

FEDERAL DEPOSIT INSURANCE CORPORATION
Washington, D.C., 20429

FORM 10-K

(Mark one)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 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: FDIC Certificate No. 90211-0

HINGHAM INSTITUTION FOR SAVINGS

(Exact name of registrant as specified in its charter)

Massachusetts
(State or other jurisdiction of
incorporation or organization)

04-1442480
(I.R.S. Employer
Identification No.)

55 Main Street, Hingham, Massachusetts
(Address of principal offices)

02043
(Zip Code)

(781) 749-2200

(Registrant's telephone number, including area code)

Securities Registered pursuant to Section 12(b) of the Act:

Common Stock, \$1.00 par value per share
(Title of Class)

NASDAQ Stock Market, LLC
(Name of exchange on which registered)

Securities registered under Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment of this Form 10-K.

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 definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one)

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input checked="" type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of June 30, 2016, the last business day of the registrant's most recently completed second fiscal quarter, was \$163,103,040 (computed using affiliate data as of February 14, 2017, an assumption which provides a reasonable basis for computation).

The number of shares outstanding of each of the Bank's classes of Common Stock, as of the latest practicable date is:

Class: Common Stock \$1.00 par value per share
Outstanding as of March 1, 2017: 2,132,750 shares

Documents Incorporated by Reference

Portions of the Hingham Institution for Savings Proxy Statement for the Annual Meeting of Stockholders to be held on April 27, 2017 are incorporated by reference into Part III of this Form 10-K.

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Cautionary Note Regarding Forward-Looking Statements

This Annual Report on Form 10-K contains “forward-looking statements” within the meaning of the U.S. Private Securities Litigation Reform Act of 1995, which are subject to a number of risks and uncertainties. All statements other than statements of historical facts contained in this Annual Report on Form 10-K, including statements regarding our future results of operations and financial condition, business strategy, plans and objectives of management for future operations and capital requirements are forward-looking statements. Without limiting the foregoing, the words “anticipates,” “believes,” “could,” “estimates,” “expects,” “intends,” “may,” “plans,” “seeks” and other similar language, whether in the negative or affirmative, are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words. Actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors. The Bank therefore cautions you against relying on any of these forward-looking statements. Important factors that could cause actual results to differ materially from those in these forward-looking statements are discussed in Item 1A., “Risk Factors” of Part I and Items 7 and 7A., “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Quantitative and Qualitative Disclosures About Market Risk,” respectively, of Part II of this Annual Report on Form 10-K. Any forward-looking statement made in this Annual Report on Form 10-K speaks only as of the date on which this Form 10-K was first filed. The Bank undertakes no obligation to publicly update any forward-looking statement, whether as a result of new information, future developments or otherwise.

PART I

Item 1. Business.

General

Hingham Institution for Savings (the “Bank”) is a Massachusetts-chartered savings bank headquartered in Hingham, Massachusetts. The Bank was originally chartered in 1834. It is the oldest financial institution headquartered in Hingham, and is one of the oldest continuously operating banks in the United States. In addition to its main office, loan office and drive-up facility in Hingham, banking offices are located in South Hingham, Hull, Scituate, Cohasset, South Weymouth, Norwell, Boston and Nantucket. At December 31, 2016, the Bank had total assets of \$2.015 billion, total deposits of \$1.366 billion and total stockholders' equity of \$161.0 million.

The Bank is principally engaged in the business of residential and commercial real estate mortgage lending, funded by a retail deposit network and borrowings. At December 31, 2016, the loan portfolio was \$1.606 billion or 80% of total assets.

At December 31, 2016, 43% of the Bank’s total loan portfolio was invested in residential mortgages (including home equity), 49% in commercial real estate (including multi-family housing), 8% in residential and commercial construction loans, and less than 1% in commercial business loans and consumer loans. The Bank focuses on the origination of commercial and residential real estate loans in its primary market area. The Bank originates both Qualified Mortgages and Non-Qualified Mortgages in its residential lending business.

Market Area and Competition

The Bank’s primary market area is Eastern Massachusetts, with the significant majority of deposit funding and mortgage lending in close proximity to its branches in Boston, the South Shore, and on the island of Nantucket. This market is attractive and the Bank faces considerable competition for both loans and deposits from both traditional competitors (banks and credit unions), as well as non-traditional competitors (insurance companies, Internet-based direct banks, and out-of-market competitors).

Competition for real estate loans is based primarily on interest rate, fees, and quality of service provided to borrowers and real estate brokers. Speed of decision and execution are important competitive differentiators, particularly in competition for commercial mortgage loans.

Competition for deposits comes from other banks, credit unions, money market funds, and non-bank investment alternatives (including equity and fixed income markets). Competitive differentiators include rates of return, convenience of branch locations and hours of operation, personalized customer service, and online and mobile banking access. Customers with significant balances, including but not limited to institutions, municipalities, and fiduciaries, also consider the financial strength, stability, and reputation of the Bank in establishing and maintaining relationships. Furthermore, the Bank has a significant advantage with these customers as it offers unlimited excess deposit insurance above the Federal Deposit Insurance Corporation (“FDIC”) limits through the Massachusetts Depositors Insurance Fund (“DIF”). The DIF is only available to Massachusetts savings banks and is not available to commercial banks or trust companies.

Lending Activities

General. At December 31, 2016, the Bank’s net loan portfolio totaled \$1.606 billion, representing 80% of its total assets. The Bank’s principal focus is real estate mortgage lending, with well over 99% of the loan portfolio secured by real estate mortgages. The portfolio is primarily composed of commercial real estate, residential owner-occupied real estate, and loans for the construction of residential real estate. It is the Bank’s primary earning asset. Commercial and industrial (“C&I”) loans and consumer loans represent less than 1% of the loan portfolio and they are not a focus of the Bank’s origination program. The Bank’s lending activities are

generally conducted in its primary market area and as of December 31, 2016, all real estate mortgages were secured by properties in the Commonwealth of Massachusetts.

Commercial Real Estate Loans. The Bank originates mortgage loans for the refinancing, acquisition, or renovation of existing commercial real estate properties such as apartments, offices, manufacturing and industrial complexes, small retail properties, various special purpose properties, and land. Although terms vary, commercial real estate loans generally have maturities of 15 years or less, with an initial fixed rate period and subsequent adjustments with a margin to a designated interest rate. The initial period is generally five years, with a limited volume of loans with longer initial fixed rate periods. These loans are generally underwritten with floors near the initial rate at time of underwriting. The Bank generally amortizes commercial real estate mortgages over a 35-year period, with a balloon payment at 10 or 15 years. The Bank generally writes commercial real estate mortgages with “step-down” prepayment fees in the event the loan pays off prior to maturity; these fees are generally a percentage of the face amount of the note. Generally, loan amounts do not exceed 75% of the lesser of the Bank estimate of value or independent appraised value of the collateral. At December 31, 2016, commercial mortgages totaled \$796.1 million and represented 49% of the Bank's total loan portfolio.

In November 2016, the Bank began commercial real estate lending operations in the Washington, D.C. metropolitan area (WMA) after two years of research and preparation. As of December 31, 2016, the Bank had not yet closed any transactions in the greater WMA. The Bank will utilize existing staff in the Commercial Real Estate Group with experience in Washington, D.C. on a fly-away basis and does not have any plans, at present, to establish a physical presence in the area. The Bank intends to apply the above underwriting criteria to transactions in the greater WMA, with an emphasis on smaller multifamily, mixed-use, and retail properties. The Bank will also target lower loan-to-value ratio transactions in order to build a greater margin of safety. The Bank does not intend to make any construction or residential real estate loans in this area.

Construction Loans. As of December 31, 2016, there were \$131.8 million in construction loans, net of unadvanced amounts, which represented 8% of the Bank's total loan portfolio and consisted primarily of residential real estate for owner-occupants, speculative sale, and long-term investment (the latter categories are referred to as “commercial construction loans” below). Although the Bank has financed the construction of commercial purpose properties (e.g. retail, industrial, office, or special purpose), this is not the focus of the Bank's construction loan program. Residential construction loans are offered on both a fixed rate and an adjustable rate basis, with a six to twelve month interest only period that converts to an amortizing loan. Commercial construction loans are generally underwritten as eighteen month notes, with a balloon payment at maturity or conversion to permanent, amortizing financing. Commercial construction loans are generally structured with origination fees in addition to the note rate of interest. All disbursements on construction loans are paid in arrears for work complete, subject to on-site inspection by a member of the Executive Committee of the Board of Directors or the Vice President of Facilities, and approved by the President or the Executive Vice President.

Residential Real Estate Loans. The Bank originates a full range of Qualified and Non-Qualified mortgages on one-to-four family residential properties as defined by the Consumer Financial Protection Bureau's Qualified Mortgage Rule. The Bank generally holds all residential real estate loans in portfolio and consequently enjoys greater latitude in structuring and executing transactions in support of its customers' needs. Loans are originated on both an adjustable rate and fixed rate basis. Qualified mortgages are generally originated with loan to value ratios up to 80% of a property's appraised value, with mortgage insurance required for those loans exceeding 80%. Non-Qualified mortgages, including but not limited to super jumbo loans in excess of \$1.5 million, co-operative loans, non-warrantable condominium loans, loans to foreign nationals, owner-occupant loans to irrevocable trusts and limited liability corporations, vacation and seasonal properties, and loans underwritten using alternative verification of the ability to repay, are generally originated up to 65% of the lesser of a Bank estimate of value or a third-party appraisal and they are generally underwritten with a premium to the Bank's conforming rates. The Bank also originates Home Equity Lines of Credit (“HELOC”) in both first and second lien position, generally at variable rates indexed to the Wall Street Journal Prime Rate, with floors near the origination rate. The maximum loan amount is generally \$250,000, subject to 60% of the appraised value of the collateral less the first mortgage loan or \$150,000, subject to 70% of the appraised value of the collateral, less the first mortgage loan. As of December 31, 2016, residential mortgages, including home equity lines of credit and second mortgages, were \$685.7 million and represented 43% of the Bank's total loan portfolio.

Consumer/Commercial Lending. The Bank offers personal installment (secured and unsecured) loans, revolving credit loans and passbook loans. Unsecured loans generally do not exceed \$30,000 and have a maximum term of three years. The Bank originates loans to local businesses in its market area generally on a secured basis with personal guarantees from the principals of any borrowing entity. Generally, commercial loans have maturities of five years or less at floating interest rates. Consumer and commercial lending is not the focus of the Bank's origination program. At December 31, 2016, consumer and commercial loans totaled \$678,000 and represented less than 1% of the Bank's total loan portfolio.

Origination of Loans. Applications for real estate and consumer loans are taken at all of the Bank's offices. Processing of all loan applications is centralized at the Bank's Main Office in Hingham. Loan applications come from a number of sources, including depositors, existing borrowers, walk-in customers, the Internet and others responding to the Bank's advertising program.

All commercial real estate, construction and residential mortgage loans are reviewed and approved by the Executive Committee of the Board of Directors, which takes an active role in managing risk for the Bank. The Executive Committee meets twice monthly or more often as needed. No lenders or officers of the Bank have the authority to make these types of loans. The President, the Executive

Vice President, and the Vice President for Retail Lending have limited authority to approve HELOC up to \$250,000. Additionally, all loans above \$1.5 million and all loans to credit relationships with aggregate exposure of \$6 million, inclusive of the subject transaction and regardless of size, are reviewed and approved by the full Board of Directors. Consequently, the majority of our commercial real estate exposure has been reviewed and approved on an individual credit basis by the Board of Directors or a committee thereof. In accordance with governing banking laws, the Bank is permitted to make loans and commitments to any one borrower, including related entities, in the aggregate amount of not more than 20% of the Bank's stockholders equity, or \$32.2 million, at December 31, 2016, which is the Bank's legal lending limit. The Bank's largest relationship as of December 31, 2016 consisted of one loan with an aggregate of \$23.9 million in exposure.

Loan Rates and Fees. Interest rates and fees charged by the Bank on its loan products are based upon the type of loan, the degree of risk, competitive market rates, and the underlying collateral. Fees are subject to the limitations imposed by the regulations of the Commissioner of Banks. Loan origination and commitment fees, net of direct loan origination costs, are deferred and are recognized as adjustments to loan interest income. The Bank amortizes these amounts over the contractual life of the related loans using the level-yield method. Exit fees and prepayment fees are recognized in full at the time of receipt.

Asset Quality. The Bank evaluates its loan portfolio continuously so as to recognize potential problem loans at an early stage and minimize losses. Given the leverage inherent in banking, maintaining good asset quality is critical to the Bank's business. The Bank commences collection procedures on commercial real estate loans once a loan payment is more than 10 days past due and on residential loans once a loan payment is 15 days past due. The Executive Committee of the Board of Directors reviews a list of all loans two payments past due every two weeks, as well as all loans in technical default due to bankruptcy, delinquent payment of real estate taxes, insurance, condo/homeowners association ("HOA") fees, or any other breach of loan covenants. The Committee also reviews the status of any collection-related legal proceedings every two weeks. The Board of Directors reviews a detailed list of all loans two or more payments past due at each monthly meeting.

The accrual of interest on mortgage and commercial loans is discontinued at the time a loan is 90 days past due unless the credit is well-secured and in process of collection. Personal loans are typically charged off no later than becoming 180 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on non-accrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

The Bank maintains two parallel quality control and loan review programs. The Bank's internal Quality Control Group reviews all originated commercial and residential mortgage loan files following origination for compliance with the Bank's policies and procedures in the areas of origination, underwriting, processing, servicing, and legal settlement. All issues are addressed at the working level immediately and reviewed with the President and CEO on a quarterly basis. The Bank has also retained an independent third-party to conduct ongoing loan review and credit risk rating. Loans are assigned an initial risk rating by the Bank at origination. An independent third-party reviews all relationships with exposure in excess of \$850,000, all new credits in excess of \$500,000, and all loans on the Bank's Watch List on a rolling quarterly basis. Watch List loans are those loans that are more than two payments past due at the end of the quarter, loans rated four or higher using our internal rating system in a previous review, loans past contractual maturity or loans identified as troubled debt restructures. The independent third-party reviews all updated financial information on borrowing entities and principals, as well as updated statements of income and expense for collateral properties, and recalculates debt coverage ratios for commercial properties based on the most recent financial information. Results of the review are reported to the Bank's Audit Committee and the full Board of Directors on a quarterly basis and serve as a mechanism for monitoring the overall credit quality of the portfolio.

Investment Activities

The Bank's investment portfolio is composed primarily of overnight cash at the Federal Reserve Bank of Boston and other correspondent banks, short-term fixed income investments (U.S. Treasury debt securities, U.S. Government Sponsored Enterprise ("US GSE") debt securities, and FDIC insured certificates of deposit), and common equity investments. The Bank also has a significant investment in the stock of the Federal Home Loan Bank, held to secure the Bank's borrowing relationship, and an investment in the Community Reinvestment Act ("CRA") Fund, held for CRA investment test purposes. The Bank's investment portfolio is managed by the Bank's senior officers in accordance with the investment policy approved by the Board of Directors. At December 31, 2016, the Bank's investment portfolio totaled \$366.8 million which represented 18% of the Bank's total assets.

Cash and Fixed Income. Cash and short-duration fixed-income investments are primarily a source of liquidity to fund the Bank's real estate lending operation and absorb any volatility in the Bank's funding position. As of December 31, 2016, the Bank held \$311.5 million in cash at the Federal Reserve Bank of Boston and \$30,000 in US GSE debt securities. In total, these investments amounted to 15% of total assets. US GSE debt securities are recorded at fair value with any unrealized gains or losses, net of taxes, reported as a component of stockholder's equity. The Bank also purchases certificates of deposit issued by FDIC insured banks. Each certificate is purchased in an amount not to exceed \$250,000 per issuing bank and is carried at cost. Certificates of deposit are reported separately from the Bank's securities portfolio. At December 31, 2016, the Bank did not hold certificates of deposit.

Common Equities. The Bank's marketable common equity holdings, by contrast, are not viewed as a source of liquidity and are managed to produce superior returns on capital over a longer time horizon. The Bank's process is focused on identifying businesses with strong returns on capital, owner-oriented management teams, good reinvestment opportunities or capital discipline, and

reasonable valuations. At December 31, 2016, the Bank held \$20.3 million in common equity investments concentrated in the financial services sector, with investments in banks, diversified insurance companies, payment networks, and a ratings agency. Net pre-tax unrealized gains on this portfolio were \$4.4 million at December 31, 2016, as compared to \$589,000 at December 31, 2015.

The Bank receives two sources of advantageous tax treatment through these investments. First, dividend distributions from these companies to the Bank are partially excluded from the Bank's taxable income due to the Dividends Received Deduction ("DRD"). Second, to the extent that these companies are capable of internal reinvestment at high rates of return or deploy capital via tax-advantaged repurchases, the deferred tax liability associated with any long-term unrealized gains on our investments constitutes an interest-free source of financing.

The Bank also derives important intangible returns from these investments by studying high-performance companies with long track records of operational excellence and superior returns on capital. We study these companies to understand what we are doing well and where we might improve. Even if we cannot generate immediately actionable equity investment ideas, this process exposes our Board of Directors and our management team to new operational concepts that may help us to improve the returns in our core business.

CRA Investment. At December 31, 2016, the Bank's equity securities included a \$6.8 million investment in the CRA Fund, a mutual fund which invests in fixed-income securities which qualify under the CRA securities test.

FHLB Stock. The Bank holds Federal Home Loan Bank of Boston ("FHLB") stock which, at December 31, 2016, amounted to \$24.5 million. As a member of the FHLB, the Bank is required to maintain a Membership Stock Investment plus an Activity-based Stock Investment in an amount which approximates 5% of FHLB borrowings.

Bank-Owned Life Insurance. The Bank has an investment in Bank Owned Life Insurance ("BOLI") which insures the life of a current Bank officer. During 2014, a former Bank officer passed and the Bank, as the loss payee, received the death benefit. At December 31, 2016, the remaining policies had a cash surrender value of \$12.0 million.

Sources of Funds

General. Deposit accounts of all types have historically constituted the primary source of funds for the Bank's lending and investment activities. To a lesser extent, the Bank also derives funds from borrowings from the FHLB, amortization and prepayment of loans and mortgage-backed securities, and sales of loans and securities. Additionally, the Bank has registered with the Federal Reserve Bank to access its discount window. The Bank has pledged the bulk of its home equity portfolio to secure borrowings from the discount window and may increase availability by pledging additional assets. The availability of funds is influenced by prevailing interest rates, competition, and other market conditions.

Deposits. At December 31, 2016, the Bank had \$1.366 billion in savings accounts, demand accounts, Negotiable Order of Withdrawal ("NOW") accounts, money market accounts and certificates of deposit. Certificates have maturities ranging in terms from ninety-one days to five years. Included among these deposit products are Individual Retirement Account certificates. The Bank also accepts deposits through its on-premises ATMs and is a member of other ATM networks, including the SUM network. The Bank also accepts term certificates of deposit through two Internet listing services. The Bank's cost of funds, and its ability to attract and maintain deposits, have been, and will continue to be, significantly affected by economic and competitive conditions. The Bank offers a variety of deposit accounts to individuals and commercial customers. The Bank's deposits are insured by the FDIC, generally up to \$250,000 per separately insured depositor and up to \$250,000 for retirement accounts. The DIF insures the portion of deposits in excess of these amounts.

Borrowings. At December 31, 2016, the Bank had \$475.3 million in borrowings from the FHLB. The Bank can borrow up to approximately \$824.6 million, in total, based on the Bank's qualified collateral, which includes certain residential mortgage loans, first mortgage loans on non-owner occupied residential property, first mortgage loans on multi-family residential property, certain securities, and pledged commercial mortgages. Upon specific approval from the FHLB, the Bank may also pledge other mortgages to secure additional borrowings.

Personnel

At December 31, 2016, the Bank had 95 full-time employees and eight part-time employees. The Bank provides its full-time employees with a comprehensive range of employee benefit programs, including a 401(k) plan, life, health, travel accident and long-term disability insurance and a stock option plan for employees and directors as the Stock Option Committee of the Board of Directors may determine. None of the employees of the Bank are represented by a labor union or other collective bargaining group and management believes that its employee relationships are excellent.

Supervision and Regulation

As a savings bank organized under Chapter 168 and operating under Chapters 168 and 172 of the Massachusetts General Laws, the deposits of which are insured by the FDIC, the Bank is subject to regulation, supervision and examination by the Massachusetts Commissioner of Banks ("Commissioner of Banks") and the FDIC. The prior approval of the FDIC and the Commissioner of Banks is required for the Bank to establish or relocate an additional branch office, assume deposits, or engage in a merger, consolidation or purchase or sale of all or substantially all of the assets of any bank or savings association. While the Bank is not a member of the Federal Reserve System, it is nonetheless subject to certain provisions of the Federal Reserve Act and regulations issued thereunder.

The description of certain laws and regulations below and elsewhere in this report does not purport to be complete and is qualified in its entirety by reference to applicable laws and regulations.

Examinations and Supervision. The FDIC and the Commissioner of Banks regularly examine the Bank's condition and operations, including, among other things, its capital adequacy, reserves, loans, investments, earnings, liquidity, compliance with laws and regulations, record of performance under the CRA and management practices. In addition, the Bank is required to furnish quarterly and annual reports of income and condition to the FDIC and periodic reports to the Commissioner of Banks. The enforcement authority of the FDIC includes the power to: impose civil money penalties; terminate insurance coverage; remove officers and directors; issue cease-and-desist orders to prevent unsafe or unsound practices or violations of laws or regulations; and impose additional restrictions and requirements with respect to banks that do not satisfy applicable regulatory capital requirements.

Community Reinvestment Act Regulations. The CRA requires lenders to identify the communities served by a bank's deposit-taking facilities and to identify the types of credit the bank is prepared to extend within these communities. Failure of a bank to receive at least a "satisfactory" rating could inhibit a bank from undertaking certain activities, including acquisitions of other financial institutions, which require regulatory approval based, in part, on CRA compliance considerations. The FDIC must take into account the record of performance of banks in meeting the credit needs of the entire community served, including low and moderate-income neighborhoods, in terms of (1) making loans in its service areas, (2) investing in community development projects, affordable housing and programs benefiting low or moderate income individuals and businesses and (3) delivering services through its branches, ATMs and other offices. Massachusetts has enacted a CRA with similar requirements applicable to banking institutions chartered by that state.

Dividends. Payments of dividends by the Bank are subject to banking law restrictions such as:

- The FDIC's authority to prevent a bank from paying dividends if such payment would constitute an unsafe or unsound banking practice or reduce the bank's capital below safe and sound levels;
- Federal legislation which prohibits FDIC-insured depository institutions from paying dividends or making capital distributions that would cause the institution to fail to meet minimum capital requirements or if it is already undercapitalized; and
- Massachusetts banking law restrictions which require dividends to be paid from net profits for the current and two previous years, and which preclude a Massachusetts bank from paying dividends if its capital is, or would become, impaired.

Affiliate Transactions. Banks are subject to restrictions imposed by federal law on extensions of credit to, purchases of assets from, and certain other transactions with affiliates and on investments in stock or other securities issued by affiliates. These restrictions prevent banks from making loans to affiliates unless the loans are secured by collateral in specified amounts and have terms at least as favorable to the bank as the terms of comparable transactions between the bank and non-affiliates. Furthermore, federal and Massachusetts laws significantly restrict extensions of credit by banks to directors, executive officers and principal stockholders and other related parties.

Deposit Insurance. At December 31, 2016, deposits made in the Bank are insured by the FDIC to the legal maximum of \$250,000 for each insured depositor and \$250,000 for retirement accounts. The Federal Deposit Insurance Reform Act of 2005, as amended in 2006, requires that the FDIC determine deposit insurance premiums using a risk-based assessment. Deposit balances in excess of those insured by the FDIC are insured in full by the DIF. On April 26, 2016, the FDIC Board of Directors approved a rule to improve the deposit insurance assessment system for established small insured depository institutions (generally, those banks with less than \$10 billion in total assets that have been insured for at least five years). The new rules became effective July 1, 2016 and did not have a material impact in the premiums paid by the Bank during 2016.

Federal Reserve Board Policies. The monetary policies and regulations of the Federal Reserve Board have had a significant effect on the operating results of banks in the past and are expected to continue to do so in the future. Federal Reserve Board policies affect the levels of interest paid on bank deposits through the Federal Reserve System's open-market operations in United States government securities, regulation of the discount rate on bank borrowings from Federal Reserve Banks and regulation of non-earning reserve requirements applicable to bank deposit account balances.

Riegle-Neal Interstate Banking and Branching Efficiency Act. The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 ("Interstate Act"), authorizes the interstate merger of banks. In addition, among other things, the Interstate Act permits banks to establish new branches on an interstate basis provided that such action is specifically authorized by the law of the host state.

Consumer Protection Regulation; Bank Secrecy Act; USA PATRIOT Act. Other aspects of the lending and deposit businesses of the Bank that are subject to regulation by the FDIC and Massachusetts banking authorities, as applicable, include disclosure requirements with respect to the payment of interest, payment and other terms of consumer and residential mortgage loans and disclosure of interest and fees and other terms of, and the availability of, funds for withdrawal from consumer deposit accounts. In addition, the Bank is subject to federal and state laws prohibiting certain forms of discrimination in credit transactions, and imposing certain record keeping, reporting and disclosure requirements with respect to residential mortgage loan applications. The Bank is also subject to federal laws establishing certain record keeping, customer identification and reporting requirements with respect to certain large cash

transactions, sales of traveler's checks or other monetary instruments, and international transportation of cash or monetary instruments. In addition, under the USA PATRIOT Act of 2001, the Bank is required to implement additional policies and procedures with respect to, or additional measures designed to address, any or all of the following matters, among others: money laundering; suspicious activities and currency transaction reporting; and currency crimes. See also consumer protection provisions set forth below under the heading "Dodd-Frank Wall Street Reform and Consumer Protection Act."

Capital Requirements. The FDIC has established guidelines with respect to the maintenance of appropriate levels of capital by state chartered FDIC-insured banks that are not members of the Federal Reserve System. If a bank's capital levels fall below the minimum requirements established by these guidelines, the bank will be expected to develop and implement a plan, acceptable to the FDIC, to achieve adequate levels of capital within a reasonable period, and may be denied approval to acquire or establish additional bank or non-bank businesses, merge with other institutions or open branch facilities until those capital levels are achieved. Federal legislation requires federal bank regulators to take "prompt corrective action" with respect to banks or bank holding companies that fail to satisfy minimum capital requirements and imposes significant restrictions on those institutions.

In particular, FDIC guidelines and regulations and the Federal Deposit Insurance Corporation Improvement Act of 1991 include, among other things:

- minimum leverage capital ratios or Tier 1 capital to total assets ratios;
- minimum capital levels measured as a percentage of a bank's risk-adjusted assets;
- as noted above, requirements that federal banking regulators take "prompt corrective action" with respect to, and impose significant restrictions on, any bank that fails to satisfy its applicable minimum capital requirements;
- assignment of a bank by the FDIC to one of three capital categories consisting of (1) well capitalized, (2) adequately capitalized and (3) undercapitalized, and one of three supervisory categories, which category assignments determine the bank's deposit insurance premium assessment rate;
- restrictions on the ability of a bank to accept brokered deposits;
- authorization of the FDIC to appoint itself as conservator or receiver for a state chartered bank under certain circumstances and expansion of the grounds for its appointment as conservator or receiver;
- adoption of uniform real estate lending standards;
- standards for safety and soundness related to, among other things, internal controls and audit systems, loan documentation, credit underwritings and interest rate risk exposure;
- restrictions on the activities and investments of state-chartered banks; and
- consumer protection provisions.

In July 2013, federal banking regulators approved final rules that implement changes to the regulatory capital framework for U.S. banks. The rules set minimum requirements for both the quantity and quality of capital held by community banking institutions. The final rule requires a minimum ratio of common equity Tier 1 capital to risk-weighted assets of 4.5%, a minimum ratio of Tier 1 capital to risk-weighted assets of 6% and a minimum leverage ratio of 4% for all banking organizations. Additionally, community banking institutions must maintain a capital conservation buffer of common equity Tier 1 capital in an amount greater than 2.5% of total risk-weighted assets to avoid being subject to limitations on capital distributions and discretionary bonus payments to executive officers. The phase-in period for the capital conservation buffer began for the Bank on January 1, 2016, with full compliance phased in by January 1, 2019. The initial phase in amount was 0.625%. At December 31, 2015 and 2016, the Bank exceeded all current and final capital requirements necessary to be considered well capitalized.

Dodd-Frank Wall Street Reform and Consumer Protection Act. In July 2010, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). The Dodd-Frank Act significantly changed the bank regulatory structure and affects the lending, deposit, investment, securitization, governance, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act required various federal agencies to adopt a broad range of new implementing rules and regulations, and to prepare numerous studies and reports for Congress. Federal agencies are given significant discretion in drafting the implementing rules and regulations, and consequently, many of the possible implications of the Dodd-Frank Act may not be known for many years. Certain provisions of the Dodd-Frank Act will have an impact on the Bank. For example:

- * The Dodd-Frank Act created a new Consumer Financial Protection Bureau (the "Bureau") with broad powers to supervise and enforce consumer protection laws. The Bureau has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit "unfair, deceptive or abusive" acts and practices. Although the Bank is currently not under the direct examination and enforcement authority of the Bureau, the Bank will continue to be examined for compliance with the consumer protection laws by the FDIC and Commissioner of Banks.

- * The Dodd-Frank Act eliminated federal prohibitions on paying interest on demand deposits, allowing businesses to have interest-bearing checking accounts.
- * The FDIC deposit insurance assessments based on the average consolidated total assets less tangible equity capital of a financial institution.
- * A number of new regulatory requirements applying to debit cards, including certain limitations on interchange fees, were enacted.
- * The Dodd-Frank Act increased the maximum amount of deposit insurance for banks, savings institutions and credit unions to \$250,000 per depositor.
- * Publicly traded companies are required to give stockholders a non-binding vote on executive compensation and so-called “golden parachute” payments. The Federal Reserve Board enacted rules prohibiting excessive compensation paid to bank executives, regardless of whether the company is publicly traded or not.
- * In December 2013, the Volcker Rule (the “Rule”) was enacted which prohibits banks from proprietary trading of securities, derivatives, commodity futures and options on these instruments for their own account. Furthermore, it prohibited banks from owning, sponsoring or having certain relationships with hedge funds or private equity funds. The rule was effective on April 1, 2014, and it did not affect the Bank as it has not entered into the affected transactions or relationships.

Available Information

The Annual Report on Form 10-K is available to the public at the Main Office and each branch office of the Bank. The Annual Report on Form 10-K and all quarterly reports on Form 10-Q are also available free of charge through the Internet site www.hinghamavings.com once such material is filed with, or furnished to, the FDIC. Information found on this website is not part of this report or any other report the Bank files with or furnishes to the FDIC. A copy of the Bank’s Annual Report on Form 10-K, as well as the Bank’s Summary Annual Report and all quarterly reports on Form 10-Q and current reports on Form 8-K and any amendments to such reports, may be obtained without charge, by any stockholder of the Bank upon written request addressed to Robert H. Gaughen, Jr., President, Hingham Institution for Savings, 55 Main Street, Hingham, MA 02043, telephone (781) 749-2200 or (800) 286-2800. Information is also available for inspection at the FDIC, Accounting and Securities Disclosure Section, Division of Supervision and Consumer Protection at 550 17th Street, N.W. Washington, DC 20429.

Executive Officers of the Registrant

<u>Name and Age</u>	<u>Positions with the Bank and Principal Occupation</u>	<u>Term of Office</u>
Robert H. Gaughen, Jr. ¹ Age – 68	President and Chief Executive Officer Chairman of the Board	1993 to Present
Patrick R. Gaughen ² Age – 36	Executive Vice President	2012 to Present
Cristian A. Melej ³ Age – 39	Vice President - Chief Financial Officer	2016 to Present
Michael J. Sinclair ⁴ Age – 54	Vice President – Retail Lending Officer	1995 to Present
Shawn T. Sullivan ⁵ Age - 55	Vice President – Commercial Lending Officer	1996 to Present

¹ Mr. Robert Gaughen, Jr. has served as a member of the Bank’s Board of Directors since May 1991 and became President and Chief Executive Officer on April 29, 1993. Previously Mr. Gaughen was President and Chief Executive Officer of East Weymouth Savings Bank. Mr. Gaughen is the father of Patrick Gaughen, Executive Vice President.

² Mr. Patrick Gaughen joined the Bank in July 2012 as Vice President Chief Strategy/Corporate Development Officer. In 2013, he was promoted to Senior Vice President - Chief Strategy/Corporate Development Officer and in 2014 was promoted to Executive Vice President. Before joining the Bank, Mr. Gaughen was a Foreign Service Officer with the U.S. Department of State providing analytical and decision-support for senior U.S. policymakers regarding U.S. foreign policy in the Near East. Mr. Gaughen is a graduate of Yale University, Georgetown University Walsh School of Foreign Service and Duke University. Mr. Gaughen is the son of Robert Gaughen Jr., President and Chief Executive Officer.

³ Mr. Melej, the Bank’s Chief Financial Officer, joined the Bank in 2016 as Vice President and Chief Financial Officer, having previously been Executive Vice President and Chief Financial Officer at C1 Financial (and its subsidiary C1 Bank) since 2013. Previous to that, Mr. Melej served as Financial Officer for Restoque Comércio e Confecção de Roupas S.A., a publicly listed Brazilian clothing retailer from 2011 to 2013. Mr. Melej holds a Master of Business Administration degree from IE Business

School (Madrid, Spain) and a bachelor's degree in civil engineering from Pontificia Universidad Católica de Chile. He is also a CFA® charterholder.

⁴ Mr. Sinclair joined the Bank in 1995 as Vice President Retail Lending Officer. Previously, he served as Vice President at Abington Savings Bank and Assistant Vice President at Quincy Savings Bank.

⁵ Mr. Sullivan joined the Bank in 1996 as Vice President - Commercial Lending. Prior to joining the Bank, he acted as Vice President - Commercial Loan Officer at Fleet Bank and as Loan Officer at U. S. Trust Company.

Item 1A. Risk Factors.

A downturn in local economic conditions could negatively impact the Bank's business. The Bank primarily serves individuals and small businesses located in Eastern Massachusetts and adjoining areas. At December 31, 2016, the substantial majority of the Bank's loans and deposits came from the Eastern Massachusetts area. Local events and the economic conditions in the area could have a material adverse impact on the ability of the Bank to attract deposits, the ability of the Bank's borrowers to repay their loans and on the value of the collateral securing these loans.

A downturn in Massachusetts real estate values could hurt our profits. Because of the concentration of the Bank's loans in Eastern Massachusetts real estate, the Bank stands to be more severely impacted by adverse trends affecting real estate than if its loan portfolio had a larger component of non-real estate related commercial loans. At December 31, 2016, approximately 99.9% of the Bank's loan portfolio consisted of real estate related loans, including mortgages on developed commercial properties (49%), residential mortgages (43%) and construction loans (8%).

The Bank's commercial loans, with limited exceptions, are secured primarily by real estate (usually income producing residential and commercial properties). All of the Bank's residential mortgage and home equity loans are secured by residential property in Eastern Massachusetts. Consequently, the Bank's ability to continue to originate real estate loans may be impaired by adverse changes in local and regional real estate markets, or by acts of nature, including hurricanes or earthquakes. Further, the value realized on the sales of foreclosed assets may be diminished by the volume of foreclosed assets being liquidated by other financial institutions. Although the Bank maintains a program to ensure its borrowers maintain appropriate hazard and flood insurance, as well as a mortgage impairment policy with a special rider for earthquake coverage, such coverage may be insufficient and the Bank may suffer losses in the event of a natural disaster.

Reliance on the Federal Home Loan Bank system may adversely affect our liquidity and/or capital position. The Bank is a member of the FHLB and the amount of its equity investment in the FHLB is based upon the amount of borrowed funds. FHLB decisions therefore directly impact the Bank's liquidity. Significant disruptions in the Federal Home Loan Bank's lending operations or significant disruptions in the Federal Home Loan Bank's access to capital markets could have a negative effect on the Bank's operations. Although the Bank maintains a borrowing relationship with the Federal Reserve Bank of Boston ("FRBB") Discount Window, there is no guarantee that the Bank could obtain sufficient funding from the FRBB in the event that FHLB funding was not available. Impairment of the FHLB's assets could also negatively affect the value of the Bank's equity investment in the FHLB and the receipt of dividends on this investment. Dividends on this investment are declared at the discretion of the FHLB board. In 2009, the FHLB board suspended its dividend and implemented a capital retention plan that restricted financial institutions from redeeming excess FHLB stock. In 2011, the FHLB announced the reinstatement of a dividend and in 2012 the FHLB reestablished the redemption of excess FHLB stock. At December 31, 2016, the Bank held \$24.5 million in FHLB stock, borrowed funds were \$475.3 million, and the Bank had \$349.3 million in unused available capacity.

Fluctuations in interest rates may negatively impact the Bank's business. The Bank's main source of income from operations is net interest income, which is equal to the difference between the interest income received on interest-earning assets (usually loans and securities) and the interest expense incurred in connection with interest-earning liabilities (usually deposits and borrowings). Residential mortgage borrowers can pre-pay their mortgage loans earlier than the stated maturity date, without penalty, in order to refinance at lower market rates. This could negatively impact the Bank's net interest income. Changes in relative interest rates may reduce the Bank's net interest income as the difference between interest income and interest expense decreases. The Bank has adopted asset and liability management policies that are intended to minimize the potential adverse effects of changes in interest rates on net interest income, primarily by altering the mix and maturity of loans, investments and funding sources. Nonetheless, the Bank cannot assure that an increase or a decrease in interest rates, especially a rapid change, will not negatively impact the Bank's results from operations or financial position. An increase in interest rates could also have a negative impact on the Bank's results from operations by reducing the ability of borrowers to repay their current loan obligations, which could not only result in increased loan defaults, foreclosures and write-offs, but also necessitate further increases to the Bank's allowance for loan losses.

Our funding sources may prove insufficient to replace deposits at maturity and support our future growth. We must maintain sufficient funds to respond to the needs of depositors and borrowers. As a part of our liquidity management, we maintain a significant level of overnight cash which is immediately accessible for liquidity. We combine this with the use of a number of funding sources including deposit growth, FHLB borrowings and repayments and maturities of loans and investments. Adverse operating results or changes in industry conditions could lead to difficulty or an inability to access these funding sources. Our financial flexibility will be severely constrained if we are unable to maintain our access to funding or if adequate financing is not available to accommodate future growth at acceptable interest rates. If we are required to rely more heavily on more expensive funding sources to support future growth, our revenues may not increase proportionately to cover our costs. In this case, our operating margins and profitability would be adversely affected.

The Bank's loan loss reserves may prove to be insufficient if future economic conditions deteriorate. The risk of credit losses on loans varies with, among other things, general economic conditions, the type of loan being made, the creditworthiness of the borrower over the term of the loan and, in the case of a collateralized loan, the value and marketability of the collateral for the loan. The Bank maintains an allowance for loan losses based upon, among other things, historical losses, loan-to-value ratios, underlying collateral values, payment history, the size of the loan portfolio and the risks associated with certain loan types, as well as other factors such as local economic trends, real estate market conditions and credit concentrations. Based upon such factors, the Bank makes various assumptions and judgments about the ultimate collectability of the loan portfolio and provides an allowance for loan losses based upon a percentage of the outstanding balances and for specific loans when their ultimate collectability is considered questionable. If the Bank's assumptions and judgments prove to be incorrect and the allowance for loan losses is inadequate to absorb inherent losses, the Bank's earnings and capital could be significantly and adversely affected. As of December 31, 2016, the allowance for loan losses was \$11.0 million, which represented 0.68% of total outstanding loans. At such date, the Bank had \$1.8 million in non-accrual loans. Although the Bank believes that its allowance for loan losses is adequate, there can be no assurance that the allowance will prove sufficient to cover loan losses. See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Provision for Loan Losses."

Competition from financial institutions and other financial service providers may adversely affect our growth and profitability. Competition in the banking and financial services industry is intense. We compete with commercial banks, savings institutions, mortgage brokerage firms, credit unions and finance companies operating locally and elsewhere. Larger banking institutions have substantially greater resources and lending limits and may offer certain services that we do not. Local competitors with excess capital may accept lower returns on new business. There is increased competition by out-of-market competitors through the Internet. Federal regulations and financial support programs may in some cases favor competitors or place us at an economic disadvantage. Our profitability depends on our continued ability to successfully compete and grow profitably in our market areas.

We could be adversely affected by the loss of one or more key executives or an inability to attract and retain qualified personnel. Our success depends on our ability to retain the services of our existing key executives and to attract and retain additional qualified personnel in the future. The loss of the services of any of our key executives or the inability to hire and retain other highly qualified personnel in the future could adversely affect our ability to conduct or grow our business.

Additional federal or state laws and regulations regarding lending, investment, funding practices, capital, and liquidity standards may adversely impact our growth and profitability. New laws, regulations, and other regulatory changes may also increase our costs of regulatory compliance and otherwise affect our operations. The FDIC sets the cost of our FDIC insurance premiums, which can affect our profitability. We are required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations. Regulatory capital requirements and their impact on the Bank may change. We may need to raise additional capital in the future to support our operations and continued growth. Our ability to raise capital, if needed, will depend on conditions in the capital markets at that time, which are outside of our control, and on our financial performance. If we cannot raise additional capital when needed, it could affect our operations and our ability to execute our strategic plan, which includes further expanding our operations through internal growth.

The Dodd-Frank Act made extensive changes in the regulation of insured depository institutions. In addition to eliminating the Office of Thrift Supervision ("OTS") and creating the Consumer Financial Protection Bureau, the Dodd-Frank Act, among other things, directs changes in the way that institutions are assessed for deposit insurance, mandates the imposition of capital requirements, requires originators of certain securitized loans to retain a percentage of the risk for the transferred loans, stipulates regulatory rate-setting for certain debit card interchange fees, repeals restrictions on the payment of interest on commercial demand deposits and contains a number of reforms related to mortgage originations. The full impact of the Dodd-Frank Act on our business will not be known until all of the regulations implementing the statute are adopted and implemented. As a result, we cannot at this time predict the extent to which the Dodd-Frank Act will impact our business, operations or financial condition. However, compliance with these new laws and regulations may require us to make changes to our business and there is a significant possibility that the Dodd-Frank Act will, at a minimum, result in increased regulatory burden, compliance costs and interest expense for the Bank.

New laws, regulations, and other regulatory changes may significantly affect the markets in which we do business, the markets for and value of our loans and investments, and our ongoing operations, costs and profitability. For more information, see "Supervision and Regulation" in Item 1 of this report.

Proposed and final regulations could restrict our ability to originate and sell loans. The Consumer Financial Protection Bureau has issued a rule designed to clarify for lenders how they can avoid legal liability under the Dodd-Frank Act, which would hold lenders accountable for ensuring a borrower's ability to repay a mortgage. Loans that meet this "qualified mortgage" definition will be presumed to have complied with the new ability-to-repay standard. Under the Consumer Financial Protection Bureau's rule, a "qualified mortgage" loan must not contain certain specified features, including:

- excessive upfront points and fees (those exceeding 3% of the total loan amount, less “bona fide discount points” for prime loans);
- interest-only payments;
- negative amortization; and
- terms of longer than 30 years.

Also, to qualify as a “qualified mortgage,” a loan must be made to a borrower whose total monthly debt-to-income ratio does not exceed 43%. Lenders must also verify and document the income and financial resources relied upon to qualify the borrower on the loan and underwrite the loan based on a fully amortizing payment schedule and maximum interest rate during the first five years, taking into account all applicable taxes, insurance and assessments.

In addition, the Dodd-Frank Act requires the regulatory agencies to issue regulations that require securitizers of loans to retain “not less than 5% of the credit risk for any asset that is not a qualified residential mortgage.” The regulatory agencies have issued a final rule to implement this requirement. The final rule provides that the definition of “qualified residential mortgage” includes loans that meet the definition of qualified mortgage issued by the Consumer Financial Protection Bureau.

The final rule could have a significant effect on the secondary market for loans and the types of loans we originate, and restrict our ability to make loans. Similarly, the Consumer Financial Protection Bureau’s rule on qualified mortgages could limit our ability or desire to make certain types of loans or loans to certain borrowers, which could limit our growth or profitability.

We invest a modest portion of our shareholder capital in equity securities, which may result in significant variability in our investment results and may negatively impact shareholders’ equity. Additionally, our equity portfolio is concentrated and declines in the value of these investments could adversely affect our financial results. Equity securities have historically produced higher returns than fixed-income investments; however, investing in equity securities may result in significant variability in investment returns from one period to the next. In volatile financial markets, we could experience significant declines in the fair value of our equity investment portfolio. Our equity portfolio is also concentrated in particular companies and industries and, as a result, is exposed to more volatility from one period to the next.

System failure or breaches of our network security could subject us to increase operating costs as well as possible liability and damage our reputation. Our computer systems and network infrastructure could be vulnerable to unforeseen problems. Our operations are dependent upon our ability to protect our computer equipment against damage from physical theft, fire, power loss, telecommunications failure or a similar catastrophic event, as well as from security breaches, denial of service attacks, viruses, worms and other disruptive problems caused by hackers. Any damage or failure that causes an interruption in our operations could have a material adverse effect on our financial condition and results of operations. Computer break-ins, phishing and other disruptions could also jeopardize the security of information stored in and transmitted through our computer systems and network infrastructure, which may result in significant liability to us and may cause existing and potential customers to refrain from doing business with us. Although we, with the help of third-party service providers, intend to continue to implement security technology and establish operational procedures to prevent such damage, our security measures may not be successful. In addition, advances in computer capabilities, new discoveries in the field of cryptography or other developments could result in a compromise or breach of the encryption we and third-party service providers use to protect customer transaction data. A failure of such security measures could have a material adverse effect on our financial condition and results of operations. It is possible that significant amount of time and money may be spent to rectify the harm caused by a breach. While we have general liability insurance and cyber liability insurance, there are limitations on coverage as well as dollar amount. Furthermore, cyber incidents carry a greater risk of injury to our reputation. Finally, depending on the type of incident, banking regulators can impose restrictions on our business and consumer laws may require reimbursement of customer loss.

Our business is highly dependent on the successful and uninterrupted functioning of our information technology and telecommunications systems and third-party servicers. We outsource many of our major systems, such as data processing, loan servicing and deposit processing systems. In particular, we rely primarily on FiServ, Inc, Google and US Bank/Elan for our information management systems. The failure of these systems, or the termination of a third-party software license or service agreement on which any of these systems is based, could interrupt our operations. Because our information technology and telecommunications systems interface with and depend on third-party systems, we could experience service denials if demand for such services exceeds capacity or such third-party systems fail or experience interruptions. If sustained or repeated, a system failure or service denial could result in a deterioration of our ability to process new and renewal loans or gather deposits and provide customer service, compromise our ability to operate effectively, result in potential noncompliance with applicable laws or regulations, damage our reputation, result in a loss of customer business and/or subject us to additional regulatory scrutiny and possible financial liability, any of which could have a material adverse effect on our financial condition and results of operations.

Our ability to successfully compete may be reduced if we are unable to make technological advances. The banking industry is experiencing rapid changes in technology. In addition to improving customer services, effective use of technology increases efficiency and enables financial institutions to reduce costs. As a result, our future success will depend in part on our ability to address our customers' needs by using technology. We cannot be sure whether we will be able to effectively develop new technology-driven products and services or be successful in marketing these products to our customers. Many of our competitors have far greater resources than we have to invest in technology.

Any future action by the U.S. Congress lowering the federal corporate income tax rate and/or eliminating the federal corporate alternative minimum tax could result in the reduction of the net deferred tax asset and a corresponding charge against earnings. The net deferred tax asset reported on the Company's balance sheet represents the net amount of income taxes expected to be received upon the reversal of temporary differences between the bases of assets and liabilities as measured by enacted tax laws, and their bases as reported in the financial statements. As of December 31, 2016, the Company's net deferred tax asset was computed using the federal statutory rate of 35%. The President of the United States and members of congress have announced plans to lower the federal corporate income tax rate from its current level of 35% and to eliminate the corporate alternative minimum tax. If these plans ultimately result in the enactment of new laws lowering the corporate income tax rate and/or eliminating the corporate alternative minimum tax, the Company's net deferred tax asset would be re-measured. This would result in a reduction of the deferred tax asset in the period of the law change and a corresponding charge against earnings.

Item 1 B. Unresolved Staff Comments.

None

Item 2. Properties.

The following table sets forth certain information relating to the Bank's premises at December 31, 2016.

	<u>Location</u>	<u>Year Acquired/Leased</u>	<u>Ownership</u>
Main Office & Corporate Offices: 49-55 Main Street Hingham, MA 02043	Hingham	1950	Owned
Branch Offices: 37 Whiting Street Hingham, MA 02043	South Hingham	1979	Owned
401 Nantasket Avenue Hull, MA 02045	Hull	1976	Owned
400 Gannett Road Scituate, MA 02066	Scituate	1995	Owned
13 Elm Street Cohasset, MA 02025	Cohasset	1995	Owned
32 Pleasant Street South Weymouth, MA 02190	South Weymouth	1998	Owned
300 Linden Ponds Way Hingham, MA 02043	South Hingham	2004	Leased
540 Tremont Street Boston, MA 02116	Boston	2006	Leased
5 Assinippi Avenue Hanover, MA 02339	Norwell/Hanover	2008	Owned
80 Charles Street Boston, MA 02114	Boston	2011	Leased
35 Main Street Nantucket, MA	Nantucket	2012	Owned
Drive-up: 71 Main Street Hingham, MA 02043	Hingham	2001	Owned

Item 3. Legal Proceedings.

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

Item 4. Mine Safety Disclosures.

Not applicable

PART II

Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

The Board of Directors declared cash dividends totaling \$1.56 per share during 2016, which included a special dividend of \$0.32 per share declared in the fourth quarter of 2016. In 2015, the Board of Directors declared cash dividends totaling \$1.46 per share, which included a special dividend of \$0.30 per share declared in the fourth quarter.

Massachusetts law imposes restrictions on the payment of dividends, including the following: (1) dividends may be paid only out of net profits, as defined, for the current year plus retained net profits from the two previous years; and (2) on the day a dividend is declared, the capital stock of the Bank must be unimpaired. Net profits are defined by statute to mean "all earnings from current operations plus actual recoveries on loans and investments and other assets after deducting from the total thereof all current operating expenses, actual losses, accrued dividends on preferred stock, if any, and all federal and state taxes." As an FDIC-insured institution, the Bank is prohibited from paying dividends if it is undercapitalized, or if paying the dividend would cause it to become undercapitalized. Federal bank regulators have also issued policy statements indicating that FDIC-insured banks should generally pay dividends only out of current operating earnings.

The declaration and amount of future dividends are subject to the discretion of the Bank's Board of Directors and will depend on various factors, including the Bank's net earnings, financial condition, cash requirements, future prospects and other factors deemed relevant by the Bank's Board of Directors.

The Bank's common shares are listed and traded on The NASDAQ Stock Market ("NASDAQ") under the symbol "HIFS."

As of December 31, 2016, there were approximately 260 stockholders of record.

The following table presents the quarterly high and low sales prices for the Bank's common stock reported by NASDAQ and the dividend declared by quarter.

	<u>High</u>	<u>Low</u>	<u>Dividend</u>
2015			
First Quarter	\$ 103.75	\$ 82.24	\$0.28
Second Quarter	116.84	98.00	0.28
Third Quarter	126.15	104.25	0.30
Fourth Quarter	135.03	112.39	0.60
2016			
First Quarter	\$ 127.71	\$ 115.80	\$0.30
Second Quarter	137.45	118.00	0.30
Third Quarter	139.90	120.25	0.32
Fourth Quarter	203.01	132.00	0.64

The closing sale price of the Bank's common stock at December 31, 2016 was \$196.78 per share.

Comparative Stock Performance Graph

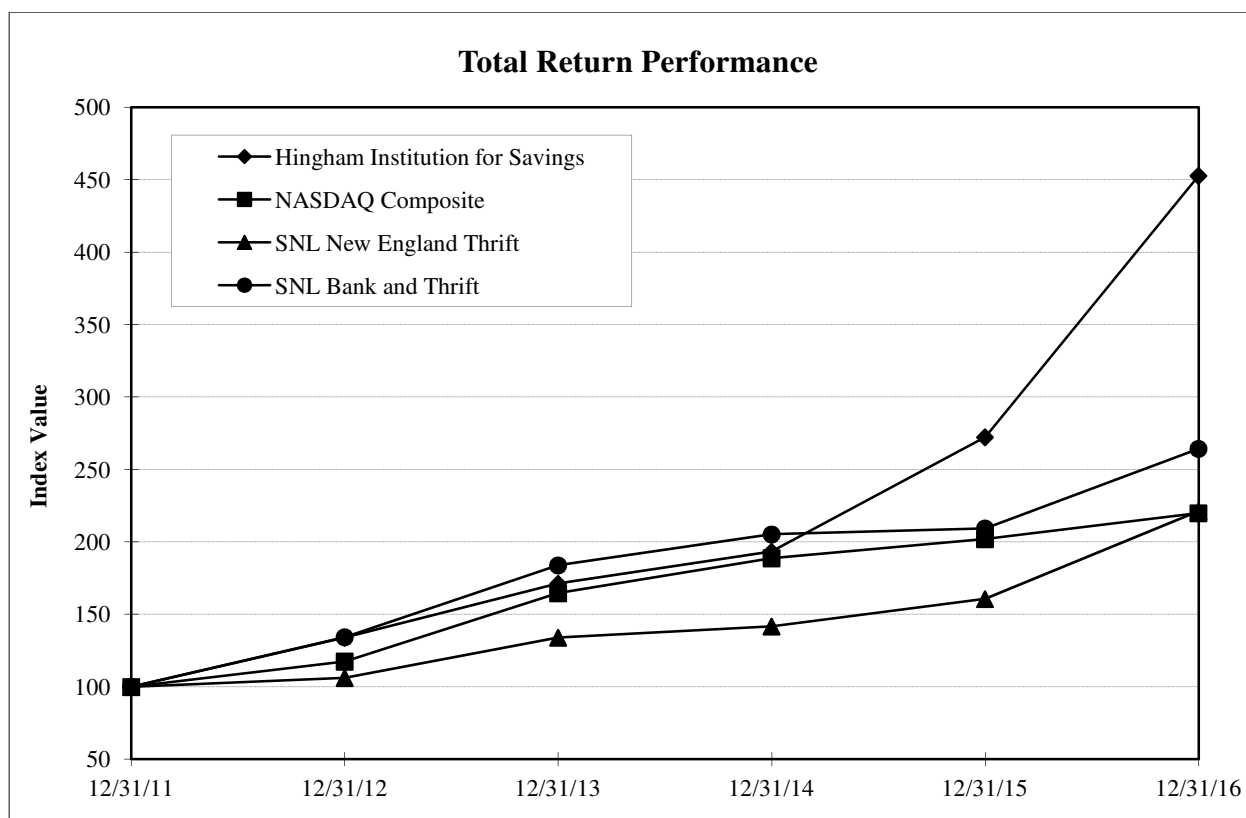
The chart which appears below sets forth the percentage change, on an annual basis, in the cumulative total return on the Bank's Common Stock since December 31, 2011 through December 31, 2016. For comparative purposes, changes in the cumulative total return on the three indices of publicly traded stocks (the "Indices") are also set forth on the chart.

The NASDAQ Composite Index reflects the total return of a group of stocks in a cross section of industries. Many of these stocks have substantially larger market capitalizations than the Bank. The SNL New England Thrift Index tracks a peer group of all publicly traded thrift institutions located in New England.

The final Index, the SNL Bank and Thrift Index, tracks a national group of publicly traded bank and thrift institutions. SNL Securities is a research and publishing firm specializing in the collection and dissemination of data on the banking, thrift, and financial services industries.

The chart begins with an equal base value of \$100 for the Bank's stock and for each of the Indices on December 31, 2011 and reflects year-end closing prices and dividends paid thereafter by the Bank and by the companies which comprise the Indices. The chart assumes full reinvestment of such dividends.

Information about the Indices has been obtained from sources believed to be reliable, but neither the accuracy nor the completeness of such information is guaranteed by the Bank.



Index	Year Ending					
	12/31/11	12/31/12	12/31/13	12/31/14	12/31/15	12/31/16
Hingham Institution for Savings	100.00	133.99	171.32	193.30	272.33	452.80
NASDAQ Composite	100.00	117.45	164.57	188.84	201.98	219.89
SNL New England Thrift	100.00	106.18	133.99	141.74	160.59	221.17
SNL Bank and Thrift	100.00	134.28	183.86	205.25	209.39	264.35

Item 6. Selected Financial Data.

The following information does not purport to be complete and is qualified in its entirety by the more detailed information contained elsewhere herein.

	At December 31,				
	2012	2013	2014	2015	2016
	(In Thousands)				
Balance Sheet Data:					
Total assets	\$ 1,205,884	\$ 1,356,441	\$ 1,552,205	\$ 1,768,528	\$ 2,014,599
Cash and cash equivalents	87,334	102,847	177,222	261,013	322,932
Securities available for sale	102,866	106,369	70,570	40,603	27,168
Loans:					
Residential loans	457,217	532,845	576,665	635,522	685,674
Commercial mortgage	438,037	498,592	607,851	681,601	796,063
Construction	60,390	53,520	60,371	95,433	131,778
Other	869	913	996	644	678
Allowance for loan losses	7,999	8,509	9,108	9,905	11,030
Deposits	869,886	940,906	1,089,217	1,217,027	1,366,109
Federal Home Loan Bank advances	234,355	302,732	329,602	402,464	475,318
Stockholders' equity	92,799	103,217	121,515	138,015	161,024

	At or For the Years Ended December 31,				
	2012	2013	2014 *	2015	2016
	(Dollars in Thousands, Except Per Share Amounts)				
Income Statement Data:					
Total interest and dividend income	\$ 48,831	\$ 49,342	\$ 56,193	\$ 61,859	\$ 71,769
Total interest expense	10,937	10,502	9,936	10,910	13,385
Net interest income	37,894	38,840	46,257	50,949	58,384
Provision for loan losses	725	380	625	625	1,135
Other income	1,580	1,604	7,863	1,483	1,735
Operating expenses	16,348	17,453	20,089	19,031	19,215
Income before income taxes	22,401	22,611	33,406	32,776	39,769
Income tax provision	9,111	9,240	11,142	13,430	16,346
Net income	\$ 13,290	\$ 13,371	\$ 22,264	\$ 19,346	\$ 23,423
Earnings per common share:					
Basic	\$ 6.25	\$ 6.28	\$ 10.46	\$ 9.09	\$ 10.99
Diluted	\$ 6.25	\$ 6.28	\$ 10.44	\$ 9.02	\$ 10.89

* Includes a net gain of approximately \$5.7 million related to non-taxable life insurance death benefit income of \$6.3 million less an accrual of \$949,000 for a contractual death benefit liability, and \$388,000 in related income tax benefits.

Financial Ratios:

Return on average assets	1.15 %	1.07 %	1.52 %	1.18 %	1.22 %
Return on average equity	15.05	13.52	19.30	14.81	15.59
Average equity to average assets	7.62	7.89	7.87	7.97	7.85
Tier 1 capital to average assets	7.65	7.80	7.86	7.95	7.98
Interest rate spread	3.25	3.07	3.13	3.06	2.99
Net interest margin	3.38	3.19	3.23	3.17	3.10
Dividend payout ratio (basic)	20.80	21.34	20.08	16.06	14.19
Efficiency ratio	41.41	43.15	37.12	36.32	32.15
Allowance for loan losses/total loans	0.84	0.78	0.73	0.70	0.68
Allowance for loan losses/non-performing loans	273.66	143.37	397.04	540.37	614.43
Net charge-offs (recoveries)/average loans outstanding	0.03	(0.01)	—	(0.01)	—
Non-performing loans/total loans	0.31	0.55	0.18	0.13	0.11
Non-performing assets/total assets	0.28	0.46	0.20	0.10	0.09
Cash dividends declared per common share	\$ 1.30	\$ 1.34	\$ 2.10	\$ 1.46	\$ 1.56
Book value per common share	\$ 43.65	\$ 48.49	\$ 57.08	\$ 64.83	\$ 75.50
Market value per common share	\$ 62.60	\$ 78.49	\$ 87.01	\$ 119.80	\$ 196.78

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation.

The following information should be read in conjunction with the Consolidated Financial Statements and Notes to the Consolidated Financial Statements contained in this report.

SIGNIFICANT ACCOUNTING POLICIES; CRITICAL EARNINGS ESTIMATES

The Bank's consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America, ("US GAAP"). The preparation of consolidated financial statements requires management to make judgments involving significant estimates and assumptions in the application of certain of its accounting policies about the effects of matters that are inherently uncertain. These estimates and assumptions, which may materially affect the reported amounts of certain assets, liabilities, revenues and expenses, are based on information available as of the date of the consolidated financial statements, and changes in this information over time could materially impact amounts reported in the consolidated financial statements as a result of the use of different estimates and assumptions. Certain accounting policies, by their nature, have a greater reliance on the use of estimates and assumptions and could produce results materially different from those originally reported.

Based on the sensitivity of financial statement amounts to the methods, estimates and assumptions underlying reported amounts, the most significant accounting policy followed by the Bank has been identified by management as the determination of the allowance for loan losses. This policy requires the most subjective or complex judgments and, as such, could be most subject to revision as new information becomes available. An understanding of the judgments, estimates and assumptions underlying this accounting policy is essential in order to understand the Bank's reported financial condition and results of operations. This accounting policy and its application in recent periods is described in more detail in the "Provision for Loan Losses" section of this discussion and analysis and in Notes 1 and 4 to the Consolidated Financial Statements contained in this annual report. If management's assumptions and judgments prove to be incorrect and the allowance for loan losses is inadequate to absorb inherent losses, or if bank regulatory authorities require the Bank to increase the allowance for loan losses as a part of their examination process, the Bank's earnings and capital could be significantly and adversely affected.

RESULTS OF OPERATIONS COMPARISON OF THE YEARS 2014, 2015 and 2016

For the year ended December 31, 2016, the Bank earned \$23.4 million as compared to \$19.3 million in 2015 and \$22.3 million in 2014. On a per-share basis, the Bank earned \$10.99 per share basic and \$10.89 per share diluted compared to \$9.09 per share basic and \$9.02 per share diluted in 2015 and \$10.46 per share basic and \$10.44 per share diluted in 2014.

Net income for 2016 increased 21% as compared to 2015, due principally to a \$7.4 million increase in net interest income combined with a \$252,000 increase in other income, partially offset by a \$2.9 million increase in the income tax provision, a \$510,000 increase in the provision for loan losses and a \$184,000 increase in operating expenses. Earnings for 2014 included a net gain of approximately \$5.7 million related to non-taxable life insurance death benefit income of \$6,302,000 less an accrual of \$949,000 for a contractual death benefit liability, and \$388,000 in related income tax benefits. Below is a summary of the transaction recorded during the first quarter of 2014 (in thousands):

Death benefit receivable from life insurance policies	\$ 10,570
Less cash surrender value of the policies	4,268
Net non-taxable income from death benefit recorded in other income	<u>6,302</u>
Contractual death benefit obligation	(1,200)
Accrued liability at time of death event	<u>251</u>
Accrual adjustment for contractual death benefit obligation recorded in salaries and benefits expense	(949)
Less related tax benefit	<u>388</u>
Net expense related to contractual death benefit obligation	<u>(561)</u>
Net gain from life insurance/death benefit transaction	<u>\$ 5,741</u>

Excluding the 2014 non-taxable life insurance death event, net income for 2015 increased 17% as compared to 2014, due principally to a \$4.7 million increase in net interest income combined with a \$109,000 reduction in operating expenses, partially offset by a decrease of \$78,000 in other income and a \$1.9 million increase in the income tax provision.

Total interest and dividend income increased by \$9.9 million in 2016 compared to 2015 due to a \$274.8 million increase in average interest-earning assets, offset by an three basis point decrease in the average yield on earning assets, reflecting market conditions. Interest expense increased by \$2.5 million due to an 17% increase in average interest-bearing liabilities and a four basis point increase in the average rate paid reflecting a combination of market conditions. Total interest and dividend income increased by \$5.7 million in 2015 compared to 2014 due to a \$175.6 million increase in average interest-earning assets, offset by an eight basis

point decrease in the average yield on earning assets, reflecting market conditions. Interest expense increased by \$974,000 due to an 11% increase in average interest-bearing liabilities. This was partially offset by a one basis point decline in the average rate paid reflecting a combination of market conditions.

Other income increased in 2016 by \$252,000 from 2015 due to an increase in gain on sale of securities and partially offset by a decline in income from insurance policies and customer service fees from deposits. Other income decreased in 2015 by \$6.4 million from 2014 as 2014 included a non-taxable life insurance death benefit of \$6.3 million representing the difference between the death benefit payment of \$10.6 million and the cash surrender value of the related policies totaling \$4.3 million. Adjusting for this transaction, other income decreased by \$78,000 in 2015 compared to 2014 due to a decline in income from insurance policies and customer service fees from deposits.

Operating expenses increased in 2016 compared to 2015 primarily in the categories of salaries and employee benefits, deposit insurance and data processing. In 2016, salaries and employee benefits increased by \$392,000, or 3%, due to annual salary increases. Occupancy and equipment expenditures decreased by \$201,000, or 10%, from 2015 to 2016 due to increased maintenance costs associated with severe winter weather incurred in 2015 and higher rental income received in 2016. Data processing expenses increased by 4% from 2015 to 2016 primarily due to higher network and software expenses. Deposit insurance expense increased 13% in 2016 due to the increase in total assets from which the assessment is calculated. Marketing expense declined by 18% when comparing 2016 to 2015 as a result of a comprehensive review of the Bank's overall marketing efforts. Foreclosure expenses decreased \$38,000 in 2016 compared to 2015 due to the lower level of OREO properties, along with reduced collection activity and recovery of expenses from the resolution of a delinquent loan. Also included in foreclosure expense are gains and losses recognized on the sale or write-downs of OREO properties. In 2016 the Bank recorded a net loss of \$3,000 on the sale of one property compared to net gains of \$126,000 on the sale of four properties in 2015. Other general and administrative expense declined in 2016 compared to 2015 as the Bank continues to review operating processes and reduce associated expenses.

Operating expenses declined in 2015 compared to 2014 primarily in the categories of salaries and employee benefits, data processing, foreclosure expenses and other general and administrative expenses. In 2015, salaries and employee benefits decreased by \$792,000, or 6%, due to accrual of a contractual death benefit in 2014 that was partially offset by annual salary increases. Occupancy and equipment expenditures increased by \$89,000, or 5%, from 2014 to 2015 due to increased maintenance costs associated with severe winter weather in 2015. Data processing expenses decreased by 1% from 2014 to 2015 primarily due to savings from renegotiated contracts with information technology vendors and were partially offset by charges related to growth in the number of loan and deposit accounts and the related transaction volume. Deposit insurance expense increased 12% in 2015 due to the increase in total assets from which the assessment is calculated. Marketing expense declined by 12% when comparing 2015 to 2014 as a result of a comprehensive review of the Bank's overall marketing efforts. Foreclosure expenses decreased \$191,000 in 2015 compared to 2014 due to the lower level of OREO properties along with reduced collection activity. Also included in foreclosure expense are gains and losses recognized on the sale or write-downs of OREO properties. In 2015 the Bank recorded net gains of \$126,000 on the sale of four properties compared to net gains of \$13,000 on the sale of three properties in 2014. Other general and administrative expense declined in 2015 compared to 2014 due to stock options issued to directors as part of the shareholders' approval of a stock option plan in 2014.

Net Interest Income

The Bank reported \$58.4 million in net interest income in 2016 compared to \$50.9 million in 2015 and \$46.3 million in 2014. The net interest margin decreased from 3.23% in 2014 to 3.17% in 2015 and to 3.10% in 2016. During the same period, the Bank recognized significant increases in loan and deposit balances contributing to an increase in net interest income; however the declining yield on interest-earning assets combined with an increase in rates paid on interest-bearing liabilities narrowed the weighted average interest rate spread.

Average total earning assets increased 17% in 2016 over 2015 and 12% in 2015 as compared to 2014. The Bank earned an average yield of 3.82% on its assets in 2016 compared to 3.85% in 2015 and 3.93% in 2014. Interest income is derived from commercial and residential mortgages, home equity, consumer and commercial loans, the securities portfolio and short-term investments. Interest income on loans increased 14% in 2016 over 2015, and 10% in 2015 over 2014, resulting from continued growth in loans, which accounted for approximately 80% of average total assets in 2016, 2015 and 2014. Mortgage loans accounted for more than 99% of average outstanding loans in each of the past three years. Interest income derived from securities and short-term investments increased in the last three years due to the higher dividend income on equity investments and FHLB stock, as well as the increase on interest on excess reserves paid by the Federal Reserve. Marketable equity securities produced dividend income of \$435,000 in 2016 compared to \$338,000 in 2015 and \$250,000 in 2014. FHLB stock produced dividends totaling \$814,000 in 2016 compared to \$457,000 in 2015 and \$241,000 in 2014.

Non-accrual loans totaled \$1.8 million at December 31, 2016 as compared to \$1.8 million at December 31, 2015 and \$2.3 million at December 31, 2014. Interest income includes actual payments received on loans classified as non-accrual. Excluded from interest income is interest not paid on such loans, which totaled \$115,000 for 2016 as compared to \$166,000 for 2015 and \$110,000 for 2014. During 2016, the balance of non-accrual loans remained stable, as some non-performing loans resolved due to payoff, foreclosure or renewed performance were offset by new delinquent loans. The process of accessing collateral continues to be delayed by

Massachusetts laws relative to foreclosure and the protections afforded to both residential and commercial borrowers through the bankruptcy process, but the Bank remains focused on ensuring that borrowers perform in accordance with contractual terms and will continue to work to resolve remaining non-accrual credits in 2017. The Bank believes that its loans classified as non-accrual are significantly collateralized, that these loans pose minimal risk of loss to the Bank, and that the allowance for loan losses is sufficient to absorb such losses. However, the Bank continues to monitor the loan portfolio and additional reserves will be recorded if necessary.

In 2014, the Bank decreased the rates paid on both certificate and core deposits in response to market conditions. In 2015 and 2016, there was increasing market pressure to raise rates on term deposits and some core deposits, driven largely by strong loan demand in the Bank's market area and changes in the economic environment. The Bank has mitigated the impact of this pressure by soliciting certificates from two Internet-based exchanges for listing certificates of deposit, as well as targeting certain core product rate increases that provided an efficient means for balanced growth. As a result, the average rate paid on deposits increased by five basis points from 2015 to 2016. Given the current economic environment, management believes it is likely that deposit market rates will continue to increase in 2017.

Interest expense on borrowed funds increased in 2016 as compared to 2015 due to a 27% increase in the average balance combined with a one basis point increase in the average rate paid. Borrowings from the FHLB are drawn to fund growth in the loan portfolio. At December 31, 2016, the weighted average rate on FHLB borrowings was 0.82% compared to 0.88% at December 31, 2015. The average cost of all borrowings was 0.86% for 2016 as compared to 0.85% for 2015 and 1.13% for 2014.

The following table details changes in net interest income and the net yield on average earning assets.

	Years Ended December 31,								
	2014			2015			2016		
	Average Balance	Interest	Yield/Rate	Average Balance	Interest	Yield/Rate	Average Balance	Interest	Yield/Rate
	(Dollars in Thousands)								
Assets:									
Loans:									
Real estate loans	\$ 1,178,916	\$ 54,922	4.66%	\$ 1,307,017	\$ 60,205	4.61%	\$ 1,524,184	\$ 68,875	4.52%
Commercial loans	254	20	7.87	238	19	7.98	140	11	7.86
Other loans	695	48	6.91	616	36	5.84	534	31	5.81
Total loans (1)(2)	1,179,865	54,990	4.66	1,307,871	60,260	4.61	1,524,858	68,917	4.52
Securities (3)(4)	110,021	827	0.75	76,193	990	1.30	54,494	1,300	2.39
Federal Reserve and other short-term investments	140,393	376	0.27	221,807	609	0.27	301,322	1,552	0.52
Total interest-earning assets	1,430,279	56,193	3.93	1,605,871	61,859	3.85	1,880,674	71,769	3.82
Other assets	35,824			33,014			33,378		
Total asset	<u>\$ 1,466,103</u>			<u>\$ 1,638,885</u>			<u>\$ 1,914,052</u>		
Liabilities and stockholders' equity:									
Interest-bearing deposits:									
Regular	\$ 80,239	16	0.02%	\$ 87,441	18	0.02%	\$ 92,509	20	0.02%
Money market	428,803	2,483	0.58	427,776	2,424	0.57	504,738	3,184	0.63
NOW (5)	33,587	3	0.01	34,956	3	0.01	34,800	3	0.01
Term certificates	380,921	3,812	1.00	487,843	5,500	1.13	544,425	6,392	1.17
Total interest-bearing deposits	923,550	6,314	0.68	1,038,016	7,945	0.77	1,176,472	9,599	0.82
Borrowed funds	321,068	3,622	1.13	348,094	2,965	0.85	442,134	3,786	0.86
Total interest-bearing liabilities	1,244,618	9,936	0.80	1,386,110	10,910	0.79	1,618,606	13,385	0.83
Demand deposits	101,974			117,741			140,758		
Other liabilities	4,130			4,387			4,456		
Stockholders' equity	115,381			130,647			150,232		
Total liabilities and stockholders' equity	<u>\$ 1,466,103</u>			<u>\$ 1,638,885</u>			<u>\$ 1,914,052</u>		
Net interest income		<u>\$ 46,257</u>			<u>\$ 50,949</u>			<u>\$ 58,384</u>	
Weighted average interest rate spread			<u>3.13%</u>			<u>3.06%</u>			<u>2.99%</u>
Net yield on average earning assets (6)			<u>3.23%</u>			<u>3.17%</u>			<u>3.10%</u>

(1) Before allowance for loan losses

(2) Includes average non-accrual loans

(3) Excludes the impact of the average unrealized gains on securities available for sale

(4) Includes Federal Home Loan Bank stock

(5) Includes mortgagors' escrow accounts

(6) Net interest income divided by average total earning assets

The following table presents information regarding changes in interest and dividend income and interest expense of the Bank for the years indicated. For each category, information is provided with respect to changes attributable to changes in rate (change in rate multiplied by old volume) and changes in volume (change in volume multiplied by old rate). The change attributable to both volume and rate is allocated proportionately to the changes due to volume and rate.

	Years Ended December 31,					
	2015 Compared to 2014			2016 Compared to 2015		
	Increase (Decrease)			Increase (Decrease)		
	Due to		Total	Due to		Total
Volume	Rate	Volume		Rate		
(In Thousands)						
Interest and dividend income:						
Loans	\$ 5,901	\$ (631)	\$ 5,270	\$ 9,827	\$ (1,170)	\$ 8,657
Securities	(309)	472	163	(342)	652	310
Federal Reserve and other short-term investments	223	10	233	274	669	943
Total interest and dividend income	<u>5,815</u>	<u>(149)</u>	<u>5,666</u>	<u>9,759</u>	<u>151</u>	<u>9,910</u>
Interest expense:						
Interest-bearing deposits:						
Regular	1	1	2	1	1	2
Money market	(6)	(53)	(59)	466	294	760
NOW	—	—	—	—	—	—
Term certificates	1,164	524	1,688	657	235	892
Total interest-bearing deposits	<u>1,159</u>	<u>472</u>	<u>1,631</u>	<u>1,124</u>	<u>530</u>	<u>1,654</u>
Borrowed funds	286	(943)	(657)	805	16	821
Total interest expense	<u>1,445</u>	<u>(471)</u>	<u>974</u>	<u>1,929</u>	<u>546</u>	<u>2,475</u>
Net interest income	<u>\$ 4,370</u>	<u>\$ 322</u>	<u>\$ 4,692</u>	<u>\$ 7,830</u>	<u>\$ (395)</u>	<u>\$ 7,435</u>

Provision for Loan Losses

The provision for loan losses is based on management's assessment of the adequacy of the allowance for loan losses. Management considers historical charge-offs, loan-to-value ratios, underlying collateral values, payment history, the size of the loan portfolio and the risks associated with certain loan types as well as other factors such as local economic trends, market conditions and credit concentrations. (Refer to Notes 1 and 4 to the Consolidated Financial Statements for more details).

In 2016, the Bank had net charge-offs of \$10,000 compared to net recoveries of \$172,000 in 2015 and net charges offs of \$26,000 in 2014. The Bank continues to closely monitor its non-accrual loans, which were 0.11% of total loans at December 31, 2016 as compared to 0.13% at December 31, 2015 and 0.18% at December 31, 2014, and its loans past due greater than 30 days, which have increased \$1.6 million to 0.69% of total loans at December 31, 2016 as compared to 0.68% at December 31, 2015 and 0.55% at December 31, 2014. The increased level of delinquent loans in 2016 over 2015 was primarily in the 30-59 day and 60-89 day categories as loans over 90 days declined. The provision for loan losses for 2016 was \$1.1 million, as compared to \$625,000 in 2015 and 2014. In 2016, the increase over 2015 was due to the level of growth in the loan portfolio. In 2015, the provision was maintained at the same level with 2014 as the Bank recognized a significant recovery to the allowance. Although most economic and market indicators continue to show stability in our market area, the Bank remains cautious. As a percentage of the gross loan portfolio, the allowance for loan losses was 0.68%, 0.70% and 0.73% at December 31, 2016, 2015 and 2014, respectively.

Other Income

Other income is comprised of customer service fees, increases in the cash surrender value of bank-owned life insurance policies, gain on sale of securities and miscellaneous income. Other income was \$1.6 million (adjusted) in 2014, \$1.5 million in 2015 and \$1.7 million in 2016. The adjusted other income in 2014 excludes a non-taxable life insurance death benefit of \$6.3 million representing the difference between the death benefit payment of \$10.6 million and the cash surrender value of the related policies totaling \$4.3 million. Other income in 2016 includes \$344,000 of gain on sale of securities, compared to \$29,000 in 2015 and none in 2014. From 2014 through 2016, there has been a slight decline in deposit account transaction fees, as the Bank has eliminated many fees on deposit products to simplify offerings and enhance the value proposition of our checking accounts to customers. There has been an offsetting trend in debit card interchange fees, as the size of the Bank's checking account base has increased and the Bank has benefited from a secular trend towards increasing use of debit cards in payments. The Bank's strategy does not rely on generating substantial noninterest fee-based revenue from our deposit accounts.

An increase in the cash surrender value of life insurance also contributed to other income in 2014, 2015 and 2016. The Bank held \$12.0 million in life insurance policies at year-end 2016 as compared to \$11.7 million at year-end 2015. Income from these assets is fully excludable from federal income taxes and contributed \$265,000 to other income in 2016, \$281,000 in 2015, and \$308,000 in 2014. The reduction in income in 2015 was due to the death benefit payment reducing the number of remaining policies. The policies accrete at a variable rate of interest with minimum stated guaranteed rates.

Operating Expenses

Total operating expenses as a percentage of average total assets were 1.00% in 2016, 1.16% in 2015 and 1.37% in 2014. Operating expenses were \$19.2 million in 2016, \$19.0 million in 2015 and \$19.1 million (adjusted by the death benefit payment to a former executive officer totaling \$949,000) in 2014. The Bank continues to focus on generating operating leverage by controlling non-interest expense, driving down non-interest expense as a percentage of total assets.

Salaries and employee benefits continue to be the largest component of operating expenses at \$12.0 million for 2016, \$11.6 million for 2015 and \$12.4 million for 2014. Included in 2014 was an accrual for \$949,000 to adjust a death benefit liability related to a former executive officer. Adjusting for this accrual, salaries and employee benefits were \$11.5 million in 2014. The increases in 2015 and 2016 are primarily due to annual merit increases which were partially offset by reductions in staffing levels, primarily in the branch network. As with most financial institutions, branch transaction levels have declined in recent years as customers use electronic banking and debit cards reducing the staffing requirements in some locations. Health care benefits, including medical and dental expenses were relatively flat when comparing 2016 to 2015 as the lower number of employees was offset by higher premiums. Health care benefits rose 7% in 2016 over 2015. Additionally, in 2014, stockholders approved a stock option plan that included the issuance of stock options to certain executive officers and the expense related to this issuance totaled \$137,000 in 2016, \$92,000 in 2015 and \$61,000 for 2014.

Occupancy and equipment expenses decreased by \$201,000, or 10% in 2016 compared to 2015 and increased 5% in 2015 compared to 2014. The increase in 2015 and subsequent decrease in 2016 was primarily related to costs associated with snow removal and damage caused by the severe winter in 2015. In addition, in 2016 the Bank generated more revenue from rental apartments located above its Nantucket branch. When the Bank purchased its Nantucket location, it built a residential apartment unit on the 2nd floor for rental purposes. In 2016, the Bank completed a residential apartment unit on the 3rd floor of the building and consequently collected rental revenue for most of the summer season from this unit. This revenue was not collected in prior years. The Bank also implemented a rent increase for an existing tenant in surplus office space in one of its South Shore locations. The Bank continues to explore ways to optimize rental income from all of its owned real property. This category also includes \$316,000, \$305,000 and \$299,000 in rent expenses for 2016, 2015 and 2014, respectively.

Data processing expenses increased \$48,000, or 4% in 2016 from 2015 but decreased \$15,000, or 1%, in 2015 from 2014. The increase in 2016 was primarily due to data processing charges associated with improvements made to Bank systems which were offset by savings associated with renegotiating certain key vendor contracts. In 2015, the Bank renegotiated certain contracts with information technology vendors and these savings were partially offset by increases due to transaction volume and the cost of new products and systems.

Deposit insurance expenses were \$1.0 million in 2016, compared to \$902,000 in 2015 and \$803,000 in 2014. Deposit insurance expense consists of premiums paid to the FDIC and the Massachusetts Deposit Insurance Fund. The increases were consistent with the Bank's change in assets which is the basis for the assessment calculation.

Marketing expenses were \$403,000 in 2016, \$489,000 in 2015 and \$557,000 in 2014. The Bank continued to optimize advertising spending in 2016 and focused expenditures on marketing with demonstrable returns on investment.

Foreclosure expenses include expenses related to foreclosing on collateral, maintaining properties, subsequent write-downs in the value of collateral and any net losses or gains associated with their disposition. During 2016, total foreclosure expense was \$34,000 compared to \$72,000 in 2015 and \$263,000 in 2014. Expenses in 2016 included \$29,000 in legal, real estate taxes, utilities and other expenses related to the foreclosure process and maintaining properties, net of the recovery of expenses from the resolution of a delinquent loan. This was partially offset by \$3,000 in net losses on the disposal of one property and \$2,000 in write-downs associated with other real estate owned during the year. Expenses for 2015 included \$198,000 in legal, real estate taxes, utilities and other expenses related to the foreclosure process and maintaining properties, partially offset by \$126,000 in net gains on the disposal of properties. Expenses in 2014 included \$276,000 in legal, real estate taxes, utilities and other expenses related to the foreclosure process and maintaining properties. This was partially offset by \$13,000 in net gains on the disposal of properties. The Bank continues to evaluate its loan portfolio continuously, so as to recognize potential problem loans at an early stage and initiate collection procedures in order to minimize economic losses.

Other expenses include audit fees, directors' fees, supplies, postage, legal fees, bank fees, reporting costs and other items. Other expenses were \$2.6 million for 2016, \$2.7 million in 2015 and \$2.9 million in 2014. The Bank's operating expenses declined as the Bank continues to pursue continuous improvement across all operating and corporate functions to reduce associated expenses.

Income Taxes

The Bank's effective tax rate for 2016 was 41.1%, compared to 41.0% in 2015 and 33.4% in 2014. The effective tax rate for 2014 was reduced by the non-taxable death benefit proceeds previously discussed. Adjusting for this transaction, the Bank's effective tax rate would have been 41.1% in 2014.

**BALANCE SHEET ANALYSIS
COMPARISON OF THE YEARS 2016 AND 2015**

The Bank had total assets of \$2.015 billion at December 31, 2016, an increase of \$246.0 million, or 14%, from the \$1.769 billion at year-end 2015.

Loans

At December 31, 2016 and 2015, the Bank reported net loans of \$1.606 billion, or 80% of total assets, and \$1.406 billion, or 79% of total assets, respectively. In 2016, the Bank originated \$528.3 million in mortgage and other loans, which resulted in net growth of \$200.1 million, or 14%. This compares to 2015, when the Bank originated \$459.8 million in mortgage and other loans which resulted in net growth of \$166.9 million, or 13%.

A summary of the balances of loans is as follows:

	As of December 31,									
	2012		2013		2014		2015		2016	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
	(Dollars in Thousands)									
Mortgage loans:										
Residential	\$ 432,162	45.2 %	\$ 507,841	46.8 %	\$ 548,004	44.0 %	\$ 602,290	42.6 %	\$ 652,444	40.4 %
Commercial	438,037	45.8	498,592	45.9	607,851	48.8	681,601	48.2	796,063	49.3
Construction	60,390	6.3	53,520	4.9	60,371	4.8	95,433	6.8	131,778	8.2
Home equity	25,055	2.6	25,004	2.3	28,661	2.3	33,232	2.3	33,230	2.1
Total mortgage loans	<u>955,644</u>	<u>99.9</u>	<u>1,084,957</u>	<u>99.9</u>	<u>1,244,887</u>	<u>99.9</u>	<u>1,412,556</u>	<u>99.9</u>	<u>1,613,515</u>	<u>100.0</u>
Other loans:										
Consumer	498	0.1	749	0.1	693	0.1	568	0.1	525	—
Commercial	371	—	164	—	303	—	76	—	153	—
Total other loans	<u>869</u>	<u>0.1</u>	<u>913</u>	<u>0.1</u>	<u>996</u>	<u>0.1</u>	<u>644</u>	<u>0.1</u>	<u>678</u>	<u>—</u>
Total loans	<u>956,513</u>	<u>100.0 %</u>	<u>1,085,870</u>	<u>100.0 %</u>	<u>1,245,883</u>	<u>100.0 %</u>	<u>1,413,200</u>	<u>100.0 %</u>	<u>1,614,193</u>	<u>100.0 %</u>
Allowance for loan losses	(7,999)		(8,509)		(9,108)		(9,905)		(11,030)	
Net deferred loan origination costs	1,148		1,518		1,881		2,238		2,484	
Loans, net	<u>\$ 949,662</u>		<u>\$ 1,078,879</u>		<u>\$ 1,238,656</u>		<u>\$ 1,405,533</u>		<u>\$ 1,605,647</u>	

The Bank's lending strategy has continued to focus on the origination of commercial, multi-family and single-family mortgage loans. Mortgage loans increased by 14% in 2016. The Bank offers both Qualified Mortgages and Non-Qualified Mortgages, as defined by the Consumer Financial Protection Bureau's Qualified Mortgage Rule. The Bank also offers home equity loans indexed to the prime lending rate and construction loans.

Maturities and sensitivities of construction and commercial loans, at December 31, 2016, are as follows:

	Over 1 Year			
	1 Year or Less	through 5 Years	Over 5 Years	Total
	(In Thousands)			
Construction, net				
Fixed rate	\$ 53,053	\$ 28,457	\$ 12,080	\$ 93,590
Adjustable rate	—	24,633	13,555	38,188
Total	<u>\$ 53,053</u>	<u>\$ 53,090</u>	<u>\$ 25,635</u>	<u>\$ 131,778</u>
Commercial				
Fixed rate	\$ 92	\$ 5	\$ 56	\$ 153
Adjustable rate	—	—	—	—
Total	<u>\$ 92</u>	<u>\$ 5</u>	<u>\$ 56</u>	<u>\$ 153</u>

The Bank's loan portfolio is reported net of the allowance for loan losses. At December 31, 2016 and 2015, the allowance was \$11.0 million and \$9.9 million, respectively. The allowance is maintained at a level which the Bank believes is adequate to absorb inherent losses in the portfolio. The allowance is reviewed by senior management on at least a quarterly basis to determine its adequacy. Factors considered include historic losses, loan-to-value ratios, underlying collateral values, payment history, the size of the loan portfolio and the risks associated with certain loan types as well as other factors such as local economic trends, real estate market conditions and credit concentrations. Recent trends in the portfolio including charge-offs, delinquency levels and stabilization in the local markets has allowed the Bank to reduce its allowance for loan losses coverage ratio in comparison to total loans. (Refer to Notes 1 and 4 to the Consolidated Financial Statements for more details). Loan losses are charged against the allowance when the uncollectibility of loan principal is confirmed. In 2016, the Bank had net charge-offs of \$10,000, compared to net recoveries of \$172,000 in 2015 and net charge-offs of \$26,000 in 2014.

The analysis of the allowance for loan losses is as follows:

	Years Ended December 31,				
	2012	2013	2014	2015	2016
	(In Thousands)				
Balance at beginning of year	\$ 7,516	\$ 7,999	\$ 8,509	\$ 9,108	\$ 9,905
Charge-offs:					
Residential real estate	153	3	11	—	9
Commercial real estate	90	—	—	—	—
Construction	—	—	—	—	—
Home equity	—	—	31	—	—
Other loans	—	3	2	—	3
Total	243	6	44	—	12
Recoveries:					
Residential real estate	—	15	1	—	2
Commercial real estate	—	121	1	172	—
Construction	1	—	—	—	—
Home equity	—	—	15	—	—
Other loans	—	—	1	—	—
Total	1	136	18	172	2
Net charge-offs (recoveries)	242	(130)	26	(172)	10
Provision for loan losses	725	380	625	625	1,135
Balance at end of year	\$ 7,999	\$ 8,509	\$ 9,108	\$ 9,905	\$ 11,030
Ratio of net charge-offs (recoveries) during the year to average loans outstanding during the year	0.03 %	(0.01) %	— %	(0.01) %	— %

As a percentage of the gross loan portfolio, the allowance for loan losses was 0.68% at December 31, 2016, as compared to 0.70%, 0.73%, 0.78%, and 0.84%, respectively, for each of the previous four years. The decrease in the percentage in 2016 reflects the improvement in impaired loans, combined with continued stabilization in the housing market and general economic indicators.

The allocation of the allowance for loan losses at December 31, is as follows:

	2012		2013		2014		2015		2016	
	Amount	Percent *	Amount	Percent *	Amount	Percent *	Amount	Percent *	Amount	Percent *
	(Dollars in Thousands)									
Residential real estate.	\$ 2,975	45 %	\$ 3,327	47 %	\$ 2,895	44 %	\$ 3,102	43 %	\$ 2,634	41 %
Commercial real estate	4,352	46	4,758	46	5,684	49	5,457	48	6,690	49
Construction	568	6	364	5	456	5	1,142	7	1,556	8
Home equity	102	3	56	2	69	2	196	2	141	2
Other loans	2	—	4	—	4	—	8	—	9	—
Total	\$ 7,999	100 %	\$ 8,509	100 %	\$ 9,108	100 %	\$ 9,905	100 %	\$ 11,030	100 %

* Percent of loans in each category to total loans

The Bank works closely with delinquent mortgagors to bring their loans current and commences foreclosure proceedings if the mortgagor is unable to satisfy their outstanding obligation. Although regulatory changes have slowed the foreclosure process in recent years, the Bank continues to pursue delinquencies vigorously.

The Bank had non-accrual loans with an outstanding balance of \$1.8 million at December 31, 2016 and 2015. As a percentage of total loans, these non-accrual loans were 0.11% at December 31, 2016 and 0.13% at December 31, 2015. Additionally, at December 31, 2016 and 2015, total impaired loans were \$4.1 million and \$4.5 million, respectively. All loans on non-accrual and troubled debt restructurings are considered impaired and, as such, are reviewed for specific reserve allocation. Management determines the amount of reserves on a case-by-case basis using either the present value of expected cash flows, or the fair value of the underlying collateral when the loan is collateral dependent. Updated appraisals on collateral are obtained when management believes that the value of the property has deteriorated. At December 31, 2016 and 2015, \$178,000 and \$285,000, respectively, was allocated to impaired loans.

Non-accrual, past-due and restructured loans are as follows:

	<u>Non-accrual</u>	<u>Past-due 90 or More Days and Still Accruing</u>	<u>Troubled Debt Restructures ⁽¹⁾</u>
	(In Thousands)		
December 31, 2012	2,923	—	3,081
December 31, 2013	5,935	—	3,040
December 31, 2014	2,294	—	3,401
December 31, 2015	1,833	—	2,667
December 31, 2016	1,795	—	2,330

⁽¹⁾ Not included in past-due or non-accrual loans

Securities

The purpose of the Bank's securities portfolio is to provide liquidity. At December 31, 2016, the portfolio of \$27.2 million represented 1% of total assets, as compared to \$40.6 million, or 2% of total assets, at year-end 2015. At December 31, 2016, less than 1% of the securities were issued or guaranteed by government-sponsored enterprises. For the most part, these securities are offered at a fixed rate and term and at spreads above comparable U.S. Treasury issues. During 2015 and 2016, the Bank allowed the bond portfolio to decline as the proceeds on maturities were moved to overnight cash accounts.

At December 31, 2016, equity securities included a \$6.8 million investment in the CRA Fund, a mutual fund which invests in securities which qualify under the CRA securities test and \$20.3 million in common equity securities. These equity investments accounted for approximately 100% of the investment portfolio at December 31, 2016.

The carrying value of the investment portfolio by type is as follows:

	<u>December 31,</u>		
	<u>2014</u>	<u>2015</u>	<u>2016</u>
	(In Thousands)		
Debt securities:			
Government-sponsored enterprises	\$ 60,432	\$ 25,008	\$ —
Residential mortgage-backed securities	87	49	30
Equity securities:			
CRA Fund	4,999	4,971	6,839
Other equity securities	5,052	10,575	20,299
Total	<u>\$ 70,570</u>	<u>\$ 40,603</u>	<u>\$ 27,168</u>

At year-end 2016 and 2015, the entire securities portfolio was classified as available for sale and was carried at fair value with unrealized gains or losses reported in accumulated other comprehensive income (loss), a separate component of stockholders' equity. The net unrealized gain on the portfolio amounted to \$2.7 million, net of tax effects, at December 31, 2016 as compared to a net unrealized gain on the portfolio of \$353,000, at year-end 2015.

At December 31, 2016, there were no unrealized losses on residential mortgage backed debt securities.

At December 31, 2016, \$7.8 million in equity securities had unrealized losses with aggregate depreciation of less than 1% from the Bank's cost basis. No issues have been identified that cause management to believe the decline in market value is other than temporary, and the Bank has the ability and intent to hold these investments until a recovery of fair value.

As a member of the FHLB, the Bank is required to hold a Membership Stock Investment plus an Activity-based Stock Investment which generally approximates 5% of the Bank's borrowings balance. At December 31, 2016 and 2015, this investment accounted for 1% of total Bank assets. At December 31, 2016 and 2015, the Bank held \$24.5 million and \$19.8 million, respectively, in FHLB stock. In 2016 and 2015, the Bank received \$814,000 and \$457,000, respectively, in dividends.

At December 31, 2015, the Bank held \$6.2 million in certificates of deposits issued by other banks. No single certificate held by the Bank exceeded the FDIC maximum insurance coverage of \$250,000 and, therefore, all were insured in full by the FDIC. There are no certificates of deposit outstanding at December 31, 2016.

Foreclosed Assets

At December 31, 2016 and 2015, the Bank had no properties in foreclosed assets. During 2016, the Bank took in one property and was able to dispose of it for a net loss of \$3,000 and during 2015, the Bank took in two properties and was able to dispose of all properties for a net gain of \$126,000.

Other Assets

The Bank held \$12.0 million in Bank-owned life insurance at December 31, 2016 as compared to \$11.7 million at December 31, 2015. The policies, which insure the life of a current Bank executive, accrete at a variable rate of interest with minimum stated guaranteed rates. The Bank monitors the financial strength and counterparty credit ratings of the policy issuers and has determined that at December 31, 2016, two of three issuers were rated at or above Bank guidelines. The third issuer retained a rating from A.M. Best at or above Bank guidelines, while the issuer's Standard and Poor ("S&P") rating was below Bank guidelines at BBB+ (Good) with a stable outlook.

Deposits

At December 31, 2016, the Bank held a total of \$1.366 billion in deposits, an increase of \$149.1 million, or 12%, from the \$1.217 billion in deposits at year-end 2015. Non-certificate deposits comprised of savings, NOW, money market, and demand deposit accounts, were \$820.4 million at December 31, 2016 as compared to \$697.5 million at year-end 2015, an increase of \$122.8 million, or 18%, which was attributable to growth in money market accounts of \$95.7 million, or 21%, in transaction accounts of \$19.5 million, or 15% and \$4.8 million, or 5% in regular savings accounts. Non-certificate deposits comprised 60% of total deposits at December 31, 2016 as compared to 57% at year-end 2015. Certificates of deposit were \$545.8 million at December 31, 2016 as compared to \$519.5 million at year-end 2015.

A summary of deposits, by type, is as follows:

	December 31,		
	2014	2015	2016
	(In Thousands)		
Regular	\$ 82,382	\$ 90,004	\$ 94,770
Money market	436,299	447,667	543,367
NOW	30,623	31,560	34,467
Demand	117,243	128,285	147,749
Total non-certificate accounts	<u>666,547</u>	<u>697,516</u>	<u>820,353</u>
Term certificates less than \$250,000	342,984	415,311	430,816
Term certificates \$250,000 or more	79,686	104,200	114,940
Total certificate accounts	<u>422,670</u>	<u>519,511</u>	<u>545,756</u>
Total deposits	<u>\$ 1,089,217</u>	<u>\$ 1,217,027</u>	<u>\$ 1,366,109</u>

Term certificates of \$250,000 or more, at December 31, 2016, by maturity are as follows:

<u>Remaining Maturity</u>	<u>Amount</u>
	(In Thousands)
3 months or less	\$ 21,523
Over 3 through 6 months	11,917
Over 6 through 12 months	42,330
Over 12 months	39,170
	<u>\$ 114,940</u>

Primary competition for deposits is other banks and credit unions in the Bank's market area and on the Internet as well as mutual funds. The Bank's ability to attract and retain deposits depends upon satisfaction of depositors' requirements with respect to insurance, product, rate and service. The Bank offers traditional deposit products, competitive rates, convenient branch locations, ATMs, debit cards, telephone banking and Internet-based banking for consumers and commercial account holders. The Bank offers limited certificate of deposit products using national Internet-based posting services. These services provide the Bank with a source of long-term funding at lower cost than is generally available via retail channels.

Deposits are insured in full through the combination of the Federal Deposit Insurance Corporation and the Depositors Insurance Fund of Massachusetts. Generally, separately insured deposit accounts are insured up to \$250,000 by the FDIC and deposit balances in excess of this amount are insured by the DIF. DIF insurance provides an advantage for the Bank as some competitors cannot offer this coverage.

Borrowings

The Bank had \$475.3 million, or 24% of total assets, in borrowed funds from the FHLB at December 31, 2016 as compared to \$402.5 million, or 23% of total assets, at year-end 2015, representing an increase of \$72.8 million. Of the total at year-end 2016, \$85.0 million with a weighted average rate of 0.73% had original maturities of less than 12 months. Generally, borrowings are drawn with a fixed rate and term; however, at December 31, 2016, \$355.0 million, or 75%, can be called by the issuer after an initial specified term, and an additional \$318,000 is subject to principal amortization over its stated life. At December 31, 2016, 30% of all borrowings will mature within one year as compared to 85% at December 31, 2015. In 2016, the Bank borrowed \$330 million of long-term advances with two FHLB option advances. One advance has a 10-year final maturity and the other has a 15-year final maturity. Both advances are callable quarterly after the first year anniversary. These advances have favorable rates but the Bank anticipates that the advances will be called prior to the final maturity date. The average rate paid on FHLB borrowings held at year-end 2016 was 0.82%, down from 0.88% at year-end 2015 and 0.90% at year-end 2014.

The Bank also has a loan payable by the Bank for the purchase from an unrelated party of property which was used for a branch office. The note is secured by the real estate and bears an interest rate of 6.00%. Principal and interest is payable in 240 monthly installments and may be prepaid without penalty beginning in 2020.

Information relating to borrowings, including the short-term portion, is detailed in the following table:

	2014	2015	2016
	(Dollars in Thousands)		
Total borrowings:			
Balance outstanding at end of year	\$ 330,575	\$ 403,386	\$ 476,186
Average amount outstanding during the year	321,068	348,094	442,134
Weighted average interest rate during the year	1.13 %	0.85 %	0.86 %
Weighted average interest rate at end of year	0.92	0.89	0.83
Borrowings with original maturities less than one year:			
Balance outstanding at end of year	\$ 197,000	\$ 305,000	\$ 85,000
Average amount outstanding during the year	177,919	232,538	158,028
Maximum outstanding at any month end	206,000	314,000	348,000
Weighted average interest rate during the year	0.21 %	0.25 %	0.49 %
Weighted average interest rate at end of year	0.23	0.46	0.73

Liquidity, Capital Resources and Contractual Obligations

The Bank continually assesses its liquidity position by forecasting incoming and outgoing cash flows. In some cases, contractual maturity dates are used to anticipate cash flows. However, when an asset or liability is subject to early repayment or redemption at the discretion of the issuer or customer, cash flows can be difficult to predict. Generally, these prepayment rights are exercised when it is most financially favorable to the issuer or customer.

The Bank's initial source of liquidity is cash and cash equivalents which comprises 16% of total assets at December 31, 2016. A significant portion of this consists of overnight cash balances at the Federal Reserve Bank of Boston. These balances are immediately accessible for liquidity.

Mortgage-backed securities, which comprise less than 1% of the portfolio, are subject to repayment at the discretion of the underlying borrower and are not considered material to the overall balance sheet or liquidity targets.

Marketable common equity holdings, although liquid, are not viewed as a source of liquidity and are managed to produce superior returns on capital over a longer time horizon.

Investment in FHLB stock is illiquid. Certificates of deposit held as an investment are at stated fixed rates and maturity dates. The Bank did not hold Certificates of deposit at December 31, 2016.

Residential loans are susceptible to principal repayment at the discretion of the borrower. Commercial mortgages, while subject to significant penalties for early repayment in most cases, can also prepay at the borrower's discretion. In 2016, prepayment rates remained stable when compared to the previous year.

The Bank invests in key executive life insurance policies that are illiquid during the life of the executive. Such policies total \$12.0 million, or less than 1% of total assets, at December 31, 2016 as compared to \$11.7 million, or less than 1%, at December 31, 2015.

Non-certificate deposit balances can generally be withdrawn from the Bank at any time. Certificates of deposit, with predefined maturity dates and subject to early redemption penalties, can also be withdrawn. The Bank estimates the volatility of its deposits in light of the general economic climate and recent actual experience. Over the past 10 years, deposits have exceeded withdrawals resulting in net cash inflows from depositors.

Approximately 25% of the Bank's borrowings are fixed in terms of maturity. Less than 1% of the borrowings amortize over their stated lives and the Bank monitors these scheduled cash outflows. Approximately 75%, or \$355.0 million, can be called for earlier repayment at the discretion of the issuer. In the current economic environment, management anticipates that \$330 million will be called during 2017.

The Bank takes each of these preceding issues into consideration when measuring its liquidity position. Specific measurements include the Bank's cash flow position from the 30-day to 90-day horizon, the level of volatile liabilities to earning assets and loan to deposit ratios. Additionally, the Bank "shocks" its cash flows by assuming significant cash outflows in both non-certificate and certificate deposit balances. At December 31, 2016 and 2015, each measurement was within predefined Bank guidelines.

To supplement its liquidity position, should the need arise, the Bank maintains its membership in the FHLB where it is eligible to obtain both short and long-term credit advances. As of December 31, 2016, the Bank can borrow up to approximately \$824.6 million to meet its borrowing needs, based on the Bank's available qualified collateral which consists primarily of 1-4 family residential mortgages, certain multifamily residential property and commercial mortgages. The Bank can pledge other mortgages and assets as collateral to secure additional borrowings. Additionally, through the Federal Reserve Bank of Boston ("FRBB"), the Bank can borrow up to \$18.3 million through the discount window based on the Bank pledging its home equity loan portfolio. The Bank can pledge other mortgages and assets as collateral to secure additional borrowings with the FRBB. At December 31, 2016, the Bank had \$475.3 million in advances outstanding from the FHLB and consequently had \$349.3 million in available unused capacity. At December 31, 2016, the Bank did not have any advances outstanding at the FRBB.

At December 31, 2016, the Bank had capital of \$161.0 million, or 8.0% of total assets, as compared to \$138.0 million, or 7.8%, at December 31, 2015. Total capital is adjusted by the unrealized gains or losses in the Bank's available-for-sale securities portfolio and, as such, it is subject to fluctuations resulting from changes in the market values of its securities available for sale. At December 31, 2016, the Bank's entire securities portfolio was classified as available for sale which had the effect of increasing capital by \$2.7 million. In comparison, at year-end 2015, capital was increased by \$353,000.

Massachusetts-chartered savings banks that are insured by the FDIC are subject to minimum capital maintenance requirements. Regulatory guidelines define the minimum amount of qualifying capital an institution must maintain as a percentage of risk-weighted assets and average total assets. The Bank's ratios exceeded these regulatory capital requirements in both 2016 and 2015 (Refer to Note 14 to the Consolidated Financial Statements for more details).

During 2016, the Bank declared dividends of \$1.56 per share which included a \$0.32 special dividend declared in the fourth quarter. In comparison, in 2015, the Bank declared dividends of \$1.46 per share that also included a \$0.30 special dividend. The Bank's dividend payout ratio, which is calculated by dividing dividends per share by earnings per share, was 14.2% for 2016 as compared to 16.1% for 2015.

In the normal course of business, there are outstanding commitments and contingencies which are not reflected in the consolidated financial statements and are expected to be paid through current and future cash flows. At December 31, 2016, the Bank had the following contractual obligations outstanding:

	Payments Due by Year				
	Total	Less than One Year	One to Three Years	Over Three to Five Years	Over Five Years
	(In Thousands)				
Contractual Obligations:					
Certificates of deposit	\$ 545,756	\$ 342,631	\$ 161,648	\$ 41,477	\$ —
Federal Home Loan Bank advances	475,318	141,000	4,318	—	330,000
Mortgage payable (1)	868	57	124	140	547
Data processing agreements (2)	5,538	900	1,800	1,584	1,254
Lease agreements (3)	1,759	309	639	487	324

- (1) Under the mortgage agreement the balance of the note may be paid off at any date after January 2020 without penalty.
- (2) Estimated payments subject to change based on transaction volume.
- (3) Leases contain provisions to pay certain operating expenses, the cost of which is not included above. Lease commitments are based on the initial contract term, or longer when, in the opinion of management, it is more likely than not that the lease will be renewed.

Off-Balance Sheet Arrangements

The Bank also monitors its off-balance sheet items. At December 31, 2016, the Bank had approximately \$216.4 million in commitments to extend credit, as compared to \$231.6 million at December 31, 2015. As noted above, the Bank also has commitments for lease obligations and data processing agreements totaling \$1.8 million and \$5.5 million, respectively, at December 31, 2016.

IMPACT OF INFLATION AND CHANGING PRICES

The consolidated financial statements and related consolidated financial data presented herein have been prepared in conformity with U.S. GAAP, which generally requires the measurement of financial position and operating results in terms of historical dollars without considering the changes in the relative purchasing power of money over time due to inflation. The primary impact of inflation on operations of the Bank is reflected in increased operating costs. Unlike most industrial companies, virtually all the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a more significant impact on a financial institution's performance than the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the price of goods and services.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

The earnings of most banking institutions are exposed to interest rate risk because their balance sheets, both assets and liabilities, are predominantly interest-bearing. It is the Bank's objective to minimize, to the degree prudently possible, its exposure to interest rate risk, bearing in mind that the Bank, by its very nature, will always be in the business of taking on interest rate risk. Interest rate risk is monitored on a quarterly basis by the Asset Liability Committee (the "ALCO") and Board of Directors of the Bank. The ALCO is comprised of members of Bank Management and the Executive Committee of the Board. The ALCO establishes and monitors the various components of the balance sheet including volume, maturities, pricing and mix of assets along with funding sources. The goal is to balance liquidity, interest rate risk and profitability.

The primary tool used in managing interest rate risk is income simulation modeling. Income simulation modeling measures changes in net interest income by projecting the future composition of the Bank's balance sheet and applying different interest rate scenarios.

Management incorporates numerous assumptions into the simulation model, such as prepayment speeds, balance sheet growth and deposit elasticity. Generally, rates are assumed to rise steadily over a twelve-month period, and then remain constant over the remaining period. At December 31, 2016, the model assumed a 100 and 200 basis point increase in interest rates where the magnitude of the rate change varies with the term. For example, longer-term rates are modeled to change by 60 basis points and short-term rates are modeled to change by 100 basis points. The model estimates that, over a twenty-four month period, net interest income will decrease 5% if rates rise 100 basis points and will decrease 8% if rates rise 200 basis points. The Bank's interest rate risk exposure is believed by management to be well managed and within pre-defined limits.

At December 31, 2016 and 2015, loans, as a percentage of total earning assets, were 82% and 81%, respectively. The composition of the Bank's liabilities changed such that interest-bearing deposits to total interest-bearing liabilities were 72% at year-end 2016, as compared to 73% at the prior year-end.

At December 31, 2016, liabilities that reprice within one year exceeded assets repricing within the same period by \$334 million compared to \$204 million at December 31, 2015. Both calculations indicate that the Bank is susceptible to lower net interest income in the event that market rates rise in the near term. Over the last year, the Bank continued to target ongoing loan growth, which includes a mix of variable and fixed rate loans. The Bank has shortened the maturities on investment securities and has significantly increased overnight cash balances. The Bank has focused on growing core deposit balances along with term deposits.

The following tables present interest-rate sensitive assets and liabilities categorized by expected maturity (or interest rate adjustment date, if earlier) and weighted average rates. Expected maturities of loans are adjusted for amortization and estimated prepayments of principal. Prepayment speeds range from 0% to 20% depending upon the particular asset category. Generally, adjustable-rate loans are indexed to Prime and treasury rates. Non-certificate deposits do not have contractual maturities. The tables reflect management's current assumptions about the volatility of such deposits.

Maturing or repricing within:	<u>One Year</u>	<u>1-2 Years</u>	<u>2-3 Years</u>	<u>3-4 Years</u>	<u>4-5 Years</u>	<u>Thereafter</u>	<u>Total</u>
	(Dollars in Thousands)						
December 31, 2016							
Interest-earning assets:							
Securities (at cost) (1), short-term investments and certificates of deposit	\$ 362,491	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 362,491
	1.04 %	— %	— %	— %	— %	— %	1.04 %
Loans:							
Fixed rate	\$ 78,622	\$ 67,090	\$ 55,920	\$ 51,074	\$ 45,929	\$ 155,282	\$ 453,917
	4.60 %	4.52 %	4.47 %	4.45 %	4.45 %	4.36 %	4.46 %
Adjustable rate	\$ 308,497	\$ 222,138	\$ 172,662	\$ 166,471	\$ 149,028	\$ 141,480	\$ 1,160,276
	4.39 %	4.34 %	4.33 %	4.20 %	4.11 %	4.37 %	4.31 %
Interest-bearing liabilities:							
Deposits:							
Non-certificate accounts	\$ 269,402	\$ —	\$ —	\$ —	\$ 403,202	\$ —	\$ 672,604
	0.90 %	— %	— %	— %	0.32 %	— %	0.55 %
Term certificates	\$ 342,631	\$ 120,368	\$ 41,280	\$ 21,297	\$ 20,180	\$ —	\$ 545,756
	1.00 %	1.28 %	1.74 %	1.89 %	1.71 %	— %	1.18 %
Borrowed funds	\$ 471,216	\$ 219	\$ 4,064	\$ 687	\$ —	\$ —	\$ 476,186
	0.79 %	5.78 %	4.02 %	6.00 %	— %	— %	0.83 %
December 31, 2015							
Interest-earning assets:							
Securities (at cost) (1), short-term investments and certificates of deposit	\$ 320,125	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 320,125
	0.80 %	— %	— %	— %	— %	— %	0.80 %
Loans:							
Fixed rate	\$ 71,092	\$ 64,382	\$ 51,652	\$ 45,960	\$ 41,627	\$ 135,086	\$ 409,799
	4.66 %	4.64 %	4.55 %	4.62 %	4.55 %	4.48 %	4.57 %
Adjustable rate	\$ 242,020	\$ 231,049	\$ 156,811	\$ 138,941	\$ 117,325	\$ 117,255	\$ 1,003,401
	4.61 %	4.46 %	4.35 %	4.44 %	4.25 %	4.52 %	4.46 %
Interest-bearing liabilities:							
Deposits:							
Non-certificate accounts	\$ 158,143	\$ —	\$ —	\$ —	\$ 411,088	\$ —	\$ 569,231
	0.83 %	— %	— %	— %	0.34 %	— %	0.48 %
Term certificates	\$ 336,869	\$ 99,198	\$ 37,301	\$ 27,883	\$ 18,260	\$ —	\$ 519,511
	1.05 %	1.20 %	1.53 %	1.92 %	1.94 %	— %	1.19 %
Borrowed funds	\$ 342,171	\$ 56,180	\$ 192	\$ 4,029	\$ 814	\$ —	\$ 403,386
	0.54 %	2.71 %	5.74 %	4.00 %	6.00 %	— %	0.89 %

(1) Includes FHLB stock

Item 8. Financial Statements and Supplementary Data.

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Management's Annual Report on Internal Control over Financial Reporting

The management of Hingham Institution for Savings (the "Bank"), is responsible for establishing and maintaining effective internal control over financial reporting. The internal control process has been designed under our supervision to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with accounting principles generally accepted in the United States of America.

Management conducted an assessment of the effectiveness of the Bank's internal control over financial reporting as of December 31, 2016, utilizing the framework established in *Internal Control-Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management has determined that the Bank's internal control over financial reporting as of December 31, 2016 is effective.

Our internal control over financial reporting includes policies and procedures that (a) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Bank; (b) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles in the United States of America, and that receipts and expenditures of the Bank are being made only in accordance with authorizations of management and directors of the Bank; and (c) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Bank's assets that could have a material effect on the Bank's financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems designed to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

The effectiveness of the Bank's internal control over financial reporting as of December 31, 2016 has been audited by Wolf & Company, P.C., an independent registered public accounting firm, as stated in their report which follows. This report expresses an unqualified opinion on the effectiveness of the Bank's internal control over financial reporting as of December 31, 2016.



Robert H. Gaughen, Jr.
Chief Executive Officer
March 7, 2017



Cristian A. Melej
Chief Financial Officer
March 7, 2017

Report of Independent Registered Public Accounting Firm on Consolidated Financial Statements

To the Board of Directors and Stockholders of
Hingham Institution for Savings:

We have audited the accompanying consolidated balance sheets of Hingham Institution for Savings and subsidiaries, (the “Bank”) as of December 31, 2016 and 2015, and the related consolidated statements of net income, comprehensive income, changes in stockholders’ equity and cash flows for each of the years in the three-year period ended December 31, 2016. We also have audited the Bank’s internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. Hingham Institution for Savings’ management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management’s Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on these consolidated financial statements and an opinion on the Bank’s internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. A company’s internal control over financial reporting includes those policies and procedures that (a) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (b) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles in the United States of America, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (c) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Hingham Institution for Savings and subsidiaries as of December 31, 2016 and 2015, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2016 in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, Hingham Institution for Savings maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Wolf + Company, P.C.

Boston, Massachusetts
March 7, 2017

CONSOLIDATED BALANCE SHEETS

ASSETS

	December 31,	
	2015	2016
	(In Thousands)	
Cash and due from banks	\$ 6,944	\$ 7,816
Federal Reserve and other short-term investments	254,069	<u>315,116</u>
Cash and cash equivalents	261,013	322,932
Certificates of deposit	6,206	—
Securities available for sale, at fair value	40,603	27,168
Federal Home Loan Bank stock, at cost	19,796	24,472
Loans, net of allowance for loan losses of \$9,905,000 and \$11,030,000 at December 31, 2015 and 2016, respectively	1,405,533	1,605,647
Bank-owned life insurance	11,697	11,962
Premises and equipment, net	15,094	14,462
Accrued interest receivable	3,270	3,529
Deferred income tax asset, net	3,281	2,489
Other assets	2,035	1,938
Total assets	<u>\$ 1,768,528</u>	<u>\$ 2,014,599</u>

LIABILITIES AND STOCKHOLDERS' EQUITY

Deposits:		
Interest-bearing	\$ 1,088,742	\$ 1,218,360
Demand	128,285	147,749
Total deposits	<u>1,217,027</u>	<u>1,366,109</u>
Federal Home Loan Bank advances	402,464	475,318
Mortgage payable	922	868
Mortgagors' escrow accounts	4,850	5,585
Accrued interest payable	303	400
Other liabilities	4,947	5,295
Total liabilities	<u>1,630,513</u>	<u>1,853,575</u>
Commitments and contingencies (Note 10)		
Stockholders' equity:		
Preferred stock, \$1.00 par value, 2,500,000 shares authorized, none issued	—	—
Common stock, \$1.00 par value, 5,000,000 shares authorized; 2,128,750 and 2,132,750 shares issued and outstanding at December 31, 2015 and 2016, respectively	2,129	2,133
Additional paid-in capital	11,052	11,575
Undivided profits	124,481	144,580
Accumulated other comprehensive income	353	2,736
Total stockholders' equity	<u>138,015</u>	<u>161,024</u>
Total liabilities and stockholders' equity	<u>\$ 1,768,528</u>	<u>\$ 2,014,599</u>

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF NET INCOME

	Years Ended December 31,		
	2014	2015	2016
	(In Thousands, Except Per Share Amounts)		
Interest and dividend income:			
Loans	\$ 54,990	\$ 60,260	\$ 68,917
Debt securities	336	195	52
Equity securities	491	795	1,248
Federal Reserve and other short-term investments	376	609	1,552
Total interest and dividend income	56,193	61,859	71,769
Interest expense:			
Deposits	6,314	7,945	9,599
Federal Home Loan Bank advances	3,562	2,908	3,732
Mortgage payable	60	57	54
Total interest expense	9,936	10,910	13,385
Net interest income	46,257	50,949	58,384
Provision for loan losses	625	625	1,135
Net interest income, after provision for loan losses	45,632	50,324	57,249
Other income:			
Customer service fees on deposits	1,014	978	928
Increase in cash surrender value of bank-owned life insurance	308	281	265
Gain on sales of securities	—	29	344
Gain on life insurance distribution	6,302	—	—
Miscellaneous	239	195	198
Total other income	7,863	1,483	1,735
Operating expenses:			
Salaries and employee benefits	12,424	11,632	12,024
Occupancy and equipment	1,968	2,057	1,856
Data processing	1,197	1,182	1,230
Deposit insurance	803	902	1,023
Marketing	557	489	403
Foreclosure	263	72	34
Other general and administrative	2,877	2,697	2,645
Total operating expenses	20,089	19,031	19,215
Income before income taxes	33,406	32,776	39,769
Income tax provision	11,142	13,430	16,346
Net income	\$ 22,264	\$ 19,346	\$ 23,423
Earnings per share:			
Basic	\$ 10.46	\$ 9.09	\$ 10.99
Diluted	\$ 10.44	\$ 9.02	\$ 10.89

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Years Ended December 31,		
	2014	2015	2016
	(In Thousands)		
Net income	\$ 22,264	\$ 19,346	\$ 23,423
Other comprehensive income:			
Net unrealized holding gain on securities available for sale	345	265	4,060
Reclassification adjustment for gain on sales of securities recognized in income (1)	—	(29)	(344)
Net unrealized gain	345	236	3,716
Tax effect	(124)	(84)	(1,333)
	221	152	2,383
Comprehensive income	\$ 22,485	\$ 19,498	\$ 25,806

- (1) Included in gain on sales of securities in the consolidated statements of net income. Provision for income taxes associated with the reclassification adjustments amounted to \$10,000 and \$123,000 for the years ended December 31, 2015 and 2016 respectively.

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	Years Ended December 31, 2014, 2015 and 2016				
	Common Stock	Additional Paid-in Capital	Undivided Profits	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
	(In Thousands)				
Balance at December 31, 2013	\$ 2,129	\$ 10,659	\$ 90,449	\$ (20)	\$ 103,217
Comprehensive income	—	—	22,264	221	22,485
Share-based compensation	—	283	—	—	283
Cash dividends declared-common (\$2.10 per share)	—	—	(4,470)	—	(4,470)
Balance at December 31, 2014	2,129	10,942	108,243	201	121,515
Comprehensive income	—	—	19,346	152	19,498
Share-based compensation	—	110	—	—	110
Cash dividends declared-common (\$1.46 per share)	—	—	(3,108)	—	(3,108)
Balance at December 31, 2015	2,129	11,052	124,481	353	138,015
Comprehensive income	—	—	23,423	2,383	25,806
Share-based compensation	—	156	—	—	156
Stock options exercised, including tax benefit of \$158,000	4	367	—	—	371
Cash dividends declared-common (\$1.56 per share)	—	—	(3,324)	—	(3,324)
Balance at December 31, 2016	\$ 2,133	\$ 11,575	\$ 144,580	\$ 2,736	\$ 161,024

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2014	2015	2016
	(In Thousands)		
Cash flows from operating activities:			
Net income	\$ 22,264	\$ 19,346	\$ 23,423
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	625	625	1,135
Amortization of securities premiums, net	490	138	17
Amortization of deferred loan origination costs, net	163	505	623
Share-based compensation expense	283	110	156
Excess tax benefits from share-based compensation arrangements	—	—	(158)
Depreciation and amortization of premises and equipment	770	766	730
Increase in cash surrender value of bank-owned life insurance	(308)	(281)	(265)
Deferred income tax provision (benefit)	168	(723)	(541)
Gain on sales of securities	—	(29)	(344)
Gain on life insurance distribution	(6,302)	—	—
Net (gain) loss on sales and write-downs of foreclosed assets	(13)	(126)	5
Changes in:			
Accrued interest receivable and other assets	2	(384)	(129)
Accrued interest payable and other liabilities	10	276	484
Net cash provided by operating activities	18,152	20,223	25,136
Cash flows from investing activities:			
Activity in available-for-sale securities:			
Maturities, prepayments and calls	6,790	35,296	25,022
Proceeds from sales	—	682	1,425
Purchases	(6,705)	(5,884)	(8,969)
Activity in certificates of deposit:			
Maturities, prepayments and calls	60,846	6,720	6,206
Purchases	(25,192)	—	—
Loans originated, net of principal payments received	(162,059)	(168,411)	(202,042)
Redemption of Federal Home Loan Bank stock	—	—	7,393
Purchase of Federal Home Loan Bank stock	(1,877)	(1,941)	(12,069)
Proceeds from sales of foreclosed assets	992	1,316	165
Proceeds from bank-owned life insurance death benefit	10,570	—	—
Additions to premises and equipment	(127)	(649)	(98)
Net cash used in investing activities	(116,762)	(132,871)	(182,967)

(continued)

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(concluded)

	Years Ended December 31,		
	2014	2015	2016
	(In Thousands)		
Cash flows from financing activities:			
Increase in deposits	\$ 148,311	\$ 127,810	\$ 149,082
Increase in mortgagors' escrow accounts	767	374	735
Proceeds from stock options exercised	—	—	213
Cash dividends paid on common stock	(2,916)	(4,556)	(3,238)
Excess tax benefits from share-based compensation arrangements	—	—	158
Increase (decrease) in Federal Home Loan Bank advances with maturities of three months or less	20,000	210,000	(220,000)
Proceeds from Federal Home Loan Bank advances with maturities of more than three months	330,000	15,000	330,000
Repayments of Federal Home Loan Bank advances with maturities of more than three months	(323,130)	(152,138)	(37,146)
Repayment of mortgage payable	(47)	(51)	(54)
Net cash provided by financing activities	172,985	196,439	219,750
Net change in cash and cash equivalents	74,375	83,791	61,919
Cash and cash equivalents at beginning of year	102,847	177,222	261,013
Cash and cash equivalents at end of year	\$ 177,222	\$ 261,013	\$ 322,932
Supplementary information:			
Interest paid on deposit accounts	\$ 6,310	\$ 7,967	\$ 9,591
Interest paid on borrowed funds	3,766	2,990	3,697
Income taxes paid, net of refunds	10,708	14,060	16,909
Non-cash activities:			
Real estate acquired through foreclosure	\$ 1,494	\$ 404	\$ 170

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years Ended December 31, 2014, 2015 and 2016

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation and consolidation

The consolidated financial statements include the accounts of Hingham Institution for Savings ("Bank") and its wholly-owned subsidiaries, Hingham Securities Corporation II, Hingham Unpledged Securities Corporation and Hingham Pledged Securities Corporation, which hold title to certain securities available for sale. During 2014, the Hingham Securities Corporation II was dissolved with all assets and liabilities transferred to the Bank. All intercompany accounts and transactions have been eliminated in consolidation.

Use of estimates

In preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. A material estimate that is susceptible to significant change in the near term relates to the determination of the allowance for loan losses.

Business and operating segments

The Bank provides a variety of financial services to individuals and small businesses through its eleven offices in Boston and southeastern Massachusetts. Its primary deposit products are savings, checking, and term certificate accounts, and its primary lending products are residential and commercial mortgage loans secured by properties in Eastern Massachusetts.

Management evaluates the Bank's performance and allocates resources based on a single segment concept. Accordingly, there are no separately identified operating segments for which discrete financial information is available. The Bank does not derive revenues from, or have assets located in foreign countries, nor does it derive revenues from any single customer that represents 10% or more of the Bank's total revenues.

Fair value hierarchy

The Bank groups its assets measured at fair value in three levels, based on the markets in which the assets are traded and the reliability of the assumptions used to determine fair value, as follows:

Level 1 – Valuation is based on quoted prices in active markets for identical assets. Level 1 assets generally include debt and equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets.

Level 2 – Valuation is based on observable inputs other than Level 1 prices, such as quoted prices for similar assets; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets.

Level 3 – Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets. Level 3 assets include those whose value is determined using unobservable inputs to pricing models, discounted cash flow methodologies, or similar techniques, as well as assets for which the determination of fair value requires significant management judgment or estimation.

Transfers between levels are recognized at the end of a reporting period, if applicable.

Reclassification

Certain amounts in the 2014 and 2015 consolidated financial statements have been reclassified to conform to the 2016 presentation.

Cash and cash equivalents

Cash and cash equivalents include amounts due from banks and short-term investments which mature within 90 days from the date of purchase and are carried at cost. At December 31, 2016, the Bank had a concentration of cash on deposit at the Federal Reserve Bank amounting to \$311.5 million.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Certificates of deposit

Certificates of deposit are purchased from FDIC-insured depository institutions in amounts not to exceed \$250,000 per institution, including accrued interest, and have original maturities greater than ninety days. Certificates of deposit are carried at cost.

Securities available for sale

Securities are classified as available for sale and recorded at fair value, with unrealized gains and losses, after tax effects, excluded from earnings and reported in accumulated other comprehensive income (loss) as a separate component of stockholders' equity.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Gains and losses on disposition of securities are recorded on the trade date and are determined using the specific identification method.

Each reporting period, the Bank evaluates all securities with a decline in fair value below the amortized cost to determine whether or not the impairment is deemed to be other than temporary ("OTTI"). OTTI is required to be recognized if (1) the Bank intends to sell the security; (2) it is "more likely than not" that the Bank will be required to sell the security before recovery of its amortized cost basis; or (3) for debt securities, the present value of expected cash flows is not sufficient to recover the entire amortized cost basis. Marketable equity securities are evaluated for OTTI based on the severity and duration of the impairment and, if deemed to be other than temporary, the declines in fair value are reflected in earnings as realized losses. For impaired debt securities that the Bank intends to sell, or more likely than not will be required to sell, the full amount of the depreciation is recognized as OTTI through earnings. For all other impaired debt securities, credit-related OTTI is recognized through earnings and non-credit related OTTI is recognized in other comprehensive income/loss, net of applicable taxes.

Federal Home Loan Bank stock

The Bank, as a member of the Federal Home Loan Bank system, is required to maintain an investment in capital stock of the Federal Home Loan Bank of Boston ("FHLB"). Based on redemption provisions of the FHLB, the stock has no quoted market value and is carried at cost. At its discretion, the FHLB may declare dividends on the stock. The Bank reviews for impairment based on the ultimate recoverability of the cost basis in the FHLB stock. As of December 31, 2016, no impairment has been recognized.

Loans

The Bank's loan portfolio includes residential real estate, commercial real estate, construction, home equity, commercial and consumer segments. A substantial portion of the loan portfolio is secured by real estate in the southeastern Massachusetts area. The ability of the Bank's debtors to honor their contracts is dependent upon real estate, construction, and general economic conditions.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding unpaid principal balances adjusted for charge-offs, the allowance for loan losses, and net deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees and certain direct origination costs are deferred and recognized as an adjustment of the related loan yield using the interest method.

The accrual of interest on mortgage and commercial loans is discontinued at the time a loan is 90 days past due (the loan is in default) unless the credit is well-secured and in process of collection. Personal loans are typically charged off no later than becoming 180 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on non-accrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on non-accrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Allowance for loan losses

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

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

General component

The general component of the allowance for loan losses is based on historical loss experience adjusted for qualitative factors stratified by loan segment. Management uses a rolling average of historical losses based on a time frame (currently two years) appropriate to capture relevant loss data for each loan segment. This historical loss factor is adjusted for the following qualitative factors: levels/trends in delinquencies; trends in volume and terms of loans; effects of changes in risk selection and underwriting standards and other changes in lending policies, procedures and practices; experience/ability/depth of lending management and staff; national and local economic trends and conditions; industry conditions and effects of changes in credit concentrations. There were no changes in the Bank's policies or methodology pertaining to the general component of the allowance for loan losses during 2016.

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

Residential real estate – The Bank generally does not originate loans with a loan-to-value ratio greater than 80 percent (without private mortgage insurance). All loans in this segment are collateralized by owner-occupied residential real estate and repayment is dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality in this segment.

Commercial real estate – Loans in this segment are primarily secured by income-producing properties throughout Massachusetts. Generally, loan amounts do not exceed 75% of the appraised value of the collateral. The underlying cash flows generated by the properties are adversely impacted by a downturn in the economy as evidenced by increased vacancy rates which, in turn, will have an effect on the credit quality in this segment. Management obtains rent rolls annually and regularly monitors the cash flows of these loans.

Construction – Loans in this segment include both owner-occupied and speculative real estate development loans for which payment is derived from sale of the property. Credit risk is affected by cost overruns, time to sell at an adequate price, the overall health of the economy and market conditions.

Home equity – Loans in this segment include equity lines of credit and second mortgages, and are generally collateralized by second liens on residential real estate. Repayment is dependent on the credit quality of the individual borrower. The Bank generally does not originate loans with combined loan-to-value ratios greater than 70% when taking into account both the balance of the home equity loans and the first mortgage loan. Similar to residential real estate, the overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality in this segment.

Commercial – Loans in this segment are made to businesses and are generally secured by assets of the business. Repayment is expected from the cash flows of the business. A weakened economy, and resultant decreased consumer spending, will have an effect on the credit quality in this segment.

Consumer – Loans in this segment are generally unsecured and repayment is dependent on the credit quality of the individual borrower.

Allocated component

The allocated component relates to loans that are classified as impaired. Impairment is measured on a loan-by-loan basis for residential real estate, commercial real estate, construction, home equity and commercial loans. A loan is considered impaired when, based on current information and events, it is probable that a creditor will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Impaired loans are generally maintained on a non-accrual basis. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, or the fair value of the collateral if the loan is collateral dependent. An allowance is established when the discounted cash flows (or collateral value) of the impaired loan is lower than the carrying amount of that loan. Large groups of smaller balance homogeneous loans, such as consumer loans, are collectively evaluated for impairment.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The Bank periodically may agree to modify the contractual terms of loans. When a loan is modified and a concession is made to a borrower experiencing financial difficulty, the modification is considered a troubled debt restructuring ("TDR"). All TDRs are initially classified as impaired.

Foreclosed assets

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value, less costs to sell, at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less costs to sell. Revenue and expenses from operations, changes in the valuation allowance and any direct write-downs are included in foreclosure expenses.

Bank-owned life insurance

Bank-owned life insurance policies are reflected on the consolidated balance sheet at cash surrender value. Changes in cash surrender value are reflected in other income in the consolidated statement of net income and are not subject to income taxes.

Premises and equipment

Land is carried at cost. Buildings, leasehold improvements and equipment are carried at cost, less accumulated depreciation and amortization computed on the straight-line method over the estimated useful lives of the assets or the expected terms of the leases if shorter. Expected terms include lease option periods to the extent that the exercise of such options is reasonably assured. It is general practice to charge the cost of maintenance and repairs to earnings when incurred; major expenditures for betterments are capitalized and depreciated.

Marketing costs

Marketing costs are expensed as incurred.

Transfers of financial assets

Transfers of an entire financial asset, a group of entire financial assets, or a participating interest in an entire financial asset are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Bank, (2) the transferee obtains the right to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets.

Income taxes

Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws. A valuation allowance is established against deferred tax assets when, based upon the available evidence, including historical and projected taxable income, it is more likely than not that some or all of the deferred tax assets will not be realized. The Bank has no uncertain tax positions at December 31, 2015 or 2016. The Bank records interest and penalties as part of income tax expense. No interest or penalties were recorded for the years ended December 31, 2014, 2015 and 2016.

Stock compensation plans

The Bank measures and recognizes compensation cost relating to share-based payment transactions based on the grant-date fair value of the equity instruments issued. Share-based compensation is recognized over the period the employee is required to provide services for the award. The Bank uses the Black-Scholes option-pricing model to determine the fair value of stock options granted.

Earnings per share

Basic earnings per share represent net income divided by the weighted-average number of shares outstanding during the period. Diluted earnings per share reflect additional shares that would have been outstanding if dilutive potential shares had been issued, as well as any adjustment to net income that would result from the assumed issuance. Potential shares that may be issued by the Bank relate solely to outstanding stock options and are determined using the treasury stock method.

Earnings per share have been computed based on the following:

	Years Ended December 31,		
	2014	2015	2016
		(In Thousands)	
Average number of shares outstanding used to calculate basic earnings per share	2,129	2,129	2,131
Effect of dilutive options	4	16	21
Average number of shares outstanding used to calculate diluted earnings per share	<u>2,133</u>	<u>2,145</u>	<u>2,152</u>

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

There were no anti-dilutive options for the years ended December 31, 2014, 2015 or 2016.

Comprehensive income

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

At December 31, 2015, accumulated other comprehensive income relates to net unrealized gains on available-for-sale securities of \$549,000, net of tax effects of \$196,000. At December 31, 2016, accumulated other comprehensive income relates to net unrealized gains on available-for-sale securities of \$4.3 million, net of tax effects of \$1.6 million.

Recent accounting pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The amendments in this Update create Topic 606, *Revenue from Contracts with Customers*, and supersede the revenue recognition requirements in Topic 605, *Revenue Recognition*, including most industry-specific revenue recognition guidance throughout the Industry Topics of the Codification. The core principle of Topic 606 is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This ASU is effective for annual reporting periods, including interim periods, beginning after December 15, 2017. Early application is permitted, but not before annual periods beginning after December 15, 2016. Adoption of this guidance is not expected to have a material impact on the Bank's consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall, (Subtopic 825-10)*. The amendments in this Update address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. Targeted changes to generally accepted accounting principles include the requirement for 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 and the elimination of the requirement to disclose the methods and significant assumptions used to estimate the fair value for financial instruments measured at amortized cost. The amendments in this Update are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. As the Bank maintains a portfolio of marketable equity investments, net unrealized gains and losses on this portfolio are currently recognized in accumulated other comprehensive income ("AOCI") and consequently result in adjustments to book value but do not affect the income statement. Following the adoption of this guidance, any such net unrealized gains and losses will be reflected in the income statement, regardless of whether such gains and losses are realized. If such guidance were effective as of January 1, 2016, approximately \$2.4 million would have been reclassified from AOCI into net income for the 2016 period. The impact of this guidance on future periods cannot be estimated at this time and the Bank does not intend to alter its investment practices in response to this guidance.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. This Update is intended to improve financial reporting about leasing transactions and the key provision impacting the Bank is the requirement for a lessee to record a right-to-use asset and a liability representing the obligation to make lease payments for long-term operating leases. The Update will be effective for fiscal years beginning after December 15, 2018, including interim periods. Management is currently evaluating the impact to the consolidated financial statements of adopting this Update.

In March 2016, the FASB issued ASU 2016-09, *Compensation-Stock Compensation (Topic 718)*. This Update is intended to simplify several aspects of the accounting for share-based payment transaction, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The Update will be effective for fiscal years beginning after December 15, 2016, including interim periods. Management believes the main impact from the adoption of this guidance relates to the recognition of excess tax benefit or deficiency through the income statement, as opposed to the current recognition of excess tax benefits in additional paid in capital and tax deficiencies in income tax expense (or additional paid in capital to the extent there is previously recognized tax benefits in additional paid in capital).

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (concluded)

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments-Credit Losses (Topic 326)*. This Update requires entities to measure expected credit losses based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. Credit losses on available-for-sale debt securities should be measured in a manner similar to current GAAP. However, the amendments in this Update require that credit losses be presented as an allowance rather than as a write down. The Update will be effective for fiscal years beginning after December 15, 2019, including interim periods. Management is currently evaluating the impact to the consolidated financial statements of adopting this Update.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230)*. This new guidance is intended to reduce diversity in practice in how certain transactions are classified in the statement of cash flows. The Update will be effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years. Adoption of this guidance is not expected to have an impact on the Bank's consolidated financial statements.

2. RESTRICTIONS ON CASH AND AMOUNTS DUE FROM BANKS

The Bank is required to maintain average balances on hand or with the Federal Reserve Bank. At December 31, 2015 and 2016, cash and due from banks included \$4,568,000 and \$6,711,000, respectively, to satisfy such reserve requirements.

3. SECURITIES AVAILABLE FOR SALE

The amortized cost and fair value of securities available for sale, with gross unrealized gains and losses, follows:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
	(In Thousands)			
<u>December 31, 2015</u>				
Debt securities:				
Government-sponsored enterprises	\$ 25,020	\$ —	\$ (12)	\$ 25,008
Residential mortgage-backed	48	1	—	49
Total debt securities	<u>25,068</u>	<u>1</u>	<u>(12)</u>	<u>25,057</u>
Equity securities:				
Community Reinvestment Act Qualified Investment Fund	5,000	—	(29)	4,971
Other equity securities	9,986	781	(192)	10,575
Total equity securities	<u>14,986</u>	<u>781</u>	<u>(221)</u>	<u>15,546</u>
Total securities available for sale	<u>\$ 40,054</u>	<u>\$ 782</u>	<u>\$ (233)</u>	<u>\$ 40,603</u>
<u>December 31, 2016</u>				
Debt securities:				
Residential mortgage-backed	<u>\$ 29</u>	<u>\$ 1</u>	<u>\$ —</u>	<u>\$ 30</u>
Equity securities:				
Community Reinvestment Act Qualified Investment Fund	<u>7,000</u>	<u>—</u>	<u>(161)</u>	<u>6,839</u>
Other equity securities	<u>15,874</u>	<u>4,455</u>	<u>(30)</u>	<u>20,299</u>
Total equity securities	<u>22,874</u>	<u>4,455</u>	<u>(191)</u>	<u>27,138</u>
Total securities available for sale	<u>\$ 22,903</u>	<u>\$ 4,456</u>	<u>\$ (191)</u>	<u>\$ 27,168</u>

At December 31, 2015 and 2016, all other equity securities are in the financial sector.

At December 31, 2015 and 2016, all debt securities were pledged to secure Federal Home Loan Bank advances. See Note 8. At December 31, 2016, all of the Bank's debt securities are amortizing securities.

For the year ended December 31, 2016, proceeds from sales of securities available for sale amounted to \$1.4 million, resulting in gross realized gains of \$344,000 and no gross realized losses. For the year ended December 31, 2015, proceeds from securities available for sale amounted to \$682,000 resulting in gross realized gains of \$29,000 and no gross realized losses.

3. SECURITIES AVAILABLE FOR SALE (concluded)

Information pertaining to securities with gross unrealized losses at December 31, 2015 and 2016, aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	Less Than Twelve Months		Over Twelve Months	
	Gross Unrealized Losses	Fair Values	Gross Unrealized Losses	Fair Values
	(In Thousands)			
<u>December 31, 2015</u>				
Debt securities:				
Government-sponsored enterprises	\$ 1	\$ 6,000	\$ 11	\$ 19,007
Equity securities	134	2,440	87	5,204
Total temporarily impaired	\$ 135	\$ 8,440	\$ 98	\$ 24,211
<u>December 31, 2016</u>				
Equity securities	174	7,533	17	274
Total temporarily impaired	\$ 174	\$ 7,533	\$ 17	\$ 274

At December 31, 2016, \$7.8 million in equity securities had unrealized losses with aggregate depreciation of 2% from the Bank's cost basis. No issues have been identified that cause management to believe the decline in fair value is other than temporary, and the Bank has the ability and intent to hold these investments until a recovery of fair value.

4. LOANS

A summary of the balances of loans follows:

	December 31,	
	2015	2016
	(In Thousands)	
Real estate loans:		
Residential	\$ 602,290	\$ 652,444
Commercial	681,601	796,063
Construction	95,433	131,778
Home equity	33,232	33,230
Total real estate loans	1,412,556	1,613,515
Other loans:		
Commercial	76	153
Consumer	568	525
Total other loans	644	678
Total loans	1,413,200	1,614,193
Allowance for loan losses	(9,905)	(11,030)
Net deferred loan origination costs	2,238	2,484
Loans, net	\$ 1,405,533	\$ 1,605,647

4. LOANS (continued)

Activity in the allowance for loan losses for the years ended December 31, 2014, 2015 and 2016 and allocation of the allowance to loan segments at December 31, 2015 and 2016, follows:

	<u>Residential Real Estate</u>	<u>Commercial Real Estate</u>	<u>Construction</u>	<u>Home Equity</u>	<u>Commercial</u>	<u>Consumer</u>	<u>Total</u>
	(In Thousands)						
Allowance for loan losses:							
Balance December 31, 2013	\$ 3,327	\$ 4,758	\$ 364	\$ 56	\$ 1	\$ 3	\$ 8,509
Provision (credit) for loan losses	(422)	925	92	29	—	1	625
Loans charged-off	(11)	—	—	(31)	—	(2)	(44)
Recoveries of loans previously charged off	1	1	—	15	—	1	18
Balance December 31, 2014	2,895	5,684	456	69	1	3	9,108
Provision (credit) for loan losses	207	(399)	686	127	—	4	625
Loans charged-off	—	—	—	—	—	—	—
Recoveries of loans previously charged off	—	172	—	—	—	—	172
Balance December 31, 2015	3,102	5,457	1,142	196	1	7	9,905
Provision (credit) for loan losses	(461)	1,233	414	(55)	1	3	1,135
Loans charged-off	(9)	—	—	—	—	(3)	(12)
Recoveries of loans previously charged off	2	—	—	—	—	—	2
Balance December 31, 2016	\$ 2,634	\$ 6,690	\$ 1,556	\$ 141	\$ 2	\$ 7	\$ 11,030
	<u>Residential Real Estate</u>	<u>Commercial Real Estate</u>	<u>Construction</u>	<u>Home Equity</u>	<u>Commercial</u>	<u>Consumer</u>	<u>Total</u>
	(In Thousands)						
December 31, 2015							
Allowance for impaired loans	\$ 258	\$ 25	\$ —	\$ 2	\$ —	\$ —	\$ 285
Allowance for non-impaired loans	2,844	5,432	1,142	194	1	7	9,620
	<u>\$ 3,102</u>	<u>\$ 5,457</u>	<u>\$ 1,142</u>	<u>\$ 196</u>	<u>\$ 1</u>	<u>\$ 7</u>	<u>\$ 9,905</u>
Impaired loans	\$ 3,180	\$ 832	\$ 462	\$ 26	\$ —	\$ —	\$ 4,500
Non-impaired loans	599,110	680,769	94,971	33,206	76	568	1,408,700
	<u>\$ 602,290</u>	<u>\$ 681,601</u>	<u>\$ 95,433</u>	<u>\$ 33,232</u>	<u>\$ 76</u>	<u>\$ 568</u>	<u>\$ 1,413,200</u>
December 31, 2016							
Allowance for impaired loans	\$ 163	\$ 14	\$ —	\$ 1	\$ —	\$ —	\$ 178
Allowance for non-impaired loans	2,471	6,676	1,556	140	2	7	10,852
	<u>\$ 2,634</u>	<u>\$ 6,690</u>	<u>\$ 1,556</u>	<u>\$ 141</u>	<u>\$ 2</u>	<u>\$ 7</u>	<u>\$ 11,030</u>
Impaired loans	\$ 2,324	\$ 1,703	\$ —	\$ 98	\$ —	\$ —	\$ 4,125
Non-impaired loans	650,120	794,360	131,778	33,132	153	525	1,610,068
	<u>\$ 652,444</u>	<u>\$ 796,063</u>	<u>\$ 131,778</u>	<u>\$ 33,230</u>	<u>\$ 153</u>	<u>\$ 525</u>	<u>\$ 1,614,193</u>

4. LOANS (continued)

The following is a summary of past due and non-accrual loans:

December 31, 2015	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due (In Thousands)	Total Past Due	Loans on Non-accrual
Residential real estate	\$ 7,527	\$ —	\$ 484	\$ 8,011	\$ 1,212
Commercial real estate	656	—	—	656	159
Construction	—	—	462	462	462
Home equity	431	—	—	431	—
Total loans	<u>\$ 8,614</u>	<u>\$ —</u>	<u>\$ 946</u>	<u>\$ 9,560</u>	<u>\$ 1,833</u>
December 31, 2016					
Residential real estate	\$ 8,064	\$ —	\$ —	\$ 8,064	\$ 668
Commercial real estate	1,472	372	522	2,366	1,052
Home equity	385	342	—	727	75
Total loans	<u>\$ 9,921</u>	<u>\$ 714</u>	<u>\$ 522</u>	<u>\$ 11,157</u>	<u>\$ 1,795</u>

At December 31, 2015 and 2016, there were no loans past due 90 days or more and still accruing interest.

The following is a summary of impaired loans:

	December 31, 2015			December 31, 2016		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
(In Thousands)						
Impaired loans without a valuation allowance:						
Residential real estate	\$ 1,409	\$ 1,461	\$ —	\$ 1,040	\$ 1,092	\$ —
Commercial real estate	159	159	—	1,052	1,052	—
Construction	462	462	—	—	—	—
Home equity	—	—	—	75	75	—
Total	<u>2,030</u>	<u>2,082</u>	<u>—</u>	<u>2,167</u>	<u>2,219</u>	<u>—</u>
Impaired loans with a valuation allowance:						
Residential real estate	1,771	1,771	258	1,284	1,284	163
Commercial real estate	673	673	25	651	651	14
Home equity	26	26	2	23	23	1
Total	<u>2,470</u>	<u>2,470</u>	<u>285</u>	<u>1,958</u>	<u>1,958</u>	<u>178</u>
Total impaired loans	<u>\$ 4,500</u>	<u>\$ 4,552</u>	<u>\$ 285</u>	<u>\$ 4,125</u>	<u>\$ 4,177</u>	<u>\$ 178</u>

4. LOANS (continued)

The following is information pertaining to impaired loans:

	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized on Cash Basis
		(In Thousands)	
<u>Year Ended December 31, 2014</u>			
Residential real estate	\$ 3,833	\$ 283	\$ 164
Commercial real estate	3,902	313	247
Construction	415	2	—
Home equity	510	30	20
Total	<u>\$ 8,660</u>	<u>\$ 628</u>	<u>\$ 431</u>
<u>Year Ended December 31, 2015</u>			
Residential real estate	\$ 2,926	\$ 157	\$ 103
Commercial real estate	2,137	186	151
Construction	477	37	31
Home equity	193	15	12
Total	<u>\$ 5,733</u>	<u>\$ 395</u>	<u>\$ 297</u>
<u>Year Ended December 31, 2016</u>			
Residential real estate	\$ 3,071	\$ 141	\$ 149
Commercial real estate	1,944	52	35
Construction	369	57	57
Home equity	62	1	2
Total	<u>\$ 5,446</u>	<u>\$ 251</u>	<u>\$ 243</u>

No additional funds are committed to be advanced in connection with impaired loans.

In the course of resolving non-performing loans, the Bank may choose to restructure the contractual terms of certain loans, with terms modified to fit the ability of the borrower to repay in line with its current financial status. A loan is considered a troubled debt restructure if, for reasons related to the debtor's financial difficulties, a concession is granted to the debtor that would not otherwise be considered. For the years ended 2014, 2015 and 2016, troubled debt restructures were not considered material.

Credit Quality Information

The Bank uses a seven-grade internal rating system for residential real estate, commercial real estate, construction and commercial loans as follows:

Loans rated 1-3B: Loans in this category are considered "pass" rated with low to average risk.

Loans rated 4: Loans in this category are considered "special mention." These loans are currently protected, but exhibit conditions that have the potential for weakness. The borrower may be affected by unfavorable economic, market or other external conditions that may affect their ability to repay the debt. These may also include credits where there is deterioration of the collateral or have deficiencies which may affect our ability to collect on the collateral. This rating is consistent with the "Other Assets Especially Mentioned" category used by the FDIC.

Loans rated 5: Loans in this category are considered "substandard." Generally, a loan is considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligors and/or the collateral pledged. There is a distinct possibility that the Bank will sustain some loss if the weakness is not corrected.

Loans rated 6: Loans in this category are considered "doubtful." Loans classified as doubtful have all the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, highly questionable and improbable.

Loans rated 7: Loans in this category are considered uncollectible ("loss") and of such little value that their continuance as loans is not warranted.

4. LOANS (concluded)

Commercial loans are assigned an initial grade at the origination of the loan. After origination, the Bank has a quality control program performed by an independent third party. On a quarterly basis, all commercial, construction and residential loan relationships with individual loans \$500,000 or more are assigned a risk rating. An in-depth review is performed on all relationships totaling \$850,000 or greater along with loans on the Bank's Watchlist. Watchlist loans are those loans that are more than two payments past due at the end of the quarter, loans rated four or higher in a previous review, impaired loans, troubled debt restructurings and loans past contractual maturity. Results of the independent loan review are reported to the Bank's Audit Committee on a quarterly basis and become the mechanism for monitoring the overall credit quality of the portfolio.

The following table presents the Bank's loans by risk ratings as of December 31, 2015 and 2016:

Rating	Residential	Commercial	Construction	Commercial
	Real Estate	Real Estate		
(In Thousands)				
December 31, 2015				
1- 3B	\$ 597,756	\$ 680,768	\$ 94,886	\$ 76
4	2,996	474	547	—
5	1,538	359	—	—
	<u>\$ 602,290</u>	<u>\$ 681,601</u>	<u>\$ 95,433</u>	<u>\$ 76</u>
December 31, 2016				
1- 3B	\$ 649,768	\$ 792,470	\$ 131,778	\$ 151
4	1,741	3,250	—	—
5	935	343	—	2
	<u>\$ 652,444</u>	<u>\$ 796,063</u>	<u>\$ 131,778</u>	<u>\$ 153</u>

For home equity and consumer loans management uses delinquency reports as the key credit quality indicator.

5. FORECLOSED ASSETS

At December 31, 2015 and 2016, the Bank did not hold any foreclosed property.

Expenses applicable to foreclosed assets include the following:

	Years Ended December 31,		
	2014	2015	2016
(In Thousands)			
Net (gain) loss on sales of real estate	\$ (69)	\$ (126)	\$ 3
Write-downs of real estate	56	—	2
Operating expenses, net of rental income	276	198	29
	<u>\$ 263</u>	<u>\$ 72</u>	<u>\$ 34</u>

6. PREMISES AND EQUIPMENT

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

	December 31,		Estimated Useful Life
	2015	2016	
(In Thousands)			
Land	\$ 4,408	\$ 4,408	N/A
Buildings	13,776	13,781	3-40 years
Leasehold improvements	812	812	10 years
Equipment	5,000	5,084	3-25 years
	<u>23,996</u>	<u>24,085</u>	
Less accumulated depreciation and amortization	<u>(8,902)</u>	<u>(9,623)</u>	
	<u>\$ 15,094</u>	<u>\$ 14,462</u>	

6. PREMISES AND EQUIPMENT (concluded)

Depreciation and amortization expense for the years ended December 31, 2014, 2015 and 2016 amounted to \$770,000, \$766,000 and \$730,000, respectively.

7. DEPOSITS

A summary of deposit balances, by type, is as follows:

	December 31,	
	2015	2016
	(In Thousands)	
Regular	\$ 90,004	\$ 94,770
Money market	447,667	543,367
NOW	31,560	34,467
Demand	128,285	147,749
Total non-certificate accounts	<u>697,516</u>	<u>820,353</u>
Term certificates less than \$250,000	415,311	430,816
Term certificates of \$250,000 or more	104,200	114,940
Total certificate accounts	<u>519,511</u>	<u>545,756</u>
Total deposits	<u>\$ 1,217,027</u>	<u>\$ 1,366,109</u>

The maturity distribution of term certificates is as follows:

<u>Maturing</u>	December 31,			
	2015		2016	
	<u>Amount</u>	<u>Weighted Average Rate</u>	<u>Amount</u>	<u>Weighted Average Rate</u>
	(Dollars in Thousands)			
Within one year	\$ 336,869	1.05 %	\$ 342,631	1.00 %
Over 1 to 2 years	99,198	1.20	120,368	1.28
Over 2 to 3 years	37,301	1.53	41,280	1.74
Over 3 to 4 years	27,883	1.92	21,297	1.89
Over 4 to 5 years	18,260	1.94	20,180	1.71
	<u>\$ 519,511</u>	1.19 %	<u>\$ 545,756</u>	1.18 %

A summary of interest expense on deposits is as follows:

	Years Ended December 31,		
	2014	2015	2016
	(In Thousands)		
Regular	\$ 16	\$ 18	\$ 20
Money market	2,483	2,424	3,184
NOW	3	3	3
Term certificates	3,812	5,500	6,392
	<u>\$ 6,314</u>	<u>\$ 7,945</u>	<u>\$ 9,599</u>

8. BORROWED FUNDS

Federal Home Loan Bank Advances

A summary of advances from the FHLB follows:

Maturing During the Year Ending December 31,	December 31,			
	2015		2016	
	Amount	Weighted Average Rate	Amount	Weighted Average Rate
	(Dollars in Thousands)			
2016	\$ 342,000	0.54 %	\$ —	— %
2017	56,000	2.69	141,000	1.51
2018	464	5.70	318	5.70
2019	4,000	3.99	4,000	3.99
2026	—	—	300,000	0.49
2031	—	—	30,000	0.42
	<u>\$ 402,464</u>	0.88 %	<u>\$ 475,318</u>	0.82 %

Expected maturities may differ from contractual maturities because certain borrowings, aggregating \$355.0 million at December 31, 2016, can be called by the FHLB after an initial specified term. In 2016, the Bank borrowed \$330 million of long-term advances with two FHLB option advances. One advance has a 10-year final maturity and the other has a 15-year final maturity. Both advances are callable quarterly after the first year anniversary and the Bank anticipates both will be called prior to the final maturity date.

All borrowings from the FHLB are secured by a blanket lien on “qualified collateral” defined principally as 65-80% of the carrying value of first mortgage loans on certain owner-occupied residential property, 75% of the carrying value of first mortgage loans on certain non-owner-occupied residential property, 76% of the carrying value of first mortgage loans on certain multi-family residential property and 65% of the carrying value of loans on certain commercial property. In addition, qualified collateral includes 93% of the fair value of all debt securities. As of December 31, 2016, the Bank can borrow up to approximately \$824.6 million to meet its borrowing needs, based on the Bank's available qualified collateral. See Note 3.

Available Lines of Credit

The Bank has an available line of credit with the FHLB at an interest rate that adjusts daily. Borrowings under this line are limited to \$4,633,000 at December 31, 2016. No amounts were drawn on the line of credit as of December 31, 2015 and 2016. Additionally, the Bank has registered with the Federal Reserve Bank to access the discount window. The Bank may access this line by assigning assets as collateral. The Bank has pledged the bulk of its home equity portfolio to secure borrowings from the discount window and may increase availability by pledging additional assets.

Mortgage Payable

The balance represents a loan payable by the Bank for the purchase from an unrelated party of property which was used for a new branch office. The note is secured by the real estate and bears interest at a fixed rate of 6.00%. Principal and interest is payable in 240 monthly installments and matures in 2028. The Bank may prepay the note in 2020 without penalty. As of December 31, 2016, future principal payments amount to:

<u>Year</u>	<u>Amount</u> (In Thousands)
2017	\$ 57
2018	60
2019	64
2020	68
2021	72
Thereafter	<u>547</u>
Total	<u>\$ 868</u>

9. INCOME TAXES

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

	Years Ended December 31,		
	2014	2015	2016
	(In Thousands)		
Current tax provision:			
Federal	\$ 8,624	\$ 11,055	\$ 13,173
State	2,350	3,098	3,714
	<u>10,974</u>	<u>14,153</u>	<u>16,887</u>
Deferred tax provision (benefit):			
Federal	90	(576)	(435)
State	78	(147)	(106)
	<u>168</u>	<u>(723)</u>	<u>(541)</u>
	<u>\$ 11,142</u>	<u>\$ 13,430</u>	<u>\$ 16,346</u>

The reasons for the differences between the statutory federal income tax rate and the effective tax rates are summarized as follows:

	Years Ended December 31,		
	2014	2015	2016
Statutory rate	35.0 %	35.0 %	35.0 %
Increase (decrease) resulting from:			
State taxes, net of federal tax benefit	4.7	5.9	5.9
Bank-owned life insurance	(0.3)	(0.3)	(0.2)
Gain on life insurance distribution	(6.6)	—	—
Other, net	0.6	0.4	0.4
Effective rate	<u>33.4 %</u>	<u>41.0 %</u>	<u>41.1 %</u>

The components of the net deferred tax asset are as follows:

	December 31,	
	2015	2016
	(In Thousands)	
Deferred tax assets:		
Federal	\$ 3,908	\$ 4,319
State	1,104	1,221
	<u>5,012</u>	<u>5,540</u>
Deferred tax liabilities:		
Federal	(1,457)	(2,716)
State	(274)	(335)
	<u>(1,731)</u>	<u>(3,051)</u>
Net deferred tax asset	<u>\$ 3,281</u>	<u>\$ 2,489</u>

9. INCOME TAXES (concluded)

The tax effects of each item that give rise to deferred tax assets (liabilities) are as follows:

	December 31,	
	2015	2016
	(In Thousands)	
Allowance for loan losses	\$ 4,046	\$ 4,506
Employee benefit plans	802	897
Fixed assets	(524)	(427)
Deferred fees on loans	(992)	(1,077)
Net unrealized gain on securities available for sale	(196)	(1,529)
Other, net	145	119
Net deferred tax asset	<u>\$ 3,281</u>	<u>\$ 2,489</u>

A summary of the change in the net deferred tax asset is as follows:

	Years Ended December 31,		
	2014	2015	2016
	(In Thousands)		
Balance at beginning of year	\$ 2,934	\$ 2,642	\$ 3,281
Deferred tax benefit (provision)	(168)	723	541
Deferred tax effects of net unrealized gain on securities available for sale	(124)	(84)	(1,333)
Balance at end of year	<u>\$ 2,642</u>	<u>\$ 3,281</u>	<u>\$ 2,489</u>

The federal income tax reserve for loan losses at the Bank's base year was \$3,780,000. If any portion of the reserve is used for purposes other than to absorb loan losses, approximately 150% of the amount actually used, limited to the amount of the reserve, will be subject to taxation in the year in which used. As the Bank intends to use the reserve only to absorb loan losses, a deferred tax liability of \$1,545,000 has not been provided.

The Bank's income tax returns are subject to review and examination by federal and state taxing authorities. The Bank is currently open to audit under the applicable statutes of limitations by the Internal Revenue Service for the years ended December 31, 2013 through 2016. The years open to examination by state taxing authorities vary by jurisdiction; no years prior to 2013 are open.

10. COMMITMENTS AND CONTINGENCIES

In the normal course of business, there are outstanding commitments and contingencies which are not reflected in the consolidated financial statements.

Legal claims

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

Loan commitments

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include unused lines of credit, commitments to originate loans, unadvanced construction funds and standby letters of credit. The instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets.

The Bank's exposure to credit loss in the event of non-performance by the other party to its financial instruments is represented by the contractual amount of these commitments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

At December 31, 2015 and 2016, the following financial instruments were outstanding for which contract amounts represent credit risk:

10. COMMITMENTS AND CONTINGENCIES (concluded)

	December 31,	
	2015	2016
	(In Thousands)	
Unused lines of credit	\$ 79,902	\$ 92,353
Commitments to originate loans	103,064	69,558
Unadvanced funds on construction loans	48,421	54,442
Standby letters-of-credit	191	32
	<u>\$ 231,578</u>	<u>\$ 216,385</u>

Commitments to extend credit are agreements to lend to a customer provided there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the borrower. The commitments to originate loans, unadvanced construction funds, and the majority of unused lines of credit are secured by real estate.

Standby letters-of-credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those letters-of-credit are primarily issued to support public and private borrowing arrangements. All letters of credit issued have expiration dates within five years. The credit risk involved in issuing letters-of-credit is essentially the same as that involved in extending loan facilities to customers. The Bank generally holds collateral supporting those commitments.

Employment agreements

The Bank has entered into employment agreements with certain senior executives. The original terms of the agreements are for two or three years and can generally be extended for one-year periods. The agreements generally provide for lump sum severance payments under certain circumstances, within a one-year period following a "change in control," as defined in the agreements.

Certain agreements provide for death benefits, which are accrued ratably over the employees' remaining service period. The Bank has purchased life insurance policies for these individuals which provide a death benefit payable to the Bank when the executive dies. The death benefits on these policies exceed the death benefit liability to the executive as of December 31, 2016. For the years ended December 31, 2014, 2015 and 2016, expenses attributable to the accrued death benefit amounted to \$1,011,000, \$62,000 and \$65,000, respectively. The expense in 2014 included \$949,000 due to the death of a former executive.

Lease commitments

Pursuant to the terms of non-cancelable lease agreements in effect at December 31, 2016, pertaining to premises and equipment, future minimum rent commitments under various operating leases are as follows:

Year Ending December 31,	Amount (In Thousands)
2017	\$ 309
2018	316
2019	323
2020	331
2021	156
Thereafter	324
Total	<u>\$ 1,759</u>

Lease commitments are based on the initial contract term, or longer, when in the opinion of management it is more likely than not that the lease will be renewed. Total rent expense for the years ended December 31, 2014, 2015 and 2016 amounted to \$299,000, \$305,000, and \$316,000, respectively.

Data Processing Commitments

The Bank has entered into contracts with various data processing vendors. The contracts range in terms from three years to six years and call for monthly fixed payments along with variable charges based on activity and the number of accounts managed. At December 31, 2016, the contracts have estimated payments totaling \$5.5 million over the next six years.

11. STOCK OPTION PLAN

In 2014, the Bank's Board of Directors adopted the 2014 Non-statutory Stock Option Plan (the "2014 Stock Option Plan"). The 2014 Stock Option Plan allows for the issuance of up to 100,000 shares of common stock (subject to adjustment in the event of stock splits, stock dividends or similar events) pursuant to non-statutory stock options. Options may not be granted at an exercise price that is less than 100% of the fair market value of the common stock on the date of grant. Under the terms of the 2014 Stock Option plan, options may not be granted for a term in excess of 10 years and may vest immediately or over a period of time. As of December 31, 2016, there were 16,000 stock options available for future grants.

Under the Bank's 1996 stock option plan, options were granted to officers, other employees, and certain directors. A total of 90,000 shares of common stock were reserved for issuance pursuant to the 1996 plan. Both "incentive options" and "non-qualified options" could be granted under the plan. All options had an exercise price per share equal to, or in excess of, the fair market value of a share of common stock at the date the option was granted, had a maximum option term of 10 years and were fully vested upon issuance. There are no remaining options available for future issuance under the plan.

Stock option activity is as follows:

	2014		2015		2016	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Shares under option:						
Outstanding at beginning of year	9,500	\$ 50.32	73,500	\$ 68.27	74,500	\$ 68.76
Granted	64,000	70.93	1,000	105.34	19,000	129.36
Exercised	—	—	—	—	(4,000)	53.09
Outstanding at end of year	<u>73,500</u>	\$ 68.27	<u>74,500</u>	\$ 68.76	<u>89,500</u>	\$ 82.33
Options exercisable at end of year	<u>33,500</u>	\$ 65.09	<u>44,500</u>	\$ 67.30	<u>51,500</u>	\$ 70.25

As of December 31, 2016, the aggregate intrinsic value of options outstanding amounted to \$10.2 million and of options exercisable amounted to \$6.5 million. The total intrinsic value of options exercised during the year ended December 31, 2016 was \$402,000.

Options outstanding consist of the following:

	December 31,			
	2015		2016	
	Shares	Weighted Average Remaining Contractual Life in Years	Shares	Weighted Average Remaining Contractual Life in Years
Option price				
\$ 35.25	2,000	1	—	—
51.95	4,500	5	4,500	4
57.92	3,000	6	3,000	5
70.93	64,000	8	62,000	7
105.34	1,000	9	1,000	8
126.17	—	—	14,000	9
138.30	—	—	5,000	10
Options outstanding	<u>74,500</u>	8	<u>89,500</u>	8
Options exercisable	<u>44,500</u>	7	<u>51,500</u>	7

11. STOCK OPTION PLAN (concluded)

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

	<u>2014</u>	<u>2015</u>	<u>2016</u>
Expected dividends	1.9%	1.3%	1.2%
Expected term	6 years	6 years	6 years
Expected volatility	15%	17%	14%
Risk-free interest rate	2.0%	2.1%	2.0%

The expected volatility is based on historical volatility. The risk-free interest rates for periods within the contractual life of the awards are based on the U.S. Treasury yield curve in effect at the time of the grant. The expected term is based on historical exercise experience. The dividend yield assumption is based on the Bank's history and expectation of dividend payouts.

The weighted-average grant-date fair value of options granted during the years ended December 31, 2014, 2015 and 2016 was \$9.22, \$18.09 and \$19.38, respectively. For the years ended December 31, 2014, 2015 and 2016, share-based compensation expense applicable to the plan amounted to \$283,000, \$110,000 and \$156,000 and the recognized tax benefit related to this expense amounted to \$117,000, \$45,000 and \$64,000, respectively. As of December 31, 2016, unrecognized share-based compensation expense related to non-vested options amounted to \$427,000. This amount is expected to be recognized over a weighted average period of 1.6 years.

12. RELATED PARTY TRANSACTIONS

The Bank has a policy providing that loans (excluding passbook loans) will not be granted to directors and officers. During the years ended December 31, 2014, 2015 and 2016, legal fees were paid to a law firm owned by certain directors of the Bank totaling \$1.8 million, \$2.0 million and \$2.0 million, respectively. Such fees related to the representation of the Bank in closing commercial and residential mortgage loans, foreclosure and collection actions and certain other routine litigation. Additionally, this law firm received the sum of \$893,000, \$1.2 million and \$956,000 in agency fees for title insurance due them in connection with loan originations during the years ended December 31, 2014, 2015 and 2016, respectively. The Bank believes that the foregoing sums have been reasonable in relation to the services provided to the Bank. All of these services are provided pursuant to a written master agreement between the Bank and the law firm which was reviewed and approved by the independent Directors of the Board. All of the above described legal fees and title insurance fees paid to the law firm have been reimbursed to the Bank by its borrowers, with the exception of \$301,000, \$239,000 and \$181,000 for the years ended December 31, 2014, 2015 and 2016, respectively. These unreimbursed fees are primarily associated with foreclosure and collection matters and the Bank generally receives these fees upon resolution of the loans.

13. EMPLOYEE BENEFIT PLANS

401(k) Plan

The Bank has a 401(k) plan whereby each employee, having completed at least three months of continuous service beginning with date of employment, becomes a participant in the plan. Employees may contribute a percentage of their compensation subject to certain limits based on federal tax laws. The Bank contributes 3% of an employee's compensation, regardless of the employee's contribution, and makes a matching contribution of \$0.50 for each dollar contributed by the employee up to a maximum matching contribution equal to 3% of the employee's yearly compensation. Matching contributions vest to the employee after two years, or at age 59½, if earlier. For the years ended December 31, 2014, 2015 and 2016, expense attributable to the plan amounted to \$411,000, \$416,000 and \$425,000, respectively.

Supplemental Employee Retirement Plan

The Bank has a supplemental employee retirement plan for a senior executive. In connection with the plan, the Bank purchased life insurance policies amounting to \$10,109,000 and contributed them to a Rabbi Trust. The value of these policies is \$11,697,000 and \$11,962,000 at December 31, 2015 and 2016, respectively, and is reflected on the consolidated balance sheets. The policies accrete at a variable rate of interest with minimum stated guaranteed rates. In addition, in accordance with the plan, a secular trust was established for the executive into which the Bank makes contributions, which become the property of the executive. Expense related to the plan amounted to \$604,000 in each of the years ended December 31, 2014, 2015 and 2016.

14. MINIMUM REGULATORY CAPITAL REQUIREMENTS

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank's consolidated financial statements. FDIC-insured depository institutions are prohibited from paying dividends or making capital distributions that would cause the institution to fail to meet minimum capital requirements or if it is already undercapitalized. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of its assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Effective January 1, 2015, federal banking regulations changed with regard to minimum capital requirements for community banking institutions. The regulation requires a minimum ratio of common equity Tier 1 capital to risk-weighted assets of 4.5%, a minimum ratio of Tier 1 capital to risk-weighted assets of 6% and a minimum leverage ratio of 4% for all banking organizations. Additionally, community banking institutions must maintain a capital conservation buffer of common equity Tier 1 capital in an amount greater than 2.5% of total risk-weighted assets to avoid being subject to limitations on capital distributions and discretionary bonuses. The capital conservation buffer will be phased in over three years, beginning on January 1, 2016, with an initial phase in amount of 0.625%. Also, certain new deductions from the adjustments to regulatory capital will be phased in over several years. Management believes the Bank's capital levels will remain "well-capitalized" through the phase-in period.

As of December 31, 2016, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, common equity Tier 1 risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since the notification that management believes have changed the Bank's category. Management believes, as of December 31, 2015 and 2016, that the Bank meets all capital adequacy requirements to which it is subject.

The Bank's actual capital amounts and ratios as of December 31, 2015 and 2016 are presented in the following tables.

	<u>Actual</u>		<u>Minimum Capital Requirement*</u>		<u>Minimum To Be Well Capitalized Under Prompt Corrective Actions Provisions</u>	
	<u>Amounts</u>	<u>Ratio</u>	<u>Amounts</u>	<u>Ratio</u>	<u>Amounts</u>	<u>Ratio</u>
			(Dollars in Thousands)			
<u>December 31, 2015</u>						
Total Capital to Risk -Weighted Assets	\$ 147,819	13.79 %	\$ 85,724	8.00 %	\$ 107,155	10.0 %
Common Equity Tier 1 Capital to Risk- Weighted Assets	137,662	12.85	48,220	4.50	69,651	6.5
Tier 1 Capital to Risk-Weighted Assets	137,662	12.85	64,293	6.00	85,724	8.0
Tier 1 Capital to Average Assets	137,662	7.95	69,278	4.00	86,597	5.0
<u>December 31, 2016</u>						
Total Capital to Risk -Weighted Assets	\$ 171,237	13.04 %	\$ 113,225	8.625 %	\$ 131,275	10.00 %
Common Equity Tier 1 Capital to Risk- Weighted Assets	158,288	12.06	67,278	5.125	85,329	6.50
Tier 1 Capital to Risk-Weighted Assets	158,288	12.06	86,970	6.625	105,020	8.00
Tier 1 Capital to Average Assets	158,288	7.98	79,389	4.000	99,236	5.00

* Minimum risk-based regulatory capital ratios and amounts at December 31, 2016 include the applicable minimum risk-based capital ratios and capital conservation buffer of 0.625%.

15. FAIR VALUES OF ASSETS AND LIABILITIES

Determination of Fair Value

The Bank uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Bank's assets and liabilities. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

The following methods and assumptions were used by the Bank in estimating fair value disclosures:

Cash and cash equivalents: The carrying amounts of cash, due from banks and short-term investments approximate fair values based on the short-term nature of the assets.

Certificates of deposit: Fair values for certificates of deposit are based upon quoted market prices.

Securities available for sale: The securities measured at fair value in Level 1 are based on quoted market prices in an active exchange market and generally include marketable equity securities traded in an active market. Securities measured at fair value in Level 2 are based on pricing models that consider standard input factors such as observable market data, benchmark yields, interest rate volatilities, broker/dealer quotes, credit spreads and new issue data. These securities typically include government-sponsored enterprise obligations and residential mortgage-backed securities. Level 2 also includes marketable equity securities that are based on quoted market prices in an inactive market. All fair value measurements are obtained from a third-party pricing service and are not adjusted by management.

Federal Home Loan Bank stock: The carrying value of Federal Home Loan Bank stock is deemed to approximate fair value based on the redemption provisions of the Federal Home Loan Bank of Boston.

Loans: For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for other loans are estimated using discounted cash flow analysis, using market interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for non-performing loans are estimated using discounted cash flow analysis or underlying collateral values, where applicable.

Deposits: The fair values of non-certificate accounts are, by definition, equal to the amount payable on demand at the reporting date which is their carrying amount. Fair values for certificates of deposit are estimated using a discounted cash flow calculation that applies market interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Federal Home Loan Bank advances: The fair values of the advances are estimated using discounted cash flow analysis based on the current incremental borrowing rates in the market for similar types of borrowing arrangements.

Mortgage payable: The fair value of the Bank's mortgage payable is estimated using discounted cash flow analysis based on the current incremental borrowing rates in the market for similar types of borrowing arrangements.

Mortgagors' escrow accounts: The carrying amounts of mortgagors' escrow accounts approximate fair value.

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

Off-balance-sheet instruments: Fair values for off-balance-sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. At December 31, 2015 and 2016, the fair value of commitments outstanding is not significant since fees charged are not material.

15. FAIR VALUES OF ASSETS AND LIABILITIES (continued)

Assets Measured at Fair Value on a Recurring Basis

Assets measured at fair value on a recurring basis are summarized below. There are no liabilities measured at fair value on a recurring basis.

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total Fair Value</u>
	(In Thousands)			
<u>December 31, 2015</u>				
Securities available for sale:				
Debt securities	\$ —	\$ 25,057	\$ —	\$ 25,057
Equity securities	13,188	2,358	—	15,546
Total securities available for sale	<u>\$ 13,188</u>	<u>\$ 27,415</u>	<u>\$ —</u>	<u>\$ 40,603</u>
<u>December 31, 2016</u>				
Securities available for sale:				
Debt securities	\$ —	\$ 30	\$ —	\$ 30
Equity securities	24,331	2,807	—	27,138
Total securities available for sale	<u>\$ 24,331</u>	<u>\$ 2,837</u>	<u>\$ —</u>	<u>\$ 27,168</u>

Assets Measured at Fair Value on a Non-recurring Basis

The Bank may also be required, from time to time, to measure certain other assets on a non-recurring basis in accordance with generally accepted accounting principles. These adjustments to fair value usually result from application of lower-of-cost-or-market accounting or write-downs of individual assets.

The following table summarizes the fair value hierarchy used to determine each adjustment and the carrying value of the related individual assets as of December 31, 2015. There are no assets measured at fair value on a non-recurring basis at December 31, 2016. There are no liabilities measured at fair value on a non-recurring basis at December 31, 2015 and 2016.

	<u>December 31, 2015</u>			<u>Year Ended</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>December 31, 2015</u>
	(In Thousands)			<u>Total Losses</u>
				(In Thousands)
Impaired loans	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 179</u>	<u>\$ (30)</u>

Losses applicable to impaired loans are estimated using the appraised value of the underlying collateral, discounting factors and other factors. The losses applicable to impaired loans are not recorded directly as an adjustment to current earnings or comprehensive income, but rather as a component in determining the overall adequacy of the allowance for loan losses. Management adjustments to the estimated fair value of impaired loans may result in increases or decreases to the provision for loan losses. Management will consider the circumstances of the individual loan when determining any estimated losses. This may include a review of an independent appraisal and if deemed necessary, an updated appraisal will be performed.

15. FAIR VALUES OF ASSETS AND LIABILITIES (concluded)

Summary of Fair Values of Financial Instruments

The estimated fair values, and related carrying amounts, of the Bank's financial instruments are as follows. Certain financial instruments and all nonfinancial instruments are exempt from disclosure requirements. Accordingly, the aggregate fair value amounts presented herein do not represent the underlying fair value of the Bank.

	Carrying Amount	Fair Value		
		Level 1	Level 2	Level 3
(In Thousands)				
December 31, 2015				
Financial assets:				
Cash and cash equivalents	\$ 261,013	\$ 261,013	\$ —	\$ —
Certificates of deposit	6,206	6,107	—	—
Securities available for sale	40,603	13,188	27,415	—
Federal Home Loan Bank stock	19,796	—	—	19,796
Loans, net	1,405,533	—	—	1,403,071
Accrued interest receivable	3,270	—	—	3,270
Financial liabilities:				
Deposits	\$ 1,217,027	\$ —	\$ —	\$ 1,221,598
Federal Home Loan Bank advances	402,464	—	404,273	—
Mortgage payable	922	—	—	1,050
Mortgagors' escrow accounts	4,850	—	—	4,850
Accrued interest payable	303	—	—	303
December 31, 2016				
Financial assets:				
Cash and cash equivalents	\$ 322,932	\$ 322,932	\$ —	\$ —
Securities available for sale	27,168	24,331	2,837	—
Federal Home Loan Bank stock	24,472	—	—	24,472
Loans, net	1,605,647	—	—	1,612,355
Accrued interest receivable	3,529	—	—	3,529
Financial liabilities:				
Deposits	\$ 1,366,109	\$ —	\$ —	\$ 1,368,203
Federal Home Loan Bank advances	475,318	—	475,658	—
Mortgage payable	868	—	—	972
Mortgagors' escrow accounts	5,585	—	—	5,585
Accrued interest payable	400	—	—	400

16. QUARTERLY FINANCIAL DATA (UNAUDITED)

Quarterly results of operations for the years ended December 31, 2015 and 2016 are as follows:

	Year Ended December 31, 2015			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(In Thousands, Except Per Share Data)			
Interest and dividend income	\$ 14,891	\$ 15,082	\$ 15,608	\$ 16,278
Interest expense	2,562	2,602	2,789	2,957
Net interest income	12,329	12,480	12,819	13,321
Provision for loan losses	175	175	175	100
Net interest income, after provision for loan losses	12,154	12,305	12,644	13,221
Other income	357	361	396	369
Operating expenses	4,860	4,669	4,772	4,730
Income before income taxes	7,651	7,997	8,268	8,860
Income tax provision	3,136	3,274	3,394	3,626
Net income	<u>\$ 4,515</u>	<u>\$ 4,723</u>	<u>\$ 4,874</u>	<u>\$ 5,234</u>
Earnings per share:				
Basic	<u>\$ 2.12</u>	<u>\$ 2.22</u>	<u>\$ 2.29</u>	<u>\$ 2.46</u>
Diluted	<u>\$ 2.11</u>	<u>\$ 2.20</u>	<u>\$ 2.27</u>	<u>\$ 2.44</u>
Cash dividends declared per share	<u>\$ 0.28</u>	<u>\$ 0.28</u>	<u>\$ 0.30</u>	<u>\$ 0.60</u> (1)
	Year Ended December 31, 2016			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(In Thousands, Except Per Share Data)			
Interest and dividend income	\$ 17,028	\$ 17,704	\$ 18,217	\$ 18,820
Interest expense	3,194	3,372	3,381	3,438
Net interest income	13,834	14,332	14,836	15,382
Provision for loan losses	255	255	300	325
Net interest income, after provision for loan losses	13,579	14,077	14,536	15,057
Other income	332	702	347	354
Operating expenses	4,870	4,842	4,793	4,710
Income before income taxes	9,041	9,937	10,090	10,701
Income tax provision	3,717	4,070	4,145	4,414
Net income	<u>\$ 5,324</u>	<u>\$ 5,867</u>	<u>\$ 5,945</u>	<u>\$ 6,287</u>
Earnings per share:				
Basic	<u>\$ 2.50</u>	<u>\$ 2.75</u>	<u>\$ 2.79</u>	<u>\$ 2.95</u>
Diluted	<u>\$ 2.48</u>	<u>\$ 2.73</u>	<u>\$ 2.76</u>	<u>\$ 2.92</u>
Cash dividends declared per share	<u>\$ 0.30</u>	<u>\$ 0.30</u>	<u>\$ 0.32</u>	<u>\$ 0.64</u> (2)

(1) Includes a special dividend of \$0.30 per common share declared on November 25, 2015 and paid on January 20, 2016.

(2) Includes a special dividend of \$0.32 per common share declared on November 23, 2016 and paid on January 18, 2017.

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.

None.

Item 9A. Controls and Procedures.

Disclosure Controls and Procedures

An evaluation was carried out under the supervision and with the participation of the Bank's management, including the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), of the effectiveness, as of December 31, 2016, of the Bank's disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Securities and Exchange Act of 1934, as amended. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of the Bank's disclosure controls and procedures as of December 31, 2016, the CEO and CFO concluded that, as of such date, the Bank's disclosure controls and procedures were effective at the reasonable assurance level.

Internal Control over Financial Reporting

Management's Annual Report on Internal Control over Financial Reporting

The Bank's management is responsible for establishing and maintaining effective internal control over financial reporting. The internal control process has been designed under the Bank management's supervision to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with accounting principles generally accepted in the United States of America.

Management conducted an assessment of the effectiveness of the Bank's internal control over financial reporting as of December 31, 2016, utilizing the framework established in *Internal Control-Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). See "Management's Annual Report on Internal Control over Financial Reporting" in this Form-10-K.

The effectiveness of our internal control over financial reporting as of December 31, 2016, has been audited by Wolf & Company, P.C., an independent registered public accounting firm, as stated in their report which is included herein.

Changes in Internal Control over Financial Reporting

There were no significant changes in the Bank's internal control over financial reporting, as defined in Rules 13a-15(e) and 15d-15(e), during the quarter ended December 31, 2016 that have materially affected, or are reasonably likely to materially affect, the Bank's internal control over financial reporting.

Item 9B. Other information.

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance.

The response to this Item is incorporated herein by reference to the information which appears in the Bank's Proxy Statement for the Annual Meeting of Stockholders to be held on April 27, 2017 under the captions titled "Election of Directors" and "Directors Not Standing for Election." Also incorporated herein by reference is the information which appears in Appendix B of the Bank's Proxy Statement for the Annual Meeting of Stockholders held on April 29, 2004.

The Bank's Ethics Policy will be provided, free of charge, to any person who makes such request in writing to the President of the Bank, Robert H. Gaughen, Jr., at the address which appears on the cover page of this Form 10-K. Any amendments to or waivers from this Ethics Policy will be filed with the FDIC on Form 8-K.

Item 11. Executive Compensation.

The response to this Item is incorporated herein by reference to the information which appears in the Bank's Proxy Statement for the Annual Meeting of Stockholders to be held on April 27, 2017 under the captions titled "Executive Compensation," "Summary Compensation Table," "Grants of Plan-Based Awards," "Outstanding Equity Awards at Fiscal Year-End," "Option Exercises and Stock Vested," and "Nonqualified Deferred Compensation."

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

Except as provided below, the response to this Item is incorporated herein by reference to the information which appears in the Bank's Proxy Statement for the Annual Meeting of Stockholders to be held on April 27, 2017 under the caption titled "Principal Stockholders: Security Ownership of Management."

The following table provides information about the securities authorized for issuance under the Bank's equity compensation plans as of December 31, 2016 (See Note 11 in Notes to Consolidated Financial Statements):

Equity Compensation Plan Information

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders: 1996 and 2014 Stock Option Plans	89,500	\$82.33	16,000
Equity compensation plans not approved by security holders:	----	----	----
Total	89,500	\$82.33	16,000

Item 13. Certain Relationships, Related Transactions and Director Independence.

The response to this Item is incorporated herein by reference to the information which appears in the Bank's Proxy Statement for the Annual Meeting of Stockholders to be held on April 27, 2017 under the caption titled "Certain Transactions with Management and Associates."

Item 14. Principal Accountant Fees and Services.

The response to this item is incorporated by reference to the information which appears in the Bank's Proxy Statement for the Annual Meeting of Stockholders to be held on April 27, 2017 under the heading "Independent Registered Public Accounting Firm."

PART IV

Item 15. Exhibits and Financial Statement Schedules.

(a) The following documents are incorporated by reference into Item 8 of this report on Form 10-K:

(1) Exhibits:

Exhibit 3i and 3ii. Articles of Incorporation and Bylaws

Amended and Restated Charter and Bylaws of Hingham Institution for Savings are incorporated herein by reference from Exhibits (A)(1)(a) and (A)(1)(b) to the Bank's Registration Statement on Form F-1 as filed with the FDIC on December 7, 1988, and as amended on December 29, 1988 ("Form F-1").

Exhibit 10. Material Contracts

Hingham Institution for Savings 1988 Stock Option Plan is incorporated herein by reference from Exhibit (A)(5) to the Bank's Form F-1.

Hingham Institution for Savings 1996 Stock Option Plan is incorporated by reference to the information which appeared in the Bank's Proxy Statement for the Annual Meeting of Stockholders which was held on April 25, 1996 under the captions titled "The 1996 Stock Option Plan" and "New Plan Benefits."

Hingham Institution for Savings 2014 Stock Option Plan is incorporated by reference to the information which appeared in the Bank's Proxy Statement for the Annual Meeting of Stockholders which was held on April 24, 2014 under the captions titled "The 2014 Stock Option Plan" and "Appendix."

Employment contracts are incorporated by reference to the information which appears in the Bank's Proxy Statement for the Annual Meeting of Stockholders to be held on April 27, 2017 under the caption titled "Employment Agreements and Special Termination Agreements."

Executive supplemental retirement agreements are incorporated by reference to the information which appears in the Bank's Proxy Statement for the Annual Meeting of Stockholders to be held on April 27, 2017 under the caption titled "Nonqualified Deferred Compensation."

Exhibit 21. Subsidiaries of Hingham Institution for Savings

In August 2002, the Bank established a Massachusetts subsidiary incorporated as the Hingham Securities Corporation II. The subsidiary was wholly owned by the Bank until July 31, 2014 when the corporation was disbanded.

In July 2004, the Bank established a Massachusetts subsidiary incorporated as the Hingham Unpledged Securities Corporation. The subsidiary is wholly owned by the Bank.

In November 2016, the Bank established a Massachusetts subsidiary incorporated as the Hingham Pledged Securities Corporation. The subsidiary is wholly owned by the Bank.

Exhibit 31.1 Certifications – Chief Executive Officer

Exhibit 31.2 Certifications – Chief Financial Officer

Exhibit 32.1 Certification Pursuant to 18 U.S.C. §1350 – Chief Executive Officer

Exhibit 32.2 Certification Pursuant to 18 U.S.C. §1350 – Chief Financial Officer

<u> /s/ </u> Kara Gaughen Smith	Director	<u>03/07/17</u> Date
<u> /s/ </u> Julio R. Hernando	Director	<u>03/07/17</u> Date
<u> /s/ </u> Brian T. Kenner	Director	<u>03/07/17</u> Date
<u> /s/ </u> Robert A. Lane	Director	<u>03/07/17</u> Date
<u> /s/ </u> Scott L. Moser	Director	<u>03/07/17</u> Date
<u> /s/ </u> Stacey M. Page	Director	<u>03/07/17</u> Date
<u> /s/ </u> Robert K. Sheridan	Director	<u>03/07/17</u> Date
<u> /s/ </u> Edward L. Sparda	Director	<u>03/07/17</u> Date
<u> /s/ </u> Geoffrey C. Wilkinson, Sr.	Director	<u>03/07/17</u> Date

I, Cristian A. Melej, certify that:

1. I have reviewed this annual report on Form 10-K of Hingham Institution for Savings;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures, and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 7, 2017

/s/
Cristian A. Melej
Chief Financial Officer
(Principal Financial Officer
and Principal Accounting Officer)

CERTIFICATION PURSUANT TO
18 U.S.C. §1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report on Form 10-K of Hingham Institution for Savings (the “Bank”) for the year ended December 31, 2016, as filed with the Federal Deposit Insurance Corporation on the date hereof (the “Report”), the undersigned Robert H. Gaughen, Jr., Chief Executive Officer of the Bank, hereby certifies pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Bank.

/s/
Robert H. Gaughen, Jr.
Chief Executive Officer
(Principal Executive Officer)

Date: March 7, 2017

CERTIFICATION PURSUANT TO
18 U.S.C. §1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report on Form 10-K of Hingham Institution for Savings (the “Bank”) for the year ended December 31, 2016, as filed with the Federal Deposit Insurance Corporation on the date hereof (the “Report”), the undersigned Cristian A. Melej, Chief Financial Officer of the Bank, hereby certifies pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents in all material respects, the financial condition and results of operations of the Bank.

_____/s/
Cristian A. Melej
Chief Financial Officer
(Principal Financial Officer
and Principal Accounting Officer)

Date: March 7, 2017