Board of Governors of the Federal Reserve System

Annual Report of Holding Companies—FR Y-6

Report at the close of business as of the end of fiscal year

This Report is required by law: Section 5(c)(1)(A) of the Bank Holding Company Act (12 U.S.C. § 1844(c)(1)(A)); sections 8(a) and 13(a) of the International Banking Act (12 U.S.C. §§ 3106(a) and 3108(a)); sections 11(a)(1), 25, and 25A of the Federal Reserve Act (12 U.S.C. §§ 248(a)(1), 602, and 611a); and sections 113, 165, 312, 618, and 809 of the Dodd-Frank Act (12 U.S.C. §§ 5361, 5365, 5412, 1850a(c)(1), and 5468(b)(1)). Return to the appropriate Federal Reserve Bank the original and the number of copies specified.

This report form is to be filed by all top-tier bank holding companies, top-tier savings and loan holding companies, and U.S. intermediate holding companies organized under U.S. law, and by any foreign banking organization that does not meet the requirements of and is not treated as a qualifying foreign banking organization under Section 211.23 of Regulation K (12 C.F.R. § 211.23). (See page one of the general instructions for more detail of who must file.) The Federal Reserve may not conduct or sponsor, and an organization (or a person) is not required to respond to, an information collection unless it displays a currently valid OMB control number.

NOTE: The *Annual Report of Holding Companies* must be signed by one director of the top-tier holding company. This individual should also be a senior official of the top-tier holding company. In the event that the top-tier holding company does not have an individual who is a senior official and is also a director, the chairman of the board must sign the report. If the holding company is an ESOP/ESOT formed as a corporation or is an LLC, see the General Instructions for the authorized individual who must sign the report.

I, Jon J. Prescott
Name of the Holding Company Director and Official

President & CEO
Title of the Holding Company Director and Official

attest that the *Annual Report of Holding Companies* (including the supporting attachments) for this report date has been prepared in conformance with the instructions issued by the Federal Reserve System and are true and correct to the best of my knowledge and belief.

With respect to information regarding individuals contained in this report, the Reporter certifies that it has the authority to provide this information to the Federal Reserve. The Reporter also certifies that it has the authority, on behalf of each individual, to consent or object to public release of information regarding that individual. The Federal Reserve may assume, in the absence of a request for confidential treatment submitted in accordance with the Board's "Rules Regarding Availability of Information," 12 C.F.R. Part 261, that the Reporter and individual consent to public release of all details in the report concerning that individual.

Signature of Holding Company Director and Official

03/17/2020
Date of Signature

For holding companies not registered with the SEC–
Indicate status of Annual Report to Shareholders:

☒ is included with the FR Y-6 report
☐ will be sent under separate cover
☐ is not prepared

For Federal Reserve Bank Use Only

RSSD ID ______
C.I. ______

Date of Report (top-tier holding company's fiscal year-end):
December 31, 2019
Month / Day / Year

N/A
Reporter's Legal Entity Identifier (LEI) (20-Character LEI Code)

Reporter's Name, Street, and Mailing Address
Katahdin Bankshares Corp.
Legal Title of Holding Company

11 Main Street
(Mailing Address of the Holding Company) Street / P.O. Box

City	State	Zip Code
Patten	ME	04765

Physical Location (if different from mailing address)

Person to whom questions about this report should be directed:

Name	Title
Joseph Porter	VP, Controller

207-521-3228
Area Code / Phone Number / Extension

207-521-0456
Area Code / FAX Number

j.porter@katahdintrust.com
E-mail Address

www.katahdintrust.com
Address (URL) for the Holding Company's web page

Is confidential treatment requested for any portion of this report submission? .... 0=No 1=Yes: 0

In accordance with the General Instructions for this report (check only one),

1. a letter justifying this request is being provided along with the report .... ☐
2. a letter justifying this request has been provided separately ... ☐

NOTE: Information for which confidential treatment is being requested must be provided separately and labeled as "confidential."

FR Y-6
For year-end December 31, 2019
Katahdin Bankshares Corp.
Main Street, P O Box 450
Patten, Maine 04765

Report Item 1a: Form 10-K filed with the Securities and Exchange Commission

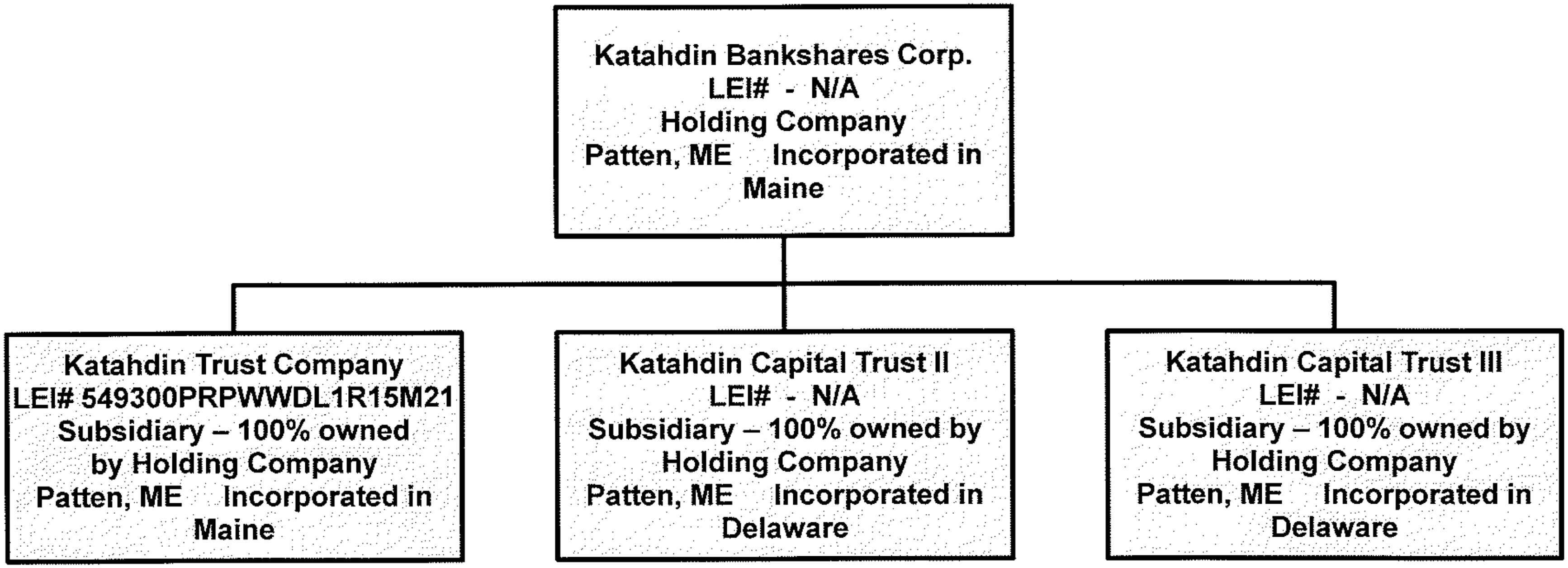
None

Report Item 1b: Annual reports to shareholders

Enclosed

Report Item 2: Organization Chart

(1.)



(2.) None

(3.) None

Results: A list of branches for your depository institution: KATAHDIN TRUST COMPANY (ID_RSSD: 327305).
This depository institution is held by KATAHDIN BANKSHARES CORPORATION (1140127) of PATTEN, ME.
The data are as of 12/31/2019. Data reflects information that was received and processed through 03/05/2020.

Reconciliation and Verification Steps

1. In the **Data Action** column of each branch row, enter one or more of the actions specified below
2. If required, enter the date in the **Effective Date** column

Actions

OK: If the branch information is correct, enter 'OK' in the **Data Action** column.
Change: If the branch information is incorrect or incomplete, revise the data, enter 'Change' in the **Data Action** column and the date when this information first became valid in the **Effective Date** column.
Close: If a branch listed was sold or closed, enter 'Close' in the **Data Action** column and the sale or closure date in the **Effective Date** column.
Delete: If a branch listed was never owned by this depository institution, enter 'Delete' in the **Data Action** column.
Add: If a reportable branch is missing, insert a row, add the branch data, and enter 'Add' in the **Data Action** column and the opening or acquisition date in the **Effective Date** column.

If printing this list, you may need to adjust your page setup in MS Excel. Try using landscape orientation, page scaling, and/or legal sized paper.

Submission Procedure

When you are finished, send a saved copy to your FRB contact. See the detailed instructions on this site for more information.
If you are e-mailing this to your FRB contact, put your institution name, city and state in the subject line of the e-mail.

Note:
To satisfy the **FR Y-10 reporting requirements**, you must also submit FR Y-10 Domestic Branch Schedules for each branch with a **Data Action** of Change, Close, Delete, or Add.
The FR Y-10 report may be submitted in a hardcopy format or via the FR Y-10 Online application - https://y10online.federalreserve.gov.

* FDIC UNINUM, Office Number, and ID_RSSD columns are for reference only. Verification of these values is not required.

Data Action	Effective Date	Branch Service Type	Branch ID_RSSD*	Popular Name	Street Address	City	State	Zip Code	County	Country	FDIC UNINUM*	Office Number*	Head Office	Head Office ID_RSSD*	Comments
OK		Full Service (Head Office)	327305	KATAHDIN TRUST COMPANY	11 MAIN STREET	PATTEN	ME	04765	PENOBSCOT	UNITED STATES	Not Required	Not Required	KATAHDIN TRUST COMPANY	327305	
OK		Full Service	114206	ASHLAND BRANCH	17 MAIN STREET	ASHLAND	ME	04732	AROOSTOOK	UNITED STATES	Not Required	Not Required	KATAHDIN TRUST COMPANY	327305	
OK		Full Service	4181457	BROADWAY BRANCH	609 BROADWAY	BANGOR	ME	04401	PENOBSCOT	UNITED STATES	Not Required	Not Required	KATAHDIN TRUST COMPANY	327305	
OK		Full Service	4420491	SPRINGER DRIVE BRANCH	52 SPRINGER DRIVE	BANGOR	ME	04401	PENOBSCOT	UNITED STATES	Not Required	Not Required	KATAHDIN TRUST COMPANY	327305	
OK		Full Service	3775569	CARIBOU BRANCH	105 BENNETT DRIVE	CARIBOU	ME	04736	AROOSTOOK	UNITED STATES	Not Required	Not Required	KATAHDIN TRUST COMPANY	327305	
OK		Full Service	150802	EAGLE LAKE OFFICE	3440 AROOSTOOK ROAD	EAGLE LAKE	ME	04739	AROOSTOOK	UNITED STATES	Not Required	Not Required	KATAHDIN TRUST COMPANY	327305	
OK		Full Service	307307	FORT FAIRFIELD OFFICE	290 MAIN STREET	FORT FAIRFIELD	ME	04742	AROOSTOOK	UNITED STATES	Not Required	Not Required	KATAHDIN TRUST COMPANY	327305	
OK		Full Service	4721031	FORT KENT BRANCH	79 WEST MAIN STREET	FORT KENT	ME	04743	AROOSTOOK	UNITED STATES	Not Required	Not Required	KATAHDIN TRUST COMPANY	327305	
OK		Full Service	4396103	HAMPDEN BRANCH	57 WESTERN AVENUE	HAMPDEN	ME	04444	PENOBSCOT	UNITED STATES	Not Required	Not Required	KATAHDIN TRUST COMPANY	327305	
OK		Full Service	1189313	HOULTON BRANCH	65 NORTH STREET	HOULTON	ME	04730	AROOSTOOK	UNITED STATES	Not Required	Not Required	KATAHDIN TRUST COMPANY	327305	
OK		Full Service	139302	ISLAND FALLS BRANCH	1007 CRYSTAL ROAD	ISLAND FALLS	ME	04747	AROOSTOOK	UNITED STATES	Not Required	Not Required	KATAHDIN TRUST COMPANY	327305	
OK		Full Service	2524304	MARS HILL BRANCH	28 MAIN STREET	MARS HILL	ME	04758	AROOSTOOK	UNITED STATES	Not Required	Not Required	KATAHDIN TRUST COMPANY	327305	
OK		Full Service	290306	OAKFIELD BRANCH	200 OAKFIELD SMYRNA ROAD	OAKFIELD	ME	04763	AROOSTOOK	UNITED STATES	Not Required	Not Required	KATAHDIN TRUST COMPANY	327305	
OK		Full Service	1850556	PRESQUE ISLE BRANCH	6 NORTH STREET	PRESQUE ISLE	ME	04769	AROOSTOOK	UNITED STATES	Not Required	Not Required	KATAHDIN TRUST COMPANY	327305	
OK		Full Service	4556774	SCARBOROUGH BRANCH	144 US ROUTE 1	SCARBOROUGH	ME	04074	CUMBERLAND	UNITED STATES	Not Required	Not Required	KATAHDIN TRUST COMPANY	327305	
OK		Full Service	369109	VAN BUREN BRANCH	29 MAIN STREET	VAN BUREN	ME	04785	AROOSTOOK	UNITED STATES	Not Required	Not Required	KATAHDIN TRUST COMPANY	327305	

Report Item 3: Shareholders

(1) **CEDE & Co.**
New York, NY/USA
Country of Incorporation – United States of America
2,192,982 shares of Common Stock = 65.09%

Report Item 4: Principal Shareholders, Directors & Officers

Principal Shareholders:

1. Name & Address:	**CEDE & Co.**, New York, NY/USA
2. Principal Occupation:	Depository Trust Company
3. Title/Position:	N/A
4. % of each class:	65.09% of stock in Katahdin Bankshares Corp., (beneficial interest)

Directors:

1. Name & Address:	**Steven L. Richardson,** Patten, ME/USA
2. Principal Occupation:	Businessman – Retail Store Owner
3. Title/Position:	a. Chairman of the Board & Director of Katahdin Bankshares Corp., b. Chairman of the Board & Director of Katahdin Trust Company, c. Partner in Richardson's Hardware.
4. % of each class:	a. Owner of 2.79% of stock in Katahdin Bankshares Corp., c. Owner of 75% of stock in Richardson's Hardware.

1. Name & Address:	**Richard B. Harnum, Jr.** Bangor, ME/USA
2. Principal Occupation:	Commercial Real Estate Development and Management
3. Title/Position:	a. Director of Katahdin Bankshares Corp., b. Director of Katahdin Trust Company, c. Shareholder of Webber Group of Companies, d. Co-owner and Managing Member of Harnum Family, LLC, e. Co-owner and Managing Member of M&H Family, LLC, f. owner and manager of RBH Enterprises, LLC, g. owner and manager of Lucerne Properties, LLC
4. % of each class:	a. Does not own any stock in Katahdin Bankshares Corp.; c. owner of 38.9% of stock in Webber Group

Of Companies; d. owner of 50% of stock in Harnum Family, LLC, e. owner of 50% of stock in M&H Family, LLC, f. owner of 100% of stock in RBH Enterprises, LLC, g. owner of 100% of stock in Lucerne Properties, LLC.

1. Name & Address:	**Paul R. Powers,** Caribou, ME/USA
2. Principal Occupation:	Contractor
3. Title/Position:	a. Director of Katahdin Bankshares Corp., b. Director of Katahdin Trust Company, c. Owner of Powers Roofing & Sheet Metal, Inc. d. Owner of B.J.J. Powers Enterprises, LLC, e. Partner in Aroostook County Redevelopment Association, f. Partner in Northern Maine Brewing Company.
4. % of each class:	a. Owner of 1.28% of stock in Katahdin Bankshares Corp. c. Owner of 60% stock in Powers Roofing & Sheet Metal, Inc., d. Owner of 100% of stock in B.J.J. Powers Enterprises; e. Owner of 6.0 % stock in Aroostook County Redevelopment Association; f. Owner of 16% stock in Northern Maine Brewing Company.
1. Name & Address:	**Peter F. Briggs,** Kennebunk, ME/USA
2. Principal Occupation:	Retired, Wholesale Beverage Industry
3. Title/Position:	a. Director of Katahdin Bankshares Corp., b. Director of Katahdin Trust Company
4. % of each class:	a. Owner of 1.43% of stock in Katahdin Bankshares Corp.
1. Name & Address:	**Richard J. York,** Houlton, ME/USA
2. Principal Occupation:	Businessman – Owner of Automobile Dealership
3. Title/Position:	a. Director of Katahdin Bankshares Corp., b. Director of Katahdin Trust Company, c. Owner of York Ford Sales, d. Owner of York Leasing, Inc., e. Owner of Freshstart Finance Company, f. Owner of York Reinsurance Ltd. g. Owner of Nature's Circle Farm
4. % of each class	a. Owner of 1.03% of stock in Katahdin Bankshares Corp., c. Owner of 47.50% of stock in York's of Houlton, d. Owner of 47.50% of stock in York Leasing Inc., e. Owner of 47.50% of stock in Freshstart Finance Company, f. Owner of 47.50% of stock in York Reinsurance Ltd., g. Owner of 65% of stock in Nature's Circle Farm.
1. Name & Address:	**Kimberley A. Niles,** Plaistow, NH/USA
2. Principal Occupation:	Business Owner
3. Title/Position:	a. Director of Katahdin Bankshares Corp., b. Director of Katahdin Trust Company, c. Managing Director of State of Granite, LLC, d. Board of Directors of Side X Side, Inc.
4. % of each class:	a. Does not own stock in Katahdin Bankshares Corp.; c. Owner of 100% of stock in State of Granite, LLC.

1. Name & Address:	**Marianna (Molly) Putnam Liddell,** Yarmouth, ME/USA
2. Principal Occupation:	Attorney, Pierce Atwood LLP
3. Title/Position:	a. Director of Katahdin Bankshares Corp., b. Director of Katahdin Trust Company, c. Partner Pierce Atwood LLP
4. % of each class:	a. Does not own stock in Katahdin Bankshares Corp., c. Owner of <5% in Pierce Atwood LLP

1. Name & Address:	**Keith P. Bourgoin** Hampden, ME/USA
2. Principal Occupation:	CPA
3. Title/Position:	a. Director of Katahdin Bankshares Corp., b. Director of Katahdin Trust Company, c. Owner and Managing Partner Haverlock, Estey & Curran LLC d. Owner and Managing Partner HEC – Hampden
4. % of each class:	a. Does not own stock in Katahdin Bankshares Corp., c. Owner of 16.66% of stock in Haverlock, Estey & Curran CPA's, d. Owner of 16.66% stock in HEC- Hampden.

1. Name & Address:	**Jon J. Prescott,** Houlton, ME/USA
2. Principal Occupation:	Bank Executive
3. Title/Position:	a. President & CEO, and Director of Katahdin Bankshares Corp., b. Director, President & CEO of Katahdin Trust Company, c. Director of MMG Insurance & Holding Company, d. Director of Houlton Water Company, e. Director Maine Bankers Association
4. % of each class:	a. Owner of 1.90% of stock in Katahdin Bankshares Corp.

Officers:

1. Name & Address: **William P. Lucy**, Verona Island, ME/USA
2. Principal Occupation: Banker
3. Title/Position: No position with holding company, Executive Vice President, Commercial Services of Katahdin Trust Company
4. % of each class: Owner of .24% of stock in Katahdin Bankshares Corp.

1. Name & Address: **Bonnie C. Foster,** Houlton, ME/USA
2. Principal Occupation: Banker
3. Title/Position: No position with holding company, Executive Vice President, Retail Banking of Katahdin Trust Company
4. % of each class: Owner of .04% of stock in Katahdin Bankshares Corp.

1. Name & Address: **Matthew M. Nightingale,** Houlton, ME/USA
2. Principal Occupation: Banker
3. Title/Position: a. Treasurer & Clerk of Katahdin Bankshares Corp., b. Executive Vice President, CFO, & Treasurer of Katahdin Trust Company, c. Director Aroostook Partnership
4. % of each class: a. Owner of .07% of stock of Katahdin Bankshares Corp.

1. Name & Address: **Krista K. Putnam,** Houlton, ME/USA
2. Principal Occupation: Banker
3. Title/Position: No position with holding company, Senior Vice President, Marketing
4. % of each class: Owner of .01% stock in Katahdin Bankshares Corp.

1. Name & Address: **Angela T. Butler**, Bangor, ME/USA
2. Principal Occupation: Banker
3. Title/Position: No position with holding company, Senior Vice President, Retail and Business Banking of Katahdin Trust Company
4. % of each class: Owner of .01% stock in Katahdin Bankshares Corp.

Your COMMUNITY BANK

2019 ANNUAL REPORT

Katahdin Bankshares Corp.

$310,000
Total Giving
2019

Communities that work

1,200
Students Received Financial Literacy Training

400

Local Non-Profit Organizations Supported

together thrive together.

7,500

Volunteer Hours 2019

DEAR FELLOW SHAREHOLDERS

> **IN 2019, WE WERE PROUD TO BE NAMED AS ONE OF THE BEST PLACES TO WORK IN MAINE FOR THE SECOND YEAR IN A ROW. IT IS A PRIVILEGE TO BE PART OF THE KATAHDIN TRUST TEAM.**

– Jon J. Prescott

2018 • 2019 Best Places to Work in ME

2019 was a terrific year on many levels for our shareholders, customers, and employees. We achieved strong results in net income available to common shareholders of $7,685,000, through loan and investment growth, management of expenses, and a slight net interest margin increase. This equated to an earnings per share pickup of $0.42, a more than 22% increase. Return on Average Assets of 0.99% was strong, as was Return of Average Equity of 11.73%. The Bank improved in most financial metrics and achieved record-high levels of loans, deposits, and total assets. Shareholders saw a robust increase in the stock price as well as an increased dividend from the prior year.

During the year we retired the $10 million of Preferred Stock Series D shares that had been outstanding. We issued $14.5 million in Senior Notes to accomplish this, at a lower interest rate than the Series D. This was a major positive financial transaction for the Company. Please refer to footnote 22, “Senior Notes,” in the notes to consolidated financial statements for more details on the issuance.

A detailed commentary on our financials is located on page eight of this report, entitled “Company Overview and Results of Operations.”

Interest rates fell throughout the year as the Federal Reserve cut rates three times. During 2019 we managed through the falling rates, which contained a flattening of the yield curve for part of the year. Interest rate levels remain very low at the time of this writing.

We continued our focus on relationship banking. We aspired to connect with customers who have multiple products and services with us, as opposed to being “transactional”. We have focused on deposit growth for several years now and will continue to do so, as the State of Maine remains thin on customer deposits. The good results we have achieved in this area have come with a lot of hard work, focused coordination, and prioritization. We must continue to have this as a top goal.

Loan growth was solid and we were able to meet our goals for the year. Asset quality remained very good, as the economy in our lending region has been stable to good, depending on the area. We increased our provision for loan losses during the year mostly to account for the loan growth.

We feel we have prospects for strong, profitable future growth and continue to position ourselves to take advantage of them. In some markets we have a very small percentage of market share, which we view as opportunity.

We have renewed our commitment to being “easy to do business with” and maintained our investment in new technologies such as Zelle®, Real-Time Account Alerts, and Fraud Text Alerts. Our goals include the development of similar or new technologies that enhance both customer experience and internal efficiency, creating a win-win situation for customers and the Bank alike.

Competition continues to be intense. Banks large and small, credit unions, non-bank financial companies such as brokerage firms, and increasingly, financial technology (fintech) companies all are competing for business. We must be mindful of the competition, but concentrate even more on our current and prospective customers and fulfilling their needs in the most positive manner possible.

Our Employee Stock Ownership Plan, or ESOP, continues to grow and now all our employees are owners of the Company. We feel this aligns our people’s interests with those of other shareholders and contributes to a long-term shared vision of outstanding results. As the ESOP grows, these positive attributes will grow as well.

KTHN STOCK

34.6%

$20.43 as of 12/31/19

ASSET GROWTH

5.95%

$850,909,000 as of 12/31/19

NET INCOME

available to common shareholders

21.6%

$7,685,000 as of 12/31/19

Our employees continue to be recognized for their outstanding efforts and commitment to community banking. In 2019, we were proud to be named as one of the *Best Places to Work in Maine* for the second year in a row. It is a privilege to be part of the Katahdin Trust team. Our employees also contributed more than 7,500 hours to various volunteer causes helping to make our communities from Fort Kent to Scarborough a better place to live, work, and do business. Being an active part of the communities in which we serve is in our DNA.

Shareholders' ability to buy and sell shares of Company stock, referred to as share liquidity, is important. In recent years, the Board and Management have taken actions to improve shareholder liquidity. Previous steps include expanding the Company presence on the OTCMarkets OTCQX® Best Market platform, and implementing a Direct Stock Purchase and Dividend Reinvestment Plan through our transfer agent, Computershare. In 2019, the Board of Directors approved a Stock Buyback Program. The Program authorized the purchase of up to $2,000,000 of Company's outstanding shares of Common Stock through December 31, 2020.[1] Through December 31, 2019, the Company has utilized $618,000 of the allotment to purchase and retire 35,160 shares. These avenues have greatly assisted shareholders wishing to sell some or all of their shares as well as providing more avenues for others to buy. Feel free to reach out if you're interested in any of these programs.

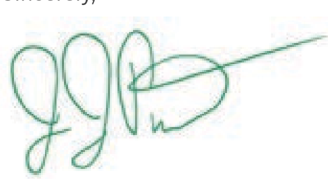
I am pleased to share with you that Katahdin Bankshares Corp. has been named to the 2020 OTCQX® Best 50, an annual ranking of the top 50 U.S. and international companies traded on the OTCQX market. The ranking is calculated based on an equal weighting of one-year total return and average daily dollar volume growth in the previous calendar year. Companies in the 2020 OTCQX Best 50 were ranked based on their performance in 2019. Katahdin Bankshares Corp.'s total return for 2019, including price appreciation and dividends, was 34.6%.

Our Annual Shareholders' Meeting will be held on Monday, May 4, 2020, at 10:30 a.m. in the Katahdin Trust Company Room at Houlton Regional Hospital. Whether or not you can attend, I encourage you to complete and return your proxy for this year's meeting. Your votes are important to the Company and voting can be easily done by mail, telephone, or online.

In closing, I could not be prouder of our team. This year's record performance would not have been possible without the dedicated efforts of our Board of Directors, all of our Katahdin Trust employees, and you, the shareholder.

Thank you for your investment and continued support.

Sincerely,



Jon J. Prescott
President & CEO

1) Shares may be repurchased by the Company or may be purchased by Katahdin Trust's Employee Stock Ownership Plan (ESOP). All such transactions may be initiated at the discretion of the Company or the ESOP, subject to market conditions and other considerations. The Board of Directors may, without prior notice, alter the terms of this Program at any time, including changing the announced share authorization level or to extend or terminate this Stock Buyback Program.

OUR MISSION

Katahdin Trust Company's mission is to provide a broad range of financial services to Maine communities. In providing these services we will endeavor to achieve the highest level of customer satisfaction possible.

WE ARE COMMITTED TO:

- Providing quality financial service by giving each and every customer courteous, personal and professional attention. Our employees will be well trained; knowledgeable and motivated at all times to fulfill our customers' financial needs.
- Continued growth and increased shareholder value at levels in line with maintaining a strong capital position.
- Treating all people fairly and equally.
- Meeting the financial needs of the communities we serve, consistent with maintaining safe and sound banking practices.
- Remaining an independent, locally owned and managed community bank that adds to the quality of life of the communities we serve.
- Helping business grow and prosper.

By adhering to our mission, Katahdin Trust Company will ensure that our customers, shareholders and employees alike will benefit from our continued growth and prosperity.

Thank You

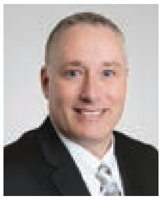
We offer a special thank you to Robert E."Bob" Anderson for his 30 years of service to our Board of Directors. He retired from the Board in April 2019. During his tenure, Bob served on every board committee at one time or another. His knowledge and expertise were instrumental in our success and in getting us where we are today as a company — wishing you all the best, Bob!

BOARD OF DIRECTORS

STEVEN L. RICHARDSON
CHAIRMAN
Partner,
Richardson's Hardware
Patten, Maine
Director since 1978

RICHARD J. YORK, SR.
VICE CHAIRMAN
Owner,
York's of Houlton
Houlton, Maine
Director since 1997

JON J. PRESCOTT
PRESIDENT & CEO
Katahdin Bankshares Corp.
and Katahdin Trust Company
Houlton, Maine
Director since 1997



KEITH P. BOURGOIN, CPA
Managing Partner,
Haverlock, Estey & Curran, LLC
Hampden, Maine
Director since 2018

PETER F. BRIGGS
Retired from the
wholesale beverage industry.
Kennebunk, Maine and
Green Valley, Arizona
Director since 1995

RICHARD B. HARNUM, JR.
President,
Harnum Holdings
Bangor, Maine
Director since 2017

MARIANNA PUTNAM LIDDELL, ESQ.
Partner,
Pierce Atwood LLP
Yarmouth, Maine
Director since 2018

KIMBERLEY A. NILES
Owner and Director,
State of Granite, LLC
Plaistow, New Hampshire
Director since 2015

PAUL R. POWERS
Owner,
Powers Roofing & Sheet Metal, Inc.
Owner,
B.J.J. Powers Enterprises
Caribou, Maine
Director since 2000

MANAGEMENT AND OFFICERS

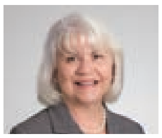
SENIOR MANAGEMENT

JON J. PRESCOTT
President & CEO

WILLIAM P. LUCY
Executive Vice President
Commercial Services

ANGELA T. BUTLER
Senior Vice President
Retail and Business Banking

MATTHEW M. NIGHTINGALE
Executive Vice President
Treasurer & CFO



BONNIE C. FOSTER
Executive Vice President
Retail Services

KRISTA K. PUTNAM
Senior Vice President
Marketing

OFFICERS

James P. Amabile
Vice President
Commercial Services Officer
Maine Financial Group

Tori A. Barber
Assistant Vice President
Branch Manager &
Retail Services Officer, Mars Hill

Annette J. Beaton
Vice President, Branch Manager &
Retail Services Officer, Houlton

Bradley A. Berthiaume
Senior Vice President
Financial Consultant
Katahdin Financial Services

Vicki L. Bessette
Vice President
Commercial Services Officer

Cindy L. Boot
Commercial Services Officer

Sarah L. Bowie
Vice President
Business Development Officer

Cale L. Burger
Vice President
Commercial Services Officer

David H. Cambridge
Senior Vice President
Commercial Services Officer

Aaron J. Cannan
Senior Vice President
Commercial Services Officer

Robert J. Cawley
Assistant Vice President
Senior Credit Analyst

Karen L. Chapman
Vice President
Training Manager

Samuel S. Clockedile
Marketing Officer

Albert "Joe" Clukey II
Vice President
Retail Services Officer

Melissa A. Dahlgren
Branch Manager &
Retail Services Officer,
Fort Fairfield

Janet M. Doak
Assistant Vice President
Branch Manager &
Retail Services Officer, Ashland

Sunny G. Flannery
Assistant Vice President
Branch Manager &
Retail Services Officer, Hampden

Angela M. Franck
Assistant Vice President
Branch Manager &
Retail Services Officer,
Fort Kent & Eagle Lake

John S. Frohock
Vice President
Managed Assets Officer

Brian J. Gardiner
Senior Vice President
Commercial Services Officer

Sarah J. Gardiner
Senior Credit Analyst

Leslie M. Gardner
Vice President
Retail Loans

Allissa M. Given
Branch Manager &
Retail Services Officer, Patten

Alison N. Gould
Assistant Vice President
Commercial Services Officer

Diane W. Green
Vice President, Branch Manager &
Retail Services Officer, Presque Isle

Billi B. Griffeth
Regional Vice President
Northern Market

Blake R. Hamel
Commercial Services Officer
Maine Financial Group

Patricia A. Hersey
Vice President
Business Development Officer

OFFICERS

Katherine H. Hill
Vice President
Bank Operations Manager

Justin K. Jamison
Vice President
Commercial Services Officer

Teresa S. Lincoln
Executive Assistant

Susan B. Lunn
Vice President
Compliance Officer

Karyn L. MacLeod
Vice President
Commercial Services Officer

Valerie J. Maynard
Senior Commercial Services Assistant

Natasha R. McCarthy
Vice President
Human Resources Director

Susan L. McCarthy
Vice President, Manager
Commercial Services Officer
Maine Financial Group

Jean E. Noyes
Vice President
Information Security Officer

Kevin B. Plourde
Senior Vice President
Credit Administrator

Joseph M. Porter
Vice President
Controller

Rebecca L. Potter
Commercial Services Officer

Andrew L. Putnam
Vice President
Chief Information Officer

Debra K. Schillinger
Assistant Vice President
Branch Manager &
Retail Services Officer,
Oakfield & Island Falls

Sarah S. Silliboy
Assistant Vice President
BSA Officer

Peggy S. Smith
Vice President, Branch Manager &
Retail Services Officer,
Caribou & Van Buren

Rebecca J. Smith
Assistant Vice President
Branch Manager &
Retail Services Officer,
Bangor & Scarborough

Craig C. Staples
Vice President
Commercial Services Officer

Pamela J. Ward
Assistant Vice President
Credit Control

Danelle L. Weston
Regional Vice President
Bangor & Portland Markets

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Employees across 16 locations in Maine

From Fort Kent to Scarborough, our employees work hard every day to make Katahdin Trust a successful and great place to work. We're proud to offer an outstanding benefits package, including performance bonus incentives, personal flex days off, college tuition reimbursement, and an Employee Stock Ownership Plan (ESOP).

Our employees are also active members and leaders in their local communities, volunteering for causes that are meaningful to them and to our customers.

Katahdin Trust is fortunate to have such an incredible team.

COMPANY OVERVIEW AND RESULTS OF OPERATIONS

Katahdin Bankshares Corp. (“KBS” or the “Company”) is a bank holding company, incorporated under the laws of the State of Maine in 1986 for the purpose of becoming the parent holding company of Katahdin Trust Company (the “Bank”). As of December 31, 2019, KBS had consolidated total assets of $850.9 million, total deposits of $714.4 million, and total shareholders’ equity of $68.9 million. Following is an overview of the Company, its strategy, and the results of 2019 operations.

Our Business

The Bank was established in 1918. It provides a full line of banking services to individuals and businesses throughout Maine and online at KatahdinTrust.com.

The Bank conducts commercial and retail banking business that includes accepting deposits from the general public and utilizing those funds to originate commercial loans, commercial and residential real estate loans, and consumer loans.

Securities and insurance products are made available to the Bank’s customers through Katahdin Financial Services in partnership with a third-party registered broker-dealer, with assets under management of $135.1 million as of December 31, 2019.

The Bank derives its income primarily from interest and fees earned on loans and investments and service charges and fees on deposit accounts. Its expenses consist primarily of interest paid on deposits and borrowed funds and operating expenses.

Our Strategy

The Bank’s goals include the following:

- Continue as a leading financial institution throughout Maine;
- Seek opportunities for profitable growth and expansion while increasing net interest income, enhancing non-interest income, and controlling operating costs;
- Provide stable long-term returns to our shareholders.

The Bank has a strong commitment to small business and has held the preferred lender designation from the U.S. Small Business Administration for nearly eight years; a designation reserved for SBA’s most experienced and trusted lenders with a proven record of small business performance and excellence; and in 2017 received the Outstanding Partner Award for originating a significant number of SBA guaranteed loans.

The Bank recognizes the importance of high-quality customer service; its stated goal is to “exceed our customers’ expectations.” Management believes its ability to deliver products and services in a highly personalized manner with superior customer service sets the Bank apart from its competitors.

The Bank also recognizes the changes in customer preferences brought about through the use of various forms of technology, and seeks to deliver those technologies best suited to its customers in an effective and complementary way.

The foundation of the Bank’s business strategy is its employees and it is committed to developing and maintaining an engaged, well-trained workforce that is knowledgeable about the Bank’s market area and its residents. The Bank’s personnel are equipped to provide high quality service. The Bank encourages and supports its staff to volunteer in their communities and each year they contribute significant hours to a variety of community organizations and causes.

BANKING SERVICES

- Online and Mobile Banking
- Mobile Check Deposit
- CardValet App
- Transfer Money
- Surcharge-Free ATMs
- Bill Pay
- 24-Hour Phone Banking
- Mobile Wallets
- Real-Time Account Alerts

SELECTED FINANCIAL DATA

The summary consolidated financial and other data should be read in conjunction with, and is qualified in its entirety by, the Company's current and prior years' annual reports and regulatory filings. Dollars in thousands, except share and per share data.

As of or for the Years Ended December 31,	2019	2018	2017	2016	2015
Balance Sheet Data					
Total assets	$ 850,909	$ 803,119	$ 794,638	$ 754,012	$ 702,289
Total investments (1)	103,173	96,319	90,445	88,965	74,836
Total loans	701,016	660,475	661,636	623,279	586,238
Allowance for loan losses	(6,293)	(5,856)	(6,048)	(6,032)	(5,330)
Total deposits	714,418	657,074	647,752	652,969	606,205
Shareholders' equity	68,879	71,057	66,799	64,415	62,357
Summary of Operations					
Interest and dividend income	$ 36,314	$ 33,172	$ 30,803	$ 29,350	$ 27,512
Interest expense	8,872	6,906	5,341	4,281	3,861
Net interest income	27,442	26,266	25,462	25,069	23,651
Provision for loan losses	460	180	1,225	1,316	50
Net interest income after the provision for loan losses	26,982	26,086	24,237	23,753	23,601
Non-interest income before impairment of investment securities	5,093	4,408	4,421	4,464	3,884
Net impairment of investment securities	4	-	5	4	2
Non-interest expense	22,076	21,520	21,529	21,535	20,372
Income before income taxes	9,995	8,974	7,124	6,678	7,111
Income taxes	1,836	1,777	2,771	1,864	2,301
Net income	$ 8,159	$ 7,197	$ 4,353	$ 4,814	$ 4,810
Less dividends on preferred stock	474	875	875	875	910
Net income available to common shareholders	$ 7,685	$ 6,322	$ 3,478	$ 3,939	$ 3,900
Per Common Shares and Common Shares Outstanding					
Net income, basic (2)	$ 2.31	$ 1.89	$ 1.03	$ 1.16	$ 1.15
Net income, diluted (2)	2.31	1.89	1.03	1.16	1.15
Book value (3)	20.77	18.29	16.94	16.17	15.47
Tangible book value (3)	19.05	16.59	15.24	14.48	13.80
Weighted average common shares outstanding: (4)					
Basic	3,326,912	3,345,012	3,373,220	3,399,826	3,404,367
Diluted	3,326,912	3,345,012	3,373,220	3,399,826	3,404,367
Common shares outstanding at period end	3,369,207	3,404,367	3,404,367	3,404,367	3,404,367
Adjusted common shares outstanding at period end (5)	3,316,671	3,339,734	3,361,298	3,380,173	3,404,367
Selected Performance Ratios					
Return on average assets	0.99%	0.91%	0.55%	0.66%	0.70%
Return on average common shareholders' equity	11.73	10.85	6.17	7.23	7.50
Net interest spread (6)	3.44	3.40	3.33	3.56	3.62
Net interest margin (7)	3.51	3.50	3.42	3.66	3.71
Efficiency ratio (8)	67.87	70.16	72.06	72.93	73.99
Asset Quality Ratios					
Allowance for loan losses to period end loans	0.90%	0.89%	0.91%	0.97%	0.91%
Allowance for loan losses to non-performing loans (9)	117.05	92.72	84.76	39.57	61.71
Non-performing loans to period end loans (9)	0.77	0.96	1.08	2.45	1.47
Non-performing assets to total assets (10)	0.64	0.79	0.95	2.11	1.31
Capital Ratios (Katahdin Trust Company)					
Total risk-based capital ratio	13.75%	13.40%	12.64%	13.02%	13.34%
Tier 1 risk-based capital ratio	12.75	12.42	11.63	11.95	12.33
Common equity tier 1 risk-based capital ratio	12.75	12.42	11.63	11.95	12.33
Tier 1 capital ratio (Leverage ratio)	9.65	9.42	8.88	9.15	9.48
Other Data					
Number of full and limited service banking offices	16	16	16	19	19
Number of full-time equivalent employees	171	173	174	186	195
Katahdin Financial Services Assets Under Management	$ 135,063	$ 106,190	$ 105,280	$ 90,160	$ 83,500

(1) Consists of investment securities and FHLB stock. (2) Computed based on the weighted average number of common shares outstanding during each period. (3) Book value and Tangible Book Value are calculated using Adjusted Common Shares Outstanding at period end. (4) Weighted Average Common Shares Outstanding less weighted average unallocated ESOP shares. Used for calculating Earnings per Common Share. (5) Common Shares Outstanding at period end less unallocated ESOP shares period end. Since unearned ESOP shares are deducted from capital, this adjustment deducts the unallocated shares from shares outstanding for calculating book value and tangible book value. (6) Net interest spread is the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities. (7) Net interest margin is the net interest income divided by the average interest-earning assets. (8) Efficiency ratio is non-interest expense divided by the sum of net interest income and non-interest income. (9) Non-performing loans consist of non-accrual loans and restructured loans, where applicable. (10) Non-performing assets consist of non-accrual loans, restructured loans, and foreclosed assets, where applicable.

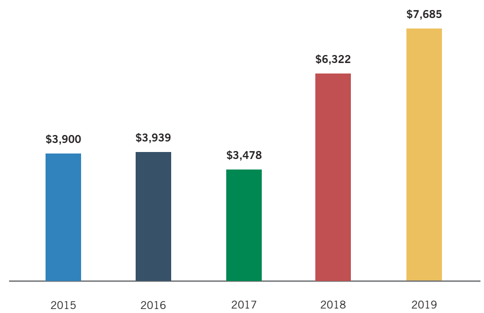
COMPANY OVERVIEW AND RESULTS OF OPERATIONS

Net Income

Net Income available to common shareholders totaled $7,685,000, an increase over 2018 of $1,363,000, which represented earnings growth of 21.6%. Contributing factors to core earnings growth include a solid expansion in net interest income, a pickup in non-interest income, improved asset quality, and limiting operating expense growth in 2019.

Earnings per common share totaled $2.31, up 42 cents or 22.2% in 2019. Return on Average Assets ended at 0.99% compared to 0.91% in 2018. Return on Average Common Equity was 11.73% compared to 10.85% in 2018.

NET INCOME ($000)
Available to common shareholders



Net Interest Income

Net interest income reached $27,442,000, exceeding the prior year by $1,176,000 or 4.5%. Net interest income reflects revenues generated through income from earning assets plus loan fees, less interest paid on interest-bearing deposits and borrowings. Although the Federal Reserve reduced interest rates 75 basis points over three meetings in 2019, we're pleased to report a slight widening of net interest spreads to 3.44% in 2019 as compared to 3.40% last year. The net interest margin was limited to a 1 basis point increase to 3.51%, mainly due to new interest expense related to the Senior Notes vs. how the now-retired Preferred Stock Dividend was posted on an after-tax basis. Overall, our interest rate sensitivity remains balanced. Management continues to assess ways to continue to improve net interest income results through both growth and pricing while working through changing interest rate cycles.

Provision and Asset Quality

Asset quality continues to be solid. We're pleased to see overall improvement in loan quality metrics. Non-performing loans to period end loans dropped from 0.96% at the end of 2018 to 0.77% at year-end 2019. Non-performing assets to total assets dropped from 0.79% to 0.64% year-over-year.

The allowance for loan losses was funded with a provision of $460,000 in 2019, while elevated from 2018, still a reasonable provision considering asset growth this year. As a result, our allowance for loan losses to period end loans ratio ended at 0.90% as compared to 0.89% at year-end 2018.

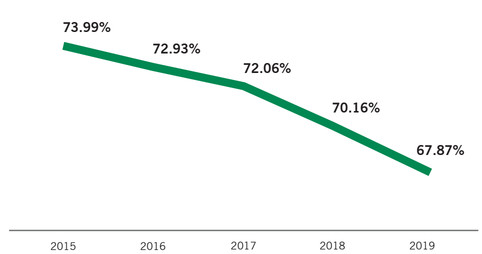
Other property and real estate owned assets continued to remain very low again in 2019, reducing the cost to carry assets through the collection process. Management continuously monitors the Bank's reserve for loan losses compared to asset quality in order to match our reserves with a reasonable estimate of risk. Detailed information regarding our allowance for loan loss can be found in footnote 4 of the audited financial statements.

Non-Interest Income and Expense

Non-interest income totaled $5,093,000, up $685,000 over 2018. Non-interest income consists largely of service charges on loans, deposits, and electronic banking activity. In 2019, the year-over-year increase can mainly be attributed to increased activity with commercial real estate customer interest rate swaps throughout the year.

Non-interest expense reached $22,076,000, representing expense growth of $556,000 or 2.6% year-over-year. The Bank has implemented strategies to reduce overhead expenses that have yielded results. Efficiency can be gained by both operating expense reduction and by creating new revenue generation. The Efficiency Ratio improved significantly to 67.87% as of year-end 2019 from 70.16% last year with a trend of reduction over the last several years. Management continues to look for opportunities to both grow revenue and operate more efficiently over time.

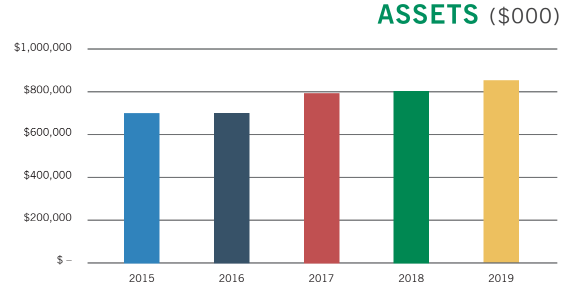
EFFICIENCY RATIO



Assets

Total assets grew by $47.8 million to $850,909,000, representing a growth rate of 5.95%. The growth is split between purchases in the investment portfolio as well as loan growth. While we continue to maintain a conservative approach to credit quality within the investment portfolio, the portfolio reached $103.2 million at year end representing an increase of $6.9 million over last year.

ASSETS ($000)



COMPANY OVERVIEW AND RESULTS OF OPERATIONS

Loans

Loan balances experienced solid growth in 2019. Total loans reached $701,016,000 by year end increasing $40,541,000 or 6.1% over year-end 2018. Commercial real estate loans grew in 2019 by $26.3 million and continued be our largest asset category, reaching $369,301,000. 1-4 family residential loans grew by $2.8 million to $141,396,000. Commercial and municipal loans grew to $181,432,000, increasing $13.1 million or 7.8%. Growth was accomplished in all areas except consumer installment loans which contracted by $1.76 million primarily due to the decision in 2016 to exit consumer indirect loans. Approximately 78.6% of the Bank's loan portfolio consists of municipal, commercial and commercial real estate loans. Loan officers continue to explore new loan opportunities throughout our market area with a focus on building lasting relationships throughout the portfolio.

Deposits

Customer deposit growth has been the number one goal over the last several years and we're again pleased with the growth in 2019. Total Deposits grew by $57.3 million, reaching $714,418,000. Within this number, local customer deposits grew $42.0 million. Local checking and savings grew by $18.4 million last year, while local money markets and certificates of deposit grew by $23.7 million. Deposit growth outpaced loan growth in 2019. Growth came from local deposit initiatives throughout our market area.

Brokered deposits and secured borrowings were reduced by $17.3 million. While at a lower level compared to prior years, these two categories continue to account for a significant portion of our funding sources totaling $117.7 million. These alternative funding sources provide the Bank flexibility with term structures in order to appropriately balance interest rate risk positions as needed. Further, access to alternative funding fills the gap between loan demand and deposit inflows which can be cyclical. Because these sources of funds can increase in cost more rapidly than local deposits in a rising rate environment, we manage the portfolio closely.

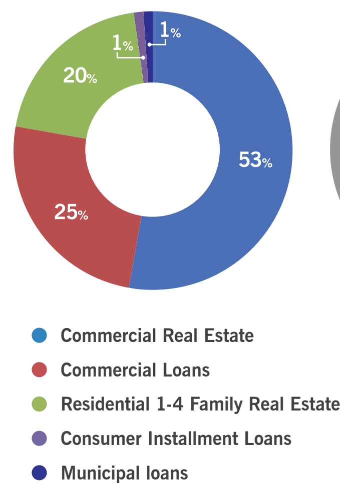
Capital

Total Shareholders' Equity stood at $68,879,000, down by $2.2 million. Solid earnings and asset appreciation in 2019 have made up a large portion of the $10 million equity reduction resulting from the Preferred Stock retirement in the third quarter.

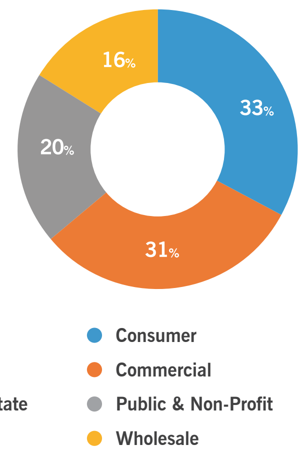
Capital ratios for the Bank grew in 2019 and continue to remain well above the minimums to be well-capitalized per regulatory capital requirements. The Bank's leverage ratio at year-end 2019 was 9.65%, compared to 9.42% at the end of 2018. Total risk-based capital stood at 13.75% compared to 13.40% in 2018.

Tangible book value of $19.05 increased by $2.46 or 14.8% over year-end 2018. The Company paid out a total of $0.44 per share in common stock dividends representing a 19.0% payout ratio of 2019 net income available to common shareholders. During the year, the Company implemented a stock buyback program and purchased a total of 35,160 shares at an average price of $17.56 per share.

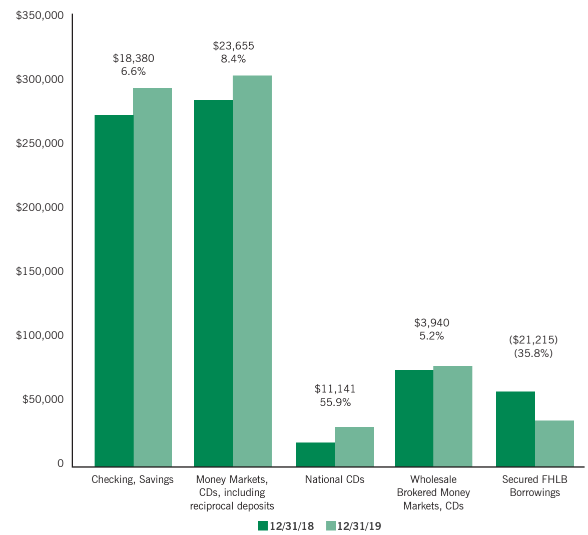
LOAN MIX



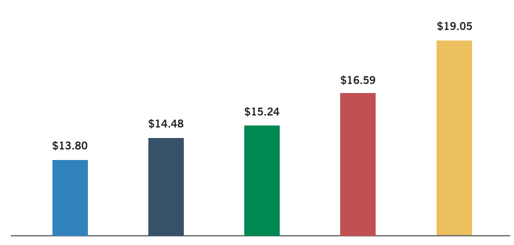
DEPOSIT SOURCES



DEPOSIT TREND ($000)



TANGIBLE BOOK VALUE



INDEPENDENT AUDITOR'S REPORT

Board of Directors and Shareholders
Katahdin Bankshares Corp. and Subsidiary

We have audited the accompanying consolidated financial statements of Katahdin Bankshares Corp. and Subsidiary (the Company), which comprise the consolidated balance sheets as of December 31, 2019 and 2018, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with U.S. generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Katahdin Bankshares Corp. and Subsidiary as of December 31, 2019 and 2018, and the consolidated results of their operations and their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Berry Dunn McNeil & Parker, LLC

Bangor, Maine
January 30, 2020

CONSOLIDATED BALANCE SHEETS

December 31, 2019 and 2018

ASSETS	2019	2018
Cash and due from banks	$ 5,818,000	$ 5,790,000
Interest bearing deposits in banks	11,579,000	11,586,000
Securities available-for-sale	100,376,000	93,148,000
Other investments	481,000	–
Securities held-to-maturity	6,000	7,000
Federal Home Loan Bank stock, at cost	2,310,000	3,164,000
Loans receivable, net of allowance for loan losses of $6,293,000 in 2019 and $5,856,000 in 2018	694,723,000	654,619,000
Bank premises and equipment, net	10,202,000	10,558,000
Goodwill	5,559,000	5,559,000
Other assets	19,855,000	18,688,000
	$ 850,909,000	$ 803,119,000

LIABILITIES AND SHAREHOLDERS' EQUITY	2019	2018
Deposits		
Demand deposits	$ 135,186,000	$ 119,166,000
NOW and money market deposits	314,078,000	289,279,000
Savings deposits	64,553,000	63,487,000
Certificates of deposit	200,601,000	185,142,000
Total deposits	714,418,000	657,074,000
Advances from Federal Home Loan Bank	37,986,000	58,801,000
Other borrowed funds	–	400,000
Accrued expenses and other liabilities	8,389,000	8,570,000
Senior notes 5.375%, net of unamortized debt issuance costs	14,020,000	–
Junior subordinated debentures	7,217,000	7,217,000
Total liabilities	782,030,000	732,062,000
Shareholders' equity		
Preferred stock, 20,000 shares authorized Series D, 4,000 shares issued and outstanding at December 31, 2018	–	9,953,000
Common stock, $.10 par value; 20,000,000 shares authorized, 3,369,207 and 3,404,367 shares issued and outstanding on December 31, 2019 and 2018, respectively	336,000	339,000
Surplus	8,294,000	8,810,000
Undivided profits	60,007,000	53,931,000
Accumulated other comprehensive income (loss)		
Net unrealized appreciation (depreciation) on securities available-for-sale, net of deferred income taxes	661,000	(1,255,000)
Net unrealized gain on derivative instruments, net of deferred income taxes	420,000	256,000
Unearned ESOP shares	(839,000)	(977,000)
Total shareholders' equity	68,879,000	71,057,000
	$ 850,909,000	$ 803,119,000

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

CONSOLIDATED STATEMENTS OF INCOME

Years Ended December 31, 2019 and 2018

	2019	2018
Interest and dividend income		
Loans	$ 33,525,000	$ 30,946,000
Investment securities	2,606,000	2,209,000
Other interest-earning assets	183,000	17,000
Total interest and dividend income	36,314,000	33,172,000
Interest expense		
Deposits	6,811,000	5,141,000
Borrowed funds and junior subordinated debentures	2,061,000	1,765,000
Total interest expense	8,872,000	6,906,000
Net interest income	27,442,000	26,266,000
Provision for loan losses	460,000	180,000
Net interest income after provision for loan losses	26,982,000	26,086,000
Noninterest income		
Service charges and fees	1,777,000	1,999,000
Realized gain on securities available-for-sale	76,000	–
Other	3,240,000	2,409,000
Total noninterest income before impairment of investment securities	5,093,000	4,408,000
Total other-than-temporary impairment losses	(6,000)	(14,000)
Portion of loss recognized in other comprehensive income	2,000	14,000
Net impairment losses recognized in net income	(4,000)	–
Net noninterest income	5,089,000	4,408,000
Noninterest expenses		
Salaries and employee benefits	13,636,000	13,083,000
Occupancy and equipment expense	2,571,000	2,782,000
Data processing	2,188,000	1,935,000
Marketing and donations	903,000	920,000
FDIC and state assessments	232,000	408,000
Other general and administrative	2,546,000	2,392,000
Total noninterest expenses	22,076,000	21,520,000
Income before income taxes	9,995,000	8,974,000
Income tax expense	1,836,000	1,777,000
Net income	$ 8,159,000	$ 7,197,000
Less dividends on preferred stock	$ 474,000	$ 875,000
Net income available to common shareholders	$ 7,685,000	$ 6,322,000
Basic earnings per common share	$ 2.31	$ 1.89
Diluted earnings per common share	$ 2.31	$ 1.89
Diluted weighted average common shares outstanding	3,326,912	3,345,012

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Years Ended December 31, 2019 and 2018

	2019	2018
Net Income	$ 8,159,000	$ 7,197,000
Other comprehensive income (loss), net of related tax effects		
Unrealized appreciation (depreciation) on available-for-sale securities		
Unrealized appreciation (depreciation) on available-for-sale securities arising during period	2,413,000	(604,000)
Reclassification adjustment for gains realized in net income	(76,000)	–
Reclassification adjustment for losses realized in net income	4,000	–
Tax effect	(492,000)	127,000
Net change in unrealized appreciation (depreciation) on available-for-sale securities, net of tax	1,849,000	(477,000)
Unrealized gain on derivative instruments, net of tax	164,000	239,000
Total other comprehensive income (loss)	2,013,000	(238,000)
Comprehensive income	$ 10,172,000	$ 6,959,000

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

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

Years Ended December 31, 2019 and 2018

	Preferred Stock	Common Stock	Surplus	Undivided Profits	Net Unrealized Appreciation (Depreciation) on Securities	Net Unrealized Gain on Derivative Instruments	Unearned ESOP Shares	Total
Balance, December 31, 2017	$ 9,859,000	$ 339,000	$ 8,778,000	$ 49,141,000	$ (778,000)	$ 17,000	$ (557,000)	$ 66,799,000
Net income	–	–	–	7,197,000	–	–	–	7,197,000
Change in net unrealized depreciation on securities available-for-sale, net of deferred income taxes of $127,000	–	–	–	–	(477,000)	–	–	($477,000)
Change in net unrealized gain on derivative instruments, at fair value, net of taxes of $50,000	–	–	–	–	–	239,000	–	239,000
Total comprehensive income	–	–	–	7,197,000	(477,000)	239,000	–	6,959,000
Cash dividends declared on common stock, $0.43 per share	–	–	–	(1,438,000)	–	–	–	(1,438,000)
Accretion on preferred stock issuance	94,000	–	–	(94,000)	–	–	–	–
Cash dividends declared on preferred stock	–	–	–	(875,000)	–	–	–	(875,000)
Shares purchased by ESOP (32,300 shares)	–	–	–	–	–	–	(529,000)	(529,000)
Common stock held by ESOP committed to be released (10,279 shares)	–	–	32,000	–	–	–	109,000	141,000
Balance, December 31, 2018	9,953,000	339,000	8,810,000	53,931,000	(1,255,000)	256,000	(977,000)	71,057,00
Net income	–	–	–	8,159,000	–	–	–	8,159,000
Change in net unrealized depreciation on securities available-for-sale, net of deferred income taxes of $492,000	–	–	–	–	1,849,000	–	–	1,849,000
Change in net unrealized gain on derivative instruments, at fair value, net of taxes of $44,000	–	–	–	–	–	164,000	–	164,000
Total comprehensive income	–	–	–	8,159,000	1,849,000	164,000	–	10,172,000
Cash dividends declared on common stock, $0.44 per share	–	–	–	(1,495,000)	–	–	–	(1,495,000)
Accretion on preferred stock issuance	47,000	–	–	(47,000)	–	–	–	–
Reclassification adjustment for effect of ASU 2016–01	–	–	–	(67,000)	67,000	–	–	–
Cash dividends declared on preferred stock	–	–	–	(474,000)	–	–	–	(474,000)
Redemption of preferred stock	(10,000,000)	–	–	–	–	–	–	(10,000,000)
Common stock purchased and retired under the Company buyback program	–	(3,000)	(615,000)	–	–	–	–	(618,000)
Common stock held by ESOP committed to be released (12,097 shares)	–	–	99,000	–	–	–	138,000	237,000
Balance, December 31, 2019	$ –	$ 336,000	$ 8,294,000	$ 60,007,000	$ 661,000	$ 420,000	$ (839,000)	$ 68,879,000

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31, 2019 and 2018

		2019		2018
Cash flows from operating activities				
Net income	$	8,159,000	$	7,197,000
Adjustments to reconcile net income to net cash provided by operating activities				
Depreciation and amortization		1,188,000		1,870,000
Net amortization of securities		273,000		278,000
Provision for loan losses		460,000		180,000
Provision for losses on other real estate owned		–		56,000
Amortization of investments in limited partnerships		107,000		–
Impairment of investment securities		4,000		–
Loss on sale of premises and equipment		5,000		–
Unrealized gain on other investments		(66,000)		–
Gain on sale of securities available-for-sale		(76,000)		–
Deferred income tax benefit		(38,000)		(69,000)
Increase in cash value of life insurance		(318,000)		(318,000)
Loss on sale of other real estate and property owned		2,000		24,000
ESOP compensation expense		237,000		141,000
Increase in accrued income receivable and other assets		(699,000)		(321,000)
(Decrease) increase in accrued expenses and other liabilities		(264,000)		1,022,000
Net cash provided by operating activities		8,974,000		10,060,000
Cash flows from investing activities				
Additions to premises and equipment		(592,000)		(695,000)
Loan originations and principal collections, net		(40,852,000)		759,000
Purchase of securities available-for-sale		(31,736,000)		(21,860,000)
Maturities of securities available-for-sale		20,662,000		14,702,000
Maturities of securities held-to-maturity		1,000		2,000
Proceeds from sales of securities available-for-sale		5,571,000		–
Investment in limited partnerships		(613,000)		–
Proceeds from sales of other real estate and property owned		231,000		328,000
Redemption of FHLB stock		2,861,000		2,065,000
Purchase of FHLB stock		(2,007,000)		(1,665,000)
Net cash used by investing activities		(46,474,000)		(6,364,000)
Cash flows from financing activities				
Net increase in deposits		57,344,000		9,322,000
Net decrease in securities sold under agreements to repurchase		–		(118,000)
Net (decrease) increase in short-term borrowings		(14,221,000)		31,645,000
Proceeds from long-term debt		1,406,000		–
Repayment of long-term debt		(8,000,000)		(38,711,000)
Net (decrease) increase in other borrowings		(400,000)		400,000
Payments for redemption of preferred stock		(10,000,000)		–
Purchase of common stock under Company buyback program		(618,000)		–
Proceeds from issuance of senior notes		14,500,000		–
Debt issuance costs incurred with senior notes		(521,000)		–
Cash dividends paid on preferred stock		(474,000)		(875,000)
Cash dividends paid on common stock		(1,495,000)		(1,438,000)
Cash provided to ESOP for purchase of shares		–		(529,000)
Net cash provided (used) by financing activities		37,521,000		(304,000)
Net increase in cash and cash equivalents		21,000		3,392,000
Cash and cash equivalents, beginning of year		17,376,000		13,984,000
Cash and cash equivalents, end of year	$	17,397,000	$	17,376,000
Supplementary cash flow information:				
Interest paid on deposits and borrowed funds	$	8,741,000	$	6,808,000
Income taxes paid		2,268,000		1,802,000
Noncash transactions				
Transfer from loans to other real estate and property owned		288,000		30,000
Preferred stock dividends declared but not paid		–		219,000

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2019 and 2018

Nature of Business

Katahdin Bankshares Corp. (the Company) is a bank holding company. A subsidiary, Katahdin Trust Company (the Bank), is a state chartered commercial bank whose deposits are insured by the Federal Deposit Insurance Corporation (FDIC). The Bank's primary business is to loan funds to and accept deposits from consumers and small businesses in Aroostook and Penobscot counties and the Portland area. The Bank has full-service branches throughout Aroostook and northern Penobscot counties, the greater Bangor area of central Maine in Penobscot county and in the Portland metro area of Cumberland county. The Scarborough location also houses Maine Financial Group (MFG), which the Bank purchased in 2007. MFG, a division of the Bank, provides equipment financing for individuals and businesses in the trucking, construction, forest products, and marine industries throughout northern New England. The Company and its subsidiary are subject to regulation and periodic examination by the FDIC, the Maine Bureau of Financial Institutions, and the Federal Reserve System.

1. Summary of Significant Accounting Policies

Basis of Presentation and Consolidation

The consolidated financial statements include the accounts of Katahdin Bankshares Corp. and its wholly owned subsidiary, Katahdin Trust Company. All significant intercompany balances and transactions have been eliminated in consolidation.

Pursuant to the criteria established by U.S. generally accepted accounting principles (GAAP), the Company has not consolidated the trusts which it formed for the purposes of issuing trust preferred securities to unaffiliated parties and investing the proceeds from the issuance thereof and the common securities of the trust in junior subordinated debentures issued by the Company. The trusts are considered affiliates (see Note 9).

Use of Estimates

In preparing consolidated financial statements in conformity with GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the valuation of other real estate and property owned. In connection with the determination of the allowance for loan losses and the carrying value of other real estate and property owned, management obtains independent appraisals for significant properties.

While management uses all available information to recognize losses on loans, future additions to the allowance for loan losses may be necessary based on changes in the economy. In addition, regulatory agencies, as a part of their examination process, periodically review the Bank's loan portfolio and may require the Bank to make additions to the allowance for loan losses based on judgments about information available to them at the time of the examination. Because of these factors, it is reasonably possible that the allowance for loan losses may change materially in the near term.

Cash and Cash Equivalents

For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash and due from banks and interest bearing deposits in banks.

The Company's due from bank accounts and interest bearing deposits in banks, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts. The Company believes it is not exposed to any significant risk on cash and cash equivalents.

Securities

Debt securities that management has the positive intent and ability to hold to maturity are classified as "held-to-maturity" and recorded at amortized cost. Debt securities not classified as held-to-maturity are classified as "available-for-sale" and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income or loss. Other investments are carried at estimated fair value with changes in fair value and realized gains or losses reported in noninterest income in 2019. Prior to the adoption of Accounting Standards Update (ASU) No. 2016-01, *Financial Instruments – Overall: Recognition and Measurement of Financial Assets and Financial Liabilities*, changes in fair value of other investments were reported in other comprehensive income (loss).

Purchase premiums and discounts are recognized in interest income using a method approximating the interest method over the terms of the securities. Declines in the fair value of individual debt securities that are deemed to be other-than-temporary are reflected in earnings when identified. For individual debt securities where the Company does not intend to sell the security and it is more-likely-than-not that the Company will not be required to sell the security before recovery of its amortized cost basis, the other-than-temporary decline in the fair value of the debt security related to 1) credit loss is recognized in earnings and 2) other factors are recognized in other comprehensive income or loss. Credit loss is deemed to exist if the present value of expected future cash flows is less than the amortized cost basis of the debt security. For individual debt securities where the Company intends to sell the security or more-likely-than-not will be required to sell the security before recovery of its amortized cost, the other-than-temporary impairment is recognized in earnings equal to the entire difference between the security's cost basis and its fair value at the balance sheet date. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Loans and Allowance for Loan Losses

Loans are stated at the amount of unpaid principal, reduced by an allowance for loan losses and deferred loan fees and costs. Interest on loans is calculated by applying the simple interest method to daily balances of the principal amount outstanding.

The allowance for loan losses is established through a provision for loan losses charged to expense. The allowance for loan losses is reviewed periodically throughout the year to determine the appropriate level based on factors such as the methodology of allocating standard reserves to categories of loans, assigning specific reserves based on valuations of certain credits and a review of the appropriateness of the unallocated reserve.

There are several factors related to the allowance for loan losses that are individually reviewed to determine the level of specific reserves, such as the economic condition and outlook for certain industry or loan type concentrations, non-accrual loans, impaired loans, real estate under foreclosure, and classified loans. These reserves are assigned to meet the probable losses related to specific loans that have been identified as impaired.

The standard reserve is determined through an analysis of past performance including historical loan losses within groups of loans. Consideration is given to adjusting formulas based on an assessment of various qualitative factors related to the loan portfolio, including but not limited to performance of the portfolio, lender experience, new loan products or strategies, and economic factors. Management follows a similar process to estimate its liability for off-balance-sheet commitments to extend credit. The unallocated reserve position represents the margin of imprecision of the allowance after the standard and specific reserve allocations have been met.

Loans past due 30 days or more are considered delinquent. Loans are charged against the allowance for loan losses when management believes that the collection of the principal is unlikely. The allowance is based on management's evaluation of the collectability of the loan portfolio, including the nature of the loans, the estimated value of underlying collateral, credit concentrations, trends in historical loss experience, specific impaired loans, and economic conditions. The allowance is an amount that management believes is appropriate to absorb possible losses on existing loans.

Management considers loans to be impaired when it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the agreement. When a loan is considered to be impaired, the amount of the impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or based on the fair value of the underlying collateral if the loan is collateral-dependent. Small balance homogenous loans are collectively evaluated for impairment.

The accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions and collection efforts that the borrower's financial condition is such that collection of interest is doubtful. Interest income on nonaccrual loans is recognized only to the extent that interest payments are received. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Loan origination fees and certain direct loan origination costs are deferred and amortized as an adjustment to income over the lives of the related loans.

1. Summary of Significant Accounting Policies (cont.)

Credit Related Financial Instruments

In the ordinary course of business, the Company has entered into commitments to extend credit, including commitments under credit card arrangements and letters-of-credit. Such financial instruments are recorded when they are funded.

Other Real Estate and Property Owned (OREO)

Assets acquired through, or in lieu of, loan foreclosure or repossession are held for sale and are initially recorded at fair value at the date of foreclosure or repossession. Subsequent to foreclosure or repossession, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in net expenses from other real estate and property owned.

Bank Premises and Equipment

Bank premises and equipment are stated at cost less accumulated depreciation computed on the straight-line and declining balance methods over the estimated useful lives of the assets.

Goodwill

On January 1, 2002, the Company adopted Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 350, *Intangibles - Goodwill and Other*. Prior to the adoption of ASC Topic 350, goodwill related to branch acquisitions was amortized using the straight-line method over ten years. Goodwill amortization has been discontinued. Goodwill related to branch acquisitions and MFG is reviewed for impairment annually, or more frequently upon the occurrence of certain events.

Income Taxes

Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws. The Company releases income tax effects from accumulated other comprehensive income when the associated transaction is recognized in earnings.

ASC Topic 740, *Income Taxes*, defines the criteria that an individual tax position must satisfy for some or all of the benefits of that position to be recognized in a company's financial statements. ASC Topic 740 prescribes a recognition threshold of more-likely-than-not, and a measurement attribute for all tax positions taken or expected to be taken on a tax return, in order for those tax positions to be recognized in the financial statements. The Company is currently open to audit under the statute of limitations by the Internal Revenue Service for the years ended December 31, 2016 through 2018.

Comprehensive Income

Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

Employee Stock Ownership Plan

Shares of the Company's common stock purchased by the Katahdin Trust Company Employee Stock Ownership Plan (ESOP) are held in a suspense account until released for allocation to participants. Shares released are allocated to each eligible participant based on the ratio of each participant's compensation, as defined in the ESOP, to the total compensation of all eligible plan participants. As the unearned shares are released from suspense, the Company recognizes compensation expense equal to the fair value of the ESOP shares committed to be released during the period. To the extent that the fair value of the ESOP shares differs from the cost of such shares, the difference is charged or credited to equity as surplus. Allocated and committed-to-be-released ESOP shares are considered outstanding for earnings per share calculations based on debt service payments. Other ESOP shares are excluded from earnings per share. The cost of unearned shares to be allocated to ESOP participants for future services not yet performed is reflected as a reduction of stockholders' equity.

Earnings Per Share

Basic earnings per share data is computed based on the weighted average number of the Company's common shares outstanding during the year, which excludes the unallocated shares of the ESOP. Common stock related to unvested restricted stock awards are considered in the calculation of weighted average shares outstanding for basic earnings per share.

Derivative Financial Instruments Designated as Hedges

The Company recognizes all derivatives in the consolidated balance sheet at fair value. On the date the Company enters into the derivative contract, the Company designates the derivative as a hedge of either a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability ("cash flow hedge") or a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment ("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 various hedge transactions. The Company also assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are effective in offsetting changes in cash flows or fair values of hedged items. Changes in fair value of a derivative that is effective and that qualifies as a cash flow hedge are recorded in other comprehensive income or loss and are reclassified into earnings when the forecasted transaction or related cash flows affect earnings. Changes in fair value of a derivative that qualifies as a fair value hedge and the change in fair value of the hedged item are both recorded in earnings and offset each other when the transaction is effective. The Company discontinues hedge accounting when it determines that the derivative is no longer effective in offsetting changes in the cash flows of the hedged item, that it is unlikely that the forecasted transaction will occur, or that the designation of the derivative as a hedging instrument is no longer appropriate.

Recently Issued Accounting Pronouncements

In January 2016, the Financial Accounting Standards Board (FASB) issued ASU No. 2016-01, *Financial Instruments – Overall: Recognition and Measurement of Financial Assets and Financial Liabilities*. The ASU was issued to enhance the reporting model for financial instruments to provide users of financial statements with more decision-useful information. This ASU changes how entities account for equity investments that do not result in consolidation and are not accounted for under the equity method of accounting. The ASU also changes certain disclosure requirements and other aspects of GAAP. The recognition for the change in fair value within net income was applied prospectively, and the Company recorded a cumulative-effect adjustment as of January 1, 2019 for its equity investments to reclassify the unrealized gain, net of tax, of $67,000 previously recognized within accumulated other comprehensive income to undivided profits.

In June 2016, FASB issued ASU No. 2016-13, *Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.* Under the new guidance, which will replace the existing incurred loss model for recognizing credit losses, banks, and other lending institutions will be required to recognize the full amount of expected credit losses. The new guidance, which is referred to as the current expected credit loss model, requires that expected credit losses for financial assets held at the reporting date that are accounted for at amortized cost be measured and recognized based on historical experience and current and reasonably supportable forecasted conditions to reflect the full amount of expected credit losses. A modified version of these requirements also applies to debt securities classified as available-for-sale. The ASU is effective for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. Management is evaluating the potential impact of the ASU and anticipates that it may have a material impact on the Company's consolidated financial statements. The Company has formed an implementation committee for ASU No. 2016-13. To date, a third-party vendor has been selected and the committee is working through modeling and calculations.

In January 2017, FASB issued ASU No. 2017-04, *Intangibles, Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*. The ASU was issued to reduce the cost and complexity of the goodwill impairment test. To simplify the subsequent measurement of goodwill, step two of the goodwill impairment test was eliminated. Instead, a company will recognize an impairment of goodwill should the carrying value of a reporting unit exceed its fair value (i.e. step one). The ASU is effective for fiscal years beginning after December 15, 2020 and will be applied prospectively. Management does not expect the ASU to have a material effect on the Company's consolidated financial statements.

In August 2017, FASB issued ASU 2017-12, *Derivatives and Hedging (Topic 815).* The amendments in this ASU improve the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements. In addition, this ASU makes certain targeted improvements to simplify the application of the hedge accounting guidance in current GAAP. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018. Early application is permitted in any interim period after issuance of the ASU. The adoption of ASU 2017-02 did not have a material effect on the Company's consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2019 and 2018

1. Summary of Significant Accounting Policies (cont.)

In February 2016, FASB issued ASU No. 2016-02, *Leases*. The ASU was issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The ASU is effective for fiscal years beginning after December 15, 2018. In July 2018, FASB issued ASU No. 2018-11, *Leases – Targeted Improvements*, to provide entities with relief from the costs of implementing certain aspects of the new leasing standard, ASU No. 2016-02. Specifically, under the amendments in ASU No. 2018-11: (1) entities may elect not to recast the comparative periods presented when transitioning to the new leasing standard, and (2) lessors may elect not to separate lease and non-lease components when certain conditions are met. The amendments have the same effective date as ASU No. 2016-02. The adoption of ASU No. 2016-02 and 2018-11 did not have a material effect on the Company's consolidated financial statements.

In August 2018, FASB issued ASU No. 2018-13, *Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*. 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 of 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. ASU No. 2018-13 is effective for interim and annual reporting periods beginning after December 15, 2019; early adoption is permitted. Entities are also allowed to elect early adoption of the eliminated or modified disclosure requirements and delay adoption of the new disclosure requirements until their effective date. As ASU No. 2018-13 only revises disclosure requirements, it will not have a material impact on the Company's consolidated financial statements.

2. Cash and Due from Banks

The Bank is required to maintain certain reserves of vault cash or deposits with the Federal Reserve Bank. The amount of this reserve requirement, included in cash and due from banks, was approximately $1,977,000 and $166,000 as of December 31, 2019 and 2018, respectively.

3. Securities

Securities have been classified in the consolidated balance sheets according to management's intent. The amortized cost and fair value of securities, with gross unrealized gains and losses, follow:

2019	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available-for-Sale				
U.S. Treasury securities	$ 999,000	$ –	$ –	$ 999,000
State and municipal	8,498,000	371,000	–	8,869,000
Corporate bonds	2,003,000	–	(63,000)	1,940,000
Mortgage-backed and CMO's	88,039,000	859,000	(330,000)	88,568,000
Total securities available-for-sale	$ 99,539,000	$1,230,000	$ (393,000)	$100,376,000
Securities Held-to-Maturity				
Mortgage-backed and CMO's	$ 6,000	$ –	$ –	$ 6,000
Total securities held-to-maturity	$ 6,000	$ –	$ –	$ 6,000

2018	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available-for-Sale				
U.S. Treasury securities	$ 1,989,000	$ –	$ (16,000)	$ 1,973,000
State and municipal	10,604,000	97,000	(88,000)	10,613,000
Corporate bonds	2,008,000	–	(75,000)	1,933,000
Mortgage-backed and CMO's	79,636,000	374,000	(1,796,000)	78,214,000
Other investments[1]	500,000	–	(85,000)	415,000
Total securities available-for-sale	$ 94,737,000	$ 471,000	$ (2,060,000)	$ 93,148,000
Securities Held-to-Maturity				
Mortgage-backed and CMO's	$ 7,000	$ –	$ –	$ 7,000
Total securities held-to-maturity	$ 7,000	$ –	$ –	$ 7,000

The following summarizes the Company's gross unrealized losses and fair values aggregated by investment category and length of time that individual securities have been in a continuous loss position at December 31, 2019:

	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Corporate bonds	$ –	$ –	$ 436,000	$ (63,000)	$ 436,000	$ (63,000)
Mortgage-backed and CMO's	17,518,000	(90,000)	19,348,000	(240,000)	36,866,000	(330,000)
Total temporarily impaired securities	$ 17,518,000	$ (90,000)	$19,784,000	$ (303,000)	$ 37,302,000	$ (393,000)

At December 31, 2019, unrealized losses within the mortgage backed and CMO's category relate to forty-seven individual securities of which twenty-six had continuous losses for more than one year. Unrealized losses within the corporate bond category relate to one bond which had a continuous loss position for more than one year. The primary cause for unrealized losses within the debt securities is the impact movements in interest rates have had in comparison to the underlying yields on these securities.

The following summarizes the Company's gross unrealized losses and fair values aggregated by investment category and length of time that individual securities have been in a continuous loss position at December 31, 2018:

	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Corporate bonds	$ –	$ –	$ 425,000	$ (75,000)	$ 425,000	$ (75,000)
Mortgage-backed and CMO's	5,278,000	(27,000)	53,454,000	(1,769,000)	58,732,000	(1,796,000)
U.S. Treasury securities	–	–	1,973,000	(16,000)	1,973,000	(16,000)
State and municipal	642,000	(2,000)	5,933,000	(86,000)	6,575,000	(88,000)
Other investments[1]	–	–	415,000	(85,000)	415,000	(85,000)
Total temporarily impaired securities	$ 5,920,000	$ (29,000)	$62,200,000	$(2,031,000)	$ 68,120,000	$(2,060,000)

At December 31, 2018, unrealized losses within the other investments category relate to one individual security which had a continuous loss for more than one year. Unrealized losses within the mortgage backed and CMO's category relate to sixty-nine individual securities of which sixty-two had continuous losses for more than one year. Unrealized losses within the state and municipal bonds category relate to fifteen individual securities of which thirteen had continuous losses for more than one year. Unrealized losses within the corporate bond category relate to one bond which had a continuous loss position for more than one year. Unrealized losses within the U.S. Treasury securities category relate to one security which had a continuous loss position for more than one year. The primary cause for unrealized losses within the debt securities is the impact movements in interest rates have had in comparison to the underlying yields on these securities.

Management evaluates investments for other-than-temporary impairment (OTTI) based on the type of investment and the period of time the investment has been in an unrealized loss position. At December 31, 2019 and 2018, management has determined that the current unrealized losses on these securities are consistent with changes in the overall bond markets caused by an increase in market yields and spread levels and the securities are not other-than-temporarily impaired. The exception to this is a mortgage backed security at Banc of America Funding Corporation (BAFC). Management performed an internal analysis on the market value of its investment at BAFC as of December 31, 2019 and 2018, and recognized OTTI write-downs related to credit loss of the security of $4,000 for the year ended December 31, 2019. No write-down related to credit loss of this security was recognized as a result of the internal analysis performed for the year ended December 31, 2018.

The following table presents gross realized gains and losses on available-for-sale securities during the years ended December 31:

	2019	2018
Proceeds from sales	$ 5,571,000	$ –
Gross realized gains	$ 76,000	$ –
Gross realized losses	–	$ –
Net realized gain	$ 76,000	$ –
Related income tax expense	$ 16,000	$ –

(1) As of December 31, 2018, other investments were classified as securities available-for-sale. Effective January 1, 2019, these investments were reclassified to other investments on the consolidated balance sheets as they are no longer eligible to be classified as available-for-sale upon adoption of ASU 2016-01.

3. Securities (cont.)

At December 31, 2019 and 2018, securities with a fair value of $32,690,000 and $33,625,000, respectively, were pledged to secure certain borrowings and municipal deposits and repurchase agreements as required or permitted by law.

The amortized cost and fair value of securities by contractual maturity at December 31, 2019 follow:

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within 1 year	$ 2,295,000	$ 2,295,000	$ –	$ –
Over 1 year through 5 years	19,503,000	19,637,000	2,000	2,000
Over 5 years through 10 years	13,521,000	13,615,000	4,000	4,000
Over 10 years	64,220,000	64,829,000	–	–
	$ 99,539,000	$ 100,376,000	$ 6,000	$ 6,000

Mortgage-backed securities and CMO's are allocated among the above maturity groupings based on their final maturity dates.

The Bank's investment in Federal Home Loan Bank (FHLB) stock was evaluated for impairment and the Bank did not identify any events or changes in circumstances that may have had a significant adverse effect on the carrying value of that investment.

Other Investments

The following table summarizes the cost and estimated fair value of the Company's other investments at December 31, 2019:

	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Other investments	$ 500,000	$ –	$ (19,000)	$ 481,000

For the year ended December 31, 2019, the Company recognized an unrealized gain of $66,000 due to the change in the fair value of its other investments. This gain has been presented within other noninterest income on the consolidated statements of income.

4. Loans

A summary of the loan balances are as follows:

	2019	2018
Mortgage loans on real estate		
Residential 1-4 family	$ 141,396,000	$ 138,583,000
Commercial	369,301,000	342,993,000
	510,697,000	481,576,000
Commercial		
Commercial and industrial	173,037,000	161,028,000
Municipal loans	8,029,000	6,892,000
Business credit cards	366,000	365,000
	181,432,000	168,285,000
Consumer installment loans	8,184,000	9,945,000
Subtotal	700,313,000	659,806,000
Less: Allowance for loan losses	6,293,000	5,856,000
Add: Net deferred loan costs	703,000	669,000
Loans, net	$ 694,723,000	$ 654,619,000

The following tables present the allowance for loan losses and select loan information for the years ended December 31, 2019 and 2018:

	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	2019 Total
Allowance for loan losses						
Beginning balance	$ 1,841,000	$ 3,280,000	$ 194,000	$ 35,000	$506,000	$ 5,856,000
Provision for (reduction of) loan losses	(139,000)	432,000	83,000	43,000	41,000	460,000
Loans charged off	(75,000)	–	(82,000)	(25,000)	–	(182,000)
Recoveries of loans previously charged off	120,000	17,000	22,000	–	–	159,000
Ending balance	$ 1,747,000	$ 3,729,000	$ 217,000	$ 53,000	$547,000	$ 6,293,000
Individually evaluated for impairment	$ 31,000	$ 458,000	$ 11,000	$ 16,000	$ –	$ 516,000
Collectively evaluated for impairment	$ 1,716,000	$ 3,271,000	$ 206,000	$ 37,000	$547,000	$ 5,777,000
Loans						
Ending balance	$ 181,432,000	$ 369,301,000	$ 141,396,000	$ 8,184,000		$ 700,313,000
Individually evaluated for impairment	$ 1,690,000	$ 2,639,000	$ 714,000	$ 99,000		$ 5,142,000
Collectively evaluated for impairment	$ 179,742,000	$ 366,662,000	$ 140,682,000	$ 8,085,000		$ 695,171,000

	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	2018 Total
Allowance for loan losses						
Beginning balance	$ 2,502,000	$ 3,100,000	$ 221,000	$ 74,000	$151,000	$ 6,048,000
Provision for (reduction of) loan losses	(345,000)	193,000	6,000	(29,000)	355,000	180,000
Loans charged off	(365,000)	(30,000)	(34,000)	(12,000)	-	(441,000)
Recoveries of loans previously charged off	49,000	17,000	1,000	2,000	-	69,000
Ending balance	$ 1,841,000	$ 3,280,000	$ 194,000	$ 35,000	$506,000	$ 5,856,000
Individually evaluated for impairment	$ 51,000	$ 300,000	$ 18,000	$ 1,000	$ -	$ 370,000
Collectively evaluated for impairment	$ 1,790,000	$ 2,980,000	$ 176,000	$ 34,000	$506,000	$ 5,486,000
Loans						
Ending balance	$ 168,285,000	$ 342,993,000	$ 138,583,000	$ 9,945,000		$ 659,806,000
Individually evaluated for impairment	$ 2,705,000	$ 2,745,000	$ 1,039,000	$ 74,000		$ 6,563,000
Collectively evaluated for impairment	$ 165,580,000	$ 340,248,000	$ 137,544,000	$ 9,871,000		$ 653,243,000

Management's judgment of the likelihood of a loss is demonstrated by the internal risk rating assigned to each loan in both the Commercial and Consumer portfolios.

Commercial: Commercial and Commercial Real Estate

The commercial portfolio is closely monitored for quality and the likelihood of loss. Based on the current information surrounding the facts and circumstances of the loan, an internal credit rating is assigned. Credit ratings 1-5 are deemed to be a performing loan with no significant likelihood of loss. The ratings are further measured with a 6 – special mention, 7 – substandard, 8 – doubtful, and 9 – loss. Each of these ratings is supported by the facts and circumstances surrounding the loan that would cause a higher probability of some loss and thus as the rating progresses down the scale a higher reserve for loan loss is allocated to the particular group mentioned.

Loans rated 1: Loans in this category include municipalities or other government establishments primarily engaged in providing general support for government or administration of education programs.

Loans rated 2: Loans in this category include borrowers of unquestioned credit standing and a consistently strong financial condition as evidenced by earnings, liquidity, leverage, and cash flow. Additionally, loans secured by cash collateral or properly margined marketable securities are considered rated 2.

Loans rated 3: These loans include borrowers that have most of the characteristics of a loan rated 2, but either the financial condition, management, or industry is not quite as strong.

Loans rated 4: These loans include borrowers that have a reasonable financial condition. While loans in this category are definitely sound, they do carry a higher risk. The borrower is generally profitable with occasional moderate losses.

Loans rated 5: These loans are considered "watch list." These loans are those commercial loans that, while creditworthy, exhibit some characteristics which require special attention by the loan officer. This is the lowest permissible rating for a new loan.

December 31, 2019 and 2018

4. Loans (cont.)

Loans rated 5 must be closely monitored as any deterioration may be cause for prompt re-rating to 6 or lower. Principal areas of concern may be management problems, industry stress, financial deterioration, operating losses, inadequate cash flow, highly cyclical industries, or any other area that would negatively affect the borrower's ability to repay the obligation in full on a timely basis.

Loans rated 6: Loans in this category are considered "special mention." These loans are considered protected but may have potential weaknesses, which may weaken the asset or inadequately protect the Bank's credit position at some future date.

Loans rated 7: Loans in this category are considered "substandard." These loans might be inadequately protected by the current net worth and paying capacity of the borrower or of the collateral pledged, if any. Assets so classified often have well-defined weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Loans rated 8: Loans in this category are considered "doubtful." Loans classified as doubtful have all the weaknesses inherent in one classified substandard with the added characteristic that the weaknesses may make collection or liquidation in full highly questionable and improbable on the basis of currently existing facts, conditions, and values. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors, which may work to the advantage of strengthening of the asset, its rating as 9 is deferred until its more exact status may be determined. Pending factors include proposed merger, acquisition, or liquidation procedures, capital injection, perfecting liens on additional collateral, and refinancing plans.

Loans rated 9: Loans in this category are considered "loss" or uncollectible. For these loans it is not practical or desirable to defer writing off the basically worthless loan even though partial recovery may be effected in the future.

Consumer: Residential 1-4 Family,
Consumer – Installment and Consumer – Indirect Installment

These loans are broken out as either a pass or substandard. A loan is typically marked as substandard when it becomes 90 days past due or under certain circumstances such as bankruptcy or excessive tax liens. Higher reserves are allocated to substandard consumer loans as there would be a higher probability of loss.

The following tables summarize credit risk indicators by portfolio as of December 31, 2019 and 2018:

Commercial Credit Risk Exposure
Credit Risk Profile by Internally Assigned Grade

2019	Commercial	Commercial Real Estate
Pass	$ 174,896,000	$ 353,404,000
Special mention	2,604,000	10,865,000
Substandard	3,932,000	5,032,000
Doubtful	–	–
Loss	–	–
2019 Total	$ 181,432,000	$ 369,301,000
2018		
Pass	$ 158,186,000	$ 323,877,000
Special mention	5,481,000	16,810,000
Substandard	4,618,000	2,306,000
Doubtful	–	–
Loss	–	–
2018 Total	$ 168,285,000	$ 342,993,000

Consumer Credit Exposure
Credit Risk Profile by Internally Assigned Grade

2019	Residential Real Estate	Consumer-Installment	Consumer-Indirect Installment
Pass	$ 140,886,000	$ 5,579,000	$ 2,545,000
Substandard	510,000	28,000	32,000
2019 Total	$ 141,396,000	$ 5,607,000	$ 2,577,000
2018			
Pass	$ 137,781,000	$ 5,068,000	$ 4,854,000
Substandard	802,000	23,000	–
2018 Total	$ 138,583,000	$ 5,091,000	$ 4,854,000

The following presents an aging analysis of past due loans as of December 31, 2019 and 2018:

2019	30–59 Days Past Due	60–89 Days Past Due	90 Days & Greater	Total Past Due	Current	Total Loans	Loans on Nonaccrual	Recorded Investment Loans > 90 Days & Accruing
Commercial	$ 957,000	$ 745,000	$ 1,276,000	$ 2,978,000	$ 178,454,000	$ 181,432,000	$ 1,608,000	$ 1,000
Commercial real estate	2,642,000	923,000	655,000	4,220,000	365,081,000	369,301,000	1,769,000	10,000
Residential real estate	260,000	11,000	150,000	421,000	140,975,000	141,396,000	513,000	–
Consumer – installment	–	–	7,000	7,000	5,600,000	5,607,000	28,000	–
Consumer – indirect installment	41,000	11,000	–	52,000	2,525,000	2,577,000	51,000	–
2019 Total	$ 3,900,000	$ 1,690,000	$ 2,088,000	$ 7,678,000	$ 692,635,000	$ 700,313,000	$ 3,969,000	$ 11,000
2018								
Commercial	$ 343,000	$ 206,000	$ 1,392,000	$ 1,941,000	$ 166,344,000	$ 168,285,000	$ 2,003,000	$ 39,000
Commercial real estate	894,000	83,000	–	977,000	342,016,000	342,993,000	842,000	–
Residential real estate	297,000	90,000	421,000	808,000	137,775,000	138,583,000	923,000	7,000
Consumer – installment	–	–	–	–	5,091,000	5,091,000	23,000	–
Consumer – indirect installment	65,000	7,000	30,000	102,000	4,752,000	4,854,000	28,000	30,000
2018 Total	$ 1,599,000	$ 386,000	$ 1,843,000	$ 3,828,000	$ 655,978,000	$ 659,806,000	$ 3,819,000	$ 76,000

4. Loans (cont.)

The Bank takes a conservative approach in credit risk management and remains focused on community lending and reinvesting, working closely with borrowers experiencing credit problems to assist in loan repayment or term modifications. Troubled debt restructured loans (TDRs) consist of loans where the Bank, for economic or legal reasons related to the borrower's financial difficulties, granted a concession to the borrower that it would not otherwise consider. TDRs involve term modifications or a reduction of either interest or principal that the Bank would not normally make for other borrowers with similar risk characteristics. Once such an obligation has been restructured, it will continue to remain in restructured status until paid in full. Current balances of loan modifications qualifying as TDRs during the years ended December 31, 2019 and 2018 were $157,000 and $1,027,000, respectively. Loans restructured due to credit difficulties that are now performing were $1,931,000 and $2,722,000 at December 31, 2019 and 2018, respectively.

At December 31, 2019 and 2018, the allowance related to TDRs was $405,000 and $313,000, respectively. The specific reserve component was determined by using the fair value of the underlying collateral, which was obtained through independent appraisals and internal evaluations, or by discounting the total expected future cash flows from the borrower. There were no commitments to lend additional funds to borrowers with loans classified as TDRs at December 31, 2019 and 2018.

In 2019, there were no loans that did not perform according to the TDR terms and were subsequently charged off or transferred to OREO. In 2018, three commercial loans did not perform according to the TDR terms and were subsequently charged off or transferred to OREO in the combined amount of $97,000.

The following is a summary of TDRs (accruing and non-accruing) by portfolio segment modified during the years ended December 31, 2019 and 2018:

2019	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Current Balance
Commercial	8	$ 190,000	$ 185,000	$ 157,000
2019 Total	8	$ 190,000	$ 185,000	$ 157,000
2018				
Commercial	12	$ 1,037,000	$ 1,063,000	$ 987,000
Commercial real estate	1	41,000	41,000	40,000
2018 Total	13	$ 1,078,000	$ 1,104,000	$ 1,027,000

The following is a summary of TDRs (accruing and non-accruing) by portfolio segment as of December 31, 2019 and 2018:

2019	Number of Contracts	Current Balance	Related Allowance
Commercial	29	$ 871,000	$ 14,000
Commercial real estate	29	2,431,000	391,000
Residential real estate	3	538,000	–
Consumer	2	46,000	–
2019 Total	63	$ 3,886,000	$ 405,000
2018			
Commercial	27	$ 1,599,000	$ 3,000
Commercial real estate	33	2,667,000	300,000
Residential real estate	3	568,000	9,000
Consumer	2	51,000	-
2018 Total	65	$ 4,885,000	$ 312,000

Impaired loans consist of non-accrual loans and TDRs. All impaired loans are allocated a portion of the allowance to cover potential losses.

The following table presents a summary of information pertaining to impaired loans by loan category as of December 31, 2019 and 2018:

2019	Recorded Investment	Unpaid Principal Balance	Related Allowance	Interest Income Recognized
With no related allowance recorded:				
Commercial	$ 1,294,000	$ 1,294,000	$ –	$ 14,000
Commercial real estate	1,122,000	1,122,000	–	56,000
Residential real estate	646,000	646,000	–	29,000
Consumer	46,000	46,000	–	1,000
With an allowance recorded:				
Commercial	$ 396,000	$ 396,000	$ 31,000	$ 10,000
Commercial real estate	1,517,000	1,517,000	458,000	47,000
Residential real estate	68,000	68,000	11,000	1,000
Consumer	53,000	53,000	16,000	3,000
2019 Total:				
Commercial	$ 1,690,000	$ 1,690,000	$ 31,000	$ 24,000
Commercial real estate	2,639,000	2,639,000	458,000	103,000
Residential real estate	714,000	714,000	11,000	30,000
Consumer	99,000	99,000	16,000	4,000

2018	Recorded Investment	Unpaid Principal Balance	Related Allowance	Interest Income Recognized
With no related allowance recorded:				
Commercial	$ 2,245,000	$ 2,245,000	$ –	$ 36,000
Commercial real estate	1,830,000	1,830,000	–	129,000
Residential real estate	828,000	828,000	–	31,000
Consumer	51,000	51,000	–	3,000
With an allowance recorded:				
Commercial	$ 460,000	$ 460,000	$ 51,000	$ 24,000
Commercial real estate	915,000	915,000	300,000	33,000
Residential real estate	211,000	211,000	18,000	2,000
Consumer	23,000	23,000	1,000	–
2018 Total:				
Commercial	$ 2,705,000	$ 2,705,000	$ 51,000	$ 60,000
Commercial real estate	2,745,000	2,745,000	300,000	162,000
Residential real estate	1,039,000	1,039,000	18,000	33,000
Consumer	74,000	74,000	1,000	3,000

The following is a summary of information pertaining to impaired loans:

	2019	2018
Impaired loans without a valuation allowance	$ 3,108,000	$ 4,954,000
Impaired loans with a valuation allowance	2,034,000	1,609,000
Total impaired loans	$ 5,142,000	$ 6,563,000
Valuation allowance related to impaired loans	$ 516,000	$ 370,000
Average investment in impaired loans	$ 6,035,000	$ 6,647,000

As of December 31, 2019 and 2018, there were seven and four mortgage loans, respectively, collateralized by residential real estate in the process of foreclosure with a total balance of $144,000 and $217,000, respectively.

5. Bank Premises and Equipment

A summary of the cost and accumulated depreciation of bank premises and equipment follows:

	2019	2018
Land	$ 2,794,000	$ 2,740,000
Buildings	11,458,000	11,460,000
Equipment	13,984,000	13,432,000
Leasehold improvements	1,112,000	1,112,000
Construction in progress	–	69,000
	29,348,000	28,813,000
Accumulated depreciation	(19,146,000)	(18,255,000)
	$ 10,202,000	$ 10,558,000

6. Deposits

At December 31, 2019, the scheduled maturities of time deposits are as follows:

2020	$ 144,298,000
2021	24,414,000
2022	13,569,000
2023	9,054,000
2024 and thereafter	9,266,000
	$ 200,601,000

Time deposit accounts in denominations that met or exceeded the insured limit were $31,738,000 and $18,603,000 at December 31, 2019 and 2018, respectively.

December 31, 2019 and 2018

7. Advances from Federal Home Loan Bank

Pursuant to collateral agreements with the FHLB, advances are collateralized by all stock in the FHLB, qualifying first mortgages and securities available-for-sale.

Fixed-rate advances of $35,551,000 and $52,156,000 at December 31, 2019 and 2018, respectively, mature through August 2023. At December 31, 2019 and 2018, the interest rates on fixed rate advances ranged from 0.00 to 2.87 percent. At December 31, 2019 and 2018, the weighted-average interest rates on fixed-rate advances were 2.03 percent and 2.17 percent, respectively.

The floating rate advance of $2,435,000 at December 31, 2019 matures in January 2020. At December 31, 2019, the interest rate on the floating rate advance was 1.85 percent. The floating rate advance of $6,645,000 at December 31, 2018 matured in January 2019. At December 31, 2018, the interest rate on the floating rate advance was 2.68 percent.

At December 31, 2019 and 2018, the Company also had $1,000,000 available under a long-term line of credit with the FHLB.

The contractual maturities of advances at December 31, 2019 are as follows:

2020	$ 24,935,000
2021	6,500,000
2022	2,500,000
2023	4,051,000

8. Other Borrowed Funds

During the year ended December 31, 2018, the Company had other borrowed funds including securities sold under agreements to repurchase. At December 31, 2019 and 2018, the Company did not have any securities sold under agreements to repurchase.

Securities sold under agreements to repurchase, which were classified as secured borrowings, generally matured within one to four days from the transaction date, except for the term repurchase agreements. Securities sold under agreements to repurchase were reflected at the amount of cash received in connection with the transaction. The Company may have been required to provide additional collateral based on the fair value of the underlying securities. At December 31, 2019 and 2018, no securities were pledged to secure other borrowed funds.

Information concerning securities sold under agreements to repurchase for the years ended December 31, 2019 and 2018 is summarized as follows:

	2019	2018
Average balance during the year	$ –	$ 72,000
Average interest rate during the year	0.00%	0.10%
Maximum month-end balance during the year	$ –	$ 120,000

At December 31, 2018, other borrowed funds consisted of short-term borrowings that matured in June 2019, under a $1,000,000 line of credit. There were no other borrowings at December 31, 2019.

At December 31, 2019 and 2018, the Company also had $18,000,000 available under lines of credit with other banks which were in addition to the line of credit disclosed in Note 7. There were no advances outstanding under these lines of credit with other banks at December 31, 2019 or 2018.

9. Capital Trust Securities

On October 14, 2003, the Company sponsored the creation of Katahdin Capital Trust II (the "Trust II"), a statutory business trust created under the laws of Delaware. The Company is the owner of all of the common securities of the Trust II. On October 16, 2003, the Trust II issued $3,000,000 of London Interbank Offered Rate (LIBOR) floating rate plus 3.05% margin Capital Securities (the "Capital Securities II," and with the common securities, the "Trust Securities II"), the proceeds from which were used by the Trust II, along with the Company's $93,000 capital contribution for the Common Securities II, to acquire $3,093,000 aggregate principal amount of the Company's LIBOR floating rate plus 3.05% Junior Subordinated Deferrable Interest Debentures due October 16, 2033 (the "Debentures"), which constitute the sole assets of the Trust II. The Company has, through the Declaration of Trust which established the Trust II, the Common Securities II and Capital Securities II Guarantee Agreements, the Debentures and a related Indenture, taken together, fully, irrevocably and unconditionally guaranteed all of the Trust II's obligations under the Trust Securities II.

On December 20, 2005, the Company sponsored the creation of Katahdin Capital Trust III (the "Trust III"), a statutory business trust created under the laws of Delaware. The Company is the owner of all of the common securities of the Trust III. On December 22, 2005, the Trust III issued $4,000,000 of LIBOR floating rate plus 1.50% margin Capital Securities (the "Capital Securities III," and with the common securities, the "Trust Securities III"), the proceeds from which were used by the Trust III, along with the Company's $124,000 capital contribution for the Common Securities III, to acquire $4,124,000 aggregate principal amount of the Company's LIBOR floating rate plus 1.50% Junior Subordinated Deferrable Interest Debentures due January 7, 2036 (the "Debentures"), which constitute the sole assets of the Trust III. The Company has, through the Declaration of Trust which established the Trust III, the Common Securities III and Capital Securities III Guarantee Agreements, the Debentures and a related Indenture, taken together, fully, irrevocably and unconditionally guaranteed all of the Trust III's obligations under the Trust Securities III.

10. Income Taxes

Allocation of federal and state income taxes between current and deferred portions is as follows:

	2019	2018
Current tax provision		
Federal	$ 1,717,000	$ 1,704,000
State	157,000	142,000
	1,874,000	1,846,000
Deferred federal tax benefit	(38,000)	(69,000)
	$ 1,836,000	$ 1,777,000

The income tax provision (benefit) differs from the expense that would result from applying federal statutory rates to income before income taxes, as follows:

	2019	2018
Computed tax expense	$ 2,099,000	$ 1,884,000
Increase (reduction) in income taxes resulting from:		
Tax exempt interest	(105,000)	(101,000)
State taxes, net of federal benefit	124,000	112,000
Income from life insurance	(67,000)	(67,000)
Preferred stock dividends	(2,000)	(2,000)
Tax credits	(278,000)	(55,000)
Fair value adjustment of unearned ESOP shares	21,000	7,000
Other	44,000	(1,000)
	$ 1,836,000	$ 1,777,000

Items which give rise to deferred income tax assets and liabilities are as follows:

	2019	2018
Deferred tax assets		
Other-than-temporary impairment of investment securities	$ 47,000	$ 46,000
Allowance for loan losses	1,321,000	1,230,000
Employee benefit plans	607,000	556,000
Net unrealized loss on other investments	4,000	–
Net unrealized loss on securities available-for-sale	–	334,000
Other	23,000	39,000
	2,002,000	2,205,000

	2019	2018
Deferred tax liabilities		
Depreciation	417,000	373,000
Amortization of goodwill	1,101,000	1,070,000
Amortization of interest rate cap premium	–	13,000
Prepaid expenses	117,000	110,000
Net unrealized gain on derivative instruments	112,000	68,000
Investment in pass-through entities	6,000	–
Net unrealized gain on securities available-for-sale	176,000	–
	1,929,000	1,634,000
Net deferred tax asset	$ 73,000	$ 571,000

10. Income Taxes (cont.)

No valuation allowance is deemed necessary for the deferred income tax asset. The net deferred income tax asset is included in other assets in the consolidated balance sheets.

11. Earnings Per Share

The following sets forth the computation of basic and diluted earnings per common share for 2019 and 2018:

	2019	2018
Net income available to common shareholders, as reported	$ 7,685,000	$ 6,322,000
Weighted-average common shares outstanding	3,326,912	3,345,012
Effect of possible sources of options or conversions	–	–
Diluted weighted-average common shares	3,326,912	3,345,012
Basic earnings per common share	$ 2.31	$ 1.89
Diluted earnings per common share	$ 2.31	$ 1.89

12. Financial Instruments with Off-Balance-Sheet Risk

The Company is a party to credit related financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and commercial letters-of-credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets.

The Company's exposure to credit loss is represented by the contractual amount of these commitments. The Company follows the same credit policies in making commitments as it does for on-balance-sheet instruments. The contractual or notional amounts of financial instruments reflect the extent of involvement the Company has in particular classes of financial instruments. See Note 24 for further discussion of derivative financial instruments.

At December 31, 2019 and 2018, the contractual amounts of the Company’s financial instruments were as follows:

	Contract Amount	
	2019	2018
Lending-related instruments:		
Home equity lines-of-credit	$ 23,935,000	$ 22,728,000
Other lines-of-credit	65,112,000	56,920,000
Credit card arrangements	3,114,000	2,846,000
Letters-of-credit	2,221,000	2,505,000
Derivative financial instruments:		
Notional amounts of interest rate swaps	193,442,000	117,980,000
Notional amounts of interest rate caps	–	25,000,000

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments for lines-of-credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements.

Unfunded commitments under commercial lines-of-credit, revolving credit lines, and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines-of-credit are uncollateralized, usually do not contain a specified maturity date, and may not be drawn upon to the total extent to which the Company is committed.

Commercial letters-of-credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those letters-of-credit are primarily issued to support public and private borrowing arrangements. Substantially all letters-of-credit issued have expiration dates within one year. The credit risk involved in issuing letters-of-credit is essentially the same as that involved in extending loan facilities to customers. The Company generally holds collateral supporting those commitments if deemed necessary.

To reduce credit risk related to the use of credit related financial instruments, the Company might deem it necessary to obtain collateral. The amount and nature of the collateral obtained is based on the Company's credit evaluation of the customer. Collateral held varies but may include cash, securities, accounts receivable, inventory, property, plant and equipment, and real estate.

13. Significant Group Concentrations of Credit Risk

A large portion of the Company's loan portfolio consists of single family residential loans and commercial real estate loans in Maine. The local economy depends heavily on Maine industries including the agricultural and forest industries, which are subject to annual variations. Accordingly, the collectability of a substantial portion of the Company's loan portfolio is dependent on the health of Maine’s economy.

The Company's policy for requiring collateral is to obtain security in excess of the amount borrowed. The amount of collateral obtained is based on management's credit evaluation of the borrower. The Company requires appraisals of real property held as collateral. For consumer loans, the Company will accept security which has a title certificate. Collateral held for commercial loans may include accounts receivable, inventory, property and equipment, and income producing properties. The contract or notional amounts of these instruments reflect the extent of the Company's involvement in particular classes of financial instruments.

The contractual amount of credit-related financial instruments such as commitments to extend credit and letters-of-credit represents the amount of potential accounting loss should the contract be fully drawn upon, the customer default, and the value of any existing collateral become worthless.

14. Legal Contingencies

Various legal claims arise from time-to-time in the normal course of business which, in the opinion of management, will have no material effect on the Company’s consolidated financial statements.

15. Minimum Regulatory Capital Requirements

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Effective January 1, 2015, the Bank implemented the Basel III regulatory framework. These new rules and framework revised minimum capital requirements and adjusted prompt corrective action thresholds. Under the Basel III regulatory framework, the quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital and common equity Tier 1 (as defined in the regulations) to risk weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined). Effective in 2015, the Company is considered a Small Bank Holding Company and therefore not subject to the Basel III capital rules. Regulatory capital requirements limit a banking organization’s capital distributions and certain discretionary bonus payments if the banking organization does not hold a “capital conservation buffer” consisting of 2.5% above its minimum risk-based capital requirements. The capital conservation buffer requirement was phased in from January 1, 2016 through January 1, 2019, when the full capital conservation buffer requirement was effective. As of December 31, 2019, the Bank had a capital conservation buffer of 5.8% of risk-weighted assets, which was in excess of the phased-in regulatory requirement of 2.5%. As of December 31, 2018, the Bank had a capital conservation buffer of 5.40% of risk-weighted assets, which was in excess of the phased-in regulatory requirement of 1.875%. Management believes, as of December 31, 2019 and 2018, that the Bank met all capital adequacy requirements to which they are subject.

As of December 31, 2019, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based, common equity Tier 1, and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since the notification that management believes have changed the Bank's category. The Bank's actual capital amounts and ratios as of December 31, 2019 and 2018 are also presented in the table.

15. Minimum Regulatory Capital Requirements (cont.)

As of December 31, 2019	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital to Risk-Weighted Assets						
Bank	$ 86,788,000	13.8%	$ 50,493,000	8.0%	$ 63,117,000	10.0%
Tier 1 Capital to Risk-Weighted Assets						
Bank	80,462,000	12.7	37,870,000	6.0	50,493,000	8.0
Common Equity Tier 1 Capital to Risk-Weighted Assets						
Bank	80,462,000	12.7	28,402,000	4.5	41,026,000	6.5
Tier 1 Capital to Average Assets						
Bank	80,462,000	9.6	33,361,000	4.0	41,701,000	5.0
As of December 31, 2018						
Total Capital to Risk-Weighted Assets						
Bank	$ 80,498,000	13.4%	$ 48,065,000	8.0%	$ 60,082,000	10.0%
Tier 1 Capital to Risk-Weighted Assets						
Bank	74,609,000	12.4	36,049,000	6.0	48,065,000	8.0
Common Equity Tier 1 Capital to Risk-Weighted Assets						
Bank	74,609,000	12.4	27,037,000	4.5	39,053,000	6.5
Tier 1 Capital to Average Assets						
Bank	74,609,000	9.4	31,694,000	4.0	39,617,000	5.0

16. Employee Benefit Plans

The Company has a safe harbor 401(k) plan whereby substantially all employees participate in the plan. Employees may contribute a portion of their compensation subject to certain limits based on federal tax laws. The Company makes safe harbor matching contributions equal to 100% of the first 3% of an employee's compensation plus 50% of the next 2% of an employee's compensation in addition to a discretionary contribution. For the years ended December 31, 2019 and 2018, expense attributable to the plan amounted to $367,000 and $355,000, respectively.

The Company has established a nonqualified supplemental executive retirement plan for the benefit of key employees. The amount of each benefit is guaranteed contingent upon employee vesting schedules. As of December 31, 2019 and 2018, the accrued liability of the plan was $2,890,000 and $2,662,000, respectively, and is recorded in accrued expenses and other liabilities. The present value of these benefits is expensed over the employment service period. The benefit expense amounted to $292,000 and $326,000 for 2019 and 2018, respectively. Life insurance policies were acquired for the purpose of serving as the primary funding source. The cash value of these policies was $12,387,000 and $12,069,000 at December 31, 2019 and 2018, respectively, and is included in other assets.

During the years ended December 31, 2019 and 2018, retainer fees were paid consisting of $13,000 for regular directors, $15,000 for the vice chairman, and $16,000 for the chairman. Additionally, during the year ended December 31, 2018, outside directors of the Bank received $700 for each Board meeting attended, and for each subcommittee meeting attended. Effective January 1, 2020, these per-meeting fees were increased to $1,000 for Board and Committee chairs and $800 for all other directors.

Certain directors are eligible to participate in the Bank's health insurance plan. Directors are reimbursed for mileage expense or other similar expenses.

In 2019, the Board of Directors implemented a director stock ownership requirement of 3 times the annual retainer of regular directors. Current and future directors will have 3 years to meet the minimum ownership requirement from the later of January 1, 2020 or from the beginning of service on the Board. The Company has a policy established for which 75% of directors' fees will be issued in Company stock until the ownership level is achieved. The number of shares issued under this policy shall be determined by end of day Over-The-Counter Markets stock price on February 15 for fees payable in the preceding January and August 15 for fees payable in the preceding July.

17. Restricted Stock Plan

The Company established a restricted stock plan during 2010 with 100,000 shares currently authorized by the Board of Directors for the compensation committee of the Board to administer. The holders of restricted stock shall have all the rights of a shareholder, including, but not limited to, the right to vote such shares and the right to receive all cash dividends and other distributions paid thereon. The compensation committee did not grant restricted stock during 2019 or 2018. A total of 11,897 shares have been issued under the restricted stock plan since inception, all of which are vested.

18. Other Noninterest Expenses

The components of other noninterest expenses which are in excess of 1% of total revenues (total interest and dividend income and noninterest income) and not shown separately in the consolidated statements of income are as follows for the years ended December 31:

	2019	2018
Other noninterest income		
Interchange and ATM fees	$ 1,212,000	$ 1,215,000
Other noninterest expenses		
Legal, audit, examination and consulting	623,000	593,000
Account servicing	554,000	517,000

19. Related Party Transactions

In the ordinary course of business, the Company has granted loans to principal officers and directors and their affiliates amounting to $15,137,000 and $18,989,000 at December 31, 2019 and 2018, respectively. Deposits from related parties held by the Company at December 31, 2019 and 2018 amounted to $8,437,000 and $6,894,000, respectively.

20. Employee Stock Ownership Plan

All Bank employees meeting certain age and service requirements are eligible to participate in the ESOP.

The Bank's ESOP purchased shares of Katahdin Bankshares Corp. common stock that include outstanding debt as follows:

Date	Shares	Net Price Per Share	Original Debt	Principal Balance Dec. 31, 2019
October 2016	25,500	$ 11.25	$ 287,000	$ 5,000

The October 2016 loan is from Katahdin Bankshares Corp. and is repayable annually with an interest rate of 2.55% for the term of 4 years.

Date	Shares	Net Price Per Share	Original Debt	Principal Balance Dec. 31, 2019
September 2017	27,000	$ 13.99	$ 371,000	$ 371,000

The September 2017 loan is from Katahdin Bankshares Corp. and is repayable annually with an interest rate of 3.30% for a term of 6 years and 3 months. The loan is interest only through 2020.

Date	Shares	Net Price Per Share	Original Debt	Principal Balance Dec. 31, 2019
June 2018	32,300	$ 16.38	$ 529,000	$ 463,000

The June 2018 loan is from Katahdin Bankshares Corp. and is repayable annually with an interest rate of 5.0% for a term of 9 years and 6 months.

The loans are secured by the shares purchased by the ESOP. Participants' benefits become fully vested after five years of service. The Bank's contributions are the primary source of funds for the ESOP's repayment of the loans. Principal and interest payments for the years ended December 31, 2019 and 2018 totaled $178,000 and $140,000, respectively. ESOP expense was $237,000 and $141,000 for the years ended December 31, 2019 and 2018, respectively.

20. Employee Stock Ownership Plan (cont.)

As of December 31, 2019, the remaining principal balance of the loans are scheduled to be paid as follows:

2020	$ 142,000
2021	143,000
2022	148,000
2023	152,000
2024	59,000
2025 and after	195,000
	$ 839,000

Shares held by the ESOP include the following at December 31:

	2019	2018
Allocated	32,263	20,166
Unallocated	52,537	64,634
	84,800	84,800

The fair value of the unallocated shares as of December 31, 2019 and 2018 was approximately $1,073,000 and $1,058,000, respectively.

21. Fair Value

GAAP defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. GAAP also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon model-based techniques incorporating various assumptions including interest rates, prepayment speeds, and credit losses. Assets and liabilities valued using model-based techniques are classified as either Level 2 or Level 3, depending on the lowest level classification of an input that is considered significant to the overall valuation. A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

Securities available-for-sale: Fair values for securities available-for-sale are determined by obtaining quoted prices on nationally recognized securities exchanges or matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities, but rather by relying on the securities' relationship to other benchmark quoted securities. The fair values of securities available-for-sale are classified as Level 2, except for the fair value of other securities which are classified as Level 1 using quoted market prices.

Derivatives: Derivatives are reported at fair value utilizing Level 2 inputs obtained from third parties to value interest rate caps and swaps.

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

	Fair Value Measurements at December 31, 2019 and 2018, Using			
December 31, 2019	Total	Quoted Prices In Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Securities available-for-sale				
U.S. Treasury securities	$ 999,000	$ –	$ 999,000	$ –
State and municipal	8,869,000	–	8,869,000	–
Corporate bonds	1,940,000	–	1,940,000	–
Mortgage-backed and CMO's	88,568,000	–	88,568,000	–
Total securities available-for-sale	100,376,000	–	100,376,000	–
Other investments	481,000	481,000	–	–
Derivative instruments	2,631,000	–	2,631,000	–
Total assets	$ 103,488,000	$ 481,000	$ 103,007,000	$ –
Liabilities				
Derivative instruments	$ 2,100,000	$ –	$ 2,100,000	$ –

December 31, 2018	Total	Quoted Prices In Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Securities available-for-sale				
U.S. Treasury securities	$ 1,973,000	$ –	$ 1,973,000	$ –
State and municipal	10,613,000	–	10,613,000	–
Corporate bonds	1,933,000	–	1,933,000	–
Mortgage-backed and CMO's	78,214,000	–	78,214,000	–
Other investments	415,000	415,000	–	–
Total securities available-for-sale	93,148,000	415,000	92,733,000	–
Derivative instruments	2,543,000	–	2,543,000	–
Total assets	$ 95,691,000	$ 415,000	$ 95,276,000	$ –
Liabilities				
Derivative instruments	$ 2,016,000	$ –	$ 2,016,000	$ –

Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis

Impaired loans: A loan is considered to be impaired when it is probable that all of the principal and interest due under the original underwriting terms of the loan may not be collected. Impairment is measured based on the fair value of the underlying collateral or the present value of future cash flows. The Company measures impairment on all nonaccrual loans for which it has established specific reserves as part of the specific allocated allowance component of the allowance for loan losses. The fair values of impaired loans are classified as Level 2.

Other real estate and property owned: Real estate acquired through foreclosure is recorded at fair value. The fair value of other real estate and property owned is based on property appraisals and an analysis of similar properties currently available. The fair values of other real estate and property owned are classified as Level 2.

Assets and liabilities measured at fair value on a nonrecurring basis are summarized below:

	Fair Value Measurements at December 31, 2019 and 2018, Using			
December 31, 2019	Total	Quoted Prices In Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Impaired loans (market approach)	$ 1,518,000	$ -	$ 1,518,000	$ -
Other real estate and property owned (market approach)	106,000	-	106,000	-
December 31, 2018				
Assets				
Impaired loans (market approach)	$ 1,239,000	$ -	$ 1,239,000	$ -
Other real estate and property owned (market approach)	41,000	-	41,000	-

Certain impaired loans were written down to their value of $1,518,000 and $1,239,000 at December 31, 2019 and 2018, respectively, resulting in an impairment charge through the allowance for loan losses.

Fair Value of Financial Instruments

GAAP requires disclosures of fair value information about financial instruments, whether or not recognized in the balance sheet, if the fair values can be reasonably determined. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial

21. Fair Value (cont.)

instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques using observable inputs when available. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. Certain financial instruments and all nonfinancial instruments are excluded from the disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company.

This summary excludes financial assets and liabilities for which carrying value approximates fair values and financial instruments that are recorded at fair value on a recurring basis. Financial instruments for which carrying values approximate fair value include cash equivalents, interest bearing deposits in banks, junior subordinated debentures, demand, savings, NOW and money market deposits. The estimated fair value of demand, savings, NOW and money market deposits is the amount payable on demand at the reporting date. Carrying value is used because the accounts have no stated maturity and the customer has the ability to withdraw funds immediately.

The following methods and assumptions were used by the Company in estimating fair value disclosures for financial instruments:

Securities held-to-maturity: Fair values for securities held-to-maturity, are determined by obtaining quoted prices on nationally recognized securities exchanges or matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for the specific securities, but rather by relying on the securities' relationship to other benchmark quoted securities.

Loans receivable: For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The fair value of impaired loans is primarily based upon the fair value of the underlying collateral as determined by appraisals of the collateral by third-party appraisers and brokers' opinions by third-party brokers, or the present value of future cash flows. The appraisals and opinions are based upon comparable prices for similar assets in active markets for residential real estate loans, and less active markets for commercial loans.

Time deposits: Fair values for maturity deposits are based on a replacement cost of funds approach, discounted to an 11 district FHLB average advances yield curve for the as of date in conjunction with the other cash flows associated with each account.

Advances from FHLB: The fair values of these borrowings are based on a replacement cost of funds approach. The borrowings are discounted to an 11 district FHLB average advances yield curve for the as of date.

Senior Notes: The fair value of the senior notes is estimated by indicative bid prices generally based upon market pricing observations in the current market.

The estimated fair values, and related carrying amounts, of the Company's financial instruments are as follows:

	Fair Value Measurement at December 31, 2019				
	Carrying Amount	Fair Value	Quoted Prices In Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial assets					
Securities held-to-maturity	$ 6,000	$ 6,000	$ –	$ 6,000	$ –
Loans receivable, net:					
Commercial	179,725,000	179,903,000	–	365,000	179,538,000
Commercial real estate	365,654,000	363,284,000	–	1,059,000	362,225,000
Residential real estate	141,211,000	137,879,000	–	57,000	137,822,000
Consumer	8,133,000	7,977,000	–	37,000	7,940,000
Loan receivable, net	694,723,000	689,043,000	–	1,518,000	687,525,000
Financial liabilities					
Certificates of deposit	200,601,000	199,137,000	–	199,137,000	–
Advances from FHLB	37,986,000	38,184,000	–	38,184,000	–
Senior Notes	14,020,000	14,790,000	–	14,790,000	–

	Fair Value Measurement at December 31, 2018				
	Carrying Amount	Fair Value	Quoted Prices In Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial assets					
Securities held-to-maturity	$ 7,000	$ 7,000	$ –	$ 7,000	$ –
Loans receivable, net:					
Commercial	166,486,000	166,343,000	–	409,000	165,934,000
Commercial real estate	339,798,000	333,059,000	–	615,000	332,444,000
Residential real estate	138,424,000	132,831,000	–	193,000	132,638,000
Consumer	9,911,000	9,865,000	–	22,000	9,843,000
Loan receivable, net	654,619,000	642,098,000	–	1,239,000	640,859,000
Financial liabilities					
Certificates of deposit	185,142,000	176,200,000	–	176,200,000	–
Advances from FHLB	58,801,000	58,185,000	–	58,185,000	–

22. Senior Notes

On June 13, 2019, the Company entered into a Senior Note Purchase Agreement (the Agreement) by and among the Company and several purchasers of Senior Notes (collectively, the Purchasers), pursuant to which the Company agreed to sell to the Purchasers, severally and not jointly, $14,500,000 in aggregate principal Senior Notes. Debt issuance costs of $521,000 were incurred in conjunction with the issuance of the Senior Notes which are being amortized over 84 months. Amortization expense was $41,000 for the year ended December 31, 2019.

The Senior Notes bear interest at 5.375% per annum and will mature on June 15, 2026, unless earlier made payable in accordance with the terms of the Agreement. Interest on the Senior Notes is payable semi-annually in arrears on each annual and semi-annual anniversary of the date of the Senior Notes. The Company used the proceeds to redeem preferred stock and for general corporate purposes. The obligations under the Agreement are unsecured and not covered by a guarantee of the Company, the Bank or any affiliate of the Company or the Bank.

23. Preferred Stock

The Company has authorized the issuance of up to 20,000 shares of preferred stock at any one time. On June 27, 2014, the Company issued 4,000 shares of Floating Rate Non-Cumulative Perpetual Preferred Stock, Series D (Series D Shares) at an issuance price of $2,500 per share. The net proceeds from the issuance totaled $9,603,000. Dividends on Series D Shares were set quarterly at a floating rate of 3-month LIBOR plus 4.25%, with a floor of 8.75% and were payable quarterly in arrears on January 15, April 15, July 15, and October 15 of each year.

Series D Shares qualify as Tier 1 capital on the Company's books for regulatory purposes and rank senior to the Company's common stock and senior or at an equal level in the Company's capital structure to any other shares of preferred stock the Company may issue in the future. The dividend rights have priority over all common stock dividends, and thus the dividends on the preferred stock need to be paid before the Company can pay dividends on the common stock.

The terms of the Series D Shares issuance provided the Company the option to elect to redeem the Series D Shares, in whole or in part, from time to time, on or after the five year anniversary of the issuance, at a redemption price of $2,500 per share.

On June 13, 2019, the Company provided notice to each holder of Series D Shares that the Company elected to redeem, on July 15, 2019 (the Redemption Date), all 4,000 outstanding Series D Shares at an aggregate redemption price of $10,000,000 plus accrued dividends of $255,208. From and after the Redemption Date, no Series D Shares were treated as outstanding, no further dividends were accrued or declared and all other rights with respect to the Series D Shares were terminated.

24. Interest Rate Swaps and Caps

The Company uses derivative instruments as partial hedges against large fluctuations in interest rates. At least quarterly, all financial instruments are reviewed as part of the asset/liability management process. The financial instruments are factored into the Company's overall interest rate risk position. The Company regularly reviews the credit quality of the counterparty from which the instruments have been purchased. The Company uses derivative financial instruments for risk management purposes and not for trading or speculative purposes. The Company controls the credit risk of these instruments through

December 31, 2019 and 2018

24. Interest Rate Swaps and Caps (cont.)

collateral, credit approvals, and monitoring procedures. The derivative instruments contain provisions that require the Company to post collateral with the counterparty for its contracts that are in a net loss positon based on their fair value and the Company's credit rating. At December 31, 2019 and 2018, the Company had posted $2,400,000 and $3,000,000, respectively, in cash collateral for the benefit of the counterparty.

The following table presents the details of the interest rate swap agreements:

Party	Notional Amount	Effective Date	Maturity Date	Variable Index Received	Fixed Rate Paid	Fair Value as of Dec. 31, 2019	Fair Value as of Dec. 31, 2018
Bank	$15,000,000	July 1, 2016	June 30, 2020	1-Month USD LIBOR	0.855%	$60,000	$372,000
Bank	$25,000,000	Sept. 9, 2019	Sept. 9, 2026	1-Month USD LIBOR	1.360%	$471,000	–

As these instruments qualify as highly effective cash flow hedges, changes in fair value are recorded in other comprehensive income (loss), net of tax.

The following presents the details of interest rate protection agreements (caps):

Party	Notional Amount	Up Front Premiums Paid	Termination Date	Floating Rate Option	Strike Rate	Fair Value as of Dec. 31, 2019	Fair Value as of Dec. 31, 2018
Bank	$25,000,000	$ 1,998,000	April 4, 2019	3-Month USD LIBOR	0.23%	–	$ 155,000

The caps were acquired to limit the Company's exposure to interest rates. The up-front premiums are being amortizing based on the expense amortization schedules established at the inception of the hedges, with the corresponding adjustment to the income statement. At inception, the hedging relationships were expected to be 100% effective in achieving offsetting cash flows attributable to the hedged risk during the term of the hedges. As these instruments qualify as highly effective cash flow hedges, the change in fair value is recorded in other comprehensive income (loss), net of tax.

The Bank enters into interest rate swap agreements executed with commercial banking customers to facilitate customers' risk management strategies. In addition to the swap agreement with the borrower, the Bank enters into a second "back-to-back" swap agreement with a third party; the general terms of the swap mirror those of the first swap agreement. In entering into this transaction, the Bank has offset its interest rate risk exposure to the swap agreement with the borrower. All interest rate swaps are valued at observable market prices for similar instruments or valued using observable market interest rates.

The following table presents summary information regarding the fair value of customer related interest rate swaps, which are included in other assets (liabilities) as of December 31:

	2019 Asset (Liability)	2018 Asset (Liability)
Swaps receive fixed	$ 2,100,000	$ 2,016,000
Swaps pay fixed	(2,100,000)	(2,016,000)
Net customer related swaps	$ –	$ –

The outstanding notional amounts of interest rate swaps entered into on behalf of customers at December 31 were as follows:

	2019	2018
Swaps receive fixed	$ 76,721,000	$ 51,490,000
Swaps pay fixed	(76,721,000)	(51,490,000)

25. Subsequent Events

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about the conditions that existed at the balance sheet date, including the estimates inherent in the process of preparing financial statements. Nonrecognized subsequent events are events that provide evidence about conditions that did not exist at the balance sheet date, but arose after that date. Management has evaluated subsequent events occurring through January 30, 2020, the date the financial statements were available to be issued.

SHAREHOLDER INFORMATION

ANNUAL MEETING

The Annual Shareholders' Meeting will be held in the Katahdin Trust Company Room at The Center for Community Health Education at Houlton Regional Hospital, Houlton, Maine on Monday, May 4, 2020 at 10:30 a.m.

SHAREHOLDER RELATIONS

Katahdin Bankshares Corp. and Katahdin Trust Company welcome shareholder and public interest in our services and activities. Questions or comments pertaining to this report and requests for other information should be directed to:

Matthew M. Nightingale
Executive Vice President, Treasurer & CFO
PO Box 36 | Houlton, ME 04730
(207) 521-3200
m.nightingale@katahdintrust.com

STOCK

Katahdin Bankshares Corp. stock is quoted on the OTC Markets quote board OTCQX under the symbol KTHN. Current stock information can be found at otcmarkets.com/stock/KTHN/quote.

BEST 50 OTCQX 2020

TRANSFER AGENT

For shareholder inquiries regarding change of address or title, please contact:

Computershare Trust Company, N.A .
PO Box 30170 | College Station, TX 77842-3170
1-800-368-5948 (U.S. or Canada)
1-781-575-4223 (outside the U.S. or Canada)
computershare.com/investor

DIRECT STOCK PURCHASE AND DIVIDEND REINVESTMENT PLAN

Katahdin's transfer agent, Computershare Trust Company, N.A. ("Computershare"), sponsors and administers the Computershare Investment Plan (CIP) for Katahdin Bankshares Corp. Common Stock. This plan offers direct stock purchase and dividend reinvestment options and is available to current Katahdin Bankshares Corp. shareholders as well as new investors. For more information, you may contact Computershare.

LOCATIONS

NORTHERN MAINE | GREATER BANGOR | GREATER PORTLAND

Ashland
17 Main Street
435-6461

Bangor
609 Broadway
942-3146

Bangor
52 Springer Drive
947-9674

Caribou
105 Bennett Drive
498-4200

Eagle Lake
3440 Aroostook Road
444-5543

Fort Fairfield
290 Main Street
472-3161

Fort Kent
79 West Main Street
834-2348

Hampden
57 Western Avenue
862-2211

Houlton
65 North Street
532-4277

Island Falls
1007 Crystal Road
463-2228

Mars Hill
28 Main Street
429-8400

Oakfield
200 Oakfield Smyrna Road
757-8288

Patten
11 Main Street
528-2211

Presque Isle
6 North Street
764-8000

Scarborough
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