

NORTHEAST BANCORP /ME/
Form 10-Q
February 13, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended December 31, 2014

Commission File Number: 1-14588

Northeast Bancorp

(Exact name of registrant as specified in its charter)

Maine

(State or other jurisdiction of incorporation or organization)

01-0425066

(I.R.S. Employer Identification No.)

500 Canal Street, Lewiston, Maine
(Address of Principal executive offices)

04240
(Zip Code)

(207) 786-3245

Registrant's telephone number, including area code

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "accelerated filer", "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (check one):

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☐

Smaller Reporting Company ☒

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. As of January 31, 2015 the registrant had outstanding 8,957,474 shares of voting common stock, \$1.00 par value per share and 880,963 shares of non-voting common stock, \$1.00 par value per share.

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PART 1- FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

NORTHEAST BANCORP AND SUBSIDIARY**CONSOLIDATED BALANCE SHEETS**

(Unaudited)

(Dollars in thousands, except share data)

	December 31, 2014		June 30, 2014	
Assets				
Cash and due from banks	\$	2,626	\$	3,372
Short-term investments		80,643		78,887
Total cash and cash equivalents		83,269		82,259
Available-for-sale securities, at fair value		107,841		113,881
Loans held for sale		5,154		11,945
Loans		575,335		516,416
Less: Allowance for loan losses		1,664		1,367
Loans, net		573,671		515,049
Premises and equipment, net		8,494		9,135
Real estate owned and other repossessed collateral, net		2,058		1,991
Federal Home Loan Bank stock, at cost		4,102		4,102
Intangible assets, net		2,467		2,798
Bank owned life insurance		15,055		14,836
Other assets		7,924		5,935
Total assets	\$	810,035	\$	761,931
Liabilities and Stockholders Equity				
Liabilities				
Deposits:				
Demand	\$	51,920	\$	50,140
Savings and interest checking		95,373		98,340
Money market		144,523		83,901
Time		339,904		341,948
Total deposits		631,720		574,329
Federal Home Loan Bank advances		35,244		42,824
Wholesale repurchase agreements		10,117		10,199
Short-term borrowings		2,775		2,984
Junior subordinated debentures issued to affiliated trusts		8,530		8,440
Capital lease obligation		1,464		1,558
Other liabilities		9,262		9,531
Total liabilities		699,112		649,865
Commitments and contingencies				
Stockholders equity				
Preferred stock, \$1.00 par value, 1,000,000 shares authorized; no shares issued and outstanding at December 31, 2014 and June 30, 2014				

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Voting common stock, \$1.00 par value, 25,000,000 shares authorized; 8,965,424 and 9,260,331 shares issued and outstanding at December 31, 2014 and June 30, 2014, respectively	8,965	9,260
Non-voting common stock, \$1.00 par value, 3,000,000 shares authorized; 880,963 shares issued and outstanding at December 31, 2014 and June 30, 2014	881	881
Additional paid-in capital	87,404	90,914
Retained earnings	15,314	12,294
Accumulated other comprehensive loss	(1,641)	(1,283)
Total stockholders' equity	110,923	112,066
Total liabilities and stockholders' equity	\$ 810,035	\$ 761,931

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

Table of Contents**NORTHEAST BANCORP AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF INCOME**

(Unaudited)

(Dollars in thousands, except share and per share data)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2014	2013	2014	2013
Interest and dividend income:				
Interest on loans	\$ 10,948	\$ 10,282	\$ 21,870	\$ 18,739
Interest on available-for-sale securities	232	262	475	544
Other interest and dividend income	79	96	146	147
Total interest and dividend income	11,259	10,640	22,491	19,430
Interest expense:				
Deposits	1,281	979	2,410	2,026
Federal Home Loan Bank advances	265	327	588	651
Wholesale repurchase agreements	73	98	145	192
Short-term borrowings	7	6	16	11
Junior subordinated debentures issued to affiliated trusts	188	192	394	385
Obligation under capital lease agreements	19	21	38	43
Total interest expense	1,833	1,623	3,591	3,308
Net interest and dividend income before provision for loan losses	9,426	9,017	18,900	16,122
Provision for loan losses	113	151	433	227
Net interest and dividend income after provision for loan losses	9,313	8,866	18,467	15,895
Noninterest income:				
Fees for other services to customers	392	421	786	861
Gain on sales of loans held for sale	447	341	1,029	880
Gain on sales of portfolio loans	445	13	525	230
(Loss) gain recognized on real estate owned and other repossessed collateral, net	(31)	(77)	(54)	(115)
Bank-owned life insurance income	110	116	219	234
Other noninterest income	7	21	19	34
Total noninterest income	1,370	835	2,524	2,124
Noninterest expense:				
Salaries and employee benefits	4,737	4,253	9,270	8,865
Occupancy and equipment expense	1,181	1,311	2,384	2,601
Professional fees	458	281	766	657
Data processing fees	347	277	692	554
Marketing expense	80	103	148	139
Loan acquisition and collection expense	413	290	687	763
FDIC insurance premiums	110	117	234	227
Intangible asset amortization	166	210	331	420
Legal settlement recovery				(250)
Other noninterest expense	718	772	1,437	1,490
Total noninterest expense	8,210	7,614	15,949	15,466
Income from continuing operations before income tax expense	2,473	2,087	5,042	2,553
Income tax expense	893	676	1,818	832

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Net income from continuing operations	1,580	1,411	3,224	1,721
(Loss) income from discontinued operations				
before tax (benefit) expense		(27)		(12)
Income tax (benefit) expense		(9)		(4)
Net (loss) income from discontinued operations		(18)		(8)
Net income	\$ 1,580	\$ 1,393	\$ 3,224	\$ 1,713
Weighted-average shares outstanding:				
Basic	10,132,349	10,432,833	10,155,598	10,436,673
Diluted	10,132,349	10,432,833	10,155,598	10,436,673
Earnings per common share:				
Basic:				
Income from continuing operations	\$ 0.16	\$ 0.13	\$ 0.32	\$ 0.16
Income from discontinued operations				
Net Income	\$ 0.16	\$ 0.13	\$ 0.32	\$ 0.16
Diluted:				
Income from continuing operations	\$ 0.16	\$ 0.13	\$ 0.32	\$ 0.16
Income from discontinued operations				
Net income	\$ 0.16	\$ 0.13	\$ 0.32	\$ 0.16
Cash dividends declared per common share	\$ 0.01	\$ 0.09	\$ 0.02	\$ 0.18

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

Table of Contents**NORTHEAST BANCORP AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(Unaudited)

(Dollars in thousands)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2014	2013	2014	2013
Net income	\$ 1,580	\$ 1,393	\$ 3,224	\$ 1,713
Other comprehensive income (loss), before tax:				
Available-for-sale securities:				
Change in net unrealized gain or loss on available-for-sale securities	538	(647)	263	(130)
Reclassification adjustment for net gains included in net income				
Total available-for-sale securities	538	(647)	263	(130)
Derivatives and hedging activities:				
Change in accumulated loss on effective cash flow hedges	(500)	565	(770)	584
Reclassification adjustments for net gains included in net income	(24)	(17)	(34)	(36)
Total derivatives and hedging activities	(524)	548	(804)	548
Total other comprehensive income (loss), before tax	14	(99)	(541)	418
Income tax expense (benefit) related to other comprehensive (loss) income	4	(34)	(183)	142
Other comprehensive income (loss), net of tax	10	(65)	(358)	276
Comprehensive income	\$ 1,590	\$ 1,328	\$ 2,866	\$ 1,989

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

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(Unaudited)

(Dollars in thousands, except share and per share data)

	Preferred Stock		Voting Common Stock		Non-voting Common Stock		Additional Paid-in Capital		Retained Earnings	Accumulated Other Comprehensive Loss	Total Stockholders' Equity					
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount								
Balance at June 30, 2013		\$	9,565,680	\$	9,566	880,963	\$	881	\$	92,745	\$	12,524	\$	(1,914)	\$	113,802
Net income										1,713						1,713
Other comprehensive income, net of tax														276		276
Dividends on common stock at \$0.18 per share										(1,879)						(1,879)
Stock-based compensation									471							471
Forfeiture of restricted common stock			(14,149)		(14)				14							
Balance at December 31, 2013		\$	9,551,531	\$	9,552	880,963	\$	881	\$	93,230	\$	12,358	\$	(1,638)	\$	114,383
Balance at June 30, 2014		\$	9,260,331	\$	9,260	880,963	\$	881	\$	90,914	\$	12,294	\$	(1,283)	\$	112,066
Net income										3,224						3,224
Other comprehensive income, net of tax														(358)		(358)
Common stock repurchased			(448,686)		(449)				(3,653)							(4,102)
Dividends on common stock at \$0.02 per share										(204)						(204)
Stock-based compensation									297							297
Issuance of restricted common stock			168,000		168				(168)							
Forfeiture of restricted common stock			(14,221)		(14)				14							
Balance at December 31, 2014		\$	8,965,424	\$	8,965	880,963	\$	881	\$	87,404	\$	15,314	\$	(1,641)	\$	110,923

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

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(Unaudited)

(Dollars in thousands)

	Six Months Ended December 31,	
	2014	2013
Operating activities:		
Net income	\$ 3,224	\$ 1,713
Adjustments to reconcile net income to net cash provided by (used in) by operating activities:		
Provision for loan losses	433	227
Loss on sale and impairment of real estate owned and other repossessed collateral, net	54	115
Accretion of fair value adjustments on loans, net	(6,117)	(4,099)
Accretion of fair value adjustments on deposits, net	(120)	(415)
Accretion of fair value adjustments on borrowings, net	(72)	(132)
Originations of loans held for sale	(49,444)	(44,651)
Net proceeds from sales of loans held for sale	57,264	47,299
Gain on sales of loans held for sale	(1,029)	(880)
Gain on sales of portfolio loans	(525)	(230)
Amortization of intangible assets	331	420
Bank-owned life insurance income, net	(219)	(234)
Depreciation of premises and equipment	847	1,035
Loss (gain) on sale of premises and equipment	28	(1)
Net gain on sale of available-for-sale securities		
Stock-based compensation	297	471
Amortization of securities, net	519	668
Changes in other assets and liabilities:		
Other assets	(1,693)	(6,568)
Other liabilities	(1,071)	3,290
Net cash provided (used in) by operating activities	2,707	(1,972)
Investing activities:		
Proceeds from sales of available-for-sale securities		
Purchases of available-for-sale securities		(12,083)
Proceeds from maturities and principal payments on available-for-sale securities	5,786	18,165
Loan purchases	(39,667)	(29,967)
Proceeds from sales of portfolio loans	3,665	216
Loan originations and principal collections, net	(16,778)	(34,000)
Purchases of premises and equipment	(234)	(594)
Proceeds from sales of premises and equipment		11
Proceeds from sales of real estate owned and other repossessed collateral	129	528
Net cash used in investing activities	(47,099)	(57,724)
Financing activities:		
Net increase in deposits	57,511	52,314
Net (decrease) increase in short-term borrowings	(209)	1,843
Repurchase of common stock	(4,102)	
Dividends paid on common stock	(204)	(1,879)
Proceeds from FHLB advances		15,000
Repayments of FHLB advances	(7,500)	
Repayment of wholesale repurchase agreements		(10,000)

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Repayment of capital lease obligation	(94)	(89)
Net cash provided by financing activities	45,402	57,189
Net decrease in cash and cash equivalents	1,010	(2,507)
Cash and cash equivalents, beginning of period	82,259	65,934
Cash and cash equivalents, end of period	\$ 83,269	\$ 63,427
Supplemental schedule of noncash investing and financing activities:		
Transfers from loans to real estate owned and other repossessed collateral	\$ 241	\$ 1,727
Transfers from real estate owned and other repossessed collateral to loans	2	

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

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NORTHEAST BANCORP AND SUBSIDIARY

Notes to Unaudited Consolidated Financial Statements

December 31, 2014

1. Basis of Presentation

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

These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, the accompanying consolidated financial statements contain all adjustments (consisting principally of normal recurring accruals) considered necessary for a fair presentation of the Company s financial position, results of operations, and cash flows for the interim periods presented. These financial statements and notes should be read in conjunction with the audited consolidated financial statements and notes thereto for the fiscal year ended June 30, 2014 (Fiscal 2014) included in the Company s Annual Report on Form 10-K filed with the Securities and Exchange Commission.

2. Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)* (ASU 2014-09). ASU 2014-09 implements a common revenue standard that clarifies the principles for recognizing revenue. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps: (i) identify the contract(s) with a customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract and (v) recognize revenue when (or as) the entity satisfies a performance obligation. ASU 2014-09 is effective January 1, 2017 and is not expected to have a significant impact on the Company s financial statements.

In June 2014, the FASB issued ASU 2014-11, *Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures* (ASU 2014-11). ASU 2014-11 requires that repurchase-to-maturity transactions be accounted for as secured borrowings consistent with the accounting for other repurchase agreements. In addition, ASU 2014-11 requires separate accounting for repurchase financings, which entails the transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty. ASU 2014-11 requires entities to disclose certain information about transfers accounted for as sales in transactions that are economically similar to repurchase agreements. In addition, ASU 2014-11 requires disclosures related to collateral, remaining contractual tenor and of the potential risks associated with repurchase agreements, securities lending transactions and repurchase-to-maturity transactions. ASU 2014-11 is effective January 1, 2015 and is not expected to have a significant impact on the Company s financial statements.

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In August 2014, the FASB issued ASU 2014-14, *Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40): Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure* (ASU 2014-14). ASU 2014-14 affects creditors that hold government-guaranteed mortgage loans, including those guaranteed by the Federal Housing Administration (FHA) of the U.S. Department of Housing and Urban Development (HUD), and the U.S. Department of Veterans Affairs (VA). The update requires that, upon foreclosure, a guaranteed mortgage loan be derecognized and a separate other receivable be recognized when specific criteria are met. ASU 2014-14 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2014. The adoption of this guidance is not expected to have a significant impact on the Company's financial statements.

Table of Contents**3. Securities Available-for-Sale**

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

	December 31, 2014				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses		Fair Value
	(Dollars in thousands)				
U.S. Government agency securities	\$ 48,302	\$ 43	\$ (28)	\$	48,317
Agency mortgage-backed securities	60,553	4	(1,033)		59,524
	\$ 108,855	\$ 47	\$ (1,061)	\$	107,841

	June 30, 2014				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses		Fair Value
	(Dollars in thousands)				
U.S. Government agency securities	\$ 48,415	\$ 31	\$ (28)	\$	48,418
Agency mortgage-backed securities	66,744	3	(1,284)		65,463
	\$ 115,159	\$ 34	\$ (1,312)	\$	113,881

When securities are sold, the adjusted cost of the specific security sold is used to compute the gain or loss on sale. There were no securities sold during the three and six months ended December 31, 2014 or 2013. At December 31, 2014, investment securities with a fair value of approximately \$34.7 million were pledged as collateral to secure outstanding borrowings.

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

	December 31, 2014				Total	
	Less than 12 Months Fair Value	Unrealized Losses	More than 12 Months Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)					
U.S. Government agency securities	\$ 27,086	\$ (28)	\$	\$	\$ 27,086	\$ (28)
Agency mortgage-backed securities	2,188	(8)	54,970	(1,025)	57,158	(1,033)
	\$ 29,274	\$ (36)	\$ 54,970	\$ (1,025)	\$ 84,244	\$ (1,061)

	June 30, 2014				Total	
	Less than 12 Months Fair Value	Unrealized Losses	More than 12 Months Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)					
U.S. Government agency securities	\$ 24,141	\$ (28)	\$	\$	\$ 24,141	\$ (28)

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Agency mortgage-backed securities

				62,734	(1,284)	62,734	(1,284)
\$	24,141	\$	(28)	\$	62,734	\$	(1,284)
						86,875	(1,312)

There were no other-than-temporary impairment losses on securities during the three and six months ended December 31, 2014 or 2013.

At December 31, 2014, the Company had twenty securities in a continuous loss position for greater than twelve months. At December 31, 2014, all of the Company's available-for-sale securities were issued or guaranteed by either government agencies or government-sponsored enterprises. The decline in fair value of the Company's available-for-sale securities at December 31, 2014 is attributable to changes in interest rates.

Management of the Company, in addition to considering current trends and economic conditions that may affect the quality of individual securities within the Company's investment portfolio, also considers the Company's ability and intent to hold such securities to maturity or recovery of cost. Management does not believe any of the Company's available-for-sale securities are other-than-temporarily impaired at December 31, 2014.

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The amortized cost and fair values of available-for-sale debt securities by contractual maturity are shown below as of December 31, 2014. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost		Fair Value
	(Dollars in thousands)		
Due within one year	\$ 9,035	\$	9,039
Due after one year through five years	39,267		39,278
Due after five years through ten years	30,053		29,718
Due after ten years	30,500		29,806
	\$ 108,855	\$	107,841

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4. Loans, Allowance for Loan Losses and Credit Quality

Loans are carried at the principal amounts outstanding, or amortized acquired fair value in the case of acquired loans, adjusted by partial charge-offs and net of deferred loan costs or fees. Loan fees and certain direct origination costs are deferred and amortized into interest income over the expected term of the loan using the level-yield method. When a loan is paid off, the unamortized portion is recognized in interest income. Interest income is accrued based upon the daily principal amount outstanding except for loans on nonaccrual status.

Loans purchased by the Company are accounted for under ASC 310-30, *Receivables - Loans and Debt Securities Acquired with Deteriorated Credit Quality* (ASC 310-30). At acquisition, the effective interest rate is determined based on the discount rate that equates the present value of the Company's estimate of cash flows with the purchase price of the loan. Prepayments are not assumed in determining a purchased loan's effective interest rate and income accretion. The application of ASC 310-30 limits the yield that may be accreted on the purchased loan, or the accretable yield, to the excess of the Company's estimate, at acquisition, of the expected undiscounted principal, interest, and other cash flows over the Company's initial investment in the loan. The excess of contractually required payments receivable over the cash flows expected to be collected on the loan represents the purchased loan's nonaccretable difference. Subsequent improvements in expected cash flows of loans with nonaccretable differences result in a prospective increase to the loan's effective yield through a reclassification of some, or all, of the nonaccretable difference to accretable yield. The effect of subsequent credit-related declines in expected cash flows of purchased loans are recorded through a specific allocation in the allowance for loan losses.

Loans are generally placed on nonaccrual status when they are past due 90 days as to either principal or interest, or when in management's judgment the collectability of interest or principal of the loan has been significantly impaired. Loans accounted for under ASC 310-30 are placed on nonaccrual when it is not possible to reach a reasonable expectation of the timing and amount of cash flows to be collected on the loan. When a loan has been placed on nonaccrual status, previously accrued and uncollected interest is reversed against interest on loans. Interest on nonaccrual loans is accounted for on a cash-basis or using the cost-recovery method when collectability is doubtful. A loan is returned to accrual status when collectability of principal is reasonably assured and the loan has performed for a reasonable period of time.

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

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

Originated	December 31, 2014		Total	Originated	June 30, 2014		Total
	Purchased				Purchased		
(Dollars in thousands)							

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Residential real estate	\$	112,272	\$	2,211	\$	114,483	\$	116,972	\$	3,687	\$	120,659
Home equity		25,534				25,534		27,975				27,975
Commercial real estate		125,567		217,914		343,481		116,617		199,481		316,098
Commercial business		82,672		267		82,939		41,518		282		41,800
Consumer		8,898				8,898		9,884				9,884
Total loans	\$	354,943	\$	220,392	\$	575,335	\$	312,966	\$	203,450	\$	516,416

Related Party Loans

The Bank's authority to extend credit to their respective directors and executive officers, as well as to entities controlled by such persons, is currently governed by the requirements of the Sarbanes-Oxley Act of 2002 and Regulation O of the Board of Governors of the Federal Reserve System. Among other things, these provisions require that extensions of credit to insiders (1) be made on terms that are substantially the same as, and follow credit underwriting procedures that are not less stringent than, those prevailing for comparable transactions with unaffiliated persons and that do not involve more than the normal risk of repayment or present other unfavorable features; and (2) not exceed certain limitations on the amount of credit extended to such persons, individually and in the aggregate, which limits are based, in part, on the amount of the Bank's capital. In addition, the extensions of credit to insiders must be approved by each Bank's Board of Directors.

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Total loans and advances, to directors, executive officers and their affiliates were \$416 thousand at December 31, 2014. All loans were performing at December 31, 2014.

Allowance for Loan Losses and Impaired Loans

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

The allowance for loan losses consists of general, specific, and unallocated reserves and reflects management's estimate of probable loan losses inherent in the loan portfolio at the balance sheet date. Management uses a consistent and systematic process and methodology to evaluate the appropriateness of the allowance for loan losses on a quarterly basis. The calculation of the allowance for loan losses is segregated by portfolio segments, which include: commercial real estate, commercial business, consumer, residential real estate, and purchased loans. Risk characteristics relevant to each portfolio segment are as follows:

Residential real estate: All loans in this segment are collateralized by residential real estate and repayment is primarily dependent on the credit quality of the individual borrower. The overall health of the economy, particularly unemployment rates and housing prices, has a significant effect on the credit quality in this segment. For purposes of the Company's allowance for loan loss calculation, home equity loans and lines of credit are included in residential real estate.

Commercial real estate: Loans in this segment are primarily income-producing properties. For owner-occupied properties, the cash flows are derived from an operating business, and the underlying cash flows may be adversely affected by deterioration in the financial condition of the operating business. The underlying cash flows generated by non-owner occupied properties may be adversely affected by increased vacancy rates. Management periodically obtains rent rolls, with which it monitors the cash flows of these loans. Adverse developments in either of these areas will have an adverse effect on the credit quality of this segment. For purposes of the allowance for loan losses, this segment also includes construction loans.

Commercial business: Loans in this segment are made to businesses and are generally secured by the assets of the business. Repayment is expected from the cash flows of the business. Weakness in national or regional economic conditions, and a corresponding weakness in consumer or business spending, will have an adverse effect on the credit quality of this segment.

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

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

The general component of the allowance for loan losses is based on historical loss experience adjusted for qualitative factors stratified by loan segment. The Company does not weight periods used in that analysis to determine the average loss rate in each portfolio segment. This historical loss factor is adjusted for the following qualitative factors:

- Levels and trends in delinquencies and nonperforming loans
- Trends in the volume and nature of loans
- Trends in credit terms and policies, including underwriting standards, procedures and practices, and the experience and ability of lending management and staff
- Trends in portfolio concentration
- National and local economic trends and conditions
- Effects of changes or trends in internal risk ratings
- Other effects resulting from trends in the valuation of underlying collateral

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There were no significant changes in the Company's policies or methodology pertaining to the general component of the allowance for loan losses during the three and six months ended December 31, 2014 or 2013.

The allocated component of the allowance for loan losses relates to loans that are classified as impaired. Impairment is measured on a loan-by-loan basis for commercial business and commercial real estate loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. An allowance is established when the discounted cash flows or collateral value of the impaired loan is lower than the carrying value of that loan. Large groups of smaller-balance homogeneous loans, such as consumer and residential real estate loans are collectively evaluated for impairment based on the group's historical loss experience adjusted for qualitative factors. Accordingly, the Company does not separately identify individual consumer and residential loans for individual impairment and disclosure. However, all TDRs are individually reviewed for impairment.

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

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

	Three Months Ended December 31, 2014							
	Residential Real Estate	Commercial Real Estate	Commercial Business	Consumer	Purchased	Unallocated	Total	
	(Dollars in thousands)							
Beginning balance	\$ 783	\$ 340	\$ 49	\$ 51	\$ 271	\$ 45	\$ 1,539	
Provision	2	(53)	5	8	142	9	113	
Recoveries	11	1		3			15	
Charge-offs				(3)			(3)	
Ending balance	\$ 796	\$ 288	\$ 54	\$ 59	\$ 413	\$ 54	\$ 1,664	

	Three Months Ended December 31, 2013							
	Residential Real Estate	Commercial Real Estate	Commercial Business	Consumer	Purchased	Unallocated	Total	
	(Dollars in thousands)							
Beginning balance	\$ 695	\$ 163	\$ 50	\$ 148	\$ 101	\$ 67	\$ 1,224	
Provision	(33)	158	2	(24)	106	(58)	151	
Recoveries				12			12	
Charge-offs	(13)			(24)			(37)	

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Ending balance	\$	649	\$	321	\$	52	\$	112	\$	207	\$	9	\$	1,350
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