SALISBURY BANCORP INC
Form 10-K
March 15, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2018

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

Commission file number 0-24751

SALISBURY BANCORP, INC.

(Exact name of registrant as specified in its charter)

Connecticut	06-1514263
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
19 Bissell Street, Lakeville, CT	06039
(Address of principal executive offices)	(Zip code)

Registrant's telephone number, including area code: **(860) 435-9801**

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

Common Stock, par value $.10 per share	NASDAQ Capital Market
(Title of each class)	(Name of each exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act: **None**

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

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” in Rule 12b-2 of the Exchange Act. See definitions of “large accelerated filer,” “accelerated filer,” and “smaller reporting company”, and “emerging growth company” in Rule 12b-2 of the Exchange Act.

(Check one):

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

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

The aggregate market value of common stock held by non-affiliates of the registrant on June 30, 2018 was $106.3 million based on the closing sales price of $44.20 of such stock. The number of shares of the registrant’s Common Stock outstanding as of March 1, 2019, was 2,806,781.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement for the 2019 Annual Meeting of Shareholders to be held on May 15, 2019, which will be filed within 120 days of fiscal year ended December 31, 2018, are incorporated by reference into Part III (Items 10, 11, 12, 13 and 14) of this Form 10-K.

FORM 10-K

SALISBURY BANCORP, INC.

For the Year Ended December 31, 2018

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PART I

Forward-Looking Statements

This Annual Report on Form 10-K may contain and incorporates by reference statements relating to future results of Salisbury Bancorp, Inc. (the “Company”) and its Subsidiary, Salisbury Bank and Trust Company (the “Bank”) (collectively, "Salisbury"), that are considered “forward-looking” within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements can be identified by words such as “believes,” “anticipates,” “expects,” “intends,” “targeted,” “continue,” “remain,” “will,” “should,” “may,” “plans,” “estimates,” and similar references to future peri however, such words are not the exclusive means of identifying such statements. These statements relate to, among other things, expectations concerning loan demand, growth and performance, simulated changes in interest rates and the adequacy of the allowance for loan losses. Actual results may differ materially from those expressed or implied as a result of certain risks and uncertainties, including, but not limited to, changes in political and economic conditions, interest rate fluctuations, competitive product and pricing pressures within Salisbury’s markets, equity and fixed income market fluctuations, personal and corporate customers’ bankruptcies, inflation, acquisitions and integrations of acquired businesses, technological changes and cybersecurity matters, changes in law and regulations, changes in fiscal, monetary, regulatory and tax policies, monetary fluctuations, success in gaining regulatory approvals when required as well as other risks and uncertainties reported from time to time in Salisbury’s filings with the Securities and Exchange Commission. See also, the “Risk Factors” set forth below.

Forward-looking statements made by Salisbury in this Annual Report on Form 10-K speak only as of the date they are made. Events or other facts that could cause Salisbury’s actual results to differ may arise from time to time, and Salisbury cannot predict all such events and factors. Salisbury undertakes no obligation to publicly update any forward-looking statement, except as may be required by law.

Item 1. BUSINESS

Salisbury Bancorp, Inc.

Salisbury Bancorp, Inc., a Connecticut corporation, formed in 1998, is the bank holding company for Salisbury Bank and Trust Company (the "Bank"), a Connecticut-chartered and Federal Deposit Insurance Corporation (the "FDIC") insured commercial bank headquartered in Lakeville, Connecticut. Salisbury’s common stock is traded on the NASDAQ Capital Market under the symbol “SAL.” Salisbury's principal business consists of its operation and control of the business of the Bank.

The Bank, formed in 1848, currently provides commercial banking, consumer financing, retail banking and trust and wealth advisory services through a network of fourteen banking offices and ten ATMs located in: Litchfield County, Connecticut; Dutchess, Orange and Ulster Counties, New York; and Berkshire County, Massachusetts and through its internet website (salisburybank.com).

Abbreviations Used Herein

Bank	Salisbury Bank and Trust Company	FRA	Federal Reserve Act
BHC	Bank Holding Company	FRB	Federal Reserve Board
BHCA	Bank Holding Company Act	GAAP	Generally Accepted Accounting Principles in the United States of America
BOLI	Bank Owned Life Insurance	GLBA	Gramm-Leach-Bliley Act
CFPB	Consumer Financial Protection Bureau	LIBOR	London Interbank Offered Rate
CRA	Community Reinvestment Act of 1977	OREO	Other Real Estate Owned
CTDOB		OTTI	Other Than Temporarily Impaired

	State of Connecticut Department of Banking		
Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act	PIC	Passive Investment Company
ESOP	Employee Stock Ownership Plan	Salisbury	Salisbury Bancorp, Inc. and Subsidiary
FACT Act	Fair and Accurate Credit Transactions Act	SBLF	Small Business Lending Fund
FASB	Financial Accounting Standards Board	SEC	Securities and Exchange Commission
FDIC	Federal Deposit Insurance Corporation	SOX	Sarbanes-Oxley Act of 2002
FHLBB	Federal Home Loan Bank of Boston	Treasury	United States Department of the Treasury

Lending Activities

The Bank originates commercial loans, commercial real estate loans, residential and commercial construction loans, residential real estate loans collateralized by one-to-four family residences, home equity lines of credit and fixed rate loans and other consumer loans predominately in Connecticut’s Litchfield County, New York’s Dutchess, Orange and Ulster Counties and Massachusetts’ Berkshire County in towns proximate to the Bank’s fourteen full service offices.

The majority of the Bank’s loans as of December 31, 2018, including some loans classified as commercial loans, were secured by real estate. Interest rates charged on loans are affected principally by the Bank’s current asset/liability strategy, the demand for such loans, the cost and supply of money available for lending purposes and the rates offered by competitors. These factors are, in turn, affected by general economic and credit conditions, monetary policies of the federal government, including the FRB, federal and state tax policies and budgetary matters.

Residential Real Estate Loans

A principal lending activity of the Bank is to originate loans secured by first mortgages on one-to-four family residences. The Bank typically originates residential real estate loans through employees who are commissioned licensed mortgage originators (in accordance with the mortgage lending compensation guidelines issued by the CFPB). The Bank originates both fixed rate and adjustable rate mortgages.

The Bank currently sells the majority of the fixed rate 30 year residential mortgage loans it originates to the FHLBB under the Mortgage Partnership Finance Program. The Bank typically retains loan servicing. The Bank retains some fixed rate residential mortgage loans and those loans originated under its first time home owner program.

The retention of adjustable rate residential mortgage loans in the portfolio and the sale of longer term, fixed rate residential mortgage loans helps reduce the Bank’s exposure to interest rate risk. However, adjustable rate mortgages generally pose credit risks different from the credit risks inherent in fixed rate loans primarily because as interest rates rise, the underlying debt service payments of the borrowers rise, thereby increasing the potential for default. Management believes that these risks, which have not had a material adverse effect on the Bank to date, generally are less onerous than the interest rate risks associated with holding long-term fixed rate loans in the loan portfolio.

Commercial Real Estate Loans

The Bank makes commercial real estate loans for the purpose of allowing borrowers to acquire, develop, construct, improve or refinance commercial real estate where the property is the primary collateral securing the loan, and the income generated from the property is the primary repayment source. Office buildings, light industrial, retail facilities or multi-family income properties, normally collateralize commercial real estate loans. Among the reasons for management’s continued emphasis on commercial real estate lending is the desire to invest in assets with yields which are generally higher than yields on one-to-four family residential mortgage loans, and are more sensitive to changes in interest rates. These loans typically have terms/amortizations of up to ten and twenty five years, respectively, and interest rates, which adjust over periods of three to ten years, based on one of various rate indices.

Commercial real estate lending generally poses a greater credit risk than residential mortgage lending to owner-occupants. The repayment of commercial real estate loans depends on the business and financial condition of the borrower. Economic events and changes in government regulations, which the Bank and its borrowers do not control, could have an adverse impact on the cash flows generated by properties securing commercial real estate loans and on the market value of such properties.

Construction Loans

The Bank originates both residential and commercial construction loans. Typically, loans are made to owner-borrowers who will occupy the properties as either their primary or secondary residence and to licensed and experienced developers for the construction of single-family homes or commercial properties.

The proceeds of commercial construction loans are disbursed in stages. Bank officers, appraisers and/or independent engineers inspect each project’s progress before additional funds are disbursed to verify that borrowers have completed project phases.

Residential construction loans to owner-borrowers generally convert to a fully amortizing long-term mortgage loan upon completion of construction. The typical construction phase is generally twelve months.

Construction lending, particularly commercial construction lending, poses greater credit risk than mortgage lending to owner-occupants. The repayment of commercial construction loans depends on the business, the financial condition of the borrower, and on the economic viability of the project financed. Economic events and changes in government regulations, which the Bank and its borrowers do not control, could have an adverse impact on the value of properties securing construction loans and on the borrower's ability to complete projects financed and sell them for amounts anticipated at the time the projects commenced.

Commercial Loans

Commercial loans are generally made on a secured basis and are primarily collateralized by equipment, inventory, accounts receivable and/or leases. Commercial loans primarily provide working capital, equipment financing, financing for leasehold improvements and financing for expansion. The Bank offers both term and revolving commercial loans. Term loans have either fixed or adjustable rates of interest and, generally, terms of between two and seven years. Term loans generally amortize during their life, although some loans require a balloon payment at maturity if the amortization exceeds seven years. Revolving commercial lines of credit typically are renewable annually and have a floating rate of interest normally indexed to the prime rate as published in the Wall Street Journal.

Commercial lending generally poses a higher degree of credit risk than real estate lending. Repayment of both secured and unsecured commercial loans depends substantially on the success of the borrower's underlying business, financial condition and cash flows. Unsecured loans generally involve a higher degree of risk of loss than do secured loans because, without collateral, repayment is primarily dependent upon the success of the borrower's business.

Secured commercial loans are generally collateralized by equipment, inventory, accounts receivable and leases. Compared to real estate, such collateral is more difficult to monitor, its value is more difficult to validate, it may depreciate more rapidly and it may not be as readily saleable if repossessed.

Consumer Loans

The Bank originates various types of consumer loans, including home equity loans and lines of credit, auto and personal installment loans. Home equity loans and lines of credit are generally secured by second mortgages placed on one-to-four family owner-occupied properties. Home equity loans have fixed interest rates, while home equity lines of credit adjust based on the prime rate as published in the Wall Street Journal. Consumer loans are originated through the branch network with the exception of Home Equity Lines of Credit, which are originated by licensed Mortgage Lending Originator staff.

Municipal Loans

The Bank makes commercial loans to municipalities and municipal entities (i.e., fire districts, school districts) located within its geographic market area. The most common loans are one-year interest-only Bond Anticipation Notes. The Bank also makes medium-term amortizing loans (two to seven years) for acquisition of capital equipment. The Bank has also underwritten several long-term amortizing loans to finance municipal buildings and infrastructure. These loans, which are unsecured, are general obligations of each municipality backed by its full faith and credit and taxing authority. Most municipal borrowers maintain a strong deposit relationship with the Bank. Loans to municipalities and municipal entities are bank-qualified tax-exempt loans and are considered to be a lower credit risk relative to most other commercial loans.

Credit Risk Management and Asset Quality

One of the Bank’s key objectives is to maintain a high level of asset quality. The Bank utilizes the following general practices to manage credit risk: ensuring compliance with prudent written policies; limiting the amount of credit that individual lenders may extend; establishing a process for credit approval accountability; careful initial underwriting and analysis of borrower, transaction, market and collateral risks; ongoing servicing of individual loans and lending relationships; continuous monitoring and risk rating of the portfolio, market dynamics and the economy; and periodically reevaluating the Bank’s strategy and overall exposure as economic, market and other relevant conditions change.

Credit Administration is responsible for determining loan loss reserve adequacy and preparing monthly and quarterly reports regarding the credit quality of the loan portfolio, which are submitted to the Loan Committee to ensure compliance with the credit policy, and managing non-performing and classified assets as well as oversight of all collection activity.

In addition to loan review’s performed by Credit Administration, loan review activities are also performed by an independent third party loan review firm that evaluates the creditworthiness of borrowers and the appropriateness of the Bank’s risk rating classifications. The firm’s findings are reported to Credit Administration, Senior Management, and the Board level Loan and Audit Committees.

Trust and Wealth Advisory Services

The Bank provides a range of fiduciary services including trust and estate administration, wealth advisory, and investment management to individuals, families, businesses and institutions.

Securities

Salisbury’s securities portfolio is structured to diversify the earnings, assets and risk structure of Salisbury, provide liquidity consistent with both projected and potential needs, collateralize certain types of deposits, assist with

maintaining a satisfactory net interest margin and comply with regulatory capital and liquidity requirements. Types of securities in the portfolio generally include U.S. Government and Agency securities, mortgage-backed securities, collateralized mortgage obligations and tax exempt municipal bonds, among others.

Sources of Funds

The Bank uses deposits, proceeds from loan and security maturities, repayments and sales, and borrowings to fund lending, investing and general operations. Deposits represent the Bank's primary source of funds.

Deposits

The Bank offers a variety of deposit accounts with a range of interest rates and other terms, which are designed to meet customer financial needs. Retail and commercial deposits are primarily received through the Bank's banking offices. Additional depositor related services provided to customers include Landlord/Tenant Lease Security Accounts and Services, Merchant Services, Payroll Services, Cash Management (Remote Deposit Capture, ACH Origination, Wire Transfers and Positive Pay), ATM, Bank-by-Phone, Internet Banking, Internet Bill Pay, Person to Person Payments, Bank to Bank Transfers, Mobile Banking with remote deposit, and Online Financial Management with Account Aggregation Services.

The FDIC provides separate insurance coverage of $250,000 per depositor for each account ownership category. Deposit flows are significantly influenced by economic conditions, the general level of interest rates and the relative attractiveness of competing deposit and investment alternatives. When determining deposit pricing, the Bank considers strategic objectives, competitive market rates, deposit flows, funding commitments and investment alternatives, FHLBB advance rates and rates on other sources of funds.

National, regional and local economic and credit conditions, changes in competitor money market, savings and time deposit rates, prevailing market interest rates and competing investment alternatives all have a significant impact on the level of the Bank's deposits. Deposit generation is a key focus for the Bank as a source of liquidity and to fund continuing asset growth. Competition for deposits has been, and is expected to, remain strong.

Borrowings

The Bank is a member of the FHLBB, which provides credit facilities for regulated, federally insured depository institutions and certain other home financing institutions. Members of the FHLBB are required to own capital stock in the FHLBB and are authorized to apply for advances on the security of their FHLBB stock and certain home mortgages and other assets (principally securities, which are obligations of, or guaranteed by, the United States Government or its agencies) provided certain creditworthiness standards have been met. Under its current credit policies, the FHLBB limits advances based on a member's assets, total borrowings and net worth. Long-term and short-term FHLBB advances may be utilized as a source of funding to meet liquidity and planning needs when the cost of these funds is favorable as compared to deposits or alternate funding sources. During 2015, Salisbury issued $10 million of subordinated debentures; See "Deposits and Borrowings" in Item 7.

Additional funding sources are available through securities sold under agreements to repurchase and the Federal Reserve Bank of Boston.

Acquisitions

In June 2017, the Bank completed its purchase and assumption of the New Paltz, New York branch of Empire State Bank, which included approximately $31 million in deposits and $7 million in branch related loans. In addition, in April 2018 the Bank completed its purchase and assumption of the Fishkill, New York branch of Orange Bank & Trust Company, which included approximately $8 million in deposits and $8 million in branch related loans.

Subsidiaries

Salisbury has one wholly-owned subsidiary, Salisbury Bank and Trust Company. The Bank has two wholly-owned subsidiaries, SBT Mortgage Service Corporation and S.B.T. Realty, Inc. SBT Mortgage Service Corporation is a passive investment company ("PIC") that holds loans collateralized by real estate originated or purchased by the Bank. Income of the PIC and its dividends to Salisbury are exempt from the Connecticut Corporate Business Tax. S.B.T. Realty, Inc. was formed to hold New York state real estate and is presently inactive.

Employees

At December 31, 2018, the Bank had 172 full-time employees and 26 part-time employees. The employees are not represented by a collective bargaining group. The Bank maintains a comprehensive employee benefit program providing, among other benefits, group medical and dental insurance, life insurance, disability insurance, an ESOP and an employee 401(k) plan. Management considers relations with its employees to be good.

Market Area

Salisbury and the Bank are headquartered in Lakeville, Connecticut, which is located in the northwestern quadrant of Connecticut's Litchfield County. The Bank has a total of fourteen banking offices, four of which are located in Connecticut's Litchfield County; three of which are located in Massachusetts' Berkshire County; five of which are located in New York's Dutchess County, one of which is located in New York's Ulster County, and one of which is located in New York's Orange County. The Bank's primary deposit gathering and lending area consists of the communities and surrounding towns that are served by its branch network in these counties. The Bank also has deposit, lending and trust relationships outside of these areas.

Competition

The Bank faces strong competition in attracting and retaining deposits and in making loans. The primary factors in competing for deposits are interest rates, personalized services, the quality and range of financial services, convenience of office locations, automated services and office hours. Its most direct competition for deposits and loans has come from other commercial banks, savings institutions and credit unions located in its market area. Competition for deposits also comes from mutual funds and other investment alternatives, which offer a range of deposit and deposit-like products. Although the Bank expects this continuing competition to have an effect upon the cost of funds, it does not anticipate any substantial adverse effect on maintaining the current deposit base. The Bank is competitive within its market area in the various deposit products it offers to depositors. Due to this fact, management believes the Bank has the ability to maintain its deposit base.

The Bank's competition for real estate loans comes primarily from mortgage banking companies, savings banks, commercial banks, insurance companies, and other institutional lenders. The primary factors in competing for loans are interest rates, loan origination fees, the quality and range of lending services and personalized service. Factors that affect competition include, among others, the general availability of funds and credit, general and local economic conditions, current interest rate levels and volatility in the mortgage markets.

The banking industry is also experiencing rapid changes in technology. In addition to improving customer services, effective use of technology increases efficiency and enables financial institutions to reduce costs. Technological advances are likely to increase competition by enabling more companies to provide cost effective products and services.

Regulation and Supervision

General

Salisbury is required to file reports and otherwise comply with the rules and regulations of the FRB, the FDIC, the SEC and NASDAQ as well as the state banking supervisory authorities in Connecticut, New York and Massachusetts.

The Bank is subject to extensive regulation by the CTDOB, as its chartering agency, and by the FDIC, as its primary federal supervisory agency. The Bank is required to file reports with, and is periodically examined by, the FDIC and the CTDOB concerning its activities and financial condition. It must obtain regulatory approvals prior to entering into certain transactions, such as mergers.

The following discussion of the laws, regulations and policies material to the operations of Salisbury and the Bank is a summary and is qualified in its entirety by reference to such laws, regulations and policies. Such statutes, regulations and policies are continually under review by Congress and the Connecticut, New York and Massachusetts State Legislatures and federal and state regulatory agencies. Any change in such laws, regulations, or policies could have a material adverse impact on Salisbury or the Bank.

Bank Holding Company Regulation

SEC and NASDAQ

Salisbury is subject to the rules and regulations of the SEC and is required to comply with the disclosure and regulatory requirements of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, as administered by the SEC. Salisbury's common stock is listed on the NASDAQ Capital Market under the trading symbol "SAL" and, accordingly, Salisbury is also subject to the rules of NASDAQ for listed companies.

Federal Reserve Board Regulation

Salisbury is a registered bank holding company under the BHCA and is subject to comprehensive regulation and regular examinations by the FRB. The FRB also has extensive enforcement authority over bank holding companies, including, among other things, the ability to assess civil money penalties, to issue cease and desist or removal orders and to require that a holding company divest subsidiaries (including its bank subsidiaries). In general, enforcement actions may be initiated for violations of law and regulations and unsafe or unsound practices.

Under FRB policy, a bank holding company must serve as a source of financial and managerial strength for its subsidiary bank. Under this policy, Salisbury is expected to commit resources to support the Bank. The FRB may require a holding company to contribute additional capital to an undercapitalized subsidiary bank.

Bank holding companies must obtain FRB approval before: (i) acquiring, directly or indirectly, ownership or control of another bank or bank holding company; (ii) acquiring all or substantially all of the assets of another bank or bank holding company; or (iii) merging or consolidating with another bank holding company.

The BHCA also prohibits a bank holding company, with certain exceptions, from acquiring direct or indirect ownership or control of any company, which is not a bank or bank holding company, or from engaging directly or indirectly in activities other than those of banking, managing or controlling banks, or providing services for its subsidiaries. The principal exceptions to these prohibitions involve certain non-bank activities, which, by statute or by FRB regulation or order, have been identified as activities closely related to the business of banking or managing or controlling banks. The list of activities permitted by the FRB includes, among other things: (i) operating a savings institution, mortgage company, finance company, credit card company or factoring company; (ii) performing certain data processing operations; (iii) providing certain investment and financial advice; (iv) underwriting and acting as an insurance agent for certain types of credit-related insurance; (v) leasing property on a full-payout, non-operating basis; (vi) selling money orders; (vii) real estate and personal property appraising; (viii) providing tax planning and preparation services; (ix) financing and investing in certain community development activities; and (x) subject to certain limitations, providing securities brokerage services for customers.

Connecticut Bank Holding Company Regulation

Salisbury is a Connecticut corporation and is also subject to the Connecticut Business Corporation Act and Connecticut banking law applicable to Connecticut bank holding companies. Under Connecticut banking law, no person may acquire beneficial ownership of more than 10% of any class of voting securities of a Connecticut-chartered bank, or any bank holding company of such a bank, without prior notification to, and lack of disapproval by, the CTDOB. The CTDOB will disapprove the acquisition if the bank or holding company to be acquired has been in existence for less than five years, unless the CTDOB waives this five-year restriction, or if the acquisition would result in the acquirer controlling 30% or more of the total amount of deposits in insured depository institutions in Connecticut. Similar restrictions apply to any person who holds in excess of 10% of any such class and desires to increase its holdings to 25% or more of such class.

Dividends

Salisbury's dividends to shareholders are substantially dependent upon Salisbury's receipt of dividends from the Bank. The FRB has issued a policy statement on the payment of cash dividends by bank holding companies, which expresses the FRB's view that a bank holding company should be a "source of strength" to its bank subsidiary and should pay cash dividends only to the extent that the holding company's net income for the past year is sufficient to cover both the cash dividends and a rate of earnings retention that is consistent with the holding company's capital needs, asset quality and overall financial condition. The FRB also indicated its view that, generally, it would be inappropriate for a company experiencing serious financial problems to borrow funds to pay dividends. Furthermore, the FRB may prohibit a bank holding company from paying any dividends if the holding company's bank subsidiary is classified as "undercapitalized" or if the dividend would violate applicable law or would be an unsafe or unsound banking practice.

Financial Modernization

GLBA permits greater affiliation among banks, securities firms, insurance companies, and other companies under a type of financial services company known as a "financial holding company." A financial holding company essentially is a bank holding company with expanded powers. Financial holding companies are authorized by statute to engage in a number of financial activities previously impermissible for bank holding companies, including securities underwriting, dealing and market making; sponsoring mutual funds and investment companies; insurance underwriting and agency; and merchant banking activities. The act also permits the FRB and the Treasury to authorize additional activities for financial holding companies if they are "financial in nature" or "incidental" to financial activities. A bank holding company may become a financial holding company if each of its subsidiary banks is "well capitalized" and "well managed" as defined in the FRB's Regulation Y, and has at least a "satisfactory" Community Reinvestment Act rating. A financial holding company must provide notice to the FRB within 30 days after commencing activities previously determined to be permissible by statute or by the FRB and the Treasury. Salisbury is a registered financial holding company.

All financial institutions are required to establish policies and procedures with respect to the ability of the Bank to share nonpublic customer data with nonaffiliated parties and to protect customer data from unauthorized access. The Bank has developed policies and procedures, and believes it is in compliance with all privacy, information sharing, and notification provisions of GLBA and the FACT Act.

State Banking Laws and Supervision

The Bank is a state-chartered commercial bank under Connecticut law and as such is subject to regulation and examination by the CTDOB. In addition, because the Bank operates branch offices in Massachusetts and New York, the Bank is also subject to certain Massachusetts and New York laws and the supervisory authority of the Massachusetts Division of Banks, and New York Department of Financial Services ("NYDFS") with respect to its branch offices in Massachusetts and New York, respectively. The approval of the state banking regulators is generally required for, among other things, the establishment of branch offices and business combination transactions. The CTDOB conducts periodic examinations of Connecticut-chartered banks. The FDIC also regulates many of the areas regulated by the CTDOB, and federal law may limit some of the authority provided to Connecticut-chartered banks by Connecticut law.

Lending Activities

Connecticut banking laws grant commercial banks broad lending authority. With certain limited exceptions, total secured and unsecured loans made to any one obligor generally may not exceed 15% of the Bank's equity capital and reserves for loan and lease losses. However, if the loan is fully secured, such limitations generally may be increased by an additional 10%.

Dividends

The Bank may pay cash dividends only out of its net profits. For purposes of this restriction, "net profits" represents the remainder of all earnings from current operations. Further, the total amount of all dividends declared by the Bank in any year may not exceed the sum of its net profits for the year in question combined with its retained net profits from the preceding two years, unless the CTDOB approves the larger dividend. Federal law also prevents the Bank from paying dividends or making other capital distributions that would cause it to become "undercapitalized." The FDIC may also limit a bank's ability to pay dividends based upon safety and soundness considerations.

Powers

Connecticut law permits Connecticut banks to sell insurance and fixed and variable-rate annuities if licensed to do so by the Connecticut Insurance Department. With the prior approval of the CTDOB, Connecticut banks are also authorized to engage in a broad range of activities related to the business of banking, or that are financial in nature or that are permitted under the BHCA, other federal statutes, or the regulations promulgated pursuant to these statutes. Connecticut banks generally are also authorized to engage in any activity permitted for a federal bank or upon filing prior written notice of its intention to engage in such activity with the CTDOB, unless the CTDOB disapproves the activity.

Assessments

Connecticut banks are required to pay assessments to the CTDOB based upon a bank’s asset size to fund the CTDOB’s operations. The assessments are generally made annually.

Enforcement Authority

Under Connecticut law, the CTDOB has extensive enforcement authority over Connecticut banks and, under certain circumstances, affiliated parties, insiders, and agents. The CTDOB’s enforcement authority includes cease and desist orders, fines, receivership, conservatorship, removal of officers and directors, emergency closures, dissolution and liquidation.

New York and Massachusetts Banking Laws and Supervision

The Bank conducts activities and operates branch offices in New York and Massachusetts as well as Connecticut. Generally, with respect to its business in New York and Massachusetts, the Bank may conduct any activity that is authorized under Connecticut law that is permissible for either New York or Massachusetts state banks or for an out-of-state national bank, at its New York and Massachusetts branch offices, respectively. The New York State Superintendent of Financial Services may exercise regulatory authority with respect to the Bank's New York branch offices. The Bank is subject to certain rules related to community reinvestment, consumer protection, fair lending, establishment of intra-state branches and the conduct of banking activities with respect to its branches located in New York State. The Massachusetts Commissioner of Banks may exercise similar authority, and the Bank is subject to similar rules under Massachusetts Banking Law with respect to the Bank's Massachusetts branch offices. Federal and state laws authorize the interstate merger of banks. Among other things, banks may establish new branches on an interstate basis provided that such action is specifically authorized by the law of the host state.

Federal Regulations

Capital Requirements

Under FDIC regulations, federally insured state-chartered banks, such as the Bank, that are not members of the Federal Reserve System ("state non-member banks") are required to comply with the following minimum leverage capital requirements: common equity Tier 1 capital to risk-based assets ratio of 4.5%, a Tier 1 capital to risk-based assets ratio of 6.0%, a total capital to risk-based assets of 8.0%, and a 4.0% Tier 1 capital to total assets leverage ratio. The existing capital requirements became effective January 1, 2015 and are the result of a final rule implementing regulatory amendments based on recommendations of the Basel Committee on Banking Supervision and certain requirements of the Dodd-Frank Act. Common equity Tier 1 capital is generally defined as common stockholders' equity and retained earnings. Tier 1 capital is generally defined as common equity Tier 1 and additional Tier 1 capital. Additional Tier 1 capital includes certain noncumulative perpetual preferred stock and related surplus and minority interests in equity accounts of consolidated subsidiaries. Total capital includes Tier 1 capital (common equity Tier 1 capital plus additional Tier 1 capital) and Tier 2 capital. Tier 2 capital is comprised of capital instruments and related surplus, meeting specified requirements, and may include cumulative preferred stock and long-term perpetual preferred stock, mandatory convertible securities, intermediate preferred stock and subordinated debt. Also included in Tier 2 capital is the allowance for loan and lease losses limited to a maximum of 1.25% of risk-weighted assets and, for institutions that have exercised an opt-out election regarding the treatment of accumulated other comprehensive income ("AOCI"), up to 45% of net unrealized gains on available-for-sale equity securities with readily determinable fair market values. The Bank chose the opt-out election. Institutions that have not exercised the AOCI opt-out have AOCI incorporated into common equity Tier 1 capital (including unrealized gains and losses on available-for-sale securities). Calculation of all types of regulatory capital is subject to deductions and adjustments specified in the regulations.

The FDIC regulations require state non-member banks to maintain certain levels of regulatory capital in relation to regulatory risk-weighted assets. The ratio of regulatory capital to regulatory risk-weighted assets is referred to as a bank's "risk-based capital ratio." Risk-based capital ratios are determined by allocating assets and specified off-balance sheet items (including recourse obligations, direct credit substitutes and residual interests) to risk-weighted categories ranging from 0% to 1,250%, with higher levels of capital being required for the categories perceived as representing greater risk.

In addition to establishing the minimum regulatory capital requirements, the regulations limit capital distributions and certain discretionary bonus payments to management if the institution does not hold a "capital conservation buffer" consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets above the amount necessary to meet its

minimum risk-based capital requirements. The capital conservation buffer requirement began phasing in January 1, 2016 at 0.625% of risk-weighted assets and increased each year until fully implemented at 2.5% on January 1, 2019.

In assessing an institution's capital adequacy, the FDIC takes into consideration not only these numeric factors, but qualitative factors as well, and has the authority to establish higher capital requirements for individual institutions where deemed necessary. As a bank holding company, the Company is also subject to regulatory capital requirements, as described in a subsequent section.

As a bank holding company, Salisbury is subject to FRB capital adequacy guidelines for bank holding companies similar to those of the FDIC for state-chartered banks.

As of December 31, 2018, the Company and the Bank met each of their capital requirements and the most recent notification from the FDIC categorized the Bank as "well-capitalized." There are no conditions or events since that notification that management believes have changed the Bank's category.

Prompt Corrective Regulatory Action

Federal law requires, among other things, that federal bank regulatory authorities take "prompt corrective action" with respect to banks that do not meet minimum capital requirements. For these purposes, the law establishes five capital categories:

- Well capitalized – at least 5% leverage capital, 6.5% Common Equity Tier 1 capital, 8% Tier 1 risk based capital and 10% total risk based capital.
- Adequately capitalized – at least 4% leverage capital, 4.5% Common Equity Tier 1 capital, 6% Tier 1 risk based capital and 8% total risk based capital.
- Undercapitalized – less than 4% leverage capital, 4.5% Common Equity Tier 1 capital, 6% Tier 1 risk based capital and 8% total risk based capital. "Undercapitalized" banks must adhere to growth, capital distribution (including dividend) and other limitations and are required to submit a capital restoration plan. A bank's compliance with such a plan is required to be guaranteed by any company that controls the undercapitalized institution in an amount equal to the lesser of 5% of the institution's total assets when deemed undercapitalized or the amount necessary to achieve the status of adequately capitalized.
- Significantly undercapitalized – less than 3% leverage capital, 3% Common Equity Tier 1 capital, 4% Tier 1 risk based capital and 6% total risk based capital. "Significantly undercapitalized" banks must comply with one or more of a number of additional restrictions, including but not limited to an order by the FDIC to sell sufficient voting stock to become adequately capitalized, requirements to reduce total assets, cease receipt of deposits from correspondent banks or dismiss directors or officers, and restrictions on interest rates paid on deposits, compensation of executive officers and capital distributions by the parent holding company.
- Critically undercapitalized – less than 2% tangible capital. "Critically undercapitalized" institutions are subject to additional measures including, subject to a narrow exception, the appointment of a receiver or conservator within 270 days after it obtains such status.

Transactions with Affiliates

Under federal law, transactions between depository institutions and their affiliates are governed by Sections 23A and 23B of the FRA. In a holding company structure, at a minimum, the parent holding company of a bank, and any companies that are controlled by such parent holding company, are deemed affiliates of its subsidiary bank. Generally, Sections 23A and 23B are intended to protect insured depository institutions from suffering losses arising from transactions with non-insured affiliates by limiting the extent to which a bank or its subsidiaries may engage in covered transactions with any one affiliate and with all affiliates of the bank in the aggregate, and by requiring that such transactions be on terms that are consistent with safe and sound banking practices.

The FRA and Regulation O impose restrictions on loans to directors, executive officers, and principal shareholders ("insiders"). Loans to insiders and their related interests may not exceed, together with all other outstanding loans to such persons and affiliated entities, the institution's total capital and surplus. Loans to insiders above specified amounts must receive the prior approval of the board of directors and must be made on terms substantially the same as offered in comparable transactions to other persons. The FRA imposes additional limitations on loans to executive officers.

Enforcement

The FDIC has extensive enforcement authority over insured banks, including the Bank. This enforcement authority includes, among other things, the ability to assess civil money penalties, issue cease and desist orders and remove directors and officers. In general, these enforcement actions may be initiated in response to violations of laws and regulations and unsafe or unsound practices.

Standards for Safety and Soundness

The FDIC, together with the other federal bank regulatory agencies, prescribe standards of safety and soundness by regulations or guidelines, relating generally to operations and management, asset growth, asset quality, earnings, stock valuation and compensation. The federal bank regulatory agencies have adopted a set of guidelines prescribing safety

and soundness standards, which establish general standards relating to internal controls and information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, and compensation, fees and benefits. In general, the guidelines require, among other things, appropriate systems and practices to identify and manage the risks and exposures specified in the guidelines. The guidelines prohibit excessive compensation as an unsafe and unsound practice and describe compensation as excessive when the amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director or principal shareholder. In addition, the federal bank regulatory agencies adopted regulations that authorize, but do not require, the agencies to order an institution that has been given notice that it is not satisfying the safety and soundness guidelines to submit a compliance plan. The federal bank regulatory agencies have also adopted guidelines for asset quality and earning standards. As a state-chartered bank, the Bank is also subject to state statutes, regulations and guidelines relating to safety and soundness, in addition to the federal requirements.

Insurance of Deposit Accounts

The Bank’s deposit accounts are insured by the Deposit Insurance Fund (“DIF”) of the FDIC up to applicable legal limits (generally, $250,000 per depositor for each account ownership category and $250,000 for certain retirement plan accounts) and are subject to deposit insurance assessments. The FDIC insurance coverage limit applies per depositor, per insured depository institution for each account ownership category.

The FDIC utilizes a risk-based assessment system that imposes insurance premiums based upon a risk matrix that takes into account a bank’s capital level and supervisory rating. The FDIC assigns an institution to one of the following capital categories based on the institution’s financial condition consisting of (1) well capitalized, (2) adequately capitalized or (3) undercapitalized, and one of three supervisory subcategories within each capital group. The supervisory subgroup to which an institution is assigned is based on a supervisory evaluation by the institution’s primary federal regulator and information which the FDIC determines to be relevant to the institution’s financial condition and the risk posed to the deposit insurance funds. An institution’s assessment rate depends on the capital category and supervisory category to which it is assigned.

FDIC insured institutions are required to pay assessments to the FDIC to fund the DIF. The Bank's current annual assessment rate is approximately 5.85 basis points of total assets. Additionally, FDIC insured institutions are required to pay assessments to the FDIC to fund interest payments on bonds issued by The Financing Corporation, an agency of the federal government established to recapitalize the predecessor to the Savings Association Insurance Fund. The assessment rate is adjusted quarterly to reflect changes in the assessment bases of the DIF based on quarterly Call Report submissions. From time to time, the FDIC may impose a supplemental special assessment in addition to other special assessments and regular premium rates to replenish the DIF during periods of economic difficulty. The amount of an emergency special assessment imposed on a bank will be determined by the FDIC if such amount is necessary to provide sufficient assessment income to repay amounts borrowed from the Treasury; to provide sufficient assessment income to repay obligations issued to and other amounts borrowed from insured depository institutions; or for any other purpose the FDIC may deem necessary.

The FDIC may terminate insurance of deposits, after notice and a hearing, if it finds that the institution is in an unsafe or unsound condition to continue operations, has engaged in unsafe or unsound practices, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC. The management of the Bank does not know of any practice, condition or violation that might lead to termination of deposit insurance.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act")

The Dodd-Frank Act, enacted in July 2010, significantly changed the bank regulatory landscape and has impacted lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act revised the statutory authorities governing the FDIC's management of the DIF. The Dodd-Frank Act granted the FDIC new DIF management tools: maintaining a positive fund balance even during a banking crisis and maintaining moderate, steady assessment rates throughout economic and credit cycles.

Among other things, the Dodd-Frank Act: (1) raised the minimum Designated Reserve Ratio ("DRR"), which the FDIC must set each year, to 1.35% (from the former minimum of 1.15%) and removed the upper limit on the DRR (which was formerly capped at 1.5%) and therefore on the size of the DIF; (2) required that the DIF reserve ratio reach 1.35% by September 30, 2020 (rather than 1.15% by the end of 2016, as formerly required); (3) required that, in setting assessments, the FDIC offset the effect of requiring that the reserve ratio reach 1.35% by September 30, 2020 (rather than 1.15% by the end of 2016) on insured depository institutions with total consolidated assets of less than $10 billion; (4) eliminated the requirement that the FDIC provide dividends from the Fund when the reserve ratio is between 1.35% and 1.50%; and (5) continued the FDIC's authority to declare dividends when the reserve ratio at the end of a calendar year is at least 1.50%, but granted the FDIC sole discretion in determining whether to suspend or limit the declaration or payment of dividends.

The Dodd-Frank Act also required that the FDIC amend its regulations to redefine the assessment base used for calculating deposit insurance assessments. Under the Dodd-Frank Act, the assessment base must, with some possible exceptions, equal average consolidated total assets minus average tangible equity.

The FDIC amended 12 CFR 327 to implement revisions to the Federal Deposit Insurance Act made by the Dodd-Frank Act by modifying the definition of an institution's deposit insurance assessment base; to change the assessment rate adjustments; to revise the deposit insurance assessment rate schedules in light of the new assessment base and altered adjustments; to implement the Dodd-Frank Act's dividend provisions; to revise the large insured depository institution assessment system to better differentiate for risk and better take into account losses from large institution failures that the FDIC may incur; and to make technical and other changes to the FDIC's assessment rules. The FDIC Board of Directors adopted the final rule, which redefined the deposit insurance assessment base as required by the Dodd-Frank Act; made changes to assessment rates; implemented the Dodd-Frank Act's DIF dividend provisions; and revised the risk-based assessment system for all large insured depository institutions, generally, those

institutions with at least $10 billion in total assets. Nearly all institutions with assets less than $10 billion, including the Bank, have benefited from a reduction in their assessments as a result of this final rule.

The Dodd-Frank Act requires publicly traded companies to give shareholders a non-binding vote of executive compensation at least every three (3) years. The legislation also authorizes the SEC to prohibit broker discretion on any voting on election of directors, executive compensation matters, and any other significant matter.

The Dodd-Frank Act also adopts various mortgage lending and predatory lending provisions and requires loan originators to retain 5% of any loan sold and securitized, unless it is a “qualified residential mortgage,” which includes standard 30 and 15-year fixed rate loans.

Consumer Protection and the Financial Protection Bureau

The Dodd-Frank Act created the Consumer Financial Protection Bureau (“CFPB”). As required by the Dodd-Frank Act, jurisdiction for all existing consumer protection laws and regulations has been transferred to the CFPB. In addition, the CFPB is granted authority to promulgate new consumer protection regulations for banks and nonbank financial firms offering consumer financial services or products to ensure that consumers are protected from “unfair, deceptive, or abusive” acts or practices.

Salisbury is subject to a number of federal and state laws designed to protect borrowers and promote lending to various sectors of the economy and population. These laws include the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Truth in Lending Act, the Home Mortgage Disclosure Act, the Real Estate Settlement Procedures Act, various state law counterparts, and the Consumer Financial Protection Act of 2010, which constitutes part of the Dodd-Frank Act and establishes the CFPB, as described above.

The CFPB issued a final rule implementing the ability-to-repay and qualified mortgage (“QM”) provisions of the Truth in Lending Act, as amended by the Dodd-Frank Act (the “QM Rule”), which became effective on January 10, 2014. The ability-to-repay provision requires creditors to make reasonable, good faith determinations that borrowers are able to repay their mortgages before extending the credit based on a number of factors and consideration of financial information about the borrower from reasonably reliable third-party documents. Under the Dodd-Frank Act and the QM Rule, loans meeting the definition of “qualified mortgage” are entitled to a presumption that the lender satisfied the ability-to-repay requirements. The presumption is a conclusive presumption/safe harbor for prime loans meeting the QM requirements and a rebuttable presumption for higher-priced/subprime loans meeting the QM requirements. The definition of a “qualified mortgage” incorporates the statutory requirements, such as not allowing negative amortization or terms longer than 30 years. The QM Rule also adds an explicit maximum 43% debt-to-income ratio limit for borrowers if the loan is to meet the QM definition, with some exceptions.

Federal Reserve System

All depository institutions must hold a percentage of certain types of deposits as reserves. Reserve requirements currently are assessed on the depository institution's net transaction accounts (mostly checking accounts). Depository institutions must also regularly submit deposit reports of their deposits and other reservable liabilities. The Bank is in compliance with these requirements.

Federal Home Loan Bank System

The Bank is a member of the Boston region of the Federal Home Loan Bank System, which consists of 11 regional Federal Home Loan Banks. The FHLBB provides a central credit facility primarily for member institutions. Member institutions are required to acquire and hold shares of capital stock in the FHLBB calculated periodically based primarily on its level of borrowings from the FHLBB. The Bank was in compliance with this requirement. At December 31, 2018, the Bank had FHLBB stock of $4.5 million and FHLBB advances of $67.2 million.

No market exists for shares of the FHLBB and, therefore, they are carried at par value. FHLBB stock may be redeemed at par value five years following termination of FHLBB membership, subject to limitations which may be imposed by the FHLBB or its regulator, the Federal Housing Finance Board, to maintain capital adequacy of the FHLBB. While the Bank currently has no intentions to terminate its FHLBB membership, the ability to redeem its investment in FHLBB stock would be subject to the conditions imposed by the FHLBB.

Other Regulations

Sarbanes-Oxley Act of 2002

The stated goals of SOX are to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws.

SOX includes very specific disclosure requirements and corporate governance rules, requires the SEC and securities exchanges to adopt extensive additional disclosure, corporate governance and other related rules, and mandates further studies of certain issues by the SEC and the Comptroller General. SOX represents significant federal involvement in matters traditionally left to state regulatory systems, such as the regulation of the accounting profession, and to state corporate law, such as the relationship between a board of directors and management and between a board of directors and its committees.

SOX addresses, among other matters, audit committees; certification of financial statements and internal controls by the Chief Executive Officer and Chief Financial Officer; the forfeiture of bonuses or other incentive-based compensation and profits from the sale of an issuer's securities by directors and senior officers in the twelve-month period following initial publication of any financial statements that later require restatement; a prohibition on insider trading during pension plan black-out periods; disclosure of off-balance sheet transactions; a prohibition on certain loans to directors and officers; expedited filing requirements for Forms 4; disclosure of a code of ethics and filing a Form 8-K for significant changes or waivers of such code; "real time" filing of periodic reports; the formation of a Public Company Accounting Oversight Board; auditor independence; and various increased criminal penalties for violations of securities laws. The SEC has enacted rules to implement various provisions of SOX.

As of December 31, 2018 the Bank is subject to section 404(b) of SOX, which requires public companies' annual reports to include the company's own assessment of internal control over financial reporting, and an auditor's attestation. See Item 9A "CONTROLS AND PROCEDURES" for management's assessment of internal controls and Item 8 "FINANCIAL STATEMENTS AND SUPPLEMENTAL DATA" for the auditor's attestation.

USA PATRIOT Act

Under the USA PATRIOT Act, all financial institutions are required to take certain measures to identify their customers, prevent money laundering, monitor customer transactions and report suspicious activity to U.S. law enforcement agencies. Financial institutions also are required to respond to requests for information from federal banking regulatory authorities and law enforcement agencies. Information sharing among financial institutions for the above purposes is encouraged by an exemption granted to complying financial institutions from the privacy provisions of GLBA and other privacy laws. Financial institutions that hold correspondent accounts for foreign banks or provide private banking services to foreign individuals are required to take measures to avoid dealing with certain foreign individuals or entities, including foreign banks with profiles that raise money laundering concerns, and are prohibited from dealing with foreign "shell banks" and persons from jurisdictions of particular concern. The primary federal banking regulators and the Secretary of the Treasury have adopted regulations to implement several of these provisions. All financial institutions are also required to establish internal anti-money laundering programs. The effectiveness of a financial institution in combating money laundering activities is a factor to be considered in any application submitted by the financial institution under the Bank Merger Act or the BHCA. Salisbury has in place a Bank Secrecy Act and USA PATRIOT Act compliance program, and has implemented internal practices, procedures, and controls to comply with anti-money laundering requirements.

Community Reinvestment Act and Fair Lending Laws

The Bank has a responsibility under the CRA to help meet the credit needs of our communities, including low and moderate-income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution's discretion to develop the types of products and services that it believes are best suited to its particular community, consistent with the CRA. In connection with its examination, the FDIC assesses the Bank's record of compliance with the CRA. In addition, the Equal Credit Opportunity Act and the Fair Housing Act prohibit discrimination in lending practices on the basis of characteristics specified in those statutes. The Bank's failure to comply with the provisions of the CRA could, at a minimum, result in regulatory restrictions on our activities. The Bank's failure to comply with the Equal Credit Opportunity Act and the Fair Housing Act could result in enforcement actions against the Bank by the FDIC as well as other federal regulatory agencies and the Department of Justice. The Bank's most recent FDIC CRA rating was "satisfactory."

The Electronic Funds Transfer Act, Regulation E and Related Laws

The Electronic Funds Transfer Act (the "EFTA") provides a basic framework for establishing the rights, liabilities, and responsibilities of consumers who use electronic funds transfer ("EFT") systems. The EFTA is implemented by the Federal Reserve's Regulation E, which governs transfers initiated through ATMs, point-of-sale terminals, payroll cards, automated clearing house ("ACH") transactions, telephone bill-payment plans, or remote banking services. Regulation E requires consumers to opt in (affirmatively consent) to participation in a bank's overdraft service program for ATM and one-time debit card transactions before overdraft fees may be assessed on the consumer's account. Notice of the opt-in right must be provided to all new customers who are consumers, and the customer's affirmative consent must be obtained, before charges may be assessed on the consumer's account for paying such overdrafts.

Regulation E also provides bank customers with an ongoing right to revoke consent to participation in an overdraft service program for ATM and one-time debit card transactions and prohibits banks from conditioning the payment of overdrafts for checks, ACH transactions, or other types of transactions that overdraw the consumer's account on the consumer's opting into an overdraft service for ATM and one-time debit card transactions. For customers who do not affirmatively consent to overdraft service for ATM and one-time debit card transactions, a bank must provide those customers with the same account terms, conditions, and features that it provides to consumers who do affirmatively consent, except for the overdraft service for ATM and one-time debit card transactions. Salisbury does not provide an overdraft service with respect to one time point-of-sale or ATM transactions.

Future Legislative Initiatives

In light of the recent changes in the composition of Congress and many state legislatures, it is anticipated that state legislatures and financial regulatory agencies will introduce various legislative and regulatory initiatives that may impact the financial services industry, generally. Such initiatives may include proposals to expand or contract the powers of bank holding companies and/or depository institutions or proposals to substantially change the financial institution regulatory system. Such legislation could change banking statutes and the operating environment of Salisbury in significant and unpredictable ways. For example, if enacted, such legislation could increase or decrease the cost of doing business, limit or expand permissible activities, or affect the competitive balance among banks, savings associations, credit unions, and other financial institutions. Salisbury cannot predict whether any such legislation will be enacted, and, if enacted, what effects that such legislation would have on the financial condition or results of operations of Salisbury. A change in statutes, regulations, or regulatory policies applicable to Salisbury or any of its subsidiaries could have a material effect on the business of Salisbury.

Impact of Inflation and Changing Prices

The Consolidated Financial Statements and their Notes presented within this document have been prepared in accordance with GAAP, which require the measurement of financial position and operating results in terms of historical dollar amounts without considering changes in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased cost of Salisbury's operations. Unlike the assets and liabilities of industrial companies, nearly all of the assets and liabilities of Salisbury are monetary in nature. As a result, interest rates have a greater impact on Salisbury's performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services.

Availability of Securities and Exchange Commission Filings

Salisbury makes available free of charge on its website (salisburybank.com) a link to its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) of the Securities Exchange Act of 1934 as soon as practicable after such reports are electronically filed with or furnished to the SEC. Such reports filed with the SEC are also available on its website (www.sec.gov). Information about accessing company filings can be obtained by calling 1-800-SEC-0330. Information on Salisbury's website is not incorporated by reference into this report. Investors are encouraged to access these reports and the other information about Salisbury's business and operations on its website. Copies of these filings may also be obtained from Salisbury free of charge upon request.

Guide 3 Statistical Disclosure by Bank Holding Companies

The following information required by Securities Act Guide 3 "Statistical Disclosure by Bank Holding Companies" is located on the pages noted below.

		Page
I.	Distribution of Assets, Liabilities and Shareholders' Equity; Interest Rates and Interest Differential	18-19, 23-31
II.	Investment Portfolio	23-24, 48-50
III.	Loan Portfolio	24-29, 51-57
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Item 1A. RISK FACTORS

Salisbury is the registered bank holding company for the Bank, its wholly-owned subsidiary. Salisbury's business and activity is currently limited to the holding of the Bank's outstanding capital stock, and the Bank is Salisbury's primary investment.

An investment in Salisbury common stock entails certain risks, some of which are inherent in the financial services industry and others of which are more specific to the Bank's business. Salisbury considers the most significant factors of which we are aware affecting risk in Salisbury common stock as those that are set forth below. These are not the only risks to which an investment in Salisbury common stock is subject, and none of the factors set forth below relates to the personal circumstances of individual investors. Investors should read this entire Form 10-K, as well as other documents and exhibits that are incorporated by reference in the 10-K and that have been filed with the SEC, in order to better understand these risks and to evaluate investment in Salisbury common stock.

Changes in interest rates and spreads could have a negative impact on earnings and financial condition.

Salisbury's earnings and financial condition are dependent to a large degree upon net interest income, which is the difference between interest earned from loans and investments and interest paid on deposits and borrowings. The narrowing of interest rate spreads, meaning the difference between interest rates earned on loans and investments, and the interest rates paid on deposits and borrowings, could adversely affect Salisbury's earnings and financial condition. Salisbury cannot predict with certainty or control changes in interest rates. Global, national, regional, and local economic conditions and the policies of regulatory authorities, including monetary policies of the FRB, affect interest income and interest expense. Salisbury has ongoing policies and procedures designed to manage the risks associated with changes in market interest rates.

However, changes in interest rates still may have an adverse effect on Salisbury's profitability. For example, high interest rates could also affect the volume of loans that Salisbury originates, because higher rates could cause customers to apply for fewer mortgages, or cause depositors to shift funds from accounts that have a comparatively lower rate, to accounts with a higher rate, or experience customer attrition due to competitor pricing or disintermediation. If the cost of interest-bearing deposits increases at a rate greater than the yields on interest-earning assets increase, net interest income will be negatively affected. Changes in the asset and liability mix may also affect net interest income. Similarly, lower interest rates cause higher yielding assets to prepay and floating or adjustable rate assets to reset to lower rates. If Salisbury is not able to reduce its funding costs sufficiently, due to either competitive factors or the maturity schedule of existing liabilities, then Salisbury's net interest margin will decline.

Weakness in the markets for residential or commercial real estate, including the secondary residential mortgage loan markets, could reduce Salisbury's net income and profitability.

Declines in home prices, increases in delinquency and default rates, and constrained secondary credit markets affect the mortgage industry generally. Salisbury's financial results may be adversely affected by changes in real estate values. Decreases in real estate values could adversely affect the value of property used as collateral for loans and investments. If poor economic conditions result in decreased demand for real estate loans, Salisbury's net income and profits may decrease.

Weakness in the secondary market for residential lending could have an adverse impact upon Salisbury's profitability. The effects of ongoing mortgage market challenges, combined with the ongoing correction in residential real estate market prices and reduced levels of home sales, could result in further price reductions in single family home values, adversely affecting the value of collateral securing mortgage loans held, mortgage loan originations and gains on sale of mortgage loans. Declines in real estate values and home sales volumes, and financial stress on borrowers as a result of job losses, or other factors, could have further adverse effects on borrowers that result in higher delinquencies and greater charge-offs in future periods beyond that which is provided for in Salisbury's allowance for loan losses, which would adversely affect Salisbury's financial condition or results of operations.

Fluctuations in economic conditions and collateral values could impact the adequacy of Salisbury's allowance for loan losses.

Salisbury's business is subject to periodic fluctuations based on national and local economic conditions. These fluctuations are not predictable, cannot be controlled and may have a material adverse impact on Salisbury's operations and financial condition. For example, declines in housing activity including declines in building permits, housing sales and home prices may make it more difficult for Salisbury's borrowers to sell their homes or refinance their debt. Slow sales could strain the resources of real estate developers and builders. The ongoing economic uncertainty has affected employment levels and could impact the ability of Salisbury's borrowers to service their debt. Bank regulatory agencies also periodically review Salisbury's allowance for loan losses and may require an increase in the provision for credit losses or the recognition of further loan charge-offs, based on judgments different than those of management. In addition, if charge-offs in future periods exceed the allowance for loan losses Salisbury will need additional provisions to increase the allowance for loan losses. Any increases in the allowance for loan losses will result in a decrease in net income and, possibly, capital, and may have a material adverse effect on Salisbury's financial condition and results of operations. Salisbury may suffer higher loan losses as a result of these factors and the resulting impact on its borrowers.

Credit market conditions may impact Salisbury's investments.

Significant credit market anomalies may impact the valuation and liquidity of Salisbury's investment securities. Illiquidity could reduce the market value of Salisbury's investments, even those with no apparent credit exposure. The valuation of Salisbury's investments requires judgment, and as market conditions change investment values may also change.

Salisbury's securities portfolio performance in difficult market conditions could have adverse effects on Salisbury's results of operations.

Under GAAP, Salisbury is required to review Salisbury's investment portfolio periodically for the presence of other-than-temporary impairment of its securities, taking into consideration current market conditions, the extent and nature of changes in fair value, issuer rating changes and trends, volatility of earnings, current analysts' evaluations, Salisbury's ability and intent to hold investments until a recovery of amortized cost, as well as other factors. Adverse developments with respect to one or more of the foregoing factors may require Salisbury to deem particular securities to be other-than-temporarily impaired, with the credit related portion of the reduction in the value recognized as a charge to Salisbury's earnings. Market volatility may make it extremely difficult to value certain securities of Salisbury. Subsequent valuations, in light of factors prevailing at that time, may result in significant changes in the values of these securities in future periods. Any of these factors could require Salisbury to recognize further impairments in the value of Salisbury's securities portfolio, which may have an adverse effect on Salisbury's results of operations in future periods.

If the goodwill that Salisbury has recorded in connection with its acquisitions becomes impaired, it could have a negative impact on Salisbury's profitability.

Applicable accounting standards require that the purchase method of accounting be used for all business combinations. Under purchase accounting, if the purchase price of an acquired company exceeds the fair value of the acquired company's net assets, the excess is carried on the acquirer's balance sheet as goodwill. At December 31, 2018, Salisbury had $13.8 million of goodwill on its balance sheet. Salisbury must evaluate goodwill for impairment at least annually. Write-downs of the amount of any impairment, if necessary, are to be charged to the results of operations in the period in which the impairment occurs. There can be no assurance that future evaluations of goodwill will not result in findings of impairment and related write-downs, which may have a material adverse effect on Salisbury's financial condition and results of operations.

Salisbury's ability to pay dividends substantially depends upon its receipt of dividends from the Bank.

Cash dividends from the Bank and Salisbury's liquid assets are the principal sources of funds for paying cash dividends on Salisbury's common stock. Unless Salisbury receives dividends from the Bank or chooses to use its liquid assets, it may not be able to pay dividends. The Bank's ability to pay dividends to Salisbury is subject to its condition and profitability as well as its regulatory requirements.

Strong competition within Salisbury's market areas may limit growth and profitability.

Competition in the banking and financial services industry is intense. Salisbury competes with commercial banks, savings institutions, mortgage brokerage firms, credit unions, finance companies, mutual funds, insurance companies, and brokerage and investment banking firms operating locally and elsewhere. As Salisbury grows, it may expand into contiguous market areas where it may not be as well-known as other institutions that have been operating in those areas for some time. In addition, larger banking institutions may become increasingly active in Salisbury's market areas, may have substantially greater resources and lending limits and may offer certain services that Salisbury does not, or cannot efficiently, provide. Salisbury's profitability depends upon its continued ability to successfully compete in its market areas. The greater resources and deposit and loan products offered by some competitors may limit its ability to grow profitably.

Salisbury and the Bank are subject to extensive federal and state regulation and supervision.

Salisbury and the Bank are subject to extensive federal and state regulation and supervision. Banking regulations are primarily intended to protect depositors' funds, federal deposit insurance funds and the banking system as a whole, not shareholders. These regulations affect Salisbury's lending practices, capital structure, investment practices, and dividend policy and growth, among other things. State and federal legislatures and regulatory agencies continually review banking laws, regulations and policies for possible changes. Changes to statutes, regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulations or policies, could affect Salisbury in substantial and unpredictable ways. Such changes could subject Salisbury to additional costs, limit the types of financial services and products it may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or reputation damage, which could have a material adverse effect on Salisbury's business, financial condition and results of operations. While Salisbury has policies and procedures designed to prevent any such violations, there can be no assurance that such violations will not occur. See the section captioned "Regulation and Supervision" in Item 1 of this report for further information.

Salisbury's stock price may be volatile.

Salisbury's stock is inactively traded and its stock price may fluctuate widely in response to a variety of factors including:

- Actual or anticipated variations in quarterly operating results
- Recommendations by securities analysts
- New technology used, or services offered, by competitors
- Significant acquisitions or business combinations, strategic partnerships, joint ventures or capital commitments by or involving Salisbury or Salisbury's competitors
- Failure to integrate acquisitions or realize anticipated benefits from acquisitions
- Operating and stock price performance of other companies that investors deem comparable to Salisbury
- News reports relating to trends, concerns and other issues in the financial services industry
- Changes in government regulations
- Geopolitical conditions such as acts or threats of terrorism or military conflicts
- Changes in the economic environment of the market areas the Bank serves

General market fluctuations, industry factors and general economic and political conditions and events, such as economic slowdowns or recessions, interest rate changes, credit loss trends or currency fluctuations could also cause Salisbury's stock price to decrease regardless of Salisbury's operating results.

Salisbury's ability to attract and retain skilled personnel may impact its success.

Salisbury's success depends, in large part, on its ability to attract and retain key people. Competition for people with specialized knowledge and skills can be intense, and Salisbury may not be able to hire people or to retain them. The unexpected loss of services of one or more of Salisbury's key personnel could have a material adverse impact on the business because of their skills, knowledge of the market, years of industry experience and the difficulty of promptly finding qualified replacement personnel.

Salisbury continually encounters technological change.

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology can increase efficiency and enable financial institutions to better serve customers and to reduce costs. However, some new technologies needed to compete effectively result in incremental operating costs. Salisbury's future success depends, in part, upon its ability to address the needs of its customers by using technology to provide products and services that will satisfy customer

demands, as well as to create additional efficiencies in operations. Many of Salisbury's competitors have substantially greater resources to invest in technological improvements. Salisbury may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to its customers. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse impact on Salisbury's business and, in turn, its financial condition and results of operations.

A failure involving controls and procedures may have an adverse effect on Salisbury.

Management regularly reviews and updates Salisbury's internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of the controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on Salisbury's business, results of operations and financial condition.

If customer information was to be misappropriated and used fraudulently, due to a breach of our systems, or those of third party vendors or service providers, including as a result of cyberattacks, Salisbury could be exposed to potential liability and reputation risk as well as increased costs.

Risk of theft of customer information resulting from security breaches by third parties exposes banks to reputation risk and potential monetary loss. Like other financial institutions, Salisbury has exposure to fraudulent misuse of its customers' personal information resulting from its general business operations through loss or theft of the information and through misappropriation of information by third parties in connection with customer use of financial instruments, such as debit cards.

In addition, Salisbury relies upon a variety of computing platforms and networks over the internet for the purposes of data processing, communications and information exchange. Despite the safeguards instituted by Salisbury, any system is susceptible to a breach of security. In addition, Salisbury relies on the services of a variety of third party vendors to meet Salisbury's data processing and communication needs. The occurrence of any failures, interruptions or security breaches of Salisbury's information systems or that of its vendors could damage Salisbury's reputation, result in a loss of customer business or expose Salisbury to civil litigation and possible financial loss. Such costs and/or losses could materially impact Salisbury's earnings.

Changes in accounting standards can materially impact Salisbury's financial statements.

Salisbury's accounting policies and methods are fundamental to how Salisbury records and reports its financial condition and results of operations. From time to time, the Financial Accounting Standards Board or regulatory authorities change the financial accounting and reporting standards that govern the preparation of Salisbury's financial statements. These changes can be hard to predict and can materially impact how Salisbury records and reports its financial condition and results of operations. In some cases, Salisbury could be required to apply a new or revised standard retroactively, resulting in Salisbury restating prior period financial statements.

Changes and interpretations of tax laws and regulations may adversely impact Salisbury's financial statements.

Local, state or federal tax authorities may interpret tax laws and regulations differently than Salisbury and challenge tax positions that Salisbury has taken on its tax returns. This may result in the disallowance of deductions or differences in the timing of deductions and result in the payment of additional taxes, interest or penalties that could materially affect Salisbury's performance.

In addition, changes in tax law, such as the federal tax reform provisions recently enacted, may adversely affect Salisbury's lending business and performance, especially those provisions regarding the deductibility of residential mortgage interest and state property taxes.

The risks presented by recent or future acquisitions could adversely affect our financial condition and results of operations.

Our business strategy has included, and may continue to include, growth through acquisition from time to time. Any recent and future acquisitions will be accompanied by the risks commonly encountered in acquisitions. These risks may include, among other things: our ability to realize anticipated cost savings; the difficulty of integrating operations and personnel; the loss of key employees; the potential disruption of our or the acquired company's ongoing business in such a way that could result in decreased revenues; the inability of our management to maximize our financial and strategic position; the inability to maintain uniform standards, controls, procedures and policies; and the impairment of relationships with the acquired company's employees and customers as a result of changes in ownership and management.

Item 1B. UNRESOLVED STAFF COMMENTS

None.

Item 2. PROPERTIES

Salisbury does not directly own or lease any properties. The properties described below are owned or leased by the Bank.

The Bank conducts its business at its main office, located at 5 Bissell Street, Lakeville, Connecticut, and through an additional thirteen full service branch offices located in Canaan, Salisbury and Sharon, Connecticut; Great Barrington, South Egremont and Sheffield, Massachusetts; and Dover Plains, Fishkill, Millerton, Newburgh, New Paltz, Poughkeepsie, and Red Oaks Mill, New York. The Bank's Trust and Wealth Advisory Services Division is based in a separate building adjacent to the main office of the Bank in Lakeville, Connecticut. The Bank owns its main office and six of its branch offices and its Canaan Operations office, and currently leases seven branch offices.

In June 2017, the Bank completed its acquisition of the New Paltz, New York branch of Empire State Bank. In addition, in April 2018, the Bank completed its purchase and assumption of the Fishkill, New York branch of Orange Bank & Trust Company Orange Bank & Trust Company. The Bank also consolidated its previous Fishkill, New York branch with the new Fishkill, New York branch. In March 2018, the Bank relocated its current branch in Newburgh, New York to another location in the same city. The Bank entered into a lease agreement for the new facility and it ceased paying rent for the previous location as of April 1, 2018. For additional information, see Note 7, "Bank Premises and Equipment," and Note 19, "Commitments and Contingent Liabilities" to the Consolidated Financial Statements.

The following table includes all property owned or leased by the Bank, but does not include Other Real Estate Owned.

Offices	Location	Owned/Leased	Lease expiration
Lakeville Office [1]	5 Bissell Street, Lakeville, CT	Owned	—
Executive Office	19 Bissell Street, Lakeville, CT	Owned	—
Salisbury Office	18 Main Street, Salisbury, CT	Owned	—
Sharon Office	5 Gay Street, Sharon, CT	Owned	—
Canaan Operations	94 Main Street, Canaan, CT	Owned	—
Canaan Office	100 Main Street, Canaan, CT	Owned	—
South Egremont Office	51 Main Street, South Egremont, MA	Leased	9/9/20
Sheffield Office	640 North Main Street, Sheffield, MA	Owned	—
Gt. Barrington Office	210 Main Street, Gt. Barrington, MA	Leased	12/30/28
Millerton Office	87 Main Street, Millerton, NY	Owned	—
Poughkeepsie Office	11 Garden Street, Poughkeepsie, NY	Owned	—
Fishkill Office	701 Route 9, Fishkill, NY	Leased	9/29/29
Red Oaks Mill Office	2064 New Hackensack Road, Poughkeepsie, NY	Leased	8/01/23
Dover Plains Office	5 Dover Village Plaza, Dover Plains, NY	Leased	7/31/22
Newburgh Office	801 Auto Park Place, Newburgh, NY	Leased	12/31/21
New Paltz Office	275 Main Street, New Paltz, NY *	Leased	9/14/19

[1]In March 2019, the Trust and Wealth Advisory Services Division relocated to 5 Bissell Street, Lakeville, CT and the Executive Office relocated to 19 Bissell Street, Lakeville, CT.

[2]The Bank has entered into a letter of intent to purchase this property, which the Bank anticipates consummating in September, 2019.

Item 3. LEGAL PROCEEDINGS

The Bank is involved in various claims and legal proceedings arising in the ordinary course of business, which management currently believes are not material, individually or in the aggregate, to the business, financial condition or operating results of Salisbury or any of its subsidiaries.

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

Item 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

Item 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

(a) Market Information

Salisbury’s common stock trades on the NASDAQ Capital Market under the symbol “SAL”. Holders

There were approximately 2,290 holders of record of the common stock of Salisbury as of March 11, 2019. This number includes brokerage firms and other financial institutions that hold stock in their name, but which is actually beneficially owned by third parties.

Dividends

For a discussion of Salisbury's dividend policy and restrictions on dividends see "Management’s Discussion and Analysis of Financial Condition and Results of Operations" under the caption “Dividends.” See also, Note 13 – “Shareholders’ Equity” of Notes to Consolidated Financial Statements.

Equity Compensation Plan Information

For the information required by this item see Note 15 – “Long Term Incentive Plans” of Notes to Consolidated Financial Statements.

(b) Recent Sales of Unregistered Securities and Use of Proceeds

None.

(c) Issuer Purchases of Equity Securities

None.

Item 6. SELECTED FINANCIAL DATA

The following table contains certain information concerning the financial position and results of operations of Salisbury at the dates and for the periods indicated. This information should be read in conjunction with the Consolidated Financial Statements and related notes.

SELECTED CONSOLIDATED FINANCIAL DATA

(in thousands, except ratios and per share amounts)

At or for the years ended December 31,	2018	2017	2016	2015	2014
Statement of Income					
Interest and dividend income	$40,372	$35,521	$34,454	$34,610	$22,855
Interest expense	7,221	4,238	3,849	3,026	2,704
Net interest and dividend income	33,151	31,283	30,605	31,584	20,151
Provision for loan losses	1,728	1,020	1,835	917	1,134
Gains on securities, net	318	178	584	192	—
Trust and wealth advisory	3,700	3,477	3,338	3,265	3,295
Service charges and fees	3,718	3,718	3,133	2,986	2,473
Gains on sales of mortgage loans, net	89	125	229	274	64
Mortgage servicing, net	308	255	156	47	94
Other	812	483	451	510	326
Non-interest income	8,945	8,236	7,891	7,274	6,252
Non-interest expense	29,835	29,329	27,387	25,921	22,138
Income before income taxes	10,533	9,170	9,274	12,020	3,131
Income tax provision	1,709	2,914	2,589	3,563	610
Net income	8,824	6,256	6,685	8,457	2,521
Net income allocated to common stock	8,713	6,201	6,633	8,298	2,355
Financial Condition					
Total assets	$1,121,554	$986,984	$935,366	$891,192	$855,427
Loans receivable, net	909,279	801,703	763,184	699,018	673,330
Allowance for loan losses	7,831	6,776	6,127	5,716	5,358
Securities	97,150	82,860	82,834	79,870	94,827
Deposits	926,739	815,495	781,770	754,533	715,426
Federal Home Loan Bank of Boston advances	67,154	54,422	37,188	26,979	28,813
Repurchase agreements	4,104	1,668	5,535	3,914	4,163
Subordinated debt, net of issuance costs	9,835	9,811	9,788	9,764	—
Total shareholders' equity	103,459	97,514	94,007	90,574	101,821
Non-performing assets	8,324	7,354	12,565	16,264	10,892
Wealth assets under administration	648,027	610,218	516,350	371,012	385,316
Discretionary wealth assets under administration	398,287	394,673	366,167	299,148	301,720
Non-discretionary assets under administration	249,740	215,545	150,183	71,864	83,596
Per Common Share Data					
Earnings, basic	$3.15	$2.25	$2.43	$3.04	$1.32
Earnings, diluted	3.13	2.24	2.41	3.02	1.32
Cash dividends declared and paid	1.12	1.12	1.12	1.12	1.12
Tangible book value	31.45	29.39	28.90	27.69	25.83
Statistical Data					
Net interest margin (taxable equivalent)	3.35 %	3.58 %	3.69 %	3.99 %	3.64 %
Efficiency ratio (taxable equivalent)	69.13	66.79	66.74	63.03	78.41

Effective tax rate	16.23	31.78	27.92	29.64	19.49
Return on average assets	0.83	0.63	0.72	0.94	0.37
Return on average common shareholders' equity	8.84	6.42	7.16	9.36	3.88
Dividend payout ratio	35.56	49.76	46.16	36.82	81.43
Allowance for loan losses to loans receivable, gross	0.85	0.84	0.80	0.81	0.79
Non-performing assets to total assets	0.74	0.74	1.34	1.82	1.27
Tier 1 leverage capital	8.25	8.53	8.69	8.56	12.31
Total risk-based capital	12.51	12.94	13.26	13.51	14.27
Weighted average common shares outstanding, basic	2,763	2,755	2,733	2,706	1,764
Weighted average common shares outstanding, diluted	2,780	2,774	2,749	2,723	1,765

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

BUSINESS

Salisbury, a Connecticut corporation, formed in 1998, is the bank holding company for the Bank, a Connecticut-chartered and FDIC insured commercial bank headquartered in Lakeville, Connecticut. Salisbury's principal business consists of the business of the Bank. The Bank, formed in 1848, is engaged in customary banking activities, including general deposit taking and lending activities to both retail and commercial markets, and trust and wealth advisory services. The Bank conducts its banking business from fourteen full-service offices in the towns of: Canaan, Lakeville, Salisbury and Sharon, Connecticut; Great Barrington, South Egremont and Sheffield, Massachusetts; and, Fishkill, Newburgh, New Paltz, Poughkeepsie, Red Oaks Mill, Dover Plains and Millerton, New York, and its trust and wealth advisory services from offices in Lakeville, Connecticut.

In June 2017, the Bank completed its acquisition of the New Paltz, New York branch of Empire State Bank. In April 2018, the Bank completed its acquisition of the Fishkill, New York branch of Orange Bank & Trust Company and consolidated its existing Fishkill branch into that new location.

Critical Accounting Policies and Estimates

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

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

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

The allowance for loan losses represents management’s estimate of credit losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it

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

Management, with the assistance of a third party, evaluates goodwill and identifiable intangible assets for impairment annually using valuation techniques that involve observations and adjustments as to comparable transactions, estimates for discount rates, projected future cash flows and time period calculations, all of which are susceptible to change based on changes in economic conditions and other factors.

For both goodwill and for the core deposit intangible, the comparable transaction methodology was used to assess, and conclude that there was no impairment at December 31, 2018.

Future events, or changes in the estimates, which are used to determine the carrying value of goodwill and identifiable intangible assets or which otherwise adversely affect their value or estimated lives could have a material adverse impact on the results of operations.

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

The following discussion and analysis of Salisbury's consolidated results of operations should be read in conjunction with the Consolidated Financial Statements and footnotes.

RESULTS OF OPERATIONS

Comparison of the Years Ended December 31, 2018 and 2017

Net Interest and Dividend Income

Net interest and dividend income (presented on a tax-equivalent basis) increased $1.4 million in 2018 over 2017. The net interest margin decreased 23 basis points to 3.35% from 3.58%, due to a 33 basis point increase in the average cost of interest-bearing liabilities partly offset by a 1 basis point increase in the average yield on interest-earning assets. The net interest margin is affected by changes in the mix of interest-earning assets and funding liabilities, asset and liability growth, and the effects of changes in market interest rates on the pricing and re-pricing of assets and liabilities. The following table sets forth the components of Salisbury's net interest income and yields on average interest-earning assets and interest-bearing funds. Income and yields on tax-exempt securities are presented on a fully taxable equivalent basis.

Years ended December 31,	Average Balance			Income / Expense			Average Yield / Rate		
(dollars in thousands)	2018	2017	2016	2018	2017	2016	2018	2017	2016
Loans (a)(d)(f)	$871,557	$780,968	$745,957	$37,504	$33,824	$32,727	4.30 %	4.33 %	4.39 %
Securities (c)(d)	87,880	79,767	76,138	2,406	2,130	2,583	2.74	2.67	3.39
FHLBB stock	4,748	3,551	3,287	238	142	121	5.01	4.00	3.68
Short term funds (b)	41,348	36,351	35,951	695	343	173	1.68	0.94	0.48
Total earning assets	1,005,533	900,637	861,333	40,843	36,439	35,604	4.06	4.05	4.13
Other assets	53,630	56,859	58,101						
Total assets	$1,059,163	$957,496	$919,434						
Interest-bearing demand deposits	$147,751	$135,756	$125,563	460	319	359	0.31	0.23	0.29
Money market accounts	195,741	191,407	200,760	1,391	685	572	0.71	0.36	0.28
Savings and other	171,662	145,779	127,539	1,100	425	226	0.64	0.29	0.18
Certificates of deposit	134,057	116,608	122,475	1,706	1,054	1,024	1.27	0.90	0.84
Total interest-bearing deposits	649,211	589,550	576,337	4,657	2,483	2,181	0.72	0.42	0.38
Repurchase agreements	3,340	2,517	3,770	12	5	6	0.36	0.20	0.16
Capital lease	2,839	1,157	419	178	96	70	6.27	8.30	16.71
Note payable	296	327	359	18	18	21	6.08	5.50	5.85
Subordinated debt (net of issuance costs)	9,823	9,799	9,776	624	624	624	6.35	6.37	6.38
FHLBB advances	64,250	35,309	30,850	1,734	1,012	947	2.70	2.87	3.07
Total interest-bearing liabilities	729,759	638,659	621,511	7,223	4,238	3,849	0.99	0.66	0.62
Demand deposits	223,329	216,151	199,163						
Other liabilities	6,266	5,937	6,057						
Shareholders' equity	99,809	96,749	92,703						
Total liabilities & shareholders' equity	$1,059,163	$957,496	$919,434						
Net interest income (f)				$33,620	$32,201	$31,755			
							3.07	3.39	3.51

Spread on interest-bearing funds			
Net interest margin (e)	3.35	3.58	3.69

(a) Includes non-accrual loans.

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

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

(d) Includes tax exempt income of $471,000, $921,000 and $1,205,000, respectively for 2018, 2017 and 2016 on tax-exempt securities and loans whose income and yields are calculated on a tax-equivalent basis.

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

(f) Interest income for 2018, 2017 and 2016 reflects net accretion related to the fair value adjustments of loans acquired in the Riverside Bank acquisition in the amount of $0.8 million, $1.2 million and $1.9 million, respectively.

The following table sets forth the changes in net interest income (presented on a tax-equivalent basis) due to volume and rate.

Years ended December 31, (in thousands)	2018 versus 2017			2017 versus 2016		
Change in interest due to	Volume	Rate	Net	Volume	Rate	Net
Loans	$3,911	$(231)	$3,680	$1,526	$(429)	$1,097
Securities	219	57	276	110	(563)	(453)
FHLBB stock	54	42	96	10	11	21
Short term funds	66	286	352	3	167	170
Interest-earning assets	4,250	154	4,404	1,649	(814)	835
Deposits	340	1,834	2,174	53	248	301
Repurchase agreements	2	5	7	(2)	1	(1)
Capital lease	123	(41)	82	92	(66)	26
Note payable	(2)	2	—	(2)	(1)	(3)
Subordinated Debt	2	(2)	—	2	(1)	—
FHLBB advances	805	(83)	722	132	(67)	65
Interest-bearing liabilities	1,270	1,715	2,985	274	114	388
Net change in net interest income	$2,980	$(1,561)	$1,419	$1,375	$(928)	$447

Net interest and dividend income represents the difference between interest and dividends earned on loans and securities and interest expense incurred on deposits and borrowings. The level of net interest income is a function of volume, rates and mix of both earning assets and interest-bearing liabilities. Net interest income can be affected by changes in interest rate levels, changes in the volume of assets and liabilities that are subject to re-pricing within different future time periods, and in the level of non-performing assets.

Interest and Dividend Income

Tax equivalent interest and dividend income increased $4.4 million, or 12.1%, to $40.8 million in 2018.

Loan income increased $3.7 million, or 10.9%, to $37.5 million in 2018. The increase was primarily due to a $90.6 million, or 11.6%, increase in average loans, partially offset by a 3 basis point decrease in average yield. Interest income for 2018 and 2017 reflects purchase accounting adjustments consisting of net accretion related to the fair value adjustments of loans acquired in the Riverside Bank acquisition in the amount of $0.8 million and $1.2 million, respectively.

Tax equivalent interest and dividend income from securities increased $276,000, or 13.0%, to $2.4 million in 2018, as a result of a $8.1 million, or 10.2%, increase in average security balances, and a 7 basis point increase in average yield. Interest from short term funds increased $352,000 in 2018 as a result of a 74 basis point increase in average yield and $5.0 million, or 13.7%, increase in average short term balances.

Interest Expense

Interest expense increased $3.0 million, or 70.4%, to $7.2 million in 2018.

Interest expense on interest bearing deposit accounts increased $2.2 million, or 87.6%, to $4.7 million in 2018, as a result of a $59.7 million, or 10.1%, increase in average interest bearing deposits and a 30 basis point increase in the average rate to 0.72%. The increase in the certificate of deposit balance from 2017 included $20 million of brokered certificates of deposits and $19.4 million of one-way buys executed through the Certificate of Deposit Account Registry Service (“CDARS”). CDARS is a product offered by Promontory Interfinancial Network that enables participating financial institutions to buy or sell excess funds to other members to fund operations and to manage

liquidity.

Interest expense on FHLBB advances increased $722,000, or 71.3%, due to a $28.9 million, or 82.0%, increase in average advances, partially offset by a 17 basis point decrease in the average borrowing rate to 2.70%.

In December 2015, Salisbury issued $10 million of subordinated debentures. The proceeds of such issuance, along with cash-on-hand, were used by Salisbury to fully redeem $16 million of its outstanding Series B Preferred Stock, which was issued pursuant to the participation in the U.S. Treasury's SBLF program. Interest expense on the subordinated debt for 2018 and 2017 was $624,000 and $624,000, respectively.

Provision and Allowance for Loan Losses

The provision for loan losses was $1,728,000 for 2018, compared with $1,020,000 for 2017. Net loan charge-offs were $673,000 and $371,000, for the respective years. The higher provision for loan losses in 2018 reflected lower recoveries partly offset by lower charge-offs.

The following table sets forth changes in the allowance for loan losses and other statistical data:

Years ended December 31, (dollars in thousands)	2018	2017	2016	2015	2014
Balance, beginning of period	$6,776	$6,127	$5,716	$5,358	$4,683
Provision for loan losses	1,728	1,020	1,835	917	1,134
Charge–offs					
Real estate mortgages	(558)	(733)	(1,031)	(1,061)	(512)
Commercial and industrial	(108)	(162)	(452)	(69)	(19)
Consumer	(81)	(76)	(67)	(82)	(28)
Charge-offs	(747)	(971)	(1,550)	(1,212)	(559)
Recoveries					
Real estate mortgages	18	286	32	129	60
Commercial and industrial	27	296	72	498	16
Consumer	29	18	22	26	24
Recoveries	74	600	126	653	100
Net charge-offs	(673)	(371)	(1,424)	(559)	(459)
Balance, end of period	$7,831	$6,776	$6,127	$5,716	$5,358
Loans receivable, gross	$915,689	$807,190	$768,064	$703,545	$677,485
Non-performing loans	6,514	6,635	8,792	16,265	9,890
Accruing loans past due 30-89 days	2,165	3,536	4,537	4,499	4,128
Ratio of allowance for loan losses:					
to loans receivable, gross	0.85%	0.84%	0.80%	0.81%	0.79%
to non-performing loans	120.21	102.13	69.69	35.15	54.18
Ratio of non-performing loans to loans receivable, gross	0.71	0.82	1.14	2.31	1.46
Ratio of accruing loans past due 30-89 days to loans receivable, gross	0.24	0.44	0.59	0.64	0.61

The reserve coverage at December 31, 2018, as measured by the ratio of allowance for loan losses to gross loans, was 0.85%, as compared with 0.84% at December 31, 2017. Non-performing loans (non-accrual loans and accruing loans past-due 90 days or more) decreased $0.1 million to $6.5 million, or 0.71% of gross loans receivable, at December 31, 2018, down from 0.82% at December 31, 2017. Accruing loans past due 30-89 days decreased $1.4 million to $2.2 million, or 0.24% of gross loans receivable at December 31, 2018. See “Overview – Loan Credit Quality” below for further discussion and analysis.

Non-Interest Income

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

Years ended December 31, (dollars in thousands)	2018	2017	2016	2018 vs. 2017		2017 vs. 2016	
Trust and wealth advisory	$3,700	$3,477	$3,338	$223	6.4 %	$139	4.2 %
Service charges and fees	3,718	3,718	3,133	—	—	585	18.7
Gains on sales of mortgage loans, net	89	125	229	(36)	(28.8)	(104)	(45.4)
Mortgage servicing, net	308	255	156	53	20.9	99	63.5
Losses on CRA mutual fund	(18)	—	—	(18)	n/a	—	n/a
Gains on securities, net	318	178	584	140	78.7	(406)	(69.5)
Bank-owned life insurance (“BOLI”) income	337	343	353	(6)	(1.7)	(10)	(2.8)
Gain on bank-owned life insurance	341	—	—	341	n/a	—	n/a
Other	152	140	98	12	8.6	42	42.9
Total non-interest income	$8,945	$8,236	$7,891	$709	8.6 %	$345	4.4 %

Non-interest income increased $709,000, or 8.6%, in 2018 versus 2017. Trust and Wealth Advisory revenues increased $223,000 primarily due to increased market values and a higher volume of assets under management, as well as higher estate planning fees. Service charges and fees were unchanged from 2017 as higher interchange fees were offset by lower deposit fees. Gains on sales of mortgage loans decreased $36,000 on lower sales volume. Mortgage loans sales totaled $4.5 million in 2018 versus $5.3 million in 2017. Income from servicing of mortgage loans increased $53,000 due primarily to a reduction in the amortization of mortgage servicing rights. Loans serviced under the FHLBB Mortgage Partnership Finance Program totaled $111.4 million and $117.5 million at December 31, 2018 and 2017, respectively. Gains on the sale of securities increased $140,000 in 2018 versus 2017. In 2018, the Bank recorded a non-taxable gain of $341,000 related to proceeds receivable from a BOLI policy due to the death of a covered former employee.

Non-Interest Expense

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

Years ended December 31, (dollars in thousands)	2018	2017	2016	2018 vs. 2017		2017 vs. 2016	
Salaries	$12,003	$11,135	$10,926	$868	7.8 %	$209	1.9 %
Employee benefits	4,280	3,767	3,891	513	13.6	(124)	(3.2)
Premises and equipment	4,535	3,831	3,375	704	18.4	456	13.5
Data processing	2,119	2,057	2,106	62	3.0	(49)	(2.3)
Professional fees	2,236	2,499	1,933	(263)	(10.6)	566	29.3
Collections, OREO, and appraisals	853	2,179	999	(1,326)	(60.9)	1,180	118.1
FDIC insurance	579	497	606	82	16.5	(109)	(18.0)
Marketing and community support	815	793	686	22	2.8	107	15.6
Amortization of intangibles	454	533	601	(79)	(14.8)	(68)	(11.3)
Other	1,961	2,038	2,264	(77)	(3.8)	(226)	(9.9)
Non-interest expense	$29,835	$29,329	$27,387	$506	1.7 %	$1,942	7.1 %

Non-interest expenses of $29.8 million for 2018 included charges of $275,000 related to the write down of OREO properties compared with OREO charges of $1.7 million in 2017. Excluding OREO related charges, non-interest expenses increased $1.9 million, or 7.05% in 2018 versus 2017. Salaries expense increased $868 thousand due to higher base salaries, merit increases, sales production, as a result of higher loan volume, and short-term incentive accruals. Employee benefits expense increased primarily due to higher 401K, ESOP and deferred compensation expenses. Premises and equipment expense increased $704,000 from 2017. The increase included a charge of $171,000 to write-off the remainder of the lease and fixed assets related to the Bank’s previously occupied Fishkill, New York branch location as well as a charge of $95,000 to write-off the remaining term of a third party software contract. Building maintenance and depreciation costs were also higher. Data processing expense increased $62,000 mainly as a result of higher core data processing costs. The decrease of $263,000 in professional fees reflected lower legal, consulting, audit and investment management expenses. Collections, OREO and appraisal expenses decreased $1.3 million primarily due to the decline in OREO charges noted above, which were partly offset by a reduction of accruals in 2017 related to OREO carrying costs and delinquent real estate taxes on bank-owned OREO properties. Marketing and community support increased $22,000 mainly related to an increase in community donations. Amortization of intangibles and all other operating expenses decreased $79,000 and $77,000, respectively.

Income Taxes

The effective income tax rates for 2018 and 2017 were 16.23% and 31.78%, respectively. The decline in the effective tax rate from 2017 primarily reflected the enactment of the Tax Cuts and Jobs Act (“TCJA”) in December 2017, which reduced the federal statutory tax rate from 34% to 21% for tax years beginning in 2018, and also included a discrete charge of $445,000 related to the remeasurement of Salisbury’s net deferred tax assets as a result of the enactment of the new law. Salisbury’s effective tax rate was less than the 21% federal statutory rate due to tax-exempt income, primarily from municipal bonds, tax advantaged loans and bank-owned life insurance. Fluctuations in the effective tax rate generally result from changes in the mix of taxable and tax exempt income. For further information on income taxes, see Note 12 of Notes to Consolidated Financial Statements.

Salisbury did not incur Connecticut income tax in 2018, 2017 or 2016, other than minimum state income tax, as a result of a Connecticut law that permits banks to shelter certain mortgage income from the Connecticut corporation business tax through the use of a special purpose entity called a Passive Investment Company or PIC. Salisbury avails itself of this benefit through its PIC, SBT Mortgage Service Corporation. Salisbury's income tax provision reflects the full impact of the Connecticut legislation. Salisbury does not expect to pay other than minimum Connecticut state income tax in the foreseeable future unless there is a change in Connecticut tax law.

Comparison of the Years Ended December 31, 2017 and 2016

Net Interest and Dividend Income

Net interest and dividend income represents the difference between interest and dividends earned on loans and securities and interest expense incurred on deposits and borrowings. The level of net interest income is a function of volume, rates and mix of both earning assets and interest-bearing liabilities. Net interest income can be affected by changes in interest rate levels, changes in the volume of assets and liabilities that are subject to re-pricing within different future time periods, and in the level of non-performing assets.

Interest and Dividend Income

Tax equivalent interest and dividend income increased $835,000, or 2.3%, to $36.4 million in 2017.

Loan income increased $1.1 million, or 3.4%, to $33.8 million in 2017. The increase was primarily due to a $35.0 million, or 4.7%, increase in average loans, partially offset by a 6 basis point decrease in average yield. Interest income for 2017 and 2016 reflects purchase accounting adjustments consisting of net accretion related to the fair value adjustments of loans acquired in the Riverside Bank acquisition in the amount of $1.2 million and $1.9 million, respectively.

Tax equivalent interest and dividend income from securities decreased $453,000, or 17.5%, to $2.1 million in 2017, as a result of a $3.6 million, or 4.8%, decrease in average security balances, and a 72 basis point decrease in average yield. Contributing factors to the lower yield include the maturity, sale, call or pay down of higher yielding securities resulting in a remaining mix of lower yielding securities in the portfolio. Interest from short term funds increased $170,000 in 2017 as a result of a 46 basis point increase in average yield and $0.4 million, or 1.1%, increase in average short term balances.

Interest Expense

Interest expense increased $389,000, or 10.1%, to $4.2 million in 2017.

Interest expense on interest bearing deposit accounts increased $302,000, or 13.8%, to $2.5 million in 2017, as a result of a $13.3 million, or 2.3%, increase in average interest bearing deposits and a 4 basis point increase in the average rate to 0.42%.

Interest expense on FHLBB advances increased $65,000, or 6.9%, due to a $4.5 million, or 14.5%, increase in average advances, partially offset by a 20 basis point decrease in the average borrowing rate to 2.87%.

In December 2015, Salisbury issued $10 million of subordinated debentures. The proceeds of such issuance, along with cash-on-hand, were used by Salisbury to fully redeem $16 million of its outstanding Series B Preferred Stock, which was issued pursuant to the participation in the U.S. Treasury's SBLF program. Interest expense on the subordinated debt for 2017 and 2016 was $624,000 and $624,000, respectively.

Provision and Allowance for Loan Losses

The provision for loan losses was $1,020,000 for 2017, compared with $1,835,000 for 2016. Net loan charge-offs were $371,000 and $1,424,000, for the respective years. The lower provision for loan losses in 2017 reflected lower charge-offs and higher recoveries.

The reserve coverage at December 31, 2017, as measured by the ratio of allowance for loan losses to gross loans, was 0.84%, as compared with 0.80% at December 31, 2016. Non-performing loans (non-accrual loans and accruing loans past-due 90 days or more) decreased $2.2 million to $6.6 million, or 0.82% of gross loans receivable, at December 31, 2017, down from 1.14% at December 31, 2016. Accruing loans past due 30-89 days decreased $1.0 million to $3.5 million, or 0.44% of gross loans receivable at December 31, 2017. See "Overview – Loan Credit Quality" below for further discussion and analysis.

Non-Interest Income

Non-interest income increased $345,000, or 4.4%, in 2017 versus 2016. Trust and Wealth Advisory revenues increased $139,000 primarily due to increased market values and a higher volume of assets under management, partially offset by decreased estate fee income. Service charges and fees increased $585,000 mainly due to increased ATM fees and ancillary account service related fees. Gains on sales of mortgage loans decreased $104,000 due to a decline in sales volume. Mortgage loans sales totaled $5.3 million in 2017 versus $10.3 million in 2016. Income from servicing of mortgage loans increased $99,000 due primarily to a reduction in the amortization of mortgage servicing rights. Loans serviced under the FHLBB Mortgage Partnership Finance Program totaled $117.5 million and $125.2 million at December 31, 2017 and 2016, respectively.

Non-Interest Expense

Non-interest expenses of $29.3 million for 2017 included charges of $1.7 million related to the write down and loss on the sale of an OREO property compared with OREO charges of $435,000 in 2016. Excluding OREO related charges, non-interest expenses increased $660,000, or 2.45% in 2017 versus 2016. Salary expense increased $209,000 due to changes in staffing levels and mix and merit increases. Employee benefit expense decreased $124,000 primarily as a result of lower deferred compensation and a decrease in employee stock ownership plan expenses. Premises and equipment expense increased $456,000 primarily as a result of the acquisition of the New Paltz branch in June 2017 and the additional lease expense associated with the relocation of the current Newburgh, New York branch to a new location. Building maintenance and depreciation costs for computer equipment and software were also higher. Data processing expense decreased $49,000 mainly as a result of expenses incurred in 2016 related to the conversion of the bank's core processing system and related infrastructure. The increase of $566,000 in professional fees primarily reflected higher consulting and audit fees as a result of Salisbury's core system conversion and new general ledger implementation as well as higher legal costs due to the New Paltz branch acquisition. Collections, OREO and appraisal expenses increased $1,180,000 primarily due to the OREO charges noted above, which were partly offset by lower taxes, appraisal and litigation costs. Marketing and community support increased $107,000 mainly related to an increase in general marketing campaigns. Amortization of intangibles decreased $68,000 reflecting the completion of the intangible asset amortization of an acquired branch office. All other operating expenses decreased $226,000.

Income Taxes

The effective income tax rates for 2017 and 2016 were 31.78% and 27.92 %, respectively. Fluctuations in the effective tax rate generally result from changes in the mix of taxable and tax exempt income. In addition, the effective tax rate for 2017 also included a discrete charge of $445,000 related to the remeasurement of Salisbury's net deferred tax assets as a result of the enactment of the TCJA in December 2017. Salisbury's effective tax rate was less than the 34% federal statutory rate due to tax-exempt income, primarily from municipal bonds, tax advantaged loans and bank-owned life insurance. For further information on income taxes, see Note 12 of Notes to Consolidated Financial Statements.

Salisbury did not incur Connecticut income tax in 2017, 2016 or 2015, other than minimum state income tax, as a result of a Connecticut law that permits banks to shelter certain mortgage income from the Connecticut corporation business tax through the use of a special purpose entity called a Passive Investment Company or PIC. Salisbury avails itself of this benefit through its PIC, SBT Mortgage Service Corporation. Salisbury's income tax provision reflects the full impact of the Connecticut legislation. Salisbury does not expect to pay other than minimum Connecticut state income tax in the foreseeable future unless there is a change in Connecticut tax law.

Overview

Assets

During 2018, Salisbury’s assets increased by $134.6 million to $1.1 billion, while net loans increased $107.6 million at December 31, 2018. At December 31, 2018, Salisbury’s tangible book value per common share was $31.45 and Tier 1 leverage and total risk-based capital ratios were 8.25% and 12.51%, respectively. As of December 31, 2018, the Bank was categorized as "well capitalized."

Securities and Short Term Funds

During 2018, securities increased $14.3 million to $97.2 million, while short-term funds (cash and due from banks and interest-bearing deposits with other banks) increased $9.9 million to $58.4 million. The carrying values of securities are as follows:

December 31, (dollars in thousands)	2018	2017	2016
Available-for-Sale			
U.S. Government agency notes	$5,049	$—	$—
Municipal bonds	5,379	3,486	15,996
Mortgage-backed securities	32,327	45,868	53,301
Collateralized mortgage obligations	17,747	13,041	5,209
SBA bonds	27,740	12,267	2,064
Other	3,576	3,550	2,235
CRA mutual fund	836	835	818
Non-Marketable			
FHLBB stock	4,496	3,813	3,211
Total Securities	$97,150	$82,860	$82,834

The amortized cost, fair value and tax equivalent yield of securities, by maturity, are as follows:

December 31, 2018 (in thousands)	Maturity	Amortized cost	Fair value	Yield(1)
U.S. Government agency notes	After 5 years but within 10 years	$ 4,991	$5,049	3.59 %
	Total	4,991	5,049	3.59
Municipal bonds	Within 1 year	296	296	1.97
	After 1 year but within 5 years	137	137	2.78
	After 10 years but within 15 years	4,368	4,410	4.79
	After 15 years	533	536	3.35
	Total	5,334	5,379	4.44
Mortgage-backed securities		32,522	32,327	3.01

	U.S. Government agency and U.S. Government-sponsored enterprises				
Collateralized mortgage obligations	U.S. Government agency and U.S. Government-sponsored enterprises	17,835	17,747	3.00	
SBA bonds		27,914	27,740	3.12	
Corporate bonds	After 5 years but within 10 years	3,500	3,576	5.57	
Securities available-for-sale		$ 92,096	$91,818	3.25	%

(1) Yield is based on amortized cost.

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

Salisbury evaluates securities for strategic fit and may reduce its position in securities, although it is not more likely than not that Salisbury will be required to sell these securities before recovery of their cost basis, which may be maturity, and does not intend to sell these securities. In 2009 Salisbury determined that five non-agency CMO securities reflected OTTI and recognized losses for deterioration in credit quality of $1,128,000. In 2018 Salisbury sold its remaining non-agency CMO securities for a pre-tax gain of $302,000. Management does not consider any of its securities to be OTTI at December 31, 2018.

It is possible that future loss assumptions could change necessitating Salisbury to recognize future OTTI. Salisbury evaluates securities for strategic fit and may reduce its position in securities, although it is not more likely than not that Salisbury will be required to sell securities before recovery of their cost basis, which may be maturity.

The carrying value of such securities judged to be OTTI are as follows:

Available-for-Sale (dollars in thousands)	Par value	Carrying value	Fair value
Non-agency CMO			
December 31, 2018	$—	$—	$—
December 31, 2017	1,055	651	981
December 31, 2016	1,431	1,008	1,340

Accumulated other comprehensive loss at December 31, 2018 included net unrealized holding losses, net of tax, of $0.2 million, which is a decrease of $0.4 million from December 31, 2017.

Loans

During 2018, net loans receivable increased $107.6 million, or 13%, to $909.3 million at December 31, 2018. Salisbury’s retail lending department originates residential mortgage, home equity loans and lines of credit, and consumer loans for the portfolio. During 2018, Salisbury originated $64.0 million of residential mortgage loans and $7.7 million of home equity loans for the portfolio, compared with $51.3 million and $8.3 million, respectively, in 2017. During 2018, total residential mortgage and home equity loans receivable grew by $48.1 million to $428.8 million at December 31, 2018, and represent 46.8% of gross loans receivable. During 2018, Salisbury’s residential mortgage lending department also originated and sold $4.6 million of residential mortgage loans, compared with $5.4 million during 2017. All such sold loans were sold through the FHLBB Mortgage Partnership Finance Program with servicing retained by Salisbury. Consumer loans, amounted to $4.5 million at December 31, 2018, represent 0.5% of gross loans receivable.

Salisbury’s commercial lending department specializes in lending to small and mid-size companies, businesses and municipalities. More specifically, we meet our clients’ credit needs by providing short-term and long-term financing, construction loans, commercial mortgages, equipment, working capital, property improvement loans and municipal financing. The department also works with both the Small Business Administration (“SBA”) and United States Department of Agriculture (“USDA”) Government Guaranteed Lending Programs; however, such loans represent a very small percent of the commercial loan portfolio. Salisbury originated $198.4 million of commercial loans during 2018 compared with $165.3 million in 2017. Total commercial loans, which include commercial real estate, commercial and industrial and municipal loans, increased $60.3 million to $469.8 million at December 31, 2018, and represent 51.2% of loans receivable.

The principal categories of loans receivable and loans held-for-sale are as follows:

December 31, (dollars in thousands)	2018	2017	2016	2015	2014
Residential 1-4 family	$345,862	$317,639	$301,128	$269,294	$261,481

Residential 5+ multifamily	36,510	18,108	13,625	12,547	14,291
Construction of residential 1-4 family	12,041	11,197	10,951	7,998	2,004
Home equity lines of credit	34,433	33,771	35,487	35,017	34,627
Residential real estate	428,846	380,715	361,191	324,856	312,403
Commercial	283,599	249,311	235,482	218,275	196,397
Construction of commercial	8,976	9,988	5,398	11,399	27,647
Commercial real estate	292,575	259,299	240,880	229,674	224,044
Farm land	4,185	4,274	3,914	3,193	3,239
Vacant land	8,322	7,883	6,600	8,563	9,342
Real estate secured	733,928	652,171	612,585	566,286	549,028
Commercial and industrial	162,905	132,731	141,473	121,421	117,918
Municipal	14,344	17,494	8,626	9,566	6,083
Consumer	4,512	4,794	5,380	6,272	4,456
Loans receivable, gross	915,689	807,190	768,064	703,545	677,485
Deferred loan origination fees and costs, net	1,421	1,289	1,247	1,189	1,203
Allowance for loan losses	(7,831)	(6,776)	(6,127)	(5,716)	(5,358)
Loans receivable, net	$909,279	$801,703	$763,184	$699,018	$673,330
Loans Held-for-sale					
Residential 1-4 family	$—	$669	$—	$763	$568

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The composition of loans receivable by forecasted maturity distribution is as follows:

December 31, 2018 (in thousands)	Within 1 year	Within 2-5 years	After 5 years	Total
Residential	$6,076	$9,166	$379,171	$394,413
Home equity lines of credit	1,256	359	32,818	34,433
Commercial	22,994	16,155	244,450	283,599
Construction of commercial	—	1,266	7,710	8,976
Land	2,362	60	10,085	12,507
Real estate secured	32,688	27,006	674,234	733,928
Commercial and industrial	26,990	38,856	97,059	162,905
Municipal	5,825	1,770	6,749	14,344
Consumer	790	2,299	1,423	4,512
Loans receivable, gross	$66,293	$69,931	$779,465	$915,689

The composition of loans receivable with either fixed, variable or adjustable interest rates is as follows:

December 31, 2018 (in thousands)	Fixed interest rates	Variable or adjustable interest rates	Total Loans
Residential	$163,931	$230,482	$394,413
Home equity lines of credit	—	34,433	34,433
Commercial	106,277	177,322	283,599
Construction of commercial	7,022	1,954	8,976
Land	2,081	10,426	12,507
Real estate secured	279,311	454,617	733,928
Commercial and industrial	66,002	96,903	162,905
Municipal	12,147	2,197	14,344
Consumer	3,719	793	4,512
Loans receivable, gross	$361,179	$554,510	$915,689

Loan Credit Quality

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

Past Due Loans

Loans past due 30 days or more decreased $1.5 million during 2018 to $7.6 million, or 0.83% of gross loans receivable at December 31, 2018, compared with $9.1 million, or 1.13% of gross loans receivable at December 31,

2017. The components of loans past due 30 days or greater are as follows:

(in thousands)	2018	2017	2016
Past due 30-59 days	$1,435	$2,594	$3,733
Past due 60-89 days	730	942	804
Past due 90-179 days	795	31	256
Accruing loans	2,960	3,567	4,793
Past due 30-59 days	208	1,186	344
Past due 60-89 days	108	684	—
Past due 90-179 days	812	516	2,260
Past due 180 days and over	3,517	3,164	4,927
Non-accrual loans	4,645	5,550	7,531
Total loans past due 30 days and over	$7,605	$9,117	$12,324

Credit Quality Segments

Salisbury categorizes loans receivable into the following credit quality segments.

- Impaired loans consist of all non-accrual loans and troubled debt restructured loans, and represent loans for which it is probable that Salisbury will not be able to collect all principal and interest amounts due according to the contractual terms of the loan agreements.
- Non-accrual loans, a sub-set of impaired loans, are loans for which the accrual of interest has been discontinued because, in the opinion of management, full collection of principal or interest is unlikely.
- Non-performing loans consist of non-accrual loans, and accruing loans past due 90 days and over that are well collateralized, in the process of collection and where full collection of principal and interest is reasonably assured. Non-performing assets consist of non-performing loans plus real estate acquired in settlement of loans.
- Troubled debt restructured loans are loans for which concessions such as reduction of interest rates, other than normal market rate adjustments, or deferral of principal or interest payments, extension of maturity dates, or reduction of principal balance or accrued interest, have been granted due to a borrower's financial condition. Loan restructuring is employed when management believes the granting of a concession will increase the probability of the full or partial collection of principal and interest.
- Potential problem loans consist of performing loans that have been assigned a substandard credit risk rating and are not classified as impaired.

Non-Performing Assets

Non-performing assets increased $1.0 million to $8.3 million at December 31, 2018, or 0.74% of assets, from $7.4 million or 0.74% of assets at December 31, 2017. The components of non-performing assets are as follows:

December 31, (in thousands)	2018	2017	2016	2015	2014
Commercial	$1,640	$3,622	$4,901	$4,611	$3,150
Vacant land	—	—	—	2,855	2,862
Farm land	216	250	1,002	1,031	384
Residential 1-4 family	2,092	2,045	1,920	6,446	3,007
Residential 5+ multifamily	1,000	151	163	89	89
Home equity lines of credit	411	66	519	601	348
Real estate secured	5,359	6,134	8,505	15,633	9,840
Commercial and industrial	360	470	27	461	33
Consumer	—	—	4	80	—
Non-accrual loans	5,719	6,604	8,536	16,174	9,873
Accruing loans past due 90 days and over	795	31	256	90	17
Non-performing loans	6,514	6,635	8,792	16,264	9,890
Real estate acquired in settlement of loans, net	1,810	719	3,773	—	1,002
Non-performing assets	$8,324	$7,354	$12,565	$16,264	$10,892

Reductions in interest income associated with non-accrual loans are as follows:

Years ended December 31, (in thousands)	2018	2017	2016
Income in accordance with original terms	$328	$992	$1,085
Income recognized	36	673	404
Reduction in interest income	$292	$319	$681

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

December 31, (in thousands)	2018	2017	2016
Current	$1,074	$1,054	$1,005
Past due 30-59 days	208	1,186	344
Past due 60-89 days	108	684	—
Past due 90-179 days	1,607	546	2,516
Past due 180 days and over	3,517	3,165	4,927
Total non-performing loans	$6,514	$6,635	$8,792

At December 31, 2018, 16.49% of non-performing loans were current with respect to loan payments, compared with 15.89% at December 31, 2017. Loans past due 180 days and over are substantially all mortgage loans in the process of foreclosure or litigation.

Salisbury endeavors to work constructively to resolve its non-performing loan issues with customers. Substantially all non-performing loans are collateralized with real estate and the repayment of such loans is largely dependent on the return of such loans to performing status or the liquidation of the underlying real estate collateral.

Troubled Debt Restructured Loans

Troubled debt restructured loans decreased $0.5 million in 2018 to $8.1 million, or 0.88% of gross loans receivable, from $8.6 million, or 1.07% of gross loans receivable at December 31, 2017. The components of troubled debt restructured loans are as follows:

December 31, (in thousands)	2018	2017	2016
Residential 1-4 family	$2,824	$3,138	$3,209
Residential 5+ multifamily	675	1,595	1,660
Home equity lines of credit	47	47	114
Vacant land	190	199	210
Commercial	2,924	2,454	2,549
Real estate secured	6,660	7,433	7,742
Commercial and industrial	141	49	56
Accruing troubled debt restructured loans	6,801	7,482	7,798
Residential 1-4 family	289	269	77
Residential 5+ multifamily	1,000	151	163
Commercial	—	624	2,022
Real estate secured	1,289	1,044	2,262
Commercial and Industrial	—	110	—
Non-accrual troubled debt restructured loans	1,289	1,154	2,262
Troubled debt restructured loans	$8,090	$8,636	$10,060

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

December 31, (in thousands)	2018	2017	2016
Current	$6,340	$7,293	$7,683
Past due 30-59 days	461	189	115
Past due 60-89 days	—	—	—
Accruing troubled debt restructured loans	6,801	7,482	7,798
Current	359	530	240
Past due 30-59 days	67	—	—
Past due 60-89 days	—	624	—
Past due 90-179 days	634	—	1,793
Past due 180 days and over	229	—	229
Non-accrual troubled debt restructured loans	1,289	1,154	2,262
Total troubled debt restructured loans	$8,090	$8,636	$10,060

At December 31, 2018, 82.82% of troubled debt restructured loans were current with respect to loan payments, as compared with 90.59% at December 31, 2017. As of December 31, 2018, 2017 and 2016, there were specific reserves on troubled debt restructured loans amounting to $252,000, $245,000, and $208,000, respectively.

Potential Problem Loans

Potential problem loans consist of performing loans that have been assigned a substandard credit risk rating and are not classified as impaired. Potential problem loans decreased $2.3 million during 2018 to $7.6 million or 0.83% of gross loans receivable at December 31, 2018, compared with $9.9 million, or 1.23% of gross loans receivable at December 31, 2017. The components of potential problem loans are as follows:

December 31, (in thousands)	2018	2017	2016
Residential 1-4 family	$1,300	$1,432	$514

Residential 5+ multifamily	—	—	—
Construction of residential 1-4 family	—	—	—
Home equity lines of credit	29	104	123
Residential real estate	1,329	1,536	637
Commercial	5,567	7,905	6,057
Construction of commercial	141	—	—
Commercial real estate	5,708	7,905	6,057
Farm land	—	—	—
Vacant land	—	—	—
Real estate secured	7,037	9,441	6,694
Commercial and industrial	605	457	581
Consumer	—	—	—
Total potential problem loans	$7,642	$9,898	$7,275

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

December 31, (in thousands)	2018	2017	2016
Current	$6,543	$8,520	$6,383
Past due 30-59 days	78	1,291	826
Past due 60-89 days	226	56	66
Past due 90-179 days	795	31	—
Total potential problem loans	$7,642	$9,898	$7,275

At December 31, 2018, 85.62% of potential problem loans were current with respect to loan payments, as compared with 86.08% at December 31, 2017. Management cannot predict the extent to which economic or other factors may impact such borrowers' future payment capacity, and there can be no assurance that such loans will not be placed on nonaccrual status, restructured, or require increased provisions for loan losses.

Deposits and Borrowings

Deposits increased $111.2 million during 2018, or 13.6%, to $926.7 million at December 31, 2018, compared with $815.5 million at December 31, 2017. Retail repurchase agreements increased $2.4 million during 2018 to $4.1 million at December 31, 2018, compared with $1.7 million at December 31, 2017. Total deposits at December 31, 2018 included two separate relationships totaling $35.2 million, or 3.80% of total deposits.

The distribution of average total deposits by account type is as follows:

	December 31, 2018			December 31, 2017		
(in thousands)	Average Balance	Percent	Weighted Average	Average Balance	Percent	Weighted Average
Demand deposits	$223,356	25.61 %	0.00 %	$216,164	26.83 %	0.00 %
Interest-bearing checking accounts	147,751	16.93	0.31	135,756	16.85	0.23
Regular savings accounts	171,662	19.67	0.71	145,779	18.09	0.29
Money market savings	195,741	22.43	0.64	191,407	23.76	0.36
Certificates of deposit	134,057	15.36	1.27	116,608	14.47	0.90
Total deposits	$872,567	100.00%	0.31 %	$805,714	100.00%	0.31 %

The classification of certificates of deposit by interest rates is as follows:

	At December 31,	
Interest rates	2018	2017
Less than 1.00%	$38,992	$50,226
1.00% to 1.99%	47,175	52,558
2.00% to 2.99%	75,512	14,047
Total	$161,679	$116,831

The distribution of certificates of deposit by interest rate and maturity is as follows:

	At December 31, 2018					
Interest rates	Less Than or Equal to One	More Than One to	More Than Two to	More Than Three	Total	Percent of Total

	Year	Two Years	Three Years	Years		
Less than 1.00%	$31,394	$7,597	$1	$—	$38,992	24.12 %
1.00% to 1.99%	22,946	9,740	7,173	7,315	47,175	29.18
2.00% to 2.99%	47,404	16,548	6,023	5,538	75,512	46.70
Total	$101,744	$33,885	$13,197	$12,853	$161,679	100.00%

Scheduled maturities of time certificates of deposit in denominations of $100,000 or more are as follows:

December 31, 2018 (in thousands)	Within 3 months	Within 3-6 months	Within 6-12 months	Over 1 year	Total
Certificates of deposit $100,000 and over	$16,570	$6,548	$29,904	$11,926	$64,948

FHLBB advances increased $12.7 million during 2018 to $67.2 million at December 31, 2018, compared with $54.4 million at December 31, 2017. The net increase primarily reflected new long-term borrowings in 2018 of $37.0 million partly offset by the repayment of matured advances totaling $7 million. Net FHLB short payoffs amounted to $17.5 million for 2018. The balance at December 31, 2018 included overnight borrowings of $9.5 million that matured on January 2, 2019. Salisbury also has an Irrevocable Letter of Credit Reimbursement Agreement with the FHLBB, whereby upon the Bank's request an irrevocable letter of credit is issued to secure municipal and certain other transactional deposit accounts. These letters of credit are secured primarily by residential mortgage loans. The amount of funds available from the FHLBB to the Bank is reduced by any letters of credit outstanding. At December 31, 2018, $33.0 million of letters of credit were outstanding and Salisbury's borrowing capacity at the FHLB was $143.7 million. There were no letters of credit outstanding at December 31, 2017.

The following table sets forth certain information concerning short-term FHLBB advances:

December 31, (dollars in thousands)	2018	2017
Highest month-end balance during period	$25,000	$30,000
Ending balance	9,500	27,000
Average balance during period	14,843	8,013

Subordinated Debentures

In December 2015, Salisbury completed the issuance of $10.0 million in aggregate principal amount of 6.00% Fixed to Floating Rate Subordinated Notes Due 2025 (the "Notes") in a private placement transaction to various accredited investors including $500 thousand to certain of Salisbury's related parties. The Notes have a maturity date of December 15, 2025 and bear interest at an annual rate of 6.00% from and including the original issue date of the Notes to, but excluding, December 15, 2020 or the earlier redemption date payable semi-annually in arrears on June 15 and December 15 of each year. Thereafter, from and including December 15, 2020 to, but excluding, December 15, 2025, the annual interest rate will be reset quarterly and equal to the three-month LIBOR, plus 430 basis points, as described in the Notes, payable quarterly, in arrears, on March 15, June 15, September 15 and December 15 of each year during the time that the Notes remain outstanding through December 15, 2025 or earlier redemption date. The notes are redeemable, without penalty, on or after December 15, 2020 and, in certain limited circumstances, prior to that date. As more completely described in the Notes, the indebtedness evidenced by the Notes, including principal and interest, is unsecured and subordinate and junior in right of Salisbury's payments to general and secured creditors and depositors of the Bank. The Notes also contain provisions with respect to redemption features and other matters pertaining to the Notes. The Notes have been structured to qualify as Tier 2 capital for regulatory capital purposes, subject to applicable limitations.

Subordinated debentures totaled $9.8 million at December 31, 2018, which includes $165 thousand of remaining unamortized debt issuance costs. The debt issuance costs are being amortized to maturity. The effective interest rate of the subordinated debentures is 6.36%.

OFF-BALANCE SHEET ARRANGEMENTS AND CONTRACTUAL CASH OBLIGATIONS

In the normal course of business, Salisbury enters into various contractual obligations that may require future cash payments. Contractual obligations at December 31, 2018 include operating leases, capital leases, contractual purchases and certain other benefit plans. For further discussion regarding leases see Note 19 to the Consolidated Financial Statements.

The accompanying table summarizes Salisbury's off-balance sheet lending-related financial instruments and significant cash obligations, by remaining maturity, at December 31, 2018. Salisbury's lending-related financial instruments include commitments that have maturities over one year. Contractual purchases include commitments for future cash expenditures, primarily for services and contracts that reflect the minimum contractual obligation under legally enforceable contracts with contract terms that are both fixed and determinable. Excluded from the following table are a number of obligations to be settled in cash, primarily in under one year. These obligations are reflected in Salisbury's Consolidated Balance Sheets and include deposits, FHLBB advances and repurchase agreements that settle within standard market timeframes.

December 31, 2018 (in thousands)	Within	Within	Within	After	
By Remaining Maturity	1 year	1-3 years	4-5 years	5 years	Total
Residential	$315	$983	$1,217	$4,236	$6,751
Home equity lines of credit	76	405	—	29,391	29,872
Commercial	2,386	2,535	305	13,825	19,051
Land	—	—	—	14	14
Real estate secured	2,777	3,923	1,522	47,466	55,688
Commercial and industrial	27,801	2,656	408	46,354	77,219
Municipal	—	—	—	250	250
Consumer	—	—	—	1,583	1,583
Unadvanced portions of loans	30,578	6,579	1,930	95,653	134,740
Commitments to originate loans	18,397	—	—	—	18,397
Standby letters of credit	3,559	305	—	1	3,865
Total	$52,534	$6,884	$1,930	$95,654	$157,002

LIQUIDITY

Salisbury manages its liquidity position to ensure it has sufficient funding availability at all times to meet both anticipated and unanticipated deposit withdrawals, loan originations and advances, securities purchases and other operating cash outflows. Salisbury's primary source of liquidity is deposits and though its preferred funding strategy is to attract and retain low cost deposits, its ability to do so is affected by competitive interest rates and terms in its marketplace, and other financial market conditions. Other sources of funding include cash flows from loan and securities principal payments and maturities, funds provided by operations, and discretionary use of national market certificates of deposit and FHLBB advances. Liquidity can also be provided through sales of securities and loans. Salisbury manages its liquidity in accordance with a liquidity funding policy, and also maintains a contingency funding plan that provides for the prompt and comprehensive response to unexpected demands for liquidity. Management believes Salisbury's funding sources will meet anticipated funding needs.

Operating activities for 2018 provided net cash of $13.3 million. Investing activities utilized net cash of $118.2 million, principally from loan originations and principal collections, net of $102.3 million and purchases of securities of $41.6 million, offset by sales, calls, and maturities of securities of $27.8 million. Financing activities provided net cash of $114.8 million, principally from a net deposit increase of $103.0 million, FHLBB advances of $37.0 million and an increase of $2.4 million in securities sold under agreements to repurchase, partly offset by net principal payments on FHLB advances of $24.5 million and common stock dividends of $3.1 million.

Operating activities for 2017 provided net cash of $10.2 million. Investing activities utilized net cash of $9.9 million, principally from loan originations and principal collections of $32.5 million and purchases of securities of $36.7 million, offset by sales, calls, and maturities of securities of $36.8 million. Financing activities provided net cash of $12.7 million, principally from a net deposit increase of $2.4 million and FHLBB advances of $17 million, offset by a decrease of $3.9 million in securities sold under agreements to repurchase and common stock dividends of $3.1 million.

Operating activities for 2016 provided net cash of $11.3 million. Investing activities utilized net cash of $74.0 million, principally from loan originations and principal collections of $69.2 million and purchases of securities of $56.2 million, offset by sales, calls, and maturities of securities of $52.7 million. Financing activities provided net cash of $36.1 million, principally from a net deposit increase of $33.9 million and an FHLBB advance of $10 million, offset by a non- time deposits decrease of $6.6 million.

CAPITAL RESOURCES

Shareholders' Equity

Shareholders' equity increased $5.9 million in 2018 to $103.5 million at December 31, 2018. Contributing to the increase in shareholders' equity was net income of $8.8 million, stock options exercised of $0.2 million and restricted stock awards of $0.4 million, partially offset by common stock dividends declared of $3.1 million and a loss in other comprehensive income of $0.4 million.

Capital Requirements

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

ratios are as follows at December 31, 2018 and 2017 under the regulatory capital rules then in effect:

	Minimum for Capital Adequacy		Well Capitalized		December 31, 2018		December 31, 2017	
	2018	2017	2018	2017	Salisbury	Bank	Salisbury	Bank
Total Capital (to risk-weighted assets)	8.00 %	8.00 %	10.00%	10.00%	12.51 %	12.09%	12.94 %	12.54%
Common Equity Tier 1 Capital	4.50	4.50	6.50	6.50	10.43	11.17	10.73	11.64
Tier 1 Capital (to risk-weighted assets)	6.00	6.00	8.00	8.00	10.43	11.17	10.73	11.64
Tier 1 Capital (to average assets)	4.00	4.00	5.00	5.00	8.25	8.83	8.53	9.25

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

The FRB's final rules implementing the Basel Committee on Banking Supervision's capital guidelines for bank holding companies and their bank subsidiaries include a common equity Tier 1 capital to risk-weighted assets minimum ratio of 4.5%, a minimum ratio of Tier 1 capital to risk-weighted assets of 6.0%, require a minimum ratio of Total capital to risk-weighted assets of 8.0%, and require a minimum Tier 1 leverage ratio of 4.0%. A capital conservation buffer, comprised of common equity Tier 1 capital, is also established above the regulatory minimum capital requirements. This capital conservation buffer began phasing in January 1, 2016 at 0.625% of risk-weighted assets and increases each subsequent year by an additional 0.625% until reaching its final level of 2.50% on January 1, 2019. Strict eligibility criteria for regulatory capital instruments were also implemented under the final rules.

The phase-in period for the final rules began for Salisbury and the Bank on January 1, 2015. As of December 31, 2018, the Company and the Bank met each of their capital requirements and the most recent notification from the FDIC categorized the Bank as “well-capitalized.” There are no conditions or events since that notification that management believes have changed the Bank’s category.

On February 8, 2019, the Office of the Comptroller of the Currency, the FRB and the FDIC published a proposal that would simplify capital requirements for certain community banking organizations with less than $10 billion in total consolidated assets (such as the Bank), consistent with Section 201 of the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018 (“EGRRCPA”). Section 201 of EGRRCPA requires the banking agencies to promulgate a rule establishing a new “Community Bank Leverage Ratio” of 8%-10% for qualifying banking organizations. Under the proposal, depository institutions and their holding companies that meet certain criteria (generally, those with limited amounts of off-balance sheet exposures, trading assets and liabilities, mortgage servicing assets, and temporary difference deferred tax assets) (“qualifying community banking organizations”) would be eligible to use a simple on-balance sheet leverage ratio as the measure of their capital adequacy. A qualifying community banking organization with a community bank leverage ratio (“CBLR”) of greater than 9% that “elects to use the CBLR framework” would not be subject to other risk-based and leverage capital requirements and would be considered to have met the well-capitalized ratio requirements for purposes of the agencies’ Prompt Corrective Action (“PCA”) framework. The proposal also “incorporates CBLR levels as proxies for the following PCA categories: adequately capitalized, undercapitalized and significantly undercapitalized,” under each of which a CBLR banking organization would be subject to the same restrictions that currently apply to any other insured depository institution in the same PCA category. As a result, the proposal would establish three CBLR proxies for the following PCA capital categories: (a) Adequately capitalized: CBLR of 7.5% or greater; (b) Undercapitalized: CBLR of less than 7.5%; (c) and significantly undercapitalized: CBLR of less than 6%. Comments on the proposal are due by April 9, 2019. Salisbury and the Bank are evaluating the potential benefits of the additional flexibility offered by EGRRCPA and will monitor the proposed regulations.

Dividends

During 2018 and 2017, Salisbury declared and paid four quarterly common stock dividends of $0.28 per common share each quarter, totaling $3,133,000 and $3,113,000, respectively. The Board of Directors of Salisbury declared a common stock dividend of $0.28 per common share payable on February 28, 2019 to shareholders of record on February 14, 2019. Common stock dividends, when declared, will generally be paid the last business day of February, May, August and November, although Salisbury is not obligated to pay dividends on those dates or at any other time.

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

FRB Supervisory Letter SR 09-4, February 24, 2009, revised March 30, 2009, states that, as a general matter, the Board of Directors of a Bank Holding Company (“BHC”) should inform the Federal Reserve and should eliminate, defer, or significantly reduce dividends if (1) net income available to shareholders for the past four quarters, net of dividends previously paid during that period, is not sufficient to fully fund the dividends; (2) the prospective rate of earnings retention is not consistent with capital needs and overall current and prospective financial condition; or (3) the BHC will not meet, or is in danger of not meeting, its minimum regulatory capital adequacy ratios. Moreover, a BHC should inform the Federal Reserve reasonably in advance of declaring or paying a dividend that exceeds earnings for the period (e.g., quarter) for which the dividend is being paid or that could result in a material adverse

change to the BHC capital position.

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

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

See Note 1 to the Consolidated Financial Statements for details of recently issued accounting pronouncements and their expected impact on Salisbury’s consolidated financial statements.

IMPACT OF INFLATION AND CHANGING PRICES

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

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

The ALCO manages interest rate risk using income simulation to measure interest rate risk inherent in Salisbury's financial instruments at a given point in time by showing the effect of interest rate shifts on net interest income over a 24-month horizon. In management's December 31, 2018 analysis, the simulations incorporate static growth assumptions over the simulation horizons for regulatory compliance and interest rate risk measurement purposes. In the dynamic growth scenarios, allowances are made for loan, deposit and security product mix shifts in selected interest rate scenarios, such as movements between lower rate savings and money market deposit accounts and higher rate time deposits, and changes in the reinvestment of loan and securities cash flows. Additionally, the simulations take into account the specific re-pricing, maturity and prepayment characteristics of differing financial instruments that may vary under different interest rate scenarios.

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

ALCO uses four interest rate scenarios to evaluate interest risk exposure and may vary these interest rate scenarios to show the effect of steepening or flattening changes in yield curves as well as parallel changes in interest rates. At December 31, 2018, ALCO used the following interest rate scenarios: (1) unchanged interest rates; (2) immediately rising interest rates – immediate parallel upward shift in market interest rates of 300 basis points across the yield curve; (3) immediately falling interest rates – immediate parallel downward shift in market interest rates of 100 basis points across the yield curve; and (4) gradual and non-parallel declines in interest rates – a gradual decline in market interest rates ranging from 98 basis points for the 2-year Treasury rates to 85 basis points for the 10-year Treasury in year one and then a further decline in market interest rates ranging from 55 basis points for the 2 year treasury rate to 45 basis points for the 10-year Treasury in year two. In this scenario, the yield curve inverts between month 2 and month 7 and then normalizes in subsequent months. Deposit rates are assumed to shift by lesser amounts due to their relative historical insensitivity to market interest rate movements. Further, deposits are assumed to have certain minimum rate levels below which they will not fall. Income simulations do not reflect adjustments in strategy that the ALCO could implement in response to rate shifts.

As of December 31, 2018, net interest income simulations indicated that Salisbury's exposure to changing interest rates over the simulation horizons remained within its tolerance levels, except for year two in the immediately falling interest rate scenario. The following table sets forth the estimated change in net interest income from an unchanged interest rate scenario over the periods indicated for changes in market interest rates using Salisbury's financial instruments as of December 31, 2018.

December 31, 2018 (in thousands)	Months 1-12		Months 13-24	
Immediately rising interest rates +300bp (static growth assumptions)	(4.10	)%	0.10	%
Immediately falling interest rates -100bp (static growth assumptions)	(2.80	)	(5.20	)
Immediately rising interest rates +400bp (static growth assumptions)	(5.60	)	(0.20	)

The negative exposure of net interest income to immediately and gradually rising rates as compared to the unchanged rate scenario results from a faster projected rise in the cost of funds versus income from earning assets, as relatively rate-sensitive money market and time deposits re-price faster than longer duration earning assets. The negative exposure of net interest income to immediately falling rates as compared to an unchanged rate scenario results from a greater decline in earning asset yields compared to rates paid on funding liabilities, as a result of faster prepayments on existing assets and lower reinvestment rates on future loans originated and securities purchased.

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

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

December 31, 2018 (in thousands)	Rates up 100bp	Rates up 200bp
U.S. Government Agency notes	$(353)	$(631)
Municipal bonds	(221)	(422)
Mortgage backed securities	(1,243)	(2,210)
Collateralized mortgage obligations	(961)	(1,931)
SBA pools	(1,960)	(3,094)
Other	(116)	(219)
Total available-for-sale debt securities	$(4,854)	$(8,507)

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of Salisbury Bancorp, Inc.

Opinion on the Financial Statements and Internal Control Over Financial Reporting

We have audited the accompanying consolidated balance sheets of Salisbury Bancorp, Inc. and Subsidiary (the Company) as of December 31, 2018 and 2017, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2018, and the related notes (collectively referred to as the financial statements). We also have audited the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in 2013.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the three years in the three-year period ended December 31, 2018, in conformity with accounting principles general accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control - Integrated Framework* issued by COSO in 2013.

Basis for Opinions

The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report of Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

To the Board of Directors and Shareholders of Salisbury Bancorp, Inc.

Our audits of the financial statements included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control Over Financial Reporting

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company’s assets that could have a material effect on the financial statements.

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

Portsmouth, New Hampshire

March 15, 2019

We (or our predecessor firms) have served as the Company’s auditor consecutively since 1993.

Salisbury Bancorp, Inc. and Subsidiary

CONSOLIDATED BALANCE SHEETS

December 31, (dollars in thousands, except par value)	2018	2017
ASSETS		
Cash and due from banks	$7,238	$9,357
Interest bearing demand deposits with other banks	51,207	39,129
Total cash and cash equivalents	58,445	48,486
Securities		
Available-for-sale at fair value	91,818	78,212
CRA mutual fund	836	835
Federal Home Loan Bank of Boston stock at cost	4,496	3,813
Loans held-for-sale	—	669
Loans receivable, net (allowance for loan losses: $7,831 and $6,776)	909,279	801,703
Other real estate owned	1,810	719
Bank premises and equipment, net	18,175	16,401
Goodwill	13,815	13,815
Intangible assets (net of accumulated amortization: $4,498 and $4,044)	1,383	1,837
Accrued interest receivable	3,148	2,665
Cash surrender value of life insurance policies	14,438	14,381
Deferred taxes	1,276	677
Other assets	2,635	2,771
Total Assets	$1,121,554	$986,984
LIABILITIES and SHAREHOLDERS' EQUITY		
Deposits		
Demand (non-interest bearing)	$228,448	$220,536
Demand (interest bearing)	153,586	142,575
Money market	204,219	190,953
Savings and other	178,807	144,600
Certificates of deposit	161,679	116,831
Total deposits	926,739	815,495
Repurchase agreements	4,104	1,668
Federal Home Loan Bank of Boston advances	67,154	54,422
Subordinated debt	9,835	9,811
Note payable	280	313
Capital lease liability	3,081	1,835
Accrued interest and other liabilities	6,902	5,926
Total Liabilities	1,018,095	889,470
Shareholders' Equity		
Common stock - $0.10 per share par value Authorized: 5,000,000; Issued: 2,884,988 and 2,872,578 Outstanding: 2,806,781 and 2,785,216	281	279
Unearned compensation - restricted stock awards	(711)	(606)
Paid-in capital	43,770	42,998
Retained earnings	60,339	54,664

Accumulated other comprehensive (loss) income, net	(220)	179
Total Shareholders' Equity	103,459	97,514
Total Liabilities and Shareholders' Equity	$1,121,554	$986,984

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

Salisbury Bancorp, Inc. and Subsidiary

CONSOLIDATED STATEMENTS OF INCOME

Years ended December 31, (in thousands except per share amounts)	2018	2017	2016
Interest and dividend income			
Interest and fees on loans	$37,072	$33,090	$32,050
Interest on debt securities			
Taxable	2,231	1,566	1,183
Tax exempt	136	380	927
Other interest and dividends	933	485	294
Total interest and dividend income	40,372	35,521	34,454
Interest expense			
Deposits	4,656	2,483	2,181
Repurchase agreements	12	5	6
Capital leases	178	96	70
Note payable	18	18	21
Subordinated debt	624	624	624
Federal Home Loan Bank of Boston advances	1,733	1,012	947
Total interest expense	7,221	4,238	3,849
Net interest and dividend income	33,151	31,283	30,605
Provision for loan losses	1,728	1,020	1,835
Net interest and dividend income after provision for loan losses	31,423	30,263	28,770
Non-interest income			
Trust and wealth advisory	3,700	3,477	3,338
Service charges and fees	3,718	3,718	3,133
Gains on sales of mortgage loans, net	89	125	229
Mortgage servicing, net	308	255	156
Losses on CRA mutual fund	(18)	—	—
Gains on securities, net	318	178	584
BOLI income and gains	678	343	353
Other	152	140	98
Total non-interest income	8,945	8,236	7,891
Non-interest expense			
Salaries	12,003	11,135	10,926
Employee benefits	4,280	3,767	3,891
Premises and equipment	4,535	3,831	3,375
Data processing	2,119	2,057	2,106
Professional fees	2,236	2,499	1,933
OREO gains, losses and writedowns, net	275	1,716	—
Collections, OREO, and appraisals	578	463	999
FDIC insurance	579	497	606
Marketing and community support	815	793	686
Amortization of intangibles	454	533	601
Other	1,961	2,038	2,264
Total non-interest expense	29,835	29,329	27,387
Income before income taxes	10,533	9,170	9,274

Income tax provision	1,709	2,914	2,589
Net income	$8,824	$6,256	$6,685
Net income allocated to common stock	$8,713	$6,201	$6,633
Basic earnings per common share	$3.15	$2.25	$2.43
Weighted average common shares outstanding, to calculate basic earnings per share	2,763	2,755	2,733
Diluted earnings per common share	3.13	2.24	2.41
Weighted average common shares outstanding, to calculate diluted earnings per share	2,780	2,774	2,749
Common dividends per share	1.12	1.12	1.12

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

Salisbury Bancorp, Inc. and Subsidiary

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Years ended December 31, (in thousands)	2018	2017	2016
Net income	$8,824	$6,256	$6,685
Other comprehensive (loss)			
Net unrealized (losses) on securities available-for-sale	(202)	(318)	(399)
Reclassification of net realized gains in net income	(318)	(178)	(584)
Unrealized (losses) on securities available-for-sale	(520)	(496)	(983)
Income tax benefit	105	198	335
Unrealized (losses) on securities available-for-sale, net of tax	(415)	(298)	(648)
Other comprehensive (loss), net of tax	(415)	(298)	(648)
Comprehensive income	$8,409	$5,958	$6,037

Salisbury Bancorp, Inc. and Subsidiary

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(in thousands,	Common Stock		Paid-in	Retained	Unearned compensation-restricted stock	Accumulated other comp-rehensive income	Total share-holders'
except share amounts)	Shares	Amount	capital	earnings	awards	(loss)	equity
Balances at December 31, 2015	2,733,576	$273	$41,364	$47,922	$ (110)	$ 1,125	$ 90,574
Net income for year	—	—	—	6,685	—	—	6,685
Other comprehensive loss, net of tax	—	—	—	—	—	(648)	(648)
Common stock dividends declared ($1.12 per share)	—	—	—	(3,086)	—	—	(3,086)
Stock options exercised	4,050	—	87	—	—	—	87
Issuance of restricted common stock	15,800	2	464	—	(466)	—	—
Forfeiture of restricted common stock	(100)	—	(3)	—	3	—	—
Issuance of common stock for directors fees	4,760	1	140	—	—	—	141
Stock based compensation-restricted stock awards	—	—	—	—	221	—	221
Tax benefit from stock compensation	—	—	33	—	—	—	33
Balances at December 31, 2016	2,758,086	$276	$42,085	$51,521	$ (352)	$ 477	$ 94,007

Net income for year	—	—	—	6,256	—	—	6,256
Other comprehensive loss, net of tax	—	—	—	—	—	(298)	(298)
Common stock dividends declared ($1.12 per share)	—	—	—	(3,113)	—	—	(3,113)
Stock options exercised	12,150	1	315	—	—	—	316
Issuance of restricted common stock	11,800	2	462	—	(464)	—	—
Forfeiture of restricted common stock	(900)	—	(28)	—	28	—	—
Issuance of common stock for directors fees	2,056	—	81	—	—	—	81
Issuance of directors restricted stock awards	2,024	—	83	—	(83)	—	—
Stock based compensation-restricted stock awards	—	—	—	—	265	—	265
Balances at December 31, 2017	2,785,216	$279	$42,998	$54,664	$ (606)	$ 179	$ 97,514
Net income for year	—	—	—	8,824	—	—	8,824
Adoption of ASU 2016-01	—	—		(16)	—	16	—
Other comprehensive loss, net of tax	—	—	—	—	—	(415)	(415)
Common stock dividends declared ($1.12 per share)	—	—	—	(3,133)	—	—	(3,133)
Stock options exercised	9,155	1	221	—	—	—	222
Issuance of restricted common stock	9,250	1	409	—	(410)	—	—
Forfeiture of restricted common stock	(800)	—	(33)	—	33	—	—
Issuance of directors restricted stock awards	3,960	—	175	—	(175)	—	—
Stock based compensation-restricted stock awards	—	—	—	—	447	—	447
Balances at December 31, 2018	2,806,781	$281	$43,770	$60,339	$ (711)	$ (220)	$ 103,459

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Salisbury Bancorp, Inc. and Subsidiary

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31, (in thousands)	2018	2017	2016
Operating Activities			
Net income	$8,824	$6,256	$6,685
Adjustments to reconcile net income to net cash provided by operating activities			
(Accretion), amortization and depreciation			
Securities	31	145	241
Bank premises and equipment	1,668	1,441	1,181
Core deposit intangible	454	533	601
Modification fees on Federal Home Loan Bank of Boston advances	232	234	230
Subordinated debt issuance costs	24	23	24
Mortgage servicing rights	48	169	242
Fair value adjustment on loans	(779)	(1,207)	(1,784)
Fair value adjustment on deposits	(37)	(78)	(121)
(Gains) and losses, including write-downs			
Sales and calls of securities available-for-sale, net	(318)	(178)	(584)
Sales of loans, excluding capitalized servicing rights	(71)	(95)	(171)
CRA Mutual Fund	18	—	—
Other real estate owned	274	1,717	435
Sales/disposals of premises and equipment	85	1	13
Gain from BOLI	(341)	—	—
Provision for loan losses	1,728	1,020	1,835
Proceeds from loans sold	4,555	5,440	10,505
Loans originated for sale	(3,815)	(6,014)	(9,571)
Increase in deferred loan origination fees and costs, net	(132)	(42)	(58)
Mortgage servicing rights originated	(43)	(63)	(95)
(Decrease) increase in mortgage servicing rights impairment reserve	—	(23)	20
Increase in interest receivable	(478)	(229)	(117)
Deferred tax (benefit) expense	(494)	888	957
(Increase) decrease in prepaid expenses	(50)	123	(296)
Increase in cash surrender value of life insurance policies	(337)	(343)	(353)
Decrease (increase) in income tax receivable	760	(173)	(178)
Decrease (increase) in other assets	48	790	(242)
Increase (decrease) in accrued expenses	769	(643)	660
Increase (decrease) in interest payable	138	10	(60)
Increase in other liabilities	69	240	1,086
Stock based compensation-restricted stock awards	447	265	221
Tax benefit from stock compensation	—	—	(33)
Net cash provided by operating activities	13,277	10,207	11,273
Investing Activities			
Purchases of Federal Home Loan Bank of Boston stock	(683)	(602)	(35)
Purchases of securities available-for-sale	(41,631)	(36,654)	(56,229)
Proceeds from sales of securities available-for-sale	10,036	199	4,865
Proceeds from calls of securities available-for-sale	695	16,141	14,221

Proceeds from maturities of securities available-for-sale	17,061	20,427	33,574
Reinvestment of CRA Mutual Fund	(19)	—	—
Loan originations and principal collections, net	(102,273)	(32,536)	(69,240)
Recoveries of loans previously charged off	74	600	126
Proceeds from sales of other real estate owned	289	2,080	—
Capital expenditures	(1,393)	(1,954)	(1,285)
Net cash and cash equivalents (paid) acquired in branch acquisition	(298)	22,396	—
Net cash utilized by investing activities	(118,142)	(9,903)	(74,003)

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

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Salisbury Bancorp, Inc. and Subsidiary

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

Years ended December 31, (in thousands)	2018	2017	2016
Financing Activities			
Increase in deposit transaction accounts, net	58,658	7,578	33,946
Increase (decrease) in time deposits, net	44,300	(5,208)	(6,588)
Increase (decrease) in securities sold under agreements to repurchase, net	2,436	(3,867)	1,621
Short-term Federal Home Loan Bank of Boston advances, net	(17,500)	17,000	10,000
Long-term Federal Home Loan Bank of Boston advances	37,000		
Principal payments on Federal Home Loan Bank of Boston advances	(7,000)	—	(21)
Principal payments on note payable	(33)	(31)	(32)
Decrease in capital lease obligation	(127)	(59)	(4)
Stock options exercised	222	316	87
Tax benefit from stock compensation	—	—	33
Issuance of shares for directors' fees	1	81	141
Common stock dividends paid	(3,133)	(3,113)	(3,086)
Net cash provided by financing activities	114,824	12,697	36,097
Net increase (decrease) in cash and cash equivalents	9,959	13,001	(26,633)
Cash and cash equivalents, beginning of year	48,486	35,485	62,118
Cash and cash equivalents, end of year	$58,445	$48,486	$35,485
Cash paid during year			
Interest	$6,864	$4,049	$3,777
Income taxes	1,443	2,291	1,238
Non-cash transfers			
From loans to other real estate owned	1,654	743	4,955
From other real estate owned to other assets	—	—	747
Capital Lease Obilgation	1,373	—	—
Other:			
Adoption of ASU 2016-01	16	—	—
BOLI proceeds included in other assets	621	—	—
Branch acquisition (1)			
Cash and cash equivalents (paid) acquired	$(298)	$22,387	—
Net loans acquired	7,849	7,097	—
Fixed assets acquired (including capital leases)	761	1,605	—
Accrued interest receivable acquired	5	12	—
Other assets acquired	6	20	—
Core deposit intangible	—	633	—
Goodwill	—	1,263	—
Deposits assumed	8,323	31,433	—
Capital lease assumed	—	1,476	—
Other liabilities assumed	—	3	—

(1) Includes branch acquisitions of Empire State Bank's New Paltz, New York Branch in 2017 and Orange Bank & Trust Company's Fishkill, New York Branch in 2018.

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

Salisbury Bancorp, Inc. and Subsidiary

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Salisbury Bancorp, Inc. ("Salisbury" or the "Company") is the bank holding company for Salisbury Bank (the "Bank"), a State chartered commercial bank. Salisbury's activity is currently limited to the holding of the Bank's outstanding capital stock and the Bank is Salisbury's only subsidiary and its primary investment. The Bank is a Connecticut chartered and Federal Deposit Insurance Corporation (the "FDIC") insured commercial bank headquartered in Lakeville, Connecticut. The Bank's principal business consists of attracting deposits from the public and using such deposits, with other funds, to make various types of loans and investments. The Bank conducts its business through fourteen full-service offices located in Litchfield, Berkshire and Dutchess, Orange and Ulster Counties in Connecticut, Massachusetts and New York, respectively.

Principles of Consolidation

The consolidated financial statements include those of Salisbury and the Bank after elimination of all inter-company accounts and transactions.

Basis of Financial Statement Presentation

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and general practices within the financial services industry. In preparing the consolidated financial statements, management is required to make extensive use of estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the statement of condition, and revenues and expenses for the period. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, expected cash flows from loans acquired in a business combination, potential other-than-temporary impairment of securities and potential impairment of goodwill and intangibles.

Certain reclassifications have been made to the 2017 and 2016 consolidated financial statements to make them consistent with the 2018 presentation.

Cash and Cash Equivalents

Cash and cash equivalents include cash and balances due from banks and interest bearing demand deposits in other banks. Due to the nature of cash and cash equivalents, Salisbury estimated that the carrying amount of such instruments approximated fair value. The nature of the Bank's business requires that it maintain amounts due from banks which, at times, may exceed federally insured limits. The Bank has not experienced any losses on such amounts and all amounts are maintained with well-capitalized institutions.

Securities

Securities that may be sold as part of Salisbury's asset/liability or liquidity management or in response to or in anticipation of changes in interest rates and resulting prepayment risk, or for other similar factors, are classified as available-for-sale and carried at their fair value. Unrealized holding gains and losses on such securities are reported

net of related taxes, if applicable, as a separate component of shareholders' equity. Securities that Salisbury has the ability and positive intent to hold to maturity are classified as held-to-maturity and carried at amortized cost. Realized gains and losses on the sales of all securities are reported in earnings and computed using the specific identification cost basis. Securities are reviewed regularly for other-than-temporary impairment (“OTTI”). Premiums and discounts are amortized or accreted utilizing the interest method over the life or call of the term of the investment security. For any debt security with a fair value less than its amortized cost basis, Salisbury will determine whether it has the intent to sell the debt security or whether it is more likely than not it will be required to sell the debt security before the recovery of its amortized cost basis. If either condition is met, Salisbury will recognize a full impairment charge to earnings. For all other debt securities that are considered OTTI and do not meet either condition, the credit loss portion of impairment will be recognized in earnings as realized losses. Declines in marketable equity securities below their cost that are deemed other than temporary are reflected in earnings as realized losses.

Federal Home Loan Bank of Boston Stock

The Bank is a member of the Federal Home Loan Bank of Boston (“FHLBB”). The FHLBB is a cooperative that provides services, including funding in the form of advances, to its member banking institutions. As a requirement of membership, the Bank must own a minimum amount of FHLBB stock, calculated periodically based primarily on its level of borrowings from the FHLBB. No market exists for shares of the FHLBB and therefore, they are carried at par value. FHLBB stock may be redeemed at par value five years following termination of FHLBB membership, subject to limitations which may be imposed by the FHLBB or its regulator, the Federal Housing Finance Board, to maintain capital adequacy of the FHLBB. While the Bank currently has no intentions to terminate its FHLBB membership, the ability to redeem its investment in FHLBB stock would be subject to the conditions imposed by the FHLBB. Based on the capital adequacy and the liquidity position of the FHLBB, management believes there is no impairment related to the carrying amount of the Bank’s FHLBB stock as of December 31, 2018. Deterioration of the FHLBB’s capital levels may require the Bank to deem its restricted investment in FHLBB stock to be OTTI. If evidence of impairment exists in the future, the FHLBB stock would reflect fair value using either observable or unobservable inputs. The Bank will continue to monitor its investment in FHLBB stock.

Loans

Loans receivable consist of loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off. Loans receivable are reported at their outstanding principal balance, net of unamortized deferred loan origination fees and costs on originated loans and unamortized premiums on purchased loans. Interest income is accrued on the unpaid principal balance. Deferred loan origination fees and costs are amortized as an adjustment to yield over the lives of the related loans.

The Bank’s loans collateralized by real estate and all other real estate owned (“OREO”) are located principally in northwestern Connecticut and New York and Massachusetts towns, which constitute Salisbury's service area. Accordingly, the collectability of a substantial portion of the loan portfolio and OREO is susceptible to changes in market conditions in Salisbury’s service area. While management uses available information to recognize losses on loans and OREO, future additions to the allowance or write-downs of OREO may be necessary based on changes in local economic conditions, particularly in Salisbury’s service area.

Loans held-for-sale consist of residential mortgage loans that management has the intent to sell. Loans held-for-sale are valued at the lower of cost or market as determined by outstanding commitments from investors or current investor yield requirements calculated on the aggregate loan basis, net of deferred loan origination fees and costs. Changes in the carrying value, deferred loan origination fees and costs, and realized gains and losses on sales of loans held-for-sale are reported in earnings as gains and losses on sales of mortgage loans, net, when the proceeds are received from investors.

The accrual of interest on loans, including troubled debt restructured loans, is generally discontinued when principal or interest is past due by 90 days or more, or earlier when, in the opinion of management, full collection of principal or interest is unlikely, except for loans that are well collateralized, in the process of collection and where full collection of principal and interest is assured. When a loan is placed on non-accrual status, interest previously accrued but not collected is reversed against current income. Income on such loans, including impaired loans, is then recognized only to the extent that cash is received and future collection of principal is probable. Loans, including troubled debt restructured loans, are restored to accrual status when principal and interest payments are brought current and future payments are reasonably assured, following a sustained period of repayment performance by the borrower in accordance with the loan's contractual terms.

Troubled debt restructured loans include those for which concessions such as reduction of interest rates, other than normal market rate adjustments, or deferral of principal or interest payments, extension of maturity dates, or reduction of principal balance or accrued interest, have been granted due to a borrower's financial condition. The decision to restructure a loan, versus aggressively enforcing the collection of the loan, may benefit Salisbury by increasing the ultimate probability of collection.

Troubled debt restructured loans are classified as accruing or non-accruing based on management's assessment of the collectability of the loan. Loans which are already on non-accrual status at the time of the troubled debt restructuring generally remain on non-accrual status for approximately six months before management considers such loans for return to accruing status. Accruing troubled debt restructured loans are generally placed into non-accrual status if and when the borrower fails to comply with the restructured terms.

Acquired Loans

Loans that Salisbury acquired through business combinations are initially recorded at fair value with no carryover of the related allowance for credit losses. Determining the fair value of the loans involves estimating the amount and timing of principal and interest cash flows initially expected to be collected on the loans and discounting those cash flows at an appropriate market rate of interest.

For loans that meet the criteria stipulated in Accounting Standards Codification ("ASC") 310-30, "Loans and Debt Securities Acquired with Deteriorated Credit Quality," Salisbury recognizes the accretable yield, which is defined as the excess of all cash flows expected to be collected at acquisition over the initial fair value of the loan, as interest income on a level-yield basis over the expected remaining life of the loan. The excess of the loan's contractually required payments over the cash flows expected to be collected is the nonaccretable difference. The nonaccretable difference is not recognized as an adjustment of yield, a loss accrual, or a valuation allowance. Going forward, Salisbury continues to evaluate whether the timing and the amount of cash to be collected are reasonably expected. Subsequent significant increases in cash flows Salisbury expects to collect will first reduce any previously recognized valuation allowance and then be reflected prospectively as an increase to the level yield. Subsequent decreases in expected cash flows may result in the loan being considered impaired. Such decreases may also result in recognition of additional provisions to the allowance for loan losses. Interest income is not recognized to the extent that the net investment in the loan would increase to an amount greater than the estimated payoff amount.

For ASC 310-30 loans, the expected cash flows reflect anticipated prepayments, determined on a loan by loan basis according to the anticipated collection plan of these loans. The expected prepayments used to determine the accretable yield are consistent between the cash flows expected to be collected and projections of contractual cash flows so as to not affect the nonaccretable difference. For ASC 310-30 loans, prepayments result in the recognition of the nonaccretable balance as current period yield. Changes in prepayment assumptions may change the amount of interest income and principal expected to be collected.

For loans that do not meet the ASC 310-30 criteria, Salisbury accretes interest income on a level yield basis using the contractually required cash flows. Salisbury subjects loans that do not meet the ASC 310-30 criteria to ASC Topic 450, "Contingencies" by collectively evaluating these loans for an allowance for loan losses.

Acquired loans that met the criteria for nonaccrual of interest prior to the acquisition are considered performing upon acquisition, regardless of whether the customer is contractually delinquent, if Salisbury can reasonably estimate the timing and amount of the expected cash flows on such loans and if Salisbury expects to fully collect the new carrying value of the loans. As such, Salisbury may no longer consider the loan to be nonaccrual or nonperforming and may accrue interest on these loans, including the impact of any accretable yield.

Allowance for Loan Losses

The allowance for loan losses represents management's estimate of the probable credit losses inherent in the loan portfolio as of the reporting date. The allowance is increased by provisions charged to earnings and by recoveries of amounts previously charged off, and is reduced by loan charge-offs. Loan charge-offs are recognized when management determines a loan or portion of a loan to be uncollectible.

The determination of the adequacy of the allowance is based on management's ongoing review of numerous factors, including the growth and composition of the loan portfolio, historical loss experience over an economic cycle, probable credit losses based upon internal and external portfolio reviews, credit risk concentrations, changes in lending policy, current economic conditions, analysis of current levels and asset quality, delinquency levels and trends, estimates of the current value of underlying collateral, the performance of individual loans in relation to contract terms, and other pertinent factors.

While management believes that the allowance for loan losses is adequate, the allowance is an estimate, and ultimate losses may vary from management's estimate. Future additions to the allowance may also be necessary based on changes in assumptions and economic conditions. In addition, various regulatory agencies periodically review the allowance for loan losses. Such agencies may require additions to the allowance based on their judgments about information available to them at the time of their examination.

Changes in the estimate are recorded in the results of operations in the period in which they become known, along with provisions for estimated losses incurred during that period.

The allowance for loan losses is computed by segregating the portfolio into three components: (1) loans collectively evaluated for impairment: general loss allocation factors for non-impaired loans based on loan product, collateral type and abundance, loan risk rating, historical loss experience, delinquency factors and other similar economic indicators, (2) loans individually evaluated for impairment: individual loss allocations for loans deemed to be impaired based on discounted cash flows or collateral value, and (3) unallocated: general loss allocations for other environmental factors.

Loans collectively evaluated for impairment

This component of the allowance for loan losses is stratified by the following loan segments: residential real estate secured (residential 1-4 family and 5+ multifamily, construction of residential 1-4 family, and home equity lines of credit), commercial real estate secured (commercial and construction of commercial), secured by land (farm and vacant land), commercial and industrial, municipal and consumer. Management's general loss allocation factors are based on a rolling five-year annual historical loss rate for each loan segment adjusted for qualitative factors and specific risk ratings. Qualitative factors include levels/trends in delinquencies; trends in volume and terms of loans; effects of changes in risk selection and underwriting standards and other changes in lending policies, procedures and practices; experience/ability/depth of lending management and staff; and national and local economic trends and conditions. There were no changes in Salisbury's policies or methodology pertaining to the general component of the allowance for loan losses during 2018.

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

Commercial real estate - Loans in this segment are primarily owner-occupied businesses or income-producing investment properties throughout Salisbury's market area. The underlying cash flows generated by the properties are adversely impacted by a downturn in the economy as evidenced by decreased sales or increased vacancy rates which, in turn, will have an effect on the credit quality in this segment. For commercial loans management annually obtains business and personal financial statements, tax returns, and, where applicable, rent rolls, and continually monitors the repayment of these loans.

Construction loans - Loans in this segment are primarily residential construction loans which typically roll into a permanent residential mortgage loan when construction is completed, or commercial construction which consist primarily of owner occupied commercial construction projects.

Commercial and industrial loans - Loans in this segment are made to businesses and are generally secured by assets of the business, including equipment and/or inventory. Repayment is expected from the cash flows of the business. A weakened economy, and resultant decreased retail or wholesale spending, has an effect on the credit quality in this segment.

Farm – Loans in this segment are made to independent agricultural businesses and may be affected by adverse weather conditions or weak commodity prices.

Vacant land – Loans in this segment are primarily dependent on the credit quality of the individual borrowers. Loan-to-value ratios for loans with vacant land for collateral are more conservative than for commercial or residential real estate loans.

Municipal loans – Loans in this segment are extensions of credit to municipal and other governmental entities throughout Salisbury's market area. The bank-qualified, tax-exempt loans are backed by the full faith and credit of the borrowing entity with taxing or appropriating authority, as appropriate. Maturities range from one year for bond anticipation notes to twenty years for long-term project finance. The ability of the borrower to pay may be affected by

an economic downturn resulting in a severe reduction in tax or other revenues coupled with the depletion of an entity's reserve liquidity. Historical default rates for bank-qualified (small issuer) general obligation municipal credit facilities are 0% since the asset class was created in 1986.

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

Loans individually evaluated for impairment

This component relates to loans that are classified as impaired. Impairment is measured on a loan by loan basis for all portfolio loans (except consumer loans and homogeneous residential real estate loans) by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. An allowance is established when the discounted cash flows (or collateral value) of the impaired loan are lower than the carrying value of that loan.

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

Salisbury 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 classified as impaired.

Unallocated

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

Mortgage Servicing Rights

As part of our growth and risk management strategy, Salisbury from time to time sells whole loans. These are typically fixed rate residential loans. Salisbury's ability to sell whole loans benefits the Bank by freeing up capital and funding to lend to new customers. Additionally, we typically earn a gain on the sale of loans sold and receive a servicing fee while maintaining the customer relationship. Mortgage Servicing Rights ("MSRs"), which the bank evaluates with the assistance of a third party on a quarterly basis, are included in other assets on the consolidated balance sheets and are accounted for under the amortization method. Under that method mortgage servicing rights are amortized in proportion to, and over the period of, estimated net servicing revenues. Refinance activities are considered in estimating the period of net servicing revenues.

Other Real Estate Owned ("OREO")

OREO consists of properties acquired through foreclosure or a deed in lieu of foreclosure. These properties are initially transferred at fair value less estimated costs to sell. Any write-down from cost to estimated fair value required at the time of foreclosure is charged to the allowance for loan losses. A valuation allowance is maintained for declines in market value and for estimated selling expenses. Increases to the valuation allowance, expenses associated with ownership of these properties, and gains and losses from their sale are included in OREO expense.

As of December 31, 2018 and 2017, the recorded investment in residential mortgage loans collateralized by residential real estate that were in the process of foreclosure was $0.5 million and $1.1 million, respectively.

Income Taxes

Deferred income taxes are provided for differences arising in the timing of income and expenses for financial reporting and for income tax purposes using the asset/liability method of accounting for income taxes. Deferred income taxes and tax benefits are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Salisbury provides deferred taxes for the

estimated future tax effects attributable to temporary differences and carry-forwards when realization is assured beyond a reasonable doubt. A valuation allowance is established against deferred tax assets when, based upon all available evidence, it is determined that it is more likely than not that some or all of the deferred tax assets will not be realized.

Bank Premises and Equipment

Bank premises, furniture and equipment are carried at cost, less accumulated depreciation and amortization computed on the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized on the straight-line basis over the shorter of the estimated useful lives of the improvements or the term of the related leases. Guidelines for expected useful life are as follows:

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- Buildings/Improvements – 39 years
- Land Improvements – 15 years
- Furniture and Fixtures – 7 years
- Computer Equipment – 5 years
- Software – 3 years

Intangible Assets

Intangible assets consist of core deposit intangibles and goodwill. Intangible assets equal the excess of the purchase price over the fair value of the tangible net assets acquired in business combinations accounted for using the acquisition method of accounting. Salisbury's intangible assets at December 31, 2018, and 2017, include goodwill of $2,358,000 arising from the purchase of a branch office in 2001, $7,152,000 arising from the 2004 acquisition of Canaan National Bancorp, Inc., $319,000 arising from the 2007 purchase of a branch office in New York State, $2,723,000 arising from the acquisition of Riverside Bank in December 2014 and $1,263,000 from the purchase of an additional branch office in New York in 2017. See Note 8.

On an annual basis, management assesses intangible assets for impairment, and for the year ending December 31, 2018, concluded there was no impairment. If a permanent loss in value is indicated, an impairment charge to income will be recognized.

Bank-Owned Life Insurance

Bank-owned life insurance policies are reflected on the consolidated balance sheet at cash surrender value. Changes in the net cash surrender value of the policies, as well as insurance proceeds received, are reflected in non-interest income on the consolidated statements of operations and are generally not subject to income taxes. The Bank reviews the financial strength of the insurance carriers prior to the purchase of life insurance policies and no less than annually thereafter. A life insurance policy with any individual carrier is limited to 15% of tier one capital and the total cash surrender value of the life insurance policies is limited to 25% of tier one capital.

Stock Based Compensation

Stock based compensation expense is recognized, based on the fair value at the date of grant on a straight line basis over the period of time between the grant date and vesting date.

Advertising Expense

Advertising costs of $608,000 and $613,000 in 2018 and 2017, respectively, are expensed as incurred and not capitalized.

Statements of Cash Flows

For the purpose of the Consolidated Statements of Cash Flows, cash and cash equivalents include cash and due from banks and interest-bearing demand deposits with other financial institutions.

Computation of Earnings per Share

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

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

Recent Accounting Pronouncements

In May 2014, August 2015, May 2016, and December 2016, respectively, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-09, 2015-14, 2016-12, and 2016-20, “Revenue from Contracts with Customers (Topic 606).” The objective of ASU 2014-09 is to clarify principles for recognizing revenue and to develop a common revenue standard for GAAP and International Financial Reporting Standards. Since the guidance does not apply to revenue associated with financial instruments, including loans and securities that are accounted for under other GAAP, the new guidance did not have a material impact on revenue most closely associated with financial instruments, including interest income and expense. The Bank completed its overall assessment of revenue streams and review of related contracts potentially affected by the ASU, including trust and asset management fees, deposit related fees, interchange fees, and merchant income. Salisbury’s revenue recognition policies conformed to Topic 606. As a result, no changes were required to be made to prior period financial statements due to the adoption of this ASU and no changes in revenue recognition were required in fiscal year ended 2018.

In January 2016, the FASB issued ASU 2016-01, “Financial Instruments – overall (subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." This ASU addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments by making targeted improvements to GAAP as follows: (1) require equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer; (2) simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. When a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at fair value; (3) eliminate the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities; (4) eliminate the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (5) require public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (6) require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; (7) require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and (8) clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity’s other deferred tax assets. Salisbury adopted the provisions of this ASU effective January 1, 2018. Adoption of this ASU did not have a material impact on Salisbury’s financial statements. In accordance with (5) above, Salisbury measured the fair value of its loan portfolio as of December 31, 2018 using an exit price notion (see note 21).

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)”. Under the new guidance, lessees will be required to recognize the following for all leases (with the exception of short-term leases): 1) a lease liability, which is the present value of a lessee's obligation to make lease payments, and 2) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Lessor accounting under the new guidance remains largely unchanged as it is substantially equivalent to existing guidance for sales-type leases, direct financing leases, and operating leases. Leveraged leases have been eliminated, although lessors can continue to account for existing leveraged leases using the current accounting guidance. Other limited changes were made to align lessor accounting with the lessee accounting model and the new revenue recognition standard. All entities will classify leases to determine how to recognize lease-related revenue and expense. Quantitative and qualitative disclosures will

be required by lessees and lessors to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. The intention is to require enough information to supplement the amounts recorded in the financial statements so that users can understand more about the nature of an entity's leasing activities. ASU 2016-02 is effective for interim and annual reporting periods beginning after December 15, 2018; early adoption is permitted. In July 2018, the FASB issued ASU 2018-10 which provided technical corrections to the new lease standard. In August 2018, the FASB issued ASU 2018-11 which requires entities to take a prospective approach, rather than a retrospective approach as initially prescribed, when transitioning to the new standard. Instead of recording the cumulative impact of all comparative reporting periods presented within retained earnings, entities will now assess all lease contracts as of January 1, 2019. Salisbury estimates that its consolidated assets and liabilities will increase by approximately $1.5 million due to the recording of operating leases as a result of adopting ASU 2016-02.

In March 2016, the FASB issued ASU 2016-09, "Compensation–Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting." This ASU includes provisions intended to simplify various aspects related to how share-based payments are accounted for and presented in the financial statements. Some of the key provisions of this new ASU include: (1) companies will no longer record excess tax benefits and certain tax deficiencies in additional paid-in capital ("APIC"). Instead, they will record all excess tax benefits and tax deficiencies as income tax expense or benefit in the income statement, and APIC pools will be eliminated. The guidance also eliminates the requirement that excess tax benefits be realized before companies can recognize them. In addition, the guidance requires companies to present excess tax benefits as an operating activity on the statement of cash flows rather than as a financing activity; (2) increase the amount an employer can withhold to cover income taxes on awards and still qualify for the exception to liability classification for shares used to satisfy the employer's statutory income tax withholding obligation. The new guidance will also require an employer to classify the cash paid to a tax authority when shares are withheld to satisfy its statutory income tax withholding obligation as a financing activity on its statement of cash flows (current guidance did not specify how these cash flows should be classified); and (3) permit companies to make an accounting policy election for the impact of forfeitures on the recognition of expense for share-based payment awards. Forfeitures can be estimated, as required today, or recognized when they occur. Salisbury has opted to recognize forfeitures as they occur as the impact is not expected to be material. Salisbury adopted ASU 2016-09 as of January 1, 2017. Adoption contributed a $105 thousand benefit to the tax provision in the second quarter 2017 and did not have a material effect on the financial results for the twelve month period ended December 31, 2018.

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments," which adds a new Topic 326 to the Codification and removes the thresholds that companies apply to measure credit losses on financial instruments measured at amortized cost, such as loans, receivables, and held-to-maturity debt securities. Under current U.S. GAAP, companies generally recognize credit losses when it is probable that the loss has been incurred. The revised guidance will remove all recognition thresholds and will require companies to recognize an allowance for credit losses for the difference between the amortized cost basis of a financial instrument and the amount of amortized cost that the company expects to collect over the instrument's contractual life. ASU 2016-13 also amends the credit loss measurement guidance for available-for-sale debt securities and beneficial interests in securitized financial assets. The guidance in ASU 2016-13 is effective for "public business entities," as defined, that are SEC filers for fiscal years and for interim periods with those fiscal years beginning after December 15, 2019. Early adoption is permitted as of the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Salisbury is currently evaluating the provisions of ASU 2016-13 to determine the potential impact the new standard will have on Salisbury's Consolidated Financial Statements.

In August 2016, the FASB issued ASU 2016-15, "Classification of Certain Cash Receipts and Cash Payments." This ASU is intended to reduce diversity in practice in how eight particular transactions are classified in the statement of cash flows. ASU 2016-15 is effective for public business entities for fiscal years beginning after December 15, 2017 and interim periods within those years. Entities are required to apply the guidance retrospectively. If it is impracticable to apply the guidance retrospectively for an issue, the amendments related to that issue would be applied prospectively. Salisbury adopted ASU 2016-15 on January 1, 2018. ASU 2016-15 did not have a material impact on Salisbury's Consolidated Financial Statements.

In January 2017, the FASB issued ASU 2017-01, "Business Combinations (Topic 805): Clarifying the Definition of a Business." This ASU is intended to add guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The amendments in this update provide a screen to determine when a set of inputs, processes, and outputs is not a business. ASU 2017-01 is effective for public business entities for fiscal years beginning after December 15, 2017 and interim periods within those years. Early adoption is permitted for transactions for which the acquisition date occurs before the issuance date or effective date of the

amendments, only when the transaction has not been reported in financial statements that have been issued or made available for issuance, or for transactions in which a subsidiary is deconsolidated or a group of assets is derecognized that occur before the issuance date or effective date of the amendments, only when the transaction has not been reported in financial statements that have been issued or made available for issuance. Entities should apply the guidance prospectively on or after the effective date. Salisbury adopted ASU 2017-01 on January 1, 2018. ASU 2017-01 did not impact Salisbury's Consolidated Financial Statements.

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In January 2017, the FASB issued ASU 2017-04, “Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment.” This ASU is intended to allow companies to simplify how an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Step 2 measures a goodwill impairment loss by comparing the implied fair value of a reporting unit’s goodwill with the carrying amount of that goodwill. The FASB is researching whether similar amendments should be considered for other entities, including public business entities. ASU 2017-04 is effective for public business entities that are SEC filers for fiscal years beginning after December 15, 2019 and interim periods within those years. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. Entities should apply the guidance prospectively. Salisbury is currently evaluating the provisions of ASU 2017-04 to determine the potential impact the new standard will have on Salisbury’s Consolidated Financial Statements.

In March 2017, the FASB issued ASU 2017-08, “Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities.” This ASU will amend the amortization period for certain purchased callable debt securities held at a premium. The Board is shortening the amortization period for the premium to the earliest call date. Under current generally accepted accounting principles, entities generally amortize the premium as an adjustment of yield over the contractual life of the instrument. ASU 2017-08 is effective for public business entities for annual periods beginning after December 15, 2018, including interim periods within those annual periods. Early adoption is permitted, including adoption in an interim period. Entities should apply the guidance on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. Salisbury does not expect that the adoption of the new standard will have a material impact on its Consolidated Financial Statements.

In May 2017, the FASB issued ASU 2017-09, “Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting.” This ASU provides clarity in the accounting guidance regarding a change to the terms or conditions of a share-based payment award. ASU 2017-09 is effective for public business entities for annual periods beginning after December 15, 2017, including interim periods within those annual periods. Entities should apply the guidance prospectively to an award modified on or after the adoption date. Salisbury adopted ASU 2017-09 on January 1, 2018. ASU 2017-09 did not impact Salisbury’s Consolidated Financial Statements.

NOTE 2 – MERGERS AND ACQUISITIONS

On December 5, 2014, the Company acquired Riverside Bank. Riverside Bank operated four banking offices serving Dutchess, Ulster and Orange Counties in New York, and was merged with and into the Bank.

The following table summarizes activity in the accretable yield for the acquired loan portfolio that falls under the purview of ASC 310-30.

(In thousands)	2018	2017
Balance at beginning of period	$517	$1,190
Acquisitions	—	—
Accretion	(164)	(541)
Disposals	(149)	(405)
Reclassification from non-accretable to accretable	—	273
Balance at end of period	$204	$517

At December 31, 2018 and 2017, Salisbury ASC 310-30 loans had an outstanding balance totaling $2.1 million and $4.2 million, respectively. The carrying value as of December 31, 2018 and 2017 was $1.9 million and $3.7 million, respectively.

NOTE 3 - SECURITIES

The composition of securities is as follows:

(in thousands)	Amortized cost (1)	Gross un- realized gains	Gross un- realized losses	Fair value
December 31, 2018				
Available-for-sale				
U.S. Government Agency notes	$ 4,991	$ 58	$ —	$ 5,049
Municipal bonds	5,334	45	—	5,379
Mortgage-backed securities:				
U.S. Government agencies and U.S. Government- sponsored enterprises	32,522	56	251	32,327
Collateralized mortgage obligations:				
U.S. Government agencies	17,835	85	173	17,747
SBA bonds	27,914	139	313	27,740
Corporate bonds	3,500	76	—	3,576
Total securities available-for-sale	$ 92,096	$ 459	$ 737	$ 91,818
CRA mutual fund	$ 836	$ —	$ —	$ 836
Non-marketable securities				
Federal Home Loan Bank of Boston stock	$ 4,496	$ —	$ —	$ 4,496

(in thousands)	Amortized cost (1)	Gross un- realized gains	Gross un- realized losses	Fair value
December 31, 2017				
Available-for-sale				
Municipal bonds	$ 3,476	$ 11	$ 1	$ 3,486
Mortgage-backed securities:				
U.S. Government agencies and U.S. Government- sponsored enterprises	45,983	152	267	45,868
Collateralized mortgage obligations:				
U.S. Government agencies	10,462	2	87	10,377
Non-agency	2,271	410	17	2,664
SBA bonds	12,278	9	20	12,267
Corporate bonds	3,500	59	9	3,550
Total securities available-for-sale	$ 77,970	$ 643	$ 401	$ 78,212
CRA mutual fund	$ 835	$ —	$ —	$ 835
Non-marketable securities				
Federal Home Loan Bank of Boston stock	$ 3,813	$ —	$ —	$ 3,813

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

Sales of securities available-for-sale and gross gains and gross losses realized are as follows:

Years ended December 31, (in thousands)	2018	2017	2016
Proceeds	$10,036	$199	$4,865
Gains realized	361	192	569
Losses realized	(43)	(14)	—
Net gains realized	318	178	569
Income tax provision	67	61	193

The following table summarizes the aggregate fair value and gross unrealized loss of securities that have been in a continuous unrealized loss position as of the dates presented:

December 31, 2018 (in thousands)	Less than 12 Months		12 Months or Longer		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair Value	Unrealized losses
Available-for-sale						
Mortgage-backed securities	$5,754	$ 40	$19,973	$ 211	$25,727	$ 251
Collateralized mortgage obligations						
U.S. Government Agencies	—	—	8,281	173	8,281	173
SBA bonds	7,343	135	7,336	178	14,679	313
Total temporarily impaired securities	13,097	175	35,590	562	48,687	737
Other-than-temporarily impaired securities	—	—	—	—	—	—
Total temporarily impaired and other-than-temporarily impaired securities	$13,097	$ 175	$35,590	$ 562	$48,687	$ 737

December 31, 2017 (in thousands)						
Available-for-sale						
Municipal bonds	$479	$1	$—	$—	$479	$1
Mortgage-backed securities	15,914	99	17,892	168	33,806	267
Collateralized mortgage obligations						
U.S. Government Agencies	9,317	87	—	—	9,317	87
Non-agency	—	—	77	3	77	3
SBA bonds	8,519	20	—	—	8,519	20
CRA mutual funds	835	16	—	—	835	16
Corporate bonds	1,491	9	—	—	1,491	9
Total temporarily impaired securities	36,555	232	17,969	171	54,524	403
Other-than-temporarily impaired securities						
Collateralized mortgage obligations						
Non-agency	101	14	—	—	101	14
Total temporarily impaired and other-than-temporarily impaired securities	$36,656	$246	$17,969	$171	$54,625	$417

The amortized cost, fair value and tax equivalent yield of securities, by maturity, are as follows:

December 31, 2018 (in thousands)	Maturity	Amortized cost	Fair value	Yield(1)	
U.S. Government agency notes	After 5 years but within 10 years	$ 4,991	$5,049	3.59	%
	Total	4,991	5,049	3.59	
Municipal bonds	Within 1 year	296	296	1.97	
	After 1 year but within 5 years	137	137	2.78	
	After 10 years but within 15 years	4,368	4,410	4.79	
	After 15 years	533	536	3.35	
	Total	5,334	5,379	4.44	
Mortgage-backed securities	U.S. Government agency and U.S. Government-sponsored enterprises	32,522	32,327	3.01	
Collateralized mortgage obligations	U.S. Government agency and U.S. Government-sponsored enterprises	17,835	17,747	3.00	
SBA bonds		27,914	27,740	3.12	
Corporate bonds	After 5 years but within 10 years	3,500	3,576	5.57	
Securities available-for-sale		$ 92,096	$91,818	3.25	%

(1) Yield is based on amortized cost.

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

The following summarizes, by security type, the basis for evaluating if the applicable securities were OTTI at December 31, 2018.

U.S. Government agency mortgage-backed securities and collateralized mortgage obligations: The contractual cash flows are guaranteed by U.S. government agencies and U.S. government-sponsored enterprises. Twenty-nine securities had unrealized losses at December 31, 2018, which approximated 1.23% of their amortized cost. Changes in fair values are a function of changes in investment spreads and interest rate movements and not changes in credit quality. Management expects to recover the entire amortized cost basis of these securities. Furthermore, Salisbury evaluates these securities for strategic fit and may reduce its position in these securities, although it is not more likely than not that Salisbury will be required to sell these securities before recovery of their cost basis, which may be maturity, and does not intend to sell these securities. Therefore, management does not consider these investments to be other-than-temporarily impaired at December 31, 2018.

SBA bonds: The contractual cash flows are guaranteed by the U.S. government. Ten securities had unrealized losses at December 31, 2018, which approximated 2.09% of their amortized cost. Changes in fair values are a function of changes in investment spreads and interest rate movements and not changes in credit quality since time of purchase. Management expects to recover the entire amortized cost basis of these securities. Furthermore, Salisbury evaluates these securities for strategic fit and may reduce its position in these securities, although it is not more likely than not that Salisbury will be required to sell these securities before recovery of their cost basis, which may be maturity, and

does not intend to sell these securities. Management evaluated the impairment status of these debt securities, and concluded that the gross unrealized losses were temporary in nature. Therefore, management does not consider these investments to be other-than temporarily impaired at December 31, 2018.

See note 6 for summary of pledged securities.

NOTE 4 - LOANS

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

December 31,	2018	2017
(in thousands)	Total Loans	Total Loans
Residential 1-4 family	$ 345,862	$ 317,639
Residential 5+ multifamily	36,510	18,108
Construction of residential 1-4 family	12,041	11,197
Home equity lines of credit	34,433	33,771
Residential real estate	428,846	380,715
Commercial	283,599	249,311
Construction of commercial	8,976	9,988
Commercial real estate	292,575	259,299
Farm land	4,185	4,274
Vacant land	8,322	7,883
Real estate secured	733,928	652,171
Commercial and industrial	162,905	132,731
Municipal	14,344	17,494
Consumer	4,512	4,794
Loans receivable, gross	915,689	807,190
Deferred loan origination fees and costs, net	1,421	1,289
Allowance for loan losses	(7,831)	(6,776)
Loans receivable, net	$ 909,279	$ 801,703
Loans held-for-sale		
Residential 1-4 family	$ —	$ 669

Salisbury has entered into loan participation agreements with other banks and transferred a portion of its originated loans to the participating banks. Transferred amounts are accounted for as sales and excluded from Salisbury's loans receivable. Salisbury and its participating lenders share ratably in any gains or losses that may result from a borrower's lack of compliance with contractual terms of the loan. Salisbury services the loans on behalf of the participating lenders and, as such, collects cash payments from the borrowers, remits payments (net of servicing fees) to participating lenders and disburses required escrow funds to relevant parties.

Salisbury also has entered into loan participation agreements with other banks and purchased a portion of the other banks' originated loans. Purchased amounts are accounted for as loans without recourse to the originating bank. Salisbury and its originating lenders share ratably in any gains or losses that may result from a borrower's lack of compliance with contractual terms of the loan. The originating banks service the loans on behalf of the participating lenders and, as such, collect cash payments from the borrowers, remit payments (net of servicing fees) to participating lenders and disburse required escrow funds to relevant parties.

At December 31, 2018 and 2017, Salisbury serviced commercial loans for other banks under loan participation agreements totaling $66.4 million and $57.2 million, respectively.

Concentrations of Credit Risk

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

Credit Quality

Salisbury uses credit risk ratings as part of its determination of the allowance for loan losses. Credit risk ratings categorize loans by common financial and structural characteristics that measure the credit strength of a borrower. The rating model has eight risk rating grades, with each grade corresponding to a progressively greater risk of default. Grades 1 through 4 are pass ratings and 5 through 8 are criticized as defined by the regulatory agencies. Risk ratings are assigned to differentiate risk within the portfolio and are reviewed on an ongoing basis and revised, if needed, to reflect changes in the borrowers' current financial position and outlook, risk profiles and the related collateral and structural positions.

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

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

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

Loans classified as "loss" are considered uncollectible and of such little value that continuance as Bank assets is unwarranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather, it is not practical or desirable to defer writing off this loan even though partial recovery may be made in the future.

Management actively reviews and tests its credit risk ratings against actual experience and engages an independent third-party to annually validate its assignment of credit risk ratings. In addition, the Bank's loan portfolio is examined periodically by its regulatory agencies, the FDIC and the CTDOB.

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

(in thousands)	Pass	Special mention	Substandard	Doubtful	Loss	Total
December 31, 2018						
Residential 1-4 family	$337,520	$4,281	$ 4,061	$ —	$ —	$345,862
Residential 5+ multifamily	34,726	784	1,000	—	—	36,510
Construction of residential 1-4 family	12,041	—	—	—	—	12,041
Home equity lines of credit	33,728	265	440	—	—	34,433
Residential real estate	418,015	5,330	5,501	—	—	428,846
Commercial	270,461	4,530	8,608	—	—	283,599
Construction of commercial	8,482	—	494	—	—	8,976
Commercial real estate	278,943	4,530	9,102	—	—	292,575
Farm land	3,969	—	216	—	—	4,185
Vacant land	8,253	69	—	—	—	8,322
Real estate secured	709,180	9,929	14,819	—	—	733,928

Commercial and industrial	159,127	2,672	1,106	—	—	162,905
Municipal	14,344	—	—	—	—	14,344
Consumer	4,502	10	—	—	—	4,512
Loans receivable, gross	$887,153	$12,611	$ 15,925	$ —	$ —	$915,689

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(in thousands)	Pass	Special mention	Substandard	Doubtful	Loss	Total
December 31, 2017						
Residential 1-4 family	$307,240	$6,452	$ 3,947	$ —	$ —	$317,639
Residential 5+ multifamily	16,129	957	1,022	—	—	18,108
Construction of residential 1-4 family	11,197	—	—	—	—	11,197
Home equity lines of credit	32,891	710	170	—	—	33,771
Residential real estate	367,457	8,119	5,139	—	—	380,715
Commercial	232,492	4,456	12,363	—	—	249,311
Construction of commercial	9,622	—	366	—	—	9,988
Commercial real estate	242,114	4,456	12,729	—	—	259,299
Farm land	4,024	—	250	—	—	4,274
Vacant land	7,806	77	—	—	—	7,883
Real estate secured	621,401	12,652	18,118	—	—	652,171
Commercial and industrial	129,219	2,536	976	—	—	132,731
Municipal	17,494	—	—	—	—	17,494
Consumer	4,744	50	—	—	—	4,794
Loans receivable, gross	$772,858	$15,238	$ 19,094	$ —	$ —	$807,190

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

(In thousands)	Current	Past due 30-59 days	60-89 days	90-179 days	180 days and over	30 days and over	Accruing 90 days and over	Non-accrual
December 31, 2018								
Residential 1-4 family	$342,881	$1,100	$521	$—	$1,360	$2,981	$—	$2,092
Residential 5+ multifamily	35,648	—	—	633	229	862	—	1,000
Construction of residential 1-4 family	12,041	—	—	—	—	—	—	—
Home equity lines of credit	33,806	235	33	—	359	627	—	411
Residential real estate	424,376	1,335	554	633	1,948	4,470	—	3,503
Commercial	281,053	264	240	833	1,209	2,546	654	1,388
Construction of commercial	8,835	—	—	141	—	141	141	252
Commercial real estate	289,888	264	240	974	1,209	2,687	795	1,640
Farm land	4,185	—	—	—	—	—	—	216
Vacant land	8,280	42	—	—	—	42	—	—
Real estate secured	726,729	1,641	794	1,607	3,157	7,199	795	5,359
Commercial and industrial	162,507	—	38	—	360	398	—	360

Municipal	14,344	—	—	—	—	—	—	—
Consumer	4,504	2	6	—	—	8	—	—
Loans receivable, gross	$908,084	$1,643	$838	$1,607	$3,517	$7,605	$795	$5,719

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(In thousands)	Current	Past due 30-59 days	60-89 days	90-179 days	180 days and over	30 days and over	Accruing 90 days and over	Non-accrual
December 31, 2017								
Residential 1-4 family	$314,798	$1,410	$165	$156	$1,110	$2,841	$—	$2,045
Residential 5+ multifamily	18,108	—	—	—	—	—	—	151
Construction of residential 1-4 family	11,197	—	—	—	—	—	—	—
Home equity lines of credit	33,219	75	477	—	—	552	—	66
Residential real estate	377,322	1,485	642	156	1,110	3,393	—	2,262
Commercial	244,869	1,888	758	—	1,796	4,442	—	3,364
Construction of commercial	9,730	—	—	—	258	258	—	258
Commercial real estate	254,599	1,888	758	—	2,054	4,700	—	3,622
Farm land	4,032	242	—	—	—	242	—	250
Vacant land	7,883	—	—	—	—	—	—	—
Real estate secured	643,836	3,615	1400	156	3,164	8,335	—	6,134
Commercial and industrial	131,991	131	218	391	—	740	31	470
Municipal	17,494	—	—	—	—	—	—	—
Consumer	4,752	34	8	—	—	42	—	—
Loans receivable, gross	$798,073	$3,780	$1,626	$547	$3,164	$9,117	$31	$6,604

Troubled Debt Restructurings (TDRs)

Troubled debt restructurings occurring during the years ended December 31, 2018 and 2017:

Business Activities Loans	December 31, 2018			December 31, 2017		
(in thousands)	Quantity	Pre-modification balance	Post-modification balance	Quantity	Pre-modification balance	Post-modification balance
Residential real estate	1	$ 68	$ 68	1	$ 222	$ 222
Commercial real estate	1	566	566	1	600	600
Commercial and industrial	—	—	—	2	182	182
Troubled debt restructurings	2	$ 634	$ 634	4	$ 1,004	$ 1,004
Rate reduction and term extension	—	$ —	$ —	3	$ 404	$ 404
Rate reduction	2	634	634	—	—	—
Term extension	—	—	—	1	600	600
Troubled debt restructurings	2	$ 634	$ 634	4	$ 1,004	$ 1,004

For the twelve months ended December 2018, there were two troubled debt restructurings. No concessions have been made with respect to loans that subsequently defaulted in the current reporting period. Salisbury currently does not have any commitments to lend additional funds to TDR loans.

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The following table discloses the recorded investment and number of modifications for TDRs within the last year where a concession has been made, that then defaulted in the current reporting period. All TDR loans are included in the Impaired Loan schedule and are individually evaluated.

	Modifications that Subsequently Defaulted			
	For the twelve months ending		For the twelve months ending	
	December 31, 2018		December 31, 2017	
	Quantity	Balance	Quantity	Balance
Troubled Debt Restructurings				
Residential 1-4 family	1	67	—	—
Total	1	67	—	—

Impaired loans

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

December 31, (in thousands)	2018	2017
Non-accrual loans, excluding troubled debt restructured loans	$4,430	$5,450
Non-accrual troubled debt restructured loans	1,289	1,154
Accruing troubled debt restructured loans	6,801	7,482
Total impaired loans	$12,520	$14,086
Commitments to lend additional amounts to impaired borrowers	$—	$—

Allowance for Loan Losses

Changes in the allowance for loan losses are as follows:

	December 31, 2018					December 31, 2017				
(In thousands)	Beginning balance	Provision	Charge-offs	Reco-veries	Ending balance	Beginning balance	Provision	Charge-offs	Reco-veries	En bal
Residential 1-4 family	$1,862	$580	$(299)	$6	$2,149	$1,926	$100	$(197)	$ 33	$1,8
Residential 5+ multifamily	155	258	—	—	413	62	93	—	—	15
Construction of residential 1-4 family	75	8	—	—	83	91	(16)	—	—	75
Home equity lines of credit	236	(18)	—	1	219	348	(115)	(4)	7	23
Residential real estate	2,328	828	(299)	7	2,864	2,427	62	(201)	40	2,3
Commercial	2,547	756	(259)	4	3,048	1,920	836	(453)	244	2,5
Construction of commercial	80	42	—	—	122	38	42	—	—	80

Commercial real estate	2,627	798	(259)	4	3,170	1,958	878	(453)	244	2,6
Farm land	32	(6)	—	7	33	28	45	(43)	2	32
Vacant land	132	(32)	—	—	100	170	(2)	(36)	—	13
Real estate secured	5,119	1,588	(558)	18	6,167	4,583	983	(733)	286	5,1
Commercial and industrial	984	255	(108)	27	1,158	1,079	(229)	(162)	296	98
Municipal	30	(18)	—	—	12	53	(23)	—	—	30
Consumer	80	28	(81)	29	56	75	63	(76)	18	80
Unallocated	563	(125)	—	—	438	337	226	—	—	56
Totals	$6,776	$1,728	$(747)	$74	$7,831	$6,127	$1,020	$(971)	$ 600	$ 6,7

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(in thousands)	December 31, 2016 Beginning balance	Provision	Charge-offs	Reco-veries	Ending balance
Residential 1-4 family	$2,132	$475	$(706)	$25	$1,926
Residential 5+ multifamily	33	32	(3)	—	62
Construction of residential 1-4 family	37	54	—	—	91
Home equity lines of credit	354	37	(47)	4	348
Residential real estate	2,556	598	(756)	29	2,427
Commercial	1,507	597	(187)	3	1,920
Construction of commercial	92	(54)	—	—	38
Commercial real estate	1,599	543	(187)	3	1,958
Farm land	37	15	(24)	—	28
Vacant land	152	82	(64)	—	170
Real estate secured	4,344	1,238	(1,031)	32	4,583
Commercial and industrial	705	754	(452)	72	1,079
Municipal	61	(8)	—	—	53
Consumer	124	(4)	(67)	22	75
Unallocated	482	(145)	—	—	337
Totals	$5,716	$1,835	$(1,550)	$126	$6,127

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

(in thousands)	Collectively evaluated [1]		Individually evaluated		Total portfolio	
	Loans	Allowance	Loans	Allowance	Loans	Allowance
December 31, 2018						
Residential 1-4 family	$340,946	$2,042	$4,916	$107	$345,862	$2,149
Residential 5+ multifamily	34,835	413	1,675	—	36,510	413
Construction of residential 1-4 family	12,041	83	—	—	12,041	83
Home equity lines of credit	33,975	213	458	6	34,433	219
Residential real estate	421,797	2,751	7,049	113	428,846	2,864
Commercial	279,389	2,907	4,210	141	283,599	3,048
Construction of commercial	8,622	106	354	16	8,976	122
Commercial real estate	288,011	3,013	4,564	157	292,575	3,170
Farm land	3,969	33	216	—	4,185	33
Vacant land	8,132	98	190	2	8,322	100
Real estate secured	721,909	5,895	12,019	272	733,928	6,167
Commercial and industrial	162,404	1,158	501	—	162,905	1,158
Municipal	14,344	12	—	—	14,344	12
Consumer	4,512	56	—	—	4,512	56
Unallocated allowance	—	438	—	—	—	438
Totals	$903,169	$7,559	$12,520	$272	$915,689	$7,831

(in thousands)	Collectively evaluated [1]		Individually evaluated		Total portfolio	
	Loans	Allowance	Loans	Allowance	Loans	Allowance
December 31, 2017						
Residential 1-4 family	$312,456	$1,759	$5,183	$103	$317,639	$1,862
Residential 5+ multifamily	16,361	154	1,747	1	18,108	155
Construction of residential 1-4 family	11,197	75	—	—	11,197	75
Home equity lines of credit	33,658	235	113	1	33,771	236
Residential real estate	373,672	2,223	7,043	105	380,715	2,328
Commercial	243,602	2,432	5,709	115	249,311	2,547
Construction of commercial	9,622	80	366	—	9,988	80
Commercial real estate	253,224	2,512	6,075	115	259,299	2,627
Farm land	4,024	32	250	—	4,274	32
Vacant land	7,684	129	199	3	7,883	132
Real estate secured	638,604	4,896	13,567	223	652,171	5,119
Commercial and industrial	132,212	952	519	32	132,731	984
Municipal	17,494	30	—	—	17,494	30
Consumer	4,794	80	—	—	4,794	80
Unallocated allowance	—	563	—	—	—	563
Totals	$793,104	$6,521	$14,086	$255	$807,190	$6,776

[1] Includes ASC 310-30 loans and allowance of $1.7 million and $0, respectively for 2018 and $2.4 million and $92,000, respectively for 2017.

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

December 31, 2018 (in thousands)	Collectively evaluated		Individually evaluated		Total portfolio	
	Loans	Allowance	Loans	Allowance	Loans	Allowance
Performing loans	$895,527	$6,989	$—	$—	$895,527	$6,989
Potential problem loans [1]	7,642	132	—	—	7,642	132
Impaired loans	—	—	12,520	272	12,520	272
Unallocated allowance	—	438	—	—	—	438
Totals	$903,169	$7,559	$12,520	$272	$915,689	$7,831

December 31, 2017 (in thousands)	Collectively evaluated		Individually evaluated		Total portfolio	
	Loans	Allowance	Loans	Allowance	Loans	Allowance
Performing loans	$783,206	$5,619	$—	$—	$783,206	$5,619
Potential problem loans [1]	9,898	339	—	—	9,898	339
Impaired loans	—	—	14,086	255	14,086	255
Unallocated allowance	—	563	—	—	—	563
Totals	$793,104	$6,521	$14,086	$255	$807,190	$6,776

[1] Potential problem loans consist of performing loans that have been assigned a substandard credit risk rating and are not classified as impaired, included in this total are purchased loans net of any purchase marks remaining on the loan.

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

(In thousands)	Impaired loans with specific allowance					Impaired loans with no specific allowance			
	Loan balance			Specific	Income	Loan balance			Income
	Book	Note	Average	allowance	recognized	Book	Note	Average	recognized
December 31, 2018									
Residential	$ 2,792	$2,842	$3,429	$107	$101	$3,799	$5,140	$3,726	$102
Home equity lines of credit	47	47	158	6	2	411	498	114	2
Residential real estate	2,839	2,889	3,587	113	103	4,210	5,638	3,840	104
Commercial	1,808	1,808	2,001	141	88	2,403	3,989	2,992	75
Construction of commercial	252	252	67	16	—	102	110	295	7
Farm land	—	—	—	—	—	216	432	232	—
Vacant land	42	42	43	2	3	147	168	151	10
Real estate secured	4,941	4,991	5,698	272	194	7,078	10,337	7,510	196
Commercial and industrial	—	—	40	—	—	501	596	469	5
Totals	$ 4,941	$4,991	$5,738	$272	$194	$7,579	$10,933	$7,979	$201

(In thousands)	Impaired loans with specific allowance					Impaired loans with no specific allowance			
	Loan balance			Specific	Income	Loan balance			Income
	Book	Note	Average	allowance	recognized	Book	Note	Average	recognized
December 31, 2017									
Residential	$3,532	$3,651	$3,376	$104	$109	$3,398	$4,279	$3,597	$119
Home equity lines of credit	47	47	79	1	2	66	117	155	—
Residential real estate	3,579	3,698	3,455	105	111	3,464	4,396	3,752	119
Commercial	2,336	2,563	2,688	115	102	3,373	4,567	3,699	305
Construction of commercial	108	114	59	—	7	258	274	310	—
Farm land	—	—	—	—	—	250	450	869	—
Vacant land	44	44	45	3	3	155	179	159	11
Real estate secured	6,067	6,419	6,247	223	223	7,500	9,866	8,789	435
Commercial and industrial	110	117	59	32	—	409	502	181	15
Consumer	—	—	—	—	—	—	6	1	—
Totals	$6,177	$6,536	$6,306	$255	$223	$7,909	$10,374	$8,971	$450

[1] Income recognized on impaired loans for the year ending December 31, 2016 was $200 thousand.

NOTE 5 - MORTGAGE SERVICING RIGHTS

Loans serviced for others are not included in the consolidated balance sheets. Balances of loans serviced for others and the fair value of mortgage servicing rights are as follows:

December 31, (in thousands)	2018	2017
Residential mortgage loans serviced for others	$111,378	$117,538
Fair value of mortgage servicing rights	951	1,010

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Changes in mortgage servicing rights are as follows:

Years ended December 31, (in thousands)	2018	2017	2016
Mortgage Servicing Rights			
Balance, beginning of period	$233	$339	$486
Originated	43	63	95
Amortization (1)	(48)	(169)	(242)
Balance, end of period	228	233	339
Valuation Allowance			
Balance, beginning of period	—	(23)	(3)
Decrease (increase) in impairment reserve (1)	—	23	(20)
Balance, end of period	—	—	(23)
Mortgage servicing rights, net	$228	$233	$316

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

NOTE 6 - PLEDGED ASSETS

The following securities and loans were pledged to secure public and trust deposits, securities sold under agreements to repurchase, FHLBB advances and credit facilities available.

December 31, (in thousands)	2018	2017
Securities available-for-sale (at fair value)	$80,991	$67,377
Loans receivable (at book value)	328,674	204,354
Total pledged assets	$409,665	$271,731

At December 31, 2018, securities were pledged as follows: $69.6 million to secure public deposits, $11.3 million to secure repurchase agreements and $0.1 million to secure FHLBB and FRB advances. Additionally, loans receivable are pledged to secure FHLBB advances and credit facilities.

NOTE 7 - BANK PREMISES AND EQUIPMENT

The components of premises and equipment are as follows:

December 31, (in thousands)	2018	2017
Land	$2,593	$2,593
Buildings and improvements	13,458	11,679
Leasehold improvements	1,553	1,690
Capital lease	3,273	1,900
Furniture, fixtures, equipment and software	8,978	8,312
Fixed assets in process	790	1,119
Total cost	30,645	27,293
Accumulated depreciation and amortization	(12,470)	(10,892)
Bank premises and equipment, net	$18,175	$16,401

NOTE 8 - GOODWILL AND INTANGIBLE ASSETS

Changes in the carrying values of goodwill and intangible assets were as follows:

Years ended December 31, (in thousands)	2018	2017	2016
Goodwill (1)			
Balance, beginning of period	$13,815	$12,552	$12,552
Additions	—	1,263	—
Impairment	—	—	—
Balance, end of period	$13,815	$13,815	$12,552
Core Deposit Intangibles			
Cost, beginning of period	$5,881	$5,248	$5,248
Additions	—	633	—
Impairment	—	—	—
Cost, end of period	5,881	5,881	5,248
Amortization, beginning of period	(4,044)	(3,511)	(2,910)
Amortization	(454)	(533)	(601)
Amortization, end of period	(4,498)	(4,044)	(3,511)
Core deposit intangibles, net	$1,383	$1,837	$1,737

(1) Not subject to amortization.

In June 2017, Salisbury acquired the New Paltz, New York branch of Empire State Bank, and assumed approximately $31.4 million in deposits and acquired approximately $7.1 million in loans. Salisbury realized goodwill in the amount of $1.26 million and a core deposit intangible of $633,000 as a result of this acquisition. Salisbury did not recognize any goodwill or a core deposit intangible as a result of its acquisition of the Fishkill, New York branch from Orange Bank and Trust Company in April 2018.

Salisbury performed an evaluation of its goodwill and intangible assets as of December 31, 2018. There was no impairment recognized during 2018 or 2017.

The core deposit intangibles were recorded as identifiable intangible assets and are being amortized over ten years using the sum-of-the-years' digits method. Estimated annual amortization expense of core deposit intangibles is as follows:

December 31, (in thousands)	CDI amortization
2019	$ 388
2020	321
2021	255
2022	192
2023	128
2024	61
2025	25
2026	13

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NOTE 9 - DEPOSITS

Scheduled maturities of time certificates of deposit are as follows:

December 31, (in thousands)	CD maturities
2019	$101,744
2020	33,885
2021	13,197
2022	5,282
2023	4,798
2024	2,773
Total	$161,679

The total amount and scheduled maturities of time certificates of deposit in denominations of $250,000 or more were as follows:

Years ended December 31, (in thousands)	2018	2017
Within three months	$1,128	$1,605
After three through six months	1,359	2,791
After six through twelve months	3,785	3,769
Over one year	9,726	6,596
Total	$15,998	$14,761

Included in certificates of deposit at December 31, 2018 and 2017 are brokered and reciprocal deposits of approximately $44.4 million and $6.6 million, respectively. Included in money market funds at December 31, 2018 and 2017 are approximately $41.1 million and $40.3 million, respectively of brokered money market accounts.

NOTE 10 – SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

Salisbury enters into overnight and short-term repurchase agreements with its customers. Securities sold under repurchase agreements are as follows:

December 31, (dollars in thousands)	2018		2017	
Repurchase agreements, ending balance	$4,104		$1,668	
Repurchase agreements, average balance during period	3,340		2,517	
Book value of collateral	11,194		4,737	
Market value of collateral	11,276		4,725	
Weighted average rate during period	0.35	%	0.20	%
Weighted average maturity		1 day		1 day

NOTE 11 – FEDERAL HOME LOAN BANK OF BOSTON ADVANCES AND OTHER BORROWED FUNDS

Federal Home Loan Bank of Boston (“FHLBB”) advances are as follows:

	December 31, 2018			December 31, 2017		
Years ended December 31, (dollars in thousands)	Total (1)	Rate (2)		Total (1)	Rate (2)	
Overnight	$9,500	2.68	%	$—		-%
2018	—	—		34,000	2.04	
2019	37,000	2.50		—	—	
2020	14,814	1.98		14,655	2.01	
2021	5,840	2.27		5,767	2.30	
Total	$67,154	2.39	%	$54,422	2.06	%

(1) Net of modification costs

(2) Weighted average rate based on scheduled maturity dates.

In addition to outstanding FHLBB advances, Salisbury has additional available borrowing capacity, based on current capital stock levels, of $143.7 million and access to an unused FHLBB line of credit of $3.5 million at December 31, 2018. Advances from the FHLBB are secured by a blanket lien on qualified collateral, consisting primarily of loans with first mortgages secured by one-to-four family properties, certain unencumbered investment securities and other qualified assets.

Subordinated Debentures:

In December 2015, Salisbury completed the issuance of $10.0 million in aggregate principal amount of 6.00% Fixed-to-Floating Rate Subordinated Notes Due 2025 (the “Notes”) in a private placement transaction to various accredited investors including $500 thousand to certain of Salisbury’s related parties. The Notes have a maturity date of December 15, 2025 and bear interest at an annual rate of 6.00% from and including the original issue date of the Notes to, but excluding, December 15, 2020 or the earlier redemption date payable semi-annually in arrears on June 15 and December 15 of each year. Thereafter, from and including December 15, 2020 to, but excluding, December 15, 2025, the annual interest rate will be reset quarterly and equal to the three-month LIBOR, plus 430 basis points, as described in the Notes, payable quarterly, in arrears, on March 15, June 15, September 15 and December 15 of each year during the time that the Notes remain outstanding through December 15, 2025 or earlier redemption date. The notes are redeemable, without penalty, on or after December 15, 2020 and, in certain limited circumstances, prior to that date. As more completely described in the Notes, the indebtedness evidenced by the Notes, including principal and interest, is unsecured and subordinate and junior in right of Salisbury’s payments to general and secured creditors and depositors of the Bank. The Notes also contain provisions with respect to redemption features and other matters pertaining to the Notes. The Notes have been structured to qualify as Tier 2 capital for regulatory capital purposes, subject to applicable limitations.

Subordinated debentures totaled $9.8 million at December 31, 2018 and 2017, which includes $165 thousand and $189 thousand, respectively of remaining unamortized debt issuance costs. The debt issuance costs are being amortized to maturity. The effective interest rate of the subordinated debentures is 6.34%.

Notes Payable:

In October 2015, Salisbury entered into a private mortgage for $380,000 to purchase the Sharon branch property. The mortgage, which has an interest rate of 6%, will mature in September 2025. The outstanding mortgage balance at December 31, 2018 and December 31, 2017 was $280,000 and $313,000, respectively.

NOTE 12 – NET DEFERRED TAX ASSET AND INCOME TAXES

Salisbury provides deferred taxes for the estimated future tax effects attributable to temporary differences and carry-forwards when realization is more likely than not. The components of the income tax provision were as follows:

Years ended December 31, (in thousands)	2018	2017	2016
Federal	$1,986	$1,831	$1,344
State	217	195	288
Current provision	2,203	2,026	1,632
Federal	(455)	840	852
State	(39)	48	105
Deferred (benefit) expense	(494)	888	957
Income tax provision	$1,709	$2,914	$2,589

The following is a reconciliation of the expected federal statutory tax to the income tax provision:

Years ended December 31,	2018	2017	2016
Income tax at statutory federal tax rate	21.00%	34.00%	34.00%
State tax, net of federal tax benefit	1.37	1.74	2.80
Tax exempt income and dividends received deduction	(3.84)	(7.00)	(9.07)
Remeasurement of net deferred tax assets	—	4.85	—
BOLI interest and gain	(1.35)	(1.34)	(1.29)
Other	(0.95)	(0.47)	1.48
Change in valuation allowance	—	—	—
Effective income tax rates	16.23%	31.78%	27.92%

The components of Salisbury's net deferred tax assets are as follows:

December 31, (in thousands)	2018	2017
Allowance for loan losses	$1,916	$1,499
Interest on non-performing loans	233	210
Accrued deferred compensation	334	248
Post-retirement benefits	11	11
Other real estate owned write-downs	—	6
Restricted stock awards	162	77
Mark-to-market purchase accounting adjustments	—	122
Net unrealized holding loss on available for sale securities	58	—
Write-down of securities	4	154
Other	282	51
Gross deferred tax assets	3,000	2,378
Deferred loan costs, net	(344)	(312)
Mark-to-market purchase accounting adjustments	(37)	—
Goodwill and core deposit intangible asset	(545)	(534)
Accelerated depreciation	(698)	(752)
Other real estate owned write-downs	(45)	—
Mortgage servicing rights	(55)	(56)
Net unrealized holding gain on available-for-sale securities	—	(47)
Gross deferred tax liabilities	(1,724)	(1,701)
Net deferred tax asset	$1,276	$677

Salisbury will only recognize a deferred tax asset when, based upon available evidence, realization is more likely than not. Salisbury remeasured its net deferred tax asset as of December 31, 2017 due to the enactment of the Tax Cuts and Job Act during the fourth quarter of 2017. This remeasurement resulted in a $445,000 increase in the tax provision for 2017 and a related reduction in the net deferred tax asset.

In accordance with Connecticut legislation, in 2004, Salisbury formed a PIC, SBT Mortgage Service Corporation. Salisbury does not expect to pay Connecticut state income tax in the foreseeable future unless there is a change in Connecticut law.

Salisbury's policy is to provide for uncertain tax positions and the related interest and penalties (recorded as a component of income tax expense, if any) based upon management's assessment of whether a tax benefit is more likely than not to be sustained upon examination by tax authorities. As of December 31, 2018 and 2017, there were no material uncertain tax positions related to federal and state tax matters. Salisbury is currently open to audit under the statute of limitations by the Internal Revenue Service and state taxing authorities for the years ended December 31, 2015 through December 31, 2018.

NOTE 13 – SHAREHOLDERS' EQUITY

Capital Requirements

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

The regulatory capital rules include a common equity Tier 1 capital risk-weighted assets minimum ratio of 4.5%, minimum ratio of Tier 1 capital to risk-weighted assets of 6.0%, require a minimum ratio of Total capital to risk-weighted assets of 8.0%, and require a minimum Tier 1 leverage ratio of 4.0%. A capital conservation buffer, comprised of common equity Tier 1 capital, is also established above the regulatory minimum capital requirements. The implementation of the capital conservation buffer began phasing in January 1, 2016 at 0.625% of risk-weighted assets and increases each subsequent January 1, by an additional 0.625% until reaching its final level of 2.5% on January 1, 2019. As of December 31, 2018, the Bank exceeded the fully phased in regulatory requirement for the capital conservation buffer. Strict eligibility criteria for regulatory capital instruments were also implemented under the final rules.

As of December 31, 2018, the Company and the Bank met each of their capital requirements and the most recent notification from the FDIC categorized the Bank as "well-capitalized." There are no conditions or events since that notification that management believes have changed the Bank's category.

(dollars in thousands)	Actual		To be Well Capitalized For Capital Adequacy Purposes		Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2018						
Total Capital (to risk-weighted assets)						
Salisbury	$107,659	12.51%	$68,848	8.0%	n/a	n/a
Bank	104,013	12.09	68,848	8.0	$86,059	10.0%
Tier 1 Capital (to risk-weighted assets)						
Salisbury	89,738	10.43	51,636	6.0	n/a	n/a
Bank	96,092	11.17	51,636	6.0	68,848	8.0
Common Equity Tier 1 Capital (to risk-weighted assets)						
Salisbury	89,738	10.43	38,727	4.5	n/a	n/a
Bank	96,092	11.17	38,727	4.5	55,939	6.5
Tier 1 Capital (to average assets)						
Salisbury	89,738	8.25	43,527	4.0	n/a	n/a
Bank	96,092	8.83	43,527	4.0	54,409	5.0
December 31, 2017						
Total Capital (to risk-weighted assets)						
Salisbury	$98,920	12.94%	$61,154	8.0%	n/a	n/a
Bank	95,810	12.54	61,130	8.0	$76,413	10.0%
Tier 1 Capital (to risk-weighted assets)						
Salisbury	82,034	10.73	45,865	6.0	n/a	n/a
Bank	88,924	11.64	45,848	6.0	61,130	8.0
Common Equity Tier 1 Capital (to risk-weighted assets)						
Salisbury	82,034	10.73	34,399	4.5	n/a	n/a
Bank	88,924	11.64	34,386	4.5	49,668	6.5
Tier 1 Capital (to average assets)						
Salisbury	82,034	8.53	38,461	4.0	n/a	n/a
Bank	88,924	9.25	38,461	4.0	48,076	5.0

Restrictions on Cash Dividends to Common Shareholders

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

FRB Supervisory Letter SR 09-4, February 24, 2009, revised March 30, 2009, notes that, as a general matter, the Board of Directors of a Bank Holding Company (“BHC”) should inform the Federal Reserve and should eliminate, defer, or significantly reduce dividends if (1) net income available to shareholders for the past four quarters, net of dividends previously paid during that period, is not sufficient to fully fund the dividends; (2) the prospective rate of earnings retention is not consistent with capital needs and overall current and prospective financial condition; or (3) the BHC will not meet, or is in danger of not meeting, its minimum regulatory capital adequacy ratios. Moreover, a BHC should inform the Federal Reserve reasonably in advance of declaring or paying a dividend that exceeds earnings for the period (e.g., quarter) for which the dividend is being paid or that could result in a material adverse

change to the BHC capital structure.

NOTE 14 –OTHER BENEFITS

401(k) Plan

Salisbury offers a 401(k) Plan to eligible employees. Under the 401(k) Plan, eligible participants may contribute a percentage of their pay subject to IRS limitations. Salisbury may make discretionary contributions to the Plan. The Plan includes a safe harbor contribution of 4% for all qualifying employees. The Bank’s safe harbor contribution percentage is reviewed annually and, under provisions of the 401(k) Plan, is subject to change in the future. An additional discretionary match may also be made for all employees that meet the 401(k) Plan’s qualifying requirements for such a match. This discretionary matching percentage, if any, is also subject to review under the provisions of the 401(k) Plan.

Both the safe harbor and additional discretionary match, if any, vest immediately.

Salisbury's 401(k) Plan contribution expense for 2018, 2017 and 2016 was $1,004,000, $821,000 and $832,000, respectively.

Employee Stock Ownership Plan (ESOP)

Salisbury offers an ESOP to eligible employees. Under the Plan, Salisbury may make discretionary contributions to the Plan. Discretionary contributions vest in full upon six years and reflect the following schedule of qualified service:

20% after the second year, 20% per year thereafter, vesting at 100% after six full years of service. Benefit expenses totaled $358,000, $132,000, and $173,000 in 2018, 2017, and 2016, respectively.

Other Retirement Plans

Salisbury adopted ASC 715-60, "Compensation - Retirement Benefits - Defined Benefit Plans - Other Postretirement" and recognized a liability for Salisbury's future postretirement benefit obligations under endorsement split-dollar life insurance arrangements. The total liability for the arrangements included in other liabilities was $992,000 and $966,000 at December 31, 2018, and 2017, respectively. Expense under this arrangement was $26,000 for 2018, $117,000 for 2017, and $74,000 for 2016.

The Bank entered into a Supplemental Retirement Plan Agreement with its former Chief Executive Officer that provides for supplemental post retirement payments for a ten year period as described in the agreement. The related liability was $25,000 and $48,000 at December 31, 2018, and 2017, respectively. The related expenses were immaterial for all periods presented.

The Bank assumed a Supplemental Retirement Plan Agreement with a former Chief Executive Officer of Riverside Bank that provides for supplemental post retirement payments for a fifteen year period as described in the agreement. The related liability was $403,000 and $446,000 at December 31, 2018 and December 31, 2017, respectively. The related expenses were immaterial for all periods presented.

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

In 2018, 2017, and 2016, the Bank awarded six (6), eight (8) and nine (9) Executives, respectively, with discretionary contributions to the plan. Expenses related to this plan amounted to $115,000 in 2018, $80,000 in 2017, and $46,000 in 2016

Management Agreements: Salisbury or the Bank has entered into various management agreements with its named executive officers, including a severance agreement with Mr. Cantele, President and Chief Executive Officer, a change in control agreement with Mr. Albero, Executive Vice President and Chief Financial Officer, and an employment agreement with Mr. Davies, President of the New York Region and Chief Lending Officer. Such agreements are designed to allow Salisbury to retain the services of the designated executives while reducing, to the extent possible, unnecessary disruptions to Salisbury's operations.

NOTE 15 - LONG TERM INCENTIVE PLANS

The Board of Directors adopted the 2011 Long Term Incentive Plan (the "Plan") on March 25, 2011, and the shareholders approved the Plan at the 2011 Annual Meeting. The Plan was amended on January 18, 2013, January 29, 2016 and again on April 28, 2017. The purpose of the Plan is to assist Salisbury and the Bank in attracting, motivating, retaining and rewarding employees, officers and directors by enabling such persons to acquire or increase a proprietary interest in Salisbury in order to strengthen the mutuality of interests between such persons and our shareholders, and providing such persons with stock-based long-term performance incentives to expend their maximum efforts in the creation of shareholder value.

The terms of the Plan provide for grants of Directors Stock Retainer Awards, Stock Options, Stock Appreciation Rights (“SARs”), Restricted Stock, Restricted Stock Units, Performance Awards, Deferred Stock, Dividend Equivalents, and Stock or Other Stock-Based Awards that may be settled in shares of common stock, cash, or other property (collectively, “Awards”). Under the Plan, the total number of shares of Common Stock reserved and available for issuance in the ten years following adoption of the Plan in connection with Awards under the Plan is 84,000 shares of Common Stock, which represented less than 5% of Salisbury’s outstanding shares of Common Stock at the time the Plan was adopted. Shares of Common Stock with respect to Awards previously granted under the Plan that are cancelled, terminate without being exercised, expire, are forfeited or lapse will again be available for issuance as Awards. Also, shares of Common Stock subject to Awards settled in cash and shares of Common Stock that are surrendered in payment of any Award or any tax withholding requirements will again be available for issuance as Awards. No more than 30,000 shares of Common Stock may be issued pursuant to Awards in any one calendar year. In addition, the Plan limits the total number of shares of Common Stock that may be awarded as Incentive Stock Options (“ISOs”) to 42,000 and the total number of shares of Common Stock that may be issued as Directors Stock Retainer Awards to 15,000. The Directors stock retainer awards were increased from 120 shares per year to 240 shares per year effective January 25, 2013. Effective January 29, 2016, the Directors stock retainer award was increased from 240 shares to 340 shares annually.

The Board of Directors adopted the 2017 Long Term Incentive Plan (the “2017 LTIP”) on February 24, 2017, which was approved by shareholders at the 2017 Annual Meeting on May 17, 2017. Pursuant to the 2017 LTIP, as of May 2017, following shareholder approval of the 2017 LTIP, no further awards will be made under the 2011 LTIP, which shall remain in existence solely for purposes of administering outstanding grants. Under the 2017 LTIP, the total number of shares of Common Stock reserved and available for issuance in the next ten years in connection with awards under the 2017 LTIP is 200,000 shares of Common Stock, which represents approximately 7% of Salisbury’s 2,770,036 outstanding shares of Common Stock as of March 20, 2017. Of the maximum shares available under the 2017 LTIP, 200,000 shares may be issued upon the exercise of stock options (all of which may be granted as incentive stock options) and 150,000 shares may be issued as restricted stock or restricted stock units (including deferred stock units), provided that, to the extent that a share is issued as a restricted stock award or a restricted stock unit, the share would no longer be available for award as a stock option, unless the restricted stock award or restricted unit is forfeited or otherwise returned to the 2017 LTIP.

In 2018, 2017 and 2016 Salisbury granted a total of 13,210, 13,824 and 15,800 shares of restricted stock pursuant to its 2011 and 2017 LTIP to certain employees and Directors. The fair value of the stock at grant date was determined to be $585,000, $547,000 and $466,000, respectively. The stock will be vested three years from the grant date.

The following table presents the amount of cumulatively granted restricted stock awards under the 2011 and 2017 Long-Term Incentive Plans:

Year Ended December 31	2018	Weighted Average Grant Price
Beginning of year	27,024	$ 34.62
Granted	13,210	44.30
Vested	0	0.00

Forfeited	(800)	40.99
End of year	39,434	$ 37.73

The fair value of the restricted shares that vested during 2018 and 2017 was $0 and $222,000, respectively. Compensation expense for restricted stock awards in 2018, 2017, and 2016 was $412,000, $259,000 and $215,000, respectively. Unrecognized compensation cost relating to the restricted stock awards was $711,000 and $606,000 as of December 31, 2018 and 2017, respectively. The remaining weighted average vesting period on restricted shares as of December 31, 2018, over which unrecognized compensation cost is expected to be recognized, is 1.3 years. In 2017, Salisbury recorded a $105,000 benefit to the tax provision for the adoption of ASU 2016-09 as discussed in Note 1 - Summary of Significant Accounting Policies. The tax benefit associated with restricted stock awards, which was recognized in earnings for 2018, 2017 and 2016, was approximately $870, $88,000 and $73,000, respectively.

Additionally in 2018, 2017 and 2016 the Compensation Committee granted a total of 53,500, 56,600, and 47,470 Phantom Stock Appreciation Units (“PSUs” pursuant to the 2013 Phantom Stock Appreciation Unit and Long-Term Incentive Plan (the “Plan”) to certain employees, including the four Named Executive Officers. The units will vest on the third anniversary of the grant date. Salisbury’s compensation expense related to the PSUs was $171,000, $135,000 and $178,000 for 2018, 2017, and 2016 respectively.

NOTE 16 – STOCK OPTIONS

Salisbury issued stock options in conjunction with its acquisition of Riverside Bank in 2014. The table below reflects the remaining outstanding options related to this transaction and presents a summary of the status of Salisbury's outstanding stock options as of and for the year ended December 31, 2018:

Year ended December 31, 2018	Number of options	Weighted average exercise price	Weighted average remaining contractual term (in years)	Aggregate intrinsic value
Beginning of period	40,500	$ 21.73		
Granted	—	—		
Exercised	(9,155)	24.26		
Forfeited or expired	(8,800)	31.11		
End of period	22,545	$ 17.04	5.00	$456,000

All options are vested and exercisable at December 31, 2018. The total intrinsic value is the amount by which the fair value of the underlying stock exceeds the exercise price of an option on the exercise date. The total intrinsic value of stock options exercised during the years ended December 31, 2018, 2017 and 2016 was $160,000, $156,000 and $41,000, respectively.

NOTE 17 - RELATED PARTY TRANSACTIONS

In the normal course of business the Bank has granted loans to executive officers, directors, principal shareholders and associates of the foregoing persons considered to be related parties. Changes in loans to executive officers, directors and their related associates are as follows (there are no loans to principal shareholders):

Years ended December 31, (in thousands)	2018	2017
Balance, beginning of period	$7,651	$7,918
Advances	4,374	508
Repayments	(2,593)	(775)
Balance, end of period	$9,432	$7,651

NOTE 18 – OTHER COMPREHENSIVE LOSS

The following table presents a reconciliation of the changes in the components of other comprehensive loss for the dates indicated, including the amount of income tax benefit allocated to each component of other comprehensive loss:

Years ended December 31, (in thousands)	2018	2017	2016
Other comprehensive loss			
Net unrealized losses on securities available-for-sale	$(202)	$(318)	$(399)
Reclassification of net realized gains in net income[1]	(318)	(178)	(584)
Unrealized losses on securities available-for-sale	(520)	(496)	(983)
Income tax benefit	105	198	335
Unrealized losses on securities available-for-sale, net of tax	(415)	(298)	(648)

Other comprehensive loss	$(415)	$(298)	$(648)

(1) Reclassification adjustments include realized security gains and losses. The gains and losses have been reclassified out of other comprehensive loss and have affected certain lines in the consolidated statements of income as follows: the pretax amount is reflected as gains on securities, net; the tax effect is included in the income tax provision; and the after tax amount is included in net income. The income tax expense related to reclassification of net realized gains was approximately $67,000, $61,000, and $199,000 in 2018, 2017 and 2016, respectively.

The components of accumulated other comprehensive income are as follows:

December 31, (dollars in thousands)	2018	2017
Unrealized (losses) gains on securities available-for-sale, net of tax	$(220)	$179
Accumulated other comprehensive income	$(220)	$179

NOTE 19 - COMMITMENTS AND CONTINGENT LIABILITIES

Commitments

The Bank's agreement with the core accounting processing service provider will continue until the eighth anniversary of the commencement date, which was November 10, 2016. If the Bank cancels the agreement prior to the end of the contract term, a lump sum termination fee will have to be paid. The fee shall consist of the total amount that would have been paid or reimbursed to the service provider during the remainder of the term of the agreement.

The Bank leases facilities and equipment under operating leases that expire at various dates through 2029. The leases have varying renewal options, generally require a fixed annual rent, and provide that real estate taxes, insurance, and maintenance are to be paid by Salisbury. Rent expense totaled $396,000, $361,000 and $245,000 for 2018, 2017 and 2016, respectively.

Future minimum lease payments at December 31, 2018 are as follows:

Future minimum lease payments (in thousands)	
2019	$ 247
2020	247
2021	228
2022	199
2023	148
Thereafter	781
	$ 1,850

The leases for three Bank branches, which are accounted for as capital leases, expire in 2020, 2028 and 2029. The leases have varying renewal options, require a fixed annual rent, and provide that real estate taxes, insurance, and maintenance are to be paid by the Bank. In September 2018, Salisbury entered into a letter of intent to purchase the New Paltz, New York branch from the landlord for $1.6 million. The letter of intent will expire in the event a mutually satisfactory sales contract is not executed by March 31, 2019. Salisbury expects the sale to close upon the expiration of the lease in September 2019. The following is a schedule by years of future minimum lease payments under the capital leases with the present value of the net minimum lease payments as of December 31, 2018.

Future minimum lease payments (in thousands)	
2019	$ 342
2020	342
2021	342

2022	345
2023	347
Thereafter	2,954
Total minimum lease payments	4,672
Less amount representing interest	1,591
	$ 3,081

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Employment and Change in Control Agreements

Salisbury has entered into severance agreements with certain senior executives, including with one (1) named executive officer, Richard J. Cantele, Jr., which provide payouts ranging from 0.5 to 2.9 times base salary and other benefits. Salisbury has also entered into several change in control agreements including with named executive officer Peter Albero, and an employment agreement with named executive officer John Davies, all of which provide a severance payment ranging from 0.5 to 2.0 times base salary and other benefits in the event employment is terminated in conjunction with a defined change in control.

Contingent Liabilities

The Bank is involved in various claims and legal proceedings, which are not material, arising in the ordinary course of business. There are no other material pending legal proceedings, other than ordinary routine litigation incidental to the registrant's business, to which Salisbury is a party or to which any of its property is subject.

NOTE 20 - FINANCIAL INSTRUMENTS

The Bank, in the normal course of business and to meet the financing needs of its customers, is a party to financial instruments with off-balance sheet risk. These financial instruments include commitments to originate loans, letters of credit, and unadvanced funds on loans. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheets. The contract amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

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

Commitments to originate loans are agreements to lend to a customer provided there are no violations of any conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but may include secured interests in mortgages, accounts receivable, inventory, property, plant and equipment and income producing properties.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance by a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. As of December 31, 2018 and 2017, the maximum potential amount of the Bank's obligation was $3,865,000 and $4,905,000, respectively, for financial, commercial and standby letters of credit. If a letter of credit is drawn upon, the Bank may seek recourse through the customer's underlying line of credit. If the customer's line of credit is also in default, the Bank may take possession of the collateral, if any, securing the line of credit.

Financial instrument liabilities with off-balance sheet credit risk are as follows:

December 31, (dollars in thousands)	2018	2017
Residential	$6,751	$16,769

Home equity lines of credit	29,872	29,031
Commercial	19,051	26,145
Land	14	64
Real estate secured	55,688	72,009
Commercial and industrial	77,219	63,942
Municipal	250	188
Consumer	1,583	1,574
Unadvanced portions of loans	134,740	137,713
Commitments to originate loans	18,397	28,222
Letters of credit	3,865	4,905
Total	$157,002	$170,840

The allowance for off balance sheet commitments is calculated by applying a reserve percentage discounted by a utilization factor to the sum of unguaranteed unused lines of credit and loan contracts that the Bank has committed to but not funded as of year-end. The allowance for off-balance sheet commitments was $90,000 and $110,000 as of December 31, 2018 and December 31, 2017, respectively.

NOTE 21 - FAIR VALUE MEASUREMENTS

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

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

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

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

- Level 1. Quoted prices in active markets for identical assets. Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.
- Level 2. Significant other observable inputs. Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third party pricing services for identical or comparable assets or liabilities.
- Level 3. Significant unobservable inputs. Valuations for assets and liabilities that are derived from other methodologies, including option pricing models, discounted cash flow models and similar techniques, are not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets and liabilities.

A financial instrument’s level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. Salisbury did not have any significant transfers of assets between levels 1 and 2 of the fair value hierarchy during the year ended December 31, 2018.

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

- Securities available-for-sale and the CRA mutual fund. Securities available-for-sale and the CRA mutual fund are recorded at fair value on a recurring basis. Level 1 securities include exchange-traded equity securities. Level 2 securities include debt securities with quoted prices, which are traded less frequently than exchange-traded instruments, whose value is determined using matrix pricing with inputs that are observable in the market or can be

derived principally from or corroborated by observable market data. This category generally includes obligations of the U.S. Treasury and U.S. government-sponsored enterprises, mortgage-backed securities, collateralized mortgage obligations, municipal bonds, SBA bonds, corporate bonds and certain preferred equities. Level 3 is for positions that are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence. In the absence of such evidence, management's best estimate is used. Subsequent to inception, management only changes level 3 inputs and assumptions when corroborated by evidence such as transactions in similar instruments, completed or pending third-party transactions in the underlying investment or comparable entities, subsequent rounds of financing, recapitalization and other transactions across the capital structure, offerings in the equity or debt markets, and changes in financial ratios or cash flows.

- Collateral dependent loans that are deemed to be impaired are valued based upon the fair value of the underlying collateral less costs to sell. Such collateral primarily consists of real estate and, to a lesser extent, other business assets. Management may adjust appraised values to reflect estimated market value declines or apply other discounts to appraised values resulting from its knowledge of the property. Internal valuations are utilized to determine the fair value of other business assets. Collateral dependent impaired loans are categorized as Level 3.
- Other real estate owned acquired through foreclosure or repossession is adjusted to fair value less costs to sell upon transfer out of loans. Subsequently, it is carried at the lower of carrying value or fair value less costs to sell. Fair value is generally based upon independent market prices or appraised values of the collateral. Management adjusts appraised values to reflect estimated market value declines or apply other discounts to appraised values for unobservable factors resulting from its knowledge of the property, and such property is categorized as Level 3.

Other than discussed above, the following methods and assumptions were used by management to estimate the fair value of significant classes of financial instruments for which it is practicable to estimate that value.

Cash and cash equivalents. Carrying value is assumed to represent fair value for cash and cash equivalents that have original maturities of ninety days or less.

Loans held-for-sale. The fair value is determined using a factor based on the estimated gain on sale of the loan.

Loans, net. The carrying value of the loans in the loan portfolio is based on their outstanding unpaid principal balances adjusted for charge-offs, the allowance for loan losses, the unamortized balance of any deferred fees or costs on originated loans and the unamortized balance of any premiums or discounts on loans purchased or acquired through mergers. The Bank adopted ASU 2016-01 in fiscal 2018, which required public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. The exit priced notion is a market-based measurement of fair value that is represented by the price to sell an asset or transfer a liability in the principal market (or most advantageous market in the absence of a principal market) on the measurement date. For December 31, 2018, the fair values of loans are estimated on an exit price basis incorporating discounts for credit, liquidity and marketability factors. This is not comparable with the fair values disclosed for December 31, 2017, which were based on an entrance price basis. For periods prior to fiscal year 2018, the fair value of the loans was estimated by discounting future cash flows using the current interest rates at which similar loans with similar terms would be made to borrowers of similar credit quality.

Accrued interest receivable/payable. Carrying value approximates fair value.

Cash surrender value of life insurance. The carrying value of this asset approximates its fair value.

Deposits. The fair value of demand, non-interest bearing checking, savings and money market deposits is determined as the amount payable on demand at the reporting date. The fair value of time deposits is estimated by discounting the estimated future cash flows using market rates offered for deposits of similar remaining maturities.

Borrowed funds. Advances from Federal Home Loan Bank – The fair value of these fixed-maturity advances is estimated by discounting future cash flows using rates currently offered for advances of similar remaining maturities. Subordinated Debentures – The fair value is estimated by using the Mid Line price as indicated for the end of the period on Bloomberg.

Capital lease liability. The fair value represents the present value of future lease payments. The discount rate represents the FHLB advance rate that corresponds to the remaining lease term.

Assets measured at fair value are as follows:

(in thousands)	Fair Value Measurements Using Level 1	Level 2	Level 3	Assets at fair value
December 31, 2018				
Assets at fair value on a recurring basis				
U.S. Government Agency notes	$—	$5,049	$—	$5,049
Municipal bonds	—	5,379	—	5,379
Mortgage-backed securities:				
U.S. Government agencies and U.S. Government-sponsored enterprises	—	32,327	—	32,327
Collateralized mortgage obligations:				
U.S. Government agencies	—	17,747	—	17,747
SBA bonds	—	27,740	—	27,740
Corporate bonds	—	3,576	—	3,576
Securities available-for-sale	$—	$91,818	$—	$91,818
CRA mutual funds	836	—	—	836
Assets at fair value on a non-recurring basis				
Collateral dependent impaired loans	$—	$—	$4,238	$4,238
Other real estate owned	$—	$—	$1,810	$1,810
December 31, 2017				
Assets at fair value on a recurring basis				
Municipal bonds	$—	$3,486	$—	$3,486
Mortgage-backed securities:				
U.S. Government agencies and U.S. Government-sponsored enterprises	—	45,868	—	45,868
Collateralized mortgage obligations:				
U.S. Government agencies	—	10,377	—	10,377
Non-agency	—	2,664	—	2,664
SBA bonds	—	12,267	—	12,267
Corporate bonds	—	3,550	—	3,550
Securities available-for-sale	$—	$78,212	$—	$78,212
CRA mutual funds	835	—	—	835
Assets at fair value on a non-recurring basis				
Collateral dependent impaired loans	$—	$—	$5,863	$5,863
Other real estate owned	$—	$—	$719	$719

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

(In thousands)	Carrying value	Estimated fair value	Fair value measurements using Level 1	Level 2	Level 3
December 31, 2018					
Financial Assets					
Cash and cash equivalents	$58,445	$58,445	$58,445	$—	$—
Securities available-for-sale	91,818	91,818	—	91,818	—
CRA mutual fund	836	836	836	—	—
Federal Home Loan Bank of Boston stock	4,496	4,496	—	—	4,496
Loans receivable, net	909,279	886,222	—	—	886,222
Accrued interest receivable	3,148	3,148	—	—	3,148
Cash surrender value of life insurance policies	14,438	14,438	14,438	—	—
Financial Liabilities					
Demand (non-interest-bearing)	$228,448	$228,448	$—	$—	$228,448
Demand (interest-bearing)	153,586	153,586	—	—	153,586
Money market	204,219	204,219	—	—	204,219
Savings and other	178,807	178,807	—	—	178,807
Certificates of deposit	161,679	162,013	—	—	162,013
Deposits	926,739	927,073	—	—	927,073
Repurchase agreements	4,104	4,104	—	—	4,104
FHLBB advances	67,154	67,231	—	—	67,231
Subordinated debt	9,835	10,006	—	—	10,006
Note payable	280	288	—	—	288
Capital lease liability	3,081	3,339	—	—	3,339
Accrued interest payable	237	237	—	—	237
December 31, 2017					
Financial Assets					
Cash and cash equivalents	$48,486	$48,486	$48,486	$—	$—
Securities available-for-sale	78,212	78,212	—	78,212	—
CRA mutual fund	835	835	835	—	—
Federal Home Loan Bank of Boston stock	3,813	3,813	—	—	3,813
Loans held-for-sale	669	669	—	—	669
Loans receivable, net	801,703	816,451	—	—	816,451
Accrued interest receivable	2,665	2,665	—	—	2,665
Cash surrender value of life insurance policies	14,381	14,381	14,381	—	—
Financial Liabilities					
Demand (non-interest-bearing)	$220,536	$220,536	$—	$—	$220,536
Demand (interest-bearing)	142,575	142,575	—	—	142,575
Money market	190,953	190,953	—	—	190,953
Savings and other	144,600	144,600	—	—	144,600
Certificates of deposit	116,831	115,290	—	—	115,290
Deposits	815,495	813,954	—	—	813,954
Repurchase agreements	1,668	1,668	—	—	1,668
FHLBB advances	54,422	54,918	—	—	54,918
Subordinated debt	9,811	10,313	—	—	10,313
Note payable	313	341	—	—	341
Capital lease liability	1,835	2,161	—	—	2,161
Accrued interest payable	99	99	—	—	99

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NOTE 22 – SALISBURY BANCORP, INC. (PARENT ONLY) CONDENSED FINANCIAL INFORMATION

The unconsolidated balance sheets and statements of income and cash flows of Salisbury Bancorp, Inc. are presented as follows:

Balance Sheets December 31, (in thousands)	2018	2017
Assets		
Cash and due from banks	$2,105	$2,519
Investment in bank subsidiary	110,525	104,404
Other assets	689	430
Total Assets	$113,319	$107,353
Liabilities and Shareholders' Equity		
Subordinated debt	$9,835	$9,811
Other liabilities	25	28
Shareholders' equity	103,459	97,514
Total Liabilities and Shareholders' Equity	$113,319	$107,353

Statements of Income Years ended December 31, (in thousands)	2018	2017	2016
Dividends from subsidiary	$3,529	$3,691	$3,491
Interest income	10	8	6
Interest expense	624	624	624
Non-interest expenses	435	530	337
Income before taxes and equity in undistributed net income of subsidiary	2,480	2,545	2,536
Income tax benefit	256	421	369
Income before equity in undistributed net income of subsidiary	2,736	2,966	2,905
Equity in undistributed net income of subsidiary	6,088	3,290	3,780
Net income	$8,824	$6,256	$6,685

Statements of Cash Flows Years ended December 31, (in thousands)	2018	2017	2016
Net income	$8,824	$6,256	$6,685
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed net income of subsidiary	(6,088)	(3,290)	(3,780)
Other	(239)	(410)	(13)
Net cash provided by operating activities	2,497	2,556	2,892
Investing Activities			
Investment in bank	—	—	—
Net cash utilized by investing activities	—	—	—
Financing Activities			
Common stock dividends paid	(3,133)	(3,113)	(3,086)
Proceeds from issuance of common stock	222	395	263
Net cash (utilized) provided by financing activities	(2,911)	(2,718)	(2,823)
Net (decrease) increase in cash and cash equivalents	(414)	(162)	69
Cash and cash equivalents, beginning of period	2,519	2,681	2,612
Cash and cash equivalents, end of period	$2,105	$2,519	$2,681

NOTE 23 – EARNINGS PER SHARE

The calculation of earnings per share is as follows:

Years ended December 31, (in thousands, except per share amounts)	2018	2017	2016
Net income applicable to common shareholders	$8,824	$6,256	$6,685
Less: Undistributed earnings allocated to participating securities	(111)	(55)	(52)
Net income allocated to common stock	$8,713	$6,201	$6,633
Weighted average common shares issued	2,798	2,779	2,755
Less: Unvested restricted stock awards	(35)	(24)	(22)
Weighted average common shares outstanding used to calculate basic earnings per common share	2,763	2,755	2,733
Add: Dilutive effect of stock options	17	19	16
Weighted average common shares outstanding used to calculate diluted earnings per common share	2,780	2,774	2,749
Earnings per common share (basic)	$3.15	$2.25	$2.43
Earnings per common share (diluted)	$3.13	$2.24	$2.41

NOTE 24 – SUBSEQUENT EVENTS

Salisbury has evaluated subsequent events for potential recognition and/or disclosure through the date these consolidated financial statements were issued.

The Board of Directors of Salisbury declared a $0.28 per common share quarterly cash dividend at their January 25, 2019 meeting. The dividend was paid on February 28, 2019 to shareholders of record as of February 14, 2019.

On February 22, 2019, Salisbury entered into a change in control agreement with Peter Albero, Chief Financial Officer, which supersedes his previous change in control agreement with Salisbury dated January 26, 2018. Such agreement provides a severance payment of 2.0 times base salary and other benefits in the event employment is terminated in conjunction with a defined change in control.

NOTE 25 – SELECTED QUARTERLY CONSOLIDATED FINANCIAL DATA (Unaudited)

Selected quarterly consolidated financial data for the years ended December 31, 2018 and 2017 is as follows:

Year ended December 31, 2018 (in thousands, except ratios and per share amounts)	Q1 2018	Q2 2018	Q3 2018	Q4 2018
Statement of Income				
Interest and dividend income	$9,300	$9,749	$10,516	$10,807
Interest expense	1,306	1,706	2,016	2,192
Net interest and dividend income	7,993	8,043	8,500	8,615
Provision (benefit) for loan losses	325	467	378	558
Trust and Wealth Advisory	894	949	936	921
Service charges and fees	868	892	932	1,025
Gains (Losses) on sales of mortgage loans, net	18	(1)	21	51
Mortgage servicing, net	83	84	84	57
(Losses) Gains on CRA mutual fund	(13)	(7)	(6)	8
(Losses) Gains on sales of available -for-sale- securities, net	(2)	17	—	302
BOLI income and gains	82	82	83	432
Other	45	42	38	28
Non-interest income	1,975	2,058	2,088	2,824
Non-interest expense	7,180	7,417	7,329	7,909
Income before income taxes	2,463	2,217	2,881	2,972
Income tax provision	446	318	537	408
Net income	2,017	1,899	2,344	2,564
Net income allocated to common stock	1,997	1,877	2,311	2,528
Financial Condition				
Total assets	1,014,934	1,096,780	1,098,715	1,121,554
Loans, net	830,370	872,796	898,625	909,279
Allowance for loan losses	7,058	7,381	7,745	7,831
Securities	84,878	90,870	101,591	97,150
Deposits	831,837	897,481	902,161	926,739
Repurchase agreements	3,962	1,691	6,658	4,104
FHLBB advances	62,480	79,538	67,596	67,154
Shareholders' equity	98,097	99,180	100,767	103,459
Non-performing assets	5,761	6,359	8,513	8,324
Per Common Share Data				
Earnings, basic	$0.72	$0.68	$0.84	$0.91
Earnings, diluted	0.71	0.68	0.83	0.91
Cash dividends declared	0.28	0.28	0.28	0.28
Cash dividends paid	0.28	0.28	0.28	0.28
Book value	35.20	35.38	35.93	36.86
Market price: (a)				
High	49.85	46.70	48.44	43.04
Low	44.00	38.15	40.36	35.25
Statistical Data				
Net interest margin (fully tax equivalent)	3.46%	3.31%	3.29%	3.34%
Efficiency ratio (fully tax equivalent)	69.35	70.87	66.91	69.13
Return on average assets	0.81	0.69	0.85	0.92

Return on average shareholders' equity	8.33	7.68	9.26	9.99
Weighted average common shares outstanding, basic	2,759	2,761	2,764	2,766
Weighted average common shares outstanding, diluted	2,780	2,779	2,779	2,779

(a) The above market prices reflect inter-dealer prices, without retail markup, markdown or commissions, and may not necessarily represent actual transactions.

Salisbury Bancorp, Inc.'s Common Stock, par value $0.10 per share ("Common Stock") trades on the NASDAQ Capital Market under the symbol: SAL. As of March 11, 2019, there were approximately 2,290 shareholders of record of the Company's Common Stock.

Selected quarterly consolidated financial data (unaudited) continued:

Year ended December 31, 2017 (in thousands, except ratios and per share amounts)	Q1 2017	Q2 2017	Q3 2017	Q4 2017
Statement of Income				
Interest and dividend income	$8,785	$8,687	$8,882	$9,167
Interest expense	953	1,026	1,116	1,143
Net interest and dividend income	7,832	7,661	7,766	8,024
Provision (benefit) for loan losses	352	364	237	67
(Losses) gains on securities, net	—	(14)	—	192
Trust and Wealth Advisory	854	892	874	857
Service charges and fees	962	902	935	919
Gains on sales of mortgage loans, net	49	30	25	21
Mortgage servicing, net	45	31	104	75
Other	113	110	142	118
Non-interest income	2,023	1,951	2,080	2,182
Non-interest expense	7,306	6,751	7,220	8,052
Income before income taxes	2,197	2,497	2,389	2,087
Income tax provision	593	615	695	1,011
Net income	1,604	1,882	1,694	1,076
Net income allocated to common stock	1,594	1,866	1,677	1,064
Financial Condition				
Total assets	939,549	974,806	979,469	986,984
Loans, net	764,665	771,850	784,136	801,703
Allowance for loan losses	6,285	6,493	6,494	6,776
Securities	80,359	84,468	88,546	82,860
Deposits	772,416	811,341	831,989	815,495
Repurchase agreements	2,350	2,126	4,529	1,668
FHLBB advances	52,745	47,302	27,364	54,422
Shareholders' equity	95,221	96,545	97,526	97,514
Non-performing assets	10,890	11,690	12,257	7,354
Per Common Share Data				
Earnings, basic	$0.58	$0.68	$0.61	$0.39
Earnings, diluted	0.58	0.67	0.60	0.38
Cash dividends declared	0.28	0.28	0.28	0.28
Cash dividends paid	0.28	0.28	0.28	0.28
Book value	34.38	34.66	35.01	35.01
Market price: (a)				
High	40.00	41.50	46.90	48.35
Low	37.30	38.50	40.40	44.00
Statistical Data				
Net interest margin (fully tax equivalent)	3.69 %	3.58 %	3.50 %	3.58 %
Efficiency ratio (fully tax equivalent)	68.68	66.56	67.18	64.90
Return on average assets	0.70	0.77	0.69	0.43
Return on average shareholders' equity	6.83	7.82	6.89	4.38

Weighted average common shares outstanding, basic	2,749	2,757	2,757	2,757
Weighted average common shares outstanding, diluted	2,768	2,775	2,777	2,778

(a) The above market prices reflect inter-dealer prices, without retail markup, markdown or commissions, and may not necessarily represent actual transactions.

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

Item 9A. CONTROLS AND PROCEDURES

Controls and Procedures

Salisbury carried out an evaluation under the supervision and with the participation of Salisbury’s management, including Salisbury’s Chief Executive Officer and Chief Financial Officer, of the effectiveness of Salisbury’s disclosure controls and procedures at and for the year ended December 31, 2018. Based upon that evaluation, management, including the principal executive officer and principal financial officer, concluded that Salisbury’s disclosure controls and procedures were effective as of the end of the period covered by this report and (i) designed to ensure that information required to be disclosed by Salisbury in the reports it files or submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC’s rules and forms; and (ii) accumulated and communicated to management as appropriate to allow timely decisions regarding required disclosure.

Management’s Annual Report on Internal Control Over Financial Reporting

Management of Salisbury and its subsidiary are responsible for establishing and maintaining effective internal control over financial reporting. Pursuant to the rules and regulations of the SEC, internal control over financial reporting is a process designed by, or under the supervision of, Salisbury’s principal executive and principal financial officers, or persons performing similar functions, and effected by Salisbury’s board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles, and includes those policies and procedures that:

i. Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of Salisbury;

ii. Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles and that receipts and expenditures of Salisbury are being made only in accordance with authorizations of management and directors of Salisbury; and

iii. Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of Salisbury’s assets that could have a material effect on the financial statements.

As of December 31, 2018, management conducted an assessment of the effectiveness of the Company’s internal control over financial reporting based on the framework established in Internal Control—Integrated Framework issued in 2013 by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management has determined that the Company’s internal control over financial reporting as of December 31, 2018 was effective.

Changes in internal control over financial reporting

There were no significant changes in internal control over financial reporting during the fourth quarter of 2018 that materially affected or are reasonably likely to materially affect Salisbury’s internal control over financial reporting. The Report of Independent Registered Public Accounting Firm is set forth in Part II, Item 8 of this Form 10-K.

Item 9B. OTHER INFORMATION

Not Applicable.

PART III

Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this item appears in Salisbury's Proxy Statement for the 2019 Annual Meeting of Shareholders, under the captions “Executive Officers;” “Directors and Nominees for Election for a Three Year Term and Director Independence” and "Corporate Governance - Meetings and Committees of the Board of Directors." Such information is incorporated herein by reference and made a part hereof.

Salisbury maintains a Code of Ethics and Conflicts of Interest Policy that applies to all of Salisbury’s directors, officers and employees, including Salisbury’s principal executive officer, principal financial officer and principal accounting officer. This Code of Ethics and Conflicts of Interest Policy is available upon request, without charge, by writing to Shelly L. Humeston, Secretary, Salisbury Bank and Trust Company, 5 Bissell Street, P.O. Box 1868, Lakeville, Connecticut 06039.

Item 11. EXECUTIVE COMPENSATION

The information required by this item appears in Salisbury's Proxy Statement for the 2019 Annual Meeting of Shareholders, under the captions: “Elements of Compensation” and "Executive Compensation" and “Board of Directors Compensation.” Such information is incorporated herein by reference and made a part hereof.

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED SHAREHOLDER MATTERS

The information required by this item appears in Salisbury’s Proxy Statement for the 2019 Annual Meeting of Shareholders, under the captions “Security Ownership of Certain Beneficial Owners and Management” “Directors and Nominees for Election for a Three Year Term” and “Director Independence” and “Executive Compensation.” Such information is incorporated herein by reference and made a part hereof.

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

The information required by this item appears in Salisbury's Proxy Statement for the 2019 Annual Meeting of Shareholders, under the captions “Directors and Nominees for Election for a Three Year Term” and “Director Independence” and "Transactions with Management and Others." Such information is incorporated herein by reference and made a part hereof.

Item 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this item appears in Salisbury's Proxy Statement for the 2019 Annual Meeting of Shareholders, under the caption "Relationship with Independent Public Accountants" and “Audit Committee Pre-Approval of Audit and Permissible Non-Audit Services of Independent Auditors.” Such information is incorporated herein by reference and made a part hereof.

PART IV

Item 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a)(1) Financial Statements. The Consolidated Financial Statements of Registrant and its subsidiary are included within Item 7 of Part II of this report.

(a)(2) Financial Statement schedules. All schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission have been omitted because they are either not applicable or the required information is included in the Consolidated Financial Statements or Notes thereto included within Item 8 of this Form 10-K.

(b) Exhibits. The following exhibits are included as part of this Form 10-K.

Exhibit No.	Description
2.1	Agreement and Plan of Merger by and among Salisbury Bancorp, Inc., Salisbury Bank and Trust Company and Riverside Bank dated March 18, 2014 (incorporated by reference to Exhibit 2.1 of Form 8-K filed on March 19, 2014).
3.1	Certificate of Incorporation of Salisbury Bancorp, Inc. (incorporated by reference to Exhibit 3.1 of Registrant's 1998 Registration Statement on Form S-4 filed April 23, 1998, File No.: 33-50857).
3.1.1	Amendment to Article Third of Certificate of Incorporation of Registrant (incorporated by reference to Exhibit 3.1 of Registrant's Form 8-K filed March 11, 2009).
3.1.2	Certificate of Amendment to Certificate of Incorporation of Registrant (incorporated by reference to Exhibit 3.1 of Registrant's Form 8-K filed March 19, 2009).
3.1.3	Certificate of Amendment to Certificate of Incorporation for the Series B Preferred Stock (incorporated by reference to Registrant's Form 8-K filed on August 25, 2011).
3.1.4	Certificate of Amendment to Certificate of Incorporation of Registrant (incorporated by reference to Exhibit 3.1 of Registrant's Form 8-K filed October 30, 2014).
3.2	Amended and Restated Bylaws (incorporated by reference to Exhibit 3.1 of Form 8-K filed November 25, 2014).
4.1	Form of Subordinated Note, dated as of December 10, 2015, issued by Salisbury Bancorp, Inc. (incorporated by reference to Exhibit 4.1of Registrant's Form 8-K filed December 10, 2015).
10.1	2011 Long Term Incentive Plan adopted by the Board on March 25, 2011 and approved by the shareholders at Salisbury's 2011 Annual Meeting of Shareholders (incorporated by reference to Exhibit 10.9 of Registrant's Annual Report on Form 10-K filed March 19, 2012).
10.2	Amendment Number One to 2011 Long Term Incentive Plan dated as of January 18, 2013 (incorporated by reference to Exhibit 10.10 of Registrant's Annual Report on Form 10-K filed March 7, 2013).
10.3	Severance Agreement between Salisbury Bank and Trust and Mr. Richard J. Cantele, Jr. effective as of January 1, 2013 (incorporated by reference to Exhibit 10.1 of Registrant's Form 8-K filed February 15, 2013).
10.4	Non-qualified Deferred Compensation Plan effective as of January 1, 2013 (incorporated by reference to Exhibit 10.2 of Registrant's Form 8-K filed February 15, 2013).
10.5	Employee Stock Ownership Plan (incorporated by reference to Exhibit 10.14 of Form 10-K filed March 28, 2014).
10.6	Salisbury Bancorp, Inc. 2015 Phantom Stock Appreciation Unit and Long-Term Incentive Plan (incorporated by reference to Exhibit 10.1 of Form 8-K filed January 2, 2015).
10.7	Amendment Number One to Salisbury Bancorp, Inc. 2015 Phantom Stock Appreciation Unit and Long-Term Incentive Plan (incorporated by reference to Exhibit 10.1 of Form 8-K filed January 30, 2015).
10.8	Amendment Number Two to 2011 Long Term Incentive Plan dated as of January 29, 2016 (incorporated by reference to Exhibit 10.12 of Form 10-K filed March 30, 2016).
10.9	

	Form of Split-dollar Life Insurance Agreements with Senior Executive Officers (incorporated by reference to Exhibit 10.13 of Form 10-K filed March 30, 2016).
10.1	Employment Agreement with John M. Davies. (incorporated by reference to Exhibit 10.14 of Form 10-K filed March 30, 2016).
10.11	Form of Subordinated Note Purchase Agreement, dated as of December 10, 2015, between Salisbury Bancorp, Inc. and the Purchasers identified therein. (incorporated by reference to Exhibit 10.1 of Registrant's Form 8-K filed December 10, 2015). (incorporated by reference to Exhibit 10.15 of Form 10-K filed March 30, 2016).

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10.12	2017 Long Term Incentive Plan adopted by the Board on February 24, 2017 and approved by shareholders at Salisbury's 2017 Annual Meeting of Shareholders (incorporated by reference to Appendix A of the Registrant's proxy filed March 20, 2017).
10.13	Amendment Number Three to 2011 Long Term Incentive Plan dated as of April 28, 2017 (incorporated by reference to Exhibit 10.2 of Form 10-Q filed May 15, 2017).
10.14	Change in Control Agreement with Peter Albero dated February 22, 2019 (incorporated by reference to Exhibit 10.1 of Form 8-K filed February 25, 2019.
10.15	Change in Control Agreement with Steven M. Essex dated February 22, 2019 (incorporated by reference to Exhibit 10.2 of Form 8-K filed February 25, 2019.
21.1	Subsidiaries of the Registrant.
23.1	Consent of Baker Newman & Noyes, LLC.
31.1	Chief Executive Officer Certification Pursuant to 17 CFR 240.13a-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Chief Financial Officer Certification Pursuant to 17 CF 240.13a-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Chief Executive Officer and Chief Financial Officer Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(c) Financial Statement Schedules

No financial statement schedules are required to be filed as Exhibits pursuant to Item 15(c).

Item 16. **FORM 10-K SUMMARY**

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SALISBURY BANCORP, INC.

/s/ Richard J. Cantele, Jr.

Richard J. Cantele, Jr.,

President and Chief Executive Officer

March 15, 2019

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

/s/ Louis E. Allyn, II
Louis E. Allyn, II
Director
March 15, 2019

/s/ Charles M. Andola
Charles M. Andola
Director
March 15, 2019

/s/ George E. Banta
George E. Banta
Director
March 15, 2019

/s/ Arthur J. Bassin
Arthur J. Bassin
Director
March 15, 2019

/s/ Richard J. Cantele, Jr.

/s/ Polly Diane Hoe
Polly Diane Hoe
Director
March 15, 2019

/s/ Nancy F. Humphreys
Nancy F. Humphreys
Director
March 15, 2019

/s/ Holly J. Nelson
Holly J. Nelson
Director
March 15, 2019

/s/ John F. Perotti
John F. Perotti
Director
March 15, 2019

/s/ Michael A. Varet

Richard J. Cantele, Jr.
Director, President and Chief Executive Officer
March 15, 2019

Michael A. Varet
Director, Chairman of the Board
March 15, 2019

/s/ David B. Farrell
David B. Farrell
Director
March 15, 2019

/s/ Michael D. Gordon
Michael D. Gordon
Director
March 15, 2019

/s/ Peter Albero
Peter Albero
Chief Financial Officer
and Chief Accounting Officer
March 15, 2019