

SALISBURY BANCORP INC  
Form 10-Q  
May 16, 2016

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

**For the quarterly period ended March 31, 2016**

**OR**

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_

Commission file number 0-24751

**SALISBURY BANCORP, INC.**

(Exact name of registrant as specified in its charter)

|  |   |
|--|---|
| Connecticut<br>(State or other jurisdiction<br>of incorporation or organization) | 06-1514263<br>(I.R.S. Employer<br>Identification No.) |
|--|---|

|   |                     |
|---|---------------------|
| 5 Bissell Street, Lakeville, CT<br>(Address of principal executive offices) | 06039<br>(Zip code) |
|---|---------------------|

**(860) 435-9801**

(Registrant's telephone number, including area code)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The number of shares of Common Stock outstanding as of May 16, 2016 is 2,753,426.

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**PART I - FINANCIAL INFORMATION****Salisbury Bancorp, Inc. and Subsidiary****CONSOLIDATED BALANCE SHEETS**

| (in thousands, except share data)  | March 31,<br>2016 | December<br>31, 2015 |
|--|-------------------|----------------------|
| <b>ASSETS</b>  | (unaudited)       |                      |
| Cash and due from banks  | \$9,309           | \$14,891             |
| Interest bearing demand deposits with other banks                        | 22,194            | 47,227               |
| Total cash and cash equivalents  | 31,503            | 62,118               |
| Securities   |                   |                      |
| Available-for-sale at fair value   | 79,034            | 76,694               |
| Federal Home Loan Bank of Boston stock at cost                           | 3,117             | 3,176                |
| Loans held-for-sale  | 183               | 763                  |
| Loans receivable, net (allowance for loan losses: \$5,877 and \$5,716)   | 728,845           | 699,018              |
| Bank premises and equipment, net   | 14,632            | 14,307               |
| Goodwill   | 12,552            | 12,552               |
| Intangible assets (net of accumulated amortization: \$3,064 and \$2,909) | 2,183             | 2,338                |
| Accrued interest receivable  | 2,451             | 2,307                |
| Cash surrender value of life insurance policies                          | 13,775            | 13,685               |
| Deferred taxes   | 2,013             | 1,989                |
| Other assets   | 1,516             | 2,245                |
| <b>Total Assets</b>  | <b>\$891,804</b>  | <b>\$891,192</b>     |
| <b>LIABILITIES and SHAREHOLDERS' EQUITY</b>                              |                   |                      |
| Deposits   |                   |                      |
| Demand (non-interest bearing)  | \$192,184         | \$201,340            |
| Demand (interest bearing)  | 122,814           | 125,465              |
| Money market   | 192,357           | 183,783              |
| Savings and other  | 126,214           | 119,651              |
| Certificates of deposit  | 122,089           | 124,294              |
| Total deposits   | 755,658           | 754,533              |
| Repurchase agreements  | 2,620             | 3,914                |
| Federal Home Loan Bank of Boston advances                                | 27,031            | 26,979               |
| Subordinated debt <sup>(1)</sup>   | 9,770             | 9,764                |
| Note payable   | 365               | 376                  |
| Capital lease liability  | 420               | 422                  |
| Accrued interest and other liabilities                                   | 4,538             | 4,630                |
| <b>Total Liabilities</b>   | <b>800,402</b>    | <b>800,618</b>       |
| Shareholders' Equity   |                   |                      |
| Common stock - \$.10 per share par value                                 |                   |                      |
| Authorized: 5,000,000  |                   |                      |
| Issued: 2,753,426 and 2,733,576  | 275               | 273                  |
| Paid-in capital  | 41,915            | 41,364               |
| Retained earnings  | 48,662            | 47,922               |
| Unearned compensation - restricted stock awards                          | (529)             | (110)                |
| Accumulated other comprehensive income                                   | 1,079             | 1,125                |

|   |           |           |
|---|-----------|-----------|
| <b>Total Shareholders' Equity</b>                 | 91,402    | 90,574    |
| <b>Total Liabilities and Shareholders' Equity</b> | \$891,804 | \$891,192 |

<sup>(1)</sup> Net of issuance costs, which are capitalized and amortized as a component of interest expense over a period of 10 years.

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**Salisbury Bancorp, Inc. and Subsidiary****CONSOLIDATED STATEMENTS OF INCOME (unaudited)**

| Three months ended March 31, (in thousands except per share amounts)       | 2016    | 2015    |
|--|---------|---------|
| <b>Interest and dividend income</b>  |         |         |
| Interest and fees on loans   | \$7,925 | \$7,922 |
| Interest on debt securities  |         |         |
| Taxable  | 293     | 326     |
| Tax exempt   | 286     | 390     |
| Other interest and dividends   | 74      | 33      |
| Total interest and dividend income   | 8,578   | 8,671   |
| <b>Interest expense</b>  |         |         |
| Deposits   | 508     | 444     |
| Repurchase agreements  | 1       | 1       |
| Capital lease  | 18      | 18      |
| Note payable   | 5       | —       |
| Subordinated debt  | 156     | —       |
| Federal Home Loan Bank of Boston advances                                  | 231     | 282     |
| Total interest expense   | 919     | 745     |
| Net interest and dividend income   | 7,659   | 7,926   |
| <b>Provision (benefit) for loan losses</b>                                 | 463     | (200 )  |
| Net interest and dividend income after provision (benefit) for loan losses | 7,196   | 8,126   |
| <b>Non-interest income</b>   |         |         |
| Trust and wealth advisory  | 784     | 822     |
| Service charges and fees   | 730     | 731     |
| Gains on sales of mortgage loans, net                                      | 39      | 94      |
| Mortgage servicing, net  | 12      | (40 )   |
| Gains on sales and calls of available-for-sale securities, net             | 2       | 175     |
| Other  | 117     | 114     |
| Total non-interest income  | 1,684   | 1,896   |
| <b>Non-interest expense</b>  |         |         |
| Salaries   | 2,574   | 2,540   |
| Employee benefits  | 1,088   | 1,005   |
| Premises and equipment   | 895     | 908     |
| Data processing  | 447     | 474     |
| Professional fees  | 380     | 650     |
| Collections and OREO   | 157     | 244     |
| FDIC insurance   | 134     | 198     |
| Marketing and community support  | 200     | 110     |
| Amortization of core deposit intangibles                                   | 155     | 169     |
| Other  | 810     | 537     |
| Total non-interest expense   | 6,840   | 6,835   |
| Income before income taxes   | 2,040   | 3,187   |
| <b>Income tax provision</b>  | 528     | 953     |
| <b>Net income</b>  | \$1,512 | \$2,234 |

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|   |         |         |
|---|---------|---------|
| <b>Net income available to common shareholders</b>                                  | \$1,512 | \$2,194 |
| Basic earnings per common share   | \$0.55  | \$0.81  |
| Weighted average common shares outstanding, to calculate basic earnings per share   | 2,723   | 2,699   |
| Diluted earnings per common share   | \$0.55  | \$0.80  |
| Weighted average common shares outstanding, to calculate diluted earnings per share | 2,741   | 2,716   |
| Common dividends per share  | \$0.28  | \$0.28  |

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**Salisbury Bancorp, Inc. and Subsidiary****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (unaudited)**

|   |         |         |
|---|---------|---------|
| Three months ended March 31, (in thousands)                         | 2016    | 2015    |
| Net income  | \$1,512 | \$2,234 |
| Other comprehensive loss  |         |         |
| Net unrealized losses on securities available-for-sale              | (68 )   | (193 )  |
| Reclassification of net realized gains in net income <sup>(1)</sup> | (2 )    | (175 )  |
| Unrealized losses on securities available-for-sale                  | (70 )   | (368 )  |
| Income tax benefit  | 24      | 128     |
| Unrealized losses on securities available-for-sale, net of tax      | (46 )   | (240 )  |
| Comprehensive income  | \$1,466 | \$1,994 |

<sup>(1)</sup> Reclassification adjustments include realized security gains and losses. The gains and losses have been reclassified out of other comprehensive loss and have affected certain lines in the consolidated statements of income as follows: The pre-tax amount is reflected as gains on sales and calls of available-for-sale securities, net, the tax effect is included in the income tax provision and the after tax amount is included in net income.

**Salisbury Bancorp, Inc. and Subsidiary****CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (unaudited)**

| (dollars in thousands)                           | Common Stock | Preferred stock | Paid-in capital | Retained earnings | Unearned compensation - restricted stock awards | Accumulated other comprehensive income | Total shareholders' equity |
|--|--------------|-----------------|-----------------|-------------------|---|--|----------------------------|
|  | Shares       | Amount          |                 |                   |   |  |                            |
| Balances at December 31, 2014                    | 2,720,766    | \$ 272          | \$ 16,000       | \$ 41,077         | \$ (313 )                                       | \$ 2,108                               | \$ 101,821                 |
| Net income                                       | —            | —               | —               | 2,234             | —   | —                                      | 2,234                      |
| Other comprehensive loss, net of tax             | —            | —               | —               | —                 | —   | (240 )                                 | (240 )                     |
| Common stock dividends declared                  | —            | —               | —               | (761 )            | —   | —                                      | (761 )                     |
| Preferred stock dividends declared               | —            | —               | —               | (40 )             | —   | —                                      | (40 )                      |
| Stock options exercised                          | 6,750        | 1               | —               | 125               | —   | —                                      | 126                        |
| Issuance of common stock for executives          | 1,000        | —               | —               | 29                | —   | —                                      | 29                         |
| Stock based compensation-restricted stock awards | —            | —               | —               | —                 | 42  | —                                      | 42                         |
| Balances at March 31, 2015                       | 2,728,516    | \$ 273          | \$ 16,000       | \$ 41,231         | \$ (271 )                                       | \$ 1,868                               | \$ 103,211                 |
| Balances at December 31, 2015                    | 2,733,576    | \$ 273          | \$ —            | \$ 41,364         | \$ (110 )                                       | \$ 1,125                               | \$ 90,574                  |
| Net income                                       | —            | —               | —               | 1,512             | —   | —                                      | 1,512                      |
| Other comprehensive loss, net of tax             | —            | —               | —               | —                 | —   | (46 )                                  | (46 )                      |



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|  |           |        |     |          |          |           |          |          |
|--|-----------|--------|-----|----------|----------|-----------|----------|----------|
| Common stock dividends declared                  | —         | —      | —   | —        | (772 )   | —         | —        | (772 )   |
| Stock options exercised                          | 4,050     | —      | —   | 87       | —        | —         | —        | 87       |
| Issuance of restricted stock awards              | 15,800    | 2      | —   | 464      | —        | —         | —        | 466      |
| Stock based compensation-restricted stock awards | —         | —      | —   | —        | —        | (419 )    | —        | (419 )   |
| Balances at March 31, 2016                       | 2,753,426 | \$ 275 | \$— | \$41,915 | \$48,662 | \$ (529 ) | \$ 1,079 | \$91,402 |

**Salisbury Bancorp, Inc. and Subsidiary****CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)**

| Three months ended March 31, (in thousands)  | 2016     | 2015     |
|--|----------|----------|
| <b>Operating Activities</b>  |          |          |
| Net income   | \$ 1,512 | \$ 2,234 |
| Adjustments to reconcile net income to net cash provided by operating activities:<br>(Accretion), amortization and depreciation: |          |          |
| Securities   | 60       | 38       |
| Bank premises and equipment  | 306      | 311      |
| Core deposit intangible  | 155      | 169      |
| Mortgage servicing rights  | 51       | 119      |
| Fair value adjustment on loans   | (586 )   | (650 )   |
| Fair value adjustment on deposits  | (38 )    | (135 )   |
| Debt issuance costs  | 6        | —        |
| (Gains) and losses, including write-downs  |          |          |
| Gain on sales and calls of securities available-for-sale, net  | (2 )     | (175 )   |
| Gain on sales of loans, excluding capitalized servicing rights   | (19 )    | (32 )    |
| Write-downs of other real estate owned   | —        | 127      |
| Loss on sale/disposals of premises and equipment   | 13       | 45       |
| Provision (benefit) for loan losses  | 463      | (200 )   |
| Proceeds from loans sold   | 1,787    | 2,134    |
| Loans originated for sale  | (1,188 ) | (1,862)  |
| Increase in deferred loan origination fees and costs, net  | (44 )    | (3 )     |
| Mortgage servicing rights originated   | (20 )    | (62 )    |
| Increase in mortgage servicing rights impairment reserve   | 20       | 10       |
| Increase in interest receivable  | (144 )   | (22 )    |
| Deferred tax benefit   | —        | (13 )    |
| Decrease (increase) in prepaid expenses  | 47       | (126 )   |
| Increase in cash surrender value of life insurance policies  | (90 )    | (92 )    |
| Decrease in income tax receivable  | 506      | —        |
| Increase in income taxes payable   | —        | 55       |
| Decrease in other assets   | 125      | 64       |
| Decrease in accrued expenses   | (113 )   | (184 )   |
| Decrease in interest payable   | (30 )    | —        |
| Increase in other liabilities  | 51       | 161      |
| Stock based compensation-restricted stock awards   | 47       | 71       |
| Net cash provided by operating activities  | 2,875    | 1,982    |
| <b>Investing Activities</b>  |          |          |
| Redemption of Federal Home Loan Bank of Boston stock   | 59       | —        |
| Purchases of securities available-for-sale   | (10,072) | (3 )     |
| Proceeds from sales of securities available-for-sale   | —        | 3,861    |
| Proceeds from calls of securities available-for-sale   | 5,351    | 3,740    |
| Proceeds from maturities of securities available-for-sale  | 2,253    | 2,304    |
| Loan originations and principal collections, net   | (29,674) | (3,011)  |
| Recoveries of loans previously charged off   | 14       | 460      |
| Capital expenditures   | (644 )   | (186 )   |
| Net cash (utilized) provided by investing activities   | (32,713) | 7,165    |



**Salisbury Bancorp, Inc. and Subsidiary****CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited) (Continued)**

| Three months ended March 31, (in thousands)                     | 2016     | 2015     |
|---|----------|----------|
| <b>Financing Activities</b>                                     |          |          |
| Increase in deposit transaction accounts, net                   | 3,330    | 9,556    |
| (Decrease) increase in time deposits, net                       | (2,167 ) | 63       |
| Decrease in securities sold under agreements to repurchase, net | (1,294 ) | (885 )   |
| Principal payments on Federal Home Loan Bank of Boston advances | (6 )     | (410 )   |
| Modification fees on Federal Home Loan Bank of Boston advances  | 58       | —        |
| Principal payments on note payable                              | (11 )    | —        |
| Decrease in capital lease obligation                            | (2 )     | (1 )     |
| Stock options exercised   | 87       | 126      |
| Common stock dividends paid                                     | (772 )   | (761 )   |
| Series B preferred stock dividends paid                         | —        | (40 )    |
| Net cash (utilized) provided by financing activities            | (777 )   | 7,648    |
| Net (decrease) increase in cash and cash equivalents            | (30,615) | 16,795   |
| Cash and cash equivalents, beginning of period                  | 62,118   | 36,105   |
| Cash and cash equivalents, end of period                        | \$31,503 | \$52,900 |
| Cash paid during period   |          |          |
| Interest  | \$760    | \$745    |
| Income taxes  | 258      | 911      |

**Salisbury Bancorp, Inc. and Subsidiary**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 - BASIS OF PRESENTATION**

The interim (unaudited) consolidated financial statements of Salisbury Bancorp, Inc. ("Salisbury") include those of Salisbury and its wholly owned subsidiary, Salisbury Bank and Trust Company (the "Bank"). In the opinion of management, the interim unaudited consolidated financial statements include all adjustments (consisting of normal recurring adjustments) necessary to present fairly the financial position of Salisbury and the statements of income, comprehensive income, shareholders' equity and cash flows for the interim periods presented.

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). In preparing the financial statements, management is required to make extensive use of estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet, and revenues and expenses for the period. Actual results could differ significantly 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, expected cash flows from loans acquired in a business combination, other-than-temporary impairment of securities and impairment of goodwill and intangibles.

Certain financial information, which is normally included in financial statements prepared in accordance with generally accepted accounting principles, but which is not required for interim reporting purposes, has been condensed or omitted. Operating results for the interim period ended March 31, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016. The accompanying condensed financial statements should be read in conjunction with the financial statements and notes thereto included in Salisbury's 2015 Annual Report on Form 10-K for the year ended December 31, 2015.

The allowance for loan losses is a significant accounting policy and is presented in the Notes to Consolidated Financial Statements and in Management's Discussion and Analysis, which provides information on how significant assets are valued in the financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions and estimates underlying those amounts, management has identified the determination of the allowance for loan losses to be the accounting area that requires the most subjective judgments, and as such could be most subject to revision as new information becomes available.

**Impact of New Accounting Pronouncements Issued**

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments – overall (subtopic 825-10): *"Recognition and Measurement of Financial Assets and Financial Liabilities."* This ASU addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments by making targeted improvements to GAAP as follows: (1) require equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer; (2) simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. When a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at fair value; (3) eliminate the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities; (4) eliminate the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be

disclosed for financial instruments measured at amortized cost on the balance sheet; (5) require public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (6) require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; (7) require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and (8) clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. ASU No. 2016-01 is effective for interim and annual reporting periods beginning after December 15, 2017. Early application is permitted as of the beginning of the fiscal year of adoption only for provisions (3) and (6) above. Early adoption of the other provisions mentioned above is not permitted. Salisbury does not expect ASU No. 2016-01 to have a material impact on the Company's Consolidated Financial Statements; however, the Company will continue to closely monitor developments and additional guidance.

In February 2016, the FASB issued ASU No. 2016-02, "Leases" (Topic 842). Under the new guidance, lessees will be required to recognize the following for all leases (with the exception of short-term leases): 1) a lease liability, which is the present value of a lessee's obligation to make lease payments, and 2) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Lessor accounting under the new guidance remains largely unchanged as it is substantially equivalent to existing guidance for sales-type leases, direct financing leases, and operating leases. Leveraged leases have been eliminated, although lessors can continue to account for existing leveraged leases using the current accounting guidance. Other limited changes were made to align lessor accounting with the lessee accounting model and the new revenue recognition standard. All entities will classify leases to determine how to recognize lease-related revenue and expense. Quantitative and qualitative disclosures will be required by lessees and lessors to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. The intention is to require enough information to supplement the amounts recorded in the financial statements so that users can understand more about the nature of an entity's leasing activities. ASU No. 2016-02 is effective for interim and annual reporting periods beginning after December 15, 2018; early adoption is permitted. All entities are required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements. They have the option to use certain relief; full retrospective application is prohibited. The Company is currently evaluating this ASU to determine the impact on its consolidated financial statements. In March 2016, the FASB issued ASU No. 2016-09, Compensation—Stock Compensation (Topic 718): "Improvements to Employee Share-Based Payment Accounting." This ASU includes provisions intended to simplify various aspects related to how share-based payments are accounted for and presented in the financial statements. Some of the key provisions of this new ASU include: (1) companies will no longer record excess tax benefits and certain tax deficiencies in additional paid-in capital ("APIC"). Instead, they will record all excess tax benefits and tax deficiencies as income tax expense or benefit in the income statement, and APIC pools will be eliminated. The guidance also eliminates the requirement that excess tax benefits be realized before companies can recognize them. In addition, the guidance requires companies to present excess tax benefits as an operating activity on the statement of cash flows rather than as a financing activity; (2) increase the amount an employer can withhold to cover income taxes on awards and still qualify for the exception to liability classification for shares used to satisfy the employer's statutory income tax withholding obligation. The new guidance will also require an employer to classify the cash paid to a tax authority when shares are withheld to satisfy its statutory income tax withholding obligation as a financing activity on its statement of cash flows (current guidance did not specify how these cash flows should be classified); and (3) permit companies to make an accounting policy election for the impact of forfeitures on the recognition of expense for share-based payment awards. Forfeitures can be estimated, as required today, or recognized when they occur. ASU No. 2016-09 is effective for interim and annual reporting periods beginning after December 15, 2016. Early adoption is permitted, but all of the guidance must be adopted in the same period. Salisbury is currently evaluating the provisions of ASU No. 2016-09 to determine the potential impact the new standard will have on the Company's Consolidated Financial Statements.

## NOTE 2 - SECURITIES

The composition of securities is as follows:

| (in thousands)            | Amortized<br>cost (1) | Gross<br>un-<br>realized<br>gains | Gross<br>un-<br>realized<br>losses | Fair<br>value |
|---------------------------|-----------------------|-----------------------------------|------------------------------------|---------------|
| March 31, 2016            |                       |                                   |                                    |               |
| <b>Available-for-sale</b> |                       |                                   |                                    |               |
| U.S. Treasury notes       | \$ 7,497              | \$ 33                             | \$ (1 )                            | \$ 7,529      |
| Municipal bonds           | 24,893                | 495                               | —                                  | 25,388        |

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|   |           |          |          |           |
|---|-----------|----------|----------|-----------|
| Mortgage-backed securities:   |           |          |          |           |
| U.S. Government agencies and U.S. Government- sponsored enterprises | 35,328    | 497      | (23 )    | 35,802    |
| Collateralized mortgage obligations:                                |           |          |          |           |
| U.S. Government agencies  | 1,850     | 12       | —        | 1,862     |
| Non-agency  | 4,198     | 382      | (12 )    | 4,568     |
| SBA bonds   | 2,843     | 28       | —        | 2,871     |
| CRA mutual funds  | 770       | 9        | —        | 779       |
| Preferred stock   | 20        | 215      | —        | 235       |
| Total securities available-for-sale                                 | \$ 77,399 | \$ 1,671 | \$ (36 ) | \$ 79,034 |
| <b>Non-marketable securities</b>                                    |           |          |          |           |
| Federal Home Loan Bank of Boston stock                              | \$ 3,117  | \$ —     | \$ —     | \$ 3,117  |



| (in thousands)  | Amortized<br>cost (1) | Gross<br>un-<br>realized<br>gains | Gross<br>un-<br>realized<br>losses | Fair<br>value |
|---|-----------------------|-----------------------------------|------------------------------------|---------------|
| December 31, 2015   |                       |                                   |                                    |               |
| <b>Available-for-sale</b>   |                       |                                   |                                    |               |
| U.S. Treasury notes   | \$ 2,499              | \$ 42                             | \$ —                               | \$ 2,541      |
| U.S. Government agency notes  | 498                   | —                                 | —                                  | 498           |
| Municipal bonds   | 29,752                | 633                               | —                                  | 30,385        |
| Mortgage-backed securities:   |                       |                                   |                                    |               |
| U.S. Government agencies and U.S. Government- sponsored enterprises | 31,900                | 385                               | (83 )                              | 32,202        |
| Collateralized mortgage obligations:                                |                       |                                   |                                    |               |
| U.S. Government agencies  | 2,002                 | 12                                | —                                  | 2,014         |
| Non-agency  | 4,487                 | 468                               | (7 )                               | 4,948         |
| SBA bonds   | 3,065                 | 31                                | —                                  | 3,096         |
| CRA mutual funds  | 766                   | —                                 | (2 )                               | 764           |
| Preferred stock   | 20                    | 226                               | —                                  | 246           |
| Total securities available-for-sale                                 | \$ 74,989             | \$ 1,797                          | \$ (92 )                           | \$ 76,694     |
| <b>Non-marketable securities</b>                                    |                       |                                   |                                    |               |
| Federal Home Loan Bank of Boston stock                              | \$ 3,176              | \$ —                              | \$ —                               | \$ 3,176      |

(1) Net of other-than-temporary impairment write-downs recognized in earnings.

Salisbury did not sell any available-for-sale securities during the three month period ended March 31, 2016, and sold \$3.9 million in available-for-sale securities during the three month period ended March 31, 2015, for a gain of \$165,000. The after tax gain totaled \$150,000.

The following table summarizes, for all securities in an unrealized loss position, including debt securities for which a portion of other-than-temporary impairment (OTTI) has been recognized in other comprehensive loss, the aggregate fair value and gross unrealized loss of securities that have been in a continuous unrealized loss position as of the date presented:

| (in thousands)   | Less than 12<br>Months |                      | 12 Months or<br>Longer |                      | Total         |                      |
|--|------------------------|----------------------|------------------------|----------------------|---------------|----------------------|
|  | Fair<br>value          | Unrealized<br>losses | Fair<br>value          | Unrealized<br>losses | Fair<br>value | Unrealized<br>losses |
| March 31, 2016   |                        |                      |                        |                      |               |                      |
| <b>Available-for-sale</b>  |                        |                      |                        |                      |               |                      |
| Municipal bonds  | \$ 4,997               | \$ (1 )              | \$ —                   | \$ —                 | \$ 4,997      | \$ (1 )              |
| Mortgage-backed securities   | 7,096                  | (18 )                | 177                    | (5 )                 | 7,273         | (23 )                |
| Collateralized mortgage obligations:   |                        |                      |                        |                      |               |                      |
| Non-agency   | 343                    | (2 )                 | 211                    | (6 )                 | 554           | (8 )                 |
| Total temporarily impaired securities  | 12,436                 | (21 )                | 388                    | (11 )                | 12,824        | (32 )                |
| Other-than-temporarily impaired securities                                   |                        |                      |                        |                      |               |                      |
| Collateralized mortgage obligations:   |                        |                      |                        |                      |               |                      |
| Non-agency   | 217                    | (4 )                 | —                      | —                    | 217           | (4 )                 |
| Total temporarily impaired and other-than-temporarily<br>impaired securities | \$ 12,653              | \$ (25 )             | \$ 388                 | \$ (11 )             | \$ 13,041     | \$ (36 )             |

Salisbury evaluates securities for OTTI where the fair value of a security is less than its amortized cost basis at the balance sheet date. As part of this process, Salisbury considers whether it has the intent to sell each debt security and whether it is more likely than not that it will be required to sell the security before its anticipated recovery. If either of these conditions is met, Salisbury recognizes an OTTI charge to earnings equal to the entire difference between the security's amortized cost basis and its fair value at the balance sheet date. For securities that meet neither of these conditions, an analysis is performed to determine if any of these securities are at risk for OTTI.

The following summarizes, by security type, the basis for evaluating if the applicable securities were OTTI at March 31, 2016.

**U.S. Government agency mortgage-backed securities:** The contractual cash flows are guaranteed by U.S. government agencies and U.S. government-sponsored enterprises. Changes in fair values are a function of changes in investment spreads and interest rate movements and not changes in credit quality. Management expects to recover the entire amortized cost basis of these securities. Furthermore, Salisbury evaluates these securities for strategic fit and may reduce its position in these securities, although it is not more likely than not that Salisbury will be required to sell these securities before recovery of their cost basis, which may be maturity, and does not intend to sell these securities. Therefore, management does not consider these securities to be OTTI at March 31, 2016.

**Municipal bonds:** Contractual cash flows are performing as expected. Salisbury's portfolio is mostly comprised of tax-exempt general obligation bonds or public-purpose revenue bonds for schools, municipal offices, sewer infrastructure and fire houses, for small towns and municipalities across the United States. In the wake of the financial crisis, most monoline bond insurers had their ratings downgraded or withdrawn because of excessive exposure to insurance for collateralized debt obligations. Where appropriate, Salisbury performs credit underwriting reviews of unrated issuers, including some that have had their ratings withdrawn and are insured by insurers that have had their ratings withdrawn, to assess default risk. For all completed reviews, pass credit risk ratings have been assigned. Management expects to recover the entire amortized cost basis of these securities. It is not more likely than not that Salisbury will be required to sell these securities before recovery of their cost basis, which may be at maturity, and Salisbury does not intend to sell these securities. Therefore, management does not consider these securities to be OTTI at March 31, 2016.

**Non-agency CMOs:** Salisbury performed a detailed cash flow analysis of its non-agency CMOs at March 31, 2016, to assess whether any of the securities were OTTI. Salisbury uses cash flow forecasts for each security based on a variety of market driven assumptions and securitization terms, including prepayment speed, default or delinquency rate, and default severity for losses including interest, legal fees, property repairs, expenses and realtor fees, that, together with the loan amount are subtracted from collateral sales proceeds to determine severity. In 2009, Salisbury determined that five non-agency CMO securities reflected OTTI and recognized losses for deterioration in credit quality of \$1,128,000. Salisbury judged the four remaining securities not to have additional OTTI and all other CMO securities not to be OTTI as of March 31, 2016. It is possible that future loss assumptions could change necessitating Salisbury to recognize future OTTI for further deterioration in credit quality. Salisbury evaluates these securities for strategic fit and depending upon such factor could reduce its position in these securities, although it has no present intention to do so, and it is not more likely than not that Salisbury will be required to sell these securities before recovery of their cost bases.

The following table presents activity related to credit losses recognized into earnings on the non-agency CMOs held by Salisbury for which a portion of an OTTI charge was recognized in accumulated other comprehensive income:

| Three months ended March 31 (in thousands)                                      | 2016    | 2015    |
|---|---------|---------|
| Balance, beginning of period  | \$1,128 | \$1,128 |
| Credit component on debt securities in which OTTI was not previously recognized | —       | —       |
| Balance, end of period  | \$1,128 | \$1,128 |

The Federal Home Loan Bank of Boston (FHLBB) is a cooperative that provides services, including funding in the form of advances, to its member banking institutions. As a requirement of membership, the Bank must own a minimum amount of FHLBB stock, calculated periodically based primarily on its level of borrowings from the FHLBB. No market exists for shares of the FHLBB and therefore, they are carried at par value. FHLBB stock may be redeemed at par value five years following termination of FHLBB membership, subject to limitations which may be imposed by the FHLBB or its regulator, the Federal Housing Finance Board, to maintain capital adequacy of the FHLBB. While the Bank currently has no intentions to terminate its FHLBB membership, the ability to redeem its

investment in FHLBB stock would be subject to the conditions imposed by the FHLBB. Based on the capital adequacy and the liquidity position of the FHLBB, management believes there is no impairment related to the carrying amount of the Bank's FHLBB stock as of March 31, 2016. Deterioration of the FHLBB's capital levels may require the Bank to deem its restricted investment in FHLBB stock to be OTTI. If evidence of impairment exists in the future, the FHLBB stock would reflect fair value using either observable or unobservable inputs. The Bank will continue to monitor its investment in FHLBB stock.

**NOTE 3 – LOANS**

The composition of loans receivable and loans held-for-sale is as follows:

| (In thousands)                                | March 31, 2016 |           |           | December 31, 2015 |           |           |
|---|----------------|-----------|-----------|-------------------|-----------|-----------|
|   | Business       | Acquired  | Total     | Business          | Acquired  | Total     |
|   | Activities     | Loans     |           | Activities        | Loans     |           |
| Residential 1-4 family                        | \$274,881      | \$7,443   | \$282,324 | \$261,495         | \$7,799   | \$269,294 |
| Residential 5+ multifamily                    | 8,095          | 6,050     | 14,145    | 6,411             | 6,136     | 12,547    |
| Construction of residential 1-4 family        | 9,332          | —         | 9,332     | 7,998             | —         | 7,998     |
| Home equity lines of credit                   | 34,329         | —         | 34,329    | 35,017            | —         | 35,017    |
| Residential real estate                       | 326,637        | 13,493    | 340,130   | 310,921           | 13,935    | 324,856   |
| Commercial                                    | 136,315        | 86,500    | 222,815   | 129,446           | 88,829    | 218,275   |
| Construction of commercial                    | 10,145         | 4,903     | 15,048    | 6,525             | 4,874     | 11,399    |
| Commercial real estate                        | 146,460        | 91,403    | 237,863   | 135,971           | 93,703    | 229,674   |
| Farm land                                     | 4,007          | —         | 4,007     | 3,193             | —         | 3,193     |
| Vacant land                                   | 8,198          | —         | 8,198     | 8,563             | —         | 8,563     |
| Real estate secured                           | 485,302        | 104,896   | 590,198   | 458,648           | 107,638   | 566,286   |
| Commercial and industrial                     | 92,528         | 35,517    | 128,045   | 74,657            | 46,764    | 121,421   |
| Municipal                                     | 9,364          | —         | 9,364     | 9,566             | —         | 9,566     |
| Consumer                                      | 5,806          | 76        | 5,882     | 6,195             | 77        | 6,272     |
| Loans receivable, gross                       | 593,000        | 140,489   | 733,489   | 549,066           | 154,479   | 703,545   |
| Deferred loan origination fees and costs, net | 1,233          | —         | 1,233     | 1,189             | —         | 1,189     |
| Allowance for loan losses                     | (5,573 )       | (304 )    | (5,877 )  | (5,481 )          | (235 )    | (5,716 )  |
| Loans receivable, net                         | \$588,660      | \$140,185 | \$728,845 | \$544,774         | \$154,244 | \$699,018 |
| Loans held-for-sale                           |                |           |           |                   |           |           |
| Residential 1-4 family                        | \$183          | \$—       | \$183     | \$763             | \$—       | \$763     |

**Concentrations of Credit Risk**

Salisbury's loans consist primarily of residential and commercial real estate loans located principally in northwestern Connecticut, New York and Massachusetts towns, which constitute Salisbury's service area. Salisbury offers a broad range of loan and credit facilities to borrowers in its service area, including residential mortgage loans, commercial real estate loans, construction loans, working capital loans, equipment loans, and a variety of consumer loans, including home equity lines of credit, and installment and collateral loans. All residential and commercial mortgage loans are collateralized by first or second mortgages on real estate. The ability of single family residential and consumer borrowers to honor their repayment commitments is generally dependent on the level of overall economic activity within the market area and real estate values. The ability of commercial borrowers to honor their repayment commitments is dependent on the general economy as well as the health of the real estate economic sector in Salisbury's market area.

**Loan Credit Quality**

The composition of loans receivable by risk rating grade is as follows:

**Business Activities Loans**

| (in thousands)                         | Pass      | Special<br>mention | Substandard | Doubtful | Loss | Total     |
|--|-----------|--------------------|-------------|----------|------|-----------|
| March 31, 2016                         |           |                    |             |          |      |           |
| Residential 1-4 family                 | \$260,994 | \$6,386            | \$ 7,411    | \$ 90    | \$ — | \$274,881 |
| Residential 5+ multifamily             | 6,075     | 1,931              | 89          | —        | —    | 8,095     |
| Construction of residential 1-4 family | 8,445     | 887                | —           | —        | —    | 9,332     |
| Home equity lines of credit            | 32,954    | 510                | 865         | —        | —    | 34,329    |
| Residential real estate                | 308,468   | 9,714              | 8,365       | 90       | —    | 326,637   |
| Commercial                             | 125,703   | 5,269              | 5,343       | —        | —    | 136,315   |
| Construction of commercial             | 10,025    | —                  | 120         | —        | —    | 10,145    |
| Commercial real estate                 | 135,728   | 5,269              | 5,463       | —        | —    | 146,460   |
| Farm land                              | 2,983     | —                  | 1,024       | —        | —    | 4,007     |
| Vacant land                            | 5,207     | 67                 | 2,924       | —        | —    | 8,198     |
| Real estate secured                    | 452,386   | 15,050             | 17,776      | 90       | —    | 485,302   |
| Commercial and industrial              | 88,953    | 2,995              | 578         | 2        | —    | 92,528    |
| Municipal                              | 9,364     | —                  | —           | —        | —    | 9,364     |
| Consumer                               | 5,788     | 17                 | 1           | —        | —    | 5,806     |
| Loans receivable, gross                | \$556,491 | \$18,062           | \$ 18,355   | \$ 92    | \$ — | \$593,000 |
| Acquired Loans                         |           |                    |             |          |      |           |

| (in thousands)                         | Pass      | Special<br>mention | Substandard | Doubtful | Loss | Total     |
|--|-----------|--------------------|-------------|----------|------|-----------|
| March 31, 2016                         |           |                    |             |          |      |           |
| Residential 1-4 family                 | \$6,663   | \$—                | \$ 780      | \$ —     | \$ — | \$7,443   |
| Residential 5+ multifamily             | 5,927     | —                  | 123         | —        | —    | 6,050     |
| Construction of residential 1-4 family | —         | —                  | —           | —        | —    | —         |
| Home equity lines of credit            | —         | —                  | —           | —        | —    | —         |
| Residential real estate                | 12,590    | —                  | 903         | —        | —    | 13,493    |
| Commercial                             | 77,995    | 3,067              | 5,438       | —        | —    | 86,500    |
| Construction of commercial             | 4,645     | —                  | 258         | —        | —    | 4,903     |
| Commercial real estate                 | 82,640    | 3,067              | 5,696       | —        | —    | 91,403    |
| Farm land                              | —         | —                  | —           | —        | —    | —         |
| Vacant land                            | —         | —                  | —           | —        | —    | —         |
| Real estate secured                    | 95,230    | 3,067              | 6,599       | —        | —    | 104,896   |
| Commercial and industrial              | 34,007    | 917                | 509         | 84       | —    | 35,517    |
| Municipal                              | —         | —                  | —           | —        | —    | —         |
| Consumer                               | 71        | 5                  | —           | —        | —    | 76        |
| Loans receivable, gross                | \$129,308 | \$3,989            | \$ 7,108    | \$ 84    | \$ — | \$140,489 |

## Business Activities Loans

| (in thousands)                         | Pass      | Special<br>mention | Substandard | Doubtful | Loss | Total     |
|--|-----------|--------------------|-------------|----------|------|-----------|
| December 31, 2015                      |           |                    |             |          |      |           |
| Residential 1-4 family                 | \$248,027 | \$6,933            | \$ 6,444    | \$ 91    | \$ — | \$261,495 |
| Residential 5+ multifamily             | 4,507     | 1,815              | 89          | —        | —    | 6,411     |
| Construction of residential 1-4 family | 7,111     | 887                | —           | —        | —    | 7,998     |
| Home equity lines of credit            | 33,687    | 545                | 785         | —        | —    | 35,017    |
| Residential real estate                | 293,332   | 10,180             | 7,318       | 91       | —    | 310,921   |
| Commercial                             | 120,903   | 4,801              | 3,742       | —        | —    | 129,446   |
| Construction of commercial             | 6,525     | —                  | —           | —        | —    | 6,525     |
| Commercial real estate                 | 127,428   | 4,801              | 3,742       | —        | —    | 135,971   |
| Farm land                              | 2,162     | —                  | 1,031       | —        | —    | 3,193     |
| Vacant land                            | 5,567     | 69                 | 2,927       | —        | —    | 8,563     |
| Real estate secured                    | 428,489   | 15,050             | 15,018      | 91       | —    | 458,648   |
| Commercial and industrial              | 72,887    | 1,214              | 555         | 1        | —    | 74,657    |
| Municipal                              | 9,566     | —                  | —           | —        | —    | 9,566     |
| Consumer                               | 6,171     | 18                 | 6           | —        | —    | 6,195     |
| Loans receivable, gross                | \$517,113 | \$16,282           | \$ 15,579   | \$ 92    | \$ — | \$549,066 |
| Acquired Loans                         |           |                    |             |          |      |           |

| (in thousands)                         | Pass      | Special<br>mention | Substandard | Doubtful | Loss | Total     |
|--|-----------|--------------------|-------------|----------|------|-----------|
| December 31, 2015                      |           |                    |             |          |      |           |
| Residential 1-4 family                 | \$6,824   | \$199              | \$ 776      | \$ —     | \$ — | \$7,799   |
| Residential 5+ multifamily             | 6,136     | —                  | —           | —        | —    | 6,136     |
| Construction of residential 1-4 family | —         | —                  | —           | —        | —    | —         |
| Home equity lines of credit            | —         | —                  | —           | —        | —    | —         |
| Residential real estate                | 12,960    | 199                | 776         | —        | —    | 13,935    |
| Commercial                             | 80,406    | 4,005              | 4,418       | —        | —    | 88,829    |
| Construction of commercial             | 4,612     | —                  | 262         | —        | —    | 4,874     |
| Commercial real estate                 | 85,018    | 4,005              | 4,680       | —        | —    | 93,703    |
| Farm land                              | —         | —                  | —           | —        | —    | —         |
| Vacant land                            | —         | —                  | —           | —        | —    | —         |
| Real estate secured                    | 97,978    | 4,204              | 5,456       | —        | —    | 107,638   |
| Commercial and industrial              | 45,363    | 875                | 443         | 83       | —    | 46,764    |
| Municipal                              | —         | —                  | —           | —        | —    | —         |
| Consumer                               | 71        | 6                  | —           | —        | —    | 77        |
| Loans receivable, gross                | \$143,412 | \$5,085            | \$ 5,899    | \$ 83    | \$ — | \$154,479 |

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The composition of loans receivable by delinquency status is as follows:

Business Activities Loans

| (in thousands)                         | Current   | Past due  |            |            |             |             | 180 days and over | 30 days and over | Accruing 90 days and over | Non-accrual |
|--|-----------|-----------|------------|------------|-------------|-------------|-------------------|------------------|---------------------------|-------------|
|  |           | 1-29 days | 30-59 days | 60-89 days | 90-179 days | 90-179 days |                   |                  |                           |             |
| March 31, 2016                         |           |           |            |            |             |             |                   |                  |                           |             |
| Residential 1-4 family                 | \$267,101 | \$1,334   | \$3,509    | \$75       | \$—         | \$—         | \$2,862           | \$6,446          | \$—                       | \$5,834     |
| Residential 5+ multifamily             | 7,946     | 60        | —          | —          | —           | —           | 89                | 89               | —                         | —           |
| Construction of residential 1-4 family | 9,160     | 172       | —          | —          | —           | —           | —                 | —                | —                         | —           |
| Home equity lines of credit            | 33,395    | 434       | 218        | 43         | 150         | 89          | 500               | —                | —                         | 701         |
| Residential real estate                | 317,602   | 2,000     | 3,727      | 118        | 150         | 3,040       | 7,035             | —                | —                         | 6,535       |
| Commercial                             | 133,401   | 156       | 833        | 668        | 342         | 915         | 2,758             | —                | —                         | 2,557       |
| Construction of commercial             | 10,145    | —         | —          | —          | —           | —           | —                 | —                | —                         | —           |
| Commercial real estate                 | 143,546   | 156       | 833        | 668        | 342         | 915         | 2,758             | —                | —                         | 2,557       |
| Farm land                              | 2,983     | 301       | —          | —          | —           | 723         | 723               | —                | —                         | 1,024       |
| Vacant land                            | 5,371     | —         | 4          | —          | —           | 2,823       | 2,827             | —                | —                         | 2,854       |
| Real estate secured                    | 469,502   | 2,457     | 4,564      | 786        | 492         | 7,501       | 13,343            | —                | —                         | 12,970      |
| Commercial and industrial              | 90,851    | 398       | 973        | 288        | —           | 18          | 1,279             | —                | —                         | 447         |
| Municipal                              | 9,364     | —         | —          | —          | —           | —           | —                 | —                | —                         | —           |
| Consumer                               | 5,763     | 24        | 15         | 4          | —           | —           | 19                | —                | —                         | —           |
| Loans receivable, gross                | \$575,480 | \$2,879   | \$5,552    | \$1,078    | \$492       | \$7,519     | \$14,641          | \$—              | \$—                       | \$13,417    |
| Acquired Loans                         |           |           |            |            |             |             |                   |                  |                           |             |

| (in thousands)                         | Current   | Past due  |            |            |             |             | 180 days and over | 30 days and over | Accruing 90 days and over | Non-accrual |
|--|-----------|-----------|------------|------------|-------------|-------------|-------------------|------------------|---------------------------|-------------|
|  |           | 1-29 days | 30-59 days | 60-89 days | 90-179 days | 90-179 days |                   |                  |                           |             |
| March 31, 2016                         |           |           |            |            |             |             |                   |                  |                           |             |
| Residential 1-4 family                 | \$6,664   | \$—       | \$—        | \$—        | \$—         | \$—         | \$779             | \$779            | \$—                       | \$779       |
| Residential 5+ multifamily             | 5,168     | 759       | —          | —          | —           | 123         | —                 | 123              | —                         | 123         |
| Construction of residential 1-4 family | —         | —         | —          | —          | —           | —           | —                 | —                | —                         | —           |
| Home equity lines of credit            | —         | —         | —          | —          | —           | —           | —                 | —                | —                         | —           |
| Residential real estate                | 11,832    | 759       | —          | —          | 123         | 779         | 902               | —                | —                         | 902         |
| Commercial                             | 80,481    | 2,635     | 1,605      | —          | —           | 1,779       | 3,384             | —                | —                         | 1,839       |
| Construction of commercial             | 4,645     | —         | —          | —          | —           | 258         | 258               | —                | —                         | 258         |
| Commercial real estate                 | 85,126    | 2,635     | 1,605      | —          | —           | 2,037       | 3,642             | —                | —                         | 2,097       |
| Farm land                              | —         | —         | —          | —          | —           | —           | —                 | —                | —                         | —           |
| Vacant land                            | —         | —         | —          | —          | —           | —           | —                 | —                | —                         | —           |
| Real estate secured                    | 96,958    | 3,394     | 1,605      | —          | 123         | 2,816       | 4,544             | —                | —                         | 2,999       |
| Commercial and industrial              | 33,725    | 844       | 123        | 825        | —           | —           | 948               | —                | —                         | 414         |
| Municipal                              | —         | —         | —          | —          | —           | —           | —                 | —                | —                         | —           |
| Consumer                               | 72        | 4         | —          | —          | —           | —           | —                 | —                | —                         | —           |
| Loans receivable, gross                | \$130,755 | \$4,242   | \$1,728    | \$825      | \$123       | \$2,816     | \$5,492           | \$—              | \$—                       | \$3,413     |





The composition of loans receivable by delinquency status is as follows:

#### Business Activities Loans

| (in thousands)                         | Current   | Past due     |               |               |                | 90-179<br>days | 180<br>days<br>and<br>over | 30<br>days<br>and<br>over | Accruing Non-       |         |
|--|-----------|--------------|---------------|---------------|----------------|----------------|----------------------------|---------------------------|---------------------|---------|
|  |           | 1-29<br>days | 30-59<br>days | 60-89<br>days | 90-179<br>days |                |                            |                           | 90 days<br>and over | accrual |
| December 31, 2015                      |           |              |               |               |                |                |                            |                           |                     |         |
| Residential 1-4 family                 | \$254,152 | \$1,781      | \$1,931       | \$683         | \$973          | \$1,975        | \$5,562                    | \$ —                      | \$5,671             |         |
| Residential 5+ multifamily             | 6,254     | —            | 68            | —             | —              | 89             | 157                        | —                         | 89                  |         |
| Construction of residential 1-4 family | 7,826     | 172          | —             | —             | —              | —              | —                          | —                         | —                   |         |
| Home equity lines of credit            | 33,744    | 363          | 306           | 101           | 113            | 390            | 910                        | —                         | 601                 |         |
| Residential real estate                | 301,976   | 2,316        | 2,305         | 784           | 1,086          | 2,454          | 6,629                      | —                         | 6,361               |         |
| Commercial                             | 126,440   | 1,618        | 474           | —             | 233            | 681            | 1,388                      | —                         | 2,349               |         |
| Construction of commercial             | 6,525     | —            | —             | —             | —              | —              | —                          | —                         | —                   |         |
| Commercial real estate                 | 132,965   | 1,618        | 474           | —             | 233            | 681            | 1,388                      | —                         | 2,349               |         |
| Farm land                              | 2,172     | 298          | —             | —             | —              | 723            | 723                        | —                         | 1,031               |         |
| Vacant land                            | 5,734     | —            | 6             | —             | —              | 2,823          | 2,829                      | —                         | 2,855               |         |
| Real estate secured                    | 442,847   | 4,232        | 2,785         | 784           | 1,319          | 6,681          | 11,569                     | —                         | 12,596              |         |
| Commercial and industrial              | 73,698    | 906          | 35            | —             | —              | 18             | 53                         | —                         | 461                 |         |
| Municipal                              | 9,566     | —            | —             | —             | —              | —              | —                          | —                         | —                   |         |
| Consumer                               | 6,096     | 61           | 21            | 17            | —              | —              | 38                         | —                         | 80                  |         |
| Loans receivable, gross                | \$532,207 | \$5,199      | \$2,841       | \$801         | \$1,319        | \$6,699        | \$11,660                   | \$ —                      | \$13,137            |         |

#### Acquired Loans

| (in thousands)                         | Current   | Past due     |               |               |                | 90-179<br>days | 180<br>days<br>and<br>over | 30<br>days<br>and<br>over | Accruing Non-       |         |
|--|-----------|--------------|---------------|---------------|----------------|----------------|----------------------------|---------------------------|---------------------|---------|
|  |           | 1-29<br>days | 30-59<br>days | 60-89<br>days | 90-179<br>days |                |                            |                           | 90 days<br>and over | accrual |
| December 31, 2015                      |           |              |               |               |                |                |                            |                           |                     |         |
| Residential 1-4 family                 | \$6,823   | \$—          | \$—           | \$110         | \$—            | \$866          | \$976                      | \$ 90                     | \$776               |         |
| Residential 5+ multifamily             | 6,136     | —            | —             | —             | —              | —              | —                          | —                         | —                   |         |
| Construction of residential 1-4 family | —         | —            | —             | —             | —              | —              | —                          | —                         | —                   |         |
| Home equity lines of credit            | —         | —            | —             | —             | —              | —              | —                          | —                         | —                   |         |
| Residential real estate                | 12,959    | —            | —             | 110           | —              | 866            | 976                        | 90                        | 776                 |         |
| Commercial                             | 81,140    | 4,848        | 916           | —             | —              | 1,925          | 2,841                      | —                         | 2,000               |         |
| Construction of commercial             | 4,612     | —            | —             | —             | —              | 262            | 262                        | —                         | 262                 |         |
| Commercial real estate                 | 85,752    | 4,848        | 916           | —             | —              | 2,187          | 3,103                      | —                         | 2,262               |         |
| Farm land                              | —         | —            | —             | —             | —              | —              | —                          | —                         | —                   |         |
| Vacant land                            | —         | —            | —             | —             | —              | —              | —                          | —                         | —                   |         |
| Real estate secured                    | 98,711    | 4,848        | 916           | 110           | —              | 3,053          | 4,079                      | 90                        | 3,038               |         |
| Commercial and industrial              | 46,128    | 471          | 83            | 82            | —              | —              | 165                        | —                         | —                   |         |
| Municipal                              | —         | —            | —             | —             | —              | —              | —                          | —                         | —                   |         |
| Consumer                               | 77        | —            | —             | —             | —              | —              | —                          | —                         | —                   |         |
| Loans receivable, gross                | \$144,916 | \$5,319      | \$999         | \$192         | \$—            | 3,053          | \$4,244                    | \$ 90                     | \$3,038             |         |

Interest on non-accrual loans that would have been recorded as additional interest income for the quarters ended March 31, 2016 and 2015 had the loans been current in accordance with their original terms totaled \$365,000 and \$135,000, respectively.

### Troubled Debt Restructurings

Troubled debt restructurings occurring during the periods are as follows:

#### Business Activities Loans

| (in thousands)  | March 31, 2016                      |                         | March 31, 2015                      |                         |        |        |
|---|-------------------------------------|-------------------------|-------------------------------------|-------------------------|--------|--------|
|   | Pre-                                | Post-                   | Pre-                                | Post-                   |        |        |
|   | Quantity<br>modification<br>balance | modification<br>balance | Quantity<br>modification<br>balance | modification<br>balance |        |        |
| Residential real estate   | 1                                   | \$ 89                   | \$ 89                               | 1                       | \$ 51  | \$ 51  |
| Commercial real estate  | —                                   | —                       | —                                   | 1                       | 297    | 297    |
| Home equity lines of credit   | —                                   | —                       | —                                   | —                       | —      | —      |
| Troubled debt restructurings  | 1                                   | \$ 89                   | \$ 89                               | 2                       | \$ 348 | \$ 348 |
| Refinance   | 1                                   | \$ 89                   | \$ 89                               | —                       | —      | —      |
| Rate reduction and term extension                                       | —                                   | —                       | —                                   | 1                       | \$ 297 | \$ 297 |
| Debt consolidation and term extension                                   | —                                   | —                       | —                                   | —                       | —      | —      |
| Debt consolidation, rate reduction, term extension and note bifurcation | —                                   | —                       | —                                   | 1                       | 51     | 51     |
| Term extension  | —                                   | —                       | —                                   | —                       | —      | —      |
| Troubled debt restructurings  | 1                                   | \$ 89                   | \$ 89                               | 2                       | \$ 348 | \$ 348 |

#### Acquired Loans

| (in thousands)                    | March 31, 2016                      |                         | March 31, 2015                      |                         |      |   |
|-----------------------------------|-------------------------------------|-------------------------|-------------------------------------|-------------------------|------|---|
|                                   | Pre-                                | Post-                   | Pre-                                | Post-                   |      |   |
|                                   | Quantity<br>modification<br>balance | modification<br>balance | Quantity<br>modification<br>balance | modification<br>balance |      |   |
| Commercial real estate            | —                                   | \$ —                    | \$ —                                | —                       | \$ — | — |
| Troubled debt restructurings      | —                                   | —                       | —                                   | —                       | —    | — |
| Rate reduction and term extension | —                                   | —                       | —                                   | —                       | —    | — |
| Troubled debt restructurings      | —                                   | —                       | —                                   | —                       | —    | — |

One loan has been modified as a troubled debt restructure during 2016 and was not past due at March 31, 2016.

### Allowance for Loan Losses

Changes in the allowance for loan losses are as follows:

| (in thousands)            | Business Activities Loans |                        |                 |                 |                   | Acquired Loans       |                        |                 |                 |                   |
|---------------------------|---------------------------|------------------------|-----------------|-----------------|-------------------|----------------------|------------------------|-----------------|-----------------|-------------------|
|                           | March 31, 2016            |                        |                 |                 |                   | March 31, 2016       |                        |                 |                 |                   |
|                           | Beginning<br>balance      | Provision<br>(benefit) | Charge-<br>offs | Reco-<br>veries | Ending<br>balance | Beginning<br>balance | Provision<br>(benefit) | Charge-<br>offs | Reco-<br>veries | Ending<br>balance |
| Residential               | \$2,477                   | \$ 86                  | \$(106 )        | \$ 1            | \$2,458           | \$79                 | \$(10 )                | \$ —            | \$ —            | \$ 69             |
| Commercial                | 1,466                     | 154                    | (36 )           | 1               | 1,585             | 132                  | 56                     | (96 )           | 2               | 94                |
| Land                      | 188                       | (1 )                   | (23 )           | —               | 164               | —                    | —                      | —               | —               | —                 |
| Real estate               | 4,131                     | 239                    | (165 )          | 2               | 4,207             | 211                  | 46                     | (96 )           | 2               | 163               |
| Commercial and industrial | 683                       | 125                    | (31 )           | 4               | 781               | 24                   | 114                    | (1 )            | 4               | 141               |
| Municipal                 | 61                        | (2 )                   | —               | —               | 59                | —                    | —                      | —               | —               | —                 |

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|             |         |        |           |      |         |       |        |          |      |        |
|-------------|---------|--------|-----------|------|---------|-------|--------|----------|------|--------|
| Consumer    | 124     | 11     | (23 )     | 2    | 114     | —     | —      | —        | —    | —      |
| Unallocated | 482     | (70 )  | —         | —    | 412     | —     | —      | —        | —    | —      |
| Totals      | \$5,481 | \$ 303 | \$ (219 ) | \$ 8 | \$5,573 | \$235 | \$ 160 | \$ (97 ) | \$ 6 | \$ 304 |

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| (in thousands)            | Business Activities Loans |                     |             |            |                | Acquired Loans    |                     |             |            |                |
|---------------------------|---------------------------|---------------------|-------------|------------|----------------|-------------------|---------------------|-------------|------------|----------------|
|                           | December 31, 2015         |                     |             |            |                | December 31, 2015 |                     |             |            |                |
|                           | Beginning balance         | Provision (benefit) | Charge-offs | Recoveries | Ending balance | Beginning balance | Provision (benefit) | Charge-offs | Recoveries | Ending balance |
| Residential               | \$2,306                   | \$ 746              | \$(698 )    | \$123      | \$2,477        | \$—               | \$ 79               | \$—         | \$—        | \$ 79          |
| Commercial                | 1,697                     | (18 )               | (214 )      | 1          | 1,466          | 7                 | 136                 | (16 )       | 5          | 132            |
| Land                      | 164                       | 157                 | (133 )      | —          | 188            | —                 | —                   | —           | —          | —              |
| Real estate               | 4,167                     | 885                 | (1,045 )    | 124        | 4,131          | 7                 | 215                 | (16 )       | 5          | 211            |
| Commercial and industrial | 583                       | (295 )              | (69 )       | 464        | 683            | 14                | (24 )               | —           | 34         | 24             |
| Municipal                 | 61                        | —                   | —           | —          | 61             | —                 | —                   | —           | —          | —              |
| Consumer                  | 117                       | 71                  | (82 )       | 18         | 124            | —                 | (8 )                | —           | 8          | —              |
| Unallocated               | 409                       | 73                  | —           | —          | 482            | —                 | —                   | —           | —          | —              |
| Totals                    | \$5,337                   | \$ 734              | \$(1,196)   | \$606      | \$5,481        | \$21              | \$ 183              | \$(16 )     | \$47       | \$ 235         |

The composition of loans receivable and the allowance for loan losses is as follows:

#### Business Activities Loans

| (in thousands)                         | Collectively evaluated |           | Individually evaluated |           | Total portfolio |           |
|--|------------------------|-----------|------------------------|-----------|-----------------|-----------|
|  | Loans                  | Allowance | Loans                  | Allowance | Loans           | Allowance |
| March 31, 2016                         |                        |           |                        |           |                 |           |
| Residential 1-4 family                 | \$266,482              | \$1,534   | \$8,399                | \$474     | \$274,881       | \$2,008   |
| Residential 5+ multifamily             | 6,330                  | 45        | 1,765                  | —         | 8,095           | 45        |
| Construction of residential 1-4 family | 9,332                  | 75        | —                      | —         | 9,332           | 75        |
| Home equity lines of credit            | 33,511                 | 309       | 818                    | 21        | 34,329          | 330       |
| Residential real estate                | 315,655                | 1,963     | 10,982                 | 495       | 326,637         | 2,458     |
| Commercial                             | 132,084                | 1,377     | 4,231                  | 80        | 136,315         | 1,457     |
| Construction of commercial             | 10,025                 | 127       | 120                    | 1         | 10,145          | 128       |
| Commercial real estate                 | 142,109                | 1,504     | 4,351                  | 81        | 146,460         | 1,585     |
| Farm land                              | 2,983                  | 24        | 1,024                  | 1         | 4,007           | 25        |
| Vacant land                            | 5,125                  | 120       | 3,073                  | 19        | 8,198           | 139       |
| Real estate secured                    | 465,872                | 3,611     | 19,430                 | 596       | 485,302         | 4,207     |
| Commercial and industrial              | 92,019                 | 780       | 509                    | 1         | 92,528          | 781       |
| Municipal                              | 9,364                  | 59        | —                      | —         | 9,364           | 59        |
| Consumer                               | 5,806                  | 114       | —                      | —         | 5,806           | 114       |
| Unallocated allowance                  | —                      | 412       | —                      | —         | —               | 412       |
| Totals                                 | \$573,061              | \$4,976   | \$19,939               | \$597     | \$593,000       | \$5,573   |

## Acquired Loans

| (in thousands)                         | Collectively evaluated |           | Individually evaluated |           | ASC 310-30 loans |           | Total portfolio |           |
|--|------------------------|-----------|------------------------|-----------|------------------|-----------|-----------------|-----------|
|  | Loans                  | Allowance | Loans                  | Allowance | Loans            | Allowance | Loans           | Allowance |
| March 31, 2016                         |                        |           |                        |           |                  |           |                 |           |
| Residential 1-4 family                 | \$6,664                | \$—       | \$779                  | \$69      | \$—              | \$—       | \$7,443         | \$69      |
| Residential 5+ multifamily             | 5,927                  | —         | 123                    | —         | —                | —         | 6,050           | —         |
| Construction of residential 1-4 family | —                      | —         | —                      | —         | —                | —         | —               | —         |
| Home equity lines of credit            | —                      | —         | —                      | —         | —                | —         | —               | —         |
| Residential real estate                | 12,591                 | —         | 902                    | 69        | —                | —         | 13,493          | 69        |
| Commercial                             | 79,134                 | 19        | 2,585                  | 27        | 4,781            | 44        | 86,500          | 90        |
| Construction of commercial             | 4,645                  | 4         | 258                    | —         | —                | —         | 4,903           | 4         |
| Commercial real estate                 | 83,779                 | 23        | 2,843                  | 27        | 4,781            | 44        | 91,403          | 94        |
| Farm land                              | —                      | —         | —                      | —         | —                | —         | —               | —         |
| Vacant land                            | —                      | —         | —                      | —         | —                | —         | —               | —         |
| Real estate secured                    | 96,370                 | 23        | 3,745                  | 96        | 4,781            | 44        | 104,896         | 163       |
| Commercial and industrial              | 34,475                 | 21        | 414                    | 114       | 628              | 6         | 35,517          | 141       |
| Municipal                              | —                      | —         | —                      | —         | —                | —         | —               | —         |
| Consumer                               | 60                     | —         | —                      | —         | 16               | —         | 76              | —         |
| Unallocated allowance                  | —                      | —         | —                      | —         | —                | —         | —               | —         |
| Totals                                 | \$130,905              | \$44      | \$4,159                | \$210     | \$5,425          | \$50      | \$140,489       | \$304     |

## Business Activities Loans

| (in thousands)                         | Collectively evaluated |           | Individually evaluated |           | Total portfolio |           |
|--|------------------------|-----------|------------------------|-----------|-----------------|-----------|
|  | Loans                  | Allowance | Loans                  | Allowance | Loans           | Allowance |
| December 31, 2015                      |                        |           |                        |           |                 |           |
| Residential 1-4 family                 | \$253,156              | \$1,415   | \$8,339                | \$610     | \$261,495       | \$2,025   |
| Residential 5+ multifamily             | 4,640                  | 33        | 1,771                  | —         | 6,411           | 33        |
| Construction of residential 1-4 family | 7,998                  | 65        | —                      | —         | 7,998           | 65        |
| Home equity lines of credit            | 34,298                 | 286       | 719                    | 68        | 35,017          | 354       |
| Residential real estate                | 300,092                | 1,799     | 10,829                 | 678       | 310,921         | 2,477     |
| Commercial                             | 125,173                | 1,265     | 4,273                  | 113       | 129,446         | 1,378     |
| Construction of commercial             | 6,403                  | 87        | 122                    | 1         | 6,525           | 88        |
| Commercial real estate                 | 131,576                | 1,352     | 4,395                  | 114       | 135,971         | 1,466     |
| Farm land                              | 2,162                  | 23        | 1,031                  | 14        | 3,193           | 37        |
| Vacant land                            | 5,486                  | 122       | 3,077                  | 29        | 8,563           | 151       |
| Real estate secured                    | 439,316                | 3,296     | 19,332                 | 835       | 458,648         | 4,131     |
| Commercial and industrial              | 74,131                 | 673       | 526                    | 10        | 74,657          | 683       |
| Municipal                              | 9,566                  | 61        | —                      | —         | 9,566           | 61        |

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|                       |           |         |          |       |           |         |
|-----------------------|-----------|---------|----------|-------|-----------|---------|
| Consumer              | 6,115     | 124     | 80       | —     | 6,195     | 124     |
| Unallocated allowance | —         | 482     | —        | —     | —         | 482     |
| Totals                | \$529,128 | \$4,636 | \$19,938 | \$845 | \$549,066 | \$5,481 |



## Acquired Loans

| (in thousands)                         | Collectively evaluated |           | Individually evaluated |           | ASC 310-30 loans |           | Total portfolio |           |
|--|------------------------|-----------|------------------------|-----------|------------------|-----------|-----------------|-----------|
|  | Loans                  | Allowance | Loans                  | Allowance | Loans            | Allowance | Loans           | Allowance |
| December 31, 2015                      |                        |           |                        |           |                  |           |                 |           |
| Residential 1-4 family                 | \$7,023                | \$—       | \$776                  | \$79      | \$—              | \$—       | \$7,799         | \$79      |
| Residential 5+ multifamily             | 6,136                  | —         | —                      | —         | —                | —         | 6,136           | —         |
| Construction of residential 1-4 family | —                      | —         | —                      | —         | —                | —         | —               | —         |
| Home equity lines of credit            | —                      | —         | —                      | —         | —                | —         | —               | —         |
| Residential real estate                | 13,159                 | —         | 776                    | 79        | —                | —         | 13,935          | 79        |
| Commercial                             | 81,300                 | 19        | 2,742                  | 107       | 4,787            | 2         | 88,829          | 128       |
| Construction of commercial             | 4,612                  | 4         | 262                    | —         | —                | —         | 4,874           | 4         |
| Commercial real estate                 | 85,912                 | 23        | 3,004                  | 107       | 4,787            | 2         | 93,703          | 132       |
| Farm land                              | —                      | —         | —                      | —         | —                | —         | —               | —         |
| Vacant land                            | —                      | —         | —                      | —         | —                | —         | —               | —         |
| Real estate secured                    | 99,071                 | 23        | 3,780                  | 186       | 4,787            | 2         | 107,638         | 211       |
| Commercial and industrial              | 45,650                 | 24        | —                      | —         | 1,114            | —         | 46,764          | 24        |
| Municipal                              | —                      | —         | —                      | —         | —                | —         | —               | —         |
| Consumer                               | 61                     | —         | —                      | —         | 16               | —         | 77              | —         |
| Unallocated allowance                  | —                      | —         | —                      | —         | —                | —         | —               | —         |
| Totals                                 | \$144,782              | \$47      | \$3,780                | \$186     | \$5,917          | \$2       | \$154,479       | \$235     |

The credit quality segments of loans receivable and the allowance for loan losses are as follows:

## Business Activities Loans

| <b>March 31, 2016 (in thousands)</b> | Collectively evaluated |           | Individually evaluated |           | Total portfolio |           |
|--------------------------------------|------------------------|-----------|------------------------|-----------|-----------------|-----------|
|                                      | Loans                  | Allowance | Loans                  | Allowance | Loans           | Allowance |
| Performing loans                     | \$569,493              | \$4,429   | \$—                    | \$—       | \$569,493       | \$4,429   |
| Potential problem loans              | 3,568                  | 135       | —                      | —         | 3,568           | 135       |
| Impaired loans                       | —                      | —         | 19,939                 | 597       | 19,939          | 597       |
| Unallocated allowance                | —                      | 412       | —                      | —         | —               | 412       |
| Totals                               | \$573,061              | \$4,976   | \$19,939               | \$597     | \$593,000       | \$5,573   |

## Acquired Loans

Collectively evaluated      Individually evaluated      Total portfolio

**March 31, 2016 (in thousands)**

|                         | Loans     | Allowance | Loans   | Allowance | Loans     | Allowance |
|-------------------------|-----------|-----------|---------|-----------|-----------|-----------|
| Performing loans        | \$133,381 | \$51      | \$—     | \$—       | \$133,381 | \$51      |
| Potential problem loans | 2,949     | 42        | —       | —         | 2,949     | 42        |
| Impaired loans          | —         | —         | 4,159   | 211       | 4,159     | 211       |
| Unallocated allowance   | —         | —         | —       | —         | —         | —         |
| Totals                  | \$136,330 | \$93      | \$4,159 | \$211     | \$140,489 | \$304     |

Business Activities Loans

**December 31, 2015 (in thousands)**

|                         | Collectively evaluated |           | Individually evaluated |           | Total portfolio |           |
|-------------------------|------------------------|-----------|------------------------|-----------|-----------------|-----------|
|                         | Loans                  | Allowance | Loans                  | Allowance | Loans           | Allowance |
| Performing loans        | \$527,905              | \$4,110   | \$—                    | \$—       | \$527,905       | \$4,110   |
| Potential problem loans | 1,223                  | 44        | —                      | —         | 1,223           | 44        |
| Impaired loans          | —                      | —         | 19,938                 | 845       | 19,938          | 845       |
| Unallocated allowance   | —                      | 482       | —                      | —         | —               | 482       |
| Totals                  | \$529,128              | \$4,636   | \$19,938               | \$845     | \$549,066       | \$5,481   |

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## Acquired Loans

| December 31, 2015 (in thousands) | Collectively evaluated |           | Individually evaluated |           | Total portfolio |           |
|----------------------------------|------------------------|-----------|------------------------|-----------|-----------------|-----------|
|                                  | Loans                  | Allowance | Loans                  | Allowance | Loans           | Allowance |
| Performing loans                 | \$148,580              | \$46      | \$—                    | \$—       | \$148,580       | \$46      |
| Potential problem loans          | 2,119                  | 2         | —                      | —         | 2,119           | 2         |
| Impaired loans                   | —                      | —         | 3,780                  | 187       | 3,780           | 187       |
| Unallocated allowance            | —                      | —         | —                      | —         | —               | —         |
| Totals                           | \$150,699              | \$48      | \$3,780                | \$187     | \$154,479       | \$235     |

A specific valuation allowance is established for the impairment amount of each impaired loan, calculated using the fair value of expected cash flows or collateral, in accordance with the most likely means of recovery. Certain data with respect to loans individually evaluated for impairment is as follows:

## Business Activities Loans

| (in thousands)                        | Impaired loans with specific allowance |          |          |           |            | Impaired loans with no specific allowance |         |         |            |
|---------------------------------------|--|----------|----------|-----------|------------|---|---------|---------|------------|
|                                       | Loan balance                           |          |          | Specific  | Income     | Loan balance                              |         |         | Income     |
|                                       | Book                                   | Note     | Average  | allowance | recognized | Book                                      | Note    | Average | recognized |
| March 31, 2016                        |  |          |          |           |            |   |         |         |            |
| Residential                           | \$7,155                                | \$7,787  | \$8,032  | \$474     | \$18       | \$3,009                                   | \$3,230 | \$2,740 | \$20       |
| Home equity lines of credit           | 488                                    | 513      | 503      | 21        | —          | 330                                       | 347     | 296     | —          |
| Residential real estate               | 7,643                                  | 8,300    | 8,535    | 495       | 18         | 3,339                                     | 3,577   | 3,036   | 20         |
| Commercial Construction of commercial | 3,095                                  | 3,412    | 3,058    | 80        | 13         | 1,136                                     | 1,403   | 1,195   | 7          |
| Farm land                             | 120                                    | 126      | 121      | 1         | 2          | —   | —       | —       | —          |
| Vacant land                           | 11                                     | 13       | 372      | 1         | —          | 1,013                                     | 1,109   | 656     | —          |
| Real estate secured                   | 2,870                                  | 3,859    | 2,870    | 19        | 1          | 203                                       | 238     | 205     | —          |
| Commercial and industrial             | 13,739                                 | 15,710   | 14,956   | 596       | 34         | 5,691                                     | 6,327   | 5,092   | 27         |
| Consumer                              | 94                                     | 98       | 95       | 1         | —          | 415                                       | 468     | 421     | 1          |
| Totals                                | —                                      | —        | —        | —         | —          | —   | —       | 20      | —          |
|                                       | \$13,833                               | \$15,808 | \$15,051 | \$597     | \$34       | \$6,106                                   | \$6,795 | \$5,533 | \$28       |

## Acquired Loans

| (in thousands)              | Impaired loans with specific allowance |       |         |           |            | Impaired loans with no specific allowance |       |         |            |
|-----------------------------|--|-------|---------|-----------|------------|---|-------|---------|------------|
|                             | Loan balance                           |       |         | Specific  | Income     | Loan balance                              |       |         | Income     |
|                             | Book                                   | Note  | Average | allowance | recognized | Book                                      | Note  | Average | recognized |
| March 31, 2016              |  |       |         |           |            |   |       |         |            |
| Residential                 | \$602                                  | \$716 | \$645   | \$69      | \$—        | \$300                                     | \$300 | \$263   | \$—        |
| Home equity lines of credit | —                                      | —     | —       | —         | —          | —   | —     | —       | —          |
|                             | 602                                    | 716   | 645     | 69        | —          | 300                                       | 300   | 263     | —          |

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|                            |         |         |         |       |     |         |         |         |      |
|----------------------------|---------|---------|---------|-------|-----|---------|---------|---------|------|
| Residential real estate    |         |         |         |       |     |         |         |         |      |
| Commercial                 | 331     | 723     | 547     | 27    | 4   | 2,255   | 2,853   | 2,176   | 13   |
| Construction of commercial | —       | —       | —       | —     | —   | 258     | 271     | 259     | —    |
| Farm land                  | —       | —       | —       | —     | —   | —       | —       | —       | —    |
| Vacant land                | —       | —       | —       | —     | —   | —       | —       | —       | —    |
| Real estate secured        | 933     | 1,439   | 1,192   | 96    | 4   | 2,813   | 3,424   | 2,698   | 13   |
| Commercial and industrial  | 332     | 439     | 83      | 114   | —   | —       | —       | —       | —    |
| Consumer                   | —       | —       | —       | —     | —   | —       | —       | —       | —    |
| Totals                     | \$1,265 | \$1,878 | \$1,275 | \$210 | \$4 | \$2,813 | \$3,424 | \$2,698 | \$13 |

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## Business Activities Loans

| (in thousands)                        | Impaired loans with specific allowance |          |          |                    |                   | Impaired loans with no specific allowance |         |         |                   |
|---------------------------------------|--|----------|----------|--------------------|-------------------|---|---------|---------|-------------------|
|                                       | Loan balance                           |          |          | Specific allowance | Income recognized | Loan balance                              |         |         | Income recognized |
|                                       | Book                                   | Note     | Average  |                    |                   | Book                                      | Note    | Average |                   |
| December 31, 2015                     |  |          |          |                    |                   |   |         |         |                   |
| Residential 1-4 family                | \$7,482                                | \$8,094  | \$6,449  | \$610              | \$167             | \$2,628                                   | \$2,770 | \$3,089 | \$98              |
| Home equity lines of credit           | 535                                    | 659      | 260      | 68                 | 9                 | 184                                       | 199     | 423     | 2                 |
| Residential real estate               | 8,017                                  | 8,753    | 6,709    | 678                | 176               | 2,812                                     | 2,969   | 3,512   | 100               |
| Commercial Construction of commercial | 3,131                                  | 3,405    | 2,850    | 113                | 123               | 1,142                                     | 1,393   | 1,624   | 49                |
| Farm land                             | 122                                    | 128      | 9        | 1                  | 7                 | —   | —       | 116     | —                 |
| Vacant land                           | 733                                    | 773      | 400      | 14                 | 25                | 298                                       | 352     | 461     | —                 |
| Real estate secured                   | 2,870                                  | 3,836    | 3,015    | 29                 | 3                 | 207                                       | 241     | 72      | 9                 |
| Commercial and industrial             | 14,873                                 | 16,895   | 12,983   | 835                | 334               | 4,459                                     | 4,955   | 5,785   | 158               |
| Consumer                              | 95                                     | 98       | 145      | 10                 | 4                 | 431                                       | 481     | 383     | 22                |
| Totals                                | —                                      | —        | —        | —                  | —                 | 80  | 108     | 12      | 1                 |
|                                       | \$14,968                               | \$16,993 | \$13,128 | \$845              | \$338             | \$4,970                                   | \$5,544 | \$6,180 | \$181             |

## Acquired Loans

| (in thousands)                        | Impaired loans with specific allowance |         |         |                    |                   | Impaired loans with no specific allowance |         |         |                   |
|---------------------------------------|--|---------|---------|--------------------|-------------------|---|---------|---------|-------------------|
|                                       | Loan balance                           |         |         | Specific allowance | Income recognized | Loan balance                              |         |         | Income recognized |
|                                       | Book                                   | Note    | Average |                    |                   | Book                                      | Note    | Average |                   |
| December 31, 2015                     |  |         |         |                    |                   |   |         |         |                   |
| Residential 1-4 family                | \$599                                  | \$716   | \$273   | \$79               | \$—               | \$177                                     | \$177   | \$376   | \$7               |
| Home equity lines of credit           | —                                      | —       | —       | —                  | —                 | —   | —       | —       | —                 |
| Residential real estate               | 599                                    | 716     | 273     | 79                 | —                 | 177                                       | 177     | 376     | 7                 |
| Commercial Construction of commercial | 675                                    | 826     | 698     | 107                | 34                | 2,067                                     | 2,843   | 2,011   | 32                |
| Farm land                             | —                                      | —       | —       | —                  | —                 | 262                                       | 273     | 167     | 22                |
| Vacant land                           | —                                      | —       | —       | —                  | —                 | —   | —       | —       | —                 |
| Real estate secured                   | 1,274                                  | 1,542   | 971     | 186                | 34                | 2,506                                     | 3,293   | 2,554   | 61                |
| Commercial and industrial             | —                                      | —       | 6       | —                  | —                 | —   | 4       | —       | —                 |
| Consumer                              | —                                      | —       | —       | —                  | —                 | —   | —       | —       | —                 |
| Totals                                | \$1,274                                | \$1,542 | \$977   | \$186              | \$34              | \$2,506                                   | \$3,297 | \$2,554 | \$61              |



**NOTE 4 - MORTGAGE SERVICING RIGHTS**

|  |            |            |
|--|------------|------------|
| March 31, (in thousands)                       | 2016       | 2015       |
| Residential mortgage loans serviced for others | \$ 129,194 | \$ 137,186 |
| Fair value of mortgage servicing rights        | 1,037      | 1,355      |

Changes in mortgage servicing rights are as follows:

|   |        |        |
|---|--------|--------|
| Three months ended March 31, (in thousands) | 2016   | 2015   |
| Mortgage Servicing Rights                   |        |        |
| Balance, beginning of period                | \$486  | \$694  |
| Originated                                  | 20     | 62     |
| Amortization (1)                            | (51 )  | (119 ) |
| Balance, end of period                      | \$455  | \$637  |
| Valuation Allowance                         |        |        |
| Balance, beginning of period                | \$(3 ) | \$—    |
| Increase in impairment reserve (1)          | (20 )  | (9 )   |
| Balance, end of period                      | (23 )  | (9 )   |
| Mortgage servicing rights, net              | \$432  | \$628  |

(1) Amortization expense and changes in the impairment reserve are recorded in mortgage servicing, net, in the consolidated statements of income.

**NOTE 5 - PLEDGED ASSETS**

|   |                |                   |
|---|----------------|-------------------|
| (in thousands)                                | March 31, 2016 | December 31, 2015 |
| Securities available-for-sale (at fair value) | \$71,444       | \$67,750          |
| Loans receivable                              | 162,284        | 153,269           |
| Total pledged assets                          | \$233,728      | \$221,019         |

At March 31, 2016, securities were pledged as follows: \$64.5 million to secure public deposits, \$6.8 million to secure repurchase agreements and \$0.1 million to secure FHLBB advances. Additionally, loans receivable were pledged to secure FHLBB advances and credit facilities.

**NOTE 6 – EARNINGS PER SHARE**

The Company defines unvested share-based payment awards that contain non-forfeitable rights to dividends as participating securities that are included in computing earnings per share (EPS) using the two-class method.

The two-class method is an earnings allocation formula that determines earnings per share for each share of common stock and participating securities according to dividends declared and participation rights in undistributed earnings. Under this method, all earnings (distributed and undistributed) are allocated to common shares and participating securities based on their respective rights to receive dividends. Basic EPS excludes dilution and is computed by dividing income allocated to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity.

The following table sets forth the computation of earnings per share (basic and diluted) for the periods indicated:

| Three months ended March 31, (in thousands, except per share data)                             | 2016    | 2015    |
|--|---------|---------|
| Net income   | \$1,512 | \$2,234 |
| Less: Preferred stock dividends declared   | —       | (40 )   |
| Net income available to common shareholders  | 1,512   | 2,194   |
| Less: Undistributed earnings allocated to participating securities                             | (13 )   | (19 )   |
| Net income allocated to common stock   | \$1,499 | \$2,175 |
| Weighted-average common shares issued  | 2,747   | 2,723   |
| Less: Unvested restricted stock awards   | (24 )   | (24 )   |
| Weighted average common shares outstanding used to calculate basic earnings per common share   | 2,723   | 2,699   |
| Add: Dilutive effect of stock options  | 18      | 17      |
| Weighted-average common shares outstanding used to calculate diluted earnings per common share | 2,741   | 2,716   |
| Earnings per common share (basic)  | \$0.55  | \$0.81  |
| Earnings per common share (diluted)  | \$0.55  | \$0.80  |

#### **NOTE 7 – SHAREHOLDERS’ EQUITY**

##### **Capital Requirements**

Salisbury and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional and discretionary actions by the regulators that, if undertaken, could have a direct material effect on Salisbury’s and the Bank’s financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, Salisbury and the Bank must meet specific guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. Salisbury and the Bank’s capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

In July 2013, the Federal Reserve Bank (FRB) approved the final rules implementing the Basel Committee on Banking Supervision’s capital guidelines for bank holding companies and their bank subsidiaries. On July 9, 2013, the FDIC also approved, as an interim final rule, the regulatory capital requirements for U.S. banks, following the actions of the FRB. On April 8, 2014, the FDIC adopted as final its interim final rule, which is identical in substance to the final rules issued by the FRB in July 2013. Under the final rules, minimum requirements will increase for both the quantity and quality of capital held by Salisbury and the Bank. The rules include a new common equity Tier 1 capital risk-weighted assets minimum ratio of 4.5%, raise the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0%, require a minimum ratio of Total capital to risk-weighted assets of 8.0%, and require a minimum Tier 1 leverage ratio of 4.0%. A new capital conservation buffer, comprised of common equity Tier 1 capital, is also established above the regulatory minimum capital requirements. The implementation of the capital conservation buffer was phased in effective January 1, 2016 at 0.625% of risk-weighted assets and increases each subsequent January 1, by an additional 0.625% until reaching its final level of 2.5% on January 1, 2019. Strict eligibility criteria for regulatory capital instruments were also implemented under the final rules.

The phase-in period for the final rules began for Salisbury on January 1, 2015. As of March 31, 2016, Salisbury and the Bank met each of their capital requirements and the most recent notification from the FDIC categorized the Bank as “well-capitalized.” There are no conditions or events since that notification that management believes have changed the Bank’s category.



Actual regulatory capital position and minimum capital requirements as defined "To Be Well Capitalized Under Prompt Corrective Action Provisions" and "For Capital Adequacy Purposes" for Salisbury and the Bank are as follows:

| (dollars in thousands)                                 | Actual   |        | For Capital Adequacy Purposes |       | To be Well Capitalized Under Prompt Corrective Action Provisions |       |
|--|----------|--------|-------------------------------|-------|--|-------|
|  | Amount   | Ratio  | Amount                        | Ratio | Amount   | Ratio |
| <b>March 31, 2016</b>                                  |          |        |                               |       |  |       |
| Total Capital (to risk-weighted assets)                |          |        |                               |       |  |       |
| Salisbury  | \$93,065 | 12.92% | \$57,633                      | 8.0%  | n/a  | —     |
| Bank   | 90,245   | 12.53  | 57,633                        | 8.0   | \$72,042   | 10.0% |
| Tier 1 Capital (to risk-weighted assets)               |          |        |                               |       |  |       |
| Salisbury  | 77,000   | 10.69  | 43,225                        | 6.0   | n/a  | —     |
| Bank   | 84,180   | 11.68  | 43,225                        | 6.0   | 57,633   | 8.0   |
| Common Equity Tier 1 Capital (to risk-weighted assets) |          |        |                               |       |  |       |
| Salisbury  | 77,000   | 10.69  | 40,429                        | 4.5   | n/a  | —     |
| Bank   | 84,180   | 11.68  | 32,419                        | 4.5   | 46,827   | 6.5   |
| Tier 1 Capital (to average assets)                     |          |        |                               |       |  |       |
| Salisbury  | 77,000   | 8.57   | 35,937                        | 4.0   | n/a  | —     |
| Bank   | 84,180   | 9.51   | 35,403                        | 4.0   | 39,828   | 5.0   |
| <b>December 31, 2015</b>                               |          |        |                               |       |  |       |
| Total Capital (to risk-weighted assets)                |          |        |                               |       |  |       |
| Salisbury  | \$92,030 | 13.51% | \$54,509                      | 8.0%  | n/a  | —     |
| Bank   | 89,249   | 13.10  | 54,504                        | 8.0   | \$68,131   | 10.0% |
| Tier 1 Capital (to risk-weighted assets)               |          |        |                               |       |  |       |
| Salisbury  | 76,120   | 11.17  | 40,878                        | 6.0   | n/a  | —     |
| Bank   | 83,340   | 12.23  | 40,878                        | 6.0   | 54,504   | 8.0   |
| Common Equity Tier 1 Capital (to risk-weighted assets) |          |        |                               |       |  |       |
| Salisbury  | 76,120   | 11.17  | 30,659                        | 4.5   | n/a  | —     |
| Bank   | 83,340   | 12.23  | 30,659                        | 4.5   | 44,285   | 6.5   |
| Tier 1 Capital (to average assets)                     |          |        |                               |       |  |       |
| Salisbury  | 76,120   | 8.56   | 36,102                        | 4.0   | n/a  | —     |
| Bank   | 83,340   | 9.37   | 35,593                        | 4.0   | 44,491   | 5.0   |

### Cash Dividends to Common Shareholders

Salisbury's ability to pay cash dividends is substantially dependent on the Bank's ability to pay cash dividends to Salisbury. There are certain restrictions on the payment of cash dividends and other payments by the Bank to Salisbury. Under Connecticut law, the Bank cannot declare a cash dividend except from net profits, defined as the remainder of all earnings from current operations. The total of all cash dividends declared by the Bank in any calendar year shall not, unless specifically approved by the Banking Commissioner, exceed the total of its net profits of that year combined with its retained net profits of the preceding two years.

FRB Supervisory Letter SR 09-4, February 24, 2009, revised March 30, 2009, notes that, as a general matter, the Board of Directors of a Bank Holding Company ("BHC") should inform the Federal Reserve and should eliminate, defer, or significantly reduce dividends if (1) net income available to shareholders for the past four quarters, net of

dividends previously paid during that period, is not sufficient to fully fund the dividends; (2) the prospective rate of earnings retention is not consistent with capital needs and overall current and prospective financial condition; or (3) the BHC will not meet, or is in danger of not meeting, its minimum regulatory capital adequacy ratios. Moreover, a BHC should inform the Federal Reserve reasonably in advance of declaring or paying a dividend that exceeds earnings for the period (e.g., quarter) for which the dividend is being paid or that could result in a material adverse change to the BHC capital structure.

### **Preferred Stock**

In August 2011, Salisbury issued to the U.S. Secretary of the Treasury (the “Treasury”) \$16 million of its Series B Preferred Stock under the Small Business Lending Fund (the “SBLF”) program. The SBLF program is a \$30 billion fund established under the Small Business Jobs Act of 2010 to encourage lending to small businesses by providing Tier 1 capital to qualified community banks with assets of less than \$10 billion. The Preferred Stock qualified as Tier 1 capital for regulatory purposes and ranked senior to the Common Stock.

During fourth quarter 2015, Salisbury completed an offering of \$10 million of unsecured 6.00% fixed-to-floating rate subordinated notes due in 2025. The notes qualify as Tier II capital and are included as such within Salisbury's total risk-based capital ratio.

The net proceeds of the offering, along with cash on hand, were used during the fourth quarter 2015 to redeem the \$16 million of Senior Non-Cumulative Perpetual Preferred Stock issued in conjunction with Salisbury's participation in the U.S. Treasury's SBLF program.

#### **NOTE 8 – BENEFITS**

Salisbury's 401(k) Plan expense was \$216,000 and \$162,000, respectively, for the three month periods ended March 31, 2016 and 2015. Other post-retirement benefit obligation expense for endorsement split-dollar life insurance arrangements was \$19,000 and \$18,000 for the three month periods ended March 31, 2016 and 2015, respectively.

In 2014, Salisbury terminated the Defined Benefit Pension Plan. Excess assets in the amount of \$1,018,000 were distributed to the Bank's Defined Contribution Plan (401k) and the Employee Stock Ownership Plan (ESOP) for future allocations to employees. The division of the excess pension assets was 66.67% to the 401k account (or \$679,000) and 33.33% to the ESOP account (or \$339,000).

#### **ESOP**

Salisbury offers an ESOP to eligible employees. Under the Plan, Salisbury may make discretionary contributions to the Plan, which generally vest in full upon six years of qualified service.

Salisbury's ESOP expense was \$36,000 and \$96,000, respectively, for the three month periods ended March 31, 2016 and 2015. First quarter 2015 included an increased ESOP accrual.

#### **Other Retirement Plans**

A Non-Qualified Deferred Compensation Plan (the "Plan") was adopted effective January 1, 2013. This Plan was adopted by the Bank for the benefit of certain key employees ("Executive" or "Executives") who have been selected and approved by the Bank to participate in this Plan and who have evidenced their participation by execution of a Non-Qualified Deferred Compensation Plan Participation Agreement ("Participation Agreement") in a form provided by the Bank. This Plan is intended to comply with Internal Revenue Code ("Code") Section 409A and any regulatory or other guidance issued under such Section.

In 2015, 2014, and 2013, the Bank awarded six (6), seven (7) and six (6) Executives, respectively, with discretionary contributions to the plan. Expenses related to this plan amounted to \$11,000 for the first quarter of 2016 and \$33,000 for the first quarter of 2015. Based on the Executive's date of retirement, the vesting schedule ranges from 7.7% per year to 50% per year.

On January 29, 2016, the Compensation Committee granted a total of 47,470 Phantom Stock Appreciation Units pursuant to its 2011 Long Term Incentive Plan, which was approved by shareholders at the 2011 Annual Meeting, including 23,012 units to three Named Executive Officers. Richard J. Cantele, Jr., President and Chief Executive Officer received 11,484 units, John Davies, President New York Region and Chief Lending Officer received 5,963 units and Donald E. White, Chief Financial Officer received 5,565 units. The units will vest on the third anniversary of the grant date.

#### **Grants of Restricted Stock and Options**

On February 16, 2016, 1,350 shares of stock options were exercised at \$21.48 per share by one former Riverside Bank executive.

On January 29, 2016, Salisbury granted a total of 15,800 shares of restricted stock pursuant to its 2011 Long Term Incentive Plan, which was approved by shareholders at the 2011 Annual Meeting, to 42 employees, including 6,000 shares to three Named Executive Officers. Richard J. Cantele, Jr., President and Chief Executive Officer received 5,000 and John Davies, President New York Region and Chief Lending Officer and Donald E. White, Chief Financial Officer each received 500 shares. The fair value of the stock as of the grant date was determined to be \$466,000 and the stock will be vested three years from the grant date.

On January 26, 2016, 2,700 shares of stock options were exercised at \$21.48 per share by two former Riverside Bank executives.

On September 28, 2015, 2,700 shares of stock options were exercised at \$21.48 per share by one former Riverside Bank executive.

On February 17, 2015 and February 25, 2015, 1,350 and 5,400 shares of stock options were exercised, respectively, at \$18.52 per share by two former Riverside Bank executives.

On March 27, 2015, Salisbury granted a total of 1,000 shares of restricted stock, pursuant to its 2011 Long Term Incentive Plan, to one (1) Named Executive Officer, Richard J. Cantele, Jr., President and Chief Executive Officer. The fair value of the stock as of the grant date was determined to be \$29,000 and the stock vested immediately.

Expense in first quarter 2016 and 2015 related to stock based compensation totaled \$47,000 and \$71,000, respectively. Unrecognized compensation cost relating to the awards as of March 31, 2016 and 2015 totaled \$275,000 and \$271,000, respectively. There were no forfeitures in the first quarter of 2016 or the first quarter of 2015.

**NOTE 9 –ACCUMULATED OTHER COMPREHENSIVE INCOME**

The components of accumulated other comprehensive income is as follows:

| (in thousands)  | March 31, 2016 | December 31, 2015 |
|---|----------------|-------------------|
| Unrealized gains on securities available-for-sale, net of tax | \$ 1,079       | \$ 1,125          |
| Accumulated other comprehensive income, net                   | \$ 1,079       | \$ 1,125          |

**NOTE 10 – FAIR VALUE OF ASSETS AND LIABILITIES**

Salisbury uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Securities available-for-sale are recorded at fair value on a recurring basis. Additionally, from time to time, other assets are recorded at fair value on a nonrecurring basis, such as loans held for sale, collateral dependent impaired loans, property acquired through foreclosure or repossession and mortgage servicing rights. These nonrecurring fair value adjustments typically involve the application of lower-of-cost-or-market accounting or write-downs of individual assets.

ASC 820-10, “Fair Value Measurement-Overall,” provides a framework for measuring fair value under generally accepted accounting principles. This guidance permitted Salisbury the irrevocable option to elect fair value for the initial and subsequent measurement for certain financial assets and liabilities on a contract-by-contract basis. Salisbury did not elect fair value treatment for any financial assets or liabilities upon adoption.

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

GAAP specifies a hierarchy of valuation techniques based on whether the types of valuation information (“inputs”) are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect Salisbury’s market assumptions. These two types of inputs have created the following fair value hierarchy:

Level 1. Quoted prices in active markets for identical assets. Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. Level 1 also includes U.S. Treasury, other U.S. Government and agency mortgage-backed securities that are traded by dealers or brokers in active markets.

Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

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

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

A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. Salisbury did not have any significant transfers of assets between levels 1 and 2 of the fair value hierarchy during the quarter ended March 31, 2016.

The following is a description of valuation methodologies for assets recorded at fair value, including the general classification of such assets and liabilities pursuant to the valuation hierarchy.

**Securities available-for-sale.** Securities available-for-sale are recorded at fair value on a recurring basis. Level 1 securities include exchange-traded equity securities. Level 2 securities include debt securities with quoted prices, which are traded less frequently than exchange-traded instruments, whose value is determined using matrix pricing with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes obligations of the U.S. Treasury and U.S. government-sponsored enterprises, mortgage-backed securities, collateralized mortgage obligations, municipal bonds, SBA bonds, corporate bonds and certain preferred equities. Level 3 is for positions that are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence. In the absence of such evidence, management's best estimate is used. Subsequent to inception, management only changes level 3 inputs and assumptions when corroborated by evidence such as transactions in similar instruments, completed or pending third-party transactions in the underlying investment or comparable entities, subsequent rounds of financing, recapitalization and other transactions across the capital structure, offerings in the equity or debt markets, and changes in financial ratios or cash flows. Collateral dependent loans that are deemed to be impaired are valued based upon the fair value of the underlying collateral less costs to sell. Such collateral primarily consists of real estate and, to a lesser extent, other business assets. Management may adjust appraised values to reflect estimated market value declines or apply other discounts to appraised values resulting from its knowledge of the property. Internal valuations are utilized to determine the fair value of other business assets. Collateral dependent impaired loans are categorized as Level 3. Other real estate owned acquired through foreclosure or repossession is adjusted to fair value less costs to sell upon transfer out of loans. Subsequently, it is carried at the lower of carrying value or fair value less costs to sell. Fair value is generally based upon independent market prices or appraised values of the collateral. Management adjusts appraised values to reflect estimated market value declines or apply other discounts to appraised values for unobservable factors resulting from its knowledge of the property, and such property is categorized as Level 3. Mortgage servicing assets are accounted for at cost, subject to impairment testing. When the carrying cost exceeds fair value, a valuation allowance is established to reduce the carrying cost to fair value. Fair value is calculated as the present value of estimated future net servicing income and relies on market based assumptions for loan prepayment speeds, servicing costs, discount rates, and other economic factors; as such, the primary risk inherent in valuing mortgage servicing assets is the impact of fluctuating interest rates on the servicing revenue stream. Mortgage servicing assets are classified within Level 3 of the fair value hierarchy.

Assets measured at fair value are as follows:

| (in thousands)   | Fair Value Measurements Using |          |         | Assets at fair value |
|--|-------------------------------|----------|---------|----------------------|
|  | Level 1                       | Level 2  | Level 3 |                      |
| March 31, 2016   |                               |          |         |                      |
| Assets at fair value on a recurring basis                          |                               |          |         |                      |
| U.S. Treasury notes  | \$—                           | \$7,529  | \$—     | \$7,529              |
| Municipal bonds  | —                             | 25,388   | —       | 25,388               |
| Mortgage-backed securities:  |                               |          |         |                      |
| U.S. Government agencies and U.S. Government-sponsored enterprises | —                             | 35,802   | —       | 35,802               |
| Collateralized mortgage obligations:                               |                               |          |         |                      |
| U.S. Government agencies   | —                             | 1,862    | —       | 1,862                |
| Non-agency   | —                             | 4,568    | —       | 4,568                |
| SBA bonds  | —                             | 2,871    | —       | 2,871                |
| CRA mutual funds   | —                             | 779      | —       | 779                  |
| Preferred stock  | 235                           | —        | —       | 235                  |
| Securities available-for-sale                                      | \$235                         | \$78,799 | \$—     | \$79,034             |
| Assets at fair value on a non-recurring basis                      |                               |          |         |                      |
| Collateral dependent impaired loans                                | —                             | —        | 14,290  | 14,290               |
| Mortgage servicing rights  | —                             | —        | 1,037   | 1,037                |
| December 31, 2015  |                               |          |         |                      |
| Assets at fair value on a recurring basis                          |                               |          |         |                      |
| U.S. Treasury notes  | \$—                           | \$2,541  | \$—     | \$2,541              |
| U.S. Government agency notes                                       | —                             | 498      | —       | 498                  |
| Municipal bonds  | —                             | 30,385   | —       | 30,385               |
| Mortgage-backed securities:  |                               |          |         |                      |
| U.S. Government agencies and U.S. Government-sponsored enterprises | —                             | 32,202   | —       | 32,202               |
| Collateralized mortgage obligations:                               |                               |          |         |                      |
| U.S. Government agencies   | —                             | 2,014    | —       | 2,014                |
| Non-agency   | —                             | 4,948    | —       | 4,948                |
| SBA bonds  | —                             | 3,096    | —       | 3,096                |
| CRA mutual funds   | —                             | 764      | —       | 764                  |
| Preferred stock  | 246                           | —        | —       | 246                  |
| Securities available-for-sale                                      | \$246                         | \$76,448 | \$—     | \$76,694             |
| Assets at fair value on a non-recurring basis                      |                               |          |         |                      |
| Collateral dependent impaired loans                                | —                             | —        | 15,211  | 15,211               |
| Mortgage servicing rights  | —                             | —        | 1,315   | 1,315                |



Carrying values and estimated fair values of financial instruments are as follows:

| (in thousands)                         | Carrying value | Estimated fair value | Fair value measurements using |         |           |
|--|----------------|----------------------|-------------------------------|---------|-----------|
|  |                |                      | Level 1                       | Level 2 | Level 3   |
| <b>March 31, 2016</b>                  |                |                      |                               |         |           |
| <b>Financial Assets</b>                |                |                      |                               |         |           |
| Cash and cash equivalents              | \$31,503       | \$31,503             | \$31,503                      | \$—     | \$—       |
| Securities available-for-sale          | 79,034         | 79,034               | 235                           | 78,799  | —         |
| Federal Home Loan Bank stock           | 3,117          | 3,117                | —                             | 3,117   | —         |
| Loans held-for-sale                    | 183            | 183                  | —                             | —       | 183       |
| Loans receivable, net                  | 728,845        | 732,699              | —                             | —       | 732,699   |
| Accrued interest receivable            | 2,451          | 2,451                | —                             | —       | 2,451     |
| Cash surrender value of life insurance | 13,775         | 13,775               | 13,775                        | —       | —         |
| <b>Financial Liabilities</b>           |                |                      |                               |         |           |
| Demand (non-interest-bearing)          | \$192,184      | \$192,184            | \$—                           | \$—     | \$192,184 |
| Demand (interest-bearing)              | 122,814        | 122,814              | —                             | —       | 122,814   |
| Money market                           | 192,357        | 192,357              | —                             | —       | 192,357   |
| Savings and other                      | 126,214        | 126,214              | —                             | —       | 126,214   |
| Certificates of deposit                | 122,089        | 122,952              | —                             | —       | 122,952   |
| Deposits                               | 755,658        | 756,521              | —                             | —       | 756,521   |
| Repurchase agreements                  | 2,620          | 2,620                | —                             | —       | 2,620     |
| FHLBB advances                         | 27,031         | 29,046               | —                             | —       | 29,046    |
| Subordinated debt                      | 9,770          | 10,190               | —                             | —       | 10,190    |
| Note payable                           | 365            | 404                  | —                             | —       | 404       |
| Capital lease liability                | 420            | 895                  | —                             | —       | 895       |
| Accrued interest payable               | 120            | 120                  | —                             | —       | 120       |
| <b>December 31, 2015</b>               |                |                      |                               |         |           |
| <b>Financial Assets</b>                |                |                      |                               |         |           |
| Cash and cash equivalents              | \$62,118       | \$62,118             | \$62,118                      | \$—     | \$—       |
| Securities available-for-sale          | 76,694         | 76,694               | 246                           | 76,448  | —         |
| Federal Home Loan Bank stock           | 3,176          | 3,176                | —                             | 3,176   | —         |
| Loans held-for-sale                    | 763            | 778                  | —                             | —       | 778       |
| Loans receivable, net                  | 699,018        | 707,154              | —                             | —       | 707,154   |
| Accrued interest receivable            | 2,307          | 2,307                | —                             | —       | 2,307     |
| Cash surrender value of life insurance | 13,685         | 13,685               | 13,685                        | —       | —         |
| <b>Financial Liabilities</b>           |                |                      |                               |         |           |
| Demand (non-interest-bearing)          | \$201,340      | \$201,340            | \$—                           | \$—     | \$201,340 |
| Demand (interest-bearing)              | 125,465        | 125,465              | —                             | —       | 125,465   |
| Money market                           | 183,783        | 183,783              | —                             | —       | 183,783   |
| Savings and other                      | 119,651        | 119,651              | —                             | —       | 119,651   |
| Certificates of deposit                | 124,294        | 125,437              | —                             | —       | 125,437   |
| Deposits                               | 754,533        | 755,676              | —                             | —       | 755,676   |
| Repurchase agreements                  | 3,914          | 3,914                | —                             | —       | 3,914     |
| FHLBB advances                         | 26,979         | 28,559               | —                             | —       | 28,559    |
| Subordinated debt                      | 9,764          | 9,764                | —                             | —       | 9,764     |
| Note payable                           | 376            | 405                  | —                             | —       | 405       |
| Capital lease liability                | 422            | 870                  | —                             | —       | 870       |
| Accrued interest payable               | 150            | 150                  | —                             | —       | 150       |

The carrying amounts of financial instruments shown in the above table are included in the consolidated balance sheets under the indicated captions.



Item 2. **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Management's Discussion and Analysis of Financial Condition and Results of Operations of Salisbury and its subsidiary should be read in conjunction with Salisbury's Annual Report on Form 10-K for the year ended December 31, 2015. Readers should also review other disclosures Salisbury files from time to time with the Securities and Exchange Commission (the "SEC").

**BUSINESS**

Salisbury, a Connecticut corporation, formed in 1998, is the bank holding company for the Bank, a Connecticut-chartered and FDIC insured commercial bank headquartered in Lakeville, Connecticut. Salisbury's principal business consists of the business of the Bank. The Bank, formed in 1848, is engaged in customary banking activities, including general deposit taking and lending activities to both retail and commercial markets, and trust and wealth advisory services. The Bank conducts its banking business from thirteen full-service offices in the towns of: Canaan, Lakeville, Salisbury and Sharon, Connecticut; Great Barrington, South Egremont and Sheffield, Massachusetts; and, Fishkill, Newburgh, Poughkeepsie, Red Oaks Mill, Dover Plains and Millerton, New York, and its trust and wealth advisory services from offices in Lakeville, Connecticut. In May 2014, the Bank established a new branch in Great Barrington, Massachusetts. In June 2014, the Bank acquired a branch office and related deposits from another institution in Sharon, Connecticut and consolidated its existing Sharon office with the new branch. In December 2014, the Bank completed its acquisition of Riverside Bank of Poughkeepsie, New York, adding four new offices and a strong commercial lending focus to Salisbury's New York market presence.

Critical Accounting Policies and Estimates

Salisbury's consolidated financial statements follow GAAP as applied to the banking industry in which it operates. Application of these principles requires management to make estimates, assumptions and judgments that affect the amounts reported in the financial statements. These estimates, assumptions and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions and judgments and as such have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried at fair value warrants an impairment write-down or valuation reserve to be established, or when an asset or liability needs to be recorded contingent upon a future event.

Salisbury's significant accounting policies are presented in Note 1 of Notes to Consolidated Financial Statements, which, along with this Management's Discussion and Analysis, provide information on how significant assets are valued in the financial statements and how those values are determined. Management believes that the following accounting estimates are the most critical to aid in fully understanding and evaluating Salisbury's reported financial results, and they require management's most difficult, subjective or complex judgments, resulting from the need to make estimates about the effect of matters that are inherently uncertain.

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

and disposition of the collateral.

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The allowance for loan losses represents management's estimate of credit losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on the balance sheet. Note 1 describes the methodology used to determine the allowance for loan losses. A discussion of the factors driving changes in the amount of the allowance for loan losses are included in the "Provision and Allowance for Loan Losses" section of Management's Discussion and Analysis.

Management evaluates goodwill and identifiable intangible assets for impairment annually using valuation techniques that involve estimates for discount rates, projected future cash flows and time period calculations, all of which are susceptible to change based on changes in economic conditions and other factors. Future events or changes in the estimates, which are used to determine the carrying value of goodwill and identifiable intangible assets or which otherwise adversely affect their value or estimated lives could have a material adverse impact on the results of operations.

Management evaluates securities for other-than-temporary impairment giving consideration to the extent to which the fair value has been less than cost, estimates of future cash flows, delinquencies and default severity, and the intent and ability of Salisbury to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. The consideration of the above factors is subjective and involves estimates and assumptions about matters that are inherently uncertain. Should actual factors and conditions differ materially from those used by management, the actual realization of gains or losses on investment securities could differ materially from the amounts recorded in the financial statements.

## **FINANCIAL CONDITION**

### **Overview**

Total assets were \$891.8 million at March 31, 2016, an increase of \$0.6 million from December 31, 2015. Loans receivable, net, were \$728.8 million at March 31, 2016, an increase of \$29.8 million from December 31, 2015. Non-performing assets of \$16.8 million at March 31, 2016, increased \$0.6 million from \$16.2 million at December 31, 2015. Reserve coverage, as measured by the ratio of the allowance for loan losses to gross loans, was 0.80%, 0.81% and 0.76%, at March 31, 2016, December 31, 2015 and March 31, 2015, respectively. Deposits increased \$1.2 million to \$755.7 million, up from \$754.5 million at December 31, 2015.

At March 31, 2016, book value and tangible book value per common share were \$33.20 and \$27.84, respectively. Salisbury's tier 1 leverage, total risk-based capital, and common equity tier 1 capital ratios were 8.57%, 12.92%, and 10.69%, respectively.

### **Securities and Short Term Funds**

During the first quarter of 2016, securities increased \$2.3 million to \$79.0 million primarily as a result of the purchase of \$10.0 million of mortgage backed securities and treasury bills, partially offset by calls and principal pay downs. FHLBB advances increased \$0.1 million, while cash and cash equivalents (non-time interest-bearing deposits with other banks, money market funds and federal funds sold) decreased \$30.6 million to \$31.5 million.

Salisbury evaluates securities for OTTI where the fair value of a security is less than its amortized cost basis at the balance sheet date. As part of this process, Salisbury considers its intent to sell each debt security and whether it is more likely than not that it will be required to sell the security before its anticipated recovery. If either of these

conditions is met, Salisbury recognizes an OTTI charge to earnings equal to the entire difference between the security's amortized cost basis and its fair value at the balance sheet date. For securities that meet neither of these conditions, an analysis is performed to determine if any of these securities are at risk for OTTI.

Salisbury evaluates securities for strategic fit and may reduce its position in securities, although it is not more likely than not that Salisbury will be required to sell securities before recovery of their cost basis, which may be maturity. Therefore, management does not consider any of its securities, other than four non-agency CMO securities reflecting OTTI, to be OTTI at March 31, 2016.

Salisbury has, and continues to monitor, CMO securities where historical recognition of losses has occurred as a result of OTTI. Salisbury determined, as of March 31, 2016, that additional recognition of OTTI was not required. It is possible that future loss assumptions could change necessitating Salisbury to recognize future OTTI.

## Loans

Net loans receivable increased \$29.8 million to \$728.8 million at March 31, 2016, compared with \$699.0 million at December 31, 2015.

## Loan Credit Quality

During the first three months of 2016, non-performing assets increased \$0.6 million primarily from the addition of five relationships, and partially offset by repayments and charged off loans.

During the first quarter of 2016, total impaired and potential problem loans increased by \$3.5 million to \$30.6 million, or 4.2% of gross loans receivable at March 31, 2016, from \$27.1 million, compared to 3.8% of gross loans receivable at December 31, 2015.

## Changes in impaired and potential problem loans are as follows:

| Three months ended<br>(in thousands)        | March 31, 2016                    |          |                               |         | March 31, 2015                    |            |                               |          |
|---|-----------------------------------|----------|-------------------------------|---------|-----------------------------------|------------|-------------------------------|----------|
|   | Impaired loans<br>Non-<br>accrual | Accruing | Potential<br>problem<br>loans | Total   | Impaired loans<br>Non-<br>accrual | Accruing   | Potential<br>problem<br>loans | Total    |
| Loans placed on non-accrual status          | \$1,316                           | \$(229 ) | \$(564 )                      | \$523   | \$4,892                           | \$(2,208 ) | \$(2,547 )                    | \$137    |
| Loans restored to accrual status            | —                                 | —        | —                             | —       | (340 )                            | 340        | —                             | —        |
| Loan risk rating downgrades to substandard  | —                                 | —        | 3,754                         | 3,754   | —                                 | —          | 40                            | 40       |
| Loan risk rating upgrades from substandard  | —                                 | —        | —                             | —       | —                                 | —          | (156 )                        | (156 )   |
| Loan repayments                             | (492 )                            | (46 )    | 15                            | (523 )  | (80 )                             | (79 )      | (269 )                        | (428 )   |
| Loan charge-offs                            | (187 )                            | —        | (30 )                         | (217 )  | (362 )                            | —          | —                             | (362 )   |
| Increase (decrease) in TDR loans            | —                                 | —        | —                             | —       | —                                 | —          | —                             | —        |
| Real estate acquired in settlement of loans | —                                 | —        | —                             | —       | —                                 | —          | —                             | —        |
| Inter-month tax advances                    | 18                                | —        | —                             | 18      | 17                                | —          | —                             | 17       |
| Increase (decrease) in loans                | \$655                             | \$(275 ) | \$3,175                       | \$3,555 | \$4,127                           | \$(1,947 ) | \$(2,932 )                    | \$(752 ) |

During the first quarter of 2016, Salisbury placed \$1.3 million of loans on non-accrual status as a result of deteriorated payment and financial performance and charged-off \$217,000 of loans primarily as a result of collateral deficiencies.

Salisbury has cooperative relationships with the vast majority of its non-performing loan customers. Substantially all non-performing loans are collateralized with real estate and the repayment of such loans is largely dependent on the return of such loans to performing status or the liquidation of the underlying real estate collateral. Salisbury pursues the resolution of all non-performing loans through collections, restructures, voluntary liquidation of collateral by the borrower and, where necessary, legal action. When attempts to work with a customer to return a loan to performing status, including restructuring the loan, are unsuccessful, Salisbury will initiate appropriate legal action seeking to

acquire property by deed in lieu of foreclosure or through foreclosure, or to liquidate business assets.



### Credit Quality Segments

Salisbury categorizes loans receivable into the following credit quality segments:

Impaired loans consist of all non-accrual loans and troubled debt restructured loans, and represent loans for which it is probable that Salisbury will not be able to collect all principal and interest amounts due according to the contractual terms of the loan agreements.

Non-accrual loans, a sub-set of impaired loans, are loans for which the accrual of interest has been discontinued because, in the opinion of management, full collection of principal or interest is unlikely.

Non-performing loans consist of non-accrual loans, and accruing loans past due 90 days and over that are well collateralized, in the process of collection and where full collection of principal and interest is reasonably assured.

Non-performing assets consist of non-performing loans plus real estate acquired in settlement of loans.

Troubled debt restructured loans are loans for which concessions such as reduction of interest rates, other than normal market rate adjustments, or deferral of principal or interest payments, extension of maturity dates, or reduction of principal balance or accrued interest, have been granted due to a borrower's financial condition. Loan restructuring is employed when management believes the granting of a concession will increase the probability of the full or partial collection of principal and interest.

- Potential problem loans consist of performing loans that have been assigned a substandard credit risk rating and are not classified as impaired.

### Credit Risk Ratings

Salisbury assigns credit risk ratings to loans receivable in order to manage credit risk and to determine the allowance for loan losses. Credit risk ratings categorize loans by common financial and structural characteristics that measure the credit strength of a borrower. Salisbury's rating model has eight risk rating grades, with each grade corresponding to a progressively greater risk of default. Grades 1 through 4 are pass ratings and 5 through 8 are ratings (special mention, substandard, doubtful, and loss) defined by the bank's regulatory agencies, the FDIC and CTDOB. Risk ratings are assigned to differentiate risk within the portfolio and are reviewed on an ongoing basis and revised, if needed, to reflect changes in the borrowers' current financial position and outlook, risk profiles and the related collateral and structural positions.

Loans risk rated as "special mention" possess credit deficiencies or potential weaknesses deserving management's close attention that if left uncorrected may result in deterioration of the repayment prospects for the loans at some future date.

Loans risk rated as "substandard" are loans where the Bank's position is clearly not protected adequately by borrower current net worth or payment capacity. These loans have well defined weaknesses based on objective evidence and include loans where future losses to the Bank may result if deficiencies are not corrected, and loans where the primary source of repayment such as income is diminished and the Bank must rely on sale of collateral or other secondary sources of collection.

Loans risk rated as "doubtful" have the same weaknesses as substandard loans with the added characteristic that the weakness makes collection or liquidation in full, given current facts, conditions, and values, to be highly improbable. The possibility of loss is high, but due to certain important and reasonably specific pending factors, which may work to strengthen the loan, its reclassification as an estimated loss is deferred until its exact status can be determined.

Loans risk rated as "loss" are considered uncollectible and of such little value that continuance as Bank assets is unwarranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather, it is not practical or desirable to defer writing off this loan even though partial recovery may be made in the future. Management actively reviews and tests its credit risk ratings against actual experience and engages an independent third-party to annually validate its assignment of credit risk ratings. In addition, the Bank's loan portfolio and risk ratings are examined annually on a rotating basis by its two primary regulatory agencies, the FDIC and CTDOB.

Impaired Loans

Loans individually evaluated for impairment (impaired loans) are loans for which Salisbury does not expect to collect all contractual principal and interest in accordance with the contractual terms of the loan. Impaired loans include all modified loans classified as troubled debt restructurings (TDRs) and loans on non-accrual status. The components of impaired loans are as follows:

| (in thousands)   | March 31, 2016 | December 31, 2015 |
|--|----------------|-------------------|
| Troubled debt restructured loans, accruing                   | \$7,269        | \$7,544           |
| Troubled debt restructured loans, non-accrual                | 3,327          | 3,044             |
| All other non-accrual loans                                  | 13,502         | 13,130            |
| Total impaired loans   | \$24,098       | \$23,718          |
| Commitments to lend additional amounts to impaired borrowers | \$—            | \$—               |

Non-Performing Assets

Non-performing assets increased \$0.6 million to \$16.8 million, or 1.9% of assets at March 31, 2016, from \$16.2 million, or 1.8% of assets at December 31, 2015, and increased \$2.0 million from \$14.9 million, or 1.7% of assets at March 31, 2015.

The 3.4% increase in non-performing assets in the first three months of 2016 resulted primarily from \$1.3 million of loans placed on non-accrual status. This increase was offset in part by \$0.5 million in payoffs and repayments and \$0.2 million charged off.

The components of non-performing assets are as follows:

| (in thousands)                              | March 31, 2016 | December 31, 2015 |
|---|----------------|-------------------|
| Residential 1-4 family                      | \$ 6,613       | \$ 6,446          |
| Residential 5+ multifamily                  | 123            | 89                |
| Home equity lines of credit                 | 701            | 601               |
| Commercial                                  | 4,654          | 4,611             |
| Farm land                                   | 1,024          | 1,031             |
| Vacant land                                 | 2,854          | 2,855             |
| Real estate secured                         | 15,969         | 15,633            |
| Commercial and industrial                   | 861            | 461               |
| Consumer                                    | —              | 80                |
| Non-accruing loans                          | 16,830         | 16,174            |
| Accruing loans past due 90 days and over    | —              | 90                |
| Non-performing loans                        | 16,830         | 16,264            |
| Real estate acquired in settlement of loans | —              | —                 |
| Non-performing assets                       | \$ 16,830      | \$ 16,264         |

The past due status of non-performing loans is as follows:

| (in thousands)             | March 31, 2016 | December 31, 2015 |
|----------------------------|----------------|-------------------|
| Current                    | \$4,334        | \$4,496           |
| Past due 001-029 days      | 357            | 362               |
| Past due 030-059 days      | 446            | 306               |
| Past due 060-089 days      | 743            | 27                |
| Past due 090-179 days      | 615            | 1,320             |
| Past due 180 days and over | 10,335         | 9,753             |

Total non-performing loans \$16,830 \$16,264

At March 31, 2016, 25.75% of non-performing loans were current with respect to loan payments, compared with 27.65% at December 31, 2015. Loans past due 180 days include a \$2.8 million loan secured by vacant land (residential building lots) where Salisbury has initiated a foreclosure action that is referred to in Item 1 of Part II, Legal Proceedings.

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Troubled Debt Restructured Loans

Troubled debt restructured loans improved slightly as a percentage of gross loans during first quarter 2016 at \$10.6 million, or 1.44% of gross loans receivable at March 31, 2016, compared to \$10.6 million, or 1.50% of gross loans receivable at December 31, 2015.

The components of troubled debt restructured loans are as follows:

| (in thousands)                               | March 31, 2016 | December 31, 2015 |
|--|----------------|-------------------|
| Residential 1-4 family                       | \$4,329        | \$4,351           |
| Home equity lines of credit                  | 117            | 118               |
| Personal                                     | —              | 222               |
| Vacant land                                  | 219            | 122               |
| Commercial                                   | 2,540          | 2,666             |
| Real estate secured                          | 7,205          | 7,479             |
| Commercial and industrial                    | 63             | 65                |
| Accruing troubled debt restructured loans    | 7,268          | 7,544             |
| Residential 1-4 family                       | 1,235          | 1,149             |
| Commercial                                   | 1,763          | 1,554             |
| Real estate secured                          | 2,998          | 2,703             |
| Commercial and industrial                    | 330            | 341               |
| Non-accrual troubled debt restructured loans | 3,328          | 3,044             |
| Troubled debt restructured loans             | \$ 10,596      | \$ 10,588         |

The past due status of troubled debt restructured loans is as follows:

| (in thousands)                               | March 31, 2016 | December 31, 2015 |
|--|----------------|-------------------|
| Current                                      | \$6,315        | \$6,771           |
| Past due 1-29 days                           | 219            | 453               |
| Past due 30-59 days                          | 445            | 320               |
| Past due 60-89 days                          | 290            | —                 |
| Accruing troubled debt restructured loans    | 7,269          | 7,544             |
| Current                                      | 1,535          | 1,810             |
| Past due 1-29 days                           | —              | —                 |
| Past due 30-59 days                          | 73             | 28                |
| Past due 60-89 days                          | 284            | —                 |
| Past due 90-179 days                         | 229            | 1,206             |
| Past due 180 days and over                   | 1,206          | —                 |
| Non-accrual troubled debt restructured loans | 3,327          | 3,044             |
| Total troubled debt restructured loans       | \$ 10,596      | \$ 10,588         |

At March 31, 2016, 74.08% of troubled debt restructured loans were current with respect to loan payments, as compared with 81.04% at December 31, 2015.

Past Due Loans

Loans past due 30 days or more increased \$4.2 million during first quarter 2016 to \$20.1 million, or 2.74% of gross loans receivable at March 31, 2016, compared with \$15.9 million, or 2.26% of gross loans receivable at December 31, 2015.

The components of loans past due 30 days or greater are as follows:

| (in thousands)                          | March 31, 2016 | December 31, 2015 |
|---|----------------|-------------------|
| Past due 030-059 days                   | \$6,835        | \$3,533           |
| Past due 060-089 days                   | 1,160          | 966               |
| Past due 090-179 days                   | —              | —                 |
| Past due 180 days and over              | —              | 90                |
| Accruing loans                          | 7,995          | 4,589             |
| Past due 030-059 days                   | 446            | 306               |
| Past due 060-089 days                   | 743            | 27                |
| Past due 090-179 days                   | 615            | 1,320             |
| Past due 180 days and over              | 10,334         | 9,663             |
| Non-accrual loans                       | 12,138         | 11,316            |
| Total loans past due 30 days or greater | \$20,133       | \$15,905          |

Potential Problem Loans

Potential problem loans increased \$3.2 million during the three months of 2016 to \$6.5 million, or 0.89% of gross loans receivable at March 31, 2016, compared with \$3.3 million, or 0.48% of gross loans receivable at December 31, 2015.

The components of potential problem loans are as follows:

| (in thousands)                         | March 31, 2016 | December 31, 2015 |
|--|----------------|-------------------|
| Residential 1-4 family                 | \$1,355        | \$655             |
| Residential 5+ multifamily             | —              | —                 |
| Construction of residential 1-4 family | —              | —                 |
| Home equity lines of credit            | 130            | 150               |
| Residential real estate                | 1,485          | 805               |
| Commercial                             | 4,839          | 2,030             |
| Construction of commercial             | —              | —                 |
| Commercial real estate                 | 4,839          | 2,030             |
| Farm land                              | —              | —                 |
| Vacant land                            | 23             | 23                |
| Real estate secured                    | 6,347          | 2,858             |
| Commercial and industrial              | 168            | 478               |
| Consumer                               | 2              | 6                 |
| Other classified loans receivable      | \$6,517        | \$3,342           |

The past due status of potential problem loans is as follows:

| (in thousands)                | March 31, 2016 | December 31, 2015 |
|-------------------------------|----------------|-------------------|
| Current                       | \$5,183        | \$2,716           |
| Past due 001-029 days         | 24             | 229               |
| Past due 030-059 days         | 1,211          | 150               |
| Past due 060-089 days         | 99             | 247               |
| Past due 090-179 days         | —              | —                 |
| Total potential problem loans | \$6,517        | \$3,342           |

At March 31, 2016, 79.53% of potential problem loans were current with respect to loan payments, as compared with 81.27% at December 31, 2015.

Management cannot predict the extent to which economic or other factors may impact such borrowers' future payment capacity, and there can be no assurance that such loans will not be placed on nonaccrual status, restructured, or require increased provisions for loan losses.

## Deposits and Borrowings

Deposits increased \$1.1 million during first quarter 2016 to \$755.7 million, from \$754.5 million at December 31, 2015, and increased \$30.8 million year-over-year from \$724.9 million at March 31, 2015. Retail repurchase agreements decreased \$1.3 million during first quarter 2016 to \$2.6 million, compared with \$3.9 million at December 31, 2015, and decreased \$0.7 million for year-over-year compared with \$3.3 million at March 31, 2015.

Federal Home Loan Bank of Boston (FHLBB) advances are unchanged at \$27.0 million as of March 31, 2016, when compared to \$27.0 million at December 31, 2015, and decreased \$1.4 million year-over-year from \$28.4 million at March 31, 2015. The decreases were due to amortizing payments of advances, maturities of advances that were not renewed, and in accordance with ASC 470-50 for two advances which were modified during the quarter ending September 30, 2015. The modification extended \$21.0 million in advances a weighted average period of 39 months.

## Liquidity

Salisbury manages its liquidity position to ensure that there is sufficient funding availability at all times to meet both anticipated and unanticipated deposit withdrawals, loan originations and advances, securities purchases and other operating cash outflows. Salisbury's primary sources of liquidity are principal payments and maturities of securities and loans, short-term borrowings through repurchase agreements and FHLBB advances, net deposit growth and funds provided by operations. Liquidity can also be provided through sales of loans and available-for-sale securities.

Salisbury manages its liquidity in accordance with a liquidity funding policy, and also maintains a contingency funding plan that provides for the prompt and comprehensive response to unexpected demands for liquidity. At March 31, 2016, Salisbury's liquidity ratio, as represented by cash, short term available-for-sale securities and marketable assets to net deposits and short term unsecured liabilities, was 18.08%, down from 22.67% at December 31, 2015. Management believes Salisbury's funding sources will meet anticipated funding needs.

Operating activities for the three-month period ended March 31, 2016 provided net cash of \$2.9 million. Investing activities utilized net cash of \$32.7 million, principally from \$30.0 million of net loan originations and principal collections and \$10.1 million of purchases of securities available-for-sale offset by proceeds of \$7.6 million from sales, calls, and maturities of securities available-for-sale. Financing activities utilized net cash of \$0.8 million, principally due common stock dividends paid totaling \$0.8 million.

At March 31, 2016, Salisbury had outstanding commitments to fund new loan originations of \$25.1 million and unused lines of credit of \$119.4 million. Salisbury believes that these commitments can be met in the normal course of business. Salisbury believes that its liquidity sources will continue to provide funding sufficient to support operating activities, loan originations and commitments, and deposit withdrawals.

**RESULTS OF OPERATIONS****For the three month periods ended March 31, 2016 and 2015****OVERVIEW**

Net income available to common shareholders was \$1.5 million, or \$0.55 per common share, for the first quarter ended March 31, 2016 (first quarter 2016), compared with \$2.1 million, or \$0.78 per common share, for the fourth quarter ended December 31, 2015 (fourth quarter 2015), and \$2.2 million, or \$0.81 per common share, for the first quarter ended March 31, 2015 (first quarter 2015).

Earnings per common share of \$0.55 decreased \$0.23 versus fourth quarter 2015, and decreased \$0.26, versus first quarter 2015. The earnings for the quarter were down as compared to the fourth and first quarter 2015 primarily as the result of a lesser interest income benefit from the purchased loan portfolio, increased interest expenses related to our issuance of the subordinated debt offering last December, an increase in expenses related to adjustments from sold loans serviced for others, and an increase in provision for loan losses as a result of the exceptional loan growth.

The net interest margin of 3.80% decreased 8 basis points versus 3.88% for the fourth quarter 2015 and decreased 31 basis points versus 4.11% for the first quarter 2015.

Net loans increased \$29.8 million, or 4.3%, in the first quarter 2016 to \$728.8 million versus the fourth quarter 2015 and increased \$52.1 million, or 7.7% versus the first quarter 2015.

Interest income for the first quarter reflects net accretion related to the fair value adjustments of loans acquired in the Riverside Bank acquisition in the amount of \$586,000 (\$443,000 net of impairments). The fourth quarter and first quarter of 2015 included similar adjustments of \$691,000 (\$728,000 net of impairments) and \$650,000 (\$650,000 net of impairments), respectively.

Provision for loan loss expense (benefit) was \$463,000 for first quarter 2016 versus \$266,000 for fourth quarter 2015, and (\$200,000) for first quarter 2015. Net loan charge-offs (recoveries) were \$302,000 for the first quarter 2016, \$209,000 for fourth quarter 2015 and (\$24,000) for the first quarter 2015. Included in the provision expense are impairments related to ASC310-30 acquired loans of \$143,000 for the first quarter 2016, (\$28,000) for the fourth quarter 2015, and \$0 for the first quarter 2015. Reserve coverage, as measured by the ratio of the allowance for loan losses to gross loans, was 0.80% for the first quarter 2016, versus 0.81% for fourth quarter 2015 and 0.76% for first quarter 2015.

Tax equivalent net interest income for first quarter 2016 decreased \$250,000, or 3.0%, versus fourth quarter 2015, and decreased \$264,000 or 3.2%, versus first quarter 2015.

**Net Interest Income**

Tax equivalent net interest income for first quarter 2016 decreased \$250,000, or 3.0%, versus fourth quarter 2015, and decreased \$264,000 or 3.2%, versus first quarter 2015. Average earning assets decreased \$3.2 million versus fourth quarter 2015, and increased \$37.4 million versus first quarter 2015. Average total interest bearing deposits increased \$3.7 million versus fourth quarter 2015 and increased \$2.3 million versus first quarter 2015. The net interest margin of 3.80% decreased 8 basis points versus 3.88% for the fourth quarter 2015 and decreased 31 basis points versus 4.11% for the first quarter 2015.



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The following table sets forth the components of Salisbury's fully tax-equivalent ("FTE") net interest income and yields on average interest-earning assets and interest-bearing liabilities.

| Three months ended March 31,<br>(dollars in thousands) | Average Balance |           | Income / Expense |         | Average Yield / Rate |        |
|--|-----------------|-----------|------------------|---------|----------------------|--------|
|  | 2016            | 2015      | 2016             | 2015    | 2016                 | 2015   |
| Loans (a)(d)   | \$721,618       | \$681,277 | \$8,101          | \$8,029 | 4.47 %               | 4.72 % |
| Securities (c)(d)                                      | 72,964          | 84,356    | 718              | 921     | 3.94                 | 4.37   |
| FHLBB stock  | 3,157           | 3,515     | 28               | 15      | 3.55                 | 1.78   |
| Short term funds (b)                                   | 41,618          | 32,780    | 46               | 18      | 0.45                 | 0.21   |
| Total interest-earning assets                          | 839,357         | 801,928   | 8,893            | 8,983   | 4.23                 | 4.49   |
| Other assets   | 59,079          | 61,078    |                  |         |                      |        |
| Total assets   | \$898,436       | \$863,006 |                  |         |                      |        |
| Interest-bearing demand deposits                       | \$125,733       | \$117,193 | 77               | 76      | 0.25                 | 0.26   |
| Money market accounts                                  | 189,167         | 173,268   | 135              | 114     | 0.28                 | 0.27   |
| Savings and other                                      | 123,299         | 127,118   | 53               | 54      | 0.17                 | 0.17   |
| Certificates of deposit                                | 123,207         | 141,568   | 243              | 200     | 0.79                 | 0.83   |
| Total interest-bearing deposits                        | 561,406         | 559,147   | 508              | 444     | 0.36                 | 0.32   |
| Repurchase agreements                                  | 3,083           | 3,408     | 1                | 1       | 0.14                 | 0.18   |
| Note payable   | 373             | —         | 5                | —       | 5.44                 | 0.00   |
| Subordinated debt                                      | 9,767           | —         | 156              | —       | 6.39                 | 0.00   |
| Capital lease  | 421             | 423       | 18               | 18      | 17.10                | 16.57  |
| FHLBB advances   | 27,002          | 28,545    | 231              | 282     | 3.39                 | 3.95   |
| Total interest-bearing liabilities                     | 602,052         | 591,523   | 919              | 745     | 0.61                 | 0.51   |
| Demand deposits  | 196,212         | 160,324   |                  |         |                      |        |
| Other liabilities                                      | 8,928           | 8,071     |                  |         |                      |        |
| Shareholders' equity                                   | 91,244          | 103,088   |                  |         |                      |        |
| Total liabilities & shareholders' equity               | \$898,436       | \$863,006 |                  |         |                      |        |
| Net interest income                                    |                 |           | \$7,974          | \$8,238 |                      |        |
| Spread on interest-bearing funds                       |                 |           |                  |         | 3.62                 | 3.98   |
| Net interest margin (e)                                |                 |           |                  |         | 3.80                 | 4.11   |

(a) Includes non-accrual loans.

(b) Includes interest-bearing deposits in other banks and federal funds sold.

(c) Average balances of securities are based on historical cost.

(d) Includes tax exempt income benefit of \$315,000 and \$312,000, respectively, for 2016 and 2015 on tax-exempt securities and loans whose income and yields are calculated on a tax-equivalent basis.

(e) Net interest income divided by average interest-earning assets.

The following table sets forth the changes in FTE interest due to volume and rate.

| Three months ended March 31, (in thousands) | 2016 versus 2015 |         |       |
|---|------------------|---------|-------|
| Change in interest due to                   | Volume           | Rate    | Net   |
| Interest-earning assets                     |                  |         |       |
| Loans                                       | \$464            | \$(392) | \$72  |
| Securities                                  | (119)            | (84)    | (203) |
| FHLBB stock                                 | (1)              | 14      | 13    |
| Short term funds                            | 7                | 21      | 28    |
| Total                                       | 351              | (441)   | (90)  |
| Interest-bearing liabilities                |                  |         |       |
| Deposits                                    | (17)             | 81      | 64    |

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|                                   |       |         |         |
|-----------------------------------|-------|---------|---------|
| Repurchase agreements             | —     | —       | —       |
| Note payable                      | 3     | 2       | 5       |
| Subordinated debt                 | 78    | 78      | 156     |
| Capital lease                     | —     | —       | —       |
| FHLBB advances                    | (14 ) | (37 )   | (51 )   |
| Total                             | 50    | 124     | 174     |
| Net change in net interest income | \$301 | \$(565) | \$(264) |

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Interest Income

Tax equivalent interest income decreased \$0.3 million to \$8.0 million for first quarter 2016 as compared with first quarter 2015.

Loan income as compared to first quarter 2015 increased \$0.1 million, or 0.9%, primarily due to a \$40.3 million, or 5.6%, increase in average loans, partially offset by a 25 basis point decrease in the average loan yield. The first quarter of 2016 reflects the net accretion of \$586,000 related to fair value adjustments of loans related to the Riverside acquisition compared to net accretion of \$650,000 in first quarter 2015. Additionally, recoveries in excess of book value of previously charged off loans also contributed \$34,000 to interest income in the first quarter of 2015.

Tax equivalent securities income decreased \$0.2 million, or 21.9%, for first quarter 2016 as compared with first quarter 2015, primarily due to an \$11.4 million, or 13.5%, decrease in average volume due to calls, prepayments of mortgage-backed securities, sales of municipal bonds and by a 43 basis point decrease in average yield.

Interest Expense

Interest expense increased \$0.2 million, or 23.4%, to \$0.9 million for first quarter 2016 as compared with first quarter 2015.

Interest on deposit accounts increased \$0.1 million, or 14.6%, as a result of a \$2.3 million increase in the average balances and by higher average deposit rates, up 4 basis points. The higher average rate resulted from the effect of market interest rates paid on interest bearing deposits and changes in product mix.

Interest expense on FHLBB borrowings decreased \$0.1 million as a result of the lower average borrowing rate, down 56 basis points, and an average balance decrease of \$1.5 million as compared with first quarter 2015. Interest expense on subordinated debt totaled \$156,000 for first quarter 2016.

**Provision and Allowance for Loan Losses**

Provision for loan loss expense (benefit) was \$463,000 for first quarter 2016 versus (\$200,000) for first quarter 2015. Included in the provision are impairments related to ASC310-30 purchased loans of \$143,000 for the first quarter 2016 and \$0 for the first quarter 2015. Net loan charge-offs (recoveries) were \$302,000 for the first quarter 2016 and (\$24,000) for the first quarter 2015. Reserve coverage, as measured by the ratio of the allowance for loan losses to gross loans, was 0.80% for the first quarter 2016, versus 0.76% for first quarter 2015.

The following table details the principal categories of credit quality ratios:

| March 31, (dollars in thousands)                                | 2016   | 2015     |
|---|--------|----------|
| Net charge-offs (recoveries) to average loans receivable, gross | 0.17 % | (0.01 )% |
| Non-performing loans to loans receivable, gross                 | 2.29   | 2.05     |
| Accruing loans past due 30-89 days to loans receivable, gross   | 1.09   | 0.82     |
| Allowance for loan losses to loans receivable, gross            | 0.80   | 0.76     |
| Allowance for loan losses to non-performing loans               | 34.92  | 37.02    |
| Non-performing assets to total assets                           | 1.89   | 1.72     |

The ratio of non-performing loans (non-accrual loans and accruing loans past-due 90 days or more) to gross loans receivable increased to 2.29% at March 31, 2016 compared to 2.05% at March 31, 2015. Such increase in non-performing loans is concentrated among a few specific relationships and is not considered to be generally indicative of any adverse trend. The ratio of accruing loans past due 30-89 days to gross loans receivable increased to 1.09% from 0.82% at March 31, 2015.

The allowance for loan losses represents management's estimate of the probable credit losses inherent in the loan portfolio as of the reporting date. The allowance is increased by provisions charged to earnings and by recoveries of amounts previously charged off, and is reduced by loan charge-offs. Loan charge-offs are recognized when management determines a loan, or portion of a loan, to be uncollectible. The allowance for loan losses is computed by segregating the portfolio into three components: (1) loans collectively evaluated for impairment: general loss allocation factors for non-impaired loans are segmented into pools of loans based on similar risk characteristics such as loan product, collateral type and loan-to-value, loan risk rating, historical loss experience, delinquency factors and other similar economic indicators, (2) loans individually evaluated for impairment: individual loss allocations for loans deemed to be impaired based on discounted cash flows or collateral value, and (3) unallocated: general loss allocations for other environmental factors.

Impaired loans and certain potential problem loans, when warranted, are individually evaluated for impairment. Impairment is measured for each individual loan, or for a borrower's aggregate loan exposure, using either the fair value of the collateral, less estimated costs to sell if the loan is collateral dependent, or the present value of expected future cash flows discounted at the loan's effective interest rate. A specific allowance is generally established when the collateral value or discounted cash flows of the loan is lower than the carrying value of that loan.

The component of the allowance for loan losses for loans collectively evaluated for impairment is estimated by stratifying loans into segments and credit risk ratings and then applying management's general loss allocation factors. The general loss allocation factors are based on expected loss experience adjusted for historical loss experience and other qualitative factors, including levels or trends in delinquencies; trends in volume and terms of loans; effects of changes in risk selection and underwriting standards and other changes in lending policies, procedures and practices; experience/ability/depth of lending management and staff; and national and local economic trends and conditions. The qualitative factors are determined based on the various risk characteristics of each loan segment. There were no significant changes in Salisbury's policies or methodology pertaining to the general component of the allowance for loan losses during first quarter 2016.

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

Determining the adequacy of the allowance and reserves at any given period is difficult, particularly during deteriorating or uncertain economic periods, and management must make estimates using assumptions and information that are often subjective and changing rapidly. The review of credit exposure related to loans is a continuing event in light of a changing economy and the dynamics of the banking and regulatory environment. Should the economic climate deteriorate, borrowers could experience difficulty and the level of non-performing loans, charge-offs and delinquencies could rise, requiring increased provisions and reserves. In management's judgment, Salisbury remains adequately reserved both against total loans and non-performing loans at March 31, 2016.

Management's loan risk rating assignments, loss percentages and specific reserves are subjected annually to an independent credit review by an external firm. In addition, the Bank is examined annually on a rotational basis by one of its two primary regulatory agencies, the FDIC and CTDOB. As an integral part of their examination process, the FDIC and CTDOB review the adequacy and methodology of the Bank's credit risk ratings and allowance for loan losses.

### Non-Interest Income

The following table details the principal categories of non-interest income.

| Three months ended March 31, (dollars in thousands)  | 2016    | 2015    | 2016 vs. 2015 |           |
|--|---------|---------|---------------|-----------|
| Trust and wealth advisory fees                       | \$784   | \$822   | \$(38 )       | (4.62 )%  |
| Service charges and fees                             | 730     | 731     | (1 )          | (0.14 )   |
| Gains on sales of mortgage loans, net                | 39      | 94      | (55 )         | (58.51 )  |
| Mortgage servicing, net                              | 12      | (40 )   | 52            | 130.00    |
| Gains on sales of available-for-sale securities, net | 2       | 175     | (173)         | (98.86 )  |
| Other  | 117     | 114     | 3             | 2.63      |
| Total non-interest income                            | \$1,684 | \$1,896 | \$(212)       | (11.18 )% |

Non-interest income decreased \$212,000, or 11.18% in 2016 versus 2015. Trust and wealth advisory revenues decreased \$38,000 versus first quarter 2015. The year-over-year revenue decrease is the result of fewer estate fees

collected in first quarter 2016. Service charges and fees decreased \$1,000 versus first quarter 2015. Income from sales and servicing of mortgage loans decreased \$3,000 versus first quarter 2015 due to a decrease in servicing values as a result of a decline in the discount rate. First quarter 2016 mortgage loans sales totaled \$1.8 million versus \$2.1 million for first quarter 2015. First quarter 2016 and first quarter 2015 included mortgage servicing amortization and periodic impairment charges (net) of \$71,000 and \$128,000, respectively. Gain on sale and calls of securities for the first quarter 2016 totaled \$2,000. Gains recognized in the first quarter of 2016 resulted from called securities, and gains in first quarter 2015 resulted from called and sold securities. Other income includes bank owned life insurance income and rental income.

**Non-Interest Expense**

The following table details the principal categories of non-interest expense.

| Three months ended March 31,<br>(dollars in thousands) | 2016    | 2015    | 2016 vs. 2015 |         |
|--|---------|---------|---------------|---------|
| Salaries   | \$2,574 | \$2,540 | \$34          | 1.34 %  |
| Employee benefits                                      | 1,088   | 1,005   | 83            | 8.26    |
| Premises and equipment                                 | 895     | 908     | (13 )         | (1.43 ) |
| Data processing  | 447     | 474     | (27 )         | (5.70 ) |
| Professional fees                                      | 380     | 650     | (270)         | (41.54) |
| Collections and OREO                                   | 157     | 244     | (87 )         | (35.66) |
| FDIC insurance   | 134     | 198     | (64 )         | (32.32) |
| Marketing and community support                        | 200     | 110     | 90            | 81.82   |
| Amortization of intangible assets                      | 155     | 169     | (14 )         | (8.28 ) |
| Other  | 810     | 537     | 273           | 50.84   |
| Non-interest expense                                   | \$6,840 | \$6,835 | \$5           | 0.07 %  |

Non-interest expense for first quarter 2016 increased \$5,000 versus first quarter 2015. Total salaries and benefits expense increased \$117,000 versus first quarter 2015. The total compensation expenses year-over-year increase of \$117,000 is mainly attributable to increased staffing levels and timing differences related to the 401K match and payroll taxes associated with the prior year's performance related compensation. Premises and equipment decreased \$13,000 versus first quarter 2015, mainly related to lower fuel and utility costs. Data processing decreased \$27,000 versus first quarter 2015. Tax preparation expenses totaling \$18,000 were reclassified from data processing to consulting in 2016. Professional fees decreased \$270,000 versus first quarter 2015, which included consulting and audit fees related to the Riverside merger. Loan related expenses decreased \$87,000 versus first quarter 2015, mainly due to the write-downs associated with OREO properties in first quarter 2015. Other expense increased \$273,000 versus first quarter 2015 primarily as a result of expenses related to sold loans serviced for others.

**Income Taxes**

The effective income tax rates for first quarter 2016 and first quarter 2015 were 25.9% and 29.9%, respectively. Generally, fluctuations in the effective tax rate result from changes in the mix of taxable and tax exempt income. The sale of \$3.9 million of municipal securities in first quarter 2015 contributed to the increase in the effective tax rate for that quarter. Salisbury's effective tax rate is generally less than the 34% federal statutory rate due to holdings of tax-exempt municipal bonds and loans as well as bank owned life insurance.

Salisbury did not incur Connecticut income tax in 2015 or 2014, other than minimum state income tax, as a result of its utilization of Connecticut tax legislation that permits banks to shelter certain mortgage income from the Connecticut corporation business tax through the use of a special purpose entity called a Passive Investment Company ("PIC"). In accordance with this legislation, in 2004 the Bank formed a PIC, SBT Mortgage Service Corporation. Salisbury's income tax provision reflects the full impact of the Connecticut legislation.

**CAPITAL RESOURCES**

Shareholders' equity was \$91.4 million at March 31, 2016, up \$0.8 million from December 31, 2015. Book value and tangible book value per common share were \$33.20 and \$27.84, respectively, compared with \$33.13 and \$27.69, respectively, at December 31, 2015. Contributing to the increase in shareholders' equity for year-to-date 2016 was net income of \$1.5 million and issued stock of \$0.1 million, partially offset by common stock dividends of \$0.8 million. Accumulated other comprehensive income consists of unrealized gains on securities available-for-sale, net of tax, of \$1.1 million as of March 31, 2016.

In August 2011, Salisbury issued to the Treasury \$16 million of its Series B Preferred Stock under the SBLF program. The SBLF program is a \$30 billion fund established under the Small Business Jobs Act of 2010 to encourage lending to small businesses by providing Tier 1 capital to qualified community banks with assets of less than \$10 billion. The Preferred Stock qualified as Tier 1 capital for regulatory purposes and ranked senior to the Common Stock.



The Series B Preferred Stock paid noncumulative dividends. The dividend rate on the Series B Preferred Stock for the initial quarterly dividend period ended September 30, 2011, and each of the next nine quarterly dividend periods the Series B Preferred Stock was outstanding, was determined each quarter based on the increase in the Bank's Qualified Small Business Lending. The dividend rate for the quarterly dividend period ended December 31, 2016, was 1.0%. For the eleventh quarterly dividend period through four and one-half years after its issuance, the dividend rate on the Series B Preferred Stock was 1.0% and after four and one-half years from its issuance the dividend rate would have been fixed at 9.0% per annum. In December 2015, Salisbury issued \$10 million of subordinated debentures and used the proceeds along with other cash-on-hand to redeem all of the Series B Preferred Stock.

On February 16, 2016, 1,350 shares of stock options were exercised at \$21.48 per share by one former Riverside Bank executive.

On January 26, 2016, 2,700 shares of stock options were exercised at \$21.48 per share by two former Riverside Bank executives.

On September 28, 2015, 2,700 shares of stock options were exercised at \$21.48 per share by one former Riverside Bank executive.

On February 17, 2015 and February 25, 2015, 1,350 and 5,400 shares of stock options were exercised, respectively, at \$18.52 per share by two former Riverside Bank executives.

On January 29, 2016, Salisbury granted a total of 15,800 shares of restricted stock pursuant to its 2011 Long Term Incentive Plan, which was approved by shareholders at the 2011 Annual Meeting, to 42 employees, including 6,000 shares to three Named Executive Officers. Richard J. Cantele, Jr., President and Chief Executive Officer received 5,000 and John Davies, President New York Region and Chief Lending Officer and Donald E. White, Chief Financial Officer each received 500 shares. The fair value of the stock as of the grant date was determined to be \$466,000 and the stock will be vested three years from the grant date.

On March 27, 2015, Salisbury granted a total of 1,000 shares of restricted stock, pursuant to its 2011 Long Term Incentive Plan, to one (1) Named Executive Officer, Richard J. Cantele, Jr., President and Chief Executive Officer. The fair value of the stock as of the grant date was determined to be \$29,000 and the stock vested immediately.

## **Capital Requirements**

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

Salisbury and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Salisbury and the Bank must meet specific guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices.

Under current regulatory definitions, Salisbury and the Bank meet all capital adequacy requirements to which they are subject and the Bank is considered to be well-capitalized. As a result, the Bank pays lower federal deposit insurance premiums than those banks that are not "well-capitalized." Requirements for classification as a well-capitalized institution and for minimum capital adequacy along with Salisbury's and the Bank's regulatory capital ratios are as

follows:

|  | March 31, 2016 |        | December 31, 2015 |        |
|--|----------------|--------|-------------------|--------|
|  | Salisbury      | Bank   | Salisbury         | Bank   |
| Total Capital (to risk-weighted assets)                | 12.92 %        | 12.53% | 13.51 %           | 13.10% |
| Tier 1 Capital (to risk-weighted assets)               | 10.69          | 11.68  | 11.17             | 12.23  |
| Common Equity Tier 1 Capital (to risk-weighted assets) | 10.69          | 11.68  | 11.17             | 12.23  |
| Tier 1 Capital (to average assets)                     | 8.57           | 9.51   | 8.56              | 9.37   |

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A well-capitalized institution, which is the highest capital category for an institution as defined by the Prompt Corrective Action regulations issued by the FDIC and the FRB, is one which maintains a Total Risk-Based ratio of 10% or above, a Tier 1 Risk-Based ratio of 8% or above, a Common Equity to Tier 1 ratio of 6.5% or above, and a Leverage ratio of 5% or above, and is not subject to any written order, written agreement, capital directive, or prompt corrective action directive to meet and maintain a specific capital level. Maintaining strong capital is essential to Salisbury and the Bank's safety and soundness. However, the effective management of capital resources requires generating attractive returns on equity to build value for shareholders while maintaining appropriate levels of capital to fund growth, meet regulatory requirements and be consistent with prudent industry practices.

In July 2013, the Federal Reserve Bank (FRB) approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for bank holding companies and their bank subsidiaries. On July 9, 2013, the FDIC also approved, as an interim final rule, the regulatory capital requirements for U.S. banks, following the actions of the FRB. On April 8, 2014, the FDIC adopted as final its interim final rule, which is identical in substance to the final rules issued by the FRB in July 2013. Under the final rules, minimum requirements will increase for both the quantity and quality of capital held by the Bank and Company. The rules include a new common equity Tier 1 capital to risk-weighted assets minimum ratio of 4.5%, raise the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0%, require a minimum ratio of Total capital to risk-weighted assets of 8.0%, and require a minimum Tier 1 leverage ratio of 4.0%. A new capital conservation buffer, comprised of common equity Tier 1 capital, is also established above the regulatory minimum capital requirements. This capital conservation buffer is being phased in beginning January 1, 2016 at 0.625% of risk-weighted assets and increases each subsequent year by an additional 0.625% until reaching its final level of 2.50% on January 1, 2019. Strict eligibility criteria for regulatory capital instruments were also implemented under the final rules.

The phase-in period for the final rules began for Salisbury and the Bank on January 1, 2015. As of March 31, 2016, the Company and the Bank met each of their capital requirements and the most recent notification from the FDIC categorized the Bank as "well-capitalized." There are no conditions or events since that notification that management believes have changed the Bank's category.

### Dividends

During the three month period ended March 31, 2016, Salisbury paid \$772,000 in common stock dividends.

On April 29, 2016, the Board of Directors of Salisbury declared a common stock dividend of \$0.28 per common share payable on May 27, 2016 to shareholders of record on May 13, 2016. Common stock dividends, when declared, will generally be paid the last Friday of February, May, August and November, although Salisbury is not obligated to pay dividends on those dates or at any other time.

Salisbury's ability to pay cash dividends is dependent on the Bank's ability to pay cash dividends to Salisbury. There are certain restrictions on the payment of cash dividends and other payments by the Bank to Salisbury. Under Connecticut law, the Bank cannot declare a cash dividend except from net profits, defined as the remainder of all earnings from current operations. The total of all cash dividends declared by the Bank in any calendar year shall not, unless specifically approved by the Banking Commissioner, exceed the total of its net profits of that year combined with its retained net profits of the preceding two years.

FRB Supervisory Letter SR 09-4, February 24, 2009, revised December 31, 2015, states that, as a general matter, the Board of Directors of a Bank Holding Company ("BHC") should inform the Federal Reserve and should eliminate, defer, or significantly reduce dividends if (1) net income available to shareholders for the past four quarters, net of dividends previously paid during that period, is not sufficient to fully fund the dividends; (2) the prospective rate of earnings retention is not consistent with capital needs and overall current and prospective financial condition; or (3) the BHC will not meet, or is in danger of not meeting, its minimum regulatory capital adequacy ratios. Moreover, a

BHC should inform the Federal Reserve reasonably in advance of declaring or paying a dividend that exceeds earnings for the period (e.g., quarter) for which the dividend is being paid or that could result in a material adverse change to the BHC capital position.

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Salisbury believes that the payment of common stock cash dividends is appropriate, provided that such payment considers Salisbury's capital needs, asset quality, and overall financial condition and does not adversely affect the financial stability of Salisbury or the Bank. The continued payment of common stock cash dividends by Salisbury will be dependent on Salisbury's future core earnings, financial condition and capital needs, regulatory restrictions, and other factors deemed relevant by the Board of Directors of Salisbury.

## IMPACT OF INFLATION AND CHANGING PRICES

Salisbury's consolidated financial statements and related notes thereto presented elsewhere in this Form 10-K are prepared in conformity with GAAP, which require the measurement of financial condition and operating results in terms of historical dollars without considering changes in the relative purchasing power of money, over time, due to inflation. Unlike some other types of companies, the financial nature of Salisbury's consolidated financial statements is more clearly affected by changes in interest rates than by inflation. Interest rates do not necessarily fluctuate in the same direction or in the same magnitude as the prices of goods and services. However, inflation does affect Salisbury to some extent because, as prices increase, the money supply grows and interest rates are affected by inflationary expectations. There is no precise method, however, to measure the effects of inflation on the Company's consolidated financial statements. Accordingly, any examination or analysis of the financial statements should take into consideration the possible effects of inflation. Although not a material factor in recent years, inflation could impact earnings in future periods.

## FORWARD-LOOKING STATEMENTS

This Form 10-Q and future filings made by Salisbury with the Securities and Exchange Commission, as well as other filings, reports and press releases made or issued by Salisbury and the Bank, and oral statements made by executive officers of Salisbury and the Bank, may include forward-looking statements relating to such matters as:

- (a) assumptions concerning future economic and business conditions and their effect on the economy in general and on the markets in which Salisbury and the Bank do business; and
- (b) expectations for revenues and earnings for Salisbury and the Bank.

Such forward-looking statements are based on assumptions rather than historical or current facts and, therefore, are inherently uncertain and subject to risk. For those statements, Salisbury claims the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

Salisbury notes that a variety of factors could cause the actual results or experience to differ materially from the anticipated results or other expectations described or implied by such forward-looking statements. The risks and uncertainties that may affect the operation, performance, development and results of Salisbury's and the Bank's business include the following:

- (a) the risk of adverse changes in business conditions in the banking industry generally and in the specific markets in which the Bank operates;
- (b) changes in the legislative and regulatory environment that negatively impacts Salisbury and the Bank through increased operating expenses;
  - (c) increased competition from other financial and non-financial institutions;
  - (d) the impact of technological advances and cybersecurity matters;
  - (e) interest rate fluctuations; and

(f) other risks detailed from time to time in Salisbury's filings with the Securities and Exchange Commission. Such developments could have an adverse impact on Salisbury's and the Bank's financial position and results of operations.

## Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Salisbury manages its exposure to interest rate risk through its Asset/Liability Management Committee (“ALCO”) using risk limits and policy guidelines to manage assets and funding liabilities to produce financial results that are consistent with Salisbury’s liquidity, capital adequacy, growth, risk and profitability targets. Interest rate risk is the risk of a negative impact to future earnings due to changes in interest rates.

The ALCO manages interest rate risk using income simulation to measure interest rate risk inherent in Salisbury’s financial instruments at a given point in time by showing the effect of interest rate shifts on net interest income over a 24-month horizon. In management’s March 31, 2016 analysis, three of the simulations incorporate static growth assumptions over the simulation horizons, with allowances made for loan, deposit and security product mix shifts in selected interest rate scenarios, such as movements between lower rate savings and money market deposit accounts and higher rate time deposits, and changes in the reinvestment of loan and securities cash flows. The fourth simulation incorporates management’s balance sheet growth assumptions. Additionally, the simulations take into account the specific re-pricing, maturity and prepayment characteristics of differing financial instruments that may vary under different interest rate scenarios.

The ALCO reviews the simulation results to determine whether Salisbury’s exposure to change in net interest income remains within established tolerance levels over the simulation horizons and to develop appropriate strategies to manage this exposure. Salisbury’s tolerance levels for changes in net interest income in its income simulations vary depending on the magnitude of interest rate changes and level of risk-based capital. All changes are measured in comparison to the projected net interest income that would result from an “unchanged” rate scenario where interest rates remain stable over the forecast horizon. The ALCO also evaluates the directional trends of net interest income, net interest margin and other financial measures over the forecast horizon for consistency with its liquidity, capital adequacy, growth, risk and profitability targets.

ALCO uses four interest rate scenarios to evaluate interest risk exposure and may vary these interest rate scenarios to show the effect of steepening or flattening changes in yield curves as well as parallel changes in interest rates. At March 31, 2016, ALCO used the following interest rate scenarios: (1) unchanged interest rates; (2) immediately rising interest rates – immediate parallel upward shift in market interest rates ranging from 300 basis points for short term rates to 300 basis points for the 10-year Treasury; (3) immediately falling interest rates – immediate non-parallel downward shift in market interest rates ranging from 57 basis points for short term rates to 77 basis points for the 10-year Treasury; and (4) immediately rising interest rates – immediate parallel upward shift in market interest rates ranging from 200 basis points for short term rates to 200 basis points for the 10-year Treasury. Deposit rates are assumed to shift by lesser amounts due to their relative historical insensitivity to market interest rate movements. Further, deposits are assumed to have certain minimum rate levels below which they will not fall. Income simulations do not reflect adjustments in strategy that the ALCO could implement in response to rates. As of March 31, 2016, net interest income simulations indicated that the Bank’s exposure to changing interest rates over the simulation horizons remained within its tolerance levels. The following table sets forth the estimated change in net interest income from an unchanged interest rate scenario over the periods indicated for changes in market interest rates using the Bank’s financial instruments as of March 31, 2016:

| As of March 31, 2016   | Months 1-12 | Months 13-24 |
|--|-------------|--------------|
| Immediately rising interest rates (static growth assumptions)  | (6.09 )%    | 1.93 %       |
| Immediately falling interest rates (static growth assumptions) | (1.71 )     | (4.17 )      |
| Immediately rising interest rates (static growth assumptions)  | (3.23 )     | 3.17         |

The negative exposure of net interest income to immediately and gradually rising rates as compared to the unchanged rate scenario results from a faster projected rise in the cost of funds versus income from earning assets, as relatively rate-sensitive money market and time deposits re-price faster than longer duration earning assets. The negative

exposure of net interest income to immediately falling rates as compared to an unchanged rate scenario results from a greater decline in earning asset yields compared to rates paid on funding liabilities, as a result of faster prepayments on existing assets and lower reinvestment rates on future loans originated and securities purchased.

While the ALCO reviews simulation assumptions and back-tests simulation results to ensure that they are reasonable and current, income simulation may not always prove to be an accurate indicator of interest rate risk or future net interest margin. Over time, the re-pricing, maturity and prepayment characteristics of financial instruments and the composition of Salisbury's balance sheet may change to a different degree than estimated. Simulation modeling assumes Salisbury's expectation for future balance sheet growth, which is a function of the business environment and customer behavior. Another significant simulation assumption is the sensitivity of core savings deposits to fluctuations in interest rates. Income simulation results assume that changes in both core savings deposit rates and balances are related to changes in short-term interest rates. The assumed relationship between short-term interest rate changes and core deposit rate and balance changes used in income simulation may differ from the ALCO's estimates. Lastly, mortgage-backed securities and mortgage loans involve a level of risk that unforeseen changes in prepayment speeds may cause related cash flows to vary significantly in differing rate environments. Such changes could affect the level of reinvestment risk associated with cash flow from these instruments, as well as their market value. Changes in prepayment speeds could also increase or decrease the amortization of premium or accretion of discounts related to such instruments, thereby affecting interest income.

Salisbury also monitors the potential change in market value of its available-for-sale debt securities in changing interest rate environments. The purpose is to determine market value exposure that may not be captured by income simulation, but which might result in changes to Salisbury's capital and liquidity position. Results are calculated using industry-standard analytical techniques and securities data. Available-for-sale equity securities are excluded from this analysis because the market value of such securities cannot be directly correlated with changes in interest rates.

The following table summarizes the potential change in market value of available-for-sale debt securities resulting from immediate parallel rate shifts:

| As of March 31, 2016 (in thousands)      | Rates up 100bp | Rates up 200bp |
|--|----------------|----------------|
| U.S. Treasury notes                      | \$(22)         | \$(44)         |
| U.S. Government agency notes             | —              | —              |
| Municipal bonds                          | (1,145)        | (2,148)        |
| Mortgage backed securities               | (800)          | (1,882)        |
| Collateralized mortgage obligations      | (248)          | (376)          |
| SBA pools                                | (6)            | (13)           |
| Other                                    | (22)           | (40)           |
| Total available-for-sale debt securities | \$(2,243)      | \$(4,503)      |

#### Item 4. CONTROLS AND PROCEDURES

##### Evaluation of Disclosure Controls and Procedures

Salisbury's management, including its Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of Salisbury's disclosure controls and procedures as of March 31, 2016. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures are effective as of March 31, 2016.

Disclosure controls and procedures are controls and other procedures that are designed to ensure that the information required to be disclosed in reports filed or submitted under the Securities Exchange Act of 1934, as amended (the "Exchange Act") is recorded, processed, summarized and reported within the time periods specified in the Securities and



Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in our reports filed under the Exchange Act is accumulated and communicated to management, including the principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Controls

In addition, based on an evaluation of its internal controls over financial reporting, no change in Salisbury's internal control over financial reporting occurred during the quarter ended March 31, 2016 that has materially affected, or is reasonably likely to materially affect, Salisbury's internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **Item 1. LEGAL PROCEEDINGS**

The Bank is involved in various claims and legal proceedings, which are not material, arising in the ordinary course of business.

As previously disclosed, the Bank, individually and in its capacity as a former Co-Trustee of the Erling C. Christophersen Revocable Trust (the "Trust"), was named as a defendant in litigation filed in the Connecticut Complex Litigation Docket in Stamford, captioned John Christophersen v. Erling Christophersen, et al., X08-CV-08-5009597S (the "First Action"). The Bank also was a counterclaim-defendant in related mortgage foreclosure litigation in the Connecticut Complex Litigation Docket in Stamford, captioned Salisbury Bank and Trust Company v. Erling C. Christophersen, et al., X08-CV-10-6005847-S (the "Foreclosure Action," together with the First Action, the "Actions"). The other parties to the Actions were John R. Christophersen; Erling C. Christophersen, individually and as Co-Trustee of the Trust; Bonnie Christophersen and Elena Dreiske, individually and as Co-Trustees of the Mildred B. Blount Testamentary Trust; People's United Bank; Law Offices of Gary Oberst, P.C.; Rhoda Rudnick; and Hinckley Allen & Snyder LLP.

The Actions involved a dispute over title to certain real property located in Westport, Connecticut that was conveyed by Erling Christophersen, as grantor, to the Trust on or about August 8, 2007. Subsequent to this conveyance, the Bank loaned \$3,387,000 to the Trust, which was secured by a commercial mortgage in favor of the Bank on the Westport property. This mortgage is the subject of the Foreclosure Action brought by the Bank.

As previously disclosed, John R. Christophersen claimed an interest in the Westport real property transferred to the Trust and sought to quiet title to the property and to recover money damages from the defendants for the alleged wrongful divestiture of his claimed interest in the property.

On June 25, 2012, the Bank and John R. Christophersen entered into a Settlement Agreement, which resolved all differences between John R. Christophersen and the Bank and resulted in the withdrawal (with prejudice) of the claims made by John R. Christophersen. All claims against the Bank have been withdrawn and the Bank is no longer a defendant or counterclaim defendant in any litigation involving the Actions. As an additional consequence of the Settlement Agreement, Bonnie Christophersen, Elena Dreiske and People's United Bank are no longer parties to any of the litigation referenced above.

On July 27, 2012, Erling Christophersen filed a Motion to Restore the First Action, and on October 15, 2012 filed a Motion to Stay the Foreclosure Action pending resolution of the Motion to Restore. The Bank opposed both motions. On February 1, 2013, the Court issued orders denying both motions. On February 14, 2013, Erling Christophersen appealed the orders denying his Motion to Restore the First Action, and Motion to Stay the Foreclosure Action.

The Appellate Court dismissed the appeal of the Foreclosure Action in May 2013, and later denied Erling Christophersen's motion for reconsideration of its decision.

The Bank proceeded in its Foreclosure Action against Erling Christophersen. Erling Christophersen asserted two special defenses and set-off claims alleging (1) that the Bank failed to defend the title claims against the properties, and (2) that the Bank took certain trustee fees without approval. The Bank moved to strike the special defenses and set off claims. In a decision issued on November 6, 2013, the Court granted the motion to strike as to the second special defense and set off, but denied the motion as to the first special defense and set off. Trial began on February 4, 2014, and concluded on February 14, 2014.

In a decision issued on June 2, 2014, the Court dismissed Erling Christophersen's special defense, and made findings as to the amount of the debt owed by Erling Christophersen and the value of the property, reserving judgment on whether to order a strict foreclosure or foreclosure by sale pending a hearing on the amount of attorneys' fees accrued, and the debt accrued since the commencement of the trial. That hearing was held on July 29, 2014. On July 25, 2014, Erling Christophersen moved to disqualify the Bank's counsel, seeking, in part, the remedy of a new trial. The Court denied that motion in a decision dated July 30, 2014. On August 5, 2014, the Court issued a Judgment of Strict Foreclosure (the "Judgment") in favor of the Bank and set September 16, 2014 as the Law Day, which is the final date fixed by the Court on which the debtor can pay off the debt or redeem the real property, with subsequent dates for subsequent encumbrances in inverse order of priority.

On September 15, 2014, Christophersen moved to open the Judgment, which motion was denied by order of the Court dated September 30, 2014. On October 3, 2014, Christophersen filed an Appeal of the Judgment and of the denial of his motion to reopen. Salisbury Bank moved to dismiss the Appeal on October 24, 2014, on grounds that Christophersen cannot represent the Trust as he is not an attorney, and that Christophersen in his individual capacity does not have any interest in the Appeal. On December 17, 2014, such motion was granted in part and dismissed in part, but the decision was moot because counsel submitted an appearance on behalf of the Trust on December 29, 2014. On January 20, 2015, Christophersen filed a motion for reconsideration, which motion was denied by order of the Appellate Court on February 10, 2015.

The parties submitted briefs and oral arguments were heard on January 7, 2016. On March 1, 2016, the Appellate Court affirmed the trial court's judgment and remanded the case for the setting of new Law Days. Subsequently, the defendant filed an application for review with the Connecticut Supreme Court, which denied Mr. Christophersen's Petition For Certification on March 23, 2016. The defendant has filed motions to open the Judgment which the Bank has opposed. The Bank is currently awaiting a decision on the defendant's motion.

On March 31, 2016 the bank filed a *Motion to Set New Law Days and Update Debt* in accordance with the order of the Appellate Court, which denied the defendant's appeal, and the Supreme Court, which refused to hear the defendant's appeal.

There are no other material pending legal proceedings, other than ordinary routine litigation incidental to the registrant's business, to which Salisbury is a party or of which any of its property is subject.

Item 1A. RISK FACTORS

Not applicable

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

Item 3. DEFAULTS UPON SENIOR SECURITIES

None

Item 4. MINE SAFETY DISCLOSURES

Not Applicable

Item 5. OTHER INFORMATION

None

Item 6. EXHIBITS

- 2.1 Agreement and Plan of Merger by and among Salisbury Bancorp, Inc., Salisbury Bank and Trust Company and Riverside Bank dated March 18, 2014 (incorporated by reference to Exhibit 2.1 of Form 8-K filed on March 19, 2014).
- 3.1 Certificate of Incorporation of Salisbury Bancorp, Inc. (incorporated by reference to Exhibit 3.1 of Registrant's 1998 Registration Statement on Form S-4 filed April 23, 1998, File No.: 33-50857).
- 3.1.1 Amendment to Article Third of Certificate of Incorporation of Registrant (incorporated by reference to Exhibit 3.1 of Registrant's Form 8-K filed March 11, 2009).
- 3.1.2 Certificate of Amendment to Certificate of Incorporation of Registrant (incorporated by reference to Exhibit 3.1 of Registrant's Form 8-K filed March 19, 2009).
- 3.1.3 Certificate of Amendment to Certificate of Incorporation for the Series B Preferred Stock (incorporated by reference to Registrant's Form 8-K filed on August 25, 2011).
- 3.1.4 Certificate of Amendment to Certificate of Incorporation of Registrant (incorporated by reference to Exhibit 3.1 of Registrant's Form 8-K filed October 30, 2014).
- 3.2 Amended and Restated Bylaws (incorporated by reference to Exhibit 3.1 of Form 8-K filed November 25, 2014).
- 4.1 Form of Subordinated Note, dated as of December 10, 2015, issued by Salisbury Bancorp, Inc. (incorporated by reference to Exhibit 4.1 of Registrant's Form 8-K filed December 10, 2015).
- 10.1 Securities Purchase Agreement dated August 25, 2011 with the U.S. Treasury Department relating to the Small Business Lending Fund (incorporated by reference to Exhibit 10.1 of Registrant's Form 8-K filed on August 25, 2011).
- 10.2 2011 Long Term Incentive Plan adopted by the Board on March 25, 2011 and approved by the shareholders at Salisbury's 2011 Annual Meeting (incorporated by reference to Exhibit 10.9 of Registrant's Annual Report on Form 10-K filed March 19, 2012).
- 10.3 Amendment Number One to 2011 Long Term Incentive Plan dated as of January 18, 2013 (incorporated by reference to Exhibit 10.10 of Registrant's Annual Report on Form 10-K filed March 7, 2013).
- 10.4 Severance Agreement between Salisbury Bank and Trust and Mr. Richard J. Cantele, Jr. effective as of January 1, 2013 (incorporated by reference to Exhibit 10.1 of Registrant's Form 8-K filed February 15, 2013).
- 10.5 Non-qualified Deferred Compensation Plan effective as of January 1, 2013 (incorporated by reference to Exhibit 10.2 of Registrant's Form 8-K filed February 15, 2013).
- 10.6 Change in Control Agreement with Donald E. White dated April 1, 2013 (incorporated by reference to Exhibit 10.3 of Form 10-Q filed May 14, 2013).
- 10.7 Employee Stock Ownership Plan (incorporated by reference to Exhibit 10.14 of Form 10-K filed March 28, 2014).
- 10.8 Salisbury Bancorp, Inc. 2015 Phantom Stock Appreciation Unit and Long-Term Incentive Plan (incorporated by reference to Exhibit 10.1 of Form 8-K filed January 2, 2015).
- 10.9 Amendment Number One to Salisbury Bancorp, Inc. 2015 Phantom Stock Appreciation Unit and Long-Term Incentive Plan (incorporated by reference to Exhibit 10.1 of Form 8-K filed January 30, 2015).
- 10.10 Amendment Number Two to 2011 Long Term Incentive Plan dated as of January 29, 2016 (incorporated by reference to Exhibit 10.12 of Registrant's Annual Report on Form 10-K filed March 30, 2016).
- 10.11 Form of Split-dollar Life Insurance Agreements with Senior Executive Officers (incorporated by reference to Exhibit 10.13 of Registrant's Form 10-K filed March 30, 2016).
- 10.12 Employment Agreement with John M. Davies (incorporated by reference to Exhibit 10.13 of Registrant's Form 10-K filed March 30, 2016).
- 10.13 Form of Subordinated Note Purchase Agreement, dated as of December 10, 2015, between Salisbury Bancorp, Inc. and the Purchasers identified therein. (incorporated by reference to Exhibit 10.1 of Registrant's Form 8-K filed December 10, 2015).
- 31.1 Chief Executive Officer Certification Pursuant to 17 CFR 240.13a-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2

Chief Financial Officer Certification Pursuant to 17 CF 240.13a-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Chief Executive Officer and Chief Financial Officer Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SALISBURY BANCORP,  
INC.

May 16, 2016 by: /s/ Richard J. Cantele, Jr.  
Richard J. Cantele, Jr.,  
President and Chief  
Executive Officer

May 16, 2016 by: /s/ Donald E. White  
Donald E. White  
Executive Vice President  
and Chief Financial  
Officer