

2015 Annual Report to Shareholders

NORTHWAY FINANCIAL, INC.
2015 ANNUAL REPORT

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Selected Financial Highlights

At or for the years ended December 31, ($000 Omitted, except per share data)	2015	2014	2013	2012	2011
Balance Sheet Data:					
Total assets	$ 933,604	$ 925,713	$ 898,329	$ 873,629	$ 820,539
Securities available-for-sale, at fair value	254,476	221,647	184,527	206,703	252,273
Loans, net of unearned income	555,922	603,593	642,259	573,577	500,078
Allowance for loan losses	8,623	8,806	11,190	10,012	10,332
Other real estate owned	463	1,138	1,581	1,126	600
Goodwill	9,934	9,934	9,934	9,934	9,934
Core deposit intangibles, net	132	194	267	352	449
Deposits	757,922	726,630	694,359	668,464	611,133
Short-term borrowings	44,042	34,850	35,465	30,270	33,291
Long-term debt	55,527	65,434	80,796	87,656	94,278
Shareholders' equity	70,307	90,918	82,188	80,878	74,892
Income Statement Data:					
Net interest and dividend income	$ 27,080	$ 28,360	$ 28,049	$ 25,779	$ 24,012
Provision for loan losses	-	1,503	2,820	2,112	4,660
Noninterest income	7,903	10,955	11,862	11,463	13,350
Noninterest expense	26,018	27,535	27,377	26,891	26,714
Net income	6,485	7,853	7,206	6,494	5,111
Net income applicable to common stock	6,212	7,585	6,925	5,854	4,115
Per Common Share Data: (1)(2)					
Net income – basic	$ 2.26	$ 2.76	$ 2.57	$ 2.23	$ 1.57
Net income – assuming dilution	2.26	2.76	2.57	2.23	1.57
Cash dividends declared and paid, common stock	0.64	0.64	0.64	0.33	0.27
Book value	25.55	24.48	21.32	21.90	19.57
Tangible book value	21.89	20.80	17.05	17.52	15.27
Selected Ratios:					
Return on average assets	0.69 %	0.84 %	0.82 %	0.77 %	0.62 %
Return on average shareholders' equity	7.01	8.96	8.89	8.25	7.87
Common stock dividend payout	28.33	23.22	24.82	14.77	17.20
Average shareholders' equity to average assets	9.86	9.40	9.20	9.31	7.93

(1) In 2013, the Company paid a stock dividend of 5%.
(2) Earnings per share and dividends declared per share for 2013, 2012, and 2011 have been adjusted to reflect the impact of the stock dividends paid.

NATURE OF OPERATIONS

Northway Financial, Inc. ("Northway" or the "Company"), headquartered in North Conway, New Hampshire, is a bank holding company formed in 1997 under the laws of New Hampshire and is registered under the Bank Holding Company Act of 1956, as amended. Northway's only business activity is to own all of the shares of, and provide management, capital and operational support to Northway Bank ("Bank"), its subsidiary headquartered in Berlin, New Hampshire, and its Delaware statutory business trusts, Northway Capital Trust III and Northway Capital Trust IV. Unless the context otherwise requires, references herein to the "Company" include Northway and its subsidiary, the Bank. The Bank is engaged principally in the business of attracting deposits from the general public and investing those deposits in securities, commercial loans, real estate loans and consumer loans.

FORWARD-LOOKING STATEMENTS

Certain statements in this report are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements may include, but are not limited to, projections of revenue, income or loss, plans for future operations and acquisitions, projections based on assumptions regarding market and liquidity risk, and plans related to products or services of the Company. Forward-looking statements are subject to known and unknown risks, uncertainties and contingencies, many of which are beyond the control of the Company. To the extent any such risks, uncertainties and contingencies are realized, the Company's actual results, performance or achievements could differ materially from anticipated results, performance or achievements. Factors that might affect such forward-looking statements include, among other factors, overall economic and business conditions, economic and business conditions in the Company's market areas, interest rate fluctuations, a prolonged continuation of the current interest rate environment, the demand for the Company's products and services, competitive factors in the industries in which the Company competes, changes in government regulation, and the timing, impact and other uncertainties of future acquisitions.

The words "believe," "expect," "anticipate," "intend," "estimate," "project" or the negative of such terms and other similar expressions which are predictions of or indicate future events and trends and which do not relate to historical matters identify forward-looking statements. Reliance should not be placed on forward-looking statements because they involve known or unknown risks, uncertainties or other factors, which may cause the actual results, performance or achievements of the Company to differ materially from anticipated future results, performance or achievements expressed or implied by such forward-looking statements. The Company expressly disclaims any obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

Though the Company has attempted to list comprehensively the factors which might affect forward-looking statements, the Company wishes to caution you that other factors may in the future prove to be important in affecting the Company's results of operations. New factors emerge from time to time and it is not possible for management to anticipate all of such factors, nor can it assess the impact of each such factor, or combination of factors, which may cause actual results to differ materially from forward-looking statements.

2015 OVERVIEW

The Company derives substantially all of its revenue and income from community bank-related activities. The Bank does not engage in any specialized finance or capital markets activities. Northway functions primarily as the holder of the common stock of the Bank and assists in the management of the operations of its subsidiary, as appropriate.

The principal component of the Company's income is net interest and dividend income. Net interest and dividend income is the difference between interest and dividend income received on earning assets, such as loans and investments, and the interest expense paid on interest-bearing liabilities, such as deposits and borrowed funds. Its other sources of income include revenues from sales of securities, sales of originated mortgages, deposit account service fees, debit card interchange income, and fee-based services, such as cash management and alternative investments.

Economic and industry factors that could cause the Company's financial performance to differ from expected results, as noted above, include changes in applicable federal and state regulation, changes in general economic conditions or the economy of the Bank's primary market area, interest rate volatility, significant changes in loan losses which may affect the Company's allowance for loan losses and the related provision for loan losses, and changes in the securities market that would affect the performance of the Company's investment portfolio. Management evaluates each of these factors on an ongoing basis to determine their impact and to initiate any strategies necessary to mitigate these risks.

2015 OVERVIEW (CONTINUED)

The Company reported net income of $6,485,000 in 2015 compared to net income of $7,853,000 in 2014. In 2015, $6,212,000, or $2.26 per common share, was available to common shareholders compared to $7,585,000, or $2.76 per common share, in 2014. Return on average shareholders' equity was 7.01% in 2015 compared to 8.96% in 2014. Return on average assets was 0.69% in 2015 compared to 0.84% in 2014.

During 2015, the Company recorded a decrease in net interest and dividend income of $1,280,000, due to a decrease in the yield on earning assets of 20 basis points as well as a shift in average earning asset balances from higher yielding loans to cash and investments. During 2015, interest and dividend income decreased $1,324,000. Average loan balances decreased $50,340,000 while the yield on loans increased 5 basis points, resulting in a net decrease in interest and dividend income on loans of $1,898,000. This was partially offset by an increase in interest and dividend income on cash and investments, net, of $574,000 as average balances increased $57,536,000 with an offsetting decrease in yield of 39 basis points. Interest expense decreased $44,000. Interest expense on borrowed funds decreased $267,000 as a result of a decrease in average borrowings of $29,644,000. This was partially offset by an increase in interest expense on deposit accounts of $223,000 due primarily to an increase in average balances of $26,515,000 and an increase in the rates paid on time accounts of 14 basis points. The provision for loan losses decreased $1,503,000 as there was no provision expense in 2015 compared to $1,503,000 in 2014. The decrease in the provision for loan losses was the result of the ongoing review of the adequacy of the allowance for loan losses, and was due to the resolution of many problem credits and an overall improvement in credit quality as well as the decrease in loan balances during 2015. Nonperforming loans as a percentage of total loans decreased to 1.25% as of December 31, 2015 from 1.71% at December 31, 2014. Noninterest income, excluding net gain on sales of loans and net securities gains, decreased $1,235,000 from 2014 as a result of a decrease in the sale of bank owned real estate of $437,000, an increase in the loss on OREO sales of $260,000, a reduction in the cash surrender value life insurance valuation of $195,000, and a reduction in customer related fee income of $210,000. Income from mortgage banking activities decreased $695,000 to $105,000 compared to $800,000 in 2014. The 2014 gain includes a gain of $245,000 resulting from the sale of the Company's mortgage servicing asset. Net gains on sales of securities were $3,067,000 compared to $4,189,000 in 2014. Noninterest expense decreased $1,517,000 in 2015 due primarily to decreases in marketing expense, OREO expenses including write-downs on other real estate owned, FDIC insurance, software expense and a decrease in the allowance for unfunded loan commitments.

Total assets increased $7,891,000, or 0.9%, to $933,604,000 at December 31, 2015 compared to $925,713,000 at December 31, 2014. The following is a summary of notable balance sheet changes.

	($000 Omitted) December 31			
			Change	
	2015	2014	Amount	Percent
Total assets	$ 933,604	$ 925,713	$ 7,891	0.9
Earning assets	895,682	881,975	13,707	1.6
Securities available-for-sale, at fair value	254,476	221,647	32,829	14.8
Interest-bearing deposits	80,783	55,576	25,207	45.4
Loans, net of unamortized cost/unearned income	555,922	603,593	(47,671)	-7.9
Deposits	757,922	726,630	31,292	4.3
Borrowings	99,569	100,284	(715)	-0.7
Shareholders' equity	70,307	90,918	(20,611)	-22.7

Loans net of unearned income decreased $47,671,000 primarily as a result of weaker loan demand, especially in the commercial sector. Securities available-for-sale and interest-bearing deposits increased $32,829,000 and $25,207,000, respectively, as loan runoff was reinvested here. Net funding increased $30,577,000 as deposits increased $31,292,000. Long-term borrowings decreased $9,907,000 due to the maturity of FHLBB advances and were partially offset by an increase in securities sold under agreements to repurchase of $9,192,000. The 4.3% increase in deposits resulted primarily from an increase in core deposit balances of $52,574,000 partially offset by a decrease in time deposits of $21,282,000. Shareholders' equity decreased $20,611,000 due primarily to the redemption of $23,593,000 of Senior Non-cumulative Perpetual Preferred Stock, Series C that had been issued to the United States Department of the Treasury (the "Treasury") in September 2011 pursuant to the Treasury's Small Business Lending Fund program. Shareholders' equity was also reduced by an increase in accumulated other comprehensive loss of $1,506,000 and dividends declared and paid to common and preferred shareholders of $1,997,000 partially offset by the recording of net income for the year ended December 31, 2015 of $6,485,000.

CONSOLIDATED STATEMENTS OF INCOME

FOR THE YEARS ENDED DECEMBER 31,	($000 Omitted, except per share data) 2015	2014
Interest and dividend income		
Interest and fees on loans	$ 26,076	$ 27,974
Interest on debt securities available-for-sale		
Taxable	4,831	4,223
Tax-exempt	1,328	1,498
Dividends	491	411
Interest on interest-bearing deposits	146	90
Total interest and dividend income	32,872	34,196
Interest expense		
Interest on deposits	3,846	3,623
Interest on short-term borrowings	47	61
Interest on long-term debt	1,899	2,152
Total interest expense	5,792	5,836
Net interest and dividend income	27,080	28,360
Provision for loan losses	-	1,503
Net interest and dividend income after provision for loan losses	27,080	26,857
Noninterest income		
Service charges and fees on deposit accounts	1,970	2,070
Debit card fees	1,523	1,633
Gain on sales and calls of securities available-for-sale, net	3,067	4,189
Mortgage banking activities, net	105	800
Commission on alternative investments	436	404
Other	802	1,859
Total noninterest income	7,903	10,955
Noninterest expense		
Salaries and employee benefits	15,184	15,348
Office occupancy and equipment	3,264	3,272
Amortization of core deposit intangibles	62	73
Other	7,508	8,842
Total noninterest expense	26,018	27,535
Income before income tax expense	8,965	10,277
Income tax expense	2,480	2,424
Net income	$ 6,485	$ 7,853
Net income available to common shareholders	$ 6,212	$ 7,585
Basic earnings per common share	$ 2.26	$ 2.76
Earnings per common share assuming dilution	$ 2.26	$ 2.76

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

FOR THE YEARS ENDED DECEMBER 31,	($000 Omitted) 2015	2014
Net income	$ 6,485	$ 7,853
Other comprehensive (loss)/income		
Net unrealized (losses)/gains on securities available-for-sale	(1,239)	10,806
Reclassification adjustment for realized gains in net income	(3,067)	(4,189)
Net unrealized (losses)/gains on securities	(4,306)	6,617
Pension valuation adjustment (see Note 14)	1,857	(1,714)
Pension prior service credit adjustment (see Note 14)	(34)	(84)
Recognized curtailment loss-pension plan (see Note 14)	(2)	-
Investment in limited partnership valuation adjustment	(9)	(59)
Other comprehensive (loss)/income	(2,494)	4,760
Income tax benefit/(provision)	988	(1,886)
Other comprehensive (loss)/income, net of tax	(1,506)	2,874
Comprehensive income	$ 4,979	$ 10,727

Reclassification adjustments are comprised of realized security gains and losses, pension valuation adjustments, and realized gains and losses in a limited partnership investment. The gains and losses have been reclassified out of accumulated other comprehensive loss and have affected certain lines in the consolidated statements of income as follows: the pre-tax amount of securities is included in gain on sales of securities available-for-sale, net, the pension valuation (amortization portion only) and pension prior service credit are included in salaries and employee benefits, and investment in limited partnership valuation adjustments are included in other noninterest expense. The tax expense amounts associated with these adjustments are included in income tax expense, and the after tax amounts are included in net income.

See Notes to Consolidated Financial Statements

CONSOLIDATED BALANCE SHEETS

AS OF DECEMBER 31,	($000 Omitted) 2015	2014
Assets		
Cash and cash equivalents		
Cash and due from banks and interest-bearing deposits	$ 91,479	$ 66,445
Total cash and cash equivalents	91,479	66,445
Interest-bearing time deposits with other banks	248	248
Securities available-for-sale, at fair value	254,476	221,647
Federal Home Loan Bank of Boston stock	3,158	3,939
Loans held-for-sale	249	433
Loans, net before allowance for loan losses	555,922	603,593
Less: allowance for loan losses	8,623	8,806
Net loans	547,299	594,787
Premises and equipment, net	12,893	13,870
Other real estate owned	463	1,138
Goodwill	9,934	9,934
Core deposit intangibles, net	132	194
Other assets	13,273	13,078
Total assets	$ 933,604	$ 925,713
Liabilities and Shareholders' Equity		
Liabilities		
Deposits		
Demand	$ 115,672	$ 94,237
Regular savings, NOW and money market deposit accounts	432,473	401,334
Certificates of deposit (in denominations of $250,000 or more)	16,660	18,901
Other time	193,117	212,158
Total deposits	757,922	726,630
Short-term borrowings	44,042	34,850
Long-term debt	55,527	65,434
Other liabilities	5,806	7,881
Total liabilities	863,297	834,795
Shareholders' equity		
Preferred stock, $1.00 par value; 1,000,000 shares authorized;		
Preferred stock, senior non-cumulative perpetual, Series C, par value $1.00 per share; 0 and 23,593 shares issued and outstanding at December 31, 2015 and December 31, 2014, respectively; liquidation value $1,000 per share	-	24
Common stock, $1.00 par value; 9,000,000 shares authorized; 3,800,438 shares issued and 2,751,650 outstanding at December 31, 2015 and December 31, 2014	3,800	3,800
Additional paid-in-capital	4,140	27,672
Retained earnings	80,889	76,438
Treasury stock, 1,048,788 shares at December 31, 2015 and December 31, 2014	(15,470)	(15,470)
Accumulated other comprehensive loss, net of tax	(3,052)	(1,546)
Total shareholders' equity	70,307	90,918
Total liabilities and shareholders' equity	$ 933,604	$ 925,713

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

($000 Omitted)

	Preferred Stock Series C	Common Stock	Additional Paid-in-Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balance at December 31, 2013	$ 24	$ 3,800	$ 27,640	$70,614	$(15,470)	$ (4,420)	$ 82,188
Net income - 2014	-	-	-	7,853	-	-	7,853
Preferred stock accretion (amortization)	-	-	32	(32)	-	-	-
Net change in accumulated other comprehensive loss, net of taxes	-	-	-	-	-	2,874	2,874
Cash dividend declared on preferred stock Series C	-	-	-	(236)	-	-	(236)
Cash dividends declared on common stock ($0.64 per share)	-	-	-	(1,761)	-	-	(1,761)
Balance at December 31, 2014	$ 24	$ 3,800	$ 27,672	$76,438	$(15,470)	$ (1,546)	$ 90,918
Net income - 2015	-	-	-	6,485	-	-	6,485
Preferred stock accretion (amortization)		-	37	(37)	-	-	-
Redemption of preferred stock	(24)		(23,569)	-	-	-	(23,593)
Net change in accumulated other comprehensive loss, net of taxes		-	-	-	-	(1,506)	(1,506)
Cash dividend declared on preferred stock Series C		-	-	(236)	-	-	(236)
Cash dividends declared on common stock ($0.64 per share)	-	-	-	(1,761)	-	-	(1,761)
Balance at December 31, 2015	$ -	$ 3,800	$ 4,140	$80,889	$(15,470)	$ (3,052)	$ 70,307

At December 31, accumulated other comprehensive loss, net of taxes, consists of the following:

	($000 Omitted) 2015	2014
Net unrealized holding (losses)/gains on available-for-sale securities	$ (661)	$ 1,940
Net unrealized loss on pension valuation	(2,382)	(3,504)
Net credit for prior service on pension	-	19
Net loss on investment in a limited partnership	(9)	(1)
	$ (3,052)	$ (1,546)

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEAR ENDED DECEMBER 31,	($000 Omitted) 2015	2014
Cash flows from operating activities:		
Net income	$ 6,485	$ 7,853
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	-	1,503
Depreciation and amortization	1,331	1,331
Deferred income tax expense	658	385
Gain on sales and calls of securities available-for-sale, net	(3,067)	(4,189)
Write-down of other real estate owned	137	203
Loss on sale, disposal and write-down of premises and equipment	30	27
Amortization of premiums and accretion of discounts on securities available-for-sale, net	1,420	1,519
Amortization of deferred prepayment penalty on FHLBB advances	93	138
Change in unearned income/unamortized cost, net	(117)	(155)
Loss (gain) on sale of former bank premises	153	(456)
Loss (gain) on sales of other real estate owned and other chattels, net	37	(71)
Gain on sale of mortgage servicing assets	-	(245)
Proceeds from sale of mortgage servicing assets	-	1,585
Net decrease in loans held-for-sale	184	1,162
Net change in other assets and other liabilities	(235)	817
Net cash provided by operating activities	7,109	11,407
Cash flows from investing activities:		
Proceeds from sales of securities available-for-sale	79,727	86,239
Proceeds from maturities and calls of securities available-for-sale	27,614	19,126
Purchase of securities available-for-sale	(142,829)	(133,198)
Redemption of FHLBB stock	781	1,106
Redemption of interest-bearing time deposits	-	3,720
Capital redemption on investment in limited partnership	-	32
Loan originations and principal collections, net	51,601	34,023
Purchase of loans, net of principal collections	(4,817)	(30)
Recoveries of previously charged-off loans	400	243
Proceeds from sale of former bank premises	429	492
Proceeds from sales of and payments received on other real estate owned	340	1,096
Additions to premises and equipment and software, net of disposals	(156)	(1,393)
Net cash provided by investing activities	13,090	11,456
Cash flows from financing activities:		
Net increase in deposits	31,292	32,271
Net increase (decrease) in short-term borrowings	9,192	(615)
Repayment of FHLBB advances	(10,000)	(15,500)
Redemption of preferred stock	(23,593)	-
Cash dividends paid	(2,056)	(1,997)
Net cash provided by financing activities	4,835	14,159
Net increase in cash and cash equivalents	25,034	37,022
Cash and cash equivalents at beginning of year	66,445	29,423
Cash and cash equivalents at end of year	$ 91,479	$ 66,445

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

FOR THE YEAR ENDED DECEMBER 31,	($000 Omitted) 2015	2014
Supplemental disclosure of cash flow information:		
Interest paid	$ 5,815	$ 5,803
Taxes paid	2,465	1,884
Non-cash investing and financing activities:		
Loans transferred to other real estate owned	384	698
Premises transferred to other real estate owned	-	87

See Notes to Consolidated Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Northway Financial, Inc. ("Northway" or the "Company"), headquartered in North Conway, New Hampshire, is a bank holding company formed in 1997 under the laws of New Hampshire and is registered under the Bank Holding Company Act of 1956, as amended. Northway's only business activity has been to own all of the shares of, and provide management, capital and operational support, to Northway Bank ("Bank"), its subsidiary headquartered in Berlin, New Hampshire, and its Delaware statutory business trusts, Northway Capital Trust III and Northway Capital Trust IV. Unless the context otherwise requires, references herein to the "Company" include Northway and its subsidiary, the Bank. The Bank is engaged principally in the business of attracting deposits from the general public and investing those deposits in securities, commercial loans, real estate loans and consumer loans.

Basis of Presentation

The consolidated financial statements include the accounts of Northway and the Bank. All significant intercompany accounts and transactions have been eliminated in the consolidation.

Northway Capital Trust III and Northway Capital Trust IV, affiliates of the Company, were formed to sell capital securities to the public through a third party trust pool. In accordance with Accounting Standards Codification ("ASC") 810-10, "Consolidation-Overall," these affiliates have not been included in the consolidated financial statements.

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America (GAAP) and to general practices within the banking industry.

In preparing the financial statements, management is required to make estimates and judgments that affect the reported amounts of assets and liabilities as of the dates of the consolidated balance sheets, and income and expense for the reporting periods. Actual results could differ from those estimates. Material estimates that are particularly susceptible to change in the near-term relate to the determination of the allowance for loan losses.

Reclassifications

Certain amounts in the prior year's financial statements have been reclassified to conform with the current year's presentation.

Cash and Cash Equivalents

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

Securities

Debt securities that the Company has the positive intent and ability to hold to maturity are classified as held-to-maturity and reported at amortized cost; if debt and equity securities are bought and held principally for the purpose of selling in the near term they are classified as trading and reported at fair value, with unrealized gains and losses included in earnings; and debt and equity securities not classified as either held-to-maturity or trading are classified as available-for-sale and reported at fair value, with unrealized gains and losses excluded from earnings and reported as a separate component of shareholders' equity, net of estimated income taxes. At this time, the Company has not established a trading account.

Premiums and discounts are amortized and accreted primarily on the level yield method over the contractual lives of the securities, adjusted for expected prepayments.

For any debt security with a fair value less than its amortized cost basis, the Company will determine whether it has the intent to sell the debt security or whether it is more likely than not it will be required to sell the debt security before the recovery of its amortized cost basis. If either condition is met, the Company will recognize a full impairment charge to earnings. For all other debt securities that are considered other-than-temporarily impaired and do not meet either condition, the credit loss portion of impairment will be recognized in earnings as realized losses. The other-than-temporary impairment related to all other factors will be recorded in other comprehensive income.

Declines in marketable equity securities below their cost that are deemed other than temporary are reflected in earnings as realized losses.

Federal Home Loan Bank of Boston ("FHLBB") stock is carried at cost and can only be sold to the FHLBB based on its current redemption policies. Management evaluates the Company's investment in FHLBB stock for other-than-temporary impairment at least on a quarterly basis and more frequently when economic or market conditions warrant such calculations. Based on its most recent analysis of the FHLBB as of December 31, 2015, management deems its investment in FHLBB stock to be not other-than-temporarily impaired.

Gains and losses on sales of securities available-for-sale are recognized at the time of the sale on a specific identification basis.

Loans Held-for-Sale

Loans held-for-sale are generally identified as such at origination and are stated at the lower of aggregate cost or market value. Market value is based on outstanding investor commitments. When loans are sold, a gain or loss is recognized to the extent that the sale proceeds exceed or are less than the carrying value of the loans. Gains and losses are determined using the specific identification method. All loans sold are without recourse to the Company.

Loans

Loans are carried at the principal amounts outstanding, net of any unearned income or unamortized cost, premiums on originated loans and discounts on acquired loans. Unearned income and unamortized cost includes loan origination fees, net of direct loan origination costs. This income or expense is deferred and recognized as adjustments to loan income over the contractual lives of the related notes using a method, the result of which approximates that of the interest method.

Loans are placed on nonaccrual status when payment of principal or interest is considered to be in doubt or is past due 90 days or more. The Company may choose to place a loan on nonaccrual status due to payment delinquency or uncertain collectability, while not classifying the loan as impaired, if (i) it is probable that the Company will collect all amounts due in accordance with the contractual terms of the loan or (ii) the loan is not a commercial, commercial real estate or an individually significant residential mortgage or consumer loan. Previously accrued income on nonaccrual loans that has not been collected is reversed from current income, and subsequent cash receipts are recorded as income if principal on the loans is deemed collectible. Loans are returned to accrual status when collection of all contractual principal and interest is reasonably assured and there has been sustained repayment performance. Further, the Company evaluates and classifies as troubled debt restructurings ("TDR") any loans modified by means of extended maturity, below market adjusted interest rates, a combination of rate and maturity, or by other means including covenant modifications, forbearance and/or other concessions.

The Company's loans are primarily secured by real estate in New Hampshire. In addition, other real estate owned is located in this market. Accordingly, the ultimate collectability of a substantial portion of the Company's loan portfolio and the recovery of other real estate owned are susceptible to changing conditions in this market.

Occasionally the Company will enter into an agreement to change the terms of an underlying loan from fixed to variable pricing or vice versa. The impact of these agreements has been deemed immaterial to the financial statements.

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. The allowance for loan losses consists of general, allocated and unallocated components, as further described below.

General component

The general component of the allowance for loan losses is based on historical loss experience adjusted for qualitative factors stratified by the following loan segments: residential real estate, residential construction, hospitality and campground loans, loans to restaurants, commercial real estate net of hospitality and campground loans and loans to restaurants, commercial real estate construction, commercial, municipal and consumer. Management uses a rolling average of historical losses based on a time

frame appropriate to capture relevant loss data for each loan segment. This historical loss factor is adjusted for the following qualitative factors: levels/trends in delinquencies; trends in volume and terms of loans; effects of changes in risk selection and underwriting standards and other changes in lending policies, procedures and practices; experience/ability/depth of lending management and staff; and national and local economic trends and conditions. There were no changes in the Company's policies pertaining to the general component of the allowance for loan losses during 2015. Methodology enhancements related to qualitative factors were refined in the third quarter of 2015, the result of which is a more robust analysis based on historic trends. This change impacted all pools, and the qualitative factors continue to be reviewed annually.

The qualitative factors are determined based on the various risk characteristics of each loan segment. Risk characteristics relevant to each portfolio segment are as follows:

Residential real estate - The Company generally does not originate loans with a cumulative loan-to-value ratio greater than 80 percent and does not make loans it considers to be "subprime." Loans in this segment are first lien mortgages, primarily collateralized by owner-occupied residential real estate and repayment is dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality in this segment.

Construction - Loans in this segment are comprised of residential construction and commercial real estate construction loans. For residential construction loans, the Company generally does not originate loans with a loan-to-value ratio greater than 80 percent and does not make loans it considers to be "subprime." Residential loans in this segment are collateralized by owner-occupied residential real estate and repayment is dependent on the credit quality of the individual borrower. These construction loans convert to permanent residential real estate mortgages at the end of the construction term. The overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality in this segment. Commercial real estate construction loans primarily include real estate development loans that convert to investor-owned and owner-occupied permanent financing. Loans in this segment are primarily income-producing properties throughout New Hampshire.

Hospitality and campground loans - Loans in this segment are secured primarily by income-producing properties in New Hampshire and are made to hotels, motels, campgrounds and like hospitality companies. The underlying cash flows generated by the properties are adversely impacted by a downturn in the economy as evidenced by reduced room occupancy and rates which, in turn, will have an impact on the credit quality in this segment.

Loans to restaurants - Loans in this segment are secured primarily by income-producing properties in New Hampshire and are made to restaurants. The underlying cash flows generated by the properties rely on tourism and are adversely impacted by a downturn in the economy.

Commercial real estate - This segment is net of hospitality and campground and restaurant loans and is subject to higher qualitative underwriting factors due to the level of concentration and possible credit risk. Loans in this segment are secured primarily by income-producing investor-owned or owner-occupied business properties throughout New Hampshire. The underlying cash flows generated by the investor-owned properties are adversely impacted by a downturn in the economy. Management obtains annual and interim financial information, as well as rent rolls annually, and continually monitors the cash flows of these loans.

Commercial loans - This segment is net of hospitality and campground and restaurant loans and is subject to higher qualitative underwriting factors due to the level of concentration and possible credit risk. Loans in this segment are made to businesses and are generally secured by assets of the business. Repayment is expected from the cash flows of the business. A weakened economy, and resultant decreased consumer spending, will have an effect on the credit quality in this segment.

Consumer loans - Loans in this segment are comprised primarily of home equity loans, which can be either first or second lien mortgages. The Company generally does not originate loans with a cumulative loan-to-value ratio greater than 80 percent and does not make loans it considers to be "subprime." Loans in this segment are collateralized by owner-occupied residential real estate and repayment is dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality in this segment. The remainder of this segment is comprised of primarily secured loans and repayment is dependent on the credit quality of the individual borrower.

Municipal loans - Loans in this segment are generally unsecured and repayment is dependent on the tax assessments of the local municipalities, which can be adversely impacted in a weakened economy.

Allocated component

The allocated component relates to loans that are classified as impaired. Impairment is measured on a loan-by-loan basis for commercial, commercial real estate and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. An allowance is specifically allocated when the discounted cash flows (or collateral value) of the impaired loan are lower than the carrying value of that loan. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer and residential real estate loans for impairment disclosures, unless such loans are subject to a TDR agreement.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

The Company periodically may agree to modify the contractual terms of loans. When a loan is modified and a concession is made to a borrower experiencing financial difficulty, the modification is considered a TDR. All TDRs are initially classified as impaired. These loans are evaluated under the same measurements used for impaired loans.

Unallocated component

An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating allocated and general reserves in the portfolio.

Servicing Assets

Servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of financial assets. Capitalized servicing rights are reported in other assets and are amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights by predominant characteristics, such as interest rates and terms. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions. Impairment is recognized through a valuation allowance for an individual stratum (i.e. homogeneous grouping), to the extent that fair value is less than the capitalized amount for the stratum.

During 2014, the Company sold its servicing assets, and a gain on sale was recorded in the amount of $245,000, which is included in mortgage banking activities in the Consolidated Statements of Income.

Premises and Equipment

Premises and equipment are carried at cost less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated useful lives of the respective assets. Estimated lives are thirty-nine years for buildings, ten to fifteen years for building improvements and three to seven years for furniture and equipment.

Amortization of leasehold improvements is computed on a straight-line basis generally over the lesser of the term of the respective lease or the asset's useful life, which is not to exceed ten years.

Other Real Estate Owned

Other real estate owned is comprised of properties acquired either through foreclosure proceedings or acceptance of a deed in lieu of foreclosure, as well as former banking premises for which banking use is no longer contemplated. If the Company receives physical possession of the debtor's assets prior to obtaining a deed in lieu of foreclosure or the occurrence of foreclosure proceedings, the Company reclassifies the loan to other real estate owned in substance.

Assets acquired through foreclosure or a similar conveyance of title are initially recorded at fair value, less estimated costs to sell, of the property constructively or actually received. If the property is held for greater than one year, an appraisal is performed annually to update the market value of the property to adjust the carrying value of the property to fair market value less estimated costs to sell, if such value is below carrying value. Gains and losses upon disposition are reflected in the statements of income as realized.

Advertising

The Company directly expenses costs associated with advertising as they are incurred.

Income Taxes

The Company uses the asset and liability method of accounting for income taxes. Under the asset and liability method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and the respective tax bases and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. The Company recognizes interest and penalties, if any, related to the underpayment of income taxes in income tax expense.

Earnings Per Share

Basic earnings per share ("EPS") excludes dilution and is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS, if applicable, reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity.

Earnings per common share have been computed based on the following:

	($000 Omitted, Shares Reported in Thousands) Years Ended December 31,	
	2015	2014
Net income	$ 6,485	$ 7,853
Preferred stock net accretion	(37)	(32)
Preferred stock dividends	(236)	(236)
Net income available to common shareholders	$ 6,212	$ 7,585
Average number of common shares outstanding	2,751.7	2,751.7
Effect of dilutive options	-	-
Average number of common shares outstanding used to calculate diluted earnings per common share	2,751.7	2,751.7

Derivative Financial Instruments

Derivative financial instruments are recognized as assets and liabilities on the consolidated balance sheets and measured at fair value, if material.

The Company enters into interest rate swap agreements with commercial loan customers to effectively convert the customer's loan from a variable rate to a fixed rate. These swaps are matched in offsetting terms to swaps that the Company enters into with an outside counterparty which effectively convert the Bank's loan from fixed rate to variable. The swaps are classified within other assets and other liabilities in the consolidated balance sheet with changes in fair value offsetting each other.

Preferred Stock

On September 15, 2011, Northway issued shares of its Series C preferred stock to the United States Department of the Treasury under the Small Business Lending Fund program (the "SBLF") in exchange for $23,593,000 in capital from the SBLF. The SBLF program is a $30 billion fund established under the Small Business Jobs Act of 2010 to encourage lending to small businesses by providing Tier 1 capital to qualified community banks with assets of less than $10 billion. The preferred stock qualifies as Tier 1 capital for regulatory purposes and ranks senior to Northway's common stock.

The Series C preferred stock paid non-cumulative dividends. The dividend rate on the Series C preferred stock for the initial quarterly dividend period ending September 30, 2011 and each of the next nine quarterly dividend periods the Series C preferred stock is outstanding was determined each quarter based on the increase in the Bank's Qualified Small Business Lending (as defined in the SBLF Purchase Agreement). The average dividend rate for the year ended December 31, 2014 was 1.0%. For the tenth quarterly dividend period through four and one-half years after its issuance, the dividend rate on the Series C preferred stock was fixed at 1.0% per annum, and after four and one-half years from its issuance the dividend rate was to be fixed at 9.0% per annum. The Series C preferred stock was non-voting, other than voting rights on matters that could adversely affect the Series C preferred stock.

The Series C preferred stock may be redeemed at any time by the Company, subject to the approval of its federal banking regulator. The redemption price is the aggregate liquidation preference of the Series C preferred stock plus accrued but unpaid dividends and pro rata portion of any lending incentive fee. All redemptions must be in an amount at least equal to 25% of the number of originally issued shares of Series C preferred stock, or 100% of the then-outstanding shares if less than 25% of the number of shares originally issued.

On December 31, 2015, the Company redeemed all of the 23,593 outstanding shares of the Company's Senior Non-cumulative Perpetual Preferred Stock, Series C, liquidation amount $1,000 per share, that had been issued to the United States Department of the Treasury in September 2011 pursuant to the SBLF program. The aggregate redemption price of the Preferred Stock was $23,652,000, including dividends accrued but unpaid through, but not including, the redemption date.

Recent Accounting Pronouncements

In May 2014 and August 2015, respectively, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09 and 2015-14, "Revenue from Contracts with Customers (Topic 606)." The objective of ASU 2014-09 is to clarify principles for recognizing revenue and to develop a common revenue standard for GAAP and International Financial Reporting Standards. The guidance in ASU 2014-09 affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards. The core principal of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The amendments in ASU 2015-14 defer the effective date of ASU 2014-09 to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier application is permitted only as of an annual reporting period beginning after December 15, 2016, including interim reporting periods within that reporting period. The Company is currently reviewing ASUs 2014-09 and 2015-14 to determine if they will have an impact on its consolidated financial statements.

In February 2015, the FASB issued ASU 2015-02, "Consolidation (Topic 810): Amendments to the Consolidation Analysis." The amendments in this ASU affect reporting entities that are required to evaluate whether they should consolidate certain legal entities. Specifically, the amendments: (1) Modify the evaluation of whether limited partnerships and similar legal entities are variable interest entities ("VIEs") or voting interest entities; (2) Eliminate the presumption that a general partner should consolidate a limited partnership; (3) Affect the consolidation analysis of reporting entities that are involved with VIEs, particularly those that have fee arrangements and related party relationships; and (4) Provide a scope exception from consolidation guidance for reporting entities with interests in legal entities that are required to comply with or operate in accordance with requirements that are similar to those in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds. The amendments in this ASU are effective for fiscal years beginning after December 15, 2015, and for interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. The Company anticipates that the adoption of this ASU will not have a material impact on its consolidated financial statements.

In April 2015, the FASB issued ASU 2015-03, "Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs." The amendments in this ASU require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this ASU. The standard is effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years, with early adoption permitted. The guidance should be applied on a retrospective basis. The Company anticipates that the adoption of this ASU will not have a material impact on its consolidated financial statements.

In April 2015, the FASB issued ASU 2015-05, "Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement." This ASU provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The new guidance does not change the accounting for a customer's accounting for service contracts. This ASU is effective for annual reporting periods beginning after December 15, 2015, and interim periods within those annual periods. The Company anticipates that the adoption of this ASU will not have a material impact on its consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." The amendments in this ASU address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments and make targeted improvements to GAAP as follows:

Require equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer.

Simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. When a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at fair value.

Eliminate the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet.

Require public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes.

Require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments.

Require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements.

Clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination securities in combination with the entity's other deferred tax assets.

The amendments in this Update are effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early application of certain of the pending content is permitted for financial statements of fiscal years or interim periods that have not yet been issued. The Company is currently reviewing this ASU to determine if it will have an impact on its consolidated financial statements. Refer to Note 2 of the notes to the consolidated financial statements for information pertaining to equity securities held by the Company as of the periods presented.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)." This update to existing GAAP is to recognize lease assets and lease liabilities for those leases currently classified as operating leases, unless the lease term is 12 months or less. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is currently reviewing this ASU to determine if it will have a material impact on its consolidated financial statements.

NOTE 2 SECURITIES AVAILABLE-FOR-SALE

The amortized cost, gross unrealized gains, gross unrealized losses, and fair value of securities at December 31, 2015 and 2014 follow:

	($000 Omitted)			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2015				
U.S. Treasury and other U.S. government agency and sponsored enterprise securities	$ 38,973	$ 116	$ 515	$ 38,574
U.S. government agency and sponsored enterprise mortgage-backed securities	121,077	68	1,012	120,133
Collateralized mortgage obligations issued by U.S. government agency and sponsored enterprises	40,744	185	54	40,875
State and political subdivision bonds	40,791	791	93	41,489
Marketable equity securities	13,985	630	1,210	13,405
	$ 255,570	$ 1,790	$ 2,884	$ 254,476
December 31, 2014				
U.S. Treasury and other U.S. government agency and sponsored enterprise securities	$ 26,679	$ 551	$ 89	$ 27,141
U.S. government agency and sponsored enterprise mortgage-backed securities	103,586	862	168	104,280
Collateralized mortgage obligations issued by U.S. government agency and sponsored enterprises	23,339	172	40	23,471
State and political subdivision bonds	53,326	1,591	75	54,842
Marketable equity securities	11,505	681	273	11,913
	$ 218,435	$ 3,857	$ 645	$ 221,647

NOTE 2 SECURITIES AVAILABLE-FOR-SALE (CONTINUED)

The contractual maturity distribution of investments in debt obligations at December 31, 2015 follows:

	($000 Omitted)				
	Within One Year	Over One Through Five Years	After Five Through Ten Years	Over Ten Years	Total Amortized Cost
U.S. Treasury and other U.S. government agency and sponsored enterprise securities	$ -	$ 1,493	$ 20,145	$ 17,335	$ 38,973
U.S. government agency and sponsored enterprise mortgage-backed securities	-	-	1,304	119,773	121,077
Collateralized mortgage obligations issued by U.S. government agency and sponsored enterprises	-	765	5,405	34,574	40,744
State and political subdivision bonds	-	-	3,509	37,282	40,791
Total amortized cost	$ -	$ 2,258	$ 30,363	$ 208,964	$ 241,585
Fair value	$ -	$ 2,234	$ 30,304	$ 208,533	$ 241,071

Actual maturities of U.S. government agency and sponsored enterprise mortgage-backed securities, collateralized mortgage obligations and state and political subdivision bonds will differ from the maturities presented because borrowers have the right to prepay obligations with or without prepayment penalties.

For the years ended December 31, 2015 and 2014, gross proceeds from the sales of securities available-for-sale amounted to $79,727,000 and $86,239,000, respectively. An analysis of gross realized gains and losses on sales of securities available-for-sale during the years ended December 31, follows:

	($000 Omitted)			
	2015		2014	
	Realized Gains	Realized Losses	Realized Gains	Realized Losses
U.S. Treasury and other U.S. government agency and sponsored enterprise securities	$ 472	$ -	$ 470	$ -
U.S. government agency and sponsored enterprise mortgage-backed securities	603	-	840	-
Collateralized mortgage obligations issued by U.S. government agency and sponsored enterprises	155	-	-	-
State and political subdivision bonds	974	-	960	-
Marketable equity securities	865	71	2,062	143
	$ 3,069	$ 71	$ 4,332	$ 143

The tax provision applicable to these net realized gains amounted to $1,188,000 and $1,661,000 for 2015 and 2014, respectively.

Securities with a carrying amount totaling $191,774,000 and $167,899,000 were pledged to secure public deposits and securities sold under agreements to repurchase at December 31, 2015 and 2014, respectively.

NOTE 2 SECURITIES AVAILABLE-FOR-SALE (CONTINUED)

The aggregate fair value and unrealized losses of securities that have been in a continuous unrealized loss position for less than twelve months and for twelve months or more are as follows as of December 31:

	($000 Omitted)					
	Less than 12 Months		12 Months or Longer		Total	
December 31, 2015	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury and other U.S. government agency and sponsored enterprise securities	$ 26,255	$ 515	$ -	$ -	$ 26,255	$ 515
U.S. government agency and sponsored enterprise mortgage-backed securities	96,455	1,012	-	-	96,455	1,012
Collateralized mortgage obligations issued by U.S. government agency and sponsored enterprises	9,087	46	757	8	9,844	54
State and political subdivision bonds	4,139	65	1,447	28	5,586	93
Marketable equity securities	4,880	494	2,308	716	7,188	1,210
Total temporarily impaired securities	$ 140,816	$ 2,132	$ 4,512	$ 752	$ 145,328	$ 2,884
December 31, 2014						
U.S. Treasury and other U.S. government agency and sponsored enterprise securities	$ -	$ -	$ 7,198	$ 89	$ 7,198	$ 89
U.S. government agency and sponsored enterprise mortgage-backed securities	8,110	41	25,915	127	34,025	168
Collateralized mortgage obligations issued by U.S. government agency and sponsored enterprises	2,589	18	898	22	3,487	40
State and political subdivision bonds	1,347	8	6,451	67	7,798	75
Marketable equity securities	4,052	273	-	-	4,052	273
Total temporarily impaired securities	$ 16,098	$ 340	$ 40,462	$ 305	$ 56,560	$ 645

At December 31, 2015, securities with a total fair value of $145,328,000 were in a loss position. These securities included twelve U.S. government agency securities with a fair value of $26,255,000 and an unrealized loss of $515,000 at December 31, 2015. These securities had an unrealized loss due to the current interest rate environment. As these securities are guaranteed by Federal Farm Credit Bank ("FFCB"), Federal Home Loan Mortgage Corporate ("FHLMC"), and Federal National Mortgage Association ("FNMA"), there is minimal credit risk associated with them. These securities are not other-than-temporarily impaired as the Company has the ability and the intent to hold these securities until cost recovery.

Twenty-six U.S. government agency and sponsored enterprise mortgage-backed securities with a fair value of $96,455,000 had an unrealized loss of $1,012,000 at December 31, 2015. These securities had a loss due to the current interest rate environment. As these securities are guaranteed by U.S. government agencies or government-sponsored enterprises such as the FHLMC, FNMA or the Government National Mortgage Association ("GNMA") there is minimal credit risk associated with them. These securities are not other-than-temporarily impaired as the Company has the ability and the intent to hold these securities until cost recovery.

Five collateralized mortgage obligations with a fair value of $9,844,000 had an unrealized loss of $54,000 at December 31, 2015. These securities had an unrealized loss due to the current interest rate environment. As these collateralized mortgage obligations are government-sponsored enterprise bonds issued by the Small Business Investment Conduit ("SBIC"), the Small Business Administration Participation Certificates ("SBAP"), or FNMA there is little or no credit risk associated with them. These securities have been classified as not other-than-temporarily impaired as the Company has the ability and intent to hold them until cost recovery.

Ten state and political subdivision securities with a fair value of $5,586,000 had an unrealized loss of $93,000 at December 31, 2015. All of these state and political subdivision securities are guaranteed by municipalities and there is minimal credit risk associated with them. These securities have been classified as not other-than-temporarily impaired as the Company has the ability and intent to hold them until cost recovery.

NOTE 2 SECURITIES AVAILABLE-FOR-SALE (CONTINUED)

Seventy-two marketable equity securities with a fair value of $7,188,000 had an unrealized loss of $1,210,000 at December 31, 2015. Marketable equity securities are subject to internal testing on a quarterly basis to determine impairment. Testing includes review of industry analyst reports, credit ratings, sector analysis and earnings projections. Based upon the December 31, 2015 review, these securities have been classified as not other-than-temporarily impaired.

NOTE 3 LOANS

Loan balances were comprised of the following:

	($000 Omitted)	
December 31,	2015	2014
Real estate:		
Residential	$ 157,832	$ 152,339
Commercial	233,374	257,139
Construction	5,894	20,647
Commercial	75,875	88,280
Consumer	48,062	51,973
Municipal	34,740	33,187
Total loans	555,777	603,565
Unamortized costs	145	28
Allowance for loan losses	(8,623)	(8,806)
Total unamortized costs and allowance for loan losses	(8,478)	(8,778)
Net loans	$ 547,299	$ 594,787

Loans are made in the ordinary course of business to directors, executive officers, and their immediate families and to organizations in which such persons have more than a 10% ownership interest. These loans are made on substantially the same terms, including interest rate and collateral, as those prevailing at the same time for comparable transactions with unrelated persons and did not involve more than the normal risk of collectability or present other unfavorable features. The total of such loans amounted to $311,000 as of December 31, 2015. During 2015, principal advances amounted to $145,000, change in status resulted in a decrease in balances of $32,000 and principal payments amounted to $156,000.

The Company's lending activities are conducted principally in New Hampshire. Although the loan portfolio is diversified, a portion of its debtors' ability to repay is dependent upon the economic conditions prevailing in New Hampshire. The Company maintains significant credit relationships with borrowers in the hotel and motel industry. The aggregate loan balances to these industries totaled $67,617,000 and $79,488,000 at December 31, 2015 and 2014, respectively.

Loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of these loans total $65,006,000 and $63,259,000 at December 31, 2015 and 2014, respectively. The Company sold $4,936,000 of mortgage loans in 2015 and $16,987,000 of mortgage loans in 2014.

During 2014, the Company sold mortgage servicing rights with a carrying value of $1,340,000 to an unrelated party and recognized a gain of $245,000. There were no servicing rights held by the Company as of December 31, 2015 and 2014.

NOTE 3 LOANS (CONTINUED)

There were no loans 90 days past due and still accruing interest at December 31, 2015 and 2014. The following tables are an aging analysis of the recorded investment in past due loans and nonaccrual loans as of December 31, 2015 and 2014.

($000 Omitted)

	Aging Analysis of Past Due Loans				
December 31, 2015	30–59 Days	60–89 Days	90 Days or More	Total Past Due	Nonaccrual Loans
Real estate:					
Residential	$ 1,644	$ 87	$ 299	$ 2,030	$ 1,490
Commercial	501	69	2,005	2,575	3,766
Construction	841	-	7	848	7
Commercial	56	-	445	501	1,084
Consumer	200	34	98	332	347
Total	$ 3,242	$ 190	$ 2,854	$ 6,286	$ 6,694

December 31, 2014	30–59 Days	60–89 Days	90 Days or More	Total Past Due	Nonaccrual Loans
Real estate:					
Residential	$ 2,007	$ 338	$ 382	$ 2,727	$ 1,766
Commercial	1,125	544	1,881	3,550	5,896
Construction	41	-	142	183	-
Commercial	83	75	131	289	2,344
Consumer	431	95	243	769	392
Total	$ 3,687	$ 1,052	$ 2,779	$ 7,518	$ 10,398

NOTE 3 LOANS (CONTINUED)

	($000 Omitted)				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
December 31, 2015					
With no related allowance recorded:					
Real estate:					
Residential	$ 801	$ 851	$ -	$ 739	$ 38
Commercial	3,805	4,769	-	3,847	209
Construction	1,229	1,229	-	1,173	70
Commercial	291	369	-	500	3
Consumer	184	202	-	104	8
Total impaired with no related allowance	6,310	7,420	-	6,363	328
With an allowance recorded:					
Real estate:					
Residential	$ 260	$ 261	$ 90	$ 97	$ 5
Commercial	2,126	2,167	733	2,183	86
Construction	179	179	136	150	13
Commercial	501	509	321	406	17
Consumer	51	53	51	10	3
Total impaired with an allowance recorded	3,117	3,169	1,331	2,846	124
Total:					
Real estate:					
Residential	1,061	1,112	90	836	43
Commercial	5,931	6,935	733	6,030	295
Construction	1,408	1,408	136	1,323	83
Commercial	792	878	321	906	20
Consumer	235	255	51	114	11
Total impaired loans	$ 9,427	$ 10,588	$ 1,331	$ 9,209	$ 452
December 31, 2014					
With no related allowance recorded:					
Real estate:					
Residential	$ 693	$ 737	$ -	$ 599	$ 27
Commercial	5,033	5,905	-	3,287	85
Construction	1,278	1,278	-	1,138	73
Commercial	1,261	2,296	-	3,661	14
Total impaired with no related allowance	8,265	10,216	-	8,685	199
With an allowance recorded:					
Real estate:					
Residential	$ 60	$ 60	$ 6	$ 62	$ 3
Commercial	1,636	1,769	659	2,188	37
Construction	93	93	93	19	1
Commercial	717	745	222	570	30
Total impaired with an allowance recorded	2,506	2,667	980	2,839	71
Total:					
Real estate:					
Residential	753	797	6	661	30
Commercial	6,669	7,674	659	5,475	122
Construction	1,371	1,371	93	1,157	74
Commercial	1,978	3,041	222	4,231	44
Total impaired loans	$ 10,771	$ 12,883	$ 980	$ 11,524	$ 270

NOTE 3 LOANS (CONTINUED)

Included in certain loan categories in the impaired loans are TDRs that were classified as impaired. TDR loans may be modified by means of extended maturity, below market adjusted interest rates, a combination of rate and maturity, or by other means including covenant modifications, forbearance and/or other concessions.

The following tables provide information on how loans were modified as TDRs during the years ended December 31:

	($000 Omitted) 2015					
				Terms of Modification		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post Modification Outstanding Recorded Investment	Extended Maturity	Adjusted Interest Rate	Combination of Rate and Maturity
Troubled debt restructurings:						
Real estate:						
Residential	1	$ 233	$ 233	$ -	$ 233	$ -
Commercial	2	55	55	48	7	-
	3	$ 288	$ 288	$ 48	$ 240	$ -

	2015	
	Number of Contracts	Recorded Investment
Troubled debt restructurings that subsequently defaulted:		
Troubled debt restructurings:		
Real estate:		
Residential	2	$ 184
Commercial	2	395
Commercial	6	1,072
	10	$ 1,651

	($000 Omitted) 2014					
				Terms of Modification		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post Modification Outstanding Recorded Investment	Extended Maturity	Adjusted Interest Rate	Combination of Rate and Maturity
Troubled debt restructurings:						
Real estate:						
Residential	1	$ 92	$ 92	$ -	$ 92	$ -
Commercial	4	757	757	268	73	416
Commercial	12	5,681	5,681	-	3,563	2,118
	17	$ 6,530	$ 6,530	$ 268	$ 3,728	$ 2,534

	2014	
	Number of Contracts	Recorded Investment
Troubled debt restructurings that subsequently defaulted:		
Troubled debt restructurings:		
Real estate:		
Residential	2	$ 296
Commercial	5	1,790
Commercial	6	212
	13	$ 2,298

During 2015, one TDR loan totaling $333,000 was transferred to OREO after a $147,000 charge-off. During 2014, one TDR loan totaling $740,000 was transferred to OREO after a $103,000 charge-off and seven TDR loans totaling $4,065,000 incurred charge-offs of $2,665,000. TDRs are individually evaluated for impairment. A specific allowance of $651,000 and 677,000 was established for TDR loans for the years ended December 31, 2015 and 2014, respectively.

NOTE 4 ALLOWANCE FOR LOAN LOSSES

The following table summarizes the allowance for loan losses by category of loans for the years ended December 31:

($000 Omitted)

	Real Estate									
	Residential	Commercial*	Construction*	Hospitality and Campground	Restaurants	Commercial*	Consumer	Municipal	Unallocated	Total
December 31, 2015										
Allowance for loans losses:										
Beginning balance	$ 834	$ 2,260	$ 288	$ 1,254	$ 93	$ 2,958	$ 619	$ 100	$ 400	$ 8,806
Charge-offs	(2)	(147)	(4)	-	-	(61)	(369)	-	-	(583)
Recoveries	9	12	1	46	(2)	235	99	-	-	400
(Benefit) provision	(98)	286	(94)	(223)	(22)	(1,126)	452	105	720	-
Ending balance	$ 743	$ 2,411	$ 191	$ 1,077	$ 69	$ 2,006	$ 801	$ 205	$ 1,120	$ 8,623
Ending balance: individually evaluated for impairment	$ 90	$ 303	$ 136	$ 430	$ -	$ 321	$ 51	$ -	$ -	$ 1,331
Ending balance: collectively evaluated for impairment	$ 653	$ 2,108	$ 55	$ 647	$ 69	$ 1,685	$ 750	$ 205	$ 1,120	$ 7,292
Loans:										
Ending balance	$ 157,832	$ 172,776	$ 5,894	$ 58,867	$ 8,750	$ 68,856	$ 48,062	$ 34,740	$ -	$ 555,777
Ending balance: individually evaluated for impairment	$ 1,061	$ 2,487	$ 1,408	$ 3,444	$ -	$ 792	$ 235	$ -	$ -	$ 9,427
Ending balance: collectively evaluated for impairment	$ 156,771	$ 170,289	$ 4,486	$ 55,423	$ 8,750	$ 68,064	$ 47,827	$ 34,740	$ -	$ 546,350
December 31, 2014										
Allowance for loans losses:										
Beginning balance	$ 814	$ 1,887	$ 654	$ 1,556	$ 119	$ 5,063	$ 506	$ 134	$ 457	$ 11,190
Charge-offs	(59)	(50)	(40)	(735)	-	(2,819)	(427)	-	-	(4,130)
Recoveries	4	3	-	20	4	87	125	-	-	243
Provision (benefit)	75	420	(326)	413	(30)	627	415	(34)	(57)	1,503
Ending balance	$ 834	$ 2,260	$ 288	$ 1,254	$ 93	$ 2,958	$ 619	$ 100	$ 400	$ 8,806
Ending balance: individually evaluated for impairment	$ 6	$ 225	$ 93	$ 434	$ -	$ 222	$ -	$ -	$ -	$ 980
Ending balance: collectively evaluated for impairment	$ 828	$ 2,035	$ 195	$ 820	$ 93	$ 2,736	$ 619	$ 100	$ 400	$ 7,826
Loans:										
Ending balance	$ 152,339	$ 196,077	$ 22,167	$ 69,019	$ 11,169	$ 67,634	$ 51,973	$ 33,187	$ -	$ 603,565
Ending balance: individually evaluated for impairment	$ 753	$ 3,259	$ 1,371	$ 3,410	$ -	$ 1,978	$ -	$ -	$ -	$ 10,771
Ending balance: collectively evaluated for impairment	$ 151,586	$ 192,818	$ 20,796	$ 65,609	$ 11,169	$ 65,656	$ 51,973	$ 33,187	$ -	$ 592,794

*Net of hospitality and campgrounds and restaurants, which are shown separately as they have higher qualitative factors due to the level of concentration and possible credit risk.

The Company utilizes a ten grade internal loan rating system for commercial real estate, commercial construction and commercial loans as follows:

- Loans rated 1-6: Loans in these categories are considered "pass" rated loans with low to average risk.
- Loans rated 7: Loans in this category are considered "special mention." These loans are starting to show signs of potential weakness and are being closely monitored by management.
- Loans rated 8: Loans in this category are considered "substandard." Generally, a loan is considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligors and/or the collateral pledged. There is a distinct possibility that the Company will sustain some loss if the weakness is not corrected.
- Loans rated 9: Loans in this category are considered "doubtful." Loans classified as doubtful have all the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, highly questionable and improbable.
- Loans rated 10: Loans in this category are considered uncollectible ("loss") and of such little value that their continuance as loans is not warranted.

On an annual basis, or more often if needed, the Company formally reviews the ratings on all commercial real estate, commercial construction and commercial relationships over $100,000. Annually, the Company engages an independent third-party loan review consulting firm to review a significant portion of loans within these segments. Management uses the results of these reviews as part of its annual review process.

NOTE 4 ALLOWANCE FOR LOAN LOSSES (CONTINUED)

The credit risk profile of the loan portfolio is as follows for the years ended December 31:

($000 Omitted)

	Real Estate								
	Residential	Commercial *	Construction *	Hospitality and Campground	Restaurant	Commercial *	Consumer	Municipal	Total
December 31, 2015									
Grade:									
Pass	$ 152,363	$ 164,574	$ 5,894	$ 53,203	$ 8,670	$ 58,239	$ 153	$ 456	$ 443,552
Special mention	1,030	2,993	-	1,660	80	4,415	38	-	10,216
Substandard	965	5,209	-	4,004	-	5,710	328	-	16,216
Doubtful	417	-	-	-	-	52	12	-	481
Loss	-	-	-	-		-	-	-	-
Loans not formally rated	3,057	-	-	-	-	440	47,531	34,284	85,312
Total	$ 157,832	$ 172,776	$ 5,894	$ 58,867	$ 8,750	$ 68,856	$ 48,062	$ 34,740	$ 555,777
December 31, 2014									
Grade:									
Pass	$ 146,480	$ 184,578	$ 17,325	$ 62,482	$ 11,088	$ 58,685	$ 217	$ 648	$ 481,503
Special mention	977	6,339	3,474	1,579	81	5,171	230	-	17,851
Substandard	1,364	5,160	1,368	4,958	-	3,775	49	-	16,674
Doubtful	3	-	-	-	-	3	2	-	8
Loss	-	-	-	-	-	-	-	-	-
Loans not formally rated	3,515	-	-	-	-	-	51,475	32,539	87,529
Total	$ 152,339	$ 196,077	$ 22,167	$ 69,019	$ 11,169	$ 67,634	$ 51,973	$ 33,187	$ 603,565

*Net of hospitality and campgrounds and restaurants, which are shown separately as they have higher qualitative factors due to the level of concentration and possible credit risk.

NOTE 5 PREMISES AND EQUIPMENT

A summary of premises and equipment follows:

	($000 Omitted) December 31,	
	2015	2014
Land	$ 5,336	$ 5,288
Buildings	12,201	12,196
Leasehold improvements	953	953
Equipment	7,334	7,235
Premises and equipment in process		147
	25,824	25,819
Less accumulated depreciation and amortization	12,931	11,949
	$ 12,893	$ 13,870

Depreciation expense for the years ended December 31, 2015 and 2014 amounted to $1,025,000 and $1,046,000, respectively.

NOTE 6 OTHER REAL ESTATE OWNED

Other real estate owned consists of real estate acquired by foreclosure or a similar conveyance of title, as well as former banking premises for which banking use is no longer contemplated. At December 31, 2015, other real estate owned of $463,000 was comprised of commercial real estate of $283,000, former banking premises of $87,000, and residential real estate of $93,000. At December 31, 2014, other real estate owned of $1,138,000 was comprised of commercial real estate of $358,000, former banking premises of $631,000 and residential real estate of $149,000. At December 31, 2015, the recorded investment in residential real estate loans in the process of foreclosure totaled $184,000. There were no assets held as other real estate owned in substance as of December 31, 2015.

Sales of other real estate owned by the Company resulted in losses of $190,000 for the year ended December 31, 2015 and gains of $71,000 for the year ended December 31, 2014. Write-downs of other real estate owned by the Company were $137,000 and $203,000 for the years ended December 31, 2015 and 2014, respectively.

NOTE 7 DEPOSITS

The aggregate amount of maturities for time deposits as of December 31, 2015 for each of the following five years is as follows:

	($000 Omitted)
2016	$ 105,680
2017	46,385
2018	16,203
2019	24,369
2020	17,140
	$ 209,777

At December 31, 2015 and 2014, deposits acquired through a deposit listing service totaled $14,920,000 and $20,432,000, respectively. Deposit listing service account balances at or in excess of $250,000 are reported as certificates of deposit in denominations of $250,000 or more on the consolidated balance sheet.

Deposits from related parties held by the Bank at December 31, 2015 and 2014 amounted to $3,540,000 and $2,931,000, respectively.

NOTE 8 SHORT-TERM BORROWINGS

Short-term borrowings at December 31, 2015 and 2014 consisted of securities sold under agreements to repurchase of $44,042,000 and $34,850,000, respectively. Securities sold under agreements to repurchase were at a weighted average rate of 0.14% and 0.12% at December 31, 2015 and 2014, respectively. The securities sold under agreements to repurchase as of December 31, 2015 and 2014 are securities sold on a short-term basis by the Company that have been accounted for not as sales but as borrowings. The underlying securities associated with securities sold under agreements to repurchase are under the control of the Company. The purchasers have agreed to sell to the Company substantially identical securities at the maturity of the agreements.

NOTE 9 LONG-TERM DEBT

Long-term debt at December 31, 2015 and 2014 consisted of FHLBB advances of $34,907,000 and $44,814,000, respectively, as well as $20,620,000 of junior subordinated debentures for each year.

As of December 31, 2015, contractual principal payments due under long-term debt, which consists of FHLBB advances and junior subordinated debentures, are as follows:

	($000 Omitted)
2016	$ 2,000
2017	32,907
2018	-
2019	-
2020	-
2021 and years thereafter	20,620
	$ 55,527

NOTE 9 LONG-TERM DEBT (CONTINUED)

The FHLBB long-term debt consisted of eight separate advances. Six of these advances, totaling $30,000,000, are callable with the following rates and terms:

($000 Omitted) Amount	Rate	Maturity Date	Next Call Date
$ 3,000	4.29%	07/20/2017	1/20/16 and quarterly thereafter
5,000	4.25%	07/27/2017	1/27/16 and quarterly thereafter
5,000	4.05%	08/02/2017	2/2/16 and quarterly thereafter
2,000	3.99%	08/16/2017	2/16/16 and quarterly thereafter
10,000	4.09%	03/16/2017	3/16/16 and quarterly thereafter
5,000	4.29%	03/23/2017	3/23/16 and quarterly thereafter
$ 30,000			

The remaining two advances, totaling $4,907,000, are at effective rates ranging from 1.27% to 2.31% with a weighted average rate of 1.69%.

The $20,620,000 of junior subordinated debentures consists of two issuances described in detail below.

On March 22, 2007, the Company completed the private placement of $10,310,000 aggregate liquidation amount of floating rate trust-preferred securities (the "Trust III Capital Securities") issued by Northway Capital Trust III ("Capital Trust III"). The Trust III Capital Securities were sold to a pooled investment vehicle. The proceeds from the sale of the Trust III Capital Securities, which included the proceeds from the sale by Capital Trust III of its common securities to the Company, were invested in floating rate junior subordinated debt securities of the Company due June 15, 2037 (the "Trust III Junior Subordinated Debt"), which were issued pursuant to an Indenture, dated March 22, 2007 between the Company and Wilmington Trust Company as Trustee. Both the Trust III Capital Securities and the Trust III Junior Subordinated Debt have a floating rate, which resets quarterly, equal to the three-month LIBOR plus 1.60%. Currently, the interest rate on these securities is 2.1120%. Payments of distributions and other amounts due on the Trust III Capital Securities are irrevocably guaranteed by the Company, to the extent that the Capital Trust III has funds available for the payments of such distributions, pursuant to a Guarantee Agreement, dated March 22, 2007, between the Company and Wilmington Trust Company, as Guarantee Trustee. The Trust III Junior Subordinated Debt and the Trust III Capital Securities may be redeemed at the option of the Company on fixed quarterly dates starting on March 15, 2012.

On June 15, 2007, the Company completed the private placement of $10,310,000 aggregate liquidation amount of floating rate trust-preferred securities (the "Trust IV Capital Securities") issued by Northway Capital IV ("Capital Trust IV"). The Trust IV Capital Securities were sold to a pooled investment vehicle. The proceeds from the sale of the Trust IV Capital Securities, which included the proceeds from the sale by the Capital Trust IV of its common securities to the Company, were invested in floating rate junior subordinated debt securities of the Company due June 15, 2037 (the "Trust IV Junior Subordinated Debt"), which were issued pursuant to an Indenture, dated June 15, 2007 between the Company and Wells Fargo Bank, National Association as Trustee. Both the Trust IV Capital Securities and the Trust IV Junior Subordinated Debt have a floating rate, which resets quarterly, equal to the three-month LIBOR plus 1.49%. Currently, the interest rate on these securities is 2.0020%. Payments of distributions and other amounts due on the Trust IV Capital Securities are irrevocably guaranteed by the Company, to the extent that the Capital Trust IV has funds available from the payments of such distributions, pursuant to a Guarantee Agreement, dated June 15, 2007, between the Company and Wells Fargo Bank, National Association, as Guarantee Trustee. The Trust IV Junior Subordinated Debt and the Trust IV Capital Securities may be redeemed at the option of the Company on fixed quarterly dates starting on June 15, 2012.

NOTE 10 GOODWILL AND OTHER INTANGIBLE ASSETS

At December 31, 2015, the Company has goodwill and core deposit intangibles totaling $10,066,000. Core deposit intangibles are being amortized over their estimated useful lives, and both core deposit intangibles and goodwill are tested for impairment at least annually.

NOTE 10 GOODWILL AND OTHER INTANGIBLE ASSETS (CONTINUED)

The changes in the carrying amount of goodwill and core deposit intangibles for the years ended December 31, 2015 and 2014 are as follows:

	($000 Ommitted) Goodwill	Core Deposit Intangibles
Balance, December 31, 2013	$ 9,934	$ 267
Amortization expense	-	(73)
Balance, December 31, 2014	9,934	194
Amortization expense	-	(62)
Balance, December 31, 2015	$ 9,934	$ 132

Estimated annual amortization expense of the core deposit intangible is as follows:

2016	$ 50
2017	38
2018	26
2019	15
2020	3

The following table reflects the gross carrying amount and accumulated amortization of core deposit intangibles as of December 31, 2015:

	($000 Omitted) Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Core deposit intangibles	$ 3,927	$ 3,795	$ 132

Management reviews the carrying amount of intangible assets on an ongoing basis, taking into consideration any events and circumstances that may indicate the carrying value may not be recoverable. During 2015 and 2014, the Company reviewed the carrying amount of intangible assets and determined that no impairment write-down was required.

NOTE 11 REGULATORY MATTERS

The Company 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 possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of its assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Company's and the Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Effective January 1, 2015 (with a phase-in period of two to four years for certain components), the Bank became subject to new capital regulations adopted by the Board of Governors of the Federal Reserve System ("FRB") and the FDIC, which implement the Basel III regulatory capital reforms and the changes required by the Dodd-Frank Act. The new regulations require a new common equity Tier 1 ("CET1") capital ratio of 4.5%, increase the minimum Tier 1 capital to risk-weighted assets ratio to 6.0% from 4.0%, require a minimum total capital to risk-weighted assets ratio of 8.0% and require a minimum Tier 1 leverage ratio of 4.0%. CET1 generally consists of common stock and retained earnings, subject to applicable adjustments and deductions. Under new prompt corrective action regulations, in order to be considered "well capitalized," the Bank must maintain a CET1 capital ratio of 6.5% (new) and a Tier 1 ratio of 8.0% (increased from 6.0%), a total risk based capital ratio of 10.0% (unchanged) and a Tier 1 leverage ratio of 5.0% (unchanged). In addition, the regulations establish a capital conservation buffer above the required capital ratios that phases in beginning January 1, 2016 at 0.625% of risk-weighted assets and increases each year by 0.625% until it is fully phased in at 2.5% effective January 1, 2019. Beginning January 1, 2016, failure to maintain the capital conservation buffer will limit the ability of the Bank to pay dividends, repurchase shares or pay discretionary bonuses.

The new regulations implemented changes to what constitutes regulatory capital. Certain instruments will no longer constitute qualifying capital, subject to phase-out periods. In addition, Tier 2 capital is no longer limited to the amount of Tier 1 capital included in total capital. Mortgage servicing rights, certain deferred tax assets and investments in unconsolidated subsidiaries

over designated percentages of CET1 will be deducted from capital. The Bank has elected to permanently opt-out of the inclusion of accumulated other comprehensive income (loss) in capital calculations, as permitted by the regulations. This opt-out will reduce the impact of market volatility on the Bank's regulatory capital ratios.

The new regulations also changed the risk weights of certain assets, including an increase in the risk weight of certain high volatility commercial real estate acquisition, development and construction loans and non-residential mortgage loans that are 90 days past due or on non-accrual status to 150% from 100%, a credit conversion factor for the unused portion of commitments with maturities of less than one year that are not cancellable to 20% from 0%, an increase in the risk weight for mortgage servicing rights and deferred tax assets that are not deducted from capital to 250% from 100%, and an increase in the risk weight for equity exposures to 600% from 0%.

Management believes, as of December 31, 2015, that the Company and the Bank meet all capital adequacy requirements to which they are subject.

As of December 31, 2015, the most recent notification from the Federal Deposit Insurance Corporation (FDIC) categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain minimum total risk-based, Tier 1 risk-based, Common Equity Tier 1 and Tier 1 leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the institution's category.

These minimum capital amounts and ratios, as well as the Company's and Bank's actual capital amounts and ratios, are presented in the following table:

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars amounts in thousands)					
As of December 31, 2015:						
Total Capital (to Risk Weighted Assets):						
Consolidated	$ 92,999	16.39 %	$ 45,389	8.00 %	N/A	N/A
Northway Bank	90,229	16.04	44,996	8.00	$ 56,245	10.00 %
Tier 1 Capital (to Risk Weighted Assets):						
Consolidated	85,883	15.14	34,041	6.00	N/A	N/A
Northway Bank	83,174	14.79	33,747	6.00	44,996	8.00
Common Equity Tier 1 Capital (to Risk Weighted Assets):						
Consolidated	66,004	11.63	N/A	N/A	N/A	N/A
Northway Bank	83,174	14.79	25,310	4.50	36,559	6.50
Tier 1 Capital (to Average Assets):						
Consolidated	85,883	9.08	37,847	4.00	N/A	N/A
Northway Bank	83,174	8.84	37,626	4.00	47,032	5.00
As of December 31, 2014:						
Total Capital (to Risk Weighted Assets):						
Consolidated	109,677	19.22	45,647	8.00	N/A	N/A
Northway Bank	92,875	16.42	45,262	8.00	56,578	10.00
Tier 1 Capital (to Risk Weighted Assets):						
Consolidated	102,336	17.94	22,824	4.00	N/A	N/A
Northway Bank	85,593	15.13	22,631	4.00	33,947	6.00
Tier 1 Capital (to Average Assets):						
Consolidated	102,336	10.83	37,783	4.00	N/A	N/A
Northway Bank	85,593	9.10	37,609	4.00	47,011	5.00

NOTE 11 REGULATORY MATTERS (CONTINUED)

Federal regulations prohibit banking companies from paying dividends on their stock if the effect would cause shareholders' equity to be reduced below applicable regulatory capital requirements or if such declaration and payment would otherwise violate regulatory requirements.

As of December 31, 2015, the Bank is restricted from declaring dividends to Northway in an amount greater than approximately $45,233,000, as such declaration would decrease capital below the Bank's required minimum level of regulatory capital.

Under New Hampshire state law, the Bank may pay dividends only out of net profits. The State of New Hampshire Banking Commissioner's approval is required for dividend payments which exceed the current year's net profits and retained net profits from the preceding two years. As of December 31, 2015, the Bank is restricted from declaring dividends to the Company in an amount greater than $7,051,000.

NOTE 12 OTHER NONINTEREST EXPENSE

The following table sets forth information relating to the Company's other noninterest expense for the years ended December 31:

	($000 Omitted) 2015	2014
Professional fees	$ 1,874	$ 1,673
Software expenses	874	1,076
ATM & debit card expenses	676	769
FDIC insurance	574	674
Telecommunications	415	482
Marketing	361	834
Other	2,734	3,334
	$ 7,508	$ 8,842

NOTE 13 FEDERAL AND STATE TAXES

The components of federal and state tax expense/(benefit) for the years ended December 31, are as follows:

	($000 Omitted) 2015	2014
Current		
Federal	$ 1,797	$ 2,010
State	25	29
	1,822	2,039
Deferred		
Federal	343	479
State	315	(94)
	658	385
Total	$ 2,480	$ 2,424

NOTE 13 FEDERAL AND STATE TAXES (CONTINUED)

The temporary differences (the differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases) that give rise to significant portions of the net deferred income tax asset at December 31, are as follows:

	($000 Omitted) 2015	2014
Deferred income tax assets		
Allowance for loan losses	$ 3,520	$ 3,628
Interest on nonaccrual loans	484	582
Net unrealized holding loss on securities available-for-sale	433	-
Net unrealized holding loss on limited partnership	6	1
Pension unfunded status valuation adjustment	1,563	2,285
Securities write-down	-	2
OREO write-down	27	157
Supplemental pension	1,074	977
New Hampshire Business Enterprise Tax credit carry-forward	201	327
Other	-	9
	7,308	7,968
Deferred income tax liabilities		
Depreciation	(775)	(759)
Amortization of goodwill and core deposit intangible	(3,192)	(2,932)
Prepaid pension	(1,276)	(1,270)
Net unrealized holding gain on securities available-for-sale	-	(1,272)
	(5,243)	(6,233)
Deferred income tax asset, net	$ 2,065	$ 1,735

The primary sources of recovery of the deferred income tax asset are taxes paid that are available for carryback and the expectation that the deductible temporary differences will reverse during periods in which the Company generates taxable income. The New Hampshire Business Enterprise Tax credit carryforward will expire between 2016 and 2018.

Total income tax expense for the years ended December 31, 2015 and 2014 differs from the "expected" federal income tax expense at the 34% statutory rate for the following reasons:

	2015	2014
Expected federal income taxes	34.0 %	34.0 %
Interest on municipal securities available-for-sale and municipal loans	(9.3)	(9.2)
State expense, net of federal expense	2.5	(0.4)
Other	0.5	(0.8)
Effective tax rate	27.7 %	23.6 %

It is the Company's policy to provide for uncertain tax positions and the related interest and penalties based upon management's assessment of whether a tax benefit is more likely than not to be sustained upon examination by tax authorities. As of December 31, 2015 and 2014, there were no material uncertain tax positions related to federal and state tax matters.

NOTE 14 EMPLOYEE BENEFITS

Pension Plan

The Company maintains a trusteed non-contributory pension plan (the "Plan") covering substantially all full-time employees. Assuming retirement at age 65 after 30 years or more of service, the benefits are computed as the sum of one percent of final average earnings up to a covered compensation limit, plus 0.65% of final average earnings in excess of covered compensation, times years of service, up to 30. Final average earnings are defined as the five consecutive years out of the employee's last ten years of employment during which compensation is highest. The amounts contributed to the Plan are determined annually on the basis of (a) the maximum amount that can be deducted for federal income tax purposes or (b) the amount certified by a consulting actuary as necessary to avoid an accumulated funding deficiency as defined by the Employee Retirement Income Security Act of 1974. Contributions are intended to provide not only benefits attributed to service to date but also for those expected to be earned in the future.

NOTE 14 EMPLOYEE BENEFITS (CONTINUED)

In October 2015, the Company approved the freezing of benefit accruals and future participation in the Plan effective December 31, 2015. The Company will be changing its contribution to its 401(k) plan as explained below.

The following table sets forth information about the Plan as of December 31, 2015 and 2014 and for the years then ended:

	($000 Omitted) 2015	2014
Obligations and funded status		
Change in benefit obligation		
Projected benefit obligation at beginning of year	$ 17,547	$ 15,172
Service cost	1,025	804
Interest cost	718	742
Actuarial loss	2	2,617
Benefits paid	(464)	(1,788)
Curtailment gain	(2,435)	-
Projected benefit obligation at end of year	16,393	17,547
Change in plan assets		
Fair value of plan assets at beginning of year	14,984	14,147
Actual return on plan assets	149	1,625
Employer contributions	1,000	1,000
Benefits paid	(464)	(1,788)
Fair value of plan assets at end of year	15,669	14,984
Funded status at end of year	$ (724)	$ (2,563)
Amounts recognized in accumulated other comprehensive loss consist of:		
Unrecognized prior service credit	$ -	$ (32)
Unrecognized net loss	3,945	5,802
Total	$ 3,945	$ 5,770
Accumulated benefit obligation	$ 16,393	$ 14,874

NOTE 14 EMPLOYEE BENEFITS (CONTINUED)

	($000 Omitted) 2015	2014
Net periodic pension cost		
Service cost	$ 1,025	$ 804
Interest cost	718	742
Expected return on plan assets	(989)	(903)
Amortization of prior service credit	(34)	(84)
Amortization of net actuarial loss	264	181
Recognized curtailment loss	2	-
Net periodic pension cost	986	740
Other changes in plan assets and benefit obligations recognized other comprehensive (income)/loss		
Net actuarial (gain)/loss for period	(1,593)	1,895
Amortization of prior service credit	34	84
Amortization of net actuarial loss	(264)	(181)
Recognized curtailment loss	(2)	-
Total	(1,825)	1,798
Total recognized net periodic pension cost and other comprehensive (income)/loss	$ (839)	$ 2,538

Estimated amortization from accumulated other comprehensive loss into net periodic pension cost over the next fiscal year	
Amortization of net loss	$ 163
Amortization of prior service credit	-

	2015	2014
Weighted-average assumptions used to determine pension obligations at measurement date		
Discount rate	4.25 %	4.25 %
Rate of compensation increase	2.75	2.75
Weighted-average assumptions used to determine net periodic pension cost for the years ended December 31,		
Discount rate	4.25 %	5.00 %
Expected long-term rate of return on plan assets	6.50	6.50
Rate of compensation increase	2.75	2.75

The expected long-term rate of return for the Plan's total assets is based on the expected return of asset categories identified below, weighted based on the target allocations for each class. Equity funds are expected to return 8% to 10% over the long-term and bond funds and short-term money markets are expected to return between 4% and 6%.

NOTE 14 EMPLOYEE BENEFITS (CONTINUED)

The Company's actual pension plan asset allocations by asset category are as follows:

	Percentage of Plan Assets at December 31:	
	2015	2014
Asset category		
Mutual funds:		
Bond funds	66.0 %	64.0 %
Equity funds	-	26.0
Real estate funds	-	10.0
Short-term money market	34.0	-
Total	100.0 %	100.0 %

The Company's pension plan assets are generally classified within level 2 of the fair value hierarchy (See NOTE 18, "Fair Value Measurements," to the Consolidated Financial Statements for a description of the fair value hierarchy) because they are valued using third party pricing services for identical or comparable assets.

The fair values of the Company's pension plan assets at December 31, 2015 and 2014, by asset category, are as follows:

	($000 Omitted) Fair Value Measurements at Reporting Date Using:			
Category	Total	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Other Observable Inputs Level 3
December 31, 2015				
Common/collective trust funds				
Corporate bond funds	$ 10,370	$ -	$ 10,370	$ -
Money market fund	5,299	-	5,299	-
Totals	$ 15,669	$ -	$ 15,669	$ -

NOTE 14 EMPLOYEE BENEFITS (CONTINUED)

Category	Total	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Other Observable Inputs Level 3
	($000 Omitted) Fair Value Measurements at Reporting Date Using:			
December 31, 2014				
Common/collective trust funds				
Corporate bond funds	$ 7,471	$ -	$ 7,471	$ -
Inflation-protected bond fund	754	-	754	-
Equity funds	826	-	826	-
Large growth	1,148	-	1,148	-
Large value	1,151	-	1,151	-
Mid-cap growth	371	-	371	-
Mid-cap value	370	-	370	-
Small-cap growth	595	-	595	-
International	818	-	818	-
Real estate	1,480	-	1,480	-
Totals	$ 14,984	$ -	$ 14,984	$ -

The investment policy, as established by the Company, is to provide for a moderate growth of capital with a moderate level of volatility by investing assets per the target allocations as follows:

Asset category	2015	2014
Mutual funds:		
Bond funds	100%	65%
Equity funds	-	25
Real estate funds	-	10
Other	-	0-5

The assets will be re-allocated quarterly to meet the above target allocations. The investment policy is reviewed on an annual basis, under the advisement of the Company's certified investment advisor, to determine if the policy should be changed.

The plan assets do not include any Northway common stock at December 31, 2015 and 2014.

The Company expects to contribute $750,000 to the Plan in 2016.

Estimated future benefit payments, which reflect future service, as appropriate, are as follows for the years ended December 31:

	($000 Omitted)
2016	$ 572
2017	597
2018	628
2019	642
2020	671
2021-2025	3,769

NOTE 14 EMPLOYEE BENEFITS (CONTINUED)

401(k) Plan

The Company offers a contributory 401(k) Plan. Under the Northway Financial, Inc. 401(k) and Profit Sharing Plan (the "401(k) Plan"), employees are eligible to participate after attaining age 21, completing six months of service and have been credited with 1,000 hours of service. Under the 401(k) Plan, the Company matches 50% of the first 4% of employee contributions. Total 401(k) Plan matching expense in 2015 and 2014 amounted to $166,000 and $172,000, respectively, and there was no profit sharing contribution expense for each of the years ended December 31, 2015 and 2014. In conjunction with the freezing of benefit accruals in the Plan mentioned above, the Company has revised the 401(k) Plan whereby the Company will match 100% of the first 3% of employee contributions and 50% of the next 2% of employee contributions. In addition, the new 401(k) Plan includes a year-end Company contribution that does not require employees to make a contribution.

Supplemental Executive Retirement Plan (SERP)

Effective May 29, 2003, the existing Executive Life program sponsored by the Company was terminated and replaced with a Supplemental Executive Retirement Plan (SERP) in which the Chief Executive Officer ("CEO") participates. The existing life insurance policy designed to support the Executive Life program is now fully owned by Northway. This policy is maintained by Northway and is used as the benchmark for the SERP.

The SERP consists of two components. The first component is a distribution of the account balance in equal installments over the ten years following the CEO's retirement without interest. This account balance reflects the cumulative net appreciation in a life insurance policy with a gross-up to reflect the Company's tax savings. The net appreciation is the gain in the surrender value of the life insurance policy less the cost of the premiums and benefit payments. The cost of premiums and benefits for 2015 was 1.80%. The account balance at the November 19, 2015 plan year end was $927,000. If the CEO dies before the end of the ten year period, his beneficiary receives the unpaid portion in a lump sum. The second component is a lifetime distribution beginning in the second year following retirement equal to the annual net appreciation in the life insurance policy with a gross-up to reflect the Company's tax savings. As of December 31, 2015 and 2014, the Company has accrued a liability related to the SERP in the amount of $2,643,000 and $2,391,000, respectively. The respective liabilities reflect the present value of all expected postretirement benefits. In the event of the CEO's death while employed by the Company, the SERP permits a death benefit of $2,000,000 be paid to his beneficiary.

Change in Control

The Company has entered into agreements with certain executive officers as well as other senior officers of the Company. These agreements provide for payments, under certain circumstances, to the officer upon the officer's termination after a change in control. Payments will be made under these agreements upon the officer's termination or resignation in connection with certain specified actions adverse to the officer's employment status after a change in control. The amount of such payments ranges from 1.0 to 2.99 times such officer's annual compensation.

NOTE 15 COMMITMENTS AND CONTINGENT LIABILITIES

The Company is obligated under non-cancelable leases expiring between September 2017 and March 2023. Options to renew for additional terms are included under certain lease agreements and are not included in the table below. The Company has one cancelable lease expiring May 2018. The total minimum rental due in future periods under these existing agreements is as follows as of December 31, 2015:

	($000 Omitted)
2016	$ 458
2017	470
2018	431
2019	298
2020	268
Thereafter	314
	$ 2,239

Rent expense for the years ended December 31, 2015 and 2014 amounted to $500,000 and $466,000, respectively.

NOTE 16 FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

The Company is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit and standby letters of credit. The instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for loan commitments and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Financial instruments with off-balance sheet credit risk at December 31, are as follows:

	($000 Omitted)	
	2015	2014
Financial instruments whose contract amounts represent credit risk:		
Unadvanced portions of home equity loans	$ 23,851	$ 23,635
Unadvanced portions of lines of credit	38,244	42,976
Unadvanced portions of commercial real estate loans	10,331	11,762
Unadvanced portions of Bounce Protection ™	14,580	15,178
Commitments to originate residential real estate loans for resale	-	512
Commitments to originate municipal loans	20,000	-
Commitments to originate all other loans	4,540	8,167
Standby letters of credit	1,273	1,386
Total	$ 112,819	$ 103,616

Commitments to originate loans, including residential real estate loans for resale and municipal loans, unadvanced portions of home equity loans, lines of credit and commercial real estate loans are agreements to lend to a customer provided there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without having been drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the borrower.

Unadvanced portions of Bounce Protection™ represent the unused portion of the Bank's overdraft privilege program.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance by a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan commitments to customers. As of December 31, 2015 and 2014, the maximum potential amount of the Company's obligation was $1,273,000 and $1,386,000, respectively, for financial and standby letters of credit. The Company's outstanding letters of credit generally have a term of less than one year. If a letter of credit is drawn upon, the Company may seek recourse through the customer's underlying line of credit. If the customer's line of credit is also in default, the Company may take possession of the collateral, if any, securing the line of credit.

The Company accrues for credit losses related to off-balance sheet financial instruments. Potential losses on off-balance sheet loan commitments are estimated using the same methodologies employed in calculating the general component of the allowance for loan losses.

NOTE 17 ON-BALANCE SHEET DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

Risk Management Policies – Hedging Instruments

The primary focus of the Company's asset/liability management program is to monitor the sensitivity of the Company's net portfolio value and net income under varying interest rate scenarios to take steps to control its risks if the risk is deemed probable. On a quarterly basis, the Company simulates the net portfolio value and net income expected to be earned over a twelve-month period following the date of simulation. The simulation is based on projection of market interest rates at varying levels and estimates the impact this level of market rates would have on the pricing for current and future interest-earning assets and interest-bearing liabilities during the measurement period. Based on the outcome of the simulation analysis, the Company

considers the use of derivatives as a means of reducing the volatility of net portfolio value and projected net income within certain ranges of projected changes in interest rates. The Company evaluates the effectiveness of entering into any derivative instrument agreement by measuring the cost of such an agreement in relation to the reduction in net portfolio value and net income volatility within an assumed range of interest rates.

Interest Rate Risk Management – Cash Flow Hedging Instruments
The Company uses long-term variable-rate debt as a source of funds for use in the Company's lending and investment activities and other general business purposes. These debt obligations expose the Company to variability in interest payments due to changes in interest rates. If interest rates increase, interest expense increases. Conversely, if interest rates decrease, interest expense decreases. Management believes it is prudent to limit the variability of a portion of its interest payments and, therefore, generally hedges a portion of its variable-rate interest payments. To meet this objective, management enters into interest rate swap agreements whereby the Company receives variable interest rate payments and makes fixed interest rate payments during the contract period.

Interest Rate Risk Management – Derivative Instruments Not Designated As Hedging Instruments
The Company enters into rate lock commitments to extend credit to borrowers for generally a 30-day or 60-day period for the origination and/or purchase of loans. Unfunded loans for which commitments have been entered into are called "pipeline loans." Some of these rate lock commitments will ultimately expire without being completed. To the extent that a loan is ultimately granted and the borrower ultimately accepts the terms of the loan, these rate lock commitments expose the Company to variability in their fair value due to changes in interest rates. If interest rates increase, the value of these rate lock commitments decreases. Conversely, if interest rates decrease, the value of these rate lock commitments increases.

Loan commitments related to the origination or acquisition of mortgage loans that will be held for sale are accounted for as derivative instruments. Such commitments, along with any related fees received from potential borrowers, are recorded at fair value in derivative assets or liabilities, with changes in fair value recorded in the net gain or loss on sale of mortgage loans. Fair value is based on fees currently charged to enter into similar agreements, and for fixed-rate commitments, also considers the difference between current levels of interest rates and the committed rates.

There were no derivatives held related to mortgage banking activities during 2015, nor outstanding as of December 31, 2015.

Collateral Requirements
To reduce the risk related to the use of both derivatives and 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.

If the counterparty does not have the right and ability to redeem the collateral or the Company is permitted to sell or re-pledge the collateral on short notice, the Company records the collateral in its balance sheet at fair value with a corresponding obligation to return it.

By using derivatives, the Company is exposed to credit risk to the extent that counterparties to the derivative contracts do not perform as required. Should a counterparty fail to perform under the terms of a derivative contract, the Company's counterparty credit risk is equal to the amount reported as a derivative asset in the consolidated balance sheet. The Company seeks to minimize counterparty credit risk through credit approvals, limits, monitoring procedures, execution of master netting arrangements and obtaining collateral, where appropriate. Counterparties to the Company's derivatives include major financial institutions with investment grade credit ratings from the major rating agencies. As such, management believes the risk of incurring credit losses on derivative contracts with those counterparties is remote and losses, if any, would be immaterial.

Derivative Financial Instruments - Interest Rate Swaps
The Company may, from time to time, enter into pay fixed/receive floating interest rate swaps that are used to manage interest rate risk associated with certain interest-earning assets and interest-bearing liabilities, principally commercial real estate loans.

The Company entered into one such agreement with a commercial business customer during 2014. The Company pays interest to the customer at a floating rate on the notional amount and receives interest from the customer at a fixed rate on the same notional amount. Concurrently, the Company entered into an offsetting interest rate swap with a financial institution counterparty. In the offsetting swap, the Company pays the counterparty interest at the same fixed rate on the same notional amount as the swap entered into with the customer, and receives interest from the counterparty for the same floating rate on the same notional amount.

NOTE 17 ON-BALANCE SHEET DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES (CONTINUED)

As a result, the interest rate swap effectively converted the fixed rate asset to a variable interest rate and consequently reduced the Company's exposure to changes in interest rates. These swaps are accounted for as fair value hedges with changes in their fair value offsetting each other.

At December 31, summary information regarding these derivatives is presented below:

	Notional Amount	Maturity Date	($000, Omitted) Interest Rate Paid Monthly	Interest Rate Received Monthly	Fair Value (1)
December 31, 2015:					
Customer interest rate swap	$ 3,159	June 15, 2029	1-mo LIBOR + 2.0%	Fixed: 4.63%	$ 161
Counterparty interest rate swap	3,159	June 15, 2029	Fixed: 4.63%	1-mo LIBOR + 2.0%	(161)
December 31, 2014:					
Customer interest rate swap	$ 3,393	June 15, 2029	1-mo LIBOR + 2.0%	Fixed: 4.63%	$ 145
Counterparty interest rate swap	3,393	June 15, 2029	Fixed: 4.63%	1-mo LIBOR + 2.0%	(145)

(1) Derivative assets and liabilities are recorded within other assets and other liabilities in the consolidated financial statements.

NOTE 18 FAIR VALUE MEASUREMENTS

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

Cash and cash equivalents: The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents approximates the fair value of those assets.

Interest-bearing time deposits with other banks: The fair values of interest-bearing time deposits with other banks are estimated using discounted cash flow analyses using interest rates currently being offered for deposits with similar terms to investors.

Securities: Fair values for securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.

FHLBB stock: The carrying amount reported in the consolidated balance sheets for FHLBB stock approximates its fair value. If redeemed, the Company will receive an amount equal to the par value of the stock.

Loans held-for-sale: Fair values for loans held-for-sale are estimated based on outstanding investor commitments, or in the absence of such commitments, are based on current investor yield requirements.

Loans: For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The 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 values of nonaccrual loans are estimated using discounted cash flow analyses or the estimated fair value of the underlying collateral where applicable.

Accrued interest receivable: The carrying value of accrued interest receivable approximates its fair value because of the short-term nature of this financial instrument.

Derivative – interest rate swap: The carrying amount reported in the consolidated balance sheets for Derivative - interest rate swap represents the fair value of the instruments. The fair value is estimated using discounted cash flow analysis using interest rates currently being offered for similar instruments.

Deposits: The fair value of demand deposits (e.g. demand, regular savings, NOW and money market deposit accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e. their carrying amounts). Fair values for time deposits are estimated using a discounted cash flow technique that applies interest rates currently being offered on such deposits to a schedule of aggregated expected monthly maturities of time deposits.

NOTE 18 FAIR VALUE MEASUREMENTS (CONTINUED)

Short-term borrowings: The carrying value of short-term borrowings approximates its fair value because of the short-term nature of these financial instruments.

FHLBB advances: The fair values of FHLBB advances are determined by discounting the anticipated future cash payments by using the rates currently available to the Company for debt with similar terms and remaining maturities.

Junior subordinated debentures: The fair values of junior subordinated debentures are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments or by discounting the anticipated future cash payments by using the rate currently available to the Company for debt with similar terms and remaining maturities.

Off-balance sheet instruments: The fair value of commitments to originate loans is estimated using the fees currently charged to enter similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments and the unadvanced portion of loans, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligation with the counterparties at the reporting date. See NOTE 15,"Commitments and Contingent Liabilities", for further information.

The estimated fair values of the Company's financial instruments are as follows:

	($000 Omitted) December 31, 2015				
	Carrying Amount	Fair Value			
		Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and cash equivalents	$ 91,479	$ 91,479	$ -	$ -	$ 91,479
Interest-bearing time deposits with other banks	248	-	249	-	249
Securities available-for-sale	254,476	13,405	241,232	-	254,637
FHLBB stock	3,158	3,158	-	-	3,158
Loans held-for-sale	249	-	255	-	255
Loans, net	547,299	-	-	549,290	549,290
Accrued interest receivable	2,696	2,696	-	-	2,696
Derivative - interest rate swap	161	-	161	-	161
Financial liabilities:					
Deposits	757,922	548,145	213,821	-	761,966
Short-term borrowings	44,042	44,042	-	-	44,042
FHLBB advances	34,907	-	36,180	-	36,180
Junior subordinated debentures	20,620	-	17,702	-	17,702
Derivative - interest rate swap	161	-	161	-	161

	($000 Omitted) December 31, 2014				
	Carrying Amount	Fair Value			
		Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and cash equivalents	$ 66,445	$ 66,445	$ -	$ -	$ 66,445
Interest-bearing time deposits with other banks	248	-	253	-	253
Securities available-for-sale	221,647	11,913	209,734	-	221,647
FHLBB stock	3,939	3,939	-	-	3,939
Loans held-for-sale	433	-	442	-	442
Loans, net	594,787	-	-	598,673	598,673
Accrued interest receivable	2,603	2,603	-	-	2,603
Derivative - interest rate swap	145	-	145	-	145
Financial liabilities:					
Deposits	726,630	495,571	234,476	-	730,047
Short-term borrowings	34,850	34,850	-	-	34,850
FHLBB advances	44,814	-	47,050	-	47,050
Junior subordinated debentures	20,620	-	19,453	-	19,453
Derivative - interest rate swap	145	-	145	-	145

The carrying amounts of financial instruments shown in the above table are included in the consolidated balance sheets under the indicated captions except that accrued interest receivable is included with other assets, interest rate swaps are included in other assets and other liabilities, and FHLBB advances and junior subordinated debentures are included with long-term debt.

At December 31, 2015 and 2014, all the Company's financial instruments were held for purposes other than trading.

Limitations

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no market exists for some of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, cash flows, current economic conditions, risk characteristics, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions and changes in the loan, debt and interest rate markets could significantly affect the estimates. Further, the income tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on the fair value estimates and have not been considered. The fair value amounts presented do not represent the underlying value of the Company because fair values of certain other financial instruments, assets and liabilities have not been determined.

ASC 820-10, "Fair Value Measurement - Overall," provides a framework for measuring fair value under generally accepted accounting principles. This guidance also allows an entity the irrevocable option to elect fair value for the initial and subsequent measurement for certain financial assets and liabilities on a contract-by-contract basis.

In accordance with ASC 820-10, the Company groups its financial assets and financial liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1 - Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 - Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third party pricing services for identical or comparable assets or liabilities.

Level 3 - Valuations for assets and liabilities that are derived from other methodologies, including option pricing models, discounted cash flow models and similar techniques, are not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets and liabilities.

A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

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. These valuation methodologies were applied to all of the Company's financial assets and financial liabilities carried at fair value for December 31, 2015 and 2014. The Company did not have any significant transfers of assets between level 1 and level 2 of the fair value hierarchy during the year ended December 31, 2015.

The Company's marketable equity securities are generally classified within level 1 of the fair value hierarchy because they are valued using quoted market prices.

The Company's investment in debt and mortgage-backed securities available-for-sale is generally classified within level 2 of the fair value hierarchy. For these securities, fair value measurements are obtained from independent pricing services. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, trading levels, market consensus prepayment speeds, credit information and the instrument's terms and conditions.

Level 3 is for positions that are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence. In the absence of such evidence, management's best estimate is used. Subsequent to inception, management only changes level 3 inputs and assumptions when corroborated by evidence such as transactions in similar instruments, completed or pending third-party transactions in the underlying investment or comparable entities, subsequent rounds of financing, recapitalization and other transactions across the capital structure, offerings in the equity or debt markets, and changes in financial ratios or cash flows.

The Company's impaired loans are reported at the fair value of the underlying collateral if repayment is expected solely from the collateral. Collateral values are estimated using level 2 inputs based upon appraisals of similar properties obtained from a third party. For level 3 inputs, fair value is based upon management estimates of the value of the underlying collateral or the present value of the expected cash flows.

Other real estate owned values are estimated using level 2 inputs based upon appraisals of similar properties obtained from a third party. For level 3 inputs, fair values are based on management estimates.

The following summarizes assets measured at fair value on a recurring basis for the periods ending December 31, 2015 and 2014:

	($000 Omitted) Fair Value Measurements at Reporting Date Using:			
	Total	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
December 31, 2015				
U.S. Treasury and other U.S. government agency and sponsored enterprise securities	$ 38,574	$ -	$ 38,574	$ -
U.S. government agency and sponsored enterprise mortgage-backed securities	120,133	-	120,133	-
Collateralized mortgage obligations issued by U.S. government agency and sponsored enterprises	40,875	-	40,875	-
State and political subdivision bonds	41,489	-	41,489	-
Marketable equity securities	13,405	13,405	-	-
Derivative - interest rate swap	161	-	161	-
Total	$ 254,637	$ 13,405	$ 241,232	$ -

NOTE 18 FAIR VALUE MEASUREMENTS (CONTINUED)

	($000 Omitted) Fair Value Measurements at Reporting Date Using:			
	Total	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
December 31, 2014				
U.S. Treasury and other U.S. government agency and sponsored enterprise securities	$ 27,141	$ -	$ 27,141	$ -
U.S. government agency and sponsored enterprise mortgage-backed securities	104,280	-	104,280	-
Collateralized mortgage obligations issued by U.S. government agency and sponsored enterprises	23,471	-	23,471	-
State and political subdivision bonds	54,842	-	54,842	-
Collateralized mortgage obligations issued by others	-	-	-	-
Marketable equity securities	11,913	11,913	-	-
Derivative - interest rate swap	145	-	145	-
Total	$ 221,792	$ 11,913	$ 209,879	$ -

The following summarizes liabilities measured at fair value on a recurring basis for the years ending December 31, 2015 and 2014:

	($000 Omitted) Fair Value Measurements at Reporting Date Using:			
	Total	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
December 31, 2015				
Derivative - interest rate swap	161	-	161	-
Total	$ 161	$ -	$ 161	$ -
December 31, 2014				
Derivative - interest rate swap	145	-	145	-
Total	$ 145	$ -	$ 145	$ -

Under certain circumstances the Company makes adjustments to its assets and liabilities although they are not measured at fair value on an ongoing basis. The following table presents the carrying value of assets reflected in the consolidated balance sheets by caption and by level in the fair value hierarchy at December 31, 2015 and 2014, for which a nonrecurring change in fair value has been recorded.

	($000 Omitted) Fair Value Measurements at Reporting Date Using:			
	Total	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
December 31, 2015				
Impaired loans	$ 1,786	$ -	$ -	$ 1,786
OREO	376	-	-	376
Totals	$ 2,162	$ -	$ -	$ 2,162
December 31, 2014				
Impaired loans	$ 1,526	$ -	$ -	$ 1,526
OREO	507	-	-	507
Totals	$ 2,033	$ -	$ -	$ 2,033

NOTE 19 SUBSEQUENT EVENTS

Management has evaluated subsequent events through March 24, 2016, which is the date the consolidated financial statements were available to be issued. The Company paid a cash dividend of $881,000, or $0.32 per share, to common shareholders on February 26, 2016. There were no other subsequent events that require adjustment to or disclosure in the consolidated financial statements.

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INDEPENDENT AUDITORS' REPORT

The Board of Directors and Shareholders
Northway Financial, Inc.
North Conway, New Hampshire

We have audited the accompanying consolidated balance sheet of Northway Financial, Inc. and Subsidiary as of December 31, 2015, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 auditors' 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 financial position of Northway Financial, Inc. and Subsidiary as of December 31, 2015, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

The consolidated financial statements of Northway Financial, Inc. and Subsidiary, as of and for the year ended December 31, 2014, were audited by other auditors whose report dated March 25, 2015 expressed an unmodified opinion on these statements.

Baker Newman & Noyes

Limited Liability Company

Peabody, Massachusetts
March 24, 2016

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