

Katahdin Bankshares Corp.

ANNUAL REPORT 2015



“For us, Katahdin Trust was a perfect fit.”

Mike Levesque
Owner, Perfect Fit | Corinna, Maine

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COVER PHOTO BY PAUL CYR

COMMITTED TO BUSINESS. BANKING ON MAINE.



"They're a local, homegrown bank. They know us by name."

Dr. Norma Desjardins, Owner, Academy Dental, Presque Isle, Maine



"They really make it simple to do business together."

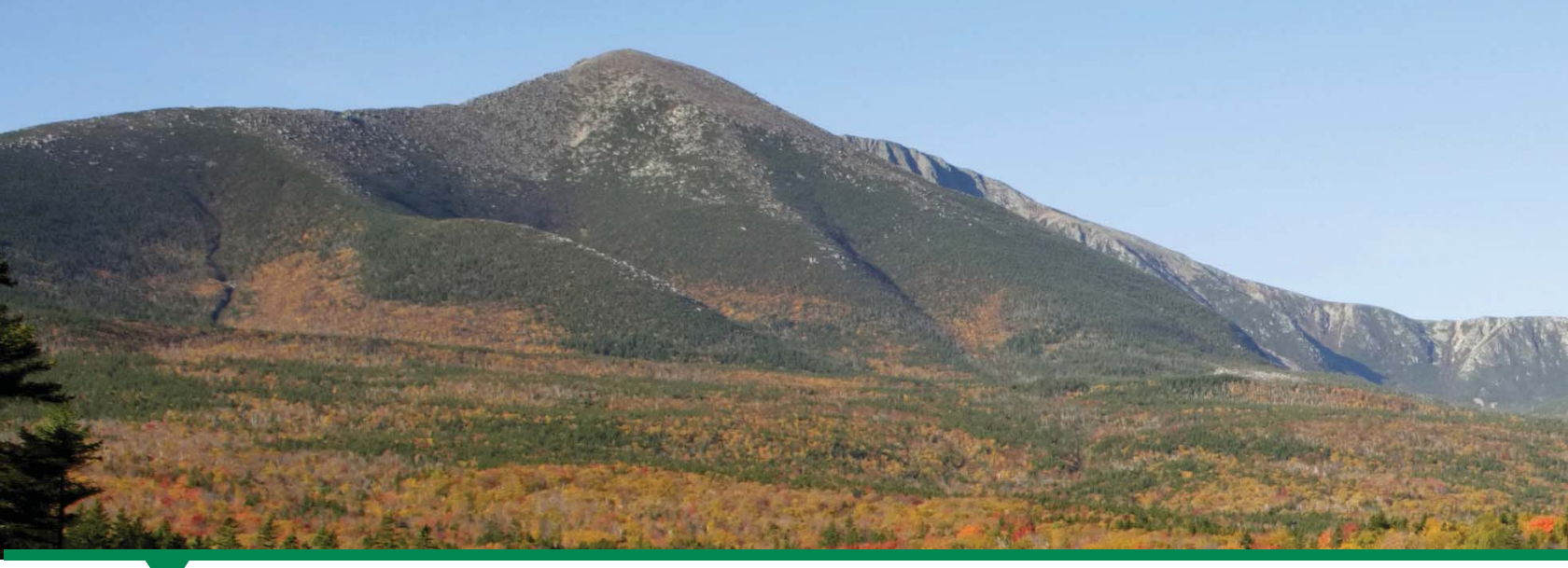
David Fielding, Owner, Fielding's Oil & Propane Co., Scarborough, Maine



"Banking with Katahdin Trust lets me spend more time in the shop."

Roger Larson, Owner, Stairs Welding RL, Inc., Hodgdon, Maine

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DEAR FELLOW SHAREHOLDERS

Net income paid before dividends on preferred stock totaled $4,810,000, a healthy increase of 13.0% over 2014. Earnings per share increased from $1.09 in 2014 to $1.15 or 5.5%. Net interest income, our largest source of earnings, increased $860,000. Return on Average Assets of .70% and Return on Average Equity of 7.50% were both increases over the prior year.

Deposit growth was a big positive in 2015 as local demand, NOW and money market and savings deposits all showed very healthy increases. Deposit growth has been an area of management concentration for many years, and it was rewarding to see our efforts pay off in this area. We saw tremendous growth in our traditional markets of over $32,000,000, and solid growth in the Bangor and Portland markets as well. While the largest growth occurred in the commercial area, we also saw personal deposits increase. Because of the increase in local funds, we were able to lessen our reliance on brokered deposits and Federal Home Loan Bank borrowings. We continue to seek every opportunity for deposit growth.

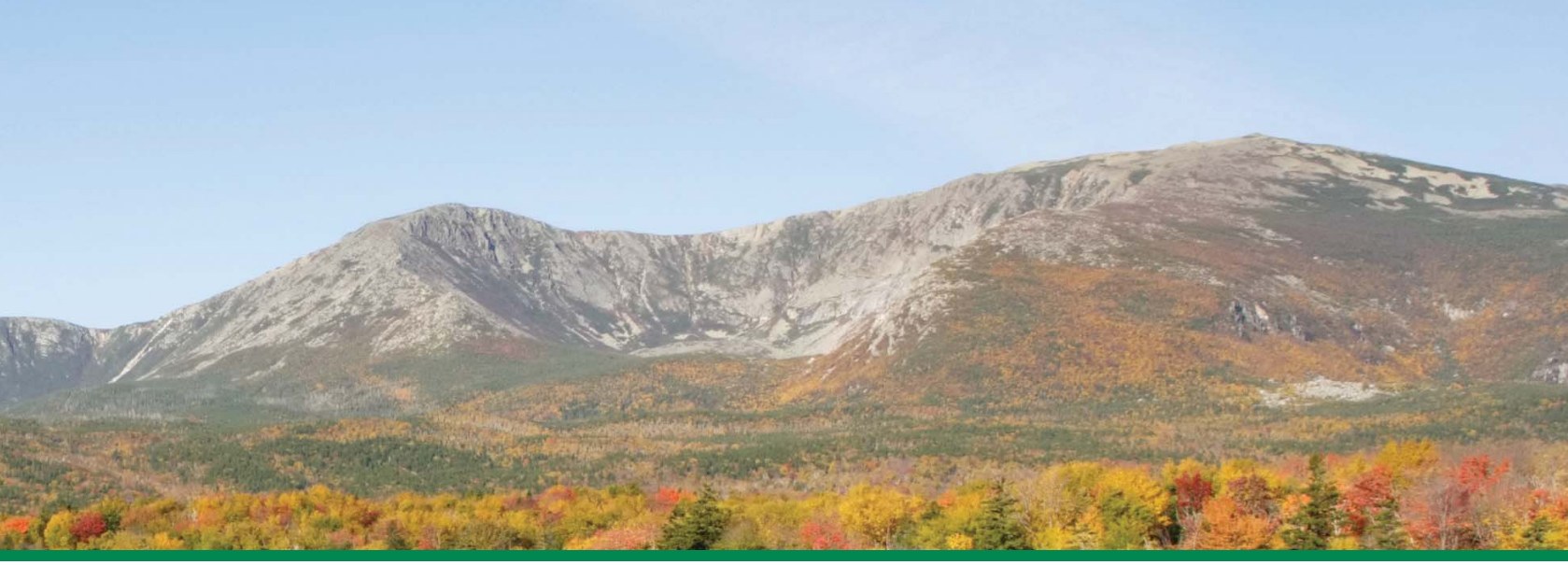
Loan growth was more difficult to come by, but we increased loans outstanding by $20,901,000. Growth occurred in both the commercial and personal loan categories.

For a detailed commentary on our financials, please refer to the section of this report entitled “Company Overview and Results of Operations.”

Management has concerns about the direction of the economy. Economic growth continues at a tepid pace. In December the Federal Reserve raised the Fed Funds Rate for the first time since 2006, with the expectation that further increases would occur in 2016. Since then through the time of this writing, volatility in the stock and commodities markets, particularly oil prices, have put 2016 Fed Funds Rate increases in doubt. Bond prices have increased, with corresponding drops in yields. We were hopeful for better loan pricing as rates increased, but see that as questionable for 2016. In this rate environment net interest margins are pressured and yields on loans and securities continue to be very low. In 2015, our net interest margin decreased by 7 basis points to 3.71%. We hope that the economy stabilizes, with the result being stronger economic growth both nationally and in our markets. In any event, we expect to grow the balance sheet, manage operating expenses carefully, and increase non-interest income. We are focused on achieving these goals.

Your Board has authorized the implementation of a Direct Stock Purchase and Dividend Reinvestment Program that will be administered by our stock transfer agent, Computershare. The plan will allow shareholders to hold their shares at Computershare in book entry form, which will enable reinvestment of dividends at current market prices. This is a convenience that we hope many will take advantage of. More information regarding how to participate in the plan will be distributed to shareholders in the coming months.

We feel we have maintained our presence as the premier community bank in northern Maine, and are seeking to further establish our brand awareness in the Bangor and Portland markets as well. With our “Banking on Maine” campaign, we enlist customers to tell our story and how it has benefited them to bank with us. We will continue this campaign in 2016. Ultimately, it is our people and their commitment to providing best in class customer service that will lead to our success. We are working



hard to carry our message to businesses and individuals throughout Maine in order to grow our business, broaden our reach, and ultimately to enhance shareholder value.

In October, Kimberley A. Niles of Scarborough was elected to the Bank's board of directors upon the retirement of board director Robert 'Bob' Anderson of Bangor. A heartfelt thank you goes out to Bob for his guidance and insight during his nearly 20 year tenure on the board. Throughout Bob's time on the board we have grown a great deal, from 7 branches in northern Maine to 19 throughout Maine and $130 million in assets to more than $700 million today. Bob was an important component of that growth. He has been an avid supporter of the Bank with tremendous commitment and loyalty and we will certainly miss his input, dedication and camaraderie.

It is with great pleasure that we welcome Kimberley to fill Bob's unexpired term. Kimberley is the Managing Director and Chief Financial Officer for Constant Energy Capital Management, an investment capital management company, in Portland, Maine and is founder and consultant for VC CFO Services, LLC, a financial consulting firm in Scarborough, Maine providing interim CFO services for companies as well as financial support services for startup opportunities and venture firms. We are very pleased to have Kimberley join us.

In our role as a true community bank, Katahdin Trust Company and its employees have long been recognized for our commitment to giving back to the communities that we serve. In 2015, we were again pleased to be recognized by the American Bankers Association for our outstanding efforts in the support we provide to local organizations throughout our market area. The Bank contributed more than $325,000 to support nearly 300 different organizations. More importantly, our employees and directors contributed 11,500 hours of time, talent and effort to their local communities. We are very proud that our commitment to our communities is so extensive, and our sense of corporate citizenship remains a signature of Katahdin Trust Company as we work beyond the walls of our Bank.

In closing, I would like to thank our employees for the superior work they perform each and every day. Their dedication and commitment to our customers statewide is indeed inspiring.

Sincerely,



Jon J. Prescott
President & CEO

OUR MISSION

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

WE ARE COMMITTED TO:

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

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



KATAHDIN TRUST BRANCH IN CARIBOU, MAINE

OUR LOCATIONS

1	Patten, 1918	**6**	Mars Hill, 1995	**11**	Limestone, 2000[1]	**16**	Bangor - Springer Drive, 2008[3]
2	Island Falls, 1921	**7**	Caribou, 1995	**12**	Fort Fairfield, 2000[1]	**17**	Bangor - Broadway, 2010
3	Oakfield, 1976	**8**	Washburn, 2000[1]	**13**	Ashland, 2000[1]	**18**	Hampden, 2011
4	Houlton, 1987	**9**	Easton, 2000[1]	**14**	Eagle Lake, 2000[1]	**19**	Fort Kent, 2014
5	Presque Isle, 1991	**10**	Van Buren, 2000[1]	**15**	Scarborough, 2007[2]		

[1]In November of 2000 the Bank doubled its number of locations with the branch acquisition from Peoples Heritage Bank (now TD Bank).

[2]In February of 2007 the Bank purchased the assets of Maine Financial Group and opened a Commercial Loan Office. In 2013, the Bank began offering full banking services at this location.

[3]In March of 2008 the Bank opened a Commercial Loan Office in Bangor. In 2012, the Bank opened a full-service branch on Springer Drive in Bangor and relocated the Commercial Loan Office to this location.



OUR BOARD

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

HAROLD L. STEWART II, ESQ.
VICE CHAIRMAN
Presque Isle, Maine. Partner, Stewart Law Office and Summit Title Company, a division of Marden, Dubord, Bernier, and Stevens, PA. Director since 2004.

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

ROBERT E. ANDERSON
Houlton, Maine. Chairman of the Board, FA Peabody Company (family owned insurance business). Director since 1989.

PETER F. BRIGGS
Presque Isle, Maine. Owner/Operator, Aroostook Beverage Co. Director since 1995.

KIMBERLEY A. NILES
Scarborough, Maine. Managing Director and Chief Financial Officer, Constant Energy Capital Management (investment capital management company); and Founder and Consultant, VC CFO Services, LLC (financial consulting firm). Director since 2015.

PAUL R. POWERS
Caribou, Maine. Owner, Powers Roofing & Sheet Metal, Inc., and Owner, B.J.J. Powers Enterprises (real estate holding company). Director since 2000.

ARTHUR L. SHUR
Island Falls, Maine. Retired from the farming industry. Director since 1983.

RICHARD J. YORK, SR.
Houlton, Maine. General Sales Manager, York's of Houlton (family car business). Director since 1997.

OUR EMPLOYEES

SENIOR MANAGEMENT

Jon J. Prescott
President & CEO

Peter P. St. John
Executive Vice President
Commercial Services

Bonnie C. Foster
Senior Vice President
Retail Services

William P. Lucy
Senior Vice President
Commercial Services

Matthew M. Nightingale
Senior Vice President
CFO & Treasurer

Vicki J. Smith
Senior Vice President
Marketing & Communications

OFFICERS

Paul J. Adams
Vice President, Indirect Lending

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

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

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

Vicki L. Bessette
Vice President
Commercial Services Officer

Fred A. Brown
Vice President
Commercial Services Officer

Cale L. Burger
Vice President
Commercial Services Officer

David H. Cambridge
Regional Vice President
Commercial Services Officer

Aaron J. Cannan
Senior Vice President
Commercial Services Officer

Robert J. Cawley
Assistant Vice President
Senior Credit Analyst

Karen L. Chapman
Vice President
Training Manager

Albert "Joe" Clukey II
Assistant Vice President
Retail Services Officer

Janet M. Doak
Branch Manager &
Retail Services Officer,
Ashland & Washburn

Bruce C. Drouin
Vice President, Managed Assets

Susan F. Fitzherbert
Branch Manager &
Retail Services Officer, Fort Fairfield

Sunny G. Flannery
Branch Manager
Retail Services Officer, Hampden

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

Brian J. Gardiner
Senior Vice President
Commercial Services Officer

Leslie M. Gardner
Vice President, Retail Loans

Katherine Z. Goodwin
BSA Officer

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

Billi B. Griffeth
Retail Officer

Patricia A. Hersey
Vice President
Business Development Officer

Katherine H. Hill
Assistant Vice President
Bank Operations Manager

Emily J. Hosford
Branch Manager &
Retail Services Officer
Patten & Island Falls

Carrie E. Hull
Branch Manager &
Retail Services Officer,
Easton & Limestone

Mary Bonnie London
Executive Assistant &
Personnel Manager

Susan B. Lunn
Vice President
Compliance Officer

Valerie J. Maynard
Senior Commercial Services Assistant

Benjamin R. McQuade
Commercial Services Officer

Jean E. Noyes
Vice President
Information Security Officer

Kevin B. Plourde
Vice President
Credit Administration

Joseph M. Porter
Vice President
Controller

Barrett S. Potter
Vice President
Commercial Services Officer

Andrew L. Putnam
Vice President
Chief Information Officer

Krista K. Putnam
Vice President
Marketing

Sherry L. Roberts
Vice President
Business Development Officer

Debra K. Schillinger
Branch Manager &
Retail Services Officer, Oakfield

Sarah S. Silliboy
Assistant Vice President
Electronic Banking Manager

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



Rebecca J. Smith
Branch Manager &
Retail Services Officer, Bangor
Craig C. Staples
Vice President
Commercial Services Officer
Pamela J. Ward
Assistant Vice President
Credit Control
Danelle L. Weston
Regional Vice President
Bangor Market
Kevin E. Whalen
Vice President
Facilities Manager

Ashley M. Andrews
Paula P. Bernier
Adam R. Bither
Jennifer L. Blaisdell
Lindsay M. Blanchette
Cheryl A. Bolstridge
Cindy L. Boot
Heidi J. Bradstreet
Danielle L. Brewer
Eva C. Brown
Jessica L. Buckley
Emily S. Bulley
Monica L. Campbell
Julie A. Chamberlain
Jenny L. Charette
Kelly Jo Clark
Wendy L. Clark
Samuel S. Clockedile
Susan M. Cone
Jane F. Conlogue
Tabitha J. Corey
Jennifer L. Craig
Clarissa H. Crandall
Debra L. Cyr
Melissa A. Dahlgren
Shelby A. Damboise
Ryan D. Daniel
Kati Deane-Grant
Tory Jo Delano
Megan L. Delong
Rachel L. Desrosier
Carol A. Dow
Constance R. Drake
Cindy L. Drew
Lynn C. Dumond
Kimberly J. Embelton
April D. Emery
Kelly J. Emery
Lisa L. Flewelling-Haney
Sue A. Fox
Frederick E. Gagnon
Sarah J. Gardiner
Penny M. Garnett
Crystal A. Gastia
Loni R. Giberson
Allissa M. Given
Jonathan P. Glazier
Julie A. Glidden
Candice L. Glover
Alison N. Gould
Lesia R. Grooms
Lorraine M. Guiggey
Misty R. Haines
Cathy J. Haley
Betty E. Hammond
Trecia M. Hanning
Victoria R. Hanson
Kelsey P. Harris
Virginia L. Hartin
Wendy L. Henderson
Nancy L. Hersey
Diane M. Hewett
Catherine A. Hobbs
Sheila D. Hosford
Kathryn R. Howes
Lisa M. Jandreau
Julie M. Kaelin
Jacqueline M. Kennedy
Kelly J. Kilcollins
Jennifer L. King
Kathryn J. Knapp
Janet L. Lane
Rosemary A. Langer
Yancy J. P. LaPointe
Dawn M. Larrabee
Denise G. Lease
Mark P. Levasseur
Crystal E. Levesque
Teresa S. Lincoln
Theresa M. L'Italien
Nicole L. Lockhart
Miranda B. Lundin
Tannis B. Lundin
Jeremy K. MacArthur
Karen L. MacDonald
Ann M. Madore
Lita A. Madore
Ryan P. Madore
Brian A. Martin
Eunice M. McAfee
Natasha R. McCarthy
Alyson E. McGillicuddy
Arianna E. McGraw
Shelly L. McHatten
Elizabeth M. Michaud
Madison V. Michaud
Rhonda A. Miller
Susan M. Miller
Abigail B. Moody
Whitney J. Moran
Timothy D. Morris
Lori J. Nadeau
Rhonda M. Nicholson
Julie O'Hara
Connie M. Ouellette
Robin M. Palmer
Crystal L. Parent
Whitney T. Peavey
Valerie J. Pelletier
Timothy W. Perry
Rebecca L. Potter
Kenneth F. Prescott
Mari E. Remeschatis
Jasmine M. Rockwell
Devin J. Rolph
Scott A. Rossignol
Tyler D. Rowe
Janet L. Saucier
Richard H. Schmidt III
Donna M. Shannon
Jana L. Shaw
Tyler P. Sherman
Louella A. Soucy
Heidi J. Stewart
Dianne M. Tapley
Katelynn N. Tardie
Juanita H. Tarr
Kathy A. Thompson
Vickey J. Tilley
Lana J. Tucker
Amy L. Turner
Marie D. Vincent
Jolene L. Wallace
Kristen V. West
Tamara J. Wheeler
Susan M. White
Mikayla B. Wiley
Betty J. Willette
Lisa M. Willigar
Crystal L. Wright
Emerson M. Wright
Mindi A. Yates

MAINE FINANCIAL GROUP

W. Scott Dillon
President
James P. Amabile
Assistant Vice President
Commercial Services Officer
Susan L. McCarthy
Assistant Vice President
Commercial Services Officer

Christopher C. Case
Susan M. Turner

COMPANY OVERVIEW AND RESULTS OF OPERATIONS

Katahdin Bankshares Corp. ("KBS" or the "Company") is a bank holding company, incorporated under the laws of the State of Maine in 1986 for the purpose of becoming the parent holding company of Katahdin Trust Company (the "Bank"). As of December 31, 2015, KBS had consolidated total assets of $702.3 million, total deposits of $606.2 million, and total shareholders' equity of $62.4 million. Following is an overview of the Company, its strategy, and the results of 2015 operations.

Our Business

Established in 1918, the Bank provides a full line of banking services to individuals and businesses from 19 offices throughout Maine and online at www.katahdintrust.com.

The Bank conducts commercial and retail banking business that includes accepting deposits from the general public and utilizing those funds to originate a variety of commercial loans, commercial and residential real estate loans and consumer loans. The Bank offers a wide range of business and personal banking services, including checking and savings accounts, money market accounts, certificates of deposits, commercial, mortgage and consumer loans and the convenience of debit cards, telephone banking, ATMs, online banking and bill payment, mobile and text banking, and eCheck Deposit, a service which enables the customer to make remote deposits electronically.

Securities and insurance products are made available to the Bank's customers through Katahdin Financial Services in partnership with a third party registered broker-dealer, with assets under management of $83.5 million as of December 31, 2015.

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

Our Strategy

The Bank's goals include continuing as the leading financial institution throughout Aroostook County and northern Penobscot County, as well as enhancing our presence in the greater Bangor and Portland areas. The Bank explores opportunities for profitable growth and expansion while seeking ways to increase net interest income, enhance non-interest income, increase efficiencies and reduce operating costs, all with the goal of maximizing long-term returns to our shareholders.

The Bank has a strong commitment to small business and has received the preferred lender designation from the U. S. Small Business Administration (SBA); a designation reserved for SBA's most experienced and trusted lenders with a proven record of small business lending performance and excellence. The Bank's goal is to have a well-rounded commercial loan portfolio which is served by an experienced commercial team that has the expertise to meet the needs of small businesses throughout the Bank's market area.

The Bank has a strong commitment to community banking. The Bank's goal is to attract as customers small and medium sized businesses as well as individuals who wish to conduct business with a community bank that demonstrates an active interest in their businesses and communities. Our staff is trained to recognize the opportunity to offer additional products and services that will strengthen each customer relationship.

The Bank recognizes the importance of high quality customer service; its stated goal is to "Exceed Our Customers' Expectations". Management believes its ability to deliver products and services in a highly personalized manner with superior customer service sets the Bank apart from its competitors.

The foundation of the Bank's business strategy is its employees. The Bank's commitment to customer service and local decision-making enables us to attract and retain customer-focused employees with knowledge of and experience in the Bank's market area. The Bank's personnel reside in their respective market area, know their customers, and are able to provide high quality service to these customers. The Bank's lenders have experience in the financial services industry and have operated in the Bank's market area through a wide range of economic cycles and lending market conditions. The Bank encourages and supports management and staff to be active community volunteers. Every year the Bank's employees contribute significant hours to a variety of community organizations ranging from charitable to civic and community.

SELECTED FINANCIAL DATA

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

Dollars in thousands, except share and per share data.

As of or for the Years Ended December 31,	2015	2014	2013	2012	2011
Balance Sheet Data					
Total assets	$ 702,289	$ 667,112	$ 646,287	$ 576,833	$ 527,724
Total investments [1]	74,836	60,597	57,506	53,713	54,120
Total loans	586,238	565,337	546,242	481,586	437,796
Allowance for loan losses	(5,330)	(5,899)	(6,097)	(6,338)	(6,320)
Total deposits	606,205	550,694	557,933	480,020	424,643
Shareholders' equity	62,357	71,086	58,961	58,118	55,101
Summary of Operations					
Interest and dividend income	$ 27,512	$ 27,031	$ 26,517	$ 26,777	$ 26,810
Interest expense	3,861	4,240	4,712	5,702	6,537
Net interest income	23,651	22,791	21,805	21,075	20,273
Provision for loan losses	50	548	798	989	600
Net interest income after the provision for loan losses	23,601	22,243	21,007	20,086	19,673
Non-interest income before impairment of investment securities	3,884	3,568	3,409	3,469	3,495
Net impairment of investment securities	2	17	19	49	169
Non-interest expense	20,372	19,621	18,815	17,633	16,620
Income before income taxes	7,111	6,173	5,582	5,873	6,379
Income taxes	2,301	1,918	1,733	1,512	1,818
Net income	$ 4,810	$ 4,255	$ 3,849	$ 4,361	$ 4,561
Less dividends on preferred stock	910	557	123	137	473
Net income available to common shareholders	$ 3,900	$ 3,698	$ 3,726	$ 4,224	$ 4,088
Per Common Shares and Common Shares Outstanding					
Net income, basic [2]	$ 1.15	$ 1.09	$ 1.09	$ 1.24	$ 1.20
Net income, diluted [2]	1.15	1.09	1.09	1.24	1.20
Book value	15.47	14.93	14.09	13.85	12.98
Tangible book value	13.80	13.26	12.41	12.16	11.26
Weighted average common shares outstanding:					
Basic	3,404,367	3,404,367	3,400,505	3,392,470	3,392,470
Diluted	3,404,367	3,404,367	3,404,367	3,404,114	3,399,831
Common shares outstanding at period end	3,404,367	3,404,367	3,404,367	3,404,367	3,400,505
Selected Performance Ratios					
Return on average assets	0.70%	0.66 %	0.64 %	0.78 %	0.88%
Return on average common shareholders' equity	7.50	7.44	7.81	9.19	9.49
Net interest spread [3]	3.62	3.66	3.75	3.91	4.08
Net interest margin [4]	3.71	3.78	3.89	4.03	4.22
Efficiency ratio [5]	73.99	74.42	74.62	71.84	69.93
Asset Quality Ratios					
Allowance for loan losses to period end loans	0.91%	1.04 %	1.12 %	1.32 %	1.44%
Allowance for loan losses to non-performing loans [6]	61.71	50.24	64.49	55.05	70.72
Non-performing loans to period end loans [6]	1.47	2.07	1.73	2.39	2.04
Non-performing assets to total assets [7]	1.31	1.83	1.50	2.05	1.74
Capital Ratios (Katahdin Trust Company)					
Total risk-based capital ratio	13.34%	13.38 %	12.54 %	13.76 %	14.70%
Tier 1 risk-based capital ratio	12.33	12.23	11.29	12.50	13.45
Common equity tier 1 risk-based capital ratio	12.33	-	-	-	-
Tier 1 capital ratio (Leverage ratio)	9.48	9.68	8.89	9.72	10.51
Other Data					
Number of full and limited service banking offices	19	19	18	18	18
Number of full-time equivalent employees	195	196	191	189	181
Katahdin Financial Services Assets Under Management	$ 83,500	$ 87,200	$ 75,400	$ 61,000	$ 49,800

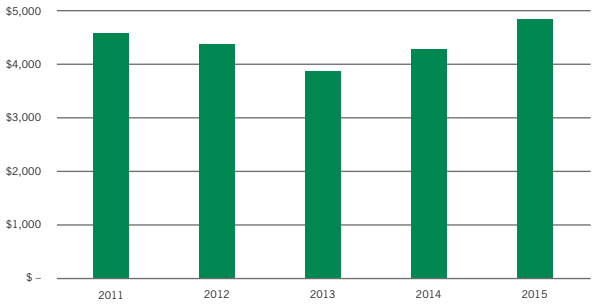
(1) Consists of investment securities and FHLB stock. (2) Computed based on the weighted average number of common shares outstanding during each period. (3) Net interest spread is the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities. (4) Net interest margin is the net interest income divided by the average interest-earning assets. (5) Efficiency ratio is non-interest expense divided by the sum of net interest income and non-interest income. (6) Non-performing loans consist of non-accrual loans and restructured loans, where applicable. (7) Non-performing assets consist of non-accrual loans, restructured loans, and foreclosed assets, where applicable.

COMPANY OVERVIEW & RESULTS OF OPERATIONS

Net Income

Net Income before preferred stock dividends reached $4,810,000 for 2015, an increase over the prior year of $555,000 or 13.0%. Continued balance sheet growth coupled with growth in non-interest income, improving credit quality and manageable expense growth led to the increased earnings in 2015. Diluted earnings per common share totaled $1.15 per share, an increase of 5.5% over last year. Return on Average Assets ended at 0.70% compared to 0.66% in 2014. Return on Average Common Equity was 7.50% as compared to 7.44% in 2014.

NET INCOME ($000)



Net Interest Income

Net interest income continued to grow reaching $23,651,000, exceeding the prior year by $860,000 or 3.8%. Net interest income reflects revenues generated through income from earning assets plus loan fees, less interest paid on interest-bearing deposits and borrowings. The additional net interest income was supported by solid loan growth which helped counter a drop in the net interest spread as compared to the prior year. The Company's average net interest spread was 3.62% in 2015, compared to the prior year average spread of 3.66%.

Although the Federal Reserve increased the short term Fed Funds Rate target in December, market interest rates again this year remained very low across the yield curve. This has necessitated year over year asset growth in order to outpace the pressure on spread income. Net interest income is our largest stream of revenue and will continue to be the major focus for the Bank.

Provision and Asset Quality

Asset quality remained solid in 2015. Non-performing loans to period end loans ended the year at 1.47%, down from 2.07% at the end of the prior year. Non-performing assets to total assets ended the year at 1.31% down from 1.83% in 2014. $50,000 was added to the provision for loan loss in 2015 as compared to $548,000 the prior year. The lower provision was a direct reflection of improving asset quality throughout 2015 and also resulted in an allowance for loan losses to period end loans ratio drop to 0.91%, compared to 1.04% in 2014. Management continuously monitors the Bank's allowance for loan losses as compared to asset quality in order to match our reserves with a reasonable estimate of risk. Detailed information regarding our allowance for loan loss can be found in the footnotes to the audited financial statements.

Non-Interest Income and Expense

Non-interest income totaled $3,884,000, an increase over 2014 of $316,000 or 8.9%. Non-interest income consists largely of service charges on loans, deposits, and electronic banking activity.

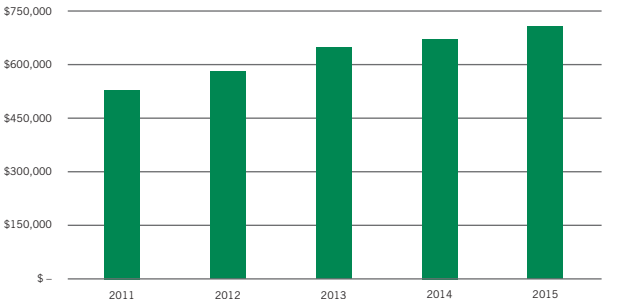
Non-interest expense in 2015 totaled $20,372,000, representing an increase of $751,000 or 3.8% over the prior year.

Growing revenue through non-interest income sources as well as directly improving day to day operating efficiencies are key management goals.

Assets

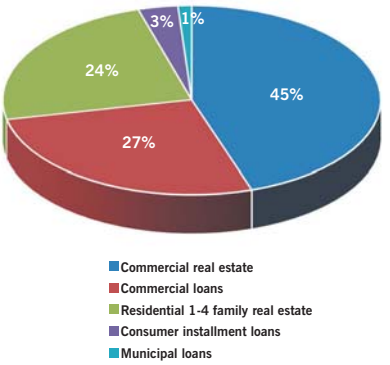
Total assets reached $702,289,000, an increase over the prior year of $35,177,000 or 5.3%. Asset growth was achieved from a mix of loan growth and investment growth. The investment portfolio ended the year at $74,836,000, representing an increase of $14,239,000 over 2014.

ASSETS ($000)



COMPANY OVERVIEW & RESULTS OF OPERATIONS

LOAN MIX



Loans

Total loans increased to $586,238,000, rising $20,901,000 or 3.7% year over year. Commercial real estate loans dropped $2.9 million to an outstanding portfolio balance of $262,691,000. Commercial equipment loans totaled $156,429,000 and grew by $15.3 million. Residential 1-4 family loans grew $4.6 million to a portfolio level of $139,381,000. Approximately 73% of the Bank's loan portfolio consists of municipal, commercial and commercial real estate loans representing the same distribution as 2014.

Deposits

Total deposits ended the year at $606,205,000, significantly higher than last year by $55,511,000 or 10.1%. This growth has come from local deposit initiatives throughout our market area. Local deposits which includes checking, savings, money markets and CD's had an increase of $62.1 million year over year as depicted in the accompanying chart. The largest growth this year came from Aroostook County, which had growth of $32 million or 51% of total local deposit growth. The remainder of the growth is split between the greater Bangor and Southern Maine markets. Secured borrowings from the Federal Home Loan Bank (FHLB) and other sources totaled $20,728,000, reduced from the prior year's level by $11,787,000.

Deposit growth remains a key focus of our strategy to grow the Bank. We were able to reduce our reliance on Brokered CDs in 2015 due to our successful deposit growth. However, Brokered CDs and secured borrowings do enable the Bank to fund asset growth when our ability to grow local deposits at any given time does not keep pace with our loan growth. These alternative funding sources provide the Bank flexibility with term structures in order to appropriately balance interest rate risk positions as needed.

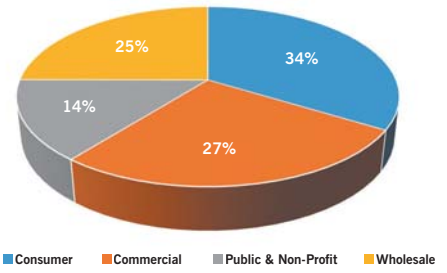
Capital

In early 2015, the Company redeemed Preferred Stock Series C shares totaling $11,000,000. This contributed to the drop in Total Shareholders' Equity to $62,357,000, down $8,729,000 from year end 2014. Capital ratios for the Bank remain well above the minimums to be well-capitalized per regulatory capital requirements. The Bank's leverage ratio at year-end 2015 was 9.48%, compared to 9.68% at the end of 2014. Total risk-based capital stood at 13.34% as compared to 13.38% in 2014.

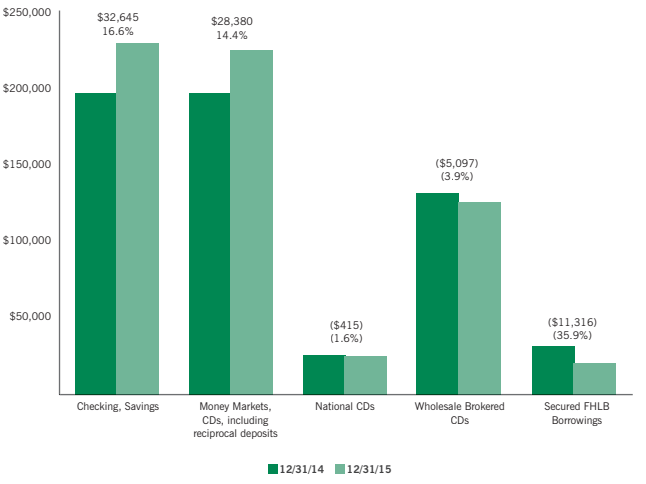
During 2015, the Federal Reserve Board issued a new rule implementing a law passed by Congress in December 2014 that expanded the applicability of its Small Bank Holding Company Policy Statement. The final rule raises the asset threshold of the policy statement from $500 million to $1 billion in total consolidated assets. Since Katahdin Bankshares Corp. is a bank holding company that qualified under this policy statement, this effectively means that the holding company is now excluded from the consolidated capital requirements. The Bank subsidiary continues to be subject to the minimum capital requirements as outlined in Footnote 16 of the Audited Financial Statements.

Tangible book value increased from $13.26 in 2014 to $13.80, a 4.1% increase in common shareholder tangible book value year over year. The Company paid out a total of $0.40 per share in common stock dividends representing a 34.8% payout ratio of 2015 net income available to common shareholders.

DEPOSIT SOURCES



DEPOSIT TREND



INDEPENDENT AUDITOR'S REPORT

BerryDunn

Board of Directors and Shareholders
Katahdin Bankshares Corp. and Subsidiary

We have audited the accompanying consolidated financial statements of Katahdin Bankshares Corp. and Subsidiary (the Company), which comprise the consolidated balance sheets as of December 31, 2015 and 2014, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Katahdin Bankshares Corp. and Subsidiary as of December 31, 2015 and 2014, and the consolidated results of their operations and their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Berry Dunn McNeil & Parker, LLC

Bangor, Maine
February 3, 2016

CONSOLIDATED BALANCE SHEETS

December 31, 2015 and 2014

ASSETS	2015	2014
Cash and due from banks	$ 6,388,000	$ 6,220,000
Interest bearing deposits in banks	5,157,000	6,048,000
Securities available-for-sale	72,501,000	58,673,000
Securities held-to-maturity	16,000	20,000
Federal Home Loan Bank stock, at cost	2,319,000	1,904,000
Loans receivable, net of allowance for loan losses of $5,330,000 in 2015 and $5,899,000 in 2014	580,908,000	559,438,000
Bank premises and equipment, net	13,172,000	14,120,000
Goodwill	5,559,000	5,559,000
Other assets	16,269,000	15,130,000
	$ 702,289,000	$ 667,112,000

LIABILITIES AND SHAREHOLDERS' EQUITY	2015	2014
Deposits		
Demand deposits	$ 103,491,000	$ 73,777,000
NOW and money market deposits	206,646,000	180,270,000
Savings deposits	53,838,000	46,372,000
Certificates of deposit over $250,000	154,737,000	159,669,000
Other certificates of deposit	87,493,000	90,606,000
Total deposits	606,205,000	550,694,000
Advances from Federal Home Loan Bank	20,188,000	31,504,000
Other borrowed funds	540,000	1,011,000
Accrued expenses and other liabilities	5,782,000	5,600,000
Junior subordinated debentures	7,217,000	7,217,000
Total liabilities	639,932,000	596,026,000
Shareholders' equity		
Preferred stock, 20,000 shares authorized		
Series C, 11,000 shares issued and outstanding on December 31, 2014	-	11,000,000
Series D, 4,000 shares issued and outstanding	9,673,000	9,603,000
Common stock, $.10 par value; 20,000,000 shares authorized, 3,404,367 shares issued and outstanding on December 31, 2015 and 2014	339,000	339,000
Surplus	8,776,000	8,776,000
Undivided profits	44,496,000	42,028,000
Accumulated other comprehensive loss		
Net unrealized depreciation on securities available-for-sale, net of deferred income taxes	(109,000)	(49,000)
Net unrealized loss on derivative instruments, net of deferred income taxes	(818,000)	(611,000)
Total shareholders' equity	62,357,000	71,086,000
	$ 702,289,000	$ 667,112,000

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

CONSOLIDATED STATEMENTS OF INCOME

Years Ended December 31, 2015 and 2014

	2015	2014
Interest and dividend income		
Loans	$ 26,063,000	$ 25,745,000
Investment securities	1,441,000	1,273,000
Other interest-earning assets	8,000	13,000
Total interest and dividend income	27,512,000	27,031,000
Interest expense		
Deposits	3,447,000	3,798,000
Borrowed funds and junior subordinated debentures	414,000	442,000
Total interest expense	3,861,000	4,240,000
Net interest income	23,651,000	22,791,000
Provision for loan losses	50,000	548,000
Net interest income after provision for loan losses	23,601,000	22,243,000
Noninterest income (loss)		
Service charges and fees	1,839,000	1,677,000
Realized gain on sale of securities available-for-sale	13,000	-
Other	2,032,000	1,891,000
Total noninterest income before impairment of investment securities	3,884,000	3,568,000
Total other-than-temporary impairment losses	(13,000)	(27,000)
Portion of loss recognized in other comprehensive income	11,000	10,000
Net impairment losses recognized in net income	(2,000)	(17,000)
Net noninterest income	3,882,000	3,551,000
Noninterest expenses		
Salaries and employee benefits	12,277,000	11,689,000
Net occupancy expense	1,614,000	1,603,000
Furniture and equipment expense	1,746,000	1,556,000
Data processing	1,020,000	905,000
Marketing	838,000	813,000
FDIC deposit assessment	494,000	498,000
Other general and administrative	2,383,000	2,557,000
Total noninterest expenses	20,372,000	19,621,000
Income before income taxes	7,111,000	6,173,000
Income tax expense	2,301,000	1,918,000
Net income	$ 4,810,000	$ 4,255,000
Less dividends on preferred stock	$ 910,000	$ 557,000
Net income available to common shareholders	$ 3,900,000	$ 3,698,000
Basic earnings per common share	$ 1.15	$ 1.09
Diluted earnings per common share	$ 1.15	$ 1.09
Diluted weighted average common shares outstanding	3,404,367	3,404,367

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Years Ended December 31, 2015 and 2014

	2015	2014
Net income	$ 4,810,000	$ 4,255,000
Other comprehensive income (loss), net of related tax effects		
Unrealized appreciation (depreciation) on available-for-sale securities		
Unrealized appreciation (depreciation) on available-for-sale securities arising during period	(58,000)	477,000
Less: reclassification adjustment for losses realized in net income	(2,000)	(17,000)
Net change in unrealized appreciation (depreciation) on available-for-sale securities	(60,000)	460,000
Unrealized loss on derivative instruments	(207,000)	(274,000)
Total other comprehensive income (loss)	(267,000)	186,000
Comprehensive income	$ 4,543,000	$ 4,441,000

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

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

Years Ended December 31, 2015 and 2014

	Preferred Stock	Common Stock	Surplus	Undivided Profits	Net Unrealized Depreciation on Securities	Net Unrealized Loss on Derivative Instruments	Total
Balance, December 31, 2013	$ 11,000,000	$ 339,000	$ 8,776,000	$ 39,692,000	$ (509,000)	$ (337,000)	$ 58,961,000
Net income	-	-	-	4,255,000	-	-	4,255,000
Change in net unrealized depreciation on securities available-for-sale, net of deferred income taxes of $237,000	-	-	-	-	460,000	-	460,000
Change in net unrealized loss on derivative instruments, at fair value, net of taxes of $(141,000)	-	-	-	-	-	(274,000)	(274,000)
Total comprehensive income	-	-	-	4,255,000	460,000	(274,000)	4,441,000
Cash dividends declared on common stock, $0.40 per share	-	-	-	(1,362,000)	-	-	(1,362,000)
Proceeds from issuance of preferred stock Series D, 4,000 shares	9,603,000	-	-	-	-	-	9,603,000
Cash dividends declared on preferred stock	-	-	-	(557,000)	-	-	(557,000)
Balance, December 31, 2014	20,603,000	339,000	8,776,000	42,028,000	(49,000)	(611,000)	71,086,000
Net income	-	-	-	4,810,000	-	-	4,810,000
Change in net unrealized depreciation on securities available-for-sale, net of deferred income taxes of $(31,000)	-	-	-	-	(60,000)	-	(60,000)
Change in net unrealized loss on derivative instruments, at fair value, net of taxes of $(107,000)	-	-	-	-	-	(207,000)	(207,000)
Total comprehensive income	-	-	-	4,810,000	(60,000)	(207,000)	4,543,000
Cash dividends declared on common stock, $0.40 per share	-	-	-	(1,362,000)	-	-	(1,362,000)
Redemption of preferred stock Series C, 11,000 shares	(11,000,000)	-	-	-	-	-	(11,000,000)
Accretion on preferred stock issuance	70,000	-	-	(70,000)	-	-	-
Cash dividends declared on preferred stock	-	-	-	(910,000)	-	-	(910,000)
Balance, December 31, 2015	$ 9,673,000	$ 339,000	$ 8,776,000	$44,496,000	$ (109,000)	$ (818,000)	$62,357,000

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31, 2015 and 2014

	2015	2014
Cash flows from operating activities		
Net income	$ 4,810,000	$ 4,255,000
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	1,541,000	1,468,000
Net amortization of securities	169,000	126,000
Provision for loan losses	50,000	548,000
Provision for losses on other real estate owned	29,000	27,000
Amortization of investments in limited partnerships	264,000	526,000
Impairment of investment securities	2,000	17,000
Gain on sale of securities available-for-sale	(13,000)	-
Deferred income tax benefit	(681,000)	(443,000)
Increase in cash value of life insurance	(1,079,000)	(262,000)
Loss on sale of other real estate and property owned	21,000	6,000
Decrease in accrued income receivable and other assets	212,000	557,000
Increase in accrued expenses and other liabilities	193,000	697,000
Net cash provided by operating activities	5,518,000	7,522,000
Cash flows from investing activities		
Additions to premises and equipment	(474,000)	(1,120,000)
Loan originations and principal collections, net	(21,944,000)	(20,121,000)
Purchase of securities available-for-sale	(23,533,000)	(11,019,000)
Maturities of securities available-for-sale	8,768,000	7,986,000
Maturities of securities held-to-maturity	4,000	2,000
Proceeds from sales of other real estate and property owned	211,000	216,000
Purchase of derivative instrument	-	(1,998,000)
Redemption of FHLB stock	-	957,000
Purchase of FHLB stock	(415,000)	(463,000)
Proceeds from sale of securities available-for-sale	690,000	-
Net cash used by investing activities	(36,693,000)	(25,560,000)
Cash flows from financing activities		
Net increase (decrease) in deposits	55,511,000	(7,239,000)
Net increase (decrease) in securities sold under agreements to repurchase	(471,000)	78,000
Net increase in short-term borrowings	13,695,000	20,305,000
Repayment of long-term debt	(25,011,000)	(5,260,000)
Proceeds from issuance of preferred stock	-	9,603,000
Redemption of preferred stock	(11,000,000)	-
Cash dividends paid on preferred stock	(910,000)	(338,000)
Cash dividends paid on common stock	(1,362,000)	(1,362,000)
Net cash provided by financing activities	30,452,000	15,787,000
Net decrease in cash and cash equivalents	(723,000)	(2,251,000)
Cash and cash equivalents, beginning of year	12,268,000	14,519,000
Cash and cash equivalents, end of year	$ 11,545,000	$ 12,268,000
Supplementary cash flow information:		
Interest paid on deposits and borrowed funds	$ 3,881,000	$ 4,288,000
Income taxes paid	1,703,000	772,000
Noncash transactions		
Transfer from loans to other real estate and property owned	424,000	280,000
Preferred stock dividends declared but not paid	219,000	219,000

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2015 and 2014

Nature of Business

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

1. Summary of Significant Accounting Policies

Basis of Presentation and Consolidation

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

Pursuant to the criteria established by U.S. generally accepted accounting principles (GAAP), the Company has not consolidated the trusts which it formed for the purposes of issuing trust preferred securities to unaffiliated parties and investing the proceeds from the issuance thereof and the common securities of the trust in junior subordinated debentures issued by the Company. The trusts are considered affiliates (see Note 10).

Use of Estimates

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

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

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

Cash and Cash Equivalents

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

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

Securities

Debt securities that management has the positive intent and ability to hold to maturity are classified as "held-to-maturity" and recorded at amortized cost. Securities not classified as held to maturity, including equity securities with readily determinable fair values, are classified as "available-for-sale" and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income.

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

Loans and Allowance for Loan Losses

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

The allowance for loan losses is established through a provision for loan losses charged to expense.

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

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

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

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

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

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

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

1. Summary of Significant Accounting Policies (cont.)

Credit Related Financial Instruments

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

Other Real Estate and Property Owned (OREO)

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

Bank Premises and Equipment

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

Goodwill

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

Other Amortizable Assets

A customer list and covenant not to compete included in other assets represent costs of certain agreements which are being amortized using the straight line method over the lives of the agreements or the estimated periods of benefit ranging from five to seven years.

The gross carrying amount of the customer list and covenant not to compete was $890,000 at December 31, 2015 and 2014, and accumulated amortization was $890,000 at December 31, 2015 and 2014. Amortization expense for 2014 was $7,000. There was no amortization expense in 2015.

Income Taxes

Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws.

ASC Topic 740, *Income Taxes,* defines the criteria that an individual tax position must satisfy for some or all of the benefits of that position to be recognized in a company's financial statements. ASC Topic 740 prescribes a recognition threshold of more-likely-than-not, and a measurement attribute for all tax positions taken or expected to be taken on a tax return, in order for those tax positions to be recognized in the financial statements. The Company is currently open to audit under the statute of limitations by the Internal Revenue Service for the years ended December 31, 2012 through 2015.

Comprehensive Income

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

Earnings Per Share

Basic earnings per share data is computed based on the weighted average number of the Company's common shares outstanding during the year. Potential common stock related to unvested restricted stock awards is considered in the calculation of weighted average shares outstanding for diluted earnings per share.

Derivative Financial Instruments Designated as Hedges

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

Recently Issued Accounting Pronouncements

In January 2014, the Financial Accounting Standards Board (FASB) issued ASU No. 2014-01, *Accounting for Investments in Qualified Affordable Housing Projects.* The amendments in this ASU permit institutions to make accounting policy elections to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit). For those investments in qualified affordable housing projects not accounted for using the proportional amortization method, the ASU requires the investment to be accounted for as an equity method investment or a cost method investment. The amendments in this ASU should be applied retrospectively to all periods presented. A reporting entity that uses the effective yield method to account for its investments in qualified affordable housing projects before the date of adoption may continue to apply the effective yield method for those preexisting investments. The amendments in this ASU are effective for annual periods beginning after December 15, 2014. The ASU did not have a material effect on the Company's consolidated financial statements.

In January 2014, FASB issued ASU No. 2014-04, *Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure.* The amendments in this ASU clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure. The amendments in this ASU are effective for annual periods beginning after December 15, 2014. The ASU did not have a material effect on the Company's consolidated financial statements.

In June 2014, FASB issued ASU No. 2014-11, Transfers and Servicing (Topic 860): *Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures.* The ASU was issued to respond to concerns about current accounting and disclosures for repurchase agreements and similar transactions. The concern was that under current accounting guidance there is an unnecessary distinction between the accounting for different types of repurchase agreements. Under current guidance, the repurchase-to-maturity transactions are accounted for as sales with forward agreements, whereas repurchase agreements that settle before the maturity of the transferred financial asset are accounted for as secured borrowings. The ASU amendments require new disclosures for repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions accounted for as secure borrowings. The ASU is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The ASU did not have a material effect on the Company's consolidated financial statements.

1. Summary of Significant Accounting Policies (cont.)

In June 2014, FASB issued ASU No. 2014-12, Compensation - Stock Compensation (Topic 718): *Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period.* The ASU was issued because current GAAP does not contain explicit guidance on how to account for share-based payments when a performance target could be achieved after the requisite service period. The ASU is effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. The ASU will not have a material effect on the Company's consolidated financial statements.

In August 2014, FASB issued ASU No. 2014-14, Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40): *Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure.* The ASU was issued to provide specific guidance on how to classify or measure foreclosed mortgage loans that are government guaranteed. The ASU is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The ASU did not have a material effect on the Company's consolidated financial statements.

2. Cash and Due from Banks

The Bank is required to maintain certain reserves of vault cash or deposits with the Federal Reserve Bank. The amount of this reserve requirement, included in cash and due from banks, was approximately $77,000 and $292,000 as of December 31, 2015 and 2014, respectively.

3. Securities

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

2015	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available-for-Sale				
U.S. Treasury securities	$ 3,409,000	$ 21,000	$ -	$ 3,430,000
State and municipal	5,311,000	100,000	-	5,411,000
Corporate bonds	1,000,000	-	(108,000)	892,000
Mortgage-backed and CMO's	62,442,000	535,000	(639,000)	62,338,000
Total debt securities	72,162,000	656,000	(747,000)	72,071,000
Money market mutual funds	4,000	-	-	4,000
Marketable equity securities	500,000	-	(74,000)	426,000
Total securities available-for-sale	$ 72,666,000	$ 656,000	$ (821,000)	$ 72,501,000
Securities Held-to-Maturity				
Mortgage-backed and CMO's	$ 16,000	$ -	$ -	$ 16,000
Total securities held-to-maturity	$ 16,000	$ -	$ -	$ 16,000

2014	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available-for-Sale				
U.S. Treasury securities	$ 2,409,000	$ 19,000	$ -	$ 2,428,000
State and municipal	2,160,000	12,000	(12,000)	2,160,000
Corporate bonds	500,000	-	(90,000)	410,000
Mortgage-backed and CMO's	53,176,000	855,000	(758,000)	53,273,000
Total debt securities	58,245,000	886,000	(860,000)	58,271,000
Money market mutual funds	2,000	-	-	2,000
Marketable equity securities	500,000	-	(100,000)	400,000
Total securities available-for-sale	$ 58,747,000	$ 886,000	$ (960,000)	$ 58,673,000
Securities Held to Maturity				
Mortgage backed and CMO's	$ 20,000	$ -	$ -	$ 20,000
Total securities held-to-maturity	$ 20,000	$ -	$ -	$ 20,000

The following summarizes the Company's gross unrealized losses and fair values aggregated by investment category and length of time that individual securities have been in a continuous loss position at December 31, 2015:

	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Corporate bonds	$ -	$ -	$ 393,000	$(108,000)	$ 393,000	$ (108,000)
Mortgage-backed and CMO's	30,173,000	(204,000)	14,736,000	(435,000)	44,909,000	(639,000)
Marketable equity securities	-	-	426,000	(74,000)	426,000	(74,000)
Total temporarily impaired securities	$30,173,000	$ (204,000)	$15,555,000	$(617,000)	$45,728,000	$ (821,000)

At December 31, 2015, unrealized losses within the marketable equity securities category relate to one individual security which had a continuous loss for more than one year. Unrealized losses within the mortgage-backed and collateralized mortgage obligations (CMO's) category relate to forty-two individual securities of which sixteen had continuous losses for more than one year. Unrealized losses within the corporate bond category relate to one bond which had a continuous loss position for more than one year. The primary cause for unrealized losses within the debt securities is the impact movements in interest rates have had in comparison to the underlying yields on these securities.

The following summarizes the Company's gross unrealized losses and fair values aggregated by investment category and length of time that individual securities have been in a continuous loss position at December 31, 2014:

	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Corporate bonds	$ -	$ -	$ 410,000	$ (90,000)	$ 410,000	$ (90,000)
Mortgage-backed and CMO's	6,958,000	(22,000)	25,934,000	(736,000)	32,892,000	(758,000)
State and municipal	1,130,000	(12,000)	-	-	1,130,000	(12,000)
Marketable equity securities	-	-	400,000	(100,000)	400,000	(100,000)
Total temporarily impaired securities	$ 8,088,000	$ (34,000)	$26,744,000	$ (926,000)	$ 34,832,000	$ (960,000)

At December 31, 2014, unrealized losses within the marketable equity securities category relate to one individual security which had a continuous loss for more than one year. Unrealized losses within the mortgage backed and CMO's category relate to twenty-eight individual securities of which twenty-three had continuous losses for more than one year. Unrealized losses within the corporate bond category relate to one bond which had a continuous loss position for more than one year. Unrealized losses within the state and municipal security category relate to two individual securities, both of which had continuous loss positions of less than one year. The primary cause for unrealized losses within the debt securities is the impact movements in interest rates have had in comparison to the underlying yields on these securities.

Management evaluates investments for other-than-temporary impairment (OTTI) based on the type of investment and the period of time the investment has been in an unrealized loss position. At December 31, 2015 and 2014, management has determined that the current unrealized losses on these securities are consistent with changes in the overall bond and equity markets caused by an increase in market yields and spread levels and the securities are not other-than-temporarily impaired. The exception to this is a mortgage backed security at Banc of America Funding Corporation (BAFC). Management performed an internal analysis on the market value of its investment at BAFC as of December 31, 2015 and 2014, and recognized OTTI write downs of this security of $2,000 and $17,000 for the years ended December 31, 2015 and 2014, respectively.

At December 31, 2015 and 2014, securities with a fair value of $24,474,000 and $21,585,000, respectively, were pledged to secure certain borrowings and municipal deposits and repurchase agreements as required or permitted by law.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2015 and 2014

3. Securities (cont.)

The amortized cost and fair value of debt securities by contractual maturity at December 31, 2015 follow:

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Over 1 year through 5 years	$ 18,377,000	$ 18,335,000	$ -	$ -
Over 5 years through 10 years	19,899,000	20,002,000	16,000	16,000
Over 10 years	33,886,000	33,734,000	-	-
	$ 72,162,000	$ 72,071,000	$ 16,000	$ 16,000

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

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

4. Loans

A summary of the loan balances follows:

	2015	2014
Mortgage loans on real estate		
Residential 1-4 family	$ 139,381,000	$ 134,790,000
Commercial	262,691,000	265,596,000
	402,072,000	400,386,000
Commercial loans	156,429,000	141,109,000
Municipal loans	6,873,000	4,700,000
Consumer installment loans	19,899,000	18,292,000
Business credit cards	340,000	260,000
Subtotal	585,613,000	564,747,000
Less: Allowance for loan losses	5,330,000	5,899,000
Add: Net deferred loan costs	625,000	590,000
Loans, net	$ 580,908,000	$ 559,438,000

An analysis of the allowance for loan losses follows:

Years Ended December 31,	2015	2014
Balance at beginning of year	$ 5,899,000	$ 6,097,000
Provision for loan losses	50,000	548,000
Loans charged off	(835,000)	(989,000)
Recoveries of loans previously charged off	216,000	243,000
Balance at end of year	$ 5,330,000	$ 5,899,000

The following tables present the allowance for loan losses and select loan information for the years ended December 31, 2015 and 2014:

	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	2015 Total
Allowance for loan losses						
Beginning balance	$ 1,848,000	$ 3,503,000	$ 316,000	$ 60,000	$172,000	$ 5,899,000
Provision for (reduction of) loan losses	569,000	(780,000)	77,000	27,000	157,000	50,000
Loans charged off	(197,000)	(490,000)	(119,000)	(29,000)	-	(835,000)
Recoveries of loans previously charged off	135,000	73,000	4,000	4,000	-	216,000
Ending balance	$ 1,924,000	$ 2,737,000	$ 278,000	$ 62,000	$329,000	$ 5,330,000
Individually evaluated for impairment	$ 45,000	$ 147,000	$ 44,000	$ 10,000	$ -	$ 246,000
Collectively evaluated for impairment	$ 1,879,000	$ 2,590,000	$ 234,000	$ 52,000	$329,000	$ 5,084,000
Loans						
Ending balance	$163,642,000	$262,691,000	$139,381,000	$19,899,000		$585,613,000
Individually evaluated for impairment	$ 675,000	$ 5,779,000	$ 1,343,000	$ 94,000		$ 7,891,000
Collectively evaluated for impairment	$162,967,000	$256,912,000	$138,038,000	$19,805,000		$577,722,000

	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	2014 Total
Allowance for loan losses						
Beginning balance	$ 2,559,000	$ 2,913,000	$ 483,000	$ 67,000	$75,000	$ 6,097,000
Provision for (reduction of) loan losses	(244,000)	819,000	(132,000)	8,000	97,000	548,000
Loans charged off	(672,000)	(241,000)	(58,000)	(18,000)	-	(989,000)
Recoveries of loans previously charged off	205,000	12,000	23,000	3,000	-	243,000
Ending balance	$ 1,848,000	$ 3,503,000	$ 316,000	$ 60,000	$172,000	$5,899,000
Individually evaluated for impairment	$ 28,000	$ 716,000	$ 42,000	$ -	$ -	$ 786,000
Collectively evaluated for impairment	$ 1,820,000	$ 2,787,000	$ 274,000	$ 60,000	$172,000	$ 5,113,000
Loans						
Ending balance	$146,069,000	$265,596,000	$134,790,000	$18,292,000		$564,747,000
Individually evaluated for impairment	$ 584,000	$ 8,555,000	$ 1,047,000	$ 61,000		$ 10,247,000
Collectively evaluated for impairment	$145,485,000	$257,041,000	$133,743,000	$18,231,000		$554,500,000

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

Commercial: Commercial and Commercial Real Estate

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

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

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

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

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

Loans rated 5: These loans are considered "watch list." These loans are those commercial loans that, while creditworthy, exhibit some characteristics which require special attention by the loan officer. This is the lowest permissible rating for a new loan. Loans rated 5 must be closely monitored as any deterioration may be cause for prompt re-rating to 6 or lower. Principal areas of concern may be management problems, industry stress, financial deterioration, operating losses, inadequate cash flow, highly cyclical industries, or any other area that would negatively affect the borrower's ability to repay the obligation in full on a timely basis.

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

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

4. Loans (cont.)

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

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

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

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

The following tables summarize credit risk indicators by portfolio as of December 31, 2015 and 2014:

Commercial Credit Risk Exposure
Credit Risk Profile by Internally Assigned Grade

2015	Commercial	Commercial Real Estate
Pass	$ 158,062,000	$ 250,450,000
Special mention	3,872,000	6,001,000
Substandard	1,708,000	6,240,000
Doubtful	-	-
Loss	-	-
2015 Total	$ 163,642,000	$ 262,691,000
2014		
Pass	$ 142,195,000	$ 243,094,000
Special mention	2,066,000	12,629,000
Substandard	1,808,000	9,873,000
Doubtful	-	-
Loss	-	-
2014 Total	$ 146,069,000	$ 265,596,000

Consumer Credit Exposure
Credit Risk Profile by Internally Assigned Grade

2015	Residential Real Estate	Consumer-Installment	Consumer-Indirect Installment
Pass	$ 138,207,000	$ 4,231,000	$ 15,613,000
Substandard	1,174,000	41,000	14,000
2015 Total	$ 139,381,000	$ 4,272,000	$ 15,627,000
2014			
Pass	$ 133,890,000	$ 3,734,000	$ 14,509,000
Substandard	900,000	49,000	-
2014 Total	$ 134,790,000	$ 3,783,000	$ 14,509,000

The following presents an aging analysis of past due loans as of December 31, 2015 and 2014:

2015	30-59 Days Past Due	60-90 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Loans on Nonaccrual	Recorded Investment Loans > 90 Days & Accruing
Commercial	$ 855,000	$ 191,000	$ 210,000	$ 1,256,000	$ 162,386,000	$ 163,642,000	$ 652,000	$ 75,000
Commercial real estate	462,000	676,000	532,000	1,670,000	261,021,000	262,691,000	3,605,000	-
Residential real estate	901,000	101,000	71,000	1,073,000	138,308,000	139,381,000	1,081,000	14,000
Consumer – installment	7,000	1,000	-	8,000	4,264,000	4,272,000	81,000	-
Consumer – indirect installment	273,000	32,000	4,000	309,000	15,318,000	15,627,000	14,000	-
2015 Total	$ 2,498,000	$ 1,001,000	$ 817,000	$ 4,316,000	$ 581,297,000	$ 585,613,000	$ 5,433,000	$ 89,000
2014								
Commercial	$ 980,000	$ 285,000	$ 415,000	$ 1,680,000	$ 144,389,000	$ 146,069,000	$ 1,004,000	$ 75,000
Commercial real estate	570,000	158,000	5,195,000	5,923,000	259,673,000	265,596,000	6,964,000	-
Residential real estate	969,000	2,000	-	971,000	133,819,000	134,790,000	1,040,000	-
Consumer – installment	24,000	-	-	24,000	3,759,000	3,783,000	97,000	7,000
Consumer – indirect installment	355,000	38,000	7,000	400,000	14,109,000	14,509,000	-	-
2014 Total	$ 2,898,000	$ 483,000	$ 5,617,000	$ 8,998,000	$ 555,749,000	$ 564,747,000	$ 9,105,000	$ 82,000

4. Loans (cont.)

The Bank takes a conservative approach in credit risk management and remains focused on community lending and reinvesting, working closely with borrowers experiencing credit problems to assist in loan repayment or term modifications. Troubled debt restructured loans (TDRs) consist of loans where the Bank, for economic or legal reasons related to the borrower's financial difficulties, granted a concession to the borrower that it would not otherwise consider. TDRs involve term modifications or a reduction of either interest or principal that the Bank would not normally make for other borrowers with similar risk characteristics. Once such an obligation has been restructured, it will continue to remain in restructured status until paid in full. Current balances of loan modifications qualifying as TDRs during the years ended December 31, 2015 and 2014 were $2,900,000 and $1,174,000, respectively. Loans restructured due to credit difficulties that are now performing were $5,418,000 and $2,704,000 at December 31, 2015 and 2014, respectively.

At December 31, 2015 and 2014, the allowance related to TDRs was $199,000 and $53,000, respectively. The specific reserve component was determined by using the fair value of the underlying collateral, which was obtained through independent appraisals and internal evaluations, or by discounting the total expected future cash flows from the borrower. There were no commitments to lend additional funds to borrowers with loans classified as TDRs at December 31, 2015 and 2014. In 2015, one commercial, one residential real estate, and one consumer loan did not perform according to the TDR terms and were subsequently charged off or transferred to OREO in the combined amount of $131,000. In 2014, there were four commercial loans that did not perform according to the TDR terms and were subsequently charged off or transferred to OREO in the combined amount of $677,000.

The following is a summary of all TDRs (accruing and non-accruing) by portfolio segment as of December 31, 2015 and 2014:

2015	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Current Balance
Commercial	23	$ 465,000	$ 524,000	$ 392,000
Commercial real estate	37	7,879,000	5,662,000	4,861,000
Residential real estate	6	1,093,000	1,093,000	989,000
2015 Total	66	$ 9,437,000	$ 7,279,000	$ 6,242,000
2014				
Commercial	4	$ 110,000	$ 122,000	$ 50,000
Commercial real estate	14	5,967,000	6,390,000	3,553,000
Residential real estate	5	914,000	914,000	894,000
Consumer	1	13,000	13,000	12,000
2014 Total	24	$ 7,004,000	$ 7,439,000	$ 4,509,000

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

The following table presents a summary of information pertaining to impaired loans by loan category as of December 31, 2015 and 2014:

2015	Recorded Investment	Unpaid Principal Balance	Related Allowance	Interest Income Recognized
With no related allowance recorded:				
Commercial	$ 549,000	$ 549,000	$ -	$ 15,000
Commercial real estate	4,361,000	4,361,000	-	121,000
Residential real estate	883,000	883,000	-	10,000
Consumer	84,000	84,000	-	1,000
With an allowance recorded:				
Commercial	$ 126,000	$ 126,000	$ 45,000	$ 7,000
Commercial real estate	1,418,000	1,418,000	147,000	42,000
Residential real estate	460,000	460,000	44,000	24,000
Consumer	10,000	10,000	10,000	1,000
2015 Total:				
Commercial	$ 675,000	$ 675,000	$ 45,000	$ 22,000
Commercial real estate	5,779,000	5,779,000	147,000	163,000
Residential real estate	1,343,000	1,343,000	44,000	34,000
Consumer	94,000	94,000	10,000	2,000

2014	Recorded Investment	Unpaid Principal Balance	Related Allowance	Interest Income Recognized
With no related allowance recorded:				
Commercial	$ 300,000	$ 300,000	$ -	$ 18,000
Commercial real estate	6,368,000	6,368,000	-	61,000
Residential real estate	69,000	69,000	-	1,000
Consumer	49,000	49,000	-	-
With an allowance recorded:				
Commercial	$ 284,000	$ 284,000	$ 28,000	$ 12,000
Commercial real estate	2,187,000	2,187,000	716,000	11,000
Residential real estate	978,000	978,000	42,000	18,000
Consumer	12,000	12,000	-	1,000
2014 Total:				
Commercial	$ 584,000	$ 584,000	$ 28,000	$ 30,000
Commercial real estate	8,555,000	8,555,000	716,000	72,000
Residential real estate	1,047,000	1,047,000	42,000	19,000
Consumer	61,000	61,000	-	1,000

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

	2015	2014
Impaired loans without a valuation allowance	$ 5,877,000	$ 6,786,000
Impaired loans with a valuation allowance	2,014,000	3,461,000
Total impaired loans	$ 7,891,000	$ 10,247,000
Valuation allowance related to impaired loans	$ 246,000	$ 786,000
Average investment in impaired loans	$ 11,041,000	$ 10,184,000

As of December 31, 2015, there were seven mortgage loans collateralized by residential real estate in the process of foreclosure with a total balance of $281,000.

5. Bank Premises and Equipment

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

	2015	2014
Land	$ 2,755,000	$ 2,729,000
Buildings	11,862,000	11,828,000
Equipment	12,343,000	11,951,000
Leasehold improvements	1,112,000	1,112,000
Construction in progress	-	2,000
	28,072,000	27,622,000
Accumulated depreciation	(14,900,000)	(13,502,000)
	$ 13,172,000	$ 14,120,000

6. Investments in Limited Partnerships

At December 31, 2015 and 2014, the Company held investments in limited partnerships with related New Market Tax Credits (NMTC). These investments are carried at cost and amortized on the effective yield method. The tax credits from these investments at December 31, 2015 and 2014 are $285,000 and $594,000, respectively, and are recorded as a reduction of income tax expense. Amortization of the investments in the limited partnerships for the years ended December 31, 2015 and 2014 totaled $264,000 and $526,000, respectively, and is recognized as a component of income tax expense in the consolidated statements of income. The carrying value of these investments at December 31, 2015 and 2014 amounted to $69,000 and $406,000, respectively, which is recorded in other assets. The Company participates in loans to the limited partnerships. The Company's total exposure to these limited partnerships at December 31, 2015 and 2014 was $9,713,000 and $10,050,000, respectively, which is comprised of the Company's equity investment in the limited partnerships and the balance of the loans receivable.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2015 and 2014

7. Deposits

At December 31, 2015, the scheduled maturities of time deposits are as follows:

2016	$ 142,372,000
2017	16,874,000
2018	45,036,000
2019	31,808,000
2020 and thereafter	6,140,000
	$ 242,230,000

8. Advances from Federal Home Loan Bank

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

Fixed-rate advances of $20,188,000 and $25,199,000 at December 31, 2015 and 2014, respectively, mature through August 2023. At December 31, 2015 and 2014, the interest rates on fixed-rate advances ranged from 0.00 to 0.48 percent. At December 31, 2015 and 2014, the weighted-average interest rates on fixed rate advances were 0.43 percent and 0.36 percent, respectively.

There were no floating rate advances at December 31, 2015. The floating rate advance of $6,305,000 at December 31, 2014 matured in January 2015. At December 31, 2014, the interest rate on the floating rate advance was 0.30 percent.

At December 31, 2015 and 2014, the Company also had $1,000,000 available under a long-term line of credit with the FHLB.

The contractual maturities of advances at December 31, 2015 are as follows:

2016	$ 20,000,000
2023	188,000

9. Other Borrowed Funds

Other borrowed funds of $540,000 and $1,011,000 at December 31, 2015 and 2014, respectively, consist of securities sold under agreements to repurchase.

Securities sold under agreements to repurchase, which are classified as secured borrowings, generally mature within one to four days from the transaction date, except for the term repurchase agreements. Securities sold under agreements to repurchase are reflected at the amount of cash received in connection with the transaction. The Company may be required to provide additional collateral based on the fair value of the underlying securities. At December 31, 2015 and 2014, securities with a fair value of $540,000 and $1,011,000, respectively, were pledged to secure other borrowed funds.

Information concerning securities sold under agreements to repurchase for the years ended December 31, 2015 and 2014 is summarized as follows:

	2015	2014
Average balance during the year	$ 660,000	$ 912,000
Average interest rate during the year	0.11%	0.11%
Maximum month-end balance during the year	$ 983,000	$ 1,011,000

At December 31, 2015, the Company also had $2,500,000 available under a line of credit expiring in September 2016. There were no advances outstanding at December 31, 2015.

10. Capital Trust Securities

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

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

11. Income Taxes

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

	2015	2014
Current tax provision		
Federal	$ 2,880,000	$ 2,269,000
State	102,000	92,000
	2,982,000	2,361,000
Deferred federal tax benefit	(681,000)	(443,000)
	$ 2,301,000	$ 1,918,000

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

	2015	2014
Computed tax expense	$ 2,383,000	$ 2,068,000
Increase (reduction) in income taxes resulting from:		
Tax exempt interest	(84,000)	(54,000)
State taxes, net of federal benefit	67,000	61,000
Income from life insurance	(92,000)	(89,000)
Preferred stock dividends	(5,000)	(5,000)
Tax credits, net of investment amortization	(14,000)	(45,000)
Other	46,000	(18,000)
	$ 2,301,000	$ 1,918,000

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

	2015	2014
Deferred tax assets		
Other-than-temporary impairment of investment securities	$ 72,000	$ 72,000
Allowance for loan losses	1,812,000	2,006,000
Employee benefit plans	861,000	776,000
Net unrealized loss on derivative instruments	379,000	321,000
Net unrealized loss on securities available-for-sale	56,000	25,000
Other	125,000	633,000
	3,305,000	3,833,000
Deferred tax liabilities		
Depreciation	1,015,000	1,072,000
Amortization of goodwill	1,578,000	1,494,000
Amortization of interest rate cap premium	196,000	-
Prepaid expenses	154,000	137,000
Investment in NMTC	177,000	350,000
Other	-	1,000
	3,120,000	3,054,000
Net deferred tax asset	$ 185,000	$ 779,000

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2015 and 2014

12. Earnings Per Share

The following sets forth the computation of basic and diluted earnings per common share for 2015 and 2014:

	2015	2014
Net income available to common shareholders, as reported	$ 3,900,000	$ 3,698,000
Weighted-average common shares outstanding	3,404,367	3,404,367
Effect of unvested restricted stock grants	-	-
Diluted weighted-average common shares	3,404,367	3,404,367
Basic earnings per common share	$ 1.15	$ 1.09
Diluted earnings per common share	$ 1.15	$ 1.09

13. Financial Instruments with Off-Balance-Sheet Risk

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

The Company's exposure to credit loss is represented by the contractual amount of these commitments. The Company follows the same credit policies in making commitments as it does for on-balance-sheet instruments.

At December 31, 2015 and 2014, the contractual amounts of the Company's financial instruments were as follows:

	Contract Amount	
	2015	2014
Lending-related instruments:		
Home equity lines-of-credit	$ 19,579,000	$ 18,886,000
Other lines-of-credit	48,836,000	40,812,000
Credit card arrangements	2,062,000	1,700,000
Letters-of-credit	2,723,000	2,467,000
Derivative financial instruments:		
Interest rate swap	4,000,000	4,000,000
Interest rate caps	28,000,000	28,000,000

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

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

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

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

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

The Company has a notional amount of $4,000,000 in an interest rate swap agreement on its junior subordinated debentures. As the interest on these debentures is a variable rate, the Company swapped the variable cost for a fixed cost. On March 30, 2010, the Company purchased a 7-year interest rate swap with an effective date of April 7, 2010 and a notional amount of $4,000,000 with a fixed cost of 3.48% and a maturity date of April 7, 2017. The fair value of the swap agreement was a liability at December 31, 2015 and 2014 of $130,000 and $225,000, respectively. As this instrument qualifies as a highly effective cash flow hedge, the change in fair value was recorded in other comprehensive income (loss), net of tax.

On March 30, 2010, the Company purchased an interest rate protection agreement (cap) with a notional amount of $3,000,000, a strike rate of 3.0% and a termination date of April 7, 2017. The cap was acquired to limit the Company's exposure to interest rates on its junior subordinated debentures. Under the agreement, the Company paid up front premiums of $270,000, which the Company is amortizing based on the expense amortization schedule established at the inception of the hedge, with the corresponding adjustment to the income statement. At inception, the hedging relationship was expected to be 100% effective in achieving offsetting cash flows attributable to the hedged risk during the term of the hedge. The fair value of the cap at December 31, 2014 was $3,000. The cap had no fair value at December 31, 2015. As this instrument qualifies as a highly effective cash flow hedge, the change in fair value was recorded in other comprehensive income (loss), net of tax.

On April 9, 2014, the Bank purchased an interest rate protection agreement (cap) with a notional amount of $25,000,000, a cap rate of .23% and a termination date of April 4, 2019. The cap was acquired to limit the Bank's exposure to rising interest rates. Under the agreement, the Bank paid up front premiums of $1,998,000, which the Bank is amortizing based on the expense amortization schedule established at the inception of the hedge, with the corresponding adjustment to the income statement. At inception, the hedging relationship was expected to be 100% effective in achieving offsetting cash flows attributable to the hedged risk during the term of the hedge. The fair value of the cap at December 31, 2015 and 2014 was $956,000 and $1,435,000, respectively. As this instrument qualifies as a highly effective cash flow hedge, the change in fair value was recorded in other comprehensive income (loss), net of tax.

14. Significant Group Concentrations of Credit Risk

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

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

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

15. Legal Contingencies

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

16. Minimum Regulatory Capital Requirements

The Company (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's and Bank's financial statements. Under capital adequacy guidelines

16.Minimum Regulatory Capital Requirements (cont.)

and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Effective January 1, 2015, the Bank implemented the Basel III regulatory framework. These new rules and framework revised minimum capital requirements and adjusted prompt corrective action thresholds. Under the Basel III regulatory framework, the quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital and common equity Tier 1 (as defined in the regulations) to risk weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined). Effective in 2015, the Company is considered a Small Bank Holding Company and therefore not subject to the Basel III capital rules. Management believes, as of December 31, 2015 and 2014, that the Company and the Bank met all capital adequacy requirements to which they are subject.

As of December 31, 2015, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based, common equity Tier 1 and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since the notification that management believes have changed the Bank's category. The Company's and the Bank's actual capital amounts and ratios as of December 31, 2015 and 2014 are also presented in the table.

As of December 31, 2015	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital to Risk-Weighted Assets						
Bank	$ 70,921,000	13.3%	$ 42,540,000	8.0%	$ 53,175,000	10.0%
Tier 1 Capital to Risk-Weighted Assets						
Bank	65,558,000	12.3	31,905,000	6.0	42,540,000	8.0
Common Equity Tier 1 Capital to Risk-Weighted Assets						
Bank	65,558,000	12.3	23,929,000	4.5	34,564,000	6.5
Tier 1 Capital to Average Assets						
Bank	65,558,000	9.4	27,822,000	4.0	34,777,000	5.0
As of December 31, 2014						
Total Capital to Risk-Weighted Assets						
Bank	$ 68,699,000	13.4%	$ 41,072,000	8.0%	$ 51,340,000	10.0%
Consolidated	80,261,000	15.6	41,070,000	8.0	N/A	N/A
Tier 1 Capital to Risk-Weighted Assets						
Bank	62,767,000	12.2	20,536,000	4.0	30,804,000	6.0
Consolidated	74,329,000	14.5	20,535,000	4.0	N/A	N/A
Tier 1 Capital to Average Assets						
Bank	62,767,000	9.7	25,943,000	4.0	32,429,000	5.0
Consolidated	74,329,000	11.5	25,943,000	4.0	N/A	N/A

17. Employee Benefit Plans

The Company has a safe harbor 401(k) plan whereby substantially all employees participate in the plan. Employees may contribute a portion of their compensation subject to certain limits based on federal tax laws. The Company makes safe harbor matching contributions equal to 100% of the first 3% of an employee's compensation plus 50% of the next 2% of an employee's compensation in addition to a discretionary contribution. For the years ended December 31, 2015 and 2014, expense attributable to the plan amounted to $313,000 and $283,000, respectively.

The Company has established a nonqualified supplemental executive retirement plan for the benefit of key employees. The amount of each benefit is guaranteed contingent upon employee vesting schedules. The present value of these benefits, being expensed over the employment service period, amounted to $186,000 and $196,000 for 2015 and 2014, respectively. Life insurance policies were acquired for the purpose of serving as the primary funding source. The cash value of these policies was $9,612,000 and $8,533,000 at December 31, 2015 and 2014, respectively, and is included in other assets.

For 2015 and 2014, in addition to a retainer fee of $12,000 for regular directors, $14,000 for the vice chairman and $15,000 for the chairman, outside directors of the Bank received $600 for each Board meeting attended, and $600 for each Board subcommittee meeting attended.

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

18. Restricted Stock Plan

The Company established a restricted stock plan during 2010 with 100,000 shares currently authorized by the Board of Directors for the compensation committee of the Board to administer. The compensation committee did not grant restricted stock during 2015 or 2014. A total of 11,897 shares have been issued under the restricted stock plan since inception, all of which are vested.

19. Other Noninterest Expenses

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

	2015	2014
Printing, postage and supplies	$ 564,000	$ 556,000
Professional fees	369,000	387,000

20. Related Party Transactions

In the ordinary course of business, the Company has granted loans to principal officers and directors and their affiliates amounting to $11,128,000 and $11,002,000 at December 31, 2015 and 2014, respectively. Deposits from related parties held by the Company at December 31, 2015 and 2014 amounted to $5,240,000 and $4,803,000, respectively.

21. Fair Value

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

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

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

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

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon model-based techniques

21. Fair Value (cont.)

incorporating various assumptions including interest rates, prepayment speeds and credit losses. Assets and liabilities valued using model-based techniques are classified as either Level 2 or Level 3, depending on the lowest level classification of an input that is considered significant to the overall valuation. A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

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

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

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

	Fair Value Measurements at December 31, 2015 and 2014, Using			
December 31, 2015	**Total**	**Quoted Prices In Active Markets For Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Assets				
Securities available-for-sale				
U.S. Treasury securities	$ 3,430,000	$ -	$ 3,430,000	$ -
State and municipal	5,411,000	-	5,411,000	-
Corporate bonds	892,000	-	892,000	-
Mortgage-backed and CMO's	62,338,000	-	62,338,000	-
Total debt securities	72,071,000	-	72,071,000	-
Money market mutual funds	4,000	4,000	-	-
Marketable equity securities	426,000	426,000	-	-
Total securities available-for-sale	72,501,000	430,000	72,071,000	-
Derivative instruments	956,000	-	956,000	-
Total assets	$ 73,457,000	$ 430,000	$73,027,000	$ -
Liabilities				
Derivative instruments	$ 130,000	$ -	$ 130,000	$ -
December 31, 2014				
Assets				
Securities available-for-sale				
U.S. Treasury securities	$ 2,428,000	$ -	$ 2,428,000	$ -
State and municipal	2,160,000	-	2,160,000	-
Corporate bonds	410,000	-	410,000	-
Mortgage-backed and CMO's	53,273,000	-	53,273,000	-
Total debt securities	58,271,000	-	58,271,000	-
Money market mutual funds	2,000	2,000	-	-
Marketable equity securities	400,000	400,000	-	-
Total securities available-for-sale	58,673,000	402,000	58,271,000	-
Derivative instruments	1,438,000	-	1,438,000	-
Total assets	$ 60,111,000	$ 402,000	$59,709,000	$ -
Liabilities				
Derivative instruments	$ 225,000	$ -	$ 225,000	$ -

Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis

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

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

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

	Fair Value Measurements at December 31, 2015 and 2014, Using			
December 31, 2015	**Total**	**Quoted Prices In Active Markets For Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Assets				
Impaired loans (market approach)	$ 1,768,000	$ -	$ 1,768,000	$ -
Other real estate owned (market approach)	399,000	-	399,000	-
December 31, 2014				
Assets				
Impaired loans (market approach)	$ 2,675,000	$ -	$ 2,675,000	$ -
Other real estate owned (market approach)	309,000	-	309,000	-

Certain impaired loans were written down to their value of $1,768,000 and $2,675,000 at December 31, 2015 and 2014, respectively, resulting in an impairment charge through the allowance for loan losses.

GAAP requires disclosures of fair value information about financial instruments, whether or not recognized in the balance sheet, if the fair values can be reasonably determined. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques using observable inputs when available. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. Certain financial instruments and all nonfinancial instruments are excluded from the disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company.

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

Cash and due from banks and interest bearing deposits in banks: The carrying amount reported in the balance sheet for cash and cash equivalents approximates fair value.

Securities: Fair values for securities, excluding FHLB stock, are determined by obtaining quoted prices on nationally recognized securities exchanges or matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for the specific securities, but rather by relying on the securities' relationship to other benchmark quoted securities. The carrying value of FHLB stock approximates fair value based on the redemption provisions of the FHLB.

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

Deposit liabilities: The fair values disclosed for demand deposits are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying

21. Fair Value (cont.)

amounts). The carrying amounts of variable-rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting date. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregate expected monthly maturities on time deposits.

Advances from Federal Home Loan Bank: The fair values of these borrowings are estimated using discounted cash flow analyses based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

Other borrowed funds: The fair values of these borrowed funds are estimated using discounted cash flow analyses based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

Junior subordinated debentures: The carrying values of these instruments approximate fair value.

Accrued interest: The carrying amounts of accrued interest approximate fair value.

Off-balance-sheet instruments: The Company's off-balance-sheet instruments consist of loan commitments. Fair values for loan commitments have not been presented as the future revenue derived from such financial instruments is not significant.

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

			Fair Value Measurement at December 31, 2015		
	Carrying Amount	Fair Value	Quoted Prices In Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial assets					
Cash and due from banks	$ 6,388,000	$ 6,388,000	$6,388,000	$ -	$ -
Interest bearing deposits in banks	5,157,000	5,157,000	5,157,000	-	-
Securities available-for-sale	72,501,000	72,501,000	430,000	72,071,000	-
Securities held-to-maturity	16,000	16,000	-	16,000	-
Federal Home Loan Bank stock	2,319,000	2,319,000	-	2,319,000	-
Loans receivable, net:					
Commercial	161,801,000	163,392,000	-	81,000	163,311,000
Commercial real estate	260,087,000	259,285,000	-	1,271,000	258,014,000
Residential real estate	139,173,000	139,306,000	-	416,000	138,890,000
Consumer	19,847,000	20,216,000	-	-	20,216,000
Loan receivable, net	580,908,000	582,199,000	-	1,768,000	580,431,000
Accrued interest receivable	1,713,000	1,713,000	-	1,713,000	-
Derivative instruments	956,000	956,000	-	956,000	-
Financial liabilities					
Deposits	606,205,000	597,112,000	-	597,112,000	-
Advances from FHLB	20,188,000	20,204,000	-	20,204,000	-
Other borrowed funds	540,000	540,000	-	540,000	-
Accrued interest payable	156,000	156,000	-	156,000	-
Junior subordinated debentures	7,217,000	7,217,000	-	7,217,000	-
Derivative instruments	130,000	130,000	-	130,000	-

			Fair Value Measurement at December 31, 2014		
Financial assets					
Cash and due from banks	$ 6,220,000	$ 6,220,000	$6,220,000	$ -	$ -
Interest bearing deposits in banks	6,048,000	6,048,000	6,048,000	-	-
Securities available-for-sale	58,673,000	58,673,000	402,000	58,271,000	-
Securities held-to-maturity	20,000	20,000	-	20,000	-
Federal Home Loan Bank stock	1,904,000	1,904,000	-	1,904,000	-
Loans receivable, net:					
Commercial	144,328,000	146,138,000	-	256,000	145,882,000
Commercial real estate	262,290,000	262,754,000	-	1,471,000	261,283,000
Residential real estate	134,574,000	135,323,000	-	936,000	134,387,000
Consumer	18,246,000	18,978,000	-	12,000	18,966,000
Loan receivable, net	559,438,000	563,193,000	-	2,675,000	560,518,000
Accrued interest receivable	1,560,000	1,560,000	-	1,560,000	-
Derivative instruments	1,438,000	1,438,000	-	1,438,000	-
Financial liabilities					
Deposits	550,694,000	545,589,000	-	545,589,000	-
Advances from FHLB	31,504,000	31,670,000	-	31,670,000	-
Other borrowed funds	1,011,000	1,015,000	-	1,015,000	-
Accrued interest payable	196,000	196,000	-	196,000	-
Junior subordinated debentures	7,217,000	7,217,000	-	7,217,000	-
Derivative instruments	225,000	225,000	-	225,000	-

22. Preferred Stock

The Company has authorized the issuance of up to 20,000 shares of preferred stock at any one time.

Preferred Series C consisting of 11,000 shares with a purchase price of $1,000 per share was outstanding in 2014 and in 2015 until April 27, 2015. The Preferred Series C shares called for varying rates of non-cumulative dividends. The applicable rate on the Preferred Series C shares ranged from 1% to 5% per year for the first 9 quarters following the investment. The Company maintained small business lending levels in order to meet the 1% dividend rate on Preferred Series C shares for eight out of the nine completed quarters, the Bank met the requirements for a 2% dividend for one quarter. From the 10th quarter through 4.5 years following the investment, the dividend rate remained fixed at a rate of 1%. After the end of the 4.5 year period following the investment, the applicable dividend rate would have been fixed at 9%. However, approximately one year prior to the dividend increase, the Preferred Series C 11,000 shares were redeemed by the Company on April 27, 2015.

On June 27, 2014, the Company issued 4,000 shares of Preferred Series D floating rate non-cumulative perpetual preferred stock at an issuance price of $2,500 per share. The net proceeds from the issuance totaled $9,603,000. The dividend will be set quarterly at a floating rate of 3 month LIBOR plus 4.25%, with a floor of 8.75%. Dividends on Preferred Series D are payable quarterly in arrears on January 15, April 15, July 15 and October 15 of each year.

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

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

23. Subsequent Events

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about the conditions that existed at the balance sheet date, including the estimates inherent in the process of preparing financial statements. Nonrecognized subsequent events are events that provide evidence about conditions that did not exist at the balance sheet date, but arose after that date. Management has evaluated subsequent events occurring through February 3, 2016, the date the financial statements were available to be issued.



PHOTO BY PAUL CYR

SHAREHOLDER INFORMATION

ANNUAL MEETING

The Annual Shareholders' Meeting will be held in the Katahdin Trust Company Room at The Center for Community Health Education at Houlton Regional Hospital, Houlton, Maine on Monday, May 2, 2016 at 10:30 a.m.

SHAREHOLDER RELATIONS

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

Matthew M. Nightingale
Senior Vice President, Treasurer & CFO
PO Box 450 | Patten, ME 04765
(207) 521-3200
m.nightingale@katahdintrust.com

TRANSFER AGENT

Shareholder inquiries regarding change of address or title should be directed to:

Investor Relations
Computershare Shareholder Services
PO Box 30170 | College Station, TX 77842-3170
(800) 368-5948
www.computershare.com/investor

STOCK

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

BRANCH OFFICES

Ashland, Bangor, Caribou, Eagle Lake, Easton, Fort Fairfield, Fort Kent, Hampden, Houlton, Island Falls, Limestone, Mars Hill, Oakfield, Patten, Presque Isle, Scarborough, Van Buren and Washburn.

