

PEAPACK GLADSTONE FINANCIAL CORP
Form 10-K
March 14, 2019

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934

For the Fiscal Year Ended December 31, 2018

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 (I.R.S. Employer
incorporation or organization) Identification No.)

500 Hills Drive, Suite 300
Bedminster, NJ 07921
(Address of principal executive offices) (Zip Code)

Registrant's telephone number (908) 234-0700

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Exchange on which Registered
Common Stock, No par value	NASDAQ Global Select Market

Securities registered pursuant to Section 12(g) of the Act:

NONE

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

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

<input type="checkbox"/> Large accelerated filer	<input type="checkbox"/> Accelerated filer
<input type="checkbox"/> Non-accelerated filer	<input type="checkbox"/> Smaller reporting company
<input type="checkbox"/> Emerging growth company	

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

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

The aggregate market value of the shares held by unaffiliated stockholders was approximately \$632 million on June 30, 2018.

As of March 1, 2019, 19,349,230 shares of no par value Common Stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company's Definitive Proxy Statement for the Company's 2019 Annual Meeting of Shareholders (the "2019 Proxy Statement") are incorporated by reference into Part III. The Company expects to file the 2019 Proxy Statement within 120 days of December 31, 2018.

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FORM 10-K

PEAPACK-GLADSTONE FINANCIAL CORPORATION

For the Year Ended December 31, 2018

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PART I

Item 1. BUSINESS

The disclosures set forth in this Form 10-K are qualified by Item 1A-Risk Factors and the section captioned “Cautionary Statement Concerning Forward-Looking Statements” in Item 7-Management’s Discussion and Analysis of Financial Condition and Results of Operations of this report and other cautionary statements set forth elsewhere in this report and filed by us from time to time with the Securities and Exchange Commission. The terms “Peapack,” the “Company,” “we,” “our” and “us” refer to Peapack-Gladstone Financial Corporation and its wholly-owned subsidiaries unless otherwise indicated or the context requires otherwise.

The Corporation

Peapack-Gladstone Financial Corporation is a bank holding company registered under the Bank Holding Company Act of 1956, as amended (the “Holding Company Act”). The Company was organized under the laws of New Jersey in August 1997 by the Board of Directors of Peapack-Gladstone Bank (the “Bank”), its principal subsidiary, to become a holding company for the Bank. The Bank is a state chartered commercial bank founded in 1921 under the laws of the State of New Jersey. The Bank is a member of the Federal Reserve System. Through its branch network in Somerset, Morris, Hunterdon and Union counties and its private banking locations in Bedminster, Morristown, Princeton and Teaneck, its private wealth management, commercial private banking, retail private banking and residential lending divisions, along with its online platforms, Peapack-Gladstone Bank offers an unparalleled commitment to client service.

Our wealth management clients include individuals, families, foundations, endowments, trusts and estates. Our commercial loan clients include business owners, professionals, retailers, contractors and real estate investors. Most forms of commercial lending are offered, including working capital lines of credit, term loans for fixed asset acquisitions, commercial mortgages, multifamily mortgages and other forms of asset-based financing.

In addition to commercial lending activities, we offer a wide range of consumer banking services, including checking and savings accounts, money market and interest-bearing checking accounts, certificates of deposit, and individual retirement accounts. We also offer residential mortgages, home equity lines of credit and other second mortgage loans. Automated teller machines are available at 24 locations. Internet banking, including an online bill payment option and mobile phone banking, is available to clients.

Available Information

Peapack-Gladstone Financial Corporation is a public company, and files interim, quarterly and annual reports with the Securities and Exchange Commission (the “SEC”). These reports and any amendments to these reports are available for free on the SEC’s website, www.sec.gov, and on our website, www.pgbank.com, as soon as reasonably practical after they have been filed with or furnished to the SEC. Information on our website should not be considered a part of this Annual Report on Form 10-K.

Employees

As of December 31, 2018, the Company employed 409 full-time equivalent persons. Management considers relations with employees to be satisfactory.

Peapack-Gladstone Bank’s Private Wealth Management Division

The Bank's Private Wealth Management Division is a New Jersey-chartered trust and investment businesses with \$5.8 billion of assets under management and/or administration as of December 31, 2018. It is headquartered in Bedminster, with additional private banking locations in Morristown, Princeton and Teaneck, New Jersey, as well as at the Bank's subsidiaries, PGB Trust & Investments of Delaware, in Greenville, Delaware, Murphy Capital Management ("MCM"), in Gladstone, New Jersey, Quadrant Capital Management ("Quadrant"), in Fairfield, New Jersey and Lassus Wherley and Associates ("Lassus Wherley") in New Providence, New Jersey and Bonita Springs, Florida. The Bank's Private Wealth Management Division is known for its integrity, client service and broad range of fiduciary, investment management and tax services, designed specifically to meet the needs of high net-worth individuals, families, foundations and endowments.

We believe our wealth management business differentiates us from our competition and adds significant value. We intend to grow this business further both in and around our market areas through our Delaware Trust subsidiary; through our existing wealth, loan and depository client base; through our innovative private banking service model, which utilizes private bankers working together to provide fully integrated client solutions; and through potential acquisitions of complimentary and/or additive wealth management businesses. Throughout the wealth management division and all other business lines, we will continue to provide the unparalleled personalized, high-touch service our valued clients have come to expect.

Our Markets

Our current market is defined as the NY-NJ-PA metropolitan statistical area. Our primary market areas are located in New Jersey and areas of New York. New Jersey had a total population exceeding 8.9 million and a median household income of \$76,475 as of 2013-2017, compared to the U.S. median household income of \$57,652 as of 2013-2017, according to estimates from the United States Census Bureau. Somerset County, where we are headquartered, is among one of the wealthiest in New Jersey, with a 2013-2017 median household income of \$106,046 according to estimates from the United States Census Bureau. We believe that these markets have economic and competitive dynamics that are consistent with our objectives and favorable to executing our growth strategy.

Competition

We operate in a market area with a high concentration of banking and financial institutions and we face substantial competition in attracting deposits and in originating loans and leases. A number of our competitors are significantly larger institutions with greater financial and managerial resources and lending limits. Our ability to compete successfully is a significant factor affecting our growth potential and profitability.

Our competition for deposits, loans and leases historically has come from other insured financial institutions such as local and regional commercial banks, savings institutions, leasing companies and credit unions located in our primary market area. We also compete with mortgage banking and finance companies for real estate loans and with commercial banks and savings institutions for consumer loans.

The Company also faces direct competition for wealth and advisory services from registered investment advisory firms and investment management companies.

Our Business Strategy

We implemented our Strategic Plan – Expanding Our Reach – in early 2013. At that time, we recognized three industry headwinds, the Plan would help address.

- that the low interest rate and tight spread environment would likely continue;
- that costs associated with compliance and risk management would increase significantly; and
- that our clients would continue to shift from traditional branches in favor of electronic delivery channels.

The key elements of our business strategy include:

- a robust wealth management business that provides a diversified and relatively predictable and stable source of revenue over time, with growth organically and through strategic acquisitions;
- a focus on commercial banking with private bankers focused on providing high touch client service through an advice based approach encompassing corporate and industrial (C&I) lending (including equipment finance lending and leasing), wealth management, depository services, electronic banking, SBA and other commercial real estate lending, and corporate advisory services;

- a highly efficient branch network and deposit gathering processes;
- robust risk management processes, including, but not limited to, active loan portfolio, capital, liquidity, and interest rate risk stress testing;
- a focus on the community and community service and involvement.

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Governmental Policies and Legislation

The banking industry is highly regulated. Statutory and regulatory controls increase a bank holding company's cost of doing business and limit the options of its management to deploy assets and maximize income. Proposals to change the laws and regulations governing the operations and taxation of banks, bank holding companies and other financial institutions are frequently made in Congress, in state legislatures and before various bank regulatory agencies. The likelihood of any major changes and the impact such changes might have on the Company or the Bank is impossible to predict. The following description is not intended to be complete and is qualified in its entirety to applicable laws and regulations.

Bank Regulation

As a New Jersey-chartered commercial bank, the Bank is subject to the regulation, supervision, and examination of the New Jersey Department of Banking and Insurance ("NJDOBI"). As a Federal Reserve-member bank, the Bank is also subject to the regulation, supervision and examination of the Federal Reserve Board ("FRB") as its primary federal regulator. The regulations of the FRB and the NJDOBI impact virtually all of our activities, including the minimum level of capital we must maintain, our ability to pay dividends, our ability to expand through new branches or acquisitions and various other matters.

Investment Advisory Regulations

In addition to the Bank's Private Wealth Management Division, we offer wealth management services through two subsidiaries of the Bank. These subsidiaries are registered investment advisers under the Investment Advisers Act of 1940, as amended, and as such are supervised by the SEC. They are also subject to various other federal laws and state licensing and/or registration requirements. These laws and regulations generally grant supervisory agencies broad administrative powers, including the power to limit or restrict the carrying on of business for failure to comply with such laws.

Holding Company Supervision

The Company is a bank holding company within the meaning of the Holding Company Act. As a bank holding company, the Company is supervised by the FRB and is required to file reports with the FRB and provide such additional information as the FRB may require.

The Holding Company Act prohibits the Company, with certain exceptions, from acquiring direct or indirect ownership or control of more than five percent of the voting shares of any company which is not a bank and from engaging in any business other than that of banking, managing and controlling banks or furnishing services to subsidiary banks, except that it may, upon application, engage in, and may own shares of companies engaged in, certain businesses found by the FRB to be so closely related to banking "as to be a proper incident thereto." The Holding Company Act requires prior approval by the FRB of the acquisition by the Company of more than five percent of the voting stock of any additional bank. Satisfactory capital ratios, Community Reinvestment Act ratings and anti-money laundering policies are generally prerequisites to obtaining federal regulatory approval to make acquisitions. The policy of the FRB provides that a bank holding company is expected to act as a source of financial strength to its subsidiary bank and to commit resources to support the subsidiary bank in circumstances in which it might not do so absent that policy. Acquisitions through the Bank require the approval of the FRB and the NJDOBI.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

The Dodd-Frank Wall Street Report and Consumer Protection Act of 2010 (the “Dodd-Frank Act”) significantly changed bank regulation and has affected the lending, investment, trading and operating activities of depository institutions and their holding companies. The Dodd-Frank Act also created a new Consumer Financial Protection Bureau (the “CFPB”) with extensive powers to supervise and enforce consumer protection laws. The CFPB has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit “unfair, deceptive or abusive” acts and practices. The CFPB also has examination and enforcement authority over all banks and savings institutions with more than \$10 billion in assets. Banks and savings institutions with \$10 billion or less in assets, such as the Bank, continue to be examined by their applicable federal bank regulators. The Dodd-Frank Act required the CFPB to issue regulations requiring lenders to make a reasonable good faith determination as to a prospective borrower’s ability to repay a residential mortgage loan. The final “Ability to Repay” rules, which were effective beginning January 2014, established a “qualified mortgage” safe harbor for loans whose terms and features are deemed to make the loan less risky.

The CFPB may issue additional final rules regarding mortgages in the future, including amendments to certain mortgage servicing rules regarding forced-placed insurance notices, policies and procedures and other matters. We cannot ensure you that existing or future regulations will not have a material adverse impact on our residential mortgage loan business.

To the extent the Dodd-Frank Act remains in place or is not materially amended it is likely to continue to affect our cost of doing business, limit our permissible activities, and affect the competitive balance within our industry and market areas.

The Economic Growth Regulatory Relief and Consumer Protection Act of 2018 (the “Relief Act”) modified certain aspects of the Dodd-Frank Act to relieve regulatory burden. In particular, the legislation exempted banks with less than \$10 billion of assets from the ability to repay requirements for certain qualified residential mortgage loans held in portfolio.

Capital Requirements

Pursuant to the Federal Deposit Insurance Corporation Improvement Act of 1991 (“FDICIA”), each federal banking agency has promulgated regulations, specifying the levels at which a financial institution would be considered “well capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized,” or “critically undercapitalized,” and to take certain mandatory and discretionary supervisory actions based on the capital level of the institution.

FRB regulations require member banks to meet several minimum capital standards: a common equity Tier 1 (“CET1”) capital to risk-based assets ratio of 4.5%, a Tier 1 capital to risk-based assets ratio of 6.0%, a total capital to risk-based assets of 8%, and a 4% Tier 1 capital to total assets leverage ratio. The present capital requirements were effective January 1, 2015 and represent increased standards over the previous requirements. The current requirements implement recommendations of the Basel Committee on Banking Supervision and certain requirements of federal law.

The capital standards require the maintenance of CET1 capital, Tier 1 capital and total capital to risk-weighted assets of at least 4.5%, 6% and 8%, respectively, and a leverage ratio of at least 4% Tier 1 capital. CET1 capital is generally defined as common stockholders’ equity and retained earnings. Tier 1 capital is generally defined as CET1 and additional Tier 1 capital. Additional Tier 1 capital includes certain noncumulative perpetual preferred stock and related surplus and minority interests in equity accounts of consolidated subsidiaries. Total capital includes Tier 1 capital and Tier 2 capital. Tier 2 capital is comprised of capital instruments and related surplus, meeting specified requirements, and may include cumulative preferred stock and long-term perpetual preferred stock, mandatory

convertible securities, intermediate preferred stock and subordinated debt.

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As fully phased in on January 1, 2019, the capital requirements also require the Company and the Bank to maintain a 2.5% “capital conservation buffer,” composed entirely of CET1, on top of the minimum risk-weighted asset ratios, effectively resulting in minimum ratios of (i) CET1 to risk-weighted assets of at least 7.0%, (ii) Tier 1 capital to risk-weighted assets of at least 8.5%, and (iii) total capital to risk-weighted assets of at least 10.5%. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of (i) CET1 to risk-weighted assets, (ii) Tier 1 capital to risk-weighted assets or (iii) total capital to risk-weighted assets above the respective minimum but below the capital conservation buffer will face constraints on dividends, equity repurchases and discretionary bonus payments to executive officers based on the amount of the shortfall.

Under current capital standards, the effects of accumulated other comprehensive income items included in capital are excluded for the purposes of determining regulatory capital ratios. Under the Basel Rules, the effects of certain accumulated other comprehensive items are not excluded; however, non-advanced approaches banking organizations, including the Company and the Bank, may make a one-time permanent election to continue to exclude these items effective as of January 1, 2015. This election was made by the Company.

Federal law requires that federal bank regulatory authorities take “prompt corrective action” with respect to institutions that do not meet minimum capital requirements. The FRB has adopted regulations to implement the prompt corrective action legislation. The regulations were amended to incorporate the previously mentioned increased regulatory capital standards that were effective January 1, 2015. An institution is deemed to be “well capitalized” if it has a total risk-based capital ratio of 10.0% or greater, a Tier 1 risk-based capital ratio of 8.0% or greater, a leverage ratio of 5.0% or greater and a CET1 ratio of 6.5% or greater. An institution is “adequately capitalized” if it has a total risk-based capital ratio of 8.0% or greater, a Tier 1 risk-based capital ratio of 6.0% or greater, a leverage ratio of 4.0% or greater and a CET1 ratio of 4.5% or greater. An institution is “undercapitalized” if it has a total risk-based capital ratio of less than 8.0%, a Tier 1 risk-based capital ratio of less than 6.0%, a leverage ratio of less than 4.0% or a CET1 ratio of less than 4.5%. An institution is deemed to be “significantly undercapitalized” if it has a total risk-based capital ratio of less than 6.0%, a Tier 1 risk-based capital ratio of less than 4.0%, a leverage ratio of less than 3.0% or a CET1 ratio of less than 3.0%. An institution is considered to be “critically undercapitalized” if it has a ratio of tangible equity (as defined in the regulations) to total assets that is equal to or less than 2.0%.

The Bank’s capital ratios were all above the minimum levels required for it to be considered a “well capitalized” financial institution at December 31, 2018 under the “prompt corrective action” regulations in effect as of such date.

The Regulatory Relief Act required that the federal banking agencies, including the FRB, to establish a “community bank leverage ratio” of between 8-10% of average total consolidated assets for qualifying institutions with less than \$10 billion of assets. Institutions with tangible equity (subject to certain adjustments) meeting the specified level and electing to follow the alternative framework would be deemed to comply with the applicable regulatory capital requirements, including the risk-based requirements, and be considered to be “well-capitalized.” The agencies have issued a proposed rule that would set the “community bank leverage ratio” at 9%.

Insurance Funds Legislation

The Bank’s deposits are insured up to applicable limits by the Deposit Insurance Fund of the FDIC. Under the FDIC’s risk-based system, insured institutions are assigned to one of four risk categories based on supervisory evaluations, regulatory capital levels and certain other factors with less risky institutions paying lower assessments on their deposits.

Effective July 1, 2016, the FDIC adopted changes that eliminated the risk categories. Assessments for institutions are now based on financial measures and supervisory ratings derived from statistical modeling estimating the probability of failure within three years. In conjunction with the Deposit Insurance Fund’s reserve ratio achieving 1.15%, the

assessment range (inclusive of possible adjustments) was reduced for insured institutions of less than \$10 billion in total assets to a range of 1.5 basis points to 30 basis points. In conjunction with the reserve ratio achieving 1.35%, the FDIC announced that institutions with less than \$10 billion of assets would be receiving certain assessment credits for the portion of assessments paid to help the ratio raise from 1.15% to 1.35%. Such credits will commence when the ratio reaches 1.38%.

Restrictions on the Payment of Dividends

The holders of the Company's common stock are entitled to receive dividends, when, as and if declared by the Board of Directors of the Company out of funds legally available. The only statutory limitation is that such dividends may not be paid when the Company is insolvent. Since the principal source of income for the Company will be dividends on Bank

common stock paid to the Company by the Bank, the Company's ability to pay dividends to its shareholders will depend on whether the Bank pays dividends to it. As a practical matter, restrictions on the ability of the Bank to pay dividends act as restrictions on the amount of funds available for the payment of dividends by the Company. As a New Jersey chartered commercial bank, the Bank is subject to the restrictions on the payment of dividends contained in the New Jersey Banking Act of 1948, as amended (the "Banking Act"). Under the Banking Act, the Bank may pay dividends only out of retained earnings, and out of surplus to the extent that surplus exceeds 50% of stated capital. Under the Financial Institutions Supervisory Act, the FDIC has the authority to prohibit a state-chartered bank from engaging in conduct that, in the FDIC's opinion, constitutes an unsafe or unsound banking practice. Under certain circumstances, the FDIC could claim that the payment of a dividend or other distribution by the Bank to the Company constitutes an unsafe or unsound practice. The Company is also subject to FRB policies, which may, in certain circumstances, limit its ability to pay dividends. The FRB policies require, among other things, that a bank holding company maintain a minimum capital base and serve as a source of strength to its subsidiary bank. The FRB by supervisory letters has advised holding corporations that it has supervisory concerns when the level of dividends is too high and would seek to prevent dividends if the dividends paid by the holding company exceeded its earnings. The FRB would most likely seek to prohibit any dividend payment that would reduce a holding company's capital below these minimum amounts. In addition, the FRB staff has recently begun interpreting its regulatory capital regulations to require holding companies to receive FRB approval prior to any repurchases or redemptions of its common shares.

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 was enacted to address, among other issues, corporate governance, auditing and accounting, executive compensation, and enhanced and timely disclosure of corporate information. We have existing policies, procedures and systems designed to comply with these regulations.

Other Laws and Regulations

Interest and other charges collected or contracted for by the Bank are subject to state usury laws and federal laws concerning interest rates. The Bank's operations are also subject to federal laws (and their implementing regulations) applicable to credit transactions, such as the:

- Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;
- Real Estate Settlement Procedures Act, requiring that borrowers for mortgage loans for one- to four-family residential real estate receive various disclosures, including good faith estimates of settlement costs, lender servicing and escrow account practices, and prohibiting certain practices that increase the cost of settlement services;
- Home Mortgage Disclosure Act, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;
- Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;
- Fair Credit Reporting Act, governing the use and provision of information to credit reporting agencies;
- Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies; and
- Truth in Savings Act, prescribing disclosure and advertising requirements with respect to deposit accounts.

The operations of the Bank also are subject to the:

- Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records;
- Electronic Funds Transfer Act and Regulation E promulgated thereunder, governing automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller

machines and other electronic banking services;

• Check Clearing for the 21st Century Act (also known as “Check 21”), which gives “substitute checks,” such as digital check images and copies made from that image, the same legal standing as the original paper check;

• USA PATRIOT Act, which requires institutions operating to, among other things, establish broadened anti-money laundering compliance programs, due diligence policies and controls to ensure the detection and reporting of money laundering. Such required compliance programs are intended to supplement existing compliance

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requirements, also applicable to financial institutions, under the Bank Secrecy Act and the Office of Foreign Assets Control regulations; and

• Gramm-Leach-Bliley Act, which places limitations on the sharing of consumer financial information by financial institutions with unaffiliated third parties. Specifically, the Gramm-Leach-Bliley Act requires all financial institutions offering financial products or services to retail customers to provide such customers with the financial institution's privacy policy and provide such customers the opportunity to "opt out" of the sharing of certain personal financial information with unaffiliated third parties.

Item 1A. RISK FACTORS

The material risks and uncertainties that Management believes affect the Company are described below. These risks and uncertainties are not the only ones affecting the Company. Additional risks and uncertainties that Management is not aware of or focused on or that Management currently deems immaterial may also impair the Company's business operations. This report is qualified in its entirety by these risk factors. If any one or more of the following risks actually occur, the Company's financial condition and results of operations could be materially and adversely affected.

Risks Relating to Ownership of Our Common Stock

We may not be able to manage our growth, which may adversely impact our financial results.

As part of our expansion strategy, we plan to broaden and expand our commercial lending in both existing and new geographic markets. In addition, as part of our expansion strategy, we may add new lines of business or offer new products and services within existing lines of business. There are substantial risks and uncertainties associated with these efforts, particularly in instances where the markets are not fully developed. We may invest significant time and resources to develop and market new lines of business and/or products and services. Initial timetables for the introduction and development of new lines of business and/or new products or services may not be achieved and price and profitability targets may not prove feasible. External factors, such as compliance with regulations, competitive alternatives, and shifting customer preferences may also impact the successful implementation of a new line of business or a new product or service. Additionally, any new line of business and/or new product or service could have a significant impact on the effectiveness of our system of internal controls. Failure to successfully manage these risks could have a material adverse effect on our business, results of operations and financial condition.

Our ability to implement our expansion strategy will depend upon a variety of factors, including our ability to attract and retain experienced personnel, the continued availability of desirable business opportunities and locations, the competitive responses from other financial institutions in the new market areas and our ability to manage growth. In order to implement our expansion strategy, we plan to hire new personnel in our existing and target markets. However, we may be unable to hire qualified personnel. In addition, the organizational and overhead costs may be greater than we anticipated. Moreover, we may not be able to obtain the regulatory approvals necessary. New business expansion efforts may take longer than expected to reach profitability, and we cannot assure that they will become profitable. The additional costs of adding new personnel may adversely impact our financial results.

Our ability to manage growth successfully will depend on whether we can continue to fund this growth while maintaining cost controls and asset quality, as well as on factors beyond our control, such as national and regional economic conditions and interest rate trends. If we are not able to control costs and maintain asset quality, such growth could adversely impact our earnings and financial condition.

We may need to raise additional capital in the future, which may not be available when needed.

The Company is required by federal regulatory authorities to maintain adequate levels of capital to support its operations. The Company may at some point need to raise additional capital to support continued growth. The Company's ability to raise additional capital, if needed, will depend on conditions in the capital markets at that time,

which are outside the Company's control, and on its financial performance. Accordingly, the Company cannot be assured of its ability to raise additional capital if needed or on terms acceptable to the Company. If the Company cannot raise additional capital when needed, the ability to further expand its operations could be materially impaired. Further, if we raise capital through the issuance of additional shares of our common stock, it would dilute the ownership interests of existing shareholders and may dilute the per share book value of our common stock. New investors may also have rights, preferences and privileges senior to our current shareholders, which may adversely impact our current shareholders.

The Dodd-Frank Wall Street Reform and Consumer Protection Act has and may continue to adversely affect our business activities, financial position and profitability by increasing our regulatory compliance burden and associated costs, placing restrictions on certain products and services, and limiting our future capital raising strategies.

The Dodd-Frank Act has and may continue to increase our regulatory compliance burden. Among the Dodd-Frank Act's significant regulatory changes, it created the CFPB which is empowered to promulgate new consumer protection regulations and revise existing regulations in many areas of consumer protection. The CFPB has exclusive authority to issue regulations, orders and guidance to administer and implement the objectives of federal consumer protection laws. Moreover, the Dodd-Frank Act permits states to adopt stricter consumer protection laws and state attorney generals may enforce consumer protection rules issued by the CFPB. The CFPB and these other changes have increased, and may continue to increase, our regulatory compliance burden and costs and may restrict the financial products and services we offer to our clients.

The Dodd-Frank Act also imposed more stringent capital requirements on bank holding companies by, among other things, imposing leverage ratios on bank holding companies and prohibiting new trust preferred issuances from counting as Tier I capital. These restrictions may limit our future capital strategies. The Dodd-Frank Act also increased regulation of derivatives and hedging transactions, which could limit our ability to enter into, or increase the costs associated with, interest rate and other hedging transactions.

Negative developments in the financial services industry and U.S. and global credit markets may adversely impact our operations and results.

Our businesses and operations, which primarily consist of lending money to clients in the form of loans, borrowing money from clients in the form of deposits and investing in securities, are sensitive to general business and economic conditions in the United States. If the U.S. economy weakens, our growth and profitability from our lending, deposit and investment operations could be constrained. Uncertainty about the federal fiscal policymaking process and the medium and long-term fiscal outlook of the federal government is a concern for businesses, consumers and investors in the United States. In addition, economic conditions in foreign countries could affect the stability of global financial markets, which could hinder U.S. economic growth. Weak economic conditions are often characterized by deflation, fluctuations in debt and equity capital markets, a lack of liquidity and/or depressed prices in the secondary market for mortgage loans, increased delinquencies on mortgage, consumer and commercial loans, residential and commercial real estate price declines and lower home sales and commercial activity.

Our business is also significantly affected by monetary and related policies of the U.S. federal government and its agencies. Changes in any of these policies are influenced by macroeconomic conditions and other factors that are beyond our control. Adverse economic conditions and government policy responses to such conditions could have a material adverse effect on our business, financial condition, results of operations and prospects.

We are more sensitive than our more geographically diversified competitors to adverse changes in the local economy.

Much of our business is with clients located within Central and Northern New Jersey, as well as New York City. Our business loans are generally made to small to mid-sized businesses, most of whose success depends on the regional economy. These businesses generally have fewer financial resources in terms of capital or borrowing capacity than larger entities. Adverse economic and business conditions in our market area could reduce our growth rate, affect our borrowers' ability to repay their loans and, consequently, adversely affect our financial condition and performance. Further, we place substantial reliance on real estate as collateral for our loan portfolio. A sharp downturn in real estate values in our market area could leave many of our loans under-secured, which could adversely affect our earnings.

If our allowance for loan losses are not sufficient to cover actual loan losses, our earnings would decrease.

We maintain an allowance for loan losses based on, among other things, the level of non-performing loans, loan growth and composition, national and regional economic conditions, historical loss experience, delinquency trends among loan types and various quantitative and qualitative factors. However, we cannot predict loan losses with certainty and we cannot assure you that charge-offs in future periods will not exceed the allowance for loan losses. In addition, regulatory agencies, as an integral part of their examination process, review our allowance for loan losses and may require additions to the allowance based on their judgment about information available to them at the time of their examination. Factors that require an increase in our allowance for loan losses could reduce our earnings.

Changes in interest rates may adversely affect our earnings and financial condition.

Our net income depends primarily upon our net interest income. Net interest income is the difference between interest income earned on loans, investments and other interest-earning assets and the interest expense incurred on deposits and borrowed funds.

Different types of assets and liabilities may react differently, and at different times, to changes in market interest rates. We expect that we will periodically experience “gaps” in the interest rate sensitivities of our assets and liabilities. That means either our interest-bearing liabilities will be more sensitive to changes in market interest rates than our interest-earning assets, or vice versa. When interest-bearing liabilities mature or reprice more quickly than interest-earning assets, an increase in market rates of interest could reduce our net interest income. Likewise, when interest-earning assets mature or reprice more quickly than interest-bearing liabilities, falling interest rates could reduce our net interest income. We are unable to predict changes in market interest rates, which are affected by many factors beyond our control, including inflation, recession, unemployment, money supply, governmental policy, domestic and international events and changes in the United States and other financial markets.

We may be adversely affected by recent changes in U.S. tax laws.

The Tax Cuts and Jobs Act, which was enacted in December 2017, is likely to have negative effects on our financial performance. The new legislation has enacted limitations on certain deductions that will have an impact on the banking industry, borrowers and the market for single-family residential real estate. These limitations include (1) a lower limit on the deductibility of mortgage interest on single-family residential mortgage loans, (2) the elimination of interest deductions for home equity loans, (3) a limitation on the deductibility of business interest expense and (4) a limitation on the deductibility of property taxes and state and local income taxes.

The recent changes in the tax laws may have an adverse effect on the market for, and the valuation of, residential properties, and on the demand for such loans in the future, and could make it harder for borrowers to make their loan payments. In addition, these recent changes may also have a disproportionate effect on taxpayers in states with high residential home prices and high state and local taxes, like New Jersey. If home ownership becomes less attractive, demand for mortgage loans could decrease. The value of the properties securing loans in our loan portfolio may be adversely impacted as a result of the changing economics of home ownership, which could require an increase in our provision for loan losses, which would reduce our profitability and could materially adversely affect our business, financial condition and results of operations.

Our exposure to credit risk could adversely affect our earnings and financial condition.

There are certain risks inherent in making loans, including risks that the principal of or interest on the loan will not be repaid timely or at all or that the value of any collateral supporting the loan will be insufficient to cover our outstanding exposure. These risks may be affected by the strength of the borrower’s business sector and local, regional and national market and economic conditions. Our risk management practices, such as monitoring the concentration of our loans within specific industries and our credit approval practices, may not adequately reduce credit risk, and our credit administration personnel, policies and procedures may not adequately adapt to changes in economic or any other conditions affecting clients and the quality of the loan portfolio. Finally, many of our loans are made to small and medium-sized businesses that are less able to withstand competitive, economic and financial pressures than larger borrowers. A failure to effectively measure and limit the credit risk associated with our loan portfolio could have a material adverse effect on our business, financial condition, results of operations and prospects.

Competition from other financial institutions in originating loans and attracting deposits may adversely affect our profitability.

We face substantial competition in originating loans. This competition comes principally from other banks, savings institutions, mortgage banking companies and other lenders. Many of our competitors enjoy advantages, including greater financial resources and higher lending limits, a wider geographic presence, and more accessible branch office locations.

In attracting deposits, we face substantial competition from other insured depository institutions such as banks, savings institutions and credit unions, as well as institutions offering uninsured investment alternatives, including money market funds. Many of our competitors enjoy advantages, including greater financial resources, more aggressive marketing campaigns, better brand recognition and more branch locations. These competitors may offer higher interest rates than we

do, which could decrease the deposits that we attract or require us to increase our rates to retain existing deposits or attract new deposits. Increased deposit competition could adversely affect our ability to generate the funds necessary for lending operations and increase our cost of funds.

We also compete with non-bank providers of financial services, such as brokerage firms, consumer finance companies, insurance companies and governmental organizations, which may offer more favorable terms. Some of our non-bank competitors are not subject to the same extensive regulations that govern our operations. As a result, such non-bank competitors may have advantages over us in providing certain products and services. This competition may reduce or limit our margins on banking services, reduce our market share and adversely affect our earnings and financial condition.

Limits on our ability to use brokered deposits as part of our funding strategy may adversely affect our ability to grow.

A “brokered deposit” is any deposit that is obtained from or through the mediation or assistance of a deposit broker, which includes larger correspondent banks and securities brokerage firms. These deposit brokers attract deposits from individuals and companies throughout the country and internationally whose deposit decisions are based almost exclusively on obtaining the highest interest rates. At December 31, 2018, brokered deposits represented approximately 6.1 percent of our total deposits and equaled \$236.1 million, comprised of the following: interest-bearing demand-brokered of \$180.0 million, and brokered certificates of deposits of \$56.1 million. There are risks associated with using brokered deposits. In order to continue to maintain our level of brokered deposits, we may be forced to pay higher interest rates than contemplated by our asset-liability pricing strategy. In addition, banks that become less than “well capitalized” under applicable regulatory capital requirements may be restricted in their ability to accept or prohibited from accepting brokered deposits. If this funding source becomes more difficult to access, we will have to seek alternative funding sources in order to continue to fund our growth. This may include increasing our reliance on Federal Home Loan Bank borrowings, attempting to attract non-brokered deposits, reducing our available for sale securities portfolio and selling loans. There can be no assurance that brokered deposits will be available, or if available, sufficient to support our continued growth.

Our commercial real estate loan and commercial C&I portfolios expose us to risks that may be greater than the risks related to our other mortgage loans.

Our loan portfolio includes non-owner-occupied commercial real estate loans for individuals and businesses for various purposes, which are secured by commercial properties, as well as real estate construction and development loans. These loans typically involve repayment dependent upon income generated, or expected to be generated, by the property securing the loan in amounts sufficient to cover operating expenses and debt service. This may be adversely affected by changes in the economy or local market conditions. These loans expose a lender to greater credit risk than loans secured by residential real estate because the collateral securing these loans typically cannot be liquidated as easily as residential real estate. If we foreclose on these loans, our holding period for the collateral typically is longer than for a single or multifamily residential property because there are fewer potential purchasers of the collateral. Additionally, non-owner-occupied commercial real estate loans generally involve relatively large balances to single borrowers or related groups of borrowers. Accordingly, charge-offs on non-owner-occupied commercial real estate loans may be larger on a per loan basis than those incurred with our residential or consumer loan portfolios. Unexpected deterioration in the credit quality of our commercial real estate loan portfolio would require us to increase our provision for loan losses, which would reduce our profitability and could materially adversely affect our business, financial condition, results of operations and prospects.

C&I loans are typically based on the borrowers’ ability to repay the loans from the cash flows of their businesses. These loans may involve greater risk because the availability of funds to repay each loan depends substantially on the success of the business itself. The collateral securing the loans and leases often depreciates over time, is difficult to

appraise and liquidate and fluctuates in value based on the success of the business. In addition, many commercial business loans have a variable rate which is indexed off of a floating rate such as Prime or LIBOR. If interest rates rise, the borrower's debt service requirement may increase, negatively impacting the borrower's ability to service their debt.

We are subject to environmental liability risk associated with our lending activities.

In the course of our business, we may purchase real estate, or we may foreclose on and take title to real estate. As a result, we could be subject to environmental liabilities with respect to these properties. We may be held liable to a governmental entity or to third parties for property damage, personal injury, investigation and clean-up costs incurred by these parties in connection with environmental contamination or may be required to investigate or clean up hazardous or toxic substances or chemical releases at a property. The costs associated with investigation or remediation activities could be substantial. In addition, if we are the owner or former owner of a contaminated site, we may be subject to common law claims by third

parties based on damages and costs resulting from environmental contamination emanating from the property. Any significant environmental liabilities could cause a material adverse effect on our business, financial condition, results of operations and prospects.

Lack of seasoning of our loan portfolio could increase risk of credit defaults in the future.

A large portion of loans in our loan portfolio and of our lending relationships are of relatively recent origin. In general, loans do not begin to show signs of credit deterioration or default until they have been outstanding for some period of time, a process referred to as “seasoning.” As a result, a portfolio of older loans will usually behave more predictably than a newer portfolio. Because a large portion of our portfolio is relatively new, the current level of delinquencies and defaults may not represent the level that may prevail as the portfolio becomes more seasoned. If delinquencies and defaults increase, we may be required to increase our provision for loan losses, which could materially adversely affect our business, financial condition, results of operations and prospects.

Deterioration in the fiscal position of the U.S. federal government could adversely affect us and our banking operations.

The fiscal position of the U.S. federal government may become uncertain. In addition to causing economic and financial market disruptions, any deterioration in the fiscal outlook of the U.S. federal government, could, among other things, materially adversely affect the market value of the U.S. and other government and governmental agency securities that we hold, the availability of those securities as collateral for borrowing, and our ability to access capital markets on favorable terms. In particular, it could increase interest rates and disrupt payment systems, money markets, and long-term or short-term fixed income markets, adversely affecting the cost and availability of funding, which could negatively affect our profitability. Any of these developments could materially adversely affect our business, financial condition, results of operations and prospects.

Government regulation significantly affects our business.

The banking industry is extensively regulated. Banking regulations are intended primarily to protect depositors, and the FDIC deposit insurance fund, not the shareholders of the Company. We are subject to regulation and supervision by the New Jersey Department of Banking and Insurance and the Federal Reserve Bank. Regulatory requirements affect our lending practices, capital structure, investment practices, dividend policy and growth. The bank regulatory agencies possess broad authority to prevent or remedy unsafe or unsound practices or violations of law. We are subject to various regulatory capital requirements, which involve both quantitative measures of our assets and liabilities and qualitative judgments by regulators regarding risks and other factors. Failure to meet minimum capital requirements or comply with other regulations could result in actions by regulators that could adversely affect our ability to pay dividends or otherwise adversely impact operations. In addition, changes in laws, regulations and regulatory practices affecting the banking industry may limit the manner in which we conduct our business. Such changes may adversely affect us, including our ability to offer new products and services, obtain financing, attract deposits, make loans and achieve satisfactory spreads and may impose additional costs on us.

The Bank is also subject to a number of Federal laws, which, among other things, require it to lend to various sectors of the economy and population, and establish and maintain comprehensive programs relating to anti-money laundering and customer identification. The Bank's compliance with these laws will be considered by the Federal banking regulators when reviewing bank merger and bank holding company acquisitions or commencing new activities or making new investments in reliance on the Gramm-Leach-Bliley Act. As a public company, we are also subject to the corporate governance standards set forth in the Sarbanes-Oxley Act, as well as any rules or regulations promulgated by the SEC or the NASDAQ Stock Market.

We are subject to certain capital requirements, which may adversely impact our return on equity, require us to raise additional capital, or constrain us from paying dividends or repurchasing shares.

A final capital rule that became effective for financial institutions on January 1, 2015, included minimum risk-based capital and leverage ratios, and refined the definition of what constitutes “capital” for purposes of calculating these ratios. The final rule also established a “capital conservation buffer” of 2.5%. The new capital conservation buffer requirement was phased in beginning in January 2016 at 0.625% of risk-weighted assets and increased each year until fully implemented at January 1, 2019. A financial institution, such as the Bank, is subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations establish a maximum percentage of eligible retained income that can be utilized for such actions.

The application of more stringent capital requirements could, among other things, result in lower returns on equity, require the raising of additional capital, and result in regulatory actions if we were to be unable to comply with such requirements. Furthermore, the imposition of liquidity requirements in connection with the implementation of Basel III could result in our having to lengthen the term of our funding, restructure our business models, and/or increase our holdings of liquid assets. See Part I, Item 1, “Business - Capital Requirements.”

We are subject to liquidity risk.

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

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

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

Our access to funding sources in amounts adequate to finance our activities could be impaired by factors that affect us specifically or the financial services industry in general. Factors that could detrimentally impact our access to liquidity sources include a decrease in the level of our business activity due to a market downturn or adverse regulatory action against us. Our ability to borrow could also be impaired by factors that are not specific to us, such as a severe disruption of the financial or credit markets or negative views and expectations about the prospects for the financial services industry as a whole. Our ability to borrow from alternative sources, such as brokered deposits, could also be impaired should the Bank’s regulatory capital falls below well capitalized.

Cyber-attacks and information security breaches could compromise our information or result in the data of our customers being improperly divulged, which could expose us to liability and losses.

Many financial institutions and companies engaged in data processing have reported significant breaches in the security of their websites or other systems, some of which have involved sophisticated and targeted attacks intended to obtain unauthorized access to confidential information, destroy data, disable or degrade service, or sabotage systems, often through the introduction of computer viruses or malware, cyber-attacks and other means. Although we have not experienced, to date, any material losses relating to such cyber-attacks or other information security breaches, there can be no assurance that we will not suffer such losses in the future. Additionally, our risk exposure to security matters may remain elevated or increase in the future due to, among other things, the increasing size and prominence of the Company in the financial services industry, our expansion of Internet and mobile banking tools and products based on customer needs.

Our information technology systems and the systems of third parties upon which we rely may experience a failure, interruption or breach in security that could negatively affect our operations and reputation.

We rely heavily on information technology systems to conduct our business, including the systems of third-party service providers. Any failure, interruption, or breach in security or operational integrity of these systems could result in failures or disruptions in our customer relationship management and general ledger, deposit, loan, and other systems. While we have policies and procedures designed to prevent or limit the impact of any failure, interruption, or breach in our security systems (including privacy and cyber-attacks), there can be no assurance that such events

will not occur or if they do occur, that they will be adequately addressed. Information security and cyber-security risks have increased significantly in recent years because of new technologies, the use of the Internet and other electronic delivery channels (including mobile devices) to conduct financial transactions. Accordingly, we may be required to expend additional resources to continue to enhance our protective measures or to investigate and remediate any information security vulnerabilities or exposures. The occurrence of any system failures, interruptions, or breaches in security could expose us to reputation risk, civil litigation, regulatory scrutiny and possible financial liability that could have a material adverse effect on our financial condition and results of operations.

Our ability to pay dividends to our common shareholders is limited by law.

Since the principal source of income for the Company is dividends paid to the Company by the Bank, the Company's ability to pay dividends to its shareholders will depend on whether the Bank pays dividends to it. As a practical matter, restrictions on the ability of the Bank to pay dividends act as restrictions on the amount of funds available for the payment of dividends by the Company. As a New Jersey-chartered commercial bank, the Bank is subject to the restrictions on the payment of dividends contained in the New Jersey Banking Act of 1948, as amended. Under the Banking Act, the Bank may pay dividends only out of retained earnings, and out of surplus to the extent that surplus exceeds 50% of stated capital. The Company is also subject to FRB policies, which may, in certain circumstances, limit its ability to pay dividends. The FRB policies require, among other things, that a bank holding company maintain a minimum capital base and the FRB in supervisory guidance has cautioned bank holding companies about paying out too much of their earnings in dividends and has stated that banks should not pay out more in dividends than they earn. The FRB would most likely seek to prohibit any dividend payment that would reduce a holding company's capital below these minimum amounts.

We may lose lower-cost funding sources.

Checking, savings, and money market deposit account balances and other forms of client deposits can decrease when clients perceive alternative investments, such as the stock market, as providing a better risk/return tradeoff. If clients move money out of bank deposits and into other investments, we would lose a relatively low-cost source of funds and have to replace them with higher cost funds, increasing our funding costs and reducing our net interest income and net income. The Bank does have certain deposits with high dollar balances which are subject to volatility. Customers with large average deposits may move these deposits for operational needs, investment opportunities or other reasons which could require the Bank to pay higher interest rates to retain these deposits or use higher rate borrowings as an alternative funding source.

There may be changes in accounting policies or accounting standards.

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

From time to time the Financial Accounting Standards Board (FASB) and the SEC change the financial accounting and reporting standards that govern the form and content of our external financial statements. In addition, accounting standard setters and those who interpret the accounting standards (such as the FASB, SEC, banking regulators and our independent auditors) may change or even reverse their previous interpretations or positions on how these standards should be applied. Changes in financial accounting and reporting standards and changes in current interpretations may be beyond our control, can be hard to predict and could materially impact how we report our financial results and condition. In certain cases, we could be required to apply a new or revised standard retroactively or apply an existing standard differently (also retroactively) which may result in our revising prior period financial statements in material amounts.

The FASB has recently issued an accounting standard update that will result in a significant change in how the Company recognizes credit losses and may have a material impact on the Company's financial condition or results of operations.

In June 2016, the FASB issued an accounting standard update, "Financial Instruments-Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments," which replaces the current "incurred loss" model for recognizing credit losses with an "expected loss" model referred to as the Current Expected Credit Loss ("CECL") model. Under the CECL model, the Company will be required to present certain financial assets carried at amortized cost, such as loans held for investment and held-to-maturity debt securities, at the net amount expected to be collected. The measurement of expected credit losses is to be based on information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. This measurement will take place at the time the financial asset is first added to the balance sheet and periodically thereafter. This differs significantly from the "incurred loss" model required under current generally accepted accounting principles ("GAAP"), which delays recognition until it is probable a loss has been incurred. Accordingly, we expect that the adoption of the CECL model will materially affect how the Company determines the allowance for loan losses and could require the Company to significantly increase our allowance. Moreover, the CECL model may create more volatility in the level of our allowance

for loan losses. If we are required to materially increase the level of allowance for loan losses for any reason, such increase could adversely affect our business, financial condition and results of operations.

We encounter continuous technological change.

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

We are subject to operational risk.

We face the risk that the design of our controls and procedures, including those to mitigate the risk of fraud by employees or outsiders, may prove to be inadequate or are circumvented, thereby causing delays in detection of errors or inaccuracies in data and information. Management regularly reviews and updates our internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of our controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on our business, results of operations and financial condition.

We may also be subject to disruptions of our systems arising from events that are wholly or partially beyond our control (including, for example, computer viruses or electrical or telecommunications outages), which may give rise to losses in service to clients and to financial loss or liability. We are further exposed to the risk that our external vendors may be unable to fulfill their contractual obligations (or will be subject to the same risk of fraud or operational errors by their respective employees as we are) and to the risk that our (or our vendors') business continuity and data security systems prove to be inadequate.

We are dependent on key personnel and the loss of one or more of those key personnel may materially and adversely affect our prospects.

Our performance is largely dependent on the talents and efforts of highly skilled individuals. There is intense competition in the financial services industry for qualified employees. In addition, we face increasing competition with businesses outside the financial services industry for the most highly skilled individuals. Our business operations could be adversely affected if we were unable to attract new employees and retain and motivate our existing employees.

A Federal government shutdown would result in reduced loan originations and related gains on sale of Small Business Administration Loans.

In late 2015, we began providing loans that are partially guaranteed by the Small Business Administration ("SBA") to provide working capital and/or finance the purchase of equipment, inventory or commercial real estate. We generally sell the guaranteed portion of the SBA loans in the secondary market, while retaining the non-guaranteed portion in the loan portfolio. During 2018, the gain on the sale of such loans amounted to \$1.6 million. During a federal

government shutdown, we are not able to close or sell these types of loans, thereby negatively affecting our non-interest income.

Legal proceedings and related matters could adversely affect us.

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

Revenues and profitability from our wealth management business may be adversely affected by any reduction in assets under management, which could reduce fees earned.

The wealth management business derives the majority of its revenue from non-interest income, which consists of trust, investment advisory and other servicing fees. Substantial revenues are generated from investment management contracts with clients. Under these contracts, the investment advisory fees paid to us are typically based on the market value of assets under management. Assets under management and supervision may decline for various reasons including declines in the market value of the assets in the funds and accounts managed or supervised, which could be caused by price declines in the securities markets generally or by price declines in specific market segments. Assets under management may also decrease due to redemptions and other withdrawals by clients or termination of contracts. This could be in response to adverse market conditions or in pursuit of other investment opportunities. If the assets under management we supervise decline and there is a related decrease in fees, it will negatively affect our results of operations.

We may not be able to attract and retain wealth management clients.

Due to strong competition, our wealth management business may not be able to attract and retain clients. Competition is strong because there are numerous well-established and successful investment management and wealth advisory firms including commercial banks and trust companies, investment advisory firms, mutual fund companies, stock brokerage firms, and other financial companies. Many of our competitors have greater resources than we have. Our ability to successfully attract and retain wealth management clients is dependent upon our ability to compete with competitors' investment products, level of investment performance, client services and marketing and distribution capabilities. If we are not successful, our results of operations and financial condition may be negatively impacted.

The wealth management industry is subject to extensive regulation, supervision and examination by regulators, and any enforcement action or adverse changes in the laws or regulations governing our business could decrease our revenues and profitability.

The wealth management business is subject to regulation by a number of regulatory agencies that are charged with safeguarding the integrity of the securities and other financial markets and with protecting the interests of customers participating in those markets. In the event of non-compliance with regulation, governmental regulators, including the SEC, and FINRA, may institute administrative or judicial proceedings that may result in censure, fines, civil penalties, the issuance of cease-and-desist orders or the deregistration or suspension of the non-compliant broker-dealer or investment adviser or other adverse consequences. The imposition of any such penalties or orders could have a material adverse effect on the wealth management segment's operating results and financial condition. We may be adversely affected as a result of new or revised legislation or regulations. Regulatory changes have imposed and may continue to impose additional costs, which could adversely impact our profitability.

Item 1B. UNRESOLVED STAFF COMMENTS

None.

Item 2. PROPERTIES

The Company owns nine branches and leases 11 branches. The Company leases an administrative and operations office building in Bedminster, New Jersey, private banking offices in Princeton, Morristown and Teaneck, New Jersey and wealth offices in Greenville, Delaware, Gladstone, Fairfield and New Providence, New Jersey and Bonita Springs, Florida.

Item 3. LEGAL PROCEEDINGS

In the normal course of business, lawsuits and claims may be brought against the Company and its subsidiaries. There is no currently pending or threatened litigation or proceedings against the Company or its subsidiaries, which assert claims that if adversely decided, we believe would have a material adverse effect on the Company.

Item 4. MINE SAFETY DISCLOSURE

Not applicable.

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PART II

Item MARKET FOR REGISTRANT'S COMMON EQUITY RELATED STOCKHOLDER MATTERS AND
5. ISSUER PURCHASES OF EQUITY SECURITIES

The common stock of the Company is traded on the NASDAQ Global Select Market under the symbol "PGC". On March 1, 2019, there were approximately 908 registered shareholders of record.

Stock Performance Graph

The following graph compares the cumulative total return on a hypothetical \$100 investment made on December 31, 2013 in (a) the Company's common stock; (b) the Russell 3000 Stock Index, and (c) the Keefe, Bruyette & Woods KBW 50 Index (top 50 U.S. banks). The graph is calculated assuming that all dividends are reinvested during the relevant periods. The graph shows how a \$100 investment would increase or decrease in value over time, based on dividends (stock or cash) and increases or decreases in the market price of the stock.

Index	Period Ended					
	12/31/13	12/31/14	12/31/15	12/31/16	12/31/17	12/31/18
Peapack-Gladstone Financial Corporation	100.00	98.20	110.13	166.59	190.10	137.54
Russell 3000 Index	100.00	112.56	113.10	127.50	154.44	146.34
KBW NASDAQ Bank Index	100.00	109.37	109.91	141.24	167.50	137.83

Stock Repurchases

The following table sets forth information for the last quarter of the fiscal year ended December 31, 2018 with respect to common shares withheld to satisfy withholding obligations (or repurchases of outstanding common shares):

	Total	Average Price Paid	Total Number of Shares Purchased As Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plans Or Programs (In Thousands)
	Number of Shares Withheld/Purchased (1)	Per Share		
October 1, 2018 -				
October 31, 2018	—	\$ —	—	\$ —
November 1, 2018 -				
November 30, 2018	—	—	—	—
December 1, 2018 -				
December 31, 2018	4,279	26.83	—	—
Total	4,279	\$ 26.83	—	\$ —

⁽¹⁾Solely represents shares withheld to satisfy tax withholding obligations upon the exercise of stock options and vesting of restricted stock awards/units.

Sales of Unregistered Securities

None.

Item 6. SELECTED FINANCIAL DATA

The following is selected consolidated financial data for the Company and its subsidiaries for the years indicated. This information is derived from the historical consolidated financial statements and should be read in conjunction with the consolidated financial statements and notes.

(Dollars in thousands, except per share data)	Years Ended December 31,				
	2018	2017	2016	2015	2014
Summary earnings:					
Interest income	\$159,686	\$138,727	\$117,048	\$99,142	\$75,575
Interest expense	44,523	27,586	20,613	14,690	7,681
Net interest income	115,163	111,141	96,435	84,452	67,894
Provision for loan losses	3,550	5,850	7,500	7,100	4,875
Net interest income after provision for loan losses	111,613	105,291	88,935	77,352	63,019
Wealth management income	33,245	23,183	18,240	17,039	15,242
Other income, exclusive of securities (losses)/gains,					
net	11,341	11,444	10,559	6,148	5,305
Securities (losses)/gains, net	(393)	—	119	527	260
Total expenses	98,086	85,611	75,112	68,926	59,540
Income before income tax expense	57,720	54,307	42,741	32,140	24,286
Income tax expense	13,550	17,810	16,264	12,168	9,396
Net income available to common shareholders	\$44,170	\$36,497	\$26,477	\$19,972	\$14,890
Per share data:					
Earnings per share-basic	\$2.33	\$2.07	\$1.62	\$1.31	\$1.23
Earnings per share-diluted	2.31	2.03	1.60	1.29	1.22
Cash dividends declared	0.20	0.20	0.20	0.20	0.20
Book value end-of-period	24.25	21.68	18.79	17.61	16.36
Basic weighted average shares outstanding	18,965,305	17,659,625	16,318,868	15,187,637	12,065,615
Common stock equivalents (dilutive)	183,340	284,060	196,130	247,359	106,492
Fully diluted weighted average shares outstanding	19,148,645	17,943,685	16,514,998	15,434,996	12,172,107

	Years Ended December 31,				
	2018	2017	2016	2015	2014
Balance sheet data (at period end):					
Total assets	\$4,617,858	\$4,260,547	\$3,878,633	\$3,364,659	\$2,702,397
Securities available to sale	377,936	327,633	305,388	195,630	332,652
Equity security	4,719	—	—	—	—
FHLB and FRB stock, at cost	18,533	13,378	13,813	13,984	11,593
Total loans	3,927,931	3,704,440	3,312,144	2,913,242	2,250,267
Allowance for loan losses	38,504	36,440	32,208	25,856	19,480
Total deposits	3,895,340	3,698,354	3,411,837	2,935,470	2,298,693
Total shareholders' equity	469,013	403,678	324,210	275,676	242,267
Cash dividends:					
Common	3,712	3,548	3,296	3,100	2,414
Assets under management and/or administration					
at Wealth Management Division (market value)	5.8 billion	5.5 billion	3.7 billion	3.3 billion	3.0 billion
Selected performance ratios:					
Return on average total assets	1.02	% 0.89	% 0.72	% 0.64	% 0.63
Return on average common shareholders' equity	10.13	10.12	8.92	7.71	7.96
Dividend payout ratio	8.40	9.72	12.45	15.52	16.21
Average equity to average assets ratio	10.02	8.80	8.12	8.30	7.94
Net interest margin					
Net interest margin	2.75	2.80	2.74	2.80	3.01
Non-interest expenses to average assets	2.25	2.09	2.06	2.21	2.53
Non-interest income to average assets	1.02	0.85	0.79	0.76	0.88
Asset quality ratios (at period end):					
Nonperforming loans to total loans	0.65	% 0.37	% 0.34	% 0.23	% 0.30
Nonperforming assets to total assets	0.56	0.37	0.30	0.22	0.30
Allowance for loan losses to nonperforming loans	149.73	269.33	285.94	383.22	284.38
Allowance for loan losses to total loans	0.98	0.98	0.97	0.89	0.87
Net charge-offs to average loans plus other					
real estate owned	0.04	0.05	0.04	0.03	0.04
Liquidity and capital ratios:					
Average loans to average deposits	103.53	% 99.63	% 100.97	% 98.30	% 92.55
Total shareholders' equity to total assets	10.16	9.47	8.36	8.19	8.96
Company Capital Ratios:					
Total capital to risk-weighted assets	15.03	14.84	13.25	11.40	15.55
Tier 1 capital to risk-weighted assets	11.76	11.31	10.60	10.42	14.38

Common equity tier 1 capital ratio to

risk-weighted assets	11.76	11.31	10.60	10.42	N/A
Tier 1 leverage ratio	9.82	9.04	8.35	8.10	9.11

Bank Capital Ratios:

Total capital to risk-weighted assets	14.59	14.34	12.87	11.32	14.96
Tier 1 capital to risk-weighted assets	13.56	13.27	11.82	10.34	13.80

Common equity tier 1 capital ratio to

risk-weighted assets	13.56	13.27	11.82	10.34	N/A
Tier 1 leverage ratio	11.32	10.61	9.31	8.04	8.74

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

CAUTIONARY STATEMENT CONCERNING FORWARD LOOKING STATEMENTS: This Annual Report on Form 10-K contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are not historical facts and include expressions about Management's confidence and strategies and Management's expectations about new and existing programs and products, investments, relationships, opportunities and market conditions. These statements may be identified by such forward-looking terminology as "expect," "look," "believe," "anticipate," "may," or similar statements or variations of such terms. Actual results may differ materially from such forward-looking statements. Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements include, but are not limited to:

- our inability to successfully grow our business and implement our strategic plan, including an inability to generate revenues to offset the increased personnel and other costs related to the strategic plan;
- the impact of anticipated higher operating expenses in 2019 and beyond;
 - our inability to successfully integrate wealth management firm acquisitions;
- our inability to manage our growth;
- our inability to successfully integrate our expanded employee base;
- an unexpected decline in the economy, in particular in our New Jersey and New York market areas;
- declines in our net interest margin caused by the interest rate environment and/or our highly competitive market;
- declines in value in our investment portfolio;
- higher than expected increases in our allowance for loan and lease losses;
- higher than expected increases in loan and lease losses or in the level of nonperforming loans;
- changes in interest rates;
- decline in real estate values within our market areas;
- legislative and regulatory actions (including the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Basel III and related regulations) that may result in increased compliance costs;
 - successful cyberattacks against our IT infrastructure and that of our IT and third party providers;
- higher than expected FDIC insurance premiums;
- adverse weather conditions;
- our inability to successfully generate new business in new geographic markets;
- our inability to execute upon new business initiatives;
- our lack of liquidity to fund our various cash obligations;
- reduction in our lower-cost funding sources;
- our inability to adapt to technological changes;
- claims and litigation pertaining to fiduciary responsibility, environmental laws and other matters;
- our ability to retain key employees;
- demands for loans and deposits in our market areas;
- adverse changes in securities markets;
- changes in accounting policies and practices;
- effects related to a prolonged shutdown of the federal government which could impact SBA and other government lending programs; and
- other unexpected material adverse changes in our operations or earnings.

Except as may be required by applicable law or regulation, the Company undertakes no duty to update any forward-looking statement to conform the statement to actual results or changes in the Company's expectations. Although we believe that the expectations reflected in the forward-looking statements are reasonable, the Company cannot guarantee future results, levels of activity, performance or achievements.

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

For the year ended December 31, 2018, the Company recorded net income of \$44.17 million, and diluted earnings per share of \$2.31 compared to \$36.50 million and \$2.03, respectively, for 2017, reflecting increases of \$7.67 million, or 21 percent,

and \$0.28 per share, or 14 percent, respectively. During 2018, the Company continued to focus on executing its Strategic Plan – known as “Expanding Our Reach” – which focuses on the client experience and organic growth across all lines of business. The Strategic Plan called for expansion of the Company’s wealth management business, organically and through wealth business acquisitions, and also expansion of the Company’s commercial and industrial (“C&I”) lending platform, through the use of private bankers, who lead with deposit gathering and wealth management discussions.

The following are select highlights for 2018:

- At December 31, 2018, the market value of assets under management and/or administration at the Private Wealth Management Division of the Bank was \$5.8 billion, reflecting an increase of 5 percent from \$5.5 billion at December 31, 2017.
- Fee income from the Private Wealth Management Division totaled \$33.2 million for 2018, growing from \$23.2 million for 2017.
- Loans at December 31, 2018 totaled \$3.93 billion. This reflected net growth of \$227.4 million, or 6 percent, from \$3.70 billion at December 31, 2017.
- Total C&I loans (including equipment finance) at December 31, 2018 totaled \$1.40 billion. This reflected net growth of \$438.7 million, or 46 percent, from \$958.3 million at December 31, 2017.
- Total “customer” deposits (defined as deposits excluding brokered CDs and brokered “overnight” interest-bearing demand deposits) at December 31, 2018 were \$3.66 billion, reflecting an increase of \$213.4 million, or 6 percent, when compared to \$3.45 billion at December 31, 2017.
- Asset quality metrics continued to be strong at December 31, 2018. Nonperforming assets at December 31, 2018 were \$25.7 million, or 0.56 percent of total assets. Total loans past due 30 through 89 days and still accruing were \$1.10 million or 0.03 percent of total loans at December 31, 2018.
- The Company’s and Bank’s capital ratios at December 31, 2018 all increased compared to the December 31, 2017 levels.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES: Management’s Discussion and Analysis of Financial Condition and Results of Operations is based upon the Company’s consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. Note 1 to the Company’s consolidated financial statements contains a summary of the Company’s significant accounting policies.

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

The provision for loan losses is based upon Management’s evaluation of the adequacy of the allowance, including an assessment of known and inherent risks in the portfolio, giving consideration to the size and composition of the loan portfolio, actual loan loss experience, level of delinquencies, detailed analysis of individual loans for which full collectability may not be assured, the existence and estimated fair value of any underlying collateral and guarantees securing the loans, and current economic and market conditions. Although Management uses the best information available, the level of the allowance for loan losses remains an estimate, which is subject to significant judgment and change. Various regulatory agencies, as an integral part of their examination process, periodically review the Company’s allowance for loan losses. Such agencies may require the Company to make additional provisions for loan losses based upon information available to them at the time of their examination. Furthermore, the majority of the

Company's loans are secured by real estate in the State of New Jersey and the New York City area. Accordingly, the collectability of a substantial portion of the carrying value of the Company's loan portfolio is susceptible to changes in local market conditions and may experience adverse economic conditions. Future adjustments to the provision for loan losses and allowance for loan losses may be necessary due to economic, operating, regulatory and other conditions beyond the Company's control.

The Company accounts for its securities in accordance with "Accounting for Certain Investments in Debt and Equity Securities," which was codified into Accounting Standards Codification ("ASC") 320. Debt securities are classified as held to maturity and carried at amortized cost when Management has the positive intent and ability to hold them to maturity.

Debt securities are classified as available for sale when they might be sold before maturity due to changes in interest rates, prepayment risk, liquidity or other factors. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax. At December 31, 2018 and 2017, all securities were classified as available for sale, with the exception of the Company's investment in the CRA investment fund. The Company adopted ASU 2016-01 "Financial Instruments" which resulted in the reclassification of the CRA investment from available for sale to equity securities.

Securities are evaluated on at least a quarterly basis to determine whether a decline in value is other-than-temporary. To determine whether a decline in value is other-than-temporary, Management considers the reasons underlying the decline, the near-term prospects of the issuer, the extent and duration of the decline and whether the Company 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 or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. "Other-than-temporary" is not intended to indicate that the decline is permanent but indicates that the prospects for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value is determined to be other-than-temporary, the amount of the impairment is recognized through earnings. No impairment charges were recognized in 2018, 2017 or 2016. For equity securities, the entire amount of impairment is recognized through earnings.

EARNINGS SUMMARY:

The following table presents certain key aspects of our performance for the years ended December 31, 2018, 2017 and 2016.

(Dollars in thousands, except per share data)	Years Ended December 31,			Change	
	2018	2017	2016	2018 v 2017	2017 v 2016
Results of Operations:					
Interest income	\$ 159,686	\$ 138,727	\$ 117,048	\$ 20,959	\$ 21,679
Interest expense	44,523	27,586	20,613	16,937	6,973
Net interest income	115,163	111,141	96,435	4,022	14,706
Provision for loan losses	3,550	5,850	7,500	(2,300)	(1,650)
Net interest income after provision for					
loan losses	111,613	105,291	88,935	6,322	16,356
Wealth management fee income	33,245	23,183	18,240	10,062	4,943
Other income	10,948	11,444	10,678	(496)	766
Total operating expense	98,086	85,611	75,112	12,475	10,499
Income before income tax expense	57,720	54,307	42,741	3,413	11,566
Income tax expense	13,550	17,810	16,264	(4,260)	1,546
Net income	\$ 44,170	\$ 36,497	\$ 26,477	\$ 7,673	\$ 10,020
Per Share Data:					
Basic earnings per common share	\$ 2.33	\$ 2.07	\$ 1.62	\$ 0.26	\$ 0.45
Diluted earnings per common share	2.31	2.03	1.60	0.28	0.43
Average common shares outstanding	18,965,305	17,659,625	16,318,868	1,305,680	1,340,757
Diluted average common shares outstanding	19,148,645	17,943,685	16,514,998	1,204,960	1,428,687
Average equity to average assets	10.02	% 8.80	% 8.12	% 1.22	% 0.68
Return on average assets	1.02	0.89	0.72	0.13	0.17
Return on average equity	10.13	10.12	8.92	0.01	1.20
Selected Balance Sheet Ratios of the					
Company:					
Regulatory total capital to risk-weighted assets	15.03	% 14.84	% 13.25	% 0.19	% 1.59
Regulatory leverage ratio	9.82	9.04	8.35	0.78	0.69
Average loans to average deposits	103.53	99.63	100.97	3.90	(1.34)
Allowance for loan losses to total loans	0.98	0.98	0.97	—	0.01
Allowance for loan losses to nonperforming	149.73	269.33	285.94	(119.60)	(16.61)

loans					
Nonperforming loans to total loans	0.65	0.37	0.34	0.28	0.03
Noninterest bearing deposits to total deposits	11.91	14.59	14.35	(2.68)	0.24
Time deposits to total deposits	16.59	16.64	16.14	(0.05)	0.50

2018 compared to 2017

The Company recorded net income of \$44.17 million and diluted earnings per share of \$2.31 for the year ended December 31, 2018 compared to net income of \$36.50 million and diluted earnings per share of \$2.03 for the year ended December 31, 2017. These results produced a return on average assets of 1.02 percent and 0.89 percent in 2018 and 2017, respectively, and a return on average shareholders' equity of 10.13 percent and 10.12 percent in 2018 and 2017, respectively.

The increase in net income for 2018 was due to higher net interest income and wealth management income, offset by increased operating expenses when compared to 2017. In addition, 2018 net income benefitted from the reduced Federal income tax rate due to the new tax law signed in December 2017. Wealth management acquisitions in 2017 and 2018

contributed to higher wealth management income and higher operating expenses in 2018. Higher operating expenses were also due to costs associated with the implementation of the Strategic Plan, described in the “Overview” section above.

2017 compared to 2016

The Company recorded net income of \$36.50 million and diluted earnings per share of \$2.03 for the year ended December 31, 2017 compared to net income of \$26.48 million and diluted earnings per share of \$1.60 for the year ended December 31, 2016. These results produced a return on average assets of 0.89 percent and 0.72 percent in 2017 and 2016, respectively, and a return on average shareholders’ equity of 10.12 percent and 8.92 percent in 2017 and 2016, respectively.

The increase in net income for 2017 was due to higher net interest income and wealth management income, offset by increased operating expenses when compared to 2016. In addition, net income included a \$1.60 million tax benefit from the reduction of the Company’s deferred tax liability due to the new tax law. Higher operating expenses were principally due to costs associated with the implementation of the Strategic Plan, described in the “Overview” section above. Additionally, the Company recorded expense of \$1.3 million related to the separation of two senior officers.

NET INTEREST INCOME AND NET INTEREST MARGIN

A major source of the Company’s operating income is net interest income, which is the difference between interest and dividends earned on earning assets and fees earned on loans, and interest paid on interest-bearing liabilities. Earning assets include loans, investment securities, interest-earning deposits and federal funds sold. Interest-bearing liabilities include interest-bearing checking, savings and time deposits, Federal Home Loan Bank advances, subordinated debt and other borrowings. Net interest income is determined by the difference between the average yields earned on earning assets and the average cost of interest-bearing liabilities (“net interest spread”) and the relative amounts of earning assets and interest-bearing liabilities. Net interest margin is calculated as net interest income annualized as a percent of total interest earning assets. The Company’s net interest income, spread and margin are affected by regulatory, economic and competitive factors that influence interest rates, loan demand and deposit flows and general levels of nonperforming assets.

The following table summarizes the Company’s net interest income and margin, on a fully tax-equivalent basis, for the periods indicated:

(Dollars in thousands)	Years Ended December 31,					
	2018		2017		2016	
NII/NIM excluding the below	\$112,840	2.69%	\$106,393	2.68%	\$94,592	2.68%
Prepayment premiums received on multifamily						
loan paydowns	2,002	0.05	3,513	0.09	1,843	0.06
Fees recognized on full paydowns of select C&I						
loans	321	0.01	1,235	0.03	—	—
NII/NIM as reported	\$115,163	2.75%	\$111,141	2.80%	\$96,435	2.74%

The following table compares the average balance sheets, interest rate spreads and net interest margins for the years ended December 31, 2018, 2017 and 2016 (on a fully tax-equivalent basis “FTE”):

Year Ended December 31, 2018			
(In thousands except yield information)	Average Balance	Income/Expense (FTE)	Yield (FTE)
Assets:			
Interest-earnings assets:			
Investments:			
Taxable (1)	\$363,259	\$ 8,903	2.45 %
Tax-exempt (1)(2)	20,489	731	3.57
Loans (2)(3):			
Mortgages	565,513	18,842	3.33
Commercial mortgages	1,976,712	74,693	3.78
Commercial	1,087,600	50,854	4.68
Commercial construction	—	—	—
Installment	71,643	2,603	3.63
Home Equity	61,828	2,786	4.51
Other	451	45	9.98
Total loans	3,763,747	149,823	3.98
Federal funds sold	101	—	0.25
Interest-earning deposits	103,059	1,806	1.75
Total interest-earning assets	4,250,655	161,263	3.79
Noninterest-earning assets:			
Cash and due from banks	5,346		
Allowance for loan losses	(37,904)		
Premises and equipment	28,477		
Other assets	103,761		
Total noninterest-earning assets	99,680		
Total assets	\$4,350,335		
Liabilities and shareholders' equity:			
Interest-bearing deposits:			
Checking	\$1,143,640	\$ 9,543	0.83 %
Money markets	1,056,368	11,322	1.07
Savings	119,699	66	0.06
Certificates of deposit - retail	554,903	9,938	1.79
Subtotal interest-bearing deposits	2,874,610	30,869	1.07
Interest-bearing demand - brokered	180,000	3,135	1.74
Certificates of deposit - brokered	64,009	1,608	2.51
Total interest-bearing deposits	3,118,619	35,612	1.14
Borrowed funds	154,765	3,606	2.33
Capital lease obligation	8,698	418	4.81
Subordinated debt	83,104	4,887	5.88
Total interest-bearing liabilities	3,365,186	44,523	1.32
Noninterest-bearing liabilities:			
Demand deposits	516,718		
Accrued expenses and other liabilities	32,541		

Total noninterest-bearing liabilities	549,259	
Shareholders' equity	435,890	
Total liabilities and shareholders' equity	\$4,350,335	
Net interest income	\$ 116,740	
Net interest spread		2.47 %
Net interest margin (4)		2.75 %

1. Average balances for available for sale securities are based on amortized cost.
2. Interest income is presented on a tax-equivalent basis using a 21 percent federal tax rate.
3. Loans are stated net of unearned income and include nonaccrual loans.
4. Net interest income on an FTE basis as a percentage of total average interest-earning assets.

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Year Ended December 31, 2017

(In thousands except yield information)	Average Balance	Income/Expense (FTE)	Yield (FTE)
Assets:			
Interest-earnings assets:			
Investments:			
Taxable (1)	\$ 300,590	\$ 6,271	2.09 %
Tax-exempt (1)(2)	26,046	766	2.94
Loans (2)(3):			
Mortgages	586,722	19,025	3.24
Commercial mortgages	2,073,804	75,304	3.63
Commercial	761,401	32,564	4.28
Commercial construction	96	4	4.17
Installment	75,995	2,322	3.06
Home Equity	67,420	2,489	3.69
Other	550	45	8.18
Total loans	3,565,988	131,753	3.69
Federal funds sold	101	—	0.25
Interest-earning deposits	115,567	1,021	0.88
Total interest-earning assets	4,008,292	\$ 139,811	3.49
Noninterest-earning assets:			
Cash and due from banks	8,986		
Allowance for loan losses	(35,246)		
Premises and equipment	30,021		
Other assets	83,060		
Total noninterest-earning assets	86,821		
Total assets	\$4,095,113		
Liabilities and shareholders' equity:			
Interest-bearing deposits:			
Checking	\$1,092,545	\$ 5,039	0.46 %
Money markets	1,076,492	5,499	0.51
Savings	120,896	66	0.05
Certificates of deposit - retail	486,960	7,118	1.46
Subtotal interest-bearing deposits	2,776,893	17,722	0.64
Interest-bearing demand - brokered	180,000	2,934	1.63
Certificates of deposit - brokered	86,967	1,910	2.20
Total interest-bearing deposits	3,043,860	22,566	0.74
Borrowed funds	71,788	1,363	1.90
Capital lease obligation	9,375	451	4.81
Subordinated debt	50,733	3,206	6.32
Total interest-bearing liabilities			