BAR HARBOR BANKSHARES
Form 10-K
March 13, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K
ý ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2017
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number: 001-13349
BAR HARBOR BANKSHARES
(Exact name of registrant as specified in its charter)

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

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

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

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

Securities registered pursuant to section 12(g) of the Act: None
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No ý
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No ý
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No o
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definition of “large accelerated filer,” “accelerated filer”, “smaller reporting company”, or "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one)
Large Accelerated Filer o Accelerated Filer ý Non-Accelerated Filer o Smaller Reporting Company o
Emerging growth company o
If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)
Yes o No ý
The aggregate market value of the common stock held by non-affiliates of Bar Harbor Bankshares was $463,788,390 based on the closing sale price of the common stock on the NYSE American on June 30, 2017, the last trading day of the registrant’s most recently completed second quarter.
The Registrant had 15,446,987 shares of common stock, par value $2.00 per share, outstanding as of March 4, 2018.
DOCUMENTS INCORPORATED BY REFERENCE
Portions of the definitive Proxy Statement for the Annual Meeting of Stockholders to be held on May 15, 2018 are incorporated by reference into Part III, Items 10-14 of this Annual Report on Form 10-K.

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PART I

ITEM 1. BUSINESS

FORWARD-LOOKING STATEMENTS

Certain statements contained in this Annual Report on Form 10-K that are not historical facts may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (referred to as the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (referred to as the Securities Exchange Act), and are intended to be covered by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. You can identify these statements from the use of the words "may," "will," "should," "could," "would," "plan," "potential," "estimate," "project," "believe," "intend," "anticipate," "expect," "target" and similar expressions forward-looking statements are subject to significant risks, assumptions and uncertainties, including among other things, changes in general economic and business conditions, increased competitive pressures, changes in the interest rate environment, legislative and regulatory change, changes in the financial markets, and other risks and uncertainties disclosed from time to time in documents that Bar Harbor Bankshares files with the Securities and Exchange Commission. All risk factors set forth in Item 1A of this Annual Report on Form 10-K should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Bar Harbor Bankshares does not intend or assume any obligation to update or revise any forward-looking statements except as may be required by law.

GENERAL

Throughout this Annual Report on Form 10-K, Bar Harbor Bankshares is referred to as "BHB", "the Company", "we", "our", or "us." The Company was established in 1887 and is the parent company of Bar Harbor Bank & Trust ("the Bank"), which is the only community Bank headquartered in Northern New England with branches in Maine, New Hampshire and Vermont. The Bank is a true community bank providing exceptional commercial, retail and wealth management banking services through a network of 47 full-service branches.

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

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

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The following presents the Company’s geographical footprint:

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

The following is a summary of the regions that the Bank primarily serves:

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

New Hampshire
The Bank operates 20 full-service branches and two stand-alone drive-up windows in New Hampshire. There are several distinct markets within this region. The first market is centered in Nashua, New Hampshire, which is a regional commercial, entertainment and dining destination. Bordering Massachusetts, Nashua enjoys a vibrant high-tech industry and a robust retail industry due in part to the state's absence of a sales tax. The west-central area of New Hampshire includes the towns of Lebanon and Hanover, which are home to Dartmouth-Hitchcock Medical Center and Dartmouth College, respectively. The Lake Sunapee market is a popular year-round recreation and resort area that includes both Lake Sunapee and Mount Sunapee.

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Vermont

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

COMPANY WEBSITE AND AVAILABILITY OF SECURITIES AND EXCHANGE COMMISSION FILINGS

Information regarding the Company is available on the Investor Relations tab at bhbt.com. The Company’s annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports filed pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available free of charge at sec.gov and at bhbt.com under the Investor Relations tab. Information on the website is not incorporated by reference and is not a part of this annual report on Form 10-K.

COMPETITION

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

The Company has generally been able to compete effectively with other financial institutions by emphasizing quality customer service, making decisions at the local level, maintaining long-term customer relationships, building customer loyalty, and providing products and services designed to address the specific needs of customers; however, no assurance can be given that the Company will continue to be able to compete effectively with other financial institutions in the future.

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

LENDING ACTIVITIES

General

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

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Loan Portfolio Analysis. The following table sets forth the year-end composition of the Bank's loan portfolio in dollar amounts and as a percentage of the portfolio for the five years indicated. Further information about the composition of the loan portfolio is contained in Note 4 - Loans of the Consolidated Financial Statements.

(in thousands, except percentages)	2017 Amount	Percent of Total	2016 Amount	Percent of Total	2015 Amount	Percent of Total	2014 Amount	Percent of Total	2013 Amount	Percent of Total
Commercial real estate	$826,746	34 %	$418,119	37 %	$396,032	40 %	$351,354	38 %	$354,398	41 %
Commercial and industrial	379,423	15	151,240	13	126,158	13	121,057	13	117,256	14
Total commercial	1,206,169	49	569,359	50	522,190	53	472,411	51	471,654	55
Residential	1,155,682	46	506,612	45	408,401	41	382,678	42	317,115	37
Consumer	123,762	5	53,093	5	59,479	6	63,935	7	64,088	8
Total loans	2,485,613	100 %	1,129,064	100 %	990,070	100 %	919,024	100 %	852,857	100 %
Allowance for loan losses	(12,325)		(10,419)		(9,439)		(8,969)		(8,475)	
Net loans	$2,473,288		$1,118,645		$980,631		$910,055		$844,382	

Commercial Real Estate

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

Commercial and Industrial Loans

Commercial and industrial loans are made to finance operations, provide working capital, finance the purchase of fixed assets, equipment or real property and business acquisitions. A borrower's cash flow from operations is generally the primary source of repayment. Accordingly, the Company's policies provide specific guidelines regarding debt service coverage and other financial ratios. Commercial and industrial loans include lines of credit, commercial term loans and owner-occupied commercial real estate loans. Commercial lines of credit are extended to businesses generally to finance operations and working capital needs. Commercial term loans are typically made to finance the acquisition of fixed assets, refinance short-term debt originally used to purchase fixed assets or make business acquisitions. Commercial and industrial loans are extended based on the financial strength and integrity of the borrower and guarantor(s) and are generally collateralized by the borrower's assets such as accounts receivable, inventory, equipment or real estate, typically with a term based on the collateral of 1-10 years. The interest rates on these loans generally are adjustable and usually are indexed to The Wall Street Journal's prime rate (Prime Rate) or London Interbank Offered Rate (LIBOR), the spread over which will vary based on market conditions and perceived credit risk.

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

Commercial and industrial loans also attract multifaceted relationships, which include deposit and treasury management services.

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

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

HELOCs have a 10 or 15 year draw period followed by 2 year amortization and require either interest-only payments during the draw period or the payment of 1.0 percent or 1.5 percent of the outstanding loan balance per month (depending on the terms). Following receipt of payments, the available credit includes amounts repaid up to the credit limit. HELOCs with a ten year draw period have a balloon payment due at the end of the draw period and then amortize for the remaining term. For loans with shorter-term draw periods, once the draw period has lapsed, generally the payment is fixed based on the loan balance and prevailing market interest rates at that time.

Maturity and Sensitivity of Loan Portfolio
The following table shows contractual final maturities of selected loan categories at December 31, 2017. The contractual maturities do not reflect premiums, discounts, deferred costs, or prepayments.

(in thousands)	1 Year or Less	1 to 5 Years	More than 5 Years	Total
Commercial real estate	$16,404	$100,097	$710,245	$826,746
Commercial and industrial	24,842	120,961	233,620	379,423
Total Commercial	41,246	221,058	943,865	1,206,169
Residential	376	23,501	1,131,805	1,155,682
Consumer	9,591	31,925	82,246	123,762
Total	$51,213	$276,484	$2,157,916	$2,485,613

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

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The following table presents the problem assets and accruing TDRs for the five years indicated:

(in thousands)	2017	2016	2015	2014	2013
Non-accruing loans:					
Commercial real estate	$8,343	$2,564	$2,390	$4,484	$3,959
Commercial and industrial	1,209	315	308	708	849
Residential	4,266	3,419	3,452	6,051	3,227
Consumer	500	198	830	1,045	805
Total non-performing loans	14,318	6,496	6,980	12,288	8,840
Real estate owned	122	90	256	523	1,625
Total non-performing assets	$14,440	$6,586	$7,236	$12,811	$10,465
Troubled debt restructurings (accruing)	$1,046	$2,713	$2,336	$1,092	$1,038
Accruing loans 90+ days past due	510	—	28	—	—
Total non-performing loans/total loans	0.58 %	0.58 %	0.71 %	1.34 %	1.04 %
Total non-performing assets/total assets	0.41	0.38	0.46	0.88	0.76

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Allowance for Loan Losses

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

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

(in thousands, except ratios)	2017	2016	2015	2014	2013
Balance at beginning of year	$10,419	$9,439	$8,969	$8,475	$8,097
Charged-off loans:					
Commercial real estate	275	133	667	238	214
Commercial and industrial	207	90	395	489	486
Residential	255	141	70	650	406
Consumer	289	47	487	243	149
Total charged-off loans	1,026	411	1,619	1,620	1,255
Recoveries on charged-off loans:					
Commercial real estate	50	40	98	85	105
Commercial and industrial	11	289	54	146	60
Residential	65	44	129	12	7
Consumer	18	39	23	38	43
Total recoveries on charged-off loans	144	412	304	281	215
Net charged-off	882	(1)	1,315	1,339	1,040
Provision for loan losses	2,788	979	1,785	1,833	1,418
Balance at end of year	$12,325	$10,419	$9,439	$8,969	$8,475
Ratios:					
Net charge-offs/average loans	0.04 %	— %	0.14 %	0.15 %	0.12 %
Recoveries/charged-off loans	14.04	100.24	18.78	17.35	17.13
Net loans charged-off/allowance for loan losses	7.16	(0.01)	13.93	14.93	12.27
Allowance for loan losses/total loans	0.50	0.92	0.95	0.98	0.99
Allowance for loan losses/non-accruing loans	86.08	160.39	135.23	72.99	95.87

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

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The following table presents the allocation of allowance for loan loss by category for the five years indicated:

(in thousands)	2017			2016			2015			2014			2013		
	Amount Allocated	Percent Allocated to Total Loans In Each Category		Amount Allocated	Percent Allocated to Total Loans In Each Category		Amount Allocated	Percent Allocated to Total Loans In Each Category		Amount Allocated	Percent Allocated to Total Loans In Each Category		Amount Allocated	Percent Allocated to Total Loans In Each Category	
Commercial real estate	$6,134	0.74	%	$5,145	1.23	%	$4,430	1.12	%	$4,613	1.31	%	$5,139	1.45	%
Commercial and industrial	2,389	0.63		1,952	1.29		1,590	1.26		1,277	1.05		1,769	1.75	
Residential	3,416	0.30		2,721	0.54		2,747	0.67		2,714	0.71		1,166	0.37	
Consumer	386	0.31		601	1.13		672	1.13		365	0.57		401	0.50	
Total	$12,325	0.50	%	$10,419	0.92	%	$9,439	0.95	%	$8,969	0.98	%	$8,475	0.99	%

INVESTMENT SECURITIES ACTIVITIES

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

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

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

(in thousands)	2017		2016		2015	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Obligations of US Government sponsored enterprises	$6,967	$6,972	$—	$—	$—	$—
US Government-sponsored enterprises	447,081	443,003	330,635	328,452	304,106	306,993
US Government agency	96,357	95,596	76,722	76,906	78,408	79,130
Private label	529	674	936	1,132	2,713	3,464
Obligations of states and political subdivisions thereof	138,522	140,200	123,832	122,366	110,952	115,382
Corporate bonds	30,527	30,797	—	—	—	—
Total	$719,983	$717,242	$532,125	$528,856	$496,179	$504,969

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The following table presents the amortized cost and weighted average yields of securities at December 31, 2017:

	One Year or Less		One to Five Years		Five to Ten Years		More Than Ten Years		Total	
(in thousands, except ratios)	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield
Obligations of US Government sponsored enterprises	$6,967	1.85 %	$—	— %	$—	— %	$—	— %	$6,967	1.85 %
US Government-sponsored enterprises	647	3.58	2,517	3.17	28,472	2.50	415,445	2.55	447,081	2.55
US Government agency	8	3.47	170	3.11	1,698	3.69	94,481	2.46	96,357	2.48
Private label	8	4.92	23	56.07	5	489.76	493	5.75	529	12.90
Obligations of states and political subdivisions thereof	30	4.60	2,903	3.93	25,231	2.31	110,358	2.98	138,522	2.88
Corporate bonds	—	—	8,724	3.50	21,711	4.81	92	7.14	30,527	4.44
Total	$7,660	2.02 %	$14,337	3.61 %	$77,117	3.15 %	$620,869	2.62 %	$719,983	2.69 %

DEPOSIT ACTIVITIES AND OTHER SOURCES OF FUNDS

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

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

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

	2017			2016			2015		
(in thousands, except ratios)	Average Balance	Percent of Total Average Deposits	Weighted Average Rate	Average Balance	Percent of Total Average Deposits	Weighted Average Rate	Average Balance	Percent of Total Average Deposits	Weighted Average Rate
Demand	$339,303	15 %	— %	$93,757	11 %	— %	$82,741	9 %	— %
NOW	455,064	20	0.25	161,494	16	0.20	149,117	16	0.20
Savings	367,785	17	0.16	72,657	7	0.09	66,736	7	0.09
Money market	300,905	14	0.49	240,325	24	0.40	200,193	22	0.36
Time deposits	760,544	34	1.07	414,347	42	1.29	427,550	46	1.18
Total	$2,223,601	100 %	0.51 %	$982,580	100 %	0.68 %	$926,337	100 %	0.66 %

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The following table presents the scheduled maturities of time deposits $100 thousand or greater at December 31, 2017:

(in thousands, except ratios)	Amount	Weighted Average Rate	
Three months or less	$72,611	0.69	%
Over 3 months through 6 months	17,640	0.64	
Over 6 months through 12 months	51,218	1.27	
Over 12 months	145,021	1.63	
Total	$286,490	1.26	%

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

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

RETAIL BROKERAGE SERVICES

The Bank retains Infinex Investments, Inc., (“Infinex”) as a full-service third-party broker-dealer, conducting business under the assumed business name “Bar Harbor Financial Services.” Bar Harbor Financial Services is a branch office of Infinex, an independent registered broker-dealer offering securities and insurance products that is not affiliated with the Company or its subsidiaries. These products are not deposits, are not insured by the FDIC or any other government agency, are not guaranteed by the Bank or any affiliate, and may be subject to investment risk, including possible loss of value.

Bar Harbor Financial Services principally serves the brokerage needs of individuals, from first-time purchasers, to sophisticated investors. It also offers a line of life insurance, annuity, and retirement products, as well as financial planning services. Infinex was formed by a group of member banks, and is one of the largest providers of third party investment and insurance services to banks and their customers in New England. Through Infinex, the Bank is able to take advantage of the expertise, capabilities, and experience of a well-established third-party broker-dealer in a cost effective manner.

TRUST MANAGEMENT SERVICES

The Bank has two wholly-owned subsidiaries that provide a comprehensive array of trust and investment management services to individuals, businesses, not-for-profit organizations, and municipalities. Bar Harbor Trust Services is a Maine-chartered trust company, and Charter Trust is a New Hampshire-chartered trust company that was obtained through the Lake Sunapee Bank Group acquisition. As a New Hampshire-chartered trust company, Charter Trust is subject to New Hampshire laws applicable to trust companies and fiduciaries. Trust management services include trustee of both living trusts and trusts under wills, including revocable, irrevocable, charitable remainder and testamentary trusts, and in this capacity holds, accounts for and manages financial assets, real estate and special assets. Trust Services offers custody, estate settlement, and fiduciary tax services.

The staff includes credentialed investment and trust professionals with extensive experience. At December 31, 2017 and 2016, trust management services had total assets under management of $1.8 billion and $403 million, respectively.

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PERSONNEL

As of December 31, 2017, the Company had 423 full time equivalent employee positions compared to 186 full time equivalents at December 31, 2016. The majority of the increase is due to the acquisition of Lake Sunapee Bank Group that closed in January 2017. The Company has also augmented the staff with targeted hires to deepen the overall employee skill set. The Company’s employees are not represented by a collective bargaining unit.

SUBSIDIARY ACTIVITIES

The Company wholly owns one consolidated bank subsidiary, which during 2017 operated under two business names: Bar Harbor Bank and Trust, and Lake Sunapee Bank, a division of Bar Harbor Bank & Trust. The Company also owns all the common stock of two Connecticut statutory trusts. These capital trusts are unconsolidated and their only material asset in total is a $20.0 million trust preferred security related to the junior subordinated debentures reported in the Company’s consolidated financial statements.

REGULATION AND SUPERVISION

Bar Harbor Bankshares is a legal entity separate and distinct from its first-tier bank subsidiary, Bar Harbor Bank & Trust and its second-tier subsidiaries, Bar Harbor Trust Services and Charter Trust Company. As a bank holding company, the Company is regulated under the Bank Holding Company Act (“BHC”) and is subject to inspection, examination and supervision by the Board of Governors of the Federal Reserve System, or the Federal Reserve Board. The Company is also under the jurisdiction of the SEC and is subject to the disclosure and regulatory requirements of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended (“Exchange Act”). The Company’s common stock is listed on the NYSE American exchange under the trading symbol “BHB,” and is subject to the rules of NYSE for listed companies.

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

Bank Holding Company Regulations Applicable to the Company

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

Permitted Activities

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

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

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Sound Banking Practices

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

Source of Strength

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

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

Anti-tying Restrictions

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

Mergers & Acquisitions

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

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

Dividends

Dividends from the Bank are the Company's principal source of cash revenues. Our earnings and activities are affected by legislation, by regulations and by local legislative and administrative bodies and decisions of courts in the jurisdictions in which we conduct business. These include limitations on the ability of the Bank to pay dividends to

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the holding company and our ability to pay dividends to our stockholders. It is the policy of the Federal Reserve Board that bank holding companies should pay cash dividends on common stock only out of income available over the past year and only if prospective earnings retention is consistent with the organization’s expected future needs and financial condition. The policy provides that bank holding companies should not maintain a level of cash dividends that undermines the bank holding company’s ability to serve as a source of strength to its banking subsidiary. Consistent with such policy, a banking organization should have comprehensive policies on dividend payments that clearly articulate the organization’s objectives and approaches for maintaining a strong capital position and achieving the objectives of the policy statement.

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

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

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

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

State Law Restrictions
As a Maine corporation, the holding company is subject to certain limitations and restrictions under applicable Maine corporate law. For example, state law restrictions in Maine include limitations and restrictions relating to

indemnification of directors, distributions and dividends to stockholders, transactions involving directors, officers or interested stockholders, maintenance of books, records, and minutes, and observance of certain corporate formalities.

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Capital Adequacy and Prompt Corrective Action

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

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

- 4.5% CET1 to risk-weighted assets;
- 6.0% Tier 1 capital (that is, CET1 plus Additional Tier 1 capital) to risk-weighted assets;
- 8.0% Total capital (that is, Tier 1 capital plus Tier 2 capital) to risk-weighted assets; and
- 4.0% Tier 1 capital to average consolidated assets as reported on consolidated financial statements (the “leverage ratio”).

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

In addition, under the prior general risk-based capital rules, the effects of accumulated other comprehensive income or loss (“AOCI”) items included in shareholders’ equity (for example, mark-to-market of securities held in the available-for-sale portfolio) under U.S. GAAP are reversed for the purposes of determining regulatory capital ratios.

Under the Capital Rules, the effects of certain AOCI items are not excluded; however, banking organizations not using the advanced approaches, including the Company and the Bank, were permitted to make a one-time permanent election to continue to exclude these items in January 2015. The Capital Rules also preclude certain hybrid securities, such as trust preferred securities issued after May 19, 2010, from inclusion in bank holding companies' Tier 1 capital.

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

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

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

For purposes of PCA, to be: (i) well-capitalized, an insured depository institution must have a total risk-based capital ratio of at least 10%, a Tier 1 risk-based capital ratio of at least 8%, a CET1 risk-based capital ratio of at least 6.5%, and a Tier 1 leverage ratio of at least 5%; (ii) adequately capitalized, an insured depository institution must have a total risk-based capital ratio of at least 8%, a Tier 1 risk-based capital ratio of at least 6%, a CET1 risk-based capital ratio of at least 4.5%, and a Tier 1 leverage ratio of at least 4%; (iii) undercapitalized, an insured depository institution would have a total risk-based capital ratio of less than 8%, a Tier 1 risk-based capital ratio of less than 6%, a CET1 risk-based capital ratio of less than 4.5%, and a Tier 1 leverage ratio of less than 4%; (iv) significantly undercapitalized, an insured depository institution would have a total risk-based capital ratio of less than 6%, a Tier 1 risk-based capital ratio of less than 4%, a CET1 risk-based capital ratio of less than 3%, and a Tier 1 leverage ratio of less than 3%. and (v) critically undercapitalized, an insured depository institution would have a ratio of tangible equity to total assets that is less than or equal to 2%.

Both the Company and the Bank have always maintained the capital ratios and leverage ratio above the levels to be considered quantitatively well-capitalized. For information regarding the capital ratios and leverage ratio of the Company and the Bank as of December 31, 2017, and December 31, 2016, see the discussion under the section captioned "Capital Resources" included in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Note 14, in the "Notes to Consolidated Financial Statements" included in Item 8, "Financial Statements and Supplementary Data", elsewhere in this report.

The Volker Rule

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

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Significant Banking Regulations Applicable to the Bank

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

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

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

Depositor Preference
The FDIA provides that, in the event of the “liquidation or other resolution” of an insured depository institution, the claims of depositors of the institution, including the claims of the FDIC as subrogee of insured depositors, and certain claims for administrative expenses of the FDIC as a receiver, will have priority over other general unsecured claims against the institution. If an insured depository institution fails, insured and uninsured depositors, along with the FDIC, will have priority in payment ahead of unsecured, non-deposit creditors, including the parent bank holding company, with respect to any extensions of credit they have made to such insured depository institution.

Reserve Requirements
Federal Reserve Board regulations require insured depository institutions to maintain non-interest earning reserves against their transaction accounts (primary interest-bearing and regular checking accounts). The Bank’s required reserves can be in the form of vault cash. If vault cash does not fully satisfy the required reserves, in the form of a balance maintained with the Federal Reserve Bank of Boston (the “FRB Boston”). Federal Reserve Board regulations required for 2017 that reserves be maintained against aggregate transaction accounts, except for transaction accounts which are exempt up to $15.5 million. Transaction accounts greater than $15.5 million up to and including $115.1 million have a reserve requirement of 3%. A 10% reserve ratio will be assessed on transaction accounts in excess of $115.1 million. The Federal Reserve Board makes annual adjustments to the tiered reserves. The Bank is in compliance with these reserve requirements.

Consumer Financial Protection
The Company is subject to a number of federal and state consumer protection laws that govern its relationship with its customers. These laws include the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Truth in Lending Act, the Truth in Savings Act, the Electronic Fund Transfer Act, the Expedited Funds Availability Act, the Home

Mortgage Disclosure Act, the Fair Housing Act, the Real Estate Settlement Procedures Act, the Fair Debt Collection Practices Act, the Right to Financial Privacy Act, the Service Members Civil Relief Act and these laws' respective state law counterparts, as well as state usury laws and laws regarding unfair and deceptive acts and practices. These and other federal laws, among other things, require disclosures of the cost of credit and terms of deposit accounts,

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provide substantive consumer rights, prohibit discrimination in credit transactions, regulate the use of credit report information, provide financial privacy protections, prohibit unfair, deceptive and abusive practices, restrict the Bank's ability to raise interest rates and subject the Bank to substantial regulatory oversight. Violations of applicable consumer protection laws can result in significant potential liability from litigation brought by customers, including actual damages, restitution and attorneys' fees.

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

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

Brokered Deposit Restrictions

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

Community Reinvestment Act

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

Insider Credit Transactions

Section 22(h) of the FRA and its implementing Regulation O restricts loans to directors, executive officers, and principal stockholders ("insiders"). Under Section 22(h), loans to insiders and their related interests may not exceed, together with all other outstanding loans to such persons and affiliated entities, the institution's total capital and surplus. Loans to insiders above specified amounts must receive the prior approval of the board of directors. Further, under Section 22(h) of the FRA, loans to directors, executive officers and principal stockholders must be made on terms substantially the same as offered in comparable transactions to other persons, except that such insiders may receive preferential loans made under a benefit or compensation program that is widely available to the bank's employees and does not give preference to the insider over the employees. Section 22(g) of the FRA places additional limitations on loans to executive officers. A violation of these restrictions may result in the assessment of substantial civil monetary penalties on the affected bank or any officer, director, employee, agent or other person participating in the conduct of the affairs of that bank, the imposition of a cease and desist order, and other regulatory sanctions.

Safety and Soundness

Under FDIA, each federal banking agency has prescribed, by regulation, non-capital safety and soundness standards for institutions under its authority. These standards cover internal controls, information and internal audit systems,

loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, such other operational and managerial standards as the agency determines to be appropriate, and standards for asset quality, earnings and stock valuation. An institution which fails to meet these standards must develop a plan acceptable to the agency, specifying the steps that the institution will take to meet the standards. Failure to submit or implement such a plan may subject the institution to regulatory sanctions.

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Examinations

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

Financial Privacy

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

Anti-Money Laundering Initiatives and the USA Patriot Act

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

Office of Foreign Assets Control Regulation

The United States has imposed economic sanctions that affect transactions with designated foreign countries, nationals and others. These are typically known as the "OFAC" rules based on their administration by the U.S. Treasury Department Office of Foreign Assets Control ("OFAC"). The OFAC-administered sanctions targeting countries take many different forms. Generally, however, they contain one or more of the following elements: (i) restrictions on trade with or investment in a sanctioned country, including prohibitions against direct or indirect imports from and exports to a sanctioned country and prohibitions on "U.S. persons" engaging in financial transactions relating to making investments in, or providing investment-related advice or assistance to, a sanctioned country; and (ii) a blocking of

assets in which the government or specially designated nationals of the sanctioned country have an interest, by prohibiting transfers of property subject to U.S. jurisdiction (including property in the possession or control of U.S. persons). Blocked assets (e.g., property and bank deposits) cannot be paid out, withdrawn, set off or transferred in any manner without a license from OFAC. The Company is responsible for, among other things, blocking accounts of, and transactions with, such targets and countries, prohibiting unlicensed trade and financial transactions with them and

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reporting blocked transactions after their occurrence. Failure to comply with these sanctions could have serious legal and reputational consequences.

Other Laws and Regulations

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

Guidance on Sound Compensation Policies

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

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

Changing Regulatory Structure and Future Legislation and Regulation

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

Monetary Policy and Economic Environment

The earnings of the Company are significantly affected by the monetary and fiscal policies of governmental authorities, including the Federal Reserve Board. Among the instruments of monetary policy used by the Federal Reserve Board to implement these objectives are open-market operations in U.S. Government securities and federal funds, changes in the discount rate on member bank borrowings, and changes in reserve requirements against member bank deposits. These instruments of monetary policy are used in varying combinations to influence the overall level of bank loans, investments, and deposits, and the interest rates charged on loans and paid for deposits. The Federal Reserve Board frequently used these instruments of monetary policy, especially its open-market operations and the discount rate, to influence the level of interest rates and to affect the strength of the economy, the level of inflation, or the price of the dollar in foreign exchange markets. The monetary policies of the Federal Reserve Board have had a significant effect on the operating results of banking institutions in the past and are expected to continue to do so in the future. It is not possible to predict the nature of future changes in monetary and fiscal policies, or the effect which they may have on the Company’s business and earnings.

Financial Information About Industry Segments

The information required under this item is included in the Company’s financial statements, which appear in Part II, Item 8, Note 1 of this Annual Report on Form 10-K, and is incorporated herein by cross reference thereto.

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ITEM 1A. RISK FACTORS

An investment in the Company involves risk, some of which, including market, liquidity, credit, operational, legal, compliance, reputational and strategic risks, could be substantial and is inherent in our business. This risk also includes the possibility that the value of the investment could decrease considerably, and dividends or other distributions concerning the investment could be reduced or eliminated. Discussed below are risk factors that could adversely affect our financial results and condition, as well as the value of, and return on investment in the Company.

Deterioration in local economies or real estate market may adversely affect our financial performance.

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

Changes in the general economy or the financial markets could adversely affect our financial performance.

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

Interest rate volatility could significantly reduce the Company’s profitability.

The Bank’s earnings and cash flows are largely dependent upon its net interest income. Net interest income is the difference between interest income earned on interest-bearing assets such as loans and securities and interest expense paid on interest-bearing liabilities such as deposits and borrowed funds. Interest rates are highly sensitive to many factors that are beyond the Company’s control, including general economic conditions, demand for loans, securities and deposits, policies of various governmental and regulatory agencies and, in particular, the Board of Governors of the Federal Reserve System. Changes in monetary policy, including changes in interest rates, or the slope of the yield curve could influence not only the interest we receive on loans and securities and the amount of interest we pay on deposits and borrowings, but such changes could also affect (i) our ability to originate loans and obtain deposits, (ii) the fair value of our financial assets and liabilities, and (iii) the average duration of our loans and securities that are collateralized by mortgages. If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and other investments, our net interest income, and therefore earnings, could be adversely affected. Earnings could also be adversely affected if the interest rates received on loans and other investments fall more quickly than the interest rates paid on deposits and other borrowings. If interest rates decline, the Bank’s higher-rate loans and investments may be subject to prepayment risk, which could negatively impact its net interest margin. Conversely, if interest rates increase, the Bank’s loans and investment securities may be subject to extension risk, which could negatively impact its net interest margin as well.

Loss of deposits or a change in deposit mix could increase our cost of funding.

Deposits are a low cost and stable source of funding. We compete with banks and other financial institutions for deposits. Funding costs may increase if we lose deposits and are forced to replace them with more expensive sources

of funding, if customers shift their deposits into higher cost products or if we need to raise interest rates to avoid losing deposits. Higher funding costs reduce our net interest margin, net interest income and net income.

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

High concentrations of commercial loans may increase exposure to credit loss upon borrower default.
As of December 31, 2017, approximately 49% of the Banks's loan portfolio consisted of commercial real estate, commercial and industrial, construction and agricultural loans. Commercial loan portfolio concentration generally exposes lenders to greater risk of delinquency and loss than residential real estate loans because repayment of the loans often depends on the successful operation and income streams from the property. Additionally, commercial loans typically involve larger balances to single borrowers or groups of related borrowers compared to residential real estate loans. Because the Bank's loan portfolio contains a significant number of large commercial loans, the deterioration of one or a few of these loans could cause a significant increase in nonperforming loans, provision for loan losses, and/or an increase in loan charge-offs, all of which could adversely affect the financial condition and results of operations of the Company.

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

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

Expansion, growth, and acquisitions could negatively impact earnings if not successful.
The Company may grow organically both by geographic expansion and through business line expansion, as well as through acquisitions. Success of these activities depends on the Company's ability to continue to maintain and develop an infrastructure appropriate to support and integrate such growth. Also, success depends on the acceptance by customers in these new markets and, in the case of expansion through acquisitions, success depends on many factors, including the long-term recruitment and retention of key personnel and acquired customer relationships. Profitability depends on whether the income generated in the new markets will offset the increased expenses of operating a larger

entity, with more staff, more locations, and more product offerings. Failure to achieve any of these success factors may have a negative impact on the Company's financial condition and results of operations.

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The Company is subject to extensive government regulation and supervision, which may interfere with our ability to conduct our business and may negatively impact our financial results.
The Bank and certain non-bank subsidiaries are subject to extensive federal and state regulation and supervision. Banking regulations are primarily intended to protect depositors' funds, the Federal Deposit Insurance Fund and the safety and soundness of the banking system as a whole, not stockholders. These regulations affect the Company's lending practices, capital structure, investment practices, dividend policy and growth, among other things. Congress and federal regulatory agencies continually review banking laws, regulations and policies for possible changes. Changes to statutes, regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulations or policies, could affect the Company in substantial and unpredictable ways. Such changes could subject the Company to additional costs, limit the types of financial services and products the Company may offer, and/or limit the pricing the Company may charge on certain banking services, among other things. Compliance personnel and resources may increase our costs of operations and adversely impact our earnings.

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

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

The Company's ability to raise additional capital, if needed, will depend on conditions in the capital markets, economic conditions, and a number of other factors, many of which are outside the Company's control, and on its financial performance. Accordingly, we cannot be assured of our Company's ability to raise additional capital if needed or on terms acceptable to us. If the Company cannot raise additional capital when needed, or on reasonable terms, it may have a material adverse effect on its financial condition and results of operations.

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

Because the nature of the financial services business involves a high volume of transactions, certain errors may be repeated or compounded before they are discovered and successfully rectified. The Company's necessary dependence upon automated systems to record and process transactions and its large transaction volume may further increase the risk that technical flaws or employee tampering or manipulation of those systems will result in losses that are difficult to detect. The Company may also be subject to disruptions of its operating systems arising from events that are wholly or partially beyond its control (i.e., computer viruses or electrical or telecommunications outages, natural disaster, disease pandemics, or other damage to property or physical assets), which may give rise to disruption of service to customers and to financial loss or liability. The Company is further exposed to the risk that its external vendors may be unable to fulfill their contractual obligations (or will be subject to the same risk of fraud or operational errors by their respective employees as we are) and to the risk that our (or our vendors') business continuity and data security

systems prove to be inadequate. The occurrence of any of these risks could result in a diminished ability to operate our business (i.e., by requiring us to expend significant resources to correct the defect), as well as potential liability to clients, reputational damage, and regulatory intervention.

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

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

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

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

Changes in tax laws and regulations and differences in interpretation of tax laws and regulations may adversely impact our financial statements.

Federal, state, and local tax authorities may change tax laws and regulations, which could result in a decrease or increase to our net deferred tax assets. In December 2017, we recognized a write-down of $4.0 million in net deferred tax assets in connection with the adoption of the Tax Cuts and Jobs Act of 2017 (the "TCJA"). Federal, state, and local tax authorities may interpret tax laws and regulations differently than we do and challenge tax positions that we have taken on tax returns. This may result in differences in the treatment of revenues, deductions, credits and/or differences in the

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timing of these items. The differences in treatment may result in payment of additional taxes, interest or penalties that could have a material adverse effect on our results.

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

The Company's controls and procedures may fail or be circumvented.
The Company regularly reviews and updates its internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurance that the objectives of the system are met.

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

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

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

The Bank is exposed to risk of environmental liabilities with respect to properties to which it takes title.
In the course of our business, the Bank may own or foreclose and take title to real estate, and could be subject to environmental liabilities with respect to these properties. We may be held liable to a governmental entity or to third parties for property damage, personal injury, investigation and clean-up costs incurred by these parties in connection with environmental contamination, or may be required to investigate or clean up hazardous or toxic substances, or chemical releases at a property. The cost associated with investigation or remediation activities could be substantial.

In addition, as the owner or former owner of a contaminated site, we may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from the property.

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

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The Company’s principal executive offices and one branch are in a building owned by the Company located at 82 Main Street, Bar Harbor, Maine. The Company also provides full-banking services at an additional 46 locations throughout Maine, New Hampshire and Vermont of which 30 are owned and 16 are leased. The Company also has two stand-alone drive up windows in New Hampshire and one in Vermont. In addition to banking offices, the Company also has an Operations Center located in Ellsworth, Maine, that houses the Company’s operations and data processing centers, as well as leased space in Hampden, Maine and Bedford, New Hampshire, where back office support for multiple lines of business and related functions is located. In the opinion of management, the physical properties of the Company and the Bank are considered adequate to meet the needs of customers in the communities served.

ITEM 3. LEGAL PROCEEDINGS

The Company and its subsidiaries are parties to certain ordinary routine litigation incidental to the normal conduct of their respective businesses, which in the opinion of management, based upon currently available information, will have no material effect on the Company's consolidated financial statements.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

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

Market Information

The common stock of the Company is traded on the NYSE American, under the trading symbol BHB. On February 21, 2017, the Company's Board of Directors declared a three-for-two stock split of its common stock, payable as a large stock dividend. The stock split was paid on March 21, 2017 to the Company's common stockholders of record at the close of business on March 7, 2017.

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The following table sets forth the high and low market prices per share of BHB Common Stock as reported by NYSE American by calendar quarter for each of the last two years:

Year	1st Quarter		2nd Quarter		3rd Quarter		4th Quarter	
	High	Low	High	Low	High	Low	High	Low
2017	$33.41	$26.42	$33.05	$27.72	$31.87	$25.09	$32.48	$26.97
2016	23.13	19.69	24.07	20.53	25.13	22.7	33.25	24.13

As of March 4, 2017, there were 15,446,987 shares of Company common stock, par value $2.00 per share, outstanding and approximately 1,646 Registered Shareholders of record, as obtained through the Company's transfer agent.

Dividends

During 2017, the Company declared and distributed regular cash dividends on its common stock in the aggregate amount of $11.5 million compared with $6.6 million in 2016. The Company's 2017 payout ratio amounted to 44.3% compared with 44.0% in 2016. The total regular cash dividends paid in 2017 amounted to $0.75 per share of common stock, compared with $0.73 in 2016, representing an increase of $0.02 per share, or 2.8%.

In the first quarter of 2018, the Company's Board of Directors declared a regular cash dividend of $0.187 per share of common stock.

The Company has a history of paying quarterly dividends on its common stock. However, the Company's ability to pay such dividends depends on a number of factors, including the Company's financial condition, earnings, its need for funds and restrictions on the Company's ability to pay dividends under federal laws and regulations. Therefore, there can be no assurance that dividends on the Company's common stock will be paid in the future.

For further information, refer to Note 14 - Shareholders' Equity and Earnings Per Common Share of the Consolidated Financial Statements.

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

No unregistered securities were sold by the Company during the years ended December 31, 2017, and 2016.

Purchases of Equity Securities by the Issuer and Affiliated Purchases

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as a part of publicly announced plans or programs	Maximum number of shares that may yet be purchased under the plans or programs (1)
October 1-31, 2017	—	$ ——	—	404,706
November 1-30, 2017	—	—	—	404,706
December 1-31, 2017	—	—	—	404,706
Total	—	$ ——	—	404,706

(1) In August 2008, the Company's Board of Directors approved a twenty-four month program to repurchase up to 675,000 shares of the Company's common stock, or approximately 10.2% of the shares then outstanding. The

Company's Board of Directors authorized the continuance of this program for additional twenty-four month periods in August 2010, 2012 and 2014. On August 16, 2016, Bar Harbor Bankshares issued a press release announcing the Company's Board of Directors has approved the continuation of the Company's existing stock repurchase plan through August 16, 2018. No other changes were made to the plan. Depending on market conditions and other factors, stock repurchases may be commenced or suspended at any time, or from time to time, without prior notice and may be made in the open market or through privately negotiated transactions. The Company records repurchased shares as treasury stock.

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Common Stock Performance Graph

The following graph illustrates the estimated yearly change in value of the Company's cumulative total stockholder return on its common stock for each of the last five years. Total shareholder return is computed by taking the difference between the ending price of the common stock at the end of the previous year and the current year, plus any dividends paid divided by the ending price of the common stock at the end of the previous year. For purposes of comparison, the graph also matches Bar Harbor Bankshares' cumulative 5-Year total shareholder return on common stock with the cumulative total returns of the NYSE American Composite index, and the SNL Bank $1B to $5B Index. The graph tracks the performance of a $100 investment in our common stock and in each index (with the reinvestment of all dividends) from December 31, 2012 to December 31, 2017.

	Period Ending					
Index	12/31/12	12/31/13	12/31/14	12/31/15	12/31/16	12/31/17
Bar Harbor Bankshares	100.00	122.99	152.73	169.23	240.25	211.29
NYSE American Composite Index	100.00	126.28	134.81	129.29	144.73	171.83
SNL Bank $1B - $5B Index	100.00	145.41	152.04	170.20	244.85	261.04

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ITEM 6. SELECTED FINANCIAL DATA

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

	At or For the Years Ended December 31,				
(in millions, except per share data)	2017	2016	2015	2014	2013
Selected Financial Data:					
Total assets	$3,565	$1,755	$1,580	$1,459	$1,374
Total earning assets	3,241	1,683	1,517	1,411	1,321
Total investments	755	554	526	492	469
Total loans	2,486	1,129	990	919	853
Allowance for loan losses	12	10	9	9	8
Total goodwill and intangible assets	108	5	5	5	6
Total deposits	2,352	1,050	943	858	836
Total borrowings	830	537	475	447	409
Total shareholders' equity	355	157	154	146	121
Selected Operating Data:					
Total interest and dividend income	$116	$57	$55	$54	$51
Total interest expense	24	12	10	10	12
Net interest income	92	45	45	44	39
Non-interest income	26	12	9	8	8
Total revenue	118	58	54	52	47
Provision for loan losses	3	1	2	2	1
Total non-interest expense	73	36	31	29	27
Income tax expense - continuing operations	17	6	6	6	5
Net income	26	15	15	15	13
Dividends per common share	$0.75	$0.73	$0.67	$0.60	$0.56
Basic earnings per common share	1.71	1.65	1.69	1.64	1.49
Diluted earnings per common share	1.70	1.63	1.67	1.63	1.48
Weighted average common shares outstanding - basic	15,184	9,069	8,970	8,890	8,847
Weighted average common shares outstanding - diluted	15,290	9,143	9,090	8,964	8,893

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	At or For the Years Ended December 31,				
	2017	2016	2015	2014	2013
Selected Operating Ratios and Other Data					
Per Common Share Data:					
Net earnings, diluted	$1.70	$1.63	$1.67	$1.63	$1.48
Total book value	22.96	17.19	17.10	16.40	13.70
Dividends	0.75	0.73	0.67	0.60	0.56
Common stock price:					
High	33.41	33.25	25.32	21.91	18.43
Low	25.09	19.69	19.31	16.01	15.06
Close	27.01	31.55	22.95	21.33	17.77
Performance Ratios:					
Return on assets	0.75 %	0.89 %	0.98 %	1.03 %	0.98 %
Return on equity	7.41	9.21	10.01	10.69	10.52
Interest rate spread	2.99	2.86	3.09	3.23	3.03
Non-interest income/total net revenue	21.99	21.39	16.69	15.04	16.22
Non-interest expense/average assets	2.10	2.14	2.01	2.05	2.00
Dividend payout ratio	44.26	44.04	39.86	36.69	37.28
Growth Ratios:					
Total commercial loans	23.83 %	9.24 %	11.21 %	0.04 %	5.72 %
Total loans	13.14	14.04	7.73	7.76	4.64
Total deposits	14.39	11.40	9.88	2.68	5.11
Total net revenues, (compared to prior year)	104.66	7.27	4.35	10.54	4.41
Earnings per share, (compared to prior year)	4.08	(2.02)	2.26	9.96	4.88
Asset Quality and Condition Ratios:					
Net charge-offs /average loans	0.04 %	— %	0.14 %	0.15 %	0.12 %
Allowance for loan losses/total loans (1)	0.50	0.92	0.95	0.98	0.99
Loans/deposits	105.68	107.50	105.02	107.11	102.06
Capital Ratios:					
Tier 1 capital to average assets - Company	8.10 %	8.94 %	9.37 %	9.30 %	9.01 %
Tier 1 capital to risk-weighted assets - Company	12.19	15.01	15.55	15.60	14.97
Tier 1 capital to average assets - Bank	8.58	9.06	9.49	9.40	9.12
Tier 1 capital to risk-weighted assets - Bank	12.92	15.20	15.77	15.77	15.16
Shareholders equity to total assets	9.95	8.93	9.76	10.02	8.83

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

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AVERAGE BALANCES AND AVERAGE YIELDS/RATES

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

	2017				2016				2015			
(in millions, except ratios)	Average Balance	Interest	Average Yield/Rate (3)		Average Balance	Interest	Average Yield/Rate (3)		Average Balance	Interest	Average Yield/Rate (3)	
Assets												
Loans (1)	$2,396.5	$98.2	4.10	%	$1,054.7	$41.9	3.97	%	$962.2	$39.5	4.11	%
Securities and other (2)	757.4	23.5	3.10		546.7	17.7	3.24		506.8	17.6	3.48	
Total earning assets	3,153.9	121.7	3.86	%	1,601.4	59.6	3.72	%	1,469.0	57.2	3.89	%
Other non-earning assets	310.1				75.5				72.3			
Total assets	$3,464.0				$1,676.9				$1,541.3			
Liabilities												
Interest bearing deposits	$1,884.3	$11.3	0.60	%	$888.8	$6.7	0.75	%	$843.6	$6.1	0.72	%
Borrowings	862.5	12.6	1.46		524.9	5.4	1.03		456.7	4.3	0.94	
Total interest-bearing liabilities	2,746.8	23.9	0.87	%	1,413.7	12.1	0.86	%	1,300.3	10.4	0.80	%
Non-interest-bearing demand deposits	339.3				93.8				82.7			
Other non-earning liabilities	27.2				7.3				6.9			
Total liabilities	3,113.3				1,514.8				1,389.9			
Total shareholders' equity	350.7				162.1				151.4			
Total liabilities and shareholders' equity	$3,464.0				$1,676.9				$1,541.3			
Net interest-earning assets	$407.1				$187.8				$168.8			
Net interest income		$97.8				$47.5				$46.8		
Net interest spread			2.99	%			2.86	%			3.09	%
Net interest margin			3.10				2.96				3.19	
Cost of funds			0.77				0.80				0.75	
Cost of deposits			0.60				0.75				0.72	
Interest-earning assets/interest bearing liabilities			114.82				113.28				112.98	
Supplementary Data												
Total non-maturity deposits	$1,463.1				$568.2				$498.8			
Total deposits	2,223.6				982.6				926.3			
Fully taxable equivalent adjustments	5.6				2.1				2.0			

(1) The average balances of loans include nonaccrual loans and deferred fees and costs.

(2) The average balance for securities available for sale is based on amortized cost. The average balance of equity also reflects this adjustment.

(3) Fully taxable equivalent considers the impact of tax advantaged investment securities and loans.

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Rate/Volume Analysis

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

	2017 Compared with 2016 Increases (Decreases) due to			2016 Compared with 2015 Increases (Decreases) due to		
(in thousands)	Rate	Volume	Net	Rate	Volume	Net
Interest income:						
Commercial real estate	$4,099	$13,489	$17,588	$(813)	$1,069	$256
Commercial and industrial	2,379	7,979	10,358	163	325	488
Residential	(3,062)	28,729	25,667	(771)	2,610	1,839
Consumer	(959)	3,662	2,703	12	(251)	(239)
Total loans	2,457	53,859	56,316	(1,409)	3,753	2,344
Securities	(1,027)	6,815	5,788	(1,334)	1,388	54
Total interest income	$1,430	$60,674	$62,104	$(2,743)	$5,141	$2,398
Interest expense:						
NOW	$216	$600	$816	$6	$25	$31
Savings	248	260	508	—	5	5
Money market	276	241	517	104	143	247
Time deposits	(1,701)	4,468	2,767	474	(155)	319
Total deposits	(961)	5,569	4,608	584	18	602
Borrowings	3,710	3,483	7,193	480	641	1,121
Total interest expense	$2,749	$9,052	$11,801	$1,064	$659	$1,723
Change in net interest income	$(1,319)	$51,622	$50,303	$(3,807)	$4,482	$675

NON-GAAP FINANCIAL MEASURES

This document contains certain non-GAAP financial measures in addition to results presented in accordance with U.S Generally Accepted Accounting Principles ("GAAP"). These non-GAAP measures are intended to provide the reader with additional supplemental perspectives on operating results, performance trends, and financial condition. Non-GAAP financial measures are not a substitute for GAAP measures; they should be read and used in conjunction with the Company's GAAP financial information. The Company's non-GAAP measures may not be comparable to similar non-GAAP information which may be presented by other companies. In all cases, it should be understood that non-GAAP operating measures do not depict amounts that accrue directly to the benefit of shareholders. An item which management excludes when computing non-GAAP adjusted earnings can be of substantial importance to the Company's results and condition for any particular quarter or year. A reconciliation of non-GAAP financial measures to GAAP measures is provided below.

The Company utilizes the non-GAAP measure of adjusted earnings in evaluating operating trends, including components for operating revenue and expense. These measures exclude amounts which the Company views as unrelated to its normalized operations, including securities gains/losses, acquisition costs, restructuring costs, systems

conversion costs and the impact of tax law changes. These adjustments are presented net of an adjustment for related income tax expense. This adjustment is determined as the difference between the GAAP tax rate and the effective tax rate applicable to adjusted income. The Company calculates several non-GAAP performance measures based on its measure of adjusted earnings, including adjusted earnings per share, adjusted return on assets, adjusted return on equity,

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and the efficiency ratio. The Company views these amounts as important to understanding its performance trends, particularly due to the impact of accounting standards related to acquisition activity. Several of these measures are used as performance metrics in assessing the achievement of short and long term incentive compensation for management. Analysts also rely on these measures in estimating and evaluating the Company's performance. Management also believes that the computation of non-GAAP earnings and earnings per share may facilitate the comparison of the Company to other companies in the financial services industry. The Company adjusts certain equity related measures to exclude intangible assets due to the importance of these measures to the investment community and as components of regulatory capital supervision.

Charges related to acquisition activity consist primarily of severance and retention, systems conversion and integration, and professional costs.

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RECONCILIATION OF NON-GAAP FINANCIAL MEASURES

The following table summarizes the reconciliation of non-GAAP items recorded for the time periods and dates indicated:

(in thousands, except ratios)		At or For The Years Ended December 31, 2017	December 31, 2016	December 31, 2015
Net income		$25,993	$ 14,933	$ 15,153
Adj: Security Gains		(19)	(4,498)	(1,334)
Adj: Loss on sale of fixed assets, net		94	248	7
Adj: Acquisition expense		3,302	2,650	54
Adj: Income taxes (1)		(1,269)	560	446
Adj: Tax reform charge		3,988	—	—
Total adjusted income (2)	(A)	$32,089	$ 13,893	$ 14,326
Net-interest income	(B)	$92,155	$ 45,374	$ 44,834
Plus: Non-interest income		25,982	12,349	8,979
Total Revenue		118,137	57,723	53,813
Adj: Net security gains		(19)	(4,498)	(1,334)
Total adjusted revenue (2)	(C)	$118,118	$ 53,225	$ 52,479
Total non-interest expense		$72,726	$ 35,935	$ 30,908
Less: Loss on sale of fixed assets, net		(94)	(248)	(7)
Less: Acquisition expense		(3,302)	(2,650)	(54)
Adjusted non-interest expense (2)	(D)	$69,330	$ 33,037	$ 30,847
(in millions)				
Total average earning assets	(E)	$3,154	$ 1,601	$ 1,469
Total average assets	(F)	3,464	1,677	1,541
Total average shareholders' equity	(G)	351	162	151
Total average tangible shareholders' equity (2) (3)	(H)	243	157	146
Total tangible shareholders' equity, period-end (2) (3)	(I)	246	151	149
Total tangible assets, period-end (2) (3)	(J)	3,457	1,750	1,575
(in thousands)				
Total common shares outstanding, period-end	(K)	15,443	9,116	9,015
Average diluted shares outstanding	(L)	15,290	9,143	9,090
Adjusted earnings per share, diluted	(A/L)	$2.10	$ 1.52	$ 1.58
Tangible book value per share, period-end (2)	(I/K)	15.94	16.61	16.50
Total tangible shareholders' equity/total tangible (2) assets	(H/J)	7.12	8.65	9.45
Performance ratios				
GAAP return on assets		0.75 %	0.89 %	0.98 %
Adjusted return on assets (2)	(A/F)	0.93	0.83	0.93
GAAP return on equity		7.41	9.21	10.01
Adjusted return on equity (2)	(A/G)	9.15	8.57	9.46
Adjusted return on tangible equity (2) (4)	(A/I)	13.40	8.90	9.86
Efficiency ratio (2)(5)	(D-N-P)/ (C+M)	55.44	58.90	55.93
Net interest margin	(B+O)/E	3.10	2.96	3.19

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Supplementary data (in thousands)				
Taxable equivalent adjustment for efficiency ratio	(M)	$4,391	$2,470	$2,284
Franchise taxes included in non-interest expense	(N)	599	140	126
Tax equivalent adjustment for net interest margin	(O)	5,615	2,093	1,958
Intangible amortization	(P)	812	92	92

(1) Assumes a marginal tax rate of 37.57% in 2017 and 35.00% in 2016 and 2015.
(2) Non-GAAP financial measure.
(3) Total tangible shareholders' equity is computed by taking total shareholders' equity less the intangible assets at period-end. Total tangible assets is computed by taking total assets less the intangible assets at period-end.
(4) Adjusted return on tangible equity is computed by dividing the total core income adjusted for the tax-effected amortization of intangible assets, assuming a marginal rate of 37.57% in 2017 and 35.00% in 2016, by tangible equity.
(5) Efficiency ratio is computed by dividing total core tangible non-interest expense by the sum of total net interest income on a fully taxable equivalent basis and total core non-interest income. The Company uses this non-GAAP measure to provide important information about its operating efficiency.

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

GENERAL

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

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

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

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

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

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

Income Taxes: Significant management judgment is required in determining income tax expense and deferred tax assets and liabilities. The Company uses the asset and liability method of accounting for income taxes in which

deferred tax assets and liabilities are established for the temporary differences between the financial reporting basis and the tax basis of the Company's assets and liabilities. The realization of the net deferred tax asset generally depends upon future levels of taxable ordinary income, taxable capital gain income, and the existence of prior years' taxable income, to which carry back refund claims could be made. A valuation allowance would be established for deferred tax assets

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that management estimates are more likely than not to be unrealizable based on available evidence at the time the estimate is made.

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

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

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

SUMMARY

Bar Harbor Bankshares produced record revenue and earnings in 2017 due to business expansion and increased operational efficiencies. Net income in 2017 was $26.0 million, or $1.70 per share, compared with $14.9 million in 2016 or $1.63 per share. The Company's 2017 results included almost a full year benefit from the operations of Lake Sunapee Bank Group ("LSBG"). The acquisition of LSBG closed in early January 2017.

Adjusted income (non-GAAP) in 2017 increased to $32.1 million, or $2.10 per share, from $13.9 million in 2016, or $1.52 per share. The measure of adjusted income excludes an after-tax reduction of $2.1 million, or $0.13 per share, during 2017 related to acquisition expenses offset by a one-time benefit associated with the sale of the Company's insurance subsidiary. Adjusted income also excluded the $4.0 million, or $0.26 per share, reduction due to the revaluation of net deferred tax assets required by the TCJA. Adjusted income in 2016 included an after-tax reduction of $1.7 million, or $0.19 per share, related to acquisition costs and an after-tax benefit of $2.9 million, or $0.32 per share, related to gains from security sales.

Return on assets in 2017 was 0.75% as compared to 0.89% in 2016 while adjusted return on assets (non-GAAP) improved to 0.93% in 2017 from 0.83% in 2016. In a similar trend, return on equity was 7.41% for 2017 compared to 9.21%; however, adjusted return on equity (non-GAAP) improved to 9.15% in 2017 from 8.57% in 2016. The Company's efficiency ratio (non-GAAP) improved to 55% in 2017 from 59% in 2016 and net interest margin improved to 3.10% in 2017 from 2.96% in 2016.

Total assets increased to $3.6 billion in 2017 from $1.8 billion in 2016, which includes the $1.6 billion of assets that were acquired from LSBG. Excluding the impact of the acquisition, total loans grew by $221.0 million or 13.1% during 2017 primarily due to commercial loan growth. All major categories of assets, liabilities and equity increased due to the acquired balances which as of the acquisition date included $1.2 billion in loans, $155.6 million in securities, $1.2 billion in deposits, and $182 million in equity as a result of the issuance of common shares of the Company to LSBG shareholders.

COMPARISON OF FINANCIAL CONDITION AT DECEMBER 31, 2017 AND 2016

Summary

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

Securities

The Company maintains a relatively high quality and liquid security portfolio consisting of mortgage-backed securities ("MBS") issued by U.S. government agencies, U.S. Government-sponsored enterprises and, to a much lesser extent, other non-agency, private-label issuers. The securities portfolio also includes obligations of US government sponsored enterprises, obligations of state and political subdivisions thereof, as well as, corporate bonds. Each investment is evaluated from a return on equity and interest rate risk perspective under the policy guidelines established by the Company's Board of Directors. The yield and duration of each security are given careful consideration given the current rising interest rate environment. Overall, management has positioned the portfolio to

provide flexibility in reacting to asset and liability changes as they arise. Included in the Company’s total securities is Federal Home Loan Bank of Boston ("FHLB") stock which is a non-marketable equity security and, therefore, is reported at cost.

Total securities increased $201.2 million which includes $156.3 million in securities acquired from LSBG and $180.9 million in securities purchased during the year ended December 31, 2017. Securities purchased included $149.4 million

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of mortgage-backed securities guaranteed by US Government agency and US Government-sponsored enterprises, $21.8 million of corporate bonds, and $8.8 million of FHLB stock. The increase was primarily offset by $126.8 million of maturities, calls, and pay-downs of amortizing securities and $7.5 million in FHLB stock repurchases. The weighted average yield on the Company's securities portfolio was 3.10% in 2017 compared to 3.24% in prior year. The average life of the securities portfolio at December 31, 2017 was estimated to be 5.1 years, with a duration of approximately 4.0 years. These metrics compare with an estimated average life of 6.3 years, with a duration of approximately 4.9 years for the portfolio at December 31, 2016.

Loans

The acquisition of LSBG increased the legal lending limit of the Bank and expanded the lending area across all three of the northern New England states which resulted in organic growth in the loan portfolio. Total loans increased to $2.5 billion in 2017 from $1.1 billion in 2016, of which $1.2 billion were acquired from Lake Sunapee Bank. Excluding the impact of the acquired balances, total loans increased during 2017 by $221.0 million or 13.1%.

At December 31, 2017, commercial loans comprised 49.0% of the total loan portfolio, compared with 50% at December 31, 2016. Residential real estate mortgage loans, comprised 46% of total loans at December 31, 2017, compared with 45% at December 31, 2016. Total commercial loans had a 23.8% organic growth rate led mostly by commercial and industrial loans. Outside of acquired loans, growth for residential mortgage loans remained relatively flat compared to 2016.

Allowance for loan losses

The determination of the allowance for loan losses is a critical accounting estimate. The Company considers the allowance for loan losses appropriate to cover probable losses which can be reasonably estimated in the loan portfolio as of the balance sheet date. Specific allowances for impaired loans are determined based upon a discounted cash flows analysis, or as appropriate, a collateral shortfall analysis. General allowances for loan losses account for the risk and estimated loss inherent in certain pools of industry and geographic loan concentrations within the loan portfolio. Under accounting standards for business combinations, acquired loans are recorded at fair value with no loan loss allowance on the date of acquisition. An allowance for loan loss is recorded by the Company for the emergence of new probable and estimable losses on acquired loans which were not impaired as of the acquisition date. Because of the accounting for acquired loans, some measures of the loan loss allowance are not comparable to periods prior to the acquisition date or to peer measures.

During 2017, the allowance for loan losses increased $1.9 million to $12.3 million, which is due to the increase in business activity loans and lower charge-off activity reflecting improved asset quality. Asset quality remained steady with non-accruing loans to total loans ratios at 0.58% at year-end 2017 and 2016. The ratio of net charge-offs to total loans remain near zero in 2017 and 2016. The ratio of the allowance to total loans decreased to 0.50% in 2017 from 0.92% in 2016, which was primarily due to the volume of loans acquired from LSBG.

The credit risk of the Bank's loan portfolio is managed through loan officer authorities, loan policies, and oversight from the Bank's Chief Credit Officer, the Bank's Management Loan Committee, the Directors' Loan Committee, and the Bank's Board of Directors. Management follows a policy of continually identifying, analyzing and grading credit risk inherent in the loan portfolio. An ongoing independent review, subsequent to management's review, of individual credits is performed by an independent loan review consulting firm, which reports to the Audit Committee of the Board of Directors. The Bank applies a risk grading system, which stratifies the portfolio and allows management to focus appropriate efforts on the highest risk components of the portfolio. The risk grades include ratings that correlate with regulatory definitions of "Pass," "Other Assets Especially Mentioned," "Substandard," "Doubtful," and "Loss." The credi risk profile of the Company's loan portfolio is described in Note 5 - Loan Loss Allowance of the Consolidated Financial Statements.

Bank Owned Life Insurance

Bank owned life insurance (“BOLI”) represents life insurance on the lives of certain current and retired employees who have provided positive consent allowing the Bank to be the beneficiary of such policies. Increases in the cash value of the policies, as well as insurance proceeds received in excess of the cash value, are recorded in other non-

interest income, and are not subject to income taxes. The cash surrender value of the BOLI is included on the Company's consolidated balance sheet.

At December 31, 2017, the cash surrender value of BOLI amounted to $58.0 million, compared with $24.4 million at the end of 2016. The increase in BOLI was primarily the result of $31.7 million due to the LSBG acquisition and $1.9 million attributed to increases in the cash surrender value of the BOLI policies.

Deposits

Historically, the Bank's deposit market area has been seasonal, with lower deposits in the winter and spring months and higher deposits in the summer and autumn months.

Excluding the impact of acquired balances, total deposits increased 14.4% to $1.2 billion in 2017 compared to 2016. Core deposits are still the primary funding source for loan growth and the Company took on additional FHLB borrowings in order to fund additional loan growth in the period. Organic growth for demand deposits and other interest bearing deposits, NOW accounts, and savings and money market accounts in total remained close to zero for 2017 compared to 2016, while time deposits grew to $575.0 million with an organic growth rate of 38% excluding the impact of acquired balances.

Borrowings

The Bank utilizes borrowed funds in leveraging its strong capital position and supporting its earning asset portfolios. Borrowed funds are principally utilized to support the Bank's investment securities portfolio and, to a lesser extent, fund loan growth. Borrowed funds also provide a means to help manage balance sheet interest rate risk, given the Bank's ability to select desired amounts, terms and maturities on a daily basis. Borrowed funds principally consist of advances from the FHLB and, to a lesser extent, securities sold under agreements to repurchase, Fed funds purchased and borrowings from the Federal Reserve Bank of Boston. Advances from the FHLB are secured by stock in the FHLB, investment securities, certain commercial real estate loans, and blanket liens on qualifying mortgage loans and home equity loans.

FHLB borrowings increased by $236.2 million during 2017, of which $175.7 million was assumed from the acquisition. Excluding the impact of the acquisition, the increase was mostly in short term FHLB advances to fund loans during the first half of the year.

Stockholders' Equity

Excluding the $181.9 million of common stock of the Company issued to LSBG shareholders, total equity increased by $16.0 million, or 10.2%, during 2017. Accumulated other comprehensive loss increased by $228 thousand primarily due to the changes in fair value of the Company's derivative hedges offset by improvements in its available for sale securities positions.

The Company evaluates changes in tangible book value, a non-GAAP financial measure which is a commonly considered valuation metric used by the investment community and which parallels some regulatory capital measures. Tangible book value increased to $246.2 million as of December 31, 2017 from $151.0 million at year-end 2016. The Company's ratio of tangible equity to tangible assets stood at 7.12% at the end of 2017, compared to 8.65% at the end of 2016. The decrease in the ratio is primarily due to the share issuance offset by goodwill and other intangible assets recorded for the LSBG acquisition in the first quarter 2017. The LSBG acquisition resulted in a $95.1 million increase in goodwill.

The Company and the Bank remained well capitalized under regulatory guidelines at period-end.

Stock Repurchase Plan

In August 2008, the Company’s Board of Directors approved a 24 month program to repurchase up to 675,000 shares of the Company’s common stock. The Company’s Board of Directors authorized the continuance of this program for additional 24 month periods in August 2010, 2012 and 2014. On August 16, 2016, the Company’s Board of Directors authorized the continuance of this program through August 17, 2018. Depending on market conditions and other

factors, these purchases may be commenced or suspended at any time, or from time to time, without prior notice and may be made in the open market or through privately negotiated transactions.

As of December 31, 2017, the Company had repurchased 270,294 shares of stock under this plan, at a total cost of $3.75 million and an average price of $13.86 per share. During 2017, the Company repurchased 9,603 shares under the plan, at a total cost of $282 thousand and an average price of $29.39. The Company records repurchased shares as treasury stock.

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

The Company’s principal source of funds to pay cash dividends and support its commitments is derived from Bank operations. During 2017, the Company declared and distributed regular cash dividends on its common stock in the aggregate amount of $11.51 million compared with $6.58 million in 2016. The Company’s 2017 dividend payout ratio amounted to 44.3%, compared with 44.0% in 2016. The total regular cash dividends paid in 2017 amounted to $0.75 per common share of common stock, compared with $0.73 in 2016, representing an increase of $0.02 per share, or 2.8%.

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

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

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

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

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

Net interest income also includes significant components related to the amortization of purchase accounting adjustments. The most significant component is purchased loan accretion related to recoveries on the resolution of acquired assets.

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Net interest income increased year-over-year by $46.8 million to $92.2 million. The increase was driven by a $1.6 billion increase in average earning assets, which includes organic growth and benefit of the LSBG acquisition. Net interest margin increased to 3.10% in 2017 compared to 2.96% in 2016. Net interest spread increased 13 basis points mostly from the addition of acquired loans but also reflecting higher yields on commercial loans. Weighted average yields for commercial real estate and commercial and industrial loans increased to 4.24% and 4.73% in 2017 from 3.71% and 4.03% in 2016, respectively. Net interest margin in 2017 also benefited from purchased loan accretion totaling $3.7 million in the year.

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

Non-Interest Income

Non-interest income for the year increased to $26.0 million from $12.3 million in 2016. Gains from sales of securities in 2016 increased non-interest income by $4.5 million. Non-interest income in 2017, excluding gains on securities, increased $18.1 million from 2016. Revenue from trust and investment management services as well as financial services on a year-to-date basis increased $8.4 million from 2016, which is principally due to the addition of Charter Trust Company as part of the LSBG acquisition. Income from trust and investment management services are principally derived from fee income based on a percentage of the fair market value of client assets under management and held in custody. Revenue from financial services is derived from retail brokerage services conducted through Bar Harbor Financial Services, an independent third-party broker. Fee income from trust, investment management and financial services represented 47% of total non-interest income in 2017 compared to 31% in 2016.

Income from customer service fees is principally derived from overdraft fees, monthly deposit account maintenance and activity fees, automated teller machine (“ATM”) fees and a variety of other deposit account related fees. Customer services fees also include Bank’s debit card product and merchant credit and debit card processing fees. Customer service fees increased $5.8 million compared to 2016 also as a result of the acquisition given the broader customer deposit base and higher number of ATM transactions. In 2017, the Company also benefited from $1.1 million in fees from its insurance subsidiary, which was acquired from the LSBG acquisition. The Company sold the insurance subsidiary in October 2017.

Loan Loss Provision

The provision for loan losses is a charge to earnings in an amount sufficient to maintain the allowance for loan losses at a level deemed adequate by the Company as an estimate of the probable and estimable loan losses in the portfolio as of period-end. The level of the allowance is a critical accounting estimate, which is subject to uncertainty. The level of the allowance is included in the discussion of financial condition. The provision for loan losses in 2017 increased to $2.8 million from $1.0 million in 2016. The amount of the provision exceeded net charge-offs in all periods shown, as the amount of the allowance has risen gradually based on loan portfolio growth and offset in part by the ongoing improvement in loan performance and credit quality.

Non-Interest Expense

Non-interest expense increased to $72.7 million from $35.9 million in 2016. Salary and employee benefit costs increased by $19.8 million compared with 2016 principally due to the LSBG acquisition. Full time equivalent staff totaled 423 at the end of 2017 compared with 186 at the end of 2016. Salary and employee benefit costs decreased on a quarterly basis in the second half of 2017 reflecting a positive trend of disciplined cost control and realized cost saves with the acquisition. Occupancy expenses increased $7.0 million as compared to 2016 due to costs of operating

additional branches from the acquisition. Acquisition costs totaled $3.3 million in 2017 and $2.7 million in 2016. Acquisition costs in 2017 include severance, system conversion and professional costs, which were offset in part by a one-time benefit from the sale of the Company's insurance subsidiary.

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Income Tax Expense

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

COMPARISON OF OPERATING RESULTS FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015

Summary

Net income in 2016 was $14.9 million, or $1.63 per share, in 2016 compared to $15.2 million, or $1.67 per share, in 2015. Acquisition costs related to LSBG reduced 2016 earnings by $1.7 million on an after-tax basis. Those costs were offset by increases in after-tax gains from security sales of $2.1 million. Increases in non-interest expenses further reduced adjusted income per share to $1.52 per share in 2016 from $1.58 in 2015.

Net Interest Income

Net interest income in 2016 on a tax-equivalent basis amounted to $47.5 million compared with $46.8 million in 2015. The increase in 2016 tax-equivalent net interest income was attributed to average earning asset growth of $132.3 million or 9.0%, as the net interest margin declined 23 basis points compared with 2015. In 2016, the tax-equivalent net interest margin amounted to 2.96%, compared with 3.19% in 2015. The decline in the net interest margin was principally attributed to a 17 basis point decline in the average earning asset yield, as well as a six basis point increase in the average cost of interest bearing liabilities. The increase in the average interest yield in 2016 is primarily due to average earning asset growth of $132.3 million while the increase in funding cost was due to a $113.4 million increase in average interest bearing liabilities.

Non-interest Income

In 2016 non-interest income totaled $12.3 million compared with $9.0 million in 2015, which was primarily the result of gains from sales of securities. Securities gains in 2016 were $4.5 million compared with $1.3 million in 2015. The realized securities gains largely reflected Bank management’s strategy of lowering the duration of the securities portfolio and its overall interest rate risk profile, while simultaneously generating income. Non-interest income in 2016 from trust management services, financial services, and customer service fees were relatively flat with those income streams of 2015.

Loan Loss Provision

The provision for loan loss decreased to $979 thousand in 2016 from $1.8 million in 2015 due to lower levels of non-performing loans and loan charge-off experience, combined with relatively stable credit quality metrics.

Non-interest Expense

Non-interest expense increased to $35.9 million in 2016 from $30.9 million in 2015 is primarily due to $2.7 million in merger expenses related to the LSBG acquisition, and a $1.9 million increase in salary and benefit expense related to strategic hires at the executive and senior level positions.

Income Taxes

The effective tax rate was 28.2% in 2016 and 28.3% in 2015. The effective tax rate remained relatively flat in 2016 as compared to 2015, which reflected the impact of 2016 security gains offset by merger-related expenses.

LIQUIDITY AND CASH FLOWS

Liquidity is measured by the Company’s ability to meet short-term cash needs at a reasonable cost or minimal loss. The Company seeks to obtain favorable sources of liabilities and to maintain prudent levels of liquid assets in order to

satisfy varied liquidity demands. Besides serving as a funding source for maturing obligations, liquidity provides flexibility in responding to customer initiated needs. Many factors affect the Company's ability to meet liquidity needs, including variations in the markets served by its network of offices, its mix of assets and liabilities, reputation and credit standing in the marketplace, and general economic conditions.

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The Bank actively manages its liquidity position through target ratios established under its Asset Liability Management Policy. Continual monitoring of these ratios, by using historical data and through forecasts under multiple rate and stress scenarios, allows the Bank to employ strategies necessary to maintain adequate liquidity. The Bank's policy is to maintain a liquidity position of at least 4% of total assets. A portion of the Bank's deposit base has been historically seasonal in nature, with balances typically declining in the winter months through late spring, during which period the Bank's liquidity position tightens.
The Bank also had capacity to borrow funds on a secured basis utilizing the Borrower in Custody program and the Discount Window at the Federal Reserve Bank of Boston (the "FRB"). At December 31, 2017, the Bank's available secured line of credit at the FRB stood at $117.1 million or 3.2% of the Bank's total assets. The Bank also has access to the national brokered deposit market, and has used this funding source to bolster its on balance sheet liquidity position.
The Bank maintains a liquidity contingency plan approved by the Bank's Board of Directors. This plan addresses the steps that would be taken in the event of a liquidity crisis, and identifies other sources of liquidity available to the Company. Company management believes that the level of liquidity is sufficient to meet current and future funding requirements. However, changes in economic conditions, including consumer savings habits and availability or access to the brokered deposit market could potentially have a significant impact on the Company's liquidity position.

CAPITAL RESOURCES

Consistent with its long-term goal of operating a sound and profitable organization, at December 31, 2017 the Company maintained its strong capital position and continued to be a "well-capitalized" financial institution according to applicable regulatory standards. Management believes this to be vital in promoting depositor and investor confidence and providing a solid foundation for future growth.

In 2015 the Company amended its Articles of Incorporation to increase the number of shares of common stock authorized for issuance from 10,000,000 shares to 20,000,000 shares. The $2.00 par value of the Company's common stock, as well as the authorized issuance of up to 1,000,000 shares of preferred stock, remained unchanged from prior periods.

In October 2009, the Company filed a shelf registration statement on Form S-3 with the SEC to register an indeterminate number of shares of common stock and preferred stock, which together have an aggregate initial offering price not to exceed $35,000 (the "Shelf Registration"). The SEC declared the Company's Shelf Registration effective on November 3, 2009. In December of 2009, the Company announced that it had completed its offering of 800,000 shares of its common stock to the public at $27.50 per share. The principal use of the net proceeds from that offering were used to repurchase all the Company's Series A preferred shares previously sold to the U.S. Department of the Treasury under its Capital Purchase Program.

The Company's Shelf Registration expired on November 3, 2012. The Company has not decided whether to file a new shelf registration statement and does not have any current plans to raise additional capital; however, the Company does recognize that financial flexibility is important and that a shelf registration filed with the SEC can be a prudent capital management tool should the need or opportunity to raise capital on attractive terms arise and, therefore, the Company may consider the filing of a new shelf registration with the SEC on terms similar to the Shelf Registration or other terms during 2017 or in other future years.

AVERAGE BALANCES, INTEREST, AVERAGE YIELDS/COST AND RATE/VOLUME ANALYSIS

Tables with the above information are presented in Item 6 of this report.

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CONTRACTUAL OBLIGATIONS

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

In the normal course of conducting its banking and financial services business, and in connection with providing products and services to its customers, the Company has entered into a variety of traditional third-party contracts for support services. Examples of such contractual agreements include, but are not limited to: services providing core banking systems, ATM and debit card processing, trust services accounting software and the leasing of T-1 telecommunication lines and other technology infrastructure supporting the Company’s network.

The following table summarizes the Company’s contractual obligations at December 31, 2017:

(in thousands)	Total	Less than One Year	One to Three Years	Three to Five Years	After Five Years
FHLB Borrowings	$745,982	$608,792	$134,874	$1,633	$683
Subordinated Notes	43,033	—	—	—	43,033
Operating lease obligations	3,460	841	1,315	727	577
Purchase obligations	19,998	2,222	4,444	4,444	8,888
Total Contractual Obligations	$812,473	$611,855	$140,633	$6,804	$53,181

OFF-BALANCE SHEET ARRANGEMENTS

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

At December 31, 2017 and 2016, the Company’s off-balance sheet arrangements were limited to standby letters of credit.

Standby Letters of Credit: The Bank guarantees the obligations or performance of certain customers by issuing standby letters of credit to third parties. These letters of credit are sometimes issued in support of third-party debt. The risk involved in issuing standby letters of credit is essentially the same as the credit risk involved in extending loan facilities to customers, and they are subject to the same origination, portfolio maintenance and management procedures in effect to monitor other credit products. The amount of collateral obtained, if deemed necessary by the Bank upon issuance of a standby letter of credit, is based upon management's credit evaluation of the customer.

At December 31, 2017 and 2016, commitments under existing standby letters of credit totaled $486 thousand and $385 thousand, respectively. The fair value of the standby letters of credit was not significant as of the foregoing dates.

IMPACT OF NEW ACCOUNTING PRONOUNCEMENTS

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

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ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market Risk

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

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

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

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

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

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

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

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

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

Changes in net interest income based upon the foregoing simulations are measured against the flat interest rate scenario and actions are taken to maintain the balance sheet interest rate risk within established policy guidelines.
As of December 31, 2017 interest rate sensitivity modeling results indicate that the Bank's balance sheet was moderately liability sensitive over the one- and two-year horizons (i.e., moderately exposed to rising interest rates).
The following table presents the changes in sensitivities for the years ended December 31, 2017 and 2016:

Change in Interest Rates-Basis Points (Rate Ramp) (In Thousands)	1 - 12 Months		13 - 24 Months	
	$ Change	% Change	$ Change	% Change
At December 31, 2017				
-100	$130	0.14 %	$301	0.32 %
+200	(3,21)	(3.44)	(7,521)	(8.07)
At December 31, 2016				
-100	$(86)	(0.18)%	$(1,530)	(3.22)%
+200	(982)	(2.07)	(3,624)	(7.63)

Assuming short-term and long-term interest rates decline 100 basis points from current levels (i.e., a parallel yield curve shift) and the Bank's balance sheet structure and size remain at current levels, management believes net interest income will improve slightly over the one year horizon with a further modest improvement over the two-year horizon. Should the yield curve steepen as rates fall, the model suggests that accelerated earning asset prepayments will slow, resulting in a more stabilized level of net interest income. Management anticipates that moderate to strong earning asset growth will be needed to meaningfully increase the Bank's current level of net interest income should both long-term and short-term interest rates decline in parallel.
Assuming the Bank's balance sheet structure and size remain at current levels and the Federal Reserve increases short-term interest rates by 200 basis points with the balance of the yield curve shifting in parallel with these increases, management believes net interest income will decline moderately over the one and two-year horizons as increased funding costs outpace increases in earning asset yields. The interest rate sensitivity simulation model suggests that as interest rates rise, the Bank's funding costs will initially re-price disproportionately with earning asset yields to a moderate degree. As funding costs begin to stabilize early in the third year of the simulation, the model suggests that the earning asset portfolios will continue to re-price at prevailing interest rate levels and cash flows from the Bank's earning asset portfolios will be reinvested into higher yielding earning assets, resulting in a widening of spreads and a stabilization of net interest income over the three year horizon and beyond. Management believes moderate to strong earning asset growth will be necessary to meaningfully increase the current level of net interest income over the one-year and two-year horizons should short-term and long-term interest rates rise in parallel.
As compared to December 31, 2016, the year-one sensitivity in the down 100 basis points scenario slightly improved year-over-year, while the year-two sensitivity in the down 100 basis points scenario showed further improvement. In the year-one up 200 basis points scenario, results were modestly down versus the prior year, while year-two, up 200

basis points results were essentially unchanged. On balance, the current aggregate position is consistent with the prior year's.

Despite five rate hikes over the last twenty-four months, the Federal Reserve continues to maintain short-term interest rates at low levels, threatening net interest income. Net interest income exposure is also significantly affected by the shape and level of the U.S. Government securities and interest rate swap yield curve, and changes in the size and composition of the Bank's loan, investment and deposit portfolios.

The preceding sensitivity analysis does not represent a Company forecast and should not be relied upon as being indicative of expected operating results. These hypothetical estimates are based upon numerous assumptions including: the nature and timing of interest rate levels and yield curve shape, prepayment speeds on loans and securities, deposit rates, pricing decisions on loans and deposits, reinvestment or replacement of asset and liability cash flows, and renegotiated loan terms with borrowers. While assumptions are developed based upon current economic and local market conditions, the Company cannot make any assurances as to the predictive nature of these assumptions including how customer preferences or competitor influences might change.

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

The Bank engages an independent consultant to periodically review its interest rate risk position and the reasonableness of assumptions used, with periodic reports provided to the Bank's Board of Directors. At December 31, 2017, there were no significant differences between the views of the independent consultant and management regarding the Bank's interest rate risk exposure.

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ITEM 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

REPORT OF INDEPENDANT REGISTERED PUBLIC ACCOUNTING FIRM

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

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Bar Harbor Bankshares and subsidiaries (the Company) as of December 31, 2017 and 2016, the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2017, and the related notes to the consolidated financial statements (collectively, the financial statements). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2017, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013, and our report dated March 13, 2018 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Basis for Opinion

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

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

/s/ RSM US LLP

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

Boston, Massachusetts
March 13, 2018

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BAR HARBOR BANKSHARES AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)	December 31, 2017	December 31, 2016
Assets		
Cash and due from banks	$ 34,262	$ 8,219
Interest-bearing deposit with the Federal Reserve Bank	56,423	220
Total cash and cash equivalents	90,685	8,439
Securities available for sale, at fair value	717,242	528,856
Federal Home Loan Bank stock	38,105	25,331
Total securities	755,347	554,187
Commercial real estate	826,746	418,119
Commercial and industrial	379,423	151,240
Residential real estate	1,155,682	506,612
Consumer	123,762	53,093
Total loans	2,485,613	1,129,064
Less: Allowance for loan losses	(12,325)	(10,419)
Net loans	2,473,288	1,118,645
Premises and equipment, net	47,708	23,419
Other real estate owned	122	90
Goodwill	100,085	4,935
Other intangible assets, net	8,383	377
Cash surrender value of bank-owned life insurance	57,997	24,450
Deferred tax assets, net	7,180	5,990
Other assets	24,389	14,817
Total assets	$ 3,565,184	$ 1,755,349
Liabilities		
Demand and other non-interest bearing deposits	$ 349,055	$ 98,856
NOW deposits	466,610	175,150
Savings deposits	364,799	77,623
Money market deposits	305,275	282,234
Time deposits	866,346	416,437
Total deposits	2,352,085	1,050,300
Senior borrowings	786,688	531,596
Subordinated borrowings	43,033	5,000
Total borrowings	829,721	536,596
Other liabilities	28,737	11,713
Total liabilities	3,210,543	1,598,609
Shareholders' equity		
Capital stock, par value $2.00; authorized 20,000,000 shares; issued 16,428,388 and 10,182,611 shares at December 31, 2017 and December 31, 2016, respectively	32,857	13,577
Additional paid-in capital	186,702	23,027
Retained earnings	144,977	130,489
Accumulated other comprehensive loss	(4,554)	(4,326)
Less: 985,462 and 1,067,016 shares of treasury stock at December 31, 2017 and December 31, 2016, respectively, at cost	(5,341)	(6,027)
Total shareholders' equity	354,641	156,740
Total liabilities and shareholders' equity	$ 3,565,184	$ 1,755,349

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

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BAR HARBOR BANKSHARES AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

	Years Ended December 31,		
(in thousands, except per share data)	2017	2016	2015
Interest and dividend income			
Loans	$94,976	$41,653	$39,303
Securities and other	21,093	15,834	15,921
Total interest and dividend income	116,069	57,487	55,224
Interest expense			
Deposits	11,307	6,699	6,097
Borrowings	12,607	5,414	4,293
Total interest expense	23,914	12,113	10,390
Net interest income	92,155	45,374	44,834
Provision for loan losses	2,788	979	1,785
Net interest income after provision for loan losses	89,367	44,395	43,049
Non-interest income			
Trust and investment management fee income	12,270	3,829	3,888
Insurance and brokerage service income	1,097	—	—
Customer service fees	8,484	2,648	2,586
Gain on sales of securities, net	19	4,498	1,334
Bank-owned life insurance income	1,539	703	606
Other income	2,573	671	565
Total non-interest income	25,982	12,349	8,979
Non-interest expense			
Salaries and employee benefits	39,589	19,775	17,884
Occupancy and equipment	11,633	4,610	4,569
Loss on premises and equipment, net	94	248	7
Outside services	3,000	767	359
Professional services	1,655	1,489	1,485
Communication	1,289	586	388
Amortization of intangible assets	812	92	92
Acquisition, conversion and other expenses	3,302	2,650	54
Other expenses	11,352	5,718	6,070
Total non-interest expense	72,726	35,935	30,908
Income before income taxes	42,623	20,809	21,120
Income tax expense	16,630	5,876	5,967
Net income	$25,993	$14,933	$15,153
Earnings per share:			
Basic	$1.71	$1.65	$1.69
Diluted	$1.70	$1.63	$1.67
Weighted average common shares outstanding:			
Basic	15,184	9,069	8,970
Diluted	15,290	9,143	9,090

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

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BAR HARBOR BANKSHARES AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)	2017	2016	2015
Net income	$25,993	$14,933	$15,153
Other comprehensive income (loss), before tax:			
Changes in unrealized loss on securities available-for-sale	528	(12,059)	(3,365)
Changes in unrealized loss on derivative hedges	(838)	(272)	(1,383)
Changes in unrealized loss on post-retirement plans	(328)	90	27
Income taxes related to other comprehensive income (loss):			
Changes in unrealized loss on securities available-for-sale	(114)	4,221	1,177
Changes in unrealized loss on derivative hedges	386	95	484
Changes in unrealized loss on post-retirement plans	138	(30)	(2)
Total other comprehensive loss	(228)	(7,955)	(3,062)
Total comprehensive income	$25,765	$6,978	$12,091

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

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

(in thousands, except share data)	Common stock amount	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income	Treasury stock	Total
Balance at December 31, 2014	$ 13,577	$ 20,905	$ 113,149	$ 6,691	$ (8,035)	$ 146,287
Comprehensive income:						
Net income	—	—	15,153	—	—	15,153
Other comprehensive loss	—	—	—	(3,062)	—	(3,062)
Total comprehensive income	—	—	15,153	(3,062)	—	12,091
Cash dividends declared ($0.67 per share)	—	—	(6,040)	—	—	(6,040)
Treasury stock purchased (984 shares)	—	—	—	—	(24)	(24)
Net issuance (96,813 shares) to employee stock plans, including related tax effects	—	(97)	(2)	—	1,121	1,022
Recognition of stock based compensation	—	816	—	—		816
Balance at December 31, 2015	$ 13,577	$ 21,624	$ 122,260	$ 3,629	$ (6,938)	$ 154,152
Balance at December 31, 2015	$ 13,577	$ 21,624	$ 122,260	$ 3,629	$ (6,938)	$ 154,152
Comprehensive income:						
Net income	—	—	14,933	—	—	14,933
Other comprehensive loss	—	—	—	(7,955)	—	(7,955)
Total comprehensive income	—	—	14,933	(7,955)	—	6,978
Cash dividends declared ($0.73 per share)	—	—	(6,577)	—	—	(6,577)
Treasury stock purchased (23,072 shares)	—	—	—	—	(497)	(497)
Net issuance (123,349 shares) to employee stock plans, including related tax effects	—	125	(127)	—	1,408	1,406
Recognition of stock based compensation	—	1,278	—	—		1,278
Balance at December 31, 2016	$ 13,577	$ 23,027	$ 130,489	$ (4,326)	$ (6,027)	$ 156,740
Balance at December 31, 2016	$ 13,577	$ 23,027	$ 130,489	$ (4,326)	$ (6,027)	$ 156,740
Comprehensive income:						
Net income	—	—	25,993	—	—	25,993
Other comprehensive loss	—	—	—	(228)	—	(228)
Total comprehensive income	—	—	25,993	(228)	—	25,765
Cash dividends declared ($0.75 per share)	—	—	(11,505)	—	—	(11,505)
Acquisition of Lake Sunapee Bank Group (6,245,780 shares)	8,328	173,591	—	—	—	181,919
Treasury stock purchased (9,603 shares)	—	—	—	—	(282)	(282)
Net issuance (91,517 shares) to employee stock plans, including related tax effects	—	(222)	—	—	968	746
Three-for-two stock split	10,952	(10,968)	—	—	—	(16)
Recognition of stock based compensation	—	1,274	—	—	—	1,274
Balance at December 31, 2017	$ 32,857	$ 186,702	$ 144,977	$ (4,554)	$ (5,341)	$ 354,641

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

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BAR HARBOR BANKSHARES AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)	Years Ended December 31, 2017	2016	2015
Cash flows from operating activities:			
Net income	$25,993	$14,933	$15,153
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	2,788	979	1,785
Net amortization of securities	5,214	3,415	2,403
Deferred income taxes	6,886	470	142
Change in unamortized net loan costs and premiums	(933)	(557)	295
Premises and equipment depreciation and amortization expense	3,553	1,551	1,710
Stock-based compensation expense	1,274	1,278	816
Accretion of purchase accounting entries, net	(3,337)	—	—
Amortization of other intangibles	812	92	92
Income from cash surrender value of bank-owned life insurance policies	(1,539)	(703)	(606)
Gain on sales of securities, net	(19)	(4,498)	(1,334)
Loss on premises and equipment, net	94	—	—
Net change in other assets and liabilities	(654)	(169)	(125)
Net cash provided by operating activities	40,132	16,791	20,331
Cash flows from investing activities:			
Proceeds from sales of securities available for sale	1,599	66,583	22,753
Proceeds from maturities, calls and prepayments of securities available for sale	121,583	109,377	106,801
Purchases of securities available for sale	(172,116)	(210,824)	(168,432)
Purchase of bank owned life insurance	—	—	(15,000)
Net change in loans	(126,828)	(10,042)	(21,088)
Purchase of loans	(18,621)	(128,951)	(51,698)
Purchase of Federal Home Loan Bank stock	(1,325)	(3,852)	(125)
Purchase of premises and equipment, net	(3,157)	(4,296)	(1,866)
Acquisitions, net of cash (paid) acquired	39,537	—	—
Proceeds from sale of other real estate	322	119	672
Net cash used in investing activities	(159,006)	(181,886)	(127,983)
Cash flows from financing activities:			
Net decrease in deposits	151,900	107,513	84,738
Net change in short-term advances from the Federal Home Loan Bank	213,593	59,700	19,200
Net change in long term advances from the Federal Home Loan Bank	(153,332)	1,234	7,382
Net change in securities sold repurchase agreements	(222)	871	1,189
Exercise of stock options	968	1,570	1,127
Purchase of treasury stock	(282)	(497)	(24)
Common stock cash dividends paid	(11,505)	(6,577)	(6,040)
Net cash provided by financing activities	201,120	163,814	107,572
Net change in cash and cash equivalents	82,246	(1,281)	(80)
Cash and cash equivalents at beginning of year	8,439	9,720	9,800
Cash and cash equivalents at end of year	$90,685	$8,439	$9,720
Supplemental cash flow information:			
Interest paid	$21,399	$11,944	$10,362

Income taxes paid, net	9,084	6,286	5,566
Acquisition of non-cash assets and liabilities:			
Assets acquired	1,454,119	—	—
Liabilities assumed	1,406,887	—	—
Other non-cash changes:			
Real estate owned acquired in settlement of loans	32	—	425

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

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BAR HARBOR BANKSHARES AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

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

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

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

Cash and Cash Equivalents: For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks, federal funds sold, and other short-term investments with maturities less than 90 days. The Federal Reserve Bank requires the Bank to maintain certain reserve requirements of vault cash and/or deposits. The reserve requirement, included in cash and equivalents, was $12.7 million and $595 thousand at year-end 2017 and 2016, respectively.

Investment Securities: All securities held at December 31, 2017 and 2016 were classified as available-for-sale ("AFS"). Available-for-sale securities primarily consist of mortgage-backed securities and obligations of state and political subdivisions therefore, and are carried at estimated fair value. Changes in estimated fair value of AFS securities, net of applicable income taxes, are reported in accumulated other comprehensive income (loss) as a separate component of shareholders' equity unless deemed to be other-than-temporarily impaired ("OTTI") as discussed below. The Bank does not have a securities trading portfolio or securities held-to-maturity.

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

Other-Than-Temporary Impairments on Investment Securities: The Company conducts an OTTI analysis of investment securities on a quarterly basis or more often if a potential loss-triggering event occurs. A write-down of a

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

Federal Home Loan Bank Stock: The Bank is a member of the Federal Home Loan Bank of Boston ("FHLB"). The Bank uses the FHLB for most of its wholesale funding needs. As a requirement of membership in the FHLB, the Bank must own a minimum required amount of FHLB stock, calculated periodically based primarily on its level of borrowings from the FHLB. FHLB stock is a non-marketable equity security and therefore is reported at cost, which generally equals par value. Shares held in excess of the minimum required amount are generally redeemable at par value.

The Company periodically evaluates its investment in FHLB stock for impairment based on, among other things, the capital adequacy of the FHLB and its overall financial condition. Based on the capital adequacy, liquidity position and sustained profitability of the FHLB, management believes there is no impairment related to the carrying amount of the Bank's FHLB stock as of December 31, 2017.

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

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

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

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

For loans that meet the criteria stipulated in ASC 310-30, "Loans and Debt Securities Acquired with Deteriorated Credit Quality," the Company recognizes the accretable yield, which is defined as the excess of all cash flows expected at acquisition over the initial fair value of the loan, as interest income on a level-yield basis over the expected remaining life of the loan. The excess of the loan's contractually required payments over the cash flows expected to be collected is the nonaccretable difference. The nonaccretable difference is not recognized as an adjustment of yield, a loss accrual, or a valuation allowance. On a quarterly basis, the Company evaluates whether the timing and the amount of cash to be collected are reasonably expected. Subsequent significant increases in cash flows the Company

expects to collect will first reduce any previously recognized valuation allowance and then be reflected prospectively as an increase to the level yield. Subsequent decreases in expected cash flows may result in the loan being considered impaired. Interest income is not recognized to the extent that the net investment in the loan would increase to an amount greater than the estimated payoff amount.

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

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

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

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

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

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

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

Loans Modified in a Troubled Debt Restructuring: Loans are considered to have been modified in a troubled debt restructuring when, due to a borrower's financial difficulties, the Company makes certain concessions to the borrower that it would not otherwise consider. Modifications may include interest rate reductions, principal or interest forgiveness, forbearance, and other actions intended to minimize economic loss and to avoid foreclosure or repossession of collateral. Generally, a non-accrual loan that has been modified in a troubled debt restructuring

remains on non-accrual status for a period of at least 6 months to demonstrate that the borrower is able to meet the terms of the modified loan. However, performance prior to the modification, or significant events that coincide with the modification, are included in assessing whether the borrower can meet the new terms and may result in the loan being returned to accrual status at the time of loan modification or after a shorter performance period. If the borrower's ability to meet the revised payment schedule is uncertain, the loan remains on non-accrual status.

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

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

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

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

Refer to Note 5 of these consolidated financial statements, Loan Loss Allowance, for further information on the allowance for loan losses, including the Company's loan loss estimation methodology.

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

Premises and Equipment: Premises and equipment and related improvements are stated at cost less accumulated depreciation. Depreciation is computed on the straight-line method over the lesser of the lease term or estimated useful lives of related assets; generally 25 to 40 years for premises and three to seven years for furniture and equipment.

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

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

the fair value of a reporting unit below its carrying amount. The impairment testing process is conducted by assigning assets and goodwill to each reporting unit. Currently, the Company's goodwill is evaluated at the entity level as there is only one reporting unit. The Company first assesses certain qualitative factors to determine if it is more likely than not that the fair value of the reporting unit is less than its carrying value. If it is more likely than not that the fair value of the reporting unit is less than the carrying value, then the fair value of each reporting unit is compared to the recorded book value "step one." If the fair value of the reporting unit exceeds its carrying value, goodwill is not considered impaired and "step two" is not considered necessary. If the carrying value of a reporting unit exceeds its fair value,

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the impairment test continues ("step two") by comparing the carrying value of the reporting unit's goodwill to the implied fair value of goodwill. The implied fair value is computed by adjusting all assets and liabilities of the reporting unit to current fair value with the offset adjustment to goodwill. The adjusted goodwill balance is the implied fair value of the goodwill. An impairment charge is recognized if the carrying fair value of goodwill exceeds the implied fair value of goodwill.

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

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

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

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

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

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

Securities Sold Under Agreements to Repurchase: The Company enters into agreements under which it sells securities subject to an obligation to repurchase the same or similar securities. Under these arrangements, the Company may transfer legal control over the assets but still retain effective control through an agreement that both entitles and obligates the Company to repurchase the assets. As a result, securities sold under agreements to repurchase are

accounted for as collateralized financing arrangements (i.e., secured borrowings) and not as a sale and subsequent repurchase of securities. The obligation to repurchase the securities is reflected as a liability in the Company's consolidated statements of condition, while the securities underlying the securities sold under agreements to repurchase remain in the respective asset accounts.

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

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

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

Stock Based Compensation: The Company has equity award plans that include stock option, restricted stock and performance stock, which are described more fully in Note 15. The Company expenses the grant date fair value of equity awards granted. The expense is recognized over the vesting periods of the grants. The Company uses its treasury shares for issuing shares upon option exercises, restricted stock and performance stock vesting.

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

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

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

taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

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

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

Recent Accounting Pronouncements

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

Standard	Description	Required Date of Adoption	Effect on financial statements
Standards Adopted in 2017			
ASU 2016-09, Improvements to Employee Share-Based Payment Accounting	This ASU amends Topic 718, Stock Compensation, and intends to improve and simplify accounting for employee shared-based payments. The amendments update the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The transition method of accounting application (i.e. prospective, retrospective or modified retrospective application) differs by amendment and is defined in the guidance.	January 1, 2017	The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.
ASU 2017-08, Receivables-Nonrefundable Fees and Other Costs	This ASU amends Subtopic 310-20, Receivables-Nonrefundable Fees and Other Costs, to shorten the amortization period for certain purchased callable debt securities held at a premium to the earliest call date. Current guidance generally requires entities to amortize a premium as a yield adjustment over the contractual life of the instrument. Shortening the amortization period is generally expected to more closely align the recognition of interest income with expectations incorporated into the pricing of the underlying securities. The amendments do not affect the accounting treatment of discounts. This ASU should be adopted on a modified retrospective basis.	January 1, 2019 Early adoption permitted, including in an interim period.	The Company elected to adopt this ASU as of March 31, 2017, which had no impact on its consolidated financial statements.

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Standard	Description	Required Date of Adoption	Effect on financial statements
Standards Not Yet Adopted			
ASU 2014-09, Revenue from Contracts with Customers ASU 2015-14, Deferral of the Effective Date ASU 2016-08, Principal versus Agent Considerations ASU 2016-10, Identifying Performance Obligations and Licensing ASU 2016-12, Narrow-Scope Improvements and Practical Expedience ASU 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers	This ASU supersedes the revenue recognition requirements in ASC Topic 605, Revenue Recognition, and most industry-specific guidance throughout the Industry topics of the Codification. The core principle of the ASU is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU may be adopted either retrospectively or on a modified retrospective basis.	January 1, 2018	The Company performed an analysis to identify all revenue streams within the scope of this accounting guidance. After reviewing the related contracts as prescribed by the five steps within this ASU, the Company concludes that the adoption will have no material impact on the consolidated financial statements in 2018.
ASU 2016-01, Recognition and Measurement of Financial Assets and Liabilities	This ASU amends ASC Topic 825, Financial Instruments-Overall, and addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. Among other minor amendments applicable to the Company, the main provisions require investments in equity securities to be measured at fair value with changes in fair value recognized through net income unless they qualify for a practicability exception (excludes investments accounted for under the equity method of accounting or those that result in consolidation of the investee). Except for disclosure requirements that will be adopted prospectively, the ASU must be adopted on a modified retrospective basis.	January 1, 2018	The Company does not have any equity securities that would be in scope of this ASU. However, the Company is subject to the exit notion pricing required in fair value disclosures starting in the first quarter of 2018. Based on its review of the current methods utilized to calculate fair value, the Company concludes that this ASU will have no material impact to its consolidated financial statements.
ASU 2016-02, Leases	This ASU creates ASU Topic 842, Leases, and supersedes Topic 840, Leases. The new guidance requires lessees to record a right-of-use asset and a	January 1, 2019	The Company is currently evaluating its operating lease arrangement under this ASU.

corresponding liability equal to the present value of future rental payments on their balance sheets for all leases with a term greater than one year. There are not significant changes to lessor accounting; however, there are certain improvements made to align lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. This guidance expands both quantitative and qualitative required disclosures. This ASU should be adopted on a modified retrospective basis.

Early indications suggest that the Company will need to recognize right-of-use assets and lease liabilities for most of its operating lease commitments

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Standard	Description	Required Date of Adoption	Effect on financial statements
Standards Not Yet Adopted (Continued)			
ASU 2016-13, Measurement of Credit Losses on Financial Instruments	This ASU amends Topic 326, Financial Instruments- Credit Losses to replace the current incurred loss accounting model with a current expected credit loss approach (CECL) for financial instruments measured at amortized cost and other commitments to extend credit. The amendments require entities to consider all available relevant information when estimating current expected credit losses, including details about past events, current conditions, and reasonable and supportable forecasts. The resulting allowance for credit losses is to reflect the portion of the amortized cost basis that the entity does not expect to collect. The amendments also eliminate the current accounting model for purchased credit impaired loans and debt securities. Additional quantitative and qualitative disclosures are required upon adoption. While the CECL model does not apply to available for sale debt securities, the ASU does require entities to record an allowance when recognizing credit losses for AFS securities, rather than reduce the amortized cost of the securities by direct write-offs. The ASU should be adopted on a modified retrospective basis. Entities that have loans accounted for under ASC 310-30 at the time of adoption should prospectively apply the guidance in this amendment for purchase credit deteriorated assets.	January 1, 2020	The Company's early stages of this evaluation include a review of existing credit models and new methodologies may be leveraged to comply with the guidance under this ASU.
ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments	This ASU amends Topic 230, Statement of Cash Flows, and provides clarification with respect to classification within the statement of cash flows where current guidance is unclear or silent. The ASU should be adopted retrospectively.	January 1, 2018	Adoption of this ASU is not expected to have a material impact on the Company's consolidated financial statements.
ASU 2017-04, Simplifying the Test for Goodwill Impairment	This ASU amends Topic 350, Intangibles-Goodwill and Other, and eliminates Step 2 from the goodwill impairment test.	January 1, 2020 Early adoption is permitted.	Adoption of this ASU is not expected to have a material impact on the Company's consolidated financial statements.
ASU 2017-07, Compensation-Retirement Benefits	This ASU amends Topic 715, Retirement Benefits, and provides more prescriptive guidance around the presentation of net period pension and postretirement benefit cost in the income statement. The amendment requires that the service cost component be disaggregated from other components of net periodic benefit cost in the income statement.	January 1, 2018 Early adoption is permitted.	Adoption of this ASU is not expected to have a material impact on the Company's consolidated financial statements.

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Standard	Description	Required Date of Adoption	Effect on financial statements
Standards Not Yet Adopted (Continued)			
ASU 2017-09, Stock Compensation: Scope of Modification Accounting	This ASU amends Topic 718, Compensation-Stock Compensation, and clarifies when modification accounting should be applied to changes in terms or conditions of share-based payment awards. The amendments narrow the scope of modification accounting by clarifying that modification accounting should be applied to awards if the change affects the fair value, vesting conditions, or classification of the award. The amendments do not impact current disclosure requirements for modifications, regardless of whether modification accounting is required under the new guidance.	January 1, 2018	Adoption of this ASU is not expected to have a material impact on the Company's consolidated financial statements.
ASU 2017-12, Targeted Improvements to Accounting for Hedging Activities	This ASU amends ASC 815, Derivatives and Hedging to (1) improve the transparency and understandability of information conveyed to financial statement users about an entity's risk management activities by better aligning the entity's financial reporting for hedging relationships with those risk management activities and (2) reduce the complexity of and simplify the application of hedge accounting by preparers.	January 1, 2019	Adoption of this ASU is not expected to have a material impact on the Company's consolidated financial statements.
ASU 2018-02, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income	The ASU amends Topic 220, Income Statement-Reporting Comprehensive Income, and is intended to help organizations reclassify certain stranded income tax effects in accumulated other comprehensive income resulting from the recently enacted Tax Reform. The guidance allows entities to reclassify stranded tax effects in accumulated other comprehensive income to retained earnings.	January 1, 2019, with early adoption permitted for financial statements that have not yet been made available for issuance.	The Company has elected to adopt this ASU for financial reporting as of March 31, 2018. The effect of the reclassification is expected to be an increase to retained earnings and decrease accumulated other comprehensive income by $1.0 million, with zero net effect on total stockholders' equity.

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NOTE 2. ACQUISITION

Lake Sunapee Bank Group

On January 13, 2017, the Company completed its acquisition of Lake Sunapee Bank Group ("Lake Sunapee"). Lake Sunapee, as a holding company, had one banking subsidiary ("Lake Sunapee Bank") that had 33 full-service branches located throughout New Hampshire and Vermont. As a result of the transaction, Lake Sunapee Bank Group merged into Bar Harbor Bankshares, and Lake Sunapee Bank merged into Bar Harbor Bank. This business combination expanded the Company's geographic footprint and increased market share in its New England-based franchise. The goodwill recognized results from the expected synergies and earnings accretion from this combination, including future cost savings related to the operations of Lake Sunapee Bank Group.

On the acquisition date, Lake Sunapee had 8.38 million common shares outstanding, which were exchanged for 4.16 million of the Company's common shares based on a 0.4970 exchange ratio as defined in the merger agreement. The merger qualified as a reorganization for federal income tax purposes, and as a result, Lake Sunapee common shares exchanged for the Company's common shares were transferred on a tax-free basis. Bar Harbor Bankshares common stock issued in this exchange was valued at $43.69 per share based on the closing price posted on January 13, 2017, resulting in a consideration value of $181.92 million. The Company also paid $27 thousand to Lake Sunapee shareholders in lieu of the issuance of fractional shares. Total consideration paid at closing reflected the increase in Bar Harbor Bankshares stock price since the time of the announcement.

The results of Lake Sunapee's operations are included in the Company's Consolidated Statement of Income from the date of acquisition. The assets and liabilities in the Lake Sunapee acquisition were recorded at their fair value based on management's best estimate using information available as of the date of acquisition.

Consideration paid, and fair values of Lake Sunapee's assets acquired and liabilities assumed, along with the resulting goodwill, are summarized in the following table:

(in thousands, except shares)	As Acquired	Fair Value Adjustments		As Recorded at Acquisition
Consideration paid:				
Bar Harbor Bankshares common stock issued to Lake Sunapee Bank Group stockholders (4,163,853 shares)				$ 181,919
Cash paid for fractional shares				27
Total consideration paid				181,946
Recognized amounts of identifiable assets acquired and liabilities assumed, at fair value:				
Cash and short-term investments	$ 40,970	$ (1,406)	(a)	$ 39,564
Investment securities	156,960	(1,381)	(b)	155,579
Loans	1,217,927	(9,728)	(c)	1,208,199
Premises and equipment	22,561	(351)	(d)	22,210
Core deposit intangible	—	7,786	(e)	7,786
Other assets	102,298	(50,419)	(f)	51,879
Deposits	(1,149,865)	(746)	(g)	(1,150,611)
Borrowings	(232,261)	(16)	(h)	(232,277)
Deferred taxes, net	(1,921)	10,387	(i)	8,466
Other liabilities	(19,912)	(4,087)	(j)	(23,999)
Total identifiable net assets	$ 136,757	$ (49,961)		$ 86,796
Goodwill				$ 95,150

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Explanation of Certain Fair Value Adjustments

a. Represents in-process payments that were made on the date of acquisition that were not recorded on Lake Sunapee's general ledger until after acquisition.

b. Represents the write down of the book value of investments to their estimated fair value based on fair values on the date of acquisition.

c. Represents the write down of the book value of loans to their estimated fair value based on current interest rates and expected cash flows, which includes an estimate of expected loan loss inherent in the portfolio. The adjustment also includes the reversal of Lake Sunapee Bank's historic allowance for loan losses. Loans that met the criteria and are being accounted for in accordance with ASC 310-30, Loans and Securities Acquired with Deteriorated Credit Quality, had a book value of $23.34 million and have a fair value $18.45 million. Non-impaired loans accounted for under ASC 310-10 had a book value of $1.20 billion and have a fair value of $1.188 billion. ASC 310-30 loans have a $1.09 million fair value adjustment discount that is accretable in earnings over the weighted average life of three years using the effective yield as determined on the date of acquisition. The effective yield is periodically adjusted for changes in expected cash flows. ASC 310-10 loans have a $11.40 million fair value adjustment discount that is amortized into earnings over the remaining term of the loans using the effective interest method, or a straight-line method if the loan is a revolving credit facility.

d. Represents the adjustment of the book value of buildings and equipment, to their estimated fair value based on appraisals and other methods. The adjustments will be depreciated over the estimated economic lives of the assets.

e. Represents the value of the core deposit base assumed in the acquisition. The core deposit asset was recorded as an identifiable intangible asset and will be amortized using a straight-line method over the average life of the deposit base, which is estimated to be twelve years.

f. Primarily represents the write-off of historical goodwill and unamortized intangibles recorded by Lake Sunapee from prior acquisitions that are not carried over to the Company's balance sheet. These adjustments are not accretable into earnings in the statement of income. Also represents the value of customer list intangibles which are accretable into earnings in the statement of income.

g. Represents adjustments made to time deposits due to the weighted average contractual interest rates exceeding the cost of similar funding at the time of acquisition. The amount will be amortized using a straight-line method over the estimated useful life of one year.

h. Represents the present value difference between cash flows of current debt instruments using contractual rates and those of similar borrowings on the date of acquisition. The adjustment will be amortized over the remaining four year weighted average contractual life.

i. Represents net deferred tax assets resulting from the fair value adjustments related to the acquired assets and liabilities, identifiable intangibles, and other purchase accounting adjustments.

j. Primarily represents the impact of change in control effects on post-retirement liabilities assumed by the Company, which are not accretable into earnings in the statement of income.

Except for collateral-dependent loans with deteriorated credit quality, the fair values for loans acquired were estimated using cash flow projections based on the remaining maturity and repricing terms. Cash flows were adjusted by estimating future credit losses and the rate of prepayments. Projected monthly cash flows were then discounted to present value using a risk-adjusted market rate for similar loans. To estimate the fair value for collateral-dependent loans with deteriorated credit quality, we analyzed the underlying collateral of the loans assuming the fair values of the loans were derived from the eventual sale of the collateral. Those values were discounted using market derived rates of return, with consideration given to the period of time and costs associated with the foreclosure and disposition of the collateral. There was no carryover of the seller’s allowance for credit losses associated with the loans that were acquired in the acquisition as the loans were initially recorded at fair value.

Capitalized goodwill, which is not amortized for book purposes, is not deductible for tax purposes.

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Information about the acquired loan portfolio subject to ASC 310-30 as of January 13, 2017 is, as follows (in thousands):

	ASC 310-30 Loans
Gross contractual receivable amounts at acquisition	$23,338
Contractual cash flows not expected to be collected (nonaccretable discount)	(3,801)
Expected cash flows at acquisition	19,537
Interest component of expected cash flows (accretable discount)	(1,089)
Fair value of acquired loans	$18,448

Direct acquisition and integration costs were expensed as incurred, and totaled $6.1 million during the twelve months ending December 31, 2017 and were $2.7 million for the same period of 2016.

Pro Forma Information (unaudited)

The following table presents selected unaudited pro forma financial information reflecting the acquisition of Lake Sunapee assuming the acquisition was completed as of January 1, 2016. The unaudited pro forma financial information includes adjustments for scheduled amortization and accretion of fair value adjustments recorded at the acquisition. These adjustments would have been different if they had been recorded on January 1, 2016, and they do not include the impact of prepayments. The unaudited pro forma financial information is presented for illustrative purposes only and is not necessarily indicative of the combined financial results of the Company and Lake Sunapee had the transaction actually been completed at the beginning of the periods presented, nor does it indicate future results for any other interim or full-year period. Pro forma basic and diluted earnings per common share were calculated using the Company's actual weighted-average shares outstanding for the periods presented plus 4.16 million shares issued as a result of the acquisition. The unaudited pro forma information is based on the actual financial statements of the Company and Lake Sunapee for the periods shown until the date of acquisition, at which time Lake Sunapee operations became included in the Company's financial statements.

The unaudited pro forma information, for the twelve months ended December 31, 2017 and 2016, set forth below reflects adjustments related to amortization and accretion of purchase accounting fair value adjustments and an estimated tax rate of 37.57%. Direct acquisition expenses incurred by the Company during 2017, as noted above, are reversed for the purposes of this unaudited pro forma information. Furthermore, the unaudited pro forma information does not reflect management’s estimate of any revenue-enhancing or anticipated cost-savings that could occur as a result of the acquisition. The Company has determined it is impractical to report the amounts of revenue and earnings for each entity since acquisition date. Due to the integration of their operations with those of the organization, the Company does not record revenue and earnings separately. The revenue and earnings of Lake Sunapee Bank's operations are included in the consolidated statements of income.

Information in the following table shows unaudited proforma data for the years ended December 31, 2017 and December 31, 2016:

	Pro Forma (unaudited) Twelve Months Ended December 31,	
(in thousands, except earnings per share)	2017	2016
Net interest income	$93,200	$90,539
Non-interest income	26,072	32,484
Net income	33,100	27,084

Pro forma earnings per share:		
Basic	$2.18	$1.77
Diluted	$2.16	$1.76

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NOTE 3. SECURITIES AVAILABLE FOR SALE

The following is a summary of securities available for sale:

(in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2017				
Securities available for sale				
Debt securities:				
Obligations of US Government sponsored enterprises	$ 6,967	$ 5	$ —	$ 6,972
Mortgage-backed securities:				
US Government-sponsored enterprises	447,081	1,738	5,816	443,003
US Government agency	96,357	413	1,174	95,596
Private label	529	150	5	674
Obligations of states and political subdivisions thereof	138,522	2,407	729	140,200
Corporate bonds	30,527	323	53	30,797
Total securities available for sale	$ 719,983	$ 5,036	$ 7,777	$ 717,242
December 31, 2016				
Securities available for sale				
Debt securities:				
Mortgage-backed securities:				
US Government-sponsored enterprises	$ 330,635	$ 2,682	$ 4,865	$ 328,452
US Government agency	76,722	797	613	76,906
Private label	936	207	11	1,132
Obligations of states and political subdivisions thereof	123,832	1,941	3,407	122,366
Corporate bonds	—	—	—	—
Total securities available for sale	$ 532,125	$ 5,627	$ 8,896	$ 528,856

The amortized cost and estimated fair value of available for sale ("AFS") securities segregated by contractual maturity at December 31, 2017 are presented below. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. Mortgage-backed securities are shown in total, as their maturities are highly variable.

	Available for sale	
(in thousands)	Amortized Cost	Fair Value
Within 1 year	$ 6,997	$ 7,002
Over 1 year to 5 years	11,627	11,621
Over 5 years to 10 years	46,942	47,776
Over 10 years	110,450	111,569
Total bonds and obligations	176,016	177,968
Mortgage-backed securities	543,967	539,274
Total securities available for sale	$ 719,983	$ 717,242

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

(in thousands)	Proceeds from Sale of Securities Available for Sale	Realized Gains	Realized Losses	Net
2017	$ 1,599	$ 19	$ —	$ 19
2016	66,583	4,498	—	4,498
2015	22,753	1,334	—	1,334

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

(in thousands)	Less Than Twelve Months		Over Twelve Months		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
December 31, 2017						
Securities available for sale						
Debt securities:						
Mortgage-backed securities:						
US Government-sponsored enterprises	$ 1,895	$ 189,486	$ 3,921	$ 117,156	$ 5,816	$ 306,642
US Government agency	559	45,221	615	30,155	1,174	75,376
Private label	—	8	5	130	5	138
Obligations of states and political subdivisions thereof	58	8,298	671	27,727	729	36,025
Corporate bonds	53	8,943	—	—	53	8,943
Total securities available for sale	$ 2,565	$ 251,956	$ 5,212	$ 175,168	$ 7,777	$ 427,124
December 31, 2016						
Securities available for sale						
Debt securities:						
Mortgage-backed securities:						
US Government-sponsored enterprises	$ 4,369	$ 197,914	$ 496	$ 10,120	$ 4,865	$ 208,034
US Government agency	472	36,941	141	4,263	613	41,204
Private label	—	107	11	312	11	419
Obligations of states and political subdivisions thereof	3,252	76,803	155	3,916	3,407	80,719
Corporate bonds	—	—	—	—	—	—
Total securities available for sale	$ 8,093	$ 311,765	$ 803	$ 18,611	$ 8,896	$ 330,376

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A summary of securities pledged as collateral for certain deposits and borrowing arrangements as of the years ended December 31, 2017 and December 31, 2016 is as follows:

(in thousands)	December 31, 2017 Carrying Value	December 31, 2017 Estimated Fair Value	December 31, 2016 Carrying Value	December 31, 2016 Estimated Fair Value
Securities pledged for deposits	$195,921	$194,681	$92,380	$92,149
Securities pledged for repurchase agreements	98,407	98,050	28,206	28,130
Securities pledged for other borrowings (1)	213,379	212,089	278,067	277,261
Total securities pledged	$507,707	$504,820	$398,653	$397,540

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

Securities Impairment

As a part of the Company's ongoing security monitoring process, the Company identifies securities in an unrealized loss position that could potentially be other-than-temporarily impaired. For the twelve months ended December 31, 2017, 2016 and 2015 the Company did not record any other-than-temporary impairment ("OTTI") losses.

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

(in thousands)	Twelve Months Ended December 31, 2017	2016	2015
Estimated credit losses as of prior year-end,	$1,697	$3,180	$3,413
Reductions for securities paid off during the period	—	1,483	233
Estimated credit losses at end of the period	$1,697	$1,697	$3,180

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

The Company expects to recover its amortized cost basis on all debt securities in its AFS portfolio, as unrealized losses are the result of changes in the interest rate environment and other market factors. Furthermore, the Company does not intend to sell nor does it anticipate that it will be required to sell any of its securities in an unrealized loss position as of December 31, 2017, prior to this recovery. The Company's ability and intent to hold these securities until recovery is supported by the Company's strong capital and liquidity positions as well as its historically low portfolio turnover.

The following summarizes, by investment security type, the basis for the conclusion that the debt securities in an unrealized loss position within the Company's AFS were not other-than-temporarily impaired at December 31, 2017:

US Government-sponsored enterprises

At December 31, 2017, 369 out of the total 787 securities in the Company's portfolios of AFS US Government sponsored enterprises were in unrealized loss positions. Aggregate unrealized losses represented 1.9% of the amortized cost of securities in unrealized loss positions. The Federal National Mortgage Association ("FNMA") and Federal Home Loan Mortgage Corporation ("FHLMC") guarantee the contractual cash flows of all of the Company's US government-sponsored enterprises. The securities are rated investment grade and there were no material underlying credit downgrades during the quarter. All securities are performing.

US Government agencies

At December 31, 2017, 91 out of the total 207 securities in the Company's portfolios of AFS US Government agency securities were in unrealized loss positions. Aggregate unrealized losses represented 1.5% of the amortized cost of securities in unrealized loss positions. The Government National Mortgage Association ("GNMA") guarantees the

contractual cash flows of all of the Company's US government agency securities. The securities are rated investment grade and there were no material underlying credit downgrades during the quarter. All securities are performing.

Private-label
At December 31, 2017, 10 of the total 26 securities in the Company's portfolio of AFS private-label mortgage-backed securities were in unrealized loss positions. Aggregate unrealized losses represented 3.4% of the amortized cost of securities in unrealized loss positions. Based upon the foregoing considerations, and the expectation that the Company will receive all of the future contractual cash flows related to the amortized cost on these securities, the Company does not consider there to be any additional other-than-temporary impairment with respect to these securities.

Obligations of states and political subdivisions thereof
At December 31, 2017, 71 of the total 264 securities in the Company's portfolio of AFS municipal bonds and obligations were in unrealized loss positions. Aggregate unrealized losses represented 2.0% of the amortized cost of securities in unrealized loss positions. The Company continually monitors the municipal bond sector of the market carefully and periodically evaluates the appropriate level of exposure to the market. At this time, the Company feels the bonds in this portfolio carry minimal risk of default and the Company is appropriately compensated for that risk. There were no material underlying credit downgrades during the quarter. All securities are performing.

Corporate bonds
At December 31, 2017, 4 out of 14 securities in the Company's portfolio of AFS corporate bonds were in an unrealized loss position. The aggregate unrealized loss represents 0.6% of the amortized cost of bonds in unrealized loss positions. The Company reviews the financial strength of all of these bonds and has concluded that the amortized cost remains supported by the expected future cash flows of these securities.

Visa Class B Common Shares
The Company was a member of the Visa USA payment network and was issued Class B shares in connection with the Visa Reorganization and the Visa Inc. initial public offering in March 2008. The Visa Class B shares are transferable only under limited circumstances until they can be converted into shares of the publicly traded class of Visa stock. This conversion cannot happen until the settlement of certain litigation, which is indemnified by Visa members. Since its initial public offering, Visa has funded a litigation reserve based upon a change in the conversion ratio of Visa Class B shares into Visa Class A shares. At its discretion, Visa may continue to increase the conversion rate in connection with any settlements in excess of amounts then in escrow for that purpose and reduce the conversion rate to the extent that it adds any funds to the escrow in the future. Based on the existing transfer restriction and the uncertainty of the litigation, the Company has recorded its Visa Class B shares on its statements of condition at zero value for all reporting periods since 2008. At December 31, 2017, the Company owned 11,623 of Visa Class B shares with a then current conversion ratio to Visa Class A shares of 1.648 (or 19,158 Visa Class A shares). Upon termination of the existing transfer restriction and settlement of the litigation, and to the extent that the Company continues to own such Visa Class B shares in the future, the Company expects to record its Visa Class B shares at fair value.

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NOTE 4. LOANS

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

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

Total loans include business activity loans and acquired loans. Acquired loans are those loans acquired from Lake Sunapee Bank Group. The following is a summary of total loans as of December 31, 2017 and December 31, 2016:

(in thousands)	December 31, 2017			December 31, 2016		
	Business Activities Loans	Acquired Loans	Total	Business Activities Loans	Acquired Loans	Total
Commercial Real Estate:						
Construction and land development	$28,892	$16,781	$45,673	$14,695	$ —	$14,695
Other commercial real estate	505,119	275,954	781,073	403,424	—	403,424
Total Commercial Real Estate	534,011	292,735	826,746	418,119	—	418,119
Commercial and Industrial:						
Other Commercial	198,051	68,069	266,120	103,586	—	103,586
Agricultural and other loans to farmers	27,588	—	27,588	31,808	—	31,808
Tax exempt	42,365	43,350	85,715	15,846	—	15,846
Total Commercial and Industrial	268,004	111,419	379,423	151,240	—	151,240
Total Commercial Loans	802,015	404,154	1,206,169	569,359	—	569,359
Residential Real Estate:						
Residential mortgages	591,411	564,271	1,155,682	506,612	—	506,612
Total Residential Real Estate	591,411	564,271	1,155,682	506,612	—	506,612
Consumer:						
Home equity	51,376	62,217	113,593	46,921	—	46,921
Other consumer	7,828	2,341	10,169	6,172	—	6,172
Total Consumer	59,204	64,558	123,762	53,093	—	53,093
Total Loans	$1,452,630	$1,032,983	$2,485,613	$1,129,064	$ —	$1,129,064

Total unamortized net premiums included in the year-end total for business activity loans were the following at December 31, 2017 and December 31, 2016:

(in thousands)	2017	2016
Unamortized net loan origination costs	$2,445	$1,518
Unamortized net premium on purchased loans	(123)	(129)
Total unamortized net costs and premiums	$2,322	$1,389

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For the year ended December 31, 2017, the Company had pledged loans with a collateral value totaling $93.3 million to the Federal Reserve Bank of Boston for certain borrowing arrangements. The Company also pledged residential first mortgage loans, home equity loans and certain commercial loans with collateral value totaling $948.2 million for FHLB borrowings for the year ended December 31, 2017. (See Note 9 for detail on the Company's borrowed funds.)

The carrying amount of the acquired loans at December 31, 2017 totaled $1.033 billion. A subset of these loans was determined to have evidence of credit deterioration at the acquisition date, which is accounted for in accordance with ASC 310-30. These purchased credit-impaired loans presently maintain a carrying value of $12.6 million (and a note balance of $17.4 million). These loans are evaluated for impairment through the periodic reforecasting of expected cash flows. Loans considered not impaired at acquisition date had a carrying amount of $1.020 billion.

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

	Twelve Months Ended December 31,	
(in thousands)	2017	2016
Balance at beginning of period	$—	$ —
Acquisitions	3,398	—
Reclassification from nonaccretable difference for loans with improved cash flows	1,925	—
Changes in expected cash flows that do not affect the nonaccretable difference	—	—
Reclassification to TDR	—	—
Accretion	(1,814)	—
Balance at end of period	$3,509	$ —

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The following is a summary of past due loans at December 31, 2017 and December 31, 2016:

Business Activities Loans

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

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Business Activities Loans

(in thousands)	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Current	Total Loans	Past Due > 90 days and Accruing
December 31, 2016							
Commercial Real Estate:							
Construction and land development	$ —	$ —	$ —	$ —	$ 14,695	$ 14,695	$ —
Other commercial real estate	195	554	1,665	2,414	401,010	403,424	—
Total Commercial Real Estate	195	554	1,665	2,414	415,705	418,119	—
Commercial and Industrial:							
Other Commercial	61	45	201	307	103,279	103,586	—
Agricultural and other loans to farmers	231	—	—	231	31,577	31,808	—
Tax exempt	—	—	—	—	15,846	15,846	—
Total Commercial and Industrial	292	45	201	538	150,702	151,240	—
Total Commercial Loans	487	599	1,866	2,952	566,407	569,359	—
Residential Real Estate:							
Residential mortgages	4,484	429	938	5,851	500,761	506,612	—
Total Residential Real Estate	4,484	429	938	5,851	500,761	506,612	—
Consumer:							
Home equity	—	—	15	15	46,906	46,921	—
Other consumer	103	1	6	110	6,062	6,172	—
Total Consumer	103	1	21	125	52,968	53,093	—
							—
Total Loans	$ 5,074	$ 1,029	$ 2,825	$ 8,928	$ 1,120,136	$ 1,129,064	$ —

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Acquired Loans

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

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Non-Accrual Loans

The following is summary information pertaining to non-accrual loans at December 31, 2017 and December 31, 2016:

	December 31, 2017			December 31, 2016		
(in thousands)	Business Activities Loans	Acquired Loans	Total	Business Activities Loans	Acquired Loans	Total
Commercial Real Estate:						
Construction and land development	$637	$ —	$637	$—	$ —	$—
Other commercial real estate	7,146	560	7,706	2,564	—	2,564
Total Commercial Real Estate	7,783	560	8,343	2,564	—	2,564
Commercial and Industrial:						
Other Commercial	703	463	1,166	284	—	284
Agricultural and other loans to farmers	43	—	43	31	—	31
Tax exempt	—	—	—	—	—	—
Total Commercial and Industrial	746	463	1,209	315	—	315
Total Commercial Loans	8,529	1,023	9,552	2,879	—	2,879
Residential Real Estate:						
Residential mortgages	3,408	858	4,266	3,419	—	3,419
Total Residential Real Estate	3,408	858	4,266	3,419	—	3,419
Consumer:						
Home equity	130	217	347	90	—	90
Other consumer	95	58	153	108	—	108
Total Consumer	225	275	500	198	—	198
Total Loans	$12,162	$ 2,156	$14,318	$6,496	$ —	$6,496

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Loans evaluated for impairment as of December 31, 2017 and December 31, 2016 were as follows:

Business Activities Loans

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

Business Activities Loans

(in thousands)	Commercial real estate	Commercial and industrial	Residential real estate	Consumer	Total
December 31, 2016					
Loans receivable:					
Balance at end of period					
Individually evaluated for impairment	$ 4,481	$ 486	$ 1,709	$ 33	$ 6,709
Collectively evaluated	413,638	150,754	504,903	53,060	1,122,355
Total	$ 418,119	$ 151,240	$ 506,612	$ 53,093	$ 1,129,064

Acquired Loans

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

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The following is a summary of impaired loans at December 31, 2017 and December 31, 2016:
Business Activities Loans

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

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Business Activities Loans

	December 31, 2016		
(in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance:			
Construction and land development	$—	$ —	$ —
Other commercial real estate	2,831	2,919	—
Other commercial	130	130	—
Agricultural and other loans to farmers	139	139	—
Tax exempt	—	—	—
Residential mortgages	1,387	1,504	—
Home equity	16	16	—
Other consumer	2	2	—
With an allowance recorded:			
Construction and land development	$—	$ —	$ —
Other commercial real estate	1,650	3,575	193
Other commercial	217	367	173
Agricultural and other loans to farmers	—	—	—
Tax exempt	—	—	—
Residential mortgages	322	322	49
Home equity	—	—	—
Other consumer	15	15	9
Total			
Commercial real estate	$4,481	$ 6,494	$ 193
Commercial and industrial	486	636	173
Residential real estate	1,709	1,826	49
Consumer	33	33	9
Total impaired loans	$6,709	$ 8,989	$ 424

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Acquired Loans

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

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The following is a summary of the average recorded investment and interest income recognized on impaired loans as of December 31, 2017 and December 31, 2016:

Business Activities Loan

(in thousands)	Twelve Months Ended December 31, 2017		Twelve Months Ended December 31, 2016	
	Average Recorded Investment	Cash Basis Interest Income Recognized	Average Recorded Investment	Cash Basis Interest Income Recognized
With no related allowance:				
Construction and land development	$ —	$ —	$ —	$ —
Other commercial real estate	2,541	66	2,768	157
Other commercial	382	6	239	4
Agricultural and other loans to farmers	113	1	156	9
Tax exempt	—	—	—	—
Residential mortgages	2,174	39	1,514	73
Home equity	27	—	17	1
Other consumer	53	3	2	2
With an allowance recorded:				
Construction and land development	$ 637	$ —	$ —	$ —
Other commercial real estate	735	—	1,619	—
Other commercial	105	1	118	—
Agricultural and other loans to farmers	—	—	—	—
Tax exempt	—	—	—	—
Residential mortgages	157	5	325	—
Home equity	—	—	—	—
Other consumer	—	—	16	—
Total				
Commercial real estate	$ 3,913	$ 66	$ 4,387	$ 157
Commercial and industrial	600	8	513	13
Residential real estate	2,331	44	1,839	73
Consumer	80	3	35	3
Total impaired loans	$ 6,924	$ 121	$ 6,774	$ 246

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Acquired Loans

(in thousands)	Twelve Months Ended December 31, 2017		Twelve Months Ended December 31, 2016	
	Average Recorded Investment	Cash Basis Interest Income Recognized	Average Recorded Investment	Cash Basis Interest Income Recognized
With no related allowance:				
Construction and land development	$ —	$ —	$ —	$ —
Other commercial real estate	136	—	—	—
Other commercial	264	1	—	—
Agricultural and other loans to farmers	—	—	—	—
Tax exempt	—	—	—	—
Residential mortgages	140	1	—	—
Home equity	58	—	—	—
Other consumer	—	—	—	—
With an allowance recorded:				
Construction and land development	$ —	$ —	$ —	$ —
Other commercial real estate	—	—	—	—
Other commercial	—	—	—	—
Agricultural and other loans to farmers	—	—	—	—
Tax exempt	—	—	—	—
Residential mortgages	—	—	—	—
Home equity	—	—	—	—
Other consumer	—	—	—	—
Total				
Commercial real estate	$ 136	$ —	$ —	$ —
Commercial and industrial	264	1	—	—
Residential real estate	140	1	—	—
Consumer	58	—	—	—
Total impaired loans	$ 598	$ 2	$ —	$ —

Troubled Debt Restructuring Loans

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

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The following tables include the recorded investment and number of modifications identified during the twelve months ended December 31, 2017 and for the twelve months ended December 31, 2016, respectively. The table includes the recorded investment in the loans prior to a modification and also the recorded investment in the loans after the loans were restructured. The modifications for the twelve months ended December 31, 2017 were attributable to maturity date extensions, adjusted interest rates and payments, or a combination of two or more concessions. The modifications for the twelve months ending December 31, 2016 were attributable to interest rate concessions, maturity date extensions, court ordered concessions, or a combination of two or more concessions.

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

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

	Twelve Months Ended December 31, 2015		
(in thousands, except modifications)	Number of Modifications	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings			
Other commercial real estate	4	$ 342	$ 352
Other commercial	—	—	—
Agricultural and other loans to farmers	1	18	15
Residential mortgages	—	—	—
Home equity	—	—	—
Other consumer	5	1,435	1,433
Total	10	$ 1,795	$ 1,800

For the twelve months ended December 31, 2017, 2016 and 2015 there were no loans that were restructured that had subsequently defaulted during the period.

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The evaluation of certain loans individually for specific impairment includes loans that were previously classified as TDRs or continue to be classified as TDRs.

As of December 31, 2017, the Company maintained foreclosed residential real estate property with a fair value of $122 thousand. Additionally, residential mortgage loans collateralized by real estate property that are in the process of foreclosure as of December 31, 2017 and December 31, 2016 totaled $843 thousand and $2.4 million, respectively. As of December 31, 2016, foreclosed residential real estate property totaled $90 thousand.

Loan Concentrations
At December 31, 2017, approximately $234.6 million or 9.4% of the Bank's loan portfolio was represented by loans to the lodging industry, compared with $128.7 million or 11.4% at December 31, 2016. Additionally, approximately $409.2 million or 16.5% of the Bank's loan portfolio was represented by loans to the real estate industry at December 31, 2017, compared with $166.7 million or 14.8% of the Bank's loan portfolio at December 31, 2016. There were no other concentrations of loans related to any single industry in excess of 10% of total loans for 2017 or 2016.

Loans to Related Parties
In the ordinary course of business, the Bank has made loans at prevailing rates and terms to directors, officers and other related parties. In management's opinion, such loans do not present more than the normal risk of collectability or incorporate other unfavorable features, and were made under terms that are consistent with the Bank's lending policies.

Loan to related parties at December 31, 2017 and December 31, 2016 are summarized below.

(in thousands)	2017	2016
Beginning balance	$10,620	$4,100
Changes in composition (1)	249	7,017
New Loans	1,124	1,127
Less: repayments	(1,506)	(1,624)
Ending balance	$10,487	$10,620

(1) Adjustments to reflect changes in status of directors and officers for each year presented.

Mortgage Banking
The Bank sells loans in the secondary market and retains the ability to service many of these loans. The Bank earns fees for the servicing provided. At year-end 2017 and 2016, the Company was servicing loans for participants totaling $497.9 million and $11.2 million, respectively. Loans serviced for others are not included in the accompanying consolidated balance sheets. The risks inherent in servicing assets relate primarily to changes in prepayments that result from shifts in interest rates. Contractually-specified servicing fees were $1.2 million, $28 thousand, and $33 thousand for the years 2017, 2016, and 2015, respectively, and included as a component of other income within non-interest income.

Servicing rights activity during 2017 and 2016 was as follows:

	At or for the Twelve Months Ended December 31,	
(in thousands)	2017	2016
Balance at beginning of year	$ 5	$ 8
Acquired from Lake Sunapee Bank Group	3,417	—

Additions	134	—
Amortization	(324)	(3)
Balance at end of year	$ 3,232	$ 5

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Total residential loans included held for sale loans of $13.4 million and $0 at December 31, 2017 and 2016, respectively. The net gains on sales of loans at December 31, 2017 and 2016 were $222 thousand and $0, respectively, and included as a component of other income within non-interest income.

NOTE 5. LOAN LOSS ALLOWANCE

The allowance for loan losses is maintained at a level considered adequate to provide for our estimate of probable credit losses inherent in the loan portfolio. The allowance is increased by provisions charged to operating expense and reduced by net charge-offs. Loans are charged against the allowance for loan losses when we believe that collectability is unlikely. While we use the best information available to make our evaluation, future adjustments may be necessary if there are significant changes in conditions.

The allowance is comprised of four distinct reserve components: (1) specific reserves related to loans individually evaluated, (2) quantitative reserves related to loans collectively evaluated (3) qualitative reserves related to loans collectively evaluated and (4) a temporal estimate is made for incurred loss emergence period for each loan category within the collectively evaluated pools.

A summary of the methodology we employ on a quarterly basis with respect to each of these components in order to evaluate the overall adequacy of our allowance for loan losses is as follows:

Specific Reserve for Loans Individually Evaluated
First, we identify loan relationships having aggregate balances in excess of $150 thousand and that may also have credit weaknesses. Such loan relationships are identified primarily through our analysis of internal loan evaluations, past due loan reports and loans adversely classified internally or by regulatory authorities. Each loan so identified is then individually evaluated to determine whether it is impaired- that is, based on current information and events, it is probable that we will be unable to collect all amounts due in accordance with the contractual terms of the underlying loan agreement. Substantially all of our impaired loans historically have been collateral dependent, meaning repayment of the loan is expected or is considered to be provided solely from the sale of the loan's underlying collateral. For such loans, we measure impairment based on the fair value of the loan's collateral, which is generally determined utilizing current appraisals. A specific reserve is established in an amount equal to the excess, if any, of the recorded investment in each impaired loan over the fair value of its underlying collateral, less estimated costs to sell. Our policy is to re-evaluate the fair value of collateral dependent loans at least every twelve months unless there is a known deterioration in the collateral's value, in which case a new appraisal is obtained.

Purchase credit impaired (“PCI”) loans are collectively evaluated, but are not included in the general reserve as described below. The evaluation of the PCI loans requires continued quarterly assessment of key assumptions and estimates similar to the initial fair value estimate, including changes in the severity of loss, timing and speed of payments, collateral value changes, expected cash flows and other relevant factors. The quarterly assessment is compared to the initial fair value estimate and a determination is made if an adjustment to the allowance for loan loss is deemed necessary.

Quantitative Reserve for Loans Collectively Evaluated
Second, we stratify loan portfolio into two general business loan pools: substandard (7 risk rated) and pass-rated (0 to 6 rated) by loan type. The Company utilizes historical loss rates for commercial real estate and commercial and industrial loans that are assessed by internal risk rating. Historical loss rates on residential real estate and consumer loans are not risk graded. Residential restate and consumer loans are considered as part of the pass-rated portfolio unless removed due to specific reserve evaluation based on past due status and/or other indications of credit deterioration. Quantitative reserves relative to each loan pool are established as follows: for all loan segments an allocation equaling 100% of the respective pool's average 3 year historical net loan charge-off rate (determined based

upon the most recent 9 quarters) is applied to the aggregate recorded investment in the pool of loans. Purchased performing loans are collectively evaluated as their own separate category within each loan pool.

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Qualitative Reserve for Loans Collectively Evaluated
Third, we consider the necessity to adjust our average historical net loan charge-off rates relative to each of the above two loan pools for potential risks factors that could result in actual losses deviating from prior loss experience. Such qualitative risk factors considered are: (1) lending policies and procedures, (2) business conditions, (3) volume and nature of the loan portfolio, (4) experience, ability and depth of lending management, (5) problem loan trends, (6) quality of the Bank's loan review system, (7) concentrations in the portfolio, (8) competition, legal, and regulatory environment and (9) collateral coverage and loan-to-value.

Loss Emergence Period for Loans Collectively Evaluated
Fourth, the general allowance related to loans collectively evaluated includes an estimate of incurred losses over an estimated loss emergence period ("LEP"). The LEP was generated utilizing a charge-off look-back analysis, which studied the time from the first indication of elevated risk of repayment (or other early event indicating a problem) to eventual charge-off to support the LEP considered in the allowance calculation. This reserving methodology established the approximate number of months of LEP that represents incurred losses for each loan portfolio within each portfolio segment in addition to the qualitative reserves.

Activity in the allowance for loan losses for the twelve months ended December 31, 2017, 2016 and 2015 was as follows:

Business Activities Loans	At or for the Twelve Months Ended December 31, 2017				
(in thousands)	Commercial real estate	Commercial and industrial	Residential real estate	Consumer	Total
Balance at beginning of period	$5,145	$ 1,952	$ 2,721	$ 601	$10,419
Charged-off loans	(124)	(189)	(226)	(162)	(701)
Recoveries on charged-off loans	49	11	65	18	143
Provision/(releases) for loan losses	967	599	797	(71)	2,292
Balance at end of period	$6,037	$ 2,373	$ 3,357	$ 386	$12,153
Individually evaluated for impairment	447	3	9	—	459
Collectively evaluated	5,590	2,370	3,348	386	11,694
Total	$6,037	$ 2,373	$ 3,357	$ 386	$12,153

Business Activities Loans	At or for the Twelve Months Ended December 31, 2016				
(in thousands)	Commercial real estate	Commercial and industrial	Residential real estate	Consumer	Total
Balance at beginning of period	$4,430	$ 1,590	$ 2,747	$ 672	$9,439
Charged-off loans	(133)	(90)	(141)	(47)	(411)
Recoveries on charged-off loans	40	289	44	39	412
Provision/(releases) for loan losses	808	163	71	(63)	979
Balance at end of period	$5,145	$ 1,952	$ 2,721	$ 601	$10,419
Individually evaluated for impairment	193	173	49	9	424
Collectively evaluated	4,952	1,779	2,672	592	9,995
Total	$5,145	$ 1,952	$ 2,721	$ 601	$10,419

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Business Activities Loans	At or for the Twelve Months Ended December 31, 2015				
(in thousands)	Commercial real estate	Commercial and industrial	Residential real estate	Consumer	Total
Balance at beginning of period	$4,613	$ 1,277	$ 2,714	$ 365	$8,969
Charged-off loans	(667)	(395)	(70)	(487)	(1,619)
Recoveries on charged-off loans	98	54	129	23	304
Provision/(releases) for loan losses	386	654	(26)	771	1,785
Balance at end of period	$4,430	$ 1,590	$ 2,747	$ 672	$9,439
Individually evaluated for impairment	101	175	97	—	373
Collectively evaluated	4,329	1,415	2,650	672	9,066
Total	$4,430	$ 1,590	$ 2,747	$ 672	$9,439

Acquired Loans	At or for the Twelve Months Ended December 31, 2017				
(in thousands)	Commercial real estate	Commercial and industrial	Residential real estate	Consumer	Total
Balance at beginning of period	$—	$ —	$ —	$ —	$—
Charged-off loans	(151)	(18)	(29)	(127)	(325)
Recoveries on charged-off loans	1	—	—	—	1
Provision/(releases) for loan losses	247	34	88	127	496
Balance at end of period	$97	$ 16	$ 59	$ —	$172
Individually evaluated for impairment	—	—	—	—	—
Collectively evaluated	97	16	59	—	172
Total	$97	$ 16	$ 59	$ —	$172

There were no loans meeting the definition of acquired for the twelve month period ending December 31, 2016 and 2015.

Credit Quality Information

Loan Origination/Risk Management: The Bank has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. The Bank’s Board of Directors reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management and the Bank's Board of Directors with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies and non-performing loans and potential problem loans. The Bank seeks to diversify the loan portfolio as a means of managing risk associated with fluctuations in economic conditions.

Credit Quality Indicators/Classified Loans: In monitoring the credit quality of the commercial portfolio, management applies a credit quality indicator and uses an internal risk rating system to categorize each loan. These credit quality indicators range from one through nine, with a higher number correlating to increasing risk of loss. These ratings are used as inputs to the calculation of the allowance for loan losses. Consistent with regulatory guidelines, the Bank provides for the classification of loans which are considered to be of lesser quality as substandard, doubtful, or loss.

The following are the definitions of the Bank’s credit quality indicators:

Pass: Loans within all classes of commercial portfolio segments that are not adversely rated, are generally contractually current as to principal and interest, and are otherwise in compliance with the contractual terms of the

loan agreement. Management believes that there is a lower risk of loss related to these loans that are considered pass.

Special mention: Loans that do not expose the Bank to risk sufficient to warrant classification in one of the subsequent categories, but which possess some weaknesses, are designated as special mention. A special mention loan has potential

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weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution's credit position at some future date. This might include loans which the lending officer may be unable to supervise properly because of: (i) lack of expertise or inadequate loan agreement; (ii) the poor condition of or lack of control over collateral; or (iii) failure to obtain proper documentation or any other deviations from prudent lending practices. Economic or market conditions which may, in the future, affect the obligor may warrant special mention of the asset. Loans for which an adverse trend in the borrower's operations or an imbalanced position in the balance sheet which has not reached a point where the liquidity, or liquidation of collateral is jeopardized may be included in this classification. Special mention loans are not adversely classified and do not expose the Bank to sufficient risks to warrant classification.

Substandard: The Bank considers a loan substandard if it is inadequately protected by the current net worth and paying capacity of the borrower or of the collateral pledged, if any. Substandard loans have a well-defined weakness that jeopardizes liquidation of the debt. Substandard loans include those loans where there is the distinct possibility of some loss of principal, if the deficiencies are not corrected.

Doubtful: Loans that the Bank classifies as doubtful have all of the weaknesses inherent in those loans that are classified as substandard but also have the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is high but because of certain important and reasonably specific pending factors which may work to the advantage and strengthening of the loan, its classification as loss is deferred until its more exact status is determined. Pending factors include proposed merger, acquisition, or liquidation procedures, capital injection, perfecting liens on additional collateral and refinancing plans. The entire amount of the loan might not be classified as doubtful when collection of a specific portion appears highly probable.

Loss: Loans that the Bank classifies as losses are those considered uncollectible and of such little value that their continuance as an asset is not warranted and the uncollectible amounts are charged-off. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this worthless asset even though a partial recovery may be effected in the future. Losses are taken in the period in which they are determined to be uncollectible.

The following tables present the Company's commercial loans by risk rating at December 31, 2017 and December 31, 2016:

Business Activities Loans
Commercial Real Estate
Credit Risk Profile by Creditworthiness Category

	Construction and land development		Commercial real estate other		Total commercial real estate	
(in thousands)	December 31, 2017	December 31, 2016	December 31, 2017	December 31, 2016	December 31, 2017	December 31, 2016
Grade:						
Pass	$28,180	$ 14,695	$483,711	$ 376,968	$ 511,891	$ 391,663
Special mention	73	—	5,706	5,868	5,779	5,868
Substandard	639	—	15,702	20,588	16,341	20,588
Total	$28,892	$ 14,695	$505,119	$ 403,424	$ 534,011	$ 418,119

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Commercial and Industrial
Credit Risk Profile by Creditworthiness Category

(in thousands)	Commercial other		Agricultural and other loans to farmers		Tax exempt loans		Total commercial and industrial	
	December 31, 2017	December 31, 2016	December 31, 2017	December 31, 2016	December 31, 2017	December 31, 2016	December 31, 2017	December 31, 2016
Grade:								
Pass	$194,147	$ 98,968	$27,046	$ 31,279	$42,208	$ 15,679	$263,401	$ 145,926
Special mention	1,933	2,384	63	251	157	167	2,153	2,802
Substandard	1,971	2,234	479	278	—	—	2,450	2,512
Total	$198,051	$ 103,586	$27,588	$ 31,808	$42,365	$ 15,846	$268,004	$ 151,240

Acquired Loans
Commercial Real Estate
Credit Risk Profile by Creditworthiness Category

(in thousands)	Commercial construction and land development		Commercial real estate other		Total commercial real estate	
	December 31, 2017	December 31, 2016	December 31, 2017	December 31, 2016	December 31, 2017	December 31, 2016
Grade:						
Pass	$ 16,523	$ —	$ 266,477	$ —	$ 283,000	$ —
Special mention	235	—	2,440	—	2,675	—
Substandard	23	—	7,037	—	7,060	—
Total	$ 16,781	$ —	$ 275,954	$ —	$ 292,735	$ —

Commercial and Industrial
Credit Risk Profile by Creditworthiness Category

(in thousands)	Commercial other		Agricultural and other loans to farmers		Tax exempt loans		Total commercial and industrial	
	December 31, 2017	December 31, 2016	December 31, 2017	December 31, 2016	December 31, 2017	December 31, 2016	December 31, 2017	December 31, 2016
Grade:								
Pass	$ 60,300	$ —	$ —	$ —	$ 43,350	$ —	$ 103,650	$ —
Special mention	5,753	—	—	—	—	—	5,753	—
Substandard	2,016	—	—	—	—	—	2,016	—
Total	$ 68,069	$ —	$ —	$ —	$ 43,350	$ —	$ 111,419	$ —

The following table summarizes information about total loans rated Special Mention or higher as of December 31, 2017 and December 31, 2016. The table below includes consumer loans that are special mention and substandard accruing that are classified in the above table as performing based on payment activity.

(in thousands)	December 31, 2017			December 31, 2016		
	Business Activities Loans	Acquired Loans	Total	Business Activities Loans	Acquired Loans	Total
Non-accrual	$12,162	$ 2,156	$14,318	$6,496	$ —	$6,496
Substandard accruing	10,284	7,833	18,117	20,368	—	20,368

Total classified	22,446	9,989	32,435	26,864	—	26,864
Special mention	7,913	8,429	16,342	8,669	—	8,669
Total Criticized	$30,359	$ 18,418	$48,777	$35,533	$ —	$35,533

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NOTE 6. PREMISES AND EQUIPMENT

Year-end premises and equipment at December 31, 2017 and December 31, 2016 are summarized as follows:

(in thousands, except years)	2017	2016	Estimated Useful Life
Land	$4,849	$2,474	N/A
Buildings and improvements	48,952	27,448	5 -39 years
Furniture and equipment	6,972	8,738	3 - 7 years
Premises and equipment, gross	60,773	38,660	
Accumulated depreciation and amortization	(13,065)	(15,241)	
Premises and equipment, net	$47,708	$23,419	

Depreciation expense for the years ended December 31, 2017, 2016 and 2015 amounted to $3.5 million, $1.5 million and $1.7 million, respectively.

NOTE 7. GOODWILL AND OTHER INTANGIBLES

The activity impacting goodwill in 2017 and 2016 is as follows:

(in thousands)	2017	2016
Balance at beginning of year	$4,935	$4,935
Lake Sunapee Bank Group acquisition	95,150	—
Balance at end of year	$100,085	$4,935

In 2017, the Company completed its annual goodwill impairment testing using data as of September 30, 2017. The analysis was performed at the consolidated Bank level of the Company, which is considered the smallest reporting unit carrying goodwill. The step one analysis under the guidance of ASC 350 was passed, and therefore step two of the goodwill impairment test was not performed and no goodwill impairment was recognized for the year ended December 31, 2017. No impairment was recorded in 2016 and 2015.

The components of other intangible assets in 2017 and 2016 are as follows:

	2017		
(in thousands)	Gross Intangible Assets	Accumulated Amortization	Net Intangible Assets
Core deposit intangible (non-maturity deposits)	$8,585	$ (1,136)	$ 7,449
Customer list and other intangibles	1,016	(82)	934
Total	$9,601	$ (1,218)	$ 8,383

	2016		
(in thousands)	Gross Intangible Assets	Accumulated Amortization	Net Intangible Assets
Core deposit intangible (non-maturity deposits)	$783	$ (406)	$ 377
Total	$783	$ (406)	$ 377

Other intangible assets are amortized on a straight-line basis over their estimated lives, which range from eight and a half years to twelve years. Amortization expenses related to intangibles totaled $812 thousand in 2017, $92 thousand in 2016 and $92 thousand in 2015.

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The estimated aggregate future amortization expense for intangible assets remaining at year-end 2017 is as follows: 2018- $827 thousand; 2019- $827 thousand; 2020- $827 thousand; 2021- $742 thousand; 2022- $734 thousand; and thereafter- $4.4 million. For the years 2017, 2016 and 2015, no impairment charges were identified for the Company's intangible assets.

NOTE 8. DEPOSITS

A summary of time deposits at December 31, 2017 and December 31, 2016 were as follows:

(in thousands)	December 31, 2017	December 31, 2016
Time less than $100,000	$ 579,856	$ 304,393
Time $100,000 or more	286,490	112,044
Total time deposits	$ 866,346	$ 416,437

At December 31, 2017 and December 31, 2016, the scheduled maturities by year for time deposits were as follows:

(in thousands)	December 31, 2017	December 31, 2016
Within 1 year	$ 406,295	$ 165,296
Over 1 year to 2 years	305,895	95,728
Over 2 years to 3 years	115,878	79,306
Over 3 years to 4 years	24,459	56,717
Over 4 years to 5 years	13,685	18,145
Over 5 years	134	1,245
Total	$ 866,346	$ 416,437

Included in time deposits are brokered deposits of $428.3 million and $237.9 million at December 31, 2017 and December 31, 2016, respectively. Included in the deposit balances contained on the balance sheet are reciprocal deposits of $49.7 million and $43.1 million at December 31, 2017 and December 31, 2016, respectively.

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NOTE 9. BORROWED FUNDS

Borrowed funds at December 31, 2017 and December 31, 2016 are summarized, as follows:

	December 31, 2017		December 31, 2016	
(in thousands, except ratios)	Amount	Weighted Average Rate	Amount	Weighted Average Rate
Short-term borrowings				
Advances from the FHLB	$608,792	1.49 %	$372,700	0.97 %
Other borrowings	40,706	0.59	21,780	0.29
Total short-term borrowings	649,498	1.43	394,480	0.93
Long-term borrowings				
Advances from the FHLB	137,190	1.72	137,116	1.59
Subordinated borrowings	38,033	4.88	—	—
Junior subordinated borrowings	5,000	4.89	5,000	4.41
Total long-term borrowings	180,223	2.47	142,116	1.69
Total	$829,721	1.66 %	$536,596	1.13 %

Short term debt includes Federal Home Loan Bank of Boston ("FHLB") advances with an original maturity of less than one year. The maximum amount of short-term advances from the FHLB outstanding at month-end during 2017 and 2016 were $720.9 million and $427.1 million, respectively. For the year ended December 31, 2017, the average short-term advances from the FHLB was $590.1 million with a weighted average rate of 1.21%. For the year ended December 31, 2016, the average short-term advances from the FHLB was $368.4 million with a weighted average rate of 0.8%. The Bank also maintains a $1.0 million secured line of credit with the FHLB that bears a daily adjustable rate calculated by the FHLB. There was no outstanding balance on the FHLB line of credit for the periods ended December 31, 2017 and December 31, 2016.

The Bank also has capacity to borrow funds on a secured basis utilizing the Borrower in Custody program and the Discount Window at the Federal Reserve Bank of Boston (the "FRB"). At December 31, 2017, the Bank's available secured line of credit at the FRB was $117.1 million. The Bank has pledged certain loans and securities to the FRB to support this arrangement. There were no borrowings with the FRB for the periods ended December 31, 2017 and December 31, 2016.

Long-term FHLB advances consist of advances with a maturity of more than one year. The advances outstanding at December 31, 2017 include callable advances totaling $27.0 million, and amortizing advances totaling $683 thousand. The advances outstanding at December 31, 2016 include callable advances totaling $17.0 million, and no amortizing advances. All FHLB borrowings, including the line of credit, are secured by a blanket security agreement on certain qualified collateral, principally all residential first mortgage loans and certain securities.

A summary of maturities of FHLB advances as of December 31, 2017 is as follows:

	December 31, 2017	
(in thousands, except rates)	Amount	Weighted Average Rate
Fixed rate advances maturing:		
2018	$608,792	1.49 %
2019	104,954	1.66
2020	29,920	1.87

2021	1,633	2.32	
2022	—	—	
2023 and thereafter	683	2.80	
Total FHLB advances	$745,982	1.53	%

In April 2008, the Bank issued fifteen year junior subordinated notes in the amount of $5.0 million due in 2023. These debt securities qualify as Tier 2 capital for the Company and the Bank. The subordinated debt securities are callable by the Bank after five years without penalty. The interest rate is three-month LIBOR plus 3.45%. At December 31, 2017 and December 31, 2016 the interest rate was 5.04% and 4.41%, respectively.

On January 13, 2017, the Company acquired $17.0 million of subordinated debt in connection with the Lake Sunapee acquisition. The original subordinated debt was issued on October 29, 2014, in connection with the execution of a Subordinated Note Purchase Agreement between and among Lake Sunapee Bank Group and certain accredited investors pursuant to which Lake Sunapee Bank Group issued an aggregate of $17.0 million of subordinated notes (the “Notes”) to the accredited investors. The Notes have a maturity date of November 1, 2024, and will bear interest at a fixed rate of 6.75% per annum. The Company may, at its option, beginning with the interest payment date of November 1, 2019, and on any interest payment date thereafter, redeem the Notes, in whole or in part, at par plus accrued and unpaid interest to the date of redemption. Any partial redemption will be made pro rata among all of the noteholders. The Notes are not subject to repayment at the option of the noteholders. The Notes are unsecured, subordinated obligations of the Company and rank junior in right of payment to the Company’s senior indebtedness and to the Company’s obligations to its general creditors.

Also in connection with the Lake Sunapee acquisition, the Company acquired 100% of the common securities totaling $600 thousand and $20.0 million of Junior Subordinated Deferrable Interest Debentures ("Debentures") issued by NHTB Capital Trust II and NHTB Capital Trust III, which are both Connecticut statutory trusts. The Debentures were originally issued on March 30, 2014, carry a variable interest rate of 3-month LIBOR plus 2.79%, and mature in 2034. The debt is callable by the Company at the time when any interest payment is made. NHTB Trust II and Trust III are considered variable interest entities for which the Company is not the primary beneficiary. Accordingly, Trust II and Trust III are not consolidated into the Company’s financial statements.

NOTE 10. EMPLOYEE BENEFIT PLANS

Pension Plans

The Company maintains a legacy, employer-sponsored defined benefit pension plan (the “Plan”) for which participation and benefit accruals were frozen on January 13, 2017. The Plan was assumed in connection with the Lake Sunapee acquisition in 2017. Accordingly, no employees are permitted to commence participation in the Plan and future salary increases and years of credited service are not considered when computing an employee’s benefits under the Plan. As of December 31, 2017, all minimum Employee Retirement Income Security Act (“ERISA”) funding requirements have been met. The Company did not have any defined benefit pension plans prior to 2017.

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The following tables set forth information about the plan for the year ended December 31, 2017:

(in thousands)	2017
Change in projected benefit obligation:	
Projected benefit obligation on acquisition date	$8,642
Service cost	—
Interest cost	334
Actuarial gain	662
Benefits paid	(269)
Settlements	(349)
Projected benefit obligation at end of year	9,020
Accumulated benefit obligation	9,020
Change in fair value of plan assets:	
Fair value of plan assets on acquisition date	10,622
Expected return on plan assets	1,022
Contributions by employer	—
Benefits paid	(269)
Settlements	(349)
Fair value of plan assets at end of year	11,026
Overfunded status	$(2,006)
Amounts recognized in consolidated balance sheet:	
Other assets	$2,006

Net periodic pension cost is comprised of the following for the year ended December 31, 2017:

(in thousands)	2017
Interest cost	$334
Expected return on plan assets	(706)
Settlement Charge	13
Net periodic pension benefit	$(359)

Change in plan assets and benefit obligations recognized in accumulated other comprehensive income during 2017 are as follows:

(in thousands)	2017
Actuarial loss	$346
Settlement charge	(13)
Total recognized in accumulated other comprehensive income (pre-tax)	333
Total recognized in net periodic pension cost and other comprehensive income (pre-tax)	$(26)

The after tax components of accumulated other comprehensive loss, which have not yet been recognized in net periodic pension cost, related to the Plan are a net loss of $208 thousand. The Company expects to make no cash contributions to the pension trust during the 2018 fiscal year. The amount expected to be amortized from accumulated other comprehensive loss into net periodic pension cost over the next fiscal year is zero.

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The principal actuarial assumptions used at December 31, 2017 were as follows:

	2017
Projected benefit obligation	
Discount rate	3.56%
Net periodic pension cost	
Discount rate	4.09%
Long term rate of return on plan assets	7.00

The discount rate that is used in the measurement of the pension obligation is determined by comparing the expected future retirement payment cash flows of the plan to the Citigroup Above Median Double-A Curve as of the measurement date. The expected long-term rate of return on Plan assets reflects expectations of future returns as applied to the plan's target allocation of asset classes. In estimating that rate, appropriate consideration was given to historical returns earned by equities and fixed income securities.

The Company's overall investment strategy with respect to the Plan's assets is to maintain assets at a level that will sufficiently cover future beneficiary obligations while achieving long term growth in assets. The Plan's targeted asset allocation is 48% equity securities and 52% fixed-income securities primarily consisting of intermediate-term products.

The fair values for investment securities are determined by quoted prices in active markets, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3).

The fair value of the Plan's assets by category and level within fair value hierarchy are as follows at December 31, 2017:

(in thousands)	Total	Level 1	Level 2
Asset Category			
Equity mutual funds:			
Large-cap	$2,143	$2,143	$—
Mid-cap	612	612	—
Small-cap	613	613	—
International	1,150	1,150	
Fixed income funds:			
Fixed-income - core plus	3,896	3,896	—
Intermediate duration	1,316	1,316	—
Common stock	610	610	—
Common/collective trusts - large-cap	555	—	555
Cash equivalents - money market	130	130	—
Total	$11,025	$10,470	$555

The Plan did not hold any assets classified as Level 3, and there were no transfers between levels during 2017.

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Estimated benefit payments under the Company's pension plan over the next 10 years at December 31, 2017 are as follows:

Year	Payments in Thousands
2018	$ 342
2019	368
2020	392
2021	422
2022	439
2023-2027	2,316

Non-qualified Supplemental Executive Retirement Plan

The Company has non-qualified supplemental executive retirement agreements with certain retired officers. The agreements provide supplemental retirement benefits payable in installments over a period of years upon retirement or death. This agreement provides a stream of future payments in accordance with individually defined vesting schedules upon retirement, termination, or in the event that the participating executive leaves the Company following a change of control event.

The after tax components of accumulated other comprehensive loss, which have not yet been recognized in net periodic benefit cost, related to the non-qualified supplemental executive retirement agreements are a net loss of $348 thousand.

The following table sets forth changes in benefit obligation, changes in plan assets, and the funded status of the plan as of and for the years ended December 31, 2017 and December 31, 2016:

(in thousands)	2017	2016
Change in benefit obligation:		
Projected benefit obligation at beginning of year	$3,670	$3,811
Service cost	—	72
Interest cost	116	128
Actuarial loss/(gain)	16	(50)
Benefits paid	(351)	(291)
Projected benefit obligation at end of year	3,451	3,670
Accumulated benefit obligation	$3,451	$3,670
Change in fair value of plan assets:		
Fair value of plan assets at beginning of year	$—	$—
Expected return on plan assets	—	—
Contributions by employer	351	291
Benefits paid	(351)	(291)
Fair value of plan assets at end of year	$—	$—
Underfunded status	$3,451	$3,670
Amounts recognized in consolidated balance sheet		
Other liabilities	$3,451	$3,720

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Net periodic benefit cost is comprised of the following for the years ended December 31, 2017 and 2016:

(in thousands)	2017	2016
Service cost	$—	$72
Interest cost	116	128
Expected return on plan assets	—	—
Amortization of unrecognized actuarial loss	21	28
Net periodic benefit cost	$137	$228

Change in plan assets and benefit obligations recognized in accumulated other comprehensive income in 2017 and 2016 are as follows:

(in thousands)	2017	2016
Amortization of actuarial loss	$(21)	$(28)
Amortization of prior service credit	—	—
Actuarial loss (gain)	16	(50)
Total recognized in accumulated other comprehensive income (pre-tax)	(5)	(78)
Total recognized in net periodic benefit cost and other comprehensive income (pre-tax)	$132	$150

The amount expected to be amortized from accumulated other comprehensive income into net periodic benefit cost over then next fiscal year is a $29 thousand.

The principal actuarial assumptions used at December 31, 2017 and December 31, 2016 were as follows:

	2017	2016
Discount rate beginning of year	3.31%	3.48%
Discount rate end of year	3.13	3.31

The discount rate used in the measurement of the non-qualified supplemental executive retirement plan obligation is determined by comparing the expected future retirement payment cash flows to the Citigroup Above Median Double-A Curve as of the measurement date.

The Company expects to contribute the following amounts to fund benefit payments under the supplemental executive retirement plans:

(in thousands)	Payments
2018	$ 378
2019	378
2020	293
2021	260
2022	260
2023-2036	2,778

401(k) Plan

The Company maintains a Section 401(k) savings plan for substantially all of its employees. Employees are eligible to participate in the 401(k) Plan on the first day of any quarter following their date of hire and attainment of age 21 ½ . Under the plan, the Company makes a matching contribution of a portion of the amount contributed by each participating employee, up to a percentage of the employee's annual salary. The plan allows for supplementary profit sharing contributions by the Company, at its discretion, for the benefit of participating employees. The total expense for this plan in 2017, 2016, and 2015 was $970 thousand, $439 thousand, and $411 thousand, respectively.

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Other Plans
As a result of the acquisition of Lake Sunapee, the Company assumed salary continuation agreements for supplemental retirement income with certain prior executives and senior officers along with an executive indexed supplemental retirement plan for one prior executive. The total liability for these agreements included in other liabilities was $7.7 million at acquisition date in January of 2017 and $8.1 million at December 31, 2017. Expense recorded in 2017 under these agreements was $581 thousand.

The Company also assumed split-dollar life insurance agreements with the acquisition of Lake Sunapee Bank with an accrued liability of $697 thousand at acquisition date in January of 2017 and $687 thousand as of year-end 2017.

NOTE 11. INCOME TAXES

The following table summarizes the current and deferred components of income tax expense for each of the years ended December 31, 2017, 2016 and 2015:

(in thousands)	2017	2016	2015
Current:			
Federal Tax Expense	$8,705	$5,189	$5,607
State Tax Expense	1,039	217	218
Total Current Expense	9,744	5,406	5,825
Deferred	2,898	470	142
Impact of federal tax reform enactment	3,988	—	—
Total Income Tax Expense	$16,630	$5,876	$5,967

The following table reconciles the expected federal income tax expense (computed by applying the federal statutory tax rate of 35%) to recorded income tax expense for the years ended December 31, 2017, 2016 and 2015:

	2017		2016		2015	
(in thousands, except ratios)	Amount	Rate	Amount	Rate	Amount	Rate
Statutory Tax Rate	$14,918	35.00 %	$7,283	35.00 %	$7,392	35.00 %
Increase (Decrease) Resulting From:						
State taxes, net of federal benefit	986	2.31	141	0.68	142	0.67
Tax exempt interest	(2,074)	-4.87	(1,388)	-6.67	(1,303)	-6.17
Federal tax credits	(130)	-0.30	—	—	—	—
Officers' life insurance	(538)	-1.26	(244)	-1.17	(209)	-0.99
Acquisition Costs	89	0.21	289	1.39	—	—
Stock-based compensation plans	(241)	-0.57	—	—	—	—
Impact of federal tax reform enactment	3,988	9.36	—	—	—	—
Other	(368)	-0.86	(205)	-0.99	(55)	-0.26
Effective Tax Rate	$16,630	39.02 %	$5,876	28.24 %	$5,967	28.25 %

The tax effects of temporary differences that give rise to deferred tax assets and deferred tax liabilities at December 31, 2017 and 2016 are summarized below. The net deferred tax asset, which is included in other assets, amounted to $7.2 million at December 31, 2017 and $6.0 million at December 31, 2016.

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The significant components of deferred tax assets and liabilities at December 31, 2017 and December 31, 2016 were as follows:

(in thousands)	2017		2016	
	Assets (1)	Liabilities (1)	Assets (2)	Liabilities (2)
Allowance for loan losses	$2,729	$ —	$3,733	$ —
Deferred compensation	3,333	—	1,018	—
Unrealized gain or loss on securities available for sale	649	—	1,144	—
Unrealized gain or loss on derivatives	853	—	968	—
Unfunded post-retirement benefits	—		219	—
Depreciation	—	1,356	—	537
Deferred loan origination costs	—	655	—	517
Other real estate owned	8	—	12	—
Non-accrual interest	273	—	215	—
Write down of impaired investments	—	—	626	—
Branch acquisition costs and goodwill	—	737	—	760
Core deposit intangible	—	1,525	82	—
Acquisition fair value adjustments				