

1ST CONSTITUTION BANCORP  
Form 10-Q  
May 15, 2014

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2014  
or

☐ 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 ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T

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(§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 ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. 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	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input checked="" type="checkbox"/>

(Do not check if a smaller reporting company)

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

As of May 7, 2014, there were 7,084,725 shares of the registrant’s common stock, no par value, outstanding.

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1ST CONSTITUTION BANCORP

FORM 10-Q

INDEX

Page

PART I. FINANCIAL INFORMATION

<u>Item 1.</u>	<u>Financial Statements</u>	1
	<u>Consolidated Balance Sheets</u> <u>(unaudited) at March 31, 2014</u> <u>and December 31, 2013</u>	1
	<u>Consolidated Statements of Income</u> <u>(unaudited) for the Three Months Ended</u> <u>March 31, 2014 and March 31, 2013</u>	2
	<u>Consolidated Statements of Comprehensive Income</u> <u>(unaudited) for the Three Months Ended</u> <u>March 31, 2014 and March 31, 2013</u>	3
	<u>Consolidated Statements of Changes in Shareholders' Equity</u> <u>(unaudited) for the Three Months Ended</u> <u>March 31, 2014 and March 31, 2013</u>	4
	<u>Consolidated Statements of Cash Flows</u> <u>(unaudited) for the Three Months Ended</u> <u>March 31, 2014 and March 31, 2013</u>	5
	<u>Notes to Consolidated Financial Statements (unaudited)</u>	6
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition</u> <u>and Results of Operations</u>	38
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	55
<u>Item 4.</u>	<u>Controls and Procedures</u>	55
PART II. OTHER INFORMATION		
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	57
<u>Item 6.</u>	<u>Exhibits</u>	58
<u>SIGNATURES</u>		59



## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements.

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

	March 31, 2014	December 31, 2013
<b>ASSETS</b>		
CASH AND DUE FROM BANKS	\$ 108,819,056	\$ 69,267,345
FEDERAL FUNDS SOLD / SHORT-TERM INVESTMENTS	100,000	11,426
Total cash and cash equivalents	108,919,056	69,278,771
INVESTMENT SECURITIES:		
Available for sale, at fair value	117,630,716	99,198,807
Held to maturity (fair value of \$155,795,659 and \$153,629,773 at March 31, 2014 and December 31, 2013, respectively)	152,734,559	152,816,815
Total investment securities	270,365,275	252,015,622
LOANS HELD FOR SALE	3,253,009	10,923,689
LOANS	531,405,382	373,336,082
Less- Allowance for loan losses	(7,030,842 )	(7,038,571 )
Net loans	524,374,540	366,297,511
PREMISES AND EQUIPMENT, net	12,370,225	10,043,505
ACCRUED INTEREST RECEIVABLE	2,943,400	2,542,602
BANK-OWNED LIFE INSURANCE	20,783,304	16,183,574
OTHER REAL ESTATE OWNED	2,136,341	2,136,341
GOODWILL AND INTANGIBLE ASSETS	13,673,821	4,889,575
OTHER ASSETS	8,271,642	8,013,897
Total assets	\$ 967,090,613	\$ 742,325,087
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>LIABILITIES:</b>		
Deposits		
Non-interest bearing	\$ 166,747,113	\$ 121,891,752
Interest bearing	672,251,094	516,660,278
Total deposits	838,998,207	638,552,030
BORROWINGS	20,978,549	10,000,000
REDEEMABLE SUBORDINATED DEBENTURES	18,557,000	18,557,000
ACCRUED INTEREST PAYABLE	937,278	883,212
ACCRUED EXPENSES AND OTHER LIABILITIES	6,355,156	5,974,531
Total liabilities	885,826,190	673,966,773
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>SHAREHOLDERS' EQUITY:</b>		
Preferred stock, no par value; 5,000,000 shares authorized, none issued	-	-
Common Stock, no par value; 30,000,000 shares authorized; 7,084,725 and 6,033,683 shares issued and 7,063,996 and 6,016,845 shares outstanding as of March 31, 2014 and December 31, 2013, respectively	60,825,466	49,403,450
Retained earnings	22,016,093	21,374,381
Treasury Stock, 20,729 shares and 16,838 shares at March 31, 2014	(211,727 )	(171,883 )

and December 31, 2013, respectively

Accumulated other comprehensive (loss)	(1,365,409 )	(2,247,634 )
Total shareholders' equity	81,264,423	68,358,314
Total liabilities and shareholders' equity	\$ 967,090,613	\$ 742,325,087

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

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

	Three Months Ended March 31,	
	2014	2013
<b>INTEREST INCOME:</b>		
Loans, including fees	\$ 6,238,439	\$ 5,972,195
Securities:		
Taxable	1,121,584	937,085
Tax-exempt	580,981	512,878
Federal funds sold and short-term investments	55,291	49,680
Total interest income	7,996,295	7,471,838
<b>INTEREST EXPENSE:</b>		
Deposits	898,731	956,336
Borrowings	115,578	103,273
Redeemable subordinated debentures	85,107	87,873
Total interest expense	1,099,416	1,147,482
Net interest income	6,896,879	6,324,356
<b>PROVISION FOR LOAN LOSSES</b>	499,998	-
Net interest income after provision for loan losses	6,396,881	6,324,356
<b>NON-INTEREST INCOME:</b>		
Service charges on deposit accounts	219,116	223,066
Gain on sales of loans	739,581	731,709
Income on Bank-owned life insurance	129,151	112,608
Other income	549,134	541,180
Total other income	1,636,982	1,608,563
<b>NON-INTEREST EXPENSES:</b>		
Salaries and employee benefits	3,587,905	3,352,863
Occupancy expense	826,195	677,806
Data processing expenses	316,049	301,382
FDIC insurance expense	150,000	19,687
Other real estate owned expenses	41,432	545,505
Merger-related expenses	1,422,723	-
Other operating expenses	1,001,721	1,185,725
Total other expenses	7,346,025	6,082,968
Income before income taxes	687,838	1,849,951
<b>INCOME TAXES</b>	46,126	524,633
Net income	\$ 641,712	\$ 1,325,318
<b>NET INCOME PER COMMON SHARE:</b>		
Basic	\$0.09	\$0.22
Diluted	\$0.09	\$0.22
<b>WEIGHTED AVERAGE SHARES</b>		

**OUTSTANDING**

Basic	\$ 6,756,782	\$ 5,895,763
Diluted	\$ 6,942,943	\$ 6,034,779

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



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

	Three months ended March 31,	
	2014	2013
Net Income	\$ 641,712	\$ 1,325,318
Other comprehensive income (loss) :		
Unrealized holding gains (losses) on securities available for sale	1,215,201	(781,959 )
Tax effect	(370,936 )	348,924
Net of tax amount	844,265	(433,035 )
Pension liability	63,266	3,220
Tax effect	(25,306 )	(1,295 )
Net of tax amount	37,960	1,925
Total other comprehensive income (loss)	882,225	(431,110 )
Comprehensive income	\$ 1,523,937	\$ 894,208

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

1st Constitution Bancorp and Subsidiaries  
Consolidated Statements of Changes in Shareholders' Equity  
For the Three Months Ended March 31, 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
Issuance of vested shares under employee benefit program (9,307 shares)	187,383				187,383
Share-based compensation	25,187				25,187
Treasury stock purchased (5,224 shares)			(47,230 )		(47,230 )
Net Income for the three month ended March 31, 2013		1,325,318			1,325,318
Other comprehensive (loss)				(431,110 )	(431,110 )
Balance, March 31, 2013	\$48,928,602	\$16,919,611	\$(108,316 )	\$ 373,183	\$66,113,080
Balance, January 1, 2014	\$49,403,450	\$21,374,381	\$(171,883 )	\$ (2,247,634 )	\$68,358,314
Issuance of vested shares under employee benefit program (31,800 shares)	224,173				224,173
Share-based compensation	37,143				37,143
Treasury stock purchased (3,891 shares)			(39,844 )		(39,844 )
Acquisition of Rumson Fair Haven Bank (1,019,242 shares)	11,160,700				11,160,700
Net income for the three months ended March 31, 2014		641,712			641,712
Other comprehensive income				882,225	882,225
Balance March 31, 2014	\$60,825,466	\$22,016,093	\$(211,727 )	\$ (1,365,409 )	\$81,264,423

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

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

	Three Months Ended March 31,	
	2014	2013
<b>OPERATING ACTIVITIES:</b>		
Net income	\$ 641,712	\$ 1,325,318
Adjustments to reconcile net income to net cash provided by operating activities-		
Provision for loan losses	499,998	-
Provision for loss on other real estate owned	-	662,918
Depreciation and amortization	487,771	270,912
Net amortization of premiums and discounts on securities	240,729	314,201
Gains on sales of other real estate owned	-	(308,010 )
Gains on sales of loans held for sale	(739,581 )	(731,709 )
Originations of loans held for sale	(15,191,079 )	(44,012,744 )
Proceeds from sales of loans held for sale	23,601,340	49,987,702
Income on Bank – owned life insurance	(129,151 )	(112,608 )
Share-based compensation expense	37,143	170,114
Decrease in accrued interest receivable	195,814	458,333
Decrease in other assets	231,587	531,820
Decrease in accrued interest payable	(93,308 )	(47,298 )
Decrease in accrued expenses and other liabilities	(233,905 )	(255,455 )
Net cash provided by operating activities	9,549,070	8,253,494
<b>INVESTING ACTIVITIES:</b>		
Purchases of securities -		
Available for sale	-	(12,761,368 )
Held to maturity	(4,178,849 )	-
Proceeds from maturities and prepayments of securities -		
Available for sale	12,660,541	5,417,275
Held to maturity	4,167,587	10,241,275
Net (increase) decrease in loans	(15,056,113 )	103,647,874
Capital expenditures	(20,793 )	(68,309 )
Net cash received in the acquisition	21,375,071	-
Proceeds from sales of other real estate owned	-	1,683,830
Net cash provided by investing activities	18,947,444	108,160,577
<b>FINANCING ACTIVITIES:</b>		
Issuance of vested shares	224,173	187,383
Purchase of Treasury Stock	(39,844 )	(47,230 )
Net increase in demand, savings and time deposits	10,959,442	3,240,282
Net increase (decrease) in borrowings	-	(32,400,000 )
Net cash provided by (used in) financing activities	11,143,771	(29,019,565 )
Increase in cash and cash equivalents	39,640,285	87,394,506
<b>CASH AND CASH EQUIVALENTS</b>		
AT BEGINNING OF PERIOD	69,278,771	14,044,921
CASH AND CASH EQUIVALENTS		
AT END OF PERIOD	\$ 108,919,056	101,439,427

## SUPPLEMENTAL DISCLOSURES OF CASHFLOW INFORMATION

## Cash paid during the period for -

Interest	\$	1,219,917	\$	1,194,780
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Income taxes		192,223		750,000
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## Non-cash investing activities

Real estate acquired in full satisfaction of loans in foreclosure	\$	-	\$	2,001,025
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## Acquisition of Rumson Fair Haven Bank

## Noncash assets acquired:

Investment securities available for sale	\$	30,024,458
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Loans		143,714,377
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Accrued interest receivable		596,612
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Premises and equipment, net		2,551,939
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Goodwill		7,698,427
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Core deposit intangible		1,188,836
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Bank-owned life insurance		4,470,579
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Other assets		885,576
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		191,130,804
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## Liabilities assumed:

Deposits		189,490,005
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Borrowings		11,030,000
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Other liabilities		825,170
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		201,345,175
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Common stock issued as consideration	\$	11,160,700
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The accompanying notes are an integral part of these financial statements.

1st Constitution Bancorp and Subsidiaries  
Notes To Consolidated Financial Statements  
March 31, 2014 (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., 249 New York Avenue, LLC, and RFHB Investment Company. 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 March 31, 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, 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 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 March 31, 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		Total
	Loans	Loans acquired with	

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	acquired with no credit quality deterioration	credit quality deterioration	
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 deposits 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 three months ended March 31, 2014, the Company incurred \$1.4 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 our Consolidated Statements of Income from the date of the acquisition (i.e., February 7, 2014) through March 31, 2014 under the column "Actual from acquisition date to March 31, 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 \$1.7 million were excluded from pro forma non-interest expenses for the three months ended March 31, 2014. Income taxes were also adjusted to exclude income tax benefits of \$462,000 related to the merger expenses for the three months ended March 31, 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 March 31, 2014	Pro Forma for the three months ended March 31, 2014	Pro Forma for the three months ended March 31, 2013
	(in thousands, except per share amounts)		

Net interest income	\$ 1,076	\$ 7,696	\$ 8,007
Non-interest income	41	1,686	1,898
Non-interest expenses	473	7,145	7,432
Income taxes	240	623	756
Net income	399	1,614	1,717
Earnings per share – Fully diluted		\$ 0.22	\$ 0.24

### (3) Net Income Per Common Share

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

Diluted net income per common share is calculated by dividing net income by the weighted average number of common shares outstanding, as adjusted for the assumed exercise of potential common stock warrants, common stock options and unvested restricted stock awards (as defined below), using the treasury stock method.

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 March 31, 2014		
	Net Income	Weighted- average shares	Per share amount
Basic earnings per common share:			
Net income	\$641,712	6,756,782	\$0.09
Effect of dilutive securities:			
Stock options, warrants and unvested restricted stock awards		186,161	
Diluted EPS:			
Net income plus assumed conversion	\$641,712	6,942,943	\$0.09

	Three Months Ended March 31, 2013		
	Net Income	Weighted- average	Per share amount

shares

Basic earnings per common share:

Net income	\$1,325,318	5,895,763	\$0.22
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Effect of Dilutive Securities:

Stock options, warrants and unvested restricted stock awards		139,016	
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Diluted EPS:

Net income plus assumed conversions	\$1,325,318	6,034,779	\$0.22
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For the three months ended March 31, 2014 and 2013, 87,296 and 30,500 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:

March 31, 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	\$ 11,429,804	\$-	\$(661,119 )	\$ 10,768,685
Residential collateralized mortgage obligations- GSE	4,382,539	112,206	(49,956 )	4,444,789
Residential collateralized mortgage obligations- non GSE	3,154,429	54,710	(5,781 )	3,203,358
Residential mortgage backed securities – GSE	30,427,673	869,202	(342,213 )	30,954,662
Obligations of State and Political subdivisions	22,182,476	200,338	(1,900,821 )	20,481,993
Trust preferred debt securities – single issuer	2,469,574	-	(401,174 )	2,068,400
Corporate debt securities	43,626,642	384,940	(37,753 )	43,973,829
Restricted stock	1,710,000	-	-	1,710,000
Mutual fund	25,000	-	-	25,000
	\$ 119,408,137	\$ 1,621,396	\$(3,398,817 )	\$ 117,630,716

March 31, 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	\$ 1,512,570	\$ -	\$ 1,512,570	\$ 6,130	\$ -	\$ 1,518,700
Residential collateralized mortgage obligations – GSE	14,077,130	-	14,077,130	424,788	-	14,501,918
Residential collateralized mortgage obligations – non – GSE	10,210,560	-	10,210,560	263,511	(247)	10,473,824
Residential mortgage backed securities – GSE	63,465,847	-	63,465,847	1,021,862	(239,185)	64,248,524
Obligations of State and Political subdivisions	62,309,859	-	62,309,859	1,761,685	(765,477)	63,306,067
Trust preferred debt securities-pooled	656,661	(500,944)	155,717	583,269	-	738,986
Corporate debt securities	1,002,876	-	1,002,876	4,764	-	1,007,640
	\$ 153,235,503	\$ (500,944)	\$ 152,734,559	\$ 4,066,009	\$ (1,004,909)	\$ 155,795,659

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

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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 March 31, 2014 and December 31, 2013 consisted of \$1,710,000 and \$1,013,100, respectively, of Federal Home Loan Bank of New York stock and \$65,000 of Atlantic Central Bankers Bank stock.

The amortized cost and estimated fair value of investment securities at March 31, 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		
U.S. Treasury securities and obligations of US Government sponsored corporations ("GSE") and agencies	\$ -	\$ -
Residential mortgage backed securities-GSE	386	387
Obligations of State and Political subdivisions	374,530	375,968



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Corporate Debt Securities	16,325,561	16,333,666
Restricted Stock	1,710,000	1,710,000
Mutual Fund	25,000	25,000
	\$ 18,435,477	\$ 18,445,021
Due after one year through five years		
U.S. Treasury securities and obligations of		
US Government sponsored corporations (“GSE”)and agencies	\$ 1,545,381	\$ 1,523,385
Residential collateralized mortgage obligations –non GSE	541,290	543,378
Residential mortgage backed securities-GSE	7,007,116	6,919,178
Obligations of State and Political subdivisions	110,000	110,231
Corporate Debt Securities	25,195,136	25,575,393
	\$ 34,398,923	\$ 34,671,565
Due after five years through ten years		
U.S. Treasury securities and obligations of US Government sponsored		
corporations (“GSE”) and agencies	\$ 9,884,423	\$ 9,245,300
Residential collateralized mortgage obligations -GSE	116,140	123,862
Residential mortgage backed Securities - GSE	7,914,672	7,990,787
Obligations of State and Political Subdivisions	4,871,859	4,865,849
Corporate Debt Securities	1,020,784	1,016,250
	\$ 23,807,878	\$ 23,242,048
Due after ten years		
Residential collateralized mortgage obligations -GSE	\$ 4,266,399	\$ 4,320,927
Residential collateralized mortgage obligations –non GSE	2,613,139	2,659,980
Residential mortgage backed securities - GSE	15,505,499	16,044,310
Obligations of State and Political subdivisions	16,826,087	15,129,945
Corporate Debt Securities	1,085,161	1,048,520
Trust Preferred Debt Securities	2,469,574	2,068,400
	\$ 42,765,858	\$ 41,272,081
Total	\$ 119,408,137	\$ 117,630,716

Held to maturity-		
Due in one year or less		
U.S. Treasury securities and obligations of US Government sponsored Corporations ("GSE") and agencies	\$ 1,512,570	\$ 1,518,700
Obligations of State and Political subdivisions	11,197,967	11,221,464
Corporate Debt Securities	1,002,876	1,007,640
	\$ 13,713,413	\$ 13,747,804
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	11,666,066	12,082,277
Corporate Debt Securities	-	-
	\$ 11,666,066	\$ 12,082,277
Due after five years through ten years		
Residential collateralized mortgage obligations – GSE	\$ 12,765	\$ 12,781
Residential collateralized mortgage obligations-non GSE	877,270	877,023
Residential mortgage backed securities – GSE	21,091,526	21,375,467
Obligations of State and Political subdivisions	19,914,474	20,643,262
	\$ 41,896,035	\$ 42,908,533
Due after ten years		
Residential collateralized mortgage obligations - GSE	14,064,365	14,489,137
Residential collateralized mortgage obligations – non GSE	9,333,290	9,596,801
Residential mortgage backed securities - GSE	42,374,321	42,873,057
Obligations of State and Political subdivisions	19,531,352	19,359,064
Trust Preferred Debt Securities - Pooled	656,661	738,986
	\$ 85,959,989	\$ 87,057,045
Total		
	\$ 153,235,503	\$ 155,795,659

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 March 31, 2014 and December 31, 2013 were as follows:

March 31, 2014	Number of Securities	Less than 12 months		12 months or longer		
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	
U.S. Treasury securities and obligations of U.S. Government sponsored corporations and agencies	2	\$ 10,768,685	\$ (661,119)	\$ -	\$ -	\$ -
Residential collateralized mortgage obligations - GSE	1	1,151,081	(49,956)	-	-	-
Residential collateralized mortgage obligations – non-GSE	3	877,023	(247)	1,097,207	(5,781)	
Residential mortgage backed securities - GSE	20	16,183,114	(454,108)	5,259,063	(127,290)	
Obligations of State and Political Subdivisions	88	14,563,695	(893,734)	13,459,681	(1,772,564)	
Trust preferred debt securities – single issuer	4	-	-	2,068,400	(401,174)	
Corporate Debt Securities	5	3,576,105	(1,112)	1,048,520	(36,641)	
Total temporarily impaired securities	123	\$ 47,119,703	\$ (2,060,276)	\$ 22,932,871	\$ (2,343,450)	\$ -

  

December 31, 2013	Number of Securities	Less than 12 months		12 months or longer		Total	
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury securities and obligations of U.S. Government sponsored corporations (GSE) and agencies	3	\$ 11,507,350	\$ (910,274)	\$ -	\$ -	\$ 11,507,350	\$ (910,274)
Residential collateralized mortgage obligations – non-GSE	8	5,328,485	(28,231)	1,094,754	(7,969)	6,423,239	(36,199)
Residential mortgage backed securities - GSE	38	40,504,327	(825,307)	-	-	40,504,327	(825,307)
Obligations of State and Political Subdivisions	95	19,403,457	(2,285,759)	8,936,441	(1,721,472)	28,339,898	(4,007,231)

Subdivisions							
st preferred debt securities – single issuer	4	-	-	2,013,100	(455,739)	2,013,100	(455,739)
st preferred debt securities – pooled	1	-	-	148,855	(507,807)	148,855	(507,807)
porate debt securities	1	-	-	1,056,110	(29,336)	1,056,110	(29,336)
tal temporarily impaired securities	150	\$ 76,743,619	\$ (4,049,571)	\$ 13,249,260	\$ (2,722,323)	\$ 89,992,879	\$ (6,771,804)

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. 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 likely that the Company will be required to sell these investments before a market price recovery or maturity; therefore, these investments are not considered other-than-temporarily impaired.

Obligations of State and Political Subdivisions: The unrealized losses on investments in these securities were caused by increases in market interest rates. It is expected that the securities would not be settled at a price less than the amortized cost of the investment. The decline in fair value is attributable to changes in interest rates and not credit quality, the Company does not intend to sell these investments and it is not more likely than not that the Company will be required to sell these investments before a market price recovery or maturity; therefore, these investments are not considered other-than-temporarily impaired.

Corporate debt securities: The unrealized losses on investments in corporate debt securities were caused by increases to market interest rates. None of the corporate issuers have defaulted on interest payments. 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; therefore, these investments are not considered other-than-temporarily impaired.

Trust preferred debt securities – single issuer: The investments in these securities with unrealized losses are comprised of four corporate trust preferred securities 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. Both of the issuers continue to maintain investment grade credit ratings and neither 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. 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; therefore, these investments are not considered other-than-temporarily impaired.

Trust preferred debt securities – pooled: This trust preferred debt security was issued by a two issuer pool (Preferred Term Securities XXV, Ltd. co-issued by Keefe, Bruyette and Woods, Inc. and First Tennessee ("PRETSL XXV")) consisting primarily of financial institution holding companies. During 2009, the Company recognized an other-than-temporary impairment 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 March 31, 2014, our evaluation was as follows:

- a. We obtained the PRETSL XXV Depository Institutions Issuer List as of March 31, 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 26-year stated maturity of this pooled security even though the individual institutions are currently performing according to terms.

- e. This March 31, 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 March 31, 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 March 31, 2014:

Security Class	Book Value	Fair Value	Unrealized Gain (Loss)	Percent of Underlying Collateral Performing	Percent of 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 Amount	(2)
PreTSL B-1 XXV	\$155,717	\$738,986	\$583,269	70.7%	6.7%	22.6%	13.6%	Ca/ NR	\$146,500	27.0%

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 March 31, 2014	Three months ended March 31, 2013
Balance at beginning of period	\$ 364	\$ 364



Change during the period		-	-
Balance at end of period	\$	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 March 31, 2014:

	30-59 Days	60-89 Days	Greater than 90 Days	Total Past Due	Current	Total Loans Receivable	Recorded Investment > 90 Days Nonaccruing	
Commercial								
Construction	\$ 459,002	\$ -	\$ -	\$ 459,002	\$ 62,331,447	\$ 62,790,449	\$ -	\$ -
Commercial Business	1,267,501	-	726,190	1,993,691	116,550,108	118,543,799		340,787
Commercial Real Estate	2,690,508	241,192	5,639,123	8,570,823	169,634,524	178,205,347	-	5,554,882
Mortgage Warehouse Lines	-	-	-	-	104,334,990	104,334,990	-	-
Residential								
Real Estate	538,410	-	1,315,189	1,853,599	39,921,947	41,775,546	-	1,443,499
Consumer								
Loans to Individuals	79,608	-	-	79,608	24,804,917	24,884,525	-	116,641
Other	-	-	-	-	205,515	205,515	-	-
Deferred Loan Costs	-	-	-	-	665,211	665,211	-	-
Total	\$ 5,035,029	\$ 241,192	\$ 7,680,502	\$ 12,956,723	\$ 518,448,659	\$ 531,405,382	\$ -	\$ 7,455,809

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 \$2,575,110 at March 31, 2014 were not classified as non-performing loans.

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 Unit 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 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 ability of individuals or company principals are excellent. Loans to individuals supported by high net worths and liquid assets.



3. Good - Loans to companies whose balance sheets show good liquidity and cash flow adequate to meet maturities of long-term debt with a comfortable margin. Such 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 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" or incompetent or there is no plan for management succession. Expectations of a loan loss are not immediate; however, if present trends continue, a loan loss could be expected.

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

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 March 31, 2014.

Commercial Credit Exposure					
- By		Commercial	Commercial	Mortgage	Residential
Internally Assigned Grade	Construction	Business	Real Estate	Warehouse Lines	Real Estate
Grade:					
Pass	\$ 59,340,092	\$ 114,608,335	\$ 145,137,802	\$ 104,334,990	\$ 40,141,706
Special Mention	-	2,122,133	22,459,847	-	1,318,225
Substandard	3,450,357	1,225,596	10,607,698	-	315,615
Doubtful	-	587,735	-	-	-
Total	\$ 62,790,449	\$ 118,543,799	\$ 178,205,347	\$ 104,334,990	\$ 41,775,546
Consumer Credit Exposure -					
By Payment Activity	Loans To				
	Individuals	Other			
Performing	\$ 24,767,884	\$ 205,515			
Nonperforming	116,641	-			
Total	\$ 24,884,525	\$ 205,515			

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

Commercial Credit Exposure					
- By		Commercial	Commercial	Mortgage	Residential
Internally Assigned Grade	Construction	Business	Real Estate	Warehouse Lines	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 March 31, 2014 and December 31, 2013:

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Period-End Allowance for Loan Losses by Impairment Method March 31, 2014

	Construction	Commercial	Commercial Real Estate	Mortgage Warehouse	Residential Real Estate	Consumer	Other	Unalloc
Allowance for loan losses:								
Ending Balance	\$ 1,265,430	\$ 1,218,036	\$ 3,135,727	\$ 521,675	\$ 182,005	\$ 92,387	\$ 1,623	\$ 613,9
Ending Balance Individually evaluated for impairment	-	73,681	1,490,169	-	15,015	-	-	-
Collectively evaluated for impairment	\$ 1,265,430	\$ 1,144,355	\$ 1,645,558	\$ 521,675	\$ 166,990	\$ 92,387	\$ 1,623	\$ 613,9
Loans receivables:								
Ending Balance	\$ 62,790,449	\$ 118,543,799	\$ 178,205,347	\$ 104,334,990	\$ 41,775,546	\$ 24,884,525	\$ 205,515	\$ -
Individually evaluated for impairment	189,363	428,885	9,117,675	-	1,443,499	90,711	-	-
Loans acquired with deteriorated credit quality	-	376,262	1,786,749	-	180,767	231,332	-	-
Collectively evaluated for impairment	\$ 62,601,086	\$ 117,738,652	\$ 167,300,923	\$ 104,334,990	\$ 40,151,280	\$ 24,562,482	\$ 205,515	\$ -

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

	Construction	Commercial	Commercial Real Estate	Mortgage Warehouse	Residential Real Estate	Consumer	Other	Unallocated
Allowance for loan losses:								
Ending Balance	\$ 1,205,267	\$ 1,271,733	\$ 3,021,766	\$ 584,757	\$ 164,673	\$ 108,849	\$ 2,183	\$ 679,343
Ending Balance Individually evaluated	-	293,692	1,490,169	-	-	-	-	-

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impairment  
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evaluated

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Loans  
receivables:

Ending

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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 three months ended March 31, 2014 and 2013 was as follows:

		Commercial	Commercial	Mortgage	Residential				
	Construction	Business	Real Estate	Warehouse	Estate	Consumer	Other	Unallocat	
Balance - December 31, 2013	\$ 1,205,267	\$ 1,271,733	\$ 3,021,766	\$ 584,757	\$ 164,673	\$ 108,849	\$ 2,183	\$ 679,34	
Provision charged to operations	60,163	454,031	113,961	(63,082)	17,332	(16,462)	(560)	(65,38	
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	\$ 613,95	
Balance - December 31, 2012	\$ 1,990,292	\$ 972,789	\$ 2,262,221	\$ 1,420,638	\$ 112,103	\$ 102,583	\$ 2,271	\$ 288,31	
Provision charged to operations	(218,010)	(18,319)	245,769	(429,900)	262	50,606	(212)	369,80	
Loans charged off	(561,993)								