

SB ONE BANCORP  
Form 10-Q  
August 09, 2018  
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, 2018

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 0-29030

SB ONE BANCORP  
(Exact name of registrant as specified in its charter)

New Jersey 22-3475473

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

100 Enterprise Drive, Suite 700, Rockaway, NJ 07866  
(Address of principal executive offices) (Zip Code)

(844) 256-7328  
(Registrant's telephone number, including area code)

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 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," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company  Emerging growth company

(Do not check if a smaller reporting company)

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes      No

As of August 2, 2018 there were 7,929,613 shares of common stock, no par value, outstanding.

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SB ONE BANCORP  
FORM 10-Q

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## FORWARD-LOOKING STATEMENTS

We may, from time to time, make written or oral “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995, including statements contained in our filings with the Securities and Exchange Commission (the “SEC”), our reports to shareholders and in other communications by us. This Quarterly Report on Form 10-Q contains “forward-looking statements” which may be identified by the use of such words as “believe,” “project,” “expect,” “anticipate,” “should,” “may,” “will,” “intend,” “planned,” “estimated,” “potential” or similar expressions. Examples of forward-looking statements include, but are not limited to, estimates with respect to our financial condition, results of operation and business that are subject to various factors which could cause actual results to differ materially from these estimates. These factors include, but are not limited to:

- changes in the interest rate environment that reduce margins;
- changes in the regulatory environment;
- the highly competitive industry and market area in which we operate;
- general economic conditions, either nationally or regionally, resulting in, among other things, a deterioration in credit quality;
- changes in business conditions and inflation;
- changes in credit market conditions;
- changes in the securities markets which affect investment management revenues;
- increases in Federal Deposit Insurance Corporation (“FDIC”) deposit insurance premiums and assessments, which could adversely affect our financial condition;
- changes in technology used in the banking business;
- the soundness of other financial services institutions, which may adversely affect our credit risk;
- our controls and procedures may fail or be circumvented;
- new lines of business or new products and services, which may subject us to additional risks;
- changes in key management personnel which may adversely impact our operations;
- the effect on our operations of recent legislative and regulatory initiatives that were or may be enacted in response to the ongoing financial crisis;
- severe weather, natural disasters, acts of war or terrorism and other external events which could significantly impact our business;
- the inability to realize expected cost savings or to implement integration plans and other adverse consequences associated with the Community Merger (as defined herein);
- failure to complete the proposed Enterprise Merger (as defined herein), the imposition of adverse regulatory conditions in connection with regulatory approval of the proposed Enterprise Merger, disruption to the parties' businesses as a result of the announcement and pendency of the Enterprise Merger, the inability to realize expected cost savings or to implement integration plans and other adverse consequences associated with the Enterprise Merger; and
- other factors detailed from time to time in our filings with the SEC.

Although we believe that the expectations reflected in such forward-looking statements are reasonable, actual results may differ materially from the results discussed in these forward-looking statements. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. We do not undertake any obligation to republish revised forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

## PART I – FINANCIAL INFORMATION

## Item 1 – Financial Statements

## SB ONE BANCORP

## CONSOLIDATED BALANCE SHEETS

(Unaudited)

| (Dollars in Thousands)   | June 30,<br>2018   | December 31,<br>2017 |
|--|--------------------|----------------------|
| <b>ASSETS</b>  |                    |                      |
| Cash and due from banks  | \$6,651            | \$ 3,270             |
| Interest-bearing deposits with other banks   | 12,245             | 8,376                |
| Cash and cash equivalents  | 18,896             | 11,646               |
| Interest bearing time deposits with other banks  | 200                | 100                  |
| Securities available for sale, at fair value   | 174,525            | 98,730               |
| Securities held to maturity, at amortized cost (fair value of \$5,508 and \$5,430 at June 30, 2018 and December 31, 2017, respectively)                          | 5,418              | 5,304                |
| Other Bank Stock, at cost  | 10,066             | 4,925                |
| Loans receivable, net of unearned income   | 1,136,546          | 820,700              |
| Less: allowance for loan losses  | 8,264              | 7,335                |
| Net loans receivable   | 1,128,282          | 813,365              |
| Foreclosed real estate   | 3,414              | 2,275                |
| Premises and equipment, net  | 18,734             | 8,389                |
| Accrued interest receivable  | 3,906              | 2,472                |
| Goodwill and intangibles   | 26,048             | 2,820                |
| Bank-owned life insurance  | 30,390             | 22,054               |
| Other assets   | 17,423             | 7,303                |
| <b>Total Assets</b>  | <b>\$1,437,302</b> | <b>\$ 979,383</b>    |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                    |                      |
| <b>Liabilities:</b>  |                    |                      |
| <b>Deposits:</b>   |                    |                      |
| Non-interest bearing   | \$232,862          | \$ 146,167           |
| Interest bearing   | 828,737            | 616,324              |
| Total deposits   | 1,061,599          | 762,491              |
| Short-term borrowings  | 157,940            | 55,350               |
| Long-term borrowings   | 30,000             | 35,000               |
| Accrued interest payable and other liabilities   | 11,087             | 4,501                |
| Subordinated debentures  | 27,853             | 27,848               |
| <b>Total Liabilities</b>   | <b>1,288,479</b>   | <b>885,190</b>       |
| <b>Stockholders' Equity:</b>   |                    |                      |
| Preferred stock, no par value, 1,000,000 shares authorized; none issued  | —                  | —                    |
| Common stock, no par value, 10,000,000 shares authorized; 7,929,613 and 6,040,564 shares issued outstanding at June 30, 2018 and December 31, 2017, respectively | 117,500            | 65,274               |
| Deferred compensation obligation under Rabbi Trust   | 1,582              | 1,399                |

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|  |             |            |   |
|--|-------------|------------|---|
| Retained earnings                              | 30,763      | 27,532     |   |
| Accumulated other comprehensive income         | 560         | 1,387      |   |
| Stock held by Rabbi Trust                      | (1,582      | ) (1,399   | ) |
| Total Stockholders' Equity                     | 148,823     | 94,193     |   |
| Total Liabilities and Stockholders' Equity     | \$1,437,302 | \$ 979,383 |   |
| See Notes to Consolidated Financial Statements |             |            |   |

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SB ONE BANCORP  
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME  
(Unaudited)

|  | Three Months   |         | Six Months Ended |          |
|--|----------------|---------|------------------|----------|
|  | Ended June 30, |         | June 30,         |          |
| (Dollars in thousands except per share data)                   | 2018           | 2017    | 2018             | 2017     |
| <b>INTEREST INCOME</b>   |                |         |                  |          |
| Loans receivable, including fees                               | \$12,562       | \$7,876 | \$24,462         | \$15,474 |
| Securities:  |                |         |                  |          |
| Taxable  | 804            | 344     | 1,540            | 685      |
| Tax-exempt   | 449            | 316     | 830              | 629      |
| Interest bearing deposits                                      | 16             | 6       | 46               | 22       |
| Total Interest Income  | 13,831         | 8,542   | 26,878           | 16,810   |
| <b>INTEREST EXPENSE</b>  |                |         |                  |          |
| Deposits   | 1,659          | 852     | 3,117            | 1,569    |
| Borrowings   | 874            | 479     | 1,380            | 960      |
| Subordinated debentures  | 313            | 316     | 628              | 637      |
| Total Interest Expense   | 2,846          | 1,647   | 5,125            | 3,166    |
| Net Interest Income  | 10,985         | 6,895   | 21,753           | 13,644   |
| <b>PROVISION FOR LOAN LOSSES</b>                               | 398            | 380     | 906              | 787      |
| Net Interest Income after Provision for Loan Losses            | 10,587         | 6,515   | 20,847           | 12,857   |
| <b>OTHER INCOME</b>  |                |         |                  |          |
| Service fees on deposit accounts                               | 311            | 285     | 639              | 538      |
| ATM and debit card fees  | 250            | 200     | 463              | 380      |
| Bank-owned life insurance                                      | 188            | 128     | 373              | 234      |
| Insurance commissions and fees                                 | 1,839          | 1,143   | 3,734            | 2,890    |
| Investment brokerage fees                                      | 41             | —       | 63               | 3        |
| Net gain on sales of securities                                | 36             | (30)    | 36               | 77       |
| Net gain on disposal of premises and equipment                 | 9              | —       | 9                | —        |
| Other  | 207            | 92      | 421              | 173      |
| Total Other Income   | 2,881          | 1,818   | 5,738            | 4,295    |
| <b>OTHER EXPENSES</b>  |                |         |                  |          |
| Salaries and employee benefits                                 | 5,411          | 3,677   | 10,469           | 7,235    |
| Occupancy, net   | 727            | 456     | 1,329            | 956      |
| Data processing  | 939            | 521     | 1,730            | 1,078    |
| Furniture and equipment  | 326            | 234     | 607              | 474      |
| Advertising and promotion                                      | 285            | 89      | 341              | 195      |
| Professional fees  | 290            | 198     | 619              | 475      |
| Director fees  | 142            | 89      | 289              | 196      |
| FDIC assessment  | 100            | 93      | 210              | 144      |
| Insurance  | 52             | 66      | 147              | 132      |
| Stationary and supplies  | 89             | 44      | 146              | 76       |
| Merger-related expenses  | 446            | 481     | 3,739            | 481      |
| Loan collection costs  | 89             | 28      | 150              | 52       |
| Net expenses and write-downs related to foreclosed real estate | 1              | 32      | 208              | 77       |
| Amortization of intangible assets                              | 60             | —       | 121              | —        |
| Other  | 623            | 518     | 1,069            | 932      |
| Total Other Expenses   | 9,580          | 6,526   | 21,174           | 12,503   |
| Income before Income Taxes                                     | 3,888          | 1,807   | 5,411            | 4,649    |

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|  |         |         |         |         |
|--|---------|---------|---------|---------|
| EXPENSE FOR INCOME TAXES   | 896     | 603     | 1,111   | 1,434   |
| Net Income   | 2,992   | 1,204   | 4,300   | 3,215   |
| OTHER COMPREHENSIVE INCOME:  |         |         |         |         |
| Unrealized (loss) gain on available for sale securities arising during the period            | (353    | ) 1,144 | (2,520  | ) 1,820 |
| Fair value adjustments on derivatives  | 328     | (455    | ) 1,435 | (415    |
| Reclassification adjustment for net (gain) on securities transactions included in net income | (36     | ) 30    | (36     | ) (77   |
| Income tax related to items of other comprehensive (loss) income                             | 17      | (287    | ) 294   | (531    |
| Other comprehensive (loss) income, net of income taxes                                       | (44     | ) 432   | (827    | ) 797   |
| Comprehensive income   | \$2,948 | \$1,636 | \$3,473 | \$4,012 |
| EARNINGS PER SHARE   |         |         |         |         |
| Basic  | \$0.38  | \$0.25  | \$0.55  | \$0.68  |
| Diluted  | \$0.38  | \$0.25  | \$0.55  | \$0.67  |
| See Notes to Consolidated Financial Statements   |         |         |         |         |



SB ONE BANCORP  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY  
Six Months Ended June 30, 2018 and 2017  
(Unaudited)

| (Dollars in Thousands)   | Number of<br>Shares<br>Outstanding | Common<br>Stock | Deferred<br>Compensation<br>Obligation<br>Under<br>Rabbi Trust | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income | Stock<br>Held by<br>Rabbi<br>Trust | Total<br>Stockholders'<br>Equity |
|--|------------------------------------|-----------------|--|----------------------|---|------------------------------------|----------------------------------|
| Balance December 31, 2016  | 4,741,068                          | \$36,538        | 1,383  | \$23,291             | \$ 243  | (1,383 )                           | \$ 60,072                        |
| Net income   | —                                  | —               | —  | 3,215                | —   | —                                  | 3,215                            |
| Other comprehensive income   | —                                  | —               | —  | —                    | 797   | —                                  | 797                              |
| Funding of Supplemental Director Retirement Plan                         | —                                  | —               | (31 )  | —                    | —   | 31                                 | —                                |
| Net proceeds of capital raise  | 1,249,999                          | 28,313          | —  | —                    | —   | —                                  | 28,313                           |
| Restricted stock granted   | 53,170                             | —               | —  | —                    | —   | —                                  | —                                |
| Restricted stock forfeited   | (3,235 )                           | —               | —  | —                    | —   | —                                  | —                                |
| Compensation expense related to stock option and restricted stock grants | —                                  | 348             | —  | —                    | —   | —                                  | 348                              |
| Dividends declared on common stock (\$0.10 per share)                    | —                                  | —               | —  | (478 )               | —   | —                                  | (478 )                           |
| Balance June 30, 2017  | 6,041,002                          | \$65,199        | \$ 1,352   | \$26,028             | \$ 1,040  | \$(1,352)                          | \$ 92,267                        |
| Balance December 31, 2017  | 6,040,564                          | \$65,274        | 1,399  | \$27,532             | \$ 1,387  | (1,399 )                           | \$ 94,193                        |
| Net income   | —                                  | —               | —  | 4,300                | —   | —                                  | 4,300                            |
| Other comprehensive loss   | —                                  | —               | —  | —                    | (827 )  | —                                  | (827 )                           |
| Shares issued in merger  | 1,873,028                          | 51,883          | —  | —                    | —   | —                                  | 51,883                           |
| Funding of Supplemental Director Retirement Plan                         | —                                  | —               | 183  | —                    | —   | (183 )                             | —                                |
| Restricted stock granted   | 20,169                             | —               | —  | —                    | —   | —                                  | —                                |
| Restricted stock forfeited   | (4,148 )                           | —               | —  | —                    | —   | —                                  | —                                |
| Compensation expense related to stock option and restricted stock grants | —                                  | 343             | —  | —                    | —   | —                                  | 343                              |
| Dividends declared on common stock (\$0.135 per share)                   | —                                  | —               | —  | (1,069 )             | —   | —                                  | (1,069 )                         |
| Balance June 30, 2018  | 7,929,613                          | \$117,500       | \$ 1,582   | \$30,763             | \$ 560  | \$(1,582)                          | \$ 148,823                       |

See Notes to Consolidated Financial Statements

SB ONE BANCORP  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

|   | Six Months Ended<br>June 30, |          |
|---|------------------------------|----------|
| (Dollars in thousands)  | 2018                         | 2017     |
| Cash Flows from Operating Activities  |                              |          |
| Net income  | \$4,300                      | \$3,215  |
| Adjustments to reconcile net income to net cash provided by operating activities: |                              |          |
| Provision for loan losses   | 906                          | 787      |
| Depreciation and amortization   | 904                          | 538      |
| Net amortization of securities premiums and discounts                             | 1,049                        | 849      |
| Amortization of subordinated debt issuance costs                                  | 5                            | 3        |
| Net realized gain on sale of securities   | (36 )                        | (77 )    |
| Net realized loss on disposal of premises and equipment                           | (9 )                         | —        |
| Net realized gain on sale of foreclosed real estate                               | (4 )                         | (13 )    |
| Write-downs of and provisions for foreclosed real estate                          | 140                          | 49       |
| Deferred income tax expense (benefit)   | 459                          | (342 )   |
| Earnings on bank-owned life insurance   | (373 )                       | (234 )   |
| Compensation expense for stock options and stock awards                           | 343                          | 348      |
| (Increase) decrease in assets:  |                              |          |
| Accrued interest receivable   | (610 )                       | (212 )   |
| Other assets  | (7,262 )                     | 135      |
| Increase (decrease) in accrued interest payable and other liabilities             | 5,987                        | (10 )    |
| Net Cash Provided by Operating Activities   | 5,799                        | 5,036    |
| Cash Flows from Investing Activities  |                              |          |
| Net cash acquired in acquisition  | 6,693                        | —        |
| Securities available for sale:  |                              |          |
| Purchases   | (88,680 )                    | (33,658) |
| Sales   | 80,496                       | 20,709   |
| Maturities, calls and principal repayments  | 4,750                        | 4,477    |
| Securities held to maturity:  |                              |          |
| Purchases   | (240 )                       | (105 )   |
| Maturities, calls and principal repayments  | 105                          | 3,056    |
| Net increase in loans   | (79,753 )                    | (77,473) |
| Proceeds from the sale of foreclosed real estate                                  | 101                          | 618      |
| Purchases of bank premises and equipment  | (560 )                       | (114 )   |
| Proceeds from the sale of premises and equipment                                  | 53                           | —        |
| Purchase of bank owned life insurance   | —                            | (5,000 ) |
| Net increase in Federal Home Loan Bank stock                                      | (3,986 )                     | (280 )   |
| Net Cash Used in Investing Activities   | (81,021 )                    | (87,770) |
| Cash Flows from Financing Activities  |                              |          |
| Net (decrease) increase in deposits   | (2,049 )                     | 49,566   |
| Net increase in short-term borrowed funds   | 90,590                       | 9,345    |
| Repayment of long-term borrowings   | (5,000 )                     | (11,000) |
| Net proceeds from capital raise   | —                            | 28,313   |
| Dividends paid  | (1,069 )                     | (478 )   |
| Net Cash Provided by Financing Activities   | 82,472                       | 75,746   |
| Net increase (decrease) in Cash and Cash Equivalents                              | 7,250                        | (6,988 ) |

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|  |          |         |
|--|----------|---------|
| Cash and Cash Equivalents - Beginning                                | 11,646   | 14,638  |
| Cash and Cash Equivalents - Ending                                   | \$18,896 | \$7,650 |
| Supplementary Cash Flows Information                                 |          |         |
| Interest paid  | \$5,000  | \$3,169 |
| Income taxes paid  | \$1,852  | \$1,828 |
| Supplementary Schedule of Noncash Investing and Financing Activities |          |         |
| Foreclosed real estate acquired in settlement of loans               | \$—      | \$133   |
| See Notes to Consolidated Financial Statements                       |          |         |

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## NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Basis of Presentation

The accompanying unaudited consolidated financial statements include the accounts of SB One Bancorp, formerly Sussex Bancorp, (“we,” “us,” “our” or the “company”) and our wholly owned subsidiary SB One Bank, formerly Sussex Bank (the “Bank”). The corporate name change was voted and approved during the shareholder meeting on April 25, 2018. The name changes were a part of a larger rebrand effort undertaken by Sussex Bank which merged with Community Bank of Bergen County, NJ earlier this year. The Bank’s wholly owned subsidiaries are SCB Investment Company, Inc., SCBNY Company, Inc., ClassicLake Enterprises, LLC, GFR Maywood, LLC, PPD Holding Company, LLC, Community Investing Company, Inc., and SB One Insurance Agency Inc. (“SB One Insurance Agency”), formerly Tri-State Insurance Agency, Inc., a full service insurance agency located in Sussex County, New Jersey with a satellite office located in Bergen County, New Jersey. SB One Insurance Agency’s operations are considered a separate segment for financial disclosure purposes. All inter-company transactions and balances have been eliminated in consolidation. The Bank operates fourteen banking offices: eight located in Sussex County, New Jersey, four located in Bergen County, New Jersey, one located in Warren County, New Jersey, and one in Queens County, New York.

We are subject to the supervision and regulation of the Board of Governors of the Federal Reserve System (the “FRB”). The Bank’s deposits are insured by the Deposit Insurance Fund (“DIF”) of the FDIC up to applicable limits. The operations of the company and the Bank are subject to the supervision and regulation of the FRB, the FDIC and the New Jersey Department of Banking and Insurance (the “Department”) and the operations of SB One Insurance Agency are subject to supervision and regulation by the Department.

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by the accounting principles generally accepted in the United States of America (“U.S. GAAP”) for full year financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and are of a normal, recurring nature. Operating results for the three and six month periods ended June 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto that are included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017.

### New Accounting Standards

In May 2014, the FASB issued an Accounting Standard Update (“ASU”) 2014-09 to amend its guidance on “Revenue from Contracts with Customers, (Topic 606). The objective of the ASU is to align the recognition of revenue with the transfer of promised goods or services provided to customers in an amount that reflects the consideration which the entity expects to be entitled in exchange for those goods or services. This ASU will replace most existing revenue recognition guidance under U.S. GAAP when it becomes effective. In August 2015, the FASB issued an amendment (ASU 2015-14) which defers the effective date of this new guidance by one year. More detailed implementation guidance on Topic 606 was issued in March 2016 (ASU 2016-08), April 2016 (ASU 2016-10), May 2016 (ASU 2016-12), December 2016 (ASU 2016-20), February 2017 (ASU 2017-05) and September 2017 (ASU 2017-13), and the effective date and transition requirements for these ASUs are the same as the effective date and transition requirements of ASU 2014-09. The amendments in Topic 606 are effective for public business entities for annual periods beginning after December 15, 2017. Approximately 83% of the Company’s revenue for the quarter ended June 30, 2018, was comprised of interest income on financial assets, which are explicitly excluded from the scope of Topic 606. With respect to our non-interest income, management has identified revenue streams within the scope of the guidance, primarily service fees on deposits, ATM and debit card fees and insurance commissions and fees which are discussed below.

Topic 606 states that revenue should be recognized when the entity satisfies a performance obligation by transferring goods or services to the customer. An asset is considered transferred when the customer obtains control of the asset and is able to use and obtain substantially all of the benefits of the asset. The entity then has to determine whether the performance obligation was satisfied over time or at a point in time to determine when to recognize revenue. The Company determined based on the criteria presented in Topic 606 that the performance obligations were satisfied at a point in time since the customer obtains immediate control of the deposit accounts, ATM/Debit Card and insurance policy and there are no additional obligations that the Company performs over time; therefore, the revenue would be recognized as received.

The Company recognized \$639 thousand in income for Service fees on deposit accounts and \$3.7 million in insurance commissions and fees for the six months ended June 30, 2018. The Company currently presents the revenue and associated costs on a gross basis. ASU 2014-09 and related amendments were adopted effective January 1, 2018, using the cumulative effect approach. Under this alternative, the Company applied the new revenue standard only to contracts that were incomplete under legacy U.S. GAAP at the date of initial application and evaluated the cumulative effect of the new standard as a potential adjustment to the opening balance of retained earnings. The Company's adoption of the ASU on January 1, 2018 did not significantly change the recognition

of revenue on the Company's consolidated financial statements and, as such, a cumulative effect adjustment to opening retained earnings was not deemed necessary.

Service fees on deposit accounts represent account analysis fees, monthly service fees, check ordering fees and other deposit related fees. Revenue is recognized when the performance obligation is completed, which is generally monthly for account maintenance services or when a transaction has been completed.

Insurance commissions and fees represent insurance policies that our insurance agency, SB One Insurance Agency, arranges between the policy holder and the related insurance agency. SB One Insurance Agency acts solely as an insurance broker that provides the service of connection between a policy holder and carrier. SB One Insurance Agency's performance obligation is satisfied once the policy becomes active therefore no other performance obligation is required. Revenues for the commissions to SB One Insurance Agency's insurance contracts will generally be recognized as of the effective date of the insurance policy or the date on which the policy premium is processed into our systems, whichever is later. Commission revenues related to installment billings are recognized on the latter of effective or invoiced date. Subsequent commission adjustments are recognized upon our receipt of notification from insurance companies concerning matters necessitating such adjustments. Profit-sharing contingent commissions are recognized when determinable, which is generally when such commissions are received from insurance companies, or when we receive formal notification of the amount of such payments.

The Company recognized \$463 thousand in ATM and debit card fees for the six months ended June 30, 2018. ATM and debit card fees are primarily comprised of debit and credit card income (interchange fees), ATM fees, merchant services income, and other service charges. Debit and credit card income is primarily comprised of interchange fees earned whenever the Company's debit and credit cards are processed through our card payment network. The Company currently presents the revenue and associated costs with debit and credit card income on a net basis. ATM fees are primarily generated when a Company cardholder uses a non-Company ATM or a non-Company cardholder uses a Company ATM. Merchant services income mainly represents fees charged to merchants to process their debit and credit card transactions, in addition to account management fees. Other service charges include revenue from processing wire transfers, agency fee income, and other services. The Company's performance obligation for fees and other service charges are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payment is typically received immediately or within one month.

Under Topic 606, a contract asset balance occurs when an entity performs a service for a customer before the customer pays consideration (resulting in a contract receivable) or before payment is due (resulting in a contract asset). A contract liability balance is an entity's obligation to transfer a service to a customer for which the entity has already received payment (or payment is due) from the customer. The Company's non-interest revenue streams are largely based on transactional activity, or standard month-end revenue accruals such as asset management fees based on month-end market values. Consideration is often received immediately or shortly after the Company satisfies its performance obligation and revenue is recognized. The Company does not typically enter into long-term revenue contracts with customers, and therefore, does not experience significant contract balances. As of June 30, 2018 and December 31, 2017, the Company did not have any significant contract balances.

In connection with the adoption of Topic 606, an entity is required to capitalize, and subsequently amortize into expense, certain incremental costs of obtaining a contract with a customer if these costs are expected to be recovered. The incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, sales commission). The Company utilizes the practical expedient which allows entities to immediately expense contract acquisition costs when the asset that would have resulted from capitalizing these costs would have been amortized in one year or less. Upon adoption of Topic 606, the Company did not capitalize any contract acquisition cost.

In January 2016, FASB issued ASU 2016-01, Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. ASU 2016-01, among other things, (i) requires equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income; (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; (iii) eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial

instruments measured at amortized cost on the balance sheet; (iv) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (v) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; (vi) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements; and (vii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale. In addition, the amendments in this ASU require an entity to disclose the fair value of its financial instruments using the exit price notion. Exit price is the price that would be received to sell an asset or paid to transfer a liability

in an orderly transaction between market participants at the measurement date. For public entities, the guidance is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. The Company has updated the fair value disclosure on Note 12 Fair Value of Financial Instruments in this report to reflect adoption of this standard, to include using the exit price notion in the fair value disclosure of financial instruments. The Company's adoption of the ASU did not have a significant impact on the Company's consolidated financial statements.

In February 2016, FASB issued ASU 2016-02, Leases (Topic 842). Under the new guidance, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (i) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (ii) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Public business entities should apply the amendments in ASU 2016-02 for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted for all public business entities upon issuance. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. In July 2018, the FASB issued ASU 2018-10, Codification Improvements to Topic 842, Leases which was issued to clarify and correct unintended application of the guidance in ASU 2016-02 (Topic 842). The amendments in this ASU affect aspects of the guidance issued in ASU 2016-02 and provide clarification to related topics; such as, 1) Rate implicit in the lease; 2) Reassessment of leases; 3) Transition guidance; and 4) Impairment of net investment in the lease. In July 2018, the FASB also issued ASU 2018-11 Leases (Topic 842) Targeted Improvements, which provides guidance related to comparative reporting requirements for initial adoption and separating lease and non-lease components. Currently, entities are required to adopt the new standard utilizing the modified retrospective approach. This amendment provides entities with an additional transition method which allows entities to initially apply the new leases standard at the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. Currently, ASU 2016-02, provides a practical expedient to lessees to allow them to not separate non-lease components from lease components; however, it does not provide a similar practical expedient to lessors. This amendment provides a practical expedient to lessors which allows them the option to not separate non-lease components from the associated lease components. However, the Lessor practical expedient is limited to circumstances in which the non-lease components would otherwise be account for under the new revenue guidance (Topic 606). In addition, both of the following conditions must be met: 1) the timing and pattern of transfer are the same for non-lease components and associated lease components 2) the lease component, if accounted for separately, would be classified as an operating lease. An entity that elects the lessor practical expedient is also required to provide certain disclosures. For entities that early adopted Topic 842 the amendments in these ASUs are effective upon issuance. For entities that haven't adopted Topic 842 the effective date and transition requirement are the same as Topic 842. The Company is currently assessing the impact of the new guidance on its consolidated financial statements by reviewing its existing lease contracts and service contracts that may include embedded leases. The Company expects to record an increase in assets and liabilities as a result of recognizing a right-of-use asset and a lease liability for its operating lease commitments.

In June, 2016, the FASB issued ASU 2016-13, Financial Instruments – Credit Losses (Topic 326), which introduces new guidance for the accounting for credit losses on instruments within its scope. The new guidance introduces an approach based on expected losses to estimate credit losses on certain types of financial instruments. It also modifies the impairment model for available-for-sale (AFS) debt securities and provides for a simplified accounting model for purchased financial assets with credit deterioration since their origination. This ASU will be effective for public business entities that are SEC filers in fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. All other entities will have one additional year. Early application of the guidance will be permitted for all entities for fiscal years beginning after December 15, 2018, including interim periods within those



fiscal years. The Company is currently evaluating the impact of the pending adoption of the new standard on its consolidated financial statements. The Company has taken steps to prepare for implementation when it becomes effective, such as evaluating the potential use of outside professionals for an updated model.

In August 2016, FASB issued ASU No. 2016-15, Classification of Certain Cash Receipts and Cash Payments (a consensus of the FASB Emerging Issues Task Force), which addresses eight classification issues related to the statement of cash flows: (i) debt prepayment or debt extinguishment costs, (ii) settlement of zero-coupon bonds, (iii) contingent consideration payments made after a business combination, (iv) proceeds from the settlement of insurance claims, (v) proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies, (vi) distributions received from equity method investees, (vii) beneficial interests in securitization transactions, and (viii) separately identifiable cash flows and application of the predominance principle. ASU 2016-15 is effective for public business entities for annual and interim periods in fiscal years beginning after December 15, 2017. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the ASU in an interim period, adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity that elects early adoption must adopt all of the amendments in the same period. Entities should apply this ASU using a retrospective transition method to each period presented. If it is impracticable for an entity to apply the ASU retrospectively

for some of the issues, it may apply the amendments for those issues prospectively as of the earliest date practicable. The Company's adoption of the ASU did not have a significant impact on the Company's consolidated financial statements.

In January 2017, FASB issued ASU 2017-04, Simplifying the Test for Goodwill Impairment (Topic 350). The main objective of this ASU is to simplify the accounting for goodwill impairment by requiring impairment charges be based upon the first step in the current two-step impairment test under Accounting Standards Codification (ASC) 350. Currently, if the fair value of a reporting unit is lower than its carrying amount (Step 1), an entity calculates any impairment charge by comparing the implied fair value of goodwill with its carrying amount (Step 2). This ASU's objective is to simplify how all entities assess goodwill for impairment by eliminating Step 2 from the goodwill impairment test. As amended, the goodwill impairment test will consist of one step comparing the fair value of a reporting unit with its carrying amount. An entity should recognize a goodwill impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value. The standard will be applied prospectively and is effective for annual and interim impairment tests performed in periods beginning after December 15, 2019. Early adoption is permitted for annual and interim goodwill impairment testing dates after January 1, 2017. The Company is currently evaluating the impact of the pending adoption on its consolidated financial statements.

In March 2017, FASB issued ASU 2017-08, Premium Amortization on Purchased Callable Debt Securities (Subtopic 310-20). The update shortens the amortization period for premiums on purchased callable debt securities to the earliest call date. The amendment will apply only to callable debt securities with explicit, noncontingent call features that are callable at fixed prices and on preset dates, apply to all premiums on callable debt securities, regardless of how they were generated, and require companies to reset the effective yield using the payment terms of the debt security if the call option is not exercised on the earliest call date. The ASU does not require an accounting change for securities held at a discount. The discount continues to be amortized to maturity and does not apply when the investor has already incorporated prepayments into the calculation of its effective yield under other GAAP. The amendments in the ASU are effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within those years. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. The Company's adoption of the ASU will not have a significant impact on the Company's consolidated financial statements.

In August 2017, FASB issued ASU 2017-12 Derivatives and Hedging (Topic 815). The objective of the ASU is to improve the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements and to make improvements to simplify the application of hedge accounting guidance in current GAAP. The amendments in the ASU will, among other things, 1) permit hedge accounting for risk components in hedging relationships involving nonfinancial risk and interest rate risks; 2) change the guidance for designating fair value hedges of interest rate risk and for measuring the change in fair value of the hedged item in fair value hedges of interest rate risk; 3) modify disclosures to include a tabular disclosure related to the effect on the income statement of fair value and cash flow hedges; and 4) eliminate the requirement to disclose the ineffective portion of the change in fair value of hedging instruments. These changes will more closely align the results of cash flow and fair value hedge accounting with risk management activities and the presentation of hedge results in the financial statements. ASU 2017-12 will be effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. For all other entities, the ASU will be effective for fiscal years beginning after December 15, 2019 and interim periods within fiscal years beginning after December 15, 2020. Early application is permitted in any interim period after issuance of the update with all transition requirements and elections being applied to hedging relationships existing on the date of adoption. The Company's adoption of the ASU will not have a significant impact on the Company's consolidated financial statements.

In June 2018, FASB issued ASU 2018-07 Compensation - Stock Compensation (Topic 718). The main objective of this ASU is to simplify the accounting for share-based payment transactions in current GAAP by expanding the scope to include nonemployee share-based payment transactions. This ASU will apply to all share-based payment transactions in which a grantor acquires goods or services to be used in their own operations by issuing share-based payments. This ASU does not apply to share-based payments used to provide financing to the issuer or awards issued in conjunction with selling goods or services to customers as part of a contract accounted for under Topic 606, Revenue from Contracts with Customers. The amendments in the ASU will require an entity to, among other things, 1) measure nonemployee share-based payment awards at the fair value of the equity instruments that an entity is obligated to issue when the good has been delivered or the service has been rendered; 2) measure equity classified nonemployee share-based payment awards at the grant date; and 3) take into consideration the probability of satisfying performance conditions when accounting for nonemployee share-based payment awards with such conditions. ASU 2018-07 will be effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within that fiscal year. Early adoption is permitted; however, an entity's adoption date shall not be earlier than the entity's adoption date of Topic 606. Per review of the ASU, the Company determined that it does not pertain to our current operations; therefore, no evaluation regarding adoption is required.

## NOTE 2 – ACQUISITIONS

On June 20, 2018, the Company announced the signing of a definitive agreement and plan of merger pursuant to which the Company will acquire Enterprise Bank N.J. (“Enterprise Bank”) in an all-stock transaction valued at approximately \$48.2 million (the “Enterprise Merger”). Subject to the terms of the merger agreement, Enterprise Bank will merge with and into SB One Bank and each outstanding share of Enterprise Bank common stock will be exchanged for 0.4538 shares of the Company’s common stock. Based on financials as of March 31, 2018, the combined company will have approximately \$1.6 billion in assets, \$1.3 billion in gross loans, and \$1.2 billion in deposits upon completion of the Enterprise Merger. The Enterprise Merger is expected to enhance and expand the Company's presence in Union, Middlesex and Essex Counties, New Jersey with the addition of 4 full service branch locations in those counties. The Enterprise Merger is expected to be completed in the fourth quarter of 2018. The consummation of the Enterprise Merger is subject to receipt of the requisite approval of Enterprise Bank’s shareholders, receipt of all required regulatory approvals, and other customary closing conditions.

On January 4, 2018 the Company announced the successful closing of the merger with Community Bank of Bergen County, NJ, a New Jersey-chartered bank (“Community”) in an all-stock transaction (the “Community Merger”). The Community Merger enhances and expands Sussex Bank’s presence in Bergen County, New Jersey with the addition of 3 full service branch locations in that county, which will complement Sussex Bank’s existing location in Oradell, New Jersey. Under the terms of the agreement, Community merged with and into SB One Bank, with SB One Bank being the surviving entity and each outstanding share of Community common stock was exchanged for 0.97 shares of SB One Bancorp's common stock. The Company issued 1,873,028 shares of its common stock, having an aggregate fair value of \$51.9 million in the Community Merger and paid approximately \$2 thousand in cash for fractional shares. Outstanding Community stock options were paid out in cash, by the Company, for a total payment of \$140 thousand.

The Community acquisition was accounted for under the acquisition method of accounting. Accordingly, the assets acquired and liabilities assumed in the acquisition were recorded at their estimated fair values based on management's best estimate using information available at the date of the acquisition, including the use of a third party valuation specialist. The following table summarized the estimated fair value of the acquired assets and liabilities assumed at the date of acquisition for Community.

| (Dollars in thousands)                          | January 4,<br>2018 |
|---|--------------------|
| Cash and cash equivalents                       | \$6,693            |
| Interest bearing time deposits with other banks | 100                |
| Securities available for sale                   | 75,909             |
| Other bank stock                                | 1,155              |
| Loans   | 236,070            |
| Foreclosed real estate                          | 1,376              |
| Premises and equipment, net                     | 10,612             |
| Accrued interest receivable                     | 824                |
| Goodwill  | 22,018             |
| Intangibles assets                              | 1,331              |
| Bank-owned life insurance                       | 7,963              |
| Other assets                                    | 1,588              |
| Total Assets                                    | \$365,639          |
| Deposits  | \$(301,157)        |
| Borrowings                                      | (12,000 )          |
| Other liabilities                               | (599 )             |

|   |             |
|---|-------------|
| Total Liabilities                             | \$(313,756) |
| Net consideration paid - common shares issued | \$51,883    |

The core deposit intangible totaled \$1.3 million and is being amortized over its estimated useful life of approximately 10 years using an accelerated method of the sum of the years digits. The goodwill will be evaluated annually for impairment. The goodwill is not deductible for tax purposes. The goodwill recognized from the merger with Community was created based on the consideration paid by the Company for enhancing its presence in the Bergen County, NJ area in addition to our expected synergies from the combined operations of the Company and Community.

The fair values of deposit liabilities with no stated maturities such as checking, money market and savings accounts, were assumed to equal the carrying amounts since these deposits are payable on demand. The fair values of certificates of deposits and IRAs represent the present value of contractual cash flows discounted at market rates for similar certificates of deposit.

The Company has finalized the accounting as a result of the merger with Community.

Fair values of the major categories of assets acquired and liabilities assumed were determined as follows:

#### Investment securities available-for-sale

The estimated fair values of the investment securities available for sale, primarily comprised of U.S. Government agency mortgage-backed securities, U.S. government agencies and municipal bonds, were determined using open market pricing provided by multiple independent securities brokers. Management reviewed the open market quotes used in pricing the securities. A fair value discount of \$261 thousand was recorded on the investments.

#### Loans

Loans acquired in the Community acquisition were recorded at fair value, and there was no carryover related allowance for loan and lease losses. The fair values of loans acquired from Community were estimated using cash flow projections based on the remaining maturity and repricing terms. Cash flows were adjusted for estimated future credit losses and the rate of prepayments. Projected cash flows were then discounted to present value using a risk-adjusted market rate for similar loans. The fair value of the acquired loans receivable had a gross amortized cost basis of \$242.5 million. The table below illustrates the fair value adjustments made to the amortized cost basis in order to present a fair value of the loans acquired. The credit adjustment on purchased credit impaired loans is derived in accordance with ASC 310-30 and represents the portion of the loan balances that has been deemed uncollectible based on the Company's expectations of future cash flows for each respective loan on a level yield amortization over 3.5 years.

(Dollars in thousands)

|   |           |
|---|-----------|
| Gross amortized cost basis at January 4, 2018                   | \$242,471 |
| Fair value adjustment on general pooled loans                   | (3,737 )  |
| Credit fair value adjustment on purchased credit impaired loans | (2,664 )  |
| Fair value of acquired loans at January 4, 2018                 | \$236,070 |

For loans acquired without evidence of credit quality deterioration, the Company prepared the interest rate loan fair value and credit fair value adjustments. Loans were grouped into general pools by characteristics such as loan type, term, collateral and rate. Market rates for similar loans were obtained from various internal and external data sources and reviewed by management for reasonableness. The average of these rates was used as the fair value interest rate a market participant would utilize. A present value approach was utilized to calculate the interest rate fair value premium of \$324 thousand.

Additionally for loans acquired without credit deterioration, a credit fair value adjustment was calculated using a two-part credit fair value analysis: 1) expected lifetime credit migration losses; and 2) estimated fair value adjustment for certain qualitative factors. The expected lifetime losses were calculated using historical losses observed at the Bank, Community and peer banks. The Company also estimated an environmental factor to apply to each loan type. The environmental factor represents potential discount which may arise due to general credit and economic factors. A credit fair value discount of \$4.1 million was determined. Both the interest rate and credit fair value adjustments relate to performing loans and loans acquired with evidence of credit quality deterioration will be substantially recognized as interest income on a level yield amortization method over the weighted average life of the loans of 4 years.

The following is a summary of the loans accounted for in accordance with ASC 310-30 that were acquired in the Community acquisition as of the closing date.

| (Dollars in thousands)  | Acquired<br>Credit<br>Impaired<br>Loans |
|---|---|
| Contractually required principal and interest at acquisition                    | \$ 6,289                                |
| Contractual cash flows not expected to be collected (non-accretable difference) | 1,819                                   |
| Expected cash flows at acquisition  | 4,470                                   |
| Interest component of expected cash flows (accretable difference)               | 846                                     |
| Fair value of acquired loans  | \$ 3,624                                |

#### Bank Premises

The Company acquired three branches of Community, all of which were owned by Community, at a premium of \$3.5 million. The fair value of Community's premises was determined based upon independent third-party appraisals performed by licensed appraisers in the market in which the premises are located which will be amortized on a straight line basis over 40 years.

#### Core Deposit Intangible

The fair value of the core deposit intangible was determined based on a discounted cash flow analysis using a discount rate commensurate with market participants. To calculate cash flows, deposit account servicing costs (net of deposit fee income) and interest expense on deposits were compared to the cost of alternative funding sources available through national brokered CD offering rates. The projected cash flows were developed using projected deposit attrition rates. The core deposit intangible will be amortized over ten years using the sum-of-years digits method.

#### Time Deposits

The fair value adjustment for time deposits represents a discount from the value of the contractual repayments of fixed-maturity deposits using prevailing market interest rates for similar-term time deposits. The time deposit discount of approximately \$965 thousand is being amortized into income on a level yield amortization method over the contractual life of the deposits of 22.5 months and a weighted average life of 16.5 months.

#### Bank Owned Life Insurance

Community's bank-owned life insurance book value was \$8.0 million with no fair value adjustment.

The following table presents certain pro forma information as if Community had been acquired on January 1, 2017. These results combine the historical results of the Company in the Company's Consolidated Statements of Income and, while certain adjustments were made for the estimated impact of certain fair value adjustments and other acquisition-related activity, they are not indicative of what would have occurred had the acquisition taken place on January 1, 2017. In particular, no adjustments have been made to eliminate the amount of Community's provision for loan losses that would not have been necessary had the acquired loans been recorded at fair value as of January 1, 2017. The Company expects to achieve further operating cost savings and other business synergies as a result of the acquisition which are not reflected in the pro forma amounts below:

| (Dollars in thousands)  | For the<br>Year<br>Ended<br>December<br>31, 2017 |
|---|--|
| Total revenues (net interest income plus non-interest income) | \$ 47,280  |
| Net Income  | 6,257  |
| Net earnings applicable to common stockholders                | \$ 0.79  |





The following table presents certain pro forma information as if Community had been acquired on January 1, 2018. These results combine the historical results of the Company in the Company's Consolidated Statements of Income and, while certain adjustments were made for the estimated impact of certain fair value adjustments and other acquisition-related activity, they are not indicative of what would have occurred had the acquisition taken place on January 1, 2018. The Company expects to achieve further operating cost savings and other business synergies as a result of the acquisition which are not reflected in the pro forma amounts below:

| (Dollars in thousands)  | For the<br>Six<br>Months<br>Ended<br>June 30,<br>2018 |
|---|---|
| Total revenues (net interest income plus non-interest income) | \$27,491  |
| Net Income  | 4,312   |
| Net earnings applicable to common stockholders                | \$0.55  |

Following the closing of the Community Merger on January 4, 2018, the Company reported the results of the combined Company. The Company cannot disaggregate the additional revenue and income before extraordinary items provided by Community since the Company operates as one consolidated entity on its internal systems. The cumulative effect to the Company's net income and net income per share are reported on a consolidated basis for the period ended June 30, 2018.

#### NOTE 3 – SECURITIES

##### Available for Sale

The amortized cost and approximate fair value of securities available for sale as of June 30, 2018 and December 31, 2017 are summarized as follows:

| (Dollars in thousands)                | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|---------------------------------------|-------------------|------------------------------|-------------------------------|---------------|
| June 30, 2018                         |                   |                              |                               |               |
| U.S. government agencies              | \$ 28,000         | \$ 16                        | \$ (247 )                     | \$27,769      |
| U.S. government-sponsored enterprises | 17,490            | 13                           | (86 )                         | 17,417        |
| State and political subdivisions      | 59,650            | 309                          | (699 )                        | 59,260        |
| Mortgage-backed securities -          |                   |                              |                               |               |
| U.S. government-sponsored enterprises | 69,492            | 35                           | (1,471 )                      | 68,056        |
| Corporate Debt                        | 2,000             | 23                           | —                             | 2,023         |
|                                       | \$ 176,632        | \$ 396                       | \$ (2,503 )                   | \$ 174,525    |
| December 31, 2017                     |                   |                              |                               |               |
| U.S. government agencies              | \$ 18,799         | \$ 90                        | \$ (28 )                      | \$ 18,861     |
| U.S. government-sponsored enterprises | 6,054             | 8                            | (1 )                          | 6,061         |
| State and political subdivisions      | 40,470            | 896                          | (132 )                        | 41,234        |
| Mortgage-backed securities -          |                   |                              |                               |               |
| U.S. government-sponsored enterprises | 30,958            | 65                           | (479 )                        | 30,544        |
| Corporate Debt                        | 2,000             | —                            | (18 )                         | 1,982         |

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\$98,281 \$1,089 \$(640) \$98,730

Securities with a carrying value of approximately \$3.1 million and \$17.3 million at June 30, 2018 and December 31, 2017, respectively, were pledged to secure public deposits and for borrowings at the Federal Reserve Bank as required or permitted by applicable laws and regulations.

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The amortized cost and fair value of securities available for sale at June 30, 2018 are shown below by contractual maturity. Actual maturities may differ from contractual maturities as issuers may have the right to call or prepay obligations with or without call or prepayment penalties. Investments which pay principal on a periodic basis are not included in the maturity categories.

| (Dollars in thousands)                 | Amortized Fair |            |
|--|----------------|------------|
|  | Cost           | Value      |
| Due in one year or less                | \$ —           | \$ —       |
| Due after one year through five years  | —              | —          |
| Due after five years through ten years | 4,952          | 4,936      |
| Due after ten years                    | 56,698         | 56,347     |
| Total bonds and obligations            | 61,650         | 61,283     |
| U.S. government agencies               | 28,000         | 27,769     |
| U.S. government-sponsored enterprises  | 17,490         | 17,417     |
| Mortgage-backed securities:            |                |            |
| U.S. government-sponsored enterprises  | 69,492         | 68,056     |
| Total available for sale securities    | \$ 176,632     | \$ 174,525 |

Gross realized gains on sales of securities available for sale were \$46 thousand and gross realized losses were \$10 thousand for the three months ended June 30, 2018. Gross realized gains on sales of securities available for sale were \$19 thousand and gross losses were \$49 thousand for the three months ended June 30, 2017.

Gross realized gains on sales of securities available for sale were \$46 thousand and \$165 thousand and gross realized losses were \$10 thousand and \$88 thousand for the six months ended June 30, 2018 and 2017, respectively.

#### Temporarily Impaired Securities

The following table shows gross unrealized losses and fair value of securities with unrealized losses that are not deemed to be other than temporarily impaired, aggregated by category and length of time that individual available for sale securities have been in a continuous unrealized loss position at June 30, 2018 and December 31, 2017.

| (Dollars in thousands)                | Less Than 12 Months |                         | 12 Months or More |                         | Total      |                         |
|---------------------------------------|---------------------|-------------------------|-------------------|-------------------------|------------|-------------------------|
|                                       | Fair Value          | Gross Unrealized Losses | Fair Value        | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| June 30, 2018                         |                     |                         |                   |                         |            |                         |
| U.S. government agencies              | \$21,676            | \$(229)                 | \$1,289           | \$(18)                  | \$22,965   | \$(247)                 |
| U.S. government-sponsored enterprises | 14,904              | (86)                    | —                 | —                       | 14,904     | (86)                    |
| State and political subdivisions      | 33,618              | (546)                   | 3,605             | (153)                   | 37,223     | (699)                   |
| Mortgage-backed securities -          |                     |                         |                   |                         |            |                         |
| U.S. government-sponsored enterprises | 49,731              | (908)                   | 14,170            | (563)                   | 63,901     | (1,471)                 |
| Total temporarily impaired securities | \$119,929           | \$(1,769)               | \$19,064          | \$(734)                 | \$138,993  | \$(2,503)               |
| December 31, 2017                     |                     |                         |                   |                         |            |                         |
| U.S. government agencies              | \$5,280             | \$(28)                  | \$—               | \$—                     | \$5,280    | \$(28)                  |
| U.S. government-sponsored enterprises | 3,469               | (1)                     | —                 | —                       | 3,469      | (1)                     |
| State and political subdivisions      | 5,212               | (42)                    | 3,701             | (90)                    | 8,913      | (132)                   |
| Mortgage-backed securities -          |                     |                         |                   |                         |            |                         |
| U.S. government-sponsored enterprises | 8,403               | (212)                   | 12,935            | (267)                   | 21,338     | (479)                   |
| Total temporarily impaired securities | \$22,364            | \$(283)                 | \$16,636          | \$(357)                 | \$39,000   | \$(640)                 |

For each security whose fair value is less than its amortized cost basis, a review is conducted to determine if an other-than-temporary impairment has occurred. As of June 30, 2018, we reviewed our available for sale securities portfolio for indications of impairment. This review included analyzing the length of time and the extent to which the fair value was lower than the cost, the financial condition and near-term prospects of the issuer, including any specific events which may influence the operations of the issuer and the intent and likelihood of selling the security. The intent and likelihood of sale of debt and equity securities are evaluated

based upon our investment strategy for the particular type of security and our cash flow needs, liquidity position, capital adequacy and interest rate risk position.

#### U.S. Government Agencies

At June 30, 2018 and December 31, 2017, the declines in fair value and the unrealized losses for our U.S. government agencies securities were primarily due to changes in spreads and market conditions and not credit quality. At June 30, 2018, there were seventeen securities with a fair value of \$23.0 million that had an unrealized loss that amounted to \$247 thousand. As of June 30, 2018, we did not intend to sell and it was not more-likely-than-not that we would be required to sell any of these securities before recovery of their amortized cost basis. Therefore, none of the U.S. government agency securities at June 30, 2018 were deemed to be other-than-temporarily impaired (“OTTI”).

At December 31, 2017, there were three securities with a fair value of \$5.3 million that had an unrealized loss that amounted to \$28 thousand.

#### U.S. Government Sponsored Agencies

At June 30, 2018 and December 31, 2017, the decline in fair value and the unrealized losses for our U.S. government sponsored agencies securities were primarily due to changes in spreads and market conditions and not credit quality. At June 30, 2018, there were seven securities with a fair value of \$14.9 million that had an unrealized loss that amounted to \$86 thousand. As of June 30, 2018, we did not intend to sell and it was not more-likely-than-not that we would be required to sell any of these securities before recovery of their amortized cost basis. Therefore, none of the U.S. government sponsored agency securities at June 30, 2018, were deemed to be OTTI.

At December 31, 2017, there were two securities with a fair value of \$3.5 million that had an unrealized loss that amounted to \$1 thousand.

#### State and Political Subdivisions

At June 30, 2018 and December 31, 2017, the decline in fair value and the unrealized losses for our state and political subdivisions securities were caused by changes in interest rates and spreads and were not the result of credit quality. At June 30, 2018, there were thirty-five securities with a fair value of \$37.2 million that had an unrealized loss that amounted to \$699 thousand. These securities typically have maturity dates greater than 10 years and the fair values are more sensitive to changes in market interest rates.

At December 31, 2017, there were nine securities with a fair value of \$8.9 million that had an unrealized loss that amounted to \$132 thousand.

#### Mortgage-Backed Securities

At June 30, 2018 and December 31, 2017, the decline in fair value and the unrealized losses for our mortgage-backed securities guaranteed by U.S. government-sponsored enterprises were primarily due to changes in spreads and market conditions and not credit quality. At June 30, 2018, there were thirty-nine securities with a fair value of \$63.9 million that had an unrealized loss that amounted to \$1.5 million. As of June 30, 2018, we did not intend to sell and it was not more-likely-than-not that we would be required to sell any of these securities before recovery of their amortized cost basis. Therefore, none of our mortgage-backed securities at June 30, 2018 were deemed to be OTTI.

At December 31, 2017, there were sixteen securities with a fair value of \$21.3 million that had an unrealized loss that amounted to \$479 thousand.

#### Corporate Debt

At June 30, 2018, there were no securities that had an unrealized loss. These securities typically have maturity dates greater than 5 years and the fair values are more sensitive to changes in market interest rates. As of June 30, 2018, we

did not intend to sell and it was more-likely-than-no that we would be required to sell any of these securities before recovery of their amortized cost basis. Therefore, none of our corporate debt as June 30, 2018, were deemed to be OTTI.

At December 31, 2017, there were no securities with an unrealized loss.

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## Held to Maturity Securities

The amortized cost and approximate fair value of securities held to maturity as of June 30, 2018 and December 31, 2017 are summarized as follows:

| (Dollars in thousands)           | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|----------------------------------|----------------|------------------------|-------------------------|------------|
| June 30, 2018                    |                |                        |                         |            |
| State and political subdivisions | \$ 5,418       | \$ 91                  | \$ (1 )                 | \$5,508    |
| December 31, 2017                |                |                        |                         |            |
| State and political subdivisions | \$ 5,304       | \$ 127                 | \$ (1 )                 | \$5,430    |

The amortized cost and carrying value of securities held to maturity at June 30, 2018 are shown below by contractual maturity. Actual maturities may differ from contractual maturities as issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

| (Dollars in thousands)                 | Amortized Cost | Fair Value |
|--|----------------|------------|
| Due in one year or less                | \$ 2,605       | \$2,614    |
| Due after one year through five years  | 253            | 252        |
| Due after five years through ten years | 2,031          | 2,090      |
| Due after ten years                    | 529            | 552        |
| Total held to maturity securities      | \$ 5,418       | \$5,508    |

## Temporarily Impaired Securities

For each security whose fair value is less than its amortized cost basis, a review is conducted to determine if an other-than-temporary impairment has occurred. As of June 30, 2018, there were two securities with a fair value of \$771 thousand that had an unrealized loss of \$1 thousand. This review includes analyzing the length of time and the extent to which the fair value has been lower than the cost, the financial condition and near-term prospects of the issuer, including any specific events which may influence the operations of the issuer and the intent and likelihood of selling the security. The intent and likelihood of sale of debt securities is evaluated based upon our investment strategy for the particular type of security and our cash flow needs, liquidity position, capital adequacy and interest rate risk position. For each security whose fair value is less than their amortized cost basis, a review is conducted to determine if an other-than-temporary impairment has occurred.

At December 31, 2017, there was one security with a fair value of \$254 thousand that had an unrealized loss of \$1 thousand.

| (Dollars in thousands)                | Less Than 12 Months |                         | 12 Months or More |                         | Total      |                         |
|---------------------------------------|---------------------|-------------------------|-------------------|-------------------------|------------|-------------------------|
|                                       | Fair Value          | Gross Unrealized Losses | Fair Value        | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| June 30, 2018                         |                     |                         |                   |                         |            |                         |
| State and political subdivisions      | \$771               | \$ (1 )                 | \$ —              | \$ —                    | —\$771     | \$ (1 )                 |
| Total temporarily impaired securities | \$771               | \$ (1 )                 | \$ —              | \$ —                    | —\$771     | \$ (1 )                 |
| December 31, 2017                     |                     |                         |                   |                         |            |                         |

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|                                       |       |         |        |        |         |
|---------------------------------------|-------|---------|--------|--------|---------|
| State and political subdivisions      | \$254 | \$ (1 ) | \$ —\$ | —\$254 | \$ (1 ) |
| Total temporarily impaired securities | \$254 | \$ (1 ) | \$ —\$ | —\$254 | \$ (1 ) |



## NOTE 4 – LOANS

The composition of net loans receivable at June 30, 2018 and December 31, 2017 is as follows:

| (Dollars in thousands)             | June 30,<br>2018 | December 31,<br>2017 |
|------------------------------------|------------------|----------------------|
| Commercial and industrial          | \$62,418         | \$ 54,759            |
| Construction                       | 62,135           | 42,484               |
| Commercial real estate             | 687,810          | 551,445              |
| Residential real estate            | 322,983          | 171,844              |
| Consumer and other                 | 2,205            | 1,130                |
| Total loans receivable             | 1,137,551        | 821,662              |
| Unearned net loan origination fees | (1,005 )         | (962 )               |
| Allowance for loan losses          | (8,264 )         | (7,335 )             |
| Net loans receivable               | \$ 1,128,282     | \$ 813,365           |

Mortgage loans serviced for others are not included in the accompanying balance sheets. The total amount of loans serviced for the benefit of others was approximately \$234 thousand and \$239 thousand at June 30, 2018 and December 31, 2017, respectively.

## Purchased Credit Impaired Loans

The carrying value of loans acquired in the Community acquisition and accounted for in accordance with ASC Subtopic 310-30, “Loans and Debt Securities Acquired with Deteriorated Credit Quality,” was \$3.6 million at June 30, 2018, which was \$10 thousand more than the balance at the time of acquisition on January 4, 2018. Under ASC Subtopic 310-30, these loans, referred to as purchased credit impaired (“PCI”) loans, may be aggregated and accounted for as pools of loans if the loans being aggregated have common risk characteristics. The Company elected to account for the loans with evidence of credit deterioration individually rather than aggregate them into pools. The difference between the undiscounted cash flows expected at acquisition and the investment in the acquired loans, or the “accretable yield,” is recognized as interest income utilizing the level-yield method over the life of each loan. Contractually required payments for interest and principal that exceed the undiscounted cash flows expected at acquisition, or the “non-accretable difference,” are not recognized as a yield adjustment, as a loss accrual or as a valuation allowance.

Increases in expected cash flows subsequent to the acquisition are recognized prospectively through an adjustment of the yield on the loans over the remaining life, while decreases in expected cash flows are recognized as impairments through a loss provision and an increase in the allowance for loan and lease losses. Valuation allowances (recognized in the allowance for loan and lease losses) on these impaired loans reflect only losses incurred after the acquisition (representing all cash flows that were expected at acquisition but currently are not expected to be received).

The following table presents changes in the accretable yield for PCI loans:

| (Dollars in thousands)              | Six<br>months<br>ended<br>June<br>30,<br>2018 |
|-------------------------------------|---|
| Accretable yield, beginning balance | \$ —  |

|   |        |
|---|--------|
| Acquisition of impaired loans                   | 846    |
| Accretable yield amortized to interest income   | (152 ) |
| Reclassification from non-accretable difference | —      |
| Accretable yield, ending balance                | \$ 694 |

There were no PCI loans in 2017.

## NOTE 5 – ALLOWANCE FOR LOAN LOSSES AND CREDIT QUALITY OF FINANCING RECEIVABLES

The following table presents changes in the allowance for loan losses disaggregated by the class of loans receivable for the three and six months ended June 30, 2018 and 2017:

| (Dollars in thousands) | Commercial<br>and<br>Industrial | Commercial<br>Construction | Commercial<br>Real<br>Estate | Residential<br>Real<br>Estate | Consumer<br>and<br>Other | Unallocated | Total   |
|------------------------|---------------------------------|----------------------------|------------------------------|-------------------------------|--------------------------|-------------|---------|
| Three Months Ended:    |                                 |                            |                              |                               |                          |             |         |
| June 30, 2018          |                                 |                            |                              |                               |                          |             |         |
| Beginning balance      | \$ 389                          | \$ 345                     | \$ 5,801                     | \$ 972                        | \$ 31                    | \$ 290      | \$7,828 |
| Charge-offs            | —                               | —                          | —                            | (10 )                         | (31 )                    | —           | (41 )   |
| Recoveries             | 1                               | —                          | 5                            | 62                            | 11                       | —           | 79      |
| Provision              | 50                              | 57                         | (317 )                       | 114                           | 16                       | 478         | 398     |
| Ending balance         | \$ 440                          | \$ 402                     | \$ 5,489                     | \$ 1,138                      | \$ 27                    | \$ 768      | \$8,264 |
| June 30, 2017          |                                 |                            |                              |                               |                          |             |         |
| Beginning balance      | \$ 92                           | \$ 425                     | \$ 4,025                     | \$ 925                        | \$ 17                    | \$ 1,313    | \$6,797 |
| Charge-offs            | —                               | —                          | —                            | (8 )                          | (8 )                     | —           | (16 )   |
| Recoveries             | —                               | —                          | 2                            | 1                             | 1                        | —           | 4       |
| Provision              | 109                             | 53                         | 216                          | (1 )                          | 10                       | (7 )        | 380     |
| Ending balance         | \$ 201                          | \$ 478                     | \$ 4,243                     | \$ 917                        | \$ 20                    | \$ 1,306    | \$7,165 |
| Six Months Ended:      |                                 |                            |                              |                               |                          |             |         |
| June 30, 2018          |                                 |                            |                              |                               |                          |             |         |
| Beginning balance      | \$ 208                          | 336                        | \$ 5,185                     | \$ 1,032                      | \$ 26                    | \$ 548      | \$7,335 |
| Charge-offs            | (11 )                           | —                          | —                            | (22 )                         | (42 )                    | —           | (75 )   |
| Recoveries             | 2                               | —                          | 6                            | 72                            | 18                       | —           | 98      |
| Provision              | 241                             | 66                         | 298                          | 56                            | 25                       | 220         | 906     |
| Ending balance         | \$ 440                          | \$ 402                     | \$ 5,489                     | \$ 1,138                      | \$ 27                    | \$ 768      | \$8,264 |
| June 30, 2017          |                                 |                            |                              |                               |                          |             |         |
| Beginning balance      | \$ 110                          | 359                        | \$ 3,932                     | \$ 899                        | \$ 19                    | \$ 1,377    | \$6,696 |
| Charge-offs            | (13 )                           | —                          | (266 )                       | (42 )                         | (13 )                    | —           | (334 )  |
| Recoveries             | —                               | —                          | 4                            | 9                             | 3                        | —           | 16      |
| Provision              | 104                             | 119                        | 573                          | 51                            | 11                       | (71 )       | 787     |
| Ending balance         | \$ 201                          | \$ 478                     | \$ 4,243                     | \$ 917                        | \$ 20                    | \$ 1,306    | \$7,165 |

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The following table presents the balance of the allowance of loan losses and loans receivable by class at June 30, 2018 and December 31, 2017 disaggregated on the basis of our impairment methodology.

| (Dollars in thousands)    | Allowance for Loan Losses |  |  | Loans Receivable |  |  |
|---------------------------|---------------------------|--|--|------------------|--|--|
|                           | Balance                   | Balance<br>Loans<br>Individually<br>Evaluated<br>for<br>Impairment | Balance<br>Related to<br>Loans<br>Collectively<br>Evaluated<br>for<br>Impairment | Balance          | Individually<br>Evaluated<br>for<br>Impairment | Collectively<br>Evaluated<br>for<br>Impairment |
| June 30, 2018             |                           |  |  |                  |  |  |
| Commercial and industrial | \$440                     | \$ 78  | \$ 362   | \$62,418         | \$ 189   | \$62,229                                       |
| Construction              | 402                       | —  | 402  | 62,135           | —  | 62,135   |
| Commercial real estate    | 5,489                     | 27   | 5,462  | 687,810          | 13,736   | 674,074  |
| Residential real estate   | 1,138                     | —  | 1,138  | 322,983          | 3,936  | 319,047  |
| Consumer and other loans  | 27                        | —  | 27   | 2,205            | —  | 2,205  |
| Unallocated               | 768                       | —  | —  | —                | —  | —  |
| Total                     | \$8,264                   | \$ 105   | \$ 7,391   | \$1,137,551      | \$ 17,861                                      | \$1,119,690                                    |
| December 31, 2017         |                           |  |  |                  |  |  |
| Commercial and industrial | \$208                     | \$—  | \$208  | \$54,759         | \$20   | \$54,739                                       |
| Construction              | 336                       | —  | 336  | 42,484           | —  | 42,484   |
| Commercial real estate    | 5,185                     | 28   | 5,157  | 551,445          | 4,763  | 546,682  |
| Residential real estate   | 1,032                     | 10   | 1,022  | 171,844          | 2,064  | 169,780  |
| Consumer and other loans  | 26                        | —  | 26   | 1,130            | —  | 1,130  |
| Unallocated               | 548                       | —  | —  | —                | —  | —  |
| Total                     | \$7,335                   | \$38   | \$6,749  | \$821,662        | \$6,847  | \$814,815                                      |

An age analysis of loans receivable, which were past due as of June 30, 2018 and December 31, 2017, is as follows:

| (Dollars in thousands)    | 30-59<br>Days<br>Past<br>Due | 60-89<br>days<br>Past<br>Due | Greater<br>Than<br>90 Days<br>(a) | Total<br>Past<br>Due | Current     | Total<br>Financing<br>Receivables | Recorded<br>Investment<br>> 90 Days<br>and<br>Accruing |
|---------------------------|------------------------------|------------------------------|-----------------------------------|----------------------|-------------|-----------------------------------|--|
| June 30, 2018             |                              |                              |                                   |                      |             |                                   |  |
| Commercial and industrial | \$—                          | \$ 104                       | \$ 189                            | \$ 293               | \$62,125    | \$62,418                          | \$ —   |
| Construction              | —                            | —                            | —                                 | —                    | 62,135      | 62,135                            | —  |
| Commercial real estate    | 1,387                        | 487                          | 13,891                            | 15,765               | 672,045     | 687,810                           | —  |
| Residential real estate   | 683                          | 53                           | 4,521                             | 5,257                | 317,726     | 322,983                           | —  |
| Consumer and other        | 154                          | —                            | —                                 | 154                  | 2,051       | 2,205                             | —  |
| Total                     | \$2,224                      | \$644                        | \$18,601                          | \$21,469             | \$1,116,082 | \$1,137,551                       | \$ —   |
| December 31, 2017         |                              |                              |                                   |                      |             |                                   |  |
| Commercial and industrial | \$—                          | \$—                          | \$20                              | \$20                 | \$54,739    | \$54,759                          | \$—  |
| Construction              | —                            | —                            | 105                               | 105                  | 42,379      | 42,484                            | —  |
| Commercial real estate    | 4,935                        | 126                          | 4,314                             | 9,374                | 542,071     | 551,445                           | —  |
| Residential real estate   | 1,304                        | 122                          | 1,581                             | 3,007                | 168,837     | 171,844                           | —  |

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|                    |         |       |         |          |           |           |     |
|--------------------|---------|-------|---------|----------|-----------|-----------|-----|
| Consumer and other | 8       | 1     | —       | 9        | 1,121     | 1,130     | —   |
| Total              | \$6,247 | \$249 | \$6,020 | \$12,515 | \$809,147 | \$821,662 | \$— |

(a) includes loans greater than 90 days past due and still accruing and non-accrual loans.

Loans for which the accrual of interest has been discontinued, excluding PCI loans, at June 30, 2018 and December 31, 2017 were:

| (Dollars in thousands)    | June 30, December 31, |          |
|---------------------------|-----------------------|----------|
|                           | 2018                  | 2017     |
| Commercial and industrial | \$ 189                | \$ 20    |
| Construction              | —                     | 105      |
| Commercial real estate    | 13,891                | 4,314    |
| Residential real estate   | 4,521                 | 1,581    |
| Total                     | \$18,601              | \$ 6,020 |

In determining the adequacy of the allowance for loan losses, we estimate losses based on the identification of specific problem loans through our credit review process and also estimate losses inherent in other loans on an aggregate basis by loan type. The credit review process includes the independent evaluation of the loan officer assigned risk ratings by the Chief Credit Officer and a third party loan review company. Such risk ratings are assigned loss component factors that reflect our loss estimate for each group of loans. It is management's and the Board of Directors' responsibility to oversee the lending process to ensure that all credit risks are properly identified, monitored, and controlled, and that loan pricing, terms and other safeguards against non-performance and default are commensurate with the level of risk undertaken and is rated as such based on a risk-rating system. Factors considered in assigning risk ratings and loss component factors include: borrower specific information related to expected future cash flows and operating results, collateral values, financial condition and payment status; levels of and trends in portfolio charge-offs and recoveries; levels in portfolio delinquencies; effects of changes in loan concentrations and observed trends in the economy and other qualitative measurements.

Our risk-rating system is consistent with the classification system used by regulatory agencies and with industry practices. Loan classifications of Substandard, Doubtful or Loss are consistent with the regulatory definitions of classified assets. The classification system is as follows:

**Pass:** This category represents loans performing to contractual terms and conditions and the primary source of repayment is adequate to meet the obligation. We have five categories within the Pass classification depending on strength of repayment sources, collateral values and financial condition of the borrower.

**Special Mention:** This category represents loans performing to contractual terms and conditions; however the primary source of repayment or the borrower is exhibiting some deterioration or weaknesses in financial condition that could potentially threaten the borrowers' future ability to repay our loan principal and interest or fees due.

**Substandard:** This category represents loans that the primary source of repayment has significantly deteriorated or weakened which has or could threaten the borrowers' ability to make scheduled payments. The weaknesses require close supervision by management and there is a distinct possibility that we could sustain some loss if the deficiencies are not corrected. Such weaknesses could jeopardize the timely and ultimate collection of our loan principal and interest or fees due. Loss may not be expected or evident, however, loan repayment is inadequately supported by current financial information or pledged collateral.

**Doubtful:** Loans so classified have all the inherent weaknesses of a substandard loan with the added provision that collection or liquidation in full is highly questionable and not reasonably assured. The probability of at least partial loss is high, but extraneous factors might strengthen the asset to prevent loss. The validity of the extraneous factors must be continuously monitored. Once these factors are questionable the loan should be considered for full or partial charge-off.

Loss: Loans so classified are considered uncollectible, and of such little value that their continuance as active assets is not warranted. Such loans are fully charged off.

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The following tables illustrate our corporate credit risk profile by creditworthiness category as of June 30, 2018 and December 31, 2017:

| (Dollars in thousands)    | Pass        | Special<br>Mention | Substandard | Doubtful | Total        |
|---------------------------|-------------|--------------------|-------------|----------|--------------|
| June 30, 2018             |             |                    |             |          |              |
| Commercial and industrial | \$61,894    | \$ —               | \$ 524      | \$ —     | —\$62,418    |
| Construction              | 61,998      | 137                | —           | —        | 62,135       |
| Commercial real estate    | 668,858     | 4,157              | 14,795      | —        | 687,810      |
| Residential real estate   | 315,862     | 349                | 6,772       | —        | 322,983      |
| Consumer and other        | 2,205       | —                  | —           | —        | 2,205        |
|                           | \$1,110,817 | \$ 4,643           | \$ 22,091   | \$ —     | —\$1,137,551 |
| December 31, 2017         |             |                    |             |          |              |
| Commercial and industrial | \$54,405    | \$189              | \$165       | \$—      | —\$54,759    |
| Construction              | 42,379      | 105                | —           | —        | —42,484      |
| Commercial real estate    | 537,636     | 3,508              | 10,301      | —        | —551,445     |
| Residential real estate   | 169,395     | 228                | 2,221       | —        | —171,844     |
| Consumer and other        | 1,130       | —                  | —           | —        | —1,130       |
|                           | \$804,945   | \$4,030            | \$12,687    | \$—      | —\$821,662   |

The following table reflects information about our impaired loans, excluding PCI loans, by class as of June 30, 2018 and December 31, 2017:

| (Dollars in thousands)              | June 30, 2018          |                                |                      | December 31, 2017      |                                |                      |
|-------------------------------------|------------------------|--------------------------------|----------------------|------------------------|--------------------------------|----------------------|
|                                     | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance |
| With no related allowance recorded: |                        |                                |                      |                        |                                |                      |
| Commercial and industrial           | \$—                    | \$ 10                          | \$ —                 | —\$ 20                 | \$ 20                          | \$ —                 |
| Commercial real estate              | 12,808                 | 808                            | —                    | 3,834                  | 4,158                          | —                    |
| Residential real estate             | 3,936                  | 936                            | —                    | 1,844                  | 1,877                          | —                    |
| With an allowance recorded:         |                        |                                |                      |                        |                                |                      |
| Commercial and industrial           | 189                    | 189                            | 78                   | —                      | —                              | —                    |
| Commercial real estate              | 928                    | 928                            | 27                   | 929                    | 1,392                          | 28                   |
| Residential real estate             | —                      | —                              | —                    | 220                    | 223                            | 10                   |
| Total:                              |                        |                                |                      |                        |                                |                      |
| Commercial and industrial           | 189                    | 199                            | 78                   | 20                     | 20                             | —                    |
| Commercial real estate              | 13,736                 | 13,736                         | 27                   | 4,763                  | 5,550                          | 28                   |
| Residential real estate             | 3,936                  | 3,936                          | —                    | 2,064                  | 2,100                          | 10                   |
|                                     | \$17,861               | \$17,871                       | \$105                | \$6,847                | \$7,670                        | \$38                 |



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The following table presents the average recorded investment and income recognized for our impaired loans, excluding PCI loans, for the three and six months ended June 30, 2018 and 2017:

| (Dollars in thousands)                           | For the Three Months Ended June 30, 2018 |                                    | For the Three Months Ended June 30, 2017 |                                    |
|--|--|------------------------------------|--|------------------------------------|
|  | Average Recorded Investment              | Average Interest Income Recognized | Average Recorded Investment              | Average Interest Income Recognized |
| With no related allowance recorded:              |  |                                    |  |                                    |
| Commercial and industrial                        | \$—                                      | \$ —                               | \$20                                     | \$ —                               |
| Construction                                     | 53                                       | —                                  | —  | —                                  |
| Commercial real estate                           | 8,358                                    | 71                                 | 3,237                                    | 8                                  |
| Residential real estate                          | 3,499                                    | 19                                 | 1,742                                    | 8                                  |
| Total impaired loans without a related allowance | 11,910                                   | 90                                 | 4,999                                    | 16                                 |
| With an allowance recorded:                      |  |                                    |  |                                    |
| Commercial and industrial                        | 94                                       | —                                  | —  | —                                  |
| Commercial real estate                           | 929                                      | —                                  | 1,168                                    | —                                  |
| Residential real estate                          | —  | —                                  | 134                                      | —                                  |
| Total impaired loans with an allowance           | 1,023                                    | —                                  | 1,302                                    | —                                  |
| Total impaired loans                             | \$12,933                                 | \$ 90                              | \$6,301                                  | \$ 16                              |
|  |  |                                    |  |                                    |
| (Dollars in thousands)                           | For the Six Months Ended June 30, 2018   |                                    | For the Six Months Ended June 30, 2017   |                                    |
|  | Average Recorded Investment              | Average Interest Income Recognized | Average Recorded Investment              | Average Interest Income Recognized |
| With no related allowance recorded:              |  |                                    |  |                                    |
| Commercial and industrial                        | \$12                                     | \$ —                               | \$20                                     | \$ —                               |
| Construction                                     | 21                                       | —                                  | —  | —                                  |
| Commercial real estate                           | 5,638                                    | 83                                 | 2,560                                    | 8                                  |
| Residential real estate                          | 2,520                                    | 30                                 | 1,544                                    | 9                                  |
| Total impaired loans without a related allowance | 8,191                                    | 113                                | 4,124                                    | 17                                 |
| With an allowance recorded:                      |  |                                    |  |                                    |
| Commercial and industrial                        | 38                                       | —                                  | 3  | —                                  |
| Commercial real estate                           | 1,071                                    | —                                  | 1,879                                    | 8                                  |
| Residential real estate                          | 64                                       | —                                  | 200                                      | —                                  |
| Total impaired loans with an allowance           | 1,173                                    | —                                  | 2,082                                    | 8                                  |
| Total impaired loans                             | \$9,364                                  | \$ 113                             | \$6,206                                  | \$ 25                              |

We recognize interest income on performing impaired loans as payments are received. On non-performing impaired loans we do not recognize interest income as all payments are recorded as a reduction of principal on such loans.

Impaired loans include loans modified in troubled debt restructurings where concessions have been granted to borrowers experiencing financial difficulties. These concessions could include a reduction in the interest rate on the loan, payment extensions, postponement or forgiveness of principal, forbearance or other actions intended to

maximize collection. The concessions rarely result in the forgiveness of principal or accrued interest. In addition, we attempt to obtain additional collateral or guarantor support when modifying such loans. Non-accruing restructured loans may be returned to accrual status when there has been a sustained period of repayment performance (generally six consecutive months of payments) and both principal and interest are deemed collectible.

The following table presents the recorded investment in troubled debt restructured loans, based on payment performance status:

| (Dollars in thousands) | Commercial<br>Real Estate | Residential<br>Real<br>Estate | Total   |
|------------------------|---------------------------|-------------------------------|---------|
| June 30, 2018          |                           |                               |         |
| Performing             | \$ 643                    | \$ 1,141                      | \$1,784 |
| Non-performing         | 2,497                     | 1,009                         | 3,506   |
| Total                  | \$ 3,140                  | \$ 2,150                      | \$5,290 |
| December 31, 2017      |                           |                               |         |
| Performing             | \$449                     | \$483                         | \$932   |
| Non-performing         | 1,594                     | 242                           | 1,836   |
| Total                  | \$2,043                   | \$725                         | \$2,768 |

Troubled debt restructured loans are considered impaired and are included in the previous impaired loans disclosures in this footnote. As of June 30, 2018, we have not committed to lend additional amounts to customers with outstanding loans that are classified as troubled debt restructuring.

There was one troubled debt restructuring in the amount of \$514 thousand that occurred during the three and six months ended June 30, 2018. There were three troubled debt restructuring in the amount of \$637 thousand that occurred during the three and six months ended June 30, 2017. The increase in troubled debt restructured loans was due to loans acquired in the Community acquisition.

| (Dollars in thousands)  | Number<br>of<br>Loans | Pre-Modification<br>Outstanding<br>Recorded<br>Investment | Post-Modification<br>Outstanding<br>Recorded<br>Investment |
|-------------------------|-----------------------|---|--|
| June 30, 2018           |                       |   |  |
| Residential real estate | 1                     | \$ 514  | \$ 306   |
| June 30, 2017           |                       |   |  |
| Residential real estate | 3                     | \$ 637  | \$ 615   |

There was no troubled debt restructuring for which there was a payment default within twelve months following the date of the restructuring for the three months ended June 30, 2018. There was no troubled debt restructuring for which there was a payment default within twelve months following the date of the restructuring for the three months ended June 30, 2017.

We may obtain physical possession of residential real estate collateralizing a consumer mortgage loan via foreclosure on an in-substance repossession. As of June 30, 2018, we had five foreclosed residential real estate properties with a carrying value of \$1.2 million. As of December 31, 2017, we had one foreclosed residential real estate property with a carrying value of \$179 thousand. In addition, as of June 30, 2018 and December 31, 2017, respectively, we had consumer loans with a carrying value of \$1.4 million and \$180 thousand collateralized by residential real estate property for which formal foreclosure proceedings were in process. The increases in amounts at June 30, 2018, compared to December 31, 2017, were due to loans acquired in the Community acquisition.

#### NOTE 6 – EARNINGS PER SHARE

Basic earnings per share are calculated by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares (unvested restricted stock grants and stock options) had been issued, as well as any adjustment to income that would result from the assumed issuance of potential common shares that may be issued by us. Potential common shares related to stock options are determined using the treasury stock method.

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| (Dollars in thousands, except share and per share data)              | Three Months Ended June 30, 2018 |             |                     | Three Months Ended June 30, 2017 |             |                     |
|--|----------------------------------|-------------|---------------------|----------------------------------|-------------|---------------------|
|  | Income Shares<br>(Numerator)     | Denominator | Per Share<br>Amount | Income Shares<br>(Numerator)     | Denominator | Per Share<br>Amount |
| Shares Outstanding (weighted average)                                | 7,860,356                        |             |                     | 4,823,697                        |             |                     |
| Shares held by Rabbi Trust   | 95,843                           |             |                     | 96,736                           |             |                     |
| Shares liability under deferred compensation agreement               | (95,843 )                        |             |                     | (96,736 )                        |             |                     |
| Basic earnings per share:  |                                  |             |                     |                                  |             |                     |
| Net earnings applicable to common stockholders                       | \$2,992                          | 7,860,356   | \$ 0.38             | \$1,204                          | 4,823,697   | \$ 0.25             |
| Effect of dilutive securities:                                       |                                  |             |                     |                                  |             |                     |
| Unvested stock awards  | —                                | 51,023      |                     | —                                | 44,837      |                     |
| Diluted earnings per share:  |                                  |             |                     |                                  |             |                     |
| Net income applicable to common stockholders and assumed conversions | \$2,992                          | 7,911,379   | \$ 0.38             | \$1,204                          | 4,868,534   | \$ 0.25             |

| (In thousands, except share and per share data)                      | Six Months Ended June 30, 2018 |             |                     | Six Months Ended June 30, 2017 |             |                     |
|--|--------------------------------|-------------|---------------------|--------------------------------|-------------|---------------------|
|  | Income Shares<br>(Numerator)   | Denominator | Per Share<br>Amount | Income Shares<br>(Numerator)   | Denominator | Per Share<br>Amount |
| Shares Outstanding (weighted average)                                | 7,800,886                      |             |                     | 4,755,018                      |             |                     |
| Shares held by Rabbi Trust   | 95,843                         |             |                     | 96,736                         |             |                     |
| Shares liability under deferred compensation agreement               | (95,843 )                      |             |                     | (96,736 )                      |             |                     |
| Basic earnings per share:  |                                |             |                     |                                |             |                     |
| Net earnings applicable to common stockholders                       | \$4,300                        | 7,800,886   | \$ 0.55             | \$3,215                        | 4,755,018   | \$ 0.68             |
| Effect of dilutive securities:                                       |                                |             |                     |                                |             |                     |
| Unvested stock awards  | —                              | 51,023      |                     | —                              | 39,651      |                     |
| Diluted earnings per share:  |                                |             |                     |                                |             |                     |
| Net income applicable to common stockholders and assumed conversions | \$4,300                        | 7,851,909   | \$ 0.55             | \$3,215                        | 4,794,669   | \$ 0.67             |

There were no shares of unvested restricted stock awards and options outstanding during the three months ended June 30, 2018 and 5,845 shares of unvested restricted stock awards and options outstanding during the three months ended June 30, 2017, which were not included in the computation of diluted earnings per share because to do so would have been anti-dilutive.

There were 20,169 and 14,323 shares of unvested restricted stock awards and options outstanding during the six months ended June 30, 2018 and 2017, respectively, which were not included in the computation of diluted earnings per share because to do so would be anti-dilutive.

NOTE 7 – OTHER COMPREHENSIVE INCOME

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale

securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

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The components of other comprehensive income, both before tax and net of tax, are as follows:

|  | Three Months Ended June 30, 2018 |            |            | Three Months Ended June 30, 2017 |            |            |
|--|----------------------------------|------------|------------|----------------------------------|------------|------------|
|  | Before Tax                       | Tax Effect | Net of Tax | Before Tax                       | Tax Effect | Net of Tax |
| (Dollars in thousands)   |                                  |            |            |                                  |            |            |
| Other comprehensive income (loss):   |                                  |            |            |                                  |            |            |
| Unrealized (loss) gains on available for sale securities   | \$ (353 )                        | \$ (99 )   | \$ (254 )  | \$ 1,144                         | \$ 457     | \$ 687     |
| Fair value adjustments on derivatives  | 328                              | 92         | 236        | (455 )                           | (182 )     | (273 )     |
| Reclassification adjustment for net losses (gains) on securities transactions included in net income | (36 )                            | (10 )      | (26 )      | 30                               | 12         | 18         |
| Total other comprehensive (loss) income  | \$ (61 )                         | \$ (17 )   | \$ (44 )   | \$ 719                           | \$ 287     | \$ 432     |

|   | Six Months Ended June 30, 2018 |            |            | Six Months Ended June 30, 2016 |            |            |
|---|--------------------------------|------------|------------|--------------------------------|------------|------------|
|   | Before Tax                     | Tax Effect | Net of Tax | Before Tax                     | Tax Effect | Net of Tax |
| (Dollars in thousands)  |                                |            |            |                                |            |            |
| Other comprehensive income (loss):  |                                |            |            |                                |            |            |
| Unrealized (loss) gains on available for sale securities                                    | \$ (2,520)                     | \$ (687)   | \$ (1,833) | \$ 1,820                       | \$ 727     | \$ 1,093   |
| Fair value adjustments on derivatives   | 1,435                          | 403        | 1,032      | (415 )                         | (166 )     | (249 )     |
| Reclassification adjustment for net gains on securities transactions included in net income | (36 )                          | (10 )      | (26 )      | (77 )                          | (30 )      | (47 )      |
| Total other comprehensive income  | \$ (1,121)                     | \$ (294)   | \$ (827 )  | \$ 1,328                       | \$ 531     | \$ 797     |

NOTE 8 – GOODWILL AND OTHER INTANGIBLES

The Company had goodwill of \$24.8 million and \$2.8 million for the periods ended June 30, 2018 and December 31, 2017, respectively. The increase was due to the merger with Community with total goodwill amounting to \$22.0 million. The Company reviews its goodwill and intangible assets annually, on September 30, or more frequently if conditions warrant, for impairment. In testing goodwill for impairment, the Company compares the estimated fair value of its reporting unit to its carrying amount, including goodwill.

The Company recorded a core deposit intangible of \$1.3 million for the Community acquisition. For the period ended June 30, 2018, the Company amortized \$121 thousand in core deposit intangible. The estimated future amortization expense for the remainder of 2018 and for each of the succeeding five years ended December 31 is as follows (dollars in thousands):

| For the Year Ended | Amortization Expense |
|--------------------|----------------------|
| 2018               | \$ 121               |
| 2019               | 217                  |
| 2020               | 194                  |
| 2021               | 169                  |
| 2022               | 145                  |
| 2023               | 121                  |





## NOTE 9 – SEGMENT INFORMATION

Our insurance agency operations are managed separately from the traditional banking and related financial services that we also offer. The insurance agency operation provides commercial, individual, and group benefit plans and personal coverage.

|   | Three Months Ended June 30, 2018 |                    |           | Three Months Ended June 30, 2017 |                    |          |
|---|----------------------------------|--------------------|-----------|----------------------------------|--------------------|----------|
|   | Banking and Financial Services   | Insurance Services | Total     | Banking and Financial Services   | Insurance Services | Total    |
| (Dollars in thousands)                    |                                  |                    |           |                                  |                    |          |
| Net interest income from external sources | \$ 10,985                        | \$ —               | \$ 10,985 | \$ 6,895                         | \$ —               | \$ 6,895 |
| Other income from external sources        | 1,009                            | 1,872              | 2,881     | 675                              | 1,143              | 1,818    |
| Depreciation and amortization             | 444                              | 6                  | 450       | 258                              | 7                  | 265      |
| Income before income taxes                | 3,288                            | 600                | 3,888     | 1,627                            | 180                | 1,807    |
| Income tax expense (1)                    | 656                              | 240                | 896       | 531                              | 72                 | 603      |
| Total assets                              | 1,425,250                        | 12,052             | 1,437,302 | 922,510                          | 6,317              | 928,827  |

|   | Six Months Ended June 30, 2018 |                    |           | Six Months Ended June 30, 2017 |                    |           |
|---|--------------------------------|--------------------|-----------|--------------------------------|--------------------|-----------|
|   | Banking and Financial Services | Insurance Services | Total     | Banking and Financial Services | Insurance Services | Total     |
| (Dollars in thousands)                    |                                |                    |           |                                |                    |           |
| Net interest income from external sources | \$ 21,753                      | \$ —               | \$ 21,753 | \$ 13,644                      | \$ —               | \$ 13,644 |
| Other income from external sources        | 1,934                          | 3,804              | 5,738     | 1,405                          | 2,890              | 4,295     |
| Depreciation and amortization             | 892                            | 12                 | 904       | 525                            | 13                 | 538       |
| Income before income taxes                | 3,902                          | 1,509              | 5,411     | 3,649                          | 1,000              | 4,649     |
| Income tax expense (1)                    | 507                            | 604                | 1,111     | 1,034                          | 400                | 1,434     |
| Total assets                              | 1,425,250                      | 12,052             | 1,437,302 | 922,510                        | 6,317              | 928,827   |

(1) Insurance Services calculated at statutory tax rate of 28.1% .

## NOTE 10 – STOCK-BASED COMPENSATION

We currently have stock-based compensation plans in place for our directors, officers, employees, consultants and advisors. Under the terms of these plans we may grant restricted shares and stock options for the purchase of our common stock. The stock-based compensation is granted under terms determined by our Compensation Committee. Our standard stock option grants have a maximum term of 10 years, generally vest over periods ranging between one and five years, and are granted with an exercise price equal to the fair market value of the common stock on the date of grant. Restricted stock is valued at the market value of the common stock on the date of grant and generally vests over periods of three to five years. All dividends paid on restricted stock, whether vested or unvested, are paid to the shareholder.

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Information regarding our stock option plans for the six months ended June 30, 2018 is as follows:

|  | Number of<br>Shares | Weighted<br>Average<br>Exercise<br>Price per<br>Share | Weighted<br>Average<br>Contractual<br>Term | Aggregate<br>Intrinsic<br>Value |
|--|---------------------|---|--|---------------------------------|
| Options outstanding, beginning of year | 69,123              | \$ 11.10  |  |                                 |
| Options outstanding, end of quarter    | 69,123              | \$ 11.10  | 6.9  | \$1,285,765                     |
| Options exercisable, end of quarter    | 36,229              | \$ 10.85  | 6.8  | \$682,976                       |
| Option price range at end of quarter   | \$9.97 to \$12.83   |   |  |                                 |
| Option price of exercisable shares     | \$9.97 to \$12.83   |   |  |                                 |

During the three months ended June 30, 2018 and 2017, we expensed \$12 thousand in stock-based compensation under stock option awards.

During the six months ended June 30, 2018 and 2017, we expensed \$24 thousand and \$25 thousand, respectively, in stock-based compensation under stock option awards.

There were no options granted during the three and six months ended June 30, 2018 and 2017. Expected future expense relating to the unvested options outstanding as of June 30, 2018 is \$91 thousand over a weighted average period of 1.9 years. Upon exercise of vested options, management expects to draw on treasury stock as the source of the shares.

The summary of changes in unvested restricted stock awards for the six months ended June 30, 2018, is as follows:

|  | Number<br>of<br>Shares | Weighted<br>Average<br>Grant<br>Date<br>Fair<br>Value |
|--|------------------------|---|
| Unvested restricted stock, beginning of year | 85,761                 | \$ 18.34  |
| Granted                                      | 20,169                 | 29.15   |
| Forfeited                                    | (4,148 )               | 17.66   |
| Vested                                       | (33,882)               | 16.35   |
| Unvested restricted stock, end of period     | 67,900                 | \$ 22.58  |

During the three months ended June 30, 2018 and 2017, we expensed \$165 thousand and \$169 thousand, respectively, in stock-based compensation under restricted stock awards. During the six months ended June 30, 2018 and 2017, we expensed \$319 thousand and \$365 thousand, respectively, in stock-based compensation under restricted stock awards.

At June 30, 2018, unrecognized compensation expense for unvested restricted stock was \$1.2 million, which is expected to be recognized over an average period of 2.3 years.

#### NOTE 11 – GUARANTEES

We do not issue any guarantees that would require liability recognition or disclosure, other than standby letters of credit. Standby letters of credit are conditional commitments issued by us to guarantee the performance of a customer to a third party. Generally, all letters of credit, when issued, have expiration dates within one year. The credit risk

involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Generally, we hold collateral and/or personal guarantees supporting these commitments. As of June 30, 2018, we had \$1.7 million of outstanding letters of credit. Management believes that the proceeds obtained through a liquidation of collateral and the enforcement of guarantees would be sufficient to cover the potential amount of future payments required under the corresponding guarantees. The amount of the liability as of June 30, 2018, for guarantees under standby letters of credit issued is not material.

NOTE 12 – FAIR VALUE OF FINANCIAL INSTRUMENTS

Management uses its best judgment in estimating the fair value of our financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily

indicative of the amounts we could have realized in a sale transaction on the dates indicated. The fair value amounts have been measured as of their respective period ends, and have not been re-evaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each period end.

In accordance with U.S. GAAP, we use a hierarchical disclosure framework associated with the level of pricing observability utilized in measuring assets and liabilities at fair value. The three broad levels defined by the hierarchy are as follows:

Level I - Quoted prices are available in active markets for identical assets or liabilities as of the reported date.

Level II - Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the reported date. The nature of these asset and liabilities include items for which quoted prices are available but traded less frequently, and items that are fair valued using other financial instruments, the parameters of which can be directly observed.

Level III - Assets and liabilities that have little to no pricing observability as of reported date. These items do not have two-way markets and are measured using management's best estimate of fair value, where the inputs into the determination of fair value require significant management judgment or estimation.

The following table summarizes the fair value of our financial assets measured on a recurring basis by the above pricing observability levels as of June 30, 2018 and December 31, 2017:

| (Dollars in thousands)                | Fair<br>Value<br>Measurements | Quoted<br>Prices in<br>Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level I) | Significant<br>Other<br>Observable<br>Inputs<br>(Level II) | Significant<br>Unobservable<br>Inputs<br>(Level III) |
|---------------------------------------|-------------------------------|---|--|--|
| June 30, 2018                         |                               |   |  |  |
| U.S. government agencies              | \$ 27,769                     | \$  | —\$ 27,769   | \$ —   |
| U.S. government-sponsored enterprises | 17,417                        | —   | 17,417   | —  |
| State and political subdivisions      | 59,260                        | —   | 59,260   | —  |
| Mortgage-backed securities -          |                               |   |  |  |
| U.S. government-sponsored enterprises | 68,056                        | —   | 68,056   | —  |
| Corporate debt                        | 2,023                         | —   | 2,023  | —  |
| Derivative instruments                |                               |   |  |  |
| Interest rate swaps                   | 2,886                         | —   | 2,886  | —  |
| December 31, 2017                     |                               |   |  |  |
| U.S. government agencies              | \$ 18,861                     | \$—   | \$—  | \$—  |
| U.S. government-sponsored enterprises | 6,061                         | —6,061  | —  | —  |
| State and political subdivisions      | 41,234                        | —41,234   | —  | —  |
| Mortgage-backed securities -          |                               |   |  |  |
| U.S. government-sponsored enterprises | 30,544                        | —30,544   | —  | —  |
| Corporate debt                        | 2,030                         | —2,030  | —  | —  |
| Derivative instruments                |                               |   |  |  |
| Interest rate swaps                   | 1,451                         | —1,451  | —  | —  |

Our available for sale and held to maturity securities portfolios contain investments, which were all rated within our investment policy guidelines at time of purchase, and upon review of the entire portfolio all securities are marketable and have observable pricing inputs.

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For financial assets measured at fair value on a nonrecurring basis, the fair value measurements by level within the fair value hierarchy used at June 30, 2018 and December 31, 2017 are as follows:

| (Dollars in thousands) | Fair Value Measurements | Quoted Prices in Active Markets for Identical Assets (Level I) | Significant Other Observable Inputs (Level II) | Significant Unobservable Inputs (Level III) |
|------------------------|-------------------------|--|--|---|
| June 30, 2018          |                         |  |  |   |
| Impaired loans         | \$ 219                  | \$ —   | —\$  | —\$ 219                                     |
| Foreclosed real estate | 737                     | —  | —  | 737   |
| December 31, 2017      |                         |  |  |   |
| Impaired loans         | \$1,794                 | \$—  | \$—  | \$1,794                                     |
| Foreclosed real estate | 568                     | —  | —  | 568   |

The following table presents additional qualitative information about assets measured at fair value on a nonrecurring basis and for which Level III inputs were used to determine fair value:

| (Dollars in thousands) | Qualitative Information about Level III Fair Value Measurements |                         |                           |                             |
|------------------------|---|-------------------------|---------------------------|-----------------------------|
|                        | Fair Value Estimate   | Valuation Techniques    | Unobservable Input        | Range (Weighted Average)    |
| June 30, 2018          |   |                         |                           |                             |
| Impaired loans         | \$ 219  | Appraisal of collateral | Appraisal adjustments (1) | 0% to (-100.0%)<br>(-7.26%) |
| Foreclosed real estate | 737   | Appraisal of collateral | Selling expenses (1)      | -7.0%(-7.0%)                |
| December 31, 2017      |   |                         |                           |                             |
| Impaired loans         | \$1,794   | Appraisal of collateral | Appraisal adjustments (1) | 0% to (-100.0%)<br>(-0.22%) |
| Foreclosed real estate | 568   | Appraisal of collateral | Selling expenses (1)      | -7.0% (-7.0%)               |

(1) Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated selling expenses. The range and weighted average of selling expenses and other appraisal adjustments are presented as a percentage of the appraisal.

The following information should not be interpreted as an estimate of the fair value of the entire company since a fair value calculation is only provided for a limited portion of our assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between our disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the

fair value of our financial instruments at June 30, 2018 and December 31, 2017:

Cash and Cash Equivalents (Carried at Cost): The carrying amounts reported in the balance sheet for cash and cash equivalents approximate those assets' fair value.

Deposits (Carried at Cost): Fair value for fixed-rate time certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered in the market on certificates to a schedule of aggregated expected monthly maturities on time deposits. We generally purchase amounts below the insured limit, limiting the amount of credit risk on these time deposits.

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**Securities:** The fair value of securities, available for sale (carried at fair value) and securities held to maturity (carried at amortized cost) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level I), or matrix pricing (Level II), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted prices. For certain securities which are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence (Level III). In the absence of such evidence, management's best estimate is used.

**Federal Home Loan Bank Stock (Carried at Cost):** The carrying amount of restricted investment in bank stock approximates fair value and considers the limited marketability of such securities.

**Loans Receivable (Carried at Cost):** The Company has adopted ASU 2016-01, and therefore is measuring the fair value of loans receivable under the exit price notion rather than the previous method of entry price notion. Under the entry price notion, the fair value estimate of loans receivable was based on discounted cash flow. At June 30, 2018, the exit price notion used to estimate the fair value of loans receivable was based on similar techniques, with the addition of current origination spreads, liquidity premiums, or credit adjustments.

**Impaired Loans (Carried at Lower of Cost or Fair Value):** Fair value of impaired loans is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included in Level III fair values, based upon the lowest level of input that is significant to the fair value measurements. The fair value of impaired loans totaled \$219 thousand and \$1.8 million at June 30, 2018 and December 31, 2017, respectively. These balances consist of loans that were written down or required additional reserves during the periods ended June 30, 2018 and December 31, 2017, respectively.

**Deposit Liabilities (Carried at Cost):** The fair values disclosed for demand, savings and money market 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 to a schedule of aggregated expected monthly maturities on time deposits.

**Borrowings (Carried at Cost):** Fair values of Federal Home Loan Bank ("FHLB") advances are estimated using discounted cash flow analysis, based on quoted prices for new FHLB advances with similar credit risk characteristics, terms and remaining maturity. These prices obtained from this active market represent a market value that is deemed to represent the transfer price if the liability were assumed by a third party.

**Derivatives (Carried at Fair Value):** The Company also uses interest rate swaps as part of its interest rate risk management strategy. Interest rate swaps designated as cash flow hedges, and which satisfy hedge accounting requirements, involve the receipt of variable amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without the exchange of the underlying notional amount. These derivatives were used to hedge the variable cash outflows associated with FHLB borrowings along with our junior subordinated debenture at U.S. Capital Trust. The effective portion of changes in the fair value of these derivatives are recorded in accumulated other comprehensive income, and are subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. The ineffective portion of the change in fair value of these derivatives is recognized directly in earnings.

The fair value of the Company's derivatives are determined using discounted cash flow analysis using observable market-based inputs, which are considered Level 2 inputs.



**Subordinated Debentures (Carried at Cost):** Fair values of subordinated debt are estimated using discounted cash flow analysis, based on market rates currently offered on such debt with similar credit risk characteristics, terms and remaining maturity.

**Accrued Interest Receivable and Accrued Interest Payable (Carried at Cost):** The carrying amounts of accrued interest receivable and payable approximate its fair value.

**Off-Balance Sheet Instruments (Disclosed at Cost):** Fair values for our off-balance sheet financial instruments (lending commitments and letters of credit) are based on fees currently charged in the market to enter into similar agreements, taking into account, the remaining terms of the agreements and the counterparties' credit standing.

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The fair values of our financial instruments at June 30, 2018 and December 31, 2017, were as follows:

| (Dollars in thousands)             | June 30, 2018        |               | Quoted<br>Prices in<br>Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level I) | Significant<br>Other<br>Observable<br>Inputs<br>(Level II) | Significant<br>Unobservable<br>Inputs<br>(Level III) |
|------------------------------------|----------------------|---------------|---|--|--|
|                                    | Carrying<br>Amount   | Fair<br>Value |   |  |  |
| Financial assets:                  |                      |               |   |  |  |
| Cash and cash equivalents          | \$ 18,896            | \$ 18,896     | \$ 18,896   | \$   | —\$  |
| Time deposits with other banks     | 200                  | 200           | —   | 200  | —  |
| Securities available for sale      | 174,525              | 174,525       | —   | 174,561  | —  |
| Securities held to maturity        | 5,418                | 5,508         | —   | 5,508  | —  |
| Federal Home Loan Bank stock       | 10,066               | 10,066        | —   | 10,066   | —  |
| Loans receivable, net of allowance | 1,128,282            | 1,082,262     | —   | —  | 1,082,262  |
| Accrued interest receivable        | 3,906                | 3,906         | —   | 3,906  | —  |
| Interest rate swaps                | 2,948                | 2,948         | —   | 2,948  | —  |
| Financial liabilities:             |                      |               |   |  |  |
| Non-maturity deposits              | 788,548              | 788,548       | —   | 788,548  | —  |
| Time deposits                      | 273,051              | 251,536       | —   | 251,536  | —  |
| Short-term borrowings              | 157,940              | 157,981       | 157,981   | —  | —  |
| Long-term borrowings               | 30,000               | 29,677        | —   | 29,677   | —  |
| Subordinated debentures            | 27,853               | 25,180        | —   | 25,180   | —  |
| Accrued interest payable           | 595                  | 595           | —   | 595  | —  |
| Interest rate swaps                | 61                   | 61            | —   | 61   | —  |
| (Dollars in thousands)             | December 31,<br>2017 |               | Quoted<br>Prices in<br>Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level I) | Significant<br>Other<br>Observable<br>Inputs<br>(Level II) | Significant<br>Unobservable<br>Inputs<br>(Level III) |
|                                    | Carrying<br>Amount   | Fair<br>Value |   |  |  |
| Financial assets:                  |                      |               |   |  |  |
| Cash and cash equivalents          | \$ 11,646            | \$ 11,646     | \$ 11,646   | \$   | —\$  |
| Time deposits with other banks     | 100                  | 100           | —   | 100  | —  |
| Securities available for sale      | 98,730               | 98,730        | —   | 98,730   | —  |
| Securities held to maturity        | 5,304                | 5,430         | —   | 5,430  | —  |
| Federal Home Loan Bank stock       | 4,925                | 4,925         | —   | 4,925  | —  |
| Loans receivable, net of allowance | 813,365              | 788,119       | —   | —  | 788,119  |
| Accrued interest receivable        | 2,472                | 2,472         | —   | 2,472  | —  |
| Interest rate swaps                | 1,451                | 1,451         | —   | 1,451  | —  |
| Financial liabilities:             |                      |               |   |  |  |
| Non-maturity deposits              | 563,694              | 563,694       | —   | 563,694  | —  |
| Time deposits                      | 198,797              | 197,549       | —   | 197,549  | —  |
| Short-term borrowings              | 55,350               | 55,335        | 55,335  | —  | —  |

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|                          |        |        |   |        |   |
|--------------------------|--------|--------|---|--------|---|
| Long-term borrowings     | 35,000 | 34,761 | — | 34,761 | — |
| Subordinated debentures  | 27,848 | 25,259 | — | 25,259 | — |
| Accrued interest payable | 470    | 470    | — | 470    | — |

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## NOTE 13 – DERIVATIVES

The Company's objectives in using interest rate derivatives are to add stability to interest expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company primarily uses interest rate swaps as part of its interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount.

The effective portion of changes in the fair value of derivatives designated and that qualify as cash flow hedges are recorded in accumulated other comprehensive income and are subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. During the three and six months ended June 30, 2018 such derivatives were used to hedge the variable cash outflows associated with four FHLB borrowings totaling \$26.0 million. The Company entered into an interest rate swap agreement to hedge its \$12.5 million variable rate (3 Mo Libor +1.44%) junior subordinated debt issued by Sussex Capital Trust II, a non-consolidated wholly-owned subsidiary of the Company, for 10 years at a fixed rate of 3.10%. During the six months ended June 30, 2018, the Company entered into two interest rate swap agreements used to hedge the variable cash outflows associated with two future three month FHLB borrowings totaling \$40.0 million, with an effective date of September 15, 2018. One interest rate swap matures September 15, 2021 with a fixed rate of 2.89%, and the other matures September 15, 2022 with a fixed rate of 2.90%. The ineffective portion of the change in fair value of the derivatives are recognized directly in earnings. The Company implemented this program during the quarter ended March 31, 2016.

During the three and six months ended June 30, 2018 and 2017, the Company did not record any hedge ineffectiveness.

The table below presents the fair value of the Company's derivative financial instruments as well as their classification on the Consolidated Statements of Income and Comprehensive Income at June 30, 2018 and December 31, 2017:

|   | June 30, 2018                   |               |                              |                    |
|---|---------------------------------|---------------|------------------------------|--------------------|
|   | Notional/<br>Contract<br>Amount | Fair<br>Value | Balance<br>Sheet<br>Location | Expiration<br>Date |
| (Dollars in thousands)                        |                                 |               |                              |                    |
| Derivatives designated as hedging instruments |                                 |               |                              |                    |
| Interest rate swaps by effective date:        |                                 |               |                              |                    |
| March 15, 2016                                | \$12,500                        | \$1,046       | Other Assets                 | March 15, 2026     |
| December 15, 2016                             | 5,000                           | 354           | Other Assets                 | December 15, 2026  |
| June 15, 2017                                 | 6,000                           | 413           | Other Assets                 | June 15, 2027      |
| December 15, 2017                             | 10,000                          | 768           | Other Assets                 | December 15, 2027  |
| December 15, 2017                             | 5,000                           | 367           | Other Assets                 | December 15, 2027  |
| September 15, 2018                            | 20,000                          | (27)          | Other Liabilities            | September 15, 2021 |
| September 15, 2018                            | 20,000                          | (35)          | Other Liabilities            | September 15, 2022 |
| Total   | \$78,500                        | \$2,886       |                              |                    |

|   | December 31, 2017               |               |                              |                    |
|---|---------------------------------|---------------|------------------------------|--------------------|
|   | Notional/<br>Contract<br>Amount | Fair<br>Value | Balance<br>Sheet<br>Location | Expiration<br>Date |
| (Dollars in thousands)                        |                                 |               |                              |                    |
| Derivatives designated as hedging instruments |                                 |               |                              |                    |
| Interest rate swaps by effective date:        |                                 |               |                              |                    |
| March 15, 2016                                | \$12,500                        | \$610         | Other Assets                 | March 15, 2026     |
| December 15, 2016                             | 5,000                           | 161           | Other Assets                 | December 15, 2026  |
| June 15, 2017                                 | 6,000                           | 170           | Other Assets                 | June 15, 2027      |
| December 15, 2017                             | 10,000                          | 352           | Other Assets                 | December 15, 2027  |
| December 15, 2017                             | 5,000                           | 158           | Other Assets                 | December 15, 2027  |
| Total   | \$38,500                        | \$1,451       |                              |                    |

The table below presents the Company's derivative financial instruments that are designated as cash flow hedgers of interest rate risk and their effect on the Company's Consolidated Statements of Income and Comprehensive Income during the three months ended June 30, 2018 and 2017:

|  | Three Months Ended June 30, 2018  |   |  |   |
|--|---|---|--|---|
|  | Amount<br>of<br>Gain<br>Recognized<br>in<br>OCI<br>on<br>Derivatives<br>net of<br>Tax<br>(Effective<br>Portion) | Location of Gain<br>(Loss) Recognized in<br>Income of<br>Derivatives<br>(Ineffective Portion) | Amount of<br>Gain<br>(Loss)<br>Recognized<br>in<br>Income<br>of<br>Derivatives<br>(Ineffective<br>Portion) |   |
| (Dollars in thousands)                 |   |   |  |   |
| Derivatives in cash flow hedges        |   |   |  |   |
| Interest rate swaps by effective date: |   |   |  |   |
| March 15, 2016                         | \$80  | Not applicable  | \$   | — |
| December 15, 2016                      | 36  | Not applicable  | —  | — |
| June 15, 2017                          | 46  | Not applicable  | —  | — |
| December 15, 2017                      | 78  | Not applicable  | —  | — |
| December 15, 2017                      | 40  | Not applicable  | —  | — |
| September 15, 2018                     | (19 )   | Not applicable  | —  | — |
| September 15, 2018                     | (25 )   | Not applicable  | —  | — |
| Total                                  | \$236   |   | \$   | — |

Three Months Ended June 30, 2017

|  |   |   |
|--|---|---|
| Amount<br>of<br>Gain<br>Recognized<br>in OCI<br>on<br>Derivatives<br>net of<br>Tax<br>(Effective<br>Portion) | Location of Gain<br>(Loss) Recognized in<br>Income of<br>Derivatives<br>(Ineffective Portion) | Amount of<br>Gain<br>(Loss)<br>Recognized in<br>Income<br>of<br>Derivatives<br>(Ineffective<br>Portion) |
|--|---|---|

(Dollars in thousands)

Derivatives in cash flow hedges

Interest rate swaps by effective date:

|                   |           |                |    |   |
|-------------------|-----------|----------------|----|---|
| March 15, 2016    | \$ (74 )  | Not applicable | \$ | — |
| December 15, 2016 | (31 )     | Not applicable | —  |   |
| June 15, 2017     | (46 )     | Not applicable | —  |   |
| December 15, 2017 | (81 )     | Not applicable | —  |   |
| December 15, 2017 | (41 )     | Not applicable | —  |   |
| Total             | \$ (273 ) |                | \$ | — |

The table below presents the Company's derivative financial instruments that are designated as cash flow hedgers of interest rate risk and their effect on the Company's Consolidated Statements of Income and Comprehensive Income during the six months ended June 30, 2018 and 2017:

Six Months Ended June 30, 2018

|   |   |   |
|---|---|---|
| Amount<br>of Gain<br>Recognized<br>in OCI<br>on<br>Derivatives<br>net of<br>Tax<br>(Effective<br>Portion) | Location of Gain<br>(Loss) Recognized in<br>Income of<br>Derivatives<br>(Ineffective Portion) | Amount of<br>Gain<br>(Loss)<br>Recognized in<br>Income<br>of<br>Derivatives<br>(Ineffective<br>Portion) |
|---|---|---|

(Dollars in thousands)

Derivatives in cash flow hedges

Interest rate swaps by effective date:

|                    |       |                |    |   |
|--------------------|-------|----------------|----|---|
| March 15, 2016     | \$314 | Not applicable | \$ | — |
| December 15, 2016  | 139   | Not applicable | —  |   |
| June 15, 2017      | 175   | Not applicable | —  |   |
| December 15, 2017  | 299   | Not applicable | —  |   |
| December 15, 2017  | 150   | Not applicable | —  |   |
| September 15, 2018 | (19 ) | Not applicable |    |   |

September 15, 2018

(25 ) Not applicable

Total

\$1,033

\$ —

33

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Six Months Ended June 30, 2017

| Amount<br>of<br>Gain<br>Recognized<br>in OCI<br>on<br>Derivatives<br>net of<br>Tax<br>(Effective<br>Portion) | Reclassification of Gain<br>(Loss) Recognized in<br>Income of<br>Derivatives<br>(Ineffective Portion) | Amount of<br>Gain<br>(Loss)<br>Recognized<br>in Income<br>of<br>Derivatives<br>(Ineffective<br>Portion) |
|--|---|---|
|--|---|---|

(Dollars in thousands)

Derivatives in cash flow hedges

Interest rate swaps by effective  
date:

|                   |                        |      |
|-------------------|------------------------|------|
| March 15, 2016    | \$(61 ) Not applicable | \$ — |
| December 15, 2016 | (23 ) Not applicable   | —    |
| June 15, 2017     | (45 ) Not applicable   | —    |
| December 15, 2017 | (80 ) Not applicable   | —    |
| December 15, 2017 | (40 ) Not applicable   | —    |
| Total             | \$(249)                | \$ — |

The Company has master netting arrangements with its counterparty. All master netting arrangements include rights to offset associated with the Company's recognized derivative assets, derivative liabilities, and cash collateral received and pledged.

Amounts reported in accumulated other comprehensive income related to derivatives are reclassified to interest expense as interest payments made on the Company's variable rate borrowing positions. During the six months ended June 30, 2018 the Company had \$10 thousand of reclassifications to interest income. During the six months ended June 30, 2017, the Company had \$64 thousand of reclassifications to interest expense.

As required under the master netting arrangement with its derivatives counterparty, the Company received financial collateral from its counterparty totaling \$2.8 million at June 30, 2018 that was not included as an offsetting amount.





## Offsetting derivatives

The following table presents a gross presentation, the effects of offsetting, and a net presentation of the Company's derivatives in the Consolidated Balance Sheets as of June 30, 2018 and December 31, 2017. The net amounts of derivative liabilities and assets can be reconciled to the tabular disclosure of the fair value hierarchy, see Note 12, Fair Value of Financial Instruments. The tabular disclosure of fair value provides the location that derivative assets and liabilities are presented on the Company's Consolidated Balance Sheets.

|                        | Gross<br>Amounts<br>Recognized | Gross<br>Amounts<br>Offset | Net<br>Amounts<br>Presented | Gross<br>Amounts<br>Not Offset<br>Cash,<br>Financial<br>Collateral<br>Instruments<br>Posted | Net<br>Amount |
|------------------------|--------------------------------|----------------------------|-----------------------------|---|---------------|
| (Dollars in thousands) |                                |                            |                             |   |               |
| June 30, 2018          |                                |                            |                             |   |               |
| Assets:                |                                |                            |                             |   |               |
| Interest Rate Swaps    | \$ 2,948                       | —                          | \$ 2,948                    | —\$ 2,800   | \$ 148        |
| Total                  | \$ 2,948                       | —                          | \$ 2,948                    | —\$ 2,800   | \$ 148        |
| Liabilities:           |                                |                            |                             |   |               |
| Interest Rate Swaps    | \$ 62                          | —                          | \$ 62                       | —   | \$ 62         |
| Total                  | \$ 62                          | —                          | \$ 62                       | —   | \$ 62         |
| December 31, 2017      |                                |                            |                             |   |               |
| Assets:                |                                |                            |                             |   |               |
| Interest Rate Swaps    | \$ 1,451                       | —                          | \$ 1,451                    | —\$ 1,200   | \$ 251        |
| Total                  | \$ 1,451                       | —                          | \$ 1,451                    | —\$ 1,200   | \$ 251        |
| Liabilities:           |                                |                            |                             |   |               |
| Interest Rate Swaps    | —                              | —                          | —                           | —   | —             |
| Total                  | —                              | —                          | —                           | —   | —             |

## NOTE 14 – BORROWINGS

At June 30, 2018, the Bank had secured borrowing potential with the Federal Home Loan Bank of New York (“FHLBNY”) for borrowings of up to \$294.0 million and a \$10.0 million line of credit at Atlantic Central Bankers Bank (“ACBB”). The borrowings at the FHLBNY are secured by a pledge of qualifying residential and commercial mortgage loans, having an aggregate unpaid principal balance of approximately \$294.0 million. At June 30, 2018, the Bank had the ability to borrow up to \$168.0 million at FHLBNY and \$10.0 million at ACBB.

At June 30, 2018 and December 31, 2017, the Company had \$157.9 million and \$55.4 million, respectively, in short term advances at the FHLBNY, having weighted average interest rates of 2.12% and 1.58%, respectively. The increase in short term advances at June 30, 2018 as compared to December 31, 2017 was to fund the Company's loan growth. These advances are priced at the federal funds rate plus a spread (generally between 20 and 30 basis points), re-price daily and mature within three months.

At June 30, 2018 the Company had \$30.0 million in long-term fixed rate advances.



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

MANAGEMENT STRATEGY

We are a community-oriented financial institution serving northern New Jersey, northeastern Pennsylvania, New York City, New York and Queens County, New York. While offering traditional community bank loan and deposit products and services, we obtain non-interest income through our insurance brokerage operations and the sale of non-deposit products.

We continue to focus on strengthening our core operating performance by improving our net interest income and margin by closely monitoring our yield on earning assets and adjusting the rates offered on deposit products. We have been focused on building for the future and strengthening our core operating results within our risk management framework.

CRITICAL ACCOUNTING POLICIES

Our consolidated financial statements are prepared in accordance with U.S. GAAP and practices within the banking industry. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in our consolidated financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions, and judgments. Actual results could differ from those estimates.

Critical accounting estimates are necessary in the application of certain accounting policies and procedures, and are particularly susceptible to significant change. Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and could potentially result in materially different results under different assumptions and conditions. There have been no material changes to our critical accounting policies during the six months ended June 30, 2018. For additional information on our critical accounting policies, please refer to Note 1 of the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2017.

COMPARISON OF OPERATING RESULTS FOR THREE MONTHS ENDED JUNE 30, 2018 AND 2017

Overview – For the quarter ended June 30, 2018, the Company reported net income of \$3.0 million, or \$0.38 per basic and diluted share, as compared to net income of \$1.2 million, or \$0.25 per basic and diluted share, for the same period last year. The increase in net income for the quarter ended June 30, 2018 was driven by a \$4.1 million, or 59.3%, increase in net interest income resulting from loan and deposit growth and a \$1.1 million increase in non-interest income driven by insurance commissions and fees. The aforementioned increases were partially offset by a \$3.1 million, or 46.8%, increase in non-interest expenses and a \$293 thousand increase in income tax expense. The changes were largely attributed to the growth in the Company resulting from the merger with Community, double digit loan growth, and a 233% increase in SB One Insurance Agency's pretax income, partially offset by costs resulting from the rebranding of the Company and its subsidiaries and additional staffing to support growth.

The Company's net income, adjusted for tax effected expenses related to the Community Merger of \$321 thousand and non-recurring rebranding expenses of \$152 thousand, respectively, increased \$1.9 million, or 117.4%, to \$3.5 million, or \$0.44 per diluted share, for the quarter ended June 30, 2018, as compared to the same period last year. The Company's return on average assets for the quarter ended June 30, 2018, was 0.85%. The Company's return on average assets adjusted for tax effected expenses related to the Community Merger and non-recurring rebranding expenses, for the quarter ended June 30, 2018, was 0.99%, an increase from 0.71% for the quarter ended June 30, 2017.

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Comparative Average Balances and Average Interest Rates – The following table presents, on a fully tax equivalent basis, a summary of our interest-earning assets and their average yields, and interest-bearing liabilities and their average costs for the three month periods ended June 30, 2018 and 2017:

| (Dollars in thousands)                     | Three Months Ended June 30, |          |                  |                 |          |                  |
|--|-----------------------------|----------|------------------|-----------------|----------|------------------|
|  | 2018                        |          |                  | 2017            |          |                  |
| Earning Assets:                            | Average Balance             | Interest | Average Rate (2) | Average Balance | Interest | Average Rate (2) |
| <b>Securities:</b>                         |                             |          |                  |                 |          |                  |
| Tax exempt (3)                             | \$64,726                    | \$678    | 4.20 %           | \$45,892        | \$477    | 4.17 %           |
| Taxable                                    | 126,462                     | 804      | 2.55 %           | 66,467          | 344      | 2.08 %           |
| Total securities                           | 191,188                     | 1,482    | 3.11 %           | 112,359         | 821      | 2.93 %           |
| Total loans receivable (1) (4)             | 1,112,480                   | 12,562   | 4.53 %           | 739,837         | 7,876    | 4.27 %           |
| Other interest-earning assets              | 8,246                       | 16       | 0.78 %           | 7,110           | 6        | 0.34 %           |
| Total earning assets                       | \$1,311,914                 | \$14,060 | 4.30 %           | \$859,306       | \$8,703  | 4.06 %           |
| Non-interest earning assets                | 96,979                      |          |                  | 45,352          |          |                  |
| Allowance for loan losses                  | (8,077 )                    |          |                  | (6,956 )        |          |                  |
| Total Assets                               | \$1,400,816                 |          |                  | \$897,702       |          |                  |
| <b>Sources of Funds:</b>                   |                             |          |                  |                 |          |                  |
| <b>Interest bearing deposits:</b>          |                             |          |                  |                 |          |                  |
| NOW  | \$250,143                   | \$347    | 0.56 %           | \$182,345       | \$130    | 0.29 %           |
| Money market                               | 91,597                      | 287      | 1.26 %           | 101,079         | 226      | 0.90 %           |
| Savings                                    | 220,075                     | 191      | 0.35 %           | 138,403         | 72       | 0.21 %           |
| Time                                       | 263,248                     | 834      | 1.27 %           | 157,283         | 424      | 1.08 %           |
| Total interest bearing deposits            | 825,063                     | 1,659    | 0.81 %           | 579,110         | 852      | 0.59 %           |
| Borrowed funds                             | 173,841                     | 874      | 2.02 %           | 79,260          | 479      | 2.42 %           |
| Junior subordinated debentures             | 27,852                      | 313      | 4.51 %           | 27,842          | 316      | 4.55 %           |
| Total interest bearing liabilities         | \$1,026,756                 | \$2,846  | 1.11 %           | \$686,212       | \$1,647  | 0.96 %           |
| <b>Non-interest bearing liabilities:</b>   |                             |          |                  |                 |          |                  |
| Demand deposits                            | 222,558                     |          |                  | 140,493         |          |                  |
| Other liabilities                          | 3,736                       |          |                  | 4,364           |          |                  |
| Total non-interest bearing liabilities     | 226,294                     |          |                  | 144,857         |          |                  |
| Stockholders' equity                       | 147,766                     |          |                  | 66,633          |          |                  |
| Total Liabilities and Stockholders' Equity | \$1,400,816                 |          |                  | \$897,702       |          |                  |
| Net Interest Income and Margin(5)          |                             | 11,214   | 3.43 %           |                 | 7,056    | 3.29 %           |
| Tax-equivalent basis adjustment            |                             | (229 )   |                  |                 | (161 )   |                  |
| Net Interest Income                        |                             | \$10,985 |                  |                 | \$6,895  |                  |

(1) Includes loan fee income.

(2) Average rates on securities are calculated on amortized costs.

(3) Full taxable equivalent basis, using an effective tax rate of 21% in 2018 and 39% in 2017 and adjusted for TEFRA (Tax and Equity Fiscal Responsibility Act) interest expense disallowance

(4) Loans outstanding include non-accrual loans.

(5) Represents the difference between interest earned and interest paid, divided by average total interest-earning assets.

Net Interest Income – Net interest income is the difference between interest and deferred fees earned on loans and other interest-earning assets and interest paid on interest-bearing liabilities. Net interest income is directly affected by changes in volume and mix of interest-earning assets and interest-bearing liabilities that support those assets, as well as changing interest rates when differences exist in repricing dates of assets and liabilities.

Net interest income on a fully tax equivalent basis increased \$4.2 million, or 58.9%, to \$11.2 million for the second quarter of 2018, as compared to \$7.1 million for the same period in 2017. The increase in net interest income was largely due to a \$452.6 million, or 52.7%, increase in average interest earning assets, principally loans receivable, which increased \$372.6 million, or 50.4%. The net interest margin increased by 14 basis points to 3.43% for the second quarter of 2018, as compared to the same period in 2017. These increases were largely attributable to the merger with Community Bank.

Interest Income – Our total interest income, on a fully tax equivalent basis, increased \$5.4 million, or 61.6%, to \$14.1 million for the quarter ended June 30, 2018, as compared to the same period last year. The increase was primarily due to higher average earning assets, which increased \$452.6 million for the quarter ended June 30, 2018, as compared to the same period in 2017. The average yield increased 24 basis points to 4.30% for the quarter ended June 30, 2018, as compared to 4.06% for the same period last year.

Our total interest income earned on loans receivable increased \$4.7 million, or 59.5%, to \$12.6 million for the second quarter of 2018, as compared to the same period in 2017. The increase was primarily driven by an increase in average balance of loans receivable of \$372.6 million, or 50.4%, for the three months ended June 30, 2018, as compared to the same period last year. The average yield increased 26 basis points to 4.53% for the quarter ended June 30, 2018, as compared to 4.27% for the same period last year. The increases in average yield was largely driven by purchase accounting accretion resulting from the merger with Community. The average yield excluding purchase accounting accretion increased 15 basis points to 4.42% for the quarter ended June 30, 2018, as compared to 4.27% for the same period last year.

Our total interest income earned on securities, on a fully tax equivalent basis, increased \$661 thousand, to \$1.5 million for the quarter ended June 30, 2018 from \$821 thousand for the same period in 2017. The increase in interest income earned on securities was mainly due to a 70.2% increase on the average balance. The average yield for the quarter ended June 30, 2018 increased eighteen basis points to 3.11% as compared to the same period in 2017.

Other interest-earning assets include federal funds sold and interest bearing deposits in other banks. Our interest earned on total other interest-earning assets increased \$10 thousand to \$16 thousand for the second quarter of 2018 as compared to the same period last year. The average balances in other interest-earning assets increased \$1.1 million to \$8.2 million in the second quarter of 2018 from \$7.1 million during the second quarter a year earlier. The average yield for the quarter ended June 30, 2018 increased 44 basis point to 0.78% as compared to 0.34% in the same period in 2017 which was mainly driven by the deposits held at the Federal Reserve Bank and Wilmington Trust.

Interest Expense – Our interest expense for the three months ended June 30, 2018 increased \$1.2 million, or 72.8%, to \$2.8 million from \$1.6 million for the same period in 2017. The increase was principally due to higher average balances in interest-bearing liabilities, which increased \$340.5 million, or 49.6%, to \$1.0 billion for the second quarter of 2018 from \$686.2 million for the same period in 2017. The average rate for the quarter ended June 30, 2018 increased fifteen basis points to 1.11% as compared to 0.96% for the same period last year.

Our interest expense on deposits increased \$807 thousand, or 94.7%, for the quarter ended June 30, 2018, as compared to the same period last year. The increase was largely attributed to the increase in the average balance of total interest bearing deposits, which increased \$246.0 million during the second quarter of 2018, as compared to the same period in 2017. The average rate increased 22 basis points to 0.81% for the quarter ended June 30, 2018, as compared to 0.59% for the same period last year. The average rate excluding purchase accounting accretion increased 17 basis points to 0.76% for the quarter ended June 30, 2018, as compared to 0.59% for the same period last year.

Our interest expense on borrowed funds increased \$395 thousand, or 82.5%, for the quarter ended June 30, 2018, as compared to the same period last year. The increase was largely attributed to a \$94.6 million increase in the average balance of borrowed funds during the second quarter of 2018, as compared to the same period in 2017. The increase was partially offset by a 40 basis point decrease in the average rate to 2.02% as compared to 2.42% in the same period in 2017.

Our interest expense on all of the Company's subordinated debt decreased \$3 thousand, or 0.90%, for the quarter ended June 30, 2018, as compared to the same period last year. The decrease was mainly attributed to a four basis points decrease in average rate to 4.51% for the quarter ended June 30, 2018, as compared to 4.55% for the same period last year.

Provision for Loan Losses – Provision for loan losses increased \$18 thousand to \$398 thousand for the second quarter of 2018, as compared to \$380 thousand for the same period in 2017. The provision for loan losses reflects management's judgment concerning the risks inherent in our existing loan portfolio and the size of the allowance



necessary to absorb the risks, as well as the activity in the allowance during the periods. Management reviews the adequacy of its allowance on an ongoing basis and will provide additional provisions, as management may deem necessary.

Non-Interest Income – Our non-interest income increased \$1.1 million, or 58.5%, to \$2.9 million for the second quarter of 2018, as compared to the same period last year. The increase was principally due to growth of \$696 thousand in insurance commissions and fees relating to SB One Insurance Agency.

Non-Interest Expense – Our non-interest expenses increased \$3.1 million, or 46.8%, to \$9.6 million for the second quarter of 2018, as compared to the same period last year. The increase was largely attributed to the growth in the Company resulting from the merger with Community and additional staffing to support growth. The increase in non-interest expenses occurred largely in salaries and employee benefits of \$1.7 million, data processing of \$418 thousand, occupancy of \$271 thousand, advertising and promotion of \$196 thousand, other expenses of \$105 thousand and professional fees of \$92 thousand. During the second quarter of 2018, the Company incurred costs not expected to reoccur related to a name change, rebranding and additional advertising of

approximately \$212 thousand, operating costs associated with the merger with Community and non-recurring operating costs of approximately \$255 thousand and a \$180 thousand increase in SB One Insurance Agency salary and employee benefits principally associated with higher insurance commissions and fee income.

**Income Taxes** – Our income tax expense, which includes both federal and state tax expenses, increased \$293 thousand, or 48.6% to \$896 thousand for the second quarter of 2018, as compared to the same period last year. The Company's effective tax rate for the second quarter of 2018 was 23.1%, as compared to 33.4% for the second quarter of 2017. The decrease in the Company's tax rate was largely due to the Tax Cuts and Jobs Act enacted in December 2017 which reduced the federal corporate income tax rate to 21% and the merger with Community which resulted in the Company's tax free income becoming a larger percentage of its overall income.

On July 1, 2018, New Jersey's Assembly Bill 4202 was signed into law. The new Bill, effective January 1, 2018, imposed a temporary surtax on corporations earning New Jersey allocated income in excess of \$1 million at a rate of 2.5% for tax years beginning on or after January 1, 2018 through December 31, 2019, and at 1.5% for years beginning on or after January 1, 2020, through December 31, 2021. The Company is still evaluating the change in income tax expense for 2018. In addition, effective for periods on or after January 1, 2019, New Jersey is adopting mandatory unitary combined reporting for its Corporation Business Tax. As a result, the Company anticipates an increase in New Jersey state income tax expenses in 2019.

#### COMPARISON OF OPERATING RESULTS FOR SIX MONTHS ENDED JUNE 30, 2018 AND 2017

**Overview** – For the six months ended June 30, 2018, the Company reported net income of \$4.3 million, or \$0.55 per basic and diluted share, or a 33.7% increase, as compared to net income of \$3.2 million, or \$0.68 per basic and \$0.67 per diluted share, for the same period last year. The changes in net income were largely attributed to the growth in the Company resulting from the merger with Community, double digit loan growth, and a 51% increase in SB One Insurance Agency's pretax income, partially offset by rebranding of the Company and its subsidiaries and additional staffing to support growth. The increase in net income for the six months ended June 30, 2018 was largely due to increases in net interest income of \$8.1 million and non-interest income of \$1.4 million, which were partially offset by an increase in non-interest expenses of \$8.7 million. The increase in non-interest expenses were largely due to the merger with Community. Expenses related to the Community Merger and salaries and employee benefits increased \$3.3 million and \$3.2 million, respectively.

The Company's net income, adjusted for tax effected expenses related to the Community Merger of \$2.7 million and non-recurring rebranding expenses of \$152 thousand, respectively, increased \$3.5 million, or 98.1%, to \$7.1 million, or \$0.91 per diluted share, for the six months ended June 30, 2018, as compared to the same period last year. The Company's return on average assets for the six months ended June 30, 2018, was 0.63%. The Company's return on average assets adjusted for tax effected expenses related to the Community Merger and non-recurring rebranding expenses, for the six months ended June 30, 2018, was 1.04%, an increase from 0.82% for the six months ended June 30, 2017.



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Comparative Average Balances and Average Interest Rates – The following table presents, on a fully tax equivalent basis, a summary of our interest-earning assets and their average yields, and interest-bearing liabilities and their average costs for the six month periods ended June 30, 2018 and 2017:

| (Dollars in thousands)                     | Six Months Ended June 30, |          |                  |                 |          |                  |
|--|---------------------------|----------|------------------|-----------------|----------|------------------|
|  | 2018                      |          |                  | 2017            |          |                  |
| Earning Assets:                            | Average Balance           | Interest | Average Rate (2) | Average Balance | Interest | Average Rate (2) |
| <b>Securities:</b>                         |                           |          |                  |                 |          |                  |
| Tax exempt (3)                             | \$59,883                  | \$1,253  | 4.22 %           | \$46,663        | \$947    | 4.09 %           |
| Taxable                                    | 123,635                   | 1,540    | 2.51 %           | 64,628          | 685      | 2.14 %           |
| Total securities                           | 183,518                   | 2,793    | 3.07 %           | 111,291         | 1,632    | 2.96 %           |
| Total loans receivable (1) (4)             | 1,088,238                 | 24,462   | 4.53 %           | 720,954         | 15,474   | 4.33 %           |
| Other interest-earning assets              | 10,576                    | 46       | 0.88 %           | 10,009          | 22       | 0.44 %           |
| Total earning assets                       | \$1,282,332               | \$27,301 | 4.29 %           | \$842,254       | \$17,128 | 4.10 %           |
| Non-interest earning assets                | 96,349                    |          |                  | 43,218          |          |                  |
| Allowance for loan losses                  | (7,792 )                  |          |                  | (6,840 )        |          |                  |
| Total Assets                               | \$1,370,889               |          |                  | \$878,632       |          |                  |
| <b>Sources of Funds:</b>                   |                           |          |                  |                 |          |                  |
| <b>Interest bearing deposits:</b>          |                           |          |                  |                 |          |                  |
| NOW  | \$254,884                 | \$745    | 0.59 %           | \$179,741       | \$249    | 0.28 %           |
| Money market                               | 94,016                    | 535      | 1.15 %           | 87,582          | 350      | 0.81 %           |
| Savings                                    | 221,005                   | 268      | 0.24 %           | 138,074         | 143      | 0.21 %           |
| Time                                       | 264,189                   | 1,569    | 1.20 %           | 161,951         | 827      | 1.03 %           |
| Total interest bearing deposits            | 834,094                   | 3,117    | 0.75 %           | 567,348         | 1,569    | 0.56 %           |
| Borrowed funds                             | 143,034                   | 1,380    | 1.95 %           | 82,571          | 960      | 2.34 %           |
| Junior subordinated debentures             | 27,851                    | 628      | 4.55 %           | 27,841          | 637      | 4.61 %           |
| Total interest bearing liabilities         | \$1,004,979               | \$5,125  | 1.03 %           | \$677,760       | \$3,166  | 0.94 %           |
| <b>Non-interest bearing liabilities:</b>   |                           |          |                  |                 |          |                  |
| Demand deposits                            | 215,665                   |          |                  | 132,785         |          |                  |
| Other liabilities                          | 4,418                     |          |                  | 3,978           |          |                  |
| Total non-interest bearing liabilities     | 220,083                   |          |                  | 136,763         |          |                  |
| Stockholders' equity                       | 145,827                   |          |                  | 64,109          |          |                  |
| Total Liabilities and Stockholders' Equity | \$1,370,889               |          |                  | \$878,632       |          |                  |
| Net Interest Income and Margin(5)          |                           | 22,176   | 3.49 %           |                 | 13,962   | 3.34 %           |
| Tax-equivalent basis adjustment            |                           | (423 )   |                  |                 | (318 )   |                  |
| Net Interest Income                        |                           | \$21,753 |                  |                 | \$13,644 |                  |

(1) Includes loan fee income.

(2) Average rates on securities are calculated on amortized costs.

(3) Full taxable equivalent basis, using an effective tax rate of 21% in 2018 and 39% in 2017 and adjusted for TEFRA (Tax and Equity Fiscal Responsibility Act) interest expense disallowance

(4) Loans outstanding include non-accrual loans.

(5) Represents the difference between interest earned and interest paid, divided by average total interest-earning assets.

Net Interest Income – Net interest income is the difference between interest and deferred fees earned on loans and other interest-earning assets and interest paid on interest-bearing liabilities. Net interest income is directly affected by changes in volume and mix of interest-earning assets and interest-bearing liabilities that support those assets, as well as changing interest rates when differences exist in repricing dates of assets and liabilities.

Net interest income on a fully tax equivalent basis increased \$8.2 million, or 58.8%, to \$22.2 million for the first six months of 2018 as compared to \$14.0 million for the same period in 2017. The increase in net interest income was largely due to a \$440.1 million, or 52.3%, increase in average interest earning assets, principally loans receivable, which increased \$367.3 million, or 50.9%. The net interest margin increased by 15 basis points to 3.49% for the first six months of 2018, as compared to the same period in 2017. These increases were largely attributable to the merger with Community.

Interest Income – Our total interest income, on a fully tax equivalent basis, increased \$10.2 million, or 59.4%, to \$27.3 million for the six months ended June 30, 2018, as compared to the same period last year. The increase was primarily due to higher average earning assets, which increased \$440.1 million for the six months ended June 30, 2018, as compared to the same period in 2017. The average yield increased nineteen basis points to 4.29% for the six months ended June 30, 2018, as compared to 4.10% for the same period last year.

Our total interest income earned on loans receivable increased \$9.0 million, or 58.1%, to \$24.5 million for the first six months of 2018, as compared to the same period in 2017. The increase was primarily driven by an increase in average balance of loans receivable of \$367.3 million, or 50.9%, for the six months ended June 30, 2018, as compared to the same period last year. The average yield increased 20 basis points to 4.53% for the six months ended June 30, 2018, as compared to 4.33% for the same period last year. The increases in average yield was largely driven by purchase accounting accretion resulting from the merger with Community. The average yield excluding purchase accounting accretion increased 9 basis points to 4.42% for the six months ended June 30, 2018, as compared to 4.33% for the same period last year.

Our total interest income earned on securities, on a fully tax equivalent basis, increased \$1.2 million, to \$2.8 million for the six months ended June 30, 2018 from \$1.6 million for the same period in 2017. The increase in interest income earned on securities was mainly due to a 64.9% increase on the average balance. The average yield for the six months ended June 30, 2018 increased eleven basis points to 3.07% as compared to the same period in 2017.

Other interest-earning assets include federal funds sold and interest bearing deposits in other banks. Our interest earned on total other interest-earning assets increased \$24 thousand to \$46 thousand for the first six months of 2018 as compared to the same period last year. The average balances in other interest-earning assets increased \$567 thousand to \$10.6 million in the first six months of 2018 from \$10.0 million during the first six months a year earlier. The average yield for the first six months of 2018 increased 44 basis points to 0.88% as compared to 0.44% in the same period in 2017 which was mainly driven by the deposits held at the Federal Reserve Bank and Wilmington Trust.

Interest Expense – Our interest expense for the six months ended June 30, 2018 increased \$2.0 million, or 61.9%, to \$5.1 million from \$3.2 million for the same period in 2017. The increase was principally due to higher average balances in interest-bearing liabilities, which increased \$327.2 million, or 48.3%, to \$1.0 billion for the first six months of 2018 from \$677.8 million for the same period in 2017. The average rate for the six months ended June 30, 2018 increased nine basis points to 1.03% as compared to 0.94% for the same period last year.

Our interest expense on deposits increased \$1.5 million, or 98.7%, for the six months ended June 30, 2018, as compared to the same period last year. The increase was largely attributed to the increase in the average balance of total interest bearing deposits, which increased \$266.7 million during the first six months of 2018, as compared to the same period in 2017. The average rate increased 19 basis points to 0.75% for the six months ended June 30, 2018, as compared to 0.56% for the same period last year. The average rate excluding purchase accounting accretion increased 14 basis points to 0.70% for the six months ended June 30, 2018, as compared to 0.56% for the same period last year.

Our interest expense on borrowed funds increased \$420 thousand, or 43.8%, for the six months ended June 30, 2018, as compared to the same period last year. The increase was largely attributed to a \$60.5 million increase in the average balance of borrowed funds during the first six months of 2018, as compared to the same period in 2017. The increase was partially offset by a 39 basis point decrease in the average rate to 1.95% as compared to 2.34% in the same period in 2017.

Our interest expense on all of the Company's subordinated debt decreased \$9 thousand, or 1.4%, for the six months ended June 30, 2018, as compared to the same period last year. The decrease was mainly attributed to a six basis points decrease in average rate to 4.55% for the six months ended June 30, 2018, as compared to 4.61% for the same

period last year.

Provision for Loan Losses – Provision for loan losses increased \$119 thousand to \$906 thousand for the first six months of 2018, as compared to \$787 thousand for the same period in 2017. The provision for loan losses reflects management’s judgment concerning the risks inherent in our existing loan portfolio and the size of the allowance necessary to absorb the risks, as well as the activity in the allowance during the periods. Management reviews the adequacy of its allowance on an ongoing basis and will provide additional provisions, as management may deem necessary.

Non-Interest Income – Our non-interest income increased \$1.4 million, or 33.6%, to \$5.7 million for the first six months of 2018 as compared to the same period last year. The increase was principally due to growth of \$844 thousand in insurance commissions and fees related to SB One Insurance Agency, an increase of \$248 thousand in other income and an increase of \$139 thousand in bank owned life insurance.

Non-Interest Expense – Our non-interest expenses increased \$8.7 million, or 69.4%, to \$21.2 million for the first six months of 2018 as compared to the same period last year. The increase was largely attributed to the growth in the Company resulting from the merger with Community and additional staffing to support growth. The increase in non-interest expenses occurred largely in merger related expenses of \$3.3 million, salaries and employee benefits of \$3.2 million, data processing of \$652 thousand, occupancy of \$373 thousand, advertising and promotion of \$146 thousand and professional fees of \$144 thousand.

Income Taxes – Our income tax expense, which includes both federal and state tax expenses, decreased \$323 thousand, or 22.5% to \$1.1 million for the first six months of 2018, as compared to the same period last year. The Company's effective tax rate for the first six months of 2018 was 20.5%, as compared to 30.9% for the first six months of 2017. The decrease in the Company's tax rate was largely due to the Tax Cuts and Jobs Act enacted in December 2017 which reduced the federal corporate income tax rate to 21% and the merger with Community which resulted in the Company's tax free income becoming a larger percentage of its overall income.

On July 1, 2018, New Jersey's Assembly Bill 4202 was signed into law. The new Bill, effective January 1, 2018, imposed a temporary surtax on corporations earning New Jersey allocated income in excess of \$1 million at a rate of 2.5% for tax years beginning on or after January 1, 2018 through December 31, 2019, and at 1.5% for years beginning on or after January 1, 2020, through December 31, 2021. The Company is still evaluating the change in income tax expense for 2018. In addition, effective for periods on or after January 1, 2019, New Jersey is adopting mandatory unitary combined reporting for its Corporation Business Tax. As a result, the Company anticipates an increase in New Jersey state income tax expenses in 2019.

#### COMPARISON OF FINANCIAL CONDITION AT JUNE 30, 2018 TO DECEMBER 31, 2017

Total Assets – At June 30, 2018, our total assets were \$1.4 billion, an increase of \$457.9 million, or 46.8%, as compared to total assets of \$979.4 million at December 31, 2017. The increase was largely attributable to \$366 million in assets through the merger with Community.

Cash and Cash Equivalents – Our cash and cash equivalents increased by \$7.3 million to \$18.9 million at June 30, 2018, or 1.3% of total assets, from \$11.6 million, or 1.2% of total assets, at December 31, 2017

Securities Portfolio – At June 30, 2018, the securities portfolio, which includes available for sale and held to maturity securities, was \$179.9 million, compared to \$104.0 million at December 31, 2017. Available for sale securities were \$174.5 million at June 30, 2018, compared to \$98.7 million at December 31, 2017. The Company liquidated the securities portfolio acquired as part of the Community Merger because it did not match its strategic objectives. The proceeds from the liquidation were subsequently used to purchase securities within sectors that conformed to the Company's objectives for profitability and liquidity. The available for sale securities are held primarily for liquidity, interest rate risk management and profitability. Accordingly, our investment policy is to invest in securities with low credit risk, such as U.S. government agency obligations, state and political obligations and mortgage-backed securities. Held to maturity securities were \$5.4 million at June 30, 2018 and \$5.3 million at December 31, 2017.

Net unrealized losses in the available for sale securities portfolio were \$2.1 million at June 30, 2018 as compared to a net unrealized gain of \$449 thousand at December 31, 2017.

We conduct a regular assessment of our investment securities to determine whether any securities are OTTI. Further details of the composition of the securities portfolio and discussion of the results of the most recent OTTI assessment are in Note 3 – Securities to our unaudited consolidated financial statements.



The unrealized losses in our securities portfolio are mostly driven by changes in spreads and market interest rates. All of our securities in an unrealized loss position have been evaluated for other-than-temporary impairment as of June 30, 2018 and we do not consider any security OTTI. We evaluated the prospects of the issuers in relation to the severity and the duration of the unrealized losses. In addition, we do not intend to sell, and it is more likely than not that we will not have to sell, any of our securities before recovery of their cost basis.

Other investments, which consisted primarily of FHLB stock, increased \$5.1 million to \$10.1 million at June 30, 2018 as compared to \$4.9 million at December 31, 2017. We also held \$200 thousand in time deposits with other financial institutions at June 30, 2018, as compared to \$100 thousand at December 31, 2017.

Loans – The loan portfolio comprises our largest class of earning assets. Total loans receivable, net of unearned income, increased \$315.8 million, or 38.5%, to \$1.1 billion at June 30, 2018, as compared to \$820.7 million at December 31, 2017. The merger with

Community resulted in an increase in total loans of \$236.1 million. During the six months ended June 30, 2018, the Company also had \$66.8 million of commercial loan production, which was partly offset by \$26.4 million in commercial loan payoffs.

The following table summarizes the composition of our gross loan portfolio by type:

| (Dollars in thousands)          | June 30,<br>2018 | December<br>31, 2017 |
|---------------------------------|------------------|----------------------|
| Commercial and industrial loans | \$62,418         | \$54,759             |
| Construction                    | 62,135           | 42,484               |
| Commercial real estate          | 687,810          | 551,445              |
| Residential real estate         | 322,983          | 171,844              |
| Consumer and other              | 2,205            | 1,130                |
| Total gross loans               | \$1,137,551      | \$821,662            |

Loan and Asset Quality – The ratio of non-performing assets (“NPAs”), which include non-accrual loans, loans 90 days past due and still accruing, troubled debt restructured loans currently performing in accordance with renegotiated terms and foreclosed real estate, to total assets increased to 1.66% at June 30, 2018 from 0.94% at December 31, 2017. NPAs exclude \$3.6 million of purchased credit-impaired (“PCI”) loans acquired through the merger with Community. NPAs increased \$14.6 million to \$23.8 million at June 30, 2018, as compared to \$9.2 million at December 31, 2017. Non-accrual loans, excluding \$3.6 million of PCI loans, increased \$12.6 million, or 209.0%, to \$18.6 million at June 30, 2018, as compared to \$6.0 million at December 31, 2017. The increase in non-accrual loans was largely attributed to two commercial real estate loans totaling \$9.0 million, \$1.5 million loans acquired from Community not classified as PCI, and 7 consumer loans totaling \$2.1 million. Loans past due 30 to 89 days totaled \$2.9 million at June 30, 2018, representing an decrease of \$3.6 million, or 55.8%, as compared to \$6.5 million at December 31, 2017.

We continue to actively market our foreclosed real estate properties, which increased \$1.1 million to \$3.4 million at June 30, 2018 as compared to \$2.3 million at December 31, 2017. At June 30, 2018, the Company’s foreclosed real estate properties had an average carrying value of approximately \$263 thousand per property.

The allowance for loan losses increased \$929 thousand, or 12.7%, to \$8.3 million, or 0.73% of total loans, at June 30, 2018, compared to \$7.3 million, or 0.89% of total loans, at December 31, 2017. The decline in allowance coverage was primarily driven by the addition of Community acquired loans with no allowance for loan losses; such loans were recorded at fair value at the acquisition date. At June 30, 2018, the percentage of allowance for loan losses to total loans, excluding Community acquired loans, was 0.90%. The Company recorded \$906 thousand in provision for loan losses for the six months ended June 30, 2018 as compared to \$787 thousand for the six months ended June 30, 2017. Additionally, the Company recorded net recoveries of \$23 thousand for the six months ended June 30, 2018, as compared to \$318 thousand in net charge-offs for the six months ended June 30, 2017. The allowance for loan losses as a percentage of non-accrual loans decreased to 44.4% at June 30, 2018 from 121.8% at December 31, 2017.

Management continues to monitor our asset quality and believes that the NPAs are adequately collateralized and anticipated material losses have been adequately reserved for in the allowance for loan losses. However, given the uncertainty of the current real estate market, additional provisions for losses may be deemed necessary in future periods. The following table provides information regarding risk elements in the loan portfolio at each of the periods presented:

(Dollars in thousands)

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|   | June 30,<br>2018 | December<br>31, 2017 |
|---|------------------|----------------------|
| Non-accrual loans                                     | \$18,601         | \$6,020              |
| Non-accrual loans to total loans                      | 1.64 %           | 0.73 %               |
| NPAs  | \$23,799         | \$9,227              |
| NPAs to total assets                                  | 1.66 %           | 0.94 %               |
| Allowance for loan losses as a % of non-accrual loans | 44.43 %          | 121.84 %             |
| Allowance for loan losses to total loans              | 0.73 %           | 0.89 %               |

A loan is considered impaired, in accordance with the impairment accounting guidance, when based on current information and events, it is probable that we will be unable to collect all amounts due from the borrower in accordance with the contractual terms of the loan. Total impaired loans were \$17.9 million and \$6.8 million at June 30, 2018 and December 31, 2017, respectively. The Company also had PCI loans from the merger with Community with a carrying value of \$3.6 million at June 30, 2018. Impaired loans include loans modified in troubled debt restructurings where concessions have been granted to borrowers experiencing

financial difficulties. These concessions could include a reduction in the interest rate on the loan, payment extensions, forgiveness of principal, forbearance or other actions intended to maximize collection. Not all impaired loans and restructured loans are on non-accrual, and therefore not all are considered non-performing loans. Restructured loans still accruing totaled \$1.8 million and \$932 thousand at June 30, 2018 and December 31, 2017, respectively.

We also continue to monitor our portfolio for potential problem loans. Potential problem loans are defined as loans which cause management to have serious concerns as to the ability of such borrowers to comply with the present loan repayment terms and which may cause the loan to be placed on non-accrual status. As of June 30, 2018, we had two loan relationships comprised of two loans totaling \$1.2 million that we deemed potential problem loans. Management is actively monitoring these loans.

Further detail of the credit quality of the loan portfolio is included in Note 5 – Allowance for Loan Losses and Credit Quality of Financing Receivables to our unaudited consolidated financial statements.

Allowance for Loan Losses – The allowance for loan losses consists of general, allocated and unallocated components. The allocated component relates to loans that are classified as impaired. For those loans that are classified as impaired, an allowance is established when the discounted cash flows, collateral value or observable market price of the impaired loan is lower than the carrying value of that loan. The general component covers non-impaired loans and is based on historical charge-off experience and expected losses derived from our internal risk rating process. The unallocated component covers the potential for other adjustments that may be made to the allowance for pools of loans after an assessment of internal or external influences on credit quality that are not fully reflected in the historical loss or risk rating data.

Management regularly assesses the appropriateness and adequacy of the loan loss reserve in relation to credit exposure associated with individual borrowers, overall trends in the loan portfolio and other relevant factors, and believes the reserve is reasonable and adequate for each of the periods presented.

At June 30, 2018, the total allowance for loan losses increased \$929 thousand, or 12.7%, to \$8.3 million, or 0.73% of total loans, compared to \$7.3 million, or 0.89% of total loans, at December 31, 2017. The decline in allowance coverage was primarily driven by the addition of Community acquired loans with no allowance for loan losses; such loans were recorded at fair value at the acquisition date. The Company recorded \$906 thousand in provision for loan losses for the six months ended June 30, 2018 as compared to \$787 thousand for the six months ended June 30, 2017. Additionally, the Company recorded net recoveries of \$23 thousand for the six months ended June 30, 2018, as compared to \$318 thousand in net charge-offs for the six months ended June 30, 2017. The allowance for loan losses as a percentage of non-accrual loans decreased to 44.4% at June 30, 2018 from 121.8% at December 31, 2017.

The table below presents information regarding our provision and allowance for loan losses for the six months ended June 30, 2018 and 2017:

| (Dollars in thousands)       | June 30,<br>2018 | June 30,<br>2017 |
|------------------------------|------------------|------------------|
| Balance, beginning of period | \$7,335          | \$6,696          |
| Provision                    | 906              | 787              |
| Charge-offs                  | (75 )            | (334 )           |
| Recoveries                   | 98               | 16               |
| Balance, end of period       | \$8,264          | \$7,165          |



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The table below presents details concerning the allocation of the allowance for loan losses to the various categories for each of the periods presented. The allocation is made for analytical purposes and it is not necessarily indicative of the categories in which future credit losses may occur. The total allowance is available to absorb losses from any category of loans.

| (Dollars in thousands)    | June 30, 2018 |   |   | December 31, 2017 |   |   |
|---------------------------|---------------|---|---|-------------------|---|---|
|                           | Amount        | Percentage of Loans In Each Category To Gross Loans | % | Amount            | Percentage of Loans In Each Category To Gross Loans | % |
| Commercial and industrial | \$440         | 6.4   | % | \$208             | 6.7   | % |
| Construction              | 402           | 5.3   | % | 336               | 5.2   | % |
| Commercial real estate    | 5,489         | 68.5  | % | 5,185             | 67.1  | % |
| Residential real estate   | 1,138         | 19.7  | % | 1,032             | 20.9  | % |
| Consumer and other loans  | 27            | 0.1   | % | 26                | 0.1   | % |
| Unallocated               | 768           | —   | % | 548               | —   | % |
| Total                     | \$8,264       | 100.0   | % | \$7,335           | 100.0   | % |

Bank-Owned Life Insurance (“BOLI”) – Our BOLI carrying value amounted to \$30.4 million at June 30, 2018 and \$22.1 million at December 31, 2017. The increase of \$8.3 million is largely due to the merger with Community.

Goodwill and Other Intangibles – Goodwill represents the excess of the purchase price over the fair market value of net assets acquired. At June 30, 2018 we had recorded goodwill totaling \$24.8 million as compared to \$2.8 million at December 31, 2017. The increase in our goodwill primarily resulted from the merger with Community in the recorded amount of \$22.0 million. Additionally, our recorded goodwill includes the acquisition of Tri-State in 2001 and the 2006 acquisition of deposits. In accordance with U.S. GAAP, goodwill is not amortized, but evaluated at least annually for impairment. Any impairment of goodwill results in a charge to income. We recorded a core deposit intangible of \$1.3 million for the Community acquisition. For the period ended June 30, 2018, we amortized \$121 thousand in core deposit intangible. We periodically assess whether events and changes in circumstances indicate that the carrying amounts of goodwill and intangible assets may be impaired. The estimated fair value of the reporting segment exceeded its book value; therefore, no write-down of goodwill was required. The goodwill related to the insurance agency is not deductible for tax purposes.

Deposits – Our total deposits increased \$299.1 million, or 39.2%, to \$1.1 billion at June 30, 2018, from \$762.5 million at December 31, 2017. The merger with Community resulted in an increase in total deposits of \$300.2 million. The growth in deposits was mostly due to an increase in interest bearing deposits of \$212.4 million, or 34.5%, and non-interest bearing deposits of \$86.7 million, or 59.3%, at June 30, 2018, as compared to December 31, 2017, respectively.

Borrowings – Our borrowings consist of short-term and long-term advances from the FHLB. The advances are secured under terms of a blanket collateral agreement by a pledge of qualifying mortgage loans. We had \$187.9 million and \$90.4 million in borrowings at the FHLB, at a weighted average interest rate of 2.06% and 1.61% at June 30, 2018 and December 31, 2017, respectively. The long-term borrowings at June 30, 2018 consisted of \$25.0 million of fixed rate advances and \$5.0 million of advances with quarterly convertible puts that allow us to put the advance back

to the FHLB quarterly after one year from issuance. During the quarter ended March 31, 2016, the Company entered into forward starting interest rate swap agreements related to four of its FHLB borrowings. Please refer to Liquidity and Capital Resources – Off-Balance Sheet Arrangements.

Subordinated Debentures – On June 28, 2007, Sussex Capital Trust II (the “Trust”), a Delaware statutory business trust and our non-consolidated wholly owned subsidiary, issued \$12.5 million of variable rate capital trust pass-through securities to investors. The Trust purchased \$12.9 million of variable rate junior subordinated deferrable interest debentures from us. The debentures are the sole asset of the Trust. The terms of the junior subordinated debentures are the same as the terms of the capital securities. We have also fully and unconditionally guaranteed the obligations of the Trust under the capital securities. The interest rate is based on the three-month LIBOR plus 144 basis points and adjusts quarterly. The rate at June 30, 2018 was 3.78%. During the quarter ended March 31, 2016, the Company entered into an interest rate swap agreement related to the junior subordinated debentures where the Company pays a fixed rate of 3.10% and receives the three-month LIBOR plus 144 basis points. Please refer to Liquidity and Capital Resources – Off-Balance Sheet Arrangements. The capital securities are currently redeemable by us at par in whole or in part. The capital securities must be redeemed upon final maturity of the subordinated debentures on September 15, 2037. The proceeds of these trust preferred securities, which have been contributed to the Bank, are included in the Bank’s capital ratio calculations and treated as Tier I capital. During the quarter ended December 31, 2016, the Company completed the private placement of the subordinated notes. The subordinated notes have a maturity date of December 22, 2026 and bear interest

at the rate of 5.75% per annum, payable quarterly, for the first five years of the term, and then at a variable rate that will reset quarterly to a level equal to the then current 3-month LIBOR plus 350 basis points over the remainder of the term.

In accordance with FASB ASC 810, Consolidations, our wholly owned subsidiary, the Trust, is not included in our consolidated financial statements.

Equity – Stockholders’ equity, inclusive of accumulated other comprehensive income, net of income taxes, was \$148.8 million, an increase of \$54.6 million when compared to December 31, 2017, largely due to the merger with Community. The Company completed the merger with Community on January 4, 2018 which was the primary driver in an increase in book value per common share of 20.4% from \$15.59 at December 31, 2017 to \$18.77 at June 30, 2018. At June 30, 2018, the leverage, Tier I risk-based capital, total risk-based capital and common equity Tier I capital ratios for the Bank were 10.62%, 12.87%, 13.60% and 12.87%, respectively, all in excess of the ratios required to be deemed “well-capitalized.”

## LIQUIDITY AND CAPITAL RESOURCES

A fundamental component of our business strategy is to manage liquidity to ensure the availability of sufficient resources to meet all financial obligations and to finance prospective business opportunities. Liquidity management is critical to our stability. Our liquidity position over any given period of time is a product of our operating, financing and investing activities. The extent of such activities is often shaped by such external factors as competition for deposits and loan demand.

Traditionally, financing for our loans and investments is derived primarily from deposits, along with interest and principal payments on loans and investments. At June 30, 2018, total deposits amounted to \$1.1 billion, an increase of \$299.1 million, or 39.2%, from December 31, 2017. At June 30, 2018 and December 31, 2017, borrowings from the FHLB and subordinated debentures totaled \$215.8 million and \$118.2 million, respectively, and represented 15.0% and 12.1% of total assets, respectively.

Loan production continued to be our principal investing activity. Total loans receivable, net of unearned income, at June 30, 2018, amounted to \$1.1 billion, an increase of \$315.8 million, or 38.5%, compared to December 31, 2017.

Our most liquid assets are cash and due from banks and federal funds sold. At June 30, 2018, the total of such assets amounted to \$18.9 million, or 1.3%, of total assets, compared to \$11.6 million, or 1.2% of total assets at December 31, 2017. Another significant liquidity source is our available for sale securities portfolio. At June 30, 2018, available for sale securities amounted to \$174.5 million, compared to \$98.7 million at December 31, 2017.

In addition to the aforementioned sources of liquidity, we have available various other sources of liquidity, including federal funds purchased from other banks and the FRB discount window. The Bank also has the capacity to borrow an additional \$168.0 million through its membership in the FHLB and \$10.0 million at Atlantic Community Bankers' Bank (“ACBB”) at June 30, 2018. Management believes that our sources of funds are sufficient to meet our present funding requirements.

In July 2013, the FRB, the Office of the Comptroller of the Currency (the “OCC”) and the FDIC approved final rules (the “Capital Rules”) that established a new capital framework for U.S. banking organizations. The Capital Rules generally implement the Basel Committee on Banking Supervision’s (the “Basel Committee”) December 2010 final capital framework referred to as “Basel III” for strengthening international capital standards. In addition, the Capital Rules implement certain provisions of the Dodd-Frank Act, including the requirements of Section 939A to remove



references to credit ratings from the federal banking agencies' rules.

At June 30, 2018, the Bank's Tier I, Total and Common Equity Tier I ("CET1") capital ratios were 12.87%, 13.60% and 12.87%, respectively. In addition to the risk-based guidelines, the Bank's regulators require that banks which meet the regulators' highest performance and operational standards maintain a minimum leverage ratio (Tier I capital as a percentage of tangible assets) of 4.0%. As of June 30, 2018, the Bank had a leverage ratio of 10.62%. The Bank's risk based and leverage ratios are in excess of those required to be considered "well-capitalized" under FDIC regulations.

The Capital Rules also requires a "capital conservation buffer," composed entirely of CET1, on top of these minimum risk-weighted asset ratios. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the capital conservation buffer will face constraints on dividends, equity and other capital instrument repurchases and compensation based on the amount of the shortfall. Beginning January 1, 2016, the capital standards applicable to the Company will include an additional capital conservation buffer of 0.625%, increasing 0.625% each year thereafter. When fully phased-in on January 1, 2019, the Company will include an additional capital conservation buffer of 2.5% of CET1, effectively resulting in minimum ratios inclusive of the capital conservation buffer of (i)

CET1 to risk-weighted assets of at least 7%, (ii) Tier 1 capital to risk-weighted assets of at least 8.5%, and (iii) total capital to risk-weighted assets of at least 10.5%. As of June 30, 2018, the Bank had a capital conservation buffer of 5.60%.

The Capital Rules substantially revised the risk-based capital requirements applicable to bank holding companies and their depository institution subsidiaries. The risk-based capital guidelines are designed to make regulatory capital requirements sensitive to differences in risk profiles among banks and bank holding companies, to account for off-balance sheet exposures and to minimize disincentives for holding liquid, low-risk assets. The capital guidelines apply on a consolidated basis to bank holding companies with consolidated assets of \$1 billion or more, and to certain bank holding companies with less than \$1 billion in assets if they are engaged in substantial non-banking activity or meet certain other criteria.

We have no investment or financial relationship with any unconsolidated entities that are reasonably likely to have a material effect on liquidity or the availability of capital resources, except for the trust preferred securities of the Trust. We are not aware of any known trends or any known demands, commitments, events or uncertainties, which would result in any material increase or decrease in liquidity. Management believes that any amounts actually drawn upon can be funded in the normal course of operations.

**Off-Balance Sheet Arrangements** – Our consolidated financial statements do not reflect off-balance sheet arrangements that are made in the normal course of business. These off-balance sheet arrangements consist of unfunded loans and letters of credit made under the same standards as on-balance sheet instruments. At June 30, 2018, these unused commitments totaled \$199.6 million and consisted of \$86.5 million in commitments to grant commercial real estate, construction and land development loans, \$40.1 million in home equity lines of credit, \$71.3 million in other unused commitments and \$1.7 million in letters of credit. These instruments have fixed maturity dates, and because many of them will expire without being drawn upon, they do not generally present any significant liquidity risk to us. Management believes that any amounts actually drawn upon can be funded in the normal course of operations.

During the first quarter of 2016, the Company entered into interest rate swap agreements with notional amounts totaling \$38.5 million, of which all are designated as cash flow hedges. The Company entered into \$26.0 million in forward starting interest rate swap agreements coinciding with the maturity of five FHLB advances over the next 21 months that had an average rate of 4.03%. The forward interest rate swaps have a term of 10 years at an average fixed rate of 1.97% and will hedge short term wholesale funding. Additionally, the Company entered into a \$12.5 million interest rate swap agreement to coincide with a junior subordinated debt issued by Sussex Capital Trust II, for a term of 10 years at a fixed rate of 3.10%.

During the second quarter of 2018, the Company entered into two interest rate swap agreements with notional amounts totaling \$40 million, of which all are designated as cash flow hedges. The Company entered into \$20.0 million in two different forward starting interest rate swap agreements coinciding with the maturity of two FHLB advances over 36 and 48 months both beginning on September 15, 2018. The forward interest rate swap with a 3 year term has a fixed rate of 2.89% and the forward interest rate swap with a 4 year term has a fixed rate of 2.90%.

### Item 3 - Quantitative and Qualitative Disclosures about Market Risk

Not applicable.

### Item 4 - Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Management, including our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) as of the end of the period covered by this report. Based upon the evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective to ensure that information required to be disclosed in the reports we file and submit under the Exchange Act is (i) recorded, processed, summarized and reported as and when required and (ii) accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely discussion regarding required disclosure.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting identified in connection with the evaluation that occurred during our last fiscal quarter that have materially affected, or that are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1 - Legal Proceedings

We are not involved in any legal proceedings other than routine legal proceedings occurring in the ordinary course of business. Management believes that such proceedings are, in the aggregate, immaterial to our financial condition and results of operations.

Item 1A - Risk Factors

For a summary of risk factors relevant to our operations, see Part 1, Item 1A, “Risk Factors” in our 2017 Annual Report on Form 10-K.

Item 2 - Unregistered Sales of Equity Securities and Use of Proceeds

There were no sales by us of unregistered securities during the three months ended June 30, 2018.

Item 3 - Defaults Upon Senior Securities

Not applicable.

Item 4 - Mine Safety Disclosures

Not applicable.

Item 5 - Other Information

Not applicable.

Item 6 - Exhibits

The exhibits required to be filed as part of this Quarterly Report on Form 10-Q are listed below.

EXHIBIT INDEX

Exhibit

Number Description

|              |  |
|--------------|--|
| <u>2.1</u>   | Agreement and Plan of Merger, dated as of April 10, 2017, by and between Sussex Bancorp, Sussex Bank and Community Bank of Bergen County, NJ (incorporated by reference to Exhibit 2.1 of the Form 8-K filed with the SEC on April 11, 2017).  |
| <u>2.2</u>   | Agreement and Plan of Merger, dated as of June 19, 2018, by and between SB One Bancorp, SB One Bank and Enterprise Bank N.J. (incorporated by reference to Exhibit 2.1 of the Form 8-K filed with the SEC on June 20, 2018).   |
| <u>3.1</u>   | Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to the Quarterly Report on 10-Q filed with the SEC on August 15, 2011).  |
| <u>3.2</u>   | Amendment to Restate Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to the Currency Report on Form 8-K filed with the SEC on May 4, 2018).   |
| <u>3.3</u>   | Second Amended and Restated By-laws (incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K filed with the SEC on May 4, 2018).  |
| <u>31.1</u>  | Rule 13a-14(a)/15d-14(a) Certification of the Chief Executive Officer.   |
| <u>31.2</u>  | Rule 13a-14(a)/15d-14(a) Certification of the Chief Financial Officer.   |
| <u>32.1*</u> | Section 1350 Certifications of the Chief Executive Officer and Chief Financial Officer.  |
| 101          | Financial statements from the Quarterly Report on Form 10-Q of SB One Bancorp for the quarter ended June 30, 2018, formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Balance Sheets; (ii) the Consolidated Statements of Income and Comprehensive Income; (iii) the Consolidated Statements of Stockholders' Equity; (iv) the Consolidated Statements of Cash Flows and (v) Notes to Unaudited Consolidated Financial Statements. |

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Furnished herewith and not deemed to be "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and shall not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Exchange Act.

SIGNATURES

In accordance with the requirements of the Securities Exchange Act of 1934, as amended, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: August 9, 2018      SB ONE BANCORP

By: /s/ Steven M. Fusco  
 Steven M. Fusco  
 Chief Financial Officer and Senior Executive Vice President  
 (Principal Financial and Accounting Officer)