PEAPACK GLADSTONE FINANCIAL CORP
Form 10-Q
November 09, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(MARK ONE)

ý **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Quarter Ended September 30, 2012

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 No. 001-16197

PEAPACK-GLADSTONE FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

New Jersey	22-3537895
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

500 Hills Drive, Suite 300

Bedminster, New Jersey 07921-1538

(Address of principal executive offices, including zip code)

(908) 234-0700

(Registrant's telephone number, including area code)

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

Yes ý 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 Regulations 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 ý 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 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 ý
Non-accelerated filer (do not check if a smaller reporting company) o	Smaller reporting company o

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

Number of shares of Common Stock outstanding as of November 1, 2012:

8,880,498

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PEAPACK-GLADSTONE FINANCIAL CORPORATION

PART 1 FINANCIAL INFORMATION

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Item 1. Financial Statements (Unaudited)

PEAPACK-GLADSTONE FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF CONDITION

(Dollars in thousands)

	(unaudited) September 30, 2012	(audited) December 31, 2011
ASSETS		
Cash and due from banks	$ 5,466	$ 7,097
Federal funds sold	100	100
Interest-earning deposits	49,354	35,856
Total cash and cash equivalents	54,920	43,053
Investment securities held to maturity (fair value $82,426 in 2012 and $99,427 in 2011)	76,698	100,719
Securities available for sale	253,489	319,520
FHLB and FRB stock, at cost	4,639	4,569
Loans held for sale, at fair value	8,443	2,841
Loans	1,096,482	1,038,345
Less: Allowance for loan losses	13,893	13,223
Net loans	1,082,589	1,025,122
Premises and equipment	30,472	31,941
Other real estate owned	3,392	7,137
Accrued interest receivable	4,040	4,078
Bank owned life insurance	30,887	27,296
Deferred tax assets, net	25,861	26,731
Other assets	8,060	7,328
TOTAL ASSETS	$ 1,583,490	$ 1,600,335
LIABILITIES		
Deposits:		
Noninterest-bearing demand deposits	$ 306,711	$ 297,459
Interest-bearing deposits:		
Checking	332,786	341,180
Savings	103,572	92,322
Money market accounts	504,863	516,920
Certificates of deposit $100,000 and over	72,168	71,783
Certificates of deposit less than $100,000	112,586	124,228

Total deposits	1,432,686	1,443,892
Federal home loan bank advances	12,335	17,680
Capital lease obligation	9,024	9,178
Accrued expenses and other liabilities	11,967	6,614
TOTAL LIABILITIES	1,466,012	1,477,364
SHAREHOLDERS' EQUITY		
Preferred stock (no par value; authorized 500,000 shares; issued 14,341 at December 31, 2011; liquidation preference of $1,000 per share)	—	13,979
Common stock (no par value; $0.83 per share; authorized 21,000,000 shares; issued shares, 9,288,676 at September 30, 2012 and 9,240,889 at December 31, 2011; outstanding shares, 8,880,498 at September 30, 2012 and 8,832,711 at December 31, 2011)	7,724	7,685
Surplus	96,909	96,323
Treasury stock at cost, 408,178 shares at September 30, 2012 and December 31, 2011	(8,988)	(8,988)
Retained earnings	20,702	13,868
Accumulated other comprehensive income, net of income tax	1,131	104
TOTAL SHAREHOLDERS' EQUITY	117,478	122,971
TOTAL LIABILITIES & SHAREHOLDERS' EQUITY	$ 1,583,490	$ 1,600,335

See accompanying notes to consolidated financial statements.

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PEAPACK-GLADSTONE FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

(Dollars in thousands, except share data)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
INTEREST INCOME				
Interest and fees on loans	$11,939	$11,563	$35,928	$34,948
Interest on investment securities held to maturity:				
Taxable	564	418	1,375	1,635
Tax-exempt	39	90	151	274
Interest on securities available for sale:				
Taxable	1,223	1,344	4,234	4,605
Tax-exempt	156	124	477	364
Interest on loans held for sale	34	12	75	33
Interest-earning deposits	27	43	58	91
Total interest income	13,982	13,594	42,298	41,950
INTEREST EXPENSE				
Interest on savings and interest-bearing deposit accounts	362	758	1,168	2,662
Interest on certificates of deposit over $100,000	229	262	678	815
Interest on other time deposits	321	422	1,031	1,357
Interest on borrowed funds	113	177	453	578
Interest on capital lease obligation	107	80	324	239
Total interest expense	1,132	1,699	3,654	5,651
NET INTEREST INCOME BEFORE PROVISION FOR LOAN LOSSES	12,850	11,895	38,644	36,299
Provision for loan losses	750	1,500	3,750	5,500
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	12,100	10,395	34,894	30,799
OTHER INCOME				
Trust department income	2,918	2,555	9,353	8,102
Service charges and fees	694	747	2,073	2,205
Bank owned life insurance	266	257	794	769
Securities gains, net	235	248	732	721
Other income	446	166	1,001	669
Total other income	4,559	3,973	13,953	12,466
OPERATING EXPENSES				
Salaries and employee benefits	7,029	5,789	19,550	17,579
Premises and equipment	2,290	2,322	7,034	7,058
Other operating expenses (See footnote 8)	2,674	2,462	8,193	8,214
Total operating expenses	11,993	10,573	34,777	32,851

INCOME BEFORE INCOME TAX EXPENSE	4,666	3,795	14,070	10,414
Income tax expense	1,834	(1,537)	5,432	773
NET INCOME	2,832	5,332	8,638	9,641
Dividends on preferred stock and accretion	—	219	474	1,008
NET INCOME AVAILABLE TO COMMON SHAREHOLDERS	$2,832	$5,113	$8,164	$8,633
EARNINGS PER COMMON SHARE				
Basic	$0.32	$0.58	$0.93	$0.98
Diluted	$0.32	$0.58	$0.93	$0.98
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING				
Basic	8,778,649	8,742,955	8,775,022	8,739,482
Diluted	8,819,431	8,743,065	8,805,859	8,741,102

See accompanying notes to consolidated financial statements.

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PEAPACK-GLADSTONE FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Dollars in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net income	$ 2,832	$ 5,332	$ 8,638	$ 9,641
Other comprehensive income:				
Unrealized gains on available for sale securities:				
Unrealized holding gains arising during the period	1,093	726	2,212	3,417
Less: Reclassification adjustment for gains included in net income	151	249	648	721
	942	477	1,564	2,696
Tax effect	(385)	(198)	(639)	(1,141)
Net of tax	557	279	925	1,555
Unrealized losses on the noncredit, other-than temporarily impaired held to maturity securities and on securities transferred from available for sale to held to maturity	60	71	173	90
Tax effect	(25)	243	(71)	235
Net of tax	35	314	102	325
Total comprehensive income	$ 3,424	$ 5,925	$ 9,665	$ 11,521

See accompanying notes to consolidated financial statements.

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PEAPACK-GLADSTONE FINANCIAL CORPORATION

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

(Dollars in thousands)

(Unaudited)

Nine Months Ended September 30, 2012

(In thousands, except per share data)	Preferred Stock	Common Stock	Surplus	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income	Total
Balance at January 1, 2012 8,832,711 common shares outstanding	$13,979	$ 7,685	$96,323	$(8,988)	$13,868	$ 104	$122,971
Net income					8,638		8,638
Net change in accumulated other comprehensive income						1,027	1,027
Issuance of restricted stock 36,263 shares		30	(30)				—
Amortization of restricted stock			332				332
Redemption of preferred stock 14,341 shares	(14,341)						(14,341)
Warrant repurchase 150,296 shares			(109)				(109)
Accretion of discount on preferred stock	362				(362)		—
Cash dividends declared on common stock ($0.05 per share)					(1,330)		(1,330)
Cash dividends declared on preferred stock					(112)		(112)
Common stock option expense			253				253
Common stock options exercised and related tax benefits, 2,022 shares		1	20				21
Sales of shares (Dividend Reinvestment Program), 9,502 shares		8	120				128
Balance at September 30, 2012 8,880,498 common shares outstanding	$—	$ 7,724	$96,909	$(8,988)	$20,702	$ 1,131	$117,478

See accompanying notes to consolidated financial statements.

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PEAPACK-GLADSTONE FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

	Nine Months Ended September 30,	
OPERATING ACTIVITIES:	2012	2011
Net income:	$ 8,638	$ 9,641
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	2,214	2,149
Amortization of premium and accretion of discount on securities, net	1,708	2,332
Amortization of restricted stock	332	191
Provision for loan losses	3,750	5,500
Provision for deferred taxes	—	622
Reversal of valuation allowance-deferred tax assets	—	(2,988)
Tax benefit on exercise of stock options	2	—
Stock-based compensation	253	273
Gains on security sales, available for sale	(648)	(721)
Gain on securities, held to maturity	(84)	—
Loans originated for sale	(67,503)	(22,539)
Proceeds from sales of loans	62,726	22,180
Gains on loans sold	(825)	(363)
Loss/(gains) on sale of other real estate owned	62	(47)
Gain on disposal of fixed assets	(7)	—
Increase in cash surrender value of life insurance, net	(595)	(693)
Decrease in accrued interest receivable	38	452
(Increase)/decrease in other assets	(572)	1,507
Increase in accrued expenses and other liabilities	1,801	1,842
NET CASH PROVIDED BY OPERATING ACTIVITIES	11,290	19,338
INVESTING ACTIVITIES:		
Proceeds from maturities of investment securities held to maturity	36,714	28,413
Proceeds from maturities of securities available for sale	61,794	48,996
Proceeds from calls of investment securities held to maturity	136	39,505
Proceeds from calls of securities available for sale	23,598	41,755
Proceeds from sales of securities available for sale	29,358	37,277
Purchase of investment securities held to maturity	(9,546)	(44,145)
Purchase of securities available for sale, including FHLB and FRB stock	(47,913)	(151,556)
Net increase in loans	(60,046)	(41,136)
Proceeds from sales of other real estate owned	2,512	1,238
Purchases of premises and equipment	(738)	(826)

Purchase of life insurance	(2,996)	—
NET CASH PROVIDED BY/(USED IN) INVESTING ACTIVITIES	32,873	(40,479)
FINANCING ACTIVITIES:		
Net (decrease)/increase in deposits	(11,206)	45,464
Repayments of Federal Home Loan Bank advances	(5,345)	(3,333)
Redemption of preferred stock	(14,341)	(7,172)
Repurchase of warrants	(111)	—
Cash dividends paid on preferred stock	(112)	(644)
Cash dividends paid on common stock	(1,330)	(1,324)
Exercise of stock options	21	—
Sales of shares (DRIP Program)	128	122
NET CASH (USED IN)/PROVIDED BY FINANCING ACTIVITIES	(32,296)	33,113
Net increase in cash and cash equivalents	11,867	11,972
Cash and cash equivalents at beginning of period	43,053	62,687
Cash and cash equivalents at end of period	$ 54,920	$ 74,659

See accompanying notes to consolidated financial statements.

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PEAPACK-GLADSTONE FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Certain information and footnote disclosures normally included in the audited consolidated financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Annual Report on form 10-K for the period ended December 31, 2011 for Peapack-Gladstone Financial Corporation (the "Corporation"). In the opinion of the Management of the Corporation, the accompanying unaudited Consolidated Interim Financial Statements contain all adjustments necessary to present fairly the financial position as of September 30, 2012 and the results of operations for the three and nine months ended September 30, 2012 and 2011 and cash flows for the nine months ended September 30, 2012 and 2011.

Principles of Consolidation: The Corporation considers that all adjustments necessary for a fair presentation of the statement of the financial position and results of operations in accordance with U.S. generally accepted accounting principles for these periods have been made. Results for such interim periods are not necessarily indicative of results for a full year.

The consolidated financial statements of Peapack-Gladstone Financial Corporation are prepared on the accrual basis and include the accounts of the Corporation and its wholly owned subsidiary, Peapack-Gladstone Bank. All significant intercompany balances and transactions have been eliminated from the accompanying consolidated financial statements.

Securities: Debt securities are classified as held to maturity and carried at amortized cost when Management has the positive intent and ability to hold them to maturity. Debt securities are classified as available for sale when they might be sold before maturity. Equity securities with readily determinable fair values are classified as available for sale. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage-backed securities where prepayments are anticipated. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Management evaluates securities for other-than-temporary impairment on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, Management considers the extent and duration of the unrealized loss and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent of requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) other-than-temporary impairment related to credit loss, which must be recognized in the income statement and 2) other-than-temporary impairment related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings.

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Loans: Loans are considered past due when they are not paid in accordance with contractual terms. The accrual of income on loans, including impaired loans, is discontinued if, in the opinion of Management, principal or interest is not likely to be paid in accordance with the terms of the loan agreement, or when principal or interest is past due 90 days or more and collateral, if any, is insufficient to cover principal and interest. All interest accrued but not received for loans placed on nonaccrual is reversed against interest income. Payments received on nonaccrual loans are recorded as principal payments. A nonaccrual loan is returned to accrual status only when interest and principal payments are brought current and future payments are reasonably assured, usually when the Bank receives contractual payments for six consecutive months. Commercial loans are generally charged off after an analysis is completed which indicates that collectability of the full principal balance is in doubt. Consumer loans are generally charged off after they become 120 days past due. Subsequent payments are credited to income only if collection of principal is not in doubt. If principal and interest payments are brought contractually current and future collectability is reasonably assured, loans are returned to accrual status. Mortgage loans are generally charged off when the value of the underlying collateral does not cover the outstanding principal balance. The majority of the Corporation’s loans are secured by real estate in the State of New Jersey.

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charges against the allowance when Management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in Management’s judgment, should be charged off.

The allowance consists of specific and general components. The specific component of the allowance relates to loans that are individually classified as impaired.

A loan is impaired when, based on current information and events, it is probable that the Corporation will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and are evaluated for impairment. Factors considered by Management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower’s prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

All loans are individually evaluated for impairment when loans are classified as substandard by Management. If a loan is considered impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan’s existing rate or at the fair value of collateral less estimated disposition

costs if repayment is expected solely from the collateral. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans, are collectively evaluated for impairment while they are performing assets. If and when a residential mortgage is placed on nonaccrual status and in the process of collections, such as through a foreclosure action, then they are evaluated for impairment on an individual basis and the loan is reported, net, at the fair value of the collateral less estimated disposition costs.

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A troubled debt restructuring is a renegotiated loan with concessions made by the lender to a borrower who is experiencing financial difficulty. Troubled debt restructurings are separately identified for impairment and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral, less estimated disposition costs. For troubled debt restructurings that subsequently default, the Corporation determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

The general component of the allowance covers loans collectively evaluated for impairment and is based primarily on the Bank's historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Corporation on a weighted average basis over the previous several years. This actual loss experience is adjusted by other qualitative factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations.

In determining an appropriate amount for the allowance, the Bank segments and evaluates the loan portfolio based on Federal call report codes. The material portfolio segments are discussed below:

Primary Residential Mortgages. The Bank originates one to four family residential mortgage loans within or near its primary geographic market area. When reviewing residential mortgage loan applications, the Bank obtains detailed verifiable information regarding income, assets and indebtedness, a credit report, and an independent appraisal of the property to be mortgaged. The Bank makes residential mortgage loans up to 80% of the appraised value and up to 95% with private mortgage insurance. The Bank uses lower loan to value ratios for large loans and loans on either second (vacation) homes or investment property. The Bank's underwriting guidelines include (i) minimum credit report scores of 680 and (ii) a maximum debt to income ratio of 40% if the loan to value is 70% or higher and 45% if the loan to value is less than 70%. The Bank may consider an exception to any guideline if the remaining characteristics of the application are sufficiently strong to compensate. The Bank retains in its portfolio residential mortgage loans with maturities of up to 15 years while loans with longer maturities are sold to third party financial institutions. The Bank does not originate, purchase or carry any sub-prime mortgage loans.

Primary risk characteristics associated with residential mortgage loans typically involve major living or lifestyle changes to the borrower, including unemployment or other loss of income; unexpected significant expenses, such as for major medical issues or catastrophic events; divorce or death. In addition, residential mortgage loans that have adjustable rates could expose the borrower to higher debt service requirements in a rising interest rate environment. Further, real estate value could drop significantly and cause the value of the property to fall below the loan amount, creating additional potential exposure for the Bank.

Bank management believes that the underwriting guidelines previously described address the primary risk characteristics. Further, the Bank has dedicated staff and system resources to monitor and collect on any potentially problematic residential mortgage loans.

Home Equity Lines of Credit. The Bank provides revolving lines of credit against one to four family residences within or near its primary geographic market. When reviewing residential mortgage loan applications, the Bank obtains detailed verifiable information regarding income, assets and indebtedness, a credit report, and an independent appraisal of the property to be mortgaged. For home equity lines of credit, the Bank utilizes the same underwriting standards as for primary residential mortgages. Primary risk characteristics associated with home equity lines of credit typically involve major living or lifestyle changes to the borrower, including unemployment or other loss of income; unexpected significant expenses, such as for major medical issues or catastrophic events; divorce or death. In addition, home equity lines of credit typically are made with variable or floating interest rates, such as the Prime Rate, which could expose the borrower to higher debt service requirements in a rising interest rate environment. Further, real estate value could drop significantly and cause the value of the property to fall below the loan amount, creating additional potential exposure for the Bank.

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Bank management believes that the underwriting guidelines previously described address the primary risk characteristics. Further, the Bank has dedicated staff and system resources to monitor and collect on any potentially problematic home equity lines of credit.

Junior Lien Loan on Residence. The Bank provides junior lien loans (“JLL”) against one to four family properties within or near its primary geographic market area. Junior liens loans can be either in the form of an amortizing home equity loan or a revolving home equity line of credit. These loans are subordinate to a first mortgage which may be from another lending institution. The Bank will require that the mortgage securing the JLL be no more junior than a second lien position The Bank will evaluate these applications in the same manner as it underwrites primary residential mortgages. The combined first mortgage and junior lien loan must be no more than 80% of the appraised value of the property when the combined debt is less than or equal to $800,000. For JLL amounts where the combined debt exceeds $800,000, the maximum LTV ratio is 65%. Primary risk characteristics associated with junior lien loans typically involve major living or lifestyle changes to the borrower, including unemployment or other loss of income; unexpected significant expenses, such as for major medical issues or catastrophic events; divorce or death. Further, real estate value could drop significantly and cause the value of the property to fall below the loan amount, creating additional potential exposure for the Bank.

Bank management believes that the underwriting guidelines previously described address the primary risk characteristics. Further, the Bank has dedicated staff and system resources to monitor and collect on any potentially problematic junior lien loans.

Multifamily and Commercial Real Estate Loans. The Bank provides mortgage loans for multifamily properties (i.e. buildings which have five or more residential units) and other commercial real estate that is either owner occupied or managed as an investment property. Commercial real estate properties primarily include office and medical buildings, retail space, and warehouse or flex space. Some properties are considered “mixed use” as they are a combination of building types, such as an apartment building that may have also have retail space. In these cases the Bank determines which component provides the majority of the rental income for the property and utilizes that component for the loan classification.

The terms and conditions of all commercial mortgage loans are tailored to the specific attributes of the borrower, the property or project, and any guarantors. In the case of multifamily and investment commercial real estate properties, the Bank reviews, among other things, the nature of and diversity of the underlying tenants and leases, the resources and experience of the sponsor, and the condition and location of the subject property. With an owner occupied property, a detailed credit assessment is also made of the operating business. While the Bank’s policy allows loan to value ratios of up to 80% of an appraised value, the majority of the loans are originated at loan to value ratios of 70% or lower. Commercial mortgage loans are generally made on a fixed rate basis with periodic rate resets every five or seven years over an underlying market index. The Bank requires an independent appraisal, a property conditions assessment from an engineering firm, and appropriate environmental due diligence.

Multifamily loans are expected to be repaid from the cash flow of the underlying property so the collective amount of rents must be sufficient to cover all operating expenses, property management and maintenance, taxes and debt service. Increases in vacancy rates, interest rates or other changes in general economic conditions can all have an impact on the borrower and their ability to repay the loan. Commercial real estate loans are generally considered to have a higher degree of credit risk than multifamily loans as they may be dependent on the ongoing success and operating viability of a fewer number of tenants who are occupying the property and who may have a greater degree of exposure to economic conditions. To mitigate this risk, the Bank will require a standby assignment of leases, greater direct recourse to the owners, and a risk appropriate interest rate and loan structure. In underwriting a commercial mortgage loan, the Bank evaluates the property's historical operating income as well as its projected sustainability and generally requires a minimum debt service coverage ratio that provides for an adequate cushion for unexpected or uncertain future events such as the potential impact of changes in interest rates, vacancy levels and lease rates.

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Commercial and Industrial Loans. The Bank provides lines of credit and term loans to operating companies for business purposes. The loans are generally secured by business assets such as accounts receivable, inventory and equipment. When underwriting business loans, among other things, the bank evaluates the historical profitability and debt servicing capacity of the borrowing entity and the financial resources and character of the principal owners and guarantors.

Commercial and industrial loans are typically repaid first by the cash flow generated by the borrower's business operation. The primary risk characteristics are specific to the underlying business and its ability to generate sustainable profitability and resulting positive cash flow. Factors that may influence a business's profitability include, but are not limited to, demand for its products or services, quality and depth of management, degree of competition, regulatory changes, and general economic conditions. Commercial and industrial loans are generally secured by business assets; however, the ability of the Bank to foreclose and realize sufficient value from the assets is often highly uncertain.

To mitigate the risk characteristics of commercial and industrial loans, the Bank will often require more frequent reporting requirements from the borrower in order to better monitor its business performance.

Commercial Construction. The Bank has substantially wound down its commercial construction lending activity given the current economic environment. New construction loans would be considered only to experienced and reputable local builders and developers that have the capital and liquidity to carry a project to completion and stabilization and for projects that are supported by either a permanent take-out or acceptable executed leases or sales contracts. When evaluating a construction loan request, the Bank will also review the construction plans and drawings, costs estimates from architects, and an independent appraisal. Construction loans typically have a 12-24 month period of interest only and at a maximum 70% LTV ratio. Construction loans are considered riskier than commercial financing on improved and established commercial real estate. The risk of potential loss increases if the original cost estimates or time to complete are significantly off.

Stock-Based Compensation: The Corporation has stock option plans that allow the granting of shares of the Corporation's common stock as incentive stock options, nonqualified stock options, restricted stock awards and stock appreciation rights to directors, officers, employees and independent contractors of the Corporation and its subsidiaries. The options granted under these plans are exercisable at a price equal to the fair market value of common stock on the date of grant and expire not more than ten years after the date of grant. Stock options may vest during a period of up to five years after the date of grant.

For the three months ended September 30, 2012 and 2011, the Corporation recorded total compensation cost for stock options of $83 thousand and $61 thousand respectively, with a recognized tax benefit of $15 thousand for the quarter ended September 30, 2012 and $11 thousand for the September 30, 2011 quarter. The Corporation recorded total compensation cost for stock options for the nine months ended September 30, 2012 and 2011, of $253 thousand and

$273 thousand, respectively, with a recognized tax benefit of $45 thousand for the nine months ended September 30, 2012 and $46 thousand for the nine months ended September 30, 2011.

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There was approximately $580 thousand of unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the Corporation's stock incentive plans at September 30, 2012. That cost is expected to be recognized over a weighted average period of 1.7 years.

For the Corporation's stock option plans, changes in options outstanding during the nine months ended September 30, 2012 were as follows:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (In Thousands)
Balance, January 1, 2012	577,782	$ 23.45		
Granted during 2012	62,560	11.01		
Exercised during 2012	(2,190)	11.10		
Expired during 2012	(12,338)	25.51		
Forfeited during 2012	(1,018)	15.02		
Balance, September 30, 2012	624,796	$ 22.22	4.27 years	$ 591
Vested and expected to vest (1)	594,387	$ 22.71	4.27 years	$ 513
Exercisable at September 30, 2012	455,858	$ 25.57	2.80 years	$ 80

(1) Does not include shares which are not expected to vest as a result of anticipated forfeitures.

The aggregate intrinsic value represents the total pre-tax intrinsic value (the difference between the Corporation's closing stock price on the last trading day of the third quarter of 2012 and the exercise price, multiplied by the number of in-the-money options). The Corporation's closing stock price on September 30, 2012 was $16.34.

For the third quarter of 2012, the per share weighted-average fair value of stock options granted was $5.29 as compared to $3.68 for the same quarter of 2011. The per share weighted-average fair value of stock options granted during the first nine months of 2012 and 2011 was $3.91 and $3.88, respectively on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Dividend Yield	1.24 %	2.02 %	1.47 %	1.60 %

Expected volatility	39	%	38	%	39	%	32	%
Expected life	7 years		7 years		7 years		7 years	
Risk-free interest rate	1.08	%	2.02	%	1.43	%	2.08	%

In January 2012 and 2011, the Corporation issued 36,263 and 28,732 restricted stock awards, respectively, at a fair value equal to the market price of the Corporation's common stock on the date of the grant. The awards vest 40 percent after two years and 20 percent each year thereafter until fully vesting on the fifth anniversary of the grant date. The Corporation recorded total compensation cost for restricted stock awards of $111 thousand for the third quarter of 2012 and $67 thousand for the same quarter of 2011. For the nine months ended September 30, 2012 and 2011, the Corporation recorded total compensation cost for restricted stock awards of $332 thousand and $191 thousand, respectively.

As of September 30, 2012, there was approximately $790 thousand of unrecognized compensation cost related to non-vested restricted stock awards granted under the Corporation's stock incentive plans. That cost is expected to be recognized over a weighted average period of 1.6 years.

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Changes in non-vested, restricted common shares for 2012 were as follows:

	Number of Shares	Weighted Average Grant Date Fair Value
Balance, January 1, 2012	84,725	$ 13.46
Granted during 2012	36,263	10.72
Vested during 2012	(22,393)	10.75
Balance, September 30, 2012	98,595	$ 13.07

Earnings per Common share – Basic and Diluted: The following is a reconciliation of the calculation of basic and diluted earnings per share. Basic net income per common share is calculated by dividing net income available to common shareholders by the weighted average common shares outstanding during the reporting period. Diluted net income per common share is computed similarly to that of basic net income per common share, except that the denominator is increased to include the number of additional common shares that would have been outstanding if all common shares underlying potentially dilutive stock options were issued or restricted stock would vest during the reporting period utilizing the Treasury stock method.

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands, except per share data)	2012	2011	2012	2011
Net income to common shareholders	$2,832	$5,113	$8,164	$8,633
Basic weighted-average common shares outstanding	8,778,649	8,742,955	8,775,022	8,739,482
Plus: common stock equivalents	40,782	110	30,837	1,620
Diluted weighted-average common shares outstanding	8,819,431	8,743,065	8,805,859	8,741,102
Net income per common share				
Basic	$0.32	$0.58	$0.93	$0.98
Diluted	0.32	0.58	0.93	0.98

Stock options and restricted stock totaling 569,642 and 600,047 shares were not included in the computation of diluted earnings per share in the third quarters of 2012 and 2011, respectively, because they were considered antidilutive. Stock options and restricted stock totaling 590,867 and 571,993 shares were not included in the computation of diluted earnings per share in the nine months ended September 30, 2012 and 2011, respectively, because they were considered antidilutive.

Income Taxes: The Corporation files a consolidated Federal income tax return and separate state income tax returns for each subsidiary based on current laws and regulations.

The Corporation is no longer subject to examination by the U.S. Federal tax authorities for years prior to 2008 or by New Jersey tax authorities for years prior to 2007.

The Corporation recognizes interest related to income tax matters as interest expense and penalties related to income tax matters as other expense. The Corporation did not have any amounts accrued for interest and penalties at September 30, 2012.

Reclassification: Certain reclassifications may have been made in the prior periods' financial statements in order to conform to the 2012 presentation.

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2. INVESTMENT SECURITIES HELD TO MATURITY

A summary of amortized cost and estimated fair value of investment securities held to maturity included in the consolidated statements of condition as of September 30, 2012 and December 31, 2011 follows:

	September 30, 2012			
(In thousands)	Carrying Amount	Gross Unrecognized Gains	Gross Unrecognized Losses	Fair Value
Mortgage-backed securities – residential	$52,179	$ 2,034	$ —	$54,213
State and political subdivisions	16,189	11	—	16,200
Trust preferred pooled securities	8,330	5,840	(2,157)	12,013
Total	$76,698	$ 7,885	$ (2,157)	$82,426

	December 31, 2011			
(In thousands)	Carrying Amount	Gross Unrecognized Gains	Gross Unrecognized Losses	Fair Value
Mortgage-backed securities – residential	$67,394	$ 1,393	$ (1)	$68,786
State and political subdivisions	24,608	52	—	24,660
Trust preferred pooled securities	8,717	2,170	(4,906)	5,981
Total	$100,719	$ 3,615	$ (4,907)	$99,427

The following tables present the Corporation's investment securities held to maturity with continuous unrealized losses and the estimated fair value of these investments as of September 30, 2012 and December 31, 2011.

	September 30, 2012 Duration of Unrealized Loss					
	Less than 12 Months		12 Months or Longer		Total	
(In thousands)	Fair Value	Unrecognized Losses	Fair Value	Unrecognized Losses	Fair Value	Unrecognized Losses
Trust preferred pooled securities	$—	$ —	$ 4,535	$ (2,157)	$4,535	$ (2,157)
Total	$—	$ —	$ 4,535	$ (2,157)	$4,535	$ (2,157)

December 31, 2011 Duration of Unrealized Loss		
Less than 12 Months	12 Months or Longer	Total

(In thousands)	Fair Value	Unrecognized Losses	Fair Value	Unrecognized Losses	Fair Value	Unrecognized Losses
Mortgage-backed securities-residential	$3,194	$ (1)	$ —	$ —	$3,194	$ (1)
Trust preferred pooled securities	—	—	2,729	(4,906)	2,729	(4,906)
Total	$3,194	$ (1)	$ 2,729	$ (4,906)	$5,923	$ (4,907)

The trust preferred pooled securities within the Corporation's held to maturity investment portfolio are collateralized by trust preferred securities issued primarily by individual bank holding companies, but also by insurance companies and real estate investment trusts. There has been little or no active trading in these securities for several years; therefore the Corporation has determined these securities to be illiquid and fair value was calculated by utilizing non-binding broker quotes. As of December 31, 2008, to estimate fair value, and determine whether the securities were other-than-temporarily impaired, the Corporation retained and worked with a third party to review the issuers (the collateral) underlying each of the securities. Among the factors analyzed were the issuers' profitability, credit quality, asset mix, capital adequacy, leverage and liquidity position, as well as an overall assessment of credit, profitability and capital trends within the portfolio's issuer universe. These factors provided an assessment of the portion of the collateral of each security which was likely to default in future periods. The cash flows associated with the collateral likely to default, together with the cash flows associated with collateral which had already deferred or defaulted, were then eliminated. In addition, the Corporation assumed constant rates of default in excess of those based upon the historic performance of the underlying collateral. The resulting cash flows were then discounted to the current period to determine fair value for each security. The discount rate utilized was based on a risk-free rate (LIBOR) plus spreads appropriate for the product, which include consideration of liquidity and credit uncertainty.

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Each quarter since December 2008, to periodically assess the credit assumptions and related input data that could affect the cash flows of each security, Management compared actual deferrals and defaults to the assumed deferrals and defaults included in the valuation model.

As of each year end since December 2008, the Corporation again worked with a third party to model the securities and review its cash flows. The modeling process and related assumptions were similar to the process and related assumptions employed as of December 31, 2008. No additional impairment charges were recorded for the three and nine months ended September 30, 2012.

Further significant downturns in the real estate markets and/or the economy could cause additional issuers to defer paying dividends on these securities and/or ultimately default. Such occurrences, if beyond those assumed in the current valuation, could cause an additional write-down of the portfolio, with a negative impact on earnings; however, the Corporation has already recorded a substantial write-down of its trust preferred pooled securities portfolio. We do not expect that an additional write-down would have a material effect on the cash flows from the securities or on our liquidity position.

3. INVESTMENT SECURITIES AVAILABLE FOR SALE

A summary of amortized cost and approximate fair value of securities available for sale included in the consolidated statements of condition as of September 30, 2012 and December 31, 2011 follows:

	September 30, 2012			
(In thousands)	Amortized Cost	Gross Unrecognized Gains	Gross Unrecognized Losses	Fair Value
U.S. government-sponsored entities	$29,645	$ 312	$ —	29,957
Mortgage-backed securities – residential	181,538	5,906	(1)	187,443
State and political subdivisions	29,115	1,511	(1)	30,625
Other securities	5,998	98	(845)	5,251
Marketable equity securities	209	4	—	213
Total	$246,505	$ 7,831	$ (847)	$253,489

December 31, 2011			
Amortized	Gross Unrecognized	Gross Unrecognized	Fair

(In thousands)	Cost	Gains	Losses	Value
U.S. government-sponsored entities	$46,729	$ 149	$ —	$46,878
Mortgage-backed securities – residential	232,240	4,891	(147)	236,984
State and political subdivisions	28,539	1,314	(2)	29,851
Other securities	5,999	40	(832)	5,207
Marketable equity securities	593	7	—	600
Total	$314,100	$ 6,401	$ (981)	$319,520

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The following tables present the Corporation's available for sale securities with continuous unrealized losses and the approximate fair value of these investments as of September 30, 2012 and December 31, 2011.

	September 30, 2012					
	Duration of Unrealized Loss					
	Less than 12 Months		12 Months or Longer		Total	
(In thousands)	Fair Value	Unrecognized Losses	Fair Value	Unrecognized Losses	Fair Value	Unrecognized Losses
Mortgage-backed securities - residential	$—	$ —	$ 95	$ (1)	$95	$ (1)
State and political subdivisions	36	(1)	—	—	36	(1)
Other securities	—	—	2,153	(845)	2,153	(845)
Total	$36	$ (1)	$ 2,248	$ (846)	$2,284	$ (847)

	December 31, 2011					
	Duration of Unrealized Loss					
	Less than 12 Months		12 Months or Longer		Total	
(In thousands)	Fair Value	Unrecognized Losses	Fair Value	Unrecognized Losses	Fair Value	Unrecognized Losses
Mortgage-backed securities- residential	$32,931	$ (120)	$ 317	$ (27)	$33,248	$ (147)
State and political subdivisions	736	(2)	—	—	736	(2)
Other securities	—	—	2,167	(832)	2,167	(832)
Total	$33,667	$ (122)	$ 2,484	$ (859)	$36,151	$ (981)

Management believes that the unrealized losses on investment securities available for sale are temporary and due to interest rate fluctuations and/or volatile market conditions rather than the creditworthiness of the issuers. The Corporation does not intend to sell these securities nor is it likely that it will be required to sell the securities before their anticipated recovery; however, Management also closely monitors market conditions and may sell the securities if it determines it would be beneficial to do so.

At September 30, 2012, the unrealized loss on other securities, $845 thousand, is related to a debt security issued by a large bank holding company that has experienced declines in all its securities due to the turmoil in the financial markets and a merger. The security, a single-issuer trust preferred security, was downgraded to below investment grade by Moody's and is currently rated Ba1. Management monitors the performance of the issuer on a quarterly basis to determine if there are any credit events that could result in deferral or default of the security. Management believes the depressed valuation is a result of the nature of the security, a trust preferred bond, and the bond's very low yield. As Management does not intend to sell this security nor is it likely that it will be required to sell the security before its anticipated recovery, the security is not considered other-than-temporarily impaired at September 30, 2012.

4. LOANS

Loans outstanding, by general ledger classification, as of September 30, 2012 and December 31, 2011, consisted of the following:

(In thousands)	September 30, 2012	% of Total Loans	December 31, 2011	% of Total Loans
Residential mortgage	$ 504,407	46.00 %	$ 498,482	48.01 %
Commercial mortgage	391,976	35.75	330,559	31.84
Commercial loans	115,602	10.54	123,845	11.93
Construction loans	9,639	0.88	13,713	1.32
Home equity lines of credit	51,440	4.69	50,291	4.84
Consumer loans, including fixed rate home equity loans	21,542	1.97	19,439	1.87
Other loans	1,876	0.17	2,016	0.19
Total loans	$ 1,096,482	100.00 %	$ 1,038,345	100.00 %

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In determining an appropriate amount for the allowance, the Bank segments and evaluates the loan portfolio based on federal call report codes. The following portfolio classes have been identified as of September 30, 2012 and December 31, 2011:

(In thousands)	September 30, 2012	% of Total Loans	December 31, 2011	% of Total Loans
Primary residential mortgage	$ 517,520	47.34 %	$ 511,418	49.40 %
Home equity lines of credit	51,441	4.71	50,394	4.87
Junior lien loan on residence	12,587	1.15	13,053	1.26
Multifamily property	127,972	11.71	104,056	10.05
Owner-occupied commercial real estate	103,022	9.43	107,852	10.42
Investment commercial real estate	235,162	21.51	186,998	18.06
Commercial and industrial	20,277	1.85	29,825	2.88
Secured by farmland	209	0.02	—	N/A
Agricultural production loans	15	N/A	18	N/A
Commercial construction loans	9,633	0.88	19,208	1.85
Consumer and other loans	15,328	1.40	12,516	1.21
Total loans	$ 1,093,166	100.00 %	$ 1,035,338	100.00 %
Net deferred fees	3,316		3,007	
Total loans including net deferred costs	$ 1,096,482		$ 1,038,345	

Included in the totals above for September 30, 2012 are $231 thousand of unamortized discount as compared to $691 thousand of unamortized discount for December 31, 2011.

The following tables present the loan balances by portfolio class, based on impairment method, and the corresponding balances in the allowance for loan losses as of September 30, 2012 and December 31, 2011:

September 30, 2012

(In thousands)	Total Loans Individually Evaluated for Impairment	Ending ALLL Attributable to Loans Individually Evaluated for Impairment	Total Loans Collectively Evaluated for Impairment	Ending ALLL Attributable to Loans Collectively Evaluated for Impairment	Total Loans	Total Ending ALLL
Primary residential mortgage	$ 8,233	$ 326	$ 509,287	$ 2,593	$ 517,520	$ 2,919
Home equity lines of credit	98	—	51,343	253	51,441	253
Junior lien loan on residence	480	—	12,107	66	12,587	66

Multifamily property	—	—	127,972	975	127,972	975
Owner-occupied commercial real estate	9,195	—	93,827	3,363	103,022	3,363
Investment commercial real estate	5,852	374	229,310	4,226	235,162	4,600
Commercial and industrial	726	44	19,551	772	20,277	816
Secured by farmland	—	—	209	3	209	3
Agricultural production	—	—	15	1	15	1
Commercial construction	—	—	9,633	291	9,633	291
Consumer and other	—	—	15,328	78	15,328	78
Unallocated	—	—	—	528	—	528
Total ALLL	$ 24,584	$ 744	$ 1,068,582	$ 13,149	$ 1,093,166	$ 13,893

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December 31, 2011

(In thousands)	Total Loans Individually Evaluated for Impairment	Ending ALLL Attributable to Loans Individually Evaluated for Impairment	Total Loans Collectively Evaluated for Impairment	Ending ALLL Attributable to Loans Collectively Evaluated for Impairment	Total Loans	Total Ending ALLL
Primary residential mortgage	$ 8,878	$ 345	$502,540	$ 2,069	$511,418	$2,414
Home equity lines of credit	489	—	49,905	204	50,394	204
Junior lien loan on residence	680	9	12,373	55	13,053	64
Multifamily property	550	52	103,506	653	104,056	705
Owner-occupied commercial real estate	9,054	322	98,798	2,786	107,852	3,108
Investment commercial real estate	5,986	509	181,012	3,672	186,998	4,181
Commercial and industrial	576	51	29,249	1,240	29,825	1,291
Agricultural production	—	—	18	1	18	1
Commercial construction	—	—	19,208	669	19,208	669
Consumer and other	—	—	12,516	78	12,516	78
Unallocated	—	—	—	508	—	508
Total ALLL	$ 26,213	$ 1,288	$1,009,125	$ 11,935	$1,035,338	$13,223

Impaired loans include nonaccrual loans of $17.0 million at September 30, 2012 and $18.9 million at December 31, 2011. Impaired loans also include performing commercial mortgage and commercial troubled debt restructured loans of $6.0 million at September 30, 2012 and $7.3 million at December 31, 2011. There was no allowance allocated to troubled debt restructured loans which are nonaccrual at September 30, 2012 and the allowance allocated to troubled debt restructured loans which are nonaccrual was $280 thousand at December 31, 2011. All accruing troubled debt restructured loans were paying in accordance with restructured terms as of September 30, 2012. The Corporation has not committed to lend additional amounts as of September 30, 2012 to customers with outstanding loans that are classified as loan restructurings.

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The following tables present loans individually evaluated for impairment by class of loans as of September 30, 2012 and December 31, 2011:

September 30, 2012

(In thousands)	Unpaid Principal Balance	Recorded Investment	Specific Reserves	Average Impaired Loans	Interest Income Recognized
With no related allowance recorded:					
Primary residential mortgage	$ 8,398	$ 6,145	$ —	$ 7,347	$ 356
Multifamily property	—	—	—	247	21
Owner-occupied commercial real estate	11,094	9,195	—	9,774	593
Investment commercial real estate	1,177	674	—	842	53
Commercial and industrial	504	438	—	642	49
Home equity lines of credit	98	98	—		