

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

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-Q**

**(MARK ONE)**

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

**For the Quarter Ended September 30, 2013**

**OR**

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

**For the transition period from to**

**Commission File No. 001-16197**

**PEAPACK-GLADSTONE FINANCIAL CORPORATION**

**(Exact name of registrant as specified in its charter)**

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

**500 Hills Drive, Suite 300**

**Bedminster, New Jersey 07921-1538**

(Address of principal executive offices, including zip code)

**(908) 234-0700**

(Registrant's telephone number, including area code)

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

Yes       No .

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulations S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes       No .

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

Large accelerated filer

Accelerated filer

Smaller reporting company

Non-accelerated filer (do not check if a smaller reporting company)

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

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

9,079,436

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**PEAPACK-GLADSTONE FINANCIAL CORPORATION**

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Item 1. Financial Statements (Unaudited)

**PEAPACK-GLADSTONE FINANCIAL CORPORATION****CONSOLIDATED STATEMENTS OF CONDITION****(Dollars in thousands)**

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

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

*See accompanying notes to consolidated financial statements.*

Table of Contents**PEAPACK-GLADSTONE FINANCIAL CORPORATION****CONSOLIDATED STATEMENTS OF INCOME****(Dollars in thousands, except share data)****(Unaudited)**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
<b>INTEREST INCOME</b>				
Interest and fees on loans	\$13,041	\$11,939	\$36,819	\$35,928
Interest on investment securities held to maturity:				
Taxable	—	564	—	1,375
Tax-exempt	—	39	—	151
Interest on securities available for sale:				
Taxable	1,141	1,223	3,503	4,234
Tax-exempt	199	156	591	477
Interest on loans held for sale	21	34	267	75
Interest-earning deposits	21	27	135	58
Total interest income	14,423	13,982	41,315	42,298
<b>INTEREST EXPENSE</b>				
Interest on savings and interest-bearing deposit accounts	363	362	998	1,168
Interest on certificates of deposit over \$100,000	191	229	618	678
Interest on other time deposits	253	321	812	1,031
Interest on borrowed funds	138	113	322	453
Interest on capital lease obligation	105	107	317	324
Total interest expense	1,050	1,132	3,067	3,654
<b>NET INTEREST INCOME BEFORE PROVISION FOR LOAN LOSSES</b>				
Provision for loan losses	13,373	12,850	38,248	38,644
	750	750	2,100	3,750
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>				
	12,623	12,100	36,148	34,894
<b>OTHER INCOME</b>				
Trust department income	3,295	2,918	10,291	9,353
Service charges and fees	724	694	2,088	2,073
Bank owned life insurance	278	266	826	794
Securities gains, net	188	235	715	732
Gain on loans held for sale at fair value	277	358	1,138	825
Gain on loans held for sale at lower of cost or fair value	—	—	522	—
Other income	20	88	42	176
Total other income	4,782	4,559	15,622	13,953
<b>OPERATING EXPENSES</b>				
Salaries and employee benefits	8,927	7,029	23,941	19,550
Premises and equipment	2,325	2,290	6,967	7,034

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

*See accompanying notes to consolidated financial statements.*



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	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
Net income	\$ 1,964	\$ 2,832	\$ 6,866	\$ 8,638
Other comprehensive (loss)/income:				
Unrealized (losses)/gains on available for sale securities:				
Unrealized holding (losses)/gains arising during the period	(204 )	1,177	(5,336 )	2,296
Less: Reclassification adjustment for gains included in net income	188	235	715	732
	(392 )	942	(6,051 )	1,564
Tax effect	160	(385 )	2,472	(639 )
Net of tax	(232 )	557	(3,579 )	925
Unrealized losses on the noncredit, other-than-temporarily impaired held to maturity securities and on securities transferred from available for sale to held to maturity	—	60	—	173
Tax effect	—	(25 )	—	(71 )
Net of tax	—	35	—	102
Total other comprehensive (loss)/income	(232 )	592	(3,579 )	1,027
Total comprehensive income	\$ 1,732	\$ 3,424	\$ 3,287	\$ 9,665

*See accompanying notes to consolidated financial statements.*

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

*See accompanying notes to consolidated financial statements.*

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

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

*See accompanying notes to consolidated financial statements.*

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**PEAPACK-GLADSTONE FINANCIAL CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Certain information and footnote disclosures normally included in the audited consolidated financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Annual Report on Form 10-K for the period ended December 31, 2012 for Peapack-Gladstone Financial Corporation (the "Corporation"). In the opinion of the Management of the Corporation, the accompanying unaudited Consolidated Interim Financial Statements contain all adjustments necessary to present fairly the financial position as of September 30, 2013 and the results of operations for the three and nine months ended September 30, 2013 and 2012 and cash flows for the nine months ended September 30, 2013 and 2012.

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

The consolidated financial statements of Peapack-Gladstone Financial Corporation (the "Corporation") are prepared on the accrual basis and include the accounts of the Corporation and its wholly-owned subsidiary, Peapack-Gladstone Bank (the "Bank"). The consolidated statements also include the Bank's wholly-owned subsidiary, PGB Trust & Investments of Delaware. All significant intercompany balances and transactions have been eliminated from the accompanying consolidated financial statements.

**Securities:** Debt securities are classified as held to maturity and carried at amortized cost when Management has the positive intent and ability to hold them to maturity. Debt securities are classified as available for sale when they might be sold before maturity. Equity securities with readily determinable fair values are classified as available for sale. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax. As of September 30, 2013 and December 31, 2012, the Corporation no longer had any debt securities classified as held to maturity.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage-backed securities where

prepayments are anticipated. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

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

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

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

The majority of the Corporation's loans are secured by real estate in the New Jersey and New York area.

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

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

All loans are individually evaluated for impairment when loans are classified as substandard by Management. If a loan is considered impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral less estimated disposition costs if repayment is expected solely from the collateral. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans are collectively evaluated for impairment while they are performing assets. If and when a residential mortgage is placed on nonaccrual status and in the process of collection, such as through a foreclosure action, then they are evaluated for impairment on an individual basis and the loan is reported, net, at the fair value of the collateral less estimated disposition costs.



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

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

In determining an appropriate amount for the allowance, the Bank segments and evaluates the loan portfolio based on Federal call report codes, which are based on collateral. The following portfolio classes have been identified:

Primary Residential Mortgages. The Bank originates one to four family residential mortgage loans within or near its primary geographic market area. Loans are secured by first liens on the primary residence or investment property. Primary risk characteristics associated with residential mortgage loans typically involve major living or lifestyle changes to the borrower, including unemployment or other loss of income; unexpected significant expenses, such as for major medical issues or catastrophic events; divorce or death. In addition, residential mortgage loans that have adjustable rates could expose the borrower to higher debt service requirements in a rising interest rate environment. Further, real estate value could drop significantly and cause the value of the property to fall below the loan amount, creating additional potential exposure for the Bank.

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

Junior Lien Loan on Residence. The Bank provides junior lien loans ("JLL") against one to four family properties within or near its primary geographic market area. Junior lien loans can be either in the form of an amortizing home equity

loan or a revolving home equity line of credit. These loans are subordinate to a first mortgage which may be from another lending institution. Primary risk characteristics associated with junior lien loans typically involve major living or lifestyle changes to the borrower, including unemployment or other loss of income; unexpected significant expenses, such as for major medical issues or catastrophic events; divorce or death. Further, real estate value could drop significantly and cause the value of the property to fall below the loan amount, creating additional potential exposure for the Bank.

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Multifamily and Commercial Real Estate Loans. The Bank provides mortgage loans for multifamily properties (i.e. buildings which have five or more residential units) and other commercial real estate that is either owner occupied or managed as an investment property in New Jersey and New York. Commercial real estate properties primarily include office and medical buildings, retail space, and warehouse or flex space. Some properties are considered “mixed use” as they are a combination of building types, such as an apartment building that may also have retail space. Multifamily loans are expected to be repaid from the cash flow of the underlying property so the collective amount of rents must be sufficient to cover all operating expenses, property management and maintenance, taxes and debt service. Increases in vacancy rates, interest rates or other changes in general economic conditions can all have an impact on the borrower and their ability to repay the loan. Commercial real estate loans are generally considered to have a higher degree of credit risk than multifamily loans as they may be dependent on the ongoing success and operating viability of a fewer number of tenants who are occupying the property and who may have a greater degree of exposure to economic conditions.

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

Commercial Construction. The Bank has substantially wound down its commercial construction lending activity given the current economic environment. New construction loans would be considered only to experienced and reputable local builders and developers that have the capital and liquidity to carry a project to completion and stabilization. Construction loans are considered riskier than commercial financing on improved and established commercial real estate. The risk of potential loss increases if the original cost estimates or time to complete are significantly underestimated.

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

**Stock-Based Compensation:** The Corporation’s 2006 Long-Term Stock Incentive Plan and 2012 Long-Term Stock Incentive Plan as amended allow the granting of shares of the Corporation’s common stock as incentive stock options, nonqualified stock options, restricted stock awards and stock appreciation rights to directors, officers, employees and independent contractors of the Corporation and its Subsidiaries. The options granted under these plans are exercisable at a price equal to the fair value of common stock on the date of grant and expire not more than ten years after the date of grant. Stock options may vest during a period of up to five years after the date of grant.

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

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

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

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

The aggregate intrinsic value represents the total pre-tax intrinsic value (the difference between the Corporation's closing stock price on the last trading day of the third quarter of 2013 and the exercise price, multiplied by the number of in-the-money options). The Corporation's closing stock price on September 30, 2013 was \$18.55.

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

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

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

after the date of award.

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

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

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

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

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

Stock options and restricted stock totaling 461,564 and 569,642 shares were not included in the computation of diluted earnings per share in the third quarters of 2013 and 2012, respectively, because they were considered antidilutive. Stock options and restricted stock totaling 479,827 and 590,867 shares were not included in the computation of diluted earnings per share in the nine months ended September 30, 2013 and 2012, respectively, because they were considered antidilutive.

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

The Corporation is no longer subject to examination by the U.S. Federal tax authorities for years prior to 2009 or by New Jersey tax authorities for years prior to 2008.

The Corporation recognizes interest related to income tax matters as interest expense and penalties related to income tax matters as other expense. The Corporation did not have any amounts accrued for interest and penalties at September 30, 2013.

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



Table of Contents**2. INVESTMENT SECURITIES AVAILABLE FOR SALE**

A summary of amortized cost and approximate fair value of securities available for sale included in the consolidated statements of condition as of September 30, 2013 and December 31, 2012 follows:

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

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

The following tables present the Corporation's available for sale securities with continuous unrealized losses and the approximate fair value of these investments as of September 30, 2013 and December 31, 2012.

	September 30, 2013						
	Duration of Unrealized Loss						
	Less than 12 Months		12 Months or Longer		Total		
(In thousands)	Fair Value	Unrecognized Losses	Fair Value	Unrecognized Losses	Fair Value	Unrecognized Losses	
U.S. government sponsored entities	\$ 15,214	\$ (770)	) \$ —	\$ —	\$ 15,214	\$ (770)	)

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Mortgage-backed securities - residential	67,274	(1,008	)	84	(3	)	67,358	(1,011	)
State and political subdivisions	5,938	(79	)	—	—		5,938	(79	)
Single-issuer trust preferred security	—	—		2,400	(599	)	2,400	(599	)
CRA investment	2,928	(72	)	—	—		2,928	(72	)
Total	\$91,354	\$ (1,929	)	\$ 2,484	\$ (602	)	\$93,838	\$ (2,531	)

December 31, 2012

Duration of Unrealized Loss

(In thousands)	Less than 12 Months		12 Months or Longer		Total				
	Fair Value	Unrecognized Losses	Fair Value	Unrecognized Losses	Fair Value	Unrecognized Losses			
U.S. government sponsored Entities	\$4,998	\$ (2	)	\$ —	\$ —	\$4,998	\$ (2	)	
Mortgage-backed securities-residential	8,433	(17	)	95	(1	)	8,528	(18	)
State and political subdivisions	1,290	(2	)	—	—	1,290	(2	)	
Single-issuer trust preferred Security	—	—		2,289	(710	)	2,289	(710	)
Total	\$14,721	\$ (21	)	\$ 2,384	\$ (711	)	\$17,105	\$ (732	)

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Management believes that the unrealized losses on investment securities available for sale are temporary and due to interest rate fluctuations and/or volatile market conditions rather than the creditworthiness of the issuers. As of September 30, 2013, the Corporation does not intend to sell these securities nor is it likely that it will be required to sell the securities before their anticipated recovery; therefore, none of the securities in unrealized loss position were determined to be other-than-temporarily impaired.

At September 30, 2013, the unrealized loss on the single-issuer trust preferred security of \$599 thousand is related to a debt security issued by a large bank holding company that has experienced declines in all its securities due to the turmoil in the financial markets and a merger. The security was downgraded to below investment grade by Moody's and is currently rated Ba1. Management monitors the performance of the issuer on a quarterly basis to determine if there are any credit events that could result in deferral or default of the security. Management believes the depressed valuation is a result of the nature of the security, a trust preferred bond, and the bond's very low yield. As Management does not intend to sell this security nor is it likely that it will be required to sell the security before its anticipated recovery, the security is not considered other-than-temporarily impaired at September 30, 2013.

**3. LOANS**

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

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

In determining an appropriate amount for the allowance, the Bank segments and evaluates the loan portfolio based on federal call report codes. The following portfolio classes have been identified as of September 30, 2013 and December 31, 2012:

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(In thousands)	September 30, 2013	% of Total Loans	December 31, 2012	% of Total Loans
Primary residential mortgage	\$ 538,758	38.67%	\$ 527,803	46.74%
Home equity lines of credit				