

FEDERAL DEPOSIT INSURANCE CORPORATION

Washington, D.C., 20429
FORM 10-Q

(Mark one)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2020

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period \_\_\_\_\_ to \_\_\_\_\_.

Commission File Number: FDIC Certificate No. 90211

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:

Table with 3 columns: Title of each class, Trading Symbol(s), Name of each exchange on which registered. Row 1: Common Stock, \$1.00 par value per share, HIFS, NASDAQ Stock Market, LLC

Securities registered under Section 12(g) of the Act: None

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 [X] 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 [X] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

- Large accelerated filer [ ] Accelerated filer [X]
Non-accelerated filer [ ] Smaller reporting company [X]
Emerging Growth Company [ ]

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. [ ]

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

The number of shares outstanding of each of the registrant's common stock, \$1.00 par value per share, outstanding as of November 4, 2020 was 2,136,900.

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## **PART I – FINANCIAL INFORMATION**

### **Item 1 – Financial Statements**

#### **HINGHAM INSTITUTION FOR SAVINGS AND SUBSIDIARIES Consolidated Balance Sheets**

	<b>December 31, 2019</b>	<b>September 30, 2020</b>
<i>(Unaudited)</i>	<b>(In Thousands, except share amounts)</b>	
<b>ASSETS</b>		
Cash and due from banks	\$ 9,057	\$ 9,816
Federal Reserve and other short-term investments	<u>243,090</u>	<u>229,555</u>
Cash and cash equivalents	252,147	239,371
Securities available for sale, at fair value	11	6
Equity securities, at fair value	47,175	57,348
Federal Home Loan Bank stock, at cost	24,890	18,985
Loans, net of allowance for loan losses of \$15,376 at December 31, 2019 and \$16,780 at September 30, 2020	2,227,062	2,358,983
Foreclosed assets	—	3,926
Bank-owned life insurance	12,727	12,895
Premises and equipment, net	14,548	15,294
Accrued interest receivable	4,926	5,116
Deferred income tax asset, net	1,213	1,176
Other assets	<u>5,647</u>	<u>6,045</u>
Total assets	<u>\$ 2,590,346</u>	<u>\$ 2,719,145</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Deposits:		
Interest-bearing	\$ 1,583,280	\$ 1,722,970
Non-interest-bearing	<u>237,554</u>	<u>303,774</u>
Total deposits	1,820,834	2,026,744
Federal Home Loan Bank advances	505,200	399,031
Mortgage payable	687	—
Mortgagors' escrow accounts	7,815	8,105
Accrued interest payable	960	274
Other liabilities	<u>7,627</u>	<u>6,679</u>
Total liabilities	<u>2,343,123</u>	<u>2,440,833</u>
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; 2,135,750 shares issued and outstanding at December 31, 2019 and 2,136,900 shares issued and outstanding at September 30, 2020	2,136	2,137
Additional paid-in capital	12,234	12,371
Undivided profits	<u>232,853</u>	<u>263,804</u>
Total stockholders' equity	<u>247,223</u>	<u>278,312</u>
Total liabilities and stockholders' equity	<u>\$ 2,590,346</u>	<u>\$ 2,719,145</u>

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

Item 1 – Financial Statements (continued)

**HINGHAM INSTITUTION FOR SAVINGS AND SUBSIDIARIES**  
**Consolidated Statements of Net Income and Comprehensive Income**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2020	2019	2020
<i>(Unaudited)</i>				
<b>(In Thousands, except per share amounts)</b>				
Interest and dividend income:				
Loans	\$ 26,153	\$ <b>26,193</b>	\$ 74,049	\$ <b>77,759</b>
Equity securities	518	<b>441</b>	1,503	<b>1,402</b>
Federal Reserve and other short-term investments	1,527	<b>47</b>	4,716	<b>844</b>
Total interest and dividend income	<u>28,198</u>	<u><b>26,681</b></u>	<u>80,268</u>	<u><b>80,005</b></u>
Interest expense:				
Deposits	7,585	<b>3,285</b>	20,805	<b>13,618</b>
Federal Home Loan Bank and Federal Reserve Bank advances	3,099	<b>567</b>	9,766	<b>4,456</b>
Mortgage payable	11	—	33	<b>3</b>
Total interest expense	<u>10,695</u>	<u><b>3,852</b></u>	<u>30,604</u>	<u><b>18,077</b></u>
Net interest income	<u>17,503</u>	<u><b>22,829</b></u>	<u>49,664</u>	<u><b>61,928</b></u>
Provision for loan losses	<u>302</u>	<u><b>350</b></u>	<u>1,282</u>	<u><b>2,113</b></u>
Net interest income, after provision for loan losses	<u>17,201</u>	<u><b>22,479</b></u>	<u>48,382</u>	<u><b>59,815</b></u>
Other income:				
Customer service fees on deposits	213	<b>181</b>	598	<b>501</b>
Increase in cash surrender value of bank-owned life insurance	61	<b>51</b>	185	<b>168</b>
Gain on equity securities, net	298	<b>3,607</b>	4,337	<b>2,463</b>
Gain on disposal of fixed assets	—	—	—	<b>218</b>
Miscellaneous	42	<b>33</b>	125	<b>114</b>
Total other income	<u>614</u>	<u><b>3,872</b></u>	<u>5,245</u>	<u><b>3,464</b></u>
Operating expenses:				
Salaries and employee benefits	3,290	<b>3,210</b>	9,614	<b>9,877</b>
Occupancy and equipment	453	<b>503</b>	1,354	<b>1,432</b>
Data processing	419	<b>502</b>	1,154	<b>1,466</b>
Deposit insurance	22	<b>212</b>	530	<b>649</b>
Marketing	188	<b>116</b>	497	<b>400</b>
Foreclosure	34	<b>167</b>	101	<b>321</b>
Other general and administrative	811	<b>718</b>	2,276	<b>2,281</b>
Total operating expenses	<u>5,217</u>	<u><b>5,428</b></u>	<u>15,526</u>	<u><b>16,426</b></u>
Income before income taxes	<u>12,598</u>	<u><b>20,923</b></u>	<u>38,101</u>	<u><b>46,853</b></u>
Income tax provision	3,565	<b>5,717</b>	10,538	<b>13,124</b>
Net income and comprehensive income	<u>\$ 9,033</u>	<u>\$ <b>15,206</b></u>	<u>\$ 27,563</u>	<u>\$ <b>33,729</b></u>
Weighted average common shares outstanding:				
Basic	<u>2,134</u>	<u><b>2,137</b></u>	<u>2,133</u>	<u><b>2,137</b></u>
Diluted	<u>2,183</u>	<u><b>2,183</b></u>	<u>2,182</u>	<u><b>2,181</b></u>
Earnings per share:				
Basic	<u>\$ 4.23</u>	<u>\$ <b>7.12</b></u>	<u>\$ 12.92</u>	<u>\$ <b>15.79</b></u>
Diluted	<u>\$ 4.14</u>	<u>\$ <b>6.96</b></u>	<u>\$ 12.63</u>	<u>\$ <b>15.46</b></u>

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

Item 1 – Financial Statements (continued)

**HINGHAM INSTITUTION FOR SAVINGS AND SUBSIDIARIES**  
**Consolidated Statements of Changes in Stockholders' Equity**  
**For the Nine Months Ended**  
**September 30, 2019 and 2020**

	<u>Common Stock</u>	<u>Additional Paid-In Capital</u>	<u>Undivided Profits</u>	<u>Total Stockholders' Equity</u>
<i>(Unaudited)</i>	<b>(In Thousands)</b>			
Balance at December 31, 2018	\$ 2,133	\$ 11,863	\$ 198,580	\$ 212,576
Comprehensive income	—	—	27,563	27,563
Share-based compensation expense	—	140	—	140
Stock options exercised	1	70	—	71
Cash dividends declared – common (\$1.17 per share)	—	—	(2,497)	(2,497)
Balance at September 30, 2019	<u>\$ 2,134</u>	<u>\$ 12,073</u>	<u>\$ 223,646</u>	<u>\$ 237,853</u>
<b>Balance at December 31, 2019</b>	<b>\$ 2,136</b>	<b>\$ 12,234</b>	<b>\$ 232,853</b>	<b>\$ 247,223</b>
<b>Comprehensive income</b>	<b>—</b>	<b>—</b>	<b>33,729</b>	<b>33,729</b>
<b>Share-based compensation expense</b>	<b>—</b>	<b>57</b>	<b>—</b>	<b>57</b>
<b>Stock options exercised</b>	<b>1</b>	<b>80</b>	<b>—</b>	<b>81</b>
<b>Cash dividends declared – common</b> <b>(\$1.30 per share)</b>	<b>—</b>	<b>—</b>	<b>(2,778)</b>	<b>(2,778)</b>
<b>Balance at September 30, 2020</b>	<b><u>\$ 2,137</u></b>	<b><u>\$ 12,371</u></b>	<b><u>\$ 263,804</u></b>	<b><u>\$ 278,312</u></b>

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

Item 1 – Financial Statements (continued)

**HINGHAM INSTITUTION FOR SAVINGS AND SUBSIDIARIES**  
**Consolidated Statements of Changes in Stockholders' Equity**  
**For the Three Months Ended**  
**September 30, 2019 and 2020**

	<b>Common Stock</b>	<b>Additional Paid-In Capital</b>	<b>Undivided Profits</b>	<b>Total Stockholders' Equity</b>
<i>(Unaudited)</i>	<b>(In Thousands)</b>			
Balance at June 30, 2019	\$ 2,134	\$ 11,980	\$ 215,466	\$ 229,580
Comprehensive income	—	—	9,033	9,033
Share-based compensation expense	—	93	—	93
Cash dividends declared – common (\$0.40 per share)	—	—	(853)	(853)
Balance at September 30, 2019	\$ 2,134	\$ 12,073	\$ 223,646	\$ 237,853
<b>Balance at June 30, 2020</b>	<b>\$ 2,137</b>	<b>\$ 12,352</b>	<b>\$ 249,559</b>	<b>\$ 264,048</b>
Comprehensive income	—	—	15,206	15,206
Share-based compensation expense	—	19	—	19
Cash dividends declared – common (\$0.45 per share)	—	—	(961)	(961)
<b>Balance at September 30, 2020</b>	<b>\$ 2,137</b>	<b>\$ 12,371</b>	<b>\$ 263,804</b>	<b>\$ 278,312</b>

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

Item 1 – Financial Statements (continued)

**HINGHAM INSTITUTION FOR SAVINGS AND SUBSIDIARIES**  
**Consolidated Statements of Cash Flows**

	<b>Nine Months Ended</b>	
	<b>September 30,</b>	
	<b>2019</b>	<b>2020</b>
<i>(Unaudited)</i>	<b>(In Thousands)</b>	
Cash flows from operating activities:		
Net income	\$ 27,563	\$ 33,729
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,282	2,113
Amortization of deferred loan origination costs, net	509	376
Share-based compensation expense	140	57
Deferred income tax provision	955	37
Depreciation and amortization of premises and equipment	491	552
Increase in cash surrender value of bank-owned life insurance	(185)	(168)
Gain on equity securities, net	(4,337)	(2,463)
Gain on disposal of fixed assets	—	(218)
Changes in operating assets and liabilities:		
Accrued interest receivable and other assets	(2,864)	(1,384)
Accrued interest payable and other liabilities	1,540	(439)
Net cash provided by operating activities	25,094	32,192
Cash flows from investing activities:		
Activity in available-for-sale securities:		
Maturities, payments and calls	3	5
Activity in equity securities:		
Proceeds from sales	26	9,569
Purchases	(4,172)	(16,809)
Purchase of Federal Home Loan Bank stock	(28,539)	(13,327)
Proceeds from redemption of Federal Home Loan Bank stock	33,620	19,232
Loans originated, net of payments received	(133,017)	(138,010)
Proceeds from sale of fixed assets	—	344
Additions to premises and equipment	(277)	(1,424)
Net cash used in investing activities	(132,356)	(140,420)

(continued)

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

**Item 1 – Financial Statements (continued)**

**Consolidated Statements of Cash Flows (concluded)**

	<b>Nine Months Ended</b>	
	<b>September 30,</b>	
	<b>2019</b>	<b>2020</b>
<i>(Unaudited)</i>	<b>(In Thousands)</b>	
Cash flows from financing activities:		
Net increase in deposits	132,575	<b>205,910</b>
Net increase in mortgagors' escrow accounts	142	<b>290</b>
Cash dividends paid on common stock	(3,498)	<b>(3,973)</b>
Proceeds from stock options exercised	71	<b>81</b>
Net decrease in Federal Home Loan Bank and Federal Reserve Bank advances with maturities of three months or less	(352,000)	<b>(185,000)</b>
Proceeds from Federal Home Loan Bank advances with maturities of more than three months	269,900	<b>263,031</b>
Repayment of Federal Home Loan Bank advances with maturities of more than three months	(4,600)	<b>(184,200)</b>
Repayment of mortgage payable	<u>(48)</u>	<u><b>(687)</b></u>
Net cash provided by financing activities	<u>42,542</u>	<u><b>95,452</b></u>
Net change in cash and cash equivalents	(64,720)	<b>(12,776)</b>
Cash and cash equivalents at beginning of period	<u>295,975</u>	<u><b>252,147</b></u>
Cash and cash equivalents at end of period	<u>\$ 231,255</u>	<u><b>\$ 239,371</b></u>
Supplementary information:		
Interest paid on deposit accounts	\$ 21,125	\$ <b>13,822</b>
Interest paid on Federal Home Loan Bank and Federal Reserve Bank advances and mortgage payable	9,468	<b>4,941</b>
Income taxes paid	10,739	<b>14,231</b>
Non-cash activities:		
Real estate acquired through foreclosure	\$ —	\$ <b>3,600</b>

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



**HINGHAM INSTITUTION FOR SAVINGS AND SUBSIDIARIES**  
**Notes to Unaudited Consolidated Financial Statements**  
**September 30, 2019 and 2020**

**NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The consolidated interim financial statements of Hingham Institution for Savings (the “Bank”) have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial statements and with the instructions to U.S. Securities and Exchange Commission Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements.

Financial information as of September 30, 2020, and for the three and nine months ended September 30, 2019 and 2020, is unaudited and, in the opinion of management, reflects all adjustments necessary for a fair presentation of such information. Such adjustments were of a normal recurring nature. Interim results are not necessarily indicative of results to be expected for the entire year. The unaudited interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements of the Bank for the year ended December 31, 2019 filed on Form 10-K.

**Earnings per common share**

Basic earnings per share represent income available to common stockholders 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 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. The amount of excess tax benefit that would be credited to additional paid-in capital assuming exercise of the options is not considered in the proceeds when applying the treasury stock method.

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

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2019</b>	<b>2020</b>	<b>2019</b>	<b>2020</b>
	<b>(In Thousands)</b>			
Average number of shares outstanding used to calculate basic earnings per share	2,134	<b>2,137</b>	2,133	<b>2,137</b>
Effect of dilutive options	49	<b>46</b>	49	<b>44</b>
Average number of shares outstanding used to calculate diluted earnings per share	2,183	<b>2,183</b>	2,182	<b>2,181</b>

For both the three and nine months ended September 30, 2019 and 2020, there were 4,000 antidilutive options.

**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.

## Notes to Unaudited Consolidated Financial Statements (continued)

### Loans

The Bank's loan portfolio includes residential real estate, commercial real estate, construction, home equity, commercial and consumer segments. A substantial majority of the loan portfolio is secured by real estate in eastern Massachusetts. The remainder of the real estate loan portfolio is located in the Washington D.C. metropolitan area ("WMA"). The ability of the Bank's debtors to honor their contracts is dependent upon the real estate, construction, and general economic conditions in these markets.

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, net of 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 the 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, allocated and unallocated loss components, as further discussed below.

#### 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 appropriate to capture relevant loss data for each loan segment. This time frame is currently two years for all loan categories, except for residential real estate which was increased to four years, beginning with the quarter ended March 31, 2020, to capture the longer term loss track record of the Bank in this 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. Besides increasing the historical loss period for residential real estate loans as discussed above, there were no changes in the Bank's policies or methodology pertaining to the general component of the allowance for loan losses during the nine months ended September 30, 2020.

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 residential real estate that is owner-occupied at the time of origination and repayment is dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality in this segment. The Bank only originates these loans in Massachusetts.

*Commercial real estate* – Loans in this segment are primarily secured by income-producing properties throughout Massachusetts and in the greater Washington D.C. metropolitan area. Underwriting and portfolio management policies are the same for both markets. 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.

## Notes to Unaudited Consolidated Financial Statements (continued)

*Construction* – Loans in this segment include both owner-occupied and speculative real estate development loans for which payment is derived from the 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. The Bank only originates these loans in Massachusetts.

*Home equity* – Loans in this segment include equity lines of credit and second mortgage loans, 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. The Bank only originates these loans in Massachusetts.

*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. These loans are not a focus of the Bank's origination program, and are originated only in Massachusetts. This segment includes loans originated under the Small Business Administration's ("SBA") Paycheck Protection Program ("PPP"). SBA PPP loans are excluded from the allowance for loan loss calculation as they are 100% guaranteed by the SBA.

*Consumer* – Loans in this segment are generally unsecured and repayment is dependent on the credit quality of the individual borrower. These loans are not a focus of the Bank's origination program, and are originated only in Massachusetts.

### 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.

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.

### Unallocated component

At times, the Bank may maintain an unallocated component of the allowance for loan loss based on market conditions and in accordance with GAAP. The Bank's Allowance for Loan Loss Policy limits the amount of the unallocated component to 5% of the recorded allowance for loan losses. At September 30, 2020, the Bank's allowance for loan losses included an unallocated amount of \$607,000, or 3.6% of the recorded allowance for loan losses, which was within the Bank's policy. There was no unallocated portion within the Bank's allowance for loan losses at December 31, 2019. The unallocated balance is allocated across the non-impaired loan categories presented in Note 6.

### **Leases**

In accordance with Accounting Standards Codification Topic 842, *Leases*, the Bank records operating lease right-of-use ("ROU") assets and operating lease liabilities relating to operating leases for some of its banking offices. These lease agreements have lease and non-lease components, which are generally accounted for separately. The ROU asset is included in other assets and the operating lease liability is included in other liabilities on the Bank's Consolidated Balance Sheets. At September 30, 2020, the ROU asset was \$1.1 million and the corresponding operating lease liability was \$1.2 million. Operating lease costs for both the quarter ended September 30, 2019 and 2020 were \$87,000. Operating lease costs for both the nine months ended September 30, 2019 and 2020 were \$261,000.

## Notes to Unaudited Consolidated Financial Statements (continued)

ROU assets represent the Bank's right to use an underlying asset for the lease term and lease liabilities represent the Bank's obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. As most of the Bank's leases do not provide an implicit rate, the Bank uses the Bank's incremental borrowing rate, which is generally the Federal Home Loan Bank ("FHLB") classic advance rate, based on the information available at commencement date in determining the present value of lease payments. The Bank will use the implicit rate when readily determinable. The weighted average discount rate for operating leases as of September 30, 2020 was 2.9%. The Bank's lease terms may include options to extend when it is reasonably certain that the Bank will exercise that option. The initial term of these lease agreements is five years, and the agreements contain up to three extension options for subsequent five year terms. Management considered options that have been exercised or are reasonably certain to be exercised in the recognition of the operating lease ROU asset. The weighted average remaining lease term for operating leases as of September 30, 2020 is 4.8 years. For operating leases, lease expense is recognized on a straight-line basis over the lease term.

The maturities of lease liabilities are as follows at September 30, 2020:

<u>Years</u>	<u>Amount</u> <u>(In Thousands)</u>
2020 (remaining three months)	\$ 85
2021	256
2022	245
2023	253
2024	240
Thereafter	<u>183</u>
Total lease payments	1,262
Imputed interest	<u>(89)</u>
Total lease liability	<u>\$ 1,173</u>

## NOTE 2: COMMITMENTS

At December 31, 2019 and September 30, 2020, outstanding loan commitments were as follows:

	<u>December 31,</u> <u>2019</u>	<u>September 30,</u> <u>2020</u>
	<u>(In Thousands)</u>	
Unused lines of credit	\$ 125,519	\$ 147,129
Commitments to originate loans	90,026	77,551
Unadvanced funds on construction loans	71,657	81,548
Standby letters of credit	25	25
Total	<u>\$ 287,227</u>	<u>\$ 306,253</u>

At September 30, 2020, the Bank had the following contractual obligations outstanding:

	<u>Payments Due by Year</u>				
	<u>Total</u>	<u>Less Than</u> <u>One Year</u>	<u>One to</u> <u>Three Years</u>	<u>Three to</u> <u>Five Years</u>	<u>More than</u> <u>Five Years</u>
	<u>(In thousands)</u>				
Certificates of deposit	\$ 1,020,466	\$ 929,775	\$ 73,247	\$ 17,444	\$ —
Federal Home Loan Bank advances	399,031	399,031	—	—	—
Data processing agreements (1)	2,591	915	1,676	—	—

(1) Estimated payments subject to change based on transaction volume.

## NOTE 3: DIVIDEND DECLARATION

On September 23, 2020, the Board of Directors declared a cash dividend of \$0.45 per share to all stockholders of record as of October 5, 2020, payable October 14, 2020.

## Notes to Unaudited Consolidated Financial Statements (continued)

### NOTE 4: 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 to determine fair value disclosures. Fair value 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 asset or liability.

#### 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.

	Level 1	Level 2	Level 3	Total Fair Value
	(In Thousands)			
<u>December 31, 2019</u>				
Securities available for sale	\$ —	\$ 11	\$ —	\$ 11
Equity securities	43,922	3,253	—	47,175
Total	<u>\$ 43,922</u>	<u>\$ 3,264</u>	<u>\$ —</u>	<u>\$ 47,186</u>
<u>September 30, 2020</u>				
Securities available for sale	\$ —	\$ 6	\$ —	\$ 6
Equity securities	53,576	3,772	—	57,348
Total	<u>\$ 53,576</u>	<u>\$ 3,778</u>	<u>\$ —</u>	<u>\$ 57,354</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 GAAP. 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, 2019 and September 30, 2020. There are no liabilities measured at fair value on a non-recurring basis at December 31, 2019 and September 30, 2020.

	<u>December 31, 2019</u>			<u>Nine Months Ended September 30, 2019</u>	<u>Three Months Ended September 30, 2019</u>
	Level 1	Level 2	Level 3	Total Losses	Total Losses
	(In Thousands)			(In Thousands)	(In Thousands)
Impaired loans	\$ —	\$ —	\$ 4,280	\$ —	\$ —
	<u>September 30, 2020</u>			<u>Nine Months Ended September 30, 2020</u>	<u>Three Months Ended September 30, 2020</u>
	Level 1	Level 2	Level 3	Total Losses	Total Losses
	(In Thousands)			(In Thousands)	(In Thousands)
Impaired loans	\$ —	\$ —	\$ 201	\$ 28	\$ 28
Foreclosed assets	—	—	3,926	681	—
Total	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 4,127</u>	<u>\$ 709</u>	<u>\$ 28</u>

Losses applicable to impaired loans and foreclosed assets 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 or foreclosed asset when determining any estimated losses. This may include a review of an independent appraisal and if deemed necessary, an updated appraisal will be performed.

## Notes to Unaudited Consolidated Financial Statements (continued)

### 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)				
<b>December 31, 2019</b>				
Financial assets:				
Cash and cash equivalents	\$ 252,147	\$ 252,147	\$ —	\$ —
Debt securities available for sale	11	—	11	—
Equity securities	47,175	43,922	3,253	—
Federal Home Loan Bank stock	24,890	—	—	24,890
Loans, net	2,227,062	—	—	2,253,927
Accrued interest receivable	4,926	—	—	4,926
Financial liabilities:				
Deposits	\$ 1,820,834	\$ —	\$ —	\$ 1,827,110
Federal Home Loan Bank advances	505,200	—	505,928	—
Mortgage payable	687	—	—	689
Mortgagors' escrow accounts	7,815	—	—	7,815
Accrued interest payable	960	—	—	960
<b>September 30, 2020</b>				
Financial assets:				
Cash and cash equivalents	\$ 239,371	\$ 239,371	\$ —	\$ —
Debt securities available for sale	6	—	6	—
Equity securities	57,348	53,576	3,772	—
Federal Home Loan Bank stock	18,985	—	—	18,985
Loans, net	2,358,983	—	—	2,392,609
Accrued interest receivable	5,116	—	—	5,116
Financial liabilities:				
Deposits	\$ 2,026,744	\$ —	\$ —	\$ 2,028,767
Federal Home Loan Bank advances	399,031	—	399,409	—
Mortgagors' escrow accounts	8,105	—	—	8,105
Accrued interest payable	274	—	—	274

### NOTE 5: SECURITIES

#### Securities available for sale

At December 31, 2019 and September 30, 2020, all securities available for sale were residential mortgage-backed securities. Both the amortized cost and fair value of the residential mortgage-backed securities were \$11,000 and \$6,000 at December 31, 2019 and September 30, 2020, respectively. There were no gross unrealized gains or gross unrealized losses at either December 31, 2019 or September 30, 2020.

At December 31, 2019 and September 30, 2020, all debt securities were pledged to secure FHLB advances. There were no sales of securities available for sale during the nine months ended September 30, 2019 or 2020.

#### Equity securities

At September 30, 2020, equity securities include a \$8.6 million investment in the Community Reinvestment Act Qualified Investment Fund and \$48.7 million investment in equity securities in the banking, insurance, rating agencies, payments, technology and industrial sectors.

There were no securities sold during the three months ended September 30, 2019. For the nine months ended September 30, 2019, proceeds from sales of equity securities amounted to \$26,000. Unrealized gains recognized during the three and nine months ended September 30, 2019, on equity securities still held at September 30, 2019, totaled \$298,000 and \$4.3 million, respectively. For the three and nine months ended September 30, 2020, proceeds from sales of equity securities amounted to \$4.0 million and \$9.6 million, respectively. During the three and nine months ended September 30, 2020, the Bank recognized \$3.3 million and \$2.5 million in unrealized gains on equity securities still held at September 30, 2020, respectively.

Notes to Unaudited Consolidated Financial Statements (continued)

NOTE 6: LOANS

A summary of the balances of loans are as follows:

	December 31, 2019	September 30, 2020
(In Thousands)		
Real estate loans:		
Residential	\$ 695,919	\$ 658,571
Commercial	1,327,126	1,517,821
Construction	186,094	157,333
Home equity	29,605	29,437
Total real estate loans	<u>2,238,744</u>	<u>2,363,162</u>
Other loans:		
Commercial	196	9,240
Consumer	586	489
Total other loans	<u>782</u>	<u>9,729</u>
 Total loans	 2,239,526	 2,372,891
Allowance for loan losses	(15,376)	(16,780)
Net deferred loan origination costs	2,912	2,872
Loans, net	<u>\$ 2,227,062</u>	<u>\$ 2,358,983</u>

A blanket lien on “qualified collateral,” defined principally as 61-77% of the carrying value of first mortgage loans on certain owner-occupied residential property, 77% 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, is used to secure borrowings from the Federal Home Loan Bank of Boston. Additionally, a blanket lien on home equity and second mortgage loans is used to secure borrowings from the Federal Reserve Bank of Boston through its discount window. At December 31, 2019 and September 30, 2020, there were no Federal Reserve Bank borrowings outstanding.

The following is a summary of past due and non-accrual loans at December 31, 2019 and September 30, 2020:

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Loans on Non-accrual
(In Thousands)					
<b>December 31, 2019</b>					
Residential real estate	\$ 4,918	\$ 1,326	\$ 4,768	\$ 11,012	\$ 5,092
Commercial real estate	1,125	—	150	1,275	508
Home equity	66	—	—	66	—
Commercial	1	—	—	1	—
Total loans	<u>\$ 6,110</u>	<u>\$ 1,326</u>	<u>\$ 4,918</u>	<u>\$ 12,354</u>	<u>\$ 5,600</u>
<b>September 30, 2020</b>					
Residential real estate	\$ —	\$ 605	\$ 870	\$ 1,475	\$ 937
Commercial real estate	—	1,915	149	2,064	504
Construction	—	—	925	925	925
Home equity	250	—	32	282	32
Consumer	3	—	—	3	—
Total loans	<u>\$ 253</u>	<u>\$ 2,520</u>	<u>\$ 1,976</u>	<u>\$ 4,749</u>	<u>\$ 2,398</u>

At December 31, 2019 and September 30, 2020, there were no loans past due 90 days or more and still accruing interest.

## Notes to Unaudited Consolidated Financial Statements (continued)

An analysis of the activity in the allowance for loan losses, by segment, for the periods ended September 30, 2019 and 2020 follows:

	Residential Real Estate	Commercial Real Estate	Construction	Home Equity	Commercial	Consumer	Total
	(In Thousands)						
<b><u>Nine months ended September 30, 2019</u></b>							
Balance December 31, 2018	\$ 2,674	\$ 9,687	\$ 1,337	\$ 105	\$ 1	\$ 4	\$ 13,808
Provision (credit) for loan losses	(79)	1,023	351	(13)	1	(1)	1,282
Loans charged off	—	(3)	—	—	—	—	(3)
Recoveries of loans previously charged off	2	—	—	—	—	1	3
Balance September 30, 2019	<u>\$ 2,597</u>	<u>\$ 10,707</u>	<u>\$ 1,688</u>	<u>\$ 92</u>	<u>\$ 2</u>	<u>\$ 4</u>	<u>\$ 15,090</u>
<b><u>Three months ended September 30, 2019</u></b>							
Balance June 30, 2019	\$ 2,456	\$ 10,485	\$ 1,740	\$ 90	\$ 2	\$ 14	\$ 14,787
Provision (credit) for loan losses	140	222	(52)	2	—	(10)	302
Loans charged off	—	—	—	—	—	—	—
Recoveries of loans previously charged off	1	—	—	—	—	—	1
Balance September 30, 2019	<u>\$ 2,597</u>	<u>\$ 10,707</u>	<u>\$ 1,688</u>	<u>\$ 92</u>	<u>\$ 2</u>	<u>\$ 4</u>	<u>\$ 15,090</u>
<b><u>Nine months ended September 30, 2020</u></b>							
Balance December 31, 2019	\$ 2,448	\$ 10,845	\$ 1,998	\$ 77	\$ 2	\$ 6	\$ 15,376
Provision (credit) for loan losses	998	1,437	(326)	5	(1)	—	2,113
Loans charged off	(709)	—	—	—	—	(1)	(710)
Recoveries of loans previously charged off	1	—	—	—	—	—	1
Balance September 30, 2020	<u>\$ 2,738</u>	<u>\$ 12,282</u>	<u>\$ 1,672</u>	<u>\$ 82</u>	<u>\$ 1</u>	<u>\$ 5</u>	<u>\$ 16,780</u>
<b><u>Three months ended September 30, 2020</u></b>							
Balance June 30, 2020	\$ 2,720	\$ 11,998	\$ 1,656	\$ 78	\$ 1	\$ 5	\$ 16,458
Provision for loan losses	46	284	16	4	—	—	350
Loans charged off	(28)	—	—	—	—	—	(28)
Recoveries of loans previously charged off	—	—	—	—	—	—	—
Balance September 30, 2020	<u>\$ 2,738</u>	<u>\$ 12,282</u>	<u>\$ 1,672</u>	<u>\$ 82</u>	<u>\$ 1</u>	<u>\$ 5</u>	<u>\$ 16,780</u>

At December 31, 2019, a residential real estate loan with a \$4.3 million recorded investment was included in non-accrual and impaired loans without a valuation allowance, based on a recent outside appraisal of the real estate collateral. In the first quarter of 2020, the Bank purchased the property at a foreclosure auction, resulting in the transfer of the loan to foreclosed assets at fair value at the foreclosure date. Based on the results of the foreclosure auction, management reassessed the fair value of the property, moving it to the lower end of the range of fair value, and recorded a \$681,000 charge-off against the allowance for loan losses at the foreclosure date.



## Notes to Unaudited Consolidated Financial Statements (continued)

An analysis of the allowance for loan losses, by segment, as of December 31, 2019 and September 30, 2020 follows:

	Residential Real Estate	Commercial Real Estate	Construction	Home Equity	Commercial	Consumer	Total
(In Thousands)							
<b>December 31, 2019</b>							
Allowance for impaired loans	\$ 104	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 104
Allowance for non-impaired loans	2,344	10,845	1,998	77	2	6	15,272
	<u>\$ 2,448</u>	<u>\$ 10,845</u>	<u>\$ 1,998</u>	<u>\$ 77</u>	<u>\$ 2</u>	<u>\$ 6</u>	<u>\$ 15,376</u>
Impaired loans	\$ 6,463	\$ 508	\$ —	\$ —	\$ —	\$ —	\$ 6,971
Non-impaired loans	689,456	1,326,618	186,094	29,605	196	586	2,232,555
	<u>\$ 695,919</u>	<u>\$ 1,327,126</u>	<u>\$ 186,094</u>	<u>\$ 29,605</u>	<u>\$ 196</u>	<u>\$ 586</u>	<u>\$ 2,239,526</u>
<b>September 30, 2020</b>							
Allowance for impaired loans	\$ 81	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 81
Allowance for non-impaired loans	2,657	12,282	1,672	82	1	5	16,699
	<u>\$ 2,738</u>	<u>\$ 12,282</u>	<u>\$ 1,672</u>	<u>\$ 82</u>	<u>\$ 1</u>	<u>\$ 5</u>	<u>\$ 16,780</u>
Impaired loans	\$ 2,010	\$ 504	\$ 925	\$ 32	\$ —	\$ —	\$ 3,471
Non-impaired loans	656,561	1,517,317	156,408	29,405	9,240	489	2,369,420
	<u>\$ 658,571</u>	<u>\$ 1,517,821</u>	<u>\$ 157,333</u>	<u>\$ 29,437</u>	<u>\$ 9,240</u>	<u>\$ 489</u>	<u>\$ 2,372,891</u>

The following is a summary of impaired loans at December 31, 2019 and September 30, 2020:

	December 31, 2019			September 30, 2020		
	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	\$ 5,450	\$ 5,502		\$ 1,291	\$ 1,343	
Commercial real estate	508	508		504	504	
Construction	—	—		925	925	
Home equity	—	—		32	32	
Total	<u>5,958</u>	<u>6,010</u>		<u>2,752</u>	<u>2,804</u>	
Impaired loans with a valuation allowance:						
Residential real estate	1,013	1,013	\$ 104	719	719	\$ 81
Total impaired loans	<u>\$ 6,971</u>	<u>\$ 7,023</u>	<u>\$ 104</u>	<u>\$ 3,471</u>	<u>\$ 3,523</u>	<u>\$ 81</u>

## Notes to Unaudited Consolidated Financial Statements (continued)

The following is information pertaining to impaired loans for the periods ended September 30, 2019 and 2020:

	Three Months Ended September 30, 2019			Nine Months Ended September 30, 2019		
	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized on Cash Basis	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized on Cash Basis
	(In Thousands)					
Impaired loans:						
Residential real estate	\$ 2,139	\$ 17	\$ —	\$ 1,977	\$ 49	\$ 10
Commercial real estate	271	—	—	265	—	18
Total impaired loans	<u>\$ 2,410</u>	<u>\$ 17</u>	<u>\$ —</u>	<u>\$ 2,242</u>	<u>\$ 49</u>	<u>\$ 28</u>

	Three Months Ended September 30, 2020			Nine Months Ended September 30, 2020		
	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized on Cash Basis	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized on Cash Basis
	(In Thousands)					
Impaired loans:						
Residential real estate	\$ 2,250	\$ 12	\$ 2	\$ 2,814	\$ 43	\$ 25
Commercial real estate	504	—	7	506	—	28
Construction	925	—	—	432	—	5
Home equity	82	—	1	63	—	3
Total impaired loans	<u>\$ 3,761</u>	<u>\$ 12</u>	<u>\$ 10</u>	<u>\$ 3,815</u>	<u>\$ 43</u>	<u>\$ 61</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 nine months ended September 30, 2019 and 2020, troubled debt restructurings 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 Federal Deposit Insurance Corporation (“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.

## Notes to Unaudited Consolidated Financial Statements (continued)

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 rolling quarterly basis, all commercial, construction and residential loan relationships with individual loans of \$500,000 or more are assigned a risk rating. An in-depth review is performed on all commercial real estate relationships with exposure in excess of \$850,000, new credits in excess of \$500,000 and all the loans on the Bank's Watch List. Watch List loans are those loans that are more than two payments past due at the end of the quarter, loans for which the borrowing entity or sponsor has filed bankruptcy, 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 rating as of December 31, 2019 and September 30, 2020:

Rating	Residential Real	Commercial	Construction	Commercial
	Estate	Real Estate		
(In Thousands)				
<b>December 31, 2019</b>				
1-3B	\$ 689,932	\$ 1,326,318	\$ 186,094	\$ 196
4	1,349	808	—	—
5	4,638	—	—	—
	<u>\$ 695,919</u>	<u>\$ 1,327,126</u>	<u>\$ 186,094</u>	<u>\$ 196</u>
<b>September 30, 2020</b>				
1-3B	\$ 657,279	\$ 1,515,054	\$ 156,408	\$ 9,240
4	737	2,767	925	—
5	555	—	—	—
	<u>\$ 658,571</u>	<u>\$ 1,517,821</u>	<u>\$ 157,333</u>	<u>\$ 9,240</u>

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

### NOTE 7: RECENT ACCOUNTING PRONOUNCEMENTS

#### Accounting Standards Issued But Yet Not Adopted

The following identifies Accounting Standards Updates ("ASU") applicable to the Bank that have been issued but are not yet effective:

In June 2016, the Financial Accounting Standards Board ("FASB") issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326)* ("ASU 2016-13"). 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. In November 2019, the FASB issued ASU 2019-10, *Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates*. This Update delayed the effective date of ASU 2016-13 for entities eligible to be smaller reporting companies ("SRC"), public business entities that are not SEC filers, and entities that are not public business entities, until fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. As of the date of issuance of ASU 2019-10, the Bank was an eligible SRC and therefore, the adoption of ASU 2016-13 is being delayed. The Bank has completed the model selection, defined the data framework and is currently parallel running the model and evaluating the results. Management will continue to monitor developments and additional guidance to determine the potential impact on the Bank's consolidated financial statements.

In April 2019, the FASB issued ASU 2019-04, *Codification Improvements to Topic 326, Financial Instruments – Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments*. The amendments in this Update affect a variety of Topics in the Codification and represent changes to clarify, correct errors in, or address implementation issues. The amendments to *Topic 326, Financial Instruments – Credit Losses* and *Topic 815, Derivatives and Hedging*, have the same effective dates and transition requirements as those standards, unless the entity has already adopted the standard. The amendments to *Topic 825, Financial Instruments* were effective for the Bank beginning on January 1, 2020. Management has evaluated the Update and determined that changes are not applicable or material to its consolidated financial statements.

In May 2019, the FASB issued ASU 2019-05, *Financial Instruments – Credit Losses (Topic 326): Targeted Transition Relief*. This Update provides transition relief by providing entities with an option to irrevocably elect the fair value option, on an instrument-by-instrument basis, for eligible financial assets measured at amortized cost basis upon adoption of ASU 2016-13. The election is not available for either available-for-sale or held-to-maturity debt securities. For entities that have not yet adopted ASU 2016-13, the effective date and transition methodology for the amendments in this Update are the same as in ASU 2016-13. The Bank does not intend to make this election at this time.

## Notes to Unaudited Consolidated Financial Statements (concluded)

In November 2019, the FASB issued ASU 2019-11, *Codification Improvements to Topic 326, Financial Instruments—Credit Losses*. This Update clarifies, corrects errors and improves certain aspects of the amendments in ASU 2016-13. For entities that have not yet adopted ASU 2016-13, the effective date for the amendments in this ASU is the same as in ASU 2016-13.

In January 2020, the FASB issued ASU 2020-01, *Investments — Equity Securities (Topic 321), Investments — Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815)*. This Update clarifies the interaction of the accounting for equity securities under Topic 321 and investments accounted for under the equity method of accounting in Topic 323 and the accounting for certain forward contracts and purchased options accounted for under Topic 815. The amendments in this Update shall be applied prospectively, and for public business entities, are effective for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. The Bank does expect the adoption of this ASU to have a material impact on its consolidated financial statements.

## Item 2 – Management's Discussion and Analysis of Financial Condition and Results of Operations

### Cautionary Note Regarding Forward-Looking Statements

The following discussion of the financial condition and results of operations of the Bank should be read in conjunction with the Consolidated Financial Statements and Notes thereto included elsewhere in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K for the year ended December 31, 2019. Matters discussed in this Quarterly Report on Form 10-Q and in our public disclosures, whether written or oral, relating to future events or our future performance, including any discussion, expressed or implied, of our anticipated growth, operating results, future earnings per share, plans and objectives, contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements are often identified by the words “believe,” “plan,” “estimate,” “project,” “target,” “continue,” “intend,” “expect,” “future,” “anticipate,” and similar expressions that are not statements of historical fact. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict, including changes in political and economic climate, interest rate fluctuations and competitive product and pricing pressures within the Bank’s market, bond market fluctuations, personal and corporate customers’ bankruptcies and inflation. Our actual results and timing of certain events could differ materially from those anticipated in these forward-looking statements as a result of certain factors including, but not limited to, those set forth under “Risk Factors” and elsewhere in this Quarterly Report on Form 10-Q and in our other public filings with the Federal Deposit Insurance Corporation (“FDIC”). It is routine for internal projections and expectations to change as the year or each quarter in the year progresses and, therefore, it should be clearly understood that all forward-looking statements and the internal projections and beliefs upon which we base our expectations included in this Quarterly Report on Form 10-Q are made only as of the date of this Quarterly Report on Form 10-Q and may change. While we may elect to update forward-looking statements at some point in the future, we do not undertake any obligation to update any forward-looking statements whether as a result of new information, future events or otherwise.

### Note on Core Return on Average Equity and Core Return on Average Assets

In accordance with Accounting Standards Codification Topic 321, *Investments - Equity Securities*, equity securities (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) are measured at fair value with changes in fair value recognized in the Consolidated Statements of Net Income, regardless of whether such gains and losses are realized, and included in the other income category. This change affects the Bank’s portfolio of marketable equity securities, which includes common equity securities and a mutual fund which invests in securities which qualify for the Community Reinvestment Act securities test. This portfolio primarily includes common equity investments, which the Bank views as long-term partnership interests in operating companies. Consequently the Bank does not view the quarterly fluctuation in market value as indicative of the change in the intrinsic value of these portfolio holdings. The performance of these holdings should be evaluated on the basis of their contribution to growth in book value per share over time, not via quarterly adjustments to net income. Consistent with this view, “Management's Discussion and Analysis of Financial Condition and Results of Operations” incorporates core net income, core return on average equity and core return on average assets, which are non-GAAP measurements that exclude the after-tax effect of gain (loss) on equity securities, net, both realized and unrealized.

The table below presents the reconciliation between net income and core net income for the three and nine months ended September 30, 2019 and 2020:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2019	2020	2019	2020
<i>(In thousands, unaudited)</i>				
Non-GAAP reconciliation:				
Net Income	\$ 9,033	\$ 15,206	\$ 27,563	\$ 33,729
Gain on equity securities, net	(298)	(3,607)	(4,337)	(2,463)
Income tax expense (1)	66	795	956	543
Core Net Income	\$ 8,801	\$ 12,394	\$ 24,182	\$ 31,809

(1) The equity securities are held in a tax-advantaged subsidiary corporation. The income tax effect of the gain on equity securities, net, was calculated using the effective tax rate applicable to the subsidiary.

## INTRODUCTION

Net income for the quarter ended September 30, 2020 was \$15,206,000 or \$7.12 per share basic and \$6.96 per share diluted as compared to \$9,033,000 or \$4.23 per share basic and \$4.14 per share diluted in earnings for the third quarter of 2019. The Bank's annualized return on average equity for the third quarter of 2020 was 22.23%, and the annualized return on average assets was 2.26% as compared to 15.33% and 1.40% for the same period in 2019. Core net income for the third quarter of 2020, which represents net income excluding the after-tax gains and losses on equity securities, both realized and unrealized, was \$12,394,000 or \$5.80 per share basic and \$5.68 per share diluted, representing an annualized core return on average equity of 18.12% and an annualized core return on average assets of 1.84%. This compares to core net income of \$8,801,000 or \$4.12 per share basic and \$4.03 per share diluted, representing an annualized core return on average equity of 14.94% and an annualized core return on average assets of 1.37% for the same period in 2019.

Net income for the nine months ended September 30, 2020 was \$33,729,000 or \$15.79 per share basic and \$15.46 per share diluted as compared to \$27,563,000 or \$12.92 per share basic and \$12.63 per share diluted for the same period last year. The Bank's annualized return on average equity for the first nine months of 2020 was 17.19%, and the annualized return on average assets was 1.68% as compared to 16.17% and 1.47% for the same period in 2019. Core net income for the nine months ended September 30, 2020 was \$31,809,000 or \$14.89 per share basic and \$14.58 per share diluted, representing an annualized core return on average equity of 16.21% and an annualized core return on average assets of 1.59%. This compares to core net income of \$24,182,000 or \$11.33 per share basic and \$11.08 per share diluted, representing an annualized core return on average equity of 14.19% and an annualized core return on average assets of 1.29% for the same period in 2019.

The net interest margin for the third quarter of 2020 increased 69 basis points to 3.46%, as compared to 2.77% for the same period last year, and the net interest margin for the nine months ended September 30, 2020 increased 46 basis points to 3.15%, as compared to 2.69% for the same period last year. In 2020 the Bank has benefited from a sharp decline in the cost of interest-bearing liabilities, including both interest-bearing deposits and wholesale funding from the FHLB, brokered time deposits and listing services time deposits. This benefit has been partially offset by a decline in the yield on interest-earning assets, driven primarily by the decline in the interest on excess reserves held at the Federal Reserve Bank ("FRB") of Boston and a lower yield on loans during the same period.

Total assets increased by \$128.8 million from December 31, 2019 and \$238.8 million from September 30, 2019, representing 7% annualized growth year-to-date and 10% growth from September 30, 2019. Net loans increased by \$131.9 million from December 31, 2019 and \$218.5 million from September 30, 2019, representing 8% annualized growth year-to-date and 10% growth from September 30, 2019. Total deposits, including wholesale deposits, increased by \$205.9 million from December 31, 2019 and \$321.0 million from September 30, 2019, representing 15% annualized growth year-to-date and 19% growth from September 30, 2019. Total retail and business deposits increased to \$1.532 billion at September 30, 2020, representing 10% annualized growth year-to-date and 8% growth from September 30, 2019. Non-interest bearing deposits, included in retail and business deposits, increased to \$303.8 million at September 30, 2020, representing 37% annualized growth year-to-date and 31% growth from September 30, 2019. During the first nine months of 2020, the Bank continued to reduce the balance of excess reserves held at the FRB of Boston and reallocated its wholesale funding mix between wholesale time deposits and Federal Home Loan Bank advances in order to reduce the cost of funds. Stockholders' equity increased to \$278.3 million as of September 30, 2020, representing both a 17% annualized growth year-to-date and increase from September 30, 2019. Book value per share increased to \$130.24 per share at September 30, 2020 from \$115.75 per share at December 31, 2019 and \$111.47 per share at September 30, 2019.

Since September 30, 2019, the Bank declared dividends of \$2.31 per share, which included a \$0.60 special dividend declared in the fourth quarter of 2019.

Key credit and operational metrics remained strong in the third quarter of 2020. At September 30, 2020, non-performing assets totaled 0.23% of total assets, compared with 0.22% at December 31, 2019 and 0.05% at September 30, 2019. Non-performing loans as a percentage of the total loan portfolio totaled 0.10% at September 30, 2020, as compared to 0.25% at December 31, 2019 and 0.06% at September 30, 2019.

The efficiency ratio was 23.50% for the third quarter of 2020, as compared to 29.28% in the same period last year. Operating expenses (annualized) as a percentage of average assets remained stable at 0.81% in the third quarter of 2020, the same as the comparable period last year. These metrics reflect the Bank's continued focus on credit quality and disciplined expense controls.

The Bank continues to exceed all of the minimum regulatory capital requirements.

## RESULTS OF OPERATIONS

### COMPARISON OF THE THREE MONTHS ENDED SEPTEMBER 30, 2020 AND 2019

#### General

The Bank reported net income of \$15.2 million for the quarter ended September 30, 2020 as compared to \$9.0 million for the quarter ended September 30, 2019. Net income was \$7.12 per share basic and \$6.96 per share diluted for the quarter ended September 30, 2020 as compared with \$4.23 per share basic and \$4.14 per share diluted for the same period in 2019. Earnings for the quarter ended September 30, 2020 were positively impacted by an increase of \$5.3 million in net interest income and an increase of \$3.3 million in other income, partially offset by an increase of \$2.2 million in the income tax provision, a \$211,000 increase in operating expenses and an increase of \$48,000 in the provision for loan losses.

The Bank's annualized return on average equity for the quarter ended September 30, 2020 was 22.23%, and the annualized return on average assets was 2.26%. The Bank's annualized return on average equity for the quarter ended September 30, 2019 was 15.33%, and the annualized return on average assets was 1.40%.

Core net income for the third quarter of 2020, which represents net income excluding the after-tax gains and losses on equity securities, both realized and unrealized, was \$12.4 million or \$5.80 per share basic and \$5.68 per share diluted, representing an annualized core return on average equity of 18.12% and an annualized core return on average assets of 1.84%. This compares to core net income of \$8.8 million or \$4.12 per share basic and \$4.03 per share diluted, representing an annualized core return on average equity of 14.94% and an annualized core return on average assets of 1.37% for the same period in 2019.

### **Net Interest Income**

Net interest income was \$22.8 million for the third quarter of 2020 and \$17.5 million for the third quarter of 2019. The \$5.3 million increase was due to a \$110.4 million, or 4%, increase in average interest-earning assets, combined with an 89 basis points increase in the weighted average spread in the three months ended September 30, 2020, compared to the same period in 2019. For the quarter ended September 30, 2020, the weighted average rate spread and net interest margin were 3.31% and 3.46%, respectively, compared to 2.42% and 2.77%, respectively, for the quarter ended September 30, 2019. Average interest-bearing liabilities increased by \$17.4 million, or 1%, and the rate paid on interest-bearing liabilities decreased by 131 basis points.

In December 2015, after an extended period of low interest rates, the Federal Reserve Bank began gradually increasing the overnight rate, impacting many short-term rates. In this environment, the Bank's cost of funds increased in tandem with short-term rates until mid-2019, while the yield on interest-earning assets increased at a slower pace, as the Federal Reserve Bank increased interest on excess reserves and the Bank gradually increased the interest rate on certain loan products. To mitigate the negative effect of these market conditions on its net interest margin, the Bank began using brokered time deposits as an alternative to other wholesale funding sources, such as FHLB borrowings or Internet listing services certificates of deposit, to take advantage of their lower cost and/or longer duration. At the same time, the Bank reduced the balance of excess reserves held at the Federal Reserve Bank, in order to minimize the carrying cost of its on-balance sheet liquidity. The Bank has continued to allocate the wholesale funding mix opportunistically and carefully managed its on-balance sheet liquidity. Since late 2019, the Federal Reserve Bank began reducing the overnight rate aggressively, while long term rates reached historic lows. As a result of these market conditions, the Bank's average rate on interest-bearing liabilities declined significantly in the first nine months of 2020, while the yield on interest-earning assets declined by a lesser extent, driven by a lower rate paid on excess reserves held at the Federal Reserve Bank and lower yield on loans. This resulted in a higher net interest margin in the third quarter of 2020 as compared to the same period in 2019.

Interest and dividend income decreased by \$1.5 million to \$26.7 million for the third quarter of 2020 as compared to \$28.2 million for the third quarter of 2019. The yield on total interest-earning assets was 4.04% for the quarter ended September 30, 2020 as compared to 4.46% for the quarter ended September 30, 2019.

Interest income on loans increased by \$40,000 when comparing the two periods, primarily resulting from a 9% increase in average loan balances, partially offset by a 39 basis point decline in yield.

Securities, FHLB stock and short-term investments, which includes the Bank's cash holdings at the Federal Reserve, accounted for 9% of the total average interest-earning assets for the quarter ended September 30, 2020, as compared to 13% for the same period in 2019. Income for these categories combined decreased \$1.6 million when comparing the two periods, primarily due to lower average yields combined with a \$90.1 million decline in combined average balances. The interest on excess reserves paid by the Federal Reserve Bank decreased over this period and the Bank reduced its cash held at the Federal Reserve Bank. At the same time, the dividend received on the FHLB stock investment decreased as a result of a lower average balance and declining short term market rates. This was partially offset by additional marketable equity securities purchased by the Bank since September 30, 2019, some of which pay cash dividends.

The average rate on interest-bearing liabilities decreased to 0.73% for the third quarter of 2020 from 2.04% for the comparable quarter of 2019. Total interest expense decreased by \$6.8 million when comparing the quarters ended September 30, 2020 and 2019 due to lower interest rates on deposits and borrowings and lower average balances of borrowed funds, partially offset by higher interest-bearing deposit average balances.

Interest expense on deposits decreased by \$4.3 million when comparing the two periods, due to a 113 basis points decrease in the weighted average rate, partially offset by an increase of \$140.1 million in average interest-bearing deposits. After a sustained period of rising short term rates, beginning in late 2019, the Bank observed falling market pricing for term deposits, money market accounts, and wholesale funds. This trend accelerated in the second and third quarters of 2020, as the Federal Reserve Bank aggressively reduced short term market rates in March of 2020. The Bank has managed core product rates, implemented special offerings, and continued to use wholesale time deposits to remain competitive while providing a cost efficient means for balanced growth. Given the current economic and competitive environment, management believes it is likely that retail and commercial deposits rates will stabilize in 2020, while wholesale time deposits rates will be likely driven by market conditions and market interest rates.

Interest expense on borrowed funds for the third quarter of 2020 decreased by \$2.5 million as compared to the same quarter in 2019, primarily due to a 195 basis points decline in the weighted average rate, combined with a \$122.7 million decrease in the average outstanding balance. The decrease in FHLB borrowings rate was primarily driven by the lower short-term market rates in 2020 and the maturity of higher rate long term advances taken in 2019.

The following tables detail the components of net interest income and yields/rates on average earning assets/liabilities.

	<b>Three Months Ended September 30,</b>					
	<b>2019</b>			<b>2020</b>		
	<b>AVERAGE BALANCE</b>	<b>INTEREST</b>	<b>YIELD/ RATE (8)</b>	<b>AVERAGE BALANCE</b>	<b>INTEREST</b>	<b>YIELD/ RATE (8)</b>
<i>(Dollars in thousands)</i>						
Loans (1) (2)	\$ 2,191,324	\$ 26,153	4.77 %	\$ 2,391,761	\$ 26,193	4.38 %
Securities (3) (4)	58,133	518	3.56	63,151	441	2.79
Federal Reserve and other short-term investments	279,802	1,527	2.18	184,710	47	0.10
Total interest-earning assets	<u>2,529,259</u>	<u>28,198</u>	<u>4.46</u>	<u>2,639,622</u>	<u>26,681</u>	<u>4.04</u>
Other assets	43,578			48,456		
Total assets	<u>\$ 2,572,837</u>			<u>\$ 2,688,078</u>		
Interest-bearing deposits (5)	\$ 1,616,151	7,585	1.88	\$ 1,756,238	3,285	0.75
Borrowed funds	482,975	3,110	2.58	360,271	567	0.63
Total interest-bearing liabilities	<u>2,099,126</u>	<u>10,695</u>	<u>2.04</u>	<u>2,116,509</u>	<u>3,852</u>	<u>0.73</u>
Non-interest-bearing deposits	230,505			290,803		
Other liabilities	7,514			7,156		
Total liabilities	<u>2,337,145</u>			<u>2,414,468</u>		
Stockholders' equity	235,692			273,610		
Total liabilities and stockholders' equity	<u>\$ 2,572,837</u>			<u>\$ 2,688,078</u>		
Net interest income		<u>\$ 17,503</u>			<u>\$ 22,829</u>	
Weighted average spread			<u>2.42 %</u>			<u>3.31 %</u>
Net interest margin (6)			<u>2.77 %</u>			<u>3.46 %</u>
Average interest-earning assets to average interest-bearing liabilities (7)	<u>120.49 %</u>			<u>124.72 %</u>		

- (1) Before allowance for loan losses.
- (2) Includes average non-accrual loans.
- (3) Excludes the impact of the average net unrealized gain or loss on securities.
- (4) Includes Federal Home Loan Bank stock.
- (5) Includes mortgagors' escrow accounts.
- (6) Net interest income divided by average total interest-earning assets.
- (7) Total interest-earning assets divided by total interest-bearing liabilities.
- (8) Annualized.

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

	<b>Three Months Ended September 30, 2020</b>		
	<b>Compared to the Three Months Ended September 30, 2019</b>		
	<b>Increase (Decrease)</b>		
	<b>Due to</b>		<b>Total</b>
	<b>Volume</b>	<b>Rate</b>	
	<b>(In Thousands)</b>		
Interest and dividend income:			
Loans	\$ 2,288	\$ (2,248)	\$ 40
Securities and FHLB stock	42	(119)	(77)
Federal Reserve and other short-term investments	(389)	(1,091)	(1,480)
Total interest and dividend income	<u>1,941</u>	<u>(3,458)</u>	<u>(1,517)</u>
Interest expense:			
Deposits	608	(4,908)	(4,300)
Borrowed funds	(640)	(1,903)	(2,543)
Total interest expense	<u>(32)</u>	<u>(6,811)</u>	<u>(6,843)</u>
Net interest income	<u>\$ 1,973</u>	<u>\$ 3,353</u>	<u>\$ 5,326</u>



## Provision for Loan Losses

At September 30, 2020, the Bank's review of the allowance for loan losses concluded that a balance of \$16.8 million was adequate to provide for losses based upon evaluation of size and risk in the loan portfolio. This balance includes an unallocated component of \$607,000. During the third quarter of 2020, the Bank provided \$350,000 to the allowance for loan losses. Comparably, for the three months ended September 30, 2019, the Bank's evaluation of the balance of the allowance for loan losses indicated the need for a provision of \$302,000. The Bank recorded \$28,000 of net charge-offs during the third quarter of 2020, as compared to \$1,000 of net recoveries during the same period last year.

See Notes 1 and 6 to the accompanying interim consolidated financial statements and "Loans and Foreclosed Real Estate" included in this Management's Discussion and Analysis for additional information pertaining to the allowance for loan losses.

## Other Income

Other income is comprised of gain on equity securities, net, customer service fees on deposits, increases in the cash surrender value of bank-owned life insurance policies and miscellaneous income. Total other income was \$3.9 million for the quarter ended September 30, 2020 compared to \$614,000 for the same period in 2019. In the third quarter of 2020, the Bank recorded gains totaling \$3.6 million on equity securities, including \$3.3 million of unrealized gains on equity securities held at the end of the period and \$349,000 of gains recognized on equity securities sold during the period. In the third quarter of 2019, the Bank recorded gains totaling \$298,000 on equity securities, all of which consisted of unrealized gains on equity securities held at the end of the period. There were no gains or losses recognized on equity securities sold during the third quarter of 2019.

Customer service fees on deposits decreased by \$32,000 in the third quarter of 2020 compared to the same period in 2019. In recent years, there has been a continuous 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 consumer and business 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. Generally, the Bank's strategy does not rely on generating substantial non-interest fee-based revenue from our deposit accounts.

An increase in the cash surrender value of life insurance also contributed to other income during the third quarter of 2020 and 2019. The Bank held \$12.9 million in life insurance policies at September 30, 2020 as compared to \$12.7 million at September 30, 2019. The policies accrete at a variable rate of interest with minimum stated guaranteed rates and related income was down \$10,000 when comparing the three months ended September 30, 2020 and 2019.

## Operating Expenses

Operating expenses include salaries and employee benefits, occupancy and equipment, data processing, deposit insurance, marketing, foreclosure, and other general and administrative expenses. Total operating expenses were \$5.4 million and \$5.2 million for the quarters ended September 30, 2020 and 2019, respectively, or an annualized 0.81% of average total assets during both periods.

Salaries and employee benefits expenses decreased \$80,000, or 2%, in the three months ended September 30, 2020 compared to the same period in 2019, primarily due to a decline in entertainment related employee benefits resulting from COVID-19 and a slightly lower number of employees, partially offset by annual merit-based salary increases. This reflects a slightly smaller branch staff, offset by an additional commercial deposit relationship manager as compared to the same period in 2019.

Occupancy and equipment expenses increased by \$50,000, or 11%, to \$503,000 in the third quarter of 2020 compared to the same period in 2019. Higher depreciation expenses related to the closure of the Beacon Hill branch and lower rental income were partially offset by lower rent and utilities expenses. The Bank owns rental apartments located above its Nantucket branch which are rented during the summer season. The COVID-19 pandemic negatively impacted the rental income derived from these units in 2020.

Data processing expenses for the third quarter of 2020 increased by \$83,000, or 20%, when compared to the same period in 2019, driven primarily by higher data processing charges associated with improvements made to the Bank's systems and volume increases in the third quarter of 2020. Technology spending at the Bank remains focused on three primary objectives: delivering new or improved customer experience, reducing costs through simplification and automation of internal processes, and securing customer and Bank confidential information.

Deposit insurance expense increased by \$190,000, when compared to the same period in 2019. The increase in expense was primarily driven by the application of Small Bank Assessment Credits by the FDIC in 2019 when compared to 2020. In the three months ended September 30, 2019, the Bank recognized a \$236,000 credit related to the second quarter of 2019 assessment period, which partially offset the third quarter of 2019 deposit insurance expense. The Bank did not recognize any credits in the three months ended September 30, 2020. Deposit insurance expense consists of premiums paid to the FDIC and the Massachusetts Depositors Insurance Fund ("DIF"). The FDIC assessment rate is determined based on several factors, including capitalization, asset growth, earnings, use of brokered deposits and level of non-performing assets, among others, and is calculated on an assessment base that takes into consideration the Bank's average total assets and average tangible equity, among other factors. The DIF assessment rate is based on an institution's risk category, which is defined based on similar factors. The Bank carefully manages its balance sheet to control the deposit insurance expense associated with excess liquidity.

Marketing expenses decreased by \$72,000, or 38%, to \$116,000 for the third quarter of 2020, driven partially by a temporary decline in advertising activity as a result of COVID-19. The Bank continues to carefully manage these expenses and focus marketing

efforts on the Bank's Commercial Real Estate and Specialized Deposit Groups.

Foreclosure expenses include expenses associated with the collection and foreclosure process, such as legal, tax, appraisal, insurance and other related foreclosure expenses. These expenses may be recovered when the loan returns to performing status or when the Bank exercises its remedies, as they are generally secured by the Bank's mortgages. Such recoveries, if any, are reflected in future periods as contra-expense. Foreclosure related expenses increased by \$133,000 when comparing the quarter ended September 30, 2020 to the same period in 2019. The increase is primarily due to expenses related to higher collection activity and to the foreclosure on a residential loan in Nantucket during the first quarter of 2020, as well as subsequent litigation to collect the deficiency owed. At September 30, 2020, the Bank had foreclosed assets of \$3.9 million, consisting only of the Nantucket property mentioned above, including repairs and improvements completed by the Bank following foreclosure. At December 31, 2019 and September 30, 2019, the Bank had no properties in foreclosed assets. The Bank continues to manage credit quality energetically.

Other general and administrative expenses, which include director fees, supplies, deposit related losses and audit-related expenses, among others, decreased by \$93,000, or 11%, when comparing the two periods, reflecting expenses related to the issuance of stock options for certain directors recorded in the quarter ended September 30, 2019 and lower travel related and other miscellaneous expenses in the quarter ended September 30, 2020, as compared to the same period last year.

### **Income Taxes**

The Bank recognizes income taxes under the asset and liability method in which deferred tax assets and liabilities are established for the temporary difference between the accounting basis and the tax basis of the Bank's assets and liabilities at enacted tax rates expected to be in effect when the amounts related to such temporary differences are realized or settled. The Bank's deferred tax asset is reviewed quarterly by management as to the realizability of such asset.

During the third quarter of 2020, the Bank recorded \$5.7 million, or 27.3% of pre-tax income, in tax expense as compared to \$3.6 million, or 28.3%, for the same quarter in 2019. The lower effective tax rate in the third quarter of 2020 was driven by higher gains on equity securities recognized during the third quarter of 2020 as compared to the same quarter in the prior year, as these securities are held at a tax-advantaged subsidiary.

## RESULTS OF OPERATIONS

### COMPARISON OF THE NINE MONTHS ENDED SEPTEMBER 30, 2020 AND 2019

#### General

The Bank reported net income of \$33.7 million for the nine months ended September 30, 2020 as compared to \$27.6 million for the nine months ended September 30, 2019. Net income was \$15.79 per share basic and \$15.46 per share diluted for the first nine months of 2020 as compared to \$12.92 per share basic and \$12.63 per share diluted for the same period in 2019. Earnings for the nine months ended September 30, 2020 were positively impacted by an increase of \$12.3 million in net interest income, partially offset by a decline of \$1.8 million in other income, an increase of \$2.6 million in the income tax provision, a \$900,000 increase in operating expenses and a \$831,000 increase in the provision for loan losses.

The Bank's annualized return on average equity for the first nine months of 2020 was 17.19%, and the annualized return on average assets was 1.68%. The Bank's annualized return on average equity for the first nine months of 2019 was 16.17%, and the annualized return on average assets was 1.47%.

Core net income for the nine months ended September 30, 2020, which represents net income excluding the after-tax gains and losses on equity securities, both realized and unrealized, was \$31.8 million or \$14.89 per share basic and \$14.58 per share diluted, representing an annualized core return on average equity of 16.21% and an annualized core return on average assets of 1.59%. This compares to core net income of \$24.2 million or \$11.33 per share basic and \$11.08 per share diluted, representing an annualized core return on average equity of 14.19% and an annualized core return on average assets of 1.29% for the same period in 2019.

#### Net Interest Income

Net interest income was \$61.9 million for the first nine months of 2020 as compared to \$49.7 million for the first nine months of 2019. The \$12.3 million increase was due to a 57 basis points increase in the weighted average rate spread, combined with a \$163.2 million, or 7%, increase in average interest-earning assets in the first nine months of 2020 compared to the same period in 2019. For the first nine months of 2020, the Bank's weighted average rate spread and net interest margin were 2.93% and 3.15%, respectively, as compared to 2.36% and 2.69%, respectively, for the same period in 2019. Average interest-bearing liabilities increased by \$88.6 million, or 4%, and the rate paid on interest-bearing liabilities decreased by 86 basis points.

In December 2015, after an extended period of low interest rates, the Federal Reserve Bank began gradually increasing the overnight rate, impacting many short-term rates. In this environment, the Bank's cost of funds increased in tandem with short-term rates until mid-2019, while the yield on interest-earning assets increased at a slower pace, as the Federal Reserve Bank increased interest on excess reserves and the Bank gradually increased the interest rate on certain loan products. To mitigate the negative effect of these market conditions on its net interest margin, the Bank began using brokered time deposits as an alternative to other wholesale funding sources, such as FHLB borrowings or Internet listing services certificates of deposit, to take advantage of their lower cost and/or longer duration. At the same time, the Bank reduced the balance of excess reserves held at the Federal Reserve Bank, in order to minimize the carrying cost of its on-balance sheet liquidity. The Bank has continued to allocate the wholesale funding mix opportunistically and carefully managed its on-balance sheet liquidity. Since late 2019, the Federal Reserve Bank began reducing the overnight rate aggressively, while long term rates reached historic lows. As a result of these market conditions, the Bank's average rate on interest-bearing liabilities declined significantly in the first nine months of 2020, while the yield on interest-earning assets declined by a lesser extent, driven by a lower rate paid on excess reserves held at the Federal Reserve Bank and lower yield on loans. This resulted in a higher net interest margin in the first nine months of 2020 as compared to the same period in 2019.

Interest and dividend income decreased by \$263,000 to \$80.0 million for the first nine months of 2020 as compared to \$80.3 million for the first nine months of 2019. The yield on total interest-earning assets was 4.06% for the nine months ended September 30, 2020 as compared to 4.35% for the nine months ended September 30, 2019.

Interest income on loans increased \$3.7 million when comparing the two periods, primarily resulting from a 10% increase in average loans, partially offset by a 21 basis points decline in overall yield.

Securities, FHLB stock and short-term investments, which includes the Bank's cash holdings at the Federal Reserve Bank, accounted for 11% of the total average interest-earning assets for the nine months ended September 30, 2020 and 13% for the same period in 2019. Income for these categories combined decreased \$4.0 million when comparing the two periods, primarily due to lower average yields combined with a \$50.0 million decline in combined average balances. The interest on excess reserves paid by the Federal Reserve Bank decreased over this period and the Bank reduced its cash held at the Federal Reserve Bank. At the same time, the dividend received on the FHLB stock investment decreased as a result of declining short term market rates. This was partially offset by additional marketable equity securities purchased by the Bank since September 30, 2019, some of which pay cash dividends.

The average rate on interest-bearing liabilities declined to 1.13% for the first nine months of 2020 from 1.99% for the comparable period in 2019. Total interest expense decreased by \$12.5 million when comparing the nine months ended September 30, 2020 and 2019 due to lower interest rates on deposits and borrowings, partially offset by higher average balances.

Interest expense on deposits decreased by \$7.2 million when comparing the two periods, due to a 67 basis point decrease in the weighted average rate, partially offset by an increase of \$72.4 million in average interest-bearing deposits. Certificate balances increased by \$60.9 million from December 31, 2019 to September 30, 2020 and non-certificate accounts increased by \$145.0 million during the same period. Non-certificate accounts represent 49.7% of total deposits at September 30, 2020 compared to 47.3% at December 31, 2019. After a sustained period of rising short term rates, beginning in late 2019, the Bank observed falling market

pricing for term deposits, money market accounts, and wholesale funds. This trend accelerated in the second and third quarters of 2020, as the Federal Reserve Bank aggressively reduced short term market rates in March of 2020. The Bank has managed core product rates, implemented special offerings, and continued to use wholesale time deposits to remain competitive while providing a cost efficient means for balanced growth. Given the current economic and competitive environment, management believes it is likely that retail and commercial deposits rates will stabilize in 2020, while wholesale time deposits rates will be likely driven by market conditions and market interest rates.

Interest expense on borrowed funds for the first nine months of 2020 decreased by \$5.3 million as compared to the same period in 2019, due primarily to a decrease of 147 basis points in the weighted average rate, partially offset by a \$16.2 million increase in average outstanding balance. The decrease in FHLB borrowings rate was primarily driven by the lower short-term market rates and the maturity of higher rate long term advances taken in 2019.

The following table details the components of net interest income and yields/rates on average earning assets/liabilities.

	<b>Nine Months Ended September 30,</b>					
	<b>2019</b>			<b>2020</b>		
	<b>AVERAGE BALANCE</b>	<b>INTEREST</b>	<b>YIELD/ RATE (8)</b>	<b>AVERAGE BALANCE</b>	<b>INTEREST</b>	<b>YIELD/ RATE (8)</b>
<i>(Dollars in thousands)</i>						
Loans (1) (2)	\$ 2,134,186	\$ 74,049	4.63 %	\$ 2,347,466	\$ 77,759	4.42 %
Securities (3) (4)	57,118	1,503	3.51	66,107	1,402	2.83
Federal Reserve and other short-term investments	270,882	4,716	2.32	211,847	844	0.53
Total interest-earning assets	<u>2,462,186</u>	<u>80,268</u>	<u>4.35</u>	<u>2,625,420</u>	<u>80,005</u>	<u>4.06</u>
Other assets	41,483			46,361		
Total assets	<u>\$ 2,503,669</u>			<u>\$ 2,671,781</u>		
Interest-bearing deposits (5)	\$ 1,548,791	20,805	1.79	\$ 1,621,175	13,618	1.12
Borrowed funds	497,694	9,799	2.63	513,925	4,459	1.16
Total interest-bearing liabilities	<u>2,046,485</u>	<u>30,604</u>	<u>1.99</u>	<u>2,135,100</u>	<u>18,077</u>	<u>1.13</u>
Non-interest-bearing deposits	222,280			267,162		
Other liabilities	7,635			7,947		
Total liabilities	<u>2,276,400</u>			<u>2,410,209</u>		
Stockholders' equity	227,269			261,572		
Total liabilities and stockholders' equity	<u>\$ 2,503,669</u>			<u>\$ 2,671,781</u>		
Net interest income		<u>\$ 49,664</u>			<u>\$ 61,928</u>	
Weighted average spread			<u>2.36 %</u>			<u>2.93 %</u>
Net interest margin (6)			<u>2.69 %</u>			<u>3.15 %</u>
Average interest-earning assets to average interest-bearing liabilities (7)	<u>120.31 %</u>			<u>122.96 %</u>		

- (1) Before allowance for loan losses.
- (2) Includes average non-accrual loans.
- (3) Excludes the impact of the average net unrealized gain or loss on securities.
- (4) Includes Federal Home Loan Bank stock.
- (5) Includes mortgagors' escrow accounts.
- (6) Net interest income divided by average total interest-earning assets.
- (7) Total interest-earning assets divided by total interest-bearing liabilities.
- (8) Annualized.

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

	<b>Nine Months Ended September 30, 2020</b>		
	<b>Compared to the Nine Months Ended September 30, 2019</b>		
	<b>Increase (Decrease)</b>		
	<b>Due to</b>		<b>Total</b>
	<b>Volume</b>	<b>Rate</b>	
	<b>(In thousands)</b>		
Interest and dividend income:			
Loans	\$ 7,169	\$ (3,459)	\$ 3,710
Securities and FHLB stock	216	(317)	(101)
Federal Reserve and other short-term investments	(853)	(3,019)	(3,872)
Total interest and dividend income	<u>6,532</u>	<u>(6,795)</u>	<u>(263)</u>
Interest expense:			
Deposits	932	(8,119)	(7,187)
Borrowed funds	310	(5,650)	(5,340)
Total interest expense	<u>1,242</u>	<u>(13,769)</u>	<u>(12,527)</u>
Net interest income	<u>\$ 5,290</u>	<u>\$ 6,974</u>	<u>\$ 12,264</u>

### Provision for Loan Losses

At September 30, 2020, the Bank's review of the allowance for loan losses concluded that a balance of \$16.8 million was adequate to provide for losses based upon evaluation of size and risk in the loan portfolio. During the first nine months of 2020, the Bank provided \$2.1 million to achieve such a loan loss allowance balance at September 30, 2020. Comparably, for the nine months ended September 30, 2019, the Bank's evaluation of the balance of the allowance for loan losses indicated the need for a provision of \$1.3 million. The increase in provision is primarily due to a \$681,000 charge-off recorded upon foreclosure of a residential loan during the first quarter of 2020 and due to loan growth in the nine months ended September 30, 2020 compared to the same period last year. The Bank recorded net charge-offs of \$709,000 during the first nine months of 2020, as compared to zero net charge-offs for the first nine months of 2019.

See Notes 1 and 6 to the accompanying interim consolidated financial statements and "Loans and Foreclosed Real Estate" included in this Management's Discussion and Analysis for additional information pertaining to the allowance for loan losses

### Other Income

Other income is comprised of gain on equity securities, net, customer service fees on deposits, increases in the cash surrender value of bank-owned life insurance policies, gain on disposal of fixed assets and miscellaneous income. Total other income was \$3.5 million for the first nine months of 2020 compared to \$5.2 million for the same period in 2019. In the first nine months of 2020, the Bank recorded gains totaling \$2.5 million on equity securities, including \$2.5 million of unrealized gains on equity securities held at the end of the period and \$33,000 of losses recognized on equity securities sold during the period. In the first nine months of 2019, the Bank recorded gains totaling \$4.3 million on equity securities, including \$4.3 million of unrealized gains on equity securities held at the end of the period and \$1,000 of gains recognized on equity securities sold during the period.

Customer service fees on deposits decreased by \$97,000, or 16%, in the first nine months of 2020 compared to the same period in 2019. In recent years, there has been a continuous 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 consumer and business 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. Generally, the Bank's strategy does not rely on generating substantial non-interest fee-based revenue from our deposit accounts.

An increase in the cash surrender value of life insurance also contributed to other income during the first nine months of 2020 and 2019. The Bank held \$12.9 million in life insurance policies at September 30, 2020 as compared to \$12.7 million at September 30, 2019. The policies accrete at a variable rate of interest with minimum stated guaranteed rates and related income was down \$17,000 when comparing the two periods. The Bank also recognized a gain of \$218,000 on the sale of its former branch property located in Scituate during the first nine months of 2020.

### Operating Expenses

Operating expenses include salaries and employee benefits, occupancy and equipment, data processing, deposit insurance, marketing, foreclosure, and other general and administrative expenses. Total operating expenses were \$16.4 million, or an annualized 0.82% of average total assets, for the nine months ended September 30, 2020 as compared to \$15.5 million, or an annualized 0.83% of average total assets, for the same period of 2019.

Salaries and employee benefits expenses increased by \$263,000, or 3%, when compared to the same period in 2019, due to annual merit-based salary increases, partially offset by a slightly lower number of employees and lower employee benefit expenses resulting from COVID-19. This reflects a slightly smaller branch staff, offset by an additional commercial lender and an additional commercial deposit relationship manager as compared to the same period in 2019.

Occupancy and equipment expenditures increased by \$78,000, or 6%, to \$1.4 million in the first nine months of 2020 compared to the same period last year. Higher rental expenses related to the commercial lending office the Bank opened in Washington D.C in the second quarter of 2019, combined with lower rental income received in 2020 and higher depreciation expenses, were partially offset by lower maintenance and utilities expenses. The Bank owns rental apartments located above its Nantucket branch which are rented during the summer season. The COVID-19 pandemic negatively impacted the rental income derived from these units in 2020.

Data processing expenses for the first nine months of 2020 increased by \$312,000, or 27%, when compared to the same period in 2019, driven primarily by higher data processing charges associated with improvements made to the Bank's systems and volume increases in the first nine months of 2020, combined with a one-time credit related to the conversion of the Bank's debit card platform from Elan to Fiserv recognized in the first nine months of 2019. Technology spending at the Bank remains focused on three primary objectives: delivering new or improved customer experience, reducing costs through simplification and automation of internal processes, and securing customer and Bank confidential information.

Deposit insurance expense increased \$119,000, or 22%, from \$530,000 for the first nine months of 2019 to \$649,000 in the first nine months of 2020. The increase in expense was primarily driven by the application of larger Small Bank Assessment Credits by the FDIC in 2019 when compared to 2020. In the first nine months of 2019, the Bank recognized a \$236,000 credit related to the second quarter of 2019 assessment period, which partially offset the first nine months of 2019 deposit insurance expense. Comparatively, in the first nine months of 2020, the Bank recognized a total credit of \$84,000 related to the fourth quarter of 2019 assessment period, which partially offset the first nine months of 2020 deposit insurance expense. At September 30, 2020, there was no remaining balance of credits to be applied to future periods. The increase was also driven by an increase in the size of the balance sheet, as this charge is calculated based on total assets. Deposit insurance expense consists of premiums paid to the FDIC and the Massachusetts DIF. The FDIC assessment rate is determined based on several factors, including capitalization, asset growth, earnings, use of brokered deposits and level of non-performing assets, among others, and is calculated on an assessment base that takes into consideration the Bank's average total assets and average tangible equity, among other factors. The DIF assessment rate is based on an institution's risk category, which is defined based on similar factors. The Bank carefully manages its balance sheet to control the deposit insurance expense associated with excess liquidity.

Marketing expenses decreased by \$97,000, or 20%, to \$400,000 for the first nine months of 2020, driven partially by a temporary decline in advertising activity as a result of COVID-19. The Bank continues to carefully manage these expenses and focus marketing efforts on the Bank's Commercial Real Estate and Specialized Deposit Groups.

Foreclosure expenses include expenses associated with the collection and foreclosure process, such as legal, tax, appraisal, insurance and other related foreclosure expenses. These expenses may be recovered when the loan returns to performing status or when the Bank exercises its remedies, as they are generally secured by the Bank's mortgages. Such recoveries, if any, are reflected in future periods as contra-expense. Foreclosure related expenses increased by \$220,000 when comparing the nine months ended September 30, 2020 to the same period in 2019. The increase is primarily due to expenses related to higher collection activity and to the foreclosure on a residential loan in Nantucket during the first quarter of 2020, as well as subsequent litigation to collect the deficiency owed. At September 30, 2020, the Bank had foreclosed assets of \$3.9 million, consisting only of the Nantucket property mentioned above, including repairs and improvements completed by the Bank following foreclosure. At December 31, 2019 and September 30, 2019, the Bank had no properties in foreclosed assets. The Bank continues to manage credit quality energetically.

Other general and administrative expenses, which include director fees, supplies, deposit related losses and audit-related expenses, among others, increased \$5,000 when comparing the two periods, reflecting higher loan related, legal and other miscellaneous expenses, partially offset by expenses related to the issuance of stock options for certain directors recorded in the quarter ended September 30, 2019.

## **Income Taxes**

The Bank recognizes income taxes under the asset and liability method in which deferred tax assets and liabilities are established for the temporary difference between the accounting basis and the tax basis of the Bank's assets and liabilities at enacted tax rates expected to be in effect when the amounts related to such temporary differences are realized or settled. The Bank's deferred tax asset is reviewed quarterly by management as to its realizability.

During the first nine months of 2020, the Bank recorded \$13.1 million, or 28.0% of pre-tax income, in tax expense as compared to \$10.5 million, or 27.7%, for the same period in 2019. The higher effective tax rate in the first nine months of 2020 was driven by lower gains on equity securities recognized during the first nine months of 2020 as compared to the same period in the prior year, as these securities are held at a tax-advantaged subsidiary. Excess tax benefits recognized on the exercise of stock options during both the first nine months of 2019 and 2020 contributed to lower the effective tax rate in both periods.

## **BALANCE SHEET ANALYSIS**

### **COMPARISON AT SEPTEMBER 30, 2020 TO DECEMBER 31, 2019**

Assets totaled \$2.719 billion at September 30, 2020, as compared to \$2.590 billion at December 31, 2019, an increase of \$128.8 million, or 7% annualized. The Bank continued to carefully manage the balance of excess reserves held at the Federal Reserve Bank, in order to minimize the carrying cost of its on-balance sheet liquidity.

#### **Securities, Short-term Investments and FHLB Stock**

Securities were \$57.4 million at September 30, 2020, an increase of \$10.2 million when compared to \$47.2 million at December 31, 2019, reflecting equity security purchases outpacing sales during the first nine months of 2020. The fair value of equity securities fluctuates with the performance of equity markets. There were no sales, maturities or calls of debt securities and principal paydowns were immaterial. At December 31, 2019 and September 30, 2020, there were no unrealized gains or losses on debt securities available for sale reported in accumulated other comprehensive income. The fair value of debt securities fluctuates with the movement of interest rates.

At September 30, 2020, less than 1% of the securities were debt securities 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.

At September 30, 2020, equity securities accounted for approximately 100% of the investment portfolio. At September 30, 2020, the Bank held an \$8.6 million investment in the CRA Fund, a mutual fund which invests in securities which qualify under the CRA securities test. Additionally, the portfolio included \$48.7 million in common equity securities. The Bank's common equity securities 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. The portfolio is concentrated in a relatively small number of investees in the financial services and technology areas, including other banks, diversified and specialized insurance companies, credit rating agencies, payment networks and technology companies. 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. During the first nine months of 2020, the Bank continued to increase its absolute allocation to such investments during the disruption in the equity markets.

As a member of the FHLB of Boston, the Bank is required to hold a Membership Stock Investment plus an Activity-based Stock Investment in the FHLB, which is based primarily on the amount of FHLB borrowings. The Bank recorded dividends totaling \$1.0 million for the nine months ended September 30, 2020, as compared to \$1.1 million for the same period in 2019. At September 30, 2020, the Bank held \$19.0 million in FHLB stock compared to \$24.9 million at December 31, 2019. The decrease was driven by a lower balance of FHLB borrowings, as the Bank increased the use of more attractively priced wholesale deposits in lieu of FHLB advances and experienced strong retail and commercial deposits growth in the first nine months of 2020.

#### **Loans and Foreclosed Real Estate**

During the first nine months of 2020, net loans outstanding increased by \$131.9 million to \$2.359 billion, from \$2.227 billion at December 31, 2019 attributable primarily to originated loans of \$520.4 million, partially offset by payoffs and amortization. This includes \$58.3 million of commercial real estate loans originated in the WMA. Comparably, loan originations for the same period in 2019 were \$378.3 million, including \$72.6 million of commercial real estate loans originated in the WMA. Loans outstanding in the WMA at September 30, 2020 and December 31, 2019 were \$312.3 million and \$261.6 million, respectively. At September 30, 2020 and December 31, 2019, net loans outstanding represented 87% and 86% of assets, respectively. Mortgage loans continue to account for more than 99% of the loan portfolio.

The Bank participated in the SBA PPP established by the Coronavirus Aid, Relief, and Economic Security Act of 2020 ("CARES Act"). However, in the first nine months of 2020 the Bank originated a limited number of loans to a mix of existing and new customers totaling \$9.3 million. The Bank intends to sell the expected forgiveness portion of such loans to the SBA at the earliest opportunity available.

**WMA:** The Bank began lending to commercial real estate borrowers in the WMA in November 2016, after two years of research and preparation. In 2019, the Bank opened a commercial lending office on a temporary location and hired a commercial real estate lender. In February 2020, the Bank acquired a property in the Georgetown neighborhood of Washington, D.C. and began working with its architects to renovate the property in anticipation of opening this permanent commercial banking office in mid-2021. The Bank also utilizes existing staff in its Commercial Real Estate Group and Specialized Deposit Group ("SDG") with experience in the WMA, on a fly-away basis from our main office.

The Bank identified the WMA as an attractive opportunity for three reasons. First, the region has favorable economic characteristics that will support long-term investments in commercial real estate. It is the capital of the world's largest economy, it is an international economic gateway, it has the highest household median income of any of the nation's major metropolitan areas, and it has a relatively high concentration of young people. Second, the commercial real estate product in the market bears significant similarity to Boston, characterized by high density, urban infill development, transit-oriented multifamily, and scarcity imposed by

land supply and restrictions on vertical development. Third, we believe that the banking market in Washington, D.C. has experienced a level of consolidation and disruption that has left smaller and mid-sized real estate investors underserved as compared to the Boston market. Although we are relatively new to this marketplace, we believe that our history as one of America's oldest banks and our family management team provide stability and surety of execution that is valued by our customers. After three years of operation in the market, we have gained increasing confidence in this thesis. We view this as an attractive opportunity for internal capital allocation and superior to geographically proximate, product-adjacent businesses like wealth management, insurance, or commercial-industrial lending in our home marketplace. The Bank is not currently originating any residential owner-occupied or commercial construction loans in the WMA, but may do so in the future.

The Bank approaches prospective borrowers directly via advertising programs, and indirectly via intermediaries such as attorneys, accountants and mortgage brokers. The Bank also has existing Boston-based customers with real estate investment holdings in both the Massachusetts and WMA markets.

All WMA underwriting and approval processes are identical to those utilized in the Boston marketplace and all loans are reviewed and approved by the Bank's Executive Committee and when larger than \$1.5 million, by the Bank's full Board of Directors. A member of the Executive Committee performs a site visit for every collateral property and the full Executive Committee performs collateral site visits at least twice annually. During the COVID-19 pandemic, some site visits may follow origination if the asset and the built environment around the asset are well known to the Bank. The Bank uses one Arlington, VA-based law firm to advise on all of its transactional needs, with oversight on each individual transaction by the Bank's primary real estate counsel in Boston. The Bank uses the same environmental assessment firm in Boston and Washington, D.C. to ensure quality of execution and manage risk. Once closed, these loans are subject to all of the Bank's regular quality control and portfolio management processes.

The Bank has made initial inroads into developing deposit relationships with WMA borrowers and services these customers remotely through the Bank's SDG in Hingham. The SDG is now servicing WMA deposit customers that do not have a lending relationship with the Bank and has a full-time relationship manager in the WMA.

Loans are carried net of the allowance for loan losses. The allowance is maintained at a level to absorb losses within the loan portfolio. At September 30, 2020, the allowance had a balance of \$16.8 million, as compared to \$15.4 million at December 31, 2019. The allowance for loan losses represented 0.71% of gross loans at September 30, 2020, as compared to 0.69% at December 31, 2019. The allowance at September 30, 2020 included an unallocated balance of \$607,000. There was no unallocated balance at December 31, 2019.

At September 30, 2020, the Bank allocated \$81,000 to loans classified as impaired. At December 31, 2019, \$104,000 was allocated to impaired 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.

At September 30, 2020, there were nine loans classified as non-accrual totaling \$2.4 million, as compared to five non-accrual loans totaling \$5.6 million at December 31, 2019. At September 30, 2020, non-performing assets were 0.23% of total assets, as compared to 0.22% at December 31, 2019. A single non-performing residential loan on Nantucket comprised the substantial majority of non-performing assets at December 31, 2019. Subsequent to December 31, 2019, the Bank purchased the property at a foreclosure auction, resulting in the transfer of the loan to foreclosed assets at fair value at the foreclosure date. Based on the results of the foreclosure auction, management reassessed the fair value of the property, moving it to the lower end of the range of fair value, and recorded a \$681,000 charge-off against the allowance for loan losses at the foreclosure date. The Bank has completed repairs and improvements to the property and has listed it for sale. The Bank is pursuing litigation against the borrowers for breach of contract and bank fraud in attempt to collect the deficiency owed. The Bank has litigation pending in state court with respect to this matter and a motion for summary judgement that we expect to be considered by the court in December 2020. At September 30, 2020, the Bank had \$3.9 million in foreclosed assets as compared to no foreclosed assets at December 31, 2019.

Management believes that its loans classified as non-accrual are significantly collateralized, pose minimal risk of loss to the Bank, and the allowance for loan loss reserves allocated to these loans is sufficient to absorb such losses, if any. However, management continues to monitor the loan portfolio and additional reserves will be recorded if necessary.



Below is a summary of non-accrual loans and foreclosed real estate:

	December 31, 2019	September 30, 2020
	(Dollars in Thousands)	
Non-accrual loans:		
Residential mortgages	\$ 5,092	\$ 937
Commercial mortgages	508	504
Construction	—	925
Home equity	—	32
Total non-accrual loans	<u>5,600</u>	<u>2,398</u>
Foreclosed real estate	—	3,926
Total non-performing assets	<u>\$ 5,600</u>	<u>\$ 6,324</u>
Percent of non-accrual loans to:		
Total loans	0.25 %	0.10 %
Total assets	0.22 %	0.09 %
Percent of non-performing assets to:		
Total loans and foreclosed real estate	0.25 %	0.27 %
Total assets	0.22 %	0.23 %
Allowance for loan losses to total loans	0.69 %	0.71 %

The CARES Act, Section 4013, stipulates that a financial institution may elect to not apply GAAP requirements to loan modifications related to the COVID-19 pandemic that would otherwise be categorized as a TDR, and suspends the determination of loan modifications related to the COVID-19 pandemic from being treated as TDRs. Modifications within the scope of the suspension include forbearance agreements, interest-rate modifications, repayment plans, and any other similar arrangements that defer or delay payments of principal or interest. In accordance with this statute, the Bank has elected not to apply GAAP requirements to such loan modifications with respect to categorization of loans as TDRs. The Bank is also aware that some financial institutions may opt to recognize income on an accrual basis on loans for which they are not collecting interest pursuant to extended forbearance agreements. Unless such contracts are modified by legislative action that mandates the deferral of interest without regard to need, the Bank does not believe such an approach is appropriate.

The Bank generally originates and services all of its loans, both residential and commercial, for its own account. Consequently, the Bank is generally not subject to the provisions of the CARES Act with respect to forbearance, deferral, and foreclosure moratoriums, as such provisions apply only to federally-guaranteed mortgages. The Bank also operates in multiple jurisdictions, including Massachusetts and the District of Columbia, where local authorities have passed legislation mandating some form of mortgage forbearance and/or a prohibition on foreclosure action on residential and/or commercial property. As of October 18, 2020, the mandatory residential mortgage forbearance period dictated by Chapter 65 of the General Laws of 2020 in Massachusetts had expired.

Since March of 2020, the Bank has received a limited number of inquiries from both residential and commercial borrowers seeking information about potential options for loan modifications or deferrals. At September 30, 2020, the Bank had less than 1% of the Bank's total loan portfolio by number and less than 3% in dollars outstanding modified in response to COVID-19. With de minimis exceptions, all such modifications were completed in the first and second quarters of 2020 and the Bank did not make material modifications in the third quarter of 2020. All such modifications are performing in accordance with their modified terms or have returned to their original contractual terms. As of September 2020, the Bank was no longer receiving regular requests for loan modifications.

The Bank expects commercial counterparties to perform according to the terms of our contracts with them. In the event that a commercial customer seeks to convert to an interest-only structure, the Bank will generally consider the borrower's relationship with the Bank, record of performance, collateral strength, deposit balances, and alternative sources of repayment when evaluating such requests. Generally the Bank will allow for temporary interest-only payments when the loan-to-value ratio is strongly protective of the Bank's senior position. While the Bank will generally work collaboratively with customers to identify reasonable restructuring solutions, it is also the senior secured lender in nearly all of its commercial transactions. The Bank does not invest in the equity component of these transactions and, therefore, it does not share in the profits and it does not share in the losses, if any, prior to the impairment of the equity. The Bank will generally require the customer to fully fund an interest-carry reserve for the modification period and/or deliver additional consideration (including additional collateral or additional guarantors) in exchange for the modification. The Bank has approved loan modifications with commercial counterparties on a limited basis, and in all such cases, the Bank received new financial statements and tax returns for all obligors. The Bank has not granted interest deferrals on any commercial loans and has not modified any construction loans as a result of COVID-19.

The Bank has worked with those residential borrowers experiencing extraordinary economic hardship to craft solutions to sustain them through this pandemic. The Bank has generally provided such borrowers with a three to six month interest only period. The

Bank has generally not reduced or deferred interest payments or suspended tax escrow unless the borrower presents extraordinary need. To the extent required by law in the Commonwealth of Massachusetts, the Bank has granted short-term interest-only modifications to a limited number of residential mortgage customers that have been impacted by COVID-19. The Bank has also deferred the collection of interest on a handful of residential loans. At September 30, 2020, two of such loans, with total outstanding loan balances of \$201,000, remained in deferral.

The table below presents the number and outstanding balances of loans that the Bank has modified as a result of COVID-19 compared as a percentage of the total number and outstanding balances of the Bank's loan portfolio as of September 30, 2020, by loan category. This table reflects all modifications in effect as of September 30, 2020 and as loans return to the original contractual terms, they will no longer be reflected on this table.

	Outstanding		Modified		% Modified	
	# of Loans	Balance (2)	# of Loans	Balance	# of Loans	Balance
<i>(In thousands, unaudited)</i>						
Residential Real Estate (1)	2,473	\$ 688,008	24	\$ 7,815	0.97 %	1.14 %
Commercial Real Estate	1,396	1,517,821	10	48,841	0.72	3.22
Construction	64	157,333	—	—	—	—
Commercial and Consumer	551	9,729	—	—	—	—
Total Loans	4,484	\$ 2,372,891	34	\$ 56,656	0.76 %	2.39 %

(1) Includes Home Equity lines of credit

(2) Gross loans, before net deferred loan origination costs and the allowance for loan losses.

### Other Assets

The Bank held \$12.9 million in bank-owned life insurance at September 30, 2020 as compared to \$12.7 million at December 31, 2019. The \$168,000 increase during the first nine months of 2020 is due to increases in the cash surrender value of policies insuring the life of a current Bank executive. The policies 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 September 30, 2020, two of three issuers were rated at or above Bank guidelines. The third issuer retained a rating from A.M. Best one notch below Bank guidelines at A-, while the issuer's Standard and Poor ("S&P") rating was below Bank guidelines at BBB (Good) with a stable outlook.

As of September 30, 2020, the right-of-use asset and the corresponding lease liability related to operating leases for some of the Bank's banking offices were \$1.1 million and \$1.2 million, respectively. The right-of-use asset is included in other assets and the lease liability is included in other liabilities in the Consolidated Balance Sheets.

During the first quarter of 2020, the Bank sold the property located at 400 Gannett Road, Scituate and recorded a \$218,000 gain. As announced in 2019, the Bank closed its South Weymouth location at 32 Pleasant St. in mid-January 2020. The Bank is actively marketing this property for sale. The carrying value of this property at September 30, 2020 was \$385,000 and management believes this amount is not material to be reported separately as assets held for sale. Therefore, this amount is included in premises and equipment, net on the Consolidated Balance Sheets. Also during the first quarter of 2020, the Bank concluded the purchase of a property in the Georgetown neighborhood of Washington, D.C., and has begun working with its architects to renovate the property in anticipation of opening a new commercial banking office in early 2021.

In June 2020, the Bank announced its intention to close its Beacon Hill branch in the fall of 2020. The branch closed in mid-September and the Bank consolidated its client service operations in Boston at its South End office. This branch was not owned by the Bank and the lease agreement expires in early 2021.

During the fourth quarter of 2019, the Bank made a \$1.5 million investment in the common stock of Founders Bank, a de novo bank organization in Washington, D.C. Founders Bank has received all required regulatory approvals and opened in April 2020. During the first quarter of 2020, the Bank received back \$470,000 of this investment, which resulted in a proportional decrease in the number of shares purchased. The Bank remained the largest shareholder after this transaction.

### Deposits

Deposits increased by \$205.9 million to \$2.027 billion at September 30, 2020, from \$1.821 billion at December 31, 2019. Certificate balances increased by \$60.9 million from December 31, 2019 to September 30, 2020 and non-certificate accounts, which include regular, money market, NOW and demand deposits, increased by \$145.0 million during the same period. The increase in certificate accounts was primarily driven by the Bank's reallocation of the wholesale funding mix during the first nine months of 2020, as the Bank allowed FHLB advances to mature during this period and replaced them with wholesale time deposits. This was partially offset by a decline in retail time deposits, as the Bank has lowered rates on these products. The increase in non-certificate accounts reflects strong growth in the Bank's retail and commercial deposits during the first nine months of 2020. Non-certificate accounts represent 49.7% of total deposits at September 30, 2020, as compared to 47.3% at December 31, 2019.

Other banks and credit unions in the Bank's market areas, banking services through the Internet, and mutual funds make up the Bank's primary competition for deposits. 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 and Internet-based banking for consumers and commercial account holders. The Bank also opens deposit accounts, including checking accounts, money market accounts, and certificates of deposit, directly online to personal customers. Occasionally, the Bank implements special offerings based on market conditions and the competitive environment. The Bank also offers limited certificate of deposit products using national Internet listing services and brokered deposits. These alternatives, at times, provide the Bank with a source of funding across different maturities at lower cost and/or longer duration than may be available via retail or other wholesale channels. At September 30, 2020, the Bank had \$494.6 million in deposits from these sources, as compared to \$391.2 million at December 31, 2019. The Bank carefully manages its wholesale funding mix allocation based on market conditions to optimize the Bank's cost on interest-bearing liabilities and net interest margin. This approach has allowed the Bank to maintain deposit balances to fund lending activity and operate with an elevated level of liquidity.

Deposits are insured in full through the combination of the Federal Deposit Insurance Corporation and the Deposit Insurance Fund of Massachusetts ("DIF"). 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.

Below is a summary of deposits:

	<b>Deposit Balances by Type</b>			
	<b>December 31, 2019</b>	<b>% of Total</b>	<b>September 30, 2020</b>	<b>% of Total</b>
	<b>(Dollars in Thousands)</b>			
Non-certificate accounts				
Regular	\$ 82,582	4.5 %	\$ 96,681	4.8 %
Money market deposits	534,884	29.4	591,369	29.2
NOW	6,246	0.3	14,454	0.7
Demand	237,554	13.1	303,774	15.0
Total non-certificate accounts	<u>861,266</u>	<u>47.3</u>	<u>1,006,278</u>	<u>49.7</u>
Term certificates of less than \$250,000	657,708	36.1	731,963	36.1
Term certificates of \$250,000 or more	301,860	16.6	288,503	14.2
Total certificate accounts	<u>959,568</u>	<u>52.7</u>	<u>1,020,466</u>	<u>50.3</u>
Total deposits	<u>\$ 1,820,834</u>	<u>100.0 %</u>	<u>\$ 2,026,744</u>	<u>100.0 %</u>

### **Borrowings**

Borrowings, which include FHLB advances and FRB advances through the discount window, were \$399.0 million, or 15% of total assets, at September 30, 2020, as compared to \$505.2 million, or 20% of total assets, at December 31, 2019. There were no FRB advances outstanding at September 30, 2020 and December 31, 2019. The Bank continued to manage its wholesale funding mix opportunistically during the first nine months of 2020. During this period, borrowings decreased by \$106.2 million, as the Bank replaced maturing FHLB advances with wholesale time deposits. FHLB advances are primarily fixed rate, with all of them scheduled to mature over the next twelve months. At both September 30, 2020 and December 31, 2019, all FHLB advances were fixed rate.

### **Liquidity and Capital Resources**

The Bank regularly 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 comprised 9% of total assets at September 30, 2020. A significant portion of this consists of overnight cash balances at the Federal Reserve Bank of Boston, which are immediately accessible for liquidity. The Bank reduced these overnight cash balances during 2019 and 2020 to minimize the carrying cost of on-balance sheet 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.

Residential loans are susceptible to principal repayment at the discretion of the borrower. Commercial mortgage loans, while subject to significant penalties for early repayment in most cases, can also prepay at the borrower's discretion. In the first nine months of 2020, prepayment rates were 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 \$12.9 million, or less than 1% of total assets, at September 30, 2020.

Non-certificate deposit balances can generally be withdrawn from the Bank at any time. Retail certificates of deposit, with predefined maturity dates and subject to early redemption penalties, can also be withdrawn subject to the discretion of the Bank. Internet listing service certificates are offered on the same terms as retail certificates, although the Bank generally does not permit early withdrawal. Brokered certificates generally may not be withdrawn before the stated maturity. 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.

All of the Bank's borrowings were fixed in terms of rate and maturity at September 30, 2020. None of the advances can be called for earlier repayment at the discretion of the issuer.

The Bank also monitors its off-balance sheet items. See "Commitments" appearing in Note 2 within the "Notes to Unaudited Consolidated Financial Statements" section of this document. At September 30, 2020, the Bank had \$306.3 million in commitments to extend credit, as compared to \$287.2 million at December 31, 2019.

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 September 30, 2020, 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 September 30, 2020, the Bank can borrow up to approximately \$1.316 billion to meet its borrowing needs, based on the Bank's available qualified collateral which consists primarily of one-to-four family residential mortgage loans, certain multifamily residential property and commercial mortgage loans. The Bank can pledge other mortgage loans and assets as collateral to secure additional borrowings. Additionally, through the FRB of Boston, the Bank can borrow up to \$18.0 million through the discount window based on the Bank pledging its home equity loan portfolio. The Bank can pledge other mortgage loans and assets as collateral to secure additional borrowings with the FRB. At September 30, 2020, the Bank had \$399.0 million in advances outstanding from the FHLB and had \$916.8 million in available unused capacity (net of accrued interest on outstanding advances). This compares to an unused capacity of \$711.5 million at December 31, 2019. The FHLB unused capacity increased in the first nine months of 2020 as a result of the decrease in borrowings. Total FHLB capacity increased by \$98.6 million from December 31, 2019 as the Bank continued to pledge collateral. At both September 30, 2020 and December 31, 2019, the Bank had no advances outstanding at the FRB.

At September 30, 2020, the Bank had capital of \$278.3 million, or 10.2% of total assets, as compared to \$247.2 million, or 9.5% of total assets, at December 31, 2019. During the nine months ended September 30, 2020, stockholders' equity increased by \$31.1 million due primarily to net income for the period of \$33.7 million, partially offset by the declaration of dividends of \$1.30 per share, which reduced capital by \$2.8 million.

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 at September 30, 2020 and December 31, 2019.

The following table details the Bank's actual capital ratios and minimum regulatory ratios as of December 31, 2019 and September 30, 2020.

	Actual		Minimum Capital Requirement*		Minimum To Be Well Capitalized Under Prompt Corrective Actions Provisions	
	Amounts	Ratio	Amounts	Ratio	Amounts	Ratio
(Dollars in Thousands)						
<b>December 31, 2019</b>						
Total Capital to Risk-Weighted Assets	\$ 262,599	13.57 %	\$ 203,259	10.50 %	\$ 193,580	10.00 %
Common Equity Tier 1 Capital to Risk-Weighted Assets	247,223	12.77	135,506	7.00	125,827	6.50
Tier 1 Capital to Risk-Weighted Assets	247,223	12.77	164,543	8.50	154,864	8.00
Tier 1 Capital to Average Assets	247,223	9.84	100,504	4.00	125,630	5.00
<b>September 30, 2020</b>						
Total Capital to Risk-Weighted Assets	\$ 295,092	14.06 %	\$ 220,430	10.50 %	\$ 209,933	10.00 %
Common Equity Tier 1 Capital to Risk-Weighted Assets	278,312	13.26	146,953	7.00	136,456	6.50
Tier 1 Capital to Risk-Weighted Assets	278,312	13.26	178,443	8.50	167,946	8.00
Tier 1 Capital to Average Assets	278,312	10.35	107,523	4.00	134,404	5.00

\* Minimum risk-based regulatory capital ratios and amounts at December 31, 2019 and September 30, 2020 include the applicable minimum risk-based capital ratios and capital conservation buffer of 2.5%

### **Item 3 – 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 composed 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 asset prepayment speeds, balance sheet growth and non-maturity deposits elasticity. Management believes that there has been no material changes in the interest rate risk reported in the Bank's Annual Report on Form 10-K for the fiscal year ended December 31, 2019, filed with the Federal Deposit Insurance Corporation. The information is contained in the Form 10-K within the section "Quantitative and Qualitative Disclosures About Market Risk."

### **Item 4 – Controls and Procedures**

#### **(a) 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 September 30, 2020, 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 September 30, 2020, the CEO and CFO concluded that, as of such date, the Bank's disclosure controls and procedures were effective at the reasonable assurance level.

#### **(b) Changes in Internal Control**

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 September 30, 2020 that have materially affected, or are reasonably likely to materially affect, the Bank's internal control over financial reporting.

## **PART II – OTHER INFORMATION**

### **Item 1 – 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 1A – Risk Factors**

There have generally been no material changes to the nature of the risk factors previously disclosed in the Bank's most recent Form 10-K for the year ended December 31, 2019 filed with the FDIC, although the potential impact of all such risk factors has been intensified as a result of COVID-19 pandemic.

In particular, *we operate in a highly regulated industry, and existing or new laws and regulations, or changes in them, could limit or restrict our activities and could have a material adverse impact on our operations.* Although we are generally not subject to the provisions of the CARES Act that regulate the servicing of federally-backed mortgage loans, we may be subject to local legislative and regulatory changes that restrict our ability to foreclose when certain residential loans fall into default and may restrict our ability to impose late fees on such loans. Such legal changes may force the Bank to defer collection of interest, without penalty or fee, and without any showing of financial hardship or need by the borrower. Our operations may also be impacted by changes in laws or regulations governing the activities of multifamily and small business landlords to whom we have extended commercial mortgage loans. To the extent that such legal changes may allow tenants to avoid or defer rental payments, ongoing cash flow from properties that secure our mortgage loans may be reduced. Depending on the extent of such legal changes, the Bank may also re-evaluate its approach to new originations, particularly with respect to residential and small multifamily commercial loans. This could have a significant impact on the Bank's ability to originate new loans that meet the Bank's credit criteria and may have a negative impact on future growth, if any. To the extent that the Bank may view such legislation as unconstitutional and may challenge such legislation via litigation, either alone or in conjunction with other lenders, there is a risk of significantly elevated legal expense associated with such action. Finally, recent legislation has limited the ability of many lenders to provide accurate data to the credit reporting agencies with respect to delinquent payments by borrowers. To the extent that the Bank utilizes such data to assess borrower creditworthiness, particularly on residential owner-occupied loans, the absence of such data may negatively impact the Bank's underwriting process.

Additionally, *we rely on well-functioning civil and bankruptcy courts to exercise our remedies and access our collateral in the event of default. To the extent such courts are closed or limited to emergency matters, there may be a material adverse impact on our operations.* We rely on such courts for a myriad of collections-related litigation, including foreclosure actions, contract suits, and small-claims actions. Although the Bank does not have and has not historically had a high volume of litigation, the Bank's very ability to exercise its remedies quickly and vigorously provides a strong incentive for performance on the part of the Bank's counterparties. To the extent that the prospect of such action is diminished by the perceived or real incapacity of courts, counterparties may be incentivized to delay or cease payment. As of September 30, 2020, federal and state courts in the Commonwealth of Massachusetts had resumed full normal operations.

Furthermore, *possible U.S. federal tax code changes could adversely affect us.* Candidates for elected office have proposed significant changes to the Internal Revenue Code, including among other things changes to U.S. federal corporate income tax rates, to the dividends received deduction ("DRD"), and to Section 1031 of the Internal Revenue Code regarding qualifying exchanges of real property. There is substantial uncertainty regarding both the timing and the details of any such tax reform. The impact of any potential tax reform on our business is uncertain and could be adverse.

## **Item 2 – Unregistered Sales of Equity Securities and Use of Proceeds**

None.

## **Item 3 – Defaults Upon Senior Securities**

None.

## **Item 4 – Mine Safety Disclosures**

Not applicable.

## **Item 5 – Other Information**

None.

## **Item 6 – Exhibits**

### Exhibit No.

31.1	Certifications – Chief Executive Officer
31.2	Certifications – Chief Financial Officer
32.1	Certification Pursuant to 18 U.S.C. §1350 – Chief Executive Officer
32.2	Certification Pursuant to 18 U.S.C. §1350 – Chief Financial Officer

## SIGNATURES

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

### HINGHAM INSTITUTION FOR SAVINGS

Date: November 4, 2020

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

Date: November 4, 2020

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



CERTIFICATIONS

EXHIBIT 31.1

I, Robert H. Gaughen, Jr., certify that:

1. I have reviewed this quarterly report on Form 10-Q of the 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:
  - 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: November 4, 2020

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

CERTIFICATIONS

EXHIBIT 31.2

I, Cristian A. Melej, certify that:

1. I have reviewed this quarterly report on Form 10-Q of the 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:
  - 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: November 4, 2020

/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 Quarterly Report on Form 10-Q of Hingham Institution for Savings (the “Bank”) for the fiscal quarter ended September 30, 2020, 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: November 4, 2020

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 Quarterly Report on Form 10-Q of Hingham Institution for Savings (the “Bank”) for the fiscal quarter ended September 30, 2020, 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: November 4, 2020