1ST CONSTITUTION BANCORP
Form 10-Q
November 12, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2013

or

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

For the transition period from _____ to _____

Commission file Number: 000-32891

1ST CONSTITUTION BANCORP
(Exact Name of Registrant as Specified in Its Charter)

| | |
|---|---|
| New Jersey<br>(State of Other Jurisdiction<br>of Incorporation or Organization) | 22-3665653<br>(I.R.S. Employer Identification No.) |
| 2650 Route 130, P.O. Box 634, Cranbury, NJ<br>(Address of Principal Executive Offices) | 08512<br>(Zip Code) |

(609) 655-4500
(Issuer's Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x

No o

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

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

| | | | |
|---|---|---|---|
| Large accelerated filer | o | Accelerated filer | o |
| Non-accelerated filer<br>(Do not check if a smaller reporting company) | o | Smaller reporting company | x |

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

As of November 12, 2013, there were 5,988,867 shares of the registrant's common stock, no par value, outstanding.

1ST CONSTITUTION BANCORP

FORM 10-Q

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

1st Constitution Bancorp and Subsidiaries
Consolidated Balance Sheets
(unaudited)

| | September 30, 2013 | December 31, 2012 |
|---|---|---|
| ASSETS | | |
| CASH AND DUE FROM BANKS | $ 123,803,713 | $ 14,033,501 |
| FEDERAL FUNDS SOLD / SHORT-TERM INVESTMENTS | 11,425 | 11,420 |
| Total cash and cash equivalents | 123,815,138 | 14,044,921 |
| INVESTMENT SECURITIES: | | |
| Available for sale, at fair value | 101,557,211 | 109,840,965 |
| Held to maturity (fair value of $152,186,281 and $121,839,363 at September 30, 2013, and December 31, 2012, respectively) | 150,572,922 | 116,027,900 |
| Total securities | 252,130,133 | 225,868,865 |
| LOANS HELD FOR SALE | 14,535,681 | 35,960,262 |
| LOANS | 362,549,473 | 521,814,110 |
| Less- Allowance for loan losses | (6,820,180) | (7,151,212) |
| Net loans | 355,729,293 | 514,662,898 |
| PREMISES AND EQUIPMENT, net | 10,172,487 | 10,630,295 |
| ACCRUED INTEREST RECEIVABLE | 2,143,535 | 2,872,099 |
| BANK-OWNED LIFE INSURANCE | 15,374,712 | 15,026,506 |
| OTHER REAL ESTATE OWNED | 2,808,554 | 8,332,601 |
| OTHER ASSETS | 13,459,319 | 13,569,935 |
| Total assets | $ 790,168,852 | $ 840,968,382 |
| LIABILITIES AND SHAREHOLDERS’ EQUITY | | |
| LIABILITIES: | | |
| Deposits | | |
| Non-interest bearing | $ 147,179,144 | $ 152,334,759 |
| Interest bearing | 539,764,810 | 555,354,716 |
| Total deposits | 686,943,954 | 707,689,475 |

| | | |
|---|---|---|
| BORROWINGS | 10,000,000 | 42,400,000 |
| REDEEMABLE SUBORDINATED DEBENTURES | 18,557,000 | 18,557,000 |
| ACCRUED INTEREST PAYABLE | 787,927 | 1,057,779 |
| ACCRUED EXPENSES AND OTHER LIABILITIES | 6,727,851 | 6,210,596 |
| Total liabilities | 723,016,732 | 775,914,850 |
| COMMITMENTS AND CONTINGENCIES | | |
| SHAREHOLDERS' EQUITY: | | |
| Preferred stock, no par value; 5,000,000 shares authorized; none issued | | |
| Common stock, no par value, 30,000,000 shares authorized; 6,008,223 and 5,985,275 shares issued and 5,988,867 and 5,977,924 shares outstanding as of September 30, 2013 and December 31, 2012 respectively | 49,395,322 | 48,716,032 |
| Retained earnings | 19,999,881 | 15,594,293 |
| Treasury Stock, at cost, 19,356 shares 7,351 shares at September 30, 2013 and December 31, 2012, respectively | (177,537) | (61,086) |
| Accumulated other comprehensive (loss) income | (2,065,546) | 804,293 |
| Total shareholders' equity | 67,152,120 | 65,053,532 |
| Total liabilities and shareholders' equity | $ 790,168,852 | $ 840,968,382 |

See accompanying notes to consolidated financial statements.

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1st Constitution Bancorp and Subsidiaries
Consolidated Statements of Income
(unaudited)

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| INTEREST INCOME | 2013 | 2012 | 2013 | 2012 |
| Loans, including fees | $ 5,701,804 | $ 6,966,886 | $ 17,319,258 | $ 19,700,449 |
| Securities | | | | |
| Taxable | 980,004 | 1,103,011 | 2,818,800 | 3,430,770 |
| Tax-exempt | 575,301 | 409,774 | 1,633,799 | 1,241,568 |
| Federal funds sold and short-term investments | 81,745 | 6,975 | 221,087 | 55,315 |
| Total interest income | 7,338,854 | 8,486,646 | 21,992,944 | 24,428,102 |
| | | | | |
| INTEREST EXPENSE | | | | |
| Deposits | 842,372 | 1,026,154 | 2,668,306 | 3,291,676 |
| Borrowings | 103,122 | 119,223 | 310,649 | 340,784 |
| Redeemable subordinated debentures | 88,338 | 96,867 | 263,982 | 292,759 |
| Total interest expense | 1,033,832 | 1,242,244 | 3,242,937 | 3,925,219 |
| | | | | |
| Net interest income | 6,305,022 | 7,244,402 | 18,750,007 | 20,502,883 |
| PROVISION FOR LOAN LOSSES | 539,998 | 499,998 | 776,664 | 1,649,994 |
| Net interest income after provision for loan losses | 5,765,024 | 6,744,404 | 17,973,343 | 18,852,889 |
| | | | | |
| NON-INTEREST INCOME | | | | |
| Service charges on deposit accounts | 231,169 | 243,443 | 675,839 | 702,671 |
| Gain on sales of loans | 641,966 | 509,138 | 1,852,821 | 1,472,502 |
| Income on bank-owned life insurance | 115,840 | 112,276 | 348,206 | 337,374 |
| Other income | 627,573 | 451,870 | 1,796,104 | 1,157,311 |
| Total non-interest income | 1,616,548 | 1,316,727 | 4,672,970 | 3,669,858 |
| | | | | |
| NON-INTEREST EXPENSE | | | | |
| Salaries and employee benefits | 3,060,143 | 3,061,065 | 9,458,247 | 9,156,318 |
| Occupancy expense | 629,922 | 523,126 | 1,930,227 | 1,860,446 |
| Data processing expenses | 273,272 | 257,990 | 868,960 | 774,110 |
| FDIC insurance expenses | 111,562 | 139,694 | 146,249 | 426,960 |
| Other operating expenses | 1,178,584 | 2,201,299 | 4,095,068 | 4,951,831 |
| | | | | |
| Total non-interest expenses | 5,253,483 | 6,183,174 | 16,498,751 | 17,169,665 |
| Income before income taxes | 2,128,089 | 1,877,957 | 6,147,562 | 5,353,082 |
| | | | | |
| INCOME TAXES | 604,851 | 523,038 | 1,741,974 | 1,533,323 |
| Net income | $ 1,523,238 | $ 1,354,919 | $ 4,405,588 | $ 3,819,759 |
| | | | | |
| NET INCOME PER SHARE | | | | |
| Basic | $ 0.25 | $ 0.25 | $ 0.74 | $ 0.71 |
| Diluted | $ 0.25 | $ 0.25 | $ 0.72 | $ 0.70 |

See accompanying notes to consolidated financial statements.

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1st Constitution Bancorp and Subsidiaries
Consolidated Statements of Comprehensive Income
(unaudited)

| | Three months ended September 30, 2013 | Three months ended September 30, 2012 | Nine months ended September 30, 2013 | Nine months ended September 30, 2012 |
|---|---|---|---|---|
| NET INCOME | $ 1,523,238 | $ 1,354,919 | $ 4,405,588 | $ 3,819,759 |
| Other comprehensive (loss) income, net of tax: | | | | |
| Unrealized holding gains (losses) on securities available for sale | (35,468) | 430,698 | (2,947,683) | 468,628 |
| Pension liability | 37,960 | 1,925 | 77,844 | 5,777 |
| Other comprehensive (loss) income | 2,492 | 432,623 | (2,869,839) | 474,405 |
| Comprehensive income | $ 1,525,730 | $ 1,787,542 | $ 1,535,749 | $ 4,294,164 |

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

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1st Constitution Bancorp and Subsidiaries
Consolidated Statements of Changes in Shareholders' Equity
For the Nine Months Ended September 30, 2013 and 2012
(unaudited)

| | Common Stock | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive (Loss) Income | Tota Shareho Equi |
|---|---|---|---|---|---|
| BALANCE, January 1, 2012 | $ 40,847,929 | $ 13,070,606 | $ (10,222) | $ 1,091,462 | $ 54,999 |
| Exercise of stock options and issuance of vested shares under employee benefit programs | 442,918 | | 13,843 | | 456 |
| Share-based compensation | 73,965 | | | | 73 |
| Treasury stock purchased | | | (80,344) | | (80 |
| Net income for the nine months ended September 30, 2012 | | 3,819,759 | | | 3,819 |
| Other comprehensive income | | | | 474,405 | 474 |
| Balance, September 30, 2012 | $ 41,364,812 | $ 16,890,365 | $ (76,723) | $ 1,565,867 | $ 59,744 |
| Balance, January 1, 2013 | $ 48,716,032 | $ 15,594,293 | $ (61,086) | $ 804,293 | $ 65,053 |
| Exercise of stock options, net, and issuance of vested shares under employee benefit programs | 603,342 | | | | 603 |
| Share-based compensation | 75,948 | | | | 75 |
| Treasury stock purchased | | | (116,451) | | (116 |
| Net Income for the nine months ended September 30, 2013 | | 4,405,588 | | | 4,405 |
| Other comprehensive (loss) | | | | (2,869,839) | (2,869 |
| Balance, September 30, 2013 | $ 49,395,322 | $ 19,999,881 | $ (177,537) | $ (2,065,546) | $ 67,152 |

See accompanying notes to consolidated financial statements.

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1st Constitution Bancorp and Subsidiaries
Consolidated Statements of Cash Flows
(unaudited)

| | Nine Months Ended September 30, 2013 | 2012 |
|---|---|---|
| OPERATING ACTIVITIES: | | |
| Net income | $ 4,405,588 | $ 3,819,759 |
| Adjustments to reconcile net income to net cash provided by operating activities- | | |
| Provision for loan losses | 776,664 | 1,649,994 |
| Provision for loss on other real estate owned | 662,918 | 1,195,288 |
| Depreciation and amortization | 805,823 | 884,595 |
| Net amortization of premiums and discounts on securities | 868,639 | 1,109,664 |
| Gains on sales of other real estate owned | (292,170) | - |
| Gains on sales of loans held for sale | (1,852,821) | (1,472,502) |
| Originations of loans held for sale | (114,126,927) | (128,302,763) |
| Proceeds from sales of loans held for sale | 137,972,505 | 126,526,811 |
| Income on Bank–owned life insurance | (348,206) | (337,374) |
| Share-based compensation expense | 380,471 | 336,898 |
| Decrease (increase) in accrued interest receivable | 728,564 | 318,198 |
| Decrease (increase) in other assets | 925,461 | (122,026) |
| Decrease in accrued interest payable | (269,852) | (263,258) |
| Increase (decrease) in accrued expenses and other liabilities | 517,255 | (35,727) |
| Net cash provided by operating activities | 31,153,912 | 5,307,557 |
| INVESTING ACTIVITIES: | | |
| Purchases of securities - | | |
| Available for sale | (16,947,137) | (31,800,023) |
| Held to maturity | (62,560,993) | (6,602,385) |
| Proceeds from maturities and prepayments of securities - | | |
| Available for sale | 20,423,187 | 28,843,391 |
| Held to maturity | 27,488,848 | 24,829,152 |
| Net decrease (increase) in loans | 155,845,716 | (22,860,591) |
| Capital expenditures | (147,040) | (815,581) |
| Additional investment in other real estate owned | (11,500) | (144,454) |
| Proceeds from sales of other real estate owned | 7,183,854 | 1,686,389 |
| Net cash provided by (used in) investing activities | 131,274,935 | (6,864,102) |
| FINANCING ACTIVITIES: | | |
| Exercise of stock options and issuance of vested shares | 603,342 | 456,761 |
| Purchase of Treasury Stock | (116,451) | (80,344) |
| Net (decrease) increase in demand, savings and time deposits | (20,745,521) | 37,135,047 |
| Net decrease in borrowings | (32,400,000) | (37,150,000) |
| Net cash (used in) provided by financing activities | (52,658,630) | 361,464 |
| Increase (decrease) in cash and cash equivalents | 109,770,217 | (1,195,081) |

| | | |
|---|---|---|
| CASH AND CASH EQUIVALENTS<br>AT BEGINNING OF PERIOD | 14,044,921 | 15,195,259 |
| CASH AND CASH EQUIVALENTS<br>AT END OF PERIOD | $ 123,815,138 | $ 14,000,178 |
| SUPPLEMENTAL DISCLOSURES<br>OF CASH FLOW INFORMATION: | | |
| Cash paid during the period for - | | |
| Interest | $ 3,512,789 | $ 4,188,477 |
| Income taxes | 1,721,000 | 1,787,000 |
| Non-cash investing activities | | |
| Real estate acquired in full satisfaction of loans in foreclosure | $ 2,311,225 | $ 553,762 |

See accompanying notes to consolidated financial statements.

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1st Constitution Bancorp and Subsidiaries
Notes To Consolidated Financial Statements
September 30, 2013 (Unaudited)

(1) Summary of Significant Accounting Policies

The accompanying unaudited Consolidated Financial Statements include 1st Constitution Bancorp (the “Company”), its wholly-owned subsidiary, 1st Constitution Bank (the “Bank”), and the Bank’s wholly-owned subsidiaries, 1st Constitution Investment Company of New Jersey, Inc., FCB Assets Holdings, Inc., 1st Constitution Title Agency, LLC, 204 South Newman Street Corp. and 249 New York Avenue, LLC. 1st Constitution Capital Trust II, a subsidiary of the Company, is not included in the Company’s consolidated financial statements, as it is a variable interest entity and the Company is not the primary beneficiary. All significant intercompany accounts and transactions have been eliminated in consolidation and certain prior period amounts have been reclassified to conform to current year presentation. The accounting and reporting policies of the Company and its subsidiaries conform to accounting principles generally accepted in the United States of America and pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”) including the instructions to Form 10-Q and Article 8 of Regulation S-X. Certain information and footnote disclosures normally included in financial statements have been condensed or omitted pursuant to such rules and regulations. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Company’s Form 10-K for the year ended December 31, 2012, filed with the SEC on March 22, 2013.

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

The Company has evaluated events and transactions occurring subsequent to the balance sheet date of September 30, 2013 for items that should potentially be recognized or disclosed in these financial statements. The evaluation was conducted through the date these financial statements were issued.

(2) Entry into a Material Definitive Agreement

On August 14, 2013, the Company and the Bank entered into an Agreement and Plan of Merger, which was subsequently amended on September 19, 2013 by the First Amendment to Agreement and Plan of Merger (the Agreement and Plan of Merger and the First Amendment to Agreement and Plan of Merger are hereinafter referred to as the “Merger Agreement”), with Rumson-Fair Haven Bank & Trust Company (“RFHB”), providing for the merger of RFHB with and into the Bank, with the Bank as the surviving entity (the “Merger”).

Subject to the terms and conditions of the Merger Agreement, upon consummation of the Merger, each outstanding share of common stock of RFHB will be converted into the right to receive, at the election of the holder of such common stock of RFHB, (i) cash consideration of $7.50 or (ii) 0.7772 of a share of common stock of the Company, or a combination of both, subject to the payment of cash in lieu of fractional shares and customary proration and allocation procedures, if necessary, to assure that 60% of the outstanding shares of common stock of RFHB are exchanged for cash and 40% of the outstanding shares of common stock of RFHB are exchanged for shares of common stock of the Company. In addition, each outstanding option to acquire shares of common stock of RFHB will be terminated and converted to the right to receive cash and equal to the product of (i) the aggregate number of shares of common stock of RFHB underlying such outstanding option multiplied by (ii) the excess, if any, of $7.50 over the per share exercise price of such outstanding option. Stock awards will be converted into shares of common stock of the Company. Each outstanding share of common stock of the Company will remain outstanding and unaffected by the Merger.

Under New Jersey banking law, shareholders of RFHB can elect to dissent from the Merger. Any shareholder electing to dissent shall be entitled to a cash payment for such shares only to the extent permitted by and in accordance with New Jersey Banking law.

The Merger Agreement contains typical representations, warranties, and covenants of the Company, the Bank and RFHB, including, among others, covenants that require, during the period between the execution of the Merger Agreement and consummation of the Merger, (i) RFHB to use commercially reasonable efforts to conduct its business in the ordinary course and consistent with past banking practice and prudent banking practice; and (ii) RFHB to not, subject to certain exceptions generally related to the Board's evaluation and exercise of its fiduciary duties, (a) solicit proposals relating to alternative business combination transactions or (b) enter into discussions or negotiations or provide confidential information in connection with any proposals for alternative business combination transactions.

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The Merger Agreement provides certain termination rights for the Company, the Bank and RFHB, and further provides that upon termination of the Merger Agreement under certain circumstances, RFHB will be obligated to pay the Company a termination fee of $1,000,000 and out of pocket expenses incurred by the Company and the Bank in connection with the Merger of up to $275,000; provided, however, that the sum of the termination fee and such out-of-pocket expenses shall not exceed $1,275,000.

Completion of the Merger is subject to customary closing conditions, including (i) receipt of the requisite approval of the shareholders of RFHB, (ii) receipt of regulatory approvals, (iii) the absence of any law or order prohibiting the closing and (iv) and the effectiveness of the registration statement to be filed by the Company with respect to the common stock to be issued in the Merger. In addition, each party’s obligation to consummate the merger is subject to certain other conditions, including the accuracy of the representations and warranties of the other party and compliance of the other party with its covenants in all material respects.

(3) Net Income Per Common Share

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

Diluted net income per common share is calculated by dividing net income by the weighted average number of common shares outstanding, as adjusted for the assumed exercise of potential common stock warrants, common stock options and unvested restricted stock awards (as defined below), using the treasury stock method. All share information has been adjusted for the effect of a 5% common stock dividend declared December 20, 2012 and paid on January 31, 2013 to shareholders of record on January 14, 2013.

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

| | Three Months Ended September 30, 2013 | | |
|---|---|---|---|
| | Net Income | Weighted-average shares | Per share Amount |
| Basic earnings per common share: | | | |
| Net income | $ 1,523,238 | 5,991,480 | $ 0.25 |
| | | | |
| Effect of dilutive securities: | | | |
| Stock options and unvested stock awards | | 155,182 | |
| | | | |
| Diluted EPS: | | | |
| Net income plus assumed conversion | $ 1,523,238 | 6,146,662 | $ 0.25 |

| | Three Months Ended September 30, 2012 | | |
|---|---|---|---|
| | Net Income | Weighted-average shares | Per share Amount |

| | | | | |
|---|---|---|---|---|
| Basic earnings per common share: | | | | |
| Net income | $ | 1,354,919 | 5,378,854 | $ 0.25 |
| Effect of dilutive securities: | | | | |
| Stock options and unvested stock awards | | | 130,019 | |
| Diluted EPS: | | | | |
| Net income plus assumed conversion | $ | 1,354,919 | 5,508,873 | $ 0.25 |

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| | Nine Months Ended September 30, 2013 | | |
|---|---|---|---|
| | Net Income | Weighted-average shares | Per share Amount |
| Basic earnings per share: | | | |
| Net income | $ 4,405,588 | 5,960,294 | $ 0.74 |
| | | | |
| Effect of dilutive securities: | | | |
| Stock options and unvested stock awards | | 128,539 | |
| | | | |
| Diluted EPS: | | | |
| Net income plus assumed conversion | $ 4,405,588 | 6,088,833 | $ 0.72 |

| | Nine Months Ended September 30, 2012 | | |
|---|---|---|---|
| | Net Income | Weighted-average shares | Per share Amount |
| Basic earnings per common share: | | | |
| Net income | $ 3,819,759 | 5,360,395 | $ 0.71 |
| | | | |
| Effect of dilutive securities: | | | |
| Stock options and unvested stock awards | | 96,107 | |
| | | | |
| Diluted EPS: | | | |
| Net income plus assumed conversion | $ 3,819,759 | 5,456,502 | $ 0.70 |

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(4) Investment Securities

Amortized cost, gross unrealized gains and losses, and the estimated fair value by security type are as follows:

| September 30, 2013: | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| Available for sale | | | | |
| U. S. Treasury securities and obligations of U.S. Government sponsored corporations ("GSE") and agencies | $ 22,382,475 | $ 33,857 | $ (789,667) | $ 21,626,665 |
| Residential collateralized mortgage obligations – GSE | 4,031,094 | 165,347 | - | 4,196,441 |
| Residential collateralized mortgage obligations – non-GSE | 3,001,533 | 70,080 | (18,950) | 3,052,663 |
| Residential mortgage backed securities – GSE | 32,795,415 | 1,002,198 | (458,845) | 33,338,768 |
| Obligations of State and Political subdivisions | 22,231,752 | 174,056 | (2,660,209) | 19,745,599 |
| Trust preferred debt securities – single issuer | 2,468,135 | - | (429,935) | 2,038,200 |
| Corporate Debt Securities | 16,267,927 | 280,241 | (27,393) | 16,520,775 |
| Restricted stock | 1,013,100 | - | - | 1,013,100 |
| Mutual fund | 25,000 | - | - | 25,000 |
| | $ 104,216,431 | $ 1,725,779 | $ (4,384,999) | $ 101,557,211 |

| September 30, 2013: | Amortized Cost | Other-Than-Temporary Impairment Recognized In Accumulated Other Comprehensive Income | Carrying Value | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|---|---|
| Held to maturity | | | | | | |
| U. S. Treasury securities and obligations of U.S. Government sponsored corporations ("GSE") and agencies | $ 1,537,229 | $ - | $ 1,537,229 | $ 14,416 | $ - | $ 1,551,645 |
| Residential collateralized Mortgage obligations – GSE | 15,701,290 | - | 15,701,290 | 578,336 | - | 16,279,626 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Residential collateralized Mortgage obligations – non-GSE | 11,234,867 | - | 11,234,867 | 329,988 | (1,637) | 11,563,218 |
| Residential mortgage backed securities – GSE | 67,487,280 | - | 67,487,280 | 869,664 | (268,803) | 68,088,141 |
| Obligations of State and political subdivisions | 50,960,864 | - | 50,960,864 | 1,405,225 | (1,327,248) | 51,038,841 |
| Trust preferred debt securities – pooled | 656,662 | (500,944) | 155,718 | - | (8,311) | 147,407 |
| Corporate debt securities | 3,495,674 | - | 3,495,674 | 21,729 | - | 3,517,403 |
| | $151,073,866 | $(500,944) | $150,572,922 | $3,219,358 | $(1,605,999) | $152,186,281 |

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| December 31, 2012: | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| Available for sale- | | | | |
| U. S. Treasury securities and obligations of U.S. Government sponsored corporations (“GSE”) and agencies | $ 29,384,595 | $ 137,847 | $ (26,907) | $ 29,495,535 |
| Residential collateralized mortgage obligations – GSE | 6,349,310 | 283,355 | - | 6,632,665 |
| Residential collateralized mortgage obligations – non-GSE | 3,811,933 | 119,323 | (7,074) | 3,924,182 |
| Residential mortgage backed securities – GSE | 24,912,948 | 1,576,387 | - | 26,489,335 |
| Obligations of State and Political subdivisions | 20,793,222 | 375,416 | (486,337) | 20,682,301 |
| Trust preferred debt securities – single issuer | 2,466,009 | - | (467,643) | 1,998,366 |
| Corporate Debt Securities | 17,797,681 | 325,731 | (23,131) | 18,100,281 |
| Restricted stock | 2,493,300 | - | - | 2,493,300 |
| Mutual fund | 25,000 | - | - | 25,000 |
| | $ 108,033,998 | $ 2,818,059 | $ (1,011,092) | $ 109,840,965 |

| December 31, 2012: | Amortized Cost | Other-Than-Temporary Impairment Recognized In Accumulated Other Comprehensive Income | Carrying Value | Gross Unrealized Gains | Gross Unrealized Losses | Fair Valu |
|---|---|---|---|---|---|---|
| Held to maturity- | | | | | | |
| Obligations of U.S. Government sponsored corporations (“GSE”) and agencies | $ 3,073,957 | $ - | $ 3,073,957 | $ 33,213 | $ - | $ 3,10 |
| Residential collateralized mortgage obligations – GSE | 19,660,625 | - | 19,660,625 | 1,021,556 | - | 20,682 |
| Residential collateralized mortgage obligations- non – GSE | 13,387,974 | - | 13,387,974 | 796,892 | (289) | 14,18 |
| Residential mortgage | 19,950,190 | - | 19,950,190 | 849,040 | (944) | 20,79 |

| | | | | | | |
|---|---|---|---|---|---|---|
| backed securities – GSE | | | | | | |
| Obligations of State and Political subdivisions | 42,815,706 | - | 42,815,706 | 3,039,935 | - | 45,85 |
| Trust preferred debt securities – pooled | 656,662 | (500,944) | 155,718 | - | (9,638) | 14 |
| Corporate debt securities | 16,983,730 | - | 16,983,730 | 84,443 | (2,745) | 17,06 |
| | $ 116,528,844 | $ (500,944 ) | $ 116,027,900 | $ 5,825,079 | $ (13,616) | $121,83 |

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Restricted stock at September 30, 2013 and December 31, 2012 consisted of $998,100 and $2,478,300, respectively, of Federal Home Loan Bank of New York stock and $15,000 of Atlantic Central Bankers Bank stock.

The amortized cost and estimated fair value of investment securities at September 30, 2013, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Restricted stock is included in "Available for sale-Due in one year or less."

| | Amortized Cost | Fair Value |
|---|---|---|
| Available for sale- | | |
| Due in one year or less | | |
| U.S. Treasury securities and obligations of U.S. Government sponsored corporations ("GSE") and agencies | $ 4,998,329 | $ 5,004,300 |
| Residential mortgage backed securities - GSE | 19,397 | 20,034 |
| Obligations of State and Political subdivisions | 110,000 | 110,343 |
| Corporate Debt Securities | 510,694 | 512,930 |
| Restricted Stock | 1,013,100 | 1,013,100 |
| Mutual Fund | 25,000 | 25,000 |
| | $ 6,676,520 | $ 6,685,707 |
| Due after one year through five years | | |
| U.S. Treasury securities and obligations of US Government sponsored corporations ("GSE") and agencies | $ 6,517,816 | $ 6,520,515 |
| Residential mortgage backed securities - GSE | 4,431,874 | 4,370,765 |
| Obligations of State and Political subdivisions | 374,281 | 375,833 |
| Corporate Debt Securities | 14,671,579 | 14,942,705 |
| | $ 25,995,550 | $ 26,209,818 |
| Due after five years through ten years | | |
| U.S. Treasury securities and obligations of U.S. Government sponsored corporations ("GSE") and agencies | $ 10,866,330 | $ 10,101,850 |
| Residential collateralized mortgage obligations - GSE | 134,797 | 144,639 |
| Residential mortgage backed securities - GSE | 11,172,951 | 11,152,731 |
| Obligations of State and Political Subdivisions | 3,167,509 | 3,227,127 |
| Corporate Debt Securities | - | - |
| | $ 25,341,587 | $ 24,626,347 |
| Due after ten years | | |
| Residential collateralized mortgage obligations - GSE | 3,896,296 | 4,051,802 |
| Residential collateralized mortgage obligations - non GSE | 3,001,534 | 3,052,663 |
| Residential mortgage backed securities - GSE | 17,171,193 | 17,795,238 |
| Obligations of State and Political subdivisions | 18,579,962 | 16,032,296 |
| Trust Preferred Debt Securities - single issuer | 2,468,135 | 2,038,200 |
| Corporate Debt Securities | 1,085,654 | 1,065,140 |
| | $ 46,202,774 | $ 44,035,339 |
| Total | $ 104,216,431 | $ 101,557,211 |

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| | | |
|---|---|---|
| Held to maturity- | | |
| Due in one year or less | | |
| U.S. Treasury securities and obligations of US Government sponsored corporations ("GSE") and agencies | $ 1,537,229 | $ 1,551,645 |
| Obligations of State and Political subdivisions | 1,261,544 | 1,273,221 |
| Corporate Debt Securities | 3,495,674 | 3,517,403 |
| | $ 6,294,447 | $ 6,342,269 |
| | | |
| Due after one year through five years | | |
| U.S. Treasury securities and obligations of US Government sponsored corporations ("GSE") and agencies | $ - | $ - |
| Obligations of State and Political subdivisions | 8,937,728 | 9,243,927 |
| Corporate Debt Securities | - | - |
| | $ 8,937,728 | $ 9,243,927 |
| | | |
| Due after five years through ten years | | |
| Residential collateralized mortgage obligations - GSE | 85,440 | 86,388 |
| Residential collateralized mortgage obligations – non-GSE | 954,327 | 952,869 |
| Residential mortgage backed securities – GSE | 21,772,966 | 21,945,961 |
| Obligations of State and Political subdivisions | 20,751,372 | 21,459,490 |
| | $ 43,564,105 | $ 44,444,708 |
| Due after ten years | | |
| Residential collateralized mortgage obligations - GSE | $ 15,615,850 | $ 16,193,239 |
| Residential collateralized mortgage obligations – non-GSE | 10,280,540 | 10,610,348 |
| Residential mortgage backed securities - GSE | 45,714,314 | 46,142,180 |
| Obligations of State and Political subdivisions | 20,010,221 | 19,062,203 |
| Trust Preferred Debt Securities - Pooled | 656,662 | 147,407 |
| | $ 92,277,587 | $ 92,155,377 |
| | | |
| Total | $ 151,073,866 | $ 152,186,281 |

Gross unrealized losses on securities and the estimated fair value of the related securities aggregated by security category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2013 and December 31, 2012 are as follows:

| September 30, 2013 | | Less than 12 months | | 12 months or longer | | Tota |
|---|---|---|---|---|---|---|
| | Number of Securities | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value |
| U.S. Treasury securities and obligations of U.S. Government sponsored corporations and agencies | 3 | $11,627,065 | $ (789,667) | $ - | $ - | $11,627,065 |
| Residential collateralized mortgage obligations – non-GSE | 3 | 952,689 | (1,637) | 1,094,497 | (18,950) | 2,047,186 |
| Residential mortgage backed securities | 28 | 30,747,798 | (727,648) | - | - | 30,747,798 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| - GSE | | | | | | | |
| Obligations of State and Political Subdivisions | 77 | 24,976,580 | (3,987,457) | - | - | 24,976,580 | |
| Trust preferred debt securities – single issuer | 4 | - | - | 2,038,200 | (429,935) | 2,038,200 | |
| Trust preferred debt securities – pooled | 1 | - | - | 147,407 | (509,255) | 147,407 | |
| Corporate Debt Securities | 3 | 2,823,855 | (27,393) | - | - | 2,823,855 | |
| Total temporarily impaired securities | 119 | $ 71,127,987 | $ (5,533,802) | $ 3,280,104 | $ (958,140) | $ 74,408,091 | $ |

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| December 31, 2012 | | Less than 12 months | | 12 months or longer | | Total | |
|---|---|---|---|---|---|---|---|
| | Number of Securities | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unre Lo |
| U.S. Treasury securities and obligations of U.S. Government sponsored corporations (GSE) and agencies | 1 | $ 9,842,200 | $ (26,907) | $ - | $ - | $ 9,842,200 | $ (2 |
| Residential collateralized mortgage obligations – non-GSE | 3 | 1,960,237 | (4,516) | 156,505 | (2,847) | 2,116,742 | |
| Residential mortgage backed securities GSE | 2 | 3,989,675 | (944) | - | - | 3,989,675 | |
| Obligations of State and Political Subdivisions | 37 | 12,794,007 | (486,337) | - | - | 12,794,007 | (48 |
| Trust preferred debt securities – Single issuer | 4 | - | - | 1,998,366 | (467,643) | 1,998,366 | (46 |
| Trust preferred debt securities – Pooled | 1 | - | - | 146,080 | (510,582) | 146,080 | (5 |
| Corporate debt securities | 5 | 3,176,328 | (25,876) | - | - | 3,176,328 | (2 |
| Total temporarily impaired securities | 53 | $ 31,762,447 | $ (544,580) | $ 2,300,951 | $ (981,072) | $ 34,063,398 | $ (1,5 |

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

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

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

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

Trust preferred debt securities – single issuer: The investments in these securities with unrealized losses are comprised of four corporate trust preferred securities that mature in 2027, all of which were single-issuer securities. The contractual terms of the trust preferred securities do not allow the issuer to settle the securities at a price less than the face value of the trust preferred securities, which is greater than the amortized cost of the trust preferred securities. None of the corporate issuers have defaulted on interest payments. Because the decline in fair value is attributable to widening of interest rate spreads, the lack of an active trading market for these securities and, to a lesser degree, market concerns on the issuers' credit quality, and because the Company does not intend to sell these investments and it is not more likely than not that the Company will be required to sell these investments before a market price recovery or maturity, these investments are not considered other-than-temporarily impaired.

Trust preferred debt security – pooled: This trust preferred debt security was issued by a two issuer pool (Preferred Term Securities XXV, Ltd. co-issued by Keefe, Bruyette and Woods, Inc. and First Tennessee ("PreTSL XXV"), consisting primarily of financial institution holding companies. During 2009, the Company recognized an other-than-temporary impairment charge of $864,727, of which $363,783 was determined to be a credit loss and charged to operations and $500,944 was recognized in other comprehensive income (loss) component of shareholders' equity.

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

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On a quarterly basis, management evaluates this security to determine if there is any additional other-than-temporary impairment ("OTTI"). As of September 30, 2013, our evaluation was as follows:

a. We obtained the PreTSL XXV Depository Institutions Issuer List as of September 30, 2013 from the FTN Financial Corp. ("FTN") website and reviewed the financial ratios and capital levels of each individual financial institution issuer.

b. We sorted the financial institutions on the issuer list to develop three "buckets" (or categories) for further deferred/default analysis based upon the indicated "Texas Ratio." The Texas Ratio is calculated by dividing the institution's Non-Performing Assets plus loans 90 days past due by the combined total of Tangible Equity plus the Allowance for Loan Losses. The three buckets consisted of those institutions with a Texas Ratio of:

(1) Above 100:

(2) 75 to 100:

(3) Below 75.

c. We then applied the following asset specific deferral/default assumptions to each of these buckets:

(1) Above 100 - 100% default; 0% recovery;

(2) 75 to 100 – 100% deferred; 15% recovery at 2 years from initial date of deferral; and

(3) Below 75 – no deferral/default

d. We then ran a cash flow projection to analyze the impact of future deferral/default activity by applying the following assumption on those institutions in bucket 3 of our analysis:

Defaults at 75 basis points applied annually; 15% recovery with a 2-year lag from the initial date of deferral.

Our rationale for these metrics is as follows: (1) the FDIC lists the number of bank failures each year from 1934 – 2008; comparing bank failures to the number of FDIC institutions produces an annual average default rate of 36 basis points; given the continuing uncertain economic environment, we believe double this amount, or 75 basis points, to be an appropriate measurement for defaults; and (2) Standard & Poor's published "Global Methodology for Rating Trust Preferred/Hybrid Securities Revised" on November 21, 2008. This analysis uses a recovery assumption of 15%, which we also deem an appropriate measurement.

Our position is that it is appropriate to apply this future default factor in our analysis as it is not realistic to assume no adverse conditions will occur over the remaining 26 year stated maturity of this pooled security even though the individual institutions are currently performing according to terms.

e. This September 30, 2013 projection of future cash flows produced a present value factor that exceeded the carrying value of the pooled trust preferred security; therefore, management concluded that no OTTI issues were present at September 30, 2013.

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A number of factors or combinations of factors could cause management to conclude in one or more future reporting periods that an unrealized loss that exists with respect to PreTSL XXV constitutes an additional credit impairment. These factors include, but are not limited to, failure to make interest payments, an increase in the severity of the unrealized loss, an increase in the continuous duration of the unrealized loss without an impairment in value or changes in market conditions and/or industry or issuer specific factors that would render management unable to forecast a full recovery in value. In addition, the fair value of trust preferred securities could decline if the overall economy and the financial condition of the issuers continue to deteriorate and there remains limited liquidity for this security.

The following table sets forth information with respect to this security at September 30, 2013:

| | | | | | | | | Expected Deferrals and Defaults as a | | Excess Subordination (2) | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Security | Class | Amortized Cost | Fair Value | Unrealized (Loss) and OTTI | Percent of Underlying Collateral Performing | Percent of Underlying Collateral In Deferral (1) | Percent of Underlying Collateral In Default (1) | % of Remaining Performing Collateral | Moody's S&P / Ratings | Amount | % of Current Performing Collateral |
| PreTSL XXV | B-1 | $656,662 | $147,407 | $(509,255) | 66.5% | 10.9% | 22.6% | 14.0% | C/ NR | $108,000 | 21.0% |

Notes to table above:

(1) This percentage represents the amount of specific deferrals / defaults that have occurred, plus those that are known for the following quarters to the total amount of original collateral. Fewer deferrals / defaults produce a lower percentage.

(2) "Excess subordination" amount is the additional defaults / deferrals necessary in the next reporting period to deplete the entire credit enhancement (excess interest and over-collateralization) beneath our tranche within each pool to the point that would cause a "break in yield". This amount assumes that all currently performing collateral continues to perform. A break in yield means that our security would not be expected to receive all the contractual cash flows (principal and interest) by maturity. The "percent of underlying collateral performing" is the ratio of the "excess subordination amount" to current performing collateral - a higher percent means there is more excess subordination to absorb additional defaults / deferrals, and the better our security is protected from loss.

The Company regularly reviews the composition of the investment securities portfolio, taking into account market risks, the current and expected interest rate environment, liquidity needs, and its overall interest rate risk profile and strategic goals.

The following table presents a cumulative roll forward of the amount of other-than-temporary impairment related to credit losses, all of which relate to PreTSL XXV, which have been recognized in earnings for debt securities held to maturity and not intended to be sold.

| (in thousands) | Three and nine months | Three and nine months |
|---|---|---|

| | ended September 30, 2013 | | ended September 30, 2012 | |
|---|---|---|---|---|
| Balance at beginning of period | $ | 364 | $ | 364 |
| Change during the period | | - | | - |
| Balance at end of period | $ | 364 | $ | 364 |

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(5) Allowance for Loan Losses and Credit Quality Disclosures

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

The following table provides an aging of the loan portfolio by loan class at September 30, 2013:

| | 30-59 Days | 60-89 Days | Greater than 90 Days | Total Past Due | Current | Total Loans Receivable | Recorded Investment > 90 Days Accruing | N |
|---|---|---|---|---|---|---|---|---|
| Commercial | | | | | | | | |
| Construction | $- | $- | $995,830 | $995,830 | $42,237,906 | $43,233,736 | $- | $ |
| Commercial Business | 130,831 | - | 439,887 | 570,718 | 65,153,689 | 65,724,407 | - | |
| Commercial Real Estate | 875,624 | - | 6,052,984 | 6,928,608 | 89,548,110 | 96,476,718 | - | |
| Mortgage Warehouse Lines | - | - | - | - | 134,534,202 | 134,534,202 | - | |
| Residential Real Estate | - | 970,123 | 164,541 | 1,134,664 | 10,521,526 | 11,656,190 | - | |
| Consumer | | | | | | | | |
| Loans to Individuals | - | - | 94,898 | 94,898 | 9,752,485 | 9,847,383 | 94,898 | |
| Other | - | - | - | - | 170,940 | 170,940 | - | |
| Deferred Loan Fees | - | - | - | - | 905,897 | 905,897 | - | |
| Total | $1,006,455 | 970,123 | $7,748,140 | $9,724,718 | $352,824,755 | $362,549,473 | $94,898 | $ |

The following table provides an aging of the loan portfolio by loan class at December 31, 2012:

| | 30-59 Days | 60-89 Days | Greater than 90 Days | Total Past Due | Current | Total Loans Receivable | Recorded Investment > 90 Days Accruing | No I |
|---|---|---|---|---|---|---|---|---|
| Commercial | | | | | | | | |
| Construction | $- | $- | $1,581,031 | $1,581,031 | $54,110,362 | $55,691,393 | $- | $1, |
| Commercial Business | 202,451 | 70,192 | 518,912 | 791,555 | 57,073,881 | 57,865,436 | - | 62 |
| Commercial Real Estate | - | - | 3,137,553 | 3,137,553 | 99,275,141 | 102,412,694 | - | 3, |
| Mortgage Warehouse Lines | - | - | - | - | 284,127,530 | 284,127,530 | - | - |
| Residential Real Estate | 320,729 | 34,975 | - | 355,704 | 10,541,603 | 10,897,307 | - | 13 |
| Consumer | | | | | | | | |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Loans to Individuals | 49,243 | - | 139,852 | 189,095 | 9,454,290 | 9,643,385 | 84,948 | - |
| Other | - | - | - | - | 189,279 | 189,279 | - | - |
| Deferred Loan Fees | - | - | - | - | 987,086 | 987,086 | - | - |
| Total | $572,423 | $105,167 | $5,377,348 | $6,054,938 | $515,759,172 | $521,814,110 | $84,948 | $5, |

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Management reviews the adequacy of the allowance on at least a quarterly basis to ensure that the provision for loan losses has been charged against earnings in an amount necessary to maintain the allowance at a level that is adequate based on management's assessment of probable estimated losses. The Company's methodology for assessing the adequacy of the allowance for loan losses consists of several key elements. These elements include a specific reserve for impaired loans, an allocated reserve, and an unallocated portion.

The Company consistently applies the following comprehensive methodology. During the quarterly review of the allowance for loan losses, the Company considers a variety of factors that include:

- General economic conditions.
- Trends in charge-offs.
- Trends and levels of delinquent loans.
- Trends and levels of non-performing loans, including loans over 90 days delinquent.
- Trends in volume and terms of loans.
- Levels of allowance for specific classified loans.
- Credit concentrations.

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

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

The specific reserve for impaired loans is established for specific loans which have been identified by management as being impaired. These impaired loans are assigned a doubtful risk rating grade because the loan has not performed according to payment terms and there is reason to believe that repayment of the loan principal, in whole or in part, is unlikely. The specific portion of the allowance is the total amount of potential unconfirmed losses for these individual doubtful loans. To assist in determining the fair value of loan collateral, the Company utilizes independent third party qualified appraisal firms which, in turn, employ their own criteria and assumptions that may include occupancy rates, rental rates, and property expenses, among others.

The second category of reserves consists of the allocated portion of the allowance. The allocated portion of the allowance is determined by taking pools of loans outstanding that have similar characteristics and applying historical loss experience for each pool. This estimate represents the potential unconfirmed losses within the portfolio. Individual loan pools are created for commercial and commercial real estate loans, construction loans, and various types of loans to individuals. The historical estimation for each loan pool is then adjusted to account for current conditions, current loan portfolio performance, loan policy or management changes, or any other factor which may cause future losses to deviate from historical levels.

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

The following discusses the risk characteristics of each of our loan portfolio segments, commercial and consumer.

Commercial

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

Consumer

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

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

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

- Consumer credit scores
- Internal credit risk grades
- Loan-to-value ratios
- Collateral
- Collection experience

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

1. Excellent - Loans that are based upon cash collateral held at the Bank and adequately margined. Loans that are based upon "blue chip" stocks listed on the major exchanges and adequately margined.

2. Above Average - Loans to companies whose balance sheets show excellent liquidity and whose long-term debt is on well-spread schedules of repayment easily covered by cash flow. Such companies have been consistently profitable and have diversification in their product lines or sources of revenue. The continuation of profitable operations for the foreseeable future is likely. Management is comprised of a mix of ages, experience, and backgrounds and management succession is in place. Sources of raw materials are abundant, and for service companies, the source of revenue is abundant. Future needs have been planned for. Character and repayment ability of individuals or company principals are excellent. Loans to individuals supported by high net worths and liquid assets.

3. Good - Loans to companies whose balance sheets show good liquidity and cash flow adequate to meet maturities of long-term debt with a comfortable margin. Such company has established a profitable record over a number of years, and there has been growth in net worth. Operating ratios are in line with those of the industry, and expenses are in proper relationship to the volume of business done and the profits achieved. Management is well-balanced and competent in their responsibilities. Economic environment is favorable; however, competition is strong. The prospects for growth are good. Loans in this category do not meet the collateral requirements of loans in categories 1 and 2 above. Loans to individuals supported by good net worths but whose supporting assets are illiquid.

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3w. Watch List - Included in this category are loans evidencing problems identified by Bank management that require closer supervision.  Such problem has not developed to the point which requires a Special Mention rating.  This category also covers situations where the Bank does not have adequate current information upon which credit quality can be determined.  The account officer has the obligation to correct these deficiencies within 30 days after the time of notification.

4.  Special Mention - Loans or borrowing relationships that require more than the usual amount of attention by Bank management.  Industry conditions may be adverse or weak.  The borrower's ability to meet current payment schedules may be questionable, even though interest and principal are being paid as agreed. Heavy reliance has been placed on the collateral.  Profits, if any, are interspersed with losses. Management is "one man" or incompetent or there is no plan for management succession.  Expectations of a loan loss are not immediate; however, if present trends continue, a loan loss could be expected.

5.  Substandard - Loans in this category possess weaknesses that jeopardize the ultimate collection of total outstandings.  These weaknesses require close supervision by Bank management.  Current financial statements are unavailable and the loan is inadequately protected by the collateral pledged.  This category will normally include loans that have been classified as substandard by the regulators.

6.  Doubtful - Loans with weaknesses inherent in the substandard classification and where collection or liquidation in full is highly questionable.  It is likely that the loan will not be collected in full and the Bank will suffer some loss which is not quantifiable at the time of review.

7.  Loss - Loans considered uncollectable and of such little value that their continuance as an active asset is not warranted.  Loans in this category should immediately be eliminated from the Bank's loan loss reserve.  Any accrued interest should immediately be backed out of income.

The following table provides a breakdown of the loan portfolio by credit quality indictor at September 30, 2013.

| Commercial Credit Exposure - By Internally Assigned Grade | Construction | Commercial Business | Commercial Real Estate | Mortgage Warehouse Lines | Residential Real Estate |
|---|---|---|---|---|---|
| Grade: | | | | | |
| Pass | $ 38,743,089 | $ 63,079,908 | $ 64,562,349 | $ 134,534,202 | $ 10,521,525 |
| Special Mention | - | 1,465,856 | 21,013,297 | - | 1,134,665 |
| Substandard | 4,490,647 | 920,157 | 10,901,072 | - | - |
| Doubtful | - | 258,486 | - | - | - |
| Total | $ 43,233,736 | $ 65,724,407 | $ 96,476,718 | $ 134,534,202 | $ 11,656,190 |

| Consumer Credit Exposure - By Payment Activity | Loans To Individuals | Other |
|---|---|---|
| Performing | $ 9,847,383 | $ 170,940 |
| Nonperforming | - | - |
| Total | $ 9,847,383 | $ 170,940 |

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The following table provides a breakdown of the loan portfolio by credit quality indicator at December 31, 2012.

| Commercial Credit Exposure - By Internally Assigned Grade | Construction | Commercial Business | Commercial Real Estate | Mortgage Warehouse Lines | Residential Real Estate |
|---|---|---|---|---|---|
| Grade: | | | | | |
| Pass | $ 49,373,827 | $ 55,498,613 | $ 76,096,964 | $ 284,127,530 | $ 10,763,114 |
| Special Mention | - | 1,019,586 | 19,060,621 | - | 134,193 |
| Substandard | 5,777,494 | 1,064,799 | 7,255,109 | - | - |
| Doubtful | 540,072 | 282,438 | - | - | - |
| Total | $ 55,691,393 | $ 57,865,436 | $ 102,412,694 | $ 284,127,530 | $ 10,897,307 |

| Consumer Credit Exposure - By Payment Activity | Loans to Individuals | Other |
|---|---|---|
| Performing | $ 9,454,288 | $ 189,279 |
| Nonperforming | 189,097 | - |
| Total | $ 9,643,385 | $ 189,279 |

Impaired Loans Disclosures

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

The following tables summarize the distribution of the allowance for loan losses and loans receivable by loan class and impairment method at September 30, 2013 and December 31, 2012:

Period-End Allowance for Loan Losses by Impairment Method – September 30, 2013

| | Construction | Commercial Business | Commercial Real Estate | Mortgage Warehouse | Residential Real Estate | Consumer | Other |
|---|---|---|---|---|---|---|---|
| Allowance for credit losses: | | | | | | | |
| Ending Balance | $ 1,208,023 | $ 1,031,607 | $ 3,064,248 | $ 672,671 | $ 141,826 | $ 110,068 | $ 2,051 |
| Ending Balance | | | | | | | |
| Individually evaluated for impairment | - | 235,027 | 1,476,632 | - | - | - | - |
| Collectively evaluated for impairment | 1,208,023 | 796,580 | 1,587,616 | 672,671 | 141,826 | 110,068 | 2,051 |
| Loans receivables: | | | | | | | |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Ending Balance | $ 43,233,736 | $ 65,724,407 | $ 96,476,718 | $ 134,534,202 | $ 11,656,190 | $ 9,847,383 | $ 170,940 |
| Individually evaluated for impairment | 1,015,112 | 701,035 | 9,646,821 | - | 164,542 | - | - |
| Collectively evaluated for impairment | 42,218,624 | 65,023,372 | 86,829,897 | 134,534,202 | 11,491,648 | 9,847,383 | 170,940 |

Period-End Allowance for Loan Losses by Impairment Method – December 31, 2012

| | Construction | Commercial Business | Commercial Real Estate | Mortgage Warehouse | Residential Real Estate | Consumer | Other |
|---|---|---|---|---|---|---|---|
| Allowance for credit losses: | | | | | | | |
| Ending Balance | $ 1,990,292 | $ 972,789 | $ 2,262,221 | $ 1,420,638 | $ 112,103 | $ 102,583 | $ 2,27 |
| Ending Balance | | | | | | | |
| Individually evaluated for impairment | 569,579 | 253,598 | 447,193 | - | 21,693 | - | |
| Collectively evaluated for impairment | 1,420,713 | 719,191 | 1,815,028 | 1,420,638 | 90,410 | 102,583 | 2,27 |
| Loans receivables: | | | | | | | |
| Ending Balance | $ 55,691,393 | $ 57,865,436 | $ 102,412,694 | $ 284,127,530 | $ 10,897,307 | $ 9,643,385 | $ 189,27 |
| Individually evaluated for impairment | 2,842,031 | 906,526 | 3,952,546 | - | 134,193 | 54,904 | |
| Collectively evaluated for impairment | 52,849,362 | 56,958,910 | 98,460,148 | 284,127,530 | 10,763,114 | 9,588,481 | 189,27 |

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The activity in the allowance for loan losses by loan class for the nine months ended September 30, 2013 was as follows:

| | Construction | Commercial Business | Commercial Real Estate | Mortgage Warehouse | Residential Real Estate | Consumer | Other | Un |
|---|---|---|---|---|---|---|---|---|
| Balance - December 31, 2012 | $ 1,990,292 | $ 972,789 | $ 2,262,221 | $ 1,420,638 | $ 112,103 | $ 102,583 | $ 2,271 | $ |
| Provision charged to operations | (218,010) | (18,319) | 245,769 | (429,900) | 262 | 50,606 | (212) | |
| Loans charged off | (561,993) | (139,289) | (384,688) | - | - | (50,855) | - | |
| Recoveries of loans charged off | - | 2,000 | 6,895 | - | - | - | - | |
| Balance - March 31, 2013 | $ 1,210,289 | $ 817,181 | $ 2,130,197 | $ 990,738 | $ 112,365 | $ 102,334 | $ 2,059 | $ |
| Provision charged to operations | 1,872 | 160,164 | 321,659 | (62,039) | (19,632) | (2,444) | 45 | ( |
| Loans charged off | - | - | - | - | - | - | - | |
| Recoveries of loans charged off | 417 | 8,574 | - | - | - | - | - | |
| Balance – June 30, 2013 | $ 1,212,578 | $ 985,919 | $ 2,451,856 | $ 928,699 | $ 92,733 | $ 99,890 | $ 2,104 | |
| Provision charged to operations | (4,555) | 34,446 | 612,392 | (256,028) | 49,093 | 10,178 | (53) | |
| Loans charged off | - | (2,068) | - | - | - | - | - | |
| Recoveries of loans charged off | - | 13,310 | - | - | - | - | - | |
| Balance - September 30, 2013 | $ 1,208,023 | $ 1,031,607 | $ 3,064,248 | $ 672,671 | $ 141,826 | $ 110,068 | $ 2,051 | $ |

The activity in the allowance for loan losses by loan class for the nine months ended September 30, 2012 was as follows:

| | Construction | Commercial Business | Commercial Real Estate | Mortgage Warehouse | Residential Real Estate | Consumer | Other | Unallocate |
|---|---|---|---|---|---|---|---|---|
| Balance - December 31, 2011 | $ 1,054,695 | $ 934,642 | $ 1,597,702 | $ 1,122,056 | $ 91,076 | $ 187,352 | $ 2,377 | $ 544,550 |
| Provision charged to operations | 217,501 | 15,757 | 241,180 | (115,451) | 148,497 | 22,076 | 6,803 | |