Katahdin
Bankshares Corp.

2020 ANNUAL REPORT

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$230k
Total Giving

268
Local Non-Profit Organizations Supported

$250k
Total Down Payment Assistance to 15 First-Time Homebuyers

2,800
Volunteer Hours

2020 COMMUNITY IMPACT

DEAR FELLOW SHAREHOLDERS

"I AM BEYOND PROUD OF WHAT OUR BANK ACCOMPLISHED IN 2020. OUR EMPLOYEES CONTINUALLY ROSE TO ALL CHALLENGES IN THESE EXTRAORDINARY TIMES AND REMAINED COMMITTED TO SERVING OUR RETAIL AND BUSINESS CUSTOMERS THROUGHOUT THE YEAR."

– Jon J. Prescott

As I look back on the past year, I am grateful for what we have achieved not only in terms of financial performance but especially in our team's commitment to helping our customers and local communities.

We achieved strong results in net income available to common shareholders, at $9,519,000, and earnings per common share increased almost 25% for the year. Return on Average Assets reached 1.02%, while Return on Average Equity was strong at 13.26%. The Bank improved in most financial metrics regarding profitability and record common stock dividends were paid. Tangible Book Value Per Share increased substantially.

There were several events of a non-recurring or atypical nature, which have been previously discussed in our 2020 quarterly reports to shareholders. Perhaps the biggest among them was the U.S. Small Business Administration Paycheck Protection Program (PPP), which Katahdin participated in along with other banks across the country. This program allowed the Bank to make forgivable loans to business customers with dire financial circumstances to help keep their workforce employed during the coronavirus crisis. In doing so, the Bank's balance sheet was inflated by approximately $73 million. These loans will be reduced to near zero balances over time. PPP loans contributed $1.99 million to net interest income through fees and interest in 2020. Other commercial and consumer loan growth was solid. Mortgage banking activities and related fee income were strong contributors to earnings.

Deposit growth exceeded expectations as PPP funds were largely deposited in the Bank until spent. We continue to focus on low-cost deposits as their long-term benefits include allowing the Bank to operate with sufficient liquidity, generating spread income, and solidifying links to our customer base. During the year, the pandemic forced us to close our branches to all but drive/walk-up and banking by appointment. However, customers turned to other methods to do their banking, such as our suite of mobile and online services. We intend to further invest in solutions for our customers to easily do business with us, as well as to maintain and improve our existing branch network.

A major consideration for your Board and Management is asset quality. During 2020, many borrowers were unable to make their scheduled payments. We worked with customers in the most appropriate way for their individual situation to get them through the toughest times while returning most of them to regular payment status. At the time of this writing, deferred loans have been reduced significantly. However, economic stress still exists and we are of course monitoring the situation on both macro and granular levels. During 2020, we added $1,260,000 to our Allowance for Loan Losses to shore up our reserves for any current or future problem loans.

As we navigate continuing uncertain times, your Company remains well-capitalized and strong. Our approach to risk management is sound and we will maintain discipline while being aggressive in enhancing customer relationships and generating new ones. While we hold a major market share in many areas in which we compete, there are numerous potential growth opportunities within our market area and we intend to pursue these opportunities in 2021 and beyond.

Further detailed commentary on our financials is located on page 9 of this report, "Company Overview and Results of Operations."

KTHN STOCK

$18.49

as of 12/31/20

ASSET GROWTH

10.1%

$937,007,000 as of 12/31/20

NET INCOME

available to common shareholders

23.9%

$9,519,000 as of 12/31/20

RETURN ON AVG EQUITY

13.26%

as of 12/31/20

Your Board and Management continue to focus on shareholder liquidity, or the ability for shareholders to buy and sell shares of Company stock. The Board reauthorized the Stock Repurchase Program for 2021. Under the program, the Company can purchase up to $2,000,000 of Katahdin's outstanding stock through January 2022.[1] In addition, the stock is quoted on the OTCQX market and can be traded through a broker using the symbol KTHN.

Our Annual Shareholders' Meeting will be held in a virtual-only format this year on Monday, May 3, 2021, at 10:30 a.m. ET. Please refer to your proxy card for instructions on how to access the meeting. Whether or not you plan on joining, I encourage each shareholder to complete and return your proxy for this year's meeting. Your votes are important to the Company and voting can be conveniently done by mail, telephone, or online.

In 2020, Katahdin was named one of the Best Places to Work in Maine for the third consecutive year. Even with restrictions in place, employees and directors still contributed 2,800 hours to various volunteer causes to help many of our friends and neighbors in need.

Through our Employee Stock Ownership Plan (ESOP), our employees are owners of the Company. Feedback indicates this plan is important as it contributes to a long-term shared vision of outstanding results. As the ESOP continues to grow, it will have a positive impact on all shareholders.

In closing, I am beyond proud of what our Bank accomplished in 2020. Our employees continually rose to all challenges in these extraordinary times and remained committed to serving our retail and business customers throughout the year. Given all the challenges we faced during a global pandemic, this year's record performance and success would have been impossible without our entire team's dedicated efforts. They went "above and beyond" and I thank them for all their hard work and passion for every customer.

Thank you for your investment in and continued support of Katahdin Trust. As always, if you have questions regarding the Company or this report, feel free to contact us.

Sincerely,

Jon J. Prescott
President & CEO

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

OUR MISSION

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

WE ARE COMMITTED TO:

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

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

In Memory

In August, we shared with sadness the passing of longtime director and supporter, Robert H. Anderson. Bob served on the Katahdin Bankshares Corp. Board of Directors from 1997 to 2015. He was a retired investment executive and lived between Bangor, Maine, and Green Valley, Arizona. Throughout Bob's nearly 20-year tenure on the board, the Bank more than doubled its branch network and increased assets from $130 million to more than $700 million. Bob was an essential component of that growth and we are forever thankful for his input, dedication, and camaraderie.

BOARD OF DIRECTORS

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

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

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

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

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

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

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

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

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

MANAGEMENT AND OFFICERS

SENIOR MANAGEMENT

JON J. PRESCOTT
President & CEO

MATTHEW M. NIGHTINGALE
Executive Vice President
Treasurer & CFO

ANGELA T. BUTLER
Senior Vice President
Retail and Business Banking

KRISTA K. PUTNAM
Senior Vice President
Marketing

WILLIAM P. LUCY
Executive Vice President
Commercial Services

OFFICERS

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

Tori A. Barber
Assistant Vice President
Training Manager

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

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

Vicki L. Bessette
Vice President
Commercial Services Officer

Cindy L. Boot
Assistant Vice President
Commercial Services Officer

Cale L. Burger
Vice President
Commercial Services Officer

David H. Cambridge
Senior Vice President
Commercial Services Officer

Aaron J. Cannan
Senior Vice President
Commercial Services Officer

Samuel S. Clockedile
Assistant Vice President
Marketing Officer

Albert "Joe" Clukey II
Vice President
Retail Services Officer

Melissa A. Dahlgren
Assistant Vice President
Branch Manager &
Retail Services Officer,
Fort Fairfield & Mars Hill

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

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

Sue A. Fox
Appraisal Department Manager

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

John S. Frohock
Vice President
Managed Assets Officer

Sarah J. Gardiner
Assistant Vice President
Senior Credit Analyst

Leslie M. Gardner
Vice President
Retail Loans

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

Jonathan P. Glazier
Business Development Officer

Alison N. Gould
Assistant Vice President
Commercial Services Officer

Billi B. Griffeth
Regional Vice President
Retail Banking

Blake R. Hamel
Commercial Services Officer
Maine Financial Group

Patricia A. Hersey
Vice President
Cash Management &
Business Development Officer

Katherine H. Hill
Vice President
Bank Operations Manager

Justin K. Jamison
Vice President
Commercial Services Officer

OFFICERS

Teresa S. Lincoln
Executive Assistant

Susan B. Lunn
Vice President
Compliance Officer

Karyn L. MacLeod
Vice President
Commercial Services Officer

Valerie J. Maynard
Senior Credit Administration Assistant

Natasha R. McCarthy
Vice President
Human Resources Director

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

Jean E. Noyes
Vice President
Information Security Officer

Kevin B. Plourde
Senior Vice President
Credit Administrator

Joseph M. Porter
Vice President
Controller

Rebecca L. Potter
Assistant Vice President
Commercial Services Officer

Andrew L. Putnam
Vice President
Chief Information Officer

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

Sarah S. Silliboy
Assistant Vice President
BSA Officer

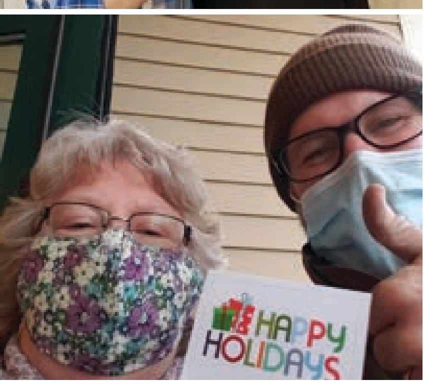
Peggy S. Smith
Vice President
Branch Manager &
Retail Services Officer,
Caribou & Van Buren

Rebecca J. Smith
Assistant Vice President
Branch Manager &
Retail Services Officer,
Broadway & Springer Dr., Bangor

Craig C. Staples
Vice President
Commercial Services Officer

Pamela J. Ward
Assistant Vice President
Credit Control

Danelle L. Weston
Retail Underwriting Officer



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Employees across Maine

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

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

Katahdin Trust is fortunate to have such an incredible team.

SELECTED FINANCIAL DATA

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

As of or for the Years Ended December 31,	2020	2019	2018	2017	2016
Balance Sheet Data					
Total assets	$ 937,007	$ 850,909	$ 803,119	$ 794,638	$ 754,012
Total investments [1]	95,973	103,173	96,319	90,445	88,965
Total loans	746,593	701,016	660,475	661,636	623,279
Allowance for loan losses	(7,454)	(6,293)	(5,856)	(6,048)	(6,032)
Total deposits	809,024	714,418	657,074	647,752	652,969
Shareholders' equity	76,202	68,879	71,057	66,799	64,415
Summary of Operations					
Interest and dividend income	$ 36,373	$ 36,314	$ 33,172	$ 30,803	$ 29,350
Interest expense	6,443	8,872	6,906	5,341	4,281
Net interest income	29,930	27,442	26,266	25,462	25,069
Provision for loan losses	1,260	460	180	1,225	1,316
Net interest income after the provision for loan losses	28,670	26,982	26,086	24,237	23,753
Non-interest income	5,833	5,089	4,408	4,416	4,460
Amortization of investments in limited partnerships [11]	1,166	107	–	–	–
Non-interest expense	22,803	21,969	21,520	21,529	21,535
Income before income taxes	10,534	9,995	8,974	7,124	6,678
Income taxes [11]	1,015	1,836	1,777	2,771	1,864
Net income	$ 9,519	$ 8,159	$ 7,197	$ 4,353	$ 4,814
Less dividends on preferred stock	-	474	875	875	875
Net income available to common shareholders	$ 9,519	$ 7,685	$ 6,322	$ 3,478	$ 3,939
Per Common Shares and Common Shares Outstanding					
Net income, basic [2]	$ 2.88	$ 2.31	$ 1.89	$ 1.03	$ 1.16
Net income, diluted [2]	2.88	2.31	1.89	1.03	1.16
Book value [3]	23.16	20.77	18.29	16.94	16.17
Tangible book value [3]	21.43	19.05	16.59	15.24	14.48
Weighted average common shares outstanding: [4]					
Basic	3,299,905	3,326,912	3,345,012	3,373,220	3,399,826
Diluted	3,299,905	3,326,912	3,345,012	3,373,220	3,399,826
Common shares outstanding at period end	3,332,638	3,369,207	3,404,367	3,404,367	3,404,367
Adjusted common shares outstanding at period end [5]	3,290,151	3,316,671	3,339,734	3,361,298	3,380,173
Selected Performance Ratios					
Return on average assets	1.02%	0.99%	0.91%	0.55%	0.66%
Return on average common shareholders' equity	13.26	11.73	10.85	6.17	7.23
Net interest spread [6]	3.18	3.44	3.40	3.33	3.56
Net interest margin [7]	3.45	3.51	3.50	3.42	3.66
Efficiency ratio [8]	63.78	67.87	70.16	72.06	72.93
Asset Quality Ratios					
Allowance for loan losses to period end loans	1.00%	0.90%	0.89%	0.91%	0.97%
Allowance for loan losses to non-performing loans [9]	155.43	117.05	92.72	84.76	39.57
Non-performing loans to period end loans [9]	0.64	0.77	0.96	1.08	2.45
Non-performing assets to total assets [10]	0.52	0.64	0.79	0.95	2.11
Capital Ratios (Katahdin Trust Company)					
Total risk-based capital ratio	14.98%	13.75%	13.40%	12.64%	13.02%
Tier 1 risk-based capital ratio	13.81	12.75	12.42	11.63	11.95
Common equity tier 1 risk-based capital ratio	13.81	12.75	12.42	11.63	11.95
Tier 1 capital ratio (Leverage ratio)	9.52	9.65	9.42	8.88	9.15
Other Data					
Number of full and limited service banking offices	16	16	16	16	19
Number of full-time equivalent employees	161	171	173	174	186
Katahdin Financial Services Assets Under Management	$ 159,970	$ 135,063	$ 106,190	$ 105,280	$ 90,160

(1) Consists of investment securities and FHLB stock. (2) Computed based on the weighted average number of common shares outstanding during each period. (3) Book Value and Tangible Book Value are calculated using Adjusted Common Shares Outstanding at period end. (4) Weighted Average Common Shares Outstanding less weighted average unallocated ESOP shares. Used for calculating Earnings per Common Share. (5) Common Shares Outstanding at period end less unallocated ESOP shares period end. Since unearned ESOP shares are deducted from capital, this adjustment deducts the unallocated shares from shares outstanding for calculating Book Value and Tangible Book Value. (6) Net interest spread is the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities. (7) Net interest margin is the net interest income divided by the average interest-earning assets. (8) Efficiency ratio is non-interest expense (excluding Amortization of Investments in Limited Partnerships) divided by the sum of net interest income and non-interest income. (9) Non-performing loans consist of non-accrual loans and restructured loans, where applicable. (10) Non-performing assets consist of non-accrual loans, restructured loans, and foreclosed assets, where applicable. (11) The Bank invested in federal historic tax credits which were recognized as a reduction of federal tax expense. Amortization of the corresponding investment was accounted for in other expenses through Amortization of Investments in Limited Partnerships.

COMPANY OVERVIEW AND RESULTS OF OPERATIONS

Katahdin Bankshares Corp. (“KBS” or the “Company”) is a bank holding company incorporated under the laws of the State of Maine in 1986 for the purpose of becoming the parent holding company of Katahdin Trust Company (the “Bank”), established in 1918. The Bank provides banking services to individuals and businesses throughout Maine and online at KatahdinTrust.com.

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

Securities and insurance products are made available to the Bank’s customers through Katahdin Financial Services (a service of Cetera Investment Service LLC, a registered broker-dealer and unaffiliated with Katahdin Trust Company), with assets under management of approximately $160.0 million as of December 31, 2020.

Following is an overview of the results of 2020 operations.

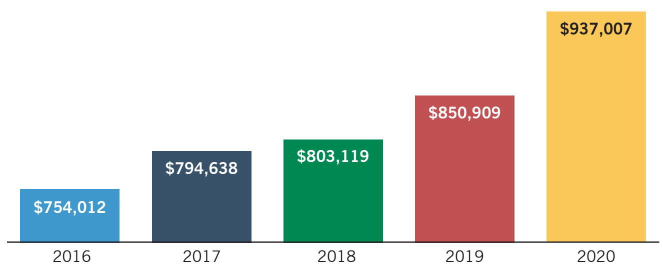
Assets

After reaching a record quarter-end number on June 30, 2020 of $981,750,000 in assets at Katahdin, total assets as of the end of 2020 settled back to $937,007,000. The year-end number exceeded year-end 2019 by $86.1 million.

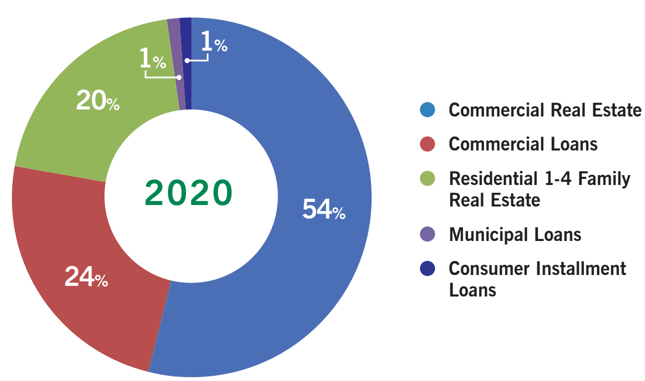
The key influence on growth surrounded government stimulus programs as a result of the Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020. This Act provided stimulus funding directly to certain segments of our customer base and created the SBA Paycheck Protection Program (PPP) forgivable loans to customers. Katahdin issued over $73 million PPP loans to nearly 600 business customers in 2020.

Our investment portfolio slid to $96.0 million by year-end 2020 from $103.2 million at year-end 2019. While we increased the portfolio during the first part of the year, cash flows increased substantially after the Federal Reserve reduced rates to near zero from a 2.50% target rate as recent as June 2019 and from a 1.75% target rate to begin the year 2020. While interest rates remain low, we continue to look for opportunities to invest cash flows in both the investment portfolio as well as through loan opportunities.

ASSETS ($000)



LOAN MIX



Loans

Total loan balances reached $746.6 million as of year-end 2020, exceeding 2019 by $45.6 million. Much of this growth is due to PPP loans outstanding as of year-end totaling $46.1 million.

A key area of growth for the Bank in 2020 was the residential portfolio and secondary market real estate loans. Both categories showed increases, totaling $23.4 million of net growth in 2020 broken down as $10.4 million added to the Bank portfolio and $13.0 million sold in the secondary market. Each of these areas contributed to solid fee income this year as well.

Commercial loans (excluding PPP) ended the year down approximately $9 million. While the commercial area did bring on new relationships in the year, the new volume did not offset two large loan payoffs mid-year. The commercial department and support staff from various areas around the Bank did an “above and beyond” job accommodating customers through the pandemic while providing credit to customers through $73 million in PPP loans, as previously mentioned.

Approximately 78.8% of the Bank’s loan portfolio consists of municipal, commercial, and commercial real estate loans. Loan officers continue to explore new loan opportunities throughout our market area with a focus on building lasting relationships. We are pleased with the volume of growth and customer expansion that took place in loans for 2020 from all areas of the Company.

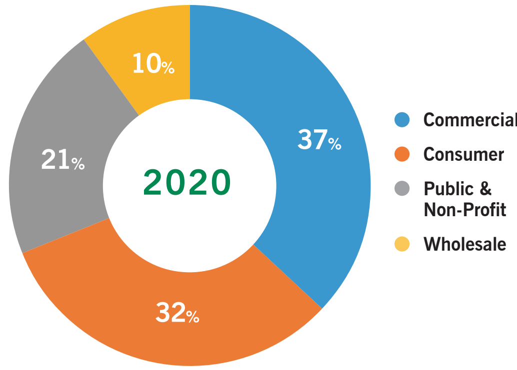
COMPANY OVERVIEW AND RESULTS OF OPERATIONS

Deposits

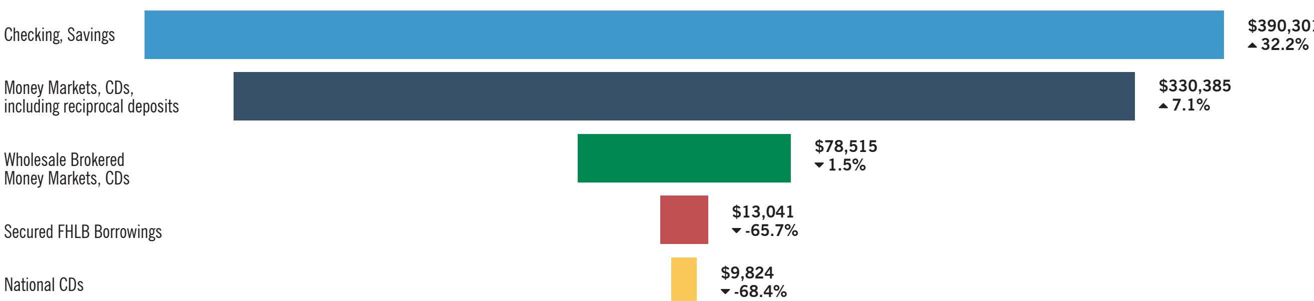
Deposit growth this past year has been exceptional. Overall deposits grew to $809 million or $94.6 million in growth over last year. Customer deposits grew by $117.1 million to $720.7 million. The growth was split between $95.1 million in checking and savings and another $22.0 million in money market and certificates of deposit. This growth has been a result of government stimulus programs, customers saving more in 2020, and continued successful new business development.

As customer deposits grew, national CDs, brokered deposits, and secured borrowings were reduced by $47.4 million during 2020. These three categories continue to account for a significant portion of our funding sources totaling $148.8 million. These alternative funding sources provide the Bank flexibility with term structures to appropriately balance interest rate risk positions as needed. Further, access to alternative funding fills gaps between loan demand and deposit inflows, which can be cyclical.

DEPOSIT SOURCES



DEPOSIT TREND ($000)



Net Interest Income

Though interest rates dropped dramatically in 2020, our balance sheet performed well. Net interest income reached $29,930,000, exceeding the prior year by $2,488,000 or 9.1%. Net interest income reflects revenues generated through income from earning assets plus loan fees, less interest paid on interest-bearing deposits and borrowings. Two key components accounted for the growth in 2020, the largest being $1.99 million generated directly from fees and interest earned on the SBA PPP loans throughout 2020. The other factor was loan growth and fees outpacing the margin compression caused by falling rates. The net interest spread dropped to 3.18% from a 3.44% average in 2019. A portion of this spread decline is due to the outstanding PPP loans that yield 1.0%. However, calculated including the fee income impact, net interest margin held at 3.45%, a reduction of only 6 basis points. Overall, our interest rate sensitivity has remained very balanced. Management continues to assess ways to continue to improve net interest income results through both growth and pricing while working through this very low interest rate cycle.

Provision and Asset Quality

While 2020 was a difficult year for many customers, we are pleased with asset quality as the year ended. From the beginning of the pandemic, the banking industry worked with customers by deferring loan payments for periods of time to allow business activity to resume. During that time frame, the Bank helped approximately 170 borrowers having an aggregate principal amount of $99.8 million defer principal payments, and in some cases both principal and interest payments. Our lending team worked to meet customer needs through this time. At the end of 2020, only 7 borrowers with under $2 million outstanding remained on deferment. While borrowers may continue to have issues with payment in the future, we are pleased with the progress through year-end. At December 31, 2020, non-performing loans to period end loans dropped from 0.77% at the end of 2019 to 0.64%. Non-performing assets to total assets dropped from 0.64% to 0.52% year-over-year.

The allowance for loan losses was funded with a provision of $1,260,000 in 2020. Elevated levels were due to the pandemic. As a result, our allowance for loan losses to period end loans ratio increased to 1.00% as compared to 0.90% at year-end 2019.

Management continuously monitors the Bank's reserve for loan losses compared to asset quality to match our reserves with a reasonable estimate of risk. Detailed information regarding our allowance for loan loss can be found in the footnote 4 of the audited financial statements.

COMPANY OVERVIEW AND RESULTS OF OPERATIONS

Non-Interest Income and Expense

Non-interest income totaled $5,833,000, up $744,000 over 2019. Non-interest income consists largely of service charges on loans, deposits, and electronic banking activity. Over 60% of the growth in non-interest income in 2020 was derived from secondary market loan generation compared to the prior year. Additionally, the year-over-year increase can be partially attributed to increased activity with customer interest rate swaps throughout the year.

When excluding amortization of investments in limited partnerships, non-interest expense reached $22,803,000, representing expense growth of $834,000 or 3.8% year-over-year. The modest growth has been a result of continued emphasis to operate efficiently while also creating new revenue. The Efficiency Ratio improved significantly to 63.78% as of year-end 2020 from 67.87% last year with a trend of reduction over the last several years from 72.93% five years ago. Management continues to look for opportunities to both grow revenue and operate more efficiently over time.

Net Income

Net Income available to common shareholders totaled $9,519,000, an increase over last year of $1,834,000, which represented earnings growth of 23.9%. The extra revenue sources mentioned previously have directly benefited the bottom line.

Earnings per common share totaled $2.88, up 57 cents or 24.7% in 2020. Return on Average Assets ended at 1.02% compared to 0.99% in 2019. Return on Average Common Shareholders' Equity was 13.26% compared to 11.73% in 2019.

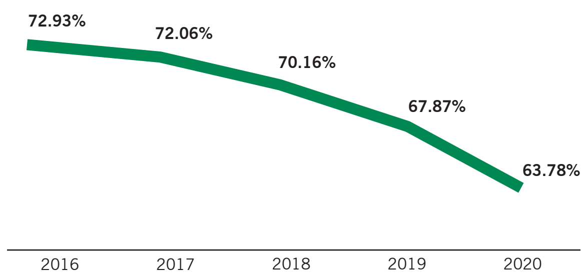
Capital

Total Shareholders' Equity stood at $76,202,000, an increase of $7.3 million. Solid earnings can be attributed to most of this growth.

Capital ratios for the Bank remained solid in 2020 and continue well above the minimums to be well-capitalized per regulatory capital requirements. The Bank's leverage ratio at year-end 2020 was 9.52%, compared to 9.65% at the end of 2019. Total risk-based capital stood at 14.98% compared to 13.75% in 2019.

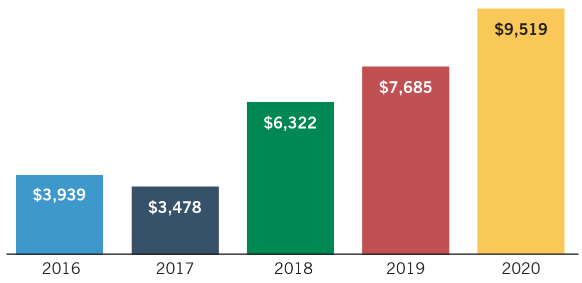
Tangible book value of $21.43 increased by $2.38, or 12.5% over year-end 2019. The Company paid out a total of $0.474 per share in common stock dividends, representing a 16.5% payout ratio. During the year, the Company repurchased a total of 49,095 shares at an average price of $19.88 per share.

EFFICIENCY RATIO

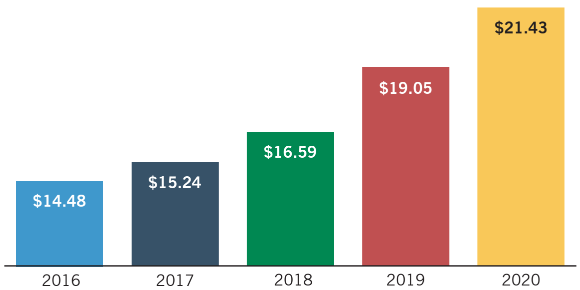


NET INCOME ($000)

Available to common shareholders



TANGIBLE BOOK VALUE



BANKING SERVICES

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

INDEPENDENT AUDITOR'S REPORT

Board of Directors and Shareholders
Katahdin Bankshares Corp. and Subsidiary

We have audited the accompanying consolidated financial statements of Katahdin Bankshares Corp. and Subsidiary (the Company), which comprise the consolidated balance sheets as of December 31, 2020 and 2019, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Katahdin Bankshares Corp. and Subsidiary as of December 31, 2020 and 2019, and the consolidated results of their operations and their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Berry Dunn McNeil & Parker, LLC

Portland, Maine
February 3, 2021

CONSOLIDATED BALANCE SHEETS

December 31, 2020 and 2019

ASSETS	2020	2019
Cash and due from banks	$ 6,362,000	$ 5,818,000
Interest bearing deposits in banks	50,579,000	11,579,000
Securities available-for-sale	94,247,000	100,376,000
Other investments, at fair value	498,000	481,000
Securities held-to-maturity	4,000	6,000
Federal Home Loan Bank stock, at cost	1,224,000	2,310,000
Loans receivable, net of allowance for loan losses of $7,454,000 in 2020 and $6,293,000 in 2019	739,139,000	694,723,000
Bank premises and equipment, net	9,946,000	10,202,000
Goodwill	5,559,000	5,559,000
Other assets	29,449,000	19,855,000
	$ 937,007,000	$ 850,909,000

LIABILITIES AND SHAREHOLDERS' EQUITY	2020	2019
Deposits		
Demand deposits	$ 197,148,000	$ 135,186,000
NOW and money market deposits	389,410,000	314,078,000
Savings deposits	80,692,000	64,553,000
Certificates of deposit	141,774,000	200,601,000
Total deposits	809,024,000	714,418,000
Advances from Federal Home Loan Bank	13,041,000	37,986,000
Accrued expenses and other liabilities	17,429,000	8,389,000
Senior notes 5.375%, net of unamortized debt issuance costs	14,094,000	14,020,000
Junior subordinated debentures	7,217,000	7,217,000
Total liabilities	860,805,000	782,030,000
Shareholders' equity		
Common stock, $.10 par value; 20,000,000 shares authorized, 3,332,638 and 3,369,207 shares issued and outstanding on December 31, 2020 and 2019, respectively	333,000	336,000
Surplus	7,669,000	8,294,000
Undivided profits	67,963,000	60,007,000
Accumulated other comprehensive income (loss)		
Net unrealized appreciation on securities available-for-sale, net of deferred income taxes	2,120,000	661,000
Net unrealized (loss) gain on derivative instruments, net of deferred income taxes	(1,043,000)	420,000
Unearned ESOP shares	(697,000)	(839,000)
Unearned compensation – restricted stock	(143,000)	–
Total shareholders' equity	76,202,000	68,879,000
	$ 937,007,000	$ 850,909,000

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

CONSOLIDATED STATEMENTS OF INCOME

Years Ended December 31, 2020 and 2019

	2020	2019
Interest and dividend income		
Loans	$ 33,945,000	$ 33,525,000
Investment securities	2,373,000	2,606,000
Other interest-earning assets	55,000	183,000
Total interest and dividend income	36,373,000	36,314,000
Interest expense		
Deposits	4,787,000	6,811,000
Borrowed funds and junior subordinated debentures	1,656,000	2,061,000
Total interest expense	6,443,000	8,872,000
Net interest income	29,930,000	27,442,000
Provision for loan losses	1,260,000	460,000
Net interest income after provision for loan losses	28,670,000	26,982,000
Noninterest income		
Service charges and fees	1,787,000	1,777,000
Net realized gain on securities available-for-sale	116,000	76,000
Other	3,932,000	3,240,000
Total noninterest income before impairment of investment securities	5,835,000	5,093,000
Total other-than-temporary impairment losses	(18,000)	(6,000)
Portion of loss recognized in other comprehensive income	16,000	2,000
Net impairment losses recognized in net income	(2,000)	(4,000)
Net noninterest income	5,833,000	5,089,000
Noninterest expenses		
Salaries and employee benefits	13,966,000	13,636,000
Occupancy and equipment expense	2,613,000	2,571,000
Data processing	2,303,000	2,188,000
Marketing and donations	829,000	903,000
FDIC and state assessments	461,000	232,000
Amortization of investments in limited partnerships	1,166,000	107,000
Other general and administrative	2,631,000	2,439,000
Total noninterest expenses	23,969,000	22,076,000
Income before income taxes	10,534,000	9,995,000
Income tax expense	1,015,000	1,836,000
Net income	$ 9,519,000	$ 8,159,000
Less dividends on preferred stock	$ –	$ 474,000
Net income available to common shareholders	$ 9,519,000	$ 7,685,000
Basic earnings per common share	$ 2.88	$ 2.31
Diluted earnings per common share	$ 2.88	$ 2.31
Diluted weighted average common shares outstanding	3,299,905	3,326,912

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Years Ended December 31, 2020 and 2019

	2020	2019
Net Income	$ 9,519,000	$ 8,159,000
Other comprehensive (loss) income, net of related tax effects		
Unrealized appreciation on available-for-sale securities		
Unrealized appreciation on available-for-sale securities arising during period	1,961,000	2,413,000
Reclassification adjustment for gains realized in net income	(158,000)	(76,000)
Reclassification adjustment for losses realized in net income	44,000	4,000
Tax effect	(388,000)	(492,000)
Net change in unrealized appreciation on available-for-sale securities, net of tax	1,459,000	1,849,000
Unrealized (loss) gain on derivative instruments, net of tax	(1,463,000)	164,000
Total other comprehensive (loss) income	(4,000)	2,013,000
Comprehensive income	$ 9,515,000	$ 10,172,000

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

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

Years Ended December 31, 2020 and 2019

	Preferred Stock	Common Stock	Surplus	Undivided Profits	Net Unrealized Appreciation (Depreciation) on Securities	Net Unrealized Gain (Loss) on Derivative Instruments	Unearned ESOP Shares	Unearned Compensation - Restricted Stock	Total
Balance, December 31, 2018	$ 9,953,000	$ 339,000	$ 8,810,000	$ 53,931,000	$ (1,255,000)	$ 256,000	$ (977,000)	$ –	$ 71,057,000
Net income	–	–	–	8,159,000	–	–	–	–	8,159,000
Change in net unrealized depreciation on securities available-for-sale, net of deferred income taxes of $492,000	–	–	–	–	1,849,000	–	–	–	1,849,000
Change in net unrealized gain on derivative instruments, at fair value, net of taxes of $44,000	–	–	–	–	–	164,000	–	–	164,000
Total comprehensive income	–	–	–	8,159,000	1,849,000	164,000	–	–	10,172,000
Cash dividends declared on common stock, $0.44 per share	–	–	–	(1,495,000)	–	–	–	–	(1,495,000)
Accretion on preferred stock issuance	47,000	–	–	(47,000)	–	–	–	–	–
Reclassification adjustment for effect of ASU 2016-01	–	–	–	(67,000)	67,000	–	–	–	–
Cash dividends declared on preferred stock	–	–	–	(474,000)	–	–	–	–	(474,000)
Redemption of preferred stock	(10,000,000)	–	–	–	–	–	–	–	(10,000,000)
Common stock purchased and retired under the Company buyback program	–	(3,000)	(615,000)	–	–	–	–	–	(618,000)
Common stock held by ESOP committed to be released (12,097 shares)	–	–	99,000	–	–	–	138,000	–	237,000
Balance, December 31, 2019	$ –	$ 336,000	$ 8,294,000	$ 60,007,000	$ 661,000	$ 420,000	$ (839,000)	$ –	$ 68,879,000
Net income	–	–	–	9,519,000	–	–	–	–	9,519,000
Change in net unrealized appreciation on securities available-for-sale, net of deferred income taxes of $387,000	–	–	–	–	1,459,000	–	–	–	1,459,000
Change in net unrealized gain on derivative instruments, at fair value, net of taxes of ($389,000)	–	–	–	–	–	(1,463,000)	–	–	(1,463,000)
Total comprehensive income	–	–	–	9,519,000	1,459,000	(1,463,000)	–	–	9,515,000
Cash dividends declared on common stock, $0.474 per share	–	–	–	(1,563,000)	–	–	–	–	(1,563,000)
Common stock purchased and retired under the Company buyback program	–	(5,000)	(912,000)	–	–	–	–	–	(917,000)
Issuance of 8,849 shares of restricted stock	–	1,000	180,000	–	–	–	–	(181,000)	–
Restricted stock award compensation	–	–	–	–	–	–	–	38,000	38,000
Director stock compensation	–	1,000	69,000	–	–	–	–	–	70,000
Common stock held by ESOP committed to be released (10,050 shares)	–	–	38,000	–	–	–	142,000	–	180,000
Balance, December 31, 2020	$ –	$ 333,000	$ 7,669,000	$ 67,963,000	$ 2,120,000	$ (1,043,000)	$ (697,000)	$ (143,000)	$ 76,202,000

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31, 2020 and 2019

	2020	2019
Cash flows from operating activities		
Net income	$ 9,519,000	$ 8,159,000
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	1,093,000	1,188,000
Net amortization of securities	612,000	273,000
Provision for loan losses	1,260,000	460,000
Amortization of investments in limited partnerships	1,177,000	107,000
Impairment of investment securities	2,000	4,000
Restricted stock award compensation	38,000	–
Loss on sale of premises and equipment	–	5,000
Unrealized gain on other investments	(17,000)	(66,000)
Gain on sale of securities available-for-sale	(116,000)	(76,000)
Deferred income tax benefit	(186,000)	(38,000)
Increase in cash value of life insurance	(389,000)	(318,000)
Loss on sale of other real estate and property owned	7,000	2,000
ESOP compensation expense	180,000	237,000
Increase in accrued income receivable and other assets	(7,069,000)	(699,000)
Increase (decrease) in accrued expenses and other liabilities	7,393,000	(264,000)
Net cash provided by operating activities	13,504,000	8,974,000
Cash flows from investing activities		
Additions to premises and equipment	(737,000)	(592,000)
Loan originations and principal collections, net	(45,676,000)	(40,852,000)
Purchase of securities available-for-sale	(45,857,000)	(31,736,000)
Maturities of securities available-for-sale	39,844,000	20,662,000
Maturities of securities held-to-maturity	2,000	1,000
Proceeds from sales of securities available-for-sale	13,490,000	5,571,000
Investment in limited partnerships	(2,037,000)	(613,000)
Proceeds from sales of other real estate and property owned	24,000	231,000
Purchase of bank-owned life insurance	(1,350,000)	–
Redemption of FHLB stock	2,813,000	2,861,000
Purchase of FHLB stock	(1,727,000)	(2,007,000)
Net cash used by investing activities	(41,211,000)	(46,474,000)
Cash flows from financing activities		
Net increase in deposits	94,606,000	57,344,000
Net decrease in short-term borrowings	(7,445,000)	(14,221,000)
Proceeds from long-term debt	–	1,406,000
Repayment of long-term debt	(17,500,000)	(8,000,000)
Net decrease increase in other borrowings	–	(400,000)
Payments for redemption of preferred stock	–	(10,000,000)
Purchase of common stock under Company buyback program	(917,000)	(618,000)
Proceeds from issuance of common stock	70,000	–
Proceeds from issuance of senior notes	–	14,500,000
Debt issuance costs incurred with senior notes	–	(521,000)
Cash dividends paid on preferred stock	–	(474,000)
Cash dividends paid on common stock	(1,563,000)	(1,495,000)
Net cash provided by financing activities	67,251,000	37,521,000
Net increase in cash and cash equivalents	39,544,000	21,000
Cash and cash equivalents, beginning of year	17,397,000	17,376,000
Cash and cash equivalents, end of year	$ 56,941,000	$ 17,397,000
Supplementary cash flow information:		
Interest paid on deposits and borrowed funds	$ 6,732,000	$ 8,741,000
Income taxes paid	1,874,000	2,268,000
Noncash transactions		
Transfer from loans to other real estate and property owned	–	288,000
Unfunded commitment in Low Income Housing Tax Credit Partnership	185,000	–

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2020 and 2019

Nature of Business

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

1. Summary of Significant Accounting Policies

Basis of Presentation and Consolidation

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

Pursuant to the criteria established by U.S. generally accepted accounting principles (GAAP), the Company has not consolidated the trusts which it formed for the purposes of issuing trust preferred securities to unaffiliated parties and investing the proceeds from the issuance thereof and the common securities of the trust in junior subordinated debentures issued by the Company. The trusts are considered affiliates (see Note 8).

Use of Estimates

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

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

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

Cash and Cash Equivalents

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

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

Securities

Debt securities that management has the positive intent and ability to hold to maturity are classified as “held-to-maturity” and recorded at amortized cost. Debt securities not classified as held-to-maturity are classified as “available-for-sale” and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income or loss. Other investments are carried at estimated fair value with changes in fair value and realized gains or losses reported in noninterest income.

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

Loans and Allowance for Loan Losses

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

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

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

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

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

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

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

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

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

1. Summary of Significant Accounting Policies (cont.)

Credit Related Financial Instruments

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

Loan Servicing

The Company capitalizes mortgage servicing rights at their fair value upon sale of the related loans. Capitalized servicing rights are reported in other assets and are amortized into other general and administrative expenses 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.

Other Real Estate and Property Owned (OREO)

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

Bank Premises and Equipment

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

Bank Owned Life Insurance (BOLI)

The Bank purchased life insurance policies insuring the lives of certain officers of the Bank. Consent was obtained from the employees prior to the purchase. The fee income stream related to the BOLI assets is reported in other noninterest income.

Goodwill

Goodwill related to branch acquisitions and MFG is not amortizable and is reviewed for impairment annually, or more frequently upon the occurrence of certain events.

Income Taxes

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

ASC Topic 740, *Income Taxes*, defines the criteria that an individual tax position must satisfy for some or all of the benefits of that position to be recognized in a company's financial statements. ASC Topic 740 prescribes a recognition threshold of more-likely- than-not, and a measurement attribute for all tax positions taken or expected to be taken on a tax return, in order for those tax positions to be recognized in the financial statements. The Company is currently open to audit under the statute of limitations by the Internal Revenue Service for the years ended December 31, 2017 through 2019.

Comprehensive Income

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

Employee Stock Ownership Plan

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

Earnings Per Share

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

Derivative Financial Instruments Designated as Hedges

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

Recently Issued Accounting Pronouncements

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

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

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2020 and 2019

1. Summary of Significant Accounting Policies (cont.)

In August 2018, FASB issued ASU No. 2018-13, *Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement*. This ASU eliminates, adds and modifies certain disclosure requirements for fair value measurements. Among the changes, entities are no longer required to disclose the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy but are required to disclose the range and weighted average used to develop significant unobservable inputs for Level 3 fair value measurements. ASU No. 2018-13 is effective for interim and annual reporting periods beginning after December 15, 2019; early adoption was permitted. Entities were also allowed to elect early adoption of the eliminated or modified disclosure requirements and delay adoption of the new disclosure requirements until their effective date. As ASU No. 2018-13 only revised disclosure requirements, it did not have a material impact on the Company's consolidated financial statements.

Risks and Uncertainties

As of December 31, 2020, local, U.S., and world governments have encouraged self-isolation to curtail the spread of the global pandemic, coronavirus disease (COVID-19), by mandating the temporary shut-down of business in many sectors and imposing limitations on travel and size and duration of group meetings. These conditions have continued to exist subsequent to December 31, 2020. Most industries are experiencing disruption to business operations and the impact of reduced consumer spending. There is unprecedented uncertainty surrounding the duration of the pandemic, its potential economic ramifications, and any government actions to mitigate them. Accordingly, while management expects this matter may have a financial impact on the Company's financial position and results of future operations, such potential impact cannot be reasonably estimated.

2. Cash and Due from Banks

The Bank is required to maintain certain reserves of vault cash or deposits with the Federal Reserve Bank. The amount of this reserve requirement, included in cash and due from banks, was $0 and approximately $1,977,000 as of December 31, 2020 and 2019, respectively.

3. Securities

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

2020	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available-for-Sale				
State and municipal	$ 5,774,000	$ 456,000	$ –	$ 6,230,000
Corporate bonds	2,000,000	–	(70,000)	1,930,000
Mortgage-backed and CMO's	83,789,000	2,364,000	(66,000)	86,087,000
Total securities available-for-sale	$ 91,563,000	$2,820,000	$ (136,000)	$ 94,247,000
Securities Held-to-Maturity				
Mortgage-backed and CMO's	$ 4,000	$ –	$ –	$ 4,000
Total securities held-to-maturity	$ 4,000	$ –	$ –	$ 4,000

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

The following summarizes the Company's gross unrealized losses and fair values aggregated by investment category and length of time that individual securities have been in a continuous loss position at December 31, 2020:

	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Corporate bonds	$ –	$ –	$ 430,000	$ (70,000)	$ 430,000	$ (70,000)
Mortgage-backed and CMO's	3,365,000	(46,000)	99,000	(20,000)	3,464,000	(66,000)
Total temporarily impaired securities	$ 3,365,000	$ (46,000)	$ 529,000	$ (90,000)	$ 3,894,000	$ (136,000)

At December 31, 2020, unrealized losses within the mortgage-backed and CMO's category relate to four individual securities of which two had continuous losses for more than one year. Unrealized losses within the corporate bond category relate to one bond which had a continuous loss position for more than one year. The primary cause for unrealized losses within the debt securities is the impact movements in interest rates have had in comparison to the underlying yields on these securities.

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

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

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

Management evaluates investments for other-than-temporary impairment (OTTI) based on the type of investment and the period of time the investment has been in an unrealized loss position. At December 31, 2020 and 2019, management has determined that the current unrealized losses on these securities are consistent with changes in the overall bond markets caused by an increase in market yields and spread levels and the securities are not other-than-temporarily impaired. The exception to this is a mortgage-backed security at Banc of America Funding Corporation (BAFC). Management performed an internal analysis on the market value of its investment at BAFC as of December 31, 2020 and 2019, and recognized OTTI write-downs related to credit loss of the security of $2,000 and $4,000 for the years ended December 31, 2020 and 2019, respectively.

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

	2020	2019
Proceeds from sales	$ 13,490,000	$ 5,571,000
Gross realized gains	$ 158,000	$ 76,000
Gross realized losses	$ (42,000)	$ –
Net realized gain	$ 116,000	$ 76,000
Related income tax expense	$ 24,000	$ 16,000

At December 31, 2020 and 2019, securities with a fair value of $59,696,000 and $32,690,000, respectively, were pledged to secure certain borrowings and municipal deposits as required or permitted by law.

3. Securities (cont.)

The amortized cost and fair value of securities by contractual maturity at December 31, 2020 follow:

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within 1 year	$ 236,000	$ 236,000	$ –	$ –
Over 1 year through 5 years	17,955,000	18,571,000	4,000	4,000
Over 5 years through 10 years	13,464,000	14,212,000	–	–
Over 10 years	59,908,000	61,228,000	–	–
	$ 91,563,000	$ 94,247,000	$ 4,000	$ 4,000

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

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

Other Investments

The following table summarizes the cost and estimated fair value of the Company's other investments at December 31, 2020:

	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Other investments	$ 500,000	$ –	$ (2,000)	$ 498,000

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

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

For the years ended December 31, 2020 and 2019, the Company recognized unrealized gains of $17,000 and $66,000, respectively, due to the change in the fair value of its other investments. These gains have been presented within other noninterest income on the consolidated statements of income.

4. Loans

A summary of the loan balances are as follows:

	2020	2019
Mortgage loans on real estate		
Residential 1-4 family	$ 151,779,000	$ 141,396,000
Commercial	399,234,000	369,301,000
	551,013,000	510,697,000
Commercial		
Commercial and industrial	179,845,000	173,037,000
Municipal loans	8,249,000	8,029,000
Business credit cards	459,000	366,000
	188,553,000	181,432,000
Consumer installment loans	6,391,000	8,184,000
Subtotal	745,957,000	700,313,000
Less: Allowance for loan losses	7,454,000	6,293,000
Add: Net deferred loan costs	636,000	703,000
Loans, net	$ 739,139,000	$ 694,723,000

On March 27, 2020, the Coronavirus Aid, Relief and Economic Security Act (CARES Act) was enacted to provide emergency assistance for individuals, families and businesses affected by the COVID-19 pandemic. Amongst other programs, the CARES Act created the Paycheck Protection Program (PPP) designed to incentivize small businesses to keep their workers on the payroll. During 2020, the Bank had received approval from the U.S. Small Business Administration (SBA) for 585 applications for PPP loans under the CARES Act with respect to $73,300,000 in loans. As of December 31, 2020, $27,205,000 of the Bank's PPP loans had been forgiven by the SBA with $46,095,000 in principal remaining outstanding. PPP loans are classified as commercial and industrial loans.

The SBA paid the Bank a 1% to 5% origination fee on the principal balance of PPP loans depending on the size of loan. As of December 31, 2020, the Bank had PPP loan deferred origination fees of $828,000 recorded in accrued expenses and other liabilities on the consolidated balance sheets. In 2020, the Bank recognized in income $1,491,000 of PPP loan origination fees. This income is recorded in loans interest income on the consolidated statements of income.

The following tables present the allowance for loan losses and select loan information for the years ended December 31, 2020 and 2019:

	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	2020 Total
Allowance for loan losses						
Beginning balance	$ 1,747,000	$ 3,729,000	$ 217,000	$ 53,000	$ 547,000	$ 6,293,000
Provision for (reduction of) loan losses	(308,000)	1,020,000	55,000	(16,000)	509,000	1,260,000
Loans charged off	(33,000)	(85,000)	(13,000)	(19,000)	–	(150,000)
Recoveries of loans previously charged off	39,000	2,000	2,000	8,000	–	51,000
Ending balance	$ 1,445,000	$ 4,666,000	$ 261,000	$ 26,000	$1,056,000	$ 7,454,000
Individually evaluated for impairment	$ 100,000	$ 666,000	$ –	$ –	$ –	$ 766,000
Collectively evaluated for impairment	$ 1,345,000	$ 4,000,000	$ 261,000	$ 26,000	$1,056,000	$ 6,688,000
Loans						
Ending balance	$ 188,553,000	$ 399,234,000	$ 151,779,000	$ 6,391,000		$ 745,957,000
Individually evaluated for impairment	$ 1,336,000	$ 2,748,000	$ 648,000	$ 76,000		$ 4,808,000
Collectively evaluated for impairment	$ 187,217,000	$ 396,486,000	$ 151,131,000	$ 6,315,000		$ 741,149,000

	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	2019 Total
Allowance for loan losses						
Beginning balance	$ 1,841,000	$ 3,280,000	$ 194,000	$ 35,000	$506,000	$ 5,856,000
Provision for (reduction of) loan losses	(139,000)	432,000	83,000	43,000	41,000	460,000
Loans charged off	(75,000)	–	(82,000)	(25,000)	–	(182,000)
Recoveries of loans previously charged off	120,000	17,000	22,000	–	–	159,000
Ending balance	$ 1,747,000	$ 3,729,000	$ 217,000	$ 53,000	$547,000	$ 6,293,000
Individually evaluated for impairment	$ 31,000	$ 458,000	$ 11,000	$ 16,000	$ –	$ 516,000
Collectively evaluated for impairment	$ 1,716,000	$ 3,271,000	$ 206,000	$ 37,000	$547,000	$ 5,777,000
Loans						
Ending balance	$ 181,432,000	$ 369,301,000	$ 141,396,000	$ 8,184,000		$ 700,313,000
Individually evaluated for impairment	$ 1,859,000	$ 2,869,000	$ 714,000	$ 99,000		$ 5,541,000
Collectively evaluated for impairment	$ 179,573,000	$ 366,432,000	$ 140,682,000	$ 8,085,000		$ 694,772,000

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

Commercial: Commercial and Commercial Real Estate

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2020 and 2019

4. Loans (cont.)

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

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

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

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

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

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

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

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

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

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

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

The following tables summarize credit risk indicators by portfolio as of December 31, 2020 and 2019:

Commercial Credit Risk Exposure
Credit Risk Profile by Internally Assigned Grade

2020	Commercial	Commercial Real Estate
Pass	$ 184,630,000	$ 378,700,000
Special mention	1,196,000	15,635,000
Substandard	2,727,000	4,899,000
Doubtful	–	–
Loss	–	–
2020 Total	$ 188,553,000	$ 399,234,000
2019		
Pass	$ 174,896,000	$ 353,404,000
Special mention	2,604,000	10,865,000
Substandard	3,932,000	5,032,000
Doubtful	–	–
Loss	–	–
2019 Total	$ 181,432,000	$ 369,301,000

Consumer Credit Exposure
Credit Risk Profile by Internally Assigned Grade

2020	Residential Real Estate	Consumer-Installment	Consumer-Indirect Installment
Pass	$ 151,114,000	$ 4,923,000	$ 1,427,000
Substandard	665,000	14,000	27,000
2020 Total	$ 151,779,000	$ 4,937,000	$ 1,454,000
2019			
Pass	$ 140,886,000	$ 5,579,000	$ 2,545,000
Substandard	510,000	28,000	32,000
2019 Total	$ 141,396,000	$ 5,607,000	$ 2,577,000

The following presents an aging analysis of past due loans as of December 31, 2020 and 2019:

2020	31–60 Days Past Due	61–90 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Loans on Nonaccrual	Recorded Investment Loans > 90 Days and Accruing
Commercial	$ 396,000	$ 11,000	$ 125,000	$ 532,000	$ 188,021,000	$ 188,553,000	$ 1,221,000	$ –
Commercial real estate	376,000	668,000	349,000	1,393,000	397,841,000	399,234,000	1,730,000	–
Residential real estate	191,000	–	3,000	194,000	151,585,000	151,779,000	506,000	–
Consumer – installment	–	–	–	–	4,937,000	4,937,000	14,000	–
Consumer – indirect installment	10,000	21,000	–	31,000	1,423,000	1,454,000	17,000	–
2020 Total	$ 973,000	$ 700,000	$ 477,000	$ 2,150,000	$ 743,807,000	$ 745,957,000	$ 3,488,000	$ –
2019								
Commercial	$ 957,000	$ 745,000	$ 1,276,000	$ 2,978,000	$ 178,454,000	$ 181,432,000	$ 1,608,000	$ 1,000
Commercial real estate	2,642,000	923,000	655,000	4,220,000	365,081,000	369,301,000	1,769,000	10,000
Residential real estate	260,000	11,000	150,000	421,000	140,975,000	141,396,000	513,000	–
Consumer – installment	–	–	7,000	7,000	5,600,000	5,607,000	28,000	–
Consumer – indirect installment	41,000	11,000	–	52,000	2,525,000	2,577,000	51,000	–
2019 Total	$ 3,900,000	$ 1,690,000	$ 2,088,000	$ 7,678,000	$ 692,635,000	$ 700,313,000	$ 3,969,000	$ 11,000

4. Loans (cont.)

The Bank takes a conservative approach in credit risk management and remains focused on community lending and reinvesting, working closely with borrowers experiencing credit problems to assist in loan repayment or term modifications when appropriate. Troubled debt restructured loans (TDRs) consist of loans where the Bank, for economic or legal reasons related to the borrower's financial difficulties, granted a concession to the borrower that it would not otherwise consider. TDRs involve term modifications or a reduction of either interest or principal that the Bank would not normally make for other borrowers with similar risk characteristics. Once such an obligation has been restructured, it will continue to remain in restructured status until paid in full. Current balances of loan modifications qualifying as TDRs during the years ended December 31, 2020 and 2019 were $722,000 and $157,000, respectively. Loans restructured due to credit difficulties that are now performing were $1,229,000 and $1,931,000 at December 31, 2020 and 2019, respectively.

At December 31, 2020 and 2019, the allowance related to TDRs was $734,000 and $405,000, respectively. The specific reserve component was determined by using the fair value of the underlying collateral, which was obtained through independent appraisals and internal evaluations, or by discounting the total expected future cash flows from the borrower. There were no commitments to lend additional funds to borrowers with loans classified as TDRs at December 31, 2020 and 2019.

In 2020, there were no loans that did not perform according to the TDR terms and were subsequently charged off or transferred to OREO. In 2019, there were no loans that did not perform according to the TDR terms and were subsequently charged off or transferred to OREO.

The following is a summary of TDRs (accruing and non-accruing) by portfolio segment modified during the years ended December 31, 2020 and 2019:

2020	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Current Balance
Commercial	7	$ 800,000	$ 784,000	$ 722,000
2020 Total	7	$ 800,000	$ 784,000	$ 722,000
2019				
Commercial	8	$ 190,000	$ 185,000	$ 157,000
2019 Total	8	$ 190,000	$ 185,000	$ 157,000

The following is a summary of TDRs (accruing and non-accruing) by portfolio segment as of December 31, 2020 and 2019:

2020	Number of Contracts	Current Balance	Related Allowance
Commercial	31	$ 1,222,000	$ 100,000
Commercial real estate	27	2,167,000	634,000
Residential real estate	3	511,000	–
Consumer	2	39,000	–
2020 Total	63	$ 3,939,000	$ 734,000
2019			
Commercial	29	$ 871,000	$ 14,000
Commercial real estate	29	2,431,000	391,000
Residential real estate	3	538,000	–
Consumer	2	46,000	–
2019 Total	63	$ 3,886,000	$ 405,000

On March 22, 2020, federal banking regulators issued an interagency statement providing guidance on accounting for loan modifications in light of the economic impact of the COVID-19 pandemic. The guidance interprets current accounting standards and indicates that a lender can conclude that a borrower is not experiencing financial difficulty if short-term (that is, six months or less) modifications are made in response to COVID-19, such as payment deferrals, fee waivers, extensions of repayment terms, or other delays in payment that are insignificant, provided that the loan is less than 30 days past due at the time a modification program is implemented. The banking agencies confirmed with the staff of the FASB that short-term modifications made on a good faith basis in response to COVID-19 to borrowers who were current prior to any relief are not troubled debt restructurings under GAAP.

The Company has adopted the troubled debt restructuring guidance issued by the federal banking agencies. During 2020, the Bank had granted short-term loan concessions and/or modifications within the terms of this guidance to approximately 170 borrowers having an aggregate principal amount of $99,805,000. As of December 31, 2020, 7 of these borrowers remained on deferral with a principal amount of $1,872,000. These loans may bear a higher risk of default in future periods.

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

The following table presents a summary of information pertaining to impaired loans by loan category as of December 31, 2020 and 2019:

2020	Recorded Investment	Unpaid Principal Balance	Related Allowance	Interest Income Recognized
With no related allowance recorded:				
Commercial	$ 1,189,000	$ 1,189,000	$ –	$ 22,000
Commercial real estate	1,421,000	1,421,000	–	55,000
Residential real estate	648,000	648,000	–	32,000
Consumer	76,000	76,000	–	6,000
With an allowance recorded:				
Commercial	$ 147,000	$ 147,000	$ 100,000	$ 2,000
Commercial real estate	1,327,000	1,327,000	666,000	12,000
Residential real estate	–	–	–	–
Consumer	–	–	–	–
2020 Total:				
Commercial	$ 1,336,000	$ 1,336,000	$ 100,000	$ 24,000
Commercial real estate	2,748,000	2,748,000	666,000	67,000
Residential real estate	648,000	648,000	–	32,000
Consumer	76,000	76,000	–	6,000

2019	Recorded Investment	Unpaid Principal Balance	Related Allowance	Interest Income Recognized
With no related allowance recorded:				
Commercial	$ 1,463,000	$ 1,463,000	$ –	$ 25,000
Commercial real estate	1,352,000	1,352,000	–	71,000
Residential real estate	646,000	646,000	–	29,000
Consumer	46,000	46,000	–	1,000
With an allowance recorded:				
Commercial	$ 396,000	$ 396,000	$ 31,000	$ 10,000
Commercial real estate	1,517,000	1,517,000	458,000	47,000
Residential real estate	68,000	68,000	11,000	1,000
Consumer	53,000	53,000	16,000	3,000
2019 Total:				
Commercial	$ 1,859,000	$ 1,859,000	$ 31,000	$ 35,000
Commercial real estate	2,869,000	2,869,000	458,000	118,000
Residential real estate	714,000	714,000	11,000	30,000
Consumer	99,000	99,000	16,000	4,000

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

	2020	2019
Impaired loans without a valuation allowance	$ 3,334,000	$ 3,507,000
Impaired loans with a valuation allowance	1,474,000	2,034,000
Total impaired loans	$ 4,808,000	$ 5,541,000
Valuation allowance related to impaired loans	$ 766,000	$ 516,000
Average investment in impaired loans	$ 5,565,000	$ 6,651,000

As of December 31, 2020, and 2019, there were eight and seven mortgage loans, respectively, collateralized by residential real estate in the process of foreclosure with a total balance of $133,000 and $144,000, respectively.

The Bank was servicing for others, mortgage loans of approximately $16,507,000 and $3,355,000 at December 31, 2020 and 2019, respectively.

The balance of mortgage servicing rights included in other assets at December 31, 2020 was $152,000. Mortgage servicing rights of $178,000 were capitalized and mortgage servicing rights of $26,000 were amortized during 2020. The Bank did not record any mortgage servicing rights as of December 31, 2019.

5. Bank Premises and Equipment

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

	2020	2019
Land	$ 2,848,000	$ 2,794,000
Buildings	11,499,000	11,458,000
Equipment	14,627,000	13,984,000
Leasehold improvements	1,112,000	1,112,000
	30,086,000	29,348,000
Accumulated depreciation	(20,140,000)	(19,146,000)
	$ 9,946,000	$ 10,202,000

6. Deposits

At December 31, 2020, the scheduled maturities of time deposits are as follows:

2021	$ 98,644,000
2022	18,185,000
2023	9,316,000
2024	10,361,000
2025 and thereafter	5,268,000
	$ 141,774,000

Time deposit accounts in denominations that met or exceeded the insured limit were $26,292,000 and $31,738,000 at December 31, 2020 and 2019, respectively.

7. Advances from Federal Home Loan Bank and Other Borrowings

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

Fixed-rate advances of $13,041,000 and $35,551,000 at December 31, 2020 and 2019, respectively, mature through August 2023. At December 31, 2020 and 2019, the interest rates on fixed-rate advances ranged from 0.00 to 2.87 percent. At December 31, 2020 and 2019, the weighted-average interest rates on fixed-rate advances were 2.27 percent and 2.03 percent, respectively.

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

At December 31, 2020 and 2019, the Company also had $1,000,000 available under a long-term line of credit with the FHLB. There were no advances outstanding on this line-of-credit as of December 31, 2020 and 2019.

At December 31, 2020 and 2019, the Company also had $27,000,000 and $18,000,000, respectively, available under lines-of-credit with other banks which were in addition to the FHLB line of credit. There were no advances outstanding under these lines-of-credit with other banks at December 31, 2020 or 2019.

The contractual maturities of advances at December 31, 2020 are as follows:

2021	$ 6,500,000
2022	2,500,000
2023	4,041,000

8. Capital Trust Securities

On October 14, 2003, the Company sponsored the creation of Katahdin Capital Trust II (the "Trust II"), a statutory business trust created under the laws of Delaware. The Company is the owner of all of the common securities of the Trust II. On October 16, 2003, the Trust II issued $3,000,000 of London Interbank Offered Rate (LIBOR) floating rate plus 3.05% margin Capital Securities (the "Capital Securities II," and with the common securities, the "Trust Securities II"), the proceeds from which were used by the Trust II, along with the Company's $93,000 capital contribution for the Common Securities II, to acquire $3,093,000 aggregate principal amount of the Company's LIBOR floating rate plus 3.05% Junior Subordinated Deferrable Interest Debentures due October 7, 2033 (the "Debentures"), which constitute the sole assets of the Trust II. The Company has, through the Declaration of Trust which established the Trust II, the Common Securities II and Capital Securities II Guarantee Agreements, the Debentures and a related Indenture, taken together, fully, irrevocably and unconditionally guaranteed all of the Trust II's obligations under the Trust Securities II.

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

9. Income Taxes

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

	2020	2019
Current tax provision		
Federal	$ 1,022,000	$ 1,717,000
State	179,000	157,000
	1,201,000	1,874,000
Deferred federal tax benefit	(186,000)	(38,000)
	$ 1,015,000	$ 1,836,000

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

	2020	2019
Computed tax expense	$ 2,212,000	$ 2,099,000
Increase (reduction) in income taxes resulting from:		
Tax exempt interest	(106,000)	(105,000)
State taxes, net of federal benefit	141,000	124,000
Income from life insurance	(82,000)	(67,000)
Preferred stock dividends	(2,000)	(2,000)
Tax credits	(1,214,000)	(278,000)
Fair value adjustment of unearned ESOP shares	8,000	21,000
Other	58,000	44,000
	$ 1,015,000	$ 1,836,000

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

	2020	2019
Deferred tax assets		
Other-than-temporary impairment of investment securities	$ 47,000	$ 47,000
Allowance for loan losses	1,565,000	1,321,000
Employee benefit plans	668,000	607,000
Net unrealized loss on derivative instruments	277,000	–
Net unrealized loss on other investments	1,000	4,000
Restricted stock awards	8,000	–
Other	18,000	23,000
	2,584,000	2,002,000

	2020	2019
Deferred tax liabilities		
Depreciation	423,000	417,000
Amortization of goodwill	1,133,000	1,101,000
Prepaid expenses	126,000	117,000
Net unrealized gain on derivative instruments	–	112,000
Investment in pass-through entities	64,000	6,000
Net unrealized gain on securities available-for-sale	563,000	176,000
Other	14,000	–
	2,323,000	1,929,000
Net deferred tax asset	$ 261,000	$ 73,000

9. Income Taxes (cont.)

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

The Company invests in qualified affordable housing projects. At December 31, 2020, the balance of the investment for qualified affordable housing projects was $489,000 and is included in other assets on the consolidated balance sheets. The Company amortizes these investments using the proportional amortization method and recognized amortization expense of $11,000 in 2020 which was included within income tax expense on the consolidated statements of income. Additionally, during the year ended December 31, 2020, the Company recognized tax credits from its investments in affordable housing tax projects of $7,000. The Company is committed to making additional capital contributions of $185,000 in 2021. The Company had not invested in any qualified affordable housing projects as of December 31, 2019.

The Company also invests in limited partnerships that generate historic tax credits. At December 31, 2020 and 2019, the balance of the investment in these limited partnerships was $1,003,000 and $487,000, respectively, and is included in other assets on the consolidated balance sheets. The Company amortizes these investments on an effective yield basis resulting in amortization expense of $1,166,000 and $107,000 in 2020 and 2019, respectively, which was included as amortization of investments in limited partnerships on the consolidated statements of income. Additionally, during the years ended December 31, 2020 and 2019, the Company recognized tax credits from its investment in these limited partnerships of $1,444,000 and $134,000, respectively.

10. Earnings Per Share

The following sets forth the computation of basic and diluted earnings per common share for 2020 and 2019:

	2020	2019
Net income available to common shareholders, as reported	$ 9,519,000	$ 7,685,000
Weighted-average common shares outstanding	3,299,905	3,326,912
Effect of possible sources of options or conversions	–	–
Diluted weighted-average common shares	3,299,905	3,326,912
Basic earnings per common share	$ 2.88	$ 2.31
Diluted earnings per common share	$ 2.88	$ 2.31

11. Financial Instruments with Off-Balance-Sheet Risk

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

The Company's exposure to credit loss is represented by the contractual amount of these commitments. The Company follows the same credit policies in making commitments as it does for on-balance-sheet instruments. The contractual or notional amounts of financial instruments reflect the extent of involvement the Company has in particular classes of financial instruments. See Note 23 for further discussion of derivative financial instruments.

At December 31, 2020 and 2019, the contractual amounts of the Company's financial instruments were as follows:

	Contract Amount	
	2020	2019
Lending-related instruments:		
Home equity lines-of-credit	$ 26,734,000	$ 23,935,000
Other lines-of-credit	86,588,000	65,112,000
Credit card arrangements	2,871,000	3,114,000
Letters-of-credit	2,889,000	2,221,000
Derivative financial instruments:		
Notional amounts of interest rate swaps	282,774,000	193,442,000

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

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

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

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

12. Significant Group Concentrations of Credit Risk

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

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

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

13. Legal Contingencies

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

14. Minimum Regulatory Capital Requirements

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

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital and common equity Tier 1 (as defined in the regulations) to risk weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined).

Regulatory capital requirements limit a banking organization's capital distributions and certain discretionary bonus payments if the banking organization does not hold a "capital conservation buffer" consisting of 2.5% above its minimum risk-based capital requirements. As of December 31, 2020, the Bank had a capital conservation buffer of 7.0% of risk-weighted assets, which was in excess of the regulatory requirement of 2.5%. As of December 31, 2019, the Bank had a capital conservation buffer of 5.8% of risk-weighted assets, which was in excess of the regulatory requirement of 2.5%.

14. Minimum Regulatory Capital Requirements (cont.)

Management believes, as of December 31, 2020 and 2019, that the Bank met all capital adequacy requirements to which they are subject.

As of December 31, 2020, the Bank is well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based, common equity Tier 1, and Tier 1 leverage ratios as set forth in the following tables. The Bank's actual capital amounts and ratios as of December 31, 2020 and 2019 are also presented in the table.

As of December 31, 2020	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital to Risk-Weighted Assets Bank	$ 95,909,000	15.0%	$ 51,216,000	8.0%	$ 64,021,000	10.0%
Tier 1 Capital to Risk-Weighted Assets Bank	88,422,000	13.8	38,412,000	6.0	51,216,000	8.0
Common Equity Tier 1 Capital to Risk-Weighted Assets Bank	88,422,000	13.8	28,809,000	4.5	41,613,000	6.5
Tier 1 Capital to Average Assets Bank	88,422,000	9.5	37,164,000	4.0	46,455,000	5.0
As of December 31, 2019						
Total Capital to Risk-Weighted Assets Bank	$ 86,788,000	13.8%	$ 50,493,000	8.0%	$ 63,117,000	10.0%
Tier 1 Capital to Risk-Weighted Assets Bank	80,462,000	12.7	37,870,000	6.0	50,493,000	8.0
Common Equity Tier 1 Capital to Risk-Weighted Assets Bank	80,462,000	12.7	28,402,000	4.5	41,026,000	6.5
Tier 1 Capital to Average Assets Bank	80,462,000	9.6	33,361,000	4.0	41,701,000	5.0

15. Employee Benefit Plans

The Company has a safe harbor 401(k) plan whereby substantially all employees participate in the plan. Employees may contribute a portion of their compensation subject to certain limits based on federal tax laws. The Company makes safe harbor matching contributions equal to 100% of the first 3% of an employee's compensation plus 50% of the next 2% of an employee's compensation in addition to a discretionary contribution. For the years ended December 31, 2020 and 2019, expense attributable to the plan amounted to $376,000 and $367,000, respectively.

The Company has established a nonqualified supplemental executive retirement plan for the benefit of key employees. The amount of each benefit is guaranteed contingent upon employee vesting schedules. As of December 31, 2020, and 2019, the accrued liability of the plan was $3,180,000 and $2,890,000, respectively, and is recorded in accrued expenses and other liabilities. The present value of these benefits is expensed over the employment service period. The benefit expense amounted to $375,000 and $292,000 for 2020 and 2019, respectively. Life insurance policies were acquired for the purpose of serving as the primary funding source. The cash value of these policies was $14,126,000 and $12,387,000 at December 31, 2020 and 2019, respectively, and is included in other assets.

16. Restricted Stock Plan

The Company established a restricted stock plan during 2010 with 100,000 shares currently authorized by the Board of Directors for the compensation committee of the Board to administer. The holders of restricted stock shall have all the rights of a shareholder, including, but not limited to, the right to vote such shares and the right to receive all cash dividends and other distributions paid thereon. On January 1, 2020, the compensation committee granted 8,849 shares with a fair value on the grant date of $20.425 per share. Of the 8,849 shares, 1,043 will vest over four years with the remainder vesting over five years. There were no grants made in 2019. A total of 20,746 shares have been issued under the restricted stock plan since inception, 11,897 of which are vested.

17. Other Noninterest Expenses

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

	2020	2019
Other noninterest income		
Interchange and ATM fees	$ 1,288,000	$ 1,212,000
Swap fee income	877,000	730,000
Other noninterest expenses		
Legal, audit, examination and consulting	637,000	623,000
Account servicing	597,000	554,000

18. Related Party Transactions

In the ordinary course of business, the Company has granted loans to principal officers and directors and their affiliates amounting to $16,501,000 and $15,137,000 at December 31, 2020 and 2019, respectively. Deposits from related parties held by the Company at December 31, 2020 and 2019 amounted to $5,423,000 and $8,437,000 respectively.

19. Employee Stock Ownership Plan

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

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

Date	Shares	Net Price Per Share	Original Debt	Principal Balance Dec. 31, 2020
October 2016	25,500	$ 11.25	$ 287,000	$ –

The October 2016 loan is from Katahdin Bankshares Corp. and was repayable annually with an interest rate of 2.55% for the term of 4 years. The loan was paid off on February 15, 2020.

Date	Shares	Net Price Per Share	Original Debt	Principal Balance Dec. 31, 2020
September 2017	27,000	$ 13.99	$ 371,000	$ 283,000

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

Date	Shares	Net Price Per Share	Original Debt	Principal Balance Dec. 31, 2020
June 2018	32,300	$ 16.38	$ 529,000	$ 414,000

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

The loans are secured by the shares purchased by the ESOP. Participants' benefits become fully vested after five years of service. The Bank's contributions are the primary source of funds for the ESOP's repayment of the loans. Principal and interest payments for the years ended December 31, 2020 and 2019 totaled $178,000 and $178,000, respectively. ESOP expense was $205,000 and $237,000 for the years ended December 31, 2020 and 2019, respectively.

19. Employee Stock Ownership Plan (cont.)

As of December 31, 2020, the remaining principal balance of the loans are scheduled to be paid as follows:

2021	$ 143,000
2022	148,000
2023	152,000
2024	59,000
2025	62,000
2026 and after	133,000
	$ 697,000

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

	2020	2019
Allocated	42,313	32,263
Unallocated	42,487	52,537
	84,800	84,800

The fair value of the unallocated shares as of December 31, 2020 and 2019 was approximately $786,000 and $1,073,000, respectively.

20. Fair Value

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

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

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

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

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

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

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

Other investments: Other investments consist of preferred stock. Other investments are reported at fair value utilizing the closing price reported in the active market in which the individual securities are traded.

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

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

		Fair Value Measurements at December 31, 2020 and 2019, Using		
December 31, 2020	Total	Quoted Prices In Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Securities available-for-sale				
State and municipal	$ 6,230,000	$ –	$ 6,230,000	$ –
Corporate bonds	1,930,000	–	1,930,000	–
Mortgage-backed and CMO's	86,087,000	–	86,087,000	–
Total securities available-for-sale	94,247,000	–	94,247,000	–
Other investments	498,000	498,000	–	–
Derivative instruments	8,491,000	–	8,491,000	–
Total assets	$ 103,236,000	$ 498,000	$ 102,738,000	$ –
Liabilities				
Derivative instruments	$ 9,812,000	$ –	$ 9,812,000	$ –

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

Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis

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

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

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

		Fair Value Measurements at December 31, 2020 and 2019, Using		
December 31, 2020	Total	Quoted Prices In Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Impaired loans (market approach)	$ 572,000	$ -	$ 572,000	$ -
Other real estate and property owned (market approach)	38,000	-	38,000	-
December 31, 2019				
Assets				
Impaired loans (market approach)	$ 854,000	$ -	$ 854,000	$ -
Other real estate and property owned (market approach)	106,000	-	106,000	-

20. Fair Value (cont.)

Certain impaired loans were written down to their value of $572,000 and $854,000 at December 31, 2020 and 2019, respectively, resulting in an impairment charge through the allowance for loan losses.

Fair Value of Financial Instruments

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

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

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

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

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

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

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

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

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

			Fair Value Measurement at December 31, 2020		
	Carrying Amount	Fair Value	Quoted Prices In Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial assets					
Securities held-to-maturity	$ 4,000	$ 4,000	$ –	$ 4,000	$ –
Loans receivable, net:					
Commercial	187,002,000	188,503,000	–	38,000	188,465,000
Commercial real estate	394,344,000	396,864,000	–	482,000	396,382,000
Residential real estate	151,432,000	151,026,000	–	52,000	150,974,000
Consumer	6,361,000	6,223,000	–	–	6,223,000
Loan receivable, net	739,139,000	742,616,000	–	572,000	742,044,000
Financial liabilities					
Certificates of deposit	141,774,000	143,277,000	–	143,277,000	–
Advances from FHLB	13,041,000	13,320,000	–	13,320,000	–
Senior Notes	14,094,000	14,826,000	–	14,826,000	–

			Fair Value Measurement at December 31, 2019		
	Carrying Amount	Fair Value	Quoted Prices In Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial assets					
Securities held-to-maturity	$ 6,000	$ 6,000	$ –	$ 6,000	$ –
Loans receivable, net:					
Commercial	179,725,000	179,903,000	–	201,000	179,702,000
Commercial real estate	365,654,000	363,284,000	–	560,000	362,724,000
Residential real estate	141,211,000	137,879,000	–	–	137,879,000
Consumer	8,133,000	7,977,000	–	93,000	7,884,000
Loan receivable, net	694,723,000	689,043,000	–	854,000	688,189,000
Financial liabilities					
Certificates of deposit	200,601,000	199,137,000	–	199,137,000	–
Advances from FHLB	37,986,000	38,184,000	–	38,184,000	–
Senior Notes	14,020,000	14,790,000	–	14,790,000	–

21. Senior Notes

On June 13, 2019, the Company entered into a Senior Note Purchase Agreement (the Agreement) by and among the Company and several purchasers of Senior Notes (collectively, the Purchasers), pursuant to which the Company agreed to sell to the Purchasers, severally and not jointly, $14,500,000 in aggregate principal Senior Notes. Debt issuance costs of $521,000 were incurred in conjunction with the issuance of the Senior Notes which are being amortized over 84 months. Amortization expense was $74,000 and $41,000 for the years ended December 31, 2020 and 2019, respectively.

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

22. Preferred Stock

The Company has authorized the issuance of up to 20,000 shares of preferred stock at any one time. On June 13, 2019, the Company provided notice to each holder of Series D Shares that the Company elected to redeem, on July 15, 2019 (the Redemption Date), all 4,000 outstanding Series D Shares at an aggregate redemption price of $10,000,000 plus accrued dividends of $255,208. From and after the Redemption Date, no Series D Shares were treated as outstanding, no further dividends were accrued or declared and all other rights with respect to the Series D Shares were terminated. As of December 31, 2020 and 2019, there were no issued and outstanding shares of preferred stock.

23. Interest Rate Swaps

The Company uses derivative instruments as partial hedges against large fluctuations in interest rates. At least quarterly, all financial instruments are reviewed as part of the asset/liability management process. The financial instruments are factored into the Company's overall interest rate risk position. The Company regularly reviews the credit quality of the counterparty from which the instruments have been purchased. The Company uses derivative financial instruments for risk management purposes and not for trading or speculative purposes. The Company controls the credit risk of these instruments through collateral, credit approvals, and monitoring procedures. The derivative instruments contain provisions that require the Company to post collateral with the counterparty for its contracts that are in a net loss position based on their fair value and the Company's credit rating. At December 31, 2020 and 2019, the Company had posted $11,635,000 and $2,400,000, respectively, in cash and securities collateral for the benefit of the counterparty.

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

Party	Notional Amount	Effective Date	Maturity Date	Variable Index Received	Fixed Rate Paid	Fair Value As of December 31, 2020	Fair Value As of December 31, 2019
Bank	$ 15,000,000	July 1, 2016	June 30, 2020	1-Month USD LIBOR	0.855%	$ –	$ 60,000
Bank	$ 25,000,000	Sept 9, 2019	Sept 9, 2026	1-Month USD LIBOR	1.360%	$ (1,340,000)	$ 471,000
Bank	$ 12,500,000	March 6, 2020	March 6, 2023	1-Month USD LIBOR	0.588%	$ (122,000)	$ –
Bank	$ 12,500,000	March 6, 2020	March 6, 2024	1-Month USD LIBOR	0.619%	$ (173,000)	$ –
Bank	$ 15,000,000	July 24, 2020	July 24, 2027	USD-Federal Funds H.15	0.260%	$ 173,000	$ –
Company	$ 3,000,000	July 7, 2021	October 7, 2033	3-Month USD LIBOR	0.990%	$ 45,000	$ –
Company	$ 4,000,000	July 7, 2021	January 7, 2036	3-Month USD LIBOR	1.040%	$ 96,000	$ –

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

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

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

	2020 Asset (Liability)	2019 Asset (Liability)
Swaps receive fixed	$ 8,350,000	$ 2,100,000
Swaps pay fixed	(8,350,000)	(2,100,000)
Net customer related swaps	$ –	$ –

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

	2020	2019
Swaps receive fixed	$ 105,387,000	$ 76,721,000
Swaps pay fixed	(105,387,000)	(76,721,000)

24. Subsequent Events

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about the conditions that existed at the balance sheet date, including the estimates inherent in the process of preparing financial statements. Non-recognized subsequent events are events that provide evidence about conditions that did not exist at the balance sheet date but arose after that date. Management has evaluated subsequent events occurring through February 3, 2021, the date the financial statements were available to be issued.

SHAREHOLDER INFORMATION

ANNUAL MEETING

The Annual Shareholders' Meeting will be held in a virtual-only format on Monday, May 3, 2021 at 10:30 a.m. ET. Instructions to attend the meeting are included on your shareholder proxy card.

SHAREHOLDER RELATIONS

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

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

STOCK

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

TRANSFER AGENT

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

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

DIRECT STOCK PURCHASE AND DIVIDEND REINVESTMENT PLAN

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

BRANCH LOCATIONS

NORTHERN MAINE

Ashland ATM
17 Main Street
435-6461

Caribou ATM
105 Bennett Drive
498-4200

Eagle Lake
3440 Aroostook Road
444-5543

Fort Fairfield ATM
290 Main Street
472-3161

Fort Kent ATM
79 West Main Street
834-2348

Houlton ATM
65 North Street
532-4277

Island Falls ATM
1007 Crystal Road
463-2228

Mars Hill ATM
28 Main Street
429-8400

Oakfield ATM
200 Oakfield Smyrna Rd
757-8288

Patten ATM
11 Main Street
528-2211

Presque Isle ATM
6 North Street
764-8000

Van Buren ATM
29 Main Street, Ste.105
868-2728

GREATER BANGOR

Bangor ATM
609 Broadway
942-3146

Bangor ATM
52 Springer Drive
947-9674

Hampden ATM
57 Western Avenue
862-2211

GREATER PORTLAND

Scarborough
144 US Route One
510-7017

Katahdin Bankshares Corp.

KatahdinTrust.com