PATRIOT NATIONAL BANCORP INC
Form 10-Q
August 08, 2014
Table Of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarter Ended June 30, 2014 Commission file number 000-29599

PATRIOT NATIONAL BANCORP, INC.

(Exact name of registrant as specified in its charter)

Connecticut	06-1559137
(State of incorporation)	(I.R.S. Employer Identification Number)

900 Bedford Street, Stamford, Connecticut 06901

(Address of principal executive offices)

(203) 324-7500

(Registrant's telephone number)

Check whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 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_____

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_____

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company in Rule 12b-2 of the Exchange Act:

Large Accelerated Filer ____ Accelerated Filer ____ Non-Accelerated Filer ____ 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 _____ No _X_

State the number of shares outstanding of each of the registrant's classes of common equity, as of the latest practicable date.

Common stock, $0.01 par value per share, 39,160,627 shares outstanding as of the close of business July 31, 2014.

Table Of Contents

Table of Contents

PART I - FINANCIAL INFORMATION		3
Item 1:	Consolidated Financial Statements	3
Item 2:	Management's Discussion and Analysis of Financial Condition and Results of Operations	45
Item 3:	Quantitative and Qualitative Disclosures about Market Risk	58
Item 4:	Controls and Procedures	60
PART II - OTHER INFORMATION		61
Item 1:	Legal Proceedings	61
Item 1A:	Risk Factors	61
Item 6:	Exhibits	61

Table Of Contents

PART I - FINANCIAL INFORMATION

Item 1: Consolidated Financial Statements

PATRIOT NATIONAL BANCORP, INC.

CONSOLIDATED BALANCE SHEETS

	(in thousands, except shares)	
	June 30, 2014 (Unaudited)	December 31, 2013
ASSETS		
Cash and due from banks:		
Noninterest bearing deposits and cash	$1,584	$1,570
Interest bearing deposits	58,345	33,296
Total cash and cash equivalents	59,929	34,866
Securities:		
Available for sale securities, at fair value (Note 2)	35,686	37,701
Other Investments	4,450	4,450
Federal Reserve Bank stock, at cost	1,517	1,444
Federal Home Loan Bank stock, at cost	4,143	4,143
Total securities	45,796	47,738
Loans receivable (net of allowance for loan losses: 2014: $5,214 2013: $5,681) (Note 3)	402,786	418,148
Accrued interest and dividends receivable	1,555	1,566
Premises and equipment, net	18,227	15,061
Cash surrender value of life insurance	22,262	22,025
Deferred tax asset (Note 6)	-	-
Other assets	1,498	1,844
Total assets	$552,053	$541,248
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Deposits (Note 4):		
Noninterest bearing deposits	$61,685	$55,358
Interest bearing deposits	364,747	374,846
Total deposits	426,432	430,204
Federal Home Loan Bank borrowings	72,000	57,000
Junior subordinated debt owed to unconsolidated trust	8,248	8,248
Accrued expenses and other liabilities	2,057	3,955
Total liabilities	508,737	499,407

Commitments and Contingencies (Note 9)		
Shareholders' equity (Notes 5 and 10)		
Preferred stock, no par value; 1,000,000 shares authorized, no shares issued and outstanding	-	-
Common stock, $.01 par value, 100,000,000 shares authorized; 2014: 39,172,332 shares issued; 39,160,627 shares outstanding. 2013 :38,786,680 shares issued; 38,774,975 shares outstanding	392	388
Additional paid-in capital	105,610	105,484
Accumulated deficit	(61,840)	(62,684)
Less: Treasury stock, at cost: 2014 and 2013, 11,705 shares	(160)	(160)
Accumulated other comprehensive income	(686)	(1,187)
Total shareholders' equity	43,316	41,841
Total liabilities and shareholders' equity	$552,053	$541,248

See Accompanying Notes to Consolidated Financial Statements.

Table Of Contents

PATRIOT NATIONAL BANCORP, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	(in thousands, except per share amounts)			
	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Interest and Dividend Income				
Interest and fees on loans	$4,667	$ 5,045	$ 9,358	$ 10,241
Interest on investment securities	133	226	268	474
Dividends on investment securities	42	29	83	58
Other interest income	14	9	26	37
Total interest and dividend income	**4,856**	**5,309**	**9,735**	**10,810**
Interest Expense				
Interest on deposits	607	1,032	1,244	2,161
Interest on Federal Home Loan Bank borrowings	33	167	66	518
Interest on subordinated debt	82	71	282	142
Interest on other borrowings	-	6	-	82
Total interest expense	**722**	**1,276**	**1,592**	**2,903**
Net interest income	**4,134**	**4,033**	**8,143**	**7,907**
Provision for Loan Losses	-	-	-	(30)
Net interest income after provision for loan losses	**4,134**	**4,033**	**8,143**	**7,937**
Non-Interest Income				
Mortgage banking activity	17	119	17	165
Loan application, inspection & processing fees	83	116	149	154
Fees and service charges	233	212	452	383
Gains on sale of loans	-	28	-	28
Gain on sale branch assets and deposits	-	51	-	51
Earnings on cash surrender value of life insurance	116	142	237	269
Other income	174	101	361	206
Total non-interest income	**623**	**769**	**1,216**	**1,256**
Non-Interest Expense				
Salaries and benefits	1,976	2,577	3,947	5,582
Occupancy and equipment expense	865	936	1,787	1,975
Data processing expense	279	289	529	660
Advertising and promotional expenses	73	76	124	118

Professional and other outside services	457	770	928	1,659
Loan administration and processing expenses	19	74	36	151
Regulatory assessments	237	304	467	678
Insurance expense	78	83	175	162
Other real estate operations	(4)	55	12	57
Material and communications	84	102	177	208
Restructuring charges and asset disposals (Note 12)	-	394	-	394
Prepayment penalty on borrowings	-	2,711	-	2,711
Other operating expenses	168	343	333	728
Total non-interest expense	**4,232**	**8,714**	**8,515**	**15,083**
Income (loss) before income taxes	**525**	**(3,912)**	**844**	**(5,890)**
Benefit for Income Taxes	-	-	-	(21)
Net income (loss)	**$525**	**$ (3,912)**	**$ 844**	**$ (5,869)**
Basic and diluted income (loss) per share	$0.01	$ (0.10)	$ 0.02	$ (0.15)

See Accompanying Notes to Consolidated Financial Statements.

Table Of Contents

PATRIOT NATIONAL BANCORP, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	(in thousands) Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net income (loss)	$525	$(3,912)	$844	$(5,869)
Other comprehensive income:				
Unrealized holding gains (losses) arising during the period	108	(629)	501	(574)
Total	108	(629)	501	(574)
Comprehensive income (loss)	**$633**	**$(4,541)**	**$1,345**	**$(6,443)**

See Accompanying Notes to Consolidated Financial Statements.

Table Of Contents

PATRIOT NATIONAL BANCORP, INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(Unaudited)

(in thousands, except shares)	Number of Shares	Common Stock	Additional Paid-In Capital	Accumulated Deficit	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total
Six months ended June 30, 2014							
Balance at December 31, 2013	38,774,975	$ 388	$ 105,484	$ (62,684)	$ (160)	$ (1,187)	$ 41,841
Comprehensive income							
Net income	-	-	-	844	-	-	844
Unrealized holding gain on available for sale securities	-	-	-	-	-	501	501
Total comprehensive income							1,345
Share-based compensation expense	-	-	130	-	-	-	130
Issuance of restricted stock	385,652	4	(4)				-
Balance, June 30, 2014	39,160,627	$ 392	$ 105,610	$ (61,840)	$ (160)	$ (686)	$ 43,316
Six months ended June 30, 2013							
Balance at December 31, 2012	38,480,114	$ 385	$ 105,356	$ (55,395)	$ (160)	$ (618)	$ 49,568
Comprehensive loss							
Net loss	-	-	-	(5,869)	-	-	(5,869)
Unrealized holding loss on available for sale securities	-	-	-	-	-	(574)	$ (574)
Total comprehensive loss							(6,443)
Share-based compensation expense	-	-	15	-	-	-	15
Redemption of restricted stock	(34,788)	-					-
Balance, June 30, 2013	38,445,326	$ 385	$ 105,371	$ (61,264)	$ (160)	$ (1,192)	$ 43,140

6

Table Of Contents

PATRIOT NATIONAL BANCORP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	(in thousands) Six Months Ended June 30, 2014	2013
Cash Flows from Operating Activities:		
Net income (loss):	$844	$(5,869)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Restructuring charges and asset disposals	-	303
Amortization of investment premiums, net	128	87
Amortization and accretion of purchase loan premiums and discounts, net	40	16
Provision for loan losses	-	(30)
Gain on sale of loans	-	(28)
Gain on sale of mortgage loans	-	(161)
Originations of mortgage loans held for sale	-	(28,975)
Proceeds from sales of mortgage loans held for sale	-	19,111
Earnings on cash surrender value of life insurance	(237)	(269)
Depreciation and amortization	573	588
Loss (gain) on sale of other real estate owned	4	(200)
Proceeds from sale of branch assets and deposits	-	127
Gain on sale of branch assets and deposits	-	(51)
Share-based compensation	130	15
Changes in assets and liabilities:		
Decrease (Increase) in net deferred loan costs	76	(110)
Decrease in accrued interest and dividends receivable	11	184
Decrease in other assets	346	795
Decrease in accrued expenses and other liabilities	(1,898)	(1,286)
Net cash provided by (used in) operating activities	**17**	**(15,753)**
Cash Flows from Investing Activities:		
Principal repayments on available for sale securities	2,388	1,514
Purchases of Federal Reserve Bank stock	(73)	-
Proceeds from repurchase of excess stock by Federal Reserve Bank	-	96
Proceeds from repurchase of excess stock by Federal Home Loan Bank	-	201
Proceeds from sale of loans	-	10,655
Net decrease in loans	15,246	477
Purchase of other real estate owned	(264)	-
Proceeds from sale of other real estate owned	260	1,310

Capital improvements of other real estate owned	-	(80)
Purchase of bank premises and equipment, net	(3,739)	(2,708)
Net cash provided by investing activities	**13,818**	**11,465**
Cash Flows from Financing Activities:		
Net increase in demand, savings and money market deposits	9,640	17,103
Net decrease in time certificates of deposits	(13,412)	(22,205)
Decrease in deposits held for sale	-	(14,538)
Increase (decrease) in FHLB borrowings	15,000	(15,000)
Decrease in repurchase agreements	-	(7,000)
Net cash provided by (used in) financing activities	**11,228**	**(41,640)**
Net increase (decrease) in cash and cash equivalents	**25,063**	**(45,928)**
Cash and Cash Equivalents:		
Beginning	34,866	71,014
Ending	$59,929	$25,086

7

Table Of Contents

PATRIOT NATIONAL BANCORP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS, Continued

(Unaudited)

	Six Months Ended June 30, 2014	2013
Supplemental Disclosures of Cash Flow Information		
Interest paid	$2,965	$2,866
Income taxes paid	$3	$3
Supplemental disclosures of noncash operating, investing and financing activities:		
Unrealized holding gain (loss) on available for sale securities arising during the period	$501	$(574)
Reduction in deposits held for sale	$-	$10,167
Reduction in branch assets held for sale	$-	$12

See Accompanying Notes to Consolidated Financial Statements.

Table Of Contents

PATRIOT NATIONAL BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Note 1: Basis of Financial Statement Presentation

The Consolidated Balance Sheet at December 31, 2013 has been derived from the audited financial statements of Patriot National Bancorp, Inc. ("Bancorp" or "the Company") at that date, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements.

The accompanying unaudited financial statements and related notes have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted. The accompanying consolidated financial statements and related notes should be read in conjunction with the previously filed audited financial statements of Bancorp and notes thereto for the year ended December 31, 2013.

The information furnished reflects, in the opinion of management, all normal recurring adjustments necessary for a fair presentation of the results for the interim periods presented. The results of operations for the six months ended June 30, 2014 are not necessarily indicative of the results of operations that may be expected for the remainder of 2014.

Note 2: Investment Securities

The amortized cost, gross unrealized losses and approximate fair values of available-for-sale securities at June 30, 2014 and December 31, 2013 are as follows:

(in thousands)	Amortized Cost	Gross Unrealized Losses	Fair Value
June 30, 2014:			
U. S. Government agency bonds	$ 7,500	$ (156)	$ 7,344
U. S. Government agency mortgage-backed securities	19,872	(374)	19,498
Corporate bonds	9,000	(156)	8,844
	$ 36,372	$ (686)	$ 35,686
December 31, 2013:			
U. S. Government agency bonds	$ 7,500	$ (421)	$ 7,079
U. S. Government agency mortgage-backed securities	22,388	(636)	21,752
Corporate bonds	9,000	(130)	8,870
	$ 38,888	$ (1,187)	$ 37,701

Table Of Contents

The following table presents the gross unrealized loss and fair value of Bancorp's available-for-sale securities, aggregated by the length of time the individual securities have been in a continuous loss position, at June 30, 2014 and December 31, 2013:

	Less Than 12 Months		12 Months or More		Total	
(in thousands)	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**
June 30, 2014:						
U. S. Government agency bonds	$-	$ -	$7,344	$ (156)	$7,344	$ (156)
U. S. Government agency mortgage -backed securities	-	-	19,484	(374)	19,484	(374)
Corporate bonds	-	-	8,844	(156)	8,844	(156)
Totals	$-	$ -	$35,672	$ (686)	$35,672	$ (686)
December 31, 2013:						
U. S. Government agency bonds	$7,079	$ (421)	$-	$ -	$7,079	$ (421)
U. S. Government agency mortgage -backed securities	8,871	(291)	12,856	(345)	21,727	(636)
Corporate bonds	-	-	8,870	(130)	8,870	(130)
Totals	$15,950	$ (712)	$21,726	$ (475)	$37,676	$ (1,187)

At June 30, 2014, all eleven available-for-sale securities had unrealized holding losses with aggregate depreciation of 1.9% from the amortized cost. At December 31, 2013, eleven securities had unrealized losses with aggregate depreciation of 3.2% from the amortized cost.

Bancorp performs a quarterly analysis of those securities that are in an unrealized loss position to determine if those losses qualify as other-than-temporary impairments. This analysis considers the following criteria in its determination: the ability of the issuer to meet its obligations, when the loss position is due to a deterioration in credit quality, management's plans and ability to maintain its investment in the security, the length of time and the amount by which the security has been in a loss position, the interest rate environment, the general economic environment and prospects or projections for improvement or deterioration.

Management believes that none of the unrealized losses on available-for-sale securities noted above are other than temporary due to the fact that they relate to market interest rate changes on U.S. Government agency debt, corporate debt and mortgage-backed securities issued by U.S. Government agencies. Management considers the issuers of the securities to be financially sound, the corporate bonds are investment grade and the Company expects to receive all contractual principal and interest related to these investments. Because the Company does not intend to sell the investments, and it is not more-likely-than-not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be at maturity, the Company does not consider those investments to be other-than-temporarily impaired at June 30, 2014.

Table Of Contents

The amortized cost and fair value of available-for-sale debt securities at June 30, 2014 by contractual maturity are presented below. Actual maturities of mortgage-backed securities may differ from contractual maturities because the mortgages underlying the securities may be prepaid without any penalties. Because mortgage-backed securities are not due at a single maturity date, they are not included in the maturity categories in the following summary:

(in thousands)	Amortized Cost	Fair Value
Maturity:		
Corporate bonds 5 to 10 years	$ 9,000	$ 8,844
U.S. Government agency bonds < 5 years	2,500	2,491
U.S. Government agency bonds 5 to 10 years	5,000	4,853
U.S. Government agency mortgage-backed securities	19,872	19,498
Total	$ 36,372	$ 35,686

Note 3: Loans Receivable and Allowance for Loan Losses

A summary of the Company’s loan portfolio at June 30, 2014 and December 31, 2013 is as follows:

(in thousands)	June 30, 2014	December 31, 2013
Real Estate		
Commercial	$ 219,762	$ 223,165
Residential	89,517	106,198
Construction	-	260
Construction to permanent	14,436	11,303
Commercial	37,849	35,061
Consumer home equity	42,384	44,081
Consumer installment	3,397	2,990
Total Loans	407,345	423,058
Premiums on purchased loans	160	200
Net deferred costs	495	571
Allowance for loan losses	(5,214)	(5,681)
Loans receivable, net	$ 402,786	$ 418,148

12

Table Of Contents

The changes in the allowance for loan losses for the periods shown are as follows:

	Three months ended June 30,		Six months ended June 30,	
(in thousands)	2014	2013	2014	2013
Balance, beginning of period	$5,480	$5,717	$5,681	$6,016
Provision for loan losses	-	-	-	(30)
Loans charged-off	(285)	(412)	(502)	(717)
Recoveries of loans previously charged-off	19	17	35	53
Balance, end of period	$5,214	$5,322	$5,214	$5,322

The unpaid principal balances of loans on nonaccrual status and considered impaired were $13.9 million at June 30, 2014 and $12.3 million at December 31, 2013. If non-accrual loans had been performing in accordance with their contractual terms, the Company would have recorded approximately $51,000 of additional income during the quarter ended June 30, 2014 and $373,000 during the quarter ended June 30, 2013. If non-accrual loans had been performing in accordance with their contractual terms, the Company would have recorded approximately $84,000 of additional income for the six months ended June 30, 2014 and $679,000 for the six month ended June 30, 2013.

For the three months ended June 30, 2014 and 2013, the interest collected and recognized as income on impaired loans, which includes non-accrual loans, trouble debt restructurings ('TDRs') and loans that were previously classified as TDRs that have been upgraded, was approximately $184,000 and $96,000 respectively. For the six months ended June 30, 2014 and 2013, the interest collected on impaired loans was approximately $419,000 and $220,000 respectively. The average recorded investment in impaired loans for the three and six months ended June 30, 2014 was $22.1 million and $21.7 million respectively.

At June 30, 2014, there were 3 loans totaling $3.4 million that were considered "TDRs", as compared to December 31, 2013 when there were 2 loans totaling $2.2 million, all of which were included in impaired loans. At June 30, 2014, 2 of the 3 loans aggregating $2.1 million were accruing loans and 1 loan of $1.3 million was a non-accruing loan. The non-accruing loan was an existing TDR at December 31, 2013 which was restructured again in the quarter ended March 31, 2014.

The Company's lending activities are conducted principally in Fairfield and New Haven Counties in Connecticut and Westchester County in New York. The Company originates commercial real estate loans, commercial business loans, and a variety of other consumer loans. In addition, the Company previously had originated loans for residential real estate, the construction of residential homes, residential developments and for land development projects. A moratorium on all new speculative construction loans was instituted by management in July 2008. All residential and commercial mortgage loans are collateralized primarily by first or second mortgages on real estate. The ability and willingness of borrowers to satisfy their loan obligations is dependent to some degree on the status of the regional economy as well as upon the regional real estate market. Accordingly, the ultimate collectability of a substantial portion of the loan portfolio and the recovery of a substantial portion of any resulting real estate acquired is susceptible to changes in market conditions.

Table Of Contents

The Company has established credit policies applicable to each type of lending activity in which it engages, evaluates the creditworthiness of each customer and, in most cases, extends credit of up to 75% of the market value of the collateral for commercial real estate at the date of the credit extension depending on the Company's evaluation of the borrowers' creditworthiness and type of collateral. In the case of construction loans, the maximum loan-to-value was 65% of the “as completed” market value. The market value of collateral is monitored on an ongoing basis and additional collateral is obtained when deemed necessary. Real estate is the primary form of collateral. Other important forms of collateral are accounts receivable, inventory, other business assets, marketable securities and time deposits. While collateral provides assurance as a secondary source of repayment, the Company ordinarily requires the primary source of repayment to be based on the borrower’s ability to generate continuing cash flows on all loans not related to construction.

Risk characteristics of the Company’s portfolio classes include the following:

Commercial Real Estate Loans – In underwriting commercial real estate loans, the Company evaluates both the prospective borrower’s ability to make timely payments on the loan and the value of the property securing the loans. Repayment of such loans may be negatively impacted should the borrower default or should there be a substantial decline in the value of the property securing the loan or a decline in the general economic conditions. Where the owner occupies the property, the Company also evaluates the business’s ability to repay the loan on a timely basis. In addition, the Company may require personal guarantees, lease assignments and/or the guarantee of the operating company when the property is owner occupied.

Commercial and Industrial Loans – The Company’s commercial and industrial loan portfolio consists primarily of commercial business loans and lines of credit to businesses and professionals. These loans are usually made to finance the purchase of inventory or new or used equipment and for other short or long-term working capital purposes. These loans are generally secured by business assets, but are also occasionally offered on an unsecured basis. In granting this type of loan, the Company primarily looks to the borrower’s cash flow as the source of repayment with collateral and personal guarantees as a secondary source. Payments on such loans are often dependent upon the successful operation of the underlying business involved. Repayment of such loans may therefore be negatively impacted by adverse changes in economic conditions, management’s inability to effectively manage the business, claims of others against the borrower’s assets which may take priority over the Company’s claims against assets, death or disability of the borrower or loss of market for the borrower’s products or services.

Residential Real Estate Loans – Home equity loans secured by residential real estate properties are offered by the Company. The company no longer offers residential loans, having exited this business in 2013. Repayment of residential real estate loans may be negatively impacted should the borrower have financial difficulties, should there be a significant decline in the value of the property securing the loan or should there be decline in general economic conditions.

Construction Loans – Construction loans are short-term loans (generally up to 18 months) secured by land for either residential or commercial development. The loans are generally made for acquisition and improvements. Funds are disbursed as phases of construction are completed. Included in this category are loans to construct single family homes where no contract of sale exists, based upon the experience and the financial strength of the builder, the type and location of the property and other factors. Construction loans are generally personally guaranteed by the principal(s). Repayment of such loans may be negatively impacted by the builders' inability to complete construction, by a downturn in the new construction market, by a significant increase in interest rates or by a decline in general economic condition.

Table Of Contents

Other Loans – The Company also offers installments loans and reserve lines of credit to individuals. Repayments of such loans are often dependent on the personal income of the borrower which may be negatively impacted by adverse changes in economic conditions. The Company does not place an emphasis on originating these types of loans.

The Company does not have any lending programs commonly referred to as subprime lending. Subprime lending generally targets borrowers with weakened credit histories typically characterized by payment delinquencies, previous charge-offs, judgments, bankruptcies, or borrowers with questionable repayment capacity as evidenced by low credit scores or high debt-burdened ratios.

Table Of Contents

The following table sets forth activity in our allowance for loan losses, by loan type, for the three months ended June 30, 2014. The following table also details the amount of loans receivable, net, that are evaluated individually, and collectively, for impairment, and the related portion of the allowance for loan losses that is allocated to each loan portfolio segment.

(in thousands)

Three months ended June 30, 2014	**Commercial**	**Commercial Real Estate**	**Construction**	**Construction to Permanent**	**Residential**	**Consumer**	**Unallocated**	**Total**
Allowance for loan losses:								
Beginning Balance	$ 2,371	$ 1,320	$ 260	$ 34	$ 704	$ 539	$ 252	$ 5,480
Charge-offs	(2)	-	(260)	-	(18)	(5)		(285)
Recoveries	4	15	-	-	-	-	-	19
Provision	105	(210)	-	115	(56)	160	(114)	-
Ending Balance	$ 2,478	$ 1,125	$ -	$ 149	$ 630	$ 694	$ 138	$ 5,214
Ending balance: individually evaluated for impairment	$ 1,750	$ 307	$ -	$ -	$ -	$ 5	$ -	$ 2,062
Ending balance: collectively evaluated for impairment	728	818	-	149	630	689	138	3,152
Total Allowance for Loan Losses	$ 2,478	$ 1,125	$ -	$ 149	$ 630	$ 694	$ 138	$ 5,214
Total Loans ending balance	$ 37,849	$ 219,762	$ -	$ 14,436	$ 89,517	$ 45,781	$ -	$ 407,345
Ending balance: individually evaluated for impairment	$ 7,291	$ 11,610	$ -	$ -	$ 5,115	$ 588	$ -	$ 24,604
Ending balance: collectively evaluated for impairment	$ 30,558	$ 208,152	$ -	$ 14,436	$ 84,402	$ 45,193	$ -	$ 382,741

Table Of Contents

The following table sets forth activity in our allowance for loan losses, by loan type, for the six months ended June 30, 2014. The following table also details the amount of loans receivable, net, that are evaluated individually, and collectively, for impairment, and the related portion of the allowance for loan losses that is allocated to each loan portfolio segment.

(in thousands)

Six months ended June 30, 2014	**Commercial**	**Commercial Real Estate**	**Construction**	**Construction to Permanent**	**Residential**	**Consumer**	**Unallocated**	**Total**
Allowance for loan losses:								
Beginning Balance	$ 2,285	$ 1,585	$ 260	$ 25	$ 795	$ 534	$ 197	$ 5,681
Charge-offs	(11)	-	(260)	-	(195)	(36)	-	(502)
Recoveries	4	30	-	-	-	1	-	35
Provision	200	(490)	-	124	30	195	(59)	-
Ending Balance	$ 2,478	$ 1,125	$ -	$ 149	$ 630	$ 694	$ 138	$ 5,214
Ending balance: individually evaluated for impairment	$ 1,750	$ 307	$ -	$ -	$ -	$ 5	$ -	$ 2,062
Ending balance: collectively evaluated for impairment	728	818	-	149	630	689	138	3,152
Total Allowance for Loan Losses	$ 2,478	$ 1,125	$ -	$ 149	$ 630	$ 694	$ 138	$ 5,214
Total Loans ending balance	$ 37,849	$ 219,762	$ -	$ 14,436	$ 89,517	$ 45,781	$ -	$ 407,345
Ending balance: individually evaluated for impairment	$ 7,291	$ 11,610	$ -	$ -	$ 5,115	$ 588	$ -	$ 24,604
Ending balance: collectively evaluated for impairment	$ 30,558	$ 208,152	$ -	$ 14,436	$ 84,402	$ 45,193	$ -	$ 382,741

Table Of Contents

The following table sets forth activity in our allowance for loan losses, by loan type, for the three months ended June 39, 2013. The following table also details the amount of loans receivable, net, that are evaluated individually, and collectively, for impairment, and the related portion of the allowance for loan losses that is allocated to each loan portfolio segment.

(in thousands)

Three months ended June 30, 2013	**Commercial**	**Commercial Real Estate**	**Construction**	**Construction to Permanent**	**Residential**	**Consumer**	**Unallocated**	**Total**
Allowance for loan losses:								
Beginning Balance	$ 1,847	$ 2,492	$ 307	$ 31	$ 746	$ 118	$ 176	$ 5,717
Charge-offs	-	(275)	(23)	-	(95)	(19)		(412)
Recoveries	1	15	-	-	1	-	-	17
Provision	(126)	(279)	(48)	(7)	282	145	33	-
Ending Balance	$ 1,722	$ 1,953	$ 236	$ 24	$ 934	$ 244	$ 209	$ 5,322
Ending balance: individually evaluated for impairment	$ 1,251	$ 539	$ 236	$ -	$ 158	$ 2	$ -	$ 2,186
Ending balance: collectively evaluated for impairment	471	1,414	-	24	776	242	209	3,136
Total Allowance for Loan Losses	$ 1,722	$ 1,953	$ 236	$ 24	$ 934	$ 244	$ 209	$ 5,322
Total Loans ending balance	$ 36,278	$ 236,224	$ 3,471	$ 9,904	$ 117,416	$ 49,090	$ -	$ 452,383
Ending balance: individually evaluated for impairment	$ 6,349	$ 15,615	$ 3,471	$ 1,228	$ 8,754	$ 600	$ -	$ 36,017
Ending balance: collectively evaluated for impairment	$ 29,929	$ 220,609	$ -	$ 8,676	$ 108,662	$ 48,490	$ -	$ 416,366

18

Table Of Contents

The following table sets forth activity in our allowance for loan losses, by loan type, for the six months ended June 30, 2013. The following table also details the amount of loans receivable, net, that are evaluated individually, and collectively, for impairment, and the related portion of the allowance for loan losses that is allocated to each loan portfolio segment.

(in thousands)

Six months ended June 30, 2013	**Commercial**	**Commercial Real Estate**	**Construction**	**Construction to Permanent**	**Residential**	**Consumer**	**Unallocated**	**Total**
Allowance for loan losses:								
Beginning Balance	$ 942	$ 3,509	$ 311	$ 19	$ 897	$ 217	$ 121	$ 6,016
Charge-offs	-	(290)	(23)	-	(385)	(19)	-	(717)
Recoveries	2	30	20	-	1	-	-	53
Provision	778	(1,296)	(72)	5	421	46	88	(30)
Ending Balance	$ 1,722	$ 1,953	$ 236	$ 24	$ 934	$ 244	$ 209	$ 5,322
Ending balance: individually evaluated for impairment	$ 1,251	$ 539	$ 236	$ -	$ 158	$ 2	$ -	$ 2,186
Ending balance: collectively evaluated for impairment	471	1,414	-	24	776	242	209	3,136
Total Allowance for Loan Losses	$ 1,722	$ 1,953	$ 236	$ 24	$ 934	$ 244	$ 209	$ 5,322
Total Loans ending balance	$ 36,278	$ 236,224	$ 3,471	$ 9,904	$ 117,416	$ 49,090	$ -	$ 452,383
Ending balance: individually evaluated for impairment	$ 6,349	$ 15,615	$ 3,471	$ 1,228	$ 8,754	$ 600	$ -	$ 36,017
Ending balance: collectively evaluated for impairment	$ 29,929	$ 220,609	$ -	$ 8,676	$ 108,662	$ 48,490	$ -	$ 416,366

Table Of Contents

The following table details for the year ended December 31, 2013 the amount of loans receivable, net, that are evaluated individually, and collectively, for impairment, and the related portion of the allowance for loan losses that is allocated to each loan portfolio segment.

(in thousands)

2013	**Commercial**	**Commercial Real Estate**	**Construction**	**Construction to Permanent**	**Residential**	**Consumer**	**Unallocated**	**Total**
Total Loans ending balance	$ 35,061	$ 223,165	$ 260	$ 11,303	$ 106,198	$ 47,071	$ -	$ 423,058
Ending balance: individually evaluated for impairment	6,152	7,767	260	1,197	6,024	593	-	21,993
Ending balance: collectively evaluated for impairment	$ 28,909	$ 215,398	$ -	$ 10,106	$ 100,174	$ 46,478	$ -	$ 401,065

Table Of Contents

The Company monitors the credit quality of its loans receivable on an ongoing manner. Credit quality is monitored by reviewing certain credit quality indicators. Management has determined that internally assigned risk ratings and loan-to-value ratios (LTVs), at period end, are the key credit quality indicators that best help management monitor the credit quality of the Company's loans receivable. Loan-to-value ratios used by management in monitoring credit quality are based on current period loan balances and original values at time of origination (unless a current appraisal has been obtained as a result of the loan being deemed impaired or the loan is a maturing construction loan).

Appraisals on properties securing non-performing loans and Other Real Estate Owned ("OREO") are updated annually. We update our impairment analysis monthly based on the most recent appraisal as well as other factors (such as senior lien positions, i.e. property taxes).

The majority of the Company's impaired loans have been resolved through courses of action other than through foreclosure. These include normal loan payoffs, the traditional workout process, triggering personal guarantee obligations, and troubled debt restructurings. However, as loan workout efforts progress to a point where the bank's liquidation of real estate collateral is the likely outcome, the impairment analysis is updated to reflect actual recent experience with bank sales of OREO properties.

Included in the allowance for loan losses are disposition discount adjustments made to real estate appraisals on collateral dependent impaired loans anticipated to become OREO in the coming quarter. The appraisal adjustments percentage is reviewed quarterly and modified based on an analysis of actual variances between appraised values as of the date prior loans were transferred into OREO and the actual average sales prices of these loans. The difference is the disposition discount.

The Company has a risk rating system as part of the risk assessment of its loan portfolio. The Company's lending officers are required to assign an Obligor and a Facility risk rating to each loan in their portfolio at origination, which is ratified or modified by the Committee to which the loan is submitted for approval. When the lender learns of important financial developments, the risk rating is reviewed accordingly, and adjusted if necessary. Similarly, the Loan Committee can adjust a risk rating.

In addition, the Company engages a third party independent loan reviewer that performs quarterly reviews of a sample of loans, validating the Bank's risk ratings assigned to such loans. The risk ratings play an important role in the establishment of the loan loss provision and to confirm the adequacy of the allowance for loan losses. Any upgrades to classified loans must be approved by the Board Loan Committee.

When assigning a risk rating to a loan, management utilizes the Bank's internal ten-point risk rating system. An asset is considered "special mention" when it has a potential weakness based on objective evidence, but does not currently expose the Company to sufficient risk to warrant classification as in one of the following categories: An asset is considered "substandard" if it is not adequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets have well defined weaknesses based on objective evidence, and are characterized by the "distinct possibility" that the Company will sustain "some loss" if the deficiencies are not corrected. Assets classified as "doubtful" have all of the weaknesses inherent in those classified "substandard" with the added characteristic that the weaknesses present make "collection or liquidation in full," on the basis of currently existing facts, conditions, and values, "highly questionable and improbable."

Charge–off generally commences after the loan is classified "doubtful" to reduce the loan to its recoverable balance. If the account is classified as "loss", the full balance is charged off regardless of the potential recovery from the sale of the collateral. This amount is recognized as a recovery once the collateral is sold.

In accordance with FFIEC ("Federal Financial Institutions Examination Council") published policies establishing uniform criteria for the classification of retail credit based on delinquency status, "Open-end" credits are charged-off when 180 days delinquent and "Closed-end" credits are charged-off when 120 days delinquent. In lieu of charging off the entire loan balance, loans with collateral may be written down to the value of the collateral less the cost to sell.

Table Of Contents

The following table details the credit risk exposure of loans receivable, by loan type and credit quality indicator at June 30, 2014:

CREDIT RISK PROFILE BY CREDIT WORTHINESS CATEGORY

(in thousands)	**Commercial**		**Commercial Real Estate**		**Construction**		**Construction to Permanent**		**Residential Real Estate**		**Consumer**		
LTVs:	**< 75%**	**>= 75%**	**< 75%**	**>= 75%**	**< 75%**	**>= 75%**	**< 75%**	**>= 75%**	**< 75%**	**>= 75%**	**< 75%**	**>= 75%**	**Othe**
Internal Risk Rating													
Pass	$26,290	$3,944	$199,352	$6,471	$-	$-	$12,674	$1,762	$67,516	$19,970	$43,547	$1,543	$659
Special Mention	150	-	3,926	3,096	-	-	-	-	-	-	-	-	-
Substandard	7,465	-	3,634	3,283	-	-	-	-	1,549	482	32	-	-
	$33,905	$3,944	$206,912	$12,850	$-	$-	$12,674	$1,762	$69,065	$20,452	$43,579	$1,543	$659

CREDIT RISK PROFILE

(in thousands)	**Commercial**	**Commercial Real Estate**	**Construction**	**Construction to Permanent**	**Residential Real Estate**	**Consumer**	**Totals**
Performing	$30,558	$215,205	$-	$14,436	$ 87,486	$ 45,749	$393,434
Non Performing	7,291	4,557	-	-	2,031	32	13,911
Total	$37,849	$219,762	$-	$14,436	$ 89,517	$ 45,781	$407,345

22

Table Of Contents

The following table details the credit risk exposure of loans receivable, by loan type and credit quality indicator at December 31, 2013:

CREDIT RISK PROFILE BY CREDIT WORTHINESS CATEGORY

(in thousands)

	Commercial		**Commercial Real Estate**		**Construction**		**Construction to Permanent**		**Residential Real Estate**		**Consumer**		
LTVs:	**< 75%**	**>= 75%**	**< 75%**	**>= 75%**	**< 75%**	**>= 75%**	**< 75%**	**>= 75%**	**< 75%**	**>= 75%**	**< 75%**	**>= 75%**	**Other**
Internal Risk Rating													
Pass	$23,493	$3,898	$199,118	$7,951	$-	$-	$10,106	$-	$82,704	$20,592	$42,542	$3,839	$650
Special Mention	167	-	6,573	2,502	-	-	-	-	-	-	-	-	-
Substandard	7,503	-	3,690	3,331	60	200	1,197	-	1,976				