home equity	246	201	447	130	217	347
Other consumer	90	1	91	95	58	153
Total consumer	336	202	538	225	275	500
Total loans	$14,111	$ 4,124	$18,235	$12,162	$ 2,156	$14,318

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Loans evaluated for impairment by portfolio segment as of December 31, 2018 and December 31, 2017 were as follows:

Business Activities Loans

(in thousands)	Commercial real estate	Commercial and industrial	Residential real estate	Consumer	Total
December 31, 2018					
Individually evaluated for impairment	$ 9,835	$ 1,445	$ 2,562	$ 13	$ 13,855
Collectively evaluated	569,899	312,217	667,627	67,299	1,617,042
Total	$ 579,734	$ 313,662	$ 670,189	$ 67,312	$ 1,630,897

Acquired Loans

(in thousands)	Commercial real estate	Commercial and industrial	Residential real estate	Consumer	Total
December 31, 2018					
Individually evaluated for impairment	$ 188	$ 426	$ 744	$ —	$ 1,358
Purchased credit impaired	6,307	679	3,095	25	10,106
Collectively evaluated	240,470	90,103	470,670	46,623	847,866
Total	$ 246,965	$ 91,208	$ 474,509	$ 46,648	$ 859,330

Business Activities Loans

(in thousands)	Commercial real estate	Commercial and industrial	Residential real estate	Consumer	Total
December 31, 2017					
Individually evaluated for impairment	$ 7,604	$ 626	$ 1,404	$ 13	$ 9,647
Collectively evaluated	526,407	267,378	590,007	59,191	1,442,983
Total	$ 534,011	$ 268,004	$ 591,411	$ 59,204	$ 1,452,630

Acquired Loans

(in thousands)	Commercial real estate	Commercial and industrial	Residential real estate	Consumer	Total
December 31, 2017					
Individually evaluated for impairment	$ 241	$ 571	$ 271	$ 63	$ 1,146
Purchased credit impaired	8,655	632	3,259	41	12,587
Collectively evaluated	283,839	110,216	560,741	64,454	1,019,250
Total	$ 292,735	$ 111,419	$ 564,271	$ 64,558	$ 1,032,983

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The following is a summary of impaired loans at December 31, 2018 and December 31, 2017:
Business Activities Loans

(in thousands)	December 31, 2018		
	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance:			
Construction and land development	$—	$ —	$ —
Other commercial real estate	8,209	8,301	—
Other commercial	649	669	—
Agricultural	—	—	—
Tax exempt	—	—	—
Residential real estate	1,671	1,709	—
Home equity	—	—	—
Other consumer	—	—	—
With an allowance recorded:			
Construction and land development	$1	$ 1	$ 1
Other commercial real estate	1,625	1,660	421
Other commercial	796	855	78
Agricultural	—	—	—
Tax exempt	—	—	—
Residential real estate	891	916	111
Home equity	13	13	—
Other consumer	—	—	—
Total			
Commercial real estate	$9,835	$ 9,962	$ 422
Commercial and industrial	1,445	1,524	78
Residential real estate	2,562	2,625	111
Consumer	13	13	—
Total impaired loans	$13,855	$ 14,124	$ 611

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Acquired Loans

(in thousands)	December 31, 2018 Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance:			
Construction and land development	$—	$ —	$ —
Other commercial real estate	188	187	—
Other commercial	426	510	—
Agricultural	—	—	—
Tax exempt	—	—	—
Residential real estate	375	524	—
Home equity	—	—	—
Other consumer	—	—	—
With an allowance recorded:			
Construction and land development	$—		
Other commercial real estate	—	—	—
Other commercial	—	—	—
Agricultural	—	—	—
Tax exempt	—	—	—
Residential real estate	369	379	41
Home equity	—	—	—
Other consumer	—	—	—
Total			
Commercial real estate	$188	$ 187	$ —
Commercial and industrial	426	510	—
Residential real estate	744	903	41
Consumer	—	—	—
Total impaired loans	$1,358	$ 1,600	$ 41

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Business Activities Loans

(in thousands)	December 31, 2017 Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance:			
Construction and land development	$—	$ —	$ —
Other commercial real estate	5,896	5,903	—
Other commercial	218	217	—
Agricultural	—	—	—
Tax exempt	—	—	—
Residential real estate	1,247	1,260	—
Home equity	13	13	—
Other consumer	—	—	—
With an allowance recorded:			
Construction and land development	$637	$ 2,563	$ 59
Other commercial real estate	1,071	1,132	388
Other commercial	408	408	3
Agricultural	—	—	—
Tax exempt	—	—	—
Residential real estate	157	157	9
Home equity	—	—	—
Other consumer	—	—	—
Total			
Commercial real estate	$7,604	$ 9,598	$ 447
Commercial and industrial	626	625	3
Residential real estate	1,404	1,417	9
Consumer	13	13	—
Total impaired loans	$9,647	$ 11,653	$ 459

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Acquired Loans

(in thousands)	December 31, 2017 Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance:			
Construction and land development	$—	$ —	$ —
Other commercial real estate	241	352	—
Other commercial	571	584	—
Agricultural	—	—	—
Tax exempt	—	—	—
Residential real estate	271	278	—
Home equity	63	156	—
Other consumer	—	—	—
With an allowance recorded:			
Construction and land development	$—		
Other commercial real estate	—	—	—
Other commercial		—	—
Agricultural	—	—	—
Tax exempt	—	—	—
Residential real estate	—	—	—
Home equity	—	—	—
Other consumer	—	—	—
Total			
Commercial real estate	$241	$ 352	$ —
Commercial and industrial	571	584	—
Residential real estate	271	278	—
Consumer	63	156	—
Total impaired loans	$1,146	$ 1,370	$ —

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The following is a summary of the average recorded investment and interest income recognized on impaired loans as of December 31, 2018 and December 31, 2017:

Business Activities Loan

(in thousands)	Twelve Months Ended December 31, 2018		Twelve Months Ended December 31, 2017	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance:				
Construction and land development	$ —	$ —	$ —	$ —
Other commercial real estate	6,878	77	2,541	66
Other commercial	634	9	382	6
Agricultural	—	—	113	1
Tax exempt	—	—	—	—
Residential real estate	1,693	39	2,174	39
Home equity	—	—	27	—
Other consumer	—	—	53	3
With an allowance recorded:				
Construction and land development	$ 1	$ —	$ 637	$ —
Other commercial real estate	1,140	—	735	—
Other commercial	735	—	105	1
Agricultural	—	—	—	—
Tax exempt	—	—	—	—
Residential real estate	826	9	157	5
Home equity	13	1	—	—
Other consumer	—	—	—	—
Total				
Commercial real estate	$ 8,019	$ 77	$ 3,913	$ 66
Commercial and industrial	1,369	9	600	8
Residential real estate	2,519	48	2,331	44
Consumer	13	1	80	3
Total impaired loans	$ 11,920	$ 135	$ 6,924	$ 121

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Acquired Loans

(in thousands)	Twelve Months Ended December 31, 2018		Twelve Months Ended December 31, 2017	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance:				
Construction and land development	$ —	$ —	$ —	$ —
Other commercial real estate	112	1	136	—
Other commercial	441	1	264	1
Agricultural	—	—	—	—
Tax exempt	—	—	—	—
Residential real estate	442	—	140	1
Home equity	—	—	58	—
Other consumer	—	—	—	—
With an allowance recorded:				
Construction and land development	$ —	$ —	$ —	$ —
Other commercial real estate	—	—	—	—
Other commercial	—	—	—	—
Agricultural	—	—	—	—
Tax exempt	—	—	—	—
Residential real estate	218	3	—	—
Home equity	—	—	—	—
Other consumer	—	—	—	—
Total				
Commercial real estate	$ 112	$ 1	$ 136	$ —
Commercial and industrial	441	1	264	1
Residential real estate	660	3	140	1
Consumer	—	—	58	—
Total impaired loans	$ 1,213	$ 5	$ 598	$ 2

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Troubled Debt Restructuring Loans

The Company's loan portfolio also includes certain loans that have been modified in a Troubled Debt Restructuring ("TDR"), where economic concessions have been granted to borrowers who have experienced or are expected to experience financial difficulties. These concessions typically result from the Company's loss mitigation activities and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance, or other actions. Certain TDRs are classified as non-performing at the time of restructure and may only be returned to performing status after considering the borrower's sustained repayment performance for a reasonable period, generally six months. TDRs are evaluated individually for impairment and may result in a specific allowance amount allocated to an individual loan.

The following tables include the recorded investment and number of modifications identified during the twelve months ended December 31, 2018, 2017 and 2016, respectively. The table includes the recorded investment in the loans prior to a modification and also the recorded investment in the loans after the loans were restructured. Modifications may include adjustments to interest rates, payment amounts, extensions of maturity, court ordered concessions or other actions intended to minimize economic loss and avoid foreclosure or repossession of collateral.

	Twelve Months Ended December 31, 2018			
(in thousands, except modifications)	Number of Modifications	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Specific Reserve
Troubled Debt Restructurings				
Construction and land development	1	$ 1	$ 1	$ 1
Other commercial real estate	9	1,896	1,564	153
Other commercial	7	556	486	55
Agricultural	1	167	—	—
Tax exempt	—	—	—	—
Residential mortgages	19	3,348	2,752	145
Home equity	1	100	100	—
Other consumer	3	13	11	—
Total	41	$ 6,081	$ 4,914	$ 354

	Twelve Months Ended December 31, 2017			
(in thousands, except modifications)	Number of Modifications	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Specific Reserve
Troubled Debt Restructurings				
Construction and land development	—	$ —	$ —	$ —
Other commercial real estate	6	388	222	—
Other commercial	6	563	545	—
Agricultural	1	19	18	—
Tax exempt	—	—	—	—
Residential mortgages	3	692	670	—
Home equity	1	13	13	—
Other consumer	1	38	36	—
Total	18	$ 1,713	$ 1,504	$ —

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(in thousands, except modifications)	Twelve Months Ended December 31, 2016			
	Number of Modifications	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Specific Reserve
Troubled Debt Restructurings				
Construction and land development	—	$ —	$ —	$ —
Other commercial real estate	6	1,459	1,354	—
Other commercial	2	38	48	—
Agricultural	3	29	44	—
Tax exempt	—	—	—	—
Residential mortgages	—	—	—	—
Home equity	—	—	—	—
Other consumer	2	11	11	9
Total	13	$ 1,537	$ 1,457	$ 9

The following table summarizes the types of loan concessions made for the periods presented:

(in thousands, except modifications)	2018		2017		2016	
	Number of Modifications	Post-Modification Outstanding Recorded Investment	Number of Modifications	Post-Modification Outstanding Recorded Investment	Number of Modifications	Post-Modification Outstanding Recorded Investment
Interest rate and maturity concession	1	$ 16	6	$ 725	6	$ 440
Amortization and maturity concession	1	286	6	490	—	—
Amortization concession	—	—	1	94	4	981
Amortization, interest rate and maturity concession	—	—	1	36	—	—
Amortization and interest rate concession	—	—	—	—	1	9
Forbearance	3	271	—			