loans into mortgage-backed securities, which are classified as securities available for sale. In addition, the Company originated and sold $35.4 million of fixed-rate residential mortgage loans on the secondary market. Residential real estate mortgage loans decreased by $18.8 million, or 8.4%, in 2001. During 2001, the Company securitized $57.0 million of fixed-rate residential mortgages loans into mortgage-backed securities, which are classified as securities available for sale. These transactions resulted in the Company's loan balances decreasing, as those assets shifted to investment securities. The Company will receive annual servicing fees as compensation for servicing the outstanding balances. These loans were sold to Freddie Mac without recourse, which means Freddie Mac assumes the risk of loss from borrower defaults subject to the terms and conditions of the purchase documents. Residential real estate loans consist of loans secured by one-to-four family residences. The Company generally retains adjustable-rate mortgages in its portfolio and will, from time to time, retain fixed-rate mortgages. With a relatively low interest rate environment, the Company's asset/liability strategy during 2002 was to keep a portion of its fixed-rate residential mortgages in its loan portfolio.

Commercial loans consist of loans secured by various corporate assets, as well as loans to provide working capital in the form of lines of credit, which may be secured or unsecured and includes commercial real estate loans secured by income producing commercial real estate. The Company focuses on lending to financially sound small- and medium-sized business customers within its geographic marketplace as well as offering loans for the acquisition, development and construction of commercial real estate. Commercial loans increased by $37.9 million, or 9.0%, during 2002. In 2001, commercial loans increased by $59.7 million, or 16.4%, over the prior year.

Consumer loans are originated by the Company for a wide variety of purposes to meet customers' needs. Consumer loans include credit card, overdraft protection, automobile, boat, recreation vehicles, mobile homes, home equity, and secured and unsecured personal loans. Consumer loans increased by $9.9 million, or 11.5%, in 2002 as a result of consumers taking advantage of the continued low interest rate environment and utilizing home equity loans to consolidate debt and make home improvements. In 2001, consumer loans decreased by $3.9 million, or 4.3%, from the prior year.

The Company's policy is to discontinue the accrual of interest on loans when, in the opinion of management, there is an indication that the borrower may be unable to meet payments as they become due. When a loan is placed on "non-accrual" status, all payments received from the customer are applied to outstanding loan principal first and accrued interest receivable once the principal obligation has been satisfied. If, in the opinion of management, a loan on non-accrual is determined to be creditworthy, it may be placed back on accrual status. Payments received on loans that are returned to accrual status are recorded from that time forward to the appropriate interest income and principal reduction categories. Non-performing loans, defined as non-accrual loans plus accruing loans 90 days or more past due, totaled $8.3 million, or 1.0%, of total loans at December 31, 2002 compared to $8.1 million, or 1.1%, of total loans at December 31, 2001.

Allowance for Loan Losses / Provision for Loan Losses

In determining the adequacy of the ALL, management reviews the loan portfolio both to ascertain whether there are specific loans to be reserved against, and to assess the collectibility of the loan portfolio in the aggregate. Non-performing loans are examined on an individual basis to determine the estimated probable loss on these loans. In addition, the ongoing evaluation process includes a formal analysis of the ALL each quarter, which considers, among other factors, the current loan mix and loan volumes, loan growth, delinquency trends, historical net loan loss experience for each loan category, and business and economic conditions affecting each loan category. Although management uses available information to establish the appropriate level of the ALL, no assurance can be given, however, that adverse economic conditions or other circumstances will not result in increased losses in the portfolio. The Company continues to monitor and modify its ALL as conditions dictate (see Note 8, "Allowance for Loan Losses," of the Notes to Consolidated Financial Statements, on page 52, for further information).

During 2002, the Company recognized $3.1 million of expense to the allowance for loan losses compared to $3.7 million and $2.9 million in 2001 and 2000, respectively. Provisions are made to the ALL in order to maintain the ALL at a level which management believes is reasonable and reflective of the overall risk of loss inherent in the loan portfolio. Accordingly, the provision decreased from $3.7 million in 2001 to $3.1 million in 2002. Net charge-offs to average loans outstanding were 0.18% in 2002 compared to 0.13% in 2001. A continued softening of the economy in the central and western Maine markets had an adverse impact on asset quality during the first half of 2002. Determining an appropriate level of ALL involves a high degree of judgment. Management believes that the ALL at December 31, 2002 of $15.2 million, or 1.88%, of total loans outstanding was appropriate given the current economic conditions in the Company's service area and the overall condition of the loan portfolio. As a percentage of total loans outstanding, the ALL was 1.87% in 2001.

The table on the next page sets forth information concerning the activity in the Company's ALL during the periods indicated.

Five-Year Activity in the Allowance for Loan Losses

(Dollars in thousands)	YEARS ENDED DECEMBER 31,				
	2002	**2001**	**2000**	**1999**	**1998**
Allowance at the beginning of period	**$ 13,514**	$ 10,801	$ 9,390	$ 8,092	$ 6,982
Provision for loan losses	**3,080**	3,681	2,930	3,670	2,056
Charge-offs:					
Commercial loans	**1,034**	536	1,296	1,520	417
Residential real estate loans	**678**	552	432	715	415
Consumer loans	**378**	461	417	425	444
Total loan charge-offs	**2,090**	1,549	2,145	2,660	1,276
Recoveries:					
Commercial loans	**212**	324	421	64	158
Residential real estate loans	**311**	64	29	54	35
Consumer loans	**215**	193	176	170	137
Total loan recoveries	**738**	581	626	288	330
Net charge-offs	**1,352**	968	1,519	2,372	946
Allowance at the end of the period	**$ 15,242**	$ 13,514	$ 10,801	$ 9,390	$ 8,092
Average loans outstanding	**$757,733**	$732,460	$675,316	$605,271	$521,559
Ratio of net charge-offs to average loans outstanding	**0.18%**	0.13%	0.22%	0.39%	0.18%
Ratio of provision for loan losses to average loans outstanding	**0.41%**	0.50%	0.43%	0.61%	0.39%
Ratio of allowance for loan losses to total loans at end of period	**1.88%**	1.87%	1.54%	1.48%	1.42%
Ratio of allowance for loan losses to net charge-offs	**1127.37%**	1396.07%	711.06%	395.87%	855.39%
Ratio of allowance for loan losses to non-performing loans at end of period	**183.64%**	167.46%	166.48%	148.32%	172.50%