1ST CONSTITUTION BANCORP
Form 10-Q
November 13, 2014

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2014
or

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

For the transition period from _____ to _____

Commission file Number: 000-32891

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

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

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

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

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

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

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

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

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

As of November 10, 2014, there were 7,134,774 shares of the registrant's common stock, no par value, outstanding.

1ST CONSTITUTION BANCORP

FORM 10-Q

INDEX

		Page
PART I.	FINANCIAL INFORMATION	
Item 1.	Financial Statements	1
	Consolidated Balance Sheets (unaudited) at September 30, 2014 and December 31, 2013	1
	Consolidated Statements of Income (unaudited) for the Three Months and Nine Months Ended September 30, 2014 and September 30, 2013	2
	Consolidated Statements of Comprehensive Income (unaudited) for the Three Months and Nine Months Ended September 30, 2014 and September 30, 2013	3
	Consolidated Statements of Changes in Shareholders' Equity (unaudited) for the Nine Months Ended September 30, 2014 and September 30, 2013	4
	Consolidated Statements of Cash Flows (unaudited) for the Nine Months Ended September 30, 2014 and September 30, 2013	5
	Notes to Consolidated Financial Statements (unaudited)	6
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	42
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	68
Item 4.	Controls and Procedures	68
PART II.	OTHER INFORMATION	
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	70
Item 6.	Exhibits	71

SIGNATURES 72

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

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

		September 30, 2014		December 31, 2013
ASSETS				
CASH AND DUE FROM BANKS	$	20,371,823	$	69,267,345
FEDERAL FUNDS SOLD / SHORT-TERM INVESTMENTS		-		11,426
Total cash and cash equivalents		20,371,823		69,278,771
INVESTMENT SECURITIES:				
Available for sale, at fair value		103,959,466		99,198,807
Hel at Mar Held to maturity (fair value of $152,466,765 and $153,629,773 September 30, 2014 and December 31, 2013, respectively)		148,182,693		152,816,815
Total investment securities		252,142,159		252,015,622
LOANS HELD FOR SALE		9,459,172		10,923,689
LOANS		620,395,918		373,336,082
Less- Allowance for loan losses		(7,107,872)		(7,038,571)
Net loans		613,288,046		366,297,511
PREMISES AND EQUIPMENT, net		12,065,252		10,043,505
ACCRUED INTEREST RECEIVABLE		2,798,265		2,542,602
BANK-OWNED LIFE INSURANCE		21,074,473		16,183,574
OTHER REAL ESTATE OWNED		1,748,455		2,136,341
GOODWILL AND INTANGIBLE ASSETS		13,587,701		4,889,575
OTHER ASSETS		7,769,204		8,013,897
Total assets	$	954,304,550	$	742,325,087
LIABILITIES AND SHAREHOLDERS' EQUITY				
LIABILITIES:				
Deposits				
Non-interest bearing	$	172,185,545	$	121,891,752
Interest bearing		651,379,201		516,660,278
Total deposits		823,564,746		638,552,030
BORROWINGS		20,798,473		10,000,000
REDEEMABLE SUBORDINATED DEBENTURES		18,557,000		18,557,000
ACCRUED INTEREST PAYABLE		802,851		883,212
ACCRUED EXPENSES AND OTHER LIABILITIES		6,105,078		5,974,531
Total liabilities		869,828,148		673,966,773
COMMITMENTS AND CONTINGENCIES				
SHAREHOLDERS' EQUITY:				
Preferred stock, no par value; 5,000,000 shares authorized, none issued		-		-
Common Stock, no par value; 30,000,000 shares authorized;		61,383,079		49,403,450

		September 30, 2014		December 31, 2013
7,165,084, and 6,081,961 shares issued and 7,134,774 and 6,065,123 shares outstanding at September 30,2014 and December 31, 2013, respectively				
Retained earnings		23,714,254		21,374,381
Treasury Stock, 30,310 shares and 16,838 shares at September 30, 2014 and December 31, 2013, respectively		(309,871)		(171,883)
Accumulated other comprehensive (loss)		(311,060)		(2,247,634)
Total shareholders' equity		84,476,402		68,358,314
Total liabilities and shareholders' equity	$	954,304,550	$	742,325,087

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

1

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
INTEREST INCOME:				
Loans, including fees	$ 8,585,950	$ 5,701,804	$ 22,694,649	$ 17,319,258
Securities:				
Taxable	961,043	980,004	3,141,787	2,818,800
Tax-exempt	575,977	575,301	1,745,708	1,633,799
Federal funds sold and short-term investments	10,184	81,745	110,892	221,087
Total interest income	10,133,154	7,338,854	27,693,036	21,992,944
INTEREST EXPENSE:				
Deposits	955,246	842,372	2,826,339	2,668,306
Borrowings	144,005	103,122	387,422	310,649
Redeemable subordinated debentures	86,534	88,338	257,314	263,982
Total interest expense	1,185,785	1,033,832	3,471,075	3,242,937
Net interest income	8,947,369	6,305,022	24,221,961	18,750,007
PROVISION FOR LOAN LOSSES	649,998	539,998	5,249,994	776,664
Net interest income after provision for loan losses	8,297,371	5,765,024	18,971,967	17,973,343
NON-INTEREST INCOME:				
Service charges on deposit accounts	267,625	231,169	753,976	675,839
Gain on sales of loans	556,054	641,966	1,562,790	1,852,821
Income on Bank-owned life insurance	143,884	115,840	422,022	348,206
Other income	514,279	627,573	1,640,068	1,796,104
Total non-interest income	1,481,842	1,616,548	4,378,856	4,672,970
NON-INTEREST EXPENSE:				
Salaries and employee benefits	3,922,104	3,060,143	11,194,732	9,458,247
Occupancy expense	833,813	629,922	2,498,903	1,930,227
Data processing expense	313,237	273,272	941,046	868,960
Other real estate owned expenses	131,973	176,796	272,014	770,858
Merger related expenses	0	0	1,532,153	0
FDIC insurance expense	210,000	111,562	544,631	146,249
Other operating expenses	1,312,524	1,001,788	3,792,012	3,324,210
Total non-interest expenses	6,723,651	5,253,483	20,775,491	16,498,751
Income before income taxes	3,055,562	2,128,089	2,575,332	6,147,562
INCOME TAXES	917,483	604,851	235,459	1,741,974
Net income	$ 2,138,079	$ 1,523,238	$ 2,339,873	$ 4,405,588
NET INCOME PER COMMON SHARE:				
Basic	$ 0.30	$ 0.25	$ 0.33	$ 0.74

Diluted	$ 0.30	$ 0.25	$ 0.33	$ 0.72

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

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

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Net Income	$ 2,138,079	$ 1,523,238	$ 2,339,873	$ 4,405,588
Other comprehensive income (loss) :				
Unrealized gains (losses) on securities available for sale	476,686	(53,738)	2,758,346	(4,466,187)
Tax effect	(255,347)	18,270	(1,014,127)	1,518,504
Net of tax amount	221,339	(35,468)	1,744,219	(2,947,683)
Realized loss on securities available for sale (1)	-	-	2,516	-
Tax effect	-	-	(1,006)	-
Net of tax amount	-	-	1,510	-
Pension liability (2)	159,474	63,265	318,075	129,751
Tax effect	(63,789)	(25,305)	(127,230)	(51,907)
Net of tax amount	95,685	37,960	190,845	77,844
Total other comprehensive income (loss)	317,024	2,492	1,936,574	(2,869,839)
Comprehensive income	$ 2,455,103	$ 1,525,730	$ 4,276,447	$ 1,535,749

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

(1) Included in other income on the Consolidated Statements of Income.
(2) Included in salaries and employee benefits on the Consolidated Statements of Income.

3

1st Constitution Bancorp and Subsidiaries
Consolidated Statements of Changes in Shareholders' Equity
For the Nine Months Ended September 30, 2014 and 2013
(Unaudited)

	Common Stock	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive (Loss) Income	Total Shareholders' Equity
Balance, January 1, 2013	$48,716,032	$15,594,293	$(61,086)	$ 804,293	$65,053,532
Exercise of stock options and issuance of shares under employee benefit program (23,233 shares)	603,342				603,342
Share-based compensation	75,948				75,948
Treasury stock purchased (6,440 shares)			(116,451)		(116,451)
Net income for the nine month ended September 30, 2013		4,405,588			4,405,588
Other comprehensive (loss)				(2,869,839)	(2,869,839)
Balance, September 30, 2013	$49,395,322	$19,999,881	$(177,537)	$ (2,065,546)	$67,152,120
Balance, January 1, 2014	$49,403,450	$21,374,381	$(171,883)	$ (2,247,634)	$68,358,314
Exercise of stock options and issuance of shares under employee benefit program (63,900 shares)	741,806				741,806
Share-based compensation	77,123				77,123
Treasury stock purchased (13,472 shares)			(137,988)		(137,988)
Acquisition of Rumson-Fair Haven Bank and Trust Company (1,019,223 shares)	11,160,700				11,160,700
Net income for the nine months ended September 30, 2014		2,339,873			2,339,873
Other comprehensive income				1,936,574	1,936,574
Balance, September 30, 2014	$61,383,079	$23,714,254	$(309,871)	$ (311,060)	$84,476,402

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

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

	Nine Months Ended September 30, 2014	2013
OPERATING ACTIVITIES:		
Net income	$ 2,339,873	$ 4,405,588
Adjustments to reconcile net income to net cash provided by operating activities-		
Provision for loan losses	5,249,994	776,664
Provision for loss on other real estate owned	111,545	662,918
Depreciation and amortization	1,338,569	805.823
Net amortization of premiums and discounts on securities	852,302	868,639
Loss on sales of securities held for sale	2,516	-
Gains on sales of other real estate owned	(21,012)	(292,170)
Gains on sales of loans held for sale	(1,562,790)	(1,852,821)
Originations of loans held for sale	(84,044,668)	(114,126,927)
Proceeds from sales of loans held for sale	87,071,975	137,972,505
Income on Bank – owned life insurance	(422,022)	(348,206)
Share-based compensation expense	443,673	380,471
Decrease in accrued interest receivable	340,949	728,564
(Increase) decrease in other assets	(307,003)	925,461
Decrease in accrued interest payable	(227,735)	(269,852)
Increase (decrease) in accrued expenses and other liabilities	(388,648)	517,255
Net cash provided by operating activities	10,777,518	31,153,912
INVESTING ACTIVITIES:		
Purchases of securities -		
Available for sale	-	(16,947,137)
Held to maturity	(14,229,098)	(62,560,993)
Proceeds from maturities and prepayments of securities -		
Available for sale	21,503,769	20,423,187
Held to maturity	18,572,106	27,488,848
Proceeds from sales of securities available for sale	5,957,188	-
Net (increase) decrease in loans	(108,783,950)	155,845,716
Capital expenditures	(262,407)	(147,040)
Net cash received in the acquisition	21,375,071	-
Additional investment in other real estate owned	-	(11,500)
Proceeds from sales of other real estate owned	230,949	7,183,854
Net cash (used in) provided by investing activities	(55,636,372)	131,274,935
FINANCING ACTIVITIES:		
Issuance of vested shares	741,806	603,342
Purchase of Treasury Stock	(137,988)	(116,451)
Net decrease in demand, savings and time deposits	(4,471,836)	(20,745,521)
Net increase (decrease in borrowings	(180,076)	(32,400,000)
Net cash used in financing activities	(4,048,094)	(52,658,630)
(Decrease) increase in cash and cash equivalents	(48,906,948)	109,770,217
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	69,278,771	14,044,921

CASH AND CASH EQUIVALENTS				
AT END OF YEAR	$	20,371,823	$	123,815,138
SUPPLEMENTAL DISCLOSURES OF CASHFLOW INFORMATION				
Cash paid during the period for -				
Interest	$	3,551,436		3,512,789
Income taxes		656,223		1,721,000
Non-cash investing activities				
Real estate acquired in full satisfaction of loans in foreclosure	$	-		2,311,225
Acquisition of Rumson-Fair Haven Bank and Trust Company				
Noncash assets acquired:				
Investment securities available for sale	$	30,024,458		
Loans		143,714,377		
Accrued interest receivable		596,612		
Premises and equipment, net		2,551,939		
Goodwill		7,698,427		
Core deposit intangible		1,188,836		
Bank-owned life insurance		4,470,579		
Other assets		885,576		
		191,130,804		
Liabilities assumed:				
Deposits		189,490,005		
Advances from FHLB		11,030,000		
Other liabilities		825,170		
		201,345,175		
Common stock issued as consideration	$	11,160,700		

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

1st Constitution Bancorp and Subsidiaries
Notes To Consolidated Financial Statements
(Unaudited)

(1) Summary of Significant Accounting Policies

The accompanying unaudited consolidated financial statements include 1st Constitution Bancorp (the "Company"), its wholly-owned subsidiary, 1st Constitution Bank (the "Bank"), and the Bank's wholly-owned subsidiaries, 1st Constitution Investment Company of New Jersey, Inc., FCB Assets Holdings, Inc., 1st Constitution Title Agency, LLC, 204 South Newman Street Corp. and 249 New York Avenue, LLC. 1st Constitution Capital Trust II, a subsidiary of the Company, is not included in the Company's consolidated financial statements, as it is a variable interest entity and the Company is not the primary beneficiary. All significant intercompany accounts and transactions have been eliminated in consolidation and certain prior period amounts have been reclassified to conform to current year presentation. The accounting and reporting policies of the Company and its subsidiaries conform to accounting principles generally accepted in the United States of America and pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC") including the instructions to Form 10-Q and Article 8 of Regulation S-X. Certain information and footnote disclosures normally included in financial statements have been condensed or omitted pursuant to such rules and regulations. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Company's Form 10-K for the year ended December 31, 2013, filed with the SEC on March 31, 2014.

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

The Company has evaluated events and transactions occurring subsequent to the balance sheet date of September 30, 2014 for items that should potentially be recognized or disclosed in these financial statements. The evaluation was conducted through the date these financial statements were issued.

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

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

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

The 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 a third party

valuation specialist. 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.

($ in thousands)		Amount
Consideration paid:		
Company stock issued	$	11,161
Cash payment		14,770
Total consideration paid		25,931
Recognized amounts of identifiable assets and liabilities assumed at fair value:		
Cash and cash equivalents		36,045
Short-term investments		100
Securities available for sale		30,024
Loans		143,714
Premises and equipment, net		2,552
Identifiable intangible assets		1,189
Bank-owned life insurance		4,471
Accrued interest receivable and other assets		1,483
Deposits		(189,490)
Borrowings		(11,030)
Other liabilities		(825)
Total identifiable assets		18,233
Goodwill	$	7,698

Accounting Standards Codification ("ASC") Topic 805-10 provides that if the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer shall report in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, the acquirer shall retrospectively adjust the provisional amounts recognized at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the measurement of the amounts recognized as of that date. During the measurement period, the acquirer also shall recognize additional assets or liabilities if new information is obtained about facts and circumstances that existed as of the acquisition date that, if known, would have resulted in the recognition of those assets and liabilities as of that date. The measurement period may not exceed one year from the acquisition date. As of September 30, 2014, independent appraisals of branch office real estate and leases had not been completed and the fair value of these assets and liabilities had not been determined.

Loans and leases acquired in the Rumson acquisition were recorded at fair value and subsequently accounted for in accordance with ASC Topic 310, and there was no carryover of Rumson's allowance for loan losses. The fair values of loans acquired from Rumson were estimated using cash flow projections based on the remaining maturity and repricing terms. Cash flows were adjusted for estimated future credit losses and the rate of prepayments. Projected cash flows were then discounted to present value using a risk-adjusted market rate for similar loans.

At the acquisition date, the Company recorded $141.1 million of loans without evidence of credit quality deterioration and $2.6 million of loans with evidence of credit quality deterioration. The following table summarizes the composition of the loans acquired and recorded at fair value.

($ in thousands)	At February 7, 2014 Loans acquired with no credit quality deterioration	Loans acquired with credit quality deterioration	Total
Commercial			
Construction	$11,920	$ -	$11,920
Commercial Real Estate	62,398	1,832	64,230
Commercial Business	18,086	368	18,454
Residential Real Estate	32,743	180	32,923
Consumer	15,953	234	16,187
Total	$141,100	$ 2,614	$143,714

The following is a summary of the loans acquired with evidence of deteriorated credit quality in the Rumson acquisition as of the closing date.

($ in thousands)	Acquired Credit Impaired Loans
Contractually required principal and interest at acquisition	$ 4,451
Contractual cash flows not expected to be collected (non-accretable difference)	1,543
Expected cash flows at acquisition	2,908
Interest component of expected cash flows (accretable difference)	294
Fair value of acquired loans	$ 2,614

The core deposit intangible totaled $1.2 million and is being amortized over its estimated useful life of approximately 10 years using an accelerated method. The goodwill will be evaluated annually for impairment. The goodwill is not deductible for tax purposes.

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

	($ in thousands)
2014	$ 216
2015	195
2016	173
2017	151
2018	130
Thereafter	324
	$1,189

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

Direct costs related to the acquisition were expensed as incurred. During the nine months ended September 30, 2014, the Company incurred $1.5 million of merger and acquisition integration-related expenses, which have been separately stated in the Company's Consolidated Statements of Income.

Supplemental Pro Forma Financial Information

The following table presents financial information regarding the former Rumson operations included in the Consolidated Statements of Income from the date of the acquisition, February 7, 2014, through September 30, 2014 under the column "Actual from acquisition date to September 30, 2014." In addition, the table provides unaudited condensed pro forma financial information assuming that the Rumson acquisition had been completed as of January 1, 2013. In the table below, merger-related expenses of $1.8 million were excluded from pro forma non-interest expenses for the nine months ended September 30, 2014. Income taxes were also adjusted to exclude income tax benefits of $624,000 related to the merger expenses for the nine months ended September 30, 2014.

The table below has been prepared for comparative purposes only and is not necessarily indicative of the actual results that would have been attained had the acquisition 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 Rumson's operations. The pro forma financial information reflects adjustments related to certain purchase accounting fair value adjustments; amortization of core deposit and other intangibles; and related income tax effects.

	Actual from Acquisition date to September 30, 2014	Pro Forma for the nine months ended September 30, 2014	Pro Forma for the Nine months ended September 30, 2013
	(in thousands, except per share amounts)		
Net interest income	$4,430	$ 25,021	$ 24,434
Non-interest income	176	4,428	5,476
Non-interest expenses	1,926	19,964	20,802
Income taxes	1,070	839	2,543
Net income	1,610	3,395	5,648
Earnings per share-diluted		$ 0.48	$ 0.79

(3) Net Income Per Common Share

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

Diluted net income per common share is calculated by dividing net income by the weighted average number of common shares outstanding, as adjusted for the assumed exercise of potential common stock warrants, and common stock options, using the treasury stock method. For periods when a net loss is incurred, there is no dilutive effect of share equivalents. Accordingly, these shares are not included in the calculation of diluted earnings per share.

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

	Three Months Ended September 30, 2014		
	Income	Weighted-average shares	Per share amount
Basic earnings per common share:			
Net Income	$2,138,079	7,119,113	$0.30
Effect of dilutive securities:			
Stock options and warrants		122,436	
Diluted EPS:			
Net income plus assumed conversion	$2,138,079	7,241,549	$0.30

	Three Months Ended September 30, 2013		
	Net Income	Weighted-average shares	Per share amount
Basic earnings per common share:			
Net income	$1,523,238	5,991,480	$0.25
Effect of Dilutive Securities:			
Stock options and warrants		155,182	
Diluted EPS:			
Net income plus assumed conversions	$1,523,238	6,146,662	$0.25

	Nine Months Ended September 30, 2014		
	Net Income	Weighted-average shares	Per share amount
Basic earnings per common share:			
Net income	$2,339,873	7,013,776	$0.33
Effect of Dilutive Securities:			
Stock options and warrants		127,792	
Diluted EPS:			
Net income plus assumed conversions	$2,339,873	7,141,568	$0.33

	Nine Months Ended September 30, 2013		
	Net Income	Weighted-average shares	Per share amount
Basic earnings per common share:			
Net income	$4,405,588	5,960,294	$0.74
Effect of Dilutive Securities:			
Stock options and warrants		128,539	
Diluted EPS:			
Net income plus assumed conversions	$4,405,588	6,088,833	$0.72

For the three months and nine months ended September 30, 2014 and 2013, 90,296 and 247,298 options, respectively, were anti-dilutive and were not included in the computation of diluted earnings per common shares.

(4) Investment Securities

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

September 30, 2014	Amortized Cost	Gross unrealized gains	Gross unrealized losses	Fair value
Available for sale-				
U. S. Treasury securities and obligations of U.S. Government sponsored corporations (“GSE”) and agencies	$11,431,027	$-	$(444,332)	$10,986,695
Residential collateralized mortgage obligations – GSE	3,684,424	82,520	(43,280)	3,723,664
Residential collateralized mortgage obligations – non GSE	2,564,282	39,395	(6,013)	2,597,664
Residential mortgage backed securities – GSE	28,136,260	822,737	(278,630)	28,680,367
Obligations of State and Political subdivisions	22,023,131	244,381	(649,000)	21,618,512
Trust preferred debt securities – single issuer	2,471,060	-	(287,360)	2,183,700
Corporate debt securities	32,294,145	322,566	(34,747)	32,581,964
Restricted stock	1,561,900	-	-	1,561,900
Mutual fund	25,000	-	-	25,000
	$104,191,229	$1,511,599	$(1,743,362	$103,959,466

September 30, 2014	Amortized Cost	Other-Than-Temporary Impairment Recognized In Accumulated Other Comprehensive Loss	Carrying Value	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held to maturity-						
U. S. Treasury securities and obligations of U.S. Government sponsored corporations (“GSE”) and agencies	$ -	$ -	$ -	$ -	$ -	$ -
Residential collateralized mortgage obligations – GSE	12,300,297	-	12,300,297	429,031	-	12,729,328
	9,099,412	-	9,099,412	292,039		9,391,451

Residential collateralized mortgage obligations – non-GSE						
Residential mortgage backed securities – GSE	58,526,504	-	58,526,504	1,085,369	(122,585)	59,489,288
Obligations of State and Political subdivisions	68,100,762	-	68,100,762	2,250,385	(105,740)	70,245,407
Trust preferred debt securities-pooled	656,662	(500,944)	155,718	455,573	-	611,291
Corporate debt securities	-	-	-	-	-	-
	$ 148,683,637	$ (500,944)	$ 148,182,693	$ 4,512,397	$ (228,325)	$ 152,466,765

December 31, 2013	Amortized Cost	Gross unrealized gains	Gross unrealized losses	Fair value
Available for sale-				
U. S. Treasury securities and obligations of U.S. Government sponsored corporations ("GSE") and agencies	$22,386,761	$33,213	$(910,274)	$21,509,700
Residential collateralized mortgage obligations – GSE	3,547,404	134,388	-	3,681,792
Residential collateralized mortgage obligations – non GSE	2,782,843	52,227	(8,674)	2,826,396
Residential mortgage backed securities – GSE	31,532,051	872,169	(438,273)	31,965,947
Obligations of State and Political subdivisions	22,206,959	149,959	(2,710,874)	19,646,044
Trust preferred debt securities – single issuer	2,468,839	-	(455,739)	2,013,100
Corporate debt securities	16,228,474	318,590	(29,336)	16,517,728
Restricted stock	1,013,100	-	-	1,013,100
Mutual fund	25,000	-	-	25,000
	$102,191,431	$1,560,546	$(4,553,170	$99,198,807

December 31, 2013	Amortized Cost	Other-Than-Temporary Impairment Recognized In Accumulated Other Comprehensive Loss	Carrying Value	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held to maturity-						
Obligations of U.S. Government sponsored corporations ("GSE") and agencies	$1,524,860	$ -	$1,524,860	$10,310	$-	$1,535,170
Residential collateralized mortgage obligations – GSE	14,803,739	-	14,803,739	379,815	-	15,183,554
Residential collateralized mortgage obligations – non-GSE	10,682,363	-	10,682,363	119,777	(27,526)	10,774,614
Residential mortgage backed securities – GSE	65,240,620	-	65,240,620	611,062	(387,034)	65,464,648
Obligations of State and Political subdivisions	59,400,916	-	59,400,916	1,399,938	(1,296,357)	59,504,497
Trust preferred debt securities – pooled	656,662	(500,944)	155,718	-	(6,863)	148,855
Corporate debt securities	1,008,599	-	1,008,599	9,836	-	1,018,435

$153,317,759	$ (500,944)	$152,816,815	$2,530,738	$(1,717,780)	$153,629,773

Restricted stock at September 30, 2014 and December 31, 2013 consisted of $1,496,900 and $998,100, respectively, of Federal Home Loan Bank of New York stock and $65,000 and $15,000, respectively, of Atlantic Central Bankers Bank stock.

The amortized cost and estimated fair value of investment securities at September 30, 2014, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Restricted stock is included in “Available for sale - Due in one year or less.”

	Amortized Cost	Fair Value
Available for sale-		
Due in one year or less		
Residential collateralized mortgage obligations - non GSE	$ 263,345	$264,102
Residential mortgage backed securities – GSE	250	250
Obligations of State and Political subdivisions	264,775	265,665
Corporate debt securities	10,224,296	10,198,171
Restricted stock	1,561,900	1,561,900
Mutual fund	25,000	25,000
	$ 12,339,566	$12,315,088
Due after one year through five years		
U.S. Treasury securities and obligations of U.S. Government sponsored corporations (“GSE”) and agencies	$ 1,540,385	$1,535,895
Residential collateralized mortgage obligations – non-GSE	-	-
Residential mortgage backed securities – GSE	7,450,510	7,358,278
Obligations of State and Political subdivisions	681,967	714,360
Corporate debt securities	21,050,621	21,351,292
	$ 30,723,483	$30,959,825
Due after five years through ten years		
U.S. Treasury securities and obligations of US Government sponsored corporations (“GSE”) and agencies	$ 9,890,642	$9,450,800
Residential collateralized mortgage obligations – GSE	102,768	109,333
Residential mortgage backed Securities – GSE	6,661,024	6,742,207
Obligations of State and Political Subdivisions	4,796,387	4,866,134
Corporate debt securities	1,019,227	1,032,500
	$ 22,470,048	$22,200,974
Due after ten years		
Residential collateralized mortgage obligations – GSE	$ 3,581,657	$3,614,332
Residential collateralized mortgage obligations – non-GSE	2,300,936	2,333,561
Residential mortgage backed securities – GSE	14,024,476	14,579,634
Obligations of State and Political subdivisions	16,280,003	15,772,352
Corporate debt securities	-	-
Trust preferred debt securities	2,471,060	2,183,700
	$ 38,658,132	$38,483,579
Total	$ 104,191,229	$103,959,466

Held to maturity-		
Due in one year or less		
U. S. Treasury securities and obligations of U.S. Government sponsored corporations (“GSE”) and agencies	$-	$-
Obligations of State and Political subdivisions	18,205,158	18,211,282
Corporate debt securities	-	-
	18,205,158	18,211,282
Due after one year through five years		
U.S. Treasury securities and obligations of US Government sponsored corporations (“GSE”) and agencies	$-	$-
Obligations of State and Political subdivisions	13,503,851	14,035,745
Corporate debt securities	-	-
	$13,503,851	$14,035,745
Due after five years through ten years		
Residential collateralized mortgage obligations – GSE	$-	$-
Residential collateralized mortgage obligations – non-GSE	802,511	805,099
Residential mortgage backed securities – GSE	19,279,679	19,492,168
Obligations of State and Political subdivisions	18,544,514	19,475,290
	$38,626,704	$39,772,557
Due after ten years		
Residential collateralized mortgage obligations – GSE	$12,299,996	$12,729,330
Residential collateralized mortgage obligations – non-GSE	8,297,202	8,586,350
Residential mortgage backed securities – GSE	39,246,826	39,997,121
Obligations of State and Political subdivisions	17,847,239	18,523,090
Trust preferred debt securities – pooled	656,661	611,290
	$78,347,924	$80,447,181
Total	$148,683,637	$152,466,765

Gross unrealized losses on available for sale and held to maturity securities and the estimated fair value of the related securities aggregated by security category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2014 and December 31, 2013 were as follows:

September 30, 2014		Less than 12 months		12 months or longer		
	Number of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair V
U.S. Treasury securities and obligations of U.S. Government sponsored corporations and agencies	2	$ 1,535,895	$ (4,490)	$ 9,450,800	$ (439,842)	$ 10,9
Residential collateralized mortgage obligations – GSE	1	1,074,027	(43,280)	-	-	1,0
Residential collateralized mortgage obligations – non-GSE	2	989,807	(892)	93,295	(5,121)	1,0
Residential mortgage backed securities – GSE	18	1,711,545	(1,679)	17,021,564	(399,536)	18,7
Obligations of State and Political Subdivisions	63	394,002	(1,596)	21,564,852	(753,144)	21,9
Trust preferred debt securities – single issuer	4	-	-	2,183,700	(287,360)	2,1
Corporate Debt Securities	2	1,420,594	(1,233)	1,028,880	(33,514)	2,4
Total temporarily impaired securities	92	$ 7,125,870	$ (53,170)	$ 51,343,091	$ (1,918,517)	$ 58,4

December 31, 2013		Less than 12 months		12 months or longer		To
	Number of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value
U.S. Treasury securities and obligations of U.S. Government sponsored corporations (GSE) and agencies	3	$ 11,507,350	$ (910,274)	$ -	$ -	$ 11,507,350
Residential collateralized mortgage Obligations – non-GSE	8	5,328,485	(28,231)	1,094,754	(7,969)	6,423,239
Residential mortgage backed securities GSE	38	40,504,327	(825,307)	-	-	40,504,327
Obligations of State and Political Subdivisions	95	19,403,457	(2,285,759)	8,936,441	(1,721,472)	28,339,898

Trust preferred debt securities – single issuer	4	-	-	2,013,100	(455,739)	2,013,100
Trust preferred debt securities – Pooled	1	-	-	148,855	(507,807)	148,855
Corporate debt securities	1	-	-	1,056,110	(29,336)	1,056,110
Total temporarily impaired securities	150	$ 76,743,619	$ (4,049,571)	$ 13,249,260	$ (2,722,323)	$ 89,992,879

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 residential mortgage obligations and mortgage-backed securities were caused by increases in market interest rates. The contractual cash flows of these securities are guaranteed by the issuer, which are primarily government or government sponsored agencies. It is expected that the securities would not be settled at a price less than the amortized cost of the investment. 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.

Obligations of State and Political Subdivisions: The unrealized losses or investments in these securities were caused by increases in market interest rates. None of the issuers have defaulted on interest payments. It is expected that the securities would not be settled at a price less than the amortized cost of the investment. 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..

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

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

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 securities issued by financial institution holding companies. During 2009, the Company recognized an other-than-temporary impairment of $864,727, of which $363,783 was determined to be a credit loss and charged to operations, and $500,944 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 an

EITF 99-20 model that considered performing collateral ratios, the level of subordination to senior tranches of the security, credit ratings of and projected credit defaults in the underlying collateral.

On a quarterly basis, management evaluates this security to determine if any additional other-than-temporary impairment is required. As of September 30, 2014, our evaluation was as follows:

a. We obtained the PRETSL XXV Depository Institutions Issuer List as of September30, 2014 from the FTN Financial Corp. ("FTN") website and reviewed the financial ratios and capital levels of each individual financial institution issuer.

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

(1) Above 100;

(2) 75 to 100; and

(3) Below 75.

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

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

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

(3) Below 75 – no deferral/default.

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

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

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

Our position is that it is appropriate to apply this future default factor in our analysis as it is not realistic to assume no adverse conditions will occur over the remaining 23-year stated maturity of this pooled security even though the individual institutions are currently performing according to terms.

e. This September 30, 2014 projection of future cash flows produced a present value that exceeded the carrying value of the pooled trust preferred security; therefore, management concluded that no other-than-temporary impairment issues were present at September 30, 2014.

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

The following table sets forth information with respect to this security at September 30, 2014:

Security	Class	Book Value	Fair Value	Unrealized Gain (Loss)	Percent of Underlying Collateral Performing	Percent of Underlying Collateral In Deferral (1)	Percent of Underlying Collateral In Default (1)	Expected Deferrals and Defaults as a % of Remaining Performing Collateral	Moody's / S&P Ratings	Excess Subordination (2) Amount	Excess Subordination (2) % of Current Performing Collateral
PreTSL XXV	B-1	$155,718	$611,290	$455,572	69.0%	5.8%	25.2%	13.7%	B1/ NR	$136,000	26.0%

Notes to table above:

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

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

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

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

(in thousands)	Three months ended September 30,	Nine months ended September 30,

	2014	2013	2014	2013
Balance at beginning of period	$ 364	$ 364	$ 364	$ 364
Change during the period	-	-	-	-
Balance at end of period	$ 364	$ 364	$ 364	$ 364

(5) Allowance for Loan Losses and Credit Quality Disclosure

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

The following table provides an aging of the loan portfolio by loan class at September 30, 2014:

	30-59 Days	60-89 Days	Greater than 90 Days	Total Past Due	Current	Total Loans Receivable	Recorded Investment > 90 Days Accruing	Nonaccrual Loans
Commercial								
Construction	$-	$-	$-	$-	$88,547,583	$88,547,583	$-	$-
Commercial Business	959,386	14,051	390,396	1,363,833	107,689,596	109,053,429	-	356,577
Commercial Real Estate	2,290,804	-	6,119,386	8,410,190	183,957,654	192,367,844	-	5,787,533
Mortgage Warehouse Lines	-	-	-	-	157,333,717	157,333,717	-	-
Residential Real Estate	-	-	1,714,972	1,714,972	47,017,079	48,732,051	320,315	1,394,657
Consumer								
Loans to Individuals	279,909	-	-	279,909	23,083,133	23,363,042	-	-
Other	-	-	-	-	197,704	197,704	-	-
Deferred Loan Costs	-	-	-	-	800,548	800,548	-	-
Total	$3,530,099	$14,051	$8,224,754	$11,768,904	$608,627,014	$620,395,918	320,315	$7,538,767

As provided by ASC 310-30, the excess of cash flows expected at acquisition over the initial investment in the loan is recognized as interest income over the life of the loan. Accordingly, loans acquired with evidence of deteriorated credit quality of $1,246,640 at September 30, 2014 were not classified as non-performing loans. Of this amount, loans aggregating $699,287 were included in the Greater than 90 Days category.

The following table provides an aging of the loan portfolio by loan class at December 31, 2013:

	30-59 Days	60-89 Days	Greater than 90 Days	Total Past Due	Current	Total Loans Receivable	Recorded Investment > 90 Days Accruing	Nonaccrual Loans
Commercial								
Construction	$-	$-	$ _	$-	$51,002,172	$51,002,172	$-	$-
Commercial Business	385,133	58,665	453,325	897,123	81,450,932	82,348,055	-	511,990
Commercial Real Estate	-	-	5,217,173	5,217,173	93,172,557	98,389,730	-	5,555,851
Mortgage Warehouse Lines	-	-	-	-	116,951,357	116,951,357	-	-
Residential Real Estate	315,615	967,099	33,494	1,316,208	12,447,970	13,764,178	-	162,012
Consumer								
Loans to Individuals	-	-	-	-	9,766,114	9,766,114	-	92,103
Other	-	-	-	-	170,526	170,526	-	-
Deferred Loan Costs	-	-	-	-	943,950	943,950	-	-
Total	$700,748	$1,025,764	$ 5,703,992	$7,430,504	$365,905,578	$373,336,082	-	$6,321,956

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 generally accepted accounting principles (GAAP) and regulatory interagency supervisory guidance. The allowance for loan losses methodology consists of two major components. The first component is an estimation of losses associated with individually identified impaired loans, which follows Accounting Standards Codification (ASC) Topic 310 (formerly SFAS 114). The second major component is an estimation of losses under ASC Topic 450 (formerly SFAS 5), which provides guidance for estimating losses on groups of loans with similar risk characteristics. The Company’s methodology results in an allowance for loan losses which includes a specific reserve for impaired loans, an allocated reserve, and an unallocated portion.

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

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

The methodology includes the segregation of the loan portfolio into loan types with a further segregation into internal 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 rated as special mention have potential weaknesses that deserve management's close attention. If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. Loans classified substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They include loans that are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified doubtful have all the weaknesses inherent in loans classified substandard with the added characteristic that collection or liquidation in full, on the basis of current conditions and facts, is highly improbable. Loans rated as doubtful in whole, or in part, are placed in nonaccrual status. Loans classified as a loss are considered uncollectible and are charged 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 and commercial real estate loans, construction loans, warehouse lines of credit and various types of loans to individuals. The historical estimation for each loan pool is then adjusted to account for current conditions, current loan portfolio performance, loan policy or management changes, or any other qualitative factor which may cause future losses to deviate from historical levels.

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

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

Commercial

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

Mortgage Warehouse Lines of Credit

The Company's Mortgage Warehouse Group provides 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 fund the origination of one-to-four family residential mortgage loans that are pre-sold to the secondary mortgage market, which includes state and national banks, national mortgage banking firms, insurance companies and government-sponsored enterprises, including the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and others. On average, an advance under the Warehouse Line of Credit remains outstanding for a period of less than 30 days, with repayment coming directly from the sale of the loan into the secondary mortgage market. Interest and a transaction fee are collected by the Bank at the time of repayment. Additionally, customers of the Warehouse Lines of Credit are required to maintain deposit relationships with the Bank that, on average, represent 10% to 15% of the loan balances.

As a separate segment of the total portfolio, the warehouse loan portfolio is 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.

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

Consumer

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

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

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

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

The Company's internal credit risk grades are based on the definitions currently utilized by the banking regulatory agencies. The grades assigned and definitions are as follows, and loans graded excellent, above average, good and

watch list are treated as “pass” for grading purposes:

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

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

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

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

5. Substandard - Loans in this category possess weaknesses that jeopardize the ultimate collection of total outstandings. These weaknesses require close supervision by Bank management. Current financial statements are unavailable and the loan is inadequately protected by the collateral pledged.

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

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

The following table provides a breakdown of the loan portfolio by credit quality indicator at September 30, 2014.

Commercial Credit Exposure - By Internally Assigned Grade	Construction	Commercial Business	Commercial Real Estate	Mortgage Warehouse Lines	Residential Real Estate
Grade:					
Pass	$88,353,183	$100,658,477	$167,521,583	$157,333,717	$47,017,079
Special Mention	194,400	7,645,736	14,177,468	-	127,977
Substandard	-	715,397	10,668,793	-	1,586,995
Doubtful	-	33,819	-	-	-
Total	$88,547,583	$109,053,429	$192,367,844	$157,333,717	$48,732,051

Consumer Credit Exposure - By Payment Activity	Loans To Individuals	Other
Performing	$23,363,042	$197,704
Nonperforming	-	-
Total	$23,363,042	$197,704

The following table provides a breakdown of the loan portfolio by credit quality indictor at December 31, 2013.

Commercial Credit Exposure - By Internally Assigned Grade	Construction	Commercial Business	Commercial Real Estate	Mortgage Warehouse Lines	Residential Real Estate
Grade:					
Pass	$47,539,033	$79,832,704	$68,620,450	$116,951,357	$12,635,067
Special Mention	-	1,406,143	19,396,574	-	1,129,111
Substandard	3,463,139	792,057	10,372,706	-	-
Doubtful	-	258,486			
Loss	-	58,665	-	-	-
Total	$51,002,172	$82,348,055	$98,389,730	$116,951,357	$13,764,178

Consumer Credit Exposure - By Payment Activity	Loans To Individuals	Other
Performing	$9,674,011	$170,526
Nonperforming	92,103	-
Total	$9,766,114	$170,526

Impaired Loans Disclosures

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

The following tables summarize the distribution of the allowance for loan losses and loans receivable by loan class and impairment method at September 30, 2014 and December 31, 2013:

Period-End Allowance for Loan Losses by Impairment Method September 30, 2014

	Construction	Commercial	Commercial Real Estate	Mortgage Warehouse	Residential Real Estate	Consumer	Othe
Allowance for loan losses:							
Ending Balance	$1,099,053	$1,641,189	$2,974,785	$786,669	$202,146	$91,417	$1,583
Ending Balance							
Individually evaluated for impairment	-	1,874	1,274,380	-	-	-	-
Collectively evaluated for impairment	$1,099,053	$1,639,315	$1,700,405	$786,669	$202,146	$91,417	$1,583
Loans receivables:							
Ending Balance	$88,547,583	$109,053,429	$192,367,844	$157,333,717	$48,732,051	$23,363,042	$197,7
Individually evaluated for impairment	449,663	492,940	9,129,396	-	1,394,657	-	-
Loans acquired with deteriorated credit quality	-	332,175	1,713,910	-	-	-	-
Collectively evaluated for impairment	$88,097,920	$108,228,314	$181,524,538	$157,333,717	$47,337,394	$23,363,042	$197,7

Period-End Allowance for Loan Losses by Impairment Method December 31, 2013

	Construction	Commercial	Commercial Real Estate	Mortgage Warehouse	Residential Real Estate	Consumer	Other
Allowance for loan losses:							
Ending Balance	$1,205,267	$1,271,733	$3,021,766	$584,757	$164,673	$108,849	$2,183
Ending Balance							
Individually evaluated for impairment	-	293,692	1,490,169	-	-	-	-
Collectively evaluated for impairment	$1,205,267	$978,041	$1,531,597	$584,757	$164,673	$108,849	$2,183
Loans receivables:							
Ending Balance	$51,002,172	$82,348,055	$98,389,730	$116,951,357	$13,764,178	$9,766,114	$170,526
Individually evaluated for impairment	19,930	776,101	9,130,605	-	162,012	92,103	-
Collectively evaluated for impairment	$50,982,242	$81,571,954	$89,259,125	$116,951,357	$13,602,166	$9,674,011	$170,526

The activity in the allowance for loan loss by loan class for the nine months ended September 30, 2014 and 2013 was as follows:

	Construction	Commercial Business	Commercial Real Estate	Mortgage Warehouse	Residential Real Estate	Consumer	Other	Unalloc
Balance - December 31, 2013	$1,205,267	$1,271,733	$3,021,766	$584,757	$164,673	$108,849	$2,183	$679,3
Provision charged to operations	60,163	454,031	113,961	(63,082)	17,332	(16,462)	(560)	(65,3
Loans charged off	-	(510,952)	-	-	-	-	-	-
Recoveries of loans charged off	-	3,225	-	-	-	-	-	-
Balance – March 31, 2014	$1,265,430	$1,218,037	$3,135,727	$521,675	$182,005	$92,387	$1,623	$613,9
Provision charged to operations	(315,416)	4,041,190	471,356	387,884	(9,152)	(1,655)	42	(474,
Loans charged off	-	(3,713,789)	-	-	-	-	-	-
Recoveries of loans charged off	-	1,328	-	-	-	-	-	-
Balance – June 30, 2014	$950,014	$1,546,766	$3,607,083	$909,559	$172,853	$90,732	$1,665	$139,7
Provision charged to operations	149,039	185,109	222,506	(122,890)	44,308	685	(82)	171,3
Loans charged off	-	(99,402)	(893,804)	-	(15,015)	-	-	-
Recoveries of loans charged off	-	8,716	39,000	-	-	-	-	-
Balance September 30, 2014	$1,099,053	$1,641,189	$2,974,785	$786,669	$202,146	$91,417	$1,583	$311,0

	Construction	Commercial Business	Commercial Real Estate	Mortgage Warehouse	Residential Real Estate	Consumer	Other	Unallo
Balance - December 31, 2012	$1,990,292	$972,789	$2,262,221	$1,420,638	$112,103	$102,583	$2,271	$288,
Provision charged to operations	(218,010)	(18,319)	245,769	(429,900)	262	50,506	(212)	369,
Loans charged off	(561,993)	(139,289)	(384,688)	-	-	(50,855)	-	-
Recoveries of loans charged off	-	2,000	6,895	-	-	-	-	-
Balance – March 31, 2013	$1,210,289	$817,181	$2,130,197	$990,738	$112,365	$102,334	$2,059	$658,
Provision charged to operations	1,872	160,164	321,659	(62,039)	(19,632)	(2,444)	45	(162
Loans charged off	-	-	-	-	-	-	-	-
Recoveries of loans charged off	417	8,574	-	-	-	-	-	-
Balance – June 30, 2013	$1,212,578	$985,919	$2,451,856	$928,699	$92,733	$99,890	$2,104	$495,
Provision charged to operations	(4,555)	34,446	612,392	(256,028)	49,093	10,178	(53)	94,5
Loans charged off	-	(2,068)	-	-	-	-	-	-
Recoveries of loans charged off	-	13,310	-	-	-	-	-	-
Balance – September 30, 2013	$1,208,023	$1,031,607	$3,064,248	$672,671	$141,826	$110,068	$2,051	$589,

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

Impaired Loans Receivables (By Class) September 30, 2014				Three months ended September 30, 2014		Nine months ended September 30, 2014	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance:							
Commercial							
Construction	$449,663	$449,663	$-	$449,663	$6,134	$302,656	$10,955
Commercial Business	793,992	1,380,582	-	786,051	6,971	579,721	20,055
Commercial Real Estate	2,913,499	3,215,830	-	2,431,613	35,288	1,511,916	105,522
Mortgage Warehouse Lines	-	-	-	-	-	-	-
Subtotal	4,157,154	5,046,075	-	3,667,327	48,393	2,394,293	136,532
Residential Real Estate	1,394,657	1,409,672	-	1,468,125	6,673	1,298,082	20,942
Consumer							
Loans to individuals	-	-	-	77,329	8,164	135,612	15,433
Other	-	-	-	-	-	-	-
Subtotal	-	-	-	77,329	8,164	135,612	15,433
With no related allowance	$5,551,811	$6,455,747	$-	$5,212,691	$63,230	$3,827,987	$172,907
With an allowance:							
Commercial							

Construction	$-	$-	$-	$-	$-	$-	$-
Commercial Business	31,123	31,123	1,874	94,772	-	245,858	-
Commercial Real Estate	7,929,807	8,638,477	1,274,380	8,700,575	54,695	8,975,029	160,475
Mortgage Warehouse Lines	-	-	-	-	-	-	-
Subtotal	7,960,930	8,669,600	1,276,254	8,795,347	54,695	9,220,887	160,475
Residential Real Estate	-	-	-	-	-	-	-
Consumer							
Loans to Individuals	-	-	-	-	-	-	-
Other	-	-	-	-	-	-	-
Subtotal	-	-	-	-	-	-	-
With an allowance	$7,960,930	$8,669,600	$1,276,254	$8,795,347	$54,695	$9,220,887	$160,475
Total:							
Construction	$449,663	$449,663	-	$449,663	$6,134	$302,656	$10,955
Commercial Business	825,115	1,411,705	1,874	880,823	6,971	825,579	20,055
Commercial Real Estate	10,843,306	11,854,307	1,274,380	11,132,188	89,983	10,468,945	265,997
Mortgage Warehouse Lines	-	-	-	-	-	-	-
Residential Real Estate	1,394,657	1,409,672	-	1,468,125	6,673	1,298,082	20,942
Consumer	-	-	-	77,239	8,164	135,612	15,433
Total	$13,512,741	$15,125,347	$1,276,254	$14,008,038	$117,925	$13,048,874	$333,382

Impaired Loans Receivables (By Class) December 31 , 2013				Year ended 12/31/2013	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance:					
Commercial					
Construction	$19,930	$ 19,930	$-	$965,268	$ 33,946
Commercial Business	243,840	400,297		258,139	5,094
Commercial Real Estate	-	-	-	1,032,115	-
Mortgage Warehouse Lines	-	-	-	-	-
Subtotal	263,770	420,227	-	2,255,522	39,040
Residential Real Estate	162,012	162,012	-	117,746	-
Consumer					
Loans to Individuals	92,103	92,103	-	34,292	-
Other	-	-	-	-	-
Subtotal	92,103	92,103	-	34,292	-
With no related allowance	$517,885	$ 674,342	$-	$2,407,560	$ 39,040
With an allowance:					
Commercial					
Construction	$-	$ -	$-	$246,853	$ -
Commercial Business	532,261	532,261	293,692	562,346	9,728
Commercial Real Estate	9,130,605	9,130,605	1,490,169	5,546,690	247,277
Mortgage Warehouse Lines	-	-	-	-	-
Subtotal	9,662,866	9,662,866	1,783,861	6,355,889	257,005
Residential Real Estate	-	-	-	44,196	-
Consumer					
Loans to Individuals	-	-	-	4,238	-
Other	-	-	-	-	-
Subtotal	-	-	-	4,238	-
With an allowance	$9,662,866	$ 9,662,866	$1,783,861	$6,404,323	$ 257,005
Total:					
Construction	19,930	19,930	-	1,212,121	33,946
Commercial Business	776,101	932,558	293,692	820,485	14,822
Commercial Real Estate	9,130,605	9,130,605	1,490,169	6,578,805	247,277
Mortgage Warehouse	-	-	-	-	-
Residential Real Estate	162,012	162,012	-	161,942	-
Consumer	92,103	92,103	-	38,530	-
Total	$10,180,751	$ 10,337,208	$1,783,861	$8,811,883	$ 296,045

Impaired Loans Receivables (By Class) – September 30, 2013

				Three months ended September 30, 2013		Nine months ended September 30, 2013	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance:							
Commercial							
Construction	$1,015,112	$1,015,112	$-	$1,184,249	$4,660	$636,741	$37,420
Commercial Business	225,899	382,356	-	157,334	1,516	532,119	-
Commercial Real Estate	-	-	-	4,004,515	-	1,480,516	-
Mortgage Warehouse Lines	-	-	-	-	-	-	-
Subtotal	1,241,011	1,397,468	-	5,346,098	6,176	2,649,376	-
Residential Real Estate	164,542	164,542	-	164,542	-	102,706	-
Consumer							
Loans to Individuals	-	-	-	-	-	-	-
Other	-	-	-	-	-	22,540	-
Subtotal		-	-	-	-	22,540	-
With no related allowance:	$1,405,553	$1,562,010	$-	$5,510,640	$6,176	2,774,622	37,420
With an allowance:							
Commercial							
Construction	$-	$-	$-	$-	$-	$329,138	$-
Commercial Business	475,136	475,136	235,027	566,473	3,915	578,713	28,570
Commercial Real Estate	9,646,821	9,646,821	1,476,632	6,184,255	61,306	4,326,187	182,967
Mortgage Warehouse Lines	-	-	-	-	-	-	-
Subtotal	10,121,957	10,121,957	1,711,659	6,750,728	65,221	5,234,038	211,537
Residential Real Estate	-	-	-	-	-	58,928	-
Consumer							
Loans to Individuals	-	-	-	-	-	5,650	
Other	-	-	-	-	-	-	
Subtotal	-	-	-	-	-	5,650	-
With an allowance:	10,121,957	10,121,957	1,711,659	6,750,728	65,221	5,298,616	-
Total:							
Commercial	11,362,968	11,519,425	1,711,659	12,096,826	71,397	7,883,414	248,957
Residential Real Estate	164,542	164,542	-	164,542	-	161,634	-
Consumer	-	-	-	-	-	28,190	-
Total	$11,527,510	$11,683,967	$1,711,659	$12,261,368	$71,397	$8,073,238	$248,957

In the normal course of business, the Bank may consider modifying loan terms for various reasons. These reasons may include as a retention strategy to compete in the current interest rate environment or as a re-amortization or extension

of a loan term to better match the loan's repayment stream with the borrower's cash flow. A modified loan would be considered a troubled debt restructuring ("TDR") if the Bank grants a concession to a borrower and has determined that the borrower is troubled (i.e., experiencing financial difficulties).

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

At September 30, 2014 the Bank had 9 loans totaling $4,288,699 which were classified as troubled debt restructurings. The following table is a summary of troubled debt restructurings, all of which were classified as impaired and occurred during the three months ended September 30, 2014.

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings:			
Commercial	2	$ 31,123	$ 31,123
Commercial Real Estate	-	-	-
Residential Real Estate	-	-	-

There were no loans modified that were TDR's during the three and nine month periods ended September 30, 2014 and September 30, 2013 that were in default.

Changes in the accretable discount for acquired credit impaired loans for the nine months ended September 30, 2014 were as follows:

Balance at beginning of period	$-
Acquisition of impaired loans	240,917
Accretion of discount	(84,409)
Balance at end of period	$156,508

The following table presents additional information regarding loans acquired and accounted for in accordance with ASC 310-30:

	February 7, 2014 Acquired loans with Evidence of Credit	September 30, 2014 Acquired loans with Evidence of Credit

	Deterioration		Deterioration	
Outstanding balance	$	3,409,340	$	2,746,260
Carrying amount	$	2,613,826	$	2,046,085

There were no changes in the expected cash flows of these loans during the nine month period ended September 30, 2014. No allowance for loan losses has been recorded for acquired loans with or without evidence of deterioration as of the acquisition date or as of September 30, 2014.

(6) Share-Based Compensation

The Company's share-based incentive plans ("Stock Plans") authorize the issuance of an aggregate of 440,701 shares of the Company's common stock (as adjusted for stock dividends) pursuant to awards that may be granted in the form of stock options to purchase common stock ("Options") and awards of shares of common stock ("Stock Awards"). The purpose of the Stock Plans is to attract and retain personnel for positions of substantial responsibility and to provide additional incentive to certain officers, directors, employees and other persons to promote the success of the Company. Under the Stock Plans, options have a term of ten years after the date of grant, subject to earlier termination in certain circumstances. Options are granted with an exercise price at the then fair market value of the Company's common stock. The grant date fair value of the option is calculated using the Black – Scholes option valuation model. As of September 30, 2014, there were 317,866 shares of common stock available for future grants under the Stock Plans, of which 271,740 shares are available for future grants under the 2013 Equity Incentive Plan and 46,126 shares are available for future grant under the 2006 Directors Stock Plan.

Share-based compensation expense related to options was $77,123 and $75,949 for the nine months ended September 30, 2014 and 2013, respectively.

Transactions under the Stock Plans during the nine months ended September 30, 2014 are summarized as follows:

Stock Options	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding at January 1, 2014	235,598	$ 8.81		
Granted	11,700	11.02		
Exercised	-	-		
Forfeited	-	-		
Expired	-	-		
Outstanding at September 30, 2014	247,298	$ 8.91	5.1	$ 502,395
Exercisable at September 30, 2014	199,881	$ 9.17	4.5	$ 380,591

The fair value of each option and the significant weighted average assumptions used to calculate the fair value of the options granted for the nine months ended September 30, 2014 are as follows:

	January 2014	April 2014
Fair value of options granted	$ 4.75	$ 4.32
Risk-free rate of return	1.65 %	1.70 %
Expected option life in years	7	7
Expected volatility	38.01 %	38.01 %
Expected dividends (1)	-	-

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

As of September 30, 2014, there was approximately $62,341 of unrecognized compensation cost related to nonvested stock option- based compensation arrangements granted under the Company's stock incentive plans. That cost is expected to be recognized over the next four years.

The following table summarizes nonvested restricted shares for the nine months ended September 30, 2014:

Non-vested shares	Number of Shares	Average Grant-Date Fair Value
Non-vested at January 1, 2014	136,490	$6.59
Granted	60,100	10.81
Vested	(55,410)	8.77
Forfeited	-	-
Non-vested at September 30, 2014	141,180	$7.53

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

Stock based compensation expense related to stock grants was $366,550 and $326,085 for the nine months ended September 30, 2014 and 2013.

As of September 30, 2014, there was approximately $1,141,472 of unrecognized compensation cost related to non-vested stock grants that will be recognized over the next three years.

(7) Benefit Plans

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

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

In connection with the benefit plans, the Bank has life insurance policies on the lives of its executives, directors and divisional officers. The Bank is the owner and beneficiary of the policies. The cash surrender values of the policies total approximately $21.1 million and $16.2 million at September 30, 2014 and December 31, 2013, respectively.

The components of net periodic expense for the Company's supplemental executive retirement plans for the three month and nine month periods ended September 30, 2014 and 2013 were as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Service cost	$ 102,337	$ 30,539	$ 159,504	$ 214,257
Interest cost	77,583	22,229	120,922	155,951
Actuarial (gain) loss recognized	(3,718)	(29,893)	(5,795)	(209,721)
Prior service cost recognized	-	942	-	6,611
	$ 176,202	$ 23,817	$ 274,631	$ 167,098

32

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

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

	Before-Tax Amount	Income Tax Effect	Net-of-Tax Amount
September 30, 2014:			
Unrealized holding (losses) gains on available-for-sale securities:			
Unrealized holding (losses) on available-for-sale securities	$(231,763)	$44,966	$(186,797)
Unrealized impairment loss on held to maturity security:			
Unrealized impairment (loss) on held to maturity security	(500,944)	170,321	(330,623)
Unfunded pension liability:			
Plan actuarial gains included in other comprehensive income	345,309	(138,949)	206,360
Accumulated other comprehensive income (loss)	$(387,398)	$76,338	$(311,060)

	Before-Tax Amount	Income Tax Effect	Net-of-Tax Amount
December 31, 2013:			
Unrealized holding (losses) gains on available-for-sale securities:			
Unrealized holding (losses) on available-for-sale securities	$(2,992,624)	$1,060,098	$(1,932,526)
Unrealized impairment loss on held to maturity security:			
Unrealized impairment (loss) on held to maturity security	(500,944)	170,321	(330,623)
Unfunded pension liability:			
Plan actuarial gains included in other comprehensive income	27,236	(11,721)	15,515
Accumulated other comprehensive income (loss)	$(3,466,332)	$1,218,698	$(2,247,634)

Changes in the components of accumulated other comprehensive income (loss) for the three and nine month periods ended September 30, 2014 and September 30, 2013 are as follows and are presented net of tax:

	Unrealized Holding Gains (Losses) on Available for Sale Securities	Unrealized Impairment Loss on Held to Maturity Security	Unfunded Pension Liability	Accumulated Other Comprehensive Income (Loss)
Three Months Ended September 30, 2014:				
Balance, beginning of period	$ (408,136)	$ (330,623)	$ 110,675	$ (628,084)
Other comprehensive income (loss) before reclassifications	221,339	-	95,685	317,024
Amounts reclassified from accumulated other comprehensive income (loss)	-	-	-	-
Other comprehensive income	221,339	-	95,685	317,024
Balance, end of period	$ (186,797)	$ (330,623)	$ 206,360	$ (311,060)

	Unrealized Holding Gains (Losses) on Available for Sale Securities	Unrealized Impairment Loss on Held to Maturity Security	Unfunded Pension Liability	Accumulated Other Comprehensive Income (Loss)
Three Months Ended September 30, 2013:				
Balance, beginning of period	$ (1,677,012)	$ (330,623)	$ (60,403)	$ (2,068,038)
Other comprehensive income (loss) before reclassifications	(35,468)	-	37,960	2,492
Amounts reclassified from accumulated other comprehensive income (loss)	-	-	-	-
Other comprehensive income	(35,468)	-	37,960	2,492
Balance, end of period	$ (1,712,480)	$ (330,623)	$ (22,443)	$ (2,065,546)

	Unrealized Holding Gains (Losses) on Available for Sale Securities	Unrealized Impairment Loss on Held to Maturity Security	Unfunded Pension Liability	Accumulated Other Comprehensive Income (Loss)

Nine Months Ended September 30, 2014:				
Balance, beginning of period	$ (1,932,526)	$ (330,623)	$ 15,515	$ (2,247,634)
Other comprehensive income (loss) before reclassifications	1,744,219	-	190,845	1,935,064
Amounts reclassified from accumulated other comprehensive income (loss), net of tax (1)	1,510	-	-	1,510
Other comprehensive income	1,745,729	-	190,845	1,936,574
Balance, end of period	$ (186,797)	$ (330,623)	$ 206,360	$ (311,060)

(1) Amounts reclassified are included in Other Income on the Consolidated Statement of Income.

	Unrealized Holding Gains (Losses) on Available for Sale Securities	Unrealized Impairment Loss on Held to Maturity Security	Unfunded Pension Liability	Accumulated Other Comprehensive Income
Nine Months Ended September 30, 2013:				
Balance, beginning of period	$ 1,235,204	$ (330,623)	$ (100,288)	$ 804,293
Other comprehensive income (loss) before reclassifications	(2,947,683)	-	77,884	(2,869,839)
Amounts reclassified from accumulated other comprehensive income (loss)	-	-	-	-
Other comprehensive income	(2,947,683)	-	77,884	(2,869,839)
Balance, end of period	$ (1,712,479)	$ (330,623)	$ (22,444)	$ (2,065,546)

(9) Recent Accounting Pronouncements

ASU 2014-04 (Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure)

In January 2014, the FASB issued ASU 2014-04, Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure. The amendments in this update clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreements. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in this update are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. An entity can elect to adopt the amendments in this update using either a modified retrospective transition method or a prospective transition method. The Company is currently evaluating the impact the adoption of the standard will have on the Company's consolidated financial position or results of operations.

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

In May 2014, the FASB issued ASU No. 2014-9, "Revenue from Contracts with Customers (Topic 606)". This update clarifies the principles for recognizing revenue from contracts with customers. This ASU, which does not apply to financial instruments, is effective for interim and annual reporting periods beginning after December 15, 2016. The Company is currently evaluating this ASU to determine the impact on its consolidated financial position, results of operations and cash flows.

ASU 2014-11 Repurchase-to-maturity Transactions, Repurchase Financings, and Disclosures to change the accounting for repurchase-to-maturity transactions and certain linked repurchase financings.

On June 12, 2014, the FASB issued ASU 2014-11, Repurchase-to-maturity Transactions, Repurchase Financings, and Disclosures to change the accounting for repurchase-to-maturity transactions and certain linked repurchase financings. This will result in accounting for both types of arrangements as secured borrowings on the balance sheet. Additionally, the ASU introduces new disclosures to (i) increase transparency about the types of collateral pledged in secured borrowing transactions and (ii) enable users to better understand transactions in which the transferor retains substantially all of the exposure to the economic return on the transferred financial asset throughout the term of the transaction.

For public business entities, the disclosure for repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions accounted for as secured borrowings is required to be presented for annual periods beginning after December 15, 2014, and for interim periods beginning after March 15, 2015. All other accounting and disclosure amendments in the ASU are effective for public business entities for the first interim or annual period beginning after December 15, 2014. The Company is currently evaluating the impact that the adoption of the standard will have on the Company's consolidated financial position or results of operations.

ASU 2014-12 Accounting for Share-Based-Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved After the Requisite Service Period (a consensus of the FAS Emerging Issues Task Force).

On June 19, 2014, the FASB issued ASU 2014-12, Accounting for Share-Based-Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved After the Requisite Service Period (a consensus of the FAS Emerging Issues Task Force) to clarify that a performance target in a share-based compensation award that could be achieved after an employee completes the requisite service period should be treated as a performance condition that affects the vesting of the award. As such, the performance target should not be reflected in estimating the grant-date fair value of the award.

ASU 2014-12 requires that a performance target included in a share-based payment award that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. Therefore, such performance target should not be reflected in estimating the grant-date fair value of the award. A reporting entity should apply existing guidance in Topic 718 as it relates to the award with performance conditions that affect vesting.

Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. In current practice, two common performance targets-a change of control event and an IPO-are considered probable when they occur. Consequently, the award would be recognized in earnings at that time.

If the performance target becomes probable of being achieved before the end of the requisite service period, the remaining unrecognized compensation cost should be recognized prospectively over the remaining requisite service period. The total amount of compensation cost recognized during and after the requisite service period should reflect the number of awards that are expected to vest and should be adjusted to reflect those awards that ultimately vest. The requisite service period ends when the employee can cease rendering service and still be eligible to vest in the award if the performance target is achieved.

For all entities, the amendments are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. The Company is currently evaluating the impact that the adoption of the standard will have on the Company’s consolidated financial position or results of operations.

ASU 2014-14 Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310 – 40): Classification of Certain Government – Guaranteed Mortgage Loans upon Foreclosure (a consensus of the FASB Emerging Issues Task Force.

In August 2014, the FASB issued ASU 2014-14, Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40); Classification of Certain Government _ Guaranteed Mortgage Loans upon Foreclosure (a consensus of the FASB Emerging Issues Task Force). The amendments in this update address a practice issue related to the classification of certain foreclosed residential and nonresidential mortgage loans that are either fully or partially guaranteed under government programs. Specifically, creditors should reclassify loans that meet certain conditions to “other receivables” upon foreclosure rather than reclassifying them to other real estate owned (OREO). The separate other receivable recorded upon foreclosure is to be measured based on the amount of the loan balance (principal and interest) the creditor expects to recover from the guarantor.

The ASU is effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The Company is currently evaluating the impact that the adoption of the standard will have on the Company’s consolidated financial position or results of operations.

(10) Fair Value Disclosures

U.S. GAAP has established a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or

liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

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

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

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

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

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below. These valuation methodologies were applied to all of the Company's financial assets and financial liabilities carried at fair value.

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

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

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

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

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

	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
September 30, 2014:				
Securities available for sale:				
U. S. Treasury securities and obligations of U.S. Government sponsored corporations (“GSE”) and agencies	$9,470,990	$1,515,705	$-	$10,986,695
Residential collateralized mortgage obligations – GSE		3,723664		3,723,664
Residential collateralized mortgage obligations – Non-GSE		2,597,664		2,597,664
Residential mortgage backed securities – GSE		28,680,367		28,680,367
Obligations of State and Political subdivisions		21,618,512		21,618,512
Trust preferred debt securities – single issuer		2,183,700		2,183,700
Corporate debt securities		32,581,964		32,581,964
Restricted stock		1,561,900		1,561,900
Mutual fund		25,000		25,000

	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
December 31, 2013:				
Securities available for sale:				
U. S. Treasury securities and obligations of U.S. Government sponsored corporations (“GSE”) and agencies	$19,994,430	$1,515,270	$-	$21,509,700
Residential collateralized mortgage obligations – GSE	-	3,681,792	-	3,681,792
Residential collateralized mortgage obligations – non-GSE	-	2,826,396	-	2,826,396
Residential mortgage backed securities – GSE	-	31,965,947	-	31,965,947
Obligations of State and Political subdivisions	-	19,646,044	-	19,646,044
Trust preferred debt securities – single issuer	-	2,013,100	-	2,013,100
Corporate debt securities	-	16,517,728	-	16,517,728
Restricted stock	-	1,013,100	-	1,013,100
Mutual fund	-	25,000	-	25,000

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). Financial assets and financial liabilities measured at fair value on a non-recurring basis at September 30, 2014 and December 31, 2013 were as follows:

	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
September 30, 2014:				
Impaired loans	$ -	$ -	$ 7,265,700	$ 7,265,700
Other real estate owned	-	-	1,748,455	1,748,455
December 31, 2013:				

Impaired loans	$ -	$ -	$ 7,879,005	$ 7,879,005
Other real estate owned	-	-	209,937	209,937

Impaired loans measured at fair value and included in the above table consisted of 10 loans having an aggregate recorded investment of $7,960,930 and specific loan loss allowances of $1,276,254 at September 30, 2014. Charge-offs of approximately $928,000 of specific reserves for potential losses that were provided in prior periods were recorded during the third quarter ended September 30, 2014 on loans with an aggregate recorded investment of approximately $6,093,000. At December 31, 2013, there were 17 loans having an aggregate balance of $9,662,862 and specific loan loss allowances of $1,783,861.

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

Quantitative Information about Level 3 Fair Value Measurements

	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range (Weighted Average)
September 30, 2014				
Impaired loans	$7,265,700	Appraisal of collateral (1)	Appraisal adjustments (2)	10-40% (19.1%)
Other real estate owned	$1,748,455	Appraisal of collateral (1)	Appraisal adjustments (2)	6%
December 31, 2013				
Impaired loans	$7,879,005	Appraisal of collateral (1)	Appraisal adjustments (2)	5-15% (8.8%)
Other real estate owned	$209,937	Appraisal of collateral (1)	Appraisal adjustments (2)	5-45% (21.7%)

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

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

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

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

Estimated fair values have been determined by using the best available data and an estimation methodology suitable for each category of financial instruments as follows:

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

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

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

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

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

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

The estimated fair values and carrying amounts of financial assets and liabilities were as follows:

	September 30, 2014				
	Carrying Value	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Fair Value
Cash and cash equivalents	$20,371,823	$20,371,823	$-	$-	$20,371,823
Securities available for sale	103,959,466	9,470,990	94,488,476	-	103,959,466
Securities held to maturity	148,182,693	-	152,466,765	-	152,466,765
Loans held for sale	9,459,172	-	9,602,000	-	9,602,000
Loans, net	613,288,046	-	-	615,200,000	615,200,000
Accrued interest receivable	2,798,265	-	2,798,265	-	2,798,265
Deposits	(823,564,746)	-	(824,154,00)	-	(824,154,000)
Borrowings	(20,798,473)	-	(21,509,000)	-	(21,509,000)
Redeemable subordinated debentures	(18,557,000)	-	18,557,000)	-	(18,557,000)
Accrued interest payable	(802,851)	-	(802,851)	-	(802,851)

	December 31, 2013				
	Carrying Value	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Fair Value
Cash and cash equivalents	$69,278,771	$69,278,771	$-	$-	$69,278,771
Securities available for sale	99,198,807	19,994,430	79,204,377	-	99,198,807
Securities held to maturity	152,816,815	-	153,629,773	-	153,629,000
Loans held for sale	10,923,689	-	10,924,000	-	10,924,000
Loans, net	366,297,511	-	-	372,548,000	372,548,000
Accrued interest receivable	2,542,602	-	2,542,602	-	2,542,602
Deposits	(638,552,030)	-	(639,539,000)	-	(639,539,000)
Borrowings	(10,000,000)	-	(11,148,000)	-	(11,148,000)
Redeemable subordinated debentures	(18,557,000)	-	(18,557,000)	-	(18,557,000)
Accrued interest payable	(883,212)	-	(883,212)	-	(883,212)

Loan commitments and standby letters of credit as of September 30, 2014 and December 31, 2013 are based on fees charged for similar agreements; accordingly, the estimated fair value of loan commitments and standby letters of credit is nominal.

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

The purpose of this discussion and analysis of the operating results and financial condition at September 30, 2014 is intended to help readers analyze the accompanying financial statements, notes and other supplemental information contained in this document. Results of operations for the three month and nine month periods ended September 30, 2014 are not necessarily indicative of results to be attained for any other period.

This discussion and analysis should be read in conjunction with the consolidated financial statements, notes and tables included elsewhere in this report and Part II, Item 7 of the Company’s Form 10-K (Management’s Discussion and Analysis of Financial Condition and Results of Operation) for the year ended December 31, 2013, as filed with the

Securities and Exchange Commission (the “SEC”) on March 31, 2014.

General

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

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

The Bank operates nineteen branches, and manages its investment portfolio through its subsidiary, 1st Constitution Investment Company of New Jersey, Inc. During the second quarter of 2014, the Bank completed the merger of RFHB Investment Company, a subsidiary of Rumson-Fair Haven Bank and Trust Company, a New Jersey state chartered commercial bank ("Rumson") that managed Rumson's investment portfolio, with and into 1st Constitution Investment Company of New Jersey, Inc. FCB Assets Holdings, Inc., a subsidiary of the Bank, is used by the Bank to manage and dispose of repossessed real estate.

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

Forward-Looking Statements

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

Factors that may cause actual results to differ from those results expressed or implied, include, but are not limited to, those listed under "Business", "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Company's Annual Report on Form 10-K for the year ended December 31, 2013filed with the SEC on March 31, 2014, such as the overall economy and the interest rate environment; the ability of customers to repay their obligations; the adequacy of the allowance for loan losses; competition; the ability to realize expected synergies from the Rumson merger in the time frame anticipated and cost or difficulties associated with integration matters that might be greater than anticipated; significant changes in accounting, tax or regulatory practices and requirements; certain interest rate risks; risks associated with investments in mortgage-backed securities; and risks associated with speculative construction lending. Although management has taken certain steps to mitigate any

negative effect of the aforementioned items, significant unfavorable changes could severely impact the assumptions used and could have an adverse effect on profitability. The Company undertakes no obligation to publicly revise any forward-looking statements to reflect anticipated or unanticipated events or circumstances occurring after the date of such statements, except as required by law.

Recent Developments

On February 7, 2014, the Company completed its acquisition of Rumson-Fair Haven Bank and Trust Company, a New Jersey state chartered commercial bank ("Rumson"), which merged with and into the Bank, with the Bank as the surviving entity. The merger agreement among the Company, the Bank and Rumson (the "Merger Agreement") provided that the shareholders of Rumson would receive, at their election, for each outstanding share of Rumson common stock that they own at the effective time of the merger, either 0.7772 shares of the Company common stock or $7.50 in cash or a combination thereof, subject to proration as described in the Merger Agreement, so that 60% of the aggregate merger consideration consisted of cash and 40% consisted of shares of the Company's common stock. The Company issued an aggregate of 1,019,242 shares of its common stock and paid $14.8 million in cash in the transaction.

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

In May of 2013, the Bank entered into a loan participation agreement with a lead lender and another bank to provide financing to Projuban, LLC d/b/a G3K Displays (the "Borrower" or "Projuban"). The loan is secured by a first security interest in the Borrower's accounts receivable, inventory, equipment and fixtures, and is further secured by the continuing guarantees of the Borrower's principals.

As previously disclosed in the Company's Current Report on Form 8-K dated June 20, 2014 (the "Current Report"), the Bank became aware of an apparent fraud by the Borrower and its principals during the second quarter of 2014. The Bank, together with the lending group to the Borrower, commenced a review and investigation of the matter, which included the engagement of forensic accountants. This review and investigation revealed that the principals of the Borrower made fraudulent misrepresentations about the collateral securing the loan and the overall financial condition of the Borrower. The loan was current in payments prior to the initial discovery of the apparent fraud. As reported in the Current Report, management determined that the Borrower's financial capacity to repay the remaining balance of the loan was unlikely due to the apparent fraud and the Borrower's cessation of operations, and that substantial doubt existed regarding future repayment of the loan. Accordingly, the Bank recorded a provision for loan losses and a corresponding charge-off of the entire balance of the loan in the amount of $3.7 million in the second quarter of 2014.

Each of these events had a significant impact on the results of operations for the nine month period ended September 30, 2014.

RESULTS OF OPERATIONS

Three Months Ended September 30, 2014 Compared to the Three Months Ended September 30, 2013

Summary

The Company reported net income for the three month period ended September 30, 2014 of $2.1 million, a 40% increase compared to $1.5 million reported for the three month period ended September 30, 2013. Net income per diluted share for the three month period ended September 30, 2014 was $0.30, an increase of 20% compared to $0.25 per diluted share for the three month period ended September 30, 2013.

The significant increase in net income for the current quarter was due to the $2.6 million increase in net interest income to $8.9 million, which was driven by growth of our loan portfolio in the second and third quarters and the

inclusion of the operations of Rumson. Non-interest income was $1.5 million and included gains from the sale of residential mortgage loans and SBA loans of $556,000.

Return on average assets was 0.88% and return on average equity was 10.25% for the third quarter of 2014 compared to 0.76% and 9.25% respectively, in the third quarter of 2013.

Third Quarter Highlights

- Net interest income was $8.9 million in the third quarter of 2014 compared to $6.4 million in the second quarter of 2014 and $6.3 million in the third quarter of 2013. The net interest margin for each of these periods was 4.05%, 3.89% and 3.51%, respectively.
- Loans were $620 million at September 30, 2014 and included $124 million of Rumson loans. Excluding the effect of the Rumson acquisition in the first quarter of 2014, loans increased $123 million since December 31, 2013 primarily during the second and third quarters of 2014, with mortgage warehouse loans increasing $40.4 million, construction loans increasing $30.3 million, commercial and commercial real estate loans increasing a combined $46.8 million and residential mortgages increasing $5.1 million. The loan to asset ratio increased to 65% at September 30, 2014 compared to 50.3% at December 31. 2013.
- During the third quarter of 2014, our mortgage banking operations originated $50 million of residential mortgage loans and sold $44.7 million of residential mortgage loans. The September 30, 2014 pipeline of residential mortgage loans in process was $53 million.
- The integration of the former Rumson operations was completed at the end of the first quarter of 2014 and customer retention has been as expected, with loans of approximately $124 million and deposits of approximately $176 million at September 30, 2014.

Earnings Analysis

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

Net Interest Income

Net interest income, the Company's largest and most significant component of net income, is the difference between interest and fees earned on loans and other earning assets, and interest paid on deposits and borrowed funds. This component represented 85.8% of the Company's net revenues (defined as net interest income plus non-interest income) for the three month period ended September 30, 2014 and 79.6% of net revenues for the three month period ended June 30, 2013. Net interest income also depends upon the relative amount of average interest-earning assets, average interest-bearing liabilities, and the interest rate earned or paid on them, respectively.

Average interest earning assets increased by $159,272,860, or 21.4%, to $902,690,697 for the three month period ended September 30, 2014 compared to $743,417,837 for the three month period ended September 30, 2013. The overall yield on interest earning assets, on a tax-equivalent basis, increased 52 basis points to 4.58% for the three month period ended September 30, 2014 when compared to 4.06% for the three month period ended September 30, 2013 due primarily to the increase in the higher-yielding average balance of the loan portfolio in the current period.

This increase in the overall yield on interest earning assets for the quarter ended September 30, 2014 compared with the corresponding quarter in 2013 was primarily due to (1) the increase in construction, commercial real estate and commercial business loans; and (2) the increase in loans and investments resulting from the Rumson merger. These factors contributed to an increase in the yield on earning assets, which primarily drove the increase in the net interest margin and net interest income.

Average interest bearing liabilities increased by $127,853,647, or 21.8%, to $713,105,066 for the three month period ended September 30, 2014 compared to $585,251,419 for the three month period ended September 30, 2013. Overall, the cost of total interest bearing liabilities decreased 4 basis points to 0.66% for the three months ended September 30, 2014 compared to 0.70% for the three months ended September 30, 2013. The increase in average interest bearing liabilities is due principally to the Rumson merger.

The net interest margin (on a tax-equivalent basis), which is net interest income divided by average interest earning assets, was 4.05% for the three months ended September 30, 2014 compared to 3.51% for the three months ended September 30, 2013.

The following table sets forth the Company's consolidated average balances of assets and liabilities and shareholders' equity as well as interest income and expense on related items, and the Company's average yield or rate for the three month periods ended September 30, 2014 and 2013. The average rates are derived by dividing interest income and expense by the average balance of assets and liabilities, respectively.

Average Balance Sheets with Resultant Interest and Rates
(yields on a tax-equivalent basis)

	Three months ended September 30, 2014			Three months ended Septe 30, 2013	
	Average Balance	Interest	Average Yield	Average Balance	Interest
Assets:					
Federal Funds Sold/Short-Term Investments	$ 18,858,143	$ 10,183	0.22%	$ 120,124,995	$ 81,745
Investment Securities:					
Taxable	168,912,644	961,043	2.28%	160,094,754	980,004
Tax-exempt (4)	90,191,047	852,447	3.78%	70,880,950	851,446
Total	259,103,691	1,813,490	2.80%	230,975,704	1,831,450
Loan Portfolio: (1)					
Construction	84,776,306	1,408,170	6.59%	41,845,395	631,428
Residential real estate	49,466,308	524,861	4.21%	11,104,532	141,896
Home Equity	23,097,660	356,320	6.12%	9,391,470	125,134
Commercial and commercial real estate	286,369,323	4,306,422	5.97%	145,186,260	2,760,124
Mortgage warehouse lines	155,715,974	1,689,856	4.31%	148,660,465	1,734,652
Installment	417,619	5,469	5.20%	268,341	4,214
All Other Loans	24,885,673	294,851	4.70%	35,860,675	304,357
Total	624,728,863	8,585,949	5.45%	392,317,138	5,701,805
Total Interest-Earning Assets	902,690,697	10,409,622	4.58%	743,417,837	7,615,000
Allowance for Loan Losses	(7,542,268)			(6,754,700)	
Cash and Due From Bank	13,872,593			10,627,034	
Other Assets	58,467,465			48,058,164	
Total Assets	$967,488,487			$ 795,348,335	
Liabilities and Shareholders' Equity:					
Money Market and Now Accounts	$ 290,077,290	$ 244,485	0.33%	$ 18,287,653	$ 178,204
Savings Accounts	196,936,099	226,556	0.46%	197,645,109	218,994
Certificates of Deposit	172,114,159	484,203	1.12%	140,761,657	445,176
Other Borrowed Funds	35,420,518	144,006	1.61%	10,000,000	103,121
Trust Preferred Securities	18,557,000	86,535	1.82%	18,557,000	88,337

Total Interest-Bearing Liabilities	713,105,066	1,185,785	0.66%	585,251,419	1,033,832
Net Interest Spread (2)			3.92%		
Demand Deposits	165,617,916			137,526,681	
Other Liabilities	6,011,491			7220361	
Total Liabilities	884,734,473			729,998,461	
Shareholders' Equity	18,557,000			65,349,874	
Total Liabilities and Shareholders' Equity	$967,488,487			$795,348,335	
Net Interest Margin (3)		$ 9,223,838	4.05%		$ 6,581,167

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

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

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

(4) Tax-equivalent basis.

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, the level of non-accrual loans and problem loans as identified through internal classification, collateral values, and the growth and size of the loan portfolio.

In addition to these factors, management takes into consideration current economic conditions and local real estate market conditions. Using this evaluation process, the Company recorded a provision for loan losses of $649,998 for the three months ended September 30, 2014 compared to $539,998 for the three months ended September 30, 2013. At September 30, 2014, non-performing loans increased by $1,537,124 or 24.3%, to $7,538,765 and the ratio of non-performing loans to total loans was 1.22% at September 30, 2014 compared to 1.69% at December 31, 2013. Non-performing loans declined at September 30, 2014 compared to $10,237,477 at June 30, 2014.

Net charge-offs were $960,000 in the third quarter of 2014 and included $928,000 of gross charge-offs of specific reserves for potential loan losses that were recorded in prior periods. These charge-offs were recorded for loans in the process of foreclosure or resolution for which management determined the loss would be realized.

At September 30, 2014, the loan portfolio balance was $620,395,918, which represented an increase of $247,059,836 compared to the December 31, 2013 loan portfolio balance of $373,336,082. The primary reasons for the current period increase in the loan portfolio were the $124 million of loans acquired in the Rumson merger and still outstanding and the internal growth of the loan portfolio during 2014.

There were no changes in the expected cash flows of the acquired loans from the Rumson merger during the third quarter of 2014. No allowance for loan losses was recorded for acquired loans with or without evidence of deteriorated credit quality as of September 30, 2014.

Non-Interest Income

Total non-interest income for the three months ended September 30, 2014 was $1,481,842, a decrease of $134,706, or 8.3%, from non-interest income of $1,616,548 for the three months ended September 30, 2013. This component represented 14.2% of the Company's net revenues for the three month period ended September 30, 2014 compared to 20.4% of net revenues for the three month period ended September 30, 2013.

Service charges on deposit accounts represent a consistent source of non-interest income. Service charge revenues increased by $36,456, or 15.8%, to $267,625 for the three months ended September 30, 2014 from $231,169 for the three months ended September 30, 2013. This increase was the result of a higher volume of uncollected funds and overdraft fees collected on deposit accounts in the third quarter of 2014.

Gain on sales of loans originated for sale decreased by $85,912, or 13.4%, to $556,054 for the three months ended September 30, 2014 when compared to $641,966 for the three months ended September 30, 2013. The Bank originates and sells both residential mortgage loans and loans guaranteed by the Small Business Administration in the secondary market. The higher interest rate environment that existed in the third quarter of 2014 compared to the same period in 2013 resulted in lower demand to refinance residential mortgages. As a result, the volume of mortgage loans originated and sold decreased for the three months ended September 30, 2014 compared to the three months ended September 30, 2013.

Non-interest income also includes income from bank-owned life insurance (“BOLI”), which amounted to $143,884 for the three months ended September 30, 2014 compared to $115,840 for the three months ended September 30, 2013. The increase in income from BOLI in the third quarter of 2014 was due primarily to the acquisition of $4.5 million of BOLI assets in the Rumson merger.

The Bank also generates non-interest income from a variety of fee-based services. These include safe deposit box rentals, wire transfer service fees, cash counting fees and Automated Teller Machine fees for non-Bank customers. Decreased customer demand for these services in general contributed to the other income component of non-interest income declining to $514,279 for the three months ended September 30, 2014 compared to $627,573 for the three months ended September 30, 2013, a decrease of $113,294 for the third quarter of 2014.

Non-Interest Expense

Non-interest expenses increased by $1,470,168, or 28.0%, to $6,723,651 for the three months ended September 30, 2014 from $5,253,483 for the three months ended September 30, 2013. The following table presents the major components of non-interest expenses for the three months ended September 30, 2014 and 2013.

Non-interest Expenses

	Three months ended September 30,			
	2014		2013	
Salaries and employee benefits	$	3,922,104	$	3,060,143
Occupancy expenses		833,813		629,922
Data processing services		313,237		273,272
Equipment expense		224,872		189,871
Marketing		86,455		79,656
Regulatory, professional and other fees		399,379		303,114
Merger-related expenses		-		-
FDIC insurance expense		210,000		111,562
Directors’ fees		21,500		24,000
Other real estate owned expenses		131,973		176,796
Amortization of intangible assets		121,029		66,992
Other expenses		459,289		338,155
Total	$	6,723,651	$	5,253,483

Salaries and employee benefits, which represent the largest portion of non-interest expenses, increased by $861,961, or 28.2%, to $3,922,104 for the three months ended September 30, 2014 compared to $3,060,143 for the three months ended September 30, 2013. Of this increase approximately $298,000 was due to salary and benefits for former Rumson employees who were retained by the Bank. The balance of the increase in salaries and employee benefits for the three months ended September30, 2014 was a result of an increase in the number of employees, regular annual merit increases and increased health care costs. Staffing levels have increased to 177 full time equivalent employees at September 30, 2014 as compared to 150 full time equivalent employees at September 30, 2013.

Occupancy expenses increased by $203,891, or 32.4%, to $833,813 for the three months ended September 30, 2014 compared to $629,922 for the three months ended September 30, 2013. The current period increase resulted primarily from increased depreciation, property taxes and maintenance costs of the five branch offices acquired as a result of the

Rumson merger.

The cost of data processing services increased to $313,237 for the three months ended September 30, 2014 from $273,272 for the three months ended September30, 2013 as additional expenses were incurred to support and maintain the five new locations acquired as a result of the Rumson merger within the Bank’s information technology systems and the growth of loan and deposit transaction volumes.

Equipment expense increased by $35,001, or 18.4%, to $224,872 for the three months ended September 30, 2014 compared to $189,871 for the three months ended September 30, 2013 primarily due to maintenance agreement costs associated with the expansion of the branch network due to the Rumson merger. Regulatory, professional and other fees increased by $96,265, or 31.8%, to $399,379 for the three months ended September 30, 2014 compared to $303,114 for the three months ended June 30, 2013. During the three months ended September 30, 2014, the Company incurred higher professional fees in connection with lending, collections, general corporate matters and post-merger matters.

FDIC insurance expense increased to $210,000 for the three months ended September 30, 2014 compared to $111,562 for the three months ended September 30, 2013 primarily as a result of the assumption of deposits and borrowings upon completion of the Rumson merger, which accounted for approximately $45,000 of the increase.

Other real estate owned expenses decreased by $44,823 to $131,973 for the three months ended September 30, 2014 compared to $176,796 for the three months ended September 30, 2013 as the Company incurred a higher level of property taxes, maintenance, disposition costs and other costs on repossessed properties held as other real estate owned during the third quarter of 2013 compared to the third quarter of 2014. At September 30, 2014, the Company held one property with a value of $1,748,455 as other real estate owned compared to four properties with an aggregate value of $2,808,554 at September 30, 2013.

Amortization of intangible assets increased $54,037 to $121,029 during the third quarter of 2014 when compared to the third quarter of 2013 due to the amortization of core deposit intangible assets of $1,189,000 recorded in the Rumson merger.

All other expenses increased to $459,289 for the three months ended September 30, 2014 compared to $338,155 for the three months ended September 30, 2013 as current year increases occurred in correspondent bank fees, maintenance agreements and ATM operating expenses. All other expenses are comprised of a variety of operating expenses and fees, as well as expenses associated with lending activities.

Income Taxes

The pre-tax income was $3,055,562 for the three months ended September 30, 2014 compared to pre-tax income of $2,128,089 for the three months ended September 30, 2013.

The Company recorded income tax expense of $917,483 for the three months ended September 30, 2014 compared to income tax expense of $604,851 for the three months ended September 30, 2013. The effective tax rate for the third quarter of 2014 was of 30.02%, which was lower than the combined statutory rate of 39.9% due primarily to the impact of tax exempt interest income. The effective tax rate for the 2013 quarter was 28.4%.

Nine Months Ended September 30, 2014 Compared to the Nine Months Ended September 30, 2013

Summary

The Company reported net income of $2,339,873, or $0.33 per diluted share, for the nine month period ended September 30, 2014 compared to net income of $4,405,588, or $0.72 per diluted share, for the nine month period ended September 30, 2013.

The results of operations for the nine months ended September 30, 2014 were impacted by the two events described above in the “Recent Developments” section. In the first quarter of 2014, the Company completed the acquisition of Rumson. For the nine months ended September 30, 2014, the Company incurred a total of $1.5 million of

merger-related expenses that reduced net income by $962,000, or $0.13 per diluted share.

49

In the second quarter, the Projuban loan for approximately $3.7 million was fully charged-off and the provision for loan losses was increased by a similar amount due to the apparent fraud by the borrower and its principals. This additional provision reduced net income by $2.2 million, or $0.31 per diluted share, and resulted in a net loss for the second quarter of 2014 and substantially lower net income for the nine months ended September 30, 2014 when compared to the nine months ended September 30, 2013.

Net income, adjusted for the effect of these events ("Adjusted Net Income"), was $5.5 million for the nine month period ended September 30, 2014, or $0.77 per diluted share. For the nine month period ended September 30, 2013, net income was $4.4 million, or $0.72 per diluted share. Adjusted Net Income and Adjusted Net Income per diluted share are non-GAAP measures. A reconciliation of these non-GAAP measures to the reported net income or loss and net income of loss per diluted share is summarized in the table below:

Reconciliation of Non-GAAP Measures (1)
(Unaudited)

	Nine Months Ended	
(In thousands, except per share amounts)	September 30, 2014	September 30, 2013
Adjusted Net Income:		
Net Income	$ 2,340	$ 4,405
Adjustments :		
Provisions for Loan losses	3,656	-
Merger-Related Expenses	1,532	-
Income Tax Effect of Adjustments (2)	(2,031)	-
Adjusted Net Income	$ 5,497	$ 4,405
Adjusted Net Income per Diluted Share		
Adjusted Net Income	$ 5,497	$ 4,405
Diluted Shares Outstanding	7,142	6,137
Adjusted Net Income per Diluted Share	$ 0.77	$ 0.72

(1) The Company used the non-GAAP financial measures, Adjusted Net Income and Adjusted Net Income per Diluted Share, because the Company believes that it is useful for the users of the financial information to understand the effect on net income of the merger related expenses incurred in the merger with Rumson Fair Haven Bank and Trust Company and the large provision for loan losses recorded as a result of the apparent fraud by a borrower and its principals. These non-GAAP financial measures improve the comparability of the current period results with the results of prior periods. The Company cautions that the non-GAAP financial measures should be considered in

addition to, but not as a substitute for, the Company's GAAP results

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

Earnings Analysis

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

Net Interest Income

Net interest income, the Company's largest and most significant component of net income, is the difference between interest and fees earned on loans and other earning assets, and interest paid on deposits and borrowed funds. This component represented 81.2% of the Company's net revenues (defined as net interest income plus non-interest income) for the nine month period ended September 30, 2014 and 80.0% of net revenues for the nine-month period ended September 30, 2013. Net interest income also depends upon the relative amount of average interest-earning assets, average interest-bearing liabilities, and the interest rate earned or paid on them, respectively.

The following table sets forth the Company's consolidated average balances of assets and liabilities and shareholders' equity as well as interest income and expense on related items, and the Company's average yield or rate for the nine month periods ended September 30, 2014 and 2013. The average rates are derived by dividing interest income and expense by the average balance of assets and liabilities, respectively.

Average Balance Sheets with Resultant Interest and Rates
(yields on a tax-equivalent basis)

	Nine months ended September 30, 2014			Nine months ended September 30, 2013		
	Average Balance	Interest	Average Yield	Average Balance	Interest	Average Yield
Assets:						
Federal Funds Sold/Short-Term Investments	$ 60,616,449	$ 110,892	0.24%	$ 112,351,662	$ 221,087	0.26%
Investment Securities:						
Taxable	177,880,389	3,141,788	2.36%	156,884,880	2,818,801	2.40%
Tax-exempt (4)	87,095,642	2,583,648	3.97%	67,610,995	2,418,022	4.77%
Total	264,976,031	5,725,436	2.89%	224,495,875	5,236,823	3.11%
Loan Portfolio: (1)						
Construction	73,497,268	3,791,105	6.90%	42,149,774	1,926,931	6.11%
Residential real estate	44,761,735	1,363,469	4.07%	11,057,154	430,207	5.20%
Home Equity	21,985,052	921,528	5.60%	9,208,816	373,778	5.43%
Commercial and commercial real estate	264,617,694	11,779,442	5.95%	143,067,333	7,838,953	7.33%
Mortgage warehouse lines	118,959,945	4,022,743	4.52%	166,142,165	5,808,889	4.67%
Installment	321,030	13,668	5.69%	254,238	12,284	6.46%
All Other Loans	21,900,870	802,694	4.90%	41,800,648	928,216	2.97%
Total	546,043,594	22,694,649	5.56%	413,680,128	17,319,258	5.60%
Total Interest-Earning Assets	871,636,074	28,530,977	4.38%	750,527,665	22,777,168	4.05%
Allowance for Loan Losses	(7,547,794)			(6,777,671)		
Cash and Due From Bank	15,325,837			18,481,914		
Other Assets	57,087,058			48,636,271		
Total Assets	$ 936,501,175			$ 810,868,179		
Liabilities and Shareholders' Equity:						
Money Market and NOW Accounts	$ 279,311,533	$ 692,097	0.33%	$ 225,215,899	$ 579,798	0.34%
Savings Accounts	200,283,559	676,075	0.45%	202,754,977	676,979	0.45%
Certificates of Deposit	169,628,119	1,458,167	1.15%	141,258,225	1,411,530	1.34%
Other Borrowed Funds	24,630,579	387,422	2.10%	10,380,769	310,649	4.00%
Trust Preferred Securities	18,557,000	257,314	1.85%	18,557,000	263,981	1.90%
Total Interest-Bearing Liabilities	692,410,790	3,471,075	0.67%	598,166,870	3,242,937	0.72%
Net Interest Spread (2)			3.71%			3.33%
Demand Deposits	156,999,596			139,542,141		

Other Liabilities	6,859,237			7,394,439		
Total Liabilities	856,269,623			745,103,450		
Shareholders' Equity	80,231,552			65,764,729		
Total Liabilities and Shareholders' Equity	$936,501,175			$810,868,179		
Net Interest Margin (3)		$ 25,059,902	3.84%		$ 19,534,230	3.48%

(1) Loan origination fees are considered an adjustment to interest income. For the purpose of calculating loan yields, average loan balances include nonaccrual loans with no related interest income and include the average balances of loans held for sale. Please refer to Management's Discussion and Analysis of Financial Condition and Results of Operation under the heading "Non-Performing Assets" for a discussion of the Bank's policy with regard to non-accrual loans.
(2) The interest rate spread is the difference between the average yield on interest earning assets and the average rate paid on interest bearing liabilities.
(3) The net interest margin is equal to net interest income divided by average interest earning assets.
(4) Tax-equivalent basis.

Average interest earning assets increased by $121,108,409, or 16.1%, to $871,636,074 for the nine month period ended September 30, 2014 compared to $750,527,665 for the nine month period ended September 30, 2013. The average investment securities portfolio increased by $40,480,156 to $264,976,031 for the nine month period ended September 30, 2014 compared to $224,495,875 for the nine month period ended September 30, 2013. The average loan portfolio increased by $132,363,466, or 32.0%, to $546,043,594 for the nine month period ended September 30, 2014 compared to $413,680,128 for the nine month period ended September 30, 2013.

Average interest bearing liabilities increased by $94,243,920, or 15.8%, to $692,410,790 for the nine month period ended September 30, 2014 from $598,166,870 for the nine month period ended September 30, 2013.

The net interest margin (on a tax-equivalent basis), which is net interest income divided by average interest earning assets, was 3.84% for the nine months ended September 30, 2014 compared to 3.48% for the nine months ended September 30, 2013.

The Company’s net interest income increased on a tax-equivalent basis by $5,525,672, or 28.3%, to $25,059,902 for the nine months ended September 30, 2014 compared to $19,534,230 for the nine months ended September 30, 2013. This increase in the Company’s net interest income and net interest margin for the nine months ended September 30, 2014 compared to the corresponding period in 2013 was primarily due to higher yields earned on an increased level of interest-earning assets, combined with lower rates paid on interest-bearing liabilities during the current period. The average yield on interest-earning assets was 4.38% for the nine month period ended September 30, 2014, an increase of 33 basis points from the yield of 4.05% for the comparable period of 2013. The average rate paid on interest-bearing liabilities for the nine months ended September 30, 2014 was 0.67%, a reduction of 5 basis points from 0.72% paid for the nine months ended September 30, 2013. The average balances of both interest-earning assets and interest-bearing liabilities increased for the nine-month period ended September 30, 2014 compared to the same period in 2013 due primarily to the merger with Rumson, which was completed on February 7, 2014.

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, the level of non-accrual loans and problem loans as identified through internal review and classification, collateral values and the growth and size of the loan portfolio.

In addition to these factors, management takes into consideration current economic conditions and local real estate market conditions. Using this evaluation process, the Company recorded a provision for loan losses of $5,249,994 for the nine months ended September 30, 2014 compared to a provision of $776,664 for the nine months ended September 30, 2013. The provision for loan losses increased to $5.2 million in the first nine months of 2014 due to the $3.7 million provision for and charge-off of the Projuban loan in the second quarter, other charge-offs of $1.5 million in 2014 and growth of the loan portfolio. Other charge-offs include $928,000 of gross charge-offs of specific reserves for potential losses that were recorded in prior periods. At September 30, 2014, non-performing loans increased by $1,537,124, or 24.3%, to $7,859,080 and the ratio of non-performing loans to total loans was 1.27% at September 30, 2014 compared to 1.69% at December 31, 2013. At September 30, 2014, the loan portfolio balance was $620,395,918, which represented an increase of $247,059,836 compared to the December 31, 2013 loan portfolio balance of $373,336,082.

There were no changes in the expected cash flows of the acquired loans from the Rumson merger from the date of merger to September 30, 2014. No allowance for loan losses was recorded for acquired loans with or without evidence of deteriorated credit quality as of September 30, 2014. The primary cause of the current period increase in the loan portfolio balance was the approximate $124 million of loans acquired in the Rumson merger and the growth of construction, commercial real estate and commercial loans during the second and third quarters of 2014.

Non-Interest Income

Total non-interest income for the nine months ended September 30, 2014 was $4,378,856, a decrease of $294,114, or 6.3%, compared to non-interest income of $4,672,970 for the nine months ended September 30, 2013.

Service charges on deposit accounts represent a consistent source of non-interest income. Service charge revenues increased to $753,976 for the nine months ended September 30, 2014 from $675,839 for the nine months ended September 30, 2013. This increase was the result of a higher volume of uncollected funds and overdraft fees collected on deposit accounts during the first nine months of 2014 compared to the first nine months of 2013.

Gain on sales of loans originated for sale decreased by $290,031, or 15.7%, to $1,562,790 for the nine months ended September 30, 2014 when compared to $1,852,821 for the nine months ended September 30, 2013. The Bank sells both residential mortgage loans and loans guaranteed by the Small Business Administration in the secondary market. The resulting volume of residential mortgage loans originated and sold decreased for the first nine months of 2014 compared to the first nine months of 2013 due to the higher interest rate environment and lower level of mortgage refinancing activity in 2014 than in 2013 which resulted in a $708,000 decline in gains from the sale of residential mortgages. Gains from the sale of SBA loans increased $418,000 to $1.0 million, which partially offset the decline in gains from the sale of residential mortgages.

Non-interest income also includes income from bank-owned life insurance (“BOLI”), which amounted to $422,022 for the nine months ended September 30, 2014 compared to $348,206 for the nine months ended September 30, 2013. The increase in income from BOLI was due to the Bank’s acquisition of $4.5 million of BOLI assets in the Rumson merger.

The Bank also generates non-interest income from a variety of fee-based services. These include safe deposit box rentals, wire transfer service fees, cash counting fees and Automated Teller Machine fees for non-Bank customers. Decreased customer demand for these services contributed to the decline in the other income component of non-interest income to $1,640,068 for the nine months ended September 30, 2014 compared to $1,796,104 for the nine months ended September 30, 2013.

Non-Interest Expense

Non-interest expenses increased by $4,276,740, or 25.9%, to $20,775,491 for the nine months ended September 30, 2014 from $16,498,751 for the nine months ended September 30, 2013. Excluding merger related expenses of $1,532,153, non-interest expenses would have been $19,243,338 in the first nine months of 2014, which would have been an increase of $2,744,587 when compared to non-interest expenses for the first nine months of 2013. Non-interest expenses attributable to the former Rumson operation were approximately $1.9 million February 7, 2014 (the date of the closing of the Rumson merger) through September 30, 2014. The following table presents the major components of non-interest expenses for the nine months ended September 30, 2014 and 2013.

Non-interest Expenses

	Nine months ended September 30,	
	2014	2013
Salaries and employee benefits	$ 11,194,732	$ 9,458,247
Occupancy expenses	2,498,903	1,930,227
Data processing services	941,046	868,960
Equipment expense	645,212	689,804
Marketing	240,001	219,326
Regulatory, professional and other fees	1,066,631	770,015
Merger-related expenses	1,532,153	0
FDIC insurance expense	544,631	146,249
Directors' fees	67,500	78,000
Other real estate owned expenses	272,014	770,858
Amortization of intangible assets	345,076	200,975
Other expenses	1,427,592	1,366,090
Total	$ 20,775,491	$ 16,498,751

Salaries and employee benefits, which represent the largest portion of non-interest expenses, increased by $1,736,485, or 18.4%, to $11,194,732 for the nine months ended September 30, 2014 compared to $9,458,247 for the nine months ended September 30, 2013. Of this increase, approximately $744,000 was due to salary and benefits for former Rumson employees that were retained by the Bank. The balance of the increase in salaries and employee benefits for the nine months ended September 30, 2014 was a result of an increase in the number of employees, regular merit increases and increased health care costs. As a result of the Rumson merger completed on February 7, 2014, staffing levels increased to 177 full time equivalent employees at September 30, 2014 as compared to 150 full time equivalent employees at September 30, 2013.

Occupancy expenses increased by $568,676, or 29.5%, to $2,498,903 for the nine months ended September 30, 2014 compared to $1,930,227 for the nine months ended September 30, 2013. The current period increase resulted primarily from increased depreciation, property taxes and maintenance costs of the five new branch office locations acquired as a result of the Rumson merger.

The cost of data processing services increased to $941,046 for the nine months ended September 30, 2014 from $868,960 for the nine months ended September 30, 2013 as additional expenses were incurred to support and maintain the five new locations acquired as a result of the Rumson merger within the Bank's information technology systems and the cost of processing a higher level of loan and deposit transactions.

Equipment expense decreased by $44,592, or 6.5%, to $645,212 for the nine months ended September 30, 2014 compared to $689,804 for the nine months ended September 30, 2013 primarily due to non-recurring costs associated with the expansion of mobile banking capabilities incurred during the first nine months of 2013.

Regulatory, professional and other fees increased by $296,616 to $1,066,631 for the nine months ended September 30, 2014 compared to $770,015 for the nine months ended September 30, 2013. During the first nine months of 2014, the Company incurred higher professional fees in connection with lending, collections other general corporate matters and post-merger related matters.

During the first nine months of 2014, the Company incurred merger-related expenses of $1,532,153 in connection with the Rumson transaction. These pre-tax expenses consisted primarily of (1) change-in-control payments of $883,000; (2) data processing contract termination payments of $228,000; (3) investment banker fees of $207,000; (4)

legal fees of $94,430; and (5) severance payments of $119,723.

FDIC insurance expense increased to $554,631 for the nine months ended September 30, 2014 compared to $146,249 for the nine months ended September 30, 2013 as a result of the assumption of deposits upon completion of the Rumson merger, which accounted for approximately $90,000 of the increase.

Other real estate owned expenses decreased by $498,844 to $272,014 for the nine months ended September 30, 2014 compared to $770,858 for the nine months ended September 30, 2013 as the Company incurred a lower level of property tax, maintenance and other costs on fewer repossessed properties held as other real estate owned during the first nine months of 2014 compared with the same period in 2013. At September 30, 2014, the Company held one property with a value of $1,748,455 as other real estate owned compared to four properties with an aggregate value of $2,808,554 at September 30, 2013.

Amortization of intangible assets increased $144,101 to $345,076 during the nine months ended September 30, 2014 when compared to the corresponding period in 2013 due to the amortization of the core deposit intangible asset of $1,189,000 recorded in the Rumson merger.

All other expenses increased to $1,427,591 for the nine months ended September 30, 2014 compared to $1,366,090 for the nine months ended September 30, 2013 as current year increases occurred primarily in correspondent bank fees, maintenance agreements and ATM operating expenses. All other expenses are also comprised of a variety of operating expenses and fees, as well as expenses associated with lending activities.

Income Taxes

Pre-tax income was $2,575,332 for the nine months ended September 30, 2014 compared to pre-tax income of $6,147,562 for the nine months ended September 30, 2013.

The Company recorded income tax expense of $235,459 for the nine months ended September 30, 2014 compared to income tax expense of $1,741,974 for the nine months ended September 30, 2013. The effective tax rate was a 9.1% for the nine months ended September 30, 2014 due principally to the lower level of pre-tax income and the effect of tax exempt interest income. The effective tax rate was 28.3% for the nine months ended September 30, 2013.

Financial Condition

September 30, 2014 Compared with December 31, 2013

Total consolidated assets at September 30, 2014 were $954,304,550, representing an increase of $211,979,463, or 28.6%, from total consolidated assets of $742,325,087 at December 31, 2013. The increase in assets was primarily attributable to the merger with Rumson, which was completed on February 7, 2014. The merger was accounted for under the acquisition method of accounting and, accordingly, assets acquired, liabilities assumed and consideration exchanged were recorded at their fair values as of the acquisition date. Included in the acquisition were the assumption of deposit liabilities of $189.5 million, the acquisition of cash and cash equivalents of $36.0 million, securities available for sale of $30.0 million and loans of $143.7 million. The Bank recorded goodwill of approximately $7.7 million and a core deposit intangible asset of approximately $1.2 million as a result of the acquisition.

Cash and Cash Equivalents

Cash and cash equivalents at September 30, 2014 totaled $20,371,823 compared to $69,278,771 at December 31, 2013. Cash and cash equivalents at September 30, 2014 consisted entirely of cash and due from banks of $20,371,823. The corresponding balances at December 31, 2013 were cash and due from banks of $69,267,345 and short term investments of $11,426, respectively. The current period decrease was primarily due to the cash outflow to fund loan demand which occurred primarily during the second and third quarters of 2014. To the extent that the Bank did not utilize the funds for loan originations, securities purchases or repayment of borrowings, the cash inflows accumulated in cash and cash equivalents.

Loans Held for Sale

Loans held for sale at September 30, 2014 were $9,459,172 compared to $10,923,689 at December 31, 2013. 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.

Investment Securities

Investment securities represented 26.4% of total assets at September 30, 2014 and 33.9% of total assets at December 31, 2013. Total investment securities increased $126,537 to $252,142,159 at September 30, 2014 from $252,015,622 at December 31, 2013. Purchases of investments totaled $14.2 million during the nine months ended September 30, 2014, and proceeds from calls, sales and repayments totaled $46 million during this period. Approximately $30 million of investment securities were acquired in the Rumson merger.

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 September 30, 2014, securities available for sale totaled $103,959,466, which is an increase of $4,760,659, or 4.8%, from securities available for sale totaling $99,198,807 at December 31, 2013.

At September 30, 2014, the securities available for sale portfolio had net unrealized losses of $231,762 compared to net unrealized losses of $2,992,624 at December 31, 2013. These unrealized losses are reflected, net of tax, in shareholders' equity as a component of accumulated other comprehensive income.

Securities held to maturity, which are carried at amortized historical cost, are investments for which there is the positive intent and ability to hold to maturity. At September 30, 2014, securities held to maturity were $148,182,693, a decrease of $4,634,122, from $152,816,815 at December 31, 2013. The fair value of the held to maturity portfolio at September 30, 2014 was $152,466,765.

Loans

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

The following table represents the components of the loan portfolio at September 30, 2014 and December 31, 2013.

Loan Portfolio Composition

	September 30, 2014		December 31, 2013	
Component	Amount	%	Amount	%
Construction loans	$ 88,547,583	14 %	$ 51,002,172	14 %
Residential real estate loans	48,732,051	8 %	13,764,178	4 %
Commercial business	109,053,429	18 %	82,348,055	22 %
Commercial real estate	192,367,844	31 %	98,389,730	26 %
Mortgage warehouse lines	157,333,717	25 %	116,951,357	31 %
Loans to individuals	23,363,042	4 %	9,766,114	3 %
Deferred loan costs	800,548	0 %	943,950	0 %
All other loans	197,704	0 %	170,526	0 %
	$ 620,395,918	100 %	$ 373,336,082	100 %

The loan portfolio increased by $247,059,836, or 66.2%, to $620,395,918 at September 30, 2014 compared to $373,336,082 at December 31, 2013. The primary reasons for the increase in the loan portfolio were the Rumson merger which added approximately $124 million in loans to the Bank's loan portfolio, principally in the residential real estate and commercial real estate components and the origination of approximately $123 million of new loans in the second and third quarters of 2014.

Commercial and commercial real estate loans totaled $301,421,273 at September 30, 2014, an increase of $120,683,488 when compared to $180,737,785 at December 31, 2013. Commercial loans consist primarily of loans to small and middle market businesses and are typically working capital loans used to finance inventory, receivables or equipment needs. These loans are generally secured by business assets of the commercial borrower. Excluding the effect of the Rumson merger, commercial and commercial real estate loans increased a combined $46.8 million in the second and third quarters.

Construction loans, excluding loans acquired in the Rumson merger, increased $29.3 million, reflecting increased real estate development activity of our customers.

The mortgage warehouse lines component of the loan portfolio increased by $40,382,360, or 34.5%, to $157,333,717 compared to $116,951,357 at December 31, 2013, reflecting the growth in residential mortgages originated for sale by our mortgage banking customers and the seasonality of the residential home purchases in our markets. The principal home buying season occurs in general from April through October.

The Bank's Mortgage Warehouse Funding Group offers revolving lines of credit that are available to licensed mortgage banking companies (the "Warehouse Line of Credit"). The Warehouse Line of Credit is used by the mortgage banker to originate one-to-four family residential mortgage loans that are pre-sold to the secondary mortgage market, which includes state and national banks, national mortgage banking firms, insurance companies and government-sponsored enterprises, including the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and others. On average, an advance under the Warehouse Line of Credit remains outstanding for a period of less than 30 days, with repayment coming directly from the sale of the loan into the secondary mortgage market. Interest and a transaction fee are collected by the Bank at the time of repayment. Additionally, customers of the Warehouse Line of Credit are required to maintain deposit relationships with the Bank that, on average, represent 10% to 15% of the loan balances.

The ability of the Company to enter into larger loan relationships and management’s philosophy of relationship banking are key factors in the Company’s strategy for loan growth. The ultimate collectability of the loan portfolio and recovery of the carrying amount of real estate are subject to changes in the Company’s market region’s economic environment and real estate market.

Non-Performing Assets

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

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

Non-performing loans increased by $1,537,124 to $7,859,080 at September 30, 2014 from $6,321,956 at December 31, 2013, but declined from $8,311,073 at June 30, 2014. The major segments of non-accrual loans consist of commercial real estate loans and commercial loans, which are in the process of collection. The table below sets forth non-performing assets and risk elements in the Bank's portfolio for the periods indicated.

As the table demonstrates, non-performing loans to total loans decreased to 1.27% at September 30, 2014 from 1.69% at December 31, 2013 primarily due to the increase in loans as a result of the Rumson merger and the internal growth of loans during 2014. At the date of this report, loan quality is considered to be sound. This was accomplished through quality loan underwriting, a proactive approach to loan monitoring and aggressive workout strategies.

Non-Performing Assets and Loans	September 30, 2014	December 31, 2013
Non-Performing loans:		
Loans 90 days or more past due and still accruing	$ 320,315	$ -
Non-accrual loans	7,538,765	6,321,956
Total non-performing loans	7,859,080	6,321,956
Other real estate owned	1,748,455	2,136,341
Other repossessed asset	66,404	0
Total non-performing assets	9,673,939	8,458,297
Performing troubled debt restructurings	3,927,889	3,858,796
Performing troubled debt restructurings and total non-performing assets	$ 13,601,828	$ 12,317,093
Non-performing loans to total loans	1.27%	1.69%
Non-performing loans to total loans excluding mortgage warehouse lines	1.70%	2.47%
Non-performing assets to total assets	1.01%	1.14%
Non-performing assets to total assets excluding mortgage warehouse lines	1.21%	1.35%
Total non-performing assets and performing troubled debt restructurings to total assets	1.43%	1.66%

Non-performing assets increased by $1,215,642 to $9,673,939 at September 30, 2014 from $8,458,297 at December 31, 2013, but declined from $10,237,477 at June 30, 2014. Other real estate owned was $1,748,455 and other repossessed assets totaled $66,404 at September 30, 2014. Other real estate owned was $2,136,341 at December 31, 2013 and $1,860,000 at June 30, 2014.

At September 30, 2014, the Bank had 9 loans totaling $4,288,699 which were troubled debt restructurings. Two of these loans totaling $360,810 are included in the above table as non-accrual loans; the remaining seven loans totaling $3,927,889 are considered performing.

As provided by ASC 310-30, 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. Accordingly, Rumson loans acquired with evidence of deteriorated credit quality of $1,246,640 at September 30, 2014 were not classified as non-performing loans.

Non-performing assets represented 1.01% of total assets at September 30, 2014 and 1.14% at December 31, 2013.

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

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

Allowance for Loan Losses and Related Provision

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

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

All, or part, of the principal balance of commercial, 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 immediately 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 GAAP and interagency supervisory guidance. The allowance for loan losses methodology consists of two major components. The first component is an estimation of losses associated with individually identified impaired loans, which follows Accounting Standards Codification (ASC) Topic 310 (formerly SFAS 114). The second major component is an estimation of losses under ASC Topic 450 (formerly SFAS 5), which provides guidance for estimating losses on groups of loans with similar risk characteristics. The Company's methodology results in an allowance for loan losses which includes a specific reserve for impaired loans, an allocated reserve, and an unallocated portion.

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

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

The methodology includes the segregation of the loan portfolio into loan types with a further segregation into risk rating categories, such as special mention, substandard, doubtful and loss. This allows for an allocation of the allowance for loan losses by loan type; however, the allowance is available to absorb any loan loss without restriction. Larger balance, non-homogeneous loans representing significant individual credit exposures are evaluated individually through the internal loan review process. It is this process that produces the watch list. The borrower's overall financial condition, repayment sources, guarantors and value of collateral, if appropriate, are evaluated. Based on these reviews, an estimate of probable losses for the individual larger-balance loans 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 of loans, such as residential mortgages and consumer credits, the loans are collectively evaluated based on delinquency status, loan type, and historical losses. These loan groups are then internally risk rated.

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

The specific allowance for impaired loans is established for specific loans which have been identified by management as being impaired. These loans are considered to be impaired primarily because the loans have not performed according to payment terms and there is reason to believe that repayment of the loan principal in whole, or in part, is unlikely. The specific portion of the allowance is the total amount of potential unconfirmed losses for these individual impaired loans. To assist in determining the fair value of loan collateral, the Company often utilizes independent third party qualified appraisal firms which 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 to account for current conditions, current loan portfolio performance, loan policy or management changes, or any other qualitative factor which may cause future losses to deviate from historical levels.

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

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

Commercial

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

Mortgage Warehouse Lines of Credit

The Company's Mortgage Warehouse 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. Additionally, customers of the Warehouse Lines of Credit are required to maintain deposit relationships with the Bank that, on average, represent 10% to 15% of the loan balances.

As a separate segment of the total portfolio, the warehouse loan portfolio is individually analyzed as a whole for allowance for loan 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.

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

Consumer

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

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

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

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

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

Allowance for Loan Losses

	September 30, 2014	December 31, 2013	September 30, 2013
Balance, beginning of period	$ 7,038,571	$ 7,151,212	$ 7,151,212
Provision charged to operating expenses	5,249,994	1,076,662	776,664
Loans charged off :			
Construction loans	-	(561,993)	(561,993)
Residential real estate loans	(15,015)	-	-
Commercial and commercial real estate	(5,217,947)	(554,827)	(486,034)
Loans to individuals	-	(91,920)	(90,865)
Lease financing	-	-	-
All other loans	-	-	-
	(5,232,962)	(1,208,739)	(1,138,892)
Recoveries			
Construction loans	-	417	417
Residential real estate loans	-	-	-
Commercial and commercial real estate	52,269	19,020	17,947
Loans to individuals	-	-	12,832
Lease financing	-	-	-
All other loans	-	-	-
	52,269	19,437	31,196
Net (charge offs) / recoveries	(5,180,693)	(1,189,302)	(1,107,696)
Balance, end of period	$ 7,107,872	$ 7,038,571	$ 6,820,180
Loans :			

At period end	$ 620,395,918	$ 373,336,082	$ 362,549,473
Average during the period	539,261,215	248,126,605	386,475,158
Net charge offs to average loans outstanding	(0.96 %)	(0.48 %)	(0.29 %)
Allowance for loan losses to :			
Total loans at period end	1.15 %	1.89 %	1.88 %
Total loans at period end excluding mortgage warehouse lines	1.34 %	2.52 %	2.99 %
Non-performing loans	90.44 %	111.34 %	88.02 %

The following table represents the allocation of the allowance for loan losses among the various categories of loans and certain other information as of September 30, 2014 and December 31, 2013, respectively. The allocation is made for analytical purposes and is not necessarily indicative of the categories in which future losses may occur. The total allowance is available to absorb losses from any segment of loans.

	September 30, 2014			December 31, 2013		
	Amount	ALL as a % of Loans	% of Loans	Amount	ALL as a % of Loans	% of Loans
Commercial and commercial real estate	$4,615,974	1.53 %	49 %	$4,293,499	2.38 %	48 %
Construction loans	1,099,053	1.24 %	14 %	1,205,267	2.36 %	14 %
Residential real estate loans	202,146	0.41 %	8 %	164,673	1.20 %	4 %
Consumer and other	93,000	0.39 %	4 %	111,032	1.14 %	3 %
Subtotal	6,010,173	1.30 %	75 %	5,774,471	2.26 %	69 %
Mortgage warehouse lines	786,669	0.50 %	25 %	584,757	0.50 %	31 %
Unallocated reserves	311,030	-	-	679,343	-	-
Total	$7,107,872	1.15 %	100 %	$7,038,571	1.89 %	100 %

The Company recorded a provision for loan losses of $5,249,994 for the nine months ended September 30, 2014 compared to a loan loss provision of $776,664 for the nine months ended September 30, 2013. Net charge offs/recoveries amounted to a net charge-off of $5,180,693 for the nine months ended September 30, 2014. The higher provision for loan losses and net charge offs for the nine months ended September 30, 2014 resulted primarily from the provision and charge-off of the Projuban loan which was described earlier in the "Recent Developments" section. In addition, net charge-offs were $960,000 in the third quarter of 2014 and included $928,000 of gross charge-offs of specific reserves for potential loan losses that were recorded in prior periods. These charge-offs were recorded for loans in the process of foreclosure or resolution for which management determined the loss would be realized.

At September 30, 2014, the allowance for loan losses was $7,107,872 compared to $7,038,571 at December 31, 2013, an increase of $69,301. The ratio of the allowance for loan losses to total loans was 1.15% and 1.89%, respectively, at September 30, 2014 and December 31, 2013. The allowance for loan losses declined to 1.15% of total loans at September 30, 2014 due primarily to the recording of $143,714,000 of loans at fair value that were acquired in the Rumson merger. No allowance for loan losses was recorded at the date of acquisition or at September 30, 2014 with respect to these loans. The allowance for loan losses as a percentage of non-performing loans was 90.44% at September 30, 2014 compared to 111.34% at December 31, 2013. Management believes that the quality of the loan portfolio remains sound considering the economic climate in the State of New Jersey and that the allowance for loan losses is adequate in relation to credit risk exposure levels.

Deposits

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

long-term relationships.

The following table summarizes deposits at September 30, 2014 and December 31, 2013.

	September 30, 2014	December 31, 2013
Demand		
Non-interest bearing	$ 172,185,545	$ 121,891,752
Interest bearing	283,403,448	200,737,912
Savings	196,578,527	180,002,971
Time	171,397,226	135,919,395
	$ 823,564,746	$ 638,552,030

At September 30, 2014, total deposits were $823,564,746, an increase of $185,012,716 or 29.0%, from $638,552,030 at December 31, 2013. This increase was primarily due to the inflow of deposits resulting from the Rumson merger. On the closing date of February 7, 2014 for the Rumson merger, the Company assumed approximately $189.5 million in total deposits. Of these deposits, $176 million were retained at September 30, 2014.

Borrowings

Borrowings are comprised of Federal Home Loan Bank ("FHLB") borrowings and overnight funds purchased. These borrowings are primarily used to fund asset growth not supported by deposit generation. The balance of borrowings was $20,798,473 at September 30, 2014, consisting solely of long-term FHLB borrowings. The corresponding balance of borrowings at December 31, 2013 was $10,000,000, consisting solely of long-term FHLB borrowings. Two long term FHLB fixed rate convertible advances were assumed by the Bank as a result of the Rumson merger. These two advances total $10,000,000 and bear interest at 4.11% and 4.63%, respectively. As a result of acquisition accounting, the two advances were fair valued and a premium of $1,030,000 was assigned. The premium is amortized over the remaining term of the borrowings. The two advances had a combined carrying amount of $10,798,473 at September 30, 2014.

The Bank also has a fixed rate convertible advance from the FHLB in the amount of $10,000,000 that bears interest at the rate of 4.08%. This advance may be called by the FHLB quarterly at the option of the FHLB if rates rise and the rate earned by the FHLB is no longer a "market" rate. This advance is fully secured by marketable securities.

Shareholders' Equity and Dividends

Shareholders' equity increased by $16,117,088, or 23.6%, to $84,476,402 at September 30, 2014 from $68,358,314 at December 31, 2013. Tangible book value per common share decreased by $0.52 to $9.94 at September 30, 2014 from $10.46 at December 31, 2013. The ratio of average shareholders' equity to total average assets was 8.57% at September 30, 2014 and 8.26% at December 31, 2013, respectively.

During February 2014, the Company issued an aggregate of 1,019,223 shares of its common stock in conjunction with the Rumson merger that increased shareholders' equity by $11,160,700. Shareholders' equity was also increased by net income of $2,339,873 and other comprehensive income of $1,936,574 for the nine month period ended September 30, 2014. Partially offsetting these increases were treasury stock purchases of $137,988 during the period.

In lieu of cash dividends to common shareholders, the Company (and its predecessor, the Bank) had declared a stock dividend every year (except 2013) since 1992 and has paid such stock dividends every year since 1993 (except 2014). A 5% stock dividend was declared in 2012 and paid in 2013. No stock dividend was declared in 2013.

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

In 2005, the Company’s board of directors authorized a common stock repurchase program that allows for the repurchase of a limited number of the Company’s shares at management’s discretion on the open market. The Company undertook this repurchase program in order to increase shareholder value. Disclosure of repurchases of Company shares, if any, made during the quarter ended September 30, 2014 is set forth under Part II, Item 2 of this report, “Unregistered Sales of Equity Securities and Use of Proceeds.” There were no repurchases of Company shares under this repurchase program during the first nine months of 2014.

Actual capital amounts and ratios for the Company and the Bank as of September 30, 2014 and December 31, 2013 were as follows:

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provision	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of September 30, 2014						
Company						
Total Capital to Risk Weighted Assets	$ 96,307,633	12.33%	$ 62,509,840	>8%	N/A	N/A
Tier 1 Capital to Risk Weighted Assets	89,199,761	11.42%	31,254,920	>4%	N/A	N/A
Tier 1 Capital to Average Assets	89,199,761	9.35%	38,171,292	>4%	N/A	N/A
Bank						
Total Capital to Risk Weighted Assets	$ 94,071,043	12.04%	$ 62,509,840	>8%	$ 78,137,300	>10%
Tier 1 Capital to Risk Weighted Assets	86,963,171	11.13%	31,254,920	>4%	46,882,380	>6-%
Tier 1 Capital to Average Assets	86,963,171	9.11%	38,171,292	>4%	47,714,115	>5%

As of December 31, 2013						
Company						
Total Capital to Risk Weighted Assets	$ 89,532,373	19.29%	$ 37,123,200	>8%	N/A	N/A
Tier 1 Capital to Risk Weighted Assets	83,716,373	18.04%	18,561,600	>4%	N/A	N/A
Tier 1 Capital to Average Assets	83,716,373	10.89%	30,757,840	>4%	N/A	N/A
Bank						
Total Capital to Risk Weighted Assets	$ 87,253,384	18.80%	$ 37,123,200	>8%	$ 46,404,000	>10%
Tier 1 Capital to Risk Weighted Assets	81,437,384	17.55%	18,561,600	>4%	27,842,400	>6%
Tier 1 Capital to Average Assets	81,437,384	10.59%	30,757,840	>4%	38,447,300	>5%

The minimum regulatory capital requirements for financial institutions require institutions to have a Tier 1 capital to average assets ratio of 4.0%, a Tier 1 capital to risk weighted assets ratio of 4.0% and a total capital to risk weighted

assets ratio of 8.0%. To be considered "well capitalized," an institution must have a minimum Tier 1 leverage ratio of 5.0%. At September 30, 2014, the ratios of the Company exceeded the ratios required to be considered well capitalized. It is management's goal to monitor and maintain adequate capital levels to continue to support asset growth and expansion of the Bank and continue its status as a well capitalized institution.

In July 2013, the Federal Reserve Board and the FDIC approved revisions to their capital adequacy guidelines and prompt corrective action rules that implement the revised standards of Basel III and address relevant provisions of the Dodd-Frank Act. The Federal Reserve Board's final rules and the FDIC's interim final rules apply to all depository institutions, top-tier bank holding companies with total consolidated assets of $500 million or more, and top-tier savings and loan holding companies ("banking organizations"). Among other things, the rules establish a new common equity Tier 1 minimum capital requirement (4.5% of risk-weighted assets) and increase the minimum Tier 1 capital to risk-based assets requirement (from 4% to 6% of risk-weighted assets). Banking organizations will also be required to have a total capital ratio of 8% (unchanged from current rules) and a Tier 1 leverage ratio of 4% (unchanged from current rules). 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 become effective for the Company and the Bank on January 1, 2015. The capital conservation buffer requirement will be phased in beginning in January 1, 2016 at 0.625% of common equity Tier 1 capital to risk-weighted assets and would increase by that amount each year until fully implemented in January 2019 at 2.5% of common equity Tier 1 capital to risk-weighted assets. Under the new capital rules in effect on January 1, 2015, management estimates that the Bank's common equity Tier 1 capital to risk weighted assets, total capital to risk weighted assets and Tier 1 capital to average assets ratios would be 11.23%, 12.13% and 9.24%, respectively at September 30, 2014.

Liquidity

At September 30, 2014, the amount of liquid assets remained at a level management deemed adequate to ensure that contractual liabilities, depositors' withdrawal requirements, and other operational and customer credit needs could be satisfied.

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

The Bank has established a borrowing relationship with FHLB, which further supports and enhances liquidity. During 2010, 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 FHLB cannot exceed 50 percent, or $477,152,275, of its total assets at September 30, 2014. 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 FHLB's Board of Directors or its Executive Committee. These limits are further restricted by a member's ability to provide eligible collateral to support its obligations to FHLB as well as the ability to meet the FHLB's stock requirement. At September 30, 2014, the Bank pledged collateral to the FHLB to support a borrowing line of $132 million, of which $20 million was utilized at September 30, 2014. The Bank also maintains an unsecured federal funds line of $25 million with a correspondent bank.

The Consolidated Statements of Cash Flows present the changes in cash from operating, investing and financing activities. At September 30, 2014, the balance of cash and cash equivalents was $20,371,823.

Net cash provided by operating activities totaled $10.8 million for the nine months ended September 30, 2014 compared to net cash provided by operations of $31.2 million for the nine months ended September 30, 2013. The decline in the current period was due primarily to a lower level of net proceeds from the origination and sale of residential mortgages compared to the prior year period. A source of funds is net income from operations adjusted for activity related to loans originated for sale, the provision for loan losses, depreciation expenses, and net amortization of premiums on securities.

Net cash used in investing activities totaled $55.6 million for the nine months ended September 30, 2014. The primary uses of funds for the nine months ended September 30, 2014 were the increase in the loan portfolio and purchase of securities. For the corresponding period in 2013, net cash was provided by investing activities due to the reduction of loans, primarily mortgage warehouse lines. Net cash of $21.4 million was received in the Rumson merger and represents cash of $36.1 million held by Rumson, less cash consideration of $14.8 million paid to shareholders of Rumson.

Net cash used in financing activities totaled $4.0 million for the nine months ended September 30, 2014 compared to net cash used in financing activities of $52.7 million for the nine months ended September 30, 2013. The primary use of funds for the nine months ended September 30, 2014 was the net decrease in total deposits of $4.5 million while for

the nine months ended September 30, 2013, the decrease in borrowings of $32.4 million and the decrease in deposits of $20.7 million were the primary uses of funds.

The securities portfolios are also a source of liquidity, providing cash flows from maturities and periodic repayments of principal. For the nine months ended September 30, 2014, prepayments and maturities of investment securities totaled $40.1 million. Proceeds from the sale of securities were $6.0 million during the nine month period ended September 30, 2014. Another source of liquidity is the loan portfolio, which provides a flow of payments and maturities.

Interest Rate Sensitivity Analysis

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

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

Based upon the current interest rate environment, as of September 30, 2014, our sensitivity to interest rate risk was as follows:

(Dollars in thousands)	Next 12 Months Net Interest Income		Economic Value of Equity	
Interest Rate Change in Basis Points	$ Change	% Change	$ Change	% Change
300	$2,489	7.1%	($3,821)	(3.25)%
200	1,393	4.0%	(2,540)	(2.16)
-	-	0.0%	-	0.0%

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

The Company continually evaluates interest rate risk management opportunities, including the use of derivative financial instruments. Management has focused its efforts on increasing the Bank's interest rate spread by attracting lower-cost retail deposits and increasing loans. As of September 30, 2014 we were in compliance with our interest rate risk policy.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Not required.

Item 4. Controls and Procedures.

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

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

The Company's principal executive officer and principal financial officer have also concluded that there was no change in the Company's internal control over financial reporting (as such term is defined in Rule 13a-15(f) under the Exchange Act) that occurred during the quarter ended September 30, 2014 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

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

Issuer Purchases of Equity Securities

On July 21, 2005, the board of directors authorized a stock repurchase program under which the Company may repurchase in open market or privately negotiated transactions up to 5% of its common shares outstanding at that date. The Company undertook this repurchase program in order to increase shareholder value. The following table provides common stock repurchases made by or on behalf of the Company during the three months ended September 30, 2014, if any.

Issuer Purchases of Equity Securities (1)

Period		Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased As Part of Publicly Announced Plan or Program	Maximum Number of Shares That May Yet be Purchased Under the Plan or Program
Beginning	Ending				
July 1, 2014	July 31, 2014	-	-	-	134,115
August 1, 2014	August 31, 2014	-	-	-	134,115
September 1, 2014	September 30, 2014	9,581	$10.24	9,581	124,534
	Total	9,581	$10.24	9,581	124,534

(1) The Company's common stock repurchase program covers a maximum of 225,824 shares of common stock of the Company, representing 5% of the outstanding common stock of the Company on July 21, 2005, as adjusted for subsequent common stock dividends.

Item 6. Exhibits.

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

* Filed herewith.

SIGNATURES

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

1ST CONSTITUTION BANCORP

Date: November 13, 2014	By:	/s/ ROBERT F. MANGANO Robert F. Mangano President and Chief Executive Officer (Principal Executive Officer)
Date: November 13, 2014	By:	/s/ STEPHEN J. GILHOOLY Stephen J. Gilhooly Senior Vice President, Treasurer and Chief Financial Officer (Principal Financial Officer)