

1ST CONSTITUTION BANCORP

Form 10-Q

August 12, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2015

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file Number: 000-32891

1ST CONSTITUTION BANCORP

(Exact Name of Registrant as Specified in Its Charter)

New Jersey

22-3665653

(State of Other Jurisdiction

(I.R.S. Employer Identification No.)

of Incorporation or Organization)

2650 Route 130, P.O. Box 634, Cranbury, NJ

08512

(Address of Principal Executive Offices)

(Zip Code)

(609) 655-4500

(Issuer's Telephone Number, Including Area Code)

(Former name, former address and former fiscal year, if changed since last report)

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

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

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

Large accelerated filer ☐ Accelerated filer ☐

Non-accelerated filer

(Do not check if a smaller reporting company) ☐ Smaller reporting company ☒

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

As of July 31, 2015, there were 7,546,835 shares of the registrant's common stock, no par value, outstanding.

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FORM 10-Q  
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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements.

## 1st Constitution Bancorp

## Consolidated Balance Sheets

(Dollars in thousands)

(Unaudited)

|                                                                                                                                                                                                              | June 30,<br>2015 | December 31,<br>2014 |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------|----------------------|
| <b>ASSETS</b>                                                                                                                                                                                                |                  |                      |
| CASH AND DUE FROM BANKS                                                                                                                                                                                      | \$ 16,364        | \$ 14,545            |
| FEDERAL FUNDS SOLD / SHORT-TERM INVESTMENTS                                                                                                                                                                  | —                | —                    |
| Total cash and cash equivalents                                                                                                                                                                              | 16,364           | 14,545               |
| INVESTMENT SECURITIES:                                                                                                                                                                                       |                  |                      |
| Available for sale, at fair value                                                                                                                                                                            | 80,576           | 80,161               |
| Held to maturity (fair value of \$130,257 and \$148,476<br>at June 30, 2015 and December 31, 2014, respectively)                                                                                             | 126,651          | 143,638              |
| Total investment securities                                                                                                                                                                                  | 207,227          | 223,799              |
| LOANS HELD FOR SALE                                                                                                                                                                                          | 9,231            | 8,372                |
| LOANS                                                                                                                                                                                                        | 758,506          | 654,297              |
| Less- Allowance for loan losses                                                                                                                                                                              | (7,351)          | (6,925)              |
| Net loans                                                                                                                                                                                                    | 751,155          | 647,372              |
| PREMISES AND EQUIPMENT, net                                                                                                                                                                                  | 11,475           | 11,373               |
| ACCRUED INTEREST RECEIVABLE                                                                                                                                                                                  | 2,976            | 3,096                |
| BANK-OWNED LIFE INSURANCE                                                                                                                                                                                    | 21,301           | 21,218               |
| OTHER REAL ESTATE OWNED                                                                                                                                                                                      | 5,328            | 5,710                |
| GOODWILL AND INTANGIBLE ASSETS                                                                                                                                                                               | 13,497           | 13,711               |
| OTHER ASSETS                                                                                                                                                                                                 | 8,376            | 7,583                |
| Total assets                                                                                                                                                                                                 | \$ 1,046,930     | \$ 956,779           |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                                                                                                                                                                  |                  |                      |
| <b>LIABILITIES:</b>                                                                                                                                                                                          |                  |                      |
| DEPOSITS                                                                                                                                                                                                     |                  |                      |
| Non-interest bearing                                                                                                                                                                                         | \$ 161,029       | \$ 162,281           |
| Interest bearing                                                                                                                                                                                             | 637,059          | 655,480              |
| Total deposits                                                                                                                                                                                               | 798,088          | 817,761              |
| BORROWINGS                                                                                                                                                                                                   | 130,728          | 25,107               |
| REDEEMABLE SUBORDINATED DEBENTURES                                                                                                                                                                           | 18,557           | 18,557               |
| ACCRUED INTEREST PAYABLE                                                                                                                                                                                     | 855              | 907                  |
| ACCRUED EXPENSES AND OTHER LIABILITIES                                                                                                                                                                       | 7,175            | 7,337                |
| Total liabilities                                                                                                                                                                                            | 955,403          | 869,669              |
| <b>SHAREHOLDERS' EQUITY:</b>                                                                                                                                                                                 |                  |                      |
| Preferred stock, no par value; 5,000,000 shares authorized, none issued                                                                                                                                      | —                | —                    |
| Common Stock, no par value; 30,000,000 shares authorized; 7,543,580 and 7,165,084<br>shares issued and 7,508,075 and 7,134,174 shares outstanding as of June 30, 2015 and<br>December 31, 2014, respectively | 65,792           | 61,448               |
| Retained earnings                                                                                                                                                                                            | 26,311           | 25,730               |

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|                                                                                                      |             |   |           |   |
|------------------------------------------------------------------------------------------------------|-------------|---|-----------|---|
| Treasury Stock, 35,505 shares and 30,910 shares at June 30, 2015 and December 31, 2014, respectively | (349        | ) | (316      | ) |
| Accumulated other comprehensive (loss) income                                                        | (227        | ) | 248       |   |
| Total shareholders' equity                                                                           | 91,527      |   | 87,110    |   |
| Total liabilities and shareholders' equity                                                           | \$1,046,930 |   | \$956,779 |   |
| The accompanying notes are an integral part of these financial statements.                           |             |   |           |   |

1st Constitution Bancorp  
Consolidated Statements of Income  
(Dollars in thousands, except per share data)  
(Unaudited)

|                                                     | Three Months Ended June 30, |          | Six Months Ended June 30, |          |
|-----------------------------------------------------|-----------------------------|----------|---------------------------|----------|
|                                                     | 2015                        | 2014     | 2015                      | 2014     |
| <b>INTEREST INCOME:</b>                             |                             |          |                           |          |
| Loans, including fees                               | \$9,238                     | \$7,870  | \$17,527                  | \$14,108 |
| Securities:                                         |                             |          |                           |          |
| Taxable                                             | 790                         | 1,059    | 1,607                     | 2,181    |
| Tax-exempt                                          | 530                         | 589      | 1,086                     | 1,170    |
| Federal funds sold and short-term investments       | 6                           | 46       | 31                        | 101      |
| Total interest income                               | 10,564                      | 9,564    | 20,251                    | 17,560   |
| <b>INTEREST EXPENSE:</b>                            |                             |          |                           |          |
| Deposits                                            | 912                         | 972      | 1,844                     | 1,871    |
| Borrowings                                          | 153                         | 128      | 279                       | 243      |
| Redeemable subordinated debentures                  | 88                          | 86       | 174                       | 171      |
| Total interest expense                              | 1,153                       | 1,186    | 2,297                     | 2,285    |
| Net interest income                                 | 9,411                       | 8,378    | 17,954                    | 15,275   |
| PROVISION FOR LOAN LOSSES                           | —                           | 4,100    | 500                       | 4,600    |
| Net interest income after provision for loan losses | 9,411                       | 4,278    | 17,454                    | 10,675   |
| <b>NON-INTEREST INCOME:</b>                         |                             |          |                           |          |
| Service charges on deposit accounts                 | 190                         | 267      | 429                       | 486      |
| Gain on sales of loans                              | 832                         | 267      | 1,879                     | 1,007    |
| Income on Bank-owned life insurance                 | 143                         | 149      | 276                       | 278      |
| Other income                                        | 453                         | 577      | 962                       | 1,126    |
| Total other income                                  | 1,618                       | 1,260    | 3,546                     | 2,897    |
| <b>NON-INTEREST EXPENSES:</b>                       |                             |          |                           |          |
| Salaries and employee benefits                      | 4,108                       | 3,685    | 8,049                     | 7,273    |
| Occupancy expense                                   | 859                         | 839      | 1,800                     | 1,665    |
| Data processing expenses                            | 306                         | 312      | 625                       | 628      |
| FDIC insurance expense                              | 180                         | 185      | 370                       | 335      |
| Other real estate owned expenses                    | 416                         | 98       | 513                       | 140      |
| Merger-related expenses                             | —                           | 109      | —                         | 1,532    |
| Other operating expenses                            | 1,733                       | 1,478    | 2,901                     | 2,479    |
| Total other expenses                                | 7,602                       | 6,706    | 14,258                    | 14,052   |
| Income (loss) before income taxes                   | 3,427                       | (1,168)  | 6,742                     | (480)    |
| INCOME TAXES                                        | 1,112                       | (728)    | 2,167                     | (682)    |
| Net income (loss)                                   | \$2,315                     | \$(440)  | \$4,575                   | \$202    |
| <b>NET INCOME (LOSS) PER COMMON SHARE:</b>          |                             |          |                           |          |
| Basic                                               | \$0.31                      | \$(0.06) | \$0.61                    | \$0.03   |
| Diluted                                             | \$0.30                      | \$(0.06) | \$0.60                    | \$0.03   |

WEIGHTED AVERAGE SHARES OUTSTANDING

|         |           |           |           |           |
|---------|-----------|-----------|-----------|-----------|
| Basic   | 7,506,310 | 7,469,403 | 7,505,019 | 7,306,846 |
| Diluted | 7,684,980 | 7,469,403 | 7,674,859 | 7,433,154 |

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

1st Constitution Bancorp  
Consolidated Statements of Comprehensive Income  
(Dollars in thousands)  
(Unaudited)

|                                                                                                         | Three Months Ended June 30, |         | Six Months Ended June 30, |         |   |
|---------------------------------------------------------------------------------------------------------|-----------------------------|---------|---------------------------|---------|---|
|                                                                                                         | 2015                        | 2014    | 2015                      | 2014    |   |
| Net Income (loss)                                                                                       | \$2,315                     | \$(440) | ) \$4,575                 | \$202   |   |
| Other comprehensive (loss) income:                                                                      |                             |         |                           |         |   |
| Unrealized holding (loss) gains on securities available for sale                                        | (765                        | ) 1,066 | (619                      | ) 2,282 |   |
| Tax effect                                                                                              | 278                         | (388    | ) 182                     | (759    | ) |
| Net of tax amount                                                                                       | (487                        | ) 678   | (437                      | ) 1,523 |   |
| Reclassification adjustment for loss included in income on securities available for sale <sup>(1)</sup> | —                           | 3       | —                         | 3       |   |
| Tax effect <sup>(2)</sup>                                                                               | —                           | (1      | ) —                       | (1      | ) |
| Net of tax amount                                                                                       | —                           | 2       | —                         | 2       |   |
| Pension liability                                                                                       | 93                          | 95      | 93                        | 158     |   |
| Tax effect                                                                                              | (38                         | ) (38   | ) (38                     | ) (63   | ) |
| Net of tax amount                                                                                       | 55                          | 57      | 55                        | 95      |   |
| Reclassification adjustment for actuarial (gains) loss included in Income <sup>(3)</sup>                | (110                        | ) —     | (155                      | ) —     |   |
| Tax effect <sup>(2)</sup>                                                                               | 44                          | —       | 62                        | —       |   |
| Net of tax amount                                                                                       | (66                         | ) —     | (93                       | ) —     |   |
| Total other comprehensive (loss) income                                                                 | (498                        | ) 737   | (475                      | ) 1,620 |   |
| Comprehensive income                                                                                    | \$1,817                     | \$297   | \$4,100                   | \$1,822 |   |

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

(1)Included in other income on the consolidated statements of income

(2)Included in income taxes on the consolidated statements of income

(3)Included in salaries and employee benefit expense on the consolidated statements of income

1st Constitution Bancorp  
Consolidated Statements of Changes in Shareholders' Equity  
For the Six Months Ended June 30, 2015 and 2014  
(Dollars in thousands)  
(Unaudited)

| (Dollars in thousands)                                      | Common<br>Stock | Retained<br>Earnings | Treasury<br>Stock | Accumulated<br>Other<br>Comprehensive<br>(Loss) Income | Total<br>Shareholders'<br>Equity |
|-------------------------------------------------------------|-----------------|----------------------|-------------------|--------------------------------------------------------|----------------------------------|
| Balance, January 1, 2014                                    | \$49,403        | \$21,374             | \$(172 )          | \$(2,248 )                                             | \$68,357                         |
| Exercise of stock options                                   | —               | —                    | —                 | —                                                      | —                                |
| Share-based compensation                                    | 373             | —                    | —                 | —                                                      | 373                              |
| Treasury stock purchased (3,891 shares)                     | —               | —                    | (40 )             | —                                                      | (40 )                            |
| Acquisition of Rumson Fair Haven Bank<br>(1,019,223 shares) | 11,161          | —                    | —                 | —                                                      | 11,161                           |
| Net Income for the six months ended<br>June 30, 2014        | —               | 202                  | —                 | —                                                      | 202                              |
| Other comprehensive income (loss)                           | —               | —                    | —                 | 1,620                                                  | 1,620                            |
| Balance, June 30, 2014                                      | \$60,937        | \$21,576             | \$(212 )          | \$(628 )                                               | \$81,673                         |
| Balance, January 1, 2015                                    | \$61,448        | \$25,730             | \$(316 )          | \$248                                                  | \$87,110                         |
| Exercise of stock options (3,313 shares)                    | 24              | —                    | —                 | —                                                      | 24                               |
| Share-based compensation (16,332 shares)                    | 326             | —                    | —                 | —                                                      | 326                              |
| Treasury stock purchased (2,947 shares)                     | —               | —                    | (33 )             | —                                                      | (33 )                            |
| 5% Stock dividend declared March 2015<br>(358,851 shares)   | 3,994           | (3,994 )             | —                 | —                                                      | —                                |
| Net income for the six months ended<br>June 30, 2015        | —               | 4,575                | —                 | —                                                      | 4,575                            |
| Other comprehensive income (loss)                           | —               | —                    | —                 | (475 )                                                 | (475 )                           |
| Balance, June 30, 2015                                      | \$65,792        | \$26,311             | \$(349 )          | \$(227 )                                               | \$91,527                         |

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



1st Constitution Bancorp  
Consolidated Statements of Cash Flows  
(Dollars in thousands)  
(Unaudited)

|                                                                                   | Six Months Ended June 30, |                 |
|-----------------------------------------------------------------------------------|---------------------------|-----------------|
|                                                                                   | 2015                      | 2014            |
| <b>OPERATING ACTIVITIES:</b>                                                      |                           |                 |
| Net income                                                                        | \$4,575                   | \$202           |
| Adjustments to reconcile net income to net cash provided by operating activities- |                           |                 |
| Provision for loan losses                                                         | 500                       | 4,600           |
| Provision for loss on other real estate owned                                     | 382                       | —               |
| Depreciation and amortization                                                     | 777                       | 881             |
| Net amortization of premiums and discounts on securities                          | 460                       | 547             |
| Loss on sales of securities held for sale                                         | —                         | 3               |
| Gains on sales of other real estate owned                                         | —                         | (21)            |
| Gains on sales of loans held for sale                                             | (1,879)                   | (1,007)         |
| Originations of loans held for sale                                               | (78,539)                  | (39,761)        |
| Proceeds from sales of loans held for sale                                        | 77,680                    | 41,813          |
| Income on Bank – owned life insurance                                             | (276)                     | (278)           |
| Share-based compensation expense                                                  | 326                       | 373             |
| Decrease (Increase) in accrued interest receivable                                | 120                       | (23)            |
| (Increase) Decrease in other assets                                               | 1,338                     | 1,196           |
| Decrease in accrued interest payable                                              | (52)                      | (126)           |
| Decrease in accrued expenses and other liabilities                                | (163)                     | (1,415)         |
| Net cash provided by operating activities                                         | 5,249                     | 6,984           |
| <b>INVESTING ACTIVITIES:</b>                                                      |                           |                 |
| Purchases of securities -                                                         |                           |                 |
| Available for sale                                                                | (7,071)                   | —               |
| Held to maturity                                                                  | (7,578)                   | (14,229)        |
| Proceeds from maturities and prepayments of securities -                          |                           |                 |
| Available for sale                                                                | 5,732                     | 14,316          |
| Held to maturity                                                                  | 24,411                    | 11,534          |
| Proceeds from sales of securities available for sale                              | —                         | 5,957           |
| Net increase in loans                                                             | (104,209)                 | (122,887)       |
| Capital expenditures                                                              | (655)                     | (112)           |
| Net cash received in the acquisition                                              | —                         | 21,375          |
| Proceeds from sales of other real estate owned                                    | —                         | 231             |
| Net cash used in investing activities                                             | (89,370)                  | (83,815)        |
| <b>FINANCING ACTIVITIES:</b>                                                      |                           |                 |
| Exercise of stock options                                                         | 24                        | —               |
| Purchase of treasury stock                                                        | (33)                      | (40)            |
| Net decrease in deposits                                                          | (19,672)                  | (8,169)         |
| Net increase in borrowings                                                        | 105,621                   | 38,910          |
| Net cash provided by financing activities                                         | 85,940                    | 30,701          |
| Increase (Decrease) in cash and cash equivalents                                  | 1,819                     | (46,130)        |
| <b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>                           | <b>14,545</b>             | <b>69,279</b>   |
| <b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>                                 | <b>\$16,364</b>           | <b>\$23,149</b> |
| <b>SUPPLEMENTAL DISCLOSURES OF CASHFLOW INFORMATION</b>                           |                           |                 |

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|                                                                            |         |          |
|----------------------------------------------------------------------------|---------|----------|
| Cash paid during the period for -                                          |         |          |
| Interest                                                                   | \$2,349 | \$2,411  |
| Income taxes                                                               | 2,275   | 596      |
| Non-cash activities .                                                      |         |          |
| Acquisition of Rumson                                                      |         |          |
| Noncash assets acquired :                                                  |         |          |
| Investment securities available for sale                                   |         | \$30,024 |
| Loans                                                                      |         | 143,714  |
| Accrued interest receivable                                                |         | 597      |
| Premises and equipment, net                                                |         | 2,552    |
| Goodwill                                                                   |         | 7,698    |
| Core deposit intangible                                                    |         | 1,189    |
| Bank-owned life insurance                                                  |         | 4,471    |
| Other assets                                                               |         | 886      |
|                                                                            |         | 191,131  |
| Liabilities assumed :                                                      |         |          |
| Deposits                                                                   |         | 189,490  |
| Advances from FHLB                                                         |         | 11,030   |
| Other liabilities                                                          |         | 825      |
|                                                                            |         | 201,345  |
| Common stock issued as consideration                                       |         | 11,161   |
| The accompanying notes are an integral part of these financial statements. |         |          |

1st Constitution Bancorp  
Notes To Consolidated Financial Statements  
June 30, 2015  
(Unaudited)

(1) Summary of Significant Accounting Policies

The accompanying unaudited consolidated financial statements include 1st Constitution Bancorp (the “Company”), its wholly-owned subsidiary, 1st Constitution Bank (the “Bank”), and the Bank’s wholly-owned subsidiaries, 1st Constitution Investment Company of New Jersey, Inc., FCB Assets Holdings, Inc., 204 South Newman Street Corp., and 249 New York Avenue, LLC. 1st Constitution Capital Trust II, a subsidiary of the Company, is not included in the Company’s consolidated financial statements, as it is a variable interest entity and the Company is not the primary beneficiary. All significant intercompany accounts and transactions have been eliminated in consolidation and certain prior period amounts have been reclassified to conform to current year presentation. The accounting and reporting policies of the Company and its subsidiaries conform to accounting principles generally accepted in the United States of America (“U.S. GAAP”) and pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”), including the instructions to Form 10-Q and Article 8 of Regulation S-X. Certain information and footnote disclosures normally included in financial statements have been condensed or omitted pursuant to such rules and regulations. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Company’s Form 10-K for the year ended December 31, 2014, filed with the SEC on March 26, 2015.

In the opinion of the Company, all adjustments (consisting only of normal recurring accruals) which are necessary for a fair presentation of the operating results for the interim periods have been included. The results of operations for periods of less than a year are not necessarily indicative of results for the full year.

The Company has evaluated events and transactions occurring subsequent to the balance sheet date of June 30, 2015 for items that should potentially be recognized or disclosed in these financial statements. The evaluation was conducted through the date these financial statements were issued.

On April 6, 2015, the Company paid a five percent common stock dividend to shareholders of record on March 16, 2015. As appropriate, common shares and per common share data presented in the consolidated financial statements and the accompanying notes below were adjusted to reflect the common stock dividend.

(2) Acquisition of Rumson-Fair Haven Bank and Trust Company

On February 7, 2014, the Company completed its acquisition of Rumson-Fair Haven Bank and Trust Company, a New Jersey state commercial bank (“Rumson”), which merged with and into the Bank, with the Bank as the surviving entity. The merger agreement among the Company, the Bank and Rumson (the “Merger Agreement”) provided that the shareholders of Rumson would receive, at their election, for each outstanding share of Rumson common stock that they own at the effective time of the merger, either 0.7772 shares of the Company common stock or \$7.50 in cash or a combination thereof, subject to proration as described in the Merger Agreement, so that 60% of the aggregate merger consideration consisted of cash and 40% consisted of shares of the Company’s common stock. The Company issued an aggregate of 1,019,223 shares of its common stock and paid \$14.8 million in cash in the transaction.

The merger was accounted for under the acquisition method of accounting and accordingly, assets acquired, liabilities assumed and consideration exchanged were recorded at preliminary estimated fair values as of the acquisition date.

Rumson’s results of operations have been included in the Company’s Consolidated Statements of Income since February 7, 2014.

The following table summarizes the final fair value of the acquired assets and liabilities.

| (Dollars in thousands)                                                           | Amount     |
|----------------------------------------------------------------------------------|------------|
| Consideration paid:                                                              |            |
| Company stock issued                                                             | \$11,161   |
| Cash payment                                                                     | 14,770     |
| Total consideration paid                                                         | 25,931     |
| Recognized amounts of identifiable assets and liabilities assumed at fair value: |            |
| Cash and cash equivalents                                                        | 36,145     |
| Securities available for sale                                                    | 30,024     |
| Loans                                                                            | 143,714    |
| Premises and equipment, net                                                      | 1,913      |
| Identifiable intangible assets                                                   | 1,189      |
| Bank-owned life insurance                                                        | 4,471      |
| Accrued interest receivable and other assets                                     | 1,738      |
| Deposits                                                                         | (189,490 ) |
| Borrowings                                                                       | (11,030 )  |
| Other liabilities                                                                | (832 )     |
| Total identifiable assets                                                        | 17,842     |
| Goodwill                                                                         | \$8,089    |

Accounting Standards Codification (“ASC”) Topic 805-10 provides that if the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer shall report in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, the acquirer shall retrospectively adjust the provisional amounts recognized at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the measurement of the amounts recognized as of that date. During the measurement period, the acquirer also shall recognize additional assets or liabilities if new information is obtained about facts and circumstances that existed as of the acquisition date that, if known, would have resulted in the recognition of those assets and liabilities as of that date. The measurement period may not exceed one year from the acquisition date. All measurements for the Rumson acquisition have been completed as of December 31, 2014.

The provisional amounts originally reported have been adjusted to reflect the review and completion of the fair value measurements. As a result of the completion of independent appraisals, the fair value of acquired real estate assets was reduced by approximately \$639,000, deferred tax assets were increased by approximately \$403,000 and goodwill was increased by approximately \$236,000. These adjustments had an insignificant effect on the results of operations since the acquisition date.

## (3) Net Income Per Common Share

Basic net income per common share is calculated by dividing net income by the weighted average number of common shares outstanding during each period.

Diluted net income per common share is calculated by dividing net income by the weighted average number of common shares outstanding, as adjusted for the assumed exercise of potential common stock warrants, common stock options and unvested restricted stock awards (as defined below), using the treasury stock method.

The following tables illustrate the reconciliation of the numerators and denominators of the basic and diluted earnings per common share (EPS) calculations. Dilutive securities in the tables below exclude common stock options and warrants with exercise prices that exceed the average market price of the Company's common stock during the periods presented. Inclusion of these common stock options and warrants would be anti-dilutive to the diluted earnings per common share calculation.

(Dollars in thousands, except per share data)

|                                    | Three Months Ended June 30, 2015 |                                |                     |
|------------------------------------|----------------------------------|--------------------------------|---------------------|
|                                    | Net<br>Income                    | Weighted-<br>average<br>shares | Per share<br>amount |
| Basic earnings per common share:   |                                  |                                |                     |
| Net income                         | \$2,315                          | 7,506,310                      | \$0.31              |
| Effect of dilutive securities:     |                                  |                                |                     |
| Stock options and warrants         |                                  | 178,670                        |                     |
| Diluted EPS:                       |                                  |                                |                     |
| Net income plus assumed conversion | \$2,315                          | 7,684,980                      | \$0.30              |

(Dollars in thousands, except per share data)

|                                  | Three Months Ended June 30, 2014 |                                |                     |
|----------------------------------|----------------------------------|--------------------------------|---------------------|
|                                  | Net<br>Loss                      | Weighted-<br>average<br>shares | Per share<br>amount |
| Basic earnings per common share: |                                  |                                |                     |
| Net loss                         | \$(440)                          | 7,469,403                      | \$(0.06)            |
| Effect of dilutive securities:   |                                  |                                |                     |
| Stock options and warrants       |                                  | —                              |                     |
| Diluted EPS:                     |                                  |                                |                     |
| Net loss plus assumed conversion | \$(440)                          | 7,469,403                      | \$(0.06)            |

(Dollars in thousands, except per share data)

|                                    | Six Months Ended June 30, 2015 |                                |                     |
|------------------------------------|--------------------------------|--------------------------------|---------------------|
|                                    | Net<br>Income                  | Weighted-<br>average<br>shares | Per share<br>amount |
| Basic earnings per common share:   |                                |                                |                     |
| Net income                         | \$4,575                        | 7,505,019                      | \$0.61              |
| Effect of dilutive securities:     |                                |                                |                     |
| Stock options and warrants         |                                | 169,840                        |                     |
| Diluted EPS:                       |                                |                                |                     |
| Net income plus assumed conversion | \$4,575                        | 7,674,859                      | \$0.60              |

(Dollars in thousands, except per share data)

|                                                              | Six Months Ended June 30, 2014 |                                |                     |
|--------------------------------------------------------------|--------------------------------|--------------------------------|---------------------|
|                                                              | Net<br>Income                  | Weighted-<br>average<br>shares | Per share<br>amount |
| Basic earnings per common share:                             |                                |                                |                     |
| Net income                                                   | \$202                          | 7,306,846                      | \$0.03              |
| Effect of dilutive securities:                               |                                |                                |                     |
| Stock options, warrants and unvested restricted stock awards |                                | 126,308                        |                     |
| Diluted EPS:                                                 |                                |                                |                     |
| Net income plus assumed conversion                           | \$202                          | 7,433,154                      | \$0.03              |

For the three months ended June 30, 2015 and 2014, 32,049 and 259,663 options, respectively, were anti-dilutive and were not included in the computation of diluted earnings per common share. For the six months ended June 30, 2015 and 2014, 44,192 and 259,663 options, respectively, were anti-dilutive and were not included in the computation of diluted earnings per share.

## (4) Investment Securities

Amortized cost, gross unrealized gains and losses, and the estimated fair value by security type are as follows:  
(Dollars in thousands)

| June 30, 2015                                                                                               | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|-------------------------------------------------------------------------------------------------------------|-------------------|------------------------------|-------------------------------|---------------|
| Available for sale                                                                                          |                   |                              |                               |               |
| U. S. Treasury securities and obligations of U.S.<br>Government sponsored corporations ("GSE") and agencies | \$ 1,533          | \$—                          | \$(2 )                        | \$ 1,531      |
| Residential collateralized mortgage<br>obligations- GSE                                                     | 3,752             | 101                          | (2 )                          | 3,851         |
| Residential mortgage backed securities – GSE                                                                | 25,064            | 710                          | (94 )                         | 25,680        |
| Obligations of State and Political subdivisions                                                             | 21,174            | 242                          | (841 )                        | 20,575        |
| Trust preferred debt securities – single issuer                                                             | 2,473             | —                            | (340 )                        | 2,133         |
| Corporate debt securities                                                                                   | 19,188            | 111                          | (60 )                         | 19,239        |
| Other debt securities                                                                                       | 1,058             | —                            | (17 )                         | 1,041         |
| Restricted stock                                                                                            | 6,526             | —                            | —                             | 6,526         |
|                                                                                                             | \$80,768          | \$ 1,164                     | \$(1,356 )                    | \$80,576      |

| June 30, 2015                                            | Amortized<br>Cost | Other-Than-<br>Temporary<br>Impairment<br>Recognized In<br>Accumulated<br>Other<br>Comprehensive<br>Loss | Carrying<br>Value | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|----------------------------------------------------------|-------------------|----------------------------------------------------------------------------------------------------------|-------------------|------------------------------|-------------------------------|---------------|
| (Dollars in thousands)                                   |                   |                                                                                                          |                   |                              |                               |               |
| Held to maturity-                                        |                   |                                                                                                          |                   |                              |                               |               |
| Residential collateralized<br>mortgage obligations – GSE | 16,403            | —                                                                                                        | 16,403            | 614                          | —                             | 17,017        |
| Residential mortgage backed<br>securities – GSE          | 51,940            | —                                                                                                        | 51,940            | 1,253                        | (58 )                         | 53,135        |
| Obligations of State and<br>Political subdivisions       | 57,445            | —                                                                                                        | 57,445            | 1,787                        | (382 )                        | 58,850        |
| Trust preferred debt<br>securities-pooled                | 657               | (501 )                                                                                                   | 156               | 392                          | —                             | 548           |
| Other debt securities                                    | 707               | —                                                                                                        | 707               | —                            | —                             | 707           |
|                                                          | \$ 127,152        | \$(501 )                                                                                                 | \$ 126,651        | \$ 4,046                     | \$(440 )                      | \$ 130,257    |

| December 31, 2014                                                                                           | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|-------------------------------------------------------------------------------------------------------------|-------------------|------------------------------|-------------------------------|---------------|
| (Dollars in thousands)                                                                                      |                   |                              |                               |               |
| Available for sale-                                                                                         |                   |                              |                               |               |
| U. S. Treasury securities and obligations of U.S.<br>Government sponsored corporations ("GSE") and agencies | \$1,538           | \$—                          | \$(14                         | ) \$1,524     |
| Residential collateralized mortgage<br>obligations- GSE                                                     | 4,455             | 101                          | (23                           | ) 4,533       |
| Residential mortgage backed securities - GSE                                                                | 27,089            | 825                          | (143                          | ) 27,771      |
| Obligations of State and Political subdivisions                                                             | 21,733            | 299                          | (329                          | ) 21,703      |
| Trust preferred debt securities-single issuer                                                               | 2,472             | —                            | (403                          | ) 2,069       |
| Corporate debt securities                                                                                   | 19,397            | 152                          | (28                           | ) 19,521      |
| Other debt securities                                                                                       | 1,290             | 1                            | (11                           | ) 1,280       |
| Restricted stock                                                                                            | 1,760             | —                            | —                             | 1,760         |
|                                                                                                             | \$79,734          | \$1,378                      | \$(951                        | ) \$80,161    |

| December 31, 2014                                      | Amortized<br>Cost | Other-Than-<br>Temporary<br>Impairment<br>Recognized In<br>Accumulated<br>Other<br>Comprehensive<br>Loss | Carrying<br>Value | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|--------------------------------------------------------|-------------------|----------------------------------------------------------------------------------------------------------|-------------------|------------------------------|-------------------------------|---------------|
| Held to maturity-                                      |                   |                                                                                                          |                   |                              |                               |               |
| Residential collateralized<br>mortgage obligations-GSE | 19,304            | —                                                                                                        | 19,304            | 700                          | —                             | 20,004        |
| Residential mortgage backed<br>securities – GSE        | 56,528            | —                                                                                                        | 56,528            | 1,563                        | (36                           | ) 58,055      |
| Obligations of State and<br>Political subdivisions     | 66,887            | —                                                                                                        | 66,887            | 2,297                        | (92                           | ) 69,092      |
| Trust preferred debt securities -<br>pooled            | 657               | (501                                                                                                     | ) 156             | 405                          | —                             | 561           |
| Other debt securities                                  | 763               | —                                                                                                        | 763               | 1                            | —                             | 764           |
|                                                        | \$144,139         | \$(501                                                                                                   | ) \$143,638       | \$4,966                      | \$(128                        | ) \$148,476   |

Restricted stock at June 30, 2015 and December 31, 2014 consisted of approximately \$6.5 million and \$1.7 million, respectively, of Federal Home Loan Bank of New York stock and \$65,000 of Atlantic Community Bankers Bank stock at each period end.



Gross unrealized losses on available for sale and held to maturity securities and the estimated fair value of the related securities aggregated by security category and length of time that individual securities have been in a continuous unrealized loss position at June 30, 2015 and December 31, 2014 were as follows:

| June 30, 2015                                                                                         |                      | Less than 12 months |                   | 12 months or longer |                   | Total      |                   |
|-------------------------------------------------------------------------------------------------------|----------------------|---------------------|-------------------|---------------------|-------------------|------------|-------------------|
| (Dollars in thousands)                                                                                | Number of Securities | Fair Value          | Unrealized Losses | Fair Value          | Unrealized Losses | Fair Value | Unrealized Losses |
| U.S. Treasury securities and obligations of U.S. Government sponsored corporations (GSE) and agencies | 1                    | \$1,531             | \$(2 )            | \$—                 | \$—               | \$1,531    | \$(2 )            |
| Residential collateralized mortgage obligations –GSE                                                  | 1                    | 907                 | (2 )              | —                   | —                 | 907        | (2 )              |
| Residential mortgage backed securities GSE                                                            | 16                   | 12,199              | (115 )            | 4,094               | (37 )             | 16,293     | (152 )            |
| Obligations of State and Political Subdivisions                                                       | 78                   | 18,115              | (732 )            | 8,368               | (491 )            | 26,483     | (1,223 )          |
| Trust preferred debt securities- single issuer                                                        | 4                    | —                   | —                 | 2,133               | (340 )            | 2,133      | (340 )            |
| Corporate debt securities                                                                             | 6                    | 11,435              | (60 )             | —                   | —                 | 11,435     | (60 )             |
| Other debt securities                                                                                 | 3                    | 682                 | —                 | 1,041               | (17 )             | 1,723      | (17 )             |
| Total temporarily impaired securities                                                                 | 109                  | \$44,869            | \$(911 )          | \$15,636            | \$(885 )          | \$60,505   | \$(1,796 )        |
| December 31, 2014                                                                                     |                      | Less than 12 months |                   | 12 months or longer |                   | Total      |                   |
| (Dollars in thousands)                                                                                | Number of Securities | Fair Value          | Unrealized Losses | Fair Value          | Unrealized Losses | Fair Value | Unrealized Losses |
| U.S. Treasury securities and obligations of U.S. Government sponsored corporations (GSE) and agencies | 1                    | \$1,524             | \$(14 )           | \$—                 | \$—               | \$1,524    | \$(14 )           |
| Residential collateralized mortgage obligations –GSE                                                  | 1                    | 1,025               | (23 )             | —                   | —                 | 1,025      | (23 )             |
| Residential mortgage backed securities GSE                                                            | 16                   | 755                 | —                 | 15,441              | (179 )            | 16,196     | (179 )            |
| Obligations of State and Political Subdivisions                                                       | 57                   | 2,491               | (23 )             | 15,621              | (398 )            | 18,112     | (421 )            |
| Trust preferred debt securities- single issuer                                                        | 4                    | —                   | —                 | 2,069               | (403 )            | 2,069      | (403 )            |
| Corporate debt securities                                                                             | 7                    | 6,259               | (5 )              | 1,017               | (23 )             | 7,276      | (28 )             |

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|                                       |    |          |       |            |          |            |          |   |
|---------------------------------------|----|----------|-------|------------|----------|------------|----------|---|
| Other debt securities                 | 2  | 985      | (6    | ) 86       | (5       | ) 1,071    | (11      | ) |
| Total temporarily impaired securities | 88 | \$13,039 | \$(71 | ) \$34,234 | \$(1,008 | ) \$47,273 | \$(1,079 | ) |

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The following table sets forth certain information regarding the amortized cost, estimated fair value, weighted average yields and contractual maturities of the Company's investment portfolio as of June 30, 2015. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Federal Home Loan Bank stock is included in "Available for Sale-Due in one year or less."

(Dollars in thousands)

|                                        | June 30, 2015     |                         |       |
|----------------------------------------|-------------------|-------------------------|-------|
|                                        | Amortized<br>Cost | Estimated<br>Fair Value | Yield |
| Available for sale                     |                   |                         |       |
| Due in one year or less                | \$ 12,054         | \$ 12,068               | 2.51% |
| Due after one year through five years  | 18,059            | 18,154                  | 1.97% |
| Due after five years through ten years | 16,295            | 16,443                  | 2.48% |
| Due after ten years                    | 34,360            | 33,911                  | 3.47% |
| Total                                  | \$80,768          | \$80,576                | 2.79% |
|                                        | Carrying<br>Value | Estimated<br>Fair Value | Yield |
| Held to maturity                       |                   |                         |       |
| Due in one year or less                | \$ 10,187         | \$ 10,187               | 0.63% |
| Due after one year through five years  | 15,678            | 16,153                  | 3.79% |
| Due after five years through ten years | 31,512            | 32,477                  | 3.37% |
| Due after ten years                    | 69,274            | 71,440                  | 3.46% |
| Total                                  | \$ 126,651        | \$ 130,257              | 3.26% |

U.S. Treasury securities and obligations of U.S. Government sponsored corporations and agencies: The unrealized losses on investments in these securities were caused by increases in market interest rates. The contractual terms of these investments do not permit the issuer to settle the securities at a price less than the par value of the investment. The Company does not intend to sell these investments and it is not more likely than not that the Company will be required to sell these investments before a market price recovery or maturity. Therefore, these investments are not considered other-than temporarily impaired.

Residential collateralized mortgage obligations and residential mortgage backed securities: The unrealized losses on investments in residential collateralized mortgage obligations and mortgage backed securities were caused by increases in market interest rates. The contractual cash flows of these securities are guaranteed by the issuers, which are primarily government or government sponsored agencies. It is expected that the securities would not be settled at a price less than the amortized cost of the investment. The decline in fair value is attributable to changes in interest rates and not credit quality. The Company does not intend to sell these investments and it is not more likely than not that the Company will be required to sell these investments before a market price recovery or maturity. Therefore, these investments are not considered other-than-temporarily impaired.

Obligations of State and Political Subdivisions: The unrealized losses on investments in these securities were caused by increases in market interest rates. It is expected that the securities would not be settled at a price less than the amortized cost of the investment. None of the issuers have defaulted on interest payments. The decline in fair value is attributable to changes in interest rates and not credit quality. The Company does not intend to sell these investments and it is not more likely than not that the Company will be required to sell these investments before a market price recovery or maturity. Therefore, these investments are not considered other-than-temporarily impaired.

Corporate debt securities: The unrealized losses on investments in corporate debt securities were caused by increases in market interest rates. None of the corporate issuers have defaulted on interest payments. The decline in fair value is attributable to changes in interest rates and not a decline in credit quality. The Company does not intend to sell these investments and it is not more likely than not that the Company will be required to sell these investments before a market price recovery or maturity. Therefore, these investments are not considered other-than-temporarily impaired.

Trust preferred debt securities – single issuer: The investments in these securities with unrealized losses are comprised of four corporate trust preferred securities issued by two large financial institutions that mature in 2027. The contractual terms of the trust preferred securities do not allow the issuer to settle the securities at a price less than the face value of the trust preferred securities, which is greater than the amortized cost of the trust preferred securities. One of the issuers continues to maintain an investment grade credit rating and neither has defaulted on interest payments. The decline in fair value is attributable to the widening of interest rate spreads and the lack of an active trading market for these securities and, to a lesser degree, market concerns about the issuers' credit quality. The Company does not intend to sell these investments and it is not more likely than not that the Company will be required to sell these investments before a market price recovery or maturity. Therefore, these investments are not considered other-than-temporarily impaired.

Trust preferred debt securities – pooled: This trust preferred debt security was issued by a two issuer pool (Preferred Term Securities XXV, Ltd. co-issued by Keefe, Bruyette and Woods, Inc. and First Tennessee ("PRETSL XXV")) consisting primarily of trust preferred debt securities issued by financial institution holding companies. During 2009, the Company recognized an other-than-temporary impairment of \$865,000, of which \$364,000 was determined to be a credit loss and charged to operations and \$501,000 was recognized in the other comprehensive income (loss) component of shareholders' equity.

The primary factor used to determine the credit portion of the impairment loss recognized in the income statement for this security was the discounted present value of projected cash flow where that present value of cash flow was less than the amortized cost basis of the security. The present value of cash flow was developed using an EITF 99-20 model that considered performing collateral ratios, the level of subordination to senior tranches of the security, and credit ratings of and projected credit defaults in the underlying collateral.

On a quarterly basis, management evaluates the security to determine if any additional other-than-temporary impairment is required. As of June 30, 2015, management concluded that no additional other-than-temporary impairment had occurred.



## (5) Allowance for Loan Losses and Credit Quality Disclosure

The Company's primary lending emphasis is the origination of commercial and commercial real estate loans and mortgage warehouse lines of credit. Based on the composition of the loan portfolio, the inherent primary risks are deteriorating credit quality, a decline in the economy, and a decline in New Jersey real estate market values. Any one, or a combination, of these events may adversely affect the loan portfolio and may result in increased delinquencies, loan losses and increased future provision levels.

The following table provides an aging of the loan portfolio by loan class at June 30, 2015:

| (Dollars in thousands)   | 30-59 Days | 60-89 Days | Greater than 90 Days | Total Past Due | Current   | Total Loans Receivable | Recorded Investment > 90 Days Accruing | Nonaccrual Loans |
|--------------------------|------------|------------|----------------------|----------------|-----------|------------------------|----------------------------------------|------------------|
| Commercial               |            |            |                      |                |           |                        |                                        |                  |
| Construction             | \$—        | \$—        | \$—                  | \$—            | \$98,307  | \$98,307               | \$—                                    | \$—              |
| Commercial Business      | 118        | —          | 263                  | 381            | 107,148   | 107,529                | —                                      | 368              |
| Commercial Real Estate   | 4,103      | 26         | 2,788                | 6,917          | 198,570   | 205,487                | —                                      | 2,638            |
| Mortgage Warehouse Lines | —          | —          | —                    | —              | 279,664   | 279,664                | —                                      | —                |
| Residential Real Estate  | 954        | —          | 1,361                | 2,315          | 40,511    | 42,826                 | —                                      | 1,361            |
| Consumer                 |            |            |                      |                |           |                        |                                        |                  |
| Loans to Individuals     | 1          | —          | 263                  | 264            | 23,065    | 23,329                 | —                                      | 263              |
| Other                    | —          | —          | —                    | —              | 215       | 215                    | —                                      | —                |
| Deferred Loan Costs      | —          | —          | —                    | —              | 1,149     | 1,149                  | —                                      | —                |
| Total                    | \$5,176    | \$26       | \$4,675              | \$9,877        | \$748,629 | \$758,506              | \$—                                    | \$4,630          |

The following table provides an aging of the loan portfolio by loan class at December 31, 2014:

| (Dollars in thousands)   | 30-59 Days | 60-89 Days | Greater than 90 Days | Total Past Due | Current   | Total Loans Receivable | Recorded Investment > 90 Days Accruing | Nonaccrual Loans |
|--------------------------|------------|------------|----------------------|----------------|-----------|------------------------|----------------------------------------|------------------|
| Commercial               |            |            |                      |                |           |                        |                                        |                  |
| Construction             | \$—        | \$—        | \$—                  | \$—            | \$95,627  | \$95,627               | \$—                                    | \$—              |
| Commercial Business      | 1,823      | 51         | 492                  | 2,366          | 108,405   | 110,771                | —                                      | 464              |
| Commercial Real Estate   | 3,988      | —          | 2,772                | 6,760          | 191,451   | 198,211                | —                                      | 2,435            |
| Mortgage Warehouse Lines | —          | —          | —                    | —              | 179,172   | 179,172                | —                                      | —                |
| Residential Real Estate  | —          | —          | 1,688                | 1,688          | 44,758    | 46,446                 | 317                                    | 1,361            |
| Consumer                 |            |            |                      |                |           |                        |                                        |                  |
| Loans to Individuals     | 4          | —          | 263                  | 267            | 22,889    | 23,156                 | —                                      | 263              |
| Other                    | —          | —          | —                    | —              | 199       | 199                    | —                                      | —                |
| Deferred Loan Costs      | —          | —          | —                    | —              | 715       | 715                    | —                                      | —                |
| Total                    | \$5,815    | \$51       | \$5,215              | \$11,081       | \$643,216 | \$654,297              | \$317                                  | \$4,523          |

As provided by ASC 310-30, the excess of cash flows expected at acquisition over the initial investment in the loan is recognized as interest income over the life of the loan. Accordingly, loans acquired with evidence of deteriorated credit quality of \$2.0 million at June 30, 2015 and \$2.0 million at December 31, 2014 were not classified as non-performing loans.

The Company's internal credit risk grades are based on the definitions currently utilized by the banking regulatory agencies. The grades assigned and definitions are as follows, and loans graded excellent, above average, good and watch list are treated as "pass" for grading purposes:

1. Excellent - Loans that are based upon cash collateral held at the Bank and adequately margined. Loans that are based upon "blue chip" stocks listed on the major exchanges and adequately margined.
2. Above Average - Loans to companies whose balance sheets show excellent liquidity and long-term debt is on well-spread schedules of repayment easily covered by cash flow. Such companies have been consistently profitable and have diversification in their product lines or sources of revenue. The continuation of profitable operations for the foreseeable future is likely. Management is comprised of a mix of ages, experience, and backgrounds and management succession is in place. Sources of raw materials are abundant, and for service companies, the source of revenue is abundant. Future needs have been planned for. Character and ability of individuals or company principals are excellent. Loans to individuals are supported by high net worths and liquid assets.
3. Good - Loans to companies whose balance sheets show good liquidity and cash flow adequate to meet maturities of long-term debt with a comfortable margin. Such companies have established profitable records over a number of years, and there has been growth in net worth. Operating ratios are in line with those of the industry, and expenses are in proper relationship to the volume of business done and the profits achieved. Management is well-balanced and competent in their responsibilities. Economic environment is favorable; however, competition is strong. The prospects for growth are good. Loans in this category do not meet the collateral requirements of loans in categories 1 and 2 above. Loans to individuals are supported by good net worths but whose supporting assets are illiquid.
- 3w. Watch - Included in this category are loans evidencing problems identified by Bank management that require closer supervision. Such problems have not developed to the point which require a Special Mention rating. This category also covers situations where the Bank does not have adequate current information upon which credit quality can be determined. The account officer has the obligation to correct these deficiencies within 30 days from the time of notification.
4. Special Mention - Loans or borrowing relationships that require more than the usual amount of attention by Bank management. Industry conditions may be adverse or weak. The borrower's ability to meet current payment schedules may be questionable, even though interest and principal are being paid as agreed. Heavy reliance has been placed on the collateral. Profits, if any, are interspersed with losses. Management is "one man" or ineffective or there is no plan for management succession. Expectations of a loan loss are not immediate; however, if present trends continue, a loan loss could be expected.
5. Substandard - Loans in this category possess weaknesses that jeopardize the ultimate collection of total outstandings. These weaknesses require close supervision by Bank management. Current financial statements are unavailable and the loan is inadequately protected by the collateral pledged.
6. Doubtful - Loans with the same weaknesses inherent in the substandard classification and where collection or liquidation in full is highly questionable. It is likely that the loan will not be collected in full and the Bank will suffer some loss which is not quantifiable at the time of review.
7. Loss - Loans considered uncollectable and of such little value that their continuance as an active asset is not warranted. Loans in this category are charged off to the Bank's loan loss reserve. Any accrued interest is backed out of income.

The following table provides a breakdown of the loan portfolio by credit quality indicator at June 30, 2015:

(Dollars in thousands)

| Commercial Credit Exposure - By Internally Assigned Grade: | Construction         | Commercial Business | Commercial Real Estate | Mortgage Warehouse Lines | Residential Real Estate |
|------------------------------------------------------------|----------------------|---------------------|------------------------|--------------------------|-------------------------|
| Pass                                                       | \$96,035             | \$99,262            | \$187,304              | \$279,664                | \$41,154                |
| Special Mention                                            | 2,272                | 7,473               | 10,745                 | —                        | 95                      |
| Substandard                                                | —                    | 648                 | 7,438                  | —                        | 1,577                   |
| Doubtful                                                   | —                    | 146                 | —                      | —                        | —                       |
| Total                                                      | \$98,307             | \$107,529           | \$205,487              | \$279,664                | \$42,826                |
| Consumer Credit Exposure - By Payment Activity             | Loans To Individuals | Other               |                        |                          |                         |
| Performing                                                 | \$23,066             | \$215               |                        |                          |                         |
| Nonperforming                                              | 263                  | —                   |                        |                          |                         |
| Total                                                      | \$23,329             | \$215               |                        |                          |                         |

The following table provides a breakdown of the loan portfolio by credit quality indicator at December 31, 2014:

(Dollars in thousands)

| Commercial Credit Exposure - By Internally Assigned Grade: | Construction         | Commercial Business | Commercial Real Estate | Mortgage Warehouse Lines | Residential Real Estate |
|------------------------------------------------------------|----------------------|---------------------|------------------------|--------------------------|-------------------------|
| Pass                                                       | \$95,391             | \$103,107           | \$178,701              | \$179,172                | \$44,768                |
| Special Mention                                            | 236                  | 6,711               | 12,052                 | —                        | 95                      |
| Substandard                                                | —                    | 792                 | 7,458                  | —                        | 1,583                   |
| Doubtful                                                   | —                    | 161                 | —                      | —                        | —                       |
| Loss                                                       | —                    | —                   | —                      | —                        | —                       |
| Total                                                      | \$95,627             | \$110,771           | \$198,211              | \$179,172                | \$46,446                |
| Consumer Credit Exposure - By Payment Activity             | Loans To Individuals | Other               |                        |                          |                         |
| Performing                                                 | \$22,893             | \$199               |                        |                          |                         |
| Nonperforming                                              | 263                  | —                   |                        |                          |                         |
| Total                                                      | \$23,156             | \$199               |                        |                          |                         |



## Impaired Loans Disclosures

Loans are considered to be impaired when, based on current information and events, it is determined that the Company will not be able to collect all amounts due according to the loan contract, including scheduled interest payments. When a loan is placed on nonaccrual status, it is also considered to be impaired. Loans are placed on nonaccrual status when: (1) the full collection of interest or principal becomes uncertain or (2) they are contractually past due 90 days or more as to interest or principal payments unless the loans are both well secured and in the process of collection.

The following tables summarize the distribution of the allowance for loan losses and loans receivable by loan class and impairment method at June 30, 2015 and December 31, 2014:

## Period-End Allowance for Loan Losses by Impairment Method as of June 30, 2015

(Dollars in thousands)

|                                                 | Construction | Commercial Business | Commercial Real Estate | Mortgage Warehouse | Residential Real Estate | Loans to Individuals | Other  | Unallocated | Deferred Loan Fees | Total      |
|-------------------------------------------------|--------------|---------------------|------------------------|--------------------|-------------------------|----------------------|--------|-------------|--------------------|------------|
| Allowance for loan losses:<br>Ending Balance    | \$ 1,090     | \$ 1,659            | \$ 2,445               | \$ 1,119           | \$ 202                  | \$ 121               | \$ 1   | \$ 714      | \$ —               | \$ 7,351   |
| Individually evaluated for impairment           | —            | 144                 | 738                    | —                  | —                       | 26                   | —      | —           | —                  | 908        |
| Loans acquired with deteriorated credit quality | —            | —                   | 38                     | —                  | —                       | —                    | —      | —           | —                  | 38         |
| Collectively evaluated for impairment           | \$ 1,090     | \$ 1,515            | \$ 1,669               | \$ 1,119           | \$ 202                  | \$ 95                | \$ 1   | \$ 714      | \$ —               | \$ 6,405   |
| Loans receivables:<br>Ending Balance            | \$ 98,307    | \$ 107,529          | \$ 205,487             | \$ 279,664         | \$ 42,826               | \$ 23,329            | \$ 215 | \$ —        | \$ 1,149           | \$ 758,506 |
| Individually evaluated for impairment           | 479          | 525                 | 5,748                  | —                  | 1,361                   | 263                  | —      | —           | —                  | 8,376      |
| Loans acquired with deteriorated credit quality | —            | 300                 | 1,699                  | —                  | —                       | —                    | —      | —           | —                  | 1,999      |
| Collectively evaluated for impairment           | \$ 97,828    | \$ 106,704          | \$ 198,040             | \$ 279,664         | \$ 41,465               | \$ 23,066            | \$ 215 | \$ —        | \$ 1,149           | \$ 748,131 |

## Period-End Allowance for Loan Losses by Impairment Method as of December 31, 2014

(Dollars in thousands)

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|                                                          | Construction | Commercial<br>Business | Commercial<br>Real<br>Estate | Mortgage<br>Warehouse | Residential<br>Real<br>Estate | Loans to<br>Individuals | Other  | Unallocated | Deferred<br>Loan<br>Fees | Total      |
|----------------------------------------------------------|--------------|------------------------|------------------------------|-----------------------|-------------------------------|-------------------------|--------|-------------|--------------------------|------------|
| Allowance for<br>loan losses:<br>Ending<br>Balance       | \$ 1,215     | \$ 1,761               | \$ 2,393                     | \$ 896                | \$ 197                        | \$ 129                  | \$ 2   | \$ 332      | \$ —                     | \$ 6,925   |
| Individually<br>evaluated for<br>impairment              | —            | 122                    | 593                          | —                     | —                             | 26                      | —      | —           | —                        | 741        |
| Collectively<br>evaluated for<br>impairment              | \$ 1,215     | \$ 1,639               | \$ 1,800                     | \$ 896                | \$ 197                        | \$ 103                  | \$ 2   | \$ 332      | \$ —                     | \$ 6,184   |
| Loans<br>receivables:<br>Ending<br>Balance               | \$ 95,627    | \$ 110,771             | \$ 198,211                   | \$ 179,172            | \$ 46,446                     | \$ 23,156               | \$ 199 | \$ —        | \$ 715                   | \$ 654,297 |
| Individually<br>evaluated for<br>impairment              | 450          | 612                    | 5,762                        | —                     | 1,361                         | 263                     | —      | —           | —                        | 8,448      |
| Loans<br>acquired with<br>deteriorated<br>credit quality | —            | 320                    | 1,705                        | —                     | —                             | —                       | —      | —           | —                        | 2,025      |
| Collectively<br>evaluated for<br>impairment              | \$ 95,177    | \$ 109,839             | \$ 190,744                   | \$ 179,172            | \$ 45,085                     | \$ 22,893               | \$ 199 | \$ —        | \$ 715                   | \$ 643,824 |

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The activity in the allowance for loan loss by loan class for the six months ended June 30, 2015 and 2014 was as follows:

| (Dollars in thousands)                     | Construction | Commercial Business | Commercial Real Estate | Mortgage Warehouse | Residential Real Estate | Consumer | Other | Unallocated | Total    |
|--------------------------------------------|--------------|---------------------|------------------------|--------------------|-------------------------|----------|-------|-------------|----------|
| Balance - December 31, 2014                | \$ 1,215     | \$ 1,761            | \$ 2,393               | \$ 896             | \$ 197                  | \$ 129   | \$ 2  | \$ 332      | \$ 6,925 |
| Provision charged (credited) to operations | (98 )        | 62                  | (4 )                   | 152                | 13                      | (13 )    | —     | 388         | 500      |
| Loans charged off                          | —            | (62 )               | —                      | —                  | —                       | —        | —     | —           | (62 )    |
| Recoveries of loans charged off            | —            | —                   | —                      | —                  | —                       | 1        | —     | —           | 1        |
| Balance - March 31, 2015                   | \$ 1,117     | \$ 1,761            | \$ 2,389               | \$ 1,048           | \$ 210                  | \$ 117   | \$ 2  | \$ 720      | \$ 7,364 |
| Provision charged (credited) to operations | (27 )        | (81 )               | 49                     | 71                 | (8 )                    | 3        | (1 )  | (6 )        | —        |
| Loans charged off                          | —            | (26 )               | —                      | —                  | —                       | —        | —     | —           | (26 )    |
| Recoveries of loans charged off            | —            | 5                   | 7                      | —                  | —                       | 1        | —     | —           | 13       |
| Balance - June 30, 2015                    | \$ 1,090     | \$ 1,659            | \$ 2,445               | \$ 1,119           | \$ 202                  | \$ 121   | \$ 1  | \$ 714      | \$ 7,351 |
| (Dollars in thousands)                     | Construction | Commercial Business | Commercial Real Estate | Mortgage Warehouse | Residential Real Estate | Consumer | Other | Unallocated | Total    |
| Balance - December 31, 2013                | \$ 1,205     | \$ 1,272            | \$ 3,022               | \$ 585             | \$ 165                  | \$ 109   | \$ 2  | \$ 679      | \$ 7,039 |
| Provision charged (credited) to operations | 60           | 454                 | 114                    | (63 )              | 17                      | (16 )    | (1 )  | (65 )       | 500      |
| Loans charged off                          | —            | (511 )              | —                      | —                  | —                       | —        | —     | —           | (511 )   |
| Recoveries of loans charged off            | —            | 3                   | —                      | —                  | —                       | —        | —     | —           | 3        |
| Balance - March 31, 2014                   | \$ 1,265     | \$ 1,218            | \$ 3,136               | \$ 522             | \$ 182                  | \$ 93    | \$ 1  | \$ 614      | \$ 7,031 |
| Provision charged (credited) to operations | (315 )       | 4,040               | 471                    | 388                | (9 )                    | (1 )     | —     | (474 )      | 4,100    |
| Loans charged off                          | —            | (3,714 )            | —                      | —                  | —                       | —        | —     | —           | (3,714 ) |
| Recoveries of loans charged off            | —            | 1                   | —                      | —                  | —                       | —        | —     | —           | 1        |
| Balance - June 30, 2014                    | \$ 950       | \$ 1,545            | \$ 3,607               | \$ 910             | \$ 173                  | \$ 92    | \$ 1  | \$ 140      | \$ 7,418 |

When a loan is identified as impaired, the measurement of impairment is based on the present value of expected future cash flows, discounted at the loan's effective interest rate, except when the sole remaining source of repayment for the loan is the liquidation of the collateral. In such cases, the current fair value of the collateral less selling costs is used. If the value of the impaired loan is less than the recorded investment in the loan, the impairment is recognized through an allowance estimate or a charge to the allowance.

## Impaired Loans Receivables (By Class) – June 30, 2015

(Dollars in thousands)

|                            |                        |                                |                      | Three Months Ended<br>June 30, 2015 |                                  | Six Months Ended June<br>30, 2015 |                                  |
|----------------------------|------------------------|--------------------------------|----------------------|-------------------------------------|----------------------------------|-----------------------------------|----------------------------------|
|                            | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Recorded<br>Investment   | Interest<br>Income<br>Recognized | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
| With no related allowance: |                        |                                |                      |                                     |                                  |                                   |                                  |
| Commercial                 |                        |                                |                      |                                     |                                  |                                   |                                  |
| Construction               | \$479                  | \$479                          | \$—                  | \$471                               | \$6                              | \$461                             | \$13                             |
| Commercial Business        | 487                    | 1,075                          | —                    | 487                                 | 3                                | 510                               | 7                                |
| Commercial Real Estate     | 2,528                  | 2,774                          | —                    | 2,666                               | 28                               | 2,702                             | 61                               |
| Mortgage Warehouse         | —                      | —                              | —                    | —                                   | —                                | —                                 | —                                |
| Lines                      |                        |                                |                      |                                     |                                  |                                   |                                  |
| Subtotal                   | 3,494                  | 4,328                          | —                    | 3,624                               | 37                               | 3,673                             | 81                               |
| Residential Real Estate    | 1,361                  | 1,376                          | —                    | 1,361                               | —                                | 1,361                             | —                                |
| Consumer                   |                        |                                |                      |                                     |                                  |                                   |                                  |
| Loans to Individuals       | —                      | —                              | —                    | —                                   | —                                | —                                 | —                                |
| Other                      | —                      | —                              | —                    | —                                   | —                                | —                                 | —                                |
| Subtotal                   | —                      | —                              | —                    | —                                   | —                                | —                                 | —                                |
| With no related allowance: | \$4,855                | \$5,704                        | \$—                  | \$4,985                             | \$37                             | \$5,034                           | \$81                             |
| With a related allowance:  |                        |                                |                      |                                     |                                  |                                   |                                  |
| Commercial                 |                        |                                |                      |                                     |                                  |                                   |                                  |
| Construction               | \$—                    | \$—                            | \$—                  | \$—                                 | \$—                              | \$—                               | \$—                              |
| Commercial Business        | 338                    | 532                            | 144                  | 354                                 | 1                                | 363                               | 1                                |
| Commercial Real Estate     | 4,920                  | 4,933                          | 776                  | 4,784                               | 87                               | 4,754                             | 158                              |
| Mortgage Warehouse         | —                      | —                              | —                    | —                                   | —                                | —                                 | —                                |
| Lines                      |                        |                                |                      |                                     |                                  |                                   |                                  |
| Subtotal                   | 5,258                  | 5,465                          | 920                  | 5,138                               | 88                               | 5,117                             | 159                              |
| Residential Real Estate    | —                      | —                              | —                    | —                                   | —                                | —                                 | —                                |
| Consumer                   |                        |                                |                      |                                     |                                  |                                   |                                  |
| Loans to Individuals       | 263                    | 263                            | 26                   | 263                                 | —                                | 263                               | —                                |
| Other                      | —                      | —                              | —                    | —                                   | —                                | —                                 | —                                |
| Subtotal                   | 263                    | 263                            | 26                   | 263                                 | —                                | 263                               | —                                |
| With a related allowance:  | 5,521                  | 5,728                          | 946                  | 5,401                               | 88                               | 5,380                             | 159                              |
| Total:                     |                        |                                |                      |                                     |                                  |                                   |                                  |
| Construction               | 479                    | 479                            | —                    | 471                                 | 6                                | 461                               | 13                               |
| Commercial Business        | 825                    | 1,607                          | 144                  | 841                                 | 4                                | 873                               | 8                                |
| Commercial Real Estate     | 7,447                  | 7,707                          | 776                  | 7,450                               | 115                              | 7,456                             | 219                              |
| Mortgage Warehouse         | —                      | —                              | —                    | —                                   | —                                | —                                 | —                                |
| Lines                      |                        |                                |                      |                                     |                                  |                                   |                                  |
| Residential Real Estate    | 1,361                  | 1,376                          | —                    | 1,361                               | —                                | 1,361                             | —                                |
| Consumer                   | 263                    | 263                            | 26                   | 263                                 | —                                | 263                               | —                                |
| Total                      | \$10,375               | \$11,432                       | \$946                | \$10,386                            | \$125                            | \$10,414                          | \$240                            |



## Impaired Loans Receivables (By Class) –December 31, 2014

(Dollars in thousands)

For the year ended  
December 31, 2014

|                            | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Recorded<br>Investment | Interest Income<br>Recognized |
|----------------------------|------------------------|--------------------------------|----------------------|-----------------------------------|-------------------------------|
| With no related allowance: |                        |                                |                      |                                   |                               |
| Commercial                 |                        |                                |                      |                                   |                               |
| Construction               | \$450                  | \$450                          | \$—                  | \$329                             | \$ 18                         |
| Commercial Business        | 558                    | 1,145                          | —                    | 586                               | 20                            |
| Commercial Real Estate     | 4,058                  | 4,344                          | —                    | 4,144                             | 139                           |
| Mortgage Warehouse Lines   | —                      | —                              | —                    | —                                 | —                             |
| Subtotal                   | 5,066                  | 5,939                          | —                    | 5,059                             | 177                           |
| Residential Real Estate    | 1,361                  | 1,376                          | —                    | 1,410                             | —                             |
| Consumer                   |                        |                                |                      |                                   |                               |
| Loans to Individuals       | —                      | —                              | —                    | —                                 | —                             |
| Other                      | —                      | —                              | —                    | —                                 | —                             |
| Subtotal                   | —                      | —                              | —                    | —                                 | —                             |
| With no related allowance  | 6,427                  | 7,315                          | —                    | 6,469                             | 177                           |
| With a related allowance:  |                        |                                |                      |                                   |                               |
| Commercial                 |                        |                                |                      |                                   |                               |
| Construction               | —                      | —                              | —                    | —                                 | —                             |
| Commercial Business        | 374                    | 374                            | 122                  | 531                               | 3                             |
| Commercial Real Estate     | 3,409                  | 3,409                          | 593                  | 3,439                             | 214                           |
| Mortgage Warehouse Lines   | —                      | —                              | —                    | —                                 | —                             |
| Subtotal                   | 3,783                  | 3,783                          | 715                  | 3,970                             | 217                           |
| Residential Real Estate    | —                      | —                              | —                    | —                                 | —                             |
| Consumer                   |                        |                                |                      |                                   |                               |
| Loans to Individuals       | 263                    | 263                            | 26                   | 251                               | —                             |
| Other                      | —                      | —                              | —                    | —                                 | —                             |
| Subtotal                   | 263                    | 263                            | 26                   | 251                               | —                             |
| With a related allowance   | 4,046                  | 4,046                          | 741                  | 4,221                             | 217                           |
| Total:                     |                        |                                |                      |                                   |                               |
| Construction               | 450                    | 450                            | —                    | 329                               | 18                            |
| Commercial Business        | 932                    | 1,519                          | 122                  | 1,117                             | 23                            |
| Commercial Real Estate     | 7,467                  | 7,753                          | 593                  | 7,583                             | 353                           |
| Mortgage Warehouse Lines   | —                      | —                              | —                    | —                                 | —                             |
| Residential Real Estate    | 1,361                  | 1,376                          | —                    | 1,410                             | —                             |
| Consumer                   | 263                    | 263                            | 26                   | 251                               | —                             |
| Total                      | \$10,473               | \$11,361                       | \$741                | \$10,690                          | \$ 394                        |

## Impaired Loans Receivables (By Class)

(Dollars in thousands)

Three months ended June 30,  
2014

|                            | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
|----------------------------|-----------------------------------|----------------------------------|
| With no related allowance: |                                   |                                  |
| Commercial                 |                                   |                                  |
| Construction               | \$339                             | \$4                              |
| Commercial Business        | 720                               | 9                                |
| Commercial Real Estate     | 2,104                             | 11                               |
| Mortgage Warehouse Lines   | —                                 | —                                |
| Subtotal                   | 3,163                             | 24                               |
| Residential Real Estate    | 1,311                             | 5                                |
| Consumer                   |                                   |                                  |
| Loans to Individuals       | 238                               | —                                |
| Other                      | —                                 | —                                |
| Subtotal                   | 238                               | —                                |
| With no related allowance: | 4,712                             | 29                               |
| With a related allowance:  |                                   |                                  |
| Commercial                 |                                   |                                  |
| Construction               | \$—                               | \$—                              |
| Commercial Business        | 172                               | —                                |
| Commercial Real Estate     | 9,101                             | 65                               |
| Mortgage Warehouse Lines   | —                                 | —                                |
| Subtotal                   | 9,273                             | 65                               |
| Residential Real Estate    | 316                               | —                                |
| Consumer                   |                                   |                                  |
| Loans to Individuals       | —                                 | —                                |
| Other                      | —                                 | —                                |
| Subtotal                   | —                                 | —                                |
| With a related allowance:  | 9,589                             | 65                               |
| Total:                     |                                   |                                  |
| Construction               | 339                               | 4                                |
| Commercial Business        | 891                               | 9                                |
| Commercial Real Estate     | 11,205                            | 76                               |
| Mortgage Warehouse Lines   | —                                 | —                                |
| Residential Real Estate    | 1,627                             | 5                                |
| Consumer                   | 239                               | —                                |
| Total                      | \$14,301                          | \$94                             |



# Purchased Credit-Impaired Loans

Purchased Credit-Impaired loans (“PCI”) are loans acquired at a discount that are due in part to credit quality. The following table presents additional information regarding acquired credit-impaired loans at June 30, 2015 and December 31, 2014:

(Dollars in thousands)

|                     | June 30, 2015 | December 31, 2014 |
|---------------------|---------------|-------------------|
| Outstanding balance | \$2,673       | \$2,705           |
| Carrying amount     | \$1,999       | \$2,025           |

There was a change in the expected cash flows on one PCI loan with a balance of \$206,000 at June 30, 2015. An allowance for loan losses in the amount of \$38,000 has been recorded for this acquired loan as of June 30, 2015. Changes in accretible discount for acquired credit-impaired loans for the three and six months ended June 30, 2015 and June 30, 2014 were as follows:

|                                | Three months ended June 30, |       | Six months ended June 30, |       |
|--------------------------------|-----------------------------|-------|---------------------------|-------|
|                                | 2015                        | 2014  | 2015                      | 2014  |
| (Dollars in thousands)         |                             |       |                           |       |
| Balance at beginning of period | \$115                       | \$221 | \$135                     | \$—   |
| Acquisition of impaired loans  | —                           | —     | —                         | 241   |
| Accretion of discount          | (14                         | ) (27 | ) (34                     | ) (47 |
| Balance at end of period       | \$101                       | \$194 | \$101                     | \$194 |

# Consumer Mortgage Loans Secured by Residential Real Estate in Process of Foreclosure

The following table summarizes the recorded investment in consumer mortgage loans secured by residential real estate in process of foreclosure:

(Dollars in thousands)

|  | June 30,<br>2015 |            | 2014      |            |
|--|------------------|------------|-----------|------------|
|  | Number           | Recorded   | Number of | Recorded   |
|  | of loans         | Investment | loans     | Investment |
|  | 5                | \$1,809    | 1         | \$33       |

In the normal course of business, the Bank may consider modifying loan terms for various reasons. These reasons may include as a retention strategy to compete in the current interest rate environment or as a re-amortization or extension of a loan term to better match the loan’s repayment stream with the borrower’s cash flow. A modified loan would be considered a troubled debt restructuring (“TDR”) if the Bank grants a concession to a borrower and has determined that the borrower is troubled (i.e., experiencing financial difficulties).

If the Bank restructures a loan to a troubled borrower, the loan terms (i.e., interest rate, payment, amortization period and maturity date) may be modified in various ways to enable the borrower to cover the modified debt service payments based on current financial statements and cash flow adequacy. If a borrower’s hardship is thought to be temporary, then modified terms may only be offered for that time period. Where possible, the Bank would attempt to obtain additional collateral and/or secondary repayment sources at the time of the restructuring in order to put the Bank in the best possible position if the borrower is not able to meet the modified terms. The Bank will not offer modified terms if it believes that modifying the loan terms will only delay an inevitable permanent default. In evaluating whether a restructuring constitutes a troubled debt restructuring, applicable guidance requires that a creditor must separately conclude that the restructuring constitutes a concession and the borrower is experiencing financial difficulties.

There were no loans modified that were TDRs in the three and six months ended June 30, 2015. For the year ended December 31, 2014, there were 3 loans with a recorded investment of \$162,000 that were modified as TDRs. There were no troubled debt restructurings that



subsequently defaulted within twelve months of restructuring during the three and six months ended June 30, 2015 and the year ended December 31, 2014.

## (6) Share-Based Compensation

The Company's share-based incentive plans ("Stock Plans") authorize the issuance of an aggregate of 512,736 shares of the Company's common stock (as adjusted for stock dividends) pursuant to awards that may be granted in the form of stock options to purchase common stock ("Options") and awards of shares of common stock ("Stock Awards"). The purpose of the Stock Plans is to attract and retain personnel for positions of substantial responsibility and to provide additional incentive to certain officers, directors, employees and other persons to promote the success of the Company. Under the Stock Plans, options have a term of ten years after the date of grant, subject to earlier termination in certain circumstances. Options are granted with an exercise price at the then fair market value of the Company's common stock. The grant date fair value is calculated using the Black – Scholes option valuation model. As of June 30, 2015, there were 314,590 shares of common stock available for future grants under the Stock Plans, of which 268,390 shares are available for future grants under the 2013 Equity Incentive Plan and 46,200 shares are available for future grant under the 2015 Directors Stock Plan.

Stock-based compensation expense related to options was \$23,000 and \$70,000 for the six months ended June 30, 2015 and 2014, respectively.

Transactions under the Stock Plans during the three and six months ended June 30, 2015 are summarized as follows:

| (Dollars in thousands, except share amounts) | Number of | Weighted<br>Average | Weighted<br>Average<br>Remaining<br>Contractual | Aggregate<br>Intrinsic |
|----------------------------------------------|-----------|---------------------|-------------------------------------------------|------------------------|
|                                              | Shares    | Exercise<br>Price   | Term (years)                                    | Value                  |
| Stock Options                                |           |                     |                                                 |                        |
| Outstanding at January 1, 2015               | 235,124   | \$8.19              |                                                 |                        |
| Granted                                      | 13,230    | 10.61               |                                                 |                        |
| Exercised                                    | (3,313)   | 7.76                |                                                 |                        |
| Forfeited                                    | (69)      | 7.65                |                                                 |                        |
| Expired                                      | —         | —                   |                                                 |                        |
| Outstanding at June 30, 2015                 | 244,972   | \$8.33              | 5.1                                             | \$1,627                |
| Exercisable at June 30, 2015                 | 205,698   | \$8.32              | 4.1                                             | \$1,296                |

The fair value of each option and the significant weighted average assumptions used to calculate the fair value of the options granted for the three and six months ended June 30, 2015 are as follows:

|                                   | January 2015 |   |
|-----------------------------------|--------------|---|
| Fair value of options granted     | \$4.05       |   |
| Risk-free rate of return          | 1.37         | % |
| Expected option life in years     | 7            |   |
| Expected volatility               | 32.37        | % |
| Expected dividends <sup>(1)</sup> | —            |   |

(1) To date, the Company has not paid cash dividends on its common stock.

As of June 30, 2015, there was approximately \$88,000 of unrecognized compensation cost related to non-vested stock option-based compensation arrangements granted under the Company's stock incentive plans. That cost is expected to be recognized over the next four years.

The following table summarizes the activity in non-vested restricted shares for the three and six months ended June 30, 2015:

|                               | Number of | Average    |
|-------------------------------|-----------|------------|
|                               | Shares    | Grant-Date |
|                               |           | Fair Value |
| Non-vested shares             |           |            |
| Non-vested at January 1, 2015 | 141,556   | \$7.51     |
| Granted                       | 33,358    | 10.62      |
| Vested                        | (26,373)  | ) 9.00     |
| Forfeited                     | (506)     | ) 9.14     |
| Non-vested at June 30, 2015   | 148,035   | \$7.94     |

The value of restricted shares is based upon the closing price of the common stock on the date of grant. The shares generally vest over a 4 year service period with compensation expense recognized on a straight-line basis.

Stock-based compensation expense related to stock grants was \$303,000 for each of the six months ended June 30, 2015 and 2014, respectively.

As of June 30, 2015, there was approximately \$1.1 million of unrecognized compensation cost related to non-vested stock grants. Compensation costs related to non-vested stock grants are recognized over four years from the date of grant.

#### (7) Benefit Plans

The Bank has a 401(k) plan which covers substantially all employees with six months or more of service. The 401(k) plan permits all eligible employees to make contributions to the plan up to the IRS salary deferral limit. The Bank's contributions to the 401(k) plan are expensed as incurred.

The Company also provides retirement benefits to certain employees under supplemental executive retirement plans. The plans are unfunded and the Company accrues actuarially determined benefit costs over the estimated service period of the employees in the plan. The Company recognizes the over-funded or under-funded status of a defined benefit post-retirement plan as an asset or liability in its balance sheet and recognizes changes in that funded status in the year in which the changes occur, through comprehensive income.

In connection with the benefit plans, the Bank has life insurance policies on the lives of its executives, directors and divisional officers. The Bank is the owner and beneficiary of the policies. The cash surrender values of the policies total approximately \$21.3 million and \$21.2 million at June 30, 2015 and December 31, 2014, respectively.

The components of net periodic expense for the Company's supplemental executive retirement plans for the three and six months ended June 30, 2015 and 2014 were as follows:

| (Dollars in thousands)    | Three Months Ended |      | Six Months Ended |      |
|---------------------------|--------------------|------|------------------|------|
|                           | June 30,           |      | June 30,         |      |
|                           | 2015               | 2014 | 2015             | 2014 |
| Service cost              | \$91               | \$43 | 165              | 57   |
| Interest cost             | 78                 | 33   | 124              | 43   |
| Actuarial gain recognized | (110)              | ) (2 | ) (155           | ) (2 |
|                           | \$59               | \$74 | 134              | 98   |

(8) Other Comprehensive Income (Loss) and Accumulated Other Comprehensive Income (Loss)

Other comprehensive income (loss) is the total of (1) net income (loss), and (2) all other changes in equity from non-shareholder sources, which are referred to as other comprehensive income (loss). The components of accumulated other comprehensive income (loss), and the related tax effects, are as follows:

|                                                                        | Before-Tax<br>Amount | Income Tax<br>Effect | Net-of-Tax<br>Amount |
|------------------------------------------------------------------------|----------------------|----------------------|----------------------|
| (Dollars in thousands)                                                 |                      |                      |                      |
| June 30, 2015                                                          |                      |                      |                      |
| Unrealized holding (losses) on available-for-sale securities           | \$(192 )             | \$31                 | \$(161 )             |
| Unrealized impairment (loss) on held to maturity security              | (501 )               | 170                  | (331 )               |
| Unfunded pension liability:                                            |                      |                      |                      |
| Plan actuarial gains and losses included in other comprehensive income | 443                  | (178 )               | 265                  |
| Accumulated other comprehensive income                                 | \$(250 )             | \$23                 | \$(227 )             |
|                                                                        | Before-Tax<br>Amount | Income Tax<br>Effect | Net-of-Tax<br>Amount |
| June 30, 2014                                                          |                      |                      |                      |
| Unrealized holding (losses) on available-for-sale securities           | \$(708 )             | \$300                | \$(408 )             |
| Unrealized impairment (loss) on held to maturity security:             | (501 )               | 170                  | (331 )               |
| Unfunded pension liability:                                            |                      |                      |                      |
| Plan actuarial gains and losses included in other comprehensive income | 186                  | (75 )                | 111                  |
| Accumulated other comprehensive loss                                   | \$(1,023 )           | \$395                | \$(628 )             |

Changes in the components of accumulated other comprehensive income (loss) are as follows and are presented net of tax:

|                                                                         | Unrealized<br>Holding<br>Gains<br>(Losses) on<br>Available for<br>Sale<br>Securities | Unrealized<br>Impairment<br>Loss on<br>Held to<br>Maturity<br>Security | Unfunded<br>Pension<br>Liability | Accumulated<br>Other<br>Comprehensive<br>(Loss) Income |
|-------------------------------------------------------------------------|--------------------------------------------------------------------------------------|------------------------------------------------------------------------|----------------------------------|--------------------------------------------------------|
| (Dollars in thousands)                                                  |                                                                                      |                                                                        |                                  |                                                        |
| Three Months Ended June 30, 2015:                                       |                                                                                      |                                                                        |                                  |                                                        |
| Balance, beginning of period                                            | \$326                                                                                | \$(331 )                                                               | \$276                            | \$271                                                  |
| Other comprehensive income (loss) before reclassifications              | (487                                                                                 | ) —                                                                    | 55                               | (432 )                                                 |
| Amounts reclassified from accumulated other comprehensive income (loss) | —                                                                                    | —                                                                      | (66 )                            | (66 )                                                  |
| Other comprehensive income (loss)                                       | (487                                                                                 | ) —                                                                    | (11                              | ) (498 )                                               |
| Balance, end of period                                                  | \$(161                                                                               | ) \$(331 )                                                             | \$265                            | \$(227 )                                               |

|                                                                         | Unrealized<br>Holding<br>Gains<br>(Losses) on<br>Available for<br>Sale<br>Securities | Unrealized<br>Impairment<br>Loss on<br>Held to<br>Maturity<br>Security | Unfunded<br>Pension<br>Liability | Accumulated<br>Other<br>Comprehensive<br>(Loss) Income |   |
|-------------------------------------------------------------------------|--------------------------------------------------------------------------------------|------------------------------------------------------------------------|----------------------------------|--------------------------------------------------------|---|
| Three Months Ended June 30, 2014:                                       |                                                                                      |                                                                        |                                  |                                                        |   |
| Balance, beginning of period                                            | \$ (1,088                                                                            | ) \$ (331                                                              | ) \$ 54                          | \$ (1,365                                              | ) |
| Other comprehensive income (loss) before reclassifications              | 678                                                                                  | —                                                                      | 57                               | 735                                                    |   |
| Amounts reclassified from accumulated other comprehensive income        | 2                                                                                    | —                                                                      | —                                | 2                                                      |   |
| Other comprehensive income                                              | 680                                                                                  | —                                                                      | 57                               | 737                                                    |   |
| Balance, end of period                                                  | \$ (408                                                                              | ) \$ (331                                                              | ) \$ 111                         | \$ (628                                                | ) |
|                                                                         | Unrealized<br>Holding<br>Gains<br>(Losses) on<br>Available for<br>Sale<br>Securities | Unrealized<br>Impairment<br>Loss on<br>Held to<br>Maturity<br>Security | Unfunded<br>Pension<br>Liability | Accumulated<br>Other<br>Comprehensive<br>(Loss) Income |   |
| (Dollars in thousands)                                                  |                                                                                      |                                                                        |                                  |                                                        |   |
| Six Months Ended June 30, 2015:                                         |                                                                                      |                                                                        |                                  |                                                        |   |
| Balance, beginning of period                                            | \$ 276                                                                               | \$ (331                                                                | ) \$ 303                         | \$ 248                                                 |   |
| Other comprehensive income (loss) before reclassifications              | (437                                                                                 | ) —                                                                    | 55                               | (382                                                   | ) |
| Amounts reclassified from accumulated other comprehensive income (loss) | —                                                                                    | —                                                                      | (93                              | ) (93                                                  | ) |
| Other comprehensive income (loss)                                       | (437                                                                                 | ) —                                                                    | (38                              | ) (475                                                 | ) |
| Balance, end of period                                                  | \$ (161                                                                              | ) \$ (331                                                              | ) \$ 265                         | \$ (227                                                | ) |
|                                                                         | Unrealized<br>Holding<br>Gains<br>(Losses) on<br>Available for<br>Sale<br>Securities | Unrealized<br>Impairment<br>Loss on<br>Held to<br>Maturity<br>Security | Unfunded<br>Pension<br>Liability | Accumulated<br>Other<br>Comprehensive<br>(Loss) Income |   |
| Six Months Ended June 30, 2014:                                         |                                                                                      |                                                                        |                                  |                                                        |   |
| Balance, beginning of period                                            | \$ (1,933                                                                            | ) \$ (331                                                              | ) \$ 16                          | \$ (2,248                                              | ) |
| Other comprehensive income (loss) before reclassifications              | 1,523                                                                                | —                                                                      | 95                               | 1,618                                                  |   |
| Amounts reclassified from accumulated other comprehensive income        | 2                                                                                    | —                                                                      | —                                | 2                                                      |   |
| Other comprehensive income                                              | 1,525                                                                                | —                                                                      | 95                               | 1,620                                                  |   |
| Balance, end of period                                                  | \$ (408                                                                              | ) \$ (331                                                              | ) \$ 111                         | \$ (628                                                | ) |





(9) Recent Accounting Pronouncements

ASU Update 2015-01 (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items.

In January 2015, the FASB issued ASU 2015-01, Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items, to eliminate the concept of extraordinary items from U.S. GAAP. The presentation and disclosure guidance for items that are unusual in nature or occur infrequently will be retained and will be expanded to include items that are both unusual in nature and infrequently occurring. ASU 2015-01 eliminates the requirement in Subtopic 225-20 to consider whether an underlying event or transaction is extraordinary and if so, to separately present the item in the income statement, net of tax, after income from continuing operations. Items that are either unusual in nature or infrequently occurring will continue to be reported as a separate component of income from continuing operations. For all entities (public and private), the ASU is effective for fiscal years beginning after December 15, 2015. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. The Company does not expect that the adoption of this guidance will have a material impact on the Company's consolidated financial statements.

ASU 2014-9 Revenue from Contracts with Customers (Topic 606)

In May 2014, the FASB issued ASU 2014-9, "Revenue from Contracts with Customers (Topic 606)." The objective of this amendment is to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP. This update affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of non-financial assets unless those contracts are in the scope of other standards. On July 9, 2015, the FASB decided to delay the effective date of the new revenue standard by one year. The new revenue standard will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. The Company does not anticipate a material impact to the consolidated financial statements related to this guidance.

(10) Fair Value Disclosures

U.S. GAAP has established a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical unrestricted assets or liabilities.

Level 2: Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported with little or no market activity).

An asset's or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below. These valuation methodologies were applied to all of the Company's financial assets and financial liabilities carried at fair value. In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality and counterparty creditworthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time. The Company's valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective of future values. While management believes the Company's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

**Securities Available for Sale.** Securities classified as available for sale are reported at fair value utilizing quoted market prices on nationally recognized exchanges (Level 1) or by using Level 2 inputs. For Level 2 securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayments speeds, credit information and the security's terms and conditions, among other things.

**Impaired loans.** Loans included in the following table are those which the Company has measured and recognized impairment, generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third party appraisals of the collateral or discounted cash flows based on the expected proceeds. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements. The fair value consists of the loan balances less specific valuation allowances.

**Other Real Estate Owned.** Foreclosed properties are adjusted to fair value less estimated selling costs at the time of foreclosure in preparation for transfer from portfolio loans to other real estate owned ("OREO"), establishing a new accounting basis. The Company subsequently adjusts the fair value on the OREO utilizing Level 3 inputs on a non-recurring basis to reflect partial write-downs based on the observable market price, current appraised value of the asset or other estimates of fair value.

The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

| (Dollars in thousands)                                                                                   | Level 1<br>Inputs | Level 2<br>Inputs | Level 3<br>Inputs | Total Fair<br>Value |
|----------------------------------------------------------------------------------------------------------|-------------------|-------------------|-------------------|---------------------|
| June 30, 2015:                                                                                           |                   |                   |                   |                     |
| Securities available for sale:                                                                           |                   |                   |                   |                     |
| U. S. Treasury securities and obligations of U.S. Government sponsored corporations (“GSE”) and agencies | \$—               | \$1,531           | \$—               | \$1,531             |
| Residential collateralized mortgage obligations- GSE                                                     | —                 | 3,851             | —                 | 3,851               |
| Residential mortgage backed securities – GSE                                                             | —                 | 25,680            | —                 | 25,680              |
| Obligations of State and Political subdivisions                                                          | —                 | 20,575            | —                 | 20,575              |
| Trust preferred debt securities – single issuer                                                          | —                 | 2,133             | —                 | 2,133               |
| Corporate debt securities                                                                                | —                 | 19,239            | —                 | 19,239              |
| Other debt securities                                                                                    | —                 | 1,041             | —                 | 1,041               |
| Restricted stock                                                                                         | —                 | 6,526             | —                 | 6,526               |
| Total                                                                                                    |                   | \$80,576          |                   | \$80,576            |

| (Dollars in thousands)                                                                                   | Level 1<br>Inputs | Level 2<br>Inputs | Level 3<br>Inputs | Total Fair<br>Value |
|----------------------------------------------------------------------------------------------------------|-------------------|-------------------|-------------------|---------------------|
| December 31, 2014:                                                                                       |                   |                   |                   |                     |
| Securities available for sale:                                                                           |                   |                   |                   |                     |
| U. S. Treasury securities and obligations of U.S. Government sponsored corporations (“GSE”) and agencies | \$—               | \$1,524           | \$—               | \$1,524             |
| Residential collateralized mortgage obligations- GSE                                                     | —                 | 4,533             | —                 | 4,533               |
| Residential mortgage backed securities – GSE                                                             | —                 | 27,771            | —                 | 27,771              |
| Obligations of State and Political subdivisions                                                          | —                 | 21,703            | —                 | 21,703              |
| Trust preferred debt securities – single issuer                                                          | —                 | 2,069             | —                 | 2,069               |
| Corporate debt securities                                                                                | —                 | 19,521            | —                 | 19,521              |
| Other debt securities                                                                                    | —                 | 1,280             | —                 | 1,280               |
| Restricted stock                                                                                         | —                 | 1,760             | —                 | 1,760               |
| Total                                                                                                    |                   | \$80,161          |                   | \$80,161            |

Certain assets and liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). Assets and financial liabilities measured at fair value on a nonrecurring basis, where there was evidence of impairment, at June 30, 2015 and December 31, 2014 were as follows:

| (Dollars in thousands)  | Level 1<br>Inputs | Level 2<br>Inputs | Level 3<br>Inputs | Total Fair<br>Value |
|-------------------------|-------------------|-------------------|-------------------|---------------------|
| June 30, 2015:          |                   |                   |                   |                     |
| Impaired loans          | \$—               | \$—               | \$317             | \$317               |
| Other real estate owned | —                 | —                 | 1,367             | 1,367               |
| December 31, 2014:      |                   |                   |                   |                     |
| Impaired loans          | \$—               | \$—               | \$3,883           | \$3,883             |
| Other real estate owned | —                 | —                 | 5,710             | 5,710               |

Impaired loans measured at fair value and included in the above table at June 30, 2015 consisted of 2 loans having an aggregate recorded investment of \$392,000 and specific loan loss allowances of \$75,000. Impaired loans measured at fair value and included in the above table at December 31, 2014 consisted of 8 loans having an aggregate balance of

\$4.0 million with a specific loan loss allowance of \$700,000 and 3 loans totaling \$578,000 which were charged down during the year.

The following table presents additional qualitative information about assets measured at fair value on a nonrecurring basis, where there was evidence of impairment, and for which the Company has utilized Level 3 inputs to determine fair value:

Quantitative Information about Level 3 Fair Value Measurements

| (Dollars in thousands)  | Fair Value Estimate | Valuation Techniques        | Unobservable Input        | Range (Weighted Average) |
|-------------------------|---------------------|-----------------------------|---------------------------|--------------------------|
| June 30, 2015           |                     |                             |                           |                          |
| Impaired loans          | \$317               | Appraisal of collateral (1) | Appraisal adjustments (2) | 11% (11%)                |
| Other real estate owned | \$1,367             | Appraisal of collateral (1) | Appraisal adjustments (2) | 20% (20%)                |
| December 31, 2014       |                     |                             |                           |                          |
| Impaired loans          | \$3,883             | Appraisal of collateral (1) | Appraisal adjustments (2) | 8%-17% (10.66%)          |
| Other real estate owned | \$5,710             | Appraisal of collateral (1) | Appraisal adjustments (2) | 0%-39 (25.1%)            |

(1) Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various Level 3 inputs which are not identifiable.

(2) Includes qualitative adjustments by management and estimated liquidation expenses.

The fair value of other real estate owned was determined using appraisals, which may be discounted based on management's review and changes in market conditions.

The following is a summary of fair value versus carrying value of all of the Company's financial instruments. For the Company and the Bank, as for most financial institutions, the bulk of its assets and liabilities are considered financial instruments. Many of the financial instruments lack an available trading market as characterized by a willing buyer and willing seller engaging in an exchange transaction. Therefore, significant estimations and present value calculations were used for the purpose of this note. Changes in assumptions could significantly affect these estimates. Estimated fair values have been determined by using the best available data and an estimation methodology suitable for each category of financial instruments as follows:

Cash and Cash Equivalents, Accrued Interest Receivable and Accrued Interest Payable (Carried at Cost). The carrying amounts reported in the balance sheet for cash and cash equivalents, accrued interest receivable and accrued interest payable approximate fair value.

Securities Held to Maturity (Carried at Amortized Cost). The fair values of securities held to maturity are determined in the same manner as for securities available for sale.

Loans Held For Sale (Carried at Lower of Aggregated Cost or Fair Value). The fair values of loans held for sale are determined, when possible, using quoted secondary market prices. If no such quoted market prices exist, fair values are determined using quoted prices for similar loans, adjusted for the specific attributes of the loans.

Gross Loans Receivable (Carried at Cost). The fair values of loans, excluding impaired loans subject to specific loss reserves, are estimated using discounted cash flow analyses that use market rates at the balance sheet date that reflect the credit and interest rate-risk inherent in the loans. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments and prepayments of principal. Generally, for variable rate loans that re-price frequently and with no significant change in credit risk, fair values are based on carrying values.

Deposit Liabilities (Carried at Cost). The fair values disclosed for demand deposits (e.g., interest and non-interest demand and savings accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered in the market on certificates of deposit to a schedule of aggregated expected monthly maturities on time deposits.

Borrowings and Subordinated Debentures (Carried at Cost). The carrying amounts of short-term borrowings approximate their fair values. The fair values of long-term FHLB advances and subordinated debentures are estimated using discounted cash flow analysis, based on quoted or estimated interest rates for new borrowings with similar

credit risk characteristics, terms and remaining maturity.

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The estimated fair values and carrying amounts of financial assets and liabilities as of June 30, 2015 and December 31, 2014 were as follows:

June 30, 2015

| (Dollars in thousands)             | Carrying<br>Value | Level 1<br>Inputs | Level 2<br>Inputs | Level 3<br>Inputs | Fair<br>Value |
|------------------------------------|-------------------|-------------------|-------------------|-------------------|---------------|
| Cash and cash equivalents          | \$16,364          | \$16,364          | \$—               | \$—               | \$16,364      |
| Securities available for sale      | 80,576            | —                 | 80,576            | —                 | 80,576        |
| Securities held to maturity        | 126,651           | —                 | 130,257           | —                 | 130,257       |
| Loans held for sale                | 9,231             | —                 | 9,370             | —                 | 9,370         |
| Loans, net                         | 751,155           | —                 | —                 | 752,475           | 752,475       |
| Accrued interest receivable        | 2,976             | —                 | 2,976             | —                 | 2,976         |
| Deposits                           | (798,088)         | ) —               | (798,546)         | ) —               | (798,546)     |
| Borrowings                         | (130,728)         | ) —               | (131,382)         | ) —               | (131,382)     |
| Redeemable subordinated debentures | (18,557)          | ) —               | (18,557)          | ) —               | (18,557)      |
| Accrued interest payable           | (855)             | ) —               | (855)             | ) —               | (855)         |

December 31, 2014

| (Dollars in thousands)             | Carrying<br>Value | Level 1<br>Inputs | Level 2<br>Inputs | Level 3<br>Inputs | Fair<br>Value |
|------------------------------------|-------------------|-------------------|-------------------|-------------------|---------------|
| Cash and cash equivalents          | \$14,545          | \$14,545          | \$—               | \$—               | \$14,545      |
| Securities available for sale      | 80,161            | —                 | 80,161            | —                 | 80,161        |
| Securities held to maturity        | 143,638           | —                 | 148,476           | —                 | 148,476       |
| Loans held for sale                | 8,372             | —                 | 8,500             | —                 | 8,500         |
| Loans, net                         | 647,372           | —                 | —                 | 656,153           | 656,153       |
| Accrued interest receivable        | 3,096             | —                 | 3,096             | —                 | 3,096         |
| Deposits                           | (817,761)         | ) —               | (818,265)         | ) —               | (818,265)     |
| Borrowings                         | (25,107)          | ) —               | (25,838)          | ) —               | (25,838)      |
| Redeemable subordinated debentures | (18,557)          | ) —               | (18,557)          | ) —               | (18,557)      |
| Accrued interest payable           | (907)             | ) —               | (907)             | ) —               | (907)         |

Loan commitments and standby letters of credit as of June 30, 2015 and December 31, 2014 were based on fees charged for similar agreements; accordingly, the estimated fair value of loan commitments and standby letters of credit was nominal.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The purpose of this discussion and analysis of the operating results and financial condition at June 30, 2015 is intended to help readers analyze the accompanying financial statements, notes and other supplemental information contained in this document. Results of operations for the three and six month periods ended June 30, 2015 are not necessarily indicative of results to be attained for any other period.

This discussion and analysis should be read in conjunction with the consolidated financial statements, notes and tables included elsewhere in this report and Part II, Item 7 of the Company's Form 10-K (Management's Discussion and Analysis of Financial Condition and Results of Operation) for the year ended December 31, 2014, as filed with the Securities and Exchange Commission (the "SEC") on March 26, 2015.

**General**

Throughout the following sections, the "Company" refers to 1st Constitution Bancorp and, as the context requires, its wholly-owned subsidiary, 1st Constitution Bank (the "Bank"), and the Bank's wholly-owned subsidiaries, 1st Constitution Investment Company of New Jersey, Inc., FCB Assets Holdings, Inc., LLC, 204 South Newman Street Corp. and 249 New York Avenue, LLC. 1st Constitution Capital Trust II ("Trust II"), a subsidiary of the Company, is not included in the Company's consolidated financial statements as it is a variable interest entity and the Company is not the primary beneficiary.

The Company is a bank holding company registered under the Bank Holding Company Act of 1956, as amended. The Company was organized under the laws of the State of New Jersey in February 1999 for the purpose of acquiring all of the issued and outstanding stock of the Bank, a full service commercial bank which began operations in August 1989, and thereby enabling the Bank to operate within a bank holding company structure. The Company became an active bank holding company on July 1, 1999. The Bank is a wholly-owned subsidiary of the Company. Other than its ownership interest in the Bank, the Company currently conducts no other significant business activities.

The Bank operates nineteen branches and manages an investment portfolio through its subsidiary, 1st Constitution Investment Company of New Jersey, Inc. FCB Assets Holdings, Inc., a subsidiary of the Bank, is used by the Bank to manage and dispose of repossessed real estate.

Trust II, a subsidiary of the Company, was created in May 2006 to issue trust preferred securities to assist the Company in raising additional capital.

**Forward-Looking Statements**

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for forward-looking statements. When used in this and in future filings by the Company with the SEC, in the Company's press releases and in oral statements made with the approval of an authorized executive officer of the Company, the words or phrases "will," "will likely result," "could," "anticipates," "believes," "continues," "expects," "plans," "will continue," "is anticipated," "estimated," "project" or "outlook" expressions (including confirmations by an authorized executive officer of the Company of any such expressions made by a third party with respect to the Company) are intended to identify forward-looking statements. The Company cautions readers not to place undue reliance on any such forward-looking statements, each of which speaks only as of the date made. Such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from historical earnings and those presently anticipated or projected.

Factors that may cause actual results to differ from those results expressed or implied, include, but are not limited to, those listed under "Business", "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Company's Annual Report on Form 10-K for the year ended December 31, 2014 filed with the SEC on March 26, 2015, such as the overall economy and the interest rate environment; the ability of customers to repay their obligations; the adequacy of the allowance for loan losses; competition; significant changes in accounting, tax or regulatory practices and requirements; certain interest rate risks; risks associated with investments in mortgage-backed securities; risks associated with speculative construction lending; and risks associated with safeguarding information technology systems. Although management has taken certain steps to mitigate any negative effect of the aforementioned items, significant unfavorable changes could severely impact the assumptions used and could have an adverse effect on profitability. The Company undertakes no obligation to publicly revise any



forward-looking statements to reflect anticipated or unanticipated events or circumstances occurring after the date of such statements, except as required by law.

#### Recent Developments

On February 20, 2015 the Board of Directors of the Company declared a five percent common stock dividend to common shareholders of record as of the close of business on March 16, 2015, which was paid on April 6, 2015. As appropriate, common shares and per common share data presented for 2015 and 2014 have been adjusted to reflect the common stock dividend.

#### Merger of Rumson-Fair Haven Bank and Trust Company with and into the Bank in 2014

On February 7, 2014, the Company completed its acquisition of Rumson-Fair Haven Bank and Trust Company, a New Jersey state-chartered commercial bank (“Rumson”), which merged with and into the Bank, with the Bank as the surviving entity. The merger agreement among the Company, the Bank and Rumson (the “Merger Agreement”) provided that the shareholders of Rumson would receive, at their election, for each outstanding share of Rumson common stock that they own at the effective time of the merger, either 0.7772 shares of the Company common stock or \$7.50 in cash, subject to proration as described in the Merger Agreement, so that 60% of the aggregate merger consideration consisted of cash and 40% consisted of shares of the Company’s common stock. The Company issued an aggregate of 1,019,223 shares of its common stock and paid \$14.8 million in cash in the transaction.

The merger was accounted for under the acquisition method of accounting and accordingly, assets acquired, liabilities assumed and consideration exchanged were recorded at their estimated fair values as of the acquisition date. Rumson’s results of operations have been included in the Company’s Consolidated Statements of Income since February 7, 2014.

## RESULTS OF OPERATIONS

Three and Six Months Ended June 30, 2015 Compared to Three and Six Months Ended June 30, 2014

## Summary

The Company reported net income of \$2.3 million for the three months ended June 30, 2015, a 27% increase compared to Adjusted Net Income (as defined below) of \$1.8 million for the three months ended June 30, 2014. Net income per diluted share was \$0.30 for the second quarter of 2015, a 25% increase compared to Adjusted Net Income per Diluted Share of \$0.24 for the second quarter of 2014.

The Company reported net income of \$4.6 million or \$0.60 per diluted share for the six month period ended June 30, 2015 compared to Adjusted Net Income of \$3.4 million or Adjusted Net Income per Diluted Share of \$0.45 for the six month period ended June 30, 2014.

Net loss and net loss per diluted share as reported were \$440,000 and \$0.06, respectively, for the second quarter of 2014 and net income and net income per diluted share as reported were \$202,000 and \$0.03, respectively, for the six months ended June 30, 2014.

Adjusted Net Income excludes the after-tax effect of merger related expenses that were incurred in the first and second quarters of 2014 in connection with the merger of Rumson with and into the Bank on February 7, 2014 and the provision for loan losses related to the full charge-off of a loan participation due to fraudulent misrepresentations by the borrower and its principals recorded in the second quarter of 2014.

The significant increase in net income for the second quarter of 2015 compared to Adjusted Net Income for the second quarter of 2014 was due primarily to the \$1.0 million increase in net interest income to \$9.4 million, which was driven by the growth of the Bank's loan portfolio in 2015. Non-interest income for the second quarter of 2015 increased \$358,000 to \$1.6 million due to higher gains from the sales of residential mortgages and SBA guaranteed commercial loans.

The significant increase in net income for the six months ended June 30, 2015 compared to Adjusted Net Income for the six months ended June 30, 2014 was due primarily to the \$2.7 million increase in net interest income to \$18.0 million, which was driven by the growth of the Bank's loan portfolio in 2015.

Adjusted Net Income and Adjusted Net Income per Diluted Share are non-GAAP measures. The following table provides a reconciliation of these non-GAAP measures to net income and net income per diluted share as reported:

| Reconciliation of Non-GAAP Measures (1)                      |                    |           |                  |           |   |
|--------------------------------------------------------------|--------------------|-----------|------------------|-----------|---|
| (Dollars in thousands, except per share amounts) (Unaudited) |                    |           |                  |           |   |
|                                                              | Three Months Ended |           | Six Months Ended |           |   |
|                                                              | June 30,           |           | June 30,         |           |   |
|                                                              | 2015               | 2014      | 2015             | 2014      |   |
| Adjusted Net Income:                                         |                    |           |                  |           |   |
| Net income                                                   | \$2,315            | \$(440)   | ) \$4,575        | \$202     |   |
| Adjustment                                                   |                    |           |                  |           |   |
| Provision for loan losses (2)                                | —                  | 3,656     | —                | 3,656     |   |
| Merger-related expenses                                      | —                  | 109       | —                | 1,532     |   |
| Income tax effect of Adjustment (3)                          | —                  | (1,504)   | ) —              | (2,031)   | ) |
| Adjusted Net Income                                          | \$2,315            | \$1,821   | \$4,575          | \$3,359   |   |
| Adjusted Net Income per Diluted Share                        |                    |           |                  |           |   |
| Adjusted Net Income                                          | \$2,315            | \$1,821   | \$4,575          | \$3,359   |   |
| Diluted shares outstanding (4)                               | 7,684,980          | 7,608,274 | 7,674,859        | 7,433,154 |   |
| Adjusted Net Income per Diluted Share                        | \$0.30             | \$0.24    | \$0.60           | \$0.45    |   |
| Adjusted Return on Assets (5)                                | 0.94               | % 0.76    | % 0.94           | % 0.74    | % |
| Adjusted Return on Equity (5)                                | 10.33              | % 8.90    | % 10.38          | % 8.58    | % |

(1) The Company used these non-GAAP financial measures, Adjusted Net Income and Adjusted Net Income per Diluted Share, because the Company believes that it is useful for the users of the financial information to

understand the effect on net

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income of the merger related expenses incurred in the merger with Rumson and the large provision for loan losses recorded as a result of the loss on a loan due to the fraudulent misrepresentations of a borrower and its principals. Management believes that these non-GAAP financial measures improve the comparability of the current period results with the results of prior periods. The Company cautions that the non-GAAP financial measures should be considered in addition to, but not as a substitute for, the Company's U.S. GAAP results.

(2) The amount represents the full charge-off of the loan that was subject to fraudulent misrepresentation by a borrower and its principals.

(3) Tax effected at an income tax rate of 39.94%, less the impact of non-deductible merger expenses.

The adjustments to the reported loss for the three month period ended June 30, 2014 result in adjusted net income.

(4) Accordingly, diluted shares outstanding include the dilutive share equivalents for purposes of computing Adjusted Net Income per Diluted Share.

(5) Adjusted Return on Assets and Adjusted Return on Equity exclude the after-tax effect of the merger-related expenses and the fraud related loan loss provision in 2014.

## Second Quarter Highlights

Net interest income was \$9.4 million in the second quarter of 2015 compared to \$8.5 million in the first quarter of 2015 and \$8.4 million in the second quarter of 2014. The net interest margin for each of these periods was 4.19%, 3.96% and 3.89%, respectively.

During the second quarter of 2015, the total loan portfolio increased \$48.3 million, or 6.8%, to \$758.5 million at June 30, 2015. Mortgage warehouse lines outstanding increased \$46.7 million to \$279.7 million at June 30, 2015, reflecting higher levels of residential mortgage originations by the Bank's mortgage banking customers due to the seasonal home buying market and favorable residential mortgage interest rates. Approximately 52% of the \$1.1 billion of funding activity during the second quarter was for the purchase of homes and home purchase loans represented 62% of the outstanding mortgage warehouse loans at June 30, 2015. The loan to asset ratio increased to 72% at June 30, 2015 compared to 68% at December 31, 2014 and 64% at June 30, 2014.

No provision for loan losses was recorded for the second quarter of 2015 due to the Bank's stable loan quality, the insignificant level of net-charge offs and a reduction in the Bank's loan loss reserve factors based on management's assessment of strengthening economic conditions in the Bank's markets and stable loan quality trends.

SBA loan sales were \$5.2 million and generated gains on sales of loans of \$518,000, and SBA commercial loan originations were \$3.6 million during the second quarter of 2015.

During the second quarter of 2015, the Bank's residential mortgage banking operation originated \$43.3 million of residential mortgages and sold \$43.8 million of residential mortgage loans, which generated gains from the sales of loans of \$314,000. At June 30, 2015, the pipeline of residential mortgage loans in process was \$68.8 million.

The Company's efficiency ratio for the second quarter of 2015 was 67.4% compared to 61.7% for the first quarter of 2015 and 66.5% for the second quarter of 2014, excluding the effect of the merger expenses. The write-down of one OREO property and related expenses and higher collection and asset recovery expenses impacted the efficiency ratio during the second quarter of 2015.

## Earnings Analysis

The Bank's results of operations depend primarily on net interest income, which is primarily affected by the market interest rate environment, the shape of the U.S. Treasury yield curve, and the difference between the yield on interest-earning assets and the rate paid on interest-bearing liabilities. Other factors that may affect the Bank's operating results are general and local economic and competitive conditions, government policies and actions of regulatory authorities.

## Net Interest Income

Net interest income, the Company's largest and most significant component of operating income, is the difference between interest and fees earned on loans and other earning assets and interest paid on deposits and borrowed funds. This component represented 85.3% of the Company's net revenues (defined as net interest income plus non-interest income) for the three month period ended June 30, 2015 compared to 86.9% of net revenues for the three months ended June 30, 2014. Net interest income also depends upon the relative amount of average interest-earning assets, average interest-bearing liabilities, and the interest rate earned or paid on them, respectively.

For the six months ended June 30, 2015, net interest income represented 83.5% of the Company's net revenues compared to 84.1% of net revenues for the six months ended June 30, 2014.

The following tables set forth the Company's consolidated average balances of assets and liabilities and shareholders' equity as well as interest income and expense on related items, and the Company's average yield or rate for the three and six month periods ended June 30, 2015 and 2014. The average rates are derived by dividing interest income and expense by the average balance of assets and liabilities, respectively.

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|                                            | Three months ended June 30, 2015 |          |                  |   | Three months ended June 30, 2014 |          |                  |   |
|--------------------------------------------|----------------------------------|----------|------------------|---|----------------------------------|----------|------------------|---|
|                                            | Average<br>Balance               | Interest | Average<br>Yield |   | Average<br>Balance               | Interest | Average<br>Yield |   |
| Assets:                                    |                                  |          |                  |   |                                  |          |                  |   |
| Federal Funds Sold/Short-Term Investments  | 8,223                            | 6        | 0.29             | % | 66,805                           | 46       | 0.28             | % |
| Investment Securities:                     |                                  |          |                  |   |                                  |          |                  |   |
| Taxable                                    | 129,888                          | 790      | 2.43             | % | 180,121                          | 1,059    | 2.35             | % |
| Tax-exempt (4)                             | 80,121                           | 785      | 3.92             | % | 91,394                           | 872      | 3.82             | % |
| Total                                      | 210,009                          | 1,575    | 3.00             | % | 271,515                          | 1,931    | 2.84             | % |
| Loan Portfolio: (1)                        |                                  |          |                  |   |                                  |          |                  |   |
| Construction                               | 96,898                           | 1,539    | 6.37             | % | 75,432                           | 1,363    | 7.25             | % |
| Residential real estate                    | 43,904                           | 463      | 4.23             | % | 49,348                           | 505      | 4.10             | % |
| Home Equity                                | 22,460                           | 267      | 4.77             | % | 23,975                           | 352      | 5.89             | % |
| Commercial and commercial real estate      | 292,497                          | 4,199    | 5.76             | % | 279,260                          | 4,158    | 5.97             | % |
| Mortgage warehouse lines                   | 217,199                          | 2,360    | 4.36             | % | 108,601                          | 1,253    | 4.63             | % |
| Installment                                | 505                              | 6        | 4.77             | % | 269                              | 4        | 5.96             | % |
| All Other Loans                            | 32,200                           | 404      | 5.03             | % | 18,394                           | 235      | 5.12             | % |
| Total                                      | 705,663                          | 9,238    | 5.25             | % | 555,279                          | 7,870    | 5.68             | % |
| Total Interest-Earning Assets              | 923,895                          | 10,819   | 4.70             | % | 893,600                          | 9,847    | 4.42             | % |
| Allowance for Loan Losses                  | (7,698                           | )        |                  |   | (7,361                           | )        |                  |   |
| Cash and Due From Bank                     | 7,680                            |          |                  |   | 15,111                           |          |                  |   |
| Other Assets                               | 63,073                           |          |                  |   | 59,536                           |          |                  |   |
| Total Assets                               | 986,950                          |          |                  |   | 960,886                          |          |                  |   |
| Liabilities and Shareholders' Equity:      |                                  |          |                  |   |                                  |          |                  |   |
| Money Market and NOW Accounts              | 304,755                          | 250      | 0.33             | % | 292,375                          | 239      | 0.33             | % |
| Savings Accounts                           | 198,252                          | 230      | 0.47             | % | 204,238                          | 227      | 0.45             | % |
| Certificates of Deposit                    | 152,253                          | 432      | 1.14             | % | 175,815                          | 506      | 1.15             | % |
| Other Borrowed Funds                       | 51,085                           | 153      | 1.20             | % | 22,357                           | 128      | 2.30             | % |
| Trust Preferred Securities                 | 18,557                           | 88       | 1.90             | % | 18,557                           | 86       | 1.85             | % |
| Total Interest-Bearing Liabilities         | 724,902                          | 1,153    | 0.64             | % | 713,342                          | 1,186    | 0.67             | % |
| Net Interest Spread (2)                    |                                  |          | 4.06             | % |                                  |          | 3.75             | % |
| Demand Deposits                            | 163,223                          |          |                  |   | 158,604                          |          |                  |   |
| Other Liabilities                          | 8,975                            |          |                  |   | 6,899                            |          |                  |   |
| Total Liabilities                          | 897,100                          |          |                  |   | 878,845                          |          |                  |   |
| Shareholders' Equity                       | 89,850                           |          |                  |   | 82,042                           |          |                  |   |
| Total Liabilities and Shareholders' Equity | 986,950                          |          |                  |   | 960,887                          |          |                  |   |
| Net Interest Margin (3)                    |                                  | 9,666    | 4.19             | % |                                  | 8,661    | 3.89             | % |

Loan origination fees are considered an adjustment to interest income. For the purpose of calculating loan yields, average loan balances include non-accrual loans with no related interest income and the average balance of loans (1) held for sale. Please refer to Management's Discussion and Analysis of Financial Condition and Results of Operation under the heading "Non-Performing Assets" for a discussion of the Bank's policy with regard to non-accrual loans.

- (2) The net interest rate spread is the difference between the average yield on interest-earning assets and the average rate paid on interest-bearing liabilities.
- (3) The net interest margin is equal to net interest income divided by average interest earning assets.
- (4) Tax- equivalent basis.



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|                                            | Six months ended June 30, 2015 |          |                  |   | Six months ended June 30, 2014 |          |                  |   |
|--------------------------------------------|--------------------------------|----------|------------------|---|--------------------------------|----------|------------------|---|
|                                            | Average<br>Balance             | Interest | Average<br>Yield |   | Average<br>Balance             | Interest | Average<br>Yield |   |
| Assets:                                    |                                |          |                  |   |                                |          |                  |   |
| Federal Funds Sold/Short-Term Investments  | 24,420                         | 31       | 0.26             | % | 81,500                         | 101      | 0.25             | % |
| Investment Securities:                     |                                |          |                  |   |                                |          |                  |   |
| Taxable                                    | 131,611                        | 1,607    | 2.44             | % | 182,440                        | 2,181    | 2.39             | % |
| Tax-exempt (4)                             | 84,867                         | 1,645    | 3.88             | % | 85,521                         | 1,772    | 4.14             | % |
| Total                                      | 216,478                        | 3,252    | 3.00             | % | 267,961                        | 3,953    | 2.95             | % |
| Loan Portfolio: (1)                        |                                |          |                  |   |                                |          |                  |   |
| Construction                               | 96,944                         | 3,080    | 6.41             | % | 67,765                         | 2,382    | 7.09             | % |
| Residential real estate                    | 44,797                         | 937      | 4.22             | % | 42,370                         | 839      | 3.99             | % |
| Home Equity                                | 22,305                         | 506      | 4.57             | % | 21,420                         | 565      | 5.32             | % |
| Commercial and commercial real estate      | 290,985                        | 8,195    | 5.68             | % | 253,562                        | 7,473    | 5.94             | % |
| Mortgage warehouse lines                   | 186,682                        | 4,079    | 4.41             | % | 100,277                        | 2,333    | 4.69             | % |
| Installment                                | 443                            | 11       | 5.01             | % | 272                            | 8        | 5.93             | % |
| All Other Loans                            | 28,996                         | 719      | 5.00             | % | 20,383                         | 508      | 5.03             | % |
| Total                                      | 671,152                        | 17,527   | 5.27             | % | 506,049                        | 14,108   | 5.62             | % |
| Total Interest-Earning Assets              | 912,050                        | 20,810   | 4.60             | % | 855,510                        | 18,162   | 4.28             | % |
| Allowance for Loan Losses                  | (7,467                         | )        |                  |   | (7,550                         | )        |                  |   |
| Cash and Due From Bank                     | 10,127                         |          |                  |   | 16,412                         |          |                  |   |
| Other Assets                               | 62,664                         |          |                  |   | 56,383                         |          |                  |   |
| Total Assets                               | 977,374                        |          |                  |   | 920,755                        |          |                  |   |
| Liabilities and Shareholders' Equity:      |                                |          |                  |   |                                |          |                  |   |
| Money Market and NOW Accounts              | 306,486                        | 506      | 0.33             | % | 273,839                        | 447      | 0.33             | % |
| Savings Accounts                           | 196,889                        | 455      | 0.47             | % | 201,985                        | 450      | 0.45             | % |
| Certificates of Deposit                    | 157,809                        | 883      | 1.13             | % | 168,365                        | 974      | 1.17             | % |
| Other Borrowed Funds                       | 36,524                         | 279      | 1.54             | % | 19,146                         | 243      | 2.56             | % |
| Trust Preferred Securities                 | 18,557                         | 174      | 1.86             | % | 18,557                         | 171      | 1.83             | % |
| Total Interest-Bearing Liabilities         | 716,265                        | 2,297    | 0.65             | % | 681,892                        | 2,285    | 0.68             | % |
| Net Interest Spread (2)                    |                                |          | 3.95             | % |                                |          | 3.60             | % |
| Demand Deposits                            | 163,516                        |          |                  |   | 152,619                        |          |                  |   |
| Other Liabilities                          | 8,677                          |          |                  |   | 7,292                          |          |                  |   |
| Total Liabilities                          | 888,458                        |          |                  |   | 841,803                        |          |                  |   |
| Shareholders' Equity                       | 88,916                         |          |                  |   | 78,952                         |          |                  |   |
| Total Liabilities and Shareholders' Equity | 977,374                        |          |                  |   | 920,755                        |          |                  |   |
| Net Interest Margin (3)                    |                                | 18,513   | 4.09             | % |                                | 15,877   | 3.74             | % |

Loan origination fees are considered an adjustment to interest income. For the purpose of calculating loan yields, average loan balances include non-accrual loans with no related interest income and includes the average balance (1) of loans held for sale. Please refer to Management's Discussion and Analysis of Financial Condition and Results of Operation under the heading "Non-Performing Assets" for a discussion of the Bank's policy with regard to non-accrual loans.

- (2) The net interest rate spread is the difference between the average yield on interest-earning assets and the average rate paid on interest-bearing liabilities.
- (3) The net interest margin is equal to net interest income divided by average interest earning assets.
- (4) Tax- equivalent basis.

Three months ended June 30, 2015 compared to three months ended June 30, 2014

The Company's net interest income increased on a tax-equivalent basis by \$1.0 million, or 11.6%, to \$9.7 million for the three months ended June 30, 2015 from \$8.7 million reported for the three months ended June 30, 2014. The increase in the Company's net interest income for the three months ended June 30, 2015 compared to the comparable 2014 period was due primarily to the growth of the loan portfolio, the higher proportion of average loans to average assets, which generated the higher yield on earning assets, and lower rates paid on interest-bearing liabilities.

The net interest margin (on a tax-equivalent basis), which is net interest income divided by average interest-earning assets, was 4.19% for the three months ended June 30, 2015 compared to 3.89% the three months ended June 30, 2014.

Average interest-earning assets increased by \$30.3 million, or 3.4%, to \$923.9 million for the three month period ended June 30, 2015 from \$893.6 million for the three month period ended June 30, 2014. The overall yield on interest-earning assets, on a tax-equivalent basis, increased 28 basis points to 4.70% for the three month period ended June 30, 2015 when compared to 4.42% for the three month period ended June 30, 2014 due primarily to the increase in the average balance of the loan portfolio in the quarter ended June 30, 2015. The growth of the average balance of the loan portfolio in the quarter ended June 30, 2015 was due primarily to the growth in Mortgage Warehouse, Construction and Commercial Real Estate loans compared to the quarter ended June 30, 2014.

Average interest-bearing liabilities increased by \$11.6 million, or 1.6%, to \$724.9 million for the three month period ended June 30, 2015 from \$713.3 million for the three month period ended June 30, 2014 due primarily to increases in Money Market and NOW Accounts and Borrowed Funds, which were partially offset by decreases in Savings Accounts and Certificates of Deposit. Overall, the cost of total interest-bearing liabilities decreased 3 basis points to 0.64% for the three months ended June 30, 2015 from 0.67% for the three months ended June 30, 2014.

Six months ended June 30, 2015 compared to six months ended June 30, 2014

For the six months ended June 30, 2015, the Company's net interest income increased on a tax-equivalent basis by \$2.6 million, or 16.6%, to \$18.5 million compared to \$15.9 million for the six months ended June 30, 2014. This increase was due primarily to the growth of the loan portfolio, an increase in the average yield on interest-earning assets and lower rates paid on interest-bearing liabilities.

For the six months ended June 30, 2015, the net interest margin was 4.09% compared to 3.74% for the six months ended June 30, 2014.

Average interest-earning assets increased by \$56.5 million, or 6.6%, to \$912.1 million for the six month period ended June 30, 2015 from \$855.5 million for the six month period ended June 30, 2014. The overall yield on interest-earning assets, on a tax-equivalent basis, increased 32 basis points to 4.60% for the six month period ended June 30, 2015 compared to 4.28% for the six month ended June 30, 2014 primarily due to the \$165.1 million increase in the average balance of the loan portfolio during the six months ended June 30, 2015.

Average interest-bearing liabilities increased by \$34.4 million or 5.0% to \$716.3 million for the six month period ended June 30, 2015 compared to \$681.9 million for the six months ended June 30, 2014 due primarily to increases in Money Market and NOW Accounts and Borrowed Funds. The total cost of interest-bearing liabilities decreased by 3 basis points to 0.65% for the six months ended June 30, 2015 from 0.68% for the six months ended June 30, 2014.

#### Provision for Loan Losses

Three months ended June 30, 2015 compared to three months ended June 30, 2014

Management considers a complete review of the following specific factors in determining the provisions for loan losses: historical losses by loan category, the level of non-accrual loans and problem loans as identified through internal review and classification, collateral values, and the growth and size of the loan portfolio.

In addition to these factors, management takes into consideration current economic conditions and the local real estate market conditions. On the basis of this evaluation process, the insignificant level of net charge-offs, the Bank's stable loan quality trends over the last four quarters and management's judgment that the loan loss reserve factors should be reduced to reflect these trends, the Company did not record a provision for loan losses for the three months ended June 30, 2015. The loan loss reserve factors were reduced by five basis points (0.05%) across all loan portfolio segments. The lower loan loss reserve factors reduced the provision for loan losses for the second quarter of 2015 by approximately \$320,000.

The provision for loan losses was \$4.1 million for the three months ended June 30, 2014 and included \$3.7 million for the full charge-off and replenishment of the allowance for the loss on a loan due to the fraudulent misrepresentations of a borrower and its principals.

At June 30, 2015, non-performing loans decreased by \$210,000, or 4.3%, to \$4.6 million from \$4.8 million at December 31, 2014 and the ratio of non-performing loans to total loans was 0.61% at June 30, 2015 compared to 0.74% at December 31, 2014.

Six months ended June 30, 2015 compared to six months ended June 30, 2014

The provision for loan losses was \$500,000 for the six months ended June 30, 2015 compared to \$4.6 million for the six months ended June 30, 2014. The lower provision for loan losses for the first six months of 2015 reflected a significantly lower level of net charge-offs of \$74,000 compared to net charge-offs of \$4.2 million for the first six months of 2014. The higher level of net charge-offs in the 2014 period included \$3.7 million of net charge-offs related to the loss on a loan due to fraudulent misrepresentations described above. Non-performing loans declined to \$4.6 million at June 30, 2015 compared to \$4.8 million at December 31, 2014 and \$8.3 million at June 30, 2014.

#### Non-Interest Income

Three months ended June 30, 2015 compared to three months ended June 30, 2014

Total non-interest income for the three months ended June 30, 2015 was \$1.6 million, an increase of \$358,000, or 28.4%, compared to non-interest income of \$1.3 million for the three months ended June 30, 2014. This increase was due principally to higher gains on the sale of loans.

Service charge revenues decreased to \$190,000 for the three months ended June 30, 2015 from \$267,000 for the three months ended June 30, 2014. This decrease was the result of a lower volume of uncollected funds and overdraft fees collected on deposit accounts during the second quarter of 2015 compared to the second quarter of 2014.

Gain on sales of loans originated for sale increased by \$565,000 to \$832,000 for the three months ended June 30, 2015 compared to \$267,000 for the three months ended June 30, 2014. The Bank sells both loans guaranteed by the Small Business Administration ("SBA") and residential mortgage loans in the secondary market. SBA loan sales were \$5.2 million and generated gains on sales of loans of \$518,000, and SBA commercial loan originations were \$3.6 million during the second quarter of 2015. Gains on the sale of SBA loans were \$156,000 in the second quarter of 2014.

During the second quarter of 2015, the Bank's residential mortgage banking operation originated \$43.3 million of residential mortgages and sold \$43.8 million of residential mortgage loans, which generated gains from the sales of loans of \$314,000 compared to gains of \$111,000 in the second quarter of 2014. At June 30, 2015, the pipeline of residential mortgage loans in process was \$68.8 million. The current lower interest rate environment for mortgage loans resulted in higher demand for mortgage financings, which generated the higher volume of mortgage loan originations for the three months ended June 30, 2015 compared to the three months ended June 30, 2014.

Non-interest income also includes income from bank-owned life insurance ("BOLI"), which amounted to \$143,000 for the three months ended June 30, 2015 compared to \$149,000 for the three months ended June 30, 2014.

The Bank also generates non-interest income from a variety of fee-based services. These include safe deposit box rental fees, wire transfer service fees and Automated Teller Machine fees for non-Bank customers. The other income

component of non-interest

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income decreased to \$453,000 for the three months ended June 30, 2015 compared to \$577,000 for the three months ended June 30, 2014 due to lower transaction activity.

Six months ended June 30, 2015 compared to six months ended June 30, 2014

Total non-interest income for the six months ended June 30, 2015 was \$3.5 million, an increase of \$649,000, or 22.4%, compared to non-interest income of \$2.9 million for the six months ended June 30, 2014. This increase was due principally to higher gains on the sale of loans.

Service charge revenues decreased to \$429,000 for the six months ended June 30, 2015 from \$486,000 for the six months ended June 30, 2014. This decrease was the result of a lower volume of uncollected funds and overdraft fees collected on deposit accounts.

Gain on sales of loans originated for sale increased by \$872,000 to \$1.9 million for the six months ended June 30, 2015 compared to \$1.0 million for the six months ended June 30, 2014. The Bank sells both loans guaranteed by the SBA and residential mortgage loans in the secondary market. SBA loan sales were \$11.9 million and generated gains on sales of loans of \$1.2 million. SBA commercial loan originations were \$13.3 million during the six months ended June 30, 2015. Gains on sales of SBA loans were \$724,000 for the six months ended June 30, 2014.

For the six months ended June 30, 2015, the Bank's residential mortgage banking operation originated \$78.5 million of residential mortgages and sold \$77.7 million of residential mortgage loans, which generated gains from the sales of loans of \$677,000. Gains on sales of residential mortgages were \$283,000 for the six months ended June 30, 2014.

Non-interest income also includes income from BOLI, which amounted to \$276,000 for the six months ended June 30, 2015 compared to \$278,000 for the six months ended June 30, 2014.

The Bank also generates non-interest income from a variety of fee-based services. These include safe deposit box rental fees, wire transfer service fees and Automated Teller Machine fees for non-Bank customers. The other income component of non-interest income decreased to \$962,000 for the six months ended June 30, 2015 compared to \$1.1 million for the six months ended June 30, 2014 due to lower transaction activity.

#### Non-Interest Expense

Non-interest expenses were \$7.6 million for the three months ended June 30, 2015, an increase of \$1.0 million compared to \$6.6 million for the second quarter of 2014, excluding the effect of the Rumson merger expense.

Approximately \$382,000 of the increase in non-interest expenses in the second quarter of 2015 reflected the write-down of one OREO property to the net realizable value of the contract for sale that was pending at June 30, 2015. The sale of this property was completed in July, 2015.

Non-interest expenses were \$14.3 million for the six months ended June 30, 2015, an increase of \$1.7 million, or 13.9%, compared to \$12.5 million for the six months ended June 30, 2014, excluding the effect of the Rumson merger expense. As explained above, \$382,000 of the increase for the six months ended June 30, 2015 reflects the write-down of one OREO property and approximately \$233,000 of the increase reflects the inclusion of the former Rumson operations for the entire first quarter of 2015 compared to only a portion of the first quarter of 2014.

The following table presents the major components of non-interest expenses for the three and six months ended June 30, 2015 and 2014.

## Non-interest Expenses

| (Dollars in thousands)                  | Three months ended June 30, |         | Six months ended June 30, |          |
|-----------------------------------------|-----------------------------|---------|---------------------------|----------|
|                                         | 2015                        | 2014    | 2015                      | 2014     |
| Salaries and employee benefits          | \$4,108                     | \$3,685 | \$8,049                   | \$7,273  |
| Occupancy expenses                      | 859                         | 839     | 1,800                     | 1,665    |
| Data processing services                | 306                         | 312     | 625                       | 628      |
| FDIC insurance expense                  | 180                         | 185     | 370                       | 335      |
| Other real estate owned expenses        | 416                         | 98      | 513                       | 140      |
| Merger-related expenses                 | —                           | 109     | —                         | 1,532    |
| Equipment expense                       | 240                         | 236     | 458                       | 420      |
| Marketing                               | 73                          | 84      | 203                       | 154      |
| Regulatory, professional and other fees | 743                         | 460     | 1,020                     | 667      |
| Directors' fees                         | 20                          | 22      | 48                        | 46       |
| Amortization of intangible assets       | 116                         | 121     | 224                       | 224      |
| Other expenses                          | 541                         | 555     | 948                       | 968      |
| Total                                   | \$7,602                     | \$6,706 | \$14,258                  | \$14,052 |

Three months ended June 30, 2015 compared to three months ended June 30, 2014

Salaries and employee benefits, which represent the largest portion of non-interest expenses, increased by \$423,000, or 11.5%, to \$4.1 million for the three months ended June 30, 2015 compared to \$3.7 million for the three months ended June 30, 2014. The increase in salaries and employee benefits for the three months ended June 30, 2015 was a result of an increase in the number of employees, regular merit increases and increased health care costs. Full time equivalent employees at June 30, 2015 increased to 181 as compared to 179 full time equivalent employees at June 30, 2014.

Occupancy expenses increased by \$20,000, or 2.4%, to \$859,000 for the three months ended June 30, 2015 compared to \$839,000 for the three months ended June 30, 2014. The increase for the quarter ended June 30, 2015 compared to the quarter ended June 30, 2014 resulted primarily from an increase in building maintenance expense, which was partially offset by decreases in rent expense and leasehold depreciation expense.

The cost of data processing services decreased slightly to \$306,000 for the three months ended June 30, 2015 from \$312,000 for the three months ended June 30, 2014, reflecting the cost containment and operating scale obtained through the integration of the former Rumson operations.

FDIC insurance expense decreased to \$180,000 for the three months ended June 30, 2015 compared to \$185,000 for the three months ended June 30, 2014 primarily as a result of the lower assessment rate for FDIC insurance premiums. The assessment rate decreased during the second quarter of 2015 compared to 2014 due primarily to the lower level of charge-offs and non-performing assets and a higher ratio of net income before taxes to risk weighted assets in the second quarter of 2015 and the two immediately preceding quarters.

Other real estate owned expenses increased by \$318,000 to \$416,000 for the three months ended June 30, 2015 compared to \$98,000 for the three months ended June 30, 2014 primarily due to the write-down of \$382,000 of one OREO property to the net realizable value of a contract for sale that was pending at June 30, 2015. At June 30, 2015, the Company held three properties with an aggregate value of \$5.3 million as other real estate owned compared to one property with an aggregate value of \$1.9 million at June 30, 2014.

Regulatory, professional and other fees increased by \$283,000, or 61.5%, to \$743,000 for the three months ended June 30, 2015 compared to \$460,000 for the three months ended June 30, 2014 due to higher legal fees incurred in pursuing the potential recovery of the loss on a loan that was a result of fraudulent misrepresentations by the borrower and its principals.

Other expenses decreased by \$14,000 to \$541,000 for the three months ended June 30, 2015 compared to \$555,000 for the three months ended June 30, 2014 as a result of decreases in correspondent bank fees, maintenance agreements and ATM operating expenses. All other expenses are also comprised of a variety of operating expenses, as well as expenses associated with lending activities.





Six months ended June 30, 2015 compared to six months ended June 30, 2014

Salaries and employee benefits, which represent the largest portion of non-interest expenses, increased by \$776,000, or 10.7%, to \$8.0 million for the six months ended June 30, 2015 compared to \$7.3 million for the six months ended June 30, 2014. Approximately \$115,000 of the increase was due to the inclusion of the former Rumson operations for the entire first quarter of 2015 compared to a portion of the first quarter of 2014. The balance of the increase in salaries and employee benefits was a result of an increase in the number of employees, regular merit increases and increased health care costs.

Occupancy expenses increased by \$135,000, or 8.1%, to \$1.8 million for the six months ended June 30, 2015 compared to \$1.7 million for the six months ended June 30, 2014. The increase in occupancy expense resulted primarily from an increase in building maintenance expense related to the costs of the five properties acquired in the Rumson merger in the first quarter of 2014, which was partially offset by decreases in rent expense and leasehold depreciation expense.

The cost of data processing services decreased slightly to \$625,000 for the six months ended June 30, 2015 from \$628,000 for the six months ended June 30, 2014, reflecting the cost containment and operating scale obtained through the integration of the former Rumson operations.

FDIC insurance expense increased to \$370,000 for the six months ended June 30, 2015 compared to \$335,000 for the six months ended June 30, 2014 primarily as a result of the increase in assets at June 30, 2015 compared to June 30, 2014.

Other real estate owned expenses increased by \$373,000 to \$513,000 for the six months ended June 30, 2015 compared to \$140,000 for the six months ended June 30, 2014 primarily due to the write-down of one OREO property of \$382,000 to the net realizable value of a contract for sale that was pending at June 30, 2015.

Regulatory, professional and other fees increased by \$353,000, or 53%, to \$1.0 million for the six months ended June 30, 2015 compared to \$667,000 for the six months ended June 30, 2014 due to higher legal fees incurred in pursuing the potential recovery of the loss on a loan that was a result of fraudulent misrepresentations by the borrower and its principals.

Other expenses decreased \$20,000 to \$948,000 for the six months ended June 30, 2015 compared to \$968,000 for the six months ended June 30, 2014 as a result of decreases in correspondent bank fees, maintenance agreements and ATM operating expenses. All other expenses are also comprised of a variety of operating expenses, as well as expenses associated with lending activities.

#### Income Taxes

Three months ended June 30, 2015 compared to three months ended June 30, 2014

Pre-tax income increased to \$3.4 million for the three months ended June 30, 2015 compared to a pre-tax loss of \$1.2 million for the three months ended June 30, 2014.

The Company recorded income tax expense of \$1.1 million for the three months ended June 30, 2015, which resulted in an effective tax rate of 32.4% compared to an income tax benefit of \$728,000 and a net tax benefit rate of 62.3% for the three months ended June 30, 2014. The increase in income tax expense for the three months ended June 30, 2015 was primarily due to the significantly higher amount of pre-tax income in the period compared to the net loss before taxes for the three months ended June 30, 2014. The high effective tax benefit rate for the three months ended June 30, 2014 was due primarily to the amount of tax-exempt income relative to the pre-tax loss for that quarter.

Six months ended June 30, 2015 compared to six months ended June 30, 2014

Pre-tax income increased to \$6.7 million for the six months ended June 30, 2015 compared to a pre-tax loss of \$480,000 for the six months ended June 30, 2014.

The Company recorded income tax expense of \$2.2 million for the six months ended June 30, 2015, which resulted in an effective tax rate of 32.1% compared to an income tax benefit of \$682,000 and a net tax benefit rate of 142% for the six months ended June



30, 2014. The high effective tax benefit rate for the six months ended June 30, 2014 was due primarily to the amount of tax exempt income relative to the pre-tax loss for the period.

#### Financial Condition

##### June 30, 2015 Compared with December 31, 2014

Total consolidated assets at June 30, 2015 were \$1.05 billion, representing an increase of \$90.1 million, or 9.4%, from total consolidated assets of \$956.8 million at December 31, 2014. The increase in assets was primarily attributable to a \$104.2 million increase in loans, which was primarily funded by a \$105.6 million increase in FHLB borrowings.

##### Cash and Cash Equivalents

Cash and cash equivalents at June 30, 2015 totaled \$16.4 million compared to \$14.5 million at December 31, 2014, an increase of \$1.8 million or 12.5%. To the extent that the Bank did not utilize the funds for loan originations or securities purchases, the cash inflows accumulated in cash and cash equivalents.

##### Loans Held for Sale

Loans held for sale at June 30, 2015 were \$9.2 million compared to \$8.4 million at December 31, 2014. As indicated in the Consolidated Statements of Cash Flows, the amount of mortgage loans originated for sale was \$78.5 million for the six months ended June 30, 2015 compared to \$39.8 million for the six months ended June 30, 2014. The decrease in long-term market interest rates that occurred during late 2014 and continued into 2015 increased the demand for mortgage loan financings during the first six months of 2015. The amount of loans held for sale varies from period to period due to changes in the amount and timing of sales of residential mortgages.

### Investment Securities

Investment securities represented approximately 20% of total assets at June 30, 2015 and approximately 23% of total assets at December 31, 2014. Total investment securities decreased \$16.6 million, or 7.4%, to \$207.2 million at June 30, 2015 from \$223.8 million at December 31, 2014. Purchases of investment securities totaled \$14.6 million during the six months ended June 30, 2015, and proceeds from calls, maturities and repayments totaled \$30.1 million during the period.

Securities available for sale are investments that may be sold in response to changing market and interest rate conditions or for other business purposes. Activity in this portfolio is undertaken primarily to manage liquidity and interest rate risk and to take advantage of market conditions that create more economically attractive returns. At June 30, 2015, securities available for sale totaled \$80.6 million, an increase of \$415,000, or 0.5%, compared to securities available for sale totaling \$80.2 million at December 31, 2014.

At June 30, 2015, the securities available for sale portfolio had net unrealized losses of \$192,000 compared to net unrealized gains of \$427,000 at December 31, 2014. These unrealized gains (losses) were reflected, net of tax, in shareholders' equity as a component of accumulated other comprehensive income.

Securities held to maturity, which are carried at amortized historical cost, are investments for which there is the positive intent and ability to hold to maturity. At June 30, 2015, securities held to maturity were \$126.7 million, a decrease of \$16.9 million from \$143.6 million at December 31, 2014. The fair value of the held to maturity portfolio at June 30, 2015 was \$130.3 million.

### Loans

The loan portfolio, which represents the Bank's largest asset, is a significant source of both interest and fee income. Elements of the loan portfolio are subject to differing levels of credit and interest rate risk. The Bank's primary lending focus continues to be mortgage warehouse lines, construction loans, commercial loans, owner-occupied commercial mortgage loans and commercial real estate loans on income producing assets.

The following table represents the components of the loan portfolio at June 30, 2015 and December 31, 2014.

#### Loan Portfolio Composition

(Dollars in thousands)

| Component                     | June 30, 2015 |     | December 31, 2014 |     |   |
|-------------------------------|---------------|-----|-------------------|-----|---|
|                               | Amount        | %   | Amount            | %   |   |
| Construction loans            | \$98,307      | 13  | % \$95,627        | 15  | % |
| Residential real estate loans | 42,826        | 6   | % 46,446          | 7   | % |
| Commercial business           | 107,529       | 14  | % 110,771         | 17  | % |
| Commercial real estate        | 205,487       | 27  | % 198,211         | 30  | % |
| Mortgage warehouse lines      | 279,664       | 37  | % 179,172         | 27  | % |
| Loans to individuals          | 23,329        | 3   | % 23,156          | 4   | % |
| Deferred loan costs           | 1,149         | —   | % 715             | —   | % |
| All other loans               | 215           | —   | % 199             | —   | % |
|                               | \$758,506     | 100 | % \$654,297       | 100 | % |

The loan portfolio increased by \$104.2 million, or 15.9%, to \$758.5 million at June 30, 2015 compared to \$654.3 million at December 31, 2014.

Mortgage warehouse lines outstanding increased \$100.5 million, reflecting higher levels of residential mortgage originations by the Bank's mortgage banking customers that was due to the seasonal home buying market and favorable residential mortgage market interest rates. The growth of this portfolio segment was the primary driver of the increase in the loan portfolio.

The Bank's Mortgage Warehouse Funding Group offers revolving lines of credit that are available to licensed mortgage banking companies. The warehouse line of credit is used by the mortgage banker to finance the origination of one-to-four family residential mortgage loans that are pre-sold to the secondary mortgage market, which includes state and national banks, national mortgage banking firms, insurance companies and government-sponsored enterprises, including the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and the Government National Mortgage Association. On average, an advance under the warehouse line of credit remains

outstanding for a period of less than 30 days, with repayment coming directly from the sale of the loan into the secondary mortgage market. Interest and a transaction fee are collected by the Bank at the time of repayment. Additionally, customers of the warehouse line of credit are required to maintain deposit relationships with the Bank that, on average, represent 10% to 12% of the loan balances.

Commercial business loans decreased slightly during the first six months of 2015. Commercial loans consist primarily of loans to small and middle market businesses and are typically working capital loans used to finance inventory, receivables or equipment needs. These loans are generally secured by business assets of the commercial borrower. Commercial real estate loans increased \$7.3 million, or 3.7% during the first six months of 2015. Commercial real estate loans consist primarily of loans to businesses collateralized by real estate employed in the business and loans to finance income producing properties.

Construction loans increased \$2.7 million, or 2.8%, during the first six months of 2015. Construction financing is provided to businesses to expand their facilities and operations and to real estate developers for the acquisition, development and construction of residential properties primarily and income producing properties secondarily. First mortgage construction loans are made to developers and builders primarily for single family homes or smaller multi-family buildings (less than ten units) that are presold, or are to be sold or leased on a speculative basis. The Bank lends to developers and builders with established relationships, successful operating histories and sound financial resources.

The Bank also finances the construction of individual, owner-occupied single family homes. These loans are made to qualified individual borrowers and are generally supported by a take-out commitment from a permanent lender. The ability of the Company to enter into larger loan relationships and management's philosophy of relationship banking are key factors in the Company's strategy for loan growth. The ultimate collectability of the loan portfolio and recovery of the carrying amount of real estate are subject to changes in the economic environment and real estate market in the Company's market region.

#### Non-Performing Assets

Non-performing assets consist of non-performing loans and other real estate owned. Non-performing loans are composed of (1) loans on a non-accrual basis and (2) loans which are contractually past due 90 days or more as to interest and principal payments but which have not been classified as non-accrual. Included in non-accrual loans are loans whose terms have been restructured to provide a reduction or deferral of interest and/or principal because of deterioration in the financial position of the borrower and which have not performed in accordance with the restructured terms.

The Bank's policy with regard to non-accrual loans is that generally, loans are placed on a non-accrual status when they are 90 days past due, unless these loans are well secured and in the process of collection or, regardless of the past due status of the loan, when management determines that the complete recovery of principal or interest is in doubt. Consumer loans are generally charged off after they become 120 days past due. Subsequent payments on loans in non-accrual status are credited to income only if collection of principal is not in doubt.

Non-accrual loans increased \$107,000 to \$4.6 million at June 30, 2015 from \$4.5 million at December 31, 2014. The major segments of non-accrual loans consist of commercial real estate loans and residential real estate loans, which are in the process of collection. The table below sets forth non-performing assets and risk elements in the Bank's portfolio for the periods indicated.

Non-performing loans to total loans decreased to 0.61% at June 30, 2015 from 0.74% at December 31, 2014 principally due to the increase in total loans. Loan quality is considered to be sound. This was accomplished through quality loan underwriting, a

proactive approach to loan monitoring and aggressive workout strategies.

| Non-Performing Assets and Loans<br>(Dollars in thousands)                               | June 30,<br>2015 | December 31,<br>2014 |  |   |
|-----------------------------------------------------------------------------------------|------------------|----------------------|--|---|
| Non-Performing loans:                                                                   |                  |                      |  |   |
| Loans 90 days or more past due and still accruing                                       | \$—              | \$317                |  |   |
| Non-accrual loans                                                                       | 4,630            | 4,523                |  |   |
| Total non-performing loans                                                              | 4,630            | 4,840                |  |   |
| Other real estate owned                                                                 | 5,328            | 5,710                |  |   |
| Other repossessed assets                                                                | 66               | 66                   |  |   |
| Total non-performing assets                                                             | 10,024           | 10,616               |  |   |
| Performing troubled debt restructurings                                                 | 3,954            | 3,925                |  |   |
| Performing troubled debt restructurings and total non-performing assets                 | \$13,978         | \$14,541             |  |   |
| Non-performing loans to total loans                                                     | 0.61             | % 0.74               |  | % |
| Non-performing loans to total loans excluding mortgage warehouse lines                  | 0.97             | % 1.02               |  | % |
| Non-performing assets to total assets                                                   | 0.96             | % 1.11               |  | % |
| Non-performing assets to total assets excluding mortgage warehouse lines                | 1.31             | % 1.37               |  | % |
| Total non-performing assets and performing troubled debt restructurings to total assets | 1.34             | % 1.52               |  | % |

Non-performing assets decreased by \$592,000 to \$10.0 million at June 30, 2015 from \$10.6 million at December 31, 2014. Other real estate owned totaled \$5.3 million at June 30, 2015 compared to \$5.7 million at December 31, 2014. At June 30, 2015, one OREO property with a carrying amount of \$1.4 million was under contract for sale. The sale of the property was completed in July, 2015.

At June 30, 2015, the Bank had ten loans totaling \$4.5 million which were troubled debt restructurings. Three of these loans totaling \$480,000 are included in the above table as non-accrual loans; the remaining seven loans totaling \$4.0 million are considered performing.

As provided by ASC 310-30, the excess of cash flows expected at acquisition over the initial investment in the loan is recognized as interest income over the life of the loan. Accordingly, loans acquired in the Rumson merger with evidence of deteriorated credit quality of \$2.0 million at June 30, 2015 were not classified as non-performing loans. Non-performing assets represented 0.96% of total assets at June 30, 2015 and 1.11% of total assets at December 31, 2014.

Management takes a proactive approach in addressing delinquent loans. The Company's President and Chief Executive Officer meets weekly with all loan officers to review the status of credits past-due 10 days or more. An action plan is discussed for delinquent loans to determine the steps necessary to induce the borrower to cure the delinquency and restore the loan to a current status. Also, delinquency notices are system-generated when loans are five days past-due and again at 15 days past-due.

In most cases, the Company's collateral is real estate. If the collateral is foreclosed upon, the real estate is carried at fair market value less the estimated selling costs. The amount, if any, by which the recorded amount of the loan exceeds the fair market value of the collateral, less estimated selling costs, is a loss which is charged to the allowance for loan losses at the time of foreclosure or repossession. Resolution of a past-due loan can be delayed if the borrower files a bankruptcy petition because a collection action cannot be continued unless the Company first obtains relief from the automatic stay provided by the bankruptcy code.

#### Allowance for Loan Losses and Related Provision

The allowance for loan losses is maintained at a level sufficient to absorb estimated credit losses in the loan portfolio as of the date of the financial statements. The allowance for loan losses is a valuation reserve available for losses incurred or inherent in the loan portfolio and other extensions of credit. The determination of the adequacy of the allowance for loan losses is a critical accounting policy of the Company.

The Company's primary lending emphasis is the origination of commercial and commercial real estate loans and mortgage warehouse lines of credit. Based on the composition of the loan portfolio, the inherent primary risks are

deteriorating credit quality, a decline in the economy, and a decline in New Jersey real estate market values. Any one, or a combination, of these events may adversely affect the loan portfolio and may result in increased delinquencies, loan losses and increased future provision levels.

All, or part, of the principal balance of commercial and commercial real estate loans and construction loans are charged off against the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely. Consumer loans are generally charged off no later than 120 days past due on a contractual basis, earlier in the event of bankruptcy, or if there



is an amount deemed uncollectible. Because all identified losses are charged off, no portion of the allowance for loan losses is restricted to any individual loan or groups of loans and the entire allowance is available to absorb any and all loan losses.

Management reviews the adequacy of the allowance on at least a quarterly basis to ensure that the provision for loan losses has been charged against earnings in an amount necessary to maintain the allowance at a level that is adequate based on management's assessment of probable estimated losses. The Company's methodology for assessing the adequacy of the allowance for loan losses consists of several key elements and is consistent with U.S. GAAP and interagency supervisory guidance. The allowance for loan losses methodology consists of two major components. The first component is an estimation of losses associated with individually identified impaired loans, which follows Accounting Standards Codification (ASC) Topic 310 (formerly SFAS 114). The second major component is an estimation of losses under ASC Topic 450 (formerly SFAS 5), which provides guidance for estimating losses on groups of loans with similar risk characteristics. The Company's methodology results in an allowance for loan losses which includes a specific reserve for impaired loans, an allocated reserve, and an unallocated portion.

When analyzing groups of loans under ASC 450, the Bank follows the Interagency Policy Statement on the Allowance for Loan and Lease Losses. The methodology considers the Company's historical loss experience adjusted for changes in trends, conditions, and other relevant factors that affect repayment of the loans as of the evaluation date. These adjustment factors, known as qualitative factors, include:

- Delinquencies and nonaccruals
- Portfolio quality
- Concentration of credit
- Trends in volume of loans
- Quality of collateral
- Policy and procedures
- Experience, ability, and depth of management
- Economic trends – national and local
- External factors – competition, legal and regulatory

The methodology includes the segregation of the loan portfolio into loan types with a further segregation into risk rating categories, such as special mention, substandard, doubtful and loss. This allows for an allocation of the allowance for loan losses by loan type; however, the allowance is available to absorb any loan loss without restriction. Larger-balance, non-homogeneous loans representing significant individual credit exposures are evaluated individually through the internal loan review process. It is this process that produces the watch list. The borrower's overall financial condition, repayment sources, guarantors and value of collateral, if appropriate, are evaluated. Based on these reviews, an estimate of probable losses for the individual larger-balance loans is determined, whenever possible, and used to establish specific loan loss reserves. In general, for non-homogeneous loans not individually assessed and for homogeneous groups of loans, such as residential mortgages and consumer credits, the loans are collectively evaluated based on delinquency status, loan type, and historical losses. These loan groups are then internally risk rated.

The watch list includes loans that are assigned a rating of special mention, substandard, doubtful and loss. Loans classified as special mention have potential weaknesses that deserve management's close attention. If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They include loans that are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified as doubtful have all the weaknesses inherent in loans classified as substandard with the added characteristic that collection or liquidation in full, on the basis of current conditions and facts, is highly improbable. Loans rated as doubtful in whole, or in part, are placed in nonaccrual status. Loans classified as a loss are considered uncollectible and are charged-off against the allowance for loan losses.

The specific allowance for impaired loans is established for specific loans which have been identified by management as being impaired. These loans are considered to be impaired primarily because the loans have not performed

according to payment terms and there is reason to believe that repayment of the loan principal in whole, or in part, is unlikely. The specific portion of the allowance is the total amount of potential unconfirmed losses for these individual impaired loans. To assist in determining the fair value of loan collateral, the Company often utilizes independent third party qualified appraisal firms, which employ their own criteria and assumptions that may include occupancy rates, rental rates, and property expenses, among others.

The second category of reserves consists of the allocated portion of the allowance. The allocated portion of the allowance is determined by taking pools of loans outstanding that have similar characteristics and applying historical loss experience for each pool. This estimate represents the potential unconfirmed losses within the portfolio.

Individual loan pools are created for commercial and commercial real estate loans, construction loans, warehouse lines of credit, and various types of loans to individuals. The historical estimation for each loan pool is then adjusted to account for current conditions, current loan portfolio performance, loan policy or management changes, or any other qualitative factor which may cause future losses to deviate from historical levels.

The Company also maintains an unallocated allowance. The unallocated allowance is used to cover any factors or conditions which may cause a potential loan loss but are not specifically identifiable. It is prudent to maintain an unallocated portion of the allowance because no matter how detailed an analysis of potential loan losses is performed, these estimates by definition lack precision. Management must make estimates using assumptions and information that is often subjective and changing rapidly.

The following discusses the risk characteristics of each of our loan portfolio segments-commercial, mortgage warehouse lines of credit, and consumer.

#### Commercial

The Company's primary lending emphasis is the origination of commercial and commercial real estate loans. Based on the composition of the loan portfolio, the inherent primary risks are deteriorating credit quality, a decline in the economy, and a decline in New Jersey real estate market values. Any one or a combination of these events may adversely affect the loan portfolio and may result in increased delinquencies, loan losses and increased future provision levels.

#### Mortgage Warehouse Lines of Credit

The Company's Mortgage Warehouse Unit provides revolving lines of credit that are available to licensed mortgage banking companies. The warehouse line of credit is used by the mortgage banker to originate one-to-four family residential mortgage loans that are pre-sold to the secondary mortgage market, which includes state and national banks, national mortgage banking firms, insurance companies and government-sponsored enterprises, including the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and others. On average, an advance under the warehouse line of credit remains outstanding for a period of less than 30 days, with repayment coming directly from the sale of the loan into the secondary mortgage market. Interest and a transaction fee are collected by the Bank at the time of repayment. Additionally, customers of the warehouse lines of credit are required to maintain deposit relationships with the Bank that, on average, represent 10% to 12% of the loan balances.

As a separate segment of the total portfolio, the warehouse loan portfolio is individually analyzed as a whole for allowance for loan loss purposes. Warehouse lines of credit are subject to the same inherent risks as other commercial lending, but the overall degree of risk differs. While the Company's loss experience with this type of lending has been non-existent since the product was introduced in 2008, there are other risks unique to this lending that still must be considered in assessing the adequacy of the allowance for loan losses. These unique risks may include, but are not limited to, (i) credit risks relating to the mortgage bankers that borrow from the Bank, (ii) the risk of intentional misrepresentation or fraud by any of such mortgage bankers, (iii) changes in the market value of mortgage loans originated by the mortgage banker, the sale of which is the expected source of repayment of the borrowings under a warehouse line of credit, due to changes in interest rates during the time in warehouse, or (iv) unsalable or impaired mortgage loans so originated, which could lead to decreased collateral value and the failure of a purchaser of the mortgage loan to purchase the loan from the mortgage banker.

These factors, along with the other qualitative factors such as economic trends, concentrations of credit, trends in the volume of loans, portfolio quality, delinquencies and nonaccruals, are also considered and may have positive or negative effects on the allocated allowance. The aggregate amount resulting from the application of these qualitative factors determines the overall risk for the portfolio and results in an allocated allowance for warehouse lines of credit.

#### Consumer

The Company's consumer loan segment is comprised of residential real estate loans, home equity loans and other loans to individuals. Individual loan pools are created for the various types of loans to individuals.

In general, for homogeneous groups such as residential mortgages and consumer credits, the loans are collectively evaluated based on delinquency status, loan type, and historical losses. These loan groups are then internally risk rated.

The Company considers the following credit quality indicators in assessing the risk in the loan portfolio:

#### Consumer credit scores

- Internal credit risk grades

#### Loan-to-value ratios

Collateral

Collection experience

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The following table presents, for the periods indicated, an analysis of the allowance for loan losses and other related data.

Allowance for Loan Losses

(Dollars in thousands)

|                                                                                  | Six Months<br>Ended June<br>30,<br>2015 |    | Year Ended<br>December 31,<br>2014 |    | Six Months<br>Ended June<br>30,<br>2014 |    |
|----------------------------------------------------------------------------------|-----------------------------------------|----|------------------------------------|----|-----------------------------------------|----|
| Balance, beginning of period                                                     | \$6,925                                 |    | \$7,039                            |    | \$7,039                                 |    |
| Provision charged to operating expenses                                          | 500                                     |    | 5,750                              |    | 4,600                                   |    |
| Loans charged off :                                                              |                                         |    |                                    |    |                                         |    |
| Construction loans                                                               | —                                       |    | —                                  |    | —                                       |    |
| Residential real estate loans                                                    | —                                       |    | (15                                | )  | —                                       |    |
| Commercial and commercial real estate                                            | (88                                     | )  | (5,906                             | )  | (4,225                                  | )  |
| Loans to individuals                                                             | —                                       |    | (1                                 | )  | —                                       |    |
| Lease financing                                                                  | —                                       |    | —                                  |    | —                                       |    |
| All other loans                                                                  | —                                       |    | —                                  |    | —                                       |    |
|                                                                                  | (88                                     | )  | (5,922                             | )  | (4,225                                  | )  |
| Recoveries                                                                       |                                         |    |                                    |    |                                         |    |
| Construction loans                                                               | —                                       |    | —                                  |    | —                                       |    |
| Residential real estate loans                                                    | —                                       |    | —                                  |    | —                                       |    |
| Commercial and commercial real estate                                            | 12                                      |    | 58                                 |    | 4                                       |    |
| Loans to individuals                                                             | 2                                       |    | —                                  |    | —                                       |    |
| Lease financing                                                                  | —                                       |    | —                                  |    | —                                       |    |
| All other loans                                                                  | —                                       |    | —                                  |    | —                                       |    |
|                                                                                  | 14                                      |    | 58                                 |    | 4                                       |    |
| Net charge offs                                                                  | (74                                     | )  | (5,864                             | )  | (4,221                                  | )  |
| Balance, end of period                                                           | \$7,351                                 |    | \$6,925                            |    | \$7,418                                 |    |
| Loans :                                                                          |                                         |    |                                    |    |                                         |    |
| At period end                                                                    | \$758,506                               |    | \$654,297                          |    | \$635,460                               |    |
| Average during the period                                                        | 671,152                                 |    | 563,379                            |    | 506,049                                 |    |
| Net charge offs to average loans outstanding                                     | (0.01                                   | )% | (1.04                              | )% | (0.83                                   | )% |
| Net charge offs to average loans outstanding, excluding mortgage warehouse loans | (0.02                                   | )% | (1.33                              | )% | (1.12                                   | )% |
| Allowance for loan losses to :                                                   |                                         |    |                                    |    |                                         |    |
| Total loans at period end                                                        | 0.97                                    | %  | 1.06                               | %  | 1.17                                    | %  |
| Total loans at period end excluding mortgage warehouse loans                     | 1.30                                    | %  | 1.27                               | %  | 1.44                                    | %  |
| Non-performing loans                                                             | 158.78                                  | %  | 143.10                             | %  | 89.26                                   | %  |

The following table represents the allocation of the allowance for loan losses (“ALL”) among the various categories of loans and certain other information as of June 30, 2015 and December 31, 2014, respectively. The allocation is made for analytical purposes and is not necessarily indicative of the categories in which future losses may occur. The total allowance is available to absorb losses from any segment of loans.

(Dollars in thousands)

|                                       | June 30, 2015 |                           |               | December 31, 2014 |                           |               |   |
|---------------------------------------|---------------|---------------------------|---------------|-------------------|---------------------------|---------------|---|
|                                       | Amount        | ALL<br>as a %<br>of Loans | % of<br>Loans | Amount            | ALL<br>as a %<br>of Loans | % of<br>Loans |   |
| Commercial and Commercial real estate | \$4,104       | 1.31                      | % 41          | % 4,154           | 1.34                      | % 48          | % |
| Construction loans                    | 1,090         | 1.11                      | % 13          | % 1,215           | 1.27                      | % 15          | % |
| Residential real estate loans         | 202           | 0.47                      | % 6           | % 197             | 0.42                      | % 7           | % |
| Loans to individuals                  | 122           | 0.52                      | % 3           | % 131             | 0.57                      | % 3           | % |
| Subtotal                              | 5,518         | 1.16                      | % 63          | % 5,697           | 1.20                      | % 73          | % |
| Mortgage warehouse lines              | 1,119         | 0.40                      | % 37          | % 896             | 0.50                      | % 27          | % |
| Unallocated reserves                  | 714           | —                         | —             | 332               | —                         | —             |   |
| Total                                 | \$7,351       | 0.97                      | % 100         | % \$6,925         | 1.06                      | % 100         | % |

The Company did not record a provision for loan losses for the three months ended June 30, 2015 compared to a provision in the amount of \$4.1 million for the three months ended June 30, 2014. No provision for loan losses was recorded in the second quarter of 2015 due to the insignificant level of net charge-offs, the Bank's stable loan quality trends over the last four quarters and management's judgment that the loan loss reserve factors should be reduced to reflect the strengthening economic conditions in the Bank's markets, the Bank's stable loan quality trends and the level of estimated potential loss in the loan portfolio. Net charge-offs amounted to \$13,000 for the three months ended June 30, 2015.

At June 30, 2015, the allowance for loan losses was \$7.4 million, a \$426,000 increase from the allowance for loan losses at December 31, 2014. As a percentage of total loans, the allowance was 0.97% at the end of the second quarter of 2015 and 1.06% at year end 2014. The allowance for loan losses was 159% of non-accrual loans at June 30, 2015 compared to 153% of non-accrual loans at December 31, 2014. Management believes that the quality of the loan portfolio remains sound considering the economic climate in the State of New Jersey and that the allowance for loan losses is adequate in relation to credit risk exposure levels.

With respect to the remaining acquired Rumson loans of \$103 million at June 30, 2015, the remaining accretable general credit discount was \$873,000 and the non-accretable credit discount was \$546,000.

#### Deposits

Deposits, which include demand deposits (interest bearing and non-interest bearing), savings deposits and time deposits, are a fundamental and cost-effective source of funding. The flow of deposits is influenced significantly by general economic conditions, changes in market interest rates and competition. The Bank offers a variety of products designed to attract and retain customers, with the Bank's primary focus being on the building and expanding of long-term relationships.

The following table summarizes deposits at June 30, 2015 and December 31, 2014.

(Dollars in thousands)

|                      | June 30, 2015 | December 31, 2014 |
|----------------------|---------------|-------------------|
| Demand               |               |                   |
| Non-interest bearing | \$161,029     | \$162,281         |
| Interest bearing     | 290,595       | 297,679           |

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|         |           |           |
|---------|-----------|-----------|
| Savings | 191,113   | 190,817   |
| Time    | 155,351   | 166,984   |
|         | \$798,088 | \$817,761 |

At June 30, 2015, total deposits were \$798.1 million, a decrease of \$19.7 million, or 2.4%, from \$817.8 million at December 31, 2014. The decrease in deposits was due primarily to the outflow of municipal deposits acquired in the Rumson merger and a decrease in certificates of deposit.

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## Borrowings

Borrowings are mainly comprised of Federal Home Loan Bank (“FHLB”) borrowings and overnight funds purchased. These borrowings are primarily used to fund asset growth not supported by deposit generation. The balance of borrowings was \$130.7 million at June 30, 2015, consisting of \$110.2 million in overnight borrowings from the FHLB and \$20.5 million of long-term FHLB borrowings, compared to \$25.1 million at December 31, 2014, consisting of \$4.4 million of overnight borrowings from the FHLB and \$20.7 million of long-term FHLB borrowings. Two long term FHLB fixed rate convertible advances were assumed by the Bank as a result of the Rumson merger. These two advances total \$10.0 million and bear interest at 4.11% and 4.63%, respectively. As a result of acquisition accounting, the two advances were fair valued and a premium of \$1.0 million was assigned. The premium is amortized over the remaining term of the borrowings. The two advances had a carrying amount of \$10.5 million at June 30, 2015.

The Bank also has a fixed rate convertible advance from the FHLB in the amount of \$10.0 million that bears interest at the rate of 4.08%. This advance may be called by the FHLB quarterly at the option of the FHLB if rates rise and the rate earned by the FHLB is no longer a “market” rate. This advance is fully secured by marketable securities.

## Shareholders’ Equity and Dividends

Shareholders’ equity increased by \$4.4 million, or 5.1%, to \$91.5 million at June 30, 2015 from \$87.1 million at December 31, 2014. Tangible book value per common share increased by \$0.59 to \$10.39 at June 30, 2015 from \$9.80 at December 31, 2014. The ratio of average shareholders’ equity to total average assets was 9.10% at June 30, 2015 compared to 8.62% at December 31, 2014.

Shareholders’ equity increased \$4.4 million due to net income of \$4.6 million, \$24,000 from the exercise of stock options and \$326,000 in share based compensation for the six months ended June 30, 2015. Partially offsetting these increases was a decline in accumulated other comprehensive income of \$475,000 during the period.

In lieu of cash dividends to common shareholders, the Company (and its predecessor, the Bank) had declared a common stock dividend every year (except 2013 and 2014) since 1992 and has paid such dividends every year since 1993 (except 2014 due to the acquisition of Rumson). On February 20, 2015, the Board of Directors of the Company declared a five percent common stock dividend to common shareholders of record as of the close of business on March 16, 2015, which was paid on April 6, 2015. Per share amounts for the prior periods have been adjusted to reflect the common stock dividend.

The Company’s common stock is quoted on the Nasdaq Global Market under the symbol “FCCY.”

In 2005, the Company’s board of directors authorized a common stock repurchase program that allows for the repurchase of a limited number of the Company’s shares at management’s discretion on the open market. The Company undertook this repurchase program in order to increase shareholder value. Disclosure of repurchases of Company shares made during the quarter ended June 30, 2015 is set forth under Part II, Item 2 of this report, “Unregistered Sales of Equity Securities and Use of Proceeds.”

Actual capital amounts and ratios for the Company and the Bank as of June 30, 2015 and December 31, 2014 were as follows:

| (Dollars in thousands)                 | Actual   |        | For Capital Adequacy Purposes |       | To Be Well Capitalized Under Prompt Corrective Action Provision |       |
|----------------------------------------|----------|--------|-------------------------------|-------|-----------------------------------------------------------------|-------|
|                                        | Amount   | Ratio  | Amount                        | Ratio | Amount                                                          | Ratio |
| As of June 30, 2015                    |          |        |                               |       |                                                                 |       |
| Company                                |          |        |                               |       |                                                                 |       |
| Common equity Tier 1 (CET1)            | \$79,483 | 8.72%  | \$40,999                      | >4.5% | N/A                                                             | N/A   |
| Total Capital to Risk Weighted Assets  | 104,835  | 11.51% | 72,888                        | >8%   | N/A                                                             | N/A   |
| Tier 1 Capital to Risk Weighted Assets | 97,483   | 10.70% | 54,666                        | >6%   | N/A                                                             | N/A   |
| Tier 1 Leverage Capital                | 97,483   | 10.00% | 38,987                        | >4%   | N/A                                                             | N/A   |
| Bank                                   |          |        |                               |       |                                                                 |       |
| Common equity Tier 1 (CET1)            | \$95,191 | 10.45% | \$40,999                      | >4.5% | \$59,221                                                        | ≥6.5% |



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|                                        |         |        |        |     |        |      |
|----------------------------------------|---------|--------|--------|-----|--------|------|
| Total Capital to Risk Weighted Assets  | 102,542 | 11.25% | 72,888 | >8% | 91,110 | ≥10% |
| Tier 1 Capital to Risk Weighted Assets | 95,191  | 10.45% | 54,666 | >6% | 72,888 | ≥8%  |
| Tier 1 Leverage Capital                | 95,191  | 9.77%  | 38,987 | >4% | 48,734 | >5%  |

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As of December 31, 2014

## Company

|                                        |          |        |          |     |     |     |
|----------------------------------------|----------|--------|----------|-----|-----|-----|
| Total Capital to Risk Weighted Assets  | \$98,309 | 12.28% | \$64,045 | >8% | N/A | N/A |
| Tier 1 Capital to Risk Weighted Assets | 91,384   | 11.41% | 32,023   | >4% | N/A | N/A |
| Tier 1 Leverage Capital                | 91,384   | 9.53%  | 38,348   | >4% | N/A | N/A |

## Bank

|                                        |          |        |          |     |          |      |
|----------------------------------------|----------|--------|----------|-----|----------|------|
| Total Capital to Risk Weighted Assets  | \$96,048 | 12.00% | \$64,045 | >8% | \$80,056 | >10% |
| Tier 1 Capital to Risk Weighted Assets | 89,123   | 11.13% | 32,023   | >4% | 48,034   | >6%  |
| Tier 1 Leverage Capital                | 89,123   | 9.30%  | 38,348   | >4% | 47,935   | >5%  |

In July 2013, the Federal Reserve Board and the FDIC approved revisions to their capital adequacy guidelines and prompt corrective action rules that implement the revised standards of Basel III and address relevant provisions of the Dodd-Frank Act. The Federal Reserve Board's final rules and the FDIC's interim final rules apply to all depository institutions, top-tier bank holding companies with total consolidated assets of \$500 million or more and top-tier savings and loan holding companies ("banking organizations"). Under Basel III Capital Rules, the initial minimum capital ratios effective as of January 1, 2015 are as follows: common equity Tier 1 (CET1) ratio of 4.5% of risk-weighted assets, Tier 1 capital ratio of 6% of risk weighted assets, total capital to risk-weighted assets of 8% and Tier 1 leverage ratio of 4%.

The rules also limit a banking organization's ability to pay dividends, engage in share repurchases or pay discretionary bonuses if the banking organization does not hold a "capital conservation buffer" consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements. The capital conservation buffer requirements will be phased in beginning January 1, 2016 at 0.625% of common equity Tier 1 capital to risk-weighted assets and would increase by that amount until fully implemented in January 2019 at 2.50% of common equity Tier 1 capital to risk-weighted assets.

At June 30, 2015, the capital ratios of the Company exceeded the minimum Basel III capital requirements. It is management's goal to monitor and maintain adequate capital levels to continue to support asset growth and the expansion of the Bank and to continue its status as a well-capitalized institution.

## Liquidity

At June 30, 2015, the amount of liquid assets and the Bank's access to off-balance sheet liquidity remained at a level management deemed adequate to ensure that contractual liabilities, depositors' withdrawal requirements, and other operational and customer credit needs could be satisfied.

Liquidity management refers to the Company's ability to support asset growth while satisfying the borrowing needs and deposit withdrawal requirements of customers. In addition to maintaining liquid assets, factors such as capital position, profitability, asset quality and availability of funding affect a bank's ability to meet its liquidity needs. On the asset side, liquid funds are maintained in the form of cash and cash equivalents, Federal funds sold, investment securities held to maturity maturing within one year, securities available for sale and loans held for sale. Additional asset-based liquidity is derived from scheduled loan repayments as well as investment repayments of principal and interest from mortgage-backed securities. On the liability side, the primary source of liquidity is the ability to generate core deposits. Short-term borrowings are used as supplemental funding sources when growth in the core deposit base does not keep pace with that of earnings assets.

The Bank has established a borrowing relationship with the FHLB which further supports and enhances liquidity. During 2010, the FHLB replaced its Overnight Line of Credit and One-Month Overnight Repricing Line of Credit facilities available to member banks with a fully secured line of up to 50 percent of a bank's quarter-end total assets. Under the terms of this facility, the Bank's total credit exposure to the FHLB cannot exceed 50 percent, or \$523.5 million, of its total assets at June 30, 2015. In addition, the aggregate outstanding principal amount of the Bank's advances, letters of credit, the dollar amount of the FHLB's minimum collateral requirement for off-balance sheet financial contracts and advance commitments cannot exceed 30 percent of the Bank's total assets, unless the Bank obtains approval from the FHLB's Board of Directors or its Executive Committee. These limits are further restricted by a member's ability to provide eligible collateral to support its obligations to the FHLB as well as the ability to meet the FHLB's stock requirement. At June 30, 2015, the Bank pledged collateral to the FHLB to support additional borrowings of \$41.8 million. The Bank also maintains an unsecured federal funds line of \$25.0 million with a correspondent bank.

The Consolidated Statements of Cash Flows present the changes in cash from operating, investing and financing activities. At June 30, 2015, the balance of cash and cash equivalents was \$16.4 million.

Net cash provided by operating activities totaled \$5.2 million for the six months ended June 30, 2015 compared to net cash provided by operating activities of \$7.0 million for the six months ended June 30, 2014. A source of funds is net income from operations adjusted for activity related to loans originated for sale and sold, the provision for loan losses, depreciation and amortization expenses, and net amortization of premiums and discounts on securities. Net cash provided by operating activities for the six months ended June 30, 2015 was less than net cash provided by operating activities for the six months ended June 30, 2014 due to lower net proceeds from sales and origination of loans in 2015 compared to 2014.

Net cash used in investing activities totaled \$89.4 million for the six months ended June 30, 2015 compared to net cash used in investing activities of \$83.8 million for the six months ended June 30, 2014. The primary use of cash for the first six months of 2015 was the net increase of loans of \$104.2 million compared to a net increase in loans of \$122.9 million for the first six months of 2014. Net cash received from the acquisition of Rumson of \$21.4 million reduced the net cash used for the first six months of 2014.

Net cash provided by financing activities was \$85.9 million for the six months ended June 30, 2015 compared to \$30.7 million for the six months ended June 30, 2014. The primary source of funds for the 2015 period was the increase in borrowed funds of \$105.6 million, which was partially offset by the decrease in deposits of \$19.7 million, compared to the \$38.9 million increase in borrowings, which was partially offset by the decrease in deposits of \$8.2 million for the 2014 period.

The securities portfolios are also a source of liquidity, providing cash flows from maturities and periodic repayments of principal. For the six months ended June 30, 2015 and June 30 2014, prepayments and maturities of investment securities totaled \$30.1 million and \$25.9 million, respectively. Another source of liquidity is the loan portfolio, which provides a flow of payments and maturities.



## Interest Rate Sensitivity Analysis

The largest component of the Company's total income is net interest income, and the majority of the Company's financial instruments are composed of interest rate-sensitive assets and liabilities with various terms and maturities. The primary objective of management is to maximize net interest income while minimizing interest rate risk. Interest rate risk is derived from timing differences and the magnitude of relative changes in the repricing of assets and liabilities, loan prepayments, deposit withdrawals, and differences in lending and funding rates. Management actively seeks to monitor and control the mix of interest rate-sensitive assets and interest rate-sensitive liabilities.

Under the interest rate risk policy established by the Board of Directors, the Company established quantitative guidelines with respect to interest rate risk and how interest rate shocks are projected to affect net interest income and economic value of equity. Summarized below is the projected effect of a parallel shift of an increase of 200 and 300 basis points, respectively, in market interest rates on net interest income and economic value of equity.

Based upon the current interest rate environment, as of June 30, 2015, sensitivity to interest rate risk was as follows:

| (Dollars in thousands)               | Next 12 Months      |          | Economic Value of Equity |          |
|--------------------------------------|---------------------|----------|--------------------------|----------|
|                                      | Net Interest Income |          |                          |          |
| Interest Rate Change in Basis Points | \$ Change           | % Change | \$ Change                | % Change |
| +300                                 | \$3,217             | 8.0%     | \$1,554                  | 1.25%    |
| +200                                 | 1,857               | 4.6%     | 1,272                    | 1.03%    |
| —                                    | —                   | —%       | —                        | —%       |

The Company employs many assumptions to calculate the impact of changes in interest rates on assets and liabilities, and actual results may not be similar to projections due to several factors, including the timing and frequency of rate changes, market conditions and the shape of the yield curve. Actual results may also differ due to actions, if any, in response to changing rates. In calculating these exposures, the Company utilized an interest rate simulation model which is validated by third-party reviewers on an annual basis.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Not required.

Item 4. Controls and Procedures.

The Company has established disclosure controls and procedures designed to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms and is accumulated and communicated to management, including the principal executive officer and principal financial officer, to allow timely decisions regarding required disclosure.

The Company's principal executive officer and principal financial officer, with the assistance of other members of the Company's management, have evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this quarterly report. Based upon such evaluation, the Company's principal executive officer and principal financial officer have concluded that the Company's disclosure controls and procedures are effective as of the end of the period covered by this quarterly report.

The Company's principal executive officer and principal financial officer have also concluded that there was no change in the Company's internal control over financial reporting (as such term is defined in Rule 13a-15(f) under the Exchange Act) that occurred during the quarter ended June 30, 2015 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II. OTHER INFORMATION

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

## Issuer Purchases of Equity Securities

On July 21, 2005, the Company's Board of Directors authorized a stock repurchase program under which the Company may repurchase up to 5% of its common shares outstanding at that date in open market or privately negotiated transactions. The Company undertook this repurchase program in order to increase shareholder value. The following table provides common stock repurchases made by or on behalf of the Company during the three months ended June 30, 2015.

Issuer Purchases of Equity Securities <sup>(1)</sup>

| Period        |                | Total<br>Number of<br>Shares<br>Purchased | Average<br>Price Paid<br>Per Share | Total Number<br>of<br>Shares<br>Purchased As<br>Part of Publicly<br>Announced Plan<br>or Program | Maximum<br>Number<br>of Shares That<br>May<br>Yet be<br>Purchased<br>Under the Plan<br>or<br>Program |
|---------------|----------------|-------------------------------------------|------------------------------------|--------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------|
| Beginning     | Ending         |                                           |                                    |                                                                                                  |                                                                                                      |
| April 1, 2015 | April 30, 2015 | —                                         | —                                  | —                                                                                                | 127,956                                                                                              |
| May 1, 2015   | May 31, 2015   | 783                                       | \$11.50                            | 783                                                                                              | 127,173                                                                                              |
| June 1, 2015  | June 30, 2015  | 93                                        | \$12.49                            | 93                                                                                               | 127,080                                                                                              |
| Total         |                | 876                                       | \$12.63                            | 876                                                                                              | 127,080                                                                                              |

The Company's common stock repurchase program covers a maximum of 237,115 shares of common stock of the (1) Company, representing 5% of the outstanding common stock of the Company on July 21, 2005, as adjusted for subsequent common stock dividends.

Item 6. Exhibits.

|         |   |                                                                                                                                                                                                                                                                       |
|---------|---|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 31.1    | * | Certification of Robert F. Mangano, principal executive officer of the Company, pursuant to Securities Exchange Act Rule 13a-14(a)                                                                                                                                    |
| 31.2    | * | Certification of Stephen J. Gilhooly, principal financial officer of the Company, pursuant to Securities Exchange Act Rule 13a-14(a)                                                                                                                                  |
| 32      | * | Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002, signed by Robert F. Mangano, principal executive officer of the Company, and Stephen J. Gilhooly, principal financial officer of the Company |
| 101.INS | * | XBRL Instance Document                                                                                                                                                                                                                                                |
| 101.SCH | * | XBRL Taxonomy Extension Schema Document                                                                                                                                                                                                                               |
| 101.CAL | * | XBRL Taxonomy Extension Calculation Linkbase Document                                                                                                                                                                                                                 |
| 101.DEF | * | XBRL Taxonomy Extension Definition Linkbase Document                                                                                                                                                                                                                  |
| 101.LAB | * | XBRL Taxonomy Extension Label Linkbase Document                                                                                                                                                                                                                       |
| 101.PRE | * | XBRL Taxonomy Extension Presentation Linkbase Document                                                                                                                                                                                                                |

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\* Filed herewith.

SIGNATURES

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

1ST CONSTITUTION BANCORP

Date: August 12, 2015

By: /s/ ROBERT F. MANGANO  
Robert F. Mangano  
President and Chief Executive Officer  
(Principal Executive Officer)

Date: August 12, 2015

By: /s/ STEPHEN J. GILHOOLY  
Stephen J. Gilhooly  
Senior Vice President, Treasurer and Chief  
Financial Officer  
(Principal Financial Officer)



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Index to Exhibits

|         |   |                                                                                                                                                                                                                                                                       |
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\* Filed herewith.