1ST CONSTITUTION BANCORP
Form 10-K
March 15, 2019

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K

(Mark One)
ý ANNUAL REPORT UNDER SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2018

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

For the transition period from ________ to _______

Commission file Number: 000-32891

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

New Jersey	22-3665653
(State or Other Jurisdiction of Incorporation or Organization)	IRS Employer Identification Number)

2650 Route 130, P.O. Box 634, Cranbury, NJ 08512
(Address of Principal Executive Offices, including Zip Code)

(609) 655-4500
(Registrant's telephone number, including area code)

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

Title of each class	Name of each exchange on which registered
Common stock, no par value	NASDAQ Stock Market LLC (NASDAQ Global Select Market)

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:

None
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No ý

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.

Yes o No ý

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 ý No o

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

Large accelerated filer	o	Accelerated filer	x
Non-accelerated filer (Do not check if a smaller reporting company)	o	Smaller reporting company	ý
		Emerging growth company	o

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

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

The aggregate market value of the registrant's common stock held by non-affiliates of the registrant, computed by reference to the price at which the common stock was last sold, or the average bid and asked price of such common stock, as of the last business day of the registrant's most recently completed second quarter, is $163,436,523.

As of February 28, 2019, 8,611,342 shares of the registrant's common stock were outstanding.

Portions of the registrant's definitive Proxy Statement for its 2019 Annual Meeting of Shareholders are incorporated by reference into Part III of this Annual Report on Form10-K.

FORM 10-K

TABLE OF CONTENTS

When used in this Annual Report on Form 10-K for the year ended December 31, 2018 (this "Form 10-K"), the words the "Company," "we," "our," and "us" refer to 1ST Constitution Bancorp and its wholly owned subsidiaries, unless we indicate otherwise.

Forward-Looking Statements

This Form 10-K contains "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 relating to, without limitation, our future economic performance, plans and objectives for future operations, and projections of revenues and other financial items that are based on our beliefs, as well as assumptions made by and information currently available to us. The words "may," "will," "anticipate," "should," "would," "believe," "contemplate," "could," "project," "predict," "expect," "estimate," "continue," and "intend," as well as other similar words and expressions of the future, are intended to identify forward-looking statements.

These forward-looking statements generally relate to our plans, objectives and expectations for future events and include statements about our expectations, beliefs, plans, objectives, intentions, assumptions and other statements that are not historical facts. These statements are based upon our opinions and estimates as of the date they are made. Although we believe that the expectations reflected in these forward-looking statements are reasonable, such forward-looking statements are subject to known and unknown risks and uncertainties that may be beyond our control, which could cause actual results, performance and achievements to differ materially from results, performance and achievements projected, expected, expressed or implied by the forward-looking statements.

Examples of events that could cause actual results to differ materially from historical results or those anticipated, expressed or implied include, without limitation, changes in the overall economy and interest rate changes; inflation, market and monetary fluctuations; the ability of our customers to repay their obligations; the accuracy of our financial statement estimates and assumptions, including the adequacy of the estimate made in connection with determining the adequacy of the allowance for loan losses; increased competition and its effect on the availability and pricing of deposits and loans; significant changes in accounting, tax or regulatory practices and requirements; changes in deposit flows, loan demand or real estate values; legislation or regulatory changes, including the Dodd-Frank Act; changes in monetary and fiscal policies of the U.S. Government; changes to the method that LIBOR rates are determined and to the potential phasing out of LIBOR after 2021; changes in loan delinquency rates or in our levels of non-performing assets; our ability to declare and pay dividends; changes in the economic climate in the market areas in which we operate; the frequency and magnitude of foreclosure of our loans; changes in consumer spending and saving habits; the effects of the health and soundness of other financial institutions, including the need of the Federal Deposit Insurance Corporation (the "FDIC") to increase the Deposit Insurance Fund assessments; technological changes; the effect of harsh weather conditions, including hurricanes and man-made disasters; the economic impact of any future terrorist threats and attacks, acts of war or threats thereof and the response of the United States to any such threats and attacks; our ability to integrate acquisitions and achieve cost savings; other risks described from time to time in our filings with the Securities and Exchange Commission (the "SEC"); and our ability to manage the risks involved in the foregoing. Although management has taken certain steps to mitigate any negative effect of the aforementioned items, significant unfavorable changes could severely impact the assumptions used and have an adverse effect on profitability. Additional information concerning the factors that could cause actual results to differ materially from those in the forward-looking statements is contained in Item 1. "Business," Item 7. "Management’s Discussion and Analysis of Financial Condition and Results of Operations," and elsewhere in this Annual Report on Form 10-K and in our other filings with the SEC. However, other factors besides those listed in Item 1A. Risk Factors or discussed in this Annual Report also could adversely affect our results and you should not consider any such list of factors to be a complete list of all potential risks or uncertainties. Any forward-looking statements made by us or on our behalf speak only as of the date they are made. We undertake no obligation to publicly revise any forward-looking statements or cautionary factors, except as required by law.

1

PART I
Item 1. Business.

1ST Constitution Bancorp

1ST Constitution Bancorp is a bank holding company registered under the Bank Holding Company Act of 1956, as amended. 1ST Constitution Bancorp was organized under the laws of the State of New Jersey in February 1999 for the purpose of acquiring all of the issued and outstanding stock of 1ST Constitution Bank (the "Bank") and thereby enabling the Bank to operate within a bank holding company structure. The Company became an active bank holding company on July 1, 1999. As of December 31, 2018, the Company has three employees, all of whom are full-time. The Bank is a wholly-owned subsidiary of the Company. Other than its investment in the Bank, the Company currently conducts no other significant business activities.

The main office of the Company and the Bank is located at 2650 Route 130 Cranbury, New Jersey 08512, and the telephone number is (609) 655-4500.

1ST Constitution Bank

The Bank is a commercial bank formed under the laws of the State of New Jersey and engages in the business of commercial and retail banking. As a community bank, the Bank offers a wide range of services (including demand, savings and time deposits and commercial and consumer/installment loans) to individuals, small businesses and not-for-profit organizations principally in the Fort Lee area of Bergen County and in Middlesex, Mercer, Somerset and Monmouth Counties of New Jersey. The Bank conducts its operations through its main office located in Cranbury, New Jersey, and operates 19 additional branch offices in Asbury Park, downtown Cranbury, Fair Haven, Fort Lee, Freehold, Hamilton Square, Hightstown, Hillsborough, Hopewell, Jamesburg, Lawrenceville, Little Silver, Neptune City, Perth Amboy, Plainsboro, Princeton, Rumson, Shrewsbury, and Skillman, New Jersey. The Bank also operates a residential mortgage loan production office in Jersey City, New Jersey. The Bank’s deposits are insured up to applicable legal limits by the FDIC. As of December 31, 2018, the Bank had 194 employees, of which 189 were full-time employees.

Management efforts focus on positioning the Bank to meet the financial needs of the communities in Middlesex, Mercer, Somerset and Monmouth Counties and the Fort Lee area of Bergen County and to provide financial services to individuals, families, institutions and small businesses. To achieve this goal, the Bank is focusing its efforts on:

- expansion of the Bank;
- personal service; and
- technological advances and e-commerce.

Expansion of the Bank

On April 11, 2018, the Company closed on the merger of New Jersey Community Bank ("NJCB"), a New Jersey-chartered bank, with and into the Bank, with the Bank being the surviving entity (the "NJCB Merger"). At the time of the merger, NJCB had approximately $95 million in assets, approximately $75 million in loans, and approximately $87 million in deposits. NJCB operated two branch offices in Monmouth County, New Jersey which became branches of the Bank as a result of the Merger.

Pursuant to the terms of the merger agreement, dated as of November 6, 2017, governing the Merger (the "Merger Agreement"), each outstanding share of NJCB common stock was exchanged for the right to receive $1.60 in cash and

0.1309 of a share of the Company's common stock. The Company issued 249,785 shares of its common stock, having an aggregate fair value of approximately $5.5 million, and paid cash of approximately $3.1 million, of which approximately $401,000 was placed into escrow under the terms of the Merger Agreement. Cash used as consideration was provided by the Bank from existing cash assets.

The Bank continually evaluates opportunities to expand its products and services to existing and new customers and expand into new markets through the acquisition of other banks and bank offices within and contiguous to its existing markets and/or by opening new branch offices.

Personal Service

The Bank provides a wide range of commercial and consumer banking services to individuals, families, institutions and small businesses in central and coastal New Jersey and the Fort Lee area of Bergen County. The Bank’s focus is to understand the needs of the community and its customers and tailor products, services and advice to meet those needs. The Bank seeks to provide a high level of personalized banking services, emphasizing quick and flexible responses to customer demands.

Technological Advances and e-Commerce

The Bank recognizes that customers want to receive service via their most convenient delivery channel, be it the traditional branch office, by telephone, ATM, or the Internet. For this reason, the Bank continues to enhance its e-commerce capabilities. At www.1stconstitution.com, customers have easy access to online banking, including account access, and to the Bank's bill payment system. Consumers and businesses may also access their accounts and make deposits through their mobile devices. Consumers can take advantage of Momentum Mortgage, our new digital mortgage platform, to apply online for loans and interact with senior management through the e-mail system. Business customers have access to cash management information and transaction capability through the Bank's online Cash Manager product which permits business customers to make deposits, originate ACH payments, initiate wire transfers, retrieve account information and place "stop payment" orders. This overall expansion in electronic banking provides the Bank's customers with the means to access the Bank's services easily and at their own convenience.

Competition

The Bank experiences substantial competition in attracting and retaining deposits and in making loans. In attracting deposits and borrowers, the Bank competes with commercial banks, savings banks, and savings and loan associations, as well as regional and national insurance companies and non-bank financial institutions, mutual funds, regulated small loan companies and local credit unions, regional and national sponsors of money market funds and corporate and government borrowers. Within the direct market area of the Bank, there are a significant number of offices of competing financial institutions. In New Jersey generally, and in the Bank's local market specifically, the Bank's most direct competitors are large commercial banks, including Bank of America, PNC Bank, JP Morgan Chase, Wells Fargo and Santander Bank, as well as savings banks and savings and loan associations, including Provident Bank and Investors Bank.

The Bank is at a competitive disadvantage compared with these larger national and regional commercial and savings banks. By virtue of their larger capital, asset size and reserves, many of such institutions have substantially greater lending limits (ceilings on the amount of credit a bank may provide to a single customer that are linked to the institution's capital) and other resources than the Bank. Many such institutions are empowered to offer a wider range of services, including trust services, than the Bank and, in some cases, have lower funding costs (the price a bank must pay for deposits and other borrowed monies used to make loans to customers) than the Bank. In addition to having established deposit bases and loan portfolios, these institutions, particularly large national and regional commercial and savings banks, have the financial ability to finance extensive advertising campaigns and to allocate considerable resources to locations and products perceived as profitable.

In addition, non-bank financial institutions offer services that compete for customers' investable funds and deposits with the Bank. For example, brokerage firms and insurance companies offer such instruments as short-term money market funds, corporate and government securities funds, mutual funds and annuities. It is expected that competition in these areas will continue to increase. Some of these competitors are not subject to the same degree of regulation and supervision as the Company and the Bank and therefore may be able to offer customers more attractive products than the Bank.

However, management of the Bank believes that loans to small and mid-sized businesses and professionals, which represent the main commercial loan business of the Bank, are not always of primary importance to the larger banking institutions. The Bank competes for this segment of the market by providing responsive personalized services, making timely local decisions, and acquiring in depth knowledge of its customers and their businesses.

Lending Activities

The Bank's lending activities include both commercial and consumer loans. Loan originations are derived from a number of sources, including real estate broker referrals, mortgage loan companies, direct solicitation by the Bank's loan officers, existing depositors and borrowers, builders, attorneys, walk-in customers and, in some instances, other lenders. The Bank has established disciplined and systematic procedures for approving and monitoring loans that vary depending on the size and nature of the loans.

Commercial Business

The Bank offers a variety of commercial loan services, including term loans, lines of credit, and loans secured by equipment and receivables. A broad range of short-to-medium term commercial loans, both secured and unsecured, are made available to businesses for working capital (including inventory and receivables), business expansion (including acquisition and development of real estate and improvements), and the purchase of equipment and machinery. Commercial loans are granted based on the borrower’s ability to generate cash flow to support its debt obligations and other cash related expenses. A borrower’s ability to repay commercial loans is substantially dependent on the success of the business itself and on the quality of its management. As a general practice, the Bank takes, as collateral, a security interest in any available real estate, equipment, inventory, receivables or other personal property of its borrowers, although the Bank occasionally makes commercial loans on an unsecured basis. Generally, the Bank requires personal guarantees of its commercial loans to offset the risks associated with such loans. The Bank also offers loans of which a portion, generally 75% to 85%, are guaranteed by the Small Business Administration ("SBA"), which is a United States government agency. The Bank generally sells the guaranteed portion of these loans into the secondary market.

Commercial Real Estate

Commercial real estate loans are made to businesses to expand their facilities and operations and to real estate operators to finance the acquisition of income producing properties. The Company's loan policy requires that borrowers have sufficient cash flow to meet the debt service requirements and the value of the property meets the loan-to-value criteria set in the loan policy. The Company monitors loan concentrations by borrower, by type of property and by location and other criteria. The Company's commercial real estate portfolio is largely secured by real estate collateral located in the State of New Jersey.

Commercial Construction Financing

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

Residential Lending

A portion of the Bank’s lending activities consists of the origination of fixed and adjustable rate residential first mortgage loans secured by owner-occupied property located in the Bank’s primary market areas. Home mortgage lending is unique in that a broad geographic territory may be serviced by originators working from strategically placed offices either within the Bank’s traditional banking facilities or from affordable office locations in commercial buildings. The Bank also offers construction loans, reverse mortgages, second mortgage home improvement loans and home equity lines of credit.

The Bank finances the construction of individual, owner-occupied single-family houses on the basis of written underwriting and construction loan management guidelines. These loans are made to qualified individual borrowers and are generally supported by a take-out commitment from a permanent lender. The construction phase of these loans has certain risks, including the viability of the contractor, the contractor’s ability to complete the project within the budget and changes in interest rates.

The Bank will generally sell its originated residential mortgage loans in the secondary market. The decision to sell is made prior to origination. The sale into the secondary market allows the Bank to mitigate its interest rate risks related to such lending operations. This brokerage arrangement allows the Bank to accommodate its clients’ demands while eliminating the interest rate risk for the 15 to 30-year period generally associated with such loans.

For commercial and residential mortgage loans, the Bank, in most cases, requires borrowers to obtain and maintain title, fire, and extended casualty insurance, and, where required by applicable regulations, flood insurance. The Bank maintains its own errors and omissions insurance policy to protect against loss in the event of failure of a mortgagor to pay premiums on fire and other hazard insurance policies. Mortgage loans originated by the Bank customarily include a "due on sale" clause, which gives the Bank the right to declare a loan immediately due and payable in certain circumstances, including, without limitation, upon the sale or other disposition by the borrower of the real property subject to a mortgage. In general, the Bank enforces "due on sale" clauses.

Non-Residential Consumer Lending

Non-residential consumer loans made by the Bank include loans for automobiles, recreation vehicles, and boats, as well as personal loans (secured and unsecured) and deposit account secured loans. Non-residential consumer loans are attractive to the Bank because they typically have a shorter term and carry higher interest rates than are charged on other types of loans. However, non-residential consumer loans pose an additional risk of collectability when compared to traditional loans, such as residential mortgage loans.

Consumer loans are granted based on employment and financial information solicited from prospective borrowers, as well as credit records collected from various reporting agencies. The stability of the borrower, willingness to pay and credit history are the primary factors to be considered. The availability of collateral is also a factor considered in making such a loan. The Bank seeks collateral that can be assigned and has good marketability with a clearly adequate margin of value. The geographic area of the borrower is another consideration, with preference given to borrowers in the Bank's primary market areas.

Supervision and Regulation

Banking is a complex, highly-regulated industry. The primary goals of the bank regulatory scheme are to maintain a safe and sound banking system and to facilitate the conduct of monetary policy. In furtherance of those goals, Congress has created several largely autonomous regulatory agencies and enacted a myriad of legislation that governs banks, bank holding companies and the banking industry. This regulatory framework is intended primarily for the protection of depositors and not for the protection of the Company's shareholders or creditors. Descriptions of, and references to, the statutes and regulations below are brief summaries thereof, and do not purport to be complete. The descriptions are qualified in their entirety by reference to the specific statutes and regulations discussed.

Regulation of the Bank Holding Company

The Company is a bank holding company within the meaning of the Bank Holding Company Act of 1956, as amended (the "BHCA"). As a bank holding company, the Company is subject to inspection, examination and supervision by the Board of Governors of the Federal Reserve System (the "Federal Reserve Board") and is required to file with the Federal Reserve Board an annual report and such additional information as the Federal Reserve Board may require pursuant to the BHCA. The Federal Reserve Board may also make examinations of the Company and its subsidiaries. The Company is subject to capital standards similar to, but separate from, those applicable to the Bank.

Under the BHCA, bank holding companies that are not financial holding companies generally may not acquire the ownership or control of more than 5% of the voting shares, or substantially all of the assets, of any company, including a bank or another bank holding company, without the Federal Reserve Board's prior approval. The Company has not applied to become a financial holding company but did obtain such approval to acquire the shares of the Bank. A bank holding company that does not qualify as a financial holding company is generally limited in the types of activities in which it may engage to those that the Federal Reserve Board had recognized as permissible for bank holding companies prior to the date of enactment of the Gramm-Leach- Bliley Financial Services Modernization Act of 1999. For example, a holding company and its banking subsidiary are prohibited from engaging in certain tie-in arrangements in connection with any extension of credit or lease or sale of any property or the furnishing of services. At present, the Company does not engage in any significant activity other than owning the Bank.

In addition to federal bank holding company regulation, the Company is registered as a bank holding company with the New Jersey Department of Banking and Insurance (the "NJ Banking Department"). The Company is required to file with the NJ Banking Department copies of the reports it files with the federal banking and securities regulators.

Regulation of the Bank Subsidiary

As a New Jersey-chartered commercial bank, the Bank is subject to supervision and examination by the NJ Banking Department. The Bank is also subject to regulation and examination by the FDIC, which is its principal federal bank regulator.

The Bank must comply with various requirements and restrictions under federal and state law, including the maintenance of reserves against deposits, restrictions on the types and amounts of loans that may be granted and the interest that may be charged thereon, limitations on the types of investments that may be made and the services that may be offered, and restrictions on dividends as described in the below section titled "Restrictions on Dividends and Redemption of Stock for the Company and the Bank." The Bank must also comply with the capital regulations promulgated by the FDIC as described in the section below titled "Capital Adequacy of the Company and the Bank." Consumer laws and regulations also affect the operations of the Bank. In addition to the impact of regulation, commercial banks are affected significantly by the actions of the Federal Reserve Board which influence the money supply and credit availability in the national economy.

For additional information on laws and regulations affecting the Bank, please refer to the below section titled "Banking Legislation and Regulations."

Capital Adequacy of the Company and the Bank

The Company is required to comply with minimum capital adequacy standards established by the Federal Reserve Board. There are two basic measures of capital adequacy for bank holding companies and the depository institutions that they own: a risk based measure and a leverage measure. All applicable capital standards must be satisfied for a bank holding company to be considered in compliance.

The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") requires each federal banking agency to revise its risk-based capital standards to ensure that those standards take adequate account of interest rate risk, concentration of credit risk and the risks of non-traditional activities. In addition, pursuant to FDICIA, each federal banking agency has promulgated regulations specifying the levels at which a bank would be considered "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," or "critically undercapitalized" and requiring that certain mandatory and discretionary supervisory actions be taken based on the capital level of the institution.

In December 2010, the Group of Governors and Heads of Supervisors of the Basel Committee on Banking Supervision, the oversight body of the Basel Committee, published its “calibrated” capital standards for major banking institutions, referred to as Basel III. Subsequently, in July 2013, the Federal Reserve Board and the FDIC approved revisions to their capital adequacy guidelines and prompt corrective action rules that implemented and addressed the revised standards of Basel III and addressed relevant provisions of the Dodd-Frank Act. The Federal Reserve Board’s and the FDIC’s rules apply to all depository institutions, top-tier bank holding companies with total consolidated assets of $500 million or more (which was subsequently increased to $1 billion or more in May 2015), and top-tier savings and loan holding companies (collectively referred to herein as, "banking organizations"). Among other things, the rules established a new Common Equity Tier 1 minimum capital requirement (4.5% of risk-weighted assets) and increased the minimum Tier 1 capital to risk-based assets requirement (from 4% to 6% of risk-weighted assets). Banking organizations are also required to have a total capital ratio of at least 8% and a Tier 1 leverage ratio of at least 4%. The rules also limit a banking organization’s ability to pay dividends, engage in share repurchases or pay discretionary bonuses if the banking organization does not hold a "capital conservation buffer" consisting of 2.5% of Common Equity Tier 1 capital to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements. The rules became effective for the Company and the Bank on January 1, 2015 (subject to phase-in periods for certain components). The Company and the Bank began phasing in the capital conservation buffer requirement on January 1, 2016 at 0.625% of Common Equity Tier 1 capital to risk-weighted assets and increased by that amount each year until fully implemented in January 2019 at 2.5% of Common Equity Tier 1 capital to risk-weighted assets. The phase-in period ended on January 1, 2019,
and the Capital Conservation Buffer is now at its fully phased-in level of 2.5%.

With respect to the Bank, the FDIC’s regulations implementing these provisions of FDICIA provide that an institution will be classified as "well capitalized" if it (i) has a total risk-based capital ratio of at least 10.0 percent, (ii) has a Tier 1 risk-based capital ratio of at least 8.0 percent, (iii) has a Common Equity Tier 1, or CET1, ratio of at least 6.5 percent, (iv) has a Tier 1 leverage ratio of at least 5.0 percent, and (v) meets certain other requirements. An institution will be classified as "adequately capitalized" if it (i) has a total risk-based capital ratio of at least 8.0 percent, (ii) has a Tier 1 risk-based capital ratio of at least 6.0 percent, (iii) has a CET1 ratio of at least 4.5 percent, (iv) has a Tier 1 leverage ratio of at least 4.0 percent, and (v) does not meet the definition of "well capitalized." An institution will be classified as "undercapitalized" if it (i) has a total risk-based capital ratio of less than 8.0 percent, (ii) has a Tier 1 risk-based capital ratio of less than 6.0 percent, (iii) has a CET1 ratio of less than 4.5 percent or (iv) has a Tier 1 leverage ratio of less than 4.0 percent. An institution will be classified as "significantly undercapitalized" if it (i) has a total risk-based capital ratio of less than 6.0 percent, (ii) has a Tier 1 risk-based capital ratio of less than 4.0 percent, (iii) has a CET1 ratio of less than 3.0 percent or (iv) has a Tier 1 leverage ratio of less than 3.0 percent. An institution will be classified as "critically undercapitalized" if it has a Tier 1 leverage ratio that is equal to or less than 2.0 percent. An insured depository institution may be deemed to be in a lower capitalization category if it receives an unsatisfactory examination rating. Similar categories apply to bank holding companies. Because the capital conservation buffer is now fully phased in, the capital ratios applicable to depository institutions will exceed the ratios to be considered well-capitalized under the prompt corrective action regulations.

Under these capital rules, the Bank’s CET1 risk-based capital, Tier 1 risk-based capital, total risk-based capital and leverage capital ratios were 12.40%, 12.40% ,13.18%, and 11.74%, respectively, at December 31, 2018. The Bank is classified as a non-advanced approaches bank for regulatory purposes and has permanently opted out of including the amount of accumulated other comprehensive income in the computation of regulatory capital.

Restrictions on Dividends and Redemption of Stock for the Company and the Bank

The primary source of cash to pay dividends, if any, to the Company’s shareholders and to meet the Company’s obligations is dividends paid to the Company by the Bank. Dividend payments by the Bank to the Company are subject to the New Jersey Banking Act of 1948 (the "Banking Act") and the Federal Deposit Insurance Act (the "FDIA"). Under the Banking Act, the Bank may not pay dividends unless, following the dividend payment, the capital stock of the Bank will be unimpaired and (i) the Bank will have a surplus of not less than 50% of its capital stock or, if not, (ii) the payment of such dividend will not reduce the surplus of the Bank. Under the FDIA, the Bank may not pay any dividends, if after paying the dividend, it would be undercapitalized under applicable capital requirements. In addition to these explicit limitations, the federal regulatory agencies are authorized to prohibit a banking subsidiary or bank holding company from engaging in an unsafe or unsound banking practice. Depending upon the circumstances, the agencies could take the position that paying a dividend would constitute an unsafe or unsound banking practice. The Bank is also limited in paying dividends if it does not maintain the necessary "capital conservation buffer' as discussed below.

It is the policy of the Federal Reserve Board that bank holding companies should pay cash dividends on common stock only out of income available over the immediately preceding year and only if prospective earnings retention is consistent with the organization’s expected future needs and financial condition. The policy provides that bank holding companies should not maintain a level of cash dividends that undermines the bank holding company’s ability to serve as a source of strength to its banking subsidiary. A bank holding company may not pay dividends when it is insolvent.

The Federal Reserve Board has issued a supervisory letter to bank holding companies that contains guidance on when the board of directors of a bank holding company should eliminate or defer or severely limit dividends, including, for example, when net income available for shareholders for the past four quarters, net of dividends paid during that period, is not sufficient to fully fund the dividends. The letter also contains guidance on the redemption of stock by bank holding companies which urges bank holding companies to advise the Federal Reserve Board of any such redemption or repurchase of common stock for cash or other value that results in the net reduction of a bank holding company’s capital at the beginning of the quarter below the capital outstanding at the end of the quarter. The Company’s payment of cash dividends to date were within the guidelines set forth in the Federal Reserve Board’s supervisory letter.

Subsequent to the issuance of the supervisory letter, the Federal Reserve Board adopted regulations requiring bank holding companies to give prior written notice to the Federal Reserve Board before purchasing or redeeming its stock if the gross consideration for the purchase or redemption, when aggregated with the net consideration (i.e., gross consideration paid for purchases and redemptions minus gross consideration received for all stock sold) paid for all purchases or redemptions of stock during the preceding 12 months, is equal to 10% or more of the bank holding company’s consolidated net worth. However, if a bank holding company (i) will be well-capitalized before and immediately after the purchase or redemption, (ii) is well-managed and (iii) is not the subject of any unresolved supervisory issues, then the bank holding company will not be required to give any prior written notice to the Federal Reserve Board. At this time, the Company fits within the above exception and is not required to give prior written notice to the Federal Reserve Board before purchasing or redeeming its stock.

The Federal Reserve Board’s capital adequacy rules also limit a banking organization’s ability to pay dividends or to engage in share repurchases if the banking organization does not hold a "capital conservation buffer" consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements. For further discussion of regulatory capital rules, please refer to the discussion under the above section titled "Capital Adequacy of the Company and the Bank."

The timing and the amount of the payment of future dividends, if any, on the Company's common shares will be at the discretion of the Company's Board of Directors and will be determined after consideration of various factors, including the level of earnings, cash requirements, regulatory capital and financial condition.

Priority on Liquidation

The Company is a legal entity separate and distinct from the Bank. The rights of the Company as the sole shareholder of the Bank, and therefore the rights of the Company’s creditors and shareholders, to participate in the distributions and earnings of the Bank when the Bank is not in receivership under Federal banking laws, are subject to various state and federal law restrictions as discussed above under the heading "Restrictions on Dividends and Redemption of Stock for the Company and the Bank." In the event of a liquidation or other resolution of an insured depository institution such as the Bank, the claims of depositors and other general or subordinated creditors are entitled to a priority of payment over the claims of holders of an obligation of the institution to its shareholders (the Company) or any shareholder or creditor of the Company. The claims on the Bank by creditors include obligations in respect of federal funds purchased and certain other borrowings, as well as deposit liabilities.

Financial Institution Legislation

Dodd-Frank Act

The Dodd-Frank Act has had a broad impact on the financial services industry, including significant regulatory and compliance requirements, including, among other things, (i) enhanced resolution authority of troubled and failing banks and their holding companies; (ii) increased capital and liquidity requirements; (iii) increased regulatory examination fees; (iv) changes to assessments to be paid to the FDIC for federal deposit insurance; and (v) numerous other provisions designed to improve supervision and oversight of, and strengthen safety and soundness for, the financial services sector. Additionally, the Dodd-Frank Act established a framework for systemic risk oversight within the financial system to be distributed among federal regulatory agencies, including the Financial Stability Oversight Council, the Federal Reserve Board, the Office of the Comptroller of the Currency, and the FDIC.

Effective July 2011, the Dodd-Frank Act eliminated federal prohibitions on paying interest on demand deposits, thus allowing businesses to have interest bearing checking accounts. As of the date of this Form 10-K, the Bank does not pay interest on demand deposits. This significant change to existing law has not had an adverse impact on our net interest margin for the years ended December 31, 2018, 2017 and 2016.

The Dodd-Frank Act also changed the base for FDIC deposit insurance assessments. Assessments are based on average consolidated total assets less tangible equity capital of a financial institution, rather than on deposits. The Dodd-Frank Act also increased the maximum amount of deposit insurance for banks, savings institutions and credit unions to $250,000 per account owner. However, if an Interest on Lawyer Trust Account ("IOLTA") qualifies for pass-through coverage as a fiduciary account, then each separate client for whom a law firm holds funds in such IOLTA may be insured up to $250,000 for his or her funds. The legislation also increased the required minimum reserve ratio for the Deposit Insurance Fund, from 1.15% to 1.35% of insured deposits, and directed the FDIC to offset the effects of increased assessments on depository institutions with less than $10 billion in assets, including the Bank.

The Dodd-Frank Act requires publicly traded companies to give their shareholders a non-binding vote on executive compensation ("say on pay") and so-called "golden parachute" payments. It also provides that the listing standards of the national securities exchanges shall require listed companies to implement and disclose "clawback" policies mandating the recovery of incentive compensation paid to executive officers in connection with accounting restatements. Such listing standards have yet to be implemented. For further discussion of incentive compensation rules, please refer to the discussion under the below section titled "Incentive Compensation."

The Dodd-Frank Act created the Consumer Financial Protection Bureau with broad powers to supervise and enforce consumer protection laws. The Consumer Financial Protection Bureau has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit "unfair, deceptive or abusive" acts and practices. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks and savings institutions with more than $10 billion in assets, which authority does not extend to the Bank at this time since we do not meet the asset threshold.

The Dodd-Frank Act also weakens the federal preemption rules that have been applicable to national banks and federal savings associations, and gives state attorneys general the ability to enforce federal consumer protection laws. The Dodd-Frank Act requires minimum leverage (Tier 1) and risk based capital requirements for bank and savings and loan holding companies, which exclude certain instruments that previously have been eligible for inclusion by bank holding companies as Tier 1 capital, such as trust preferred securities; however, bank holding companies with assets of less than $15 billion as of December 31, 2009 are permitted to include trust preferred securities that were issued before May 19, 2010 as Tier 1 capital.

The Dodd-Frank Act and the rules and regulations promulgated under the Dodd-Frank Act have impacted the Bank, as well as all community banks, by increasing our operating and compliance costs. To the extent the Dodd-Frank Act remains in place, it is likely to further increase our operating and compliance costs as certain yet to be written implementing rules and regulations are enacted.

Volcker Rule

On December 10, 2013, the Federal Reserve, the Office of the Comptroller of the Currency, the FDIC, the Commodity Futures Trading Commission and the SEC issued final rules to implement the Volcker Rule contained in Section 619 of the Dodd-Frank Act, which became effective on July 21, 2015, for investments in covered funds made after December 31, 2013. The

Volcker Rule prohibits an insured depository institution and its affiliates from: (i) engaging in "proprietary trading" and (ii) investing in or sponsoring certain types of funds (defined as "Covered Funds") subject to certain limited exceptions. The rule also effectively prohibits short-term trading strategies by any U.S. banking entity if those strategies involve instruments other than those specifically permitted for trading and prohibits the use of some hedging strategies.The Company identified no investments that met the definition of Covered Funds and that were required to be divested by July 21, 2015 under the foregoing rules.

Incentive Compensation

The Dodd-Frank Act requires the federal bank regulatory agencies and the SEC to establish joint regulations or guidelines prohibiting incentive-based payment arrangements at specified regulated entities with at least $1 billion in total assets, such as the Company and the Bank, that encourage inappropriate risks by providing an executive officer, employee, director or principal shareholder with excessive compensation, fees, or benefits or that could lead to material financial loss to the entity. In addition, these agencies must establish regulations or guidelines requiring enhanced disclosure to regulators of incentive-based compensation arrangements. The agencies proposed such regulations in April 2011 and subsequently proposed revised regulations in May 2016, but the revised regulations have not been finalized. If the revised regulations are adopted in the form proposed, they will impose limitations on the manner in which the Company may structure compensation for its executives and employees.

In 2010, the Federal Reserve, the Office of the Comptroller of the Currency and the FDIC issued comprehensive final guidance on incentive compensation policies intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The guidance, which covers all employees that have the ability to materially affect the risk profile of an organization, either individually or as part of a group, is based on the key principles that a banking organization’s incentive compensation arrangements should (i) provide incentives that do not encourage risk-taking beyond the organization’s ability to effectively identify and manage risks, (ii) be compatible with effective internal controls and risk management, and (iii) be supported by strong corporate governance, including active and effective oversight by the organization’s board of directors. These three principles are incorporated into the proposed joint compensation regulations under the Dodd-Frank Act.

The Federal Reserve will review, as part of its regular, risk-focused examination process, the incentive compensation arrangements of banking organizations, such as the Company, that are not "large, complex banking organizations." These reviews will be tailored to each organization based on the scope and complexity of the organization’s activities and the prevalence of incentive compensation arrangements. The findings of the supervisory initiatives will be included in reports of examination. Deficiencies will be incorporated into the organization’s supervisory ratings, which can affect the organization’s ability to make acquisitions and take other actions. Enforcement actions may be taken against a banking organization if its incentive compensation arrangements, or related risk-management control or governance processes, pose a risk to the organization’s safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

Gramm-Leach-Bliley Financial Services Modernization Act of 1999

The Gramm-Leach-Bliley Financial Services Modernization Act of 1999 (the "Modernization Act") became effective in early 2000. The Modernization Act:

- allows bank holding companies meeting management, capital and Community Reinvestment Act standards to engage in a substantially broader range of non-banking activities, including insurance underwriting and making merchant banking investments in commercial and financial companies; if a bank holding company elects to become a financial holding company, it files a certification, effective in 30 days, and thereafter may engage in certain financial activities without further approvals;

- allows banks to establish subsidiaries to engage in certain activities that a financial holding company could engage in, provided that the bank meets certain management, capital and Community Reinvestment Act standards; and
- allows insurers and other financial services companies to acquire banks and removes various restrictions applicable to bank holding company ownership of securities firms and mutual fund advisory companies; and establishes the overall regulatory structure applicable to financial holding companies that also engage in insurance and securities operations.

The Modernization Act also amended the BHCA and the Bank Merger Act to require the federal banking agencies to consider the effectiveness of a financial institution's anti-money laundering activities when reviewing an application under these acts. The Modernization Act modified other laws, including laws related to financial privacy and community reinvestment.

Additional proposals to change the laws and regulations governing the banking and financial services industry are frequently introduced in Congress, in state legislatures and before the various bank regulatory agencies. The likelihood and timing of any such changes and the impact such changes might have on the Company cannot be determined at this time.

Public Company Legislation

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley Act”), which became law on July 30, 2002, added new legal requirements affecting corporate governance, accounting and corporate reporting for companies with publicly traded securities.

The Sarbanes-Oxley Act provides for, among other things:

- a prohibition on personal loans made or arranged by the issuer to its directors and executive officers (except for loans made by a bank subject to Regulation O of the Federal Reserve Board);
- independence requirements for audit committee members;
- disclosure of whether at least one member of the audit committee is a "financial expert" (as such term is defined by the SEC and if not, why not;
- independence requirements for outside auditors;
- a prohibition on a company’s registered public accounting firm from performing statutorily mandated audit services for the company if the company’s chief executive officer, chief financial officer, comptroller, chief accounting officer or any person serving in equivalent positions had been employed by such firm and participated in the audit of such company during the one-year period preceding the audit initiation date;
- certification of financial statements and annual and quarterly reports by the principal executive officer and the principal financial officer;
- the forfeiture of bonuses or other incentive-based compensation and profits from the sale of an issuer’s securities by directors and senior officers in the twelve month period following initial publication of any financial statements that later require restatement due to corporate misconduct;
- disclosure of off-balance sheet transactions;
- two-business day filing requirements for insiders filing Forms 4;
- disclosure of a code of ethics for financial officers and filing a Form 8-K for a change or waiver of such code;
- "real time" filing of periodic reports;
- posting of certain SEC filings and other information on the company’s website;
- the reporting of securities violations "up the ladder" by both in-house and outside attorneys;
- restrictions on the use of non-GAAP financial measures;
- the formation of a public accounting oversight board; and
- various increased criminal penalties for violations of securities laws.

Additionally, Section 404 of the Sarbanes-Oxley Act requires that a public company subject to the reporting requirements of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), include in its annual report (i) a management’s report on internal control over financial reporting assessing the company’s internal controls, and (ii) if the company is an "accelerated filer" or a "large accelerated filer", an auditor’s attestation report, completed by the registered public accounting firm that prepares or issues an accountant’s report which is included in the company’s annual report, attesting to the effectiveness of management’s internal control assessment.

The Company met the "accelerated filer" requirements as of the end of its fiscal year ended December 31, 2016 pursuant to Rule 12b-2 of the Exchange Act. However, pursuant to Rule 12b-2 and SEC Release No. 33-8876, the

Company (as a smaller reporting company transitioning to the larger reporting company system) was not required to satisfy the larger reporting company disclosure requirements until its first Quarterly Report on Form 10-Q for the fiscal year ended December 31, 2017. The Company was further required to include an attestation report of the Company’s independent registered public accounting firm regarding the Company’s internal control over financial reporting in its Annual Report on Form 10-K for the year ended December 31, 2016. In 2018, the SEC increased the public float threshold to be considered a “smaller reporting company” to $250 million from $75 million with respect to the accelerated filer reporting and disclosure requirements. However, the SEC did not change the public float threshold to be considered an “accelerated filer,” which remains $75 million or more, but less than $700 million with respect to the attestation report of the Company's independent registered public accounting firm. The Company meets the criteria to be both a “smaller reporting company” and an “accelerated filer,” and is therefore required to continue to include the attestation report of the Company’s independent registered public accounting firm regarding the Company’s internal control over financial reporting in its Annual Report on Form 10-K. Although the Company satisfies the definition of a “smaller reporting company,” the Company has determined to continue to provide disclosures as an “accelerated filer” that are not required for a "smaller reporting company" for the foreseeable future.

Each of the national stock exchanges, including the Nasdaq Global Market where the Company’s common stock is listed, have in place corporate governance rules, including rules requiring director independence, and the adoption of charters for the nominating, corporate governance, and audit committees. These rules are intended to, among other things, make the board of directors independent of management and allow shareholders to more easily and efficiently monitor the performance of companies and directors. These burdens increase the Company’s legal and accounting fees and the amount of time that the Board of Directors and management must devote to corporate governance issues.

Section 302(a) of the Sarbanes-Oxley Act requires the Company’s principal executive officer and principal financial officer to certify that the Company’s Quarterly and Annual Reports do not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of circumstances under which they were made, not misleading. Among other things, these officers must certify that: they are responsible for establishing, maintaining and regularly evaluating the effectiveness of the Company’s disclosure controls and procedures and internal control over financial reporting; they have made certain disclosures to the Company’s auditors and the audit committee of the Board of Directors about the Company’s internal control over financial reporting; and they have included information in the Company’s Quarterly and Annual Reports about their evaluation of disclosure controls and procedures and whether there have been significant changes in the Company’s internal controls over financial reporting.

Banking Legislation and Regulations

Anti-Money Laundering

As part of the USA PATRIOT Act, signed into law on October 26, 2001, Congress adopted the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001 (the "FATA"). The FATA authorizes the Secretary of the Treasury, in consultation with the heads of other government agencies, to adopt special measures applicable to financial institutions such as banks, bank holding companies, broker-dealers and insurance companies. Among its other provisions, the FATA requires each financial institution: (i) to establish an anti-money laundering program; (ii) to establish due diligence policies, procedures and controls that are reasonably designed to detect and report instances of money laundering in United States private banking accounts and correspondent accounts maintained for non-United States persons or their representatives; and (iii) to avoid establishing, maintaining, administering, or managing correspondent accounts in the United States for, or on behalf of, a foreign shell bank that does not have a physical presence in any country. In addition, the FATA expands the circumstances under which funds in a bank account may be forfeited and requires covered financial institutions to respond under certain circumstances to requests for information from federal banking agencies within 120 hours.

The Department of Treasury has issued regulations implementing the due diligence requirements. These regulations require minimum standards to verify customer identity and maintain accurate records, encourage cooperation among financial institutions, federal banking agencies, and law enforcement authorities regarding possible money laundering or terrorist activities, prohibit the anonymous use of "concentration accounts," and require all covered financial institutions to have in place an anti-money laundering compliance program.

Community Reinvestment Act

Under the Community Reinvestment Act (the "CRA"), as implemented by FDIC regulations, a bank has a continuing and affirmative obligation, consistent with its safe and sound operation, to help meet the credit needs of its entire community, including low- and moderate-income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions, nor does it limit an institution's discretion to develop the types of products and services that it believes are best suited to its particular community, consistent with CRA. The CRA requires the FDIC to assess an institution's record of meeting the credit needs of its community and to take such record into account in its evaluation of certain applications by the applicable institution. The CRA requires public disclosure of an institution's CRA rating and requires that the FDIC provide a written evaluation of an institution's CRA performance utilizing a four-tiered descriptive rating system. An institution's CRA rating is considered in determining whether to grant charters, branches and other deposit facilities, relocations, mergers, consolidations and acquisitions. Performance less than satisfactory may be the basis for denying an application. At its last CRA examination, the Bank was rated "satisfactory" under the CRA.

FIRREA

Under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"), a depository institution insured by the FDIC can be held liable for any loss incurred by, or reasonably expected to be incurred by, the FDIC in connection with (i) the default of a commonly controlled FDIC-insured depository institution or (ii) any assistance provided by the FDIC to a commonly controlled FDIC-insured depository institution in danger of default. These provisions have commonly been referred to as FIRREA’s "cross guarantee" provisions. Further, under FIRREA, the failure to meet capital guidelines could subject a bank to a variety of enforcement remedies available to federal regulatory authorities.

FIRREA also imposes certain independent appraisal requirements upon a bank’s real estate lending activities and further imposes certain loan-to-value restrictions on a bank’s real estate lending activities. Banking regulators have promulgated regulations in these areas.

Insurance of Deposits

The Bank’s deposits are insured up to applicable limits by the Deposit Insurance Fund of the FDIC. This limit is $250,000 per account owner. FDICIA is applicable to depository institutions and deposit insurance. The FDIC established a risk-based assessment system for all insured depository institutions and established an insurance premium assessment system based upon: (i) the probability that the insurance fund will incur a loss with respect to the institution, (ii) the likely amount of the loss, and (iii) the revenue needs of the insurance fund. The resulting matrix sets the assessment premium for a particular institution in accordance with its capital level and overall rating by the primary regulator.

As a result of the Dodd-Frank Act, the FDIC modified its assessment rules so that an institution’s deposit insurance assessment base changed from total deposits to total assets less tangible equity. These assessment base rates range from 2.5 to 9 basis points for Risk Category I banks and up to 45 basis points for Risk Category IV banks. Risk Category II and III banks have assessment base rates ranging from 9 to 33 basis points, respectively. If the risk category of the Bank changes adversely, our FDIC insurance premiums could increase.

Lending Limits

In January 2013, the NJ Banking Department issued an order requiring a New Jersey chartered bank’s calculation of lending limits to any person or entity to include credit exposure to such person or entity arising from a derivative transaction, repurchase agreement, reverse repurchase agreement, securities lending transaction or securities borrowing transaction. Previously, such credit exposure was not included in a New Jersey chartered bank’s calculation of lending limits. New Jersey chartered banks must comply with the operative provisions of the order, which include compliance with all of the rules set forth in the Office of the Comptroller of the Currency’s rules on lending limits (codified at 12 C.F.R pts. 32, 159 and 160). This change in the calculation of lending limits did not have a significant impact on the Bank’s operations.

Available Information

The Internet website address of the Company is http://www.1stconstitution.com. The information on our website is not incorporated into this Annual Report. The Company’s Annual Reports on Form 10-K and Quarterly Reports on Form 10-Q, and Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act are made available free of charge, on or through our Internet website, as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC. All filings we make with the SEC are also available free of charge via EDGAR through the SEC’s website at http://www.sec.gov.

We also make available, free of charge, through the investors page on our website, charters of the committees of our Board of Directors, as well as other information and materials, including information about how to contact our Board of Directors, its committees and their members.

Item 1A. Risk Factors.

The following are some important factors that could cause the Company's actual results to differ materially from those referred to or implied in any forward-looking statement. These are in addition to the risks and uncertainties discussed elsewhere in this Form 10-K and the Company's other filings with the SEC.

An economic downturn or the return of negative developments in the financial services industry could negatively impact our operations.

The U.S. economic downturn from 2008 to 2010 resulted in uncertainty in the financial markets in general. Although the U.S. economy has experienced a recovery in the years since then, the possibility of a fall-back into recession always exists. The Federal Reserve, in an attempt to help the overall economy, has kept interest rates historically low through its targeted federal funds rate even though it has increased the federal funds rate once in each of 2015 and 2016, three times in 2017 and four times in 2018. If the Federal Reserve increases the federal funds rate in the future, overall interest rates may rise, which may negatively impact the housing markets and the U.S. economy. An economic downturn or the return of negative developments in the financial services industry could negatively impact our operations by causing an increase in our provision for loan losses and a deterioration of our loan portfolio. Such a downturn may also adversely affect our ability to originate or sell loans. The occurrence of any of these events could have an adverse impact on our financial performance.

A downturn affecting the economy and/or the real estate market in our primary market area would adversely affect our loan portfolio and our growth potential.

Much of the Company's lending is in northern and central New Jersey and the New York City metropolitan area. As a result of this geographic concentration, a significant broad-based deterioration in economic conditions in the New Jersey and New York City metropolitan area could have a material adverse impact on the quality of the Company's loan portfolio, results of operations and future growth potential. A prolonged decline in economic conditions in our market area could restrict borrowers' ability to pay outstanding principal and interest on loans when due, and consequently, adversely affect the cash flows and results of operations of the Company's business.

The Company's loan portfolio is primarily secured by real estate collateral located in the State of New Jersey. Conditions in the real estate markets in which the collateral for the Company's loans are located strongly influence the level of the Company's non-performing loans and results of operations. A decline in the New Jersey real estate markets could adversely affect the Company's loan portfolio. Decreases in local real estate values would adversely affect the value of property used as collateral for the Company's loans. Adverse changes in the economy also may have a negative effect on the ability of our borrowers to make timely repayments of their loans, which would have an adverse impact on our earnings.

The Company faces significant competition.

The Company faces significant competition from many other banks, savings institutions and other financial institutions that have branch offices or otherwise operate in the Company's market area. Non-bank financial institutions, such as securities brokerage firms, insurance companies and money market funds, engage in activities which compete directly with traditional bank business, which has also led to greater competition. Many of these competitors have substantially greater financial resources than the Company, including larger capital bases that allow them to attract customers seeking larger loans than the Company is able to accommodate and the ability to aggressively advertise their products and to allocate considerable resources to locations and products perceived as profitable. There can be no assurance that the Company and the Bank will be able to successfully compete with these entities in the future.

The Company is subject to interest rate risk.

The Company's earnings are largely dependent upon its net interest income. Net interest income is the difference between interest income earned on interest-earning assets such as loans and securities and interest expense paid on interest-bearing liabilities such as deposits and borrowed funds. Interest rates are highly sensitive to many factors that are beyond the Company's control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the Federal Reserve Board. Changes in monetary policy, including changes in interest rates, could influence not only the interest the Company receives on loans and securities and the amount of interest it pays on deposits and borrowings, but such changes could also affect (i) the Company's ability to originate loans and obtain deposits, (ii) the fair value of the Company's financial assets and liabilities, and (iii) the average duration of the Company's mortgage-backed securities portfolio. If the spread between the interest rates paid on deposits and other borrowings and the interest rates received on loans and other investments narrows, the Company's net interest income, and therefore earnings, could be adversely affected. This also includes the risk that interest-earning assets may be more responsive to changes in interest rates than interest-bearing liabilities, or vice versa (repricing risk), the risk that the individual interest rates or rate indices underlying various interest-earning assets and interest-bearing liabilities may not change in the same degree over a given time period (basis risk), and the risk of changing interest rate relationships across the spectrum of interest-earning asset and interest-bearing liability maturities (yield curve risk).

Although management believes it has implemented effective asset and liability management strategies to reduce the potential effects of changes in interest rates on the Company's results of operations, any substantial, unexpected, prolonged change in market interest rates could have a material adverse effect on the Company's financial condition and results of operations.

Historically low interest rates may adversely affect our net interest income and profitability.

During the last ten years, it has been the policy of the Federal Reserve Board to maintain interest rates at historically low levels through its targeted federal funds rate and the purchase of mortgage-backed securities and Treasury securities. As a result, yields have been at levels lower than were available prior to 2008 on securities we have purchased and loans we have originated. Consequently, the average yield on our interest-earning assets has decreased during the low interest rate environment. As a general matter, our interest-bearing assets re-price or mature more quickly than our interest-bearing liabilities. Our ability to lower our interest expense is limited at these interest rate levels, while the average yield on our interest-earning assets could decrease. While the Federal Reserve Board raised the targeted federal funds rate and discount rate in 2015, 2016, 2017 and 2018, and may further raise the targeted federal funds rate and discount rate in the future, we believe that interest rates may remain relatively low and could decline in the near future from current levels. Accordingly, our net interest margin could decline, which may have an adverse effect on our profitability.

The Company is subject to risks associated with speculative construction lending.

The risks associated with speculative construction lending include the borrower's inability to complete the construction process on time and within budget, the sale of the project within projected absorption periods, the economic risks associated with real estate collateral, and the potential of a rising interest rate environment. Such loans may include financing the development and/or construction of residential subdivisions. This activity may involve financing land purchases, infrastructure development (i.e., roads, utilities, etc.), as well as construction of residences or multi-family dwellings for subsequent sale or lease by the developer/builder. Because the sale and leasing of developed properties is integral to the success of developer business, loan repayments may be especially subject to the volatility of real estate market values. Management has established underwriting and monitoring criteria to minimize the inherent risks of speculative commercial real estate construction lending. Further, management concentrates lending efforts with developers demonstrating successful performance on marketable projects within the Bank's lending areas.

Our mortgage warehouse lending business represents a significant portion of our overall lending activity and is subject to numerous risks.

Our primary lending emphasis is the origination of commercial business and commercial real estate loans and mortgage warehouse lines of credit. Based on the composition of our 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.

A significant portion of our loan portfolio consists of the mortgage warehouse lines of credit. Risks associated with these loans include, without limitation, (i) credit risks relating to the mortgage bankers that borrow from us, (ii) the risk of intentional misrepresentation or fraud by any of such mortgage bankers, (iii) changes in the market value of mortgage loans originated by the mortgage banker, the sale of which is the expected source of repayment of the borrowings under a warehouse line of credit, due to changes in interest rates during the time in warehouse, or (iv) unsalable or impaired mortgage loans so originated, which could lead to decreased collateral value and the failure of a purchaser of the mortgage loan to purchase the loan from the mortgage banker.

The impact of interest rates on our mortgage warehouse business can be significant. Changes in interest rates can impact the number of residential mortgages originated and initially funded under mortgage warehouse lines of credit and thus our mortgage warehouse related revenues. A decline in mortgage rates generally increases the demand for mortgage loans. Conversely, in a constant or increasing rate environment, we would expect fewer loans may be originated. Although we use models to assess the impact of interest rates on mortgage related revenues, the estimates of net income produced by these models are dependent on estimates and assumptions of future loan demand, prepayment speeds and other factors which may overstate or understate actual subsequent experience. Further, the concentration of our loan portfolio on loans originated through our mortgage warehouse business increases the risk associated with our loan portfolio because of the concentration of loans in a single line of business, namely one-to-four family residential mortgage lending, and in a particular segment of that business, namely mortgage warehouse lending.

If our allowance for loan losses is not sufficient to cover actual loan losses, our earnings could decrease.

We make various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. In determining the amount of the allowance for loan losses, we review our loans and our loan and delinquency experience, and we evaluate economic conditions. If our assumptions are incorrect, our allowance for loan losses may not be sufficient to cover losses inherent in our loan portfolio, resulting in additions to our allowance. Material additions to our allowance would materially decrease our net income.

In addition, bank regulators periodically review our loan portfolio and our allowance for loan losses and may require us to increase our provision for loan losses or recognize further loan charge-offs or reclassify loans. Any increase in our allowance for loan losses or loan charge-offs or loan reclassifications as required by these regulatory authorities might have a material adverse effect on our financial condition and results of operations.

If we do not successfully integrate banks that we may acquire in the future, the combined bank may be adversely affected.

If we make any acquisitions in the future, we will need to integrate the acquired entities into our existing business and systems. We may experience difficulties in accomplishing this integration or in effectively managing the combined bank after any future acquisition. The integration of any acquired entity will also divert the attention of our management. We cannot assure you that we will be successful in integrating any future acquisitions into our own business.

The expected benefits from acquiring another entity may not be realized if the combined bank does not achieve certain cost savings and other benefits.

Our belief that cost savings and revenue enhancements are achievable in any future acquisition is a forward-looking statement that is inherently uncertain. The combined bank's actual cost savings and revenue enhancements, if any, for any future acquisition cannot be quantified at this time. Any actual cost savings or revenue enhancements will depend on future expense levels and operating results, the timing of certain events and general industry, regulatory and business conditions. Many of these events will be beyond the control of the combined bank.

We depend on our executive officers and key personnel to implement our strategy and could be harmed by the loss of their services.

We believe that the implementation of our strategy will depend in large part on the skills of our executive management team and our ability to motivate and retain these and other key personnel. Accordingly, the loss of service of one or more of our executive officers or key personnel could reduce our ability to successfully implement our business strategy and materially and adversely affect us. Leadership changes will occur from time to time, and if significant resignations occur, we may not be able to recruit additional qualified personnel. We believe our executive management team possesses valuable knowledge about the banking industry and that their knowledge and relationships would be very difficult to replicate. Although our Chief Executive Officer and President has entered into an employment agreement with us, it is possible that he may not complete the term of his employment agreement or may choose not to renew it upon expiration.

Our customers also rely on us to deliver personalized financial services. Our success depends on the experience of our branch managers and lending officers and on their relationships with the customers and communities they serve. The loss of the service of these individuals could undermine the confidence of our customers in our ability to provide such personalized services. We need to continue to attract and retain these individuals and to recruit other qualified individuals to ensure continued growth. In addition, competitors may recruit these individuals in light of the value of the individuals’ relationships with their customers and communities and we may not be able to retain such relationships absent the individuals. If we are unable to attract and retain our branch managers and lending officers, and recruit individuals with appropriate skills and knowledge to support our business, our business strategy, business, financial condition and results of operations may be adversely affected.

Our directors and executive officers own a significant percentage of our stock and will be able to exert significant control over matters subject to shareholder approval.

As of December 31, 2018, our directors and executive officers, together with their affiliates and related persons, beneficially own, in the aggregate, approximately 14.3% of our outstanding shares of common stock. These shareholders, if acting together, may have the ability to determine the outcome of matters submitted to our shareholders for approval, including the election and removal of directors and any merger, consolidation, or sale of all or substantially all of our assets. In addition, these persons, acting together, may have the ability to control the management and affairs of our company. Accordingly, this concentration of ownership may harm the market price of our common stock by:

- delaying, deferring, or preventing a change in control;
- entrenching our management and/or the board of directors;
- impeding a merger, consolidation, takeover, or other business combination involving us; or
- discouraging a potential acquirer from making a tender offer or otherwise attempting to obtain control of us.

Federal and state government regulation impacts the Company’s operations.

The operations of the Company and the Bank are heavily regulated and will be affected by present and future legislation and by the policies established from time to time by various federal and state regulatory authorities. In particular, the monetary policies of the Federal Reserve Board have had a significant effect on the operating results of banks in the past and are expected to continue to do so in the future. Among the instruments of monetary policy used by the Federal Reserve Board to implement its objectives are changes in the discount rate charged on bank borrowings and the targeted Federal Funds rate. It is not possible to predict what changes, if any, will be made to the monetary policies of the Federal Reserve Board or to existing federal and state legislation or the effect that such changes may have on the future business and earnings prospects of the Company.

The Company and the Bank are subject to examination, supervision and comprehensive regulation by various federal and state agencies. Compliance with the rules and regulations of these agencies may be costly and may limit growth and restrict certain activities, including payment of dividends, investments, loans and interest rate charges, interest rates paid on deposits, and locations of offices. The Bank is also subject to capitalization guidelines set forth in federal legislation and regulations.

The laws and regulations applicable to the banking industry could change at any time, and we cannot predict the impact of these changes on our business and profitability. Because government regulation greatly affects the business and financial results of all commercial banks and bank holding companies, the cost of compliance could adversely affect the Company’s results of operations.

Legislative and regulatory reforms may materially adversely impact our financial condition, results of operations, liquidity, or stock price.

The Dodd-Frank Act restructures the regulation of depository institutions. The Dodd-Frank Act contains various provisions designed to enhance the regulation of depository institutions and prevent the recurrence of a financial crisis such as occurred in 2008-2009. Also included was the creation of the Consumer Financial Protection Bureau, a new federal agency administering consumer and fair lending laws, a function that was previously performed by the depository institution regulators. The federal preemption of state laws currently accorded federally chartered depository institutions has been reduced as well. We expect that many of the requirements called for in the Dodd-Frank Act will be implemented over time, and most will be subject to implementing regulations over the course of several years. Given the uncertainty associated with the manner in which the provisions of the Dodd-Frank Act will be implemented by the various regulatory agencies and through regulations, the full extent of the impact such requirements will have on financial institutions’ operations is unclear. The changes resulting from the Dodd-Frank Act may impact the profitability of our business activities, require changes to certain of our business practices, impose upon us more stringent capital, liquidity and leverage ratio requirements or otherwise adversely affect our business. These changes may also require us to invest significant management attention and resources to evaluate and make necessary changes in order to comply with new statutory and regulatory requirements.

In addition, international banking industry regulators have largely agreed upon significant changes in the regulation of capital required to be held by banks and their holding companies to support their businesses. The international rules, known as Basel III, generally increased the capital required to be held and narrow the types of instruments which will qualify as providing appropriate capital and imposed a new liquidity measurement. The Basel III requirements are complex and will be phased in over many years.

The Basel III rules do not apply to U.S. banks or holding companies automatically. Among other things, the Dodd-Frank Act requires U.S. regulators to reform the system under which the safety and soundness of banks and other financial institutions, individually and systemically, are regulated. That reform effort included the regulation of capital and liquidity.

On July 2, 2013, the Federal Reserve approved a final rule (the “Final Rule”) to establish a new comprehensive regulatory capital framework for all U.S. banking organizations. On July 9, 2013, the FDIC approved an interim final rule (which became final in April 2014 with no substantive changes) that was substantially similar to the Final Rule. Effective January 1, 2015, these new requirements established the following minimum capital ratios: (1) a common equity Tier 1 (“CET1”) capital ratio of 4.5% of risk-weighted assets; (2) a Tier 1 capital ratio of 6.0% of risk-weighted assets; (3) a total capital ratio of 8.0% of risk-weighted assets; and (4) a leverage ratio of 4.0%. In addition, there is a requirement to maintain a capital conservation buffer, comprised of

CET1 capital, in an amount greater than 2.5% of risk-weighted assets over the minimum capital required by each of the minimum risk-based capital ratios in order to avoid limitations on the organization's ability to pay dividends, repurchase shares or pay discretionary bonuses. The capital conservation buffer requirement began phasing in on January 1, 2016, and initially required a buffer amount greater than 0.625% during 2016 in order to avoid these limitations. Following 2016, the required amount of the capital conservation buffer continues to increase each year until January 1, 2019 when the buffer amount must be greater than 2.5% in order to avoid the above limitations.

These regulations define what qualifies as capital for purposes of meeting these various capital requirements, as well as the risk weight of certain assets for purposes of the risk-based capital ratios.

Under these regulations, in order to be considered well-capitalized for prompt corrective action purposes, the Bank will be required to maintain the following ratios: (1) a CET1 ratio of at least 6.5% of risk-weighted assets; (2) a Tier 1 capital ratio of at least 8.0% of risk weighted assets; (3) a total capital ratio of a least 10.0% of risk-weighted assets; and (4) a leverage ratio of at least 5.0%. The Bank's CET1 risk-based capital, Tier 1 risk-based capital, total risk-based capital and leverage capital ratios were 12.40%, 12.40%, 13.18%, and 11.74%, respectively, at December 31, 2018.

The application of these capital requirements could increase the Company's required capital levels and the cost of capital, among other things. Any permanent significant increase in the Company's cost of capital could have significant adverse impacts on the profitability of many of our products, the types of products we could offer profitably, our overall profitability, and our overall growth opportunities, among other things. Implementation of changes to asset risk weightings for risk-based capital calculations or items included or deducted in calculating regulatory capital and/or additional capital conservation buffers could also result in management modifying the Company's business strategy and limiting the Company's ability to repurchase our common stock. Furthermore, the imposition of liquidity requirements in connection with the implementation of Basel III could result in us having to lengthen the term of our funding, restructure our business models, and/or increase our holdings of liquid assets. Although most financial institutions would be affected, these business impacts could be felt unevenly, depending upon the business and product mix of each institution. Other potential adverse effects could include higher dilution of common shareholders if we had to issue additional shares and a higher risk that we might fall below regulatory capital thresholds in an adverse economic cycle.

Any additional changes in the regulation and oversight of the Company, in the form of new laws, rules and regulations, could make compliance more difficult or expensive or otherwise materially adversely affect our business, financial condition or operations.

The price of our common stock may fluctuate.

The price of our common stock on the NASDAQ Global Market constantly changes and recently, given the uncertainty in the financial markets, has fluctuated widely. From the beginning of fiscal year 2017 through the end of fiscal year 2018, our stock price fluctuated between a high of $27.00 per share and a low of $15.75 per share. We expect that the market closing price of our common stock will continue to fluctuate. Consequently, the current market price of our common stock may not be indicative of future market prices, and we may be unable to sustain or increase the value of an investment in our common stock.

Our common stock price can fluctuate as a result of a variety of factors, many of which are beyond our control. These factors include:

- quarterly fluctuations in our operating and financial results;
- operating results that vary from the expectations of management, securities analysts and investors;
-

- changes in expectations as to our future financial performance, including financial estimates by securities analysts and investors;
- events negatively impacting the financial services industry which result in a general decline in the market valuation of our common stock;
- announcements of material developments affecting our operations or our dividend policy;
- future sales of our equity securities;
- new laws or regulations or new interpretations of existing laws or regulations applicable to our business;
- changes in accounting standards, policies, guidance, interpretations or principles; and
- general domestic economic and market conditions.

In addition, recently, the stock market generally has experienced extreme price and volume fluctuations. Industry factors and general economic and political conditions and events, such as economic slowdowns or recessions, interest rate changes or credit loss trends, could also cause our stock price to decrease regardless of our operating results.

The Bank is subject to liquidity risk.

Liquidity risk is the potential that the Bank will be unable to meet its obligations as they become due, capitalize on growth opportunities as they arise, or pay regular dividends because of an inability to liquidate assets or obtain adequate funding in a timely basis, at a reasonable cost and within acceptable risk tolerances.

Liquidity is required to fund various obligations, including credit commitments to borrowers, mortgage and other loan originations, withdrawals by depositors, repayment of borrowings, dividends to shareholders, operating expenses and capital expenditures.

Liquidity is derived primarily from retail deposit growth and retention; principal and interest payments on loans; principal and interest payments on investment securities; sale, maturity and prepayment of investment securities; net cash provided from operations and access to other funding sources.

Our access to funding sources in amounts adequate to finance our activities could be impaired by factors that affect us specifically or the financial services industry in general. Factors that could detrimentally impact our access to liquidity sources include a decrease in the level of our business activity due to a market downturn or adverse regulatory action against us. Our ability to borrow could also be impaired by factors that are not specific to us, such as a severe disruption of the financial markets or negative views and expectations about the prospects for the financial services industry as a whole. If we become unable to obtain funds when needed, it could have a material adverse effect on our business and in turn, our consolidated financial condition and results of operations.

The Company is subject to liquidity risk.

Our recurring cash requirements, at the holding company level, primarily consist of interest expense on junior subordinated debentures issued to capital trusts. Holding company cash needs are routinely satisfied by dividends collected from the Bank.

While we expect that the holding company will continue to receive dividends from the Bank sufficient to satisfy holding company cash needs, in the event that the Bank has insufficient resources or is subject to legal or regulatory restrictions on the payment of dividends, the Bank may be unable to provide dividends or a sufficient level of dividends to the holding company; in that event, the holding company may have insufficient funds to satisfy its obligations as they become due.

Future growth, operating results or regulatory requirements may require us to raise additional capital but that capital may not be available.

We are required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations. To the extent our future operating results erode capital or we elect to expand through loan growth or acquisition, we may be required to raise additional capital. Our ability to raise capital will depend on conditions in the capital markets, which are outside of our control, and on our financial performance. Accordingly, we cannot be assured of our ability to raise capital when needed or on favorable terms. If we cannot raise additional capital when needed, we will be subject to increased regulatory supervision and the imposition of restrictions on our growth and business. These actions could negatively impact our ability to operate or further expand our operations and may result in increases in operating expenses and reductions in revenues that could have a material effect on our consolidated financial condition and results of operations.

Higher FDIC deposit insurance premiums and assessments could adversely affect our financial condition.

As a result of the Dodd-Frank Act, the FDIC modified its assessment rules so that an institution's deposit insurance assessment base changed from total deposits to total assets less tangible equity. These assessment base rates range from 2.5 to 9 basis points for Risk Category I banks and up to 45 basis points for Risk Category IV banks. Risk Category II and III banks have assessment base rates ranging from 9 to 33 basis points, respectively. If the risk category of the Bank changes adversely, our FDIC insurance premiums could increase.

Insured depository institution failures, as well as deterioration in banking and economic conditions, could significantly increase the loss provisions of the FDIC, resulting in a decline in the designated reserve ratio of the Deposit Insurance Fund to historical lows. Effective January 1, 2011, the FDIC increased the designated reserve ratio from 1.25% to 2.00%. In addition, the Dodd-

Frank Act permanently increased the deposit insurance limit on FDIC deposit insurance coverage to $250,000 per insured depositor, retroactive to January 1, 2008, which may result in even larger losses to the Deposit Insurance Fund.

The FDIC may further increase or decrease the assessment rate schedule in order to manage the Deposit Insurance Fund to prescribed statutory target levels. An increase in the risk category for the Bank or in the assessment rates could have an adverse effect on the Bank's earnings. The FDIC may terminate deposit insurance for an institution if it determines that such institution has engaged in or is engaging in unsafe or unsound banking practices, is in an unsafe or unsound condition, or has violated applicable laws, regulations or orders.

Future offerings of debt or other securities may adversely affect the market price of our stock.

In the future, the Company may attempt to increase its capital resources or, if the Company’s or the Bank’s capital ratios fall below the required minimums, the Company or the Bank could be forced to raise additional capital by making additional offerings of debt or preferred equity securities, including medium-term notes, trust preferred securities, senior or subordinated notes and preferred stock. Upon liquidation, holders of our debt securities and shares of preferred stock and lenders with respect to other borrowings will receive distributions of our available assets prior to the holders of our common stock.

The Company may issue additional shares of common stock which may dilute the ownership and voting power of our shareholders and the book value of our common stock.

The Company is currently authorized to issue up to 30,000,000 shares of common stock, of which 8,611,342 shares were outstanding on February 28, 2019. We may decide to issue additional shares of common stock for any corporate purposes. Our Board of Directors has the authority, without action or vote of our shareholders, to issue all or part of the authorized but unissued shares of common stock in public offerings or up to 20% of our outstanding common stock in non-public offerings. Any issuance of shares of our common stock will dilute the percentage ownership interest of our common shareholders and may reduce the market price of our common stock or dilute the book value of our common stock, or both. Holders of our common stock are not entitled to preemptive rights or other protections against dilution.

The Company may lose lower-cost funding sources.

Checking, savings, and money market deposit account balances and other forms of customer deposits can decrease when customers perceive alternative investments, such as the stock market, as providing a better risk/return tradeoff. If customers move money out of bank deposits and into other investments, the Company could lose a relatively low-cost source of funds, increasing its funding costs and reducing the Company’s net interest income and net income.

There may be changes in accounting policies or accounting standards.

The Company’s accounting policies are fundamental to understanding its financial results and condition. Some of these policies require the use of estimates and assumptions that may affect the value of the Company’s assets or liabilities and financial results. The Company identified its accounting policies regarding the allowance for loan losses, security impairment, goodwill and other intangible assets, and income taxes to be critical because they require management to make difficult, subjective and complex judgments about matters that are inherently uncertain. Under each of these policies, it is possible that materially different amounts would be reported under different conditions, using different assumptions, or as new information becomes available.

From time to time the Financial Accounting Standards Board ("FASB") and the SEC change the financial accounting and reporting standards that govern the form and content of the Company's external financial statements. FASB recently adopted new accounting standards related to fair value accounting, measurement of credit losses on financial instruments and accounting for leases that could materially change the Company's financial statements in the future. In addition, accounting standard setters and those who interpret the accounting standards (such as the FASB, SEC, banking regulators and the Company's independent auditors) may change or even reverse their previous interpretations or positions on how these standards should be applied. Changes in financial accounting and reporting standards and changes in current interpretations may be beyond the Company's control, can be hard to predict and could materially impact how the Company reports its financial results and condition. In certain cases, the Company could be required to apply a new or revised standard retroactively or apply an existing standard differently (also retroactively), which may result in the Company restating prior period financial statements in material amounts.

In addition, the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") updated the criteria in its Internal-Control Integrated Framework for assessing the effectiveness of internal controls over financial reporting. The Company adopted such updated criteria, which changed the manner in which the Company assesses its internal controls over financial reporting, effective December 31, 2016. In the future, there may be further changes to the criteria used to assess the effectiveness of internal controls, which may result in the Company expending more resources to assess its internal controls.

Failure to maintain effective systems of internal controls over financial reporting could have a material adverse effect on our results of operations and financial condition disclosures.

We must have effective internal controls over financial reporting in order to provide reliable financial reports, to effectively prevent fraud, and to operate successfully as a public company. If we were unable to provide reliable financial reports or prevent fraud, our reputation and operating results would be harmed. As part of our ongoing monitoring of our internal controls over financial reporting, we may discover material weaknesses or significant deficiencies requiring remediation. A "material weakness" is a deficiency, or a combination of deficiencies, in internal controls over financial reporting, such that there is a reasonable possibility that a material misstatement of a company's annual or interim financial statements will not be prevented or detected on a timely basis.

We continually work to improve our internal controls; however, we cannot be certain that these measures will ensure appropriate and adequate controls over our future financial processes and reporting. Any failure to maintain effective controls or to timely implement any necessary improvement of our internal controls could, among other things, result in losses from fraud or error, harm our reputation, or cause investors to lose confidence in our reported financial information, each of which could have a material adverse effect on our results of operations and financial condition and the market value of our common stock.

We may be required to increase our allowance for credit losses as a result of a recent change to an accounting standard.

In 2016, the FASB released a new standard for determining the amount of the allowance for credit losses. The new standard will be effective for the Company for reporting periods beginning January 1, 2020. The new credit loss model will be a significant change from the standard in place today, as it requires the allowance for credit losses to be calculated based on current expected credit losses (commonly referred to as the “CECL model”) rather than losses inherent in the portfolio as of a point in time. Because the new CECL model focuses on the life of the loan concept, more data will be required to support allowance estimates, including that loan portfolios will need to be broken down by origination year. As a result, audit and disclosure requirements will increase. The extent of the increase is under evaluation, but will depend upon the nature and characteristics of the Company’s loan portfolio at the adoption date, and the macroeconomic conditions and forecasts at that date. As a result, the potential financial impact is currently unknown.

The fair value of our investment securities can fluctuate due to market conditions out of our control.

As of December 31, 2018, approximately 77% of our investment securities portfolio was comprised of U.S. government agency and sponsored enterprises obligations, U.S. government agency and sponsored enterprises' mortgage backed securities and municipal securities. As of December 31, 2018, the fair value of our investment portfolio was approximately $212.4 million. Factors beyond our control can significantly influence the fair value of securities in our portfolio and can cause potential adverse changes to the fair value of these securities. These factors include, but are not limited to, ratings agency downgrades of the securities, defaults by the issuer or with respect to the underlying securities, changes in market interest rates and instability in the credit markets. Any of these mentioned factors, among others, could cause other-than-temporary impairments in future periods and result in a realized loss, which could have a material adverse effect on our business. The process for determining whether impairment is other-than-temporary usually requires complex, subjective judgements about the future financial performance of the issuer and any collateral underlying the security in order to assess the probability of receiving all contractual principal and interest payments on the security.

Because of changing economic and market conditions affecting issuers and the performance of underlying collateral, we may recognize realized and/or unrealized losses in future periods, which could have an adverse effect on our financial condition and results of operations.

The Company encounters continuous technological change.

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and may reduce costs. The Company's future success depends, in part, upon its ability to address the needs of its customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in the Company's operations. Many of the Company's competitors have substantially greater resources to invest in technological improvements. The Company may not be able to effectively implement new technology-driven products and services or to successfully market these products and services to its customers. Failure to keep pace with technological change affecting the financial services industry could have a material adverse impact on the Company’s business and, in turn, the Company’s financial condition and results of operations.

The Company is subject to operational risk.

We rely on certain external vendors to provide products and services necessary to maintain our day-to-day operations. These third parties provide key components of our business operations such as data processing, recording and monitoring transactions, online banking interfaces and services, Internet connections and network access. While we have selected these third-party vendors carefully, we do not control their actions. Any complications caused by these third parties, including those resulting from disruptions in communication or electrical services provided by a vendor, failure of a vendor to handle current or higher volumes, cyber-attacks and security breaches at a vendor, failure of a vendor to provide services for any reason or poor performance of services, could adversely affect our ability to deliver products and services to our customers and otherwise conduct our business. Financial or operational difficulties of a third-party vendor could also hurt our operations if those difficulties interfere with the vendor’s ability to provide services. Furthermore, our vendors could also be sources of operational and information security risk, including from breakdowns or failures of their own systems or capacity constraints. Replacing these third-party vendors could also create significant delay and expense. Problems caused by external vendors could be disruptive to our operations, which could have a material adverse impact on our business, financial condition and results of operations.

Loss of, or failure to adequately safeguard, confidential or proprietary information may adversely affect the Company’s business, financial operations or reputation.

The Company regularly collects, processes, transmits and stores significant amounts of confidential information regarding its customers, employees and others. This information is necessary for the conduct of the Company’s business activities, including the ongoing maintenance of deposit, loan and other account relationships for the Bank's customers, and receiving instructions and affecting transactions for those customers and other users of the Bank’s products and services. In addition to confidential information regarding its customers, employees and others, the Company compiles, processes, transmits and stores proprietary, non-public information concerning its own business, operations, plans and strategies. In some cases, this confidential or proprietary information is collected, compiled, processed, transmitted or stored by third parties on behalf of the Company.

Information security risks have generally increased in recent years because of the proliferation of new technologies and the increased sophistication and activities of perpetrators of cyber-attacks. Although cybersecurity incidents in the financial services industry are on the rise, we have not experienced any losses relating to cyber-attacks or other information security breaches. However, there can be no assurance that we will not suffer such losses in the future. A failure in or breach of the Company’s operational or information security systems, or those of the Company’s third-party service providers, as a result of cyber-attacks or information security breaches or due to employee error, malfeasance or other disruptions could adversely affect its business, result in the disclosure or misuse of confidential or proprietary information, damage its reputation, increase its costs and/or cause losses. The Company may also be required to expend significant additional resources to modify its protective measures, to investigate and remediate vulnerabilities or other exposures or to make required notifications or disclosure. As a result, cyber security and the continued development and enhancement of the controls and processes designed to protect the Company’s systems, computers, software, data and networks from attack, damage or unauthorized access are a very high priority for the Company.

If this confidential or proprietary information were to be mishandled, misused or lost, the Company could be exposed to significant regulatory consequences, reputational damage, civil litigation and financial loss. Mishandling, misuse or loss of this confidential or proprietary information could occur, for example, if the confidential or proprietary information were erroneously provided to parties who are not permitted to have the information, either by fault of the systems or employees of the Company, or the systems or employees of third parties which have collected, compiled, processed, transmitted or stored the information on the Company's behalf, where the information is intercepted or otherwise inappropriately taken by third parties or where there is a failure or breach of the network, communications or information systems which are used to collect, compile, process, transmit or store the information.

The Company continues to implement protections and adopt procedures to address the risks posed by the current information technology environment. For example, the Company has and continues to introduce systems and software to prevent cyber incidents and continues to review and strengthen its defenses to cybersecurity threats through the use of various services, programs and outside vendors. The Company also continually reviews and revises its cybersecurity policy to ensure that it remains up to date. In the event that the Company experiences a material cybersecurity incident or identifies a material cybersecurity threat, the Company will make all reasonable efforts to properly disclose it in a timely fashion. However, it is impossible for the Company to know when or if such incidents may arise or the business impact of any such incident.

As a result of such risks, the Company has significantly increased the resources dedicated to this effort and believes that further increases may be required in the future, in anticipation of increases in the sophistication and persistency of such attacks. The Company has and is likely to continue to incur additional costs in preparing its infrastructure and maintaining it to resist any such attacks. In addition to personnel dedicated to overseeing the infrastructure and systems to defend against cybersecurity incidents, senior management is regularly briefed on issues, preparedness and any incidents requiring response. At its regularly scheduled meetings, the Audit Committee of the Board of Directors and the Board of Directors are periodically briefed and brought up to date on cybersecurity matters.

Notwithstanding the precaution we need to take to safeguard this confidential and proprietary information from mishandling, misuse or loss, these precautions do not provide absolute assurance that mishandling, misuse or loss of the information will not occur, or that if mishandling, misuse or loss of the information did occur, those events would be promptly detected and addressed. Nor is there any guarantee that the Company's cybersecurity efforts will be successful in discovering or preventing a security breach, and any failure or failures to safeguard against such security breaches may have a material adverse impact on the Company’s business, financial results, or reputation

Possible replacement of the LIBOR benchmark interest rate may have an impact on our business, financial condition or results of operations.

On July 27, 2017, the Financial Conduct Authority (FCA), a regulator of financial services firms in the United Kingdom, announced that it intends to stop persuading or compelling banks to submit LIBOR rates after 2021. The FCA and submitting LIBOR banks have indicated they will support the LIBOR indices through 2021 to allow for an orderly transition to an alternative reference rate. In the United States, efforts to identify a set of alternative U.S. dollar reference interest rates include proposals by the Alternative Reference Rates Committee of the Federal Reserve Board. Other financial services regulators and industry groups are evaluating the possible phase-out of LIBOR and the development of alternate reference rate indices or reference rates. Some of our assets and liabilities are indexed to LIBOR. We are evaluating the potential impact of the possible replacement of the LIBOR benchmark interest rate, but are not able to predict whether LIBOR will cease to be available after 2021, whether the alternative rates the Federal Reserve Board proposes to publish will become market benchmarks in place of LIBOR, or what the impact of such a transition will have on our business, financial condition, or results of operations. Reform of, or the replacement or phasing out of, LIBOR and proposed regulation of LIBOR and other “benchmarks” may materially adversely affect the amount of interest paid on any LIBOR-based loans, investment securities and borrowings of the Company and the Company’s business, financial condition and results of operations.

We may not be able to detect money laundering and other illegal or improper activities fully or on a timely basis, which could expose us to additional liability and could have a material adverse effect on us.

We are required to comply with anti-money laundering, anti-terrorism and other laws and regulations in the United States. These laws and regulations require us, among other things, to adopt and enforce “know-your-customer” policies and procedures and to report suspicious and large transactions to applicable regulatory authorities. These laws and regulations have become increasingly complex and detailed, require improved systems, sophisticated monitoring and compliance personnel and have become the subject of enhanced government supervision.

While we have adopted policies and procedures aimed at detecting and preventing the use of our banking network for money laundering and related activities, those policies and procedures may not completely eliminate instances in which we may be used by customers to engage in money laundering and other illegal or improper activities. To the extent we fail to fully comply with applicable laws and regulations, the FDIC and/or with other banking agencies have the authority to impose fines and other penalties on us. In addition, our business and reputation could suffer if customers use our banking network for money laundering or illegal or improper purposes. At its regularly scheduled meetings, the Audit Committee of the Board of Directors and the Board of Directors are periodically briefed and brought up to date on money laundering and related matters.

There may be claims and litigation.

From time to time as part of the Company's normal course of business, customers make claims and take legal actions against the Company based on actions or inactions of the Company. If such claims and legal actions are not resolved in a manner favorable to the Company, they may result in financial liability and/or adversely affect the market perception of the Company and its products and services. This may also impact customer demand for the Company's products and services. Any financial liability or reputation damage could have a material adverse effect on the Company's business, which, in turn, could have a material adverse effect on its financial condition and results of operations.

Severe weather, acts of terrorism and other external events could significantly impact our business.

A significant portion of our primary markets are located near coastal waters which could generate naturally occurring severe weather, or in response to climate change, that could have a significant impact on our ability to conduct business. Additionally, surrounding areas, including New Jersey, may be central targets for potential acts of terrorism against the United States. Such events could affect the stability of our deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue and/or cause additional expenses. Although the Company has established disaster recovery policies and procedures, the occurrence of any such event in the future could have a material adverse effect on our business, which, in turn, could have a material adverse effect on our financial condition and results of operations.

Item 1B. Unresolved Staff Comments.

Not applicable.

Item 2. Properties.

We currently operate 20 bank branch offices in New Jersey, including the Bank's main office in Cranbury, New Jersey. In addition, there is an Operations Center which is leased in Cranbury, New Jersey. The following table provides certain information with respect to our bank branch offices as of February 28, 2019:

Location	Leased or Owned	Original Year Leased or Acquired	Year of Lease Expiration
Main Office 2650 Route 130 Cranbury, New Jersey	Leased	1989	2027
Village Office 74 North Main Street Cranbury, New Jersey	Owned	2005	—
Plainsboro Office Plainsboro Village Center 11 Shalks Crossing Road Plainsboro, New Jersey	Leased	1998	2021
Hamilton Square Office 3659 Nottingham Way Hamilton, New Jersey	Leased	1999	2024
Princeton Office The Windrows at Princeton Forrestal 2000 Windrow Drive Princeton, New Jersey	Leased	2001	2019
Perth Amboy Office 145 Fayette Street Perth Amboy, New Jersey	Leased	2003	2026
Jamesburg Office 1 Harrison Street Jamesburg, New Jersey	Owned	2002	—
Fort Lee Office 180 Main Street Fort Lee, New Jersey	Leased	2006	2024
Hightstown Office 140 Mercer Street Hightstown, New Jersey	Leased	2007	2024
Lawrenceville Property 150 Lawrenceville-Pennington Road Lawrenceville, New Jersey	Owned	2009	—
South River Operations Center 1246 South River Road, Bldg. 2 Cranbury, New Jersey	Leased	2010	2020
Rocky Hill Office 995 Route 518 Skillman, New Jersey	Owned	2011	—
Hopewell Office 86 East Broad Street Hopewell, New Jersey	Owned	2011	—

Hillsborough Office 32 New Amwell Road Hillsborough, New Jersey	Owned	2011	—
Rumson Office 20 Bingham Avenue Rumson, New Jersey	Leased	2014	2026

24

Location	Leased or Owned	Original Year Leased or Acquired	Year of Lease Expiration
Fair Haven Office 636 River Road Fair Haven, New Jersey	Leased	2014	2022
Asbury Park Office 511 Cookman Avenue Asbury Park, New Jersey	Owned	2014	—
Shrewsbury Office 500 Broad Street Shrewsbury, New Jersey	Leased	2014	2031
Little Silver Office 517 Prospect Avenue Little Silver, New Jersey	Leased	2015	2019(1)
Freehold Office 3441 US Highway 9 Freehold, New Jersey	Leased	2018	2022
Neptune City Office 118 3rd Avenue Neptune City, New Jersey	Leased	2018	2022

Management believes the foregoing facilities are suitable for the Company’s and the Bank’s present and projected operations.

(1) The current lease period expires on July 31, 2019 and the lease involves one lease extension for a period of 5 years. The Company expects to exercise the lease extension option.

Item 3. Legal Proceedings.

The Company may, in the ordinary course of business, become a party to litigation involving collection matters, contract claims and other legal proceedings relating to the conduct of its business. Management is not aware of any material pending legal proceedings against the Company which, if determined adversely, would have a material adverse effect on the Company’s financial condition or results of operations.

Item 4. Mine Safety Disclosures.

Not applicable.

PART II

Item 5. Market for Registrant’s Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities.

The common stock of the Company trades on the Nasdaq Global Market under the trading symbol FCCY. On February 28, 2019, there were approximately 292 registered shareholders of record.

Performance

The following graph compares the cumulative total return on a hypothetical $100 investment made on December 31, 2013 in (a) the Company's common stock; (b) the SNL US Bank & Thrift Index; (c) the SNL US Bank $500M-$1B Index; and (d) the SNL US Bank $1B-$5B Index. The graph is calculated assuming that all dividends are reinvested during the relevant periods. The graph shows how a $100 investment would increase or decrease in value over time, based on dividends (stock or cash) and increases or decreases in the market price of the stock.

	Period Ending					
Index	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017	12/31/2018
1st Constitution Bancorp	100.00	99.00	122.85	188.64	186.26	205.36
SNL US Bank & Thrift	100.00	111.63	113.89	143.78	169.07	140.05
SNL US Bank $500M-$1B	100.00	109.71	123.83	167.20	203.98	196.88
SNL US Bank $1B-$5B	100.00	104.56	117.04	168.38	179.51	157.27

On December 31, 2018, the last reported sale price of the Company's common stock was $19.93.

The timing and the amount of the payment of future cash dividends, if any, on the Company's common shares will be at the discretion of the Company's Board of Directors and will be determined after consideration of various factors, including the level of earnings, cash requirements, regulatory capital and financial condition.

Issuer Purchases of Equity Securities

On January 21, 2016, the Board of Directors of the Company authorized a new common stock repurchase program. Under the new common stock repurchase program, the Company may repurchase in open market or privately negotiated transactions up to five (5%) percent of its common stock outstanding on the date of approval of the stock repurchase program, which limitations will be adjusted for any future stock dividends. The Company's common stock repurchase program covers a maximum of 396,141 shares of common stock of the Company, representing 5% of the outstanding common stock of the Company on January 21, 2016, as adjusted for subsequent common stock dividends. There were no repurchases under the plan during 2018.

Period		Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased As Part of Publicly Announced Program	Maximum Number of Shares That May Yet be Purchased Under the Program
Beginning	Ending				
October 1, 2018	October 31, 2018	—	$ ——		394,141
November 1, 2018	November 30, 2018	—	—	—	394,141
December 1, 2018	December 31, 2018	—	—	—	394,141
Total		—	$ ——		394,141

Sales of Unregistered Securities

None.

Equity Compensation Plan Information

The following table shows information at December 31, 2018 for all equity compensation plans under which shares of our common stock may be issued.

	Number of Securities to be Issued Upon Exercise of Outstanding Options	Weighted-Average Exercise Price of Outstanding Options	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (excluding securities reflected in column (a))
Plan Category	(a)	(b)	(c)
Equity Compensation Plans Approved by Security Holders	139,511	$ 8.70	55,136
Equity Compensation Plans Not Approved by Security Holders	—	—	—

Total	139,511	$ 8.70	55,136

Item 6. Selected Financial Data

	As of and for the years ended December 31,				
(In thousands, except per share data)	2018	2017	2016	2015	2014
Summary earnings:					
Interest income	$51,473	$41,663	$39,135	$39,323	$35,888
Interest expense	8,041	5,498	5,158	4,636	4,658
Net interest income	43,432	36,165	33,977	34,687	31,230
Provision (credit) for loan losses	900	600	(300)	1,100	5,750
Net interest income after provision (credit) for loan losses	42,532	35,565	34,277	33,587	25,480
Non-interest income	7,918	8,240	6,922	6,586	6,814
Non-interest expense	34,085	31,006	27,291	27,447	26,865
Income before income tax expense	16,365	12,799	13,908	12,726	5,429
Income tax expense	4,317	5,871	4,623	4,062	1,073
Net income	$12,048	$6,928	9,285	$8,664	$4,356
Per share data:					
Earnings per share - basic	$1.45	$0.86	$1.17	$1.1	$0.56
Earnings per share - diluted	1.40	0.83	1.14	1.07	0.55
Cash dividends declared	0.255	0.16	0.10	—	—
Book value end-of-period (1)	14.77	13.81	13.11	12.72	12.21
Basic weighted average shares outstanding	8,320,718	8,049,981	7,962,121	7,901,278	7,366,955
Common stock equivalents (dilutive)	272,791	262,803	215,318	174,474	368,348
Fully diluted weighted average shares outstanding	8,593,509	8,312,784	8,177,439	8,075,752	7,735,303
Balance sheet data (at period end):					
Total assets	$1,177,833	$1,079,274	$1,038,213	$967,991	$956,779
Securities, available for sale	132,222	105,458	103,794	91,422	80,161
Investment securities	79,572	110,267	126,810	123,261	143,638
Total loans	883,164	789,906	724,808	682,121	654,297
Allowance for loan losses	(8,402)	(8,013)	(7,494)	(7,560)	(6,925)
Total deposits	950,672	922,006	834,516	786,757	817,761
Shareholders' equity	127,085	111,653	104,801	95,960	87,110
Common cash dividends	2,120	1,289	800	—	—
Selected performance ratios:					
Return on average total assets	1.06%	0.67%	0.93%	0.89%	0.46%
Return on average shareholders' equity	10.11%	6.36%	9.21%	9.49%	5.34%
Dividend payout ratio (2)	17.60%	18.61%	8.62%	n/a	n/a
Net interest margin	4.09%	3.81%	3.70%	3.90%	3.84%
Non-interest income to average assets	0.70%	0.80%	0.69%	0.67%	0.61%
Non-interest expenses to average assets	3.00%	3.01%	2.72%	2.81%	2.89%
Nonperforming loans to total loans	0.75%	0.90%	0.72%	0.88%	0.74%
Nonperforming assets to total assets	0.77%	0.66%	0.52%	0.72%	1.11%
Allowance for loan losses to nonperforming loans	127.69%	112.64%	144.17%	125.59%	143.08%
Allowance for loan losses to total loans	0.95%	1.01%	1.03%	1.11%	1.06%
Net recoveries (charge-offs) to average loans	(0.06)%	(0.01)%	0.03%	(0.07)%	(1.04)%

(1) Book value at end-of-period calculated by dividing shareholders' equity by number of outstanding common shares at end of period.

(2) Dividend payout ratio calculated by dividing dividends declared during the year by net income.

	As of and for the years ended December 31,				
(In thousands, except per share data)	2018	2017	2016	2015	2014
Liquidity and capital ratios:					
Average loans to average deposits	87.28%	81.80%	84.58%	83.39%	69.15%
Total shareholders' equity to total assets	10.79%	10.35%	10.09%	9.91 %	9.10 %
Total capital to risk-weighted assets	13.17%	12.84%	13.24%	13.08%	12.28%
Tier 1 capital to risk-weighted assets	12.39%	12.02%	12.41%	12.18%	11.41%
Common equity tier 1 capital ratio to risk-weighted assets	10.72%	10.19%	10.4 %	10.03%	n/a
Tier 1 leverage ratio	11.73%	11.23%	10.93%	10.80%	9.53 %

Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

Overview

The following discussion and analysis is intended to provide information about the financial condition and results of operations of 1st Constitution Bancorp and its subsidiaries on a consolidated basis and should be read in conjunction with the consolidated financial statements and the related notes and supplemental financial information appearing elsewhere in this report.

1st Constitution Bancorp (the "Company"), formed in 1999, is the parent holding company for 1st Constitution Bank (the "Bank"), a commercial bank formed in 1989 that provides a wide range of financial services to consumers, businesses and government entities. The Bank's branch network primarily serves Central New Jersey and offers consumer and business banking products delivered through a network of well-trained staff dedicated to a positive client experience and enhancing shareholder value. Much of the Company's lending activity is in Northern and Central New Jersey and the New York metropolitan area. For purposes of the discussion below, 1st Constitution Capital Trust II (Trust II), a subsidiary of the Company, is not included in the Company's consolidated financial statements as it is a variable interest entity and the Company is not the primary beneficiary.

On April 11, 2018, the Company completed the merger of NJCB with and into the Bank (the "NJCB Merger"). The NJCB merger contributed approximately $95 million in assets, approximately $75 million in loans, and approximately $87 million in deposits.

Critical Accounting Policies and Estimates

Management’s Discussion and Analysis of Financial Condition and Results of Operations is based upon the Company’s consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"). The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. Note 1 to the Company’s Consolidated Financial Statements for the year ended December 31, 2018 contains a summary of the Company’s significant accounting policies.

Management believes that the Company’s policies with respect to the methodologies for the determination of the allowance for loan losses and for determining other-than-temporary security impairment involve a higher degree of complexity and requires management to make difficult and subjective judgments, which often require assumptions or estimates about highly uncertain matters. Changes in these judgments, assumptions or estimates could materially impact results of operations. These critical policies and their application are periodically reviewed with the Audit Committee and the Board of Directors.

The provision for loan losses is based upon management's evaluation of the adequacy of the allowance, including an assessment of known and inherent risks in the portfolio, after giving consideration to the size and composition of the loan portfolio, actual loan loss experience, level of delinquencies, detailed analysis of individual loans for which full collectability may not be assured, the existence and estimated net realizable value of any underlying collateral and guarantees securing the loans and current economic and market conditions. Although management uses the best information available, the level of the allowance for loan losses remains an estimate, which is subject to significant judgment and short-term change. Various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to make additional provisions for loan losses based upon information available to them at the time of their examination. Furthermore, the majority of the Company's loans are secured by real estate in the State of New Jersey. Accordingly, the collectability of a substantial portion of the carrying value of the Company's loan portfolio is susceptible to changes in local market conditions and may be adversely affected should real estate values decline or should the New Jersey market area experience adverse economic conditions. Future adjustments to the allowance for loan losses may be necessary due to economic, operating, regulatory and other conditions beyond the Company's control.

Real estate acquired through foreclosure, or a deed-in-lieu of foreclosure, is recorded at fair value less estimated selling costs at the date of acquisition or transfer and, subsequently, fair value less estimated selling costs. Adjustments to the carrying value at the date of acquisition or transfer are charged to the allowance for loan losses. The carrying value of the individual properties is subsequently adjusted to estimated fair value less estimated selling costs, at which time a provision for losses on such real estate is charged to operations if it is lower. Appraisals are critical in determining the fair value of the other real estate owned ("OREO") amount. Assumptions for appraisals are instrumental in determining the value of properties. Overly optimistic assumptions or negative changes to assumptions could significantly affect the valuation of a property. The assumptions supporting such appraisals are carefully reviewed by management to determine that the resulting values reasonably reflect amounts realizable.

Debt securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Debt securities are classified as available for sale when they might be sold before maturity due to changes in interest rates, prepayment risk, liquidity or other factors. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax.

Management utilizes various inputs to determine the fair value of its investment portfolio. To the extent they exist, unadjusted quoted market prices in active markets for identical investments (level 1) or quoted prices on similar assets (level 2) are utilized to determine the fair value of each investment in the portfolio. In the absence of quoted prices, valuation techniques would be used to determine fair value of any investments that require inputs that are both significant to the fair value measurement and unobservable (level 3). Valuation techniques are based on various assumptions, including, but not limited to, cash flows, discount rates, rate of return, adjustments for nonperformance and liquidity and liquidation values. A significant degree of judgment is involved in valuing investments using level 3 inputs. The use of different assumptions could have a positive or negative effect on the Company's consolidated financial condition or results of operations.

Securities are evaluated on at least a quarterly basis to determine whether a decline in fair value is other-than-temporary. To determine whether a decline in value is other-than-temporary, management considers the reasons underlying the decline, including, but not limited to, the length of time an investment's book value is greater than fair value, the extent and duration of the decline and the near-term prospects of the issuer as well as any credit deterioration of the investment. If the decline in value of an investment is deemed to be other-than-temporary, the entire difference between amortized cost and fair value is recognized as impairment through earnings.

The Company records income taxes using the asset and liability method. Accordingly, deferred tax assets and liabilities are recognized for the expected future tax consequences of events that have been recognized in the financial statements or tax returns; are attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases; and are measured using enacted tax rates expected to apply in the years when those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income tax expense in the period of enactment.

Deferred tax assets are recorded on the consolidated balance sheet at net realizable value. The Company periodically performs an assessment to evaluate the amount of deferred tax assets that it is more likely than not to realize. Realization of deferred tax assets is dependent upon the amount of taxable income expected in future periods as tax benefits require taxable income to be realized. If a valuation allowance is required, the deferred tax asset on the consolidated balance sheet is reduced via a corresponding income tax expense in the consolidated statement of income.

30

Earnings Summary

2018 compared to 2017

The Company reported net income of $12.0 million for the year ended December 31, 2018 compared to net income of $6.9 million for the year ended December 31, 2017. Diluted earnings per share were $1.40 for the year ended December 31, 2018 compared to diluted earnings per share of $0.83 for the year ended December 31, 2017. For the year ended December 31, 2018, net income increased $5.1 million, or 73.9%, and net income per diluted share increased $0.57.

On April 11, 2018, the Company completed the merger of NJCB with and into the Bank. As a result of the NJCB merger, merger-related expenses of $2.1 million were incurred and the after-tax effect of the merger expenses reduced net income for the year ended December 31, 2018 by $1.6 million. The acquisition method of accounting for the business combination resulted in the recognition of a gain on the bargain purchase of $230,000 and no goodwill. For the year ended December 31, 2017, the Company recorded $265,000 in merger-related expenses. As a result of the enactment of the Tax Cuts and Jobs Act (“Tax Act”) on December 22, 2017, which reduced the maximum federal corporate income tax rate from 35% to 21% beginning in 2018, the Company revalued its net deferred tax assets to reflect the lower federal corporate income tax rate that would be in effect in future years which resulted in an additional $1.7 million of income tax expense due to the revaluation of the Company’s deferred tax assets.

Excluding the gain on bargain purchase, the merger-related expenses and the additional income tax expense, Adjusted Net Income for the year ended December 31, 2018 was $13.4 million, or $1.56 per diluted share, compared to Adjusted Net Income of $8.8 million, or $1.06 per diluted share, for the year ended December 31, 2017. Adjusted Net Income for 2018 increased $4.5 million or 51.4% compared to Adjusted Net Income for 2017. The increase was due primarily to an increase of $7.3 million in net interest income, which was partially offset by an increase of $300,000 in the provision for loan losses, an increase of $3.1 million in non-interest expense and a decrease of $322,000 in non-interest income. The NJCB merger contributed $960,000 to the net income and Adjusted net income for the year ended December 31, 2018.

Return on average total assets (“ROAA”) and return on average shareholders' equity (“ROAE”) were 1.06% and 10.11%, respectively, for the year ended December 31, 2018 compared to 0.67% and 6.36%, respectively, for the year ended December 31, 2017. Excluding the gain on bargain purchase, the merger-related expenses and the additional income tax expense, ROAA and ROAE were 1.17% and 11.21%, respectively, for the year ended December 31, 2018 compared to 0.86% and 8.10%, respectively, for the year ended December 31, 2017.

Adjusted net income, Adjusted earnings per diluted share, Adjusted ROAA and Adjusted ROAE are non-GAAP financial measures. These non-GAAP financial measures should be considered in addition to, but not as a substitute for, the Company's GAAP financial results. Management believes that the presentation of these non-GAAP financial measures of the Company may be helpful to readers in understanding the Company's financial performance without including the gain on bargain purchase and the merger-related expenses of the NJCB merger and the revaluation of the deferred tax assets when comparing the Company's income statements for the years ended December 31, 2018 and 2017, and for the years ended December 31, 2017 and 2016.

The table below shows the major components of net income for the years ended December 31, 2018 and 2017 and a reconciliation of the non-GAAP measures to reported net income discussed above.

			Change in	
(Dollars in thousands)	2018	2017	$	%
Net interest income	$43,432	$36,165	$7,267	20.1 %
Provision for loan losses	900	600	300	50.0 %
Non-interest income	7,918	8,240	(322)	(3.9)%
Non-interest expense	34,085	31,006	3,079	9.9 %
Net income before income taxes	16,365	12,799	3,566	27.9 %
Income taxes	4,317	5,871	(1,554)	(26.5)%
Net income	12,048	6,928	5,120	73.9 %
Adjustments:				
Revaluation of deferred tax assets	(28)	1,712	(1,740)	N.M.
Merger-related expenses	2,141	265	1,876	707.9 %
Gain on bargain purchase	(230)	—	(230)	N.M.
Income tax effect of adjustments	(568)	(77)	(491)	637.7 %
Total adjustments	1,315	1,900	(585)	(30.8)%
Adjusted net income	$13,363	$8,828	$4,535	51.4 %
Earnings per common share:				
Basic, as reported	$1.45	$0.86	$0.59	68.6 %
Adjustments	0.16	0.24	(0.08)	(33.3)%
Basic, as adjusted	$1.61	$1.10	$0.51	46.4 %
Diluted, as reported	$1.40	0.83	$0.57	68.7 %
Adjustments	0.16	0.23	(0.07)	(30.4)%
Diluted, as adjusted	$1.56	$1.06	$0.50	47.2 %
Return on average total assets:				
As reported	1.06 %	0.67 %		
Adjusted net income	$13,363	$8,828		
Average assets	1,137,768	1,031,796		
As adjusted	1.17 %	0.86 %		
Return on average shareholders' equity:				
As reported	10.11 %	6.36 %		
Adjusted net income	$13,363	$8,828		
Average shareholders' equity	119,212	108,925		
As adjusted	11.21 %	8.10 %		

32

2017 compared to 2016

The Company reported net income of $6.9 million or $0.83 per diluted share for the year ended December 31, 2017 compared to net income of $9.3 million or $1.14 per diluted share for the year ended December 31, 2016. For the year ended December 31, 2017, net income decreased $2.4 million, or 25.4%, and net income per diluted share decreased $0.31.

The decrease in net income for 2017 compared to 2016 included additional estimated income tax expense of $1.7 million, or $0.21 per diluted share, due to the revaluation of the Company's net deferred tax assets. As a result of the enactment of the Tax Act on December 22, 2017, which reduced the maximum federal corporate income tax rate from 35% to 21% beginning in 2018, the Company revalued its net deferred tax assets to reflect the lower federal corporate income tax rate that would be in effect in future years. Additionally, merger-related expenses on an after-tax basis of $188,000, or $0.02 per diluted share, related to the then-pending NJCB merger with and into the Bank, were incurred during the fourth quarter of 2017.

Excluding the additional income tax expense and the merger-related expenses, adjusted net income for the year ended December 31, 2017 was $8.8 million, or $1.06 per diluted share, compared to net income for the year ended December 31, 2016 of $9.3 million, or $1.14 per diluted share, reflecting a decrease of $457,000, or 4.9%, compared to 2016. This decrease was due primarily to an increase of $900,000 in the provision for loan losses and an increase in non-interest expense of $3.7 million, which were partially offset by an increase in net interest income of $2.2 million and an increase of $1.3 million in non-interest income.

ROAA and ROAE were 0.67% and 6.36%, respectively, for the year ended December 31, 2017 compared to 0.93% and 9.21%, respectively, for the year ended December 31, 2016. Excluding the additional income tax expense and the merger-related expense, adjusted ROAA and adjusted ROAE for the year ended December 31, 2017 were 0.86% and 8.10%, respectively.

If the lower federal corporate income tax rate had been in effect in 2017, the Company's reported 2017 income tax expense of $5.9 million, excluding the $1.7 million of tax expense due to the revaluation of the net deferred tax assets, would have been approximately $2.9 million, or $1.3 million lower.

The table below shows the major components of net income for the years ended December 31, 2017 and 2016 and a reconciliation of the non-GAAP measures to reported net income discussed above.

			Change in	
(Dollars in thousands)	2017	2016	$	%
Net interest income	$36,165	$33,977	$2,188	6.4 %
Provision (credit) for loan losses	600	(300)	900	(300.0)
Non-interest income	8,240	6,922	1,318	19.0
Non-interest expense	31,006	27,291	3,715	13.6
Net income before income taxes	12,799	13,908	(1,109)	(8.0)
Income taxes	5,871	4,623	1,248	27.0
Net income	6,928	9,285	(2,357)	(25.4)%
Adjustments:				
Revaluation of deferred tax assets	1,712	—	1,712	N.M.
Merger-related expenses	265	—	265	N.M.
Income tax effect of adjustments	(77)	—	(77)	N.M.
Total adjustments	1,900	—	1,900	N.M.
Adjusted net income	$8,828	$9,285	$(457)	(4.9)%
Earnings per common share:				
Basic, as reported	$0.86	$1.17	$(0.31)	(26.5)%
Adjustments	0.24	—	0.24	N.M.
Basic, as adjusted	$1.10	$1.17	$(0.07)	(6.0)%
Diluted, as reported	$0.83	1.14	$(0.31)	(27.2)%
Adjustments	0.23	—	0.23	N.M.
Diluted, as adjusted	$1.06	$1.14	$(0.08)	(7.0)%
Return on average total assets:				
As reported	0.67 %	0.93 %		
Adjusted net income	$8,828	$9,285		
Average assets	1,031,796	1,001,769		
As adjusted	0.86 %	0.93 %		
Return on average shareholders' equity:				
As reported	6.36 %	9.21 %		
Adjusted net income	$8,828	$9,285		
Average shareholders' equity	108,925	100.807		
As adjusted	8.10 %	9.21 %		

Net Interest Income and Net Interest Margin

Net interest income, the Company’s largest and most significant component of operating income, is the difference between interest and fees earned on loans, investment securities and other earning assets and interest paid on deposits and borrowed funds. This component represented 85%, 81% and 83% of the Company’s net revenues (net interest income plus non-interest income) for the years ended December 31, 2018, 2017 and 2016, respectively. Net interest income is determined by the difference between the yields earned on earning assets and the rates paid on interest-bearing liabilities ("Net Interest Spread") and the relative amounts of average earning assets and average interest-bearing liabilities. The Company's net interest spread is affected by the monetary policy of the Federal Reserve Board, and regulatory, economic and competitive factors that influence interest rates, loan demand and deposit flows as well as general levels of nonperforming assets.

The following table summarizes the Company's net interest income and related spread and margin for the periods indicated:

	Years ended December 31,					
(Dollars in thousands)	2018		2017		2016	
Net interest income	$43,432		$36,165		$33,977	
Interest rate spread	3.81	%	3.58	%	3.50	%
Net interest margin	4.09		3.81		3.70	

35

The following tables compare the Company’s consolidated average balance sheets, interest income and expense, net interest spreads and net interest margins for the years ended December 31, 2018, 2017 and 2016 (on a fully tax-equivalent basis). The average rates are derived by dividing interest income and expense by the average balance of assets and liabilities, respectively.

	December 31, 2018		
(In thousands except yield/cost information)	Average Balance	Interest	Average Yield/Cost
Assets			
Interest-earning assets:			
Federal funds sold/short term investments	$20,157	$258	1.28 %
Investment securities:			
Taxable	146,631	4,024	2.74
Tax-exempt (1)	74,477	2,518	3.38
Total investment securities	221,108	6,542	2.96
Loans: (2)			
Commercial real estate	356,581	18,318	5.07
Mortgage warehouse lines	153,868	8,403	5.46
Construction	137,976	9,090	6.59
Commercial business	111,150	6,059	5.45
Residential real estate	46,301	2,085	4.44
Loans to individuals	23,155	1,083	4.61
Loans held for sale	2,738	123	4.49
All other loans	1,197	41	3.38
Total loans	832,966	45,202	5.38
Total interest-earning assets	1,074,231	52,002	4.81 %
Non-interest-earning assets:			
Allowance for loan losses	(8,314)		
Cash and due from bank	5,595		
Other assets	66,256		
Total non-interesting-earning assets	63,537		
Total assets	$1,137,768		
Liabilities and Shareholders' Equity			
Interest-bearing Liabilities:			
Money market and NOW accounts	$356,906	$1,978	0.55 %
Savings accounts	203,940	1,467	0.72
Certificates of deposit	189,521	3,066	1.62
Other borrowed funds	36,612	836	2.28
Redeemable subordinated debentures	18,557	694	3.74
Total interest-bearing liabilities	805,536	8,041	1.00 %
Non-interest-bearing liabilities:			
Demand deposits	204,002		
Other liabilities	9,018		
Total non-interest-bearing liabilities	213,020		
Shareholders' equity	119,212		
Total liabilities and shareholders' equity	$1,137,768		
Net interest spread (3)			3.81 %
Net interest income and margin (4)		$43,961	4.09 %

(1) Tax-equivalent basis, using 21% federal tax rate in 2018.
(2)

Loan origination fees and costs are considered an adjustment to interest income. For the purpose of calculating loan yields, average loan balances include non-accrual loans with no related interest income and average balance of loans held for sale.

(3) The net interest rate spread is the difference between the average yield on interest earning assets and the average rate paid on interest bearing liabilities.

(4) The net interest margin is equal to net interest income divided by average interest earning assets.

	December 31, 2017			
	Average		Average	
(In thousands except yield/cost information)	Balance	Interest	Yield/Cost	
Assets				
Interest-earning assets:				
Federal funds sold/short term investments	$27,533	$230	0.84	%
Investment securities:				
Taxable	140,431	3,326	2.37	
Tax-exempt (1)	90,186	3,167	3.51	
Total investment securities	230,617	6,493	2.82	
Loans: (2)				
Commercial real estate	274,192	13,851	4.98	
Mortgage warehouse lines	160,756	6,937	4.26	
Construction	115,913	6,780	5.77	
Commercial business	96,193	5,474	5.63	
Residential real estate	41,898	1,777	4.24	
Loans to individuals	22,171	903	4.07	
Loans held for sale	4,197	202	4.81	
All other loans	1,690	43	2.51	
Total loans	717,010	35,967	4.96	
Total interest-earning assets	975,160	42,690	4.33	%
Non-interest-earning assets:				
Allowance for loan losses	(7,703)			
Cash and due from bank	5,371			
Other assets	58,968			
Total non-interesting-earning assets	56,636			
Total assets	$1,031,796			
Liabilities and Shareholders' Equity				
Interest-bearing Liabilities:				
Money market and NOW accounts	$336,445	$1,440	0.43	%
Savings accounts	210,798	1,332	0.63	
Certificates of deposit	145,539	1,778	1.22	
Other borrowed funds	21,139	429	2.03	
Redeemable subordinated debentures	18,557	519	2.80	
Total interest-bearing liabilities	732,478	5,498	0.75	%
Non-interest-bearing liabilities:				
Demand deposits	183,802			
Other liabilities	6,591			
Total non-interest-bearing liabilities	190,393			
Shareholders' equity	108,925			
Total liabilities and shareholders' equity	$1,031,796			
Net interest spread (3)			3.58	%
Net interest income and margin (4)		$37,192	3.81	%

(1) Tax-equivalent basis, using 34% federal tax rate in 2017.

(2) Loan origination fees and costs are considered an adjustment to interest income. For the purpose of calculating loan yields, average loan balances include non-accrual loans with no related interest income and average balance of loans held for sale.

(3) The net interest rate spread is the difference between the average yield on interest earning assets and the average rate paid on interest bearing liabilities.

(4) The net interest margin is equal to net interest income divided by average interest earning assets.

	December 31, 2016		
(In thousands except yield/cost information)	Average Balance	Interest	Average Yield/Cost
Assets			
Interest-earning assets:			
Federal funds sold/short term investments	$21,041	$88	0.42 %
Investment securities:			
Taxable	143,461	3,268	2.28
Tax-exempt (1)	81,570	3,075	3.77
Total investment securities	225,031	6,343	2.82
Loans: (2)			
Commercial real estate	220,700	12,435	5.56
Mortgage warehouse lines	205,711	8,425	4.04
Construction	93,648	4,896	5.16
Commercial business	102,810	4,953	4.77
Residential real estate	42,694	1,828	4.28
Loans to individuals	23,250	933	4.01
Loans held for sale	7,256	176	2.43
All other loans	2,367	55	2.29
Total loans	698,436	33,701	4.77
Total interest-earning assets	944,508	40,132	4.21 %
Non-interest-earning assets:			
Allowance for loan losses	(7,538)		
Cash and due from bank	5,120		
Other assets	59,679		
Total non-interesting-earning assets	57,261		
Total assets	$1,001,769		
Liabilities and Shareholders' Equity			
Interest-bearing Liabilities:			
Money market and NOW accounts	$301,086	$1,128	0.37 %
Savings accounts	206,208	1,208	0.59
Certificates of deposit	152,078	1,708	1.12
Other borrowed funds	48,448	687	1.42
Redeemable subordinated debentures	18,557	427	2.30
Total interest-bearing liabilities	726,377	5,158	0.71 %
Non-interest-bearing liabilities:			
Demand deposits	166,380		
Other liabilities	8,205		
Total non-interest-bearing liabilities	174,585		
Shareholders' equity	100,807		
Total liabilities and shareholders' equity	$1,001,769		
Net interest spread (3)			3.50 %
Net interest income and margin (4)		$34,974	3.70 %

(1) Tax-equivalent basis, using 34% federal tax rate in 2016.

(2) Loan origination fees and costs are considered an adjustment to interest income. For the purpose of calculating loan yields, average loan balances include non-accrual loans with no related interest income and average balance of loans held for sale.

(3) The net interest rate spread is the difference between the average yield on interest earning assets and the average rate paid on interest bearing liabilities.

(4) The net interest margin is equal to net interest income divided by average interest earning assets.

Changes in net interest income and net interest margin result from the interaction between the volume and composition of interest earning assets, interest bearing liabilities, related yields and funding costs. The effect of volume and rate changes on net interest income (on a tax-equivalent basis) for the periods indicated are shown below:

	Year ended 2018 compared with 2017 Due to Change in:			Year ended 2017 compared with 2016 Due to Change in:		
(Dollars in thousands)	Volume	Rate	Total	Volume	Rate	Total
Assets						
Federal funds sold/short term investments	$(62)	$90	$28	$27	$115	$142
Investment securities:						
Taxable	148	550	698	(69)	127	58
Tax-exempt	(552)	(97)	(649)	325	(233)	92
Total investment securities	(404)	453	49	256	(106)	150
Loans:						
Commercial real estate	4,105	362	4,467	2,973	(1,557)	1,416
Mortgage warehouse lines	(293)	1,759	1,466	(1,816)	328	(1,488)
Construction	1,273	1,037	2,310	1,148	736	1,884
Commercial business	842	(257)	585	(316)	837	521
Residential real estate	187	121	308	(34)	(17)	(51)
Loans to individuals	40	140	180	(43)	13	(30)
Loans held for sale	(70)	(9)	(79)	(74)	100	26
Other	(12)	10	(2)	(16)	4	(12)
Total loans	6,072	3,163	9,235	1,822	444	2,266
Total interest income	$5,606	$3,706	$9,312	$2,105	$453	$2,558
Liabilities						
Money market and NOW accounts	88	450	538	132	180	312
Savings accounts	(43)	178	135	27	97	124
Certificates of deposit	537	751	1,288	(73)	143	70
Other borrowed funds	314	93	407	(387)	129	(258)
Redeemable subordinated debentures	—	175	175	—	92	92
Total interest expense	896	1,647	2,543	(301)	641	340
Net interest income	$4,710	$2,059	$6,769	$2,406	$(188)	$2,218

2018 compared to 2017

For the year ended December 31, 2018, the Company's net interest income, on a fully tax-equivalent basis, increased by $6.8 million, or 18.2%, to $44.0 million compared to $37.2 million for the year ended December 31, 2017. This increase was due primarily to an increase in average earning assets, as well as an increase in the average yield on earning assets, which were partially offset by an increase in interest expense on average interest-bearing liabilities.

Average earning assets were $1.1 billion with a yield of 4.81% for 2018 compared to average earning assets of $975.2 million with a yield of 4.33% for 2017. The 100 basis point increase in the Federal Reserve Board’s targeted federal funds rate and the corresponding increase in the Prime Rate since December of 2017 has had a positive effect on the yields of construction and warehouse loans with variable interest rate terms. The generally higher interest rate environment in 2018 compared to 2017 also had a positive effect on the yields of commercial real estate and residential real estate loans.

For the year ended December 31, 2018, interest income on interest earning assets increased by $9.3 million and interest income on average loans increased by $9.2 million as the average balances of commercial real estate, construction and commercial business loans grew by $82.4 million, $22.1 million and $15.0 million, respectively. For 2018, average loans increased $116.0 million to $833.0 million. The NJCB merger contributed approximately $63.0 million to the increase in average loans at December 31, 2018, which consisted primarily of commercial real estate loans.

Interest expense on average interest-bearing liabilities was $8.0 million, or 1.00%, for the year ended December 31, 2018 compared to $5.5 million, or 0.75%, for the year ended December 31, 2017. The increase of $2.5 million in interest expense on interest-bearing liabilities for 2018 compared to 2017 primarily reflects higher short-term market interest rates and increased competition for deposits in 2018 compared to 2017. For 2018, average interest-bearing liabilities increased $73.1 million to $805.5 million. The NJCB merger contributed approximately $60.9 million to the increase in average interest-bearing liabilities at December 31, 2018.

2017 compared to 2016

For the year ended December 31, 2017, the Company's net interest income, on a fully tax-equivalent basis, increased by $2.2 million, or 6.3%, to $37.2 million compared to $35.0 million for the year ended December 31, 2016. This increase was due primarily to an increase in average earning assets as well as an increase in the average yield on earning assets, which were partially offset by an increase in interest expense on average interest-bearing liabilities.

Average earning assets were $975.2 million with a yield of 4.33% for 2017 compared to average earning assets of $944.5 million with a yield of 4.21% for 2016. The 75 basis point increase in the Federal Reserve Board’s targeted federal funds rate and the corresponding increase in the Prime Rate since December of 2016 has had a positive effect on the yields of construction, commercial business and warehouse loans with variable interest rate terms.

For the year ended December 31, 2017, interest income on interest bearing assets increased by $2.6 million and interest income on average loans increased by $2.3 million as the average balances of commercial real estate and construction loans grew by $53.5 million and $22.2 million, respectively. For 2017, average loans increased $18.6 million to $717.0 million.

Interest expense on average interest-bearing liabilities was $5.5 million, or 0.75%, for the year ended December 31, 2017 compared to $5.2 million, or 0.71%, for the year ended December 31, 2016. The increase of $340,000 in interest expense on interest-bearing liabilities for 2017 compared to 2016 primarily reflects higher short-term market interest rates and increased competition for deposits in 2017 compared to 2016.

Provision for Loan Losses

Management considers a complete review of the following specific factors in determining the provisions for loan losses: historical losses by loan category, non-accrual loans and problem loans as identified through internal classifications, collateral values and the growth, size and risk elements of the loan portfolio. In addition to these factors, management takes into consideration current economic conditions and local real estate market conditions.

In general, over the last five years, the Company experienced an improvement in loan credit quality and achieved a steady resolution of non-performing loans and assets related to the severe recession, which was reflected in the current level of non-performing loans at December 31, 2018. Net charge-offs of commercial business and commercial real estate loans since 2015 have declined significantly from prior periods, which has resulted in a reduction of the historical loss factors for these segments of the loan portfolio that were applied by management to estimate the allowance for loan losses at December 31, 2018.

2018 compared to 2017

The Company recorded a provision for loan losses of $900,000 for the year ended December 31, 2018 compared to a provision of $600,000 for the year ended December 31, 2017. For 2018, net charge-offs of $511,000 were recorded compared to net charge-offs of $81,000 in 2017. The allowance for loan losses at December 31, 2018 and 2017 totaled $8.4 million and $8.0 million, respectively. The increase in the provision for loan losses for 2018 was primarily attributed to the growth of commercial real estate, construction and commercial business loans and the change in the mix of loans in the loan portfolio.

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At December 31, 2018, non-performing loans totaled $6.6 million compared to $7.1 million at December 31, 2017, a decrease of $534,000, or 7.5%, and the ratio of non-performing loans to total loans decreased to 0.75% at December 31, 2018 from 0.90% at December 31, 2017.

2017 compared to 2016

The Company recorded a provision for loan losses of $600,000 for the year ended December 31, 2017 and a credit (negative) provision of $300,000 for the year ended December 31, 2016. For 2017, net charge-offs of $81,000 were recorded compared to net recoveries of $234,000 in 2016. The allowance for loan losses at December 31, 2017 and 2016 totaled $8.0 million and $7.5 million, respectively. The increase in the provision for loan losses for 2017 was primarily attributed to loan growth and an increase in nonperforming loans while the credit (negative) provision for loan losses for 2016 was primarily attributed to the net recovery of loans previously charged off.

At December 31, 2017, non-performing loans totaled $7.1 million compared to $5.2 million at December 31, 2016, an increase of $1.9 million, or 36.9%, and the ratio of non-performing loans to total loans increased to 0.90% at December 31, 2017 from 0.72% at December 31, 2016.

Non-Interest Income

2018 compared to 2017

Total non-interest income for the year ended December 31, 2018 decreased $322,000 to $7.9 million from $8.2 million for the year ended December 31, 2017. This revenue component represented 15% and 19% of the Company’s net revenues for the years ended December 31, 2018 and 2017, respectively.

Service charges on deposit accounts increased by $42,000 to $638,000 for the year ended December 31, 2018 compared to $596,000 for the year ended December 31, 2017 due primarily to the increase in deposit accounts as a result of the NJCB merger.

Gains on sales of loans held for sale decreased $674,000 to $4.5 million for the year ended December 31, 2018 compared to $5.1 million for the year ended December 31, 2017. The Company sells both residential mortgage loans and portions of commercial business loans guaranteed by the Small Business Administration ("SBA") in the secondary market.

Gains on the sale of residential mortgage loans were $2.6 million in 2018 compared to $3.9 million in 2017. In 2017, $89.1 million of residential mortgage loans were sold compared to $121.1 million in 2017. The decrease in the residential lending activity and gains on the sale of loans was due primarily to the lower volume of residential lending and loans sold in 2018 as a result of higher mortgage interest rates in 2018 compared to 2017.

In 2018, $23.3 million of SBA loans were sold and generated net gains of $1.9 million compared to SBA loans sold and net gains of $13.3 million and $1.2 million, respectively, in 2017.

Non-interest income also includes income from Bank-owned life insurance (“BOLI”), which totaled $575,000 for the year ended December 31, 2018 compared to $522,000 for the year ended December 31, 2017. The increase was due primarily to a $3.7 million increase in BOLI resulting from the NJCB merger.

The acquisition method of accounting for the business combination with NJCB resulted in the recognition of a gain on bargain purchase of $230,000 from the NJCB merger.

The Company also generates non-interest income from a variety of fee-based services. These include safe deposit box rentals, wire transfer service fees and Automated Teller Machine fees for non-Bank customers. The other income component of non-interest income was $2.0 million for the year ended December 31, 2018 compared to $1.8 million for the year ended December 31, 2017.

2017 compared to 2016

Total non-interest income for the year ended December 31, 2017 increased to $8.2 million from $6.9 million for the year ended December 31, 2016. This revenue component represented 19% and 17% of the Company’s net revenues for the years ended December 31, 2017 and 2016, respectively.

Service charges on deposit accounts decreased by $119,000 to $596,000 for the year ended December 31, 2017 compared to $715,000 for the year ended December 31, 2016 due primarily to declines in insufficient funds charges.

Gains on sales of loans held for sale increased $1.3 million to $5.1 million for the year ended December 31, 2017 compared to $3.8 million for the year ended December 31, 2016. The Company sells both residential mortgage loans and portions of commercial business loans guaranteed by the SBA in the secondary market.

Gains on the sale of residential mortgage loans were $3.9 million in 2017 compared to $2.2 million in 2016. In 2017, $121.1 million of residential mortgage loans were sold compared to $88.1 million in 2016. The increase in the residential lending activity and gains on the sale of loans was due primarily to the hiring of a new residential lending team in July of 2016.

In 2017, $13.3 million of SBA loans were sold and generated net gains of $1.2 million compared to SBA loans sold and net gains of $17.0 million and $1.6 million, respectively, in 2016.

Non-interest income also includes income from BOLI, which totaled $522,000 for the year ended December 31, 2017 compared to $549,000 for the year ended December 31, 2016.

The Company also generates non-interest income from a variety of fee-based services. These include safe deposit box rentals, wire transfer service fees and Automated Teller Machine fees for non-Bank customers. The other income component of non-interest income was $1.8 million for the year ended December 31, 2017 compared to $1.9 million for the year ended December 31, 2016.

Non-Interest Expenses

The following table presents the major components of non-interest expense:

	Year ended December 31,		
(In thousands)	2018	2017	2016
Salaries and employee benefits	$19,853	$18,804	$16,543
Occupancy expense	3,623	3,169	3,243
Data processing expenses	1,332	1,314	1,277
Equipment expense	1,175	1,008	917
Marketing	280	225	240
Telephone	391	389	377
Regulatory, professional and consulting fees	1,713	2,263	1,706
Insurance	375	373	303
Merger-related expenses	2,141	265	—
FDIC insurance expense	486	360	453
Other real estate owned expenses	158	42	74
Amortization of intangible assets	318	384	404
Supplies	294	259	219
Other expenses	1,946	2,151	1,535
Total	$34,085	$31,006	$27,291

2018 compared to 2017

For the year ended December 31, 2018, non-interest expenses totaled $34.1 million, an increase of $3.1 million, or 9.9%, when compared to $31.0 million for the year ended December 31, 2017. The increase in non-interest expenses included increases in salaries and employee benefit expenses, occupancy expense, merger-related expenses and expenses related to the operations of the former NJCB offset by a decrease in regulatory, professional and consulting fees.

Salaries and employee benefits, which represents the largest portion of non-interest expenses, increased by $1.0 million, or 5.6%, to $19.9 million compared to $18.8 million for the year ended December 31, 2017 due primarily to salaries for former NJCB employees who joined the Company, merit increases and increases in employee benefits expenses. Cash incentive compensation and employee health benefits increased $90,000 and $155,000, respectively, during 2018. At December 31, 2018, there were 189 full-time equivalent employees compared to 179 full-time equivalent employees at December 31, 2017.

Occupancy expense totaled $3.6 million in 2018 compared to $3.2 million in 2017, increasing $454,000, or 14.3%, from 2017 to 2018 due primarily to the addition of the two former NJCB branch offices. For the years ended

December 31, 2018 and 2017, equipment expense was $1.2 million and $1.0 million, respectively, reflecting an increase of $167,000, or 16.6%, from 2017 to 2018.

The cost of data processing services remained relatively flat at $1.3 million for the years ended December 31, 2018 and 2017.

Regulatory, professional and consulting fees decreased by $550,000, or 24.3%, to $1.7 million for the year ended December 31, 2018 compared to $2.3 million for the year ended December 31, 2017. The level of professional and consulting fees declined due primarily to lower legal and consulting fees related to loan collections and litigation expenses.

FDIC insurance expense increased to $486,000 for the year ended December 31, 2018 compared to $360,000 for the year ended December 31, 2017 due primarily to the internal growth of assets and the increase in assets as a result of the NJCB merger.

OREO expenses increased to $158,000 in 2018 from $42,000 for 2017 due primarily to an increase in OREO assets held during 2018. At December 31, 2018, the Company held $2.5 million in OREO compared to no OREO held at December 31, 2017. The Company incurred expenses in connection with general maintenance, insurance and real estate taxes. OREO at December 31, 2018 was comprised of one residential property with a carrying value of $1.1 million acquired in the NJCB merger, land with a carrying value of $93,000 and a commercial real estate property that was foreclosed in the third quarter of 2018 with a fair value of $1.3 million.

Marketing expenses were $280,000 for the year 2018, an increase of $55,000 compared with $225,000 in 2017. The majority of the increase was primarily related to marketing of the Bank’s products and services to the former customers of NJCB.

Supplies increased $35,000 to $294,000 in 2018 compared to $259,000 in 2017. The majority of the increase was related to the NJCB merger.

Amortization of intangible assets decreased $66,000 to $318,000 for the year ended December 31, 2018 compared to $384,000 for the year ended December 31, 2017 due to the lower amortization of core deposit intangible assets.

Merger-related expenses of $2.1 million related to the NJCB merger were incurred in 2018 compared to $265,000 in 2017.

Other expenses were $1.9 million for the year ended December 31, 2018 compared to $2.2 million for the year ended December 31, 2017. The decrease in other expenses was due primarily to the absence in the 2018 period of any write-off of deferred loan origination costs, which were approximately $500,000 in 2017, which was partially offset by increases in various other expense categories.

2017 compared to 2016

For the year ended December 31, 2017, non-interest expenses totaled $31.0 million, an increase of $3.7 million, or 13.6%, when compared to $27.3 million for the year ended December 31, 2016. The increase in non-interest expenses included increases in salaries and employee benefit expenses, regulatory, professional and consulting fees and merger-related expenses.

Salaries and employee benefits, which represents the largest portion of non-interest expenses, increased by $2.3 million, or 13.7%, to $18.8 million compared to $16.5 million for the year ended December 31, 2016 due primarily to increases in commissions paid to residential loan officers and stock-based compensation expense, normal merit increases and increases in employee health benefit costs. Commissions paid to residential loan officers increased by $643,000 as a result of a higher volume of residential mortgage loans originated during 2017. Stock-based compensation and cash incentive compensation increased $292,000 and $151,000, respectively, during 2017 and employee health benefits increased $252,000 during 2017. The increase also reflects the full year effect of the increase in staff in the residential mortgage department, which accounted for $426,000 of the increase in salaries and employee benefits. At December 31, 2017, there were 179 full-time equivalent employees compared to 199 full-time equivalent employees at December 31, 2016.

Occupancy expense totaled $3.2 million for both 2017 and 2016, decreasing $74,000, or 2.3%, from 2016 to 2017 due primarily to a decrease in depreciation expense. For the years ended December 31, 2017 and 2016, equipment expense was $1.0 million and $917,000, respectively, reflecting an increase of $91,000, or 9.9%, from 2016 to 2017.

The cost of data processing services remained relatively flat at $1.3 million for the years ended December 31, 2017 and 2016.

Regulatory, professional and consulting fees increased by $557,000, or 32.7%, to $2.3 million for the year ended December 31, 2017 compared to $1.7 million for the year ended December 31, 2016. The level of regulatory, professional and consulting fees has increased over the last several years due primarily to compliance with increased regulatory requirements, management of enterprise risk and information security and increased external and internal professional audit fees as well as loan collection and litigation costs. .

FDIC insurance expense decreased to $360,000 for the year ended December 31, 2017 compared to $453,000 for the year ended December 31, 2016 due to a lower assessment rate that reflected the improvement in asset quality and the continued improvement in the Company's financial performance in 2017.

OREO expenses decreased to $42,000 in 2017 from $74,000 for 2016 due primarily to the low amount of OREO assets held during 2017. At December 31, 2017, the Company held no OREO compared to one commercial real estate property with a carrying value of $166,000 held as OREO at December 31, 2016. In 2017 and 2016, the Company sold $626,000 and $1.0 million of OREO properties, respectively.

Amortization of intangible assets decreased $20,000 to $384,000 for the year ended December 31, 2017 compared to $404,000 for the year ended December 31, 2016 due to the lower amortization of core deposit intangible assets.

Other expenses were $2.2 million for the year ended December 31, 2017 compared to $1.5 million for the year ended December 31, 2016. During 2017, management updated its deferred loan origination cost analysis and methodology, which resulted in the identification of approximately $500,000 of deferred loan origination costs at December 31, 2016 that were charged to expense in the first quarter of 2017. The balance of the increase was due to smaller increases in various expense categories.

Income Taxes

2018 compared to 2017

The Company recorded income tax expense of $4.3 million in 2018, resulting in a effective tax rate of 26.4%, compared to income tax expense of $5.9 million in 2017, which resulted in an effective tax rate of 45.9%. Income tax expense for 2017 includes $1.7 million of additional income tax expense due to the revaluation of the deferred tax assets as a result of the enactment of the Tax Act in December 2017. Absent the $1.7 million of additional income tax expense, the effective tax rate would have been 32.5% for 2017. The Tax Act reduced the maximum federal corporate income tax rate to 21% from 35%, effective January 1, 2018, which explains the lower effective tax rate in 2018. Partially offsetting the lower federal corporate income tax rate was the enactment of legislation by the State of New Jersey in July 2018, which increased the corporate income tax rate to 11.5% from 9% for taxable income of $1.0 million or more effective January 1, 2018 and resulted in a 2% higher effective tax rate in 2018.

2017 compared to 2016

The Company recorded income tax expense of $5.9 million in 2017 compared to income tax expense of $4.6 million in 2016. The increase in income tax expense in 2017 compared to 2016 was primarily due to the recording of additional estimated income tax expense of $1.7 million due to the revaluation of the deferred tax assets as a result of the enactment of the Tax Act. The Tax Act reduced the maximum federal corporate income tax rate to 21% from 35%, effective January 1, 2018, which required the Company to revalue its deferred tax assets.

The effective tax rate for 2017 was 45.9% and absent the $1.7 million of additional income tax expense, it would have been 32.5%. The effective tax rate for 2016 was 33.2%.

Financial Condition

Cash and Cash Equivalents

At December 31, 2018, cash and cash equivalents totaled $16.8 million compared to $18.8 million at December 31, 2017.

Investment Securities

Amortized cost, gross unrealized gains and losses and the fair value by security type for the available for sale portfolio at December 31, 2018 and 2017 were as follows:

	2018			
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. treasury securities and obligations of U.S. government-sponsored corporations ("GSE")	$2,993	$ —	$ (41)	$2,952
Residential collateralized mortgage obligations - GSE	48,789	70	(676)	48,183
Residential mortgage-backed securities - GSE	13,945	37	(100)	13,882
Obligations of state and political subdivisions	23,506	85	(249)	23,342
Single-issuer trust preferred debt securities	1,490	—	(161)	1,329
Corporate debt securities	28,323	—	(1,037)	27,286
Other debt securities	15,383	11	(146)	15,248
Total	$134,429	$ 203	$ (2,410)	$132,222

	2017			
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. treasury securities and obligations of U.S. government-sponsored corporations ("GSE")	$1,997	$ —	$ (30)	$1,967
Residential collateralized mortgage obligations-GSE	27,688	18	(381)	27,325
Residential mortgage backed securities – GSE	14,231	129	(72)	14,288
Obligations of state and political subdivisions	19,575	227	(82)	19,720
Trust preferred debt securities – single issuer	2,481	—	(132)	2,349
Corporate debt securities	27,917	14	(248)	27,683
Other debt securities	12,140	12	(26)	12,126
Total	$106,029	$ 400	$ (971)	$105,458

Amortized cost, carrying value, gross unrealized gains and losses and the fair value by security type for the held to maturity portfolio at December 31, 2018 and 2017 were as follows:

	2018					
(In thousands)	Amortized Cost	Other-Than-Temporary Impairment Recognized In Accumulated Other Comprehensive Loss	Carrying Value	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U. S. treasury securities and obligations of U.S.government sponsored corporations (“GSE”)	$—	$ —	$—	$ —	$ —	$—
Residential collateralized mortgage obligations - GSE	6,701	—	6,701	30	(143)	6,588
Residential mortgage backed securities- GSE	31,343	—	31,343	84	(346)	31,081
Obligations of state and political subdivisions	38,494	—	38,494	634	(118)	39,010
Trust preferred debt securities - pooled	657	(501)	156	569	—	725
Other debt securities	2,878	—	2,878	—	(78)	2,800
Total	$80,073	$ (501)	$79,572	$ 1,317	$ (685)	$80,204

(Dollars in thousands)	2017 Amortized Cost	Other-Than-Temporary Impairment Recognized In Accumulated Other Comprehensive Loss	Carrying Value	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U. S. treasury securities and obligations of U.S. government sponsored corporations ("GSE")	$3,234	$ —	$3,234	$ —	$ (84)	$3,150
Residential collateralized mortgage obligations – GSE	8,701	—	8,701	94	(123)	8,672
Residential mortgage backed securities - GSE	34,072	—	34,072	231	(127)	34,176
Obligations of state and political subdivisions	63,797	—	63,797	1,224	(35)	64,986
Trust preferred debt securities - pooled	657	(501)	156	418	—	574
Other debt securities	307	—	307	—	—	307
Total	$110,768	$ (501)	$110,267	$ 1,967	$ (369)	$111,865

The investment securities portfolio totaled $211.8 million, or 18.0% of total assets, at December 31, 2018 compared to $215.7 million, or 20.0% of total assets, at December 31, 2017. Proceeds from maturities and prepayments for the year ended December 31, 2018 totaled $55.9 million while purchases of investment securities totaled $42.9 million during this period. On an average balance basis, the investment securities portfolio represented 20.6% and 23.6% of average interest-earning assets for the years ended December 31, 2018 and 2017, respectively.

Securities available for sale are investments that may be sold in response to changing market and interest rate conditions or for other business purposes. Activity in this portfolio is undertaken primarily to manage liquidity and interest rate risk and to take advantage of market conditions that create more economically attractive returns. At December 31, 2018, available-for-sale securities amounted to $132.2 million, which was an increase of $26.7 million from $105.5 million at December 31, 2017.

The following table sets forth certain information regarding the amortized cost, carrying value, fair value, weighted average yields and contractual maturities of the Company's investment portfolio as of December 31, 2018. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

(Dollars in thousands)	Amortized cost	Fair Value	Yield
Available for sale			
Due in one year or less	$8,388	$8,354	2.07%
Due after one year through five years	35,001	34,018	3.17
Due after five years through ten years	22,272	21,992	3.03
Due after ten years	68,768	67,858	2.94
Total	$134,429	$132,222	2.96%

(Dollars in thousands)	Carrying Value	Fair Value	Yield
Held to maturity			

Due in one year or less	$9,433	$9,449	3.48%
Due after one year through five years	18,616	18,912	3.66
Due after five years through ten years	22,475	22,562	3.14
Due after ten years	29,048	29,281	3.22
Total	$79,572	$80,204	3.14%

Proceeds from maturities and prepayments of securities available for sale amounted to $17.7 million for the year ended December 31, 2018 compared to $25.8 million for the year ended December 31, 2017. At December 31, 2018, the portfolio had net unrealized losses of $2.2 million compared to net unrealized losses of $571,000 at December 31, 2017. These unrealized losses are reflected net of tax in shareholders' equity as a component of accumulated other comprehensive income (loss).

Securities held to maturity, which are carried at amortized historical cost, are investments for which there is the positive intent and ability to hold to maturity. At December 31, 2018, securities held to maturity were $79.6 million, reflecting a decrease of $30.7 million from $110.3 million at December 31, 2017. The fair value of the held-to-maturity portfolio at December 31, 2018 was $80.2 million.

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.

On a quarterly basis, management evaluates each security in the portfolio with an individual unrealized loss to determine if that loss represents other-than-temporary impairment. During the fourth quarter of 2009, management determined that it was necessary, following other-than-temporary impairment requirements, to write down the cost basis of the Company's only pooled trust preferred security. 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 $865,000 with respect to this security. No other-than-temporary impairment losses were recorded during 2018 and 2017. See Note 3 to the consolidated financial statements for additional information.

Loans Held for Sale

Loans held for sale at December 31, 2018 totaled $3.0 million compared to $4.3 million at December 31, 2017. The total loans originated for sale was $111.1 million for 2018 and 2017, respectively. At December 31, 2018, residential mortgage loans held for sale totaled $2.1 million and SBA loans held for sale totaled $875,000. The amount of loans held for sale varies from period to period due to changes in the amount and timing of sales of residential mortgage loans and SBA loans.

Loans

The loan portfolio, which represents the Company's largest asset, is a significant source of both interest and fee income. Elements of the loan portfolio are subject to differing levels of credit and interest rate risk. The Company's primary lending focus continues to be mortgage warehouse lines, construction loans, commercial business loans, owner-occupied commercial real estate mortgage loans and income producing commercial real estate loans. Total loans averaged $833.0 million for the year ended December 31, 2018, an increase of $116.0 million, or 16.2%, compared to an average of $717.0 million for the year ended December 31, 2017. At December 31, 2018, total loans amounted to $883.2 million, which was an increase of $93.3 million, or 11.8%, when compared to $789.9 million at December 31, 2017. Loans acquired in the NJCB merger were $63.0 million at December 31, 2018. The average yield earned on the loan portfolio was 5.38% for the year ended December 31, 2018 compared to 4.96% for the year ended December 31, 2017, which was an increase of 42 basis points.

The following table represents the components of the loan portfolio as of the dates indicated.

	December 31,				
	2018	2017	2016	2015	2014

(Dollars in thousands)	Amount	%		Amount	%		Amount	%		Amount	%		Amount	%	
Commercial real estate	$388,431	44	%	$308,924	39	%	$242,393	34	%	$207,250	30	%	$198,211	30	%
Mortgage warehouse lines	154,183	17		189,412	24		216,259	30		216,572	32		179,172	27	
Construction	149,387	17		136,412	17		96,035	13		93,745	14		95,627	15	
Commercial business	120,590	14		92,906	12		99,650	14		99,277	15		110,771	17	
Residential real estate	47,263	5		40,494	5		44,791	6		40,744	6		46,446	7	
Loans to individuals	22,962	3		21,025	3		23,736	3		23,074	3		23,156	4	
Other	181	—		183	—		207	—		233	—		199	—	
Deferred loan costs, net	167	—		550	—		1,737	—		1,226	—		715	—	
Total	$883,164	100	%	$789,906	100	%	$724,808	100	%	$682,121	100	%	$654,297	100	%

Commercial business loans averaged $111.2 million for the year ended December 31, 2018, an increase of $15.0 million, or 15.5%, compared to the average of $96.2 million for the year ended December 31, 2017. Commercial business loans consist primarily of loans to small and middle market businesses and are typically working capital loans used to finance inventory, receivables or equipment needs. These loans are generally secured by business assets of the commercial borrower. Commercial real estate loans averaged $356.6 million for the year ended December 31, 2018, an increase of $82.4 million, or 30.0%, compared to the average of $274.2 million for the year ended December 31, 2017. Commercial real estate loans consist primarily of loans to businesses that are collateralized by real estate assets employed in the operation of the business (owner-occupied properties) and loans to real estate investors to finance the acquisition and/or improvement of income producing commercial properties. The average yield on the commercial business loans was 5.45% in 2018 compared to 5.63% in 2017. The average yield on commercial real estate loans was 5.07% and 4.98% for 2018 and 2017, respectively.

Construction loans averaged $138.0 million for the year ended December 31, 2018, an increase of $22.1 million, or 19.1%, compared to the average of $115.9 million for the year ended December 31, 2017. Generally, these loans represent owner-occupied or investment properties and usually complement a broader commercial relationship between the Company and the borrower. Construction loans are structured to provide for advances only after work is completed and inspected by qualified professionals. The average yield on the construction loan portfolio increased 82 basis points to 6.59% for 2018 from 5.77% for 2017.

The Company’s Mortgage Warehouse Funding Group offers revolving lines of credit that are available to licensed mortgage banking companies (the “warehouse line of credit”). The warehouse line of credit is used by the mortgage banker to originate one-to-four family residential mortgage loans that are pre-sold to the secondary mortgage market, which includes state and national banks, national mortgage banking firms, insurance companies and government-sponsored enterprises, including the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and others. On average, an advance under the warehouse line of credit remains outstanding for a period of less than 30 days, with repayment coming directly from the sale of the loan into the secondary mortgage market. Interest and a transaction fee are collected by the Company at the time of repayment. The Company had outstanding warehouse line of credit advances of $154.2 million at December 31, 2018 compared to $189.4 million at December 31, 2017. During 2018 and 2017, warehouse lines of credit advances averaged $153.9 million and $160.8 million, respectively, and yielded 5.46% and 4.26%, respectively. During 2018, $3.4 billion of mortgage loans were financed through our Mortgage Warehouse Funding Group compared to $3.5 billion of mortgage loans financed in 2017. The decline in the warehouse lines of credit advances in 2018 compared to 2017 reflected the decline in residential mortgage refinancing activity in 2018 compared to 2017 due, in general, to higher market interest rates for residential mortgages in 2018 than in 2017. The number of active mortgage banking customers was 44 in 2018 and 2017.

Average residential real estate loans increased $4.4 million to $46.3 million at December 31, 2018 compared to $41.9 million at December 31, 2017. Loans to individuals, which are comprised primarily of home equity loans, averaged $23.2 million during December 31, 2018 compared to $22.2 million during 2017.

The following table provides information concerning the maturities and interest rate sensitivity of the loan portfolio at December 31, 2018.

(Dollars in thousands)	Maturity Range Within One Year	After One But Within Five Years	After Five Years	Total
Commercial real estate	$55,190	$303,418	$29,823	$388,431

Mortgage warehouse lines	154,183	—	—	154,183
Construction	147,482	—	1,905	149,387
Commercial business	62,255	27,590	30,745	120,590
Residential real estate	4,606	18,099	24,558	47,263
Loans to individuals and other loans	20,678	917	1,548	23,143
Total	$444,394	$350,024	$88,579	$882,997
Fixed rate loans	$15,915	$75,776	$73,519	$165,210
Floating rate loans	428,479	274,248	15,060	717,787
Total	$444,394	$350,024	$88,579	$882,997

48

Non-Performing Assets

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

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

During 2018, $2.0 million of loans were transferred to non-accrual status, $1.8 million were transferred to OREO, $664,000 of loans were resolved and $55,000 in loans were classified as past due and still accruing. As a result, non-performing loans decreased by $534,000 to $6.6 million at December 31, 2018 from $7.1 million at December 31, 2017.

At December 31, 2018, non-performing loans were comprised of three commercial real estate loans aggregating $1.4 million, four residential mortgage loans aggregating $1.2 million, six commercial business loans aggregating $3.5 million and five home equity loans aggregating $398,000.

Included in non-performing commercial business loans is a shared national credit syndicated loan with an outstanding balance of $2.9 million at December 31, 2018. During the first quarter of 2017, the Company was notified that a shared national credit syndicated loan in which it was a participant in a $4.3 million facility had further deteriorated. The Company downgraded the loan, which had a balance of $4.0 million, and placed it on non-accrual. In the second quarter of 2017, the borrower was recapitalized through an equity contribution by new investors and the loan was paid down by $906,000 and all interest was brought current. All loan payments for this borrower are current at December 31, 2018. Management continues to closely monitor the borrower's financial position.

The table below sets forth non-performing assets and risk elements in the Bank's loan portfolio for the years indicated.

	December 31,				
(Dollars in thousands)	2018	2017	2016	2015	2014
Non-Performing loans:					
Loans 90 days or more past due and still accruing	$55	$—	$24	$—	$317
Non-accrual loans	6,525	7,114	5,174	6,020	4,523
Total non-performing loans	6,580	7,114	5,198	6,020	4,840
Other real estate owned	2,515	—	166	966	5,710
Other repossessed assets	—	—	—	—	66
Total non-performing assets	9,095	7,114	5,364	6,986	10,616
Performing troubled debt restructurings	4,003	3,728	864	1,535	3,925
Performing troubled debt restructurings and total non-performing assets	$13,098	$10,842	$6,228	$8,521	$14,541
Non-performing loans to total loans	0.75 %	0.90 %	0.72 %	0.88 %	0.74 %
Non-performing loans to total loans excluding warehouse lines	0.90	1.18	1.02	1.29	1.02
Non-performing assets to total assets	0.77	0.66	0.52	0.72	1.11
	0.89	0.80	0.65	0.93	1.37

Non-performing assets to total assets excluding mortgage warehouse lines					
Total non-performing assets and performing troubled debt restructurings to total assets	1.11	1.00	0.60	0.88	1.52

As the table demonstrates, non-performing loans to total loans decreased to 0.75% at December 31, 2018 from 0.90% at December 31, 2017. Loan quality was stable and the loan portfolio is considered to be sound. This was accomplished through quality loan underwriting, a proactive approach to loan monitoring and aggressive workout strategies.

Additional interest income before taxes amounting to $155,000, $514,000 and $522,000 would have been recognized in 2018, 2017 and 2016, respectively, if interest on all loans had been recorded based upon their original contract terms.

Non-performing assets increased $2.0 million to $9.1 million at December 31, 2018 from $7.1 million at December 31, 2017 and were 0.77% of total assets at December 31, 2018 compared to 0.66% at December 31, 2017. Non-performing loans decreased $534,000 to $6.6 million at December 31, 2018 from $7.1 million at December 31, 2017. Other real estate owned increased to $2.5 million at December 31, 2018 and was comprised of one residential property with a carrying value of $1.1 million acquired in the NJCB merger, land with a carrying value of $93,000 and a commercial real estate property that was foreclosed in the third quarter of 2018 with a fair value of $1.3 million. There was no other real estate owned at December 31, 2017.

In 2018, no OREO properties were sold and in 2017, the Company transferred $455,000 of non-performing loans to OREO and sold $626,000 in OREO properties.

At December 31, 2018, the Company had twelve loans totaling $7.3 million that were troubled debt restructurings. Four of these loans totaling $3.3 million are included in the above table as non-accrual loans and the remaining eight loans totaling $4.0 million are considered performing.

At December 31, 2017, the Company had ten loans totaling $5.5 million that were troubled debt restructurings. Two of these loans totaling $1.8 million are included in the above table as non-accrual loans and the remaining eight loans totaling $3.7 million were considered performing.

In accordance with U.S. GAAP, the excess of cash flows expected at acquisition over the initial investment in the purchase of a credit impaired loan is recognized as interest income over the life of the loan. At December 31, 2018, there were two loans acquired with evidence of deteriorated credit quality totaling $865,000 that were not classified as non-performing loans and there were no loans acquired with evidence of deteriorated credit quality that were not classified as non-performing loans at December 31, 2017.

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

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

Allowance for Loan Losses and Related Provision

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

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

All, or part, of the principal balance of commercial business, commercial real estate and construction loans are charged off against the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely. Consumer loans are generally charged off no later than 120 days past due on a contractual basis, earlier in the event of bankruptcy, or if there is an amount deemed uncollectible. Because all identified losses are charged off, no portion of the allowance for loan losses is restricted to any individual loan or groups of loans and the entire allowance is available to absorb any and all loan losses.

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

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

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

The methodology includes the segregation of the loan portfolio into loan types with a further segregation into risk rating categories, such as special mention, substandard, doubtful and loss. This allows for an allocation of the allowance for loan losses by loan type; however, the allowance is available to absorb any loan loss without restriction. Larger balance, non-homogeneous loans representing significant individual credit exposures are evaluated individually through the internal loan review process. It is this process that produces the watch list. The borrower's overall financial condition, repayment sources, guarantors and value of collateral, if appropriate, are evaluated. Based on these reviews, an estimate of probable losses for the individual larger-balance loans are 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 criticized as special mention have potential weaknesses that deserve management's close attention. If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They include loans that are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified as doubtful have all the weaknesses inherent in loans classified as substandard with the added characteristic that collection or liquidation in full, on the basis of current conditions and facts, is highly improbable. Loans rated as doubtful in whole, or in part, are placed on non-accrual status. Loans classified as a loss are considered uncollectible and are charged off against the allowance for loan losses.

The specific allowance for impaired loans is established for specific loans that have been identified by management as being impaired. These loans are considered to be impaired primarily because the loans have not performed according to payment terms and there is reason to believe that repayment of the loan principal in whole, or in part, is unlikely. The specific portion of the allowance is the total amount of potential unconfirmed losses for these individual impaired loans. To assist in determining the fair value of loan collateral, the Company often utilizes independent third party qualified appraisal firms, which, 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 outstanding loans that have similar characteristics and applying historical loss experience for each pool. This estimate represents the potential unconfirmed losses within the portfolio. Individual loan pools are created for commercial and commercial real estate loans, construction loans, warehouse lines of credit and various types of loans to individuals. The historical estimation for each loan pool is then adjusted for qualitative factors, such as economic trends, concentrations of credit, trends in the volume of loans, portfolio quality, delinquencies and non-accrual trends. These factors are evaluated for each class of the loan portfolio and may have positive or negative effects on the allocated allowance for the loan portfolio segment. The aggregate amount resulting from the application of these qualitative factors determines the overall risk for the portfolio and results in an allocated allowance for each of the loan segments.

The Company also maintains an unallocated allowance. The unallocated allowance is used to cover any factors or conditions that 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 portfolios.

Commercial Business

The Company offers a variety of commercial loan services, including term loans, lines of credit and loans secured by equipment and receivables. A broad range of short-to-medium term commercial loans, both secured and unsecured, are made available to businesses for working capital (including inventory and receivables), business expansion (including acquisition and development of real estate and improvements) and the purchase of equipment and machinery. Commercial business loans are granted based on the borrower's ability to generate cash flow to support its debt obligations and other cash related expenses. A borrower's ability to repay commercial business loans is substantially dependent on the success of the business itself and on the quality of its management. As a general practice, the Company takes, as collateral, a security interest in any available real estate, equipment, inventory, receivables or other personal property of its borrowers, although the Company occasionally makes commercial business loans on an unsecured basis. Generally, the Company requires personal guarantees of its commercial business loans to offset the risks associated with such loans.

Much of the Company's lending is in northern and central New Jersey and the New York City metropolitan area. As a result of this geographic concentration, a significant broad-based deterioration in economic conditions in New Jersey and the New York City metropolitan area could have a material adverse impact on the Company's loan portfolio. A prolonged decline in economic conditions in our market area could restrict borrowers' ability to pay outstanding principal and interest on loans when due. The value of assets pledged as collateral may decline and the proceeds from the sale or liquidation of these assets may not be sufficient to repay the loan.

Commercial Real Estate

Commercial real estate loans are made to businesses to expand their facilities and operations and to real estate operators to finance the acquisition of income producing properties. The Company's loan policy requires that borrowers have sufficient cash flow to meet the debt service requirements and the value of the property meets the loan-to-value criteria set in the loan policy. The Company monitors loan concentrations by borrower, by type of property and by location and other criteria.

The Company's commercial real estate portfolio is largely secured by real estate collateral located in the State of New Jersey and the New York City metropolitan area. Conditions in the real estate markets in which the collateral for the Company's loans are located strongly influence the level of the Company's non-performing loans. A decline in the New Jersey and New York City metropolitan area real estate markets could adversely affect the Company's loan portfolio. Decreases in local real estate values would adversely affect the value of property used as collateral for the Company's loans. Adverse changes in the economy also may have a negative effect on the ability of our borrowers to make timely repayments of their loans.

Construction Financing

Construction financing is provided to businesses to expand their facilities and operations and to real estate developers for the acquisition, development and construction of residential and commercial properties. First mortgage construction loans are made to developers and builders primarily for single family homes and multi-family buildings that are presold or are to be sold or leased on a speculative basis.

The Company lends to builders and developers with established relationships, successful operating histories and sound financial resources. Management has established underwriting and monitoring criteria to minimize the inherent risks of real estate construction lending. The risks associated with speculative construction lending include the borrower's inability to complete the construction process on time and within budget, the sale or rental of the project within projected absorption periods and the economic risks associated with real estate collateral. Such loans may include financing the development and/or construction of residential subdivisions. This activity may involve financing land purchases and infrastructure development (i.e., roads, utilities, etc.) as well as construction of residences or multi-family dwellings for subsequent sale by the developer/builder. Because the sale or rental of developed properties is integral to the success of developer business, loan repayment may be especially subject to the volatility of real estate market values.

Mortgage Warehouse Lines of Credit

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

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

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. The principal risk is the borrower becomes unemployed or has a significant reduction in income.

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

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

•Consumer credit scores;
•Internal credit risk grades;
•Loan-to-value ratios;
•Collateral; and
•Collection experience.

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

(Dollars in thousands)	2018	2017	2016	2015	2014
Balance, beginning of year	$8,013	$7,494	$7,560	$6,925	$7,039
Provision (credit) charged to operating expenses	900	600	(300)	1,100	5,750
Loans charged off:					
Construction loans	—	—	—	—	—
Residential real estate loans	—	(101)	—	—	(15)
Commercial business and commercial real estate loans	(553)	(61)	(157)	(477)	(5,906)
Loans to individuals	(16)	—	—	(14)	(1)
All other loans	(17)	—	(1)	—	—
	(586)	(162)	(158)	(491)	(5,922)
Recoveries:					
Construction loans	—	—	—	—	—
Residential real estate loans	—	—	—	—	—
Commercial business and commercial real estate loans	74	64	386	20	58
Loans to individuals	1	4	6	6	—
All other loans	—	13	—	—	—
	75	81	392	26	58
Net (charge offs) recoveries	(511)	(81)	234	(465)	(5,864)
Balance, end of year	$8,402	$8,013	$7,494	$7,560	$6,925
Loans:					
At year end	$883,164	$789,906	$724,808	$682,121	$654,297
Average during the year	832,966	717,010	698,436	684,485	556,362
Net recoveries (charge offs) to average loans outstanding	(0.06)%	(0.01)%	0.03%	(0.07)%	(1.04)%
Net recoveries (charge-offs) to average loans, excluding mortgage warehouse loans	(0.08)%	(0.01)%	0.05%	(0.10)%	(1.36)%
Allowance for loan losses to:					
Total loans at year end	0.95%	1.01%	1.03%	1.11%	1.06%
Total loans at year end excluding mortgage warehouse lines and related allowance	1.05%	1.19%	1.28%	1.44%	1.27%
Non-performing loans	127.69%	112.64%	144.17%	125.59%	143.08%

At December 31, 2018, the allowance for loan losses was $8.4 million compared to $8.0 million at December 31, 2017, an increase of $389,000. The ratio of the allowance for loan losses to total loans at December 31, 2018 and 2017 was 0.95% and 1.01%, respectively. The allowance for loan losses as a percentage of non-performing loans was 127.69% at December 31, 2018 compared to 112.64% at December 31, 2017.

The allowance for loan losses increased in 2018 due primarily to a provision for $900,000, which reflected net charge-offs of $511,000, compared to a provision for loan losses in the amount of $600,000 in 2017, which reflected net charge-offs of $81,000.

The allowance for loan losses decreased as a percentage of total loans to 0.95% at December 31, 2018 from 1.01% at December 31, 2017 due primarily to acquisition accounting for the NJCB merger, which resulted in the NJCB loans being recorded at their fair value and included a credit risk adjustment of approximately$1.6 million at the date of the

NJCB merger.

Management believes that the quality of the loan portfolio remains sound, considering the economic climate and economy in the State of New Jersey and the New York City metropolitan area and that the allowance for loan losses is adequate in relation to credit risk exposure levels.

The following tables present the allocation of the allowance for loan losses among loan classes and certain other information as of the dates indicated. The total allowance is available to absorb losses from any segment of loans.

(Dollars in thousands)	December 31, 2018			2017			2016		
	Amount	ALL as a % of Loans	Loans as a % of Total Loans	Amount	ALL as a % of Loans	Loans as a % of Total Loans	Amount	ALL as a % of Loans	Loans as a % of Total Loans
Commercial real estate	$3,439	0.89%	44 %	$2,949	0.95%	39 %	$2,574	1.06%	34 %
Commercial business	1,829	1.52	14	1,720	1.85	12	1,732	1.74	14
Construction loans	1,732	1.16	17	1,703	1.25	17	1,204	1.25	13
Residential real estate	431	0.91	5	392	0.97	5	367	0.82	6
Loans to individuals and other	148	0.64	3	114	0.54	3	112	0.47	3
Subtotal	7,579	1.09	83	6,878	1.15	76	5,989	1.18	70
Mortgage warehouse lines	731	0.47	17	852	0.45	24	973	0.45	30
Unallocated reserves	92	—	—	283	—	—	532	—	—
Total	$8,402	0.95%	100%	$8,013	1.01%	100%	$7,494	1.03%	100%

	December 31, 2015			2014		
	Amount	ALL as a % of Loans	% of Loans	Amount	ALL as a % of Loans	% of Loans
Commercial real estate	$3,049	1.47%	30 %	$2,393	1.21%	30 %
Commercial business	2,005	2.02	15	1,761	1.59	17
Construction loans	1,025	1.09	14	1,215	1.27	15
Residential real estate	288	0.71	6	197	0.42	7
Loans to individuals and other	109	0.47	3	131	0.56	4
Subtotal	6,476	1.39	68	5,697	1.20	73
Mortgage warehouse lines	866	0.40	32	896	0.50	27
Unallocated reserves	218	—	—	332	—	—
Total	$7,560	1.11%	100%	$6,925	1.06%	100%

The allowance for loan losses, excluding the portion related to mortgage warehouse lines, increased to $7.7 million at December 31, 2018 from $7.2 million at December 31, 2017.

Deposits

The following table sets forth the balances and contractual rates payable to our customers, by account type, as of December 31, 2018 and 2017:

(Dollars in thousands)	December 31, 2018 Amount	Percent Of Total	Weighted Average Contractual Rate	December 31, 2017 Amount	Percent Of Total	Weighted Average Contractual Rate
Non-interest bearing demand	$212,981	22 %	— %	$196,509	21 %	— %
Interest bearing demand	323,503	34 %	0.63 %	372,133	41 %	0.43 %
Savings	189,612	20 %	0.83 %	215,197	23 %	0.63 %
Total core deposits	$726,096	76 %	0.51 %	$783,839	85 %	0.38 %
Certificates of deposit	$224,576	24 %	1.98 %	$138,167	15 %	1.22 %
Total	$950,672	100 %	0.85 %	$922,006	100 %	0.52 %

The following table indicates the amount of certificates of deposit by time remaining until maturity as of December 31, 2018.

(In thousands)	3 Months or Less	Over 3 to 6 Months	Over 6 to 12 Months	Over 12 Months	Total
Certificates of deposit of $100,000 or more	$28,445	$17,672	$38,496	$79,601	$164,214
Certificates of deposit less than $100,000	10,400	6,675	14,355	28,932	60,362
Total	$38,845	$24,347	$52,851	$108,533	$224,576

The following table illustrates the components of average total deposits for the years indicated:

(Dollars in thousands)	2018 Average Balance	Percentage of Total	2017 Average Balance	Percentage of Total	2016 Average Balance	Percentage of Total
Non-interest bearing demand	$204,002	21 %	$183,802	21 %	$166,380	20 %
Interest bearing demand	356,906	38 %	336,445	38 %	301,086	36 %
Savings	203,940	21 %	210,798	24 %	206,208	25 %
Certificates of deposit	189,521	20 %	145,539	17 %	152,078	19 %
Total	$954,369	100 %	$876,584	100 %	$825,752	100 %

Deposits, which include demand deposits (interest bearing and non-interest bearing), savings deposits and certificates of deposit, are a fundamental and cost-effective source of funding. The flow of deposits is influenced significantly by general economic conditions, changes in market interest rates and competition. The Company offers a variety of products designed to attract and retain customers, with the Company's primary focus on the building and expanding of long-term relationships. Deposits for the year ended December 31, 2018 averaged $954.4 million, an increase of $77.8 million, or 8.9%, compared to $876.6 million for the year ended December 31, 2017. The NJCB merger provided $59.7 million in average deposits for the year ended December 31, 2018.

At December 31, 2018, total deposits were $950.7 million, an increase of $28.7 million, or 3.1%, from $922.0 million at December 31, 2017. The NJCB merger provided $69.6 million in deposits at December 31, 2018. The increase in total deposits in 2018 was due principally to an increase of $86.4 million in certificates of deposit, and a $16.5 million increase in non-interest bearing demand deposits which were partially offset by a $48.6 million decrease in interest-bearing demand deposits and a $25.6 million decrease in savings deposits. Total deposits, excluding NJCB deposits, declined $40.9 million during the year 2018. Municipal deposits, primarily interest-bearing demand deposits and savings accounts, declined approximately $46.2 million from the end of 2017. As a result of the Tax Act, a number of the Bank's municipal customers experienced significant advanced payments in December 2017 for real estate taxes that were due in 2018. This was due to income tax planning considerations by individuals. As the Bank's municipal customers expended these additional funds during the year 2018, their deposit balances declined from the levels at December 31, 2017. The average cost of the Company's interest-bearing deposit accounts for 2018 was 0.87%, an increase from the average cost of 0.66% for 2017.

Average non-interest bearing demand deposits increased by $20.2 million, or 11.0%, to $204.0 million for the year ended December 31, 2018 from $183.8 million for the year ended December 31, 2017. At December 31, 2018, non-interest bearing demand deposits totaled $213.0 million, an increase of $16.5 million, or 8.4%, compared to $196.5 million at December 31, 2017. Non-interest bearing demand deposits made up 22.4% of total deposits at December 31, 2018 compared to 21.3% at December 31, 2017 and represent a stable, interest-free source of funds.

In 2018, the average balance of savings accounts decreased by $6.9 million to $203.9 million compared to an average balance of $210.8 million in 2017. Savings accounts increased by $25.6 million, or 11.9%, to $189.6 million at December 31, 2017 from $215.2 million at December 31, 2017. The average cost of savings deposits was 0.72% for 2018 compared to 0.63% in 2017.

Interest-bearing demand deposits, which include interest-bearing checking accounts, money market and NOW accounts and the Company's premier money market product, 1st Choice account, increased by $20.5 million, or 6.1%, to an average of $356.9 million for 2018 from an average of $336.4 million for 2017. At December 31, 2018, interest-bearing demand deposits were $323.5 million compared to $372.1 million at December 31, 2017. The average cost of interest-bearing demand deposits was 0.55% for 2018 compared to 0.43% in 2017.

Certificates of deposit at December 31, 2018 were $224.6 million, an increase of $86.4 million from $138.2 million at December 31, 2017. The average cost of certificates of deposits increased to 1.62% in 2018 from 1.22% in 2017.

Borrowings

Borrowings are comprised of Federal Home Loan Bank ("FHLB") borrowings and overnight funds purchased and are primarily used to fund asset growth not supported by deposit generation. The average balance of other borrowed funds increased by $15.5 million to $36.6 million for 2018 from an average balance of $21.1 million for 2017 due to an increase in overnight borrowings in 2018 to meet the need for funding of the Bank's loan growth. The average cost of other borrowed funds increased 25 basis points to 2.28% for 2018 compared to 2.03% for 2017 because of the increase in short-term market interest rates.

Shareholders' Equity and Dividends

Shareholders' equity increased by $15.4 million, or 13.8%, to $127.1 million at December 31, 2018 from $111.7 million at December 31, 2017. Book value per common share was $14.77 at December 31, 2018 compared to $13.81 at December 31, 2017. The ratio of average shareholders' equity to total average assets was 10.48% and 10.56% for 2018 and 2017, respectively. The increase in shareholders' equity from December 31, 2017 to December 31, 2018 was primarily the result of net income for 2018 and the issuance of common stock in connection with the NJCB merger, which was partially offset by dividends paid.

On December 19, 2018, both of the outstanding warrants were exercised and pursuant to the terms and conditions of the two warrants, the Company issued a net of 198,378 shares. No cash was received from the exercise of the warrants.

In lieu of cash dividends, the Company (and its predecessor, the Bank) declared a stock dividend every year for the years 1992 through 2012 and paid such dividends every year for the years 1993 through 2013. The Company declared two stock dividends in 2015 and did not declare a stock dividend in 2014 or 2013. The Company began declaring and paying cash dividends in September 2016. The timing and the amount of the payment of future cash dividends, if any, on the Company's common shares will be at the discretion of the Company's Board of Directors and will be determined after consideration of various factors, including the level of earnings, cash requirements, regulatory capital and financial condition.

The Federal Reserve Board has issued a supervisory letter to bank holding companies that contains guidance on when the board of directors of a bank holding company should eliminate or defer or severely limit dividends, including, for example, when net income available for shareholders for the past four quarters, net of dividends paid during that period, is not sufficient to fully fund the dividends. The letter also contains guidance on the redemption of stock by bank holding companies, which urges bank holding companies to advise the Federal Reserve Board of any such redemption or repurchase of common stock for cash or other value that results in the net reduction of a bank holding company’s capital at the beginning of the quarter below the capital outstanding at the end of the quarter. The Company's payment of cash dividends to date were within the guidelines set forth in the Federal Reserve Board's supervisory letter.

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

The Company and the Bank are subject to various regulatory capital requirements administered by the Federal Reserve Board and the FDIC. For information on regulatory capital, see “Capital Adequacy of the Company and the Bank” in the “Supervision and Regulation” section under Item 1. “Business” and Note 19, "Regulatory Capital Requirements" of the Notes to Consolidated Financial Statements.

The Company believes that its shareholders’ equity and regulatory capital position are adequate to support the planned operations of the Company for the foreseeable future.

Capital Resources

The Company and the Bank are subject to various regulatory capital requirements administered by the Federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company’s and the Bank’s financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of the Company’s and the Bank’s assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Company’s and the Bank’s capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios of Common Equity Tier 1, Total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined) and Tier I capital to average assets (Leverage ratio, as defined). As of December 31, 2018, the Company and the Bank met all capital adequacy requirements to which they are subject.

To be categorized as adequately capitalized, the Company and the Bank must maintain minimum Common Equity Tier 1, Total capital to risk-weighted assets, Tier 1 capital to risk-weighted assets and Tier I leverage capital ratios as set forth in the below table. As of December 31, 2018, the Bank's capital ratios exceeded the regulatory standards for well-capitalized institutions. Certain bank regulatory limitations exist on the availability of the Bank’s assets for the payment of dividends by the Bank without prior approval of bank regulatory authorities.

In July 2013, the Federal Reserve Board and the FDIC approved revisions to their capital adequacy guidelines and prompt corrective action rules that implemented and addressed the revised standards of Basel III and addressed relevant provisions of the Dodd-Frank Act. The Federal Reserve Board’s final rules and the FDIC’s interim final rules (which became final in April 2014 with no substantive changes) apply to all depository institutions, top-tier bank holding companies with total consolidated assets of $500 million or more (which was subsequently increased to $1 billion or more in May 2015) and top-tier savings and loan holding companies (“banking organizations”). Among other things, the rules established a Common Equity Tier 1 minimum capital requirement (4.5% of risk-weighted assets) and increased the minimum Tier 1 capital to risk-based assets requirement (from 4% to 6% of risk-weighted assets). Banking organizations are also required to have a total capital ratio of at least 8% and a Tier 1 leverage ratio of at least 4%.

The rules also limited a banking organization’s ability to pay dividends, engage in share repurchases or pay discretionary bonuses if the banking organization does not hold a “capital conservation buffer” consisting of 2.5% of Common Equity Tier 1 capital to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements. The rules became effective for the Company and the Bank on January 1, 2015. The capital conservation buffer requirement began phasing in on January 1, 2016 at 0.625% of Common Equity Tier 1 capital to risk-weighted assets and increases by that amount each year until fully implemented in January 2019 at 2.5% of Common Equity Tier 1 capital to risk-weighted assets. As of December 31, 2018, the Company and the Bank were required to maintain a capital conservation buffer of 1.875%. and as of January 1, 2019, the Company and the Bank were required to maintain a capital conservation buffer of 2.5%.

The Company's and the Bank's regulatory capital ratios, excluding the impact of the capital conservation buffer, as of December 31, 2018 were as follows:

(Dollars in thousands)	Actual Amount	Actual Ratio	For Capital Adequacy Purposes Amount	For Capital Adequacy Purposes Ratio	To Be Well Capitalized Under Prompt Corrective Action Provisions Amount	To Be Well Capitalized Under Prompt Corrective Action Provisions Ratio
Company						
Common Equity Tier 1	$115,537	10.72%	$48,496	4.50%	N/A	N/A
Total capital to risk-weighted assets	141,939	13.17%	86,214	8.00%	N/A	N/A
Tier 1 capital to risk-weighted assets	133,537	12.39%	64,661	6.00%	N/A	N/A
Tier 1 leverage capital	133,537	11.73%	45,538	4.00%	N/A	N/A
Bank						
Common Equity Tier 1	$133,548	12.40%	$48,471	4.50%	$70,013	6.50 %
Total capital to risk-weighted assets	141,950	13.18%	86,170	8.00%	107,712	10.00%
Tier 1 capital to risk-weighted assets	133,548	12.40%	64,627	6.00%	86,170	8.00 %
Tier 1 leverage capital	133,548	11.74%	45,516	4.00%	56,894	5.00 %

At December 31, 2018, the Company and the Bank met all the regulatory capital adequacy requirements to which they were subject and were classified as “well capitalized” under the regulatory framework for prompt corrective action. Management believes that no conditions or events have occurred since December 31, 2018 that would materially adversely change the Company’s or the Bank’s capital classifications. Management believes that the Company’s and the Bank’s capital resources are adequate to support the Company’s and the Bank’s current strategic and operating plans. The Company and the Bank do not expect any material changes in the mix and relative cost of their capital resources in 2019.

The Company and the Bank do not have material commitments for capital expenditures at December 31, 2018. Any non-material commitments for capital expenditures are in the ordinary course of business and will be funded through cash flow from operations in 2019.

Off-Balance Sheet Arrangements and Contractual Obligations

In the normal course of business the Company enters into various transactions that, in accordance with U.S. GAAP, are not included on the balance sheet. The Company issues off-balance sheet financial instruments in connection with its lending activities and to meet the financing needs of its customers. These financial instruments include commitments to fund loans, lines of credit and commercial and standby letters of credit. These instruments carry various degrees of credit risk and market risk, which are essentially the same risks involved in extending loans. The Company generally follows the same credit and collateral policies in making these commitments and conditional obligations as it does for instruments recorded on the Company’s consolidated balance sheet. Many of these commitments and conditional obligations are expected to expire without being drawn, and the contractual amounts do not necessarily represent future cash requirements. These off-balance sheet arrangements have not had and are not reasonably likely to have a current or future material effect on the Company’s financial position, revenues, expenses, results of operations, liquidity, capital expenditures or capital resources.

The financial instrument commitments at December 31, 2018 were as follows:

(In thousands)	Less than One Year	One to	Three to	Over Five	Total

		Three Years	Five Years	Years	
Commercial and standby letters of credit	$766	$—	$—	$—	$766
Commitments to fund loans	22,870	185	28	—	23,083
Commitments to extend credit	338,873	39,477	2,082	22,563	402,995
Commitments to sell residential loans	4,328	—	—	—	4,328
Total	$366,837	$39,662	$2,110	$22,563	$431,172

59

Commercial and standby letters of credit

Letters of credit are conditional commitments issued by the Company to guarantee the performance of a specified financial obligation of a customer to a third party. In the event that the customer does not perform in accordance with the terms of the agreement with the third party, the Company would be required to fund the commitment. The maximum potential future payments that the Company could be required to make was $766,000 at December 31, 2018.

Commitments to fund loans

Commitments to fund loans are legally binding loan commitments with set expiration dates and specified interest rates as well as for specific purposes. These loan commitments are intended to be disbursed, subject to the satisfaction of certain conditions, upon the request of the borrower.

Commitments to extend credit

The Company issues lines of credit to commercial businesses, to owners of commercial real estate, for the construction or acquisition of real estate properties and to consumers for home equity and personal expenditures. Many of these commitments may not be drawn but are available to the borrower under the terms of the loan agreement.

Commitments to sell residential loans

The Company enters into best efforts forward sales commitments to sell residential mortgage loans that it has closed (loans held for sale), or it expects to close (commitments to originate loans to be sold). These commitments are utilized to reduce the Company's market price risk from the date of commitment to the date of sale. The notional amount of the forward sales commitments was approximately $4.3 million at December 31, 2018.

The following table presents additional information regarding the Company's outstanding contractual obligations as of December 31, 2018:

	Payments Due by Period				
(In thousands)	Less than One Year	One to Three Years	Three to Five Years	More than Five Years	Total
Operating leases	$1,525	$2,637	$1,806	$2,285	$8,253
Borrowed funds and subordinated debentures	71,775	—	—	18,557	90,332
Certificates of deposit	116,043	95,729	12,804	—	224,576
Retirement benefit obligation projected	4,587	—	—	—	4,587
Total contractual obligations:	$193,930	$98,366	$14,610	$20,842	$327,748

Liquidity

At December 31, 2018, the amount of liquid assets held by the Company remained at a level management deemed adequate to ensure that contractual liabilities, depositors' withdrawal requirements and other operational and customer credit needs could be satisfied.

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

The Company has established a borrowing relationship with the FHLB, which further supports and enhances liquidity. During 2010, the FHLB replaced its Overnight Line of Credit and One-Month Overnight Repricing Line of Credit facilities available to member banks with a fully secured line of up to 50 percent of a bank's quarter-end total assets. Under the terms of this facility, the Bank's total credit exposure to the FHLB cannot exceed 50 percent, or $589.0 million, of its total assets at December 31, 2018. In addition, the aggregate outstanding principal amount of the Bank's advances, letters of credit, the dollar amount of the FHLB's minimum collateral requirement for off balance sheet financial contracts and advance commitments cannot exceed 30 percent of the Bank's total assets, unless the Bank obtains approval from the FHLB's Board of Directors or its Executive Committee. These limits are further restricted by a member bank's ability to provide eligible collateral to support its obligations to the FHLB, as well as a member bank's ability to meet the FHLB's stock requirement. A December 31, 2018 and December 31, 2017, the Bank pledged approximately $270.9 million and $177.8 million of loans, respectively, to support the FHLB borrowing capacity. At December 31, 2018 and December 31, 2017, the Bank had available borrowing capacity of $131.2 million and $140.3 million, respectively, at the FHLB of New York. The Bank also maintains unsecured federal funds lines of $46.0 million with two correspondent banks.

The Consolidated Statements of Cash Flows present the changes in cash from operating, investing and financing activities. At December 31, 2018, the balance of cash and cash equivalents was $16.8 million.

Net cash provided by operating activities totaled $17.3 million for the year ended December 31, 2018 compared to net cash provided by operating activities of $21.9 million for the year ended December 31, 2017. The primary source of funds was net income from operations, adjusted for activity related to loans originated for sale, the provision for loan losses, depreciation expense and net amortization of premiums on securities. Cash was used in operations primarily for originating loans held for sale. The decrease in net cash provided by operating activities was due primarily to net cash provided by the origination and sale of loans totaling $1.2 million in 2018 compared to $10.6 million of cash provided by the origination and sale of loans in 2017, which was partially offset by the increase in net income of $5.1 million.

Net cash used in investing activities totaled $9.9 million for the year ended December 31, 2018 compared to $51.5 million for the year ended December 31, 2017. The cash used in lending activities was $21.0 million in 2018 compared to $65.4 million in 2017. The cash used in lending activity was partially offset by cash provided by investment securities transactions of $12.9 million in 2018 compared to net cash provided by investment securities transactions of $14.0 million in 2017.

Net cash used in financing activities totaled $9.3 million for the year ended December 31, 2018 compared to net cash provided by financing activities of $33.5 million for the year ended December 31, 2017. The net cash used in financing activities in 2018 was due primarily to the net decrease in deposits, which was partially offset by an increase in overnight borrowings. The Company paid dividends totaling $2.1 million in 2018 compared to $1.7 million in 2017.

The investment securities portfolios are also a source of liquidity, providing cash flows from maturities and periodic repayments of principal. For the year ended December 31, 2018, sales, repayments and maturities of investment securities totaled $55.9 million compared to $84.3 million in 2017. Another source of liquidity is the loan portfolio, which provides a flow of payments and maturities.

Management believes that the Company's liquidity position is adequate to service the needs of its borrowers and depositors and provide for its planned operations.

Interest Rate Sensitivity Analysis

The largest component of the Company’s total income is net interest income and the majority of the Company’s financial instruments are composed of interest rate sensitive assets and liabilities with various terms and maturities. The primary objective of management is to maximize net interest income while minimizing interest rate risk. The Company’s assets consist primarily of floating rate construction loans, commercial lines of credit and fixed rate commercial real estate loans and its liabilities consist primarily of deposits. Interest rate risk is derived from timing differences and the magnitude of relative changes in the repricing of assets and liabilities, loan prepayments, deposit withdrawals and differences in lending and funding rates. Management actively seeks to monitor and control the mix of interest rate sensitive assets and liabilities.

The following table sets forth certain information relating to the Company's financial instruments that are sensitive to changes in interest rates, categorized by expected maturity or repricing of such instruments, at December 31, 2018.

	Interest Sensitivity Period				Total Within	One Year to	Over	Non-interest	
(In thousands)	30 Day	90 Day	180 Day	365 Day	One Year	Five Years	Five Years	Sensitive	T
Assets :									
Cash and due from banks	$12,743	$—	$763	$—	$13,506	$—	$—	$3,338	$1
Federal funds sold	—	—	—	—	—	—	—	—	—
Investment securities	37,869	19,513	6,380	22,409	86,171	82,888	33,262	9,473	21
Loans held for sale	3,020	—	—	—	3,020	—	—	—	3,
Loans, net of allowance for loan losses	397,257	25,888	39,513	71,867	534,525	315,684	22,629	10,326	88
Other assets	—	—	—	—	—	—	—	63,269	63
	$450,889	$45,401	$46,656	$94,276	$637,222	$398,572	$55,891	$86,406	$1
Liabilities and Equity:									
Demand deposits - non-interest bearing	$—	$—	$—	$—	$—	$—	$—	$212,981	$2
Demand deposits - interest bearing	151,564	—	—	—	151,564	139,084	32,855	—	32
Savings deposits	104,772	—	—	31	104,803	46,912	37,897	—	18
Certificates of deposits	11,243	27,638	23,486	53,676	116,043	108,533	—	—	22
Borrowings	71,775	—	—	—	71,775	—	—	—	71
Redeemable subordinated debentures	—	18,000	—	—	18,000	—	—	557	18
Non-interest-bearing sources	—	—	—	—	—	—	—	137,087	13
	$339,354	$45,638	$23,486	$53,707	$462,185	$294,529	$70,752	$350,625	$1
Asset (Liability) Sensitivity Gap :									
Period Gap	$111,535	$(237)	$23,170	$40,569	$175,037	$104,043	$(14,861)	$(264,219)	—
Cumulative Gap	$111,535	$111,298	$134,468	$175,037	$175,037	$279,080	$264,219	—	—
Cumulative Gap to Total Assets	9.5%	9.4%	11.4%	14.9%	14.9%	23.7%	22.4%	—	—

Under the Company's interest rate risk policy established by its Board of Directors, quantitative guidelines have been established with respect to the Company's interest rate risk and how interest rate shocks are projected to affect the Company's net interest income and economic value of equity ("EVE"). The Company engages the services of an outside consultant to assist with the measurement and analysis of interest rate risk. The Company uses a combination of analyses to monitor its exposure to changes in interest rates. The EVE analysis is a financial model that estimates the change in EVE over a range of instantaneously shocked interest rate scenarios. EVE is the discounted present value of expected cash flows from assets, liabilities and off-balance sheet contracts. In calculating changes in EVE, assumptions estimating loan prepayment rates, reinvestment rates and deposit decay rates that seem most likely based on historical experience during prior interest rate changes are employed. The net interest income simulation uses data derived from an asset and liability analysis and applies several elements, including actual interest rate indices and margins, contractual limitations and the U.S. Treasury yield curve as of the balance sheet date. The financial model uses immediate parallel yield curve shocks (in both directions) to determine possible changes in net interest income as if the theoretical rate shocks occurred. The EVE analysis and net interest income simulation model results are presented quarterly to the Asset/Liability Committee of the Board of Directors.

Summarized below are the projected effects of a parallel shift of increases of 200 and 300 basis points, respectively, and a decrease of 200 basis points in market rates on the Company's net interest income and EVE.

Change in Interest Rates	Economic Value of Equity [2]			Next 12 Months Net Interest Income		
Basis Point (bp) [1]	Dollar	Dollar	Percentage	Dollar	Dollar	Percentage
(Dollars in thousands)	Amount	Change	Change	Amount	Change	Change
+300 bp	$167,824	$(4,005)	(2.33)%	$50,668	$4,215	9.10 %
+200 bp	169,632	(2,197)	(1.28)%	49,274	2,821	6.10 %
0 bp	171,829	—	—	46,453	—	—
-200 bp	168,019	(3,810)	(2.22)%	41,289	(5,164)	(11.12)%

(1) Assumes an instantaneous and parallel shift in interest rates at all maturities.
(2) EVE is the discounted present value of expected cash flows from assets, liabilities and off-balance sheet contracts.

The above table indicates that, as of December 31, 2018, in the event of a 200 basis point increase in interest rates, the Company would be expected to experience a 1.28% decrease in EVE and a $2.8 million, or 6.1%, increase in net interest income over the next twelve months. As of December 31, 2018, in the event of a 200 basis points decrease in interest rates, the Company would be expected to experience a 2.22% decrease in EVE and a 11.12% decrease in net interest income. This data does not reflect any future actions that management may take in response to changes in interest rates, such as changing the mix of assets and liabilities, which could change the results of the EVE and net interest income calculations.

Certain shortcomings are inherent in any methodology used in the above interest rate risk measurements. Modeling changes in EVE and net interest income require certain assumptions that may or may not reflect the manner in which actual yields and costs respond to changes in market interest rates. In this regard, the estimated EVE and net interest income presented above assumes that the composition of the Company's interest-rate sensitive assets and liabilities existing at the beginning of a period remains constant over the period being measured and, accordingly, the data does not reflect any actions that the Company may take in response to changes in interest rates. The estimates also assume a particular change in interest rates is reflected uniformly across the yield curve regardless of the duration to maturity or the repricing characteristics of specific assets and liabilities. Although the estimated EVE and net interest income provide an indication of the Company's sensitivity to interest rate changes at a particular point in time, such measurement is not intended to and does not provide a precise forecast of the effects of changes in market interest rates on the Company's EVE and net interest income and will differ from actual results.

On July 27, 2017, the Financial Conduct Authority (FCA), a regulator of financial services firms in the United Kingdom, announced that it intends to stop persuading or compelling banks to submit LIBOR rates after 2021. The FCA and submitting LIBOR banks have indicated they will support the LIBOR indices through 2021 to allow for an orderly transition to an alternative reference rate. In the United States, efforts to identify a set of alternative U.S. dollar reference interest rates include proposals by the Alternative Reference Rates Committee of the Federal Reserve Board. Other financial services regulators and industry groups are evaluating the possible phase-out of LIBOR and the development of alternate reference rate indices or reference rates. Some of our assets and liabilities are indexed to LIBOR. We are evaluating the potential impact of the possible replacement of the LIBOR benchmark interest rate, but are not able to predict whether LIBOR will cease to be available after 2021, whether the alternative rates the Federal Reserve Board proposes to publish will become market benchmarks in place of LIBOR, or what the impact of such a transition will have on our business, financial condition, or results of operations. Reform of, or the replacement or phasing out of, LIBOR and proposed regulation of LIBOR and other "benchmarks" may materially adversely affect the amount of interest paid on any LIBOR-based loans, investment securities and borrowings of the Company and the Company's business, financial condition and results of operations.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

The Company's Asset Liability Committee ("ALCO") is responsible for developing, implementing and monitoring asset liability management strategies and advising the Board on such strategies, as well as the related level of interest rate risk. Interest rate risk simulation models are prepared on a quarterly basis. These models demonstrate balance sheet gaps and predict changes to net interest income and the economic market value of portfolio equity under various interest rate scenarios.

ALCO is generally authorized to manage interest rate risk through the management of capital, cash flows and duration of assets and liabilities, including sales and purchases of assets, as well as additions of borrowings and other sources of medium or longer term funding.

The following strategies are among those used to manage interest rate risk:

- Actively market commercial business loan originations, which tend to have adjustable rate features and which generate customer relationships that can result in higher core deposit accounts;
- Actively market commercial mortgage loan originations, which tend to have shorter terms and higher interest rates than residential mortgage loans and which generate customer relationships that can result in higher core deposit accounts;
- Actively market core deposit relationships, which are generally longer duration liabilities;
- Utilize short term and long term certificates of deposit and/or wholesale borrowings to manage liability duration;
- Closely monitor and actively manage the investment portfolio, including management of duration, prepayment and interest rate risk;
- Maintain adequate levels of capital; and
- Utilize loan sales and/or loan participations.

ALCO uses simulation modeling to analyze the Company's net interest income sensitivity as well as the Company's economic value of portfolio equity under various interest rate scenarios. The model is based on the actual maturity and estimated repricing characteristics of rate sensitive assets and liabilities. The model incorporates certain prepayment and interest rate assumptions, which management believes to be reasonable as of December 31, 2018. The model assumes changes in interest rates without any proactive change in the balance sheet by management. In the model, the forecasted shape of the yield curve remained static as of December 31, 2018.

In an immediate and sustained 200 basis point increase in market interest rates at December 31, 2018, net interest income for year one would increase approximately 6.1%, when compared to a flat interest rate scenario. In year two, this sensitivity improves to an increase of 9.1%, when compared to a flat interest rate scenario. In an immediate and sustained 200 basis points decrease in market interest rates, net interest income for year one would decrease approximately 11.1% and would decrease approximately 16.0% in year two.

Certain shortcomings are inherent in the methodologies used in determining interest rate risk. Simulation modeling requires making certain assumptions that may or may not reflect the manner in which actual yields and costs respond to changes in market interest rates. In this regard, the modeling assumes that the composition of our interest-sensitive assets and liabilities existing at the beginning of a period remains constant over the period being measured and assumes that a particular change in interest rates is reflected uniformly across the yield curve regardless of the duration or repricing of specific assets and liabilities. Accordingly, although the information provides an indication of our interest rate risk exposure at a particular point in time, such measurements are not intended to, and do not, provide a precise forecast of the effect of changes in market interest rates on our net interest income and will differ from actual results.

Model simulation results indicate the Company is asset sensitive, which indicates the Company's net interest income should increase in a rising rate environment and decrease in a falling rate environment. Management believes the Company's interest rate risk position is balanced and reasonable.

Item 8. Financial Statements and Supplementary Data.

Reference is made to Items 15(a)(1) and (2) on page 67 for a list of financial statements and supplementary data required to be filed pursuant to this Item 8. The information required by this Item 8 is provided beginning on page 67 hereof.

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.

None.

Item 9A. Controls and Procedures.

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

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

Management's Report on Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

The Company's internal control over financial reporting includes those policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that the receipts and expenditures of the Company are being made only in accordance with authorizations of its management and directors; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on its financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of the effectiveness of internal control over financial reporting to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with policies or procedures may deteriorate.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis. A significant deficiency is a control deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness; yet important enough to merit attention by those responsible for oversight of the Company's financial reporting.

The Company's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2018. In making this assessment, management used the criteria set forth in Internal Control-Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based on their assessment using those criteria, management concluded that, as of December 31, 2018, the Company's internal control over financial reporting was effective.

BDO USA, LLP, the Company's independent registered public accounting firm, audited our internal control over financial reporting as of December 31, 2018. Their attestation report, which appears in the Company's consolidated financial statements that are contained in the Annual Report on Form 10-K immediately following Item 15, expressed an unqualified opinion on our internal control over financial reporting. Such report is incorporated herein by reference.

Management is also responsible for compliance with laws and regulations relating to safety and soundness which are designated by the FDIC and the appropriate federal banking agency. Management assessed its compliance with these designated laws and regulations relating to safety and soundness and concluded that the Company complied, in all significant respects, with such laws and regulations during the year ended December 31, 2018.

The Company's principal executive officer and principal financial officer also evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act). Based on such evaluation, the Company's principal executive officer and principal financial officer concluded that such disclosure controls and procedures were effective as of December 31, 2018 (the end of the period covered by this Annual Report on Form 10-K).

The Company’s principal executive officer and principal financial officer have also concluded that there was no change in the Company’s internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the quarter ended December 31, 2018 that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting.

Item 9B. Other Information.

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance.

The information required by this item is incorporated by reference to the Company’s Proxy Statement for its 2019 Annual Meeting of Shareholders under the captions "Directors and Executive Officers," "Corporate Governance" and "Stock Ownership of Management and Principal Shareholders."

Item 11. Executive Compensation.

The information required by this item is incorporated by reference to the Company’s Proxy Statement for its 2019 Annual Meeting of Shareholders under the caption "Executive Compensation" and "Director Compensation."

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters.

The information required by this item is incorporated by reference from the Company’s Proxy Statement for its 2019 Annual Meeting of Shareholders under the captions "Equity Plans" and "Stock Ownership of Management and Principal Shareholders."

Item 13. Certain Relationships and Related Transactions, and Director Independence.

This information required by this item is incorporated by reference from the Company’s Proxy Statement for its 2019 Annual Meeting of Shareholders under the captions "Certain Transactions With Management" and "Corporate Governance."

Item 14. Principal Accounting Fees and Services.

The information required by this item is incorporated by reference to the Company’s Proxy Statement for its 2019 Annual Meeting of Shareholders under the caption "Principal Accounting Fees and Services."

PART IV

Item 15. Exhibits, Financial Statement Schedules.

(a) Financial Statements and Financial Statement Schedules

1. The following documents are filed as part of this Annual Report on Form 10-K:

Reports of Independent Registered Public Accounting Firm

Financial Statements of 1st Constitution Bancorp.

Consolidated Balance Sheets–December 31, 2018 and 2017.

Consolidated Statements of Income – For the Years Ended December 31, 2018, 2017 and 2016.

Consolidated Statements of Comprehensive Income – For the Years Ended December 31, 2018, 2017 and 2016.

Consolidated Statements of Changes in Shareholders' Equity–For the Years Ended December 31, 2018, 2017 and 2016.

Consolidated Statements of Cash Flows – For the Years Ended December 31, 2018, 2017 and 2016.

Notes to Consolidated Financial Statements

These statements are incorporated by reference to the Company's Annual Report to Shareholders for the year ended December 31, 2018.

2. All schedules are omitted because they are either inapplicable or not required, or because the information required therein is included in the Consolidated Financial Statements and Notes thereto.

3. Exhibits

EXHIBIT INDEX

Exhibit No.	Description
2	Agreement and Plan of Merger, dated as of November 6, 2017, by and among the Company, the Bank and NJCB (incorporated by reference to Exhibit 2.1 to the Company's Form 8-K (SEC File No. 000-32891) filed with the SEC on November 7, 2017)
3(i)	Certificate of Incorporation of the Company (conformed copy) (incorporated by reference to Exhibit 3(i)(A) to the Company's Form 10-K (SEC File No. 000-32891) filed with the SEC on March 27, 2009)
3(ii)	By-laws of the Company, as amended February 21, 2019 (conformed copy)
4.1	Specimen Share of Common Stock (incorporated by reference to Exhibit 4.1 to the Company's Form 10-KSB (SEC File No. 000-32891) filed with the SEC on March 22, 2002)
4.2	Warrant, dated November 23, 2011, to purchase shares of the Company's common stock (incorporated by reference to Exhibit 4.5 to the Company's Form 10-K (SEC File No. 000-32891) filed with the SEC on March 22, 2013)
4.3	

		Warrant, dated November 23, 2011, to purchase shares of the Company's common stock (incorporated by reference to Exhibit 4.6 to the Company's Form 10-K (SEC File No. 000-32891) filed with the SEC on March 22, 2013)
10.1	#	1st Constitution Bancorp Supplemental Executive Retirement Plan, dated as of October 1, 2002 (incorporated by reference to Exhibit 10.1 to the Company's Form 10-QSB (SEC File No. 000-32891) filed with the SEC on November 13, 2002)
10.2	#	Amended and Restated 1st Constitution Bancorp Directors' Insurance Plan, effective as of June 16, 2005 (incorporated by reference to Exhibit No. 10 to the Company's Form 8-K (SEC File No. 000-32891) filed with the SEC on March 24, 2006)
10.3	#	1st Constitution Bancorp Form of Executive Life Insurance Agreement (incorporated by reference to Exhibit 10.4 to the Company's Form 10-QSB (SEC File No. 000-32891) filed with the SEC on November 13, 2002)

67

10.4	#	Amendment No. 1 to 1st Constitution Bancorp Supplemental Executive Retirement Plan, effective January 1, 2004 (incorporated by reference to Exhibit 10.12 to the Company’s Form 10-Q (SEC File No. 000-32891) filed with the SEC on August 11, 2004)
10.5	#	The 1st Constitution Bancorp 2005 Equity Incentive Plan (incorporated by reference to Exhibit A of the Company's proxy statement on Schedule 14A for its annual meeting of shareholders held on May 19, 2005 (SEC File No. 000-32891) filed with the SEC on April 15, 2005)
10.6	#	Form of Restricted Stock Agreement under the 1st Constitution Bancorp 2005 Equity Incentive Plan (incorporated by reference to Exhibit 10.18 to the Company’s Form 10-Q (SEC File No. 000-32891) filed with the SEC on August 8, 2005)
10.7	#	Form of Nonqualified Stock Option Agreement under the 1st Constitution Bancorp 2005 Equity Incentive Plan (incorporated by reference to Exhibit 10.19 to the Company’s Form 10-Q (SEC File No. 000-32891) filed with the SEC on August 8, 2005)
10.8	#	Form of Incentive Stock Option Agreement under the 1st Constitution Bancorp 2005 Equity Incentive Plan (incorporated by reference to Exhibit 10.20 to the Company’s Form 10-Q (SEC File No. 000-32891) filed with the SEC on August 8, 2005)
10.9		Amended and Restated Declaration of Trust of 1st Constitution Capital Trust II, dated as of June 15, 2006, among 1st Constitution Bancorp, as sponsor, the Delaware and institutional trustee named therein, and the administrators named therein (incorporated by reference to Exhibit 10.1 to the Company’s Form 8-K (SEC File No. 000-32891) filed with the SEC on June 16, 2006)
10.10		Indenture, dated as of June 15, 2006, between 1st Constitution Bancorp, as issuer, and the trustee named therein, relating to the Floating Rate Junior Subordinated Debt Securities due 2036 (incorporated by reference to Exhibit 10.2 to the Company’s Form 8-K (SEC File No. 000-32891) filed with the SEC on June 16, 2006)
10.11		Guarantee Agreement, dated as of June 15, 2006, between 1st Constitution Bancorp and the guarantee trustee named therein (incorporated by reference to Exhibit 10.3 to the Company’s Form 8-K (SEC File No. 000-32891) filed with the SEC on June 16, 2006)
10.12	#	Amendment No. 2 to 1st Constitution Bancorp Supplemental Executive Retirement Plan, effective as of December 31, 2004 (incorporated by reference to Exhibit 10.24 to the Company’s Form 10-K (SEC File No. 000-32891) filed with the SEC on April 15, 2008)
10.13	#	1st Constitution Bancorp 2005 Supplemental Executive Retirement Plan, effective as of January 1, 2005 (incorporated by reference to Exhibit 10.1 to the Company’s Form 8-K (SEC File No. 000-32891) filed with the SEC on December 28, 2006)
10.14	#	Amended and Restated Employment Agreement between the Company and Robert F. Mangano dated as of July 1, 2010 (incorporated by reference to Exhibit 10 to the Company’s Form 8-K (SEC File No. 000-32891) filed with the SEC on July 14, 2010)
10.15	#	1st Constitution Bancorp 2013 Equity Incentive Plan (incorporated by reference to Appendix A of the Company's proxy statement on Schedule 14A for its annual meeting of shareholders held on May 23, 2013 (SEC File No. 000-32891) filed with the SEC on April 11, 2013)
10.16	#	Form of Restricted Stock Agreement under the 1st Constitution Bancorp 2013 Equity Incentive Plan (incorporated by reference to Exhibit 10.16 to the Company’s Form 10-K (SEC File No. 000-32891) filed with the SEC on March 22, 2016)
10.17	#	Form of Incentive Stock Option Agreement under the 1st Constitution Bancorp 2013 Equity Incentive Plan (incorporated by reference to Exhibit 10.17 to the Company’s Form 10-K (SEC File No. 000-32891) filed with the SEC on March 22, 2016)
10.18	#	Letter Agreement, dated January 31, 2014, between 1st Constitution Bank and Stephen J. Gilhooly (incorporated by reference to Exhibit 10.1 to the Company’s Form 8-K (SEC File No. 000-32891) filed with the SEC on April 1, 2014)
10.19	#	Amendment to the Amended and Restated Employment Agreement, effective as of April 4, 2014, between 1st Constitution Bancorp and Robert F. Mangano (incorporated by reference to Exhibit 10.1 to the Company’s Form 8-K (SEC File No. 000-3281) filed with the SEC on April 8, 2014)

10.20#	1st Constitution Bancorp 2015 Directors Stock Plan (incorporated by reference to Appendix A to the Company's proxy statement on Schedule 14A for its annual meeting of shareholders held on May 21, 2015 (SEC File No. 000-32891) that was filed with the SEC on April 14, 2015)
10.21#	Second Amendment, effective as of April 12, 2016, to the Amended and Restated Employment Agreement, dated as of July 1, 2010, by and between 1st Constitution Bancorp and Robert F. Mangano (the “Employment Agreement”), as amended by the Amendment to the Employment Agreement, effective as of April 4, 2014 (the “First Amendment”), by and between 1st Constitution Bancorp and Robert F. Mangano (incorporated by reference to Exhibit 10.1 to the Company’s Form 8-K (SEC File No. 000-32891) filed with the SEC on April 12, 2016)

10.22	#	Amended and Restated Indemnification Agreement, dated as of April 24, 2013, by and between Rumson-Fair Haven Bank and Trust Company and James G. Aaron (which was assumed by 1st Constitution Bank following the merger of Rumson-Fair Haven Bank and Trust Company with and into 1st Constitution Bank) (incorporated by reference to Exhibit 10.2 to the Company's Form 10-Q (SEC File No. 000-32891) filed with the SEC on August 10, 2016)
10.23	#	Third Amendment, effective as of April 7, 2017, to the Amended and Restated Employment Agreement, dated as of July 1, 2010, by and between the Company and Robert F. Mangano, as amended (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K (SEC File No. 000-32891) filed with the SEC on April 12, 2017)
10.24	#	Form of Restricted Stock Agreement for Non-Employee Directors under the 1st Constitution Bancorp 2015 Directors Stock Plan (incorporated by reference to Exhibit 10.2 to the Company's Form 10-Q (SEC File No. 000-32891) filed with the SEC on August 10, 2017)
10.25	#	Employment Agreement, dated as of January 1, 2015, by and among the Company, the Bank and John T. Andreacio (incorporated by reference to Exhibit 10.25 to the Company's Form 10-K (SEC File No. 000-32891) filed with the SEC on March 19, 2018)
10.26	#	Employment Agreement, dated as of May 7, 2018, by and between 1st Constitution Bancorp and 1st Constitution Bank, on one hand, and Naqi A. Naqvi, on the other hand (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K (SEC File No. 000-32891) filed with the SEC on May 11, 2018)
21	*	Subsidiaries of the Company
23.1	*	Consent of BDO USA, LLP as Independent Registered Public Accounting Firm
31.1	*	Certification of the principal executive officer of the Company, pursuant to Exchange Act Rule 13a-14(a)
31.2	*	Certification of the principal financial officer of the Company, pursuant to Exchange Act Rule 13a-14(a)
32	*	Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, signed by the principal executive officer and the principal financial officer of the Company
101.INS	*	XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document
101.SCH	*	XBRL Taxonomy Extension Schema Document
101.CAL	*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	*	XBRL Taxonomy Extension Presentation Linkbase Document

* Filed herewith.
# Management contract or compensatory plan or arrangement.

(b) Exhibits.

Exhibits required by Section 601 of Regulation S-K (see (a) above).

(c) Financial Statement Schedules

See the notes to the Consolidated Financial Statements included in this Annual Report on Form 10-K.

Item 16. Form 10-K Summary.

Not applicable.

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
1st Constitution Bancorp
Cranbury, New Jersey

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of 1st Constitution Bancorp (the "Company") as of December 31, 2018 and 2017, the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2018, and the related notes (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2018 and 2017, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2018, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") and our report dated March 14, 2019, expressed an unqualified opinion thereon.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's consolidated financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ BDO USA, LLP

We have served as the Company's auditor since 2013.

Woodbridge, New Jersey
March 15, 2019

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
1st Constitution Bancorp
Cranbury, New Jersey

Opinion on Internal Control over Financial Reporting
We have audited 1ST Constitution Bancorp's (the “Company’s”) internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (the “COSO criteria”). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on the COSO criteria.
We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), the consolidated balance sheets of the Company as of December 31, 2018 and 2017, the related consolidated statements of income, comprehensive income, changes in shareholders’ equity, and cash flows for each of the three years in the period ended December 31, 2018, and the related notes and our report dated March 14, 2019 expressed an unqualified opinion thereon.
Basis for Opinion
The Company’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Item 9A, Management’s Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company’s internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.
We conducted our audit of internal control over financial reporting in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.
Definition and Limitations of Internal Control over Financial Reporting
A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.
Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ BDO USA, LLP

Woodbridge, New Jersey
March 15, 2019

1ST CONSTITUTION BANCORP
CONSOLIDATED BALANCE SHEETS
December 31, 2018 and 2017
(Dollars in Thousands, except share data)

	2018	2017
ASSETS		
Cash and due from banks	$4,983	$5,037
Interest-earning deposits	11,861	13,717
Total cash and cash equivalents	16,844	18,754
Investment securities:		
Available for sale, at fair value	132,222	105,458
Held to maturity (fair value of $80,204 and $111,865 at December 31, 2018 and December 31, 2017, respectively)	79,572	110,267
Total investment securities	211,794	215,725
Loans held for sale	3,020	4,254
Loans	883,164	789,906
Less: Allowance for loan losses	(8,402)	(8,013)
Net loans	874,762	781,893
Premises and equipment, net	11,653	10,705
Accrued interest receivable	3,860	3,478
Bank-owned life insurance	28,705	25,051
Other real estate owned	2,515	—
Goodwill and intangible assets	12,258	12,496
Other assets	12,422	6,918
Total assets	$1,177,833	$1,079,274
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES		
Deposits		
Non-interest bearing	$212,981	$196,509
Interest bearing	737,691	725,497
Total deposits	950,672	922,006
Short-term borrowings	71,775	20,500
Redeemable subordinated debentures	18,557	18,557
Accrued interest payable	1,228	804
Accrued expenses and other liabilities	8,516	5,754
Total liabilities	1,050,748	967,621
SHAREHOLDERS' EQUITY		
Preferred stock, no par value; 5,000,000 shares authorized; none issued	—	—
Common stock, no par value; 30,000,000 shares authorized; 8,639,276 and 8,116,201 shares issued and 8,605,978 and 8,082,903 shares outstanding as of December 31, 2018 and December 31, 2017, respectively	79,536	72,935
Retained earnings	49,750	39,822
Treasury stock, 33,298 shares at December 31, 2018 and 2017	(368)	(368)
Accumulated other comprehensive loss	(1,833)	(736)
Total shareholders' equity	127,085	111,653
Total liabilities and shareholders' equity	$1,177,833	$1,079,274

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

72

1ST CONSTITUTION BANCORP
CONSOLIDATED STATEMENTS OF INCOME
For the Years Ended December 31, 2018, 2017 and 2016
(Dollars in thousands, except per share data)

	2018	2017	2016
INTEREST INCOME			
Loans, including fees	$ 45,202	$ 35,967	$ 33,701
Securities:			
Taxable	4,024	3,326	3,268
Tax-exempt	1,989	2,140	2,078
Federal funds sold and short-term investments	258	230	88
Total interest income	51,473	41,663	39,135
INTEREST EXPENSE			
Deposits	6,511	4,550	4,044
Borrowings	836	429	687
Redeemable subordinated debentures	694	519	427
Total interest expense	8,041	5,498	5,158
Net interest income	43,432	36,165	33,977
PROVISION (CREDIT) FOR LOAN LOSSES	900	600	(300)
Net interest income after provision (credit) for loan losses	42,532	35,565	34,277
NON-INTEREST INCOME			
Service charges on deposit accounts	638	596	715
Gain on sales of loans, net	4,475	5,149	3,785
Income on bank-owned life insurance	575	522	549
Gain on bargain purchase	230	—	—
Gain on sales of securities	12	129	—
Other income	1,988	1,844	1,873
Total other income	7,918	8,240	6,922
NON-INTEREST EXPENSES			
Salaries and employee benefits	19,853	18,804	16,543
Occupancy expense	3,623	3,169	3,243
Data processing expenses	1,332	1,314	1,277
FDIC insurance expense	486	360	453
Other real estate owned expenses	158	42	74
Merger-related expenses	2,141	265	—
Other operating expenses	6,492	7,052	5,701
Total other expenses	34,085	31,006	27,291
Income before income taxes	16,365	12,799	13,908
INCOME TAXES	4,317	5,871	4,623
Net income	$ 12,048	$ 6,928	$ 9,285
EARNINGS PER COMMON SHARE			
Basic	$ 1.45	$ 0.86	$ 1.17
Diluted	1.40	0.83	1.14
WEIGHTED AVERAGE SHARES OUTSTANDING			
Basic	8,320,718	8,049,981	7,962,121
Diluted	8,593,509	8,312,784	8,177,439

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

1ST CONSTITUTION BANCORP
Consolidated Statements of Comprehensive Income
For the years ended December 31, 2018, 2017 and 2016
(Dollars in thousands)

	Twelve Months Ended December 31,		
	2018	2017	2016
Net income	$12,048	$6,928	$9,285
Other comprehensive income (loss):			
Unrealized losses on securities available for sale	(1,624)	(14)	(667)
Tax effect (3)	388	40	243
Net of tax amount	(1,236)	26	(424)
Reclassification adjustment for realized gains on securities available for sale (1)	(12)	(93)	—
Tax effect (3)	3	38	—
Net of tax amount	(9)	(55)	—
Pension liability	269	62	83
Tax effect	(77)	(24)	(31)
Net of tax amount	192	38	52
Reclassification adjustment for actuarial gains for unfunded pension liability (2)	(62)	(60)	(160)
Tax effect (3)	18	24	62
Net of tax amount	(44)	(36)	(98)
Total other comprehensive loss	(1,097)	(27)	(470)
Comprehensive income	$10,951	$6,901	$8,815

(1) Included in gain on sale of securities on the consolidated statements of income
(2) Included in salaries and employee benefits expense on the consolidated statements of income
(3) Included in income taxes on the consolidated statements of income

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

1[ST] CONSTITUTION BANCORP
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
For the Years Ended December 31, 2018, 2017 and 2016
(Dollars in thousands)

	Common Stock	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balance, January 1, 2016	$ 70,845	$ 25,589	$ (344)	$ (130)	$ 95,960
Net income	—	9,285	—	—	9,285
Exercise of stock options and issuance of restricted shares (18,645 and 73,450 shares, respectively)	96	—	—	—	96
Share-based compensation	754	—	—	—	754
Treasury stock purchased (2,000 shares)	—	—	(24)	—	(24)
Cash dividends ($0.10 per share)	—	(800)	—	—	(800)
Other comprehensive loss	—	—	—	(470)	(470)
Balance, December 31, 2016	71,695	34,074	(368)	(600)	104,801
Net income	—	6,928	—	—	6,928
Exercise of stock options and issuance of restricted shares (31,640 and 60,613 shares, respectively)	247	—	—	—	247
Share-based compensation	993	—	—	—	993
Cash dividends ($0.16 per share)	—	(1,289)	—	—	(1,289)
Other comprehensive loss	—	—	—	(27)	(27)
Reclassifications of certain deferred tax effects	—	109	—	(109)	—
Balance, December 31, 2017	72,935	39,822	(368)	(736)	111,653
Net income	—	12,048	—	—	12,048
Exercise of stock options and issuance of restricted shares (12,762 and 62,150 shares, respectively)	88	—	—	—	88
Share-based compensation	1,019	—	—	—	1,019
Exercise of stock warrants (198,378 shares)	—	—	—	—	—
Issuance of common stock (249,785 shares)	5,494	—	—	—	5,494
Cash dividends ($0.255 per share)	—	(2,120)	—	—	(2,120)
Other comprehensive loss	—	—	—	(1,097)	(1,097)
Balance, December 31, 2018	$ 79,536	$ 49,750	$ (368)	$ (1,833)	$ 127,085

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

1ST CONSTITUTION BANCORP
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2018, 2017 and 2016
(Dollars in thousands)

	2018	2017	2016
OPERATING ACTIVITIES:			
Net Income	$12,048	$6,928	$9,285
Adjustments to reconcile net income to net cash provided by operating activities			
Provision (credit) for loan losses	900	600	(300)
Depreciation and amortization	1,389	1,380	1,415
Net amortization of premiums and discounts on securities	556	879	1,141
SBA loan discount accretion	(323)	(247)	(153)
Gain on bargain purchase	(230)	—	—
Gain on sales of securities available for sale	(12)	(93)	—
Gain on sales of securities held to maturity	—	(36)	—
Gains on sales of other real estate owned	—	(5)	(31)
Gains on sales of loans held for sale	(4,475)	(5,149)	(3,785)
Originations of loans held for sale	(111,109)	(110,831)	(96,968)
Proceeds from sales of loans held for sale	116,818	126,555	91,708
Increase in cash surrender value on bank-owned life insurance	(589)	(522)	(549)
Loss on cash surrender value on bank-owned life insurance	14	—	—
Share-based compensation expense	1,019	993	754
Deferred tax expense	305	620	354
Re-measurement of deferred tax assets and liabilities	(28)	1,712	—
Increase in accrued interest receivable	(123)	(383)	(242)
(Increase) decrease in other assets	(1,589)	(181)	388
Increase (decrease) in accrued interest payable	424	(62)	20
Increase (decrease) in accrued expenses and other liabilities	2,333	(266)	(552)
Net cash provided by operating activities	17,328	21,892	2,485
INVESTING ACTIVITIES:			
Purchases of securities :			
Available for sale	(35,209)	(35,680)	(37,300)
Held to maturity	(7,723)	(34,592)	(35,212)
Proceeds from maturities and prepayments of securities:			
Available for sale	17,664	25,770	23,354
Held to maturity	38,192	49,889	31,429
Proceeds from sales of securities:			
Available for sale	—	7,602	—
Held to maturity	—	1,034	—
Proceeds from bank-owned life insurance benefits paid	893	—	248
Net (purchase) redemption of restricted stock	(2,510)	2,408	(661)
Net (increase) in loans	(19,762)	(65,387)	(42,626)
Capital expenditures	(648)	(846)	(457)
Forfeitable deposit on other real estate owned	175	—	—
Capital improvement to other real estate owned	—	(5)	(61)
Net cash paid for NJCB merger	(996)		
Proceeds from sales of other real estate owned	—	631	1,033
Purchase of bank-owned life insurance	—	(2,345)	(300)
Net cash used in investing activities	(9,924)	(51,521)	(60,553)

FINANCING ACTIVITIES:			
Exercise of stock options	88	247	96

76

Purchase of treasury stock	—	—	(24)
Cash dividends paid to shareholders	(2,120)	(1,690)	(399)
Net (decrease) increase in deposits	(58,557)	87,490	47,759
Increase (decrease) in overnight borrowings	51,275	(42,550)	24,154
Repayment of long-term borrowing	—	(10,000)	(10,000)
Net cash (used in) provided by financing activities	(9,314)	33,497	61,586
(Decrease) increase in cash and cash equivalents	(1,910)	3,868	3,518
Cash and cash equivalents at beginning of year	18,754	14,886	11,368
Cash and cash equivalents at end of period	$16,844	$18,754	$14,886
Supplemental disclosures of cash flow information:			
Cash paid during the period for :			
Interest	$7,617	$5,560	$5,138
Income taxes	3,226	3,220	4,590
Noncash items:			
Transfer of loans to other real estate owned	1,460	455	141
Acquisition of New Jersey Community Bank			
Noncash assets acquired:			
Investment securities available for sale	$11,173		
Loans	75,144		
Premises and equipment, net	1,120		
Bank-owned life insurance	3,972		
Accrued interest receivable	259		
Core deposit intangible asset	80		
Other real estate owned	1,230		
Other assets	1,601		
	$94,579		
Liabilities assumed:			
Deposits	$87,223		
Other liabilities	636		
	$87,859		
Common stock issued for NJCB merger	$5,494		

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

1ST CONSTITUTION BANCORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2018 and 2017

1. Summary of Significant Accounting Policies

1ST Constitution Bancorp (the “Company”) is a bank holding company registered under the Bank Holding Company Act of 1956, as amended, and was organized under the laws of the State of New Jersey. The Company is the parent to 1ST Constitution Bank (the “Bank”), a New Jersey state-chartered commercial bank. The Bank provides community banking services to a broad range of customers, including corporations, individuals, partnerships and other community organizations in the central, coastal and northeastern New Jersey areas. The Bank conducts its operations through its main office located in Cranbury, New Jersey and operated, as of December 31, 2018, 19 additional branch offices in Asbury Park, Cranbury, Fair Haven, Fort Lee, Freehold, Hamilton Square, Hightstown, Hillsborough, Hopewell, Jamesburg, Lawrenceville, Little Silver, Neptune City, Perth Amboy, Plainsboro, Skillman, Princeton, Rumson, and Shrewsbury, New Jersey. The Bank also operates two residential mortgage loan production offices in Forked River and Jersey City, New Jersey.

The Company has evaluated events and transactions occurring subsequent to the balance sheet date of December 31, 2018 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.

Basis of Financial Statement Presentation: The consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP"). In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the balance sheet and revenues and expenses for that period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, other-than-temporary security impairment, the fair value of other real estate owned, if any, and the valuation of deferred tax assets.

Principles of Consolidation: The consolidated financial statements of the Company are prepared on the accrual basis and include the accounts of the Company and its wholly-owned subsidiary, the Bank, and the Bank’s wholly-owned subsidiaries, 1st Constitution Investment Company of New Jersey, Inc., FCB Assets Holdings, Inc., 204 South Newman Street, LLC and 249 New York Avenue, LLC. 1st Constitution Capital Trust II, a subsidiary of the Company (“Trust II”), 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. While the following footnotes include the collective results of the Company and the Bank, the footnotes primarily reflect the Bank's and its subsidiaries' activities. 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.

Concentration of Credit Risk: Financial instruments which potentially subject the Company and its subsidiaries to concentrations of credit risk primarily consist of investment securities and loans. At December 31, 2018, 48.9% of our investment securities portfolio consisted of U.S. Government and Agency issues and collateralized mortgage obligations collateralized by agency mortgage backed securities. In addition, 29.2% of the portfolio consisted of municipal bonds. The remaining 21.9% of our investment securities consisted of corporate debt and asset-backed issues. The Bank’s lending activity is primarily concentrated in loans collateralized by real estate located primarily in the State of New Jersey. As a result, credit risk is broadly dependent on the real estate market and general economic conditions in that state.

Interest Rate Risk: The Bank is principally engaged in the business of attracting deposits from the general public and using these deposits, together with other funds, to purchase investment securities and to make loans, the majority of which are secured by real estate. The potential for interest-rate risk exists as a result of the Company's generally shorter duration of interest-sensitive assets compared to the generally longer duration of interest-sensitive liabilities. In a changing interest rate environment, assets held by the Bank will re-price faster than liabilities of the Bank, thereby affecting net interest income. For this reason, management regularly monitors the maturity structure and rate adjustment features of the Bank’s assets and liabilities in order to measure its level of interest-rate risk and to plan for future volatility.

Investment Securities: Investment securities which the Company has the intent and ability to hold until maturity are classified as held to maturity and are recorded at cost, adjusted for amortization of premiums and accretion of discounts. Investment securities that are held for indefinite periods of time, that management intends to use as part of its asset/liability management strategy, or that may be sold in response to changes in interest rates, changes in prepayment risk, increased capital requirements or other similar factors, are classified as available for sale and are carried at fair value. Unrealized gains and losses on available for sale securities are recorded as a separate component of shareholders' equity. Realized gains and losses, which are computed using the specific identification method, are recognized in earnings on a trade date basis.

If the fair value of a security is less than its amortized cost, the security is deemed to be impaired. Management evaluates all securities with unrealized losses quarterly to determine if such impairments are temporary or other-than-temporary in accordance with the Accounting Standards Codification ("ASC") of the Financial Accounting Standards Board ("FASB"). Temporary impairments on available for sale securities are recognized, on a tax-effected basis, through other comprehensive income ("OCI") with offsetting adjustments to the carrying value of the security and the balance of related deferred taxes. Temporary impairments of held to maturity securities are not recorded in the consolidated financial statements; however, information concerning the amount and duration of impairments on held to maturity securities are disclosed.

Other-than-temporary impairments ("OTTI") on all equity securities and on debt securities that the Company has decided to sell, or will, more likely than not, be required to sell prior to the full recovery of fair value to a level equal to or exceeding amortized cost, are recognized in earnings. If neither of these conditions regarding the likelihood of sale for a debt security apply, the OTTI is bifurcated into credit-related and noncredit-related components. Credit-related impairment generally represents the amount by which the present value of the cash flows that are expected to be collected on a debt security fall below its amortized cost. The noncredit-related component represents the remaining portion of the impairment not otherwise designated as credit-related. The Company recognizes credit-related OTTI in earnings. Noncredit-related OTTI on debt securities are recognized in OCI.

Premiums and discounts on all securities are amortized/accreted to maturity by use of the level-yield method considering the impact of principal amortization and prepayments.

Federal law requires a member institution of the FHLB system to hold restricted stock of its district FHLB according to a predetermined formula. The Bank's investment in the restricted stock of the FHLB of New York is carried at cost and is included in other assets. The investment in FHLB stock was $3.9 million and $1.5 million at December 31, 2018 and December 31, 2017, respectively.

Management evaluates the FHLB restricted stock for impairment in accordance with U.S. GAAP. Management's determination of whether these investments are impaired is based on their assessment of the ultimate recoverability of their cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of their cost is influenced by criteria such as (1) the significance of the decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, and (3) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the FHLB. Management believes no impairment charge is necessary related to the FHLB stock as of December 31, 2018.

Bank-Owned Life Insurance: The Company invests in bank-owned life insurance ("BOLI"). BOLI involves the purchasing of life insurance by the Company on a select group of its executives, directors, officers and employees. The Company is the owner and beneficiary of the policies. This pool of insurance, due to the advantages of the Bank, is profitable to the Company. This profitability offsets a portion of current and future benefit costs and is intended to provide a funding source for the payment of future benefits. The Bank's deposits fund BOLI and the earnings from BOLI are recognized as non-interest income.

Loans and Loans Held For Sale: Loans that management intends to hold to maturity are stated at the principal amount outstanding, net of unearned income. Unearned income is recognized over the lives of the respective loans, principally using the effective interest method. Interest income is generally not accrued on loans, including impaired loans, where interest or principal is 90 days or more past due, unless the loans are adequately secured and in the process of collection, or on loans where management has determined that the borrowers may be unable to meet contractual principal and/or interest obligations. When it is probable that, based upon current information, the Bank will not collect all amounts due under the contractual terms of the loan, the loan is reported as impaired. Smaller balance homogeneous type loans, such as residential loans and loans to individuals, which are collectively evaluated, are generally excluded from consideration for impairment. Loan impairment is measured based upon the present value of the expected future cash flows discounted at the loan's effective interest rate or the underlying fair value of collateral for collateral dependent loans. When a loan, including an impaired loan, is placed on non-accrual, interest accruals cease and uncollected accrued interest is reversed and charged against current income. Non-accrual loans are generally not returned to accruing status until principal and interest payments have been brought current and full collectibility is reasonably assured. Cash receipts on non-accrual and impaired loans are applied to principal, unless the loan is deemed fully collectible.

Loans held for sale are carried at the lower of aggregated cost or fair value. The fair value of loans held for sale are determined, when possible, using quoted secondary market prices. If no such quoted market prices exist, fair values are determined using quoted prices for similar loans, adjusted for the specific attributes of the loans. Realized gains and losses on loans held for sale are recognized at settlement date and are determined based on the cost, including deferred net loan origination fees and the costs of the specific loans sold. Residential mortgage loans are sold with servicing released.

The Bank accounts for its transfers and servicing of financial assets in accordance with ASC Topic 860, “Transfers and Servicing” ("ASC Topic 860"). The Bank originates residential mortgages under a definitive plan to sell those loans with servicing generally released. Residential mortgage loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or estimated fair value. The Bank also originates commercial loans, of which a portion are guaranteed by the Small Business Administration ("SBA"). The guaranteed portion of the loans is generally sold into the secondary market. Gains and losses on sales are also accounted for in accordance with ASC Topic 860.

The Bank enters into commitments to originate loans whereby the interest rate on the loan is determined prior to funding “rate lock commitments.” Rate lock commitments on residential mortgage loans that are intended to be sold are considered to be derivatives. Time elapsing between the issuance of a loan commitment and closing and sale of the loan generally ranges from 30 to 120 days. The Bank protects itself from changes in interest rates through the use of best efforts forward delivery commitments, whereby the Bank commits to sell a loan at the time the borrower commits to an interest rate with the intent that the buyer has assumed interest rate risk on the loan. As a result, the Bank is generally not exposed to losses nor will it realize significant gains related to its rate lock commitments due to changes in interest rates.

The fair value of rate lock commitments and best efforts commitments is not readily ascertainable with precision because rate lock commitments and best efforts commitments are not actively traded in stand-alone markets. The Bank determines the fair value of rate lock commitments based upon the forward sales price that is obtained in the best efforts commitment at the time the borrower locks in the interest rate on the loan while taking into consideration the probability that the rate lock commitments will close. Due to high correlation between rate lock commitments and best efforts commitments, no gain or loss occurs on the rate lock commitments. The estimated fair value of rate lock commitments was $79,000 and $135,000 at December 31, 2018 and 2017, respectively.

ASC Topic 460, "Guarantees," requires a guarantor entity, at the inception of a guarantee covered by the measurement provisions of the interpretation, to record a liability for the fair value of the obligation undertaken in issuing the guarantee.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the financial performance of a customer to a third party. Those guarantees are primarily issued to support contracts entered into by customers. Most guarantees extend for one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank defines the fair value of these letters of credit as the fees paid by the customer or similar fees collected on similar instruments. The Bank amortizes the fees collected over the life of the instrument. The Bank generally obtains collateral, such as real estate or liens on customer assets, for these types of commitments. The Bank’s potential liability would be reduced by any proceeds obtained in liquidation of the collateral. The Bank had standby letters of credit for customers aggregating $766 thousand and $1.2 million at December 31, 2018 and 2017, respectively. These letters of credit are primarily related to real estate lending and the approximate value of underlying collateral upon liquidation is expected to be sufficient to cover this maximum potential exposure at December 31, 2018. The amount of the liability related to guarantees under issued standby letters of credit was not material as of December 31, 2018 and 2017.

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

All, or part, of the principal balance of commercial and commercial real estate loans and construction loans are charged off against the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely. Consumer loans are generally charged off no later than 120 days past due on a contractual basis, or earlier in the event of bankruptcy, or if there is an amount deemed uncollectible. Because all identified losses are charged off, no portion of the allowance for loan losses is restricted to any individual loan or groups of loans, and the entire allowance is available to absorb any and all loan losses.

Loans are placed in a nonaccrual status when the ultimate collectability of principal or interest in whole, or in part, is in doubt. Past-due loans contractually past-due 90 days or more for either principal or interest are also placed in nonaccrual status unless they are both well secured and in the process of collection. Impaired loans are evaluated individually.

Purchased Credit-Impaired ("PCI") loans are loans acquired at a discount that is due, in part, to credit quality. PCI loans are accounted for in accordance with ASC Subtopic 310-30, "Receivables, Loans and Debt Securities Acquired with Deteriorated Credit Quality" and are initially recorded at fair value (as determined by the present value of expected future cash flows) with no valuation allowance (i.e., the allowance for loan losses). The difference between the undiscounted cash flows expected at acquisition and the initial carrying amount (fair value) of the PCI loans or the "accretable yield," is recognized as interest income utilizing the level-yield method over the life of the loans. Contractually required payments for interest and principal that exceed the undiscounted cash flows expected at acquisition, or the "non-accretable difference," are not recognized as a yield adjustment, as a loss accrual or a valuation allowance. Reclassifications of the non-accretable difference to the accretable yield may occur subsequent to the loan acquisition dates due to increases in expected cash flows of the loans and result in an increase in yield on a prospective basis.

The following is our charge-off policy for our loan segments:

Commercial, Commercial Real Estate and Construction

Loans are generally fully or partially charged down to the fair value of collateral securing the asset when:

- Management judges the loan to be uncollectible;
- Repayment is deemed to be protracted beyond reasonable time frames;
- The loan has been classified as a loss by either internal loan review process or external examiners;
- The customer has filed bankruptcy and the loss becomes evident owing to a lack of assets; or
- The loan is significantly past due unless both well secured and in the process of collection.

Consumer

Consumer loans are generally charged off no later than 120 days past due on a contractual basis, earlier in the event of bankruptcy, or if there is an amount deemed uncollectible.

Premises and Equipment: Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is computed primarily on the straight-line method over the estimated useful lives of the related assets for financial reporting purposes and using the mandated methods by asset type for income tax purposes. Building, furniture and fixtures, equipment and leasehold improvements are depreciated or amortized over the estimated useful lives of the assets or lease terms, as applicable. Estimated useful lives of buildings are forty years, furniture and fixtures and equipment are three to fifteen years and leasehold improvements are generally three to ten years. Expenditures for maintenance and repairs are charged to expense as incurred.

The Bank accounts for impairment of long-lived assets in accordance with ASC Topic 360, "Property, Plant, and Equipment," which requires recognition and measurement for the impairment of long-lived assets to be held and used or to be disposed of by sale. The Bank had no impaired long-lived assets at December 31, 2018 and 2017.

Income Taxes: There are two components of income tax expense or benefit: current and deferred. Current income tax expense or benefit approximates cash to be paid or refunded for taxes for the applicable period. Deferred tax assets and liabilities are recognized due to differences between the basis of assets and liabilities as measured by tax laws and their basis as reported in the financial statements. Deferred tax assets are subject to management's judgment based upon available evidence that future realizations are likely. If management determines that the Company may not be able to realize some or all of the net deferred tax asset in the future, a charge to income tax expense may be required to increase the valuation reserve of the net deferred tax asset. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred tax expense or benefit is recognized for the change in deferred tax assets and liabilities.

The Company accounts for uncertainty in income taxes recognized in its consolidated financial statements in accordance with ASC Topic 740, "Income Taxes," which prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, and also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company has not identified any significant income tax uncertainties through the evaluation of its income tax positions for the years ended December 31, 2018 and 2017 and has not recognized any liabilities for tax uncertainties as of December 31, 2018 and 2017. Our policy is to recognize interest and penalties on unrecognized tax benefits in income tax expense; such amounts were not significant during the years ended December 31, 2018 and 2017. The tax years subject to examination by the taxing authorities are, for federal and state purposes, the years ended December 31, 2018, 2017, 2016 and 2015.

On December 22, 2017, the 2017 Tax Cuts and Jobs Act (the “Tax Act”) was enacted into law. The Tax Act contained several key tax provisions including the reduction in the maximum corporate federal tax rate to 21% from 35% effective January 1, 2018. As a result, the Company was required to re-measure, through income tax expense, its deferred tax assets and liabilities using the enacted rate at which it expects them to be recovered or settled. In December 2017, the U.S. Securities and Exchange Commission ("SEC") also issued Staff Accounting Bulletin No. 118, "Income Tax Accounting Implications of the Tax Cuts and Jobs Act" ("SAB 118"), which allows companies to record provisional amounts during a measurement period not to extend beyond one year of the enactment date. Because the Tax Act was passed late in December 2017 and ongoing analysis and interpretation of the other key tax provisions was expected over the next 12 months, the Company considered the deferred tax re-measurements and other items to be provisional in nature. In 2018, the Company completed its analysis within the measurement period in accordance with SAB 118. See Note 13 - Income Taxes - for additional information.

Other Real Estate Owned ("OREO"): OREO obtained through loan foreclosures or the receipt of deeds-in-lieu of foreclosure is recorded at the fair value of the related property, as determined by current appraisals less estimated costs to sell at the initial transfer from the loan portfolio. Write-downs on these properties, which occur after the initial transfer from the loan portfolio, are recorded as operating expenses. Costs of holding such properties are charged to expense in the current period. Gains, to the extent realized, and losses on the disposition of these properties are reflected in current operations.

Goodwill and Other Intangible Assets: Goodwill represents the excess of the cost of an acquired entity over the fair value of the identifiable net assets acquired in accordance with the acquisition method of accounting. Goodwill is not amortized but is reviewed for potential impairment on an annual basis, or more often if events or circumstances indicated that there may be impairment, in accordance with ASC Topic 350, “Intangibles – Goodwill and Other.” Goodwill is tested for impairment at the reporting unit level and an impairment loss is recorded to the extent that the carrying amount of goodwill exceeds its implied fair value. Core deposit intangibles are a measure of the value of checking and savings deposits acquired in business combinations accounted for under the purchase method. Core deposit intangibles are amortized over their estimated lives (ranging from five to ten years) and identifiable intangible assets are evaluated for impairment if events and circumstances indicate a possible impairment. Any impairment loss related to goodwill and other intangible assets is reflected as other non-interest expense in the statement of income in the period in which the impairment was determined. No assurance can be given that future impairment tests will not result in a charge to earnings. See Note 8 – Goodwill and Intangible Assets - for additional information.

Share-Based Compensation: The Company recognizes compensation expense for stock awards and options in accordance with ASC Topic 718, “Compensation – Stock Compensation.” The expense of stock-based compensation is generally measured at fair value at the grant date with compensation expense recognized over the service period, which is usually the vesting period. The Company utilizes the Black-Scholes option-pricing model to estimate the fair value of each stock option on the date of grant. The Black-Scholes model takes into consideration the exercise price and expected life of the options, the current price of the underlying stock and its expected volatility, the expected dividends on the stock and the current risk-free interest rate for the expected life of the option. The Company’s estimate of the fair value of a stock option is based on expectations derived from historical experience and may not necessarily equate to its market value when fully vested.   See Note 15 – Share-Based Compensation - for additional information.

Benefit Plans: The Company provides certain retirement savings benefits to employees under a 401(k) plan. The Company’s contributions to the 401(k) plan are expensed as incurred.

The Company also provides retirement benefits to certain employees under supplemental executive retirement plans. The plans are unfunded and the Company accrues actuarially determined benefit costs over the estimated service period of the employees in the plans. In accordance with ASC Topic 715, “Compensation – Retirement Benefits,” the Company recognizes the unfunded status of these postretirement plans as a liability in its consolidated balance sheets and recognizes changes in that unfunded status in the year in which the changes occur through other comprehensive income.

Cash and Cash Equivalents: Cash and cash equivalents includes cash on hand, interest and non-interest bearing amounts due from banks, federal funds sold and short-term investments. Generally, federal funds are sold and short-term investments are made for a one or two-day period.

Advertising Costs: It is the Company's policy to expense advertising costs in the period in which they are incurred.

Earnings Per Common Share: Basic earnings per common share is calculated by dividing net income by the weighted average number of common shares outstanding during each period. Diluted earnings 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 dilutive common stock warrants and common stock options using the treasury stock method.

Awards of restricted shares are included in outstanding shares when granted. Unvested restricted shares are entitled to non-forfeitable dividends and participate in undistributed earnings with common shares. Awards of this nature are considered participating securities and basic and diluted earnings per share are computed under the two-class method.

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. For the years ended December 31, 2018, 2017 and 2016, 19,350, 8,900 and 11,088 options, respectively, were anti-dilutive and were not included in the computation of diluted earnings per common share.

The following table illustrates the calculation of both basic and diluted earnings per share for the years ended December 31, 2018, 2017 and 2016:

(In thousands, except per share data)	2018	2017	2016
Net income	$ 12,048	$ 6,928	$ 9,285
Basic weighted average shares outstanding	8,320,718	8,049,981	7,962,121
Plus: common stock equivalents	272,791	262,803	215,318
Diluted weighted average shares outstanding	8,593,509	8,312,784	8,177,439
Earnings per share:			
Basic	$ 1.45	$ 0.86	$ 1.17
Diluted	1.40	0.83	1.14

Comprehensive Income: Comprehensive income consists of net income and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains and losses on securities available for sale, other-than-temporary non-credit related security impairments, and changes in the funded status of benefit plans.

Variable Interest Entities: Management has determined that Trust II qualifies as a variable interest entity under ASC Topic 810, "Consolidation." Trust II issued mandatorily redeemable preferred stock to investors, loaned the proceeds to the Company and holds, as its sole asset, subordinated debentures issued by the Company. As a qualified variable interest entity, Trust II's balance sheet and statement of operations have never been consolidated with those of the Company because the Company is not the beneficiary.

In March 2005, the Federal Reserve Board ("FRB") adopted a final rule that would continue to allow the inclusion of trust preferred securities in Tier 1 capital, but with stricter quantitative limits. Under the final rule, after a five-year transition period, the aggregate amount of trust preferred securities and certain other capital elements would be limited to 25% of Tier 1 capital elements, net of goodwill. The amount of trust preferred securities and certain other elements in excess of the limit could be included in Tier 2 capital, subject to restrictions. Based on the final rule, the Company has included all of its $18.0 million in trust preferred securities in Tier 1 capital at December 31, 2018 and 2017.

83

Segment Information: U.S. GAAP establishes standards for public business enterprises to report information about operating segments in their annual financial statements and requires that those enterprises report selected information about operating segments in subsequent interim financial reports issued to shareholders. It also established standards for related disclosure about products and services, geographic areas and major customers. Operating segments are components of an enterprise, which are evaluated regularly by the chief operating decision-maker in deciding how to allocate and assess resources and performance. The Company's chief operating decision-maker is the President and Chief Executive Officer. The Company has applied the aggregation criteria for its operating segments to create one reportable segment, "Community Banking."

The Company's Community Banking segment consists of construction, commercial, retail and mortgage banking operations. The Community Banking segment is managed as a single strategic unit, which generates revenue from a variety of products and services provided by the Company. Construction, commercial, retail and mortgage lending is dependent upon the ability of the Company to fund itself with retail deposits and other borrowings and to manage interest rate, liquidity and credit risk as a single unit.

Reclassifications: Certain reclassifications have been made to the prior period amounts to conform with the current period presentation. Such reclassification had no impact on net income or total shareholders' equity.

Recent Accounting Pronouncements
ASU 2018-15 - Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40)
In August 2018, the FASB issued ASU 2018-15, "Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement," to help entities evaluate the accounting for fees paid by a customer in a cloud computing arrangement (hosting arrangement) by providing guidance for determining when the arrangement includes a software license.

The amendments in this Update align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal use software license). The accounting for the service element of a hosting arrangement that is a service contract is not affected by the amendments in this Update.

The amendments in this ASU also require the entity (customer) to expense the capitalized implementation costs of a hosting arrangement that is a service contract over the term of the hosting arrangement. The term of the hosting arrangement includes the non-cancellable period of the arrangement plus periods covered by (1) an option to extend the arrangement if the customer is reasonably certain to exercise that option, (2) an option to terminate the arrangement if the customer is reasonably certain not to exercise the termination option, and (3) an option to extend (or not to terminate) the arrangement in which exercise of the option is in the control of the vendor. The entity also is required to apply the existing impairment guidance in Subtopic 350-40 to the capitalized implementation costs as if the costs were long-lived assets.

The amendments in this ASU also require the entity to present the expense related to the capitalized implementation costs in the same line item in the statement of income as the fees associated with the hosting element (service) of the arrangement and classify payments for capitalized implementation costs in the statement of cash flows in the same manner as payments made for fees associated with the hosting element. The entity is also required to present the capitalized implementation costs in the consolidated balance sheets in the same line item that a prepayment for the fees of the associated hosting arrangement would be presented.

The Company is currently evaluating the potential impact, if any, of adopting this ASU on its financial statements. The provisions of this ASU are effective for fiscal years beginning after December 15, 2019.

ASU 2018-14 - Compensation - Retirement Benefits - Defined Benefit Plans - General (Subtopic 715-20)
In August 2018, the FASB issued ASU 2018-14 - “Compensation - Retirement Benefits - Defined Benefit Plans - General (Subtopic 715-20),” which consists of amendments to the disclosure framework project to improve the effectiveness of disclosures in the notes to the financial statements. The amendments in this Update modify the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans.

The following disclosure requirements are removed from Subtopic 715-20:

1. The amounts in accumulated other comprehensive income expected to be recognized as components of net periodic benefit cost over the next fiscal year;
2. The amount and timing of plan assets expected to be returned to the employer;

84

3. The disclosures related to the June 2001 amendments to the Japanese Welfare Pension Insurance Law;
4. Related party disclosures about the amount of future annual benefits covered by insurance and annuity contracts and significant transactions between the employer or related parties and the plan;
5. For nonpublic entities, the reconciliation of the opening balances to the closing balances of plan assets measured on a recurring basis in Level 3 of the fair value hierarchy. However, nonpublic entities will be required to disclose separately the amounts of transfers into and out of Level 3 of the fair value hierarchy and purchases of Level 3 plan assets; and
6. For public entities, the effects of a one-percentage point change in assumed health care cost trend rates on the (a) aggregate of the service and interest cost components of net periodic benefit costs and (b) benefit obligation for postretirement health care benefits.

The following disclosure requirements are added to Subtopic 715-20:

1. The weighted-average interest crediting rates for cash balance plans and other plans with promised interest crediting rates; and
2. An explanation of the reasons for significant gains and losses related to changes in the benefit obligation for the period.

The amendments in this ASU also clarify the disclosure requirements in paragraph 715-20-50-3, which state that the following information for defined benefit pension plans should be disclosed:

1. The projected benefit obligation (“PBO”) and fair value of plan assets for plans with PBOs in excess of plan assets; and
2. The accumulated benefit obligation (“ABO”) and fair value of plan assets for plans with ABOs in excess of plan assets.

The amendments in this ASU remove disclosures that no longer are considered cost beneficial, clarify the specific requirements of disclosures and add disclosure requirements identified as relevant. Although narrow in scope, the amendments are considered an important part of the FASB’s efforts to improve the effectiveness of disclosures in the notes to financial statements by applying concepts in the Concepts Statement.

For the Company, the provisions of this ASU are effective for fiscal years beginning after December 15, 2020. The Company does not expect the adoption of this guidance to have a material impact on the disclosures in the Company’s consolidated financial statements.

ASU 2018-13 - Fair Value Measurement (Topic 820)
In August 2018 the FASB issued ASU 2018-13, “Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement,” which modifies the disclosure requirements on fair value measurements. The following disclosure requirements that are applicable to public entities were removed from Topic 820:
1. The amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy;
2. The policy for timing of transfers between levels; and
3. The valuation process for Level 3 fair value measurements.

The following disclosure requirements were modified in Topic 820:

1. In lieu of a roll-forward for Level 3 fair value measurements, a nonpublic entity is required to disclose transfers into and out of Level 3 of the fair value hierarchy and purchases and issues of Level 3 assets and liabilities;
2. For investments in certain entities that calculate net asset value, an entity is required to disclose the timing of liquidation of an investee’s assets and the date when restrictions from redemption might lapse only if the investee has

communicated the timing to the entity or announced the timing publicly; and

3. The amendments clarify that the measurement uncertainty disclosure is to communicate information about the uncertainty in measurement as of the reporting date.

The following disclosure requirements were added to Topic 820; however, the disclosures are not required for nonpublic entities:

1. The changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 fair value measurements held at the end of the reporting period; and
2. The range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements. For certain unobservable inputs, an entity may disclose other quantitative information (such as the median or arithmetic average) in lieu of the weighted average if the entity determines that other quantitative information would be a more reasonable and rational method to reflect the distribution of unobservable inputs used to develop Level 3 fair value measurements.

In addition, the amendments eliminate “at a minimum” from the phrase “an entity shall disclose at a minimum” to promote the appropriate exercise of discretion by entities when considering fair value measurement disclosures and to clarify that materiality is an appropriate consideration of entities and their auditors when evaluating disclosure requirements.

For the Company, the provisions of this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those years. The adoption of this guidance in 2019 did not have a material impact on the Company’s consolidated financial statements.

ASU 2018-11 - Leases - Targeted Improvements (Topic 842)
In July, 2018 the FASB issued ASU 2018-11, “Leases-Targeted Improvements,” which provides an additional (and optional) transition method for a cumulative effect adjustment. The additional transition method allows entities to initially apply the new lease standard at the adoption date (January 1, 2019 for calendar-year-end public business entities) and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. This additional transition method changes only when an entity is required to initially apply the transition requirements of the new leases standard; it does not change how those requirements apply. An entity’s reporting for the comparative periods presented in the financial statements in which it adopts the new lease standard will continue to be in accordance with current U.S. GAAP (Topic 840, Leases).

For the Company, the provisions of this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those years. The Company adopted this guidance effective January 1, 2019 along with the adoption of ASU 2016-02-, “Leases.” The adoption of this guidance did have a material impact on the Company's financial statements. See the discussion regarding the adoption of ASU 2016-02 on page 89.

ASU 2018-07 - Compensation - Stock Compensation (Topic 718)

In June 2018, the FASB issued ASU 2018-07, “Compensation-Stock Compensation,” which expands the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from non-employees.

The amendments specify that Topic 718 applies to all share-based payment transactions in which a grantor acquires goods or services to be used or consumed in a grantor’s own operations by issuing share-based payment awards. The amendment also clarifies that Topic 718 does not apply to share-based payments used to effectively provide (1) financing to the issuer or (2) awards granted in conjunction with selling goods or services to customers as part of a contract accounted for under Topic 606, “Revenue from Contracts with Customers.”

For the Company, the provisions of this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those years. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes the interim period.

The adoption of this guidance in 2019 did not have a material impact on the Company's consolidated financial statements.

ASU Update 2017-08 - Premium Amortization on Purchased Callable Debt Securities

In March 2017, the FASB issued ASU 2017-08, "Premium Amortization on Purchased Callable Debt Securities," which shortens the amortization period for premiums on purchased callable debt securities to the earliest call date (i.e., yield-to-earliest call amortization) rather than amortizing over the full contractual term. The ASU does not change the accounting for securities held at a discount.

The amendments apply to callable debt securities with explicit, non-contingent call features that are callable at fixed prices and on preset dates. If a security may be prepaid based upon prepayments of the underlying loans and not because the issuer exercised a date specific call option, it is excluded from the scope of the new standard. However, for instruments with contingent call features, once the contingency is resolved and the security is callable at a fixed price and preset date, the security is within the scope of the amendments. Further, the amendments apply to all premiums on callable debt securities, regardless of how they were generated.

The amendments require companies to reset the effective yield using the payment terms of the debt security if the call option is not exercised on the earliest call date. If the security has additional future call dates, any excess of the amortized cost basis over the amount repayable by the issuer at the next call date should be amortized to the next call date.

For the Company, the provisions of this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those years. The adoption of this guidance in 2019 did not have a material impact on the Company's consolidated financial statements.

ASU Update 2017-07 - Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost

In March 2017, the FASB issued ASU 2017-07, "Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost," which requires that an employer disaggregate the service cost component from the other components of net benefit costs as follows: (1) service cost must be presented in the same line item(s) as other employee compensation costs. These costs are generally included within income from continuing operations but in some cases, may be eligible for capitalization if certain criteria are met; and (2) all other components of net benefit cost must be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. These generally include interest cost, actual return on plan assets, amortization of prior service cost included in accumulated other comprehensive income and gains or losses from changes in the value of the projected benefit obligation or plan assets.

For the Company, the provisions of this ASU are effective for fiscal years beginning after December 15, 2017, including interim periods within those years. The adoption of this guidance in 2018 did not have a material impact on the Company’s consolidated financial statements.

ASU Update 2017-04 - Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment

In January 2017, the FASB issued ASU 2017-04 "Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment," which simplifies how all entities assess goodwill for impairment by eliminating Step 2 from the goodwill impairment test. As amended, the goodwill impairment test will consist of one step comparing the fair value of a reporting unit with its carrying amount. An entity should recognize a goodwill impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value. The primary goal of this ASU is to simplify the goodwill impairment test and provide cost savings for all entities by removing the requirement to determine the fair value of individual assets and liabilities in order to calculate a reporting unit's "implied" goodwill under current U.S. GAAP.

For the Company, the provisions of this ASU are effective for its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. The amendments should be adopted prospectively. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017.

The adoption of this guidance in 2018 did not have a material impact on the Company's consolidated financial statements.

ASU Update 2017-01 - Business Combinations (Topic 805): Clarifying the Definition of a Business

In January 2017, the FASB issued ASU 2017-01 "Business Combinations (Topic 805): Clarifying the Definition of a Business," which clarifies the definition of a business with the objective of adding guidance to assist companies and other reporting organizations with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The amendments in this ASU provide a more robust framework to use in determining when a set of assets and activities is a business. The current definition of a business is interpreted broadly and can be difficult to apply. Stakeholders indicated that analyzing transactions is inefficient and costly and the definition does not permit the use of reasonable judgment.

Under current implementation guidance, there are three elements of a business: inputs, processes and outputs. While an integrated set of assets and activities (collectively referred to as a "set") that is a business usually has outputs, outputs are not required to be present. Additionally, all the inputs and processes that a seller uses in operating a set are not required if market participants can acquire the set and continue to produce outputs, for example, by integrating the acquired set with their own inputs and processes.

The ASU introduces a "screen" to assist entities in determining when a set should not be considered a business. If substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets, the set is not considered a business. If the screen is not met, the ASU requires that to be considered a business, a set must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output. Further, the ASU removes the evaluation of whether a market participant could replace missing elements (as required under current U.S. GAAP).

For the Company, the ASU is effective for annual periods beginning after December 15, 2017, including interim periods within those periods. The amendments in this ASU should be applied prospectively on or after the effective date. No disclosures are required at transition.

The adoption of this guidance in 2018 did not have a material impact on the Company's consolidated financial statements.

ASU Update 2016-15 - Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments.

In August 2016, the FASB issued ASU 2016-15 "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments," which clarifies whether the following items should be categorized as operating, investing or financing in the statement of cash flows: (1) debt prepayment and extinguishment costs, (2) settlement of zero-coupon debt, (3) settlement of contingent consideration, (4) insurance proceeds, (5) settlement of corporate-owned life insurance (COLI) and bank-owned life insurance (BOLI) policies, (6) distributions from equity method investees, (7) beneficial interests in securitization transactions and (8) receipts and payments with aspects of more than one class of cash flows.

For the Company, the provisions of this ASU are effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years. The Company classifies cash flows related to BOLI in accordance with the guidance, and the adoption of this guidance in 2018 did not have a material impact on its consolidated financial statements.

ASU Update 2016-13 - Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments

In June 2016, the FASB issued ASU 2016-13 "Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments," which requires credit losses on most financial assets to be measured at amortized cost and certain other instruments to be measured using an expected credit loss model (referred to as the current expected credit loss (CECL) model).

Under this model, entities will estimate credit losses over the entire contractual term of the instrument (considering estimated prepayments but not expected extensions or modifications unless reasonable expectation of a troubled debt restructuring exists) from the date of initial recognition of that instrument.

The ASU also replaces the current accounting model for purchased credit impaired loans and debt securities. The allowance for credit losses for purchased financial assets with a more-than-insignificant amount of credit deterioration since origination ("PCD assets") should be determined in a similar manner to other financial assets measured on an amortized cost basis. Upon initial recognition, the allowance for credit losses is added to the purchase price ("gross up approach") to determine the initial amortized cost basis. The subsequent accounting for PCD assets will use the CECL model described above.

The ASU made certain targeted amendments to the existing impairment model for available-for-sale (AFS) debt securities. For an AFS debt security for which there is neither the intent nor a more-likely-than-not requirement to sell, an entity will record credit losses as an allowance rather than a write-down of the amortized cost basis.

For the Company, the provisions of this ASU are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted for all entities as of the fiscal year beginning after December 15, 2018, including interim periods within those fiscal years.

The Company has completed the initial analysis of its financial assets and will be building and validating the CECL models in 2019 to evaluate the impact of the pending adoption of the new standard on its consolidated financial statements.

ASU Update 2016-02 - Leases

In February 2016, the FASB issued ASU 2016-02 "Leases." From the lessee's perspective, the new standard establishes a right- of-use ("ROU") model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement for a lessee. From the lessor's perspective, the new standard requires a lessor to classify leases as either sales-type, finance or operating. A lease will be treated as a sale if it transfers all of the risks and rewards, as well as control of the underlying asset, to the lessee. If risks and rewards are conveyed without the transfer of control, the lease is treated as a financing. If the lessor doesn’t convey risks and rewards or control, an operating lease results.

The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company adopted Topic 842 in the first quarter of 2019 utilizing the optional transition method as provided by ASU 2018-11. Under the optional transition method, only the most recent period presented will reflect the adoption with a cumulative-effect adjustment to the opening balance of retained earnings and the comparative prior periods will be presented under the previous guidance of Topic 840.

The new guidance includes a number of optional transition-related practical expedients. The Company elected to apply the practical expedients that relate to: the identification and classification of leases that commenced before January 1, 2019 and the initial direct costs of these leases.

The election of these practical expedients allows the Company to continue to account for these leases that commenced before January 1, 2019 in accordance with previous GAAP. All of the Company’s leases that commenced before January 1, 2019 were operating leases and the lease expense will continue to be recognized based on the terms of the leases, except that a right-of-use asset and a lease liability will be recognized for each operating lease at each reporting date based on the present value of the remaining minimum lease payments.

The Company has 16 leases for real property, which includes leases for 13 of its branch offices and leases for three offices that are used for general office space. All of the real property leases include one or more options to extend the lease term. Two of the leases for branch offices are a lease for the land under the building and the Company owns the leasehold improvements. The Company also has 13 leases for office equipment, which are primarily copier/printers.

For purposes of adopting Topic 842, the Company assumed in general that it would exercise the next lease extension for each real estate lease so that it would have the use of the property for at least a 5 to 10 year future period. With respect to one lease for land, the Company assumed that it would exercise all extensions covering a 25 year period because of the significance of the leasehold improvements. None of the equipment leases include extensions and generally have three to five year terms.

Due to the significance of the leases for real estate and the assumption regarding the exercise of the extensions for one land lease, the adoption of Topic 842 results in the recognition of a significant lease liability and ROU asset.

Upon adoption on January 1, 2019, the Company recognized a lease liability of approximately $16.2 million and a ROU asset of $15.7 million. If the increase in assets due to the recognized ROU asset had been included in assets at December 31, 2018, the Company’s regulatory capital ratios for CET 1 risk-based capital, Tier 1 risk-based capital, total risk-based capital, and leverage capital ratios would have been 10.57%, 12.22%, 12.98%, and 11.73%, respectively.

ASU Update 2016-01 - Financial Instruments-Overall: Recognition and Measurement of Financial Assets and Financial Liabilities

In January 2016, the FASB issued ASU 2016-01 "Financial Instruments-Overall: Recognition and Measurement of Financial Assets and Financial Liabilities." The guidance in the ASU, among other things, requires equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income; simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; requires an entity to present separately in other comprehensive income, the portion of the change in fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements; and clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities.

For the Company, the guidance in this ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The adoption of this guidance in 2018 did not have a material impact on the Company’s consolidated financial statements.

ASU 2014-09 -Revenue from Contracts with Customers (Topic 606)

In May 2014, the FASB issued ASU 2014-09, deferred by ASU 2015-14, “Revenue from Contracts with Customers (Topic 606).” The amendments in this update establish a comprehensive revenue recognition standard for virtually all industries under U.S. GAAP, including those that previously followed industry specific guidance such as the real estate, construction and software industries. The revenue standard's core principle is built on the contract between a vendor and a customer for the provision of goods and services. It attempts to depict the exchange of rights and obligations between the parties in the pattern of revenue recognition based on the consideration to which the vendor is entitled. To accomplish this objective, the standard requires five basic steps: (1) identify the contract with the customer, (2) identify the performance obligations in the contract, (3) determine the transaction price, (4) allocate the transaction price to the performance obligations in the contract and (5) recognize revenue when (or as) the entity satisfies a performance obligation.

In December 2016, the FASB issued ASU 2016-20 "Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers," amending the new revenue recognition standard that it jointly issued with the International Accounting Standards Board ("IASB") in 2014. The amendments do not change the core principles of the standard, but clarify certain narrow aspects of the standard, including its scope, contract cost accounting, disclosures, illustrative examples and other matters. The ASU becomes effective concurrently with ASU 2014-09 "Revenue from Contracts with Customers (Topic 606)."

The Company's revenue is comprised of primarily interest income on interest-earning assets less interest expense on interest-bearing liabilities and non-interest income. The scope of this guidance excludes net interest income as well as other revenues associated with financial assets and liabilities (such as gains on the sale of loans, loan fees and loan servicing fees), including loans, leases and securities. Accordingly, a significant portion of the Company's revenues will not be affected.

On January 1, 2018, the Company adopted Accounting Standards Update (“ASU”) 2014-09, “Revenue from Contracts with Customers” and all subsequent amendments to the ASU (collectively, “Topic 606”), which (i) creates a single framework for recognizing revenue from contracts with customers that fall within its scope and (ii) revises when it is appropriate to recognize a gain or loss from the transfer of nonfinancial assets, such as other real estate owned (“OREO”). The majority of the Company’s revenues come from interest income, other services to customers and other sources, including loans, leases and securities that are outside the scope of Topic 606. The Company’s services that fall within the scope of Topic 606 are presented within non-interest income and are recognized as revenue as the Company satisfies its obligations to customers. Services within the scope of Topic 606 include service charges on deposits, interchange income, other services and the sale of OREO. Refer to Note 24 - Revenue from Contracts with Customers - for further discussion on the Company’s accounting policies for revenue sources within the scope of Topic 606.

The Company adopted Topic 606 using the modified retrospective method for reporting periods beginning after January 1, 2018. The Company did not have any contracts that were not completed as of January 1, 2018. The adoption of Topic 606 did not result in a change to the accounting for any of the in-scope revenue streams; therefore, no cumulative effect adjustment was recorded.

(2) Acquisition of New Jersey Community Bank
On April 11, 2018, the Company completed its acquisition of 100 percent of the shares of common stock of New Jersey Community Bank ("NJCB"), which merged with and into the Bank. The shareholders of NJCB received total consideration of $8.6 million, which was comprised of 249,785 shares of common stock of the Company with a market value of $5.5 million and cash of $3.1 million, of which $401,000 was placed in escrow to cover costs and expenses, including settlement costs, if any, that the Company may incur after closing the merger as a result of a certain litigation matter.

The merger was accounted for under the acquisition method of accounting, and accordingly, assets acquired, liabilities assumed and consideration exchanged were recorded at preliminary estimated fair values as of the NJCB merger date. NJCB’s results of operations have been included in the Company’s Consolidated Statements of Income since April 11, 2018.

The assets acquired and liabilities assumed in the merger were recorded at their estimated fair values based on management's best estimates, using information available at the date of the merger, including the use of third party valuation specialists. The fair values are preliminary estimates and subject to adjustment for up to one year after the closing date of the merger.
The following table summarizes the estimated fair value of the acquired assets and liabilities assumed:

(Dollars in thousands)	Amount
Consideration paid:	
Company stock issued	$5,494
Cash payment	2,668
Cash held in escrow	401
Total consideration paid	$8,563
Recognized amounts of identifiable assets acquired and liabilities assumed at fair value:	
Cash and cash equivalents	$2,073
Investment securities available for sale	11,173
Loans	75,144
Premises and equipment, net	1,120
Core deposit intangible asset	80
Bank-owned life insurance	3,972
Accrued interest receivable	259
Other real estate owned	1,230
Other assets	1,601
Deposits	(87,223)
Other liabilities	(636)
Total identifiable assets and liabilities, net	$8,793
Gain from bargain purchase	$230

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

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

Loans acquired in the NJCB merger were recorded at fair value and subsequently accounted for in accordance with ASC Topic 310. The fair values of loans acquired were estimated, utilizing cash flow projections based on the remaining maturity and repricing terms. Cash flows were adjusted for estimated future credit losses of approximately $1.6 million and estimated prepayments. Projected cash flows were then discounted to present value, utilizing a risk-adjusted market rate for similar loans that management determined market participants would likely use.

At the NJCB merger date, the Company recorded $74.3 million of loans without evidence of credit quality deterioration and $881,000 of loans with evidence of credit quality deterioration.

The following table summarizes the composition of the loans acquired and recorded at fair value:

(Dollars in thousands)	At April 11, 2018 Loans acquired with no credit quality deterioration	Loans acquired with credit quality deterioration	Total
Commercial			
Construction	$ 798	$ —	$798
Commercial real estate	58,191	873	59,064
Commercial business	1,293	8	1,301
Residential real estate	7,572	—	7,572
Consumer	6,409	—	6,409
Total loans	$ 74,263	$ 881	$75,144

The following is a summary of the loans acquired with evidence of deteriorated credit quality in the NJCB acquisition as of the date of the closing of the merger:

(Dollars in thousands)	Acquired Credit Impaired Loans
Contractually required principal and interest at acquisition	$ 1,658
Contractual cash flows not expected to be collected (non-accretable difference)	609
Expected cash flows at acquisition	1,049
Interest component of expected cash flows (accretable difference)	168
Fair value of acquired loans	$ 881

Bank-owned life insurance was recorded at the cash surrender value of the insurance policies, which approximates the redemption value of the policies.

The core deposit intangible asset totaled $80,000 and is being amortized over its estimated useful life of approximately 10 years, using an accelerated method. No goodwill was recognized in the transaction.

The following table presents the projected amortization of the core deposit intangible asset for each period:

(Dollars in thousands)	Amount
Year	
2018	$ 15
2019	13
2020	12
2021	10
2022	8
Thereafter	22
	$ 80

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

Direct costs related to the NJCB merger were expensed as incurred. For the year ended December 31, 2018 and 2017, the Company incurred $2.1 million and $265,000, respectively, of expenses for termination of contracts, legal and financial advisory fees, severance and other integration related expenses, which have been separately stated as merger-related expenses in the Company’s Consolidated Statements of Income.

Supplemental Pro Forma Financial Information

The following table presents financial information regarding the former NJCB operations included in the Company’s Consolidated Statements of Income from the date of the NJCB merger (April 11, 2018) through December 31, 2018 under the column “Actual from Acquisition Date to December 31, 2018.” In addition, the table presents unaudited condensed pro forma financial information assuming that the NJCB merger had been completed as of January 1, 2018 and January 1, 2017, respectively. In the table, merger-related expenses of $2.1 million and $365,000 were excluded from the pro forma non-interest expenses for the year ended December 31, 2018 and December 31, 2017, respectively. Income taxes were also adjusted to exclude income tax benefits of $568,000 and $77,000 related to the merger expenses for the year ended December 31, 2018 and December 31, 2017, respectively.

The table has been prepared for comparative purposes only and is not necessarily indicative of the actual results that would have been attained had the NJCB merger occurred as of the beginning of the periods presented, nor is it indicative of future results. Furthermore, the unaudited pro forma financial information does not reflect management’s estimate of any revenue-enhancing opportunities nor anticipated cost savings that may have occurred as a result of the integration and consolidation of NJCB’s operations. The pro forma financial information reflects adjustments related to certain merger expenses and the related income tax effects.

(Dollars in thousands)	Actual from Acquisition Date to 12/31/2018	Pro Forma for the Twelve Months Ended 12/31/2018	Pro Forma for the Twelve Months Ended 12/31/2017
Net interest income	$2,504	$44,280	$39,231
Non-interest income	92	7,864	8,509
Non-interest expenses	1,223	33,032	35,206
Income taxes	413	4,886	5,871
Net income	960	13,327	6,063

3. Investment Securities

A summary of amortized cost and fair value of investment securities available for sale as of December 31, 2018 and 2017 follows:

	2018			
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value

U.S. Treasury securities and obligations of U.S. Government sponsored corporations (“GSE”)	$2,993	$ —	$ (41)	$2,952
Residential collateralized mortgage obligations - GSE	48,789	70	(676)	48,183
Residential mortgage backed securities - GSE	13,945	37	(100)	13,882
Obligations of state and political subdivisions	23,506	85	(249)	23,342
Trust preferred debt securities – single issuer	1,490	—	(161)	1,329
Corporate debt securities	28,323	—	(1,037)	27,286
Other debt securities	15,383	11	(146)	15,248
	$134,429	$ 203	$ (2,410)	$132,222

(In thousands)	2017 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U. S. Treasury securities and obligations of U.S. Government sponsored corporations (“GSE”)	$1,997	$ —	$ (30)	$1,967
Residential collateralized mortgage obligations - GSE	27,688	18	(381)	27,325
Residential mortgage backed securities - GSE	14,231	129	(72)	14,288
Obligations of state and political subdivisions	19,575	227	(82)	19,720
Trust preferred debt securities – single issuer	2,481	—	(132)	2,349
Corporate debt securities	27,917	14	(248)	27,683
Other debt securities	12,140	12	(26)	12,126
	$106,029	$ 400	$ (971)	$105,458

A summary of amortized cost, carrying value and fair value of investment securities held to maturity as of December 31, 2018 and 2017 follows:

(In thousands)	2018 Amortized Cost	Other-Than-Temporary Impairment Recognized In Accumulated Other Comprehensive Loss	Carrying Value	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Residential collateralized mortgage obligations - GSE	$6,701	$ —	$6,701	$ 30	$ (143)	$6,588
Residential mortgage backed securities - GSE	31,343	—	31,343	84	(346)	31,081
Obligations of state and political subdivisions	38,494	—	38,494	634	(118)	39,010
Trust preferred debt securities - pooled	657	(501)	156	569	—	725
Other debt securities	2,878	—	2,878	—	(78)	2,800
	$80,073	$ (501)	$79,572	$ 1,317	$ (685)	$80,204

(In thousands)	2017 Amortized Cost	Other-Than-Temporary Impairment Recognized In Accumulated Other Comprehensive Loss	Carrying Value	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U. S. Treasury securities and obligations of U.S. Government sponsored corporations (“GSE”)	$3,234	$ —	$3,234	$ —	$ (84)	$3,150
Residential collateralized mortgage obligations - GSE	8,701	—	8,701	94	(123)	8,672
Residential mortgage backed securities - GSE	34,072	—	34,072	231	(127)	34,176
Obligations of state and political subdivisions	63,797	—	63,797	1,224	(35)	64,986
Trust preferred debt securities - pooled	657	(501)	156	418	—	574
Other debt securities	307	—	307	—	—	307
	$110,768	$ (501)	$110,267	$ 1,967	$ (369)	$111,865

At December 31, 2018 and December 31, 2017, $80.4 million and $98.4 million of investment securities, respectively, were pledged to secure public funds, collateralize borrowings from the FHLB and for other purposes required or permitted by law.

During 2018, the Company received proceeds from the calls of securities with a book value of $1.4 million and resulted in a gain of $12,000 for the year ended December 31, 2018.
During 2017, the Company sold securities with a book value of $8.5 million for a net gain of $129,000. Included in the sales were $1.0 million of securities that were in the held to maturity portfolio and that resulted in a gain of $36,000 for year ended December 31, 2017. All held to maturity securities sold were mortgage backed securities with a remaining book value of less than 15% of the original principal balance at the time of purchase and, as allowed in ASC 320-10-25-14, were treated as held to maturity. There were no securities gains or losses in 2016.
The following is a summary of the proceeds from the sales of investment securities and the associated gross gains, gross losses, and net tax expense for the years ended December 31, 2018, 2017, and 2016.

(In thousands)	2018 Available for Sale	Held to Maturity	2017 Available for Sale	Held to Maturity	2016 Available for Sale	Held to Maturity
Proceeds	$ —	$ —	$7,602	$ 1,034	$ —	$ —
Gross gains	—	—	120	36	—	—
Gross losses	—	—	(27)	—	—	—
Net tax expense	—	—	38	12	—	—

The following table sets forth certain information regarding the amortized cost, carrying value, fair value, weighted average yields and contractual maturities of the Company's investment portfolio as of December 31, 2018. 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.

(Dollars in thousands)	Amortized Cost	Fair Value	Yield
Available for sale			
Due in one year or less	$ 8,388	$ 8,354	2.07 %
Due after one year through five years	35,001	34,018	3.17
Due after five years through ten years	22,272	21,992	3.03
Due after ten years	68,768	67,858	2.94
Total	$ 134,429	$ 132,222	2.96 %

	Carrying Value	Fair Value	Yield
Held to maturity			
Due in one year or less	$ 9,433	$ 9,449	3.48 %
Due after one year through five years	18,616	18,912	3.66
Due after five years through ten years	22,475	22,562	3.14
Due after ten years	29,048	29,281	3.22
Total	$ 79,572	$ 80,204	3.33 %

The following table presents gross unrealized losses on the Company's investment securities and the fair value of the related securities and length of time that the individual securities have been in a continuous unrealized loss position at December 31, 2018 and 2017.

	2018						
		Less than 12 months		12 months or longer		Total	
(In thousands)	Number of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U. S. Treasury securities and obligations of U.S. Government sponsored corporations (“GSE”)	2	$ 994	$ (1)	$ 1,958	$ (40)	$ 2,952	$ (41)
Residential collateralized mortgage obligations - GSE	34	20,756	(138)	22,106	(682)	42,862	(819)
Residential mortgage backed securities - GSE	68	18,393	(141)	19,402	(305)	37,795	(446)
Obligations of state and political subdivisions	67	12,785	(154)	11,638	(213)	24,423	(367)
Trust preferred debt securities -single issuer	2	1,329	(162)	—	—	1,329	(162)
Corporate debt securities	10	8,912	(632)	18,374	(405)	27,286	(1,037)
Other debt securities	9	10,943	(93)	4,613	(130)	15,556	(223)
Total temporarily impaired securities	192	$ 74,112	$ (1,321)	$ 78,091	$ (1,775)	$ 152,203	$ (3,095)

	2017						
		Less than 12 months		12 months or longer		Total	
(In thousands)	Number of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury securities and obligations of U.S. Government sponsored corporations (GSE)	2	$1,967	$ (30)	$3,150	$ (84)	$5,117	$ (114)
Residential collateralized mortgage obligations-GSE	11	19,237	(205)	8,788	(299)	28,025	(504)
Residential mortgage backed securities - GSE	35	21,770	(141)	3,074	(58)	24,844	(199)
Obligations of state and political subdivisions	42	11,594	(82)	2,717	(35)	14,311	(117)
Trust preferred debt securities– single issuer	4	—	—	2,349	(132)	2,349	(132)
Corporate debt securities	7	11,967	(98)	7,662	(150)	19,629	(248)
Other debt securities	4	8,840	(25)	21	(1)	8,861	(26)
Total temporarily impaired securities	105	$75,375	$ (581)	$27,761	$ (759)	$103,136	$ (1,340)

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

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

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

Trust preferred debt securities – single issuer: The investments in these securities are comprised of two corporate trust preferred securities issued by one large financial institutions that both mature in 2027. The contractual terms of the trust preferred securities do not allow the issuer to settle the securities at a price less than the face value of the trust preferred securities, which is greater than the amortized cost of the trust preferred securities. The issuer continues to maintain an investment grade credit rating and has not defaulted on interest payments. The decline in fair value is attributable to the widening of interest rate spreads and the lack of an active trading market for these securities and, to a lesser degree, market concerns about the issuers' credit quality. The Company does not intend to sell these investments and it is not more likely than not that the Company will be required to sell these investments before a market price recovery or maturity. Therefore, these investments are not considered other-than-temporarily impaired.

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

Other debt securities. The unrealized losses on investments in other debt securities were caused by an increase in market interest rates, which includes the yield required by the market participant for the issuer's credit risk. None of the issuers have defaulted on interest payments. The decline in fair value is attributable to changes in market interest rates. The Company does not intend to sell these investments and it is not more likely than not that the Company will be required to sell these investments before a market price recovery or maturity. Therefore, these investments are not considered other-than-temporarily impaired.

Trust preferred debt securities – pooled: This trust preferred debt security was issued by a two issuer pool (Preferred Term Securities XXV, Ltd. co-issued by Keefe, Bruyette and Woods, Inc. and First Tennessee ("PRETSL XXV")), consisting primarily of financial institution holding companies. During 2009, the Company recognized an other-than-temporary impairment charge of $865,000, of which $364,000 was determined to be a credit loss and charged to operations and $501,000 was recognized in the other comprehensive income (loss) component of shareholders' equity. The primary factor used to determine the credit portion of the impairment loss to be recognized in the income statement for this security was the discounted present value of projected cash flow, where that present value of cash flow was less than the amortized cost basis of the security. The present value of cash flow was developed using a model that considered performing collateral ratios, the level of subordination to senior tranches of the security and credit ratings of and projected credit defaults in the underlying collateral. On a quarterly basis, management evaluates this security to determine if any additional other-than-temporary impairment is required. As of December 31, 2018, management concluded that no additional other-than-temporary impairment had occurred.

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.

4. Loans and Loans Held for Sale

The following table presents loans outstanding, by class of loan, as of December 31,

(In thousands)	2018	2017
Commercial real estate	$388,431	$308,924
Mortgage warehouse lines	154,183	189,412
Construction	149,387	136,412
Commercial business	120,590	92,906
Residential real estate	47,263	40,494
Loans to individuals	22,962	21,025
Other loans	181	183
Gross Loans	882,997	789,356
Deferred loan costs, net	167	550
Total	$883,164	$789,906

The Company's lending focus and business is concentrated primarily in New Jersey, particularly northern and central New Jersey and the New York City metropolitan area. A significant portion of the total loan portfolio is secured by real estate or other collateral located in these areas.

The Company is a participant in the Small Business Administration ("SBA") Preferred Lender Program and originates loans under the program that are later sold. The Company also sells residential mortgage loans in the secondary market on a non-recourse basis, generally with the related loan servicing rights released to purchasers. Loans held for sale at December 31, 2018 and 2017 included $2.1 million and $2.3 million, respectively, in residential mortgage loans that the Company intends to sell under best efforts forward sales commitments providing for delivery to purchasers generally within a two month period. The estimated fair value of the derivatives of interest-rate lock commitments was $79,000 at December 31, 2018 and $135,000 at December 31, 2017.

The following table presents loans held for sale, by type of loan, as of December 31, 2018 and 2017.

(In thousands)	2018	2017
Residential real estate	$2,145	$2,269
SBA	875	1,985
	$3,020	$4,254

Loans sold to others and serviced by the Company are not included in the accompanying Consolidated Balance Sheets. The total amount of such loans serviced, but owned by outside investors, amounted to approximately $71.7 million and $42.3 million at

December 31, 2018 and 2017, respectively. At December 31, 2018 and 2017, the carrying value, of servicing assets was $991,000 and $726,000, respectively. The fair value of SBA servicing assets was determined using a discount rate of 11.50% on the servicing asset and 13.50% on the excess servicing and constant prepayment speeds averaging 11.70%.

The table below summarizes the changes in the related servicing assets for the years ended December 31, 2018 and 2017.

(In thousands)	2018	2017
Balance, beginning of year	$726	$605
Servicing assets capitalized	517	302
Amortization expense	(252)	(181)
Balance, end of year	$991	$726

In addition, the Company had discounts of $1.1 million and $863,000 related to the retained portion of the unsold SBA loans at December 31, 2018 and 2017, respectively.

5. Allowance for Loan Losses and Credit Quality Disclosures

The Company's primary lending emphasis is the origination of commercial business and commercial real estate loans and mortgage warehouse lines of credit. Based on the composition of the loan portfolio, the primary inherent risks are deteriorating credit quality, a decline in the economy and a decline in New Jersey and New York City metropolitan area 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 December 31, 2018 and 2017:

	2018							
(Dollars in thousands)	30-59 Days	60-89 Days	Greater than 90 Days	Total Past Due	Current	Total Loans Receivable	Recorded Investment > 90 Days Accruing	Nonaccrual Loans
Commercial real estate	$—	$499	$1,201	$1,700	$386,731	$ 388,431	$ —	$ 1,439
Mortgage warehouse lines	—	—	—	—	154,183	154,183	—	—
Construction	—	—	—	—	149,387	149,387	—	—
Commercial business	280	—	466	746	119,844	120,590	—	3,532
Residential real estate	588	—	1,156	1,744	45,519	47,263	—	1,156
Loans to individuals	16	237	263	516	22,446	22,962	55	398
Other	—	—	—	—	181	181	—	—
	$884	$736	$3,086	$4,706	$878,291	882,997	$ 55	$ 6,525
Deferred loan costs, net						167		
Total						$ 883,164		

	2017							
(Dollars in thousands)	30-59 Days	60-89 Days	Greater than 90 Days	Total Past Due	Current	Total Loans Receivable	Recorded Investment > 90 Days Accruing	Nonaccrual Loans
Commercial real estate	$540	$—	$2,465	$3,005	$305,919	$ 308,924	$ —	$ 2,465
Mortgage warehouse lines	—	—	—	—	189,412	189,412	—	—
Construction	—	—	—	—	136,412	136,412	—	—
Commercial business	180	545	619	1,344	91,562	92,906	—	4,212
Residential real estate	911	256	69	1,236	39,258	40,494	—	69
Loans to individuals	119	—	116	235	20,790	21,025	—	368
Other	—	—	—	—	183	183	—	—
	$1,750	$801	$3,269	$5,820	$783,536	789,356	$ —	$ 7,114
Deferred loan costs, net						550		
Total						$ 789,906		

As provided by ASC 310-30, the excess of cash flows expected at acquisition over the initial investment in the loan is recognized as interest income over the life of the loan. At December 31, 2018 and 2017, there were $865,000 and $439,000 of PCI loans, respectively, that were not classified as non-performing loans due to the accretion of income based on their original contract terms.

Additional income before taxes amounting to $155,000, $514,000 and $522,000 would have been recognized in 2018, 2017 and 2016, respectively, if interest on all loans had been recorded based upon their original contract terms.

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

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

- Delinquencies and non-accruals;
- Portfolio quality;
- Concentration of credit;
- Trends in volume and type of loans;
- Quality of collateral;
- Policy and procedures;
- Experience, ability and depth of management;
- Economic trends – national and local; and

• External factors – competition, legal and regulatory.

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

The specific allowance for impaired loans is established for specific loans that have been identified by management as being impaired. These loans are considered to be impaired primarily because the loans have not performed according to payment terms and there is reason to believe that repayment of the loan principal in whole, or in part, is unlikely. The specific portion of the allowance is the total amount of potential unconfirmed losses for these individual impaired loans. To assist in determining the fair value of loan collateral, the Company often utilizes independent third party qualified appraisal firms which, 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 business loans and commercial real estate loans, construction loans, warehouse lines of credit and various types of loans to individuals. The historical loss estimation for each loan pool is then adjusted for qualitative factors such as economic trends, concentrations of credit, trends in the volume of loans, portfolio quality, delinquencies and non-accrual trends. These factors are evaluated for each class of the loan portfolio and may have positive or negative effects on the allocated allowance for the loan portfolio segment. The aggregate amount resulting from the application of these qualitative factors determines the overall risk for the portfolio and results in an allocated allowance for each of the loan segments.

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 portfolios.

Commercial Business

The Company offers a variety of commercial loan services, including term loans, lines of credit and loans secured by equipment and receivables. A broad range of short-to-medium term commercial loans, both secured and unsecured, are made available to businesses for working capital (including inventory and receivables), business expansion (including acquisition and development of real estate and improvements) and the purchase of equipment and machinery. Commercial business loans are granted based on the borrower's ability to generate cash flow to support its debt obligations and other cash related expenses. A borrower's ability to repay commercial business loans is substantially dependent on the success of the business itself and on the quality of its management. As a general practice, the Company takes as collateral a security interest in any available real estate, equipment, inventory, receivables or other personal property of its borrowers, although the Company occasionally makes commercial business loans on an unsecured basis. Generally, the Company requires personal guarantees of its commercial business loans to offset the risks associated with such loans.

Much of the Company's lending is in northern and central New Jersey and New York City metropolitan area. As a result of this geographic concentration, a significant broad-based deterioration in economic conditions in New Jersey and the New York City metropolitan area could have a material adverse impact on the Company's loan portfolio. A prolonged decline in economic conditions in our market area could restrict borrowers' ability to pay outstanding principal and interest on loans when due. The value of assets pledged as collateral may decline and the proceeds from the sale or liquidation of these assets may not be sufficient to repay the loan.

Commercial Real Estate

Commercial real estate loans are made to businesses to expand their facilities and operations and to real estate operators to finance the acquisition of income producing properties. The Company's loan policy requires that borrowers have sufficient cash flow to meet the debt service requirements and the value of the property meets the loan-to-value criteria set in the loan policy. The Company monitors loan concentrations by borrower, by type of property and by location and other criteria.

The Company's commercial real estate portfolio is largely secured by real estate collateral located in the State of New Jersey and the New York City metropolitan area. Conditions in the real estate markets in which the collateral for the Company's loans are located strongly influence the level of the Company's non-performing loans. A decline in the New Jersey and the New York City metropolitan area real estate market could adversely affect the Company's loan portfolio. Decreases in local real estate values would adversely affect the value of property used as collateral for the Company's loans. Adverse changes in the economy also may have a negative effect on the ability of our borrowers to make timely repayments of their loans.

Construction Financing

Construction financing is provided to businesses to expand their facilities and operations and to real estate developers for the acquisition, development and construction of residential and commercial properties. First mortgage construction loans are made to developers and builders primarily for single family homes and multi-family buildings that are presold or are to be sold or leased on a speculative basis.

The Company lends to builders and developers with established relationships, successful operating histories and sound financial resources. Management has established underwriting and monitoring criteria to minimize the inherent risks of real estate construction lending. The risks associated with speculative construction lending include the borrower's inability to complete the construction process on time and within budget, the sale or rental of the project within projected absorption periods and the economic risks associated with real estate collateral. Such loans may include financing the development and/or construction of residential subdivisions. This activity may involve financing land purchases and infrastructure development (i.e., roads, utilities, etc.) as well as construction of residences or multi-family dwellings for subsequent sale by the developer/builder. Because the sale or rental of developed properties is integral to the success of developer business, loan repayment may be especially subject to the volatility of real estate market values.

Mortgage Warehouse Lines of Credit

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

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

Consumer

The Company’s consumer loan portfolio segment is comprised of residential real estate loans, loans to individuals and other loans. Individual loan pools are created for the various types of loans to individuals. The principal risk is the borrower becomes unemployed or has a significant reduction in income.

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

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

• Consumer credit scores;

- Internal credit risk grades;
- Loan-to-value ratios;
- Collateral; and
- Collection experience.

Internal Risk Rating of Loans

The Company’s internal credit risk grades are based on the definitions currently utilized by the banking 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 Company and adequately margined. Loans that are based upon "blue chip" stocks listed on the major stock exchanges and adequately margined.

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

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

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

4. Special Mention - A "special mention" loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or in the Company's credit position at some future date. Special mention loans are not adversely classified and do not expose the Company to sufficient risk to warrant adverse classification.

5. Substandard - A "substandard" loan is inadequately protected by the current sound worth and paying capacity of the obligor or by the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

6. Doubtful - A loan classified as "doubtful" has all the weaknesses inherent in a loan classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

7. Loss - A loan classified as "loss" is considered uncollectible and of such little value that its continuance on the books is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this loan even though partial recovery may occur in the future.

The following table provides a breakdown of the loan portfolio by credit quality indicator at December 31, 2018 and 2017:

Commercial Credit Exposure by Internally Assigned Grade	2018				
(In thousands)	Construction	Commercial Business	Commercial Real Estate	Mortgage Warehouse Lines	Residential Real Estate
Pass	$146,460	$ 104,162	$ 366,424	$ 152,378	$ 45,825
Special Mention	2,927	12,703	13,317	1,805	103
Substandard	—	3,487	8,690	—	1,335
Doubtful	—	238	—	—	—
Total	$149,387	$ 120,590	$ 388,431	$ 154,183	$ 47,263

Consumer Credit Exposure by Payment Activity	2018	
(In thousands)	Loans to Individuals	Other
Performing	$22,564	$181
Nonperforming	398	—
Total	$22,962	$181

Commercial Credit Exposure by Internally Assigned Grade	2017				
(In thousands)	Construction	Commercial Business	Commercial Real Estate	Mortgage Warehouse Lines	Residential Real Estate
Pass	$136,180	$ 84,746	$ 289,203	$ 189,412	$ 39,539
Special Mention	232	3,454	13,267	—	666
Substandard	—	1,252	6,454	—	289
Doubtful	—	3,454	—	—	—
Total	$136,412	$ 92,906	$ 308,924	$ 189,412	$ 40,494

Consumer Credit Exposure by Payment Activity	2017	
(In thousands)	Loans to Individuals	Other
Performing	$20,657	$183
Nonperforming	368	—
Total	$21,025	$183

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 non-accrual status, it is also considered to be impaired. Loans are placed on non-accrual status when: (1) the full collection of interest or principal becomes uncertain; or (2) they are contractually past due 90 days or more as to interest or principal payments unless the loans are both well secured and in the process of collection.

104

The following tables summarize the distribution of the allowance for loan losses and loans receivable by loan class and impairment method as of and for the years ended December 31, 2018, 2017 and 2016, respectively.

	2018									
(Dollars in thousands)	Construction	Commercial Business	Commercial Real Estate	Mortgage Warehouse Lines	Residential Real Estate	Loans to Individuals	Other	Unallocated	Deferred Fees	Total
Allowance for loan losses:										
Beginning balance	$1,703	$1,720	$2,949	$852	$392	$114	$—	$283		$8,013
Provision (credit) charged to operations	29	158	920	(121)	39	49	17	(191)		900
Loans charged off	—	(62)	(491)	—	—	(16)	(17)	—		(586)
Recoveries of loans charged off	—	13	61	—	—	1	—	—		75
Ending balance	$1,732	$1,829	$3,439	$731	$431	$148	$—	$92		$8,402
Individually evaluated for impairment	$—	$380	$71	$—	$—	$—	$—	$—		$451
Loans acquired with deteriorated credit quality	—	—	2	—	—	—	—	—	—	2
Collectively evaluated for impairment	1,732	1,449	3,366	731	431	148	—	92		7,949
Ending balance	$1,732	$1,829	$3,439	$731	$431	$148	$—	$92		$8,402
Loans receivables:										
Individually evaluated for impairment	$103	$3,775	$5,093	$—	$1,156	$398	$—	$—	$—	$10,525
Loans acquired with deteriorated credit quality	—	319	1,419	—	—	—	—	—	—	1,738
Collectively evaluated for impairment	149,284	116,496	381,919	154,183	46,107	22,564	181	—	167	870,901
Total	$149,387	$120,590	$388,431	$154,183	$47,263	$22,962	$181	$—	$167	$883,164

(In thousands)	2017 Construction	Commercial Business	Commercial Real Estate	Mortgage Warehouse Lines	Residential Real Estate	Loans to Individuals	Other	Unallocated	Deferred Fees	Total
Allowance for loan losses:										
Beginning balance	$1,204	$1,732	$2,574	$973	$367	$112	$—	$ 532		$7,494
(Credit) provision charged to operations	499	2	358	(121)	126	(2)	(13)	(249)		600
Loans charged off	—	(61)	—	—	(101)	—	—	—		(162)
Recoveries of loans charged off	—	47	17	—	—	4	13	—		81
Ending balance	$1,703	$1,720	$2,949	$852	$392	$114	$—	$ 283		$8,013
Individually evaluated for impairment	$—	$592	$92	$—	$—	$—	$—	$ —		$684
Collectively evaluated for impairment	1,703	1,128	2,857	852	392	114	—	283		7,329
Ending balance	$1,703	$1,720	$2,949	$852	$392	$114	$—	$ 283		$8,013
Loans receivable:										
Individually evaluated for impairment	$232	$4,459	$5,713	$—	$69	$368	$—	$ —	$ —	$10,841
Loans acquired with deteriorated credit quality	—	274	590	—	—	—	—	—	—	864
Collectively evaluated for impairment	136,180	88,173	302,621	189,412	40,425	20,657	183	—	550	778,201
Total	$136,412	$92,906	$308,924	$189,412	$40,494	$21,025	$183	$ —	$ 550	$789,906

(In thousands)	2016 Construction	Commercial Business	Commercial Real Estate	Mortgage Warehouse Lines	Residential Real Estate	Loans to Individuals	Other	Unallocated	Deferred Fees	Total
Allowance for loan losses:										
Beginning balance	$1,025	$2,005	$3,049	$866	$288	$109	$—	$ 218		$7,560
(Credit) provision charged to operations	179	(177)	(800)	107	79	(3)	1	314		(300)
Loans charged off	—	(97)	(60)	—	—	—	(1)	—		(158)
Recoveries of loans charged off	—	1	385	—	—	6	—	—		392
Ending balance	$1,204	$1,732	$2,574	$973	$367	$112	$—	$ 532		$7,494
	$7	$101	$114	$—	$38	$—	$—	$ —		$260

Individually evaluated for impairment										
Collectively evaluated for impairment	1,197	1,631	2,460	973	329	112	—	532		7,234
Ending balance	$1,204	$1,732	$2,574	$973	$367	$112	$—	$ 532		$7,494
Loans receivable:										
Individually evaluated for impairment	$391	$947	$3,817	$—	$544	$337	$—	$ —	$—	$6,036
Loans acquired with deteriorated credit quality	—	191	930	—	—	—	—	—	—	1,121
Collectively evaluated for impairment	95,644	98,721	237,437	216,259	44,247	23,399	207	—	1,737	717,651
Total	$96,035	$99,859	$242,184	$216,259	$44,791	$23,736	$207	$ —	$1,737	$724,808

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

The following tables summarize information regarding impaired loans receivable by loan class as of and for the years ended December 31, 2018, 2017 and 2016, respectively.

	2018				
(Dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Year to Date 2018 Average Recorded Investment	Year to Date 2018 Interest Income Recognized
With no related allowance:					
Commercial:					
Construction	$ 103	$ 103	$ —	$ 115	$ 7
Commercial business	992	1,332	—	1,112	112
Commercial real estate	2,304	2,629	—	2,757	48
Mortgage warehouse lines	—	—	—	—	—
	3,399	4,064	—	3,984	167
Consumer:					
Residential real estate	1,156	1,241	—	846	—
Loans to individuals	398	478	—	410	—
Other	—	—	—	—	—
	1,554	1,719	—	1,256	—
With no related allowance	4,953	5,783	—	5,240	167
With an allowance:					
Commercial:					
Construction	—	—	—	—	—
Commercial business	3,102	3,217	380	3,326	44
Commercial real estate	4,208	4,208	73	4,336	252
Mortgage warehouse lines	—	—	—	—	—
	7,310	7,425	453	7,662	296
Consumer:					
Residential real estate	—	—	—	—	—
Loans to individuals	—	—	—	—	—
Other	—	—	—	—	—
	—	—	—	—	—
With an allowance	7,310	7,425	453	7,662	296
Total:					
Construction	103	103	—	115	7
Commercial business	4,094	4,549	380	4,438	156
Commercial real estate	6,512	6,837	73	7,093	300
Mortgage warehouse lines	—	—	—	—	—
Residential real estate	1,156	1,241	—	846	—
Loans to individuals	398	478	—	410	—
Other	—	—	—	—	—
	$ 12,263	$ 13,208	$ 453	$ 12,902	$ 463

	December 31, 2017				
(Dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Year to Date 2017 Average Recorded Investment	Year to Date 2017 Interest Income Recognized
With no related allowance:					
Commercial:					
Construction	$				