PEAPACK GLADSTONE FINANCIAL CORP
Form 10-Q
November 01, 2013

**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, 2013**

**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 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 ¨.

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 ¨.

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 ¨ | Accelerated filer ý |
| | Smaller reporting company ¨ |
| Non-accelerated filer (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 ý.

Number of shares of Common Stock outstanding as of October 25, 2013:

9,079,436

1

**PEAPACK-GLADSTONE FINANCIAL CORPORATION**

**PART 1 FINANCIAL INFORMATION**


| | | |
|---|---|---|
| Item 1 | Financial Statements (Unaudited) | |
| | Consolidated Statements of Condition at September 30, 2013 and December 31, 2012 | Page 3 |
| | Consolidated Statements of Income for the three and nine months ended September 30, 2013 and 2012 | Page 4 |
| | Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2013 and 2012 | Page 5 |
| | Consolidated Statement of Changes in Shareholders' Equity for the nine months ended September 30, 2013 | Page 6 |
| | Consolidated Statements of Cash Flows for the nine months ended September 30, 2013 and 2012 | Page 7 |
| | Notes to Consolidated Financial Statements | Page 8 |
| Item 2 | Management's Discussion and Analysis of Financial Condition and Results of Operations | Page 33 |
| Item 3 | Quantitative and Qualitative Disclosures about Market Risk | Page 48 |
| Item 4 | Controls and Procedures | Page 48 |


**PART 2 OTHER INFORMATION**


| | | |
|---|---|---|
| Item 1A | Risk Factors | Page 49 |
| Item 2 | Unregistered Sales of Equity Securities and Use of Proceeds | Page 58 |
| Item 6 | Exhibits | Page 58 |

Table of Contents

Item 1. Financial Statements (Unaudited)

**PEAPACK-GLADSTONE FINANCIAL CORPORATION**

**CONSOLIDATED STATEMENTS OF CONDITION**

**(Dollars in thousands)**

| | (unaudited) September 30, 2013 | (audited) December 31, 2012 |
|---|---|---|
| ASSETS | | |
| Cash and due from banks | $ 5,886 | $ 6,733 |
| Federal funds sold | 101 | 100 |
| Interest-earning deposits | 33,528 | 112,395 |
| Total cash and cash equivalents | 39,515 | 119,228 |
| | | |
| Securities available for sale | 273,952 | 304,479 |
| FHLB and FRB stock, at cost | 7,707 | 4,639 |
| | | |
| Loans held for sale, at fair value | 724 | 6,461 |
| Loans held for sale, at lower of cost or fair value | — | 13,749 |
| Loans | 1,396,949 | 1,132,584 |
| Less: Allowance for loan losses | 14,056 | 12,735 |
| Net loans | 1,382,893 | 1,119,849 |
| | | |
| Premises and equipment | 29,022 | 30,030 |
| Other real estate owned | 2,759 | 3,496 |
| Accrued interest receivable | 4,017 | 3,864 |
| Bank owned life insurance | 31,691 | 31,088 |
| Deferred tax assets, net | 7,951 | 9,478 |
| Other assets | 17,473 | 21,475 |
| TOTAL ASSETS | $ 1,797,704 | $ 1,667,836 |
| | | |
| LIABILITIES | | |
| Deposits: | | |
| Noninterest-bearing demand deposits | $ 345,736 | $ 298,095 |
| Interest-bearing deposits: | | |
| Checking | 338,626 | 346,877 |
| Savings | 115,571 | 109,686 |
| Money market accounts | 611,498 | 583,197 |
| Certificates of deposit $100,000 and over | 62,136 | 68,741 |
| Certificates of deposit less than $100,000 | 98,996 | 109,831 |
| Total deposits | 1,572,563 | 1,516,427 |
| Overnight borrowings | 30,361 | — |
| Federal home loan bank advances | 47,692 | 12,218 |
| Capital lease obligation | 8,809 | 8,971 |
| Accrued expenses and other liabilities | 11,861 | 8,163 |

| | | |
|---|---|---|
| TOTAL LIABILITIES | 1,671,286 | 1,545,779 |
| SHAREHOLDERS' EQUITY | | |
| Common stock (no par value; stated value, $0.83 per share; authorized 21,000,000 shares; issued shares, 9,486,414 at September 30, 2013 and 9,325,977 at December 31, 2012; outstanding shares, 9,078,236 at September 30, 2013 and 8,917,799 at December 31, 2012) | 7,889 | 7,755 |
| Surplus | 99,963 | 97,675 |
| Treasury stock at cost, 408,178 shares at September 30, 2013 and December 31, 2012 | (8,988) | (8,988) |
| Retained earnings | 26,834 | 21,316 |
| Accumulated other comprehensive income, net of income tax | 720 | 4,299 |
| TOTAL SHAREHOLDERS' EQUITY | 126,418 | 122,057 |
| TOTAL LIABILITIES & SHAREHOLDERS' EQUITY | $ 1,797,704 | $ 1,667,836 |

*See accompanying notes to consolidated financial statements.*

3

Table of Contents

**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, | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| INTEREST INCOME | | | | |
| Interest and fees on loans | $13,041 | $11,939 | $36,819 | $35,928 |
| Interest on investment securities held to maturity: | | | | |
| Taxable | — | 564 | — | 1,375 |
| Tax-exempt | — | 39 | — | 151 |
| Interest on securities available for sale: | | | | |
| Taxable | 1,141 | 1,223 | 3,503 | 4,234 |
| Tax-exempt | 199 | 156 | 591 | 477 |
| Interest on loans held for sale | 21 | 34 | 267 | 75 |
| Interest-earning deposits | 21 | 27 | 135 | 58 |
| Total interest income | 14,423 | 13,982 | 41,315 | 42,298 |
| INTEREST EXPENSE | | | | |
| Interest on savings and interest-bearing deposit accounts | 363 | 362 | 998 | 1,168 |
| Interest on certificates of deposit over $100,000 | 191 | 229 | 618 | 678 |
| Interest on other time deposits | 253 | 321 | 812 | 1,031 |
| Interest on borrowed funds | 138 | 113 | 322 | 453 |
| Interest on capital lease obligation | 105 | 107 | 317 | 324 |
| Total interest expense | 1,050 | 1,132 | 3,067 | 3,654 |
| NET INTEREST INCOME BEFORE PROVISION FOR LOAN LOSSES | 13,373 | 12,850 | 38,248 | 38,644 |
| Provision for loan losses | 750 | 750 | 2,100 | 3,750 |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | 12,623 | 12,100 | 36,148 | 34,894 |
| OTHER INCOME | | | | |
| Trust department income | 3,295 | 2,918 | 10,291 | 9,353 |
| Service charges and fees | 724 | 694 | 2,088 | 2,073 |
| Bank owned life insurance | 278 | 266 | 826 | 794 |
| Securities gains, net | 188 | 235 | 715 | 732 |
| Gain on loans held for sale at fair value | 277 | 358 | 1,138 | 825 |
| Gain on loans held for sale at lower of cost or fair value | — | — | 522 | — |
| Other income | 20 | 88 | 42 | 176 |
| Total other income | 4,782 | 4,559 | 15,622 | 13,953 |
| OPERATING EXPENSES | | | | |
| Salaries and employee benefits | 8,927 | 7,029 | 23,941 | 19,550 |
| Premises and equipment | 2,325 | 2,290 | 6,967 | 7,034 |

| | | | | |
|---|---|---|---|---|
| Other operating expenses | 2,913 | 2,674 | 9,629 | 8,193 |
| Total operating expenses | 14,165 | 11,993 | 40,537 | 34,777 |
| INCOME BEFORE INCOME TAX EXPENSE | 3,240 | 4,666 | 11,233 | 14,070 |
| Income tax expense | 1,276 | 1,834 | 4,367 | 5,432 |
| NET INCOME | 1,964 | 2,832 | 6,866 | 8,638 |
| Dividends on preferred stock and accretion | — | — | — | 474 |
| NET INCOME AVAILABLE TO COMMON SHAREHOLDERS | $1,964 | $2,832 | $6,866 | $8,164 |
| EARNINGS PER COMMON SHARE | | | | |
| Basic | $0.22 | $0.32 | $0.77 | $0.93 |
| Diluted | $0.22 | $0.32 | $0.76 | $0.93 |
| WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING | | | | |
| Basic | 8,950,931 | 8,778,649 | 8,910,514 | 8,775,022 |
| Diluted | 9,022,415 | 8,819,431 | 8,982,158 | 8,805,859 |

*See accompanying notes to consolidated financial statements.*

Table of Contents

**PEAPACK-GLADSTONE FINANCIAL CORPORATION**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**(Dollars in thousands)**

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| Net income | $ 1,964 | $ 2,832 | $ 6,866 | $ 8,638 |
| Other comprehensive (loss)/income: | | | | |
| Unrealized (losses)/gains on available for sale securities: | | | | |
| Unrealized holding (losses)/gains arising during the period | (204) | 1,177 | (5,336) | 2,296 |
| Less: Reclassification adjustment for gains included in net income | 188 | 235 | 715 | 732 |
| | (392) | 942 | (6,051) | 1,564 |
| Tax effect | 160 | (385) | 2,472 | (639) |
| Net of tax | (232) | 557 | (3,579) | 925 |
| 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 | — | 173 |
| Tax effect | — | (25) | — | (71) |
| Net of tax | — | 35 | — | 102 |
| Total other comprehensive (loss)/income | (232) | 592 | (3,579) | 1,027 |
| Total comprehensive income | $ 1,732 | $ 3,424 | $ 3,287 | $ 9,665 |

*See accompanying notes to consolidated financial statements.*

Table of Contents

**PEAPACK-GLADSTONE FINANCIAL CORPORATION**

**CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY**

**(Dollars in thousands)**

**(Unaudited)**

**Nine Months Ended September 30, 2013**

| (In thousands, except per share data) | Common Stock | Surplus | Treasury Stock | Retained Earnings | Accumulated Other Comprehensive Income | Total |
|---|---|---|---|---|---|---|
| Balance at January 1, 2013 8,917,799 common shares outstanding | $ 7,755 | $ 97,675 | $ (8,988 ) | $ 21,316 | $ 4,299 | $ 122,057 |
| Net income | | | | 6,866 | | 6,866 |
| Net change in accumulated other comprehensive income/(loss) | | | | | (3,579 ) | (3,579 ) |
| Issuance of restricted stock 39,474 shares | 33 | (33 ) | | | | — |
| Amortization of restricted stock | | 304 | | | | 304 |
| Cash dividends declared on common stock ($0.15 per share) | | | | (1,348 ) | | (1,348 ) |
| Common stock option expense | | 234 | | | | 234 |
| Common stock options exercised and related tax benefits, 1,782 shares | 2 | 15 | | | | 17 |
| Sales of shares (Dividend Reinvestment Program), 112,156 shares | 93 | 1,644 | | | | 1,737 |
| Issuance of shares for Profit Sharing Plan 7,025 shares | 6 | 124 | | | | 130 |
| Balance at September 30, 2013 9,078,236 common shares outstanding | $ 7,889 | $ 99,963 | $ (8,988 ) | $ 26,834 | $ 720 | $ 126,418 |

*See accompanying notes to consolidated financial statements.*

Table of Contents

**PEAPACK-GLADSTONE FINANCIAL CORPORATION**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(Dollars in thousands)**

**(Unaudited)**

| | Nine Months Ended September 30, | |
|---|---|---|
| OPERATING ACTIVITIES: | 2013 | 2012 |
| Net income: | $ 6,866 | $ 8,638 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 2,196 | 2,214 |
| Amortization of premium and accretion of discount on securities, net | 1,499 | 1,708 |
| Amortization of restricted stock | 304 | 332 |
| Provision for loan losses | 2,100 | 3,750 |
| Provision for OREO losses | 930 | — |
| Provision for deferred taxes | 3,999 | — |
| Tax benefit on exercise of stock options | — | 2 |
| Stock-based compensation | 234 | 253 |
| Gains on security sales, available for sale | (715) | (648) |
| Gains on securities, held to maturity | — | (84) |
| Loans originated for sale at fair value | (66,293) | (67,503) |
| Proceeds from sales of loans at fair value | 73,169 | 62,726 |
| Gains on loans held for sale at fair value | (1,138) | (825) |
| Gains on loans held for sale at lower of cost or fair value | (522) | — |
| (Gains)/Losses on sale of other real estate owned | (2) | 62 |
| Losses/(Gains) on disposal of fixed assets | 49 | (7) |
| Increase in cash surrender value of life insurance, net | (603) | (595) |
| (Increase)/Decrease in accrued interest receivable | (153) | 38 |
| Decrease/(Increase) in other assets | 4,002 | (572) |
| Increase in accrued expenses and other liabilities | 3,536 | 1,801 |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | 29,458 | 11,290 |
| INVESTING ACTIVITIES: | | |
| Maturities of investment securities held to maturity | — | 36,714 |
| Maturities of securities available for sale | 68,794 | 61,794 |
| Calls of securities held to maturity | — | 136 |
| Calls of securities available for sale | 18,115 | 23,598 |
| Sales of securities available for sale | 42,839 | 29,358 |
| Purchase of investment securities held to maturity | — | (9,546) |
| Purchase of securities available for sale, including FHLB and FRB stock | (109,124) | (47,913) |
| Proceeds from sales of loans held for sale at lower of cost or fair value | 14,271 | — |
| Net increase in loans | (268,263) | (60,046) |
| Sales of other real estate owned | 2,928 | 2,512 |
| Purchases of premises and equipment | (1,237) | (738) |
| Purchase of life insurance | — | (2,996) |

| | | |
|---|---|---|
| NET CASH (USED IN)/PROVIDED BY INVESTING ACTIVITIES | (231,677 ) | 32,873 |
| FINANCING ACTIVITIES: | | |
| Net increase/(decrease) in deposits | 56,136 | (11,206 ) |
| Net increase in overnight borrowings | 30,361 | — |
| Net increase in other borrowings | 35,692 | |
| Repayments of Federal Home Loan Bank advances | (218 ) | (5,345 ) |
| Redemption of preferred stock | — | (14,341 ) |
| Repurchase of warrants | — | (111 ) |
| Cash dividends paid on preferred stock | — | (112 ) |
| Cash dividends paid on common stock | (1,348 ) | (1,330 ) |
| Exercise of Stock Options | 17 | 21 |
| Sales of shares (DRIP Program) | 1,737 | 128 |
| Purchase of shares for Profit Sharing Plan | 130 | — |
| NET CASH PROVIDED BY/(USED IN) FINANCING ACTIVITIES | 122,507 | (32,296 ) |
| Net decrease in cash and cash equivalents | (79,713 ) | 11,867 |
| Cash and cash equivalents at beginning of period | 119,228 | 43,053 |
| Cash and cash equivalents at end of period | $ 39,515 | $ 54,920 |

*See accompanying notes to consolidated financial statements.*

7

Table of Contents

**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, 2012 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, 2013 and the results of operations for the three and nine months ended September 30, 2013 and 2012 and cash flows for the nine months ended September 30, 2013 and 2012.

**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 (the “Corporation”) are prepared on the accrual basis and include the accounts of the Corporation and its wholly-owned subsidiary, Peapack-Gladstone Bank (the “Bank”). The consolidated statements also include the Bank’s wholly-owned subsidiary, PGB Trust & Investments of Delaware. 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. As of September 30, 2013 and December 31, 2012, the Corporation no longer had any debt securities classified as held to maturity.

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.

Table of Contents

**Loans:** Loans that Management has the intent and ability to hold for the foreseeable future or until maturity are stated at the principal amount outstanding. Interest on loans is recognized based upon the principal amount outstanding. Loans are stated at face value, less purchased premium and discounts and net deferred fees. Loan origination fees and certain direct loan origination costs are deferred and recognized over the life of the loan as an adjustment, on a level-yield method, to the loan's yield. The definition of recorded investment in loans includes accrued interest receivable, however, for the Corporation's loan disclosures, accrued interest was excluded as the impact was not material.

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, generally when the Bank receives contractual payments for a minimum of six 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. Nonaccrual 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 New Jersey and New York area.

**Allowance for Loan Losses:** The allowance for loan losses is a valuation allowance for probably incurred credit losses. Loan losses are charged against the allowance when Management believes the uncollectability 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. 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 collection, 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.

Table of Contents

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 impaired 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 non-impaired loans 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 three 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; 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, which are based on collateral. The following portfolio classes have been identified:

Primary Residential Mortgages. The Bank originates one to four family residential mortgage loans within or near its primary geographic market area. Loans are secured by first liens on the primary residence or investment property. 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.

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. 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.

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 lien 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. 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.

Table of Contents

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 in New Jersey and New York. 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 also have retail space. 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.

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. 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.

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. 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 underestimated.

Consumer and Other. These are loans to individuals for household, family and other personal expenditures as well as obligations of states and political subdivisions in the U.S. This also represents all other loans that cannot be categorized in any of the previous mentioned loan segments.

**Stock-Based Compensation:** The Corporation's 2006 Long-Term Stock Incentive Plan and 2012 Long-Term Stock Incentive Plan as amended 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 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, 2013 and 2012, the Corporation recorded total compensation cost for stock options of $65 thousand and $83 thousand respectively, with a recognized tax benefit of $11 thousand for the quarter ended September 30, 2013 and $15 thousand for the September 30, 2012 quarter. The Corporation recorded total compensation cost for stock options for the nine months ended September 30, 2013 and 2012, of $234 thousand and $253 thousand, respectively, with a recognized tax benefit of $41 thousand for the nine months ended September 30, 2013 and $45 thousand for the nine months ended September 30, 2012. There was approximately $568 thousand of unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the Corporation's stock incentive plans at September 30, 2013. That cost is expected to be recognized over a weighted average period of 1.2 years.

Table of Contents

For the Corporation's stock option plans, changes in options outstanding during the nine months ended September 30, 2013 were as follows:

| | Number of Options | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value (In Thousands) |
|---|---|---|---|---|
| Balance, January 1, 2013 | 613,507 | $ 22.37 | | |
| Granted during 2013 | 84,050 | 14.81 | | |
| Exercised during 2013 | (2,790) | 11.76 | | |
| Expired during 2013 | (36,996) | 26.08 | | |
| Forfeited during 2013 | (2,938) | 13.41 | | |
| Balance, September 30, 2013 | 654,833 | $ 21.27 | 4.06 years | $ 599 |
| Vested and expected to vest (1) | 619,909 | $ 21.71 | 4.06 years | $ 778 |
| Exercisable at September 30, 2013 | 471,024 | $ 24.34 | 2.37 years | $ 75 |

(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 2013 and the exercise price, multiplied by the number of in-the-money options). The Corporation's closing stock price on September 30, 2013 was $18.55.

For the third quarter of 2013, the per share weighted-average fair value of stock options granted was $6.89 compared to $5.29 for the same quarter of 2012. The per share weighted-average fair value of stock options granted during the first nine months of 2013 and 2012 was $5.28 and $3.91, respectively on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

| | Three Months Ended September 30, 2013 | Three Months Ended September 30, 2012 | Nine Months Ended September 30, 2013 | Nine Months Ended September 30, 2012 |
|---|---|---|---|---|
| Dividend Yield | 1.09 % | 1.24 % | 1.31 % | 1.47 % |
| Expected volatility | 41 % | 39 % | 39 % | 39 % |
| Expected life | 7 years | 7 years | 7 years | 7 years |
| Risk-free interest rate | 1.88 % | 1.08 % | 1.13 % | 1.43 % |

The Corporation also awards restricted stock to certain executives at a fair value equal to the fair value of the Corporation's common stock on the date of the grant. The awards may vest fully during a period of up to five years after the date of award.

For the three months ended September 30, 2013 and 2012, the Corporation recorded total compensation cost for restricted shares of $264 thousand and $111 thousand, respectively. For the nine months ended September 30, 2013 and 2012, the Corporation recorded total compensation cost for restricted stock awards of $461 thousand and $332 thousand, respectively. As of September 30, 2013, there was approximately $795 thousand of unrecognized compensation cost related to non-vested restricted stock awards granted under the Corporation’s stock incentive plans, which is expected to be recognized over a weighted average period of 1.5 years.

Table of Contents

Changes in non-vested, restricted common shares for 2013 were as follows:

| | Number of Shares | Weighted Average Grant Date Fair Value |
|---|---|---|
| Balance, January 1, 2013 | 82,717 | $ 12.87 |
| Granted during 2013 | 39,474 | 14.87 |
| Vested during 2013 | (19,035 ) | 13.48 |
| Balance, September 30, 2013 | 103,156 | $ 13.52 |

**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) | 2013 | 2012 | 2013 | 2012 |
| Net income to common shareholders | $1,964 | $2,832 | $6,866 | $8,164 |
| Basic weighted-average common shares outstanding | 8,950,931 | 8,778,649 | 8,910,514 | 8,775,022 |
| Plus: common stock equivalents | 71,484 | 40,782 | 71,644 | 30,837 |
| Diluted weighted-average common shares outstanding | 9,022,415 | 8,819,431 | 8,982,158 | 8,805,859 |
| Net income per common share | | | | |
| Basic | $0.22 | $0.32 | $0.77 | $0.93 |
| Diluted | 0.22 | 0.32 | 0.76 | 0.93 |

Stock options and restricted stock totaling 461,564 and 569,642 shares were not included in the computation of diluted earnings per share in the third quarters of 2013 and 2012, respectively, because they were considered antidilutive. Stock options and restricted stock totaling 479,827 and 590,867 shares were not included in the computation of diluted earnings per share in the nine months ended September 30, 2013 and 2012, 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 2009 or by New Jersey tax authorities for years prior to 2008.

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, 2013.

**Reclassification:** Certain reclassifications may have been made in the prior periods' financial statements in order to conform to the 2013 presentation.

13

Table of Contents

**2. 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, 2013 and December 31, 2012 follows:

| | September 30, 2013 | | | |
|---|---|---|---|---|
| (In thousands) | Amortized Cost | Gross Unrecognized Gains | Gross Unrecognized Losses | Fair Value |
| U.S. government-sponsored entities | $15,984 | $ — | $ (770) | $15,214 |
| Mortgage-backed securities – residential | 194,093 | 3,220 | (1,011) | 196,302 |
| State and political subdivisions | 56,658 | 529 | (79) | 57,108 |
| Single-issuer trust preferred security | 2,999 | — | (599) | 2,400 |
| CRA investment | 3,000 | — | (72) | 2,928 |
| Total | $272,734 | $ 3,749 | $ (2,531) | $273,952 |

| | December 31, 2012 | | | |
|---|---|---|---|---|
| (In thousands) | Amortized Cost | Gross Unrecognized Gains | Gross Unrecognized Losses | Fair Value |
| U.S. government-sponsored entities | $26,647 | $ 200 | $ (2) | $26,845 |
| Mortgage-backed securities – residential | 215,092 | 6,366 | (18) | 221,440 |
| State and political subdivisions | 49,262 | 1,372 | (2) | 50,632 |
| Single-issuer trust preferred security | 2,999 | — | (710) | 2,289 |
| CRA investment | 3,000 | 62 | — | 3,062 |
| Marketable equity securities | 210 | 1 | — | 211 |
| Total | $297,210 | $ 8,001 | $ (732) | $304,479 |

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, 2013 and December 31, 2012.

| | September 30, 2013 | | | | | |
|---|---|---|---|---|---|---|
| | 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 |
| U.S. government sponsored entities | $15,214 | $ (770) | $ — | $ — | $15,214 | $ (770) |

| | | | | | | |
|---|---|---|---|---|---|---|
| Mortgage-backed securities - residential | 67,274 | (1,008) | 84 | (3) | 67,358 | (1.011) |
| State and political subdivisions | 5,938 | (79) | — | — | 5,938 | (79) |
| Single-issuer trust preferred security | — | — | 2,400 | (599) | 2,400 | (599) |
| CRA investment | 2,928 | (72) | — | — | 2,928 | (72) |
| Total | $91,354 | $ (1,929) | $ 2,484 | $ (602) | $93,838 | $ (2,531) |

| | December 31, 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 |
| U.S. government sponsored Entities | $4,998 | $ (2) | $ — | $ — | $4,998 | $ (2) |
| Mortgage-backed securities- residential | 8,433 | (17) | 95 | (1) | 8,528 | (18) |
| State and political subdivisions | 1,290 | (2) | — | — | 1,290 | (2) |
| Single-issuer trust preferred Security | — | — | 2,289 | (710) | 2,289 | (710) |
| Total | $14,721 | $ (21) | $ 2,384 | $ (711) | $17,105 | $ (732) |

Table of Contents

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. As of September 30, 2013, 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; therefore, none of the securities in unrealized loss position were determined to be other-than-temporarily impaired.

At September 30, 2013, the unrealized loss on the single-issuer trust preferred security of $599 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 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, 2013.

**3. LOANS**

Loans outstanding, by general ledger classification, as of September 30, 2013 and December 31, 2012, consisted of the following:

| (In thousands) | September 30, 2013 | % of Total Loans | December 31, 2012 | % of Total Loans |
|---|---|---|---|---|
| Residential mortgage | $ 527,927 | 37.79 % | $ 515,014 | 45.47 % |
| Commercial mortgage | 680,762 | 48.73 | 420,086 | 37.09 |
| Commercial loans | 110,843 | 7.93 | 115,372 | 10.19 |
| Construction loans | 8,390 | 0.60 | 9,328 | 0.83 |
| Home equity lines of credit | 47,020 | 3.37 | 49,635 | 4.38 |
| Consumer loans, including fixed rate home equity loans | 19,932 | 1.43 | 21,188 | 1.87 |
| Other loans | 2,075 | 0.15 | 1,961 | 0.17 |
| Total loans | $ 1,396,949 | 100.00% | $ 1,132,584 | 100.00% |

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, 2013 and December 31, 2012:

| (In thousands) | September 30, 2013 | % of Total Loans | December 31, 2012 | % of Total Loans |
|---|---|---|---|---|
| Primary residential mortgage | $ 538,758 | 38.67 % | $ 527,803 | 46.74 % |
| Home equity lines of credit | 47,020 | 3.37 | 49,635 | 4.40 |
| Junior lien loan on residence | 13,169 | 0.95 | 11,893 | 1.05 |
| Multifamily property | 393,889 | 28.27 | 161,705 | 14.32 |
| Owner-occupied commercial real estate | 82,437 | 5.92 | 84,720 | 7.50 |
| Investment commercial real estate | 264,516 | 18.99 | 242,586 | 21.48 |
| Commercial and industrial | 32,095 | 2.30 | 25,820 | 2.29 |
| Secured by farmland | 201 | 0.01 | 207 | 0.02 |
| Agricultural production loans | — | N/A | 14 | N/A |
| Commercial construction loans | 8,390 | 0.60 | 9,323 | 0.83 |
| Consumer and other loans | 12,783 | 0.92 | 15,480 | 1.37 |
| Total loans | $ 1,393,258 | 100.00 % | $ 1,129,186 | 100.00 % |
| Net deferred fees | 3,691 | | 3,398 | |
| Total loans including net deferred costs | $ 1,396,949 | | $ 1,132,584 | |

Table of Contents

Included in the totals above for September 30, 2013 are $417 thousand of unamortized discount compared to $543 thousand of unamortized discount for December 31, 2012.

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, 2013 and December 31, 2012:

September 30, 2013

| (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 | $ 3,816 | $ 120 | $ 534,942 | $ 2,782 | $ 538,758 | $ 2,902 |
| Home equity lines of credit | 158 | — | 46,862 | 238 | 47,020 | 238 |
| Junior lien loan on residence | 225 | — | 12,944 | 202 | 13,169 | 202 |
| Multifamily property | — | — | 393,889 | 2,910 | 393,889 | 2,910 |
| Owner-occupied commercial real estate | 3,390 | — | 79,047 | 2,075 | 82,437 | 2,075 |
| Investment commercial real estate | 4,949 | 769 | 259,567 | 3,799 | 264,516 | 4,568 |
| Commercial and industrial | 486 | 291 | 31,609 | 692 | 32,095 | 983 |
| Secured by farmland | — | — | 201 | 2 | 201 | 2 |
| Agricultural production | — | — | — | — | — | — |
| Commercial construction | 3,770 | — | 4,620 | 110 | 8,390 | 110 |
| Consumer and other | — | — | 12,783 | 66 | 12,783 | 66 |
| Total ALLL | $ 16,794 | $ 1,180 | $ 1,376,464 | $ 12,876 | $ 1,393,258 | $ 14,056 |

December 31, 2012

| | Ending ALLL | | Ending ALLL |
|---|---|---|---|

| (In thousands) | Total Loans Individually Evaluated For Impairment | Attributable To Loans Individually Evaluated For Impairment | Total Loans Collectively Evaluated For Impairment | Attributable To Loans Collectively Evaluated For Impairment | Total Loans | Total Ending ALLL Before Allocation | Allocation Of Previous Unallocated ALLL | Total Ending ALLL |
|---|---|---|---|---|---|---|---|---|
| Primary residential mortgage | $ 7,155 | $ 148 | $ 520,648 | $ 2,789 | $ 527,803 | $ 2,937 | $ 110 | $ 3,047 |
| Home equity lines of credit | 110 | — | 49,525 | 257 | 49,635 | 257 | 10 | 267 |
| Junior lien loan on residence | 562 | 240 | 11,331 | 71 | 11,893 | 311 | 3 | 314 |
| Multifamily property | — | — | 161,705 | 1,255 | 161,705 | 1,255 | 50 | 1,305 |
| Owner-occupied commercial real estate | 4,724 | — | 79,996 | 2,413 | 84,720 | 2,413 | 96 | 2,509 |
| Investment commercial real estate | 5,173 | 384 | 237,413 | 3,627 | 242,586 | 4,011 | 144 | 4,155 |
| Commercial and industrial | 423 | 41 | 25,397 | 733 | 25,820 | 774 | 29 | 803 |
| Secured by farmland | — | — | 207 | 3 | 207 | 3 | — | 3 |
| Agricultural production | — | — | 14 | — | 14 | — | — | — |
| Commercial construction | — | — | 9,323 | 231 | 9,323 | 231 | 9 | 240 |
| Consumer and other | — | — | 15,480 | 89 | 15,480 | 89 | 3 | 92 |
| Unallocated | — | — | — | 454 | — | 454 | (454 ) | — |
| Total ALLL | $ 18,147 | $ 813 | $ 1,111,039 | $ 11,922 | $ 1,129,186 | $ 12,735 | $ — | $ 12,735 |

16

Table of Contents

Impaired loans include nonaccrual loans of $6.9 million at September 30, 2013 and $11.7 million at December 31, 2012. Impaired loans also include performing residential, commercial mortgage and commercial troubled debt restructured loans of $6.1 million at September 30, 2013 and $6.4 million at December 31, 2012. The allowance allocated to troubled debt restructured loans which are nonaccrual was $261 thousand at September 30, 2013 and the allowance allocated to troubled debt restructured loans which are nonaccrual was $240 thousand at December 31, 2012. All accruing troubled debt restructured loans were paying in accordance with restructured terms as of September 30, 2013. The Corporation has not committed to lend additional amounts as of September 30, 2013 to customers with outstanding loans that are classified as loan restructurings.

The following tables present loans individually evaluated for impairment by class of loans as of September 30, 2013 and December 31, 2012:

September 30, 2013

| (In thousands) | Unpaid Principal Balance | Recorded Investment | Specific Reserves | Average Impaired Loans | Interest Income Recognized |
|---|---|---|---|---|---|
| With no related allowance recorded: | | | | | |
| Primary residential mortgage | 3,951 | 3,195 | — | 5,405 | $ 60 |
| Multifamily property | — | — | — | — | — |
| Owner-occupied commercial real estate | 3,645 | 3,390 | — | 4,290 | 55 |
| Investment commercial real estate | — | — | — | 144 | 2 |
| Commercial and industrial | 165 | 165 | — | 106 | 3 |
| Commercial Construction | 3,770 | 3,770 | — | — | — |
| Home equity lines of credit | 160 | 158 | — | 121 | 4 |
| Junior lien loan on residence | 302 | 225 | — | 344 | 6 |
| Consumer and other | — | — | — | — | — |
| Total loans with no related allowance | 11,993 | 10,903 | — | 10,410 | $ 130 |
| With related allowance recorded: | | | | | |
| Primary residential mortgage | 621 | 621 | 120 | 631 | $ 28 |
| Owner-occupied commercial real estate | — | — | — | — | — |
| Investment commercial real estate | 4,949 | 4,949 | 769 | 4,949 | 619 |
| Commercial and industrial | 331 | 321 | 291 | 252 | 4 |
| Junior lien loan on residence | — | — | — | — | — |
| Total loans with related allowance | 5,901 | 5,891 | 1,180 | 5,832 | $ 651 |
| Total loans individually evaluated for impairment | 17,894 | 16,794 | 1,180 | 16,242 | $ 781 |

December 31, 2012

| (In thousands) | Unpaid Principal Balance | Recorded Investment | Specific Reserves | Average Impaired Loans | Interest Income Recognized |
|---|---|---|---|---|---|
| With no related allowance recorded: | | | | | |
| Primary residential mortgage | $ 8,605 | $ 6,148 | $ — | $ 8,110 | $ 384 |
| Multifamily property | — | — | — | 185 | 16 |
| Owner-occupied commercial real estate | 4,971 | 4,724 | — | 9,575 | 570 |

| | | | | | |
|---|---|---|---|---|---|
| Investment commercial real estate | 336 | — | — | 796 | 51 |
| Commercial and industrial | 432 | 345 | — | 640 | 47 |
| Home equity lines of credit | 110 | 110 | — | 221 | 11 |
| Junior lien loan on residence | 429 | 235 | — | 439 | 30 |
| Total loans with no related allowance | $ 14,883 | $ 11,562 | $ — | $ 19,966 | $ 1,109 |
| With related allowance recorded: | | | | | |
| Primary residential mortgage | $ 1,056 | $ 1,007 | $ 148 | $ 851 | $ 38 |
| Multifamily property | — | — | — | — | — |
| Owner-occupied commercial real estate | — | — | — | — | — |
| Investment commercial real estate | 5,183 | 5,173 | 384 | 5,013 | 251 |
| Commercial and industrial | 78 | 78 | 41 | 92 | 74 |
| Junior lien loan on residence | 327 | 327 | 240 | — | 8 |
| Commercial construction | — | — | — | 194 | — |
| Total loans with related allowance | $ 6,644 | $ 6,585 | $ 813 | $ 6,150 | $ 371 |
| Total loans individually evaluated for Impairment | $ 21,527 | $ 18,147 | $ 813 | $ 26,116 | $ 1,480 |

17

Table of Contents

The Corporation did not recognize any income on nonaccruing impaired loans for the three and nine months ended September 30, 2013 and 2012.

The following tables present the recorded investment in nonaccrual and loans past due over 90 days still on accrual by class of loans as of September 30, 2013 and December 31, 2012:

| | September 30, 2013 | |
|---|---|---|
| (In thousands) | Nonaccrual | Loans Past Due Over 90 Days And Still Accruing Interest |
| Primary residential mortgage | $ 2,804 | $ — |
| Home equity lines of credit | 111 | — |
| Junior lien loan on residence | 225 | — |
| Owner-occupied commercial real estate | 3,390 | — |
| Commercial and industrial | 361 | — |
| Total | $ 6,891 | $ — |

| | December 31, 2012 | |
|---|---|---|
| (In thousands) | Nonaccrual | Loans Past Due Over 90 Days And Still Accruing Interest |
| Primary residential mortgage | $ 6,519 | $ — |
| Home equity lines of credit | 110 | — |
| Junior lien loan on residence | 562 | — |
| Owner-occupied commercial real estate | 4,317 | — |
| Investment commercial real estate | 224 | — |
| Total | $ 11,732 | $ — |

The following tables present the aging of the recorded investment in past due loans as of September 30, 2013 and December 31, 2012 by class of loans, excluding nonaccrual loans:

| | September 30, 2013 | | | |
|---|---|---|---|---|
| (In thousands) | 30-59 Days Past Due | 60-89 Days Past Due | Greater Than 90 Days Past Due | Total Past Due |
| Primary residential mortgage | $ 1,661 | $ 96 | $ — | $ 1,757 |

| | | | | |
|---|---|---|---|---|
| Home equity lines of credit | 24 | — | — | 24 |
| Investment commercial real estate | — | 244 | — | 244 |
| Consumer and other loans | 13 | 1 | — | 14 |
| Total | $1,698 | $ 341 | $ — | $ 2,039 |

Table of Contents

| (In thousands) | December 31, 2012 30-59 Days Past Due | 60-89 Days Past Due | Greater Than 90 Days Past Due | Total Past Due |
|---|---|---|---|---|
| Primary residential mortgage | $2,513 | $ 203 | $ — | $ 2,716 |
| Home equity lines of credit | 25 | — | — | 25 |
| Junior lien loan on residence | 31 | — | — | 31 |
| Owner-occupied commercial real estate | 407 | — | — | 407 |
| Investment commercial real estate | 592 | — | — | 592 |
| Commercial and industrial | 15 | — | — | 15 |
| Total | $3,583 | $ 203 | $ — | $ 3,786 |

**Credit Quality Indicators:**

The Corporation categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Corporation analyzes loans individually by classifying the loans as to credit risk. The risk rating analysis of loans is performed (i) when the loan is initially underwritten, (ii) annually for loans in excess of $500,000, (iii) on a random quarterly basis from either internal reviews with the Senior Credit Officer or externally through an independent loan review firm, or (iv) whenever Management otherwise identifies a potentially negative trend or issue relating to a borrower. In addition, for all loan types, the Corporation evaluates credit quality based on the aging status of the loan, which was previously presented.

The Corporation uses the following definitions for risk ratings:

Special Mention: Loans subject to special mention have a potential weakness that deserves Management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loans or of the institution's credit position at some future date.

Substandard: Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful: Loans classified as doubtful have all the weakness inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Table of Contents

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass-rated loans. As of September 30, 2013, and based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

| (In thousands) | Pass | Special Mention | Substandard | Doubtful |
|---|---|---|---|---|
| Primary residential mortgage | $533,479 | $1,101 | $ 4,178 | $ — |
| Home equity lines of credit | 46,909 | — | 111 | — |
| Junior lien loan on residence | 12,916 | — | 253 | — |
| Multifamily property | 393,374 | 515 | — | — |
| Farmland | 201 | — | — | — |
| Owner-occupied commercial real estate | 72,369 | 653 | 9,415 | — |
| Investment commercial real estate | 234,645 | 15,654 | 14,217 | — |
| Agricultural production loans | — | — | — | — |
| Commercial and industrial | 31,585 | 24 | 486 | — |
| Commercial construction | 3,067 | 1,553 | 3,770 | — |
| Consumer and other loans | 11,931 | 852 | — | — |
| Total | $1,340,476 | $20,352 | $ 32,430 | $ — |

As of December 31, 2012, and based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

| (In thousands) | Pass | Special Mention | Substandard | Doubtful |
|---|---|---|---|---|
| Primary residential mortgage | $517,336 | $3,152 | $ 7,315 | $ — |
| Home equity lines of credit | 49,525 | — | 110 | — |
| Junior lien loan on residence | 11,294 | 37 | 562 | — |
| Multifamily property | 161,229 | 476 | — | — |
| Owner-occupied commercial real estate | 73,809 | 334 | 10,577 | — |
| Investment commercial real estate | 216,394 | 13,237 | 12,955 | — |
| Agricultural production loans | 14 | — | — | — |
| Commercial and industrial | 25,191 | 134 | 495 | — |
| Secured by farmland | 207 | — | — | — |
| Commercial construction | 3,999 | 5,324 | — | — |
| Consumer and other loans | 15,480 | — | — | — |
| Total | $1,074,478 | $22,694 | $ 32,014 | $ — |

At September 30, 2013, $16.8 million of the $32.4 million of the substandard loans were also considered impaired compared to December 31, 2012, when $18.1 million of the $32.0 million of the substandard loans were also impaired.

The activity in the allowance for loan losses for the three months ended September 30, 2013 is summarized below:

| (In thousands) | July 1, 2013 Beginning ALLL | Charge-Offs | Recoveries | Provision | September 30, 2013 Ending ALLL |
|---|---|---|---|---|---|
| Primary residential mortgage | $ 3,062 | $ (155) | $ 35 | $ (40) | $ 2,902 |
| Home equity lines of credit | 253 | — | — | (15) | 238 |
| Junior lien loan on residence | 71 | (50) | 2 | 179 | 202 |
| Multifamily property | 2,159 | — | — | 751 | 2,910 |
| Owner-occupied commercial real estate | 2,414 | — | 19 | (358) | 2,075 |
| Investment commercial real estate | 4,160 | — | 6 | 402 | 4,568 |
| Agricultural production loans | — | — | — | — | — |
| Commercial and industrial | 1,130 | — | 12 | (159) | 983 |
| Secured by farmland | 3 | — | — | (1) | 2 |
| Commercial construction | 112 | — | — | (2) | 110 |
| Consumer and other loans | 74 | (3) | 2 | (7) | 66 |
| Total ALLL | $ 13,438 | $ (208) | $ 76 | $ 750 | $ 14,056 |

20

Table of Contents

The activity in the allowance for loan losses for the nine months ended September 30, 2013 is summarized below:

| (In thousands) | January 1, 2013 Beginning ALLL | Charge-Offs | Recoveries | Provision | September 30, 2013 Ending ALLL |
|---|---|---|---|---|---|
| Primary residential mortgage | $ 3,047 | $ (611) | $ 48 | $ 418 | $ 2,902 |
| Home equity lines of credit | 267 | — | — | (29) | 238 |
| Junior lien loan on residence | 314 | (345) | 9 | 224 | 202 |
| Multifamily property | 1,305 | — | 11 | 1,594 | 2,910 |
| Owner-occupied commercial real estate | 2,509 | — | 57 | (491) | 2,075 |
| Investment commercial real estate | 4,155 | — | 18 | 395 | 4,568 |
| Agricultural production loans | — | — | — | — | — |
| Commercial and industrial | 803 | (15) | 49 | 146 | 983 |
| Secured by farmland | 3 | — | — | (1) | 2 |
| Commercial construction | 240 | — | 1 | (131) | 110 |
| Consumer and other loans | 92 | (7) | 6 | (25) | 66 |
| Total ALLL | $ 12,735 | $ (978) | $ 199 | $ 2,100 | $ 14,056 |

The activity in the allowance for loan losses for the three months ended September 30, 2012 is summarized below:

| (In thousands) | July 1, 2012 Beginning ALLL | Charge-Offs | Recoveries | Provision | September 30, 2012 Ending ALLL |
|---|---|---|---|---|---|
| Primary residential mortgage | $ 2,602 | $ (183) | $ 1 | $ 499 | $ 2,919 |
| Home equity lines of credit | 208 | — | — | 45 | 253 |
| Junior lien loan on residence | 55 | — | 1 | 10 | 66 |
| Multifamily property | 839 | (18) | — | 154 | 975 |
| Farmland | 3 | — | — | — | 3 |
| Owner-occupied commercial real estate | 3,418 | (345) | 19 | 271 | 3,363 |
| Investment commercial real estate | 4,784 | (64) | 2 | (122) | 4,600 |
| Agricultural production loans | 1 | — | — | — | 1 |
| Commercial and industrial | 917 | — | 51 | (152) | 816 |
| Commercial construction | 234 | — | — | 57 | 291 |
| Consumer and other loans | 77 | (8) | 1 | 8 | 78 |
| Unallocated | 548 | — | — | (20) | 528 |
| Total ALLL | $ 13,686 | $ (618) | $ 75 | $ 750 | $ 13,893 |

The activity in the allowance for loan losses for the nine months ended September 30, 2012 is summarized below:

| (In thousands) | January 1, 2012 Beginning ALLL | Charge-Offs | Recoveries | Provision | September 30, 2012 Ending ALLL |
|---|---|---|---|---|---|
| Primary residential mortgage | $ 2,414 | $ (1,171) | $ 2 | $ 1,674 | $ 2,919 |
| Home equity lines of credit | 204 | (91) | — | 140 | 253 |
| Junior lien loan on residence | 64 | (57) | 5 | 54 | 66 |
| Multifamily property | 705 | (393) | — | 663 | 975 |
| Farmland | — | — | — | 3 | 3 |
| Owner-occupied commercial real estate | 3,108 | (1,261) | 145 | 1,371 | 3,363 |
| Investment commercial real estate | 4,181 | (120) | 11 | 528 | 4,600 |
| Agricultural production loans | 1 | — | — | — | 1 |
| Commercial and industrial | 1,291 | (112) | 55 | (418) | 816 |
| Commercial construction | 669 | (72) | — | (306) | 291 |
| Consumer and other loans | 78 | (28) | 7 | 21 | 78 |
| Unallocated | 508 | — | — | 20 | 528 |
| Total ALLL | $ 13,223 | $ (3,305) | $ 225 | $ 3,750 | $ 13,893 |

Table of Contents

**Troubled Debt Restructurings:**

The Corporation has allocated $919 thousand and $483 thousand of specific reserves, on accruing TDR's, to customers whose loan terms have been modified in troubled debt restructurings as of September 30, 2013 and December 31, 2012, respectively. There were no unfunded commitments to lend additional amounts to customers with outstanding loans that are classified as troubled debt restructurings.

During the nine month period ending September 30, 2013 and 2012, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a permanent reduction of the recorded investment in the loan.

The following table presents loans by class modified as troubled debt restructurings that occurred during the three-month period ending September 30, 2013:

| (Dollars in thousands) | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
|---|---|---|---|
| Primary residential mortgage | 1 | $ 278 | $ 278 |
| Total | 1 | $ 278 | $ 278 |

The following table presents loans by class modified as troubled debt restructurings that occurred during the nine month period ending September 30, 2013:

| (Dollars in thousands) | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
|---|---|---|---|
| Primary residential mortgage | 4 | $ 760 | $ 760 |
| Total | 4 | $ 760 | $ 760 |

The identification of the troubled debt restructured loans did not have a significant impact on the allowance for loan losses. There were no loans modified as troubled debt restructurings that occurred during the three month period ending September 30, 2012.

The following table presents loans by class modified as troubled debt restructurings that occurred during the nine month period ending September 30, 2012:

| (Dollars in thousands) | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
|---|---|---|---|
| Primary residential mortgage | 4 | 603 | $ 603 |
| Junior lien on residence | 1 | 240 | 240 |
| Owner-occupied commercial real estate | 1 | 2,177 | 2,177 |
| Total | 6 | 3,020 | $ 3,020 |

22

Table of Contents

The following table presents loans by class modified as troubled debt restructurings for which there was a payment default, within twelve months of modification, during the nine month period ended September 30, 2013:

| (Dollars in thousands) | Number of Contracts | Recorded Investment |
|---|---|---|
| Primary residential mortgage | 1 | $ 59 |
| Total | 1 | $ 59 |

There were no loans modified as troubled debt restructurings for which there was a payment default, within twelve months of modification, during the nine months ended September 30, 2012.

The default that occurred during the nine months ended September 30, 2013 did not have a significant impact on the allowance for loan losses.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Corporation’s internal underwriting policy. At the time a loan is restructured, the Bank performs a full re-underwriting analysis, which includes, at a minimum, obtaining current financial statements and tax returns, copies of all leases, and an updated independent appraisal of the property. A loan will continue to accrue interest if it can be reasonably determined that the borrower should be able to perform under the modified terms, that the loan has not been chronically delinquent (both to debt service and real estate taxes) or in nonaccrual status since its inception, and that there have been no charge-offs on the loan. Restructured loans with previous charge-offs would not accrue interest at the time of the troubled debt restructuring. At a minimum, six months of contractual payments would need to be made on a restructured loan before returning a loan to accrual status. Once a loan is classified as a TDR, the loan is reported as a TDR until the loan is paid in full, sold or charged-off. In rare circumstances, a loan may be removed from TDR status, if it meets the requirements of ASC 310-40-50-2.

**4. FEDERAL HOME LOAN BANK ADVANCES AND OTHER BORROWINGS**

Advances from the Federal Home Loan Bank of New York (FHLB) totaled $47.7 million and $12.2 million at September 30, 2013 and December 31, 2012, respectively, with a weighted average interest rate of 1.95 and 3.03 percent, respectively. Advances totaling $35.7 million, with a weighted average interest rate of 1.59 percent at September 30, 2013, have fixed maturity dates. These advances are secured by blanket pledges of certain 1-4 family residential mortgages totaling $389.5 million at September 30, 2013.

Also at September 30, 2013, the Corporation had $12.0 million in variable rate advances, with a weighted average rate of 3.01 percent, that are noncallable for one, two or three years and then callable quarterly with final maturities of five , seven or ten years from the original date of the advance. All of these advances are beyond their initial noncallable periods. These advances are secured by pledges of investment securities totaling $14.0 million at September 30, 2013.

There were overnight borrowings of $30.4 million at September 30, 2013. There were no overnight borrowings at December 31, 2012. Overnight borrowings from the FHLB averaged $18.9 million and $6.4 million with a weighted average interest rate of 0.35 percent and 0.34 percent for the three and nine months ended September 30, 2013, respectively.

Table of Contents

The final maturity dates of the advances and other borrowings are scheduled as follows:

| (In thousands) | |
|---|---|
| 2013 | $— |
| 2014 | — |
| 2015 | — |
| 2016 | 11,897 |
| 2017 | 14,897 |
| Over 5 years | 20,898 |
| Total | $47,692 |

**5. BUSINESS SEGMENTS**

The Corporation assesses its results among two operating segments, Banking and Peapack-Gladstone Bank Trust & Investments. Management uses certain methodologies to allocate income and expense to the business segments. A funds transfer pricing methodology is used to assign interest income and interest expense. Certain indirect expenses are allocated to segments. These include support unit expenses such as technology and operations and other support functions. Taxes are allocated to each segment based on the effective rate for the period shown.

Banking: The Banking segment includes commercial, commercial real estate, residential and consumer lending activities; deposit generation; operation of ATMs; telephone and internet banking services; merchant credit card services and customer support and sales.

Peapack-Gladstone Bank Trust & Investments: Peapack-Gladstone Bank Trust & Investments includes asset management services provided for individuals and institutions; personal trust services, including services as executor, trustee, administrator, custodian and guardian; corporate trust services including services as trustee for pension and profit sharing plans; and other financial planning and advisory services.

The following table presents the statements of income and total assets for the Corporation's reportable segments for the three and nine months ended September 30, 2013 and 2012.

Three Months Ended September 30, 2013

Peapack-
Gladstone
Bank Trust

| (In thousands) | Banking | & Investments | Total |
| --- | --- | --- | --- |
| Net interest income | $ 12,537 | $ 836 | $ 13,373 |
| Noninterest income | 1,427 | 3,355 | 4,782 |
| Total income | 13,964 | 4,191 | 18,155 |
| | | | |
| Provision for loan losses | 750 | — | 750 |
| Salaries and benefits | 6,975 | 1,952 | 8,927 |
| Premises and equipment expense | 2,181 | 144 | 2,325 |
| Other noninterest expense | 1,894 | 1,019 | 2,913 |
| Total noninterest expense | 11,800 | 3,115 | 14,915 |
| Income before income tax expense | 2,164 | 1,076 | 3,240 |
| Income tax expense | 850 | 426 | 1,276 |
| Net income | $ 1,314 | $ 650 | $ 1,964 |

24

Table of Contents

| | Three Months Ended September 30, 2012 | | |
|---|---|---|---|
| (In thousands) | Banking | Peapack-Gladstone Bank Trust & Investments | Total |
| Net interest income | $ 12,011 | $ 839 | $ 12,850 |
| Noninterest income | 1,564 | 2,995 | 4,559 |
| Total income | 13,575 | 3,834 | 17,409 |
| | | | |
| Provision for loan losses | 750 | — | 750 |
| Salaries and benefits | 5,696 | 1,333 | 7,029 |
| Premises and equipment expense | 2,149 | 141 | 2,290 |
| Other noninterest expense | 1,837 | 837 | 2,674 |
| Total noninterest expense | 10,432 | 2,311 | 12,743 |
| Income before income tax expense | 3,143 | 1,523 | 4,666 |
| Income tax expense | 1,235 | 599 | 1,834 |
| Net income | $ 1,908 | $ 924 | $ 2,832 |

| | Nine Months Ended September 30, 2013 | | |
|---|---|---|---|
| (In thousands) | Banking | Peapack-Gladstone Bank Trust & Investments | Total |
| Net interest income | $ 35,602 | $ 2,646 | $ 38,248 |
| Noninterest income | 5,051 | 10,571 | 15,622 |
| Total income | 40,653 | 13,217 | 53,870 |
| | | | |
| Provision for loan losses | 2,100 | — | 2,100 |
| Salaries and benefits | 19,464 | 4,477 | 23,941 |
| Premises and equipment expense | 6,531 | 436 | 6,967 |
| Other noninterest expense | 6,311 | 3,318 | 9,629 |
| Total noninterest expense | 34,406 | 8,231 | 42,637 |
| Income before income tax expense | 6,247 | 4,986 | 11,233 |
| Income tax expense | 2,429 | 1,938 | 4,367 |
| Net income | $ 3,818 | $ 3,048 | $ 6,866 |
| | | | |
| Total assets for period end | $ 1,796,440 | $ 1,264 | $ 1,797,704 |

| | Nine Months Ended September 30, 2012 | | |
|---|---|---|---|
| (In thousands) | Banking | Peapack-Gladstone Bank Trust & Investments | Total |
| Net interest income | $ 36,116 | $ 2,528 | $ 38,644 |
| Noninterest income | 4,390 | 9,563 | 13,953 |

| | | | |
|---|---|---|---|
| Total income | 40,506 | 12,091 | 52,597 |
| | | | |
| Provision for loan losses | 3,750 | — | 3,750 |
| Salaries and benefits | 15,631 | 3,919 | 19,550 |
| Premises and equipment expense | 6,604 | 430 | 7,034 |
| Other noninterest expense | 5,395 | 2,798 | 8,193 |
| Total noninterest expense | 31,380 | 7,147 | 38,527 |
| Income before income tax expense | 9,126 | 4,944 | 14,070 |
| Income tax expense | 3,524 | 1,908 | 5,432 |
| Net income | $ 5,602 | $ 3,036 | $ 8,638 |
| | | | |
| Total assets for period end | $ 1,582,127 | $ 1,363 | $ 1,583,490 |

Table of Contents

**6. FAIR VALUE**

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

| | |
|---|---|
| Level 1: | Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date. |
| Level 2: | Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data. |
| Level 3: | Significant unobservable inputs that reflect a company’s own assumptions about the assumptions that market participants would use in pricing as asset or liability. |

The Corporation used the following methods and significant assumptions to estimate the fair value:

Investment Securities: The fair values for investment securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3).

Loans Held for Sale, at Fair Value: The fair value of loans held for sale is determined using quoted prices for similar assets, adjusted for specific attributes of that loan or other observable market data, such as outstanding commitments from third party investors (Level 2).

Loans Held for Sale, at Lower of Cost or Fair Value: The fair value of this category of loans held for sale is determined using the lower of book value or estimated sale price as calculated by a third-party broker for each loan (Level 2).

Impaired Loans: The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

Other Real Estate Owned: Nonrecurring adjustments to certain commercial and residential real estate properties classified as other real estate owned (OREO) are measured at fair value, less costs to sell. Fair values are based on recent real estate appraisals. These appraisals may use a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

Appraisals for both collateral-dependent impaired loans and other real estate owned are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by Management. Once received, a member of the Credit Department reviews the assumptions and approaches utilized in the appraisal, as well as, the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. Appraisals on collateral dependent impaired loans and other real estate owned