# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2020

or

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

For the transition period from _____ to _____

Commission file Number: 000-32891

# 1ST CONSTITUTION BANCORP

(Exact Name of Registrant as Specified in Its Charter)

| | |
|---|---|
| New Jersey | 22-3665653 |
| (State of Other Jurisdiction of Incorporation or Organization) | (I.R.S. Employer Identification No.) |

| | | | | |
|---|---|---|---|---|
| 2650 Route 130 | P.O. Box 634 | Cranbury | New Jersey | 08512 |
| (Address of Principal Executive Offices) | | | | (Zip Code) |

(Registrant's Telephone Number, Including Area Code) (609) 655-4500

(Former name, former address and former fiscal year, if changed since last report)

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

| Title of each class | Trading Symbol(s) | Name of each exchange on which registered |
|---|---|---|
| Common stock, no par value | FCCY | NASDAQ Global Market |

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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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.

| | | | |
|---|---|---|---|
| Large accelerated filer | ☐ | Accelerated filer | ☒ |
| Non-accelerated filer | ☐ | Smaller reporting company | ☒ |
| | | Emerging growth company | ☐ |

If an emerging growth company, indicated 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 ☒

As of November 3, 2020, there were 10,237,851 shares of the registrant's common stock, no par value, outstanding.

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## PART I. FINANCIAL INFORMATION

**Item 1. Financial Statements.**

**1ST Constitution Bancorp**
**Consolidated Balance Sheets**
**(Dollars in thousands)**
**(Unaudited)**

| | September 30, 2020 | December 31, 2019 |
|---|---|---|
| **ASSETS** | | |
| Cash and due from banks | $ 8,811 | $ 2,547 |
| Interest-earning deposits | 11,244 | 12,295 |
| Total cash and cash equivalents | 20,055 | 14,842 |
| Investment securities | | |
| Available for sale, at fair value | 135,123 | 155,782 |
| Held to maturity (fair value of $90,735 and $78,223 at September 30, 2020 and December 31, 2019, respectively) | 87,811 | 76,620 |
| Total investment securities | 222,934 | 232,402 |
| Loans held for sale | 28,196 | 5,927 |
| Loans | 1,455,684 | 1,216,028 |
| Less: allowance for loan losses | (14,450) | (9,271) |
| Net loans | 1,441,234 | 1,206,757 |
| Premises and equipment, net | 14,503 | 15,262 |
| Right-of-use assets | 16,910 | 17,957 |
| Accrued interest receivable | 5,689 | 4,945 |
| Bank-owned life insurance | 37,131 | 36,678 |
| Other real estate owned | 267 | 571 |
| Goodwill and intangible assets | 36,471 | 36,779 |
| Other assets | 20,640 | 14,142 |
| Total assets | $ 1,844,030 | $ 1,586,262 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| **LIABILITIES** | | |
| Deposits | | |
| Non-interest bearing | $ 426,528 | $ 287,555 |
| Interest bearing | 1,084,505 | 989,807 |
| Total deposits | 1,511,033 | 1,277,362 |
| Short-term borrowings | 105,867 | 92,050 |
| Redeemable subordinated debentures | 18,557 | 18,557 |
| Accrued interest payable | 1,069 | 1,592 |
| Lease liability | 17,714 | 18,617 |
| Accrued expenses and other liabilities | 7,783 | 7,506 |
| Total liabilities | 1,662,023 | 1,415,684 |
| **SHAREHOLDERS' EQUITY** | | |
| Preferred stock, no par value; 5,000,000 shares authorized; none issued | — | — |
| Common stock, no par value; 30,000,000 shares authorized; 10,285,229 and 10,224,974 shares issued and 10,237,520 and 10,191,676 shares outstanding as of September 30, 2020 and December 31, 2019, respectively | 110,825 | 109,964 |
| Retained earnings | 70,058 | 60,791 |
| Treasury stock, 47,709 and 33,298 shares at September 30, 2020 and December 31, 2019, respectively | (611) | (368) |
| Accumulated other comprehensive income | 1,735 | 191 |
| Total shareholders' equity | 182,007 | 170,578 |
| Total liabilities and shareholders' equity | $ 1,844,030 | $ 1,586,262 |

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

**1ST Constitution Bancorp**
**Consolidated Statements of Income**
**(Dollars in thousands, except per share data)**
**(Unaudited)**

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2020 | 2019 | 2020 | 2019 |
| **INTEREST INCOME** | | | | |
| Loans, including fees | $ 16,477 | $ 13,316 | $ 46,656 | $ 38,342 |
| Securities: | | | | |
| Taxable | 725 | 1,130 | 2,633 | 3,615 |
| Tax-exempt | 504 | 393 | 1,438 | 1,256 |
| Federal funds sold and short-term investments | 2 | 35 | 95 | 129 |
| Total interest income | 17,708 | 14,874 | 50,822 | 43,342 |
| **INTEREST EXPENSE** | | | | |
| Deposits | 2,171 | 2,904 | 8,133 | 7,892 |
| Borrowings | 95 | 268 | 205 | 698 |
| Redeemable subordinated debentures | 90 | 185 | 348 | 575 |
| Total interest expense | 2,356 | 3,357 | 8,686 | 9,165 |
| Net interest income | 15,352 | 11,517 | 42,136 | 34,177 |
| **PROVISION FOR LOAN LOSSES** | 2,320 | 350 | 5,340 | 1,050 |
| Net interest income after provision for loan losses | 13,032 | 11,167 | 36,796 | 33,127 |
| **NON-INTEREST INCOME** | | | | |
| Service charges on deposit accounts | 126 | 165 | 471 | 490 |
| Gain on sales of loans | 3,396 | 1,351 | 6,987 | 3,556 |
| Income on bank-owned life insurance | 188 | 149 | 632 | 437 |
| Gain on sales and calls of securities | 79 | 16 | 97 | 16 |
| Other income | 947 | 525 | 2,105 | 1,743 |
| Total non-interest income | 4,736 | 2,206 | 10,292 | 6,242 |
| **NON-INTEREST EXPENSES** | | | | |
| Salaries and employee benefits | 7,106 | 5,231 | 19,276 | 15,472 |
| Occupancy expense | 1,222 | 972 | 3,597 | 2,984 |
| Data processing expenses | 486 | 379 | 1,402 | 1,072 |
| FDIC insurance expense | 225 | (47) | 484 | 113 |
| Other real estate owned expenses | 27 | 52 | 58 | 134 |
| Merger-related expenses | — | 302 | 64 | 575 |
| Other operating expenses | 1,896 | 1,546 | 5,711 | 4,746 |
| Total non-interest expenses | 10,962 | 8,435 | 30,592 | 25,096 |
| Income before income taxes | 6,806 | 4,938 | 16,496 | 14,273 |
| **INCOME TAXES** | 1,896 | 1,315 | 4,475 | 3,883 |
| Net income | $ 4,910 | $ 3,623 | $ 12,021 | $ 10,390 |
| **EARNINGS PER COMMON SHARE** | | | | |
| Basic | $ 0.48 | $ 0.42 | $ 1.18 | $ 1.20 |
| Diluted | $ 0.48 | $ 0.42 | $ 1.17 | $ 1.19 |
| **WEIGHTED AVERAGE SHARES OUTSTANDING** | | | | |
| Basic | 10,230,488 | 8,666,251 | 10,213,601 | 8,641,684 |
| Diluted | 10,268,951 | 8,722,349 | 10,260,477 | 8,698,959 |

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

## 1ST Constitution Bancorp
## Consolidated Statements of Comprehensive Income
## (Dollars in thousands)
## (Unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2020 | 2019 | 2020 | 2019 |
| Net income | $ 4,910 | $ 3,623 | $ 12,021 | $ 10,390 |
| Other comprehensive income: | | | | |
| Unrealized holding gains on securities available for sale | 435 | 200 | 1,964 | 2,631 |
| Tax effect | (103) | (48) | (475) | (638) |
| Net of tax amount | 332 | 152 | 1,489 | 1,993 |
| Reclassification adjustment for losses (gains) on securities available for sale[1] | 14 | (16) | 3 | (16) |
| Tax effect [2] | (4) | 4 | (1) | 4 |
| Net of tax amount | 10 | (12) | 2 | (12) |
| Reclassification adjustment for unrealized impairment loss on held to maturity security[3] | 6 | 2 | 14 | 6 |
| Tax effect | (1) | — | (4) | (1) |
| Net of tax amount | 5 | 2 | 10 | 5 |
| Pension liability | 70 | 56 | 211 | 167 |
| Tax effect | (20) | (18) | (62) | (49) |
| Net of tax amount | 50 | 38 | 149 | 118 |
| Reclassification adjustment for actuarial gains for unfunded pension liability[4] | (51) | (44) | (151) | (132) |
| Tax effect [2] | 15 | 14 | 45 | 40 |
| Net of tax amount | (36) | (30) | (106) | (92) |
| Total other comprehensive income | 361 | 150 | 1,544 | 2,012 |
| Comprehensive income | $ 5,271 | $ 3,773 | $ 13,565 | $ 12,402 |

[1] Included in gain on sales and calls of securities on the consolidated statements of income
[2] Included in income taxes on the consolidated statements of income
[3] Included in investment securities held to maturity on the consolidated balance sheets
[4] Included in salaries and employee benefits expense on the consolidated statements of income

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

**1ST Constitution Bancorp**
**Consolidated Statements of Changes in Shareholders' Equity**
**For the Three and Nine Months Ended September 30, 2020 and 2019**
**(Dollars in thousands)**
**(Unaudited)**

| | Common Stock | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive Income (Loss) | Total Shareholders' Equity |
|---|---|---|---|---|---|
| Balance, July 1, 2019 | $ 80,190 | $ 55,224 | $ (368) | $ 29 | $ 135,075 |
| Net income | — | 3,623 | — | — | 3,623 |
| Exercise of stock options and issuance of restricted shares (8,358 shares and 25,350 shares, respectively) | 60 | — | — | — | 60 |
| Share-based compensation | 268 | — | — | — | 268 |
| Cash dividends ($0.075 per share) | — | (649) | — | — | (649) |
| Other comprehensive income | — | — | — | 150 | 150 |
| Balance, September 30, 2019 | $ 80,518 | $ 58,198 | $ (368) | $ 179 | $ 138,527 |
| Balance, July 1, 2020 | $ 110,546 | $ 66,067 | $ (503) | $ 1,374 | $ 177,484 |
| Net income | — | 4,910 | — | — | 4,910 |
| Exercise of stock options and issuance of restricted shares (755 shares and 26,100 shares, respectively) | 5 | — | — | — | 5 |
| Share-based compensation | 274 | — | — | — | 274 |
| Cash dividends ($0.09 per share) | — | (919) | — | — | (919) |
| Treasury stock purchase (8,383 shares) | | | (108) | | (108) |
| Other comprehensive income | — | — | — | 361 | 361 |
| Balance, September 30, 2020 | $ 110,825 | $ 70,058 | $ (611) | $ 1,735 | $ 182,007 |

| | Common Stock | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive Income (Loss) | Total Shareholders' Equity |
|---|---|---|---|---|---|
| Balance, January 1, 2019 | $ 79,536 | $ 49,750 | $ (368) | $ (1,833) | $ 127,085 |
| Net income | — | 10,390 | — | — | 10,390 |
| Exercise of stock options and issuance of restricted shares (24,277 shares and 53,931 shares, respectively) | 149 | — | — | — | 149 |
| Share-based compensation | 833 | — | — | — | 833 |
| Cash dividends ($0.225 per share) | — | (1,942) | — | — | (1,942) |
| Other comprehensive income | — | — | — | 2,012 | 2,012 |
| Balance, September 30, 2019 | $ 80,518 | $ 58,198 | $ (368) | $ 179 | $ 138,527 |
| Balance, January 1, 2020 | $ 109,964 | $ 60,791 | $ (368) | $ 191 | $ 170,578 |
| Net income | — | 12,021 | — | — | 12,021 |
| Exercise of stock options and issuance of restricted shares (755 shares and 59,500 shares, respectively) | 5 | — | — | — | 5 |
| Share-based compensation | 856 | — | — | — | 856 |
| Cash dividends ($0.27 per share) | — | (2,754) | — | — | (2,754) |
| Treasury stock purchased (14,411 shares) | — | — | (243) | — | (243) |
| Other comprehensive income | — | — | — | 1,544 | 1,544 |
| Balance, September 30, 2020 | $ 110,825 | $ 70,058 | $ (611) | $ 1,735 | $ 182,007 |

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

**1ST Constitution Bancorp**
**Consolidated Statements of Cash Flows**
**(Dollars in thousands)**
**(Unaudited)**

| | Nine Months Ended September 30, 2020 | Nine Months Ended September 30, 2019 |
|---|---|---|
| **OPERATING ACTIVITIES:** | | |
| Net income | $ 12,021 | $ 10,390 |
| Adjustments to reconcile net income to net cash (used in) provided by operating activities- | | |
| Provision for loan losses | 5,340 | 1,050 |
| Depreciation and amortization | 1,561 | 1,020 |
| Net amortization of premiums and discounts on securities | 956 | 425 |
| SBA loan discount accretion | (300) | (289) |
| Loss (gain) on sales and calls of securities available for sale | 3 | (16) |
| Gain on sales and calls of securities held to maturity | (100) | — |
| Gain on sales of other real estate owned | (71) | (137) |
| Gain on sales of loans held for sale | (6,987) | (3,556) |
| Originations of loans held for sale | (238,201) | (100,664) |
| Proceeds from sales of loans held for sale | 222,919 | 100,502 |
| Increase in cash surrender value on bank–owned life insurance | (557) | (437) |
| Gain on cash surrender value on bank-owned life insurance | (75) | — |
| Share-based compensation expense | 856 | 833 |
| Decrease in deferred tax asset | 498 | 1,146 |
| Noncash rent and equipment expense | 144 | 152 |
| (Increase) decrease in accrued interest receivable | (744) | 208 |
| (Increase) in other assets | (9,492) | (3,442) |
| (Decrease) increase in accrued interest payable | (523) | 374 |
| Increase (decrease) in accrued expenses and other liabilities | 338 | (693) |
| Net cash (used in) provided by operating activities | (12,414) | 6,866 |
| **INVESTING ACTIVITIES:** | | |
| Purchases of securities: | | |
| Available for sale | (23,415) | (28,472) |
| Held to maturity | (32,665) | (9,101) |
| Proceeds from sales, calls, maturities and payments of securities: | | |
| Available for sale | 45,425 | 27,988 |
| Held to maturity | 21,244 | 13,592 |
| Proceeds from bank-owned life insurance benefits paid | 179 | — |
| Net redemption (purchase) of restricted stock | 1,753 | (2,062) |
| Net increase in loans | (239,517) | (142,053) |
| Capital expenditures | (248) | (657) |
| Proceeds from sales of other real estate owned | 375 | 1,192 |
| Net cash used in investing activities | (226,869) | (139,573) |
| **FINANCING ACTIVITIES:** | | |
| Exercise of stock options | 5 | 149 |
| Purchase of treasury shares | (243) | — |
| Cash dividends paid to shareholders | (2,754) | (1,942) |
| Net increase in deposits | 233,671 | 72,387 |
| Increase in short-term borrowings | 13,817 | 66,025 |
| Net cash provided by financing activities | 244,496 | 136,619 |
| Increase in cash and cash equivalents | 5,213 | 3,912 |
| Cash and cash equivalents at beginning of period | 14,842 | 16,844 |
| Cash and cash equivalents at end of period | $ 20,055 | $ 20,756 |

| | | | | |
|---|---|---|---|---|
| **Supplemental Disclosures of Cash Flow Information** | | | | |
| Cash paid during the period for - | | | | |
| Interest | $ | 9,209 | $ | 8,791 |
| Income taxes | | 4,311 | | 4,528 |
| Noncash items: | | | | |
| Right-of-use assets | $ | 250 | $ | 15,080 |
| Lease liability | | 250 | | 15,699 |

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

## (1) Summary of Significant Accounting Policies

The accompanying unaudited consolidated financial statements include 1ST Constitution Bancorp (the "Company"), its wholly-owned subsidiary, 1ST Constitution Bank (the "Bank"), and the Bank's wholly-owned subsidiaries, 1ST Constitution Investment Company of New Jersey, Inc., FCB Assets Holdings, Inc and 1st Constitution Real Estate Investment Corporation. 1ST Constitution Capital Trust II, a subsidiary of the Company, is not included in the Company's consolidated financial statements, as it is a variable interest entity and the Company is not the primary beneficiary. All significant intercompany accounts and transactions have been eliminated in consolidation. The accounting and reporting policies of the Company and its subsidiaries conform to accounting principles generally accepted in the United States of America ("U.S. GAAP") and to the rules and regulations of the Securities and Exchange Commission (the "SEC"), including the instructions to Form 10-Q and Article 10 of Regulation S-X. Certain information and footnote disclosures normally included in financial statements have been condensed or omitted pursuant to such rules and regulations. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2019, filed with the SEC on March 16, 2020.

Goodwill

The Company completed its annual testing of goodwill for impairment in the fourth quarter of 2019 and concluded at that time that the fair value of the reporting unit exceeded the carrying amount of the reporting unit. In completing the impairment testing the Company identified a single reporting unit and the $35.0 million of goodwill at December 31, 2019 was assigned to the single reporting unit.

The decline in the market price of the Company's common stock and the resulting aggregate market capitalization of the Company declining below the total amount of common shareholders' equity at September 30, 2020, was an indication that the carrying amount of goodwill may exceed its fair value. Even though the decline in the market price of the Company's common stock during 2020 was consistent with a broad decline in the market value of all banking company stocks and was not specific to the Company, it was a triggering event that required an evaluation of the potential impairment of goodwill.

For the third quarter of 2020, the Company performed a quantitative impairment test of goodwill utilizing a discounted cash flow valuation methodology based upon an updated five year projection of the Company's financial performance. A discount rate was estimated utilizing the build up method with a risk free rate, an equity risk premium and a size premium. This discount rate was applied to the projected cash flows over the five year period, which included a terminal value in year five based on a multiple of the projected cash flow in year five. The year five terminal multiple was based upon the observed average market price to earnings multiple for the trailing last twelve months of earnings for companies included in the SNL US Bank Index at September 30, 2020. This multiple does not include a control premium. This estimated fair value exceeded the carrying value of shareholders' equity at September 30, 2020 by 10.3%.

The five year projection was based on the Company's 2020 business plan, historical operating results and internal financial models and included key assumptions for significantly elevated loan losses as a result of the COVID pandemic in the first three years of the projection. The Company's actual financial results for the quarter ended June 30, 2020 and September 30, 2020 exceeded the financial projections for those periods.

It is not possible to know the severity and duration of the COVID-19 pandemic and the severity and duration of the economic disruption that will occur in the near term. While the Company has projected loan losses significantly higher than its historical experience in its five year projections, the actual loan losses may vary due to the uncertainty of the severity and duration of the economic disruption. Changes in market interest rates and the economic conditions in the Company's market area may also affect the Company's future net interest income and net income.

If the Company's common stock price remains below the Company's book value per common share in future periods, the Company will continue to evaluate goodwill for impairment on a quarterly basis. Changes in economic conditions, actual loan losses at levels higher than projected, changes in market interest rates and changes in discount rates and valuation multiples may affect the Company's financial projections and valuation. The Company may determine that goodwill becomes impaired in a future period and a portion or all of the goodwill may be written off.

On the basis of the evaluation of goodwill, management concluded that it was more likely than not the fair value of the reporting unit exceeded the carrying value of the reporting unit. Accordingly, goodwill was not impaired at September 30, 2020.

In the opinion of the Company, all adjustments (consisting only of normal recurring accruals) that are necessary for a fair presentation of the operating results for the interim periods have been included. The results of operations for periods of less than a year are not necessarily indicative of results for the full year.

The Company has evaluated events and transactions occurring subsequent to the balance sheet date of September 30, 2020 for items that should potentially be recognized or disclosed in these consolidated financial statements. The evaluation was conducted through the date these consolidated financial statements were issued.

COVID-19 Impact

The sudden emergence of the COVID-19 global pandemic in the first quarter of 2020, and the responses thereto (including business and school closures, restrictions on travel and social distancing protocols), has caused, and is continuing to cause, widespread uncertainty, social and economic disruption, highly volatile financial markets and unprecedented increases in unemployment levels in a short period of time. As a result, almost all businesses located in the Bank's primary market areas of northern and central New Jersey, communities along the New Jersey shore, and the New York City metropolitan area, and their employees, have been adversely impacted.

The ultimate impact of the COVID-19 pandemic on the businesses and the people in the communities that the Bank serves, and on the Company's operations and financial performance, will depend on future developments related to the duration, extent and severity of the pandemic and measures taken by governmental and private parties in response thereto, including but not limited to the enactment of further legislation or the adoption of policies designed to deliver monetary aid and other relief to borrowers. In addition, to the extent that the Bank's customers are not able to fulfill their contractual obligations, the Company's business operations, asset valuations, financial condition, cash flows and results of operations could be materially adversely impacted. Material adverse impacts may also include all or a combination of valuation impairments on our intangible assets, investments, loans, deferred tax assets, or other real estate owned ("OREO"). Similarly, the Company's operations rely on third-party vendors to process, record and monitor transactions. If any of these vendors are unable to provide these services, our ability to serve customers could be disrupted. The pandemic could also negatively impact customers' ability to conduct banking and other financial transactions. The Company's operations could also be adversely impacted if key personnel or a significant number of employees were unable to work due to illness or restrictions.

On March 27, 2020, the President of the United States signed into law the Coronavirus Aid, Relief and Economic Security ("CARES") Act to provide relief for individuals and businesses that have been negatively impacted by the COVID-19 pandemic.

The CARES Act includes a provision for the Company to opt out of applying the "troubled-debt restructuring" accounting guidance in Accounting Standards Codification ("ASC") Topic 310-40 for certain loan modifications. Loan modifications made between March 1, 2020 and the earlier of i) December 30, 2020 or ii) 60 days after the President declares a termination of the COVID-19 national emergency are eligible for this relief if the related loans were not more than 30 days past due as of December 31, 2019. The Bank adopted this provision as of March 31, 2020.

Adoption of New Accounting Standards

***ASU 2018-15 - Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40)***

In August 2018, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2018-15, "Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement," to help entities evaluate the accounting for fees paid by a customer in a cloud computing arrangement (hosting arrangement) by providing guidance for determining when the arrangement includes a software license.

The amendments in this Update align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal use software license). The accounting for the service element of a hosting arrangement that is a service contract is not affected by the amendments in this Update.

The amendments in this ASU also require the entity (customer) to expense the capitalized implementation costs of a hosting arrangement that is a service contract over the term of the hosting arrangement. The term of the hosting arrangement includes the non-cancellable period of the arrangement plus periods covered by (1) an option to extend the arrangement if the customer is reasonably certain to exercise that option, (2) an option to terminate the arrangement if the customer is reasonably certain not to exercise the termination option, and (3) an option to extend (or not to terminate) the arrangement in which exercise of the option is in the control of the vendor. The entity also is required to apply the existing impairment guidance in Subtopic 350-40 to the capitalized implementation costs as if the costs were long-lived assets.

The amendments in this ASU also require the entity to present the expense related to the capitalized implementation costs in the same line item in the consolidated statements of income as the fees associated with the hosting element (service) of the arrangement and classify payments for capitalized implementation costs in the consolidated statements of cash flows in the same manner as payments made for fees associated with the hosting element. The entity is also required to present the capitalized implementation costs in the consolidated balance sheets in the same line item that a prepayment for the fees of the associated hosting arrangement would be presented.

The adoption of this guidance in 2020 did not have a material impact on the Company's consolidated financial statements.

***ASU 2018-14 - Compensation - Retirement Benefits - Defined Benefit Plans - General (Subtopic 715-20)***

In August 2018, the FASB issued ASU 2018-14 - "Compensation - Retirement Benefits - Defined Benefit Plans - General (Subtopic 715-20)," which consists of amendments to the disclosure framework project to improve the effectiveness of disclosures in the notes to the financial statements. The amendments in this Update modify the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans.

The following disclosure requirements are removed from Subtopic 715-20:

1. The amounts in accumulated other comprehensive income expected to be recognized as components of net periodic benefit cost over the next fiscal year;
2. The amount and timing of plan assets expected to be returned to the employer;
3. The disclosures related to the June 2001 amendments to the Japanese Welfare Pension Insurance Law;
4. Related party disclosures about the amount of future annual benefits covered by insurance and annuity contracts and significant transactions between the employer or related parties and the plan;
5. For nonpublic entities, the reconciliation of the opening balances to the closing balances of plan assets measured on a recurring basis in Level 3 of the fair value hierarchy. However, nonpublic entities will be required to disclose separately the amounts of transfers into and out of Level 3 of the fair value hierarchy and purchases of Level 3 plan assets; and
6. For public entities, the effects of a one-percentage point change in assumed health care cost trend rates on the (a) aggregate of the service and interest cost components of net periodic benefit costs and (b) benefit obligation for postretirement health care benefits.

The following disclosure requirements are added to Subtopic 715-20:

1. The weighted-average interest crediting rates for cash balance plans and other plans with promised interest crediting rates; and
2. An explanation of the reasons for significant gains and losses related to changes in the benefit obligation for the period.

The amendments in this ASU also clarify the disclosure requirements in paragraph 715-20-50-3, which state that the following information for defined benefit pension plans should be disclosed:

1. The projected benefit obligation ("PBO") and fair value of plan assets for plans with PBOs in excess of plan assets; and
2. The accumulated benefit obligation ("ABO") and fair value of plan assets for plans with ABOs in excess of plan assets.

The amendments in this ASU remove disclosures that no longer are considered cost beneficial, clarify the specific requirements of disclosures and add disclosure requirements identified as relevant. Although narrow in scope, the amendments are considered an important part of the FASB's efforts to improve the effectiveness of disclosures in the notes to financial statements by applying concepts in the Concepts Statement.

For the Company, the provisions of this ASU are effective for fiscal years ending after December 15, 2020. Early adoption was permitted. The adoption of this guidance in 2020 did not have a material impact on the Company's consolidated financial statements.

**(2) Acquisition of Shore Community Bank**

On November 8, 2019, the Company completed its acquisition of 100 percent of the shares of common stock of Shore Community Bank ("Shore"), which merged with and into the Bank (the “Shore Merger”). The former shareholders of Shore received total consideration of $54.3 million, which was comprised of 1,509,275 shares of common stock of the Company with a market value of $29.2 million and cash of $25.1 million, of which $925,000 was cash paid in exchange for unexercised outstanding stock options.

The Shore Merger was accounted for under the acquisition method of accounting, and accordingly, assets acquired, liabilities assumed and consideration exchanged were recorded at preliminary estimated fair values as of the Shore Merger date. The excess of the fair value of the consideration paid over the preliminary net fair value of Shore's assets and liabilities resulted in the recognition of goodwill of $23.2 million. Shore’s results of operations have been included in the Company’s Consolidated Financial Statements since November 8, 2019.

The assets acquired and liabilities assumed in the merger were recorded at their estimated fair values based on management’s best estimates, using information available at the date of the merger, including the use of third party valuation specialists. The measurement period may not exceed one year from the acquisition date and the measurement period for the Shore Merger is expected to end on November 7, 2020.

The following table summarizes the fair value of the acquired assets and liabilities assumed as of November 8, 2019:

| (Dollars in thousands) | | Amount |
|---|---|---|
| Consideration paid: | | |
| Company stock issued | $ | 29,175 |
| Cash payment | | 24,233 |
| Cash payment for unexercised outstanding stock options | | 925 |
| Total consideration paid | $ | 54,333 |
| | | |
| Recognized amounts of identifiable assets acquired and liabilities assumed at fair value: | | |
| Cash and cash equivalents | $ | 32,599 |
| Investment securities available for sale | | 26,440 |
| Loans | | 205,833 |
| Premises and equipment, net | | 4,433 |
| Core deposit intangible asset | | 1,467 |
| Bank-owned life insurance | | 7,250 |
| Right-of-use assets | | 3,226 |
| Accrued interest receivable | | 778 |
| Other real estate owned | | 605 |
| Other assets | | 2,518 |
| Deposits | | (249,836) |
| Lease liability | | (3,226) |
| Other liabilities | | (948) |
| Total identifiable assets and liabilities, net | $ | 31,139 |
| | | |
| Goodwill recorded from Shore merger | $ | 23,194 |

ASC Topic 805-10 provides that if the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer shall report, in its financial statements, provisional amounts for the items for which the accounting is incomplete. During the measurement period, the acquirer shall adjust the provisional amounts recognized at the acquisition date and may recognize additional assets or liabilities to reflect new information obtained from facts and circumstances that existed as of the acquisition date. Thus, the acquirer shall adjust its financial statements as needed, including recognizing in its current-period earnings the full effect of a change in depreciation, amortization, or other income effects, if any, as a result of the change to provisional amounts calculated as if the accounting had been completed at the acquisition date. The measurement period may not exceed one year from the acquisition date.

Investments were recorded at fair value, utilizing quoted market prices on nationally recognized exchanges (Level 1) or by using Level 2 inputs.  For Level 2 securities, the Company obtained fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayments speeds, credit information and the security's terms and conditions, among other things.

Loans acquired in the Shore Merger were recorded at fair value and subsequently accounted for in accordance with ASC Topic 310. The fair values of loans acquired were estimated, utilizing cash flow projections based on the remaining maturity and repricing terms. Cash flows were adjusted for estimated future credit losses of approximately $3.6 million and estimated prepayments. Projected cash flows were then discounted to present value, utilizing a risk-adjusted market rate for similar loans that management determined market participants would likely use.

At the Shore Merger date, the Company recorded $201.3 million of loans without evidence of credit quality deterioration and $4.6 million of loans with evidence of credit quality deterioration.

The following table summarizes the composition of the loans acquired and recorded at fair value:

| | At November 8, 2019 | | |
|---|---|---|---|
| (Dollars in thousands) | Loans acquired with no credit quality deterioration | Loans acquired with credit quality deterioration | Total |
| Commercial | | | |
| Construction | $ 9,733 | $ — | $ 9,733 |
| Commercial real estate | 135,482 | 4,071 | 139,553 |
| Commercial business | 12,027 | — | 12,027 |
| Residential real estate | 36,849 | 500 | 37,349 |
| Consumer | 7,171 | — | 7,171 |
| Total loans | $ 201,262 | $ 4,571 | $ 205,833 |

The following is a summary of the loans acquired with evidence of deteriorated credit quality in the Shore Merger as of the date of the closing of the merger:

| (Dollars in thousands) | Acquired Credit Impaired Loans |
|---|---|
| Contractually required principal and interest at acquisition | $ 7,584 |
| Contractual cash flows not expected to be collected (non-accretable difference) | 2,355 |
| | |
| Expected cash flows at acquisition | 5,229 |
| Interest component of expected cash flows (accretable difference) | 658 |
| | |
| Fair value of acquired loans | $ 4,571 |

Bank-owned life insurance was recorded at the cash surrender value of the insurance policies, which approximates the redemption value of the policies.

The Company recorded a core deposit intangible asset related to a value ascribed to demand, interest checking, money market and savings account, referred to as core deposits, acquired as part of the acquisition. The value assigned to the acquired core deposits represents the future economic benefit of the potential cost savings from acquiring the core deposits, net of operating expenses and including ancillary fee income, compared to the cost of obtaining alternative funds from available market sources. Management used estimates including the expected attrition rates of depository accounts, future interest rate levels, and the cost of servicing various depository products. The core deposit intangible asset totaled $1.5 million and is being amortized over its estimated useful life of approximately 10 years, using an accelerated method.

The following table presents the projected amortization of the core deposit intangible asset for each period beginning October 1, 2020:

| (Dollars in thousands) | Amount |
|---|---|
| Year | |
| 2020 | $ 62 |
| 2021 | 236 |
| 2022 | 209 |
| 2023 | 182 |
| 2024 | 156 |
| Thereafter | 378 |
| Total | $ 1,223 |

The fair values of deposit liabilities with no stated maturities, such as checking, money market and savings accounts, were assumed to equal the carrying value amounts since these deposits are payable on demand. The fair values of certificates of deposit represent the present value of contractual cash flows discounted at market rates for similar certificates of deposit.

Direct costs related to the Shore Merger were expensed as incurred. For the year ended December 31, 2019, the Company incurred $1.7 million of expenses for termination of contracts, legal and financial advisory fees, severance and other integration related expenses, which have been separately stated as merger-related expenses in the Company's Consolidated Statements of Income.

**Supplemental Financial Information**

The following table presents financial information regarding the former Shore operations included in the Company's Consolidated Statements of Income for the nine months ended September 30, 2020 under the column "Shore Nine Months Ended September 30, 2020." In addition, the table presents unaudited condensed pro forma financial information for the three and nine months ended September 30, 2019 assuming that the Shore Merger had been completed as of January 1, 2019.

The table has been prepared for comparative purposes only and is not necessarily indicative of the actual results that would have been attained had the Shore Merger occurred as of the beginning of the periods presented, nor is it indicative of future results. Furthermore, the unaudited pro forma financial information does not reflect management's estimate of any revenue-enhancing opportunities nor anticipated cost savings that may have occurred as a result of the integration and consolidation of Shore's operations.

| (Dollars in thousands) | Shore Nine Months Ended September 30, 2020 | Actual for the Nine Months Ended September 30, 2020 | Pro Forma for the Three Months Ended September 30, 2019 | Pro Forma for the Nine Months Ended September 30, 2019 |
|---|---|---|---|---|
| Net interest income | $ 7,185 | $ 42,136 | $ 14,161 | $ 41,936 |
| Non-interest income | 284 | 10,292 | 2,373 | 6,748 |
| Non-interest expenses | 2,869 | 30,528 | 9,312 | 29,048 |
| Income taxes | 1,108 | 4,494 | 1,731 | 4,939 |
| Net income | 2,997 | 12,066 | 5,171 | 13,528 |

**(3) Earnings Per Common Share**

Basic earnings per common share is calculated by dividing net income by the weighted average number of common shares outstanding during each period. Diluted earnings per common share is calculated by dividing net income by the weighted average number of common shares outstanding, as adjusted for the assumed exercise of dilutive common stock options using the treasury stock method.

Awards of restricted shares are included in outstanding shares when granted. Unvested restricted shares are entitled to non-forfeitable dividends and participate in undistributed earnings with common shares. Awards of this nature are considered participating securities and basic and diluted earnings per share are computed under the two-class method.

Dilutive securities in the tables below exclude common stock options with exercise prices that exceed the average market price of the Company's common stock during the periods presented. Inclusion of these common stock options would be anti-dilutive to the diluted earnings per common share calculation. For the three months ended September 30, 2020 and 2019, 54,930 and 27,930 options, respectively, were anti-dilutive and were not included in the computation of diluted earnings per share. For the nine months ended September 30, 2020 and 2019, 41,430 and 27,930 options, respectively, were anti-dilutive and were not included in the computation of diluted earnings per share.

The following table illustrates the calculation of both basic and diluted earnings per share for the three and nine months ended September 30, 2020 and 2019:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (Dollars in thousands, except per share data) | 2020 | 2019 | 2020 | 2019 |
| | | | | |
| Net income | $ 4,910 | $ 3,623 | $ 12,021 | $ 10,390 |
| | | | | |
| Basic weighted average shares outstanding | 10,230,488 | 8,666,251 | 10,213,601 | 8,641,684 |
| Plus: common stock equivalents | 38,463 | 56,098 | 46,876 | 57,275 |
| Diluted weighted average shares outstanding | 10,268,951 | 8,722,349 | 10,260,477 | 8,698,959 |
| Earnings per share: | | | | |
| Basic | $ 0.48 | $ 0.42 | 1.18 | 1.20 |
| Diluted | $ 0.48 | $ 0.42 | 1.17 | 1.19 |

## (4) Investment Securities

A summary of amortized cost and fair value of investment securities available for sale follows:

| | September 30, 2020 | | | |
|---|---|---|---|---|
| (Dollars in thousands) | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| U.S. Treasury securities and obligations of U.S. Government sponsored entities (“GSE”) | $ 3,574 | $ 1 | $ (6) | $ 3,569 |
| Residential collateralized mortgage obligations - GSE | 41,047 | 533 | (159) | 41,421 |
| Residential mortgage backed securities - GSE | 14,478 | 611 | (7) | 15,082 |
| Obligations of state and political subdivisions | 28,538 | 1,026 | — | 29,564 |
| Trust preferred debt securities - single issuer | 1,493 | — | (105) | 1,388 |
| Corporate debt securities | 19,500 | 497 | (72) | 19,925 |
| Other debt securities | 24,112 | 323 | (261) | 24,174 |
| Total | $ 132,742 | $ 2,991 | $ (610) | $ 135,123 |

| | December 31, 2019 | | | |
|---|---|---|---|---|
| (Dollars in thousands) | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| U.S. Treasury securities and obligations of U.S. Government sponsored entities (“GSE”) | $ 774 | $ — | $ (10) | $ 764 |
| Residential collateralized mortgage obligations - GSE | 53,223 | 194 | (242) | 53,175 |
| Residential mortgage backed securities - GSE | 18,100 | 292 | (5) | 18,387 |
| Obligations of state and political subdivisions | 33,177 | 342 | — | 33,519 |
| Trust preferred debt securities - single issuer | 1,492 | — | (50) | 1,442 |
| Corporate debt securities | 23,224 | 139 | (84) | 23,279 |
| Other debt securities | 25,378 | 80 | (242) | 25,216 |
| Total | $ 155,368 | $ 1,047 | $ (633) | $ 155,782 |

A summary of amortized cost, carrying value and fair value of investment securities held to maturity follows:

| | September 30, 2020 | | | | | |
|---|---|---|---|---|---|---|
| (Dollars in thousands) | Amortized Cost | Other-Than-Temporary Impairment Recognized In Accumulated Other Comprehensive Loss | Carrying Value | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Residential collateralized mortgage obligations - GSE | $ 5,831 | $ — | $ 5,831 | $ 246 | $ — | $ 6,077 |
| Residential mortgage backed securities - GSE | 26,863 | — | 26,863 | 1,260 | — | 28,123 |
| Obligations of state and political subdivisions | 52,842 | — | 52,842 | 970 | (10) | 53,802 |
| Trust preferred debt securities - pooled | 652 | (478) | 174 | 382 | — | 556 |
| Other debt securities | 2,101 | — | 2,101 | 76 | — | 2,177 |
| Total | $ 88,289 | $ (478) | $ 87,811 | $ 2,934 | $ (10) | $ 90,735 |

| | December 31, 2019 | | | | | |
|---|---|---|---|---|---|---|
| (Dollars in thousands) | Amortized Cost | Other-Than-Temporary Impairment Recognized In Accumulated Other Comprehensive Loss | Carrying Value | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Residential collateralized mortgage obligations - GSE | $ 5,117 | $ — | $ 5,117 | $ 76 | $ (35) | $ 5,158 |
| Residential mortgage backed securities - GSE | 36,528 | — | 36,528 | 481 | (54) | 36,955 |
| Obligations of state and political subdivisions | 32,533 | — | 32,533 | 690 | (25) | 33,198 |
| Trust preferred debt securities - pooled | 657 | (492) | 165 | 479 | — | 644 |
| Other debt securities | 2,277 | — | 2,277 | — | (9) | 2,268 |
| Total | $ 77,112 | $ (492) | $ 76,620 | $ 1,726 | $ (123) | $ 78,223 |

At September 30, 2020 and December 31, 2019, $89.4 million and $92.2 million of investment securities, respectively, were pledged to secure public funds and collateralized borrowings from the Federal Home Loan Bank of New York ("FHLB") and for other purposes required or permitted by law.

Restricted stock was included in other assets at September 30, 2020 and December 31, 2019 and totaled $2.6 million and $4.3 million, respectively. Restricted stock consisted of $2.4 million of FHLB stock and $160,000 of Atlantic Community Bankers Bank stock at September 30, 2020 and $4.1 million of FHLB and $160,000 of Atlantic Community Bankers Bank stock at December 31, 2019.

The following table sets forth certain information regarding the amortized cost, carrying value, fair value, weighted average yields and contractual maturities of the Company's investment portfolio as of September 30, 2020. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

| | September 30, 2020 | | |
|---|---|---|---|
| (Dollars in thousands) | Amortized Cost | Fair Value | Yield |
| **Available for sale** | | | |
| Due in one year or less | $ 5,047 | $ 5,041 | 1.11 % |
| Due after one year through five years | 28,103 | 29,194 | 2.38 % |
| Due after five years through ten years | 33,831 | 34,088 | 1.77 % |
| Due after ten years | 65,761 | 66,800 | 2.15 % |
| Total | $ 132,742 | $ 135,123 | 2.07 % |
| | | | |
| | Carrying Value | Fair Value | Yield |
| **Held to maturity** | | | |
| Due in one year or less | $ 18,359 | $ 18,411 | 2.43 % |
| Due after one year through five years | 6,279 | 6,464 | 4.56 % |
| Due after five years through ten years | 16,842 | 17,565 | 2.87 % |
| Due after ten years | 46,331 | 48,295 | 2.81 % |
| Total | $ 87,811 | $ 90,735 | 2.87 % |

During the third quarter of 2020, $2.6 million of residential mortgage backed securities that were classified as held to maturity were sold and a gain of $87,000 was recognized. The remaining par values of all of these securities that were sold were less than 15% of the original par value. Accordingly, the securities sold were considered to be equivalent to holding the securities to their maturity.

Gross unrealized losses on available for sale and held to maturity securities and the fair value of the related securities aggregated by security category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2020 and December 31, 2019 were as follows:

| | September 30, 2020 | | | | | | |
|---|---|---|---|---|---|---|---|
| | | Less than 12 months | | 12 months or longer | | Total | |
| (Dollars in thousands) | Number of Securities | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| U.S. Treasury securities and obligations of U.S. Government sponsored entities (GSE) and agencies | 1 | $ 588 | $ (6) | $ — | $ — | $ 588 | $ (6) |
| Residential collateralized mortgage obligations - GSE | 7 | 7,948 | (37) | 11,610 | (122) | 19,558 | (159) |
| Residential mortgage backed securities - GSE | 3 | 212 | (7) | — | — | 212 | (7) |
| Obligations of state and political subdivisions | 3 | 2,782 | (10) | — | — | 2,782 | (10) |
| Trust preferred debt securities - single issuer | 2 | — | — | 1,389 | (105) | 1,389 | (105) |
| Corporate debt securities | 3 | 2,980 | (19) | 4,947 | (53) | 7,927 | (72) |
| Other debt securities | 9 | — | — | 14,822 | (261) | 14,822 | (261) |
| Total temporarily impaired securities | 28 | $ 14,510 | $ (79) | $ 32,768 | $ (541) | $ 47,278 | $ (620) |

| | December 31, 2019 | | | | | | |
|---|---|---|---|---|---|---|---|
| | | Less than 12 months | | 12 months or longer | | Total | |
| (Dollars in thousands) | Number of Securities | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| U.S. Treasury securities and obligations of U.S. Government sponsored entities (GSE) and agencies | 1 | $ 764 | $ (10) | $ — | $ — | $ 764 | $ (10) |
| Residential collateralized mortgage obligations - GSE | 39 | 18,328 | (138) | 13,300 | (139) | 31,628 | (277) |
| Residential mortgage backed securities - GSE | 13 | 5,505 | (59) | — | — | 5,505 | (59) |
| Obligations of state and political subdivisions | 4 | 2,311 | (25) | 527 | — | 2,838 | (25) |
| Trust preferred debt securities - single issuer | 2 | — | — | 1,442 | (50) | 1,442 | (50) |
| Corporate debt securities | 4 | 2,994 | (5) | 7,954 | (79) | 10,948 | (84) |
| Other debt securities | 12 | 13,692 | (151) | 5,598 | (100) | 19,290 | (251) |
| Total temporarily impaired securities | 75 | $ 43,594 | $ (388) | $ 28,821 | $ (368) | $ 72,415 | $ (756) |

*U.S. Treasury securities and obligations of U.S. government-sponsored entities and agencies:* The unrealized losses on investments in these securities were caused by increases in market interest rates. The Company does not intend to sell these investments and it is not more likely than not that the Company will be required to sell these investments before a market price recovery or maturity. Therefore, these investments are not considered other-than-temporarily impaired.

*Residential collateralized mortgage obligations and residential mortgage backed securities:* The unrealized losses on investments in residential collateralized mortgage obligations and mortgage backed securities were caused by increases in market interest rates. The contractual cash flows of these securities are guaranteed by the issuers, which are primarily government or government sponsored agencies. It is expected that the securities would not be settled at a price less than the amortized cost of the investment. The decline in fair value is attributable to changes in interest rates and not credit quality. The Company does not intend to sell these investments and it is not more likely than not that the Company will be required to sell these investments before a market price recovery or maturity. Therefore, these investments are not considered other-than-temporarily impaired.

*Obligations of state and political subdivisions:* The unrealized losses on investments in these securities were caused by increases in market interest rates. It is expected that the securities would not be settled at a price less than the amortized cost of the investment. None of the issuers have defaulted on interest payments. These investments are not considered to be other than temporarily impaired because the decline in fair value is attributable to changes in interest rates and not credit quality. The Company does not intend to sell these investments and it is not more likely than not that the Company will be required to sell these investments before a market price recovery or maturity. Therefore, these investments are not considered other-than-temporarily impaired.

*Trust preferred debt securities – single issuer*: The investments in these securities with unrealized losses are comprised of two corporate trust preferred securities issued by one large financial institution that mature in 2027. The contractual terms of the trust preferred securities do not allow the issuer to settle the securities at a price less than the face value of the trust preferred securities, which is greater than the amortized cost of the trust preferred securities. The issuer maintains an investment grade credit rating and has not defaulted on interest payments. The decline in fair value is attributable to the widening of interest rate and credit spreads and the lack of an active trading market for these securities. The Company does not intend to sell these investments and it is not more likely than not that the Company will be required to sell these investments before a market price recovery or maturity. Therefore, these investments are not considered other-than-temporarily impaired.

*Corporate debt securities*. The unrealized losses on investments in corporate debt securities were caused by an increase in market interest rates, which includes the yield required by market participants for the issuer's credit risk. All of the issuers maintain an investment grade rating and none of the corporate issuers have defaulted on interest payments. The decline in fair value is attributable to changes in market interest rates. The Company does not intend to sell these investments and it is not more likely than not that the Company will be required to sell these investments before a market price recovery or maturity. Therefore, these investments are not considered other-than-temporarily impaired.

*Other debt securities*. The unrealized losses on investments in other debt securities were caused by an increase in market interest rates, which includes the yield required by market participants for the issuer's credit risk. All of the issuers maintain an investment grade rating and none of the issuers have defaulted on interest payments. The decline in fair value is attributable to changes in market interest rates. The Company does not intend to sell these investments and it is not more likely than not that the Company will be required to sell these investments before a market price recovery or maturity. Therefore, these investments are not considered other-than-temporarily impaired.

*Trust preferred debt securities – pooled:* This trust preferred debt security was issued by a two issuer pool (Preferred Term Securities XXV, Ltd. co-issued by Keefe, Bruyette and Woods, Inc. and First Tennessee ("PRETSL XXV")), consisting primarily of financial institution holding companies. During 2009, the Company recognized an other-than-temporary impairment charge of $865,000, of which $364,000 was determined to be a credit loss and charged to operations and $501,000 was recognized in the other comprehensive income (loss) component of shareholders' equity. The primary factor used to determine the credit portion of the impairment loss to be recognized in the income statement for this security was the discounted present value of projected cash flow, where that present value of cash flow was less than the amortized cost basis of the security. The present value of cash flow was developed using a model that considered performing collateral ratios, the level of subordination to senior tranches of the security and credit ratings of and projected credit defaults in the underlying collateral. Due to recovery of the cash flows underlying the security, the Company began to accrete the $501,000 of impairment charge in the other comprehensive income component in 2019. Total accretion of $14,000 was recognized in the first nine months of 2020 as an increase in the carrying amount of the security. On a quarterly basis, management evaluates this security to determine if any additional other-than-temporary impairment is required. As of September 30, 2020, management concluded that no additional other-than-temporary impairment had occurred.

## (5) Allowance for Loan Losses and Credit Quality

The Company's primary lending emphasis is the origination of commercial real estate loans, mortgage warehouse lines of credit and commercial business loans. Based on the composition of the loan portfolio, the inherent primary risks are deteriorating credit quality, a decline in the economy and a decline in New Jersey and New York City metropolitan area real estate market values. Any one, or a combination, of these events may adversely affect the loan portfolio and may result in increased delinquencies, loan losses and increased future provision levels.

The following table provides an aging of the loan portfolio by loan class at September 30, 2020:

| (Dollars in thousands) | 30-59 Days | 60-89 Days | Greater than 90 Days | Total Past Due | Current | Total Loans Receivable | Recorded Investment > 90 Days Accruing | Non-accrual Loans |
|---|---|---|---|---|---|---|---|---|
| Commercial real estate | $ 2,290 | $ 3,264 | $ 4,263 | $ 9,817 | $ 606,140 | $ 615,957 | $ — | $ 8,083 |
| Mortgage warehouse lines | — | — | — | — | 374,007 | 374,007 | — | — |
| Construction | — | — | 7,500 | 7,500 | 134,083 | 141,583 | — | 7,500 |
| Commercial business | 961 | 118 | 299 | 1,378 | 208,626 | 210,004 | — | 444 |
| Residential real estate | 310 | 882 | 754 | 1,946 | 86,260 | 88,206 | 92 | 817 |
| Loans to individuals | — | — | 300 | 300 | 27,132 | 27,432 | — | 309 |
| Other loans | — | — | — | — | 122 | 122 | — | — |
| Total loans | $ 3,561 | $ 4,264 | $ 13,116 | $ 20,941 | $1,436,370 | 1,457,311 | $ 92 | $ 17,153 |
| Deferred loan (fees) costs, net | | | | | | (1,627) | | |
| **Total loans** | | | | | | $ 1,455,684 | | |

The following table provides an aging of the loan portfolio by loan class at December 31, 2019:

| (Dollars in thousands) | 30-59 Days | 60-89 Days | Greater than 90 Days | Total Past Due | Current | Total Loans Receivable | Recorded Investment > 90 Days Accruing | Non-accrual Loans |
|---|---|---|---|---|---|---|---|---|
| Commercial real estate | $ 238 | $ 1,927 | $ 3,882 | $ 6,047 | $ 561,608 | $ 567,655 | $ — | $ 2,596 |
| Mortgage warehouse lines | — | — | — | — | 236,672 | 236,672 | — | — |
| Construction | — | — | — | — | 148,939 | 148,939 | — | — |
| Commercial business | 381 | — | 330 | 711 | 138,560 | 139,271 | — | 501 |
| Residential real estate | 2,459 | 271 | 677 | 3,407 | 86,852 | 90,259 | — | 708 |
| Loans to individuals | 296 | — | 311 | 607 | 31,997 | 32,604 | — | 692 |
| Other loans | — | — | — | — | 137 | 137 | — | — |
| Total loans | $ 3,374 | $ 2,198 | $ 5,200 | $10,772 | $ 1,204,765 | 1,215,537 | $ — | $ 4,497 |
| Deferred loan costs, net | | | | | | 491 | | |
| **Total loans** | | | | | | $1,216,028 | | |

As provided by ("ASC") 310-30, the excess of cash flows expected at acquisition over the initial investment in the loan is recognized as interest income over the life of the loan. At September 30, 2020 and December 31, 2019, there were $4.0 million and $5.4 million of purchased credit impaired loans, respectively, that were not classified as non-performing loans due to the accretion of income.

The Company's internal credit risk grades are based on the definitions currently utilized by the banking regulatory agencies. The grades assigned and their definitions are as follows:

1. Excellent - Loans that are based upon cash collateral held at the Company and adequately margined. Loans that are based upon "blue chip" stocks listed on the major stock exchanges and adequately margined.

2. Above Average - Loans to companies whose balance sheets show excellent liquidity and long-term debt is on well-spread schedules of repayment easily covered by cash flow. Such companies have been consistently profitable and have diversification in their product lines or sources of revenue. The continuation of profitable operations for the foreseeable future is likely. Management is comprised of a mix of ages, experience and backgrounds and management succession is in place. Sources of raw materials and, for service companies, the sources of revenue are abundant. Future needs have been planned for. Character and management ability of individuals or company principals are excellent. Loans to individuals are supported by their high net worth and liquid assets.

3. Good - Loans to companies whose balance sheets show good liquidity and cash flow adequate to meet maturities of long-term debt with a comfortable margin. Such companies have established profitable records over a number of years, and there has been growth in net worth. Operating ratios are in line with those of the industry, and expenses are in proper relationship to the volume of business done and the profits achieved. Management is well-balanced and competent in their responsibilities. Economic environment is favorable; however, competition is strong. The prospects for growth are good. Loans in this category do not meet the collateral requirements of loans graded excellent and above average.

3w. Watch - Included in this category are loans evidencing problems identified by Company management that require closer supervision, but do not require a "special mention" rating. This category also covers situations where the Company does not have adequate current information upon which credit quality can be determined. The account officer has the obligation to correct these deficiencies within 30 days from the time of notification. Loans that received modification to provide a deferral of interest and or principal for up to 90 days that complied with the CARES Act criteria were rated watch by management.

4. Special Mention - A "special mention" loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or the Company's credit position at some future date. Special mention loans are not adversely classified and do not expose the Company to sufficient risk to warrant adverse classification.

5. Substandard - A "substandard" loan is inadequately protected by the current net worth and paying capacity of the obligor or by the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize

the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

6. Doubtful - A loan classified as “doubtful” has all the weaknesses inherent of a loan classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

7. Loss - A loan classified as “loss” is considered uncollectible and of such little value that its continuance on the books is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value. Rather, this classification indicates that it is not practical or desirable to defer writing off this loan even though partial recovery may occur in the future.

Loans graded as “excellent,” “above average,” “good” and “watch” are treated as “pass” for grading purposes. The following table provides a breakdown of the loan portfolio by credit quality indicator at September 30, 2020:

(Dollars in thousands)

| Commercial Credit Exposure - By Internally Assigned Grade | Construction | Commercial Business | Commercial Real Estate | Mortgage Warehouse Lines | Residential Real Estate |
|---|---|---|---|---|---|
| Pass | $ 134,083 | $ 199,857 | $ 576,015 | $ 373,070 | $ 85,118 |
| Special Mention | — | 3,117 | 14,930 | 937 | 1,243 |
| Substandard | 7,500 | 6,794 | 25,012 | — | 1,845 |
| Doubtful | — | 236 | — | — | — |
| Total | $ 141,583 | $ 210,004 | $ 615,957 | $ 374,007 | $ 88,206 |

| Consumer Credit Exposure - By Payment Activity | Loans To Individuals | Other loans |
|---|---|---|
| Performing | $ 27,123 | $ 122 |
| Non-performing | 309 | — |
| Total | $ 27,432 | $ 122 |

The following table provides a breakdown of the loan portfolio by credit quality indicator at December 31, 2019:

(Dollars in thousands)

| Commercial Credit Exposure - By Internally Assigned Grade | Construction | Commercial Business | Commercial Real Estate | Mortgage Warehouse Lines | Residential Real Estate |
|---|---|---|---|---|---|
| Pass | $ 147,132 | $ 135,804 | $ 538,104 | $ 235,808 | $ 87,512 |
| Special Mention | — | 1,990 | 9,994 | 864 | 922 |
| Substandard | 1,807 | 1,477 | 19,557 | — | 1,825 |
| Doubtful | — | — | — | — | — |
| Total | $ 148,939 | $ 139,271 | $ 567,655 | $ 236,672 | $ 90,259 |

| Consumer Credit Exposure - By Payment Activity | Loans To Individuals | Other loans |
|---|---|---|
| Performing | $ 31,912 | $ 137 |
| Non-performing | 692 | — |
| Total | $ 32,604 | $ 137 |

**Impaired Loans**

Loans are considered to be impaired when, based on current information and events, it is determined that the Company will not be able to collect all amounts due according to the loan agreement, including scheduled interest payments. When a loan is placed on non-accrual status, it is also considered to be impaired. Loans are placed on non-accrual status when: (1) the full collection of interest or principal becomes uncertain or (2) the loans are contractually past due 90 days or more as to interest or principal payments unless the loans are both well secured and in the process of collection.

The following tables summarize the distribution of the allowance for loan losses and loans receivable by loan class and impairment method at September 30, 2020 and December 31, 2019:

| | September 30, 2020 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| (Dollars in thousands) | Construction | Commercial Business | Commercial Real Estate | Mortgage Warehouse Lines | Residential Real Estate | Loans to Individuals | Other Loans | Unallocated | Total |
| **Allowance for loan losses:** | | | | | | | | | |
| Individually evaluated for impairment | $ 1,433 | $ 89 | $ 87 | $ — | $ — | $ — | $ — | $ — | $ 1,609 |
| Loans acquired with deteriorated credit quality | — | — | 9 | — | — | — | — | — | 9 |
| Collectively evaluated for impairment | 1,786 | 2,482 | 5,981 | 1,707 | 524 | 179 | | 173 | 12,832 |
| Ending Balance | $ 3,219 | $ 2,571 | $ 6,077 | $ 1,707 | $ 524 | $ 179 | $ — | $ 173 | $ 14,450 |
| **Loans receivable:** | | | | | | | | | |
| Individually evaluated for impairment | $ 7,500 | $ 1,183 | $ 12,634 | $ — | $ 817 | $ 310 | $ — | $ — | $ 22,444 |
| Loans acquired with deteriorated credit quality | — | 315 | 4,863 | — | 402 | — | — | — | 5,580 |
| Collectively evaluated for impairment | 134,083 | 208,506 | 598,460 | 374,007 | 86,987 | 27,122 | 122 | — | 1,429,287 |
| Ending Balance | $ 141,583 | $ 210,004 | $ 615,957 | $ 374,007 | $ 88,206 | $ 27,432 | $ 122 | $ — | 1,457,311 |
| Deferred loan fees, net | | | | | | | | | (1,627) |
| | | | | | | | | | $ 1,455,684 |

| | December 31, 2019 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| (Dollars in thousands) | Construction | Commercial Business | Commercial Real Estate | Mortgage Warehouse Lines | Residential Real Estate | Loans to Individuals | Other Loans | Unallocated | Total |
| **Allowance for loan losses:** | | | | | | | | | |
| Individually evaluated for impairment | $ 8 | $ 7 | $ 50 | $ — | $ — | $ — | $ — | $ — | $ 65 |
| Loans acquired with deteriorated credit quality | — | 3 | 1 | — | — | — | — | — | 4 |
| Collectively evaluated for impairment | 1,381 | 1,399 | 4,473 | 1,083 | 412 | 185 | — | 269 | 9,202 |
| Ending Balance | $ 1,389 | $ 1,409 | $ 4,524 | $ 1,083 | $ 412 | $ 185 | $ — | $ 269 | $ 9,271 |
| **Loans receivable:** | | | | | | | | | |
| Individually evaluated for impairment | $ 1,807 | $ 1,251 | $ 6,171 | $ — | $ 708 | $ 692 | $ — | $ — | $ 10,629 |
| Loans acquired with deteriorated credit quality | — | 334 | 5,419 | — | 504 | — | — | — | 6,257 |
| Collectively evaluated for impairment | 147,132 | 137,686 | 556,065 | 236,672 | 89,047 | 31,912 | 137 | — | 1,198,651 |
| Ending Balance | $ 148,939 | $ 139,271 | $ 567,655 | $ 236,672 | $ 90,259 | $ 32,604 | $ 137 | $ — | 1,215,537 |
| Deferred loan costs, net | | | | | | | | | 491 |
| | | | | | | | | | $ 1,216,028 |

At September 30, 2020, there were $75.6 million of Small Business Administration ("SBA") Paycheck Protection Program ("PPP") loans which are 100% guaranteed by the SBA, and, accordingly, no allowance was provided for such loans.

The activity in the allowance for loan loss by loan class for the three and nine months ended September 30, 2020 and 2019 was as follows:

| Balance - (Dollars in thousands) | Construction | Commercial Business | Commercial Real Estate | Mortgage Warehouse Lines | Residential Real Estate | Loans to Individuals | Other Loans | Unallocated | Total |
|---|---|---|---|---|---|---|---|---|---|
| Balance - July 1, 2020 | $ 1,661 | $ 1,780 | $ 6,619 | $ 1,337 | $ 506 | $ 182 | $ — | $ 41 | $ 12,126 |
| Provision charged/ (credited) to operations | 1,558 | 791 | (549) | 370 | 18 | — | — | 132 | 2,320 |
| Loans charged off | — | — | — | — | — | (3) | — | — | (3) |
| Recoveries of loans charged off | — | — | 7 | — | — | — | — | — | 7 |
| Balance - September 30, 2020 | $ 3,219 | $ 2,571 | $ 6,077 | $ 1,707 | $ 524 | $ 179 | $ — | $ 173 | $ 14,450 |
| | | | | | | | | | |
| Balance - July 1, 2019 | $ 1,760 | $ 1,546 | $ 3,754 | $ 933 | $ 480 | $ 142 | $ — | $ 26 | $ 8,641 |
| Provision charged/ (credited) to operations | (175) | (148) | 533 | 204 | (74) | 8 | — | 2 | 350 |
| Loans charged off | — | — | (18) | — | — | — | — | — | (18) |
| Recoveries of loans charged off | — | — | — | — | — | 4 | — | — | 4 |
| Balance - September 30, 2019 | $ 1,585 | $ 1,398 | $ 4,269 | $ 1,137 | $ 406 | $ 154 | $ — | $ 28 | $ 8,977 |

| (Dollars in thousands) | Construction | Commercial Business | Commercial Real Estate | Mortgage Warehouse Lines | Residential Real Estate | Loans to Individuals | Other Loans | Unallocated | Total |
|---|---|---|---|---|---|---|---|---|---|
| Balance - January 1, 2020 | $ 1,389 | $ 1,409 | $ 4,524 | $ 1,083 | $ 412 | $ 185 | $ — | $ 269 | $ 9,271 |
| Provision charged/ (credited) to operations | 1,830 | 1,327 | 1,546 | 624 | 112 | (3) | — | (96) | 5,340 |
| Loans charged off | — | (165) | — | — | — | (3) | — | — | (168) |
| Recoveries of loans charged off | — | — | 7 | — | — | — | — | — | 7 |
| Balance - September 30, 2020 | $ 3,219 | $ 2,571 | $ 6,077 | $ 1,707 | $ 524 | $ 179 | $ — | $ 173 | $ 14,450 |
| | | | | | | | | | |
| January 1, 2019 | $ 1,732 | $ 1,829 | $ 3,439 | $ 731 | $ 431 | $ 148 | $ — | $ 92 | $ 8,402 |
| Provision charged/ (credited) to operations | (147) | (86) | 923 | 406 | (25) | — | 43 | (64) | 1,050 |
| Loans charged off | — | (345) | (93) | — | — | — | (43) | — | (481) |
| Recoveries of loans charged off | — | — | — | — | — | 6 | — | — | 6 |
| Balance - September 30, 2019 | $ 1,585 | $ 1,398 | $ 4,269 | $ 1,137 | $ 406 | $ 154 | $ — | $ 28 | $ 8,977 |

When a loan is identified as impaired, the measurement of impairment is based on the present value of expected future cash flows, discounted at the loan's effective interest rate, except when the sole remaining source of repayment for the loan is the liquidation of the collateral. In such cases, the current fair value of the collateral less selling costs is used. If the value of the impaired loan is less than the recorded investment in the loan, the impairment is recognized through an allowance estimate or a charge to the allowance.

**Impaired Loans Receivables (By Class)**

| (Dollars in thousands) | Recorded Investment | Unpaid Principal Balance | Related Allowance | Three Months Ended September 30, 2020 Average Recorded Investment | Three Months Ended September 30, 2020 Interest Income Recognized | Nine Months Ended September 30, 2020 Average Recorded Investment | Nine Months Ended September 30, 2020 Interest Income Recognized |
|---|---|---|---|---|---|---|---|
| **With no allowance:** | | | | | | | |
| Commercial: | | | | | | | |
| Construction | $ — | $ — | $ — | $ 6,185 | $ — | $ 6,197 | $ — |
| Commercial Business | 1,284 | 2,686 | — | 1,509 | 17 | 1,408 | 51 |
| Commercial Real Estate | 15,327 | 16,541 | — | 14,328 | 146 | 10,334 | 439 |
| Mortgage Warehouse Lines | — | — | — | — | — | — | — |
| Subtotal | 16,611 | 19,227 | — | 22,022 | 163 | 17,939 | 490 |
| Residential Real Estate | 1,219 | 1,470 | — | 1,265 | 7 | 1,277 | 25 |
| Consumer: | | | | | | | |
| Loans to Individuals | 310 | 337 | — | 419 | — | 539 | — |
| Other loans | — | 2 | — | — | — | — | — |
| Subtotal | 310 | 339 | — | 419 | — | 539 | — |
| **With no allowance:** | $ 18,140 | $ 21,036 | $ — | $ 23,706 | $ 170 | $ 19,755 | $ 515 |
| **With an allowance:** | | | | | | | |
| Commercial: | | | | | | | |
| Construction | $ 7,500 | $ 7,500 | $ 1,433 | $ 2,500 | $ — | $ 1,235 | $ — |
| Commercial Business | 214 | 214 | 89 | 214 | — | 337 | — |
| Commercial Real Estate | 2,170 | 3,478 | 96 | 2,923 | 21 | 3,717 | 63 |
| Mortgage Warehouse Lines | — | — | — | — | — | — | — |
| Subtotal | 9,884 | 11,192 | 1,618 | 5,637 | 21 | 5,289 | 63 |
| Residential Real Estate | — | — | — | — | — | — | — |
| Consumer: | | | | | | | |
| Loans to Individuals | — | — | — | — | — | — | — |
| Other loans | — | — | — | — | — | — | — |
| Subtotal | — | — | — | — | — | — | — |
| **With an allowance:** | $ 9,884 | $ 11,192 | $ 1,618 | $ 5,637 | $ 21 | $ 5,289 | $ 63 |
| **Total:** | | | | | | | |
| Construction | 7,500 | 7,500 | 1,433 | 8,685 | — | 7,432 | — |
| Commercial Business | 1,498 | 2,900 | 89 | 1,723 | 17 | 1,745 | 51 |
| Commercial Real Estate | 17,497 | 20,019 | 96 | 17,251 | 167 | 14,051 | 502 |
| Mortgage Warehouse Lines | — | — | — | — | — | — | — |
| Residential Real Estate | 1,219 | 1,470 | — | 1,265 | 7 | 1,277 | 25 |
| Consumer | 310 | 339 | — | 419 | — | 539 | — |
| **Total** | $ 28,024 | $ 32,228 | $ 1,618 | $ 29,343 | $ 191 | $ 25,044 | $ 578 |

**Impaired Loans Receivables (By Class)**

| | December 31, 2019 | | |
|---|---|---|---|
| (Dollars in thousands) | Recorded Investment | Unpaid Principal Balance | Related Allowance |
| **With no allowance:** | | | |
| Commercial: | | | |
| Construction | $ — | $ — | $ — |
| Commercial Business | 680 | 1,971 | — |
| Commercial Real Estate | 7,141 | 8,204 | — |
| Mortgage Warehouse Lines | — | — | — |
| Subtotal | 7,821 | 10,175 | — |
| Residential Real Estate | 1,212 | 1,465 | — |
| Consumer: | | | |
| Loans to Individuals | 692 | 802 | — |
| Other loans | — | — | — |
| Subtotal | 692 | 802 | — |
| **With no allowance** | $ 9,725 | $ 12,442 | $ — |
| **With an allowance:** | | | |
| Commercial: | | | |
| Construction | $ 1,807 | $ 1,807 | $ 8 |
| Commercial Business | 905 | 993 | 10 |
| Commercial Real Estate | 4,449 | 5,757 | 51 |
| Mortgage Warehouse Lines | — | — | — |
| Subtotal | 7,161 | 8,557 | 69 |
| Residential Real Estate | — | — | — |
| Consumer: | | | |
| Loans to Individuals | — | — | — |
| Other loans | — | — | — |
| Subtotal | — | — | — |
| **With an allowance** | $ 7,161 | $ 8,557 | $ 69 |
| | | | |
| **Total:** | | | |
| Construction | $ 1,807 | $ 1,807 | $ 8 |
| Commercial Business | 1,585 | 2,964 | 10 |
| Commercial Real Estate | 11,590 | 13,961 | 51 |
| Mortgage Warehouse Lines | — | — | — |
| Residential Real Estate | 1,212 | 1,465 | — |
| Consumer | 692 | 802 | — |
| **Total** | $ 16,886 | $ 20,999 | $ 69 |

**Impaired Loans Receivables (By Class)**

| | Three Months Ended September 30, 2019 | | Nine Months Ended September 30, 2019 | |
|---|---|---|---|---|
| (Dollars in thousands) | Average Recorded Investment | Interest Income Recognized | Average Recorded Investment | Interest Income Recognized |
| **With no allowance:** | | | | |
| Commercial: | | | | |
| Construction | $ — | $ — | $ 46 | $ 2 |
| Commercial Business | 951 | 4 | 952 | 56 |
| Commercial Real Estate | 2,819 | 17 | 1,999 | 50 |
| Mortgage Warehouse Lines | — | — | | — |
| Subtotal | 3,770 | 21 | 2,997 | 108 |
| Residential Real Estate | 1,402 | — | 1,296 | — |
| | | | | |
| Consumer: | | | | |
| Loans to Individuals | 792 | — | 675 | — |
| Other loans | — | — | | — |
| Subtotal | 792 | — | 675 | — |
| **With no allowance** | $ 5,964 | $ 21 | $ 4,968 | $ 108 |
| **With an allowance:** | | | | |
| Commercial: | | | | |
| Construction | $ 602 | $ 29 | $ 201 | $ 29 |
| Commercial Business | 578 | 20 | 1,008 | 23 |
| Commercial Real Estate | 4,782 | 59 | 4,611 | 176 |
| Mortgage Warehouse Lines | — | — | — | — |
| Subtotal | 5,962 | 108 | 5,820 | 228 |
| Residential Real Estate | — | — | — | — |
| Consumer: | | | | |
| Loans to Individuals | — | — | — | — |
| Other loans | — | — | — | — |
| Subtotal | — | — | — | — |
| **With an allowance** | $ 5,962 | $ 108 | $ 5,820 | $ 228 |
| **Total:** | | | | |
| Construction | $ 602 | $ 29 | 247 | 31 |
| Commercial Business | 1,529 | 24 | 1,960 | 79 |
| Commercial Real Estate | 7,601 | 76 | 6,610 | 226 |
| Mortgage Warehouse Lines | — | — | — | — |
| Residential Real Estate | 1,402 | — | 1,296 | — |
| Consumer | 792 | — | 675 | — |
| **Total** | $ 11,926 | $ 129 | $ 10,788 | $ 336 |

**Purchased Credit-Impaired Loans**

Purchased credit-impaired loans ("PCI") are loans acquired at a discount due in part to the deteriorated credit quality. On November 8, 2019, as part of the Shore Merger, the Company acquired purchased credit-impaired loans with loan balances totaling $6.3 million and fair values totaling $4.6 million. The following table presents additional information regarding purchased credit-impaired loans at September 30, 2020 and December 31, 2019:

| (Dollars in thousands) | September 30, 2020 | December 31, 2019 |
|---|---|---|
| Outstanding balance | $ 6,907 | $ 8,038 |
| Carrying amount | $ 5,581 | $ 6,257 |

Changes in accretable discount for purchased credit-impaired loans for the three and nine months ended September 30, 2020 and September 30, 2019 were as follows:

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| (Dollars in thousands) | 2020 | 2019 | 2020 | 2019 |
| Balance at beginning of period | $ 426 | $ 94 | $ 657 | $ 164 |
| Acquisition of impaired loans | — | — | — | — |
| Accretion of discount | (112) | (23) | (343) | (93) |
| Balance at end of period | $ 314 | $ 71 | $ 314 | $ 71 |

**Consumer Mortgage Loans Secured by Residential Real Estate in Process of Foreclosure**

The following table summarizes the recorded investment in consumer mortgage loans secured by residential real estate in the process of foreclosure (dollars in thousands):

| September 30, 2020 | | December 31, 2019 | |
|---|---|---|---|
| Number of loans | Recorded Investment | Number of loans | Recorded Investment |
| 1 | $ 311 | 2 | $ 382 |

**Troubled Debt Restructurings**

In the normal course of business, the Bank may consider modifying loan terms for various reasons. These reasons may include as a retention strategy to compete in the current interest rate environment or to re-amortize or extend a loan term to better match the loan's repayment stream with the borrower's cash flow. A modified loan would be considered a troubled debt restructuring ("TDR") if the Bank grants a concession to a borrower and has determined that the borrower is troubled (i.e., experiencing financial difficulties).

If the Bank restructures a loan to a troubled borrower, the loan terms (i.e., interest rate, payment, amortization period and maturity date) may be modified in various ways to enable the borrower to cover the modified debt service payments based on current financial statements and cash flow adequacy. If a borrower's hardship is thought to be temporary, then modified terms may be offered for only that time period. Where possible, the Bank attempts to obtain additional collateral and/or secondary repayment sources at the time of the restructuring in order to put the Bank in the best possible position if the borrower is not able to meet the modified terms. The Bank will not offer modified terms if it believes that modifying the loan terms will only delay an inevitable permanent default. In evaluating whether a restructuring constitutes a TDR, applicable guidance requires that a creditor must separately conclude that the restructuring constitutes a concession and the borrower is experiencing financial difficulties.

There were no loans modified as a TDR during the nine months ended September 30, 2020. There were three commercial business loans with an aggregate pre- and post-modified recorded investment of $596,000 and one construction loan with a pre- and post-modified recorded investment of $1.8 million that were each modified as a TDR during the nine months ended September 30, 2019. There were no TDRs that subsequently defaulted within 12 months of restructuring during the nine months ended September 30, 2020 and 2019.

Pursuant to the CARES Act, loan modifications made between March 1, 2020 and the earlier of i) December 30, 2020 or ii) 60 days after the President declares a termination of the COVID-19 national emergency are not classified as TDRs if the related loans were not more than 30 days past due as of December 31, 2019. For the nine months ended September 30, 2020, $149.3 million of loans to borrowers had been modified to defer the payment of interest and or principal for up to 90 days. These modified loans were not considered to be TDRs under the CARES Act.

Through September 30, 2020, $140.9 million of commercial business and commercial real estate loans and $8.4 million of consumer loans had been modified to provide deferral of interest and or principal by borrowers for up to 90 days. As of September 30, 2020, $123.6 million of these modified loans that had previously received deferrals were no longer deferred and had made the contractually due payments. During the third quarter of 2020, commercial business and commercial real estate loans totaling $10.3 million received a second deferral and commercial real estate loans totaling $1.8 million received a first deferral of interest and or principal for up to 90 days. Commercial real estate loans totaling $4.6 million that had received deferrals in the second quarter of 2020 were placed on non-accrual in the third quarter of 2020. One commercial real estate loan in the amount of $595,000 had not made the first payment after the end of the deferral period. Commercial business and commercial real estate loans with a deferral of principal and or interest for up to 90 days totaled $12.1 million at September 30, 2020.

During the third quarter of 2020, all but $974,000 of the $8.4 million of consumer loans that had received a deferral made the contractually due payments.

**(6) Revenue from Contracts with Customers**

All of the Company's revenue from contracts with customers in the scope of ASC 606 is recognized within non-interest income. The following table presents the Company's sources of non-interest income for the three and nine months ended September 30, 2020 and 2019. Items outside the scope of ASC 606 are noted as such.

| | Three months ended | | Nine months ended | |
|---|---|---|---|---|
| (Dollars in thousands) | September 30, 2020 | September 30, 2019 | September 30, 2020 | September 30, 2019 |
| Service charges on deposit accounts: | | | | |
| Overdraft fees | $ 32 | $ 100 | $ 157 | $ 272 |
| Other | 94 | 65 | 314 | 218 |
| Interchange income | 186 | 122 | 487 | 343 |
| Other income - in scope | 105 | 103 | 320 | 309 |
| Gain on sale of OREO | 71 | — | 71 | 137 |
| Income on bank-owned life insurance [1] | 188 | 149 | 632 | 437 |
| Gain on sales of loans [1] | 3,396 | 1,351 | 6,987 | 3,556 |
| Loan servicing fees [1] | 164 | 181 | 487 | 540 |
| Gain on sales and calls of securities [1] | 79 | 16 | 97 | 16 |
| Other income [1] | 421 | 119 | 740 | 414 |
| | $ 4,736 | $ 2,206 | $ 10,292 | $ 6,242 |

[1] Not within the scope of ASC 606

**(7) Share-Based Compensation**

The Company's share-based incentive plans ("Stock Plans") authorize the issuance of an aggregate of 945,873 shares of the Company's common stock (as adjusted for stock dividends) through awards that may be granted in the form of stock options to purchase common stock (each an "Option" and collectively, "Options"), awards of restricted shares of common stock ("Stock Awards"), restricted stock units ("RSUs"), stock appreciation rights or such other awards as the Compensation Committee of the Board of Directors (the "Compensation Committee") may determine.

As of September 30, 2020, there were 372,491 shares of common stock available for future grants under the Stock Plans.

The following table summarizes Options activity during the nine months ended September 30, 2020:

| (Dollars in thousands, except share amounts) | Number of Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (Years) | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Outstanding at January 1, 2020 | 122,151 | $ 9.85 | 3.9 | 1,500 |
| Granted | 27,000 | 17.53 | 9.4 | |
| Exercised | (755) | 6.93 | | |
| Outstanding at September 30, 2020 | 148,396 | $ 11.26 | 4.3 | $ 440 |
| | | | | |
| Exercisable at September 30, 2020 | 114,996 | $ 9.30 | 3.0 | $ 440 |

The fair value of each Option and the significant weighted average assumptions used to calculate the fair value of the Options granted during the nine months ended September 30, 2020 were as follows:

| | Grant Date | |
|---|---|---|
| | January 6, 2020 | March 19, 2020 |
| Fair value of options granted | $ 5.27 | $ 2.09 |
| Risk-free rate of return | 1.72 % | 1.00 % |
| Expected option life in years | 7 | 7 |
| Expected volatility | 24.53 % | 24.63 % |
| Expected dividends | 1.35 % | 2.86 % |

Share-based compensation expense related to Options was $58,000 and $47,000 for the nine months ended September 30, 2020 and 2019, respectively. As of September 30, 2020, there was approximately $109,000 of unrecognized compensation cost related to unvested Options.

The following table summarizes the activity in Stock Awards for the nine months ended September 30, 2020:

| (Dollars in thousands, except share amounts) | Number of Shares | Average Grant-Date Fair Value |
|---|---|---|
| Outstanding at January 1, 2020 | 134,359 | $ 13.84 |
| Granted | 59,500 | 14.45 |
| Vested | (62,501) | 17.31 |
| Non-vested at September 30, 2020 | 131,358 | $ 12.46 |

Share-based compensation expense related to Stock Awards was $798,000 and $786,000 for the nine months ended September 30, 2020 and 2019, respectively. As of September 30, 2020, there was approximately $1.8 million of unrecognized compensation cost related to unvested Stock Awards.

The following table summarizes the activity in RSUs for the nine months ended September 30, 2020:

| (Dollars in thousands, except share amounts) | Number of Shares | Average Grant-Date Fair Value |
|---|---|---|
| Outstanding at January 1, 2020 | 10,300 | $ 19.38 |
| Granted | 18,950 | 21.92 |
| Vested | (3,433) | 19.38 |
| Non-vested at September 30, 2020 | 25,817 | $ 21.24 |

Share-based compensation expense related to RSUs was $130,000 and $50,000 for the nine months ended September 30, 2020 and 2019, respectively. As of September 30, 2020, there was approximately $229,000 of unrecognized compensation cost related to unvested RSUs.

RSUs vest pro-rata over 3 years subject to achievement of certain established performance metrics. The ultimate number of RSUs earned, if any, will depend on the performance measured over each annual period during the applicable 3-year performance period. If performance measures are achieved, the RSUs will vest on the date of certification of performance achievement by the Compensation Committee following each annual performance period. On March 19, 2020, the Compensation Committee certified that the applicable performance metrics were achieved at 138% of target for 2019. Awards of RSUs are settled in cash unless the recipient timely elects for the RSUs to be settled in shares of common stock. The RSUs are recorded as a liability by the Company and the liability is adjusted as the market value of the Company's stock price changes.

**(8) Benefit Plans**

The Bank has a 401(k) plan that covers substantially all employees with six months or more of service. The Bank's 401(k) plan permits all eligible employees to make contributions to the plan up to the IRS salary deferral limit. The Bank's contributions to the 401(k) plan are expensed as incurred.

The Company also provides retirement benefits to certain employees under supplemental executive retirement plans. The plans are unfunded and the Company accrues actuarially determined benefit costs over the estimated service period of the employees in the plans. The Company recognizes the over-funded or under-funded status of a defined benefit post-retirement plan as an asset or liability on its balance sheet and recognizes changes in that funded status in the year in which the changes occur through comprehensive income. At September 30, 2020 and December 31, 2019, the Company's President and Chief Executive Officer was the only eligible participant in the supplemental executive retirement plans.

In connection with the benefit plans, the Bank has life insurance policies on the lives of its executive officers, directors and certain employees. The Bank is the owner and beneficiary of these policies. The cash surrender values of these policies totaled approximately $37.1 million and $36.7 million at September 30, 2020 and December 31, 2019, respectively.

The components of net periodic expense for the Company's supplemental executive retirement plans for the three and nine months ended September 30, 2020 and 2019 were as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (Dollars in thousands) | 2020 | 2019 | 2020 | 2019 |
| Service cost | $ 46 | $ 48 | $ 138 | $ 142 |
| Interest cost | 42 | 40 | 124 | 122 |
| Actuarial gain recognized | (51) | (44) | (151) | (132) |
| Total | $ 37 | $ 44 | $ 111 | $ 132 |

**(9) Other Comprehensive Income (Loss) and Accumulated Other Comprehensive Income (Loss)**

Other comprehensive income (loss) is the total of (1) net income (loss) and (2) all other changes in equity from non-shareholder sources, which are referred to as other comprehensive income (loss). The components of accumulated other comprehensive income (loss), and the related tax effects, are as follows:

| | September 30, 2020 | | |
|---|---|---|---|
| (Dollars in thousands) | Before-Tax Amount | Income Tax Effect | Net-of-Tax Amount |
| Net unrealized holding gains on investment securities available for sale | $ 2,381 | $ (587) | $ 1,794 |
| Unrealized impairment loss on held to maturity security | (478) | 114 | (364) |
| Gains on unfunded pension liability | 424 | (119) | 305 |
| Accumulated other comprehensive income | $ 2,327 | $ (592) | $ 1,735 |

| | December 31, 2019 | | |
|---|---|---|---|
| (Dollars in thousands) | Before-Tax Amount | Income Tax Effect | Net-of-Tax Amount |
| Net unrealized holding gains on investment securities available for sale | $ 414 | $ (111) | $ 303 |
| Unrealized impairment loss on held to maturity security | (492) | 118 | (374) |
| Gains on unfunded pension liability | 364 | (102) | 262 |
| Accumulated other comprehensive income | $ 286 | $ (95) | $ 191 |

Changes in the components of accumulated other comprehensive income (loss) are as follows and are presented net of tax for the three and nine months ended September 30, 2020 and September 30, 2019:

| (Dollars in thousands) | Unrealized Holding Gains (Losses) on Available for Sale Securities | Unrealized Impairment Loss on Held to Maturity Security | Unfunded Pension Liability | Accumulated Other Comprehensive Income (Loss) |
|---|---|---|---|---|
| Balance - July 1, 2020 | $ 1,452 | $ (369) | $ 291 | $ 1,374 |
| Other comprehensive income before reclassifications | 332 | — | 50 | 382 |
| Amounts reclassified from accumulated other comprehensive income | — | 5 | (36) | (31) |
| Reclassification adjustment for losses realized in income | 10 | — | — | 10 |
| Other comprehensive income | 342 | 5 | 14 | 361 |
| Balance - September 30, 2020 | $ 1,794 | $ (364) | $ 305 | $ 1,735 |
| | | | | |
| Balance - July 1, 2019 | $ 162 | $ (379) | $ 246 | $ 29 |
| Other comprehensive income before reclassifications | 152 | — | 38 | 190 |
| Amounts reclassified from accumulated other comprehensive income | — | 2 | (30) | (28) |
| Reclassification adjustment for gains realized in income | (12) | — | — | (12) |
| Other comprehensive income | 140 | 2 | 8 | 150 |
| Balance - September 30, 2019 | $ 302 | $ (377) | $ 254 | $ 179 |
| | | | | |
| January 1, 2020 | $ 303 | $ (374) | $ 262 | $ 191 |
| Other comprehensive income before reclassifications | 1,489 | — | 149 | 1,638 |
| Amounts reclassified from accumulated other comprehensive income | — | 10 | (106) | (96) |
| Reclassification adjustment for losses realized in income | 2 | — | — | 2 |
| Other comprehensive income | 1,491 | 10 | 43 | 1,544 |
| Balance - September 30, 2020 | $ 1,794 | $ (364) | $ 305 | $ 1,735 |
| | | | | |
| January 1, 2019 | $ (1,679) | $ (382) | $ 228 | $ (1,833) |
| Other comprehensive income before reclassifications | 1,993 | — | 118 | 2,111 |
| Amounts reclassified from accumulated other comprehensive income | — | 5 | (92) | (87) |
| Reclassification adjustment for gains realized in income | (12) | — | — | (12) |
| Other comprehensive income | 1,981 | 5 | 26 | 2,012 |
| Balance - September 30, 2019 | $ 302 | $ (377) | $ 254 | $ 179 |

**(10) Recent Accounting Pronouncements**

***ASU 2016-13 - Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments***

In June 2016, the FASB issued ASU No. 2016-13 "Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments," which requires credit losses on most financial assets to be measured at amortized cost and certain other instruments to be measured using an expected credit loss model (referred to as the current expected credit loss (CECL) model).

Under this model, entities will estimate credit losses over the entire contractual term of the instrument (considering estimated prepayments but not expected extensions or modifications unless reasonable expectation of a troubled debt restructuring exists) from the date of initial recognition of that instrument.

The ASU also replaces the current accounting model for purchased credit impaired loans and debt securities. The allowance for credit losses for purchased financial assets with a more-than-insignificant amount of credit deterioration since origination ("PCD assets") should be determined in a similar manner to other financial assets measured on an amortized cost basis. Upon initial recognition, the allowance for credit losses is added to the purchase price ("gross up approach") to determine the initial amortized cost basis. The subsequent accounting for PCD assets will use the CECL model described above.

The ASU made certain targeted amendments to the existing impairment model for available-for-sale (AFS) debt securities. For an AFS debt security for which there is neither the intent nor a more-likely-than-not requirement to sell, an entity will record credit losses as an allowance rather than a write-down of the amortized cost basis.

For the Company, the provisions of this ASU are effective for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. Early adoption is permitted for all entities as of the fiscal year beginning after December 15, 2018, including interim periods within those fiscal years.

The Company has completed the initial analysis of its financial assets and will continue to build and validate the CECL models in 2020 to evaluate the impact of the adoption of the new standard on its consolidated financial statements.

In April 2019, the FASB issued ASU 2019-04, Codification Improvements to Topic 326, Financial Instruments-Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments. The amendments in this ASU make minor improvements to the Codification by eliminating certain inconsistencies and clarifying the current guidance.

In June 2019, the FASB issued ASU 2019-05, Financial Instruments-Credit Losses (Topic 326): *Targeted Transition Relief*.
This ASU provides optional targeted transition relief that allows reporting entities to irrevocably elect the fair value option on financial instruments that 1) were previously recorded at amortized cost and 2) are within the scope of Topic 326 if the instruments are eligible for the fair value option under Topic 825. The new guidance is effective for public companies for annual reporting periods and interim periods within those annual periods beginning after December 15, 2019.

In November 2019, the FASB issued ASU No. 2019-10, “Financial Instruments - Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842). ASU 2019-10 provides that the FASB’s recently developed philosophy regarding the implementation of effective dates applies to ASU 2016-13, Financial Instruments - Credit Losses (Topic 326), among other ASUs. For the Company, the provisions of this ASU are effective for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. Early adoption is permitted for all entities as of the fiscal year beginning after December 15, 2018, including interim periods within those fiscal years. See the discussions regarding the adoption of ASU 2016-13 above.

Also in November 2019, the FASB issued ASU No. 2019-11, “Financial Instruments - Credit Losses: Codification Improvements (Topic 326)” to clarify its new credit impairment guidance in ASC 326, based on implementation issues raised by stakeholders. ASU 2019-11 clarifies that expected recoveries are to be included in the allowance for credit losses for these financial assets; an accounting policy election can be made to adjust the effective interest rate for existing troubled debt restructurings based on the prepayment assumptions instead of the prepayment assumptions applicable immediately prior to the restructuring event; and extends the practical expedient to exclude accrued interest receivable from all additional relevant disclosures involving the amortized cost basis. For the Company, the provisions of this ASU are effective for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. Early adoption is permitted for all entities as of the fiscal year beginning after December 15, 2018, including interim periods within those fiscal years. See the discussions regarding the adoption of ASU 2016-13 above.

***ASU 2020-02 - Financial Instruments - Credit Losses (Topic 326) and Leases (Topic 842)***

In January 2020, the FASB issued ASU No. 2020-02, “Financial Instruments - Credit Losses (Topic 326) and Leases (Topic 842): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 119 and Update to SEC Section on Effective Date Related to Accounting Standards Update No. 2016-02, Leases (Topic 842).” This ASU adds and amends SEC paragraphs in the Accounting Standards Codification to reflect the issuance of SEC Staff Accounting Bulletin No. 119, related to the new credit losses standard, and comments by the SEC staff related to the revised effective date of the new leases standard. This ASU is effective upon issuance. See the discussion regarding the adoption of ASU 2016-13 above.

*ASU 2020-03 - Codification Improvements to Financial Instruments*

In March 2020, the FASB issued ASU No. 2020-03, "Codification Improvements to Financial Instruments." This ASU clarifies various financial instruments topics, including the CECL standard issued in 2016. Amendments related to ASU 2016-13 for entities that have not yet adopted that guidance are effective upon adoption of the amendments in ASU 2016-13. Early adoption is not permitted before an entity's adoption of ASU 2016-13. Other amendments are effective upon issuance of this ASU. See the discussion regarding the adoption of ASU 2016-13 above.

*ASU 2020-04 - Reference Rate Reform (Topic 848)*

In March 2020, the FASB issued ASU No. 2020-04, "Reference Rate Reform (Topic 848)" provides optional expedients and exceptions for applying U.S. GAAP to contract modifications and hedging relationships that reference LIBOR or another reference rate expected to be discontinued, subject to meeting certain criteria. Under the new guidance, an entity can elect by accounting topic or industry subtopic to account for the modification of a contract affected by reference rate reform as a continuation of the existing contract, if certain conditions are met. In addition, the new guidance allows an entity to elect on a hedge-by-hedge basis to continue to apply hedge accounting for hedging relationships in which the critical terms change due to reference rate reform, if certain conditions are met. A one-time election to sell and/or transfer held-to-maturity debt securities that reference a rate affected by reference rate reform is also allowed. ASU No. 2020-04 became effective for all entities as of March 12, 2020 and will apply to all LIBOR reference rate modifications through December 31, 2022.

**(11) Fair Value Disclosures**

U.S. GAAP has established a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical unrestricted assets or liabilities.

Level 2: Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported with little or no market activity).

An asset's or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below. These valuation methodologies were applied to all of the Company's financial assets and financial liabilities carried at fair value.

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality and counterparty creditworthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time. The Company's valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective of future values. While management believes the Company's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

*Securities Available for Sale*. Securities classified as available for sale are reported at fair value utilizing Level 1 and Level 2 inputs. For Level 2 securities, the fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayments speeds, credit information and the security's terms and conditions, among other things.

*Interest Rate Lock Derivatives*. Interest rate lock commitments do not trade in active markets with readily observable prices. The fair value of an interest rate lock commitment is estimated based upon the forward sales price that is obtained in the best efforts commitment at the time the borrower locks in the interest rate on the loan and the probability that the locked rate commitment will close.

*Impaired Loans.* Impaired loans are those which the Company has measured and recognized impairment, generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the collateral or discounted cash flows based on the expected proceeds. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements. The fair value consists of the loan balances less specific valuation allowances.

*Other Real Estate Owned.* Foreclosed properties are adjusted to fair value less estimated selling costs at the time of foreclosure in preparation for transfer from portfolio loans to other real estate owned ("OREO"), thereby establishing a new accounting basis. The Company subsequently adjusts the fair value of the OREO, utilizing Level 3 inputs on a non-recurring basis to reflect partial write-downs based on the observable market price, current appraised value of the asset or other estimates of fair value. The fair value of other real estate owned is determined using appraisals, which may be discounted based on management's review and changes in market conditions.

The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

| | September 30, 2020 | | | |
|---|---|---|---|---|
| (Dollars in thousands) | Level 1 Inputs | Level 2 Inputs | Level 3 Inputs | Total Fair Value |
| Securities available for sale: | | | | |
| U.S. Treasury securities and obligations of U.S. Government sponsored entities ("GSE") and agencies | $ — | $ 3,569 | $ — | $ 3,569 |
| Residential collateralized mortgage obligations - GSE | — | 41,421 | — | 41,421 |
| Residential mortgage backed securities - GSE | — | 15,082 | — | 15,082 |
| Obligations of state and political subdivisions | — | 29,564 | — | 29,564 |
| Trust preferred debt securities - single issuer | — | 1,388 | — | 1,388 |
| Corporate debt securities | 9,311 | 10,614 | — | 19,925 |
| Other debt securities | — | 24,174 | — | 24,174 |
| Interest rate lock derivative | — | 673 | — | 673 |
| Total | $ 9,311 | $ 126,485 | $ — | $ 135,796 |

| | December 31, 2019 | | | |
|---|---|---|---|---|
| (Dollars in thousands) | Level 1 Inputs | Level 2 Inputs | Level 3 Inputs | Total Fair Value |
| Securities available for sale: | | | | |
| U.S. Treasury securities and obligations of U.S. Government sponsored entities ("GSE") and agencies | $ — | $ 764 | $ — | $ 764 |
| Residential collateralized mortgage obligations - GSE | — | 53,175 | — | 53,175 |
| Residential mortgage backed securities - GSE | — | 18,387 | — | 18,387 |
| Obligations of state and political subdivisions | — | 33,519 | — | 33,519 |
| Trust preferred debt securities - single issuer | — | 1,442 | — | 1,442 |
| Corporate debt securities | 11,151 | 12,128 | — | 23,279 |
| Other debt securities | — | 25,216 | — | 25,216 |
| Interest rate lock derivative | — | 159 | — | 159 |
| Total | $ 11,151 | $ 144,790 | $ — | $ 155,941 |

Certain assets and liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). Assets and liabilities subject to fair value adjustments (impairment) on a nonrecurring basis at September 30, 2020 and December 31, 2019 were as follows:

| (Dollars in thousands) | Level 1 Inputs | Level 2 Inputs | Level 3 Inputs | Total Fair Value |
|---|---|---|---|---|
| September 30, 2020 | | | | |
| Impaired loans | $ — | $ — | $ 8,265 | $ 8,265 |
| | | | | |
| December 31, 2019 | | | | |
| Impaired loans | $ — | $ — | $ 7,092 | $ 7,092 |
| Other real estate owned | — | — | 93 | 93 |

Impaired loans measured at fair value and included in the above table at September 30, 2020 consisted of eight loans having an aggregate recorded investment of $9.9 million and specific loan loss allowance of $1.6 million. Impaired loans measured at fair value and included in the above table at December 31, 2019 consisted of twelve loans having an aggregate balance of $7.2 million with specific loan loss allowance of $69,000.

The following table presents additional qualitative information about assets measured at fair value on a nonrecurring basis, where there was evidence of impairment, and for which the Company has utilized Level 3 inputs to determine fair value:

| (Dollars in thousands) | Fair Value Estimate | Valuation Techniques | Unobservable Input | Range (Weighted Average) |
|---|---|---|---|---|
| September 30, 2020 | | | | |
| Impaired loans | $ 8,265 | Appraisal of collateral (1) | Appraisal adjustments (2) | —% - 28.5% (12.2%) |
| | | | | |
| December 31, 2019 | | | | |
| Impaired loans | $ 7,092 | Appraisal of collateral (1) | Appraisal adjustments (2) | 0.1% - 40.4% (12.6%) |
| Other real estate owned | $ 93 | Appraisal of collateral (1) | Appraisal adjustments (2) | 47.0% (47.0%) |

(1) Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various Level 3 inputs that are not identifiable.

(2) Includes qualitative adjustments by management and estimated liquidation expenses.

The following is a summary of fair value versus carrying value of all of the Company's financial instruments. For the Company and the Bank, as with most financial institutions, the bulk of assets and liabilities are considered financial instruments. Many of the financial instruments lack an available trading market as characterized by a willing buyer and willing seller engaging in an exchange transaction. Therefore, significant estimations and present value calculations were used for the purpose of this note. Changes in assumptions could significantly affect these estimates.

The estimated fair values and carrying amounts of financial assets and liabilities as of September 30, 2020 and December 31, 2019 were as follows:

| | September 30, 2020 | | | | |
|---|---|---|---|---|---|
| (Dollars in thousands) | Carrying Value | Level 1 Inputs | Level 2 Inputs | Level 3 Inputs | Fair Value |
| Cash and cash equivalents | $ 20,055 | $ 20,055 | $ — | $ — | $ 20,055 |
| Securities available for sale | 135,123 | 9,311 | 125,812 | — | 135,123 |
| Securities held to maturity | 87,811 | — | 90,735 | — | 90,735 |
| Loans held for sale | 28,196 | — | 29,099 | — | 29,099 |
| Net loans | 1,441,234 | — | — | 1,498,557 | 1,498,557 |
| SBA servicing asset | 855 | — | 1,245 | — | 1,245 |
| Interest rate lock derivative | 673 | — | 673 | — | 673 |
| Accrued interest receivable | 5,689 | — | 5,689 | — | 5,689 |
| FHLB stock | 2,422 | — | 2,422 | — | 2,422 |
| Deposits | (1,511,033) | — | (1,513,161) | — | (1,513,161) |
| Short-term borrowings | (105,867) | — | (105,867) | — | (105,867) |
| Redeemable subordinated debentures | (18,557) | — | (10,877) | — | (10,877) |
| Accrued interest payable | (1,069) | — | (1,069) | — | (1,069) |

| | December 31, 2019 | | | | |
|---|---|---|---|---|---|
| (Dollars in thousands) | Carrying Value | Level 1 Inputs | Level 2 Inputs | Level 3 Inputs | Fair Value |
| Cash and cash equivalents | $ 14,842 | $ 14,842 | $ — | $ — | $ 14,842 |
| Securities available for sale | 155,782 | 11,151 | 144,631 | — | 155,782 |
| Securities held to maturity | 76,620 | — | 78,223 | — | 78,223 |
| Loans held for sale | 5,927 | — | 6,093 | — | 6,093 |
| Net loans | 1,206,757 | — | — | 1,243,088 | 1,243,088 |
| SBA servicing asset | 930 | — | 1,245 | — | 1,245 |
| Interest rate lock derivative | 159 | — | 159 | — | 159 |
| Accrued interest receivable | 4,945 | — | 4,945 | — | 4,945 |
| FHLB stock | 4,176 | — | 4,176 | — | 4,176 |
| Deposits | (1,277,362) | — | (1,278,166) | — | (1,278,166) |
| Short-term borrowings | (92,050) | — | (92,050) | — | (92,050) |
| Redeemable subordinated debentures | (18,557) | — | (12,837) | — | (12,837) |
| Accrued interest payable | (1,592) | — | (1,592) | — | (1,592) |

Loan commitments and standby letters of credit as of September 30, 2020 and December 31, 2019 were based on fees charged for similar agreements; accordingly, the estimated fair value of loan commitments and standby letters of credit was nominal.

**(12) Leases**

At September 30, 2020, the Company had 37 operating leases under which the Company is a lessee. Of the 37 leases, 23 leases were for real property, including leases for 19 of the Company's branch offices and 4 leases for general office space including the Company's headquarters. All of the real property leases include one or more options to extend the lease term. Four of the branch office leases are for the land on which the branch offices are located and the Company owns the leasehold improvements.

In addition, the Company had 12 leases for office equipment, consisting primarily of copiers and printers, and two automobile leases. None of these leases include extensions and generally have three to five year terms.

At September 30, 2020, the Company did not have any finance leases.

For the three and nine months ended September 30, 2020 and 2019, the Company recognized rent and equipment expense associated with leases as follows:

| (In thousands) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2020 | 2019 | 2020 | 2019 |
| Operating lease cost: | | | | |
| Fixed rent expense and equipment expense | $ 1,338 | $ 501 | $ 2,005 | $ 1,477 |
| Variable rent expense | — | — | — | — |
| Short-term lease expense | 23 | 3 | 35 | 7 |
| Sublease income | — | — | — | — |
| Net lease cost | $ 1,361 | $ 504 | $ 2,040 | $ 1,484 |

| (In thousands) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2020 | 2019 | 2020 | 2019 |
| Lease cost - occupancy expense | $ 1,245 | $ 438 | $ 1,859 | $ 1,295 |
| Lease cost - other expense | 116 | 66 | 181 | 189 |
| Net lease cost | $ 1,361 | $ 504 | $ 2,040 | $ 1,484 |

For the nine months ended September 30, 2020 and 2019, the following cash and non-cash activities were associated with the leases:

| | Nine Months Ended September 30, | |
|---|---|---|
| (In thousands) | 2020 | 2019 |
| Cash paid for amounts included in the measurement of lease liabilities: | | |
| Operating cash flows from operating leases | $ 1,896 | $ 1,332 |
| | | |
| Non-cash investing and financing activities: | | |
| Additions to ROU assets obtained from: | | |
| Net lease cost | — | — |
| New operating lease liabilities | 250 | 417 |

The future payments due under operating leases at September 30, 2020 and 2019 were as follows:

| | At September 30, | |
|---|---|---|
| (In thousands) | 2020 | 2019 |
| Due in less than one year | $ 2,071 | $ 1,841 |
| Due in one year but less than two years | 2,059 | 1,796 |
| Due in two years but less than three years | 2,014 | 1,784 |
| Due in three years but less than four years | 1,882 | 1,767 |
| Due in four years but less than five years | 1,712 | 1,644 |
| Thereafter | 13,836 | 12,483 |
| Total future payments | $ 23,574 | $ 21,315 |
| Less: Implied interest | (5,860) | (5,616) |
| Total lease liability | $ 17,714 | $ 15,699 |

At September 30, 2020, future payments due under operating leases were based on ASC Topic 842 and included, in general, at least one lease renewal option on all real estate leases except on one land lease where all renewal options were included. As of September 30, 2020, the weighted-average remaining lease term for all operating leases was 14.8 years. The weighted average discount rate associated with the operating leases at September 30, 2020 was 3.34%.

**(13) Borrowings**

The Company has overnight or short-term borrowing lines established with FHLB, other correspondent banks and participates in Federal Reserve Bank's PPPLF funding program. At September 30, 2020, the Company had overnight or short-term borrowings totaling $105.9 million with an average interest rate of 0.35%. Overnight or short-term borrowings at December 31, 2019 totaled $92.1 million with an average interest rate of 1.81%. These borrowings are primarily used to fund asset growth not supported by deposit generation.

At September 30, 2020, unused overnight or short-term borrowing potential totaled $281.1 million from the FHLB and unused Fed Funds borrowing commitments of $46.0 million from correspondent banks.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

When used in this Quarterly Report on Form 10-Q for the period ended September 30, 2020 (this "Form 10-Q"), the words "the Company," "we," "our," and "us" refer to 1ST Constitution Bancorp and, as the context requires, its wholly-owned subsidiary, 1ST Constitution Bank (the "Bank"), and the Bank's wholly-owned subsidiaries, 1ST Constitution Investment Company of New Jersey, Inc., FCB Assets Holdings, Inc. and 1st Constitution Real Estate Investment Corporation. 1ST Constitution Capital Trust II ("Trust II"), a subsidiary of the Company, is not included in the Company's consolidated financial statements as it is a variable interest entity and the Company is not the primary beneficiary. Trust II, a subsidiary of the Company, was created in May 2006 to issue trust preferred securities to assist the Company in raising additional capital.

This discussion and analysis of the operating results for the three and nine months ended September 30, 2020 and financial condition at September 30, 2020 is intended to help readers analyze the accompanying financial statements, notes and other supplemental information contained in this Form 10-Q. Results of operations for the three- and nine-month periods ended September 30, 2020 are not necessarily indicative of results to be attained for any other periods.

This discussion and analysis should be read in conjunction with the consolidated financial statements, notes and tables included elsewhere in this Form 10-Q and Part II, Item 7 of the Company's Form 10-K (Management's Discussion and Analysis of Financial Condition and Results of Operation) for the year ended December 31, 2019, as filed with the Securities and Exchange Commission (the "SEC") on March 16, 2020 (the "2019 Form 10-K"), as well as the risk factors set forth under Part I, Item 1A of the 2019 Form 10-K, as modified and supplemented by the risk factors under Part II, Item 1A of the Company's Form 10-Q for the period ended March 31, 2020, as filed with the SEC on May 11, 2020.

### Forward-Looking Statements

This Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for forward-looking statements. When used in this and in future filings by the Company with the SEC, and in the Company's written and oral statements made with the approval of an authorized executive officer of the Company, the words or phrases "will," "will likely result," "could," "anticipates," "believes," "continues," "expects," "plans," "will continue," "is anticipated," "estimated," "project" or "outlook" or similar expressions (including confirmations by an authorized executive officer of the Company of any such expressions made by a third party with respect to the Company) are intended to identify forward-looking statements. The Company cautions readers not to place undue reliance on any such forward-looking statements, each of which speaks only as of the date made. Such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from historical earnings and those presently anticipated or projected.

These forward-looking statements are based upon our opinions and estimates as of the date they are made and are not guarantees of future performance. Although we believe that the expectations reflected in these forward-looking statements are reasonable, such forward-looking statements are subject to known and unknown risks and uncertainties that may be beyond our control, which could cause actual results, performance and achievements to differ materially from results, performance and achievements projected, expected, expressed or implied by the forward-looking statements.

Examples of factors or events that could cause actual results to differ materially from historical results or those anticipated, expressed or implied include, without limitation, changes in the overall economy and interest rate changes; inflation, market and monetary fluctuations; the ability of our customers to repay their obligations; the accuracy of our financial statement estimates and assumptions, including the adequacy of the estimate made in connection with determining the adequacy of the allowance for loan losses; increased competition and its effect on the availability and pricing of deposits and loans; significant changes in accounting, tax or regulatory practices and requirements; changes in deposit flows, loan demand or real estate values; the enactment of legislation or regulatory changes; changes in monetary and fiscal policies of the U.S. government; changes to the method that LIBOR rates are determined and to the phasing out of LIBOR after 2021; changes in loan delinquency rates or in our levels of non-performing assets; our ability to declare and pay dividends; changes in the economic climate in the market areas in which we operate; the frequency and magnitude of foreclosure of our loans; changes in consumer spending and saving habits; the effects of the health and soundness of other financial institutions, including the need of the FDIC to increase the Deposit Insurance Fund assessments; technological changes; the effects of climate change and harsh weather conditions, including hurricanes and man-made disasters; the economic impact of any future terrorist threats and attacks, acts of war or threats thereof and the response of the United States to any such threats and attacks; our ability to integrate acquisitions and achieve cost savings; other risks described from time to time in our filings with the SEC; and our ability to manage the risks involved in the foregoing. Further, the foregoing factors may be exacerbated by the ultimate impact of the COVID-19 pandemic, which is unknown at this time.

In addition, statements about the COVID-19 pandemic and the potential effects and impacts of the COVID-19 pandemic on the Company's business, financial condition, liquidity and results of operations may constitute forward-looking statements and are subject to the risk that actual results may differ, possibly materially, from what is reflected in such forward-looking statements due to factors and future developments that are uncertain, unpredictable and, in many cases, beyond our control, including the scope, duration and extent of the pandemic, actions taken by governmental authorities in response to the pandemic and the direct and indirect impact of the pandemic on our employees, customers, business and third-parties with which we conduct business.

Although management has taken certain steps to mitigate any negative effect of the aforementioned factors and the COVID-19 pandemic, significant unfavorable changes could severely impact the assumptions used and have an adverse effect on profitability. Any forward-looking statements made by us or on our behalf speak only as of the date they are made, and we do not undertake any obligation to update any forward-looking statement to reflect the impact of subsequent events or circumstances, except as required by law.

**OVERVIEW**

The Company is a bank holding company registered under the Bank Holding Company Act of 1956, as amended. The Company was organized under the laws of the State of New Jersey in February 1999 for the purpose of acquiring all of the issued and outstanding stock of the Bank, a full-service commercial bank that began operations in August 1989, thereby enabling the Bank to operate within a bank holding company structure. The Company became an active bank holding company on July 1, 1999. Other than its ownership interest in the Bank, the Company currently conducts no other significant business activities.

The Bank operates 26 branches and manages its investment portfolio through its subsidiary, 1ST Constitution Investment Company of New Jersey, Inc. FCB Assets Holdings, Inc., a subsidiary of the Bank, is used by the Bank to manage and dispose of repossessed real estate.

On November 8, 2019, the Company and the Bank completed the merger of Shore Community Bank ("Shore") with and into the Bank (the "Shore Merger"). Shore's results of operations have been included in the Company's Consolidated Financial Statements since November 8, 2019. Therefore, comparisons of the Company's Consolidated Financial Statements from before and after the Shore Merger are impacted by the inclusion of former Shore operations after November 7, 2019. See Note 2 - Acquisition of Shore Community Bank - for further information.

COVID-19 Impact and Response

The sudden emergence of the COVID-19 pandemic in the first quarter of 2020 has created widespread uncertainty, social and economic disruption, highly volatile financial markets and unprecedented increases in unemployment levels in a short period of time. Mandated business and school closures, restrictions on travel and social distancing have resulted in almost all businesses and employees being adversely impacted. The businesses located in the Bank's primary market areas of northern and central New Jersey, communities along the New Jersey shore, and the New York City metropolitan area, and their employees, have been adversely impacted. As a result of the COVID-19 pandemic and the resulting economic disruption and uncertainty, it is not possible to determine the overall impact of the pandemic on the Company's business. To the extent that customers are not able to fulfill their contractual obligations to the Company, the Company's business operations, asset valuations, financial condition, cash flows and results of operations could be materially adversely impacted. Material adverse impacts may include all or a combination of valuation impairments on our intangible assets, investments, loans, deferred tax assets, or other real estate owned ("OREO").

The ultimate impact of the COVID-19 pandemic on the Company's operations and financial performance will depend on future developments related to the duration, extent and severity of the pandemic; the length of time that restrictions on travel and gatherings, capacity and other operational limitations or closures imposed on or by businesses and schools, and social distancing measures remain in place; and the enactment of further legislation or the adoption of policies designed to deliver monetary aid and other relief to borrowers, including but not limited to federal stimulus, forbearance or Federal Reserve monetary policy. In addition, The Company's operations rely on third-party vendors to process, record and monitor transactions. If any of these vendors are unable to provide these services, our ability to serve customers could be disrupted. The pandemic could further negatively impact customers' ability to conduct banking and other financial transactions. The Company's operations could be adversely impacted if key personnel or a significant number of employees were unable to work due to illness or restrictions.

On March 27, 2020, the President of the United States signed into law the Coronavirus Aid, Relief and Economic Security ("CARES") Act to provide relief for individuals and businesses that have been negatively impacted by the COVID-19 pandemic.

The CARES Act includes a provision for the Company to opt out of applying the "troubled-debt restructuring" accounting guidance in ASC 310-40 for certain loan modifications. Loan modifications made between March 1, 2020 and the earlier of (i) December 30, 2020 or ii) 60 days after the President declares a termination of the COVID-19 national emergency are eligible for this relief if the related loans were not more than 30 days past due as of December 31, 2019. The Bank adopted this provision as of March 31, 2020.

In the Company's Forms 10-Q for the quarters ended March 31, 2020 and June 30, 2020, the Company reported the steps that it took in response to the sudden emergence of the COVID-19 pandemic. During the third quarter of 2020, the Company continued working with customers severely impacted by the resulting economic disruption. Management significantly increased the provision for loan losses in response to the higher incurred losses in the loan portfolio. Management may further adjust the provision and allowance for loan losses in response to changes in economic conditions and the performance of the loan portfolio in future periods.

As we conduct our daily operations, the safety of our employees and customers remains our primary concern and we continue to maintain the same measures and protective procedures that we implemented in the second quarter of 2020.

To support our loan and deposit customers and the communities we serve:

- We continue to provide access to additional credit and forbearance on loan interest and or principal payments for up to 90 days where management has determined that it is warranted. For the nine months ended September 30, 2020, $149.3 million of loans ($140.9 million of commercial loans and $8.4 million of consumer loans) were modified to provide deferral of interest and or principal by borrowers for up to 90 days.
- As a long-standing Small Business Administration ("SBA") preferred lender, we actively participated in the SBA's Paycheck Protection Program ("PPP") established under the CARES Act. For the nine months ended September 30, 2020, we funded 467 SBA PPP loans totaling $75.6 million.
- We are registered to utilize the Main Street New Loan Facility ("Facility") established by the Board of Governors of the Federal Reserve System (the "Federal Reserve") under the CARES Act to provide financing to our customers and communities. This Facility is intended to facilitate lending by banks to small and medium-sized businesses, which we believe may be beneficial to certain of our customers.
- We are participating in the Federal Reserve's PPP loan funding program and are pledging the PPP loans to collateralize a like amount of borrowings from the Federal Reserve at a favorable interest rate of 0.35% up to a two-year term.

Modification of Loans and Deferral of Payments

During the nine months ended September 30, 2020, $140.9 million of commercial business and commercial real estate loans and $8.4 million of consumer loans had been modified to provide deferral of interest and or principal by borrowers for up to 90 days. As of September 30, 2020, $123.6 million of commercial business and commercial real estate loans that had previously received deferrals were no longer deferred and had made the contractually due payments in the third quarter of 2020. During the third quarter of 2020, commercial business and commercial real estate loans to three borrowers totaling $10.3 million received a second modification and commercial real estate loans to three borrowers totaling $1.8 million received a first modification to defer principal and or interest up to 90 days. Two commercial real estate loans totaling $4.6 million that had received a modification in the second quarter of 2020 were placed on non-accrual during the third quarter of 2020. One commercial real estate loan with a balance of $595,000 had not made the first payment after the end of the deferral period. Commercial business and commercial real estate loans with a modification to defer principal and or interest up to 90 days totaled $12.1 million at September 30, 2020.

All but two loans totaling $974,000 of the $8.4 million of consumer loans that had received a deferral made the contractually due payments during the third quarter of 2020.

## RESULTS OF OPERATIONS

***Three and Nine Months Ended September 30, 2020 Compared to Three and Nine Months Ended September 30, 2019***

### Summary

The Company reported net income of $4.9 million and diluted earnings per share of $0.48 for the three months ended September 30, 2020 compared to net income of $3.6 million and diluted earnings per share of $0.42 for the three months ended September 30, 2019. For the nine months ended September 30, 2020, net income was $12.0 million and diluted earnings per share were $1.17 compared to net income of $10.4 million and diluted earnings per share of $1.19 for the nine months ended September 30, 2019.

Return on average total assets and return on average shareholders' equity were 1.08% and 10.92%, respectively, for the three months ended September 30, 2020 compared to return on average total assets and return on average shareholders' equity of 1.14% and 10.57%, respectively, for the three months ended September 30, 2019. Return on average total assets and return on average shareholders' equity were 0.96% and 9.17%, respectively, for the nine months ended September 30, 2020 compared to return on average assets and return on average shareholders' equity of 1.14% and 10.52%, respectively, for the nine months ended September 30, 2019. Book value per share was $17.78 at September 30, 2020 compared to $16.74 at December 31, 2019.

Management anticipates that the Company’s results of operations and net income will continue to be impacted for the foreseeable future due to the economic disruption related to the COVID-19 pandemic.

- The provision for loan losses and allowance for loan losses may increase as borrowers continue to be negatively affected by the contraction of economic activity and the dramatic increase in unemployment.
- Due to the asset sensitive nature of the Company’s balance sheet, the Federal Reserve’s reduction in the targeted fed funds rate to zero to 0.25% and the concomitant decline in the prime rate to 3.25% in March 2020 caused a reduction in the average yield of loans tied to the prime rate and the overall lower market interest rate environment negatively impacted the net interest margin. The net interest margin was also impacted by the funding of the PPP loans with a 1.0% interest rate, which will be partially offset by the recognition of the loan fees earned on these loans. The timing and impact to the net interest margin will be contingent on how quickly and the extent to which the PPP loans become grants that are repaid by the SBA over the next two years. The net interest margin and the net interest income may decline in future periods if the Company cannot reduce the cost of interest-bearing liabilities at the same time and to the same extent as the decline in the average yield of assets.
- Residential real estate sales, and therefore the origination and sale of residential mortgages may decline as a result of the restrictions implemented to contain the spread of COVID-19, such as business closures and social distancing measures. This decline in turn, would result in lower gain on sales of loans and a decrease in non-interest income.
- A significant increase in non-performing loans could result in increased non-interest expense due to higher expenses for loan collection and recovery costs.

<u>Goodwill</u>

The Company completed its annual testing of goodwill for impairment in the fourth quarter of 2019 and concluded at that time that the fair value of the reporting unit exceeded the carrying amount of the reporting unit. In completing the impairment testing the Company identified a single reporting unit and the $35.0 million of goodwill at December 31, 2019 was assigned to the single reporting unit.

The decline in the market price of the Company’s common stock and the resulting aggregate market capitalization of the Company declining below the total amount of common shareholders’ equity at September 30, 2020, was an indication that the carrying amount of goodwill may exceed its fair value. Even though the decline in the market price of the Company’s common stock during 2020 was consistent with a broad decline in the market value of all banking company stocks and was not specific to the Company, it was a triggering event that required an evaluation of the potential impairment of goodwill.

For the third quarter of 2020, the Company performed a quantitative impairment test of goodwill utilizing a discounted cash flow valuation methodology based upon an updated five year projection of the Company’s financial performance. A discount rate was estimated utilizing the build up method with a risk free rate, an equity risk premium and a size premium. This discount rate was applied to the projected cash flows over the five year period, which included a terminal value in year five based on a multiple of the projected cash flow in year five. The year five terminal multiple was based upon the observed average market price to earnings multiple for the trailing last twelve months of earnings for companies included in the SNL US Bank Index at September 30, 2020. This multiple does not include a control premium. This estimated fair value exceeded the carrying value of shareholders’ equity at September 30, 2020 by 10.3%.

The five year projection was based on the Company’s 2020 business plan, historical operating results and internal financial models and included key assumptions for significantly elevated loan losses as a result of the COVID pandemic in the first three years of the projection. The Company’s actual financial results for the quarter ended June 30, 2020 and September 30, 2020 exceeded the financial projections for those periods.

It is not possible to know the severity and duration of the COVID-19 pandemic and the severity and duration of the economic disruption that will occur in the near term. While the Company has projected loan losses significantly higher than its historical experience in its five year projections, the actual loan losses may vary due to the uncertainty of the severity and duration of the economic disruption. Changes in market interest rates and the economic conditions in the Company’s market area may also affect the Company’s future net interest income and net income.

If the Company’s common stock price remains below the Company’s book value per common share in future periods, the Company will continue to evaluate goodwill for impairment on a quarterly basis. Changes in economic conditions, actual loan losses at levels higher than projected, changes in market interest rates and changes in discount rates and valuation multiples may affect the Company’s financial projections and valuation. The Company may determine that goodwill becomes impaired in a future period and a portion or all of the goodwill may be written off.

On the basis of the evaluation of goodwill, management concluded that it was more likely than not the fair value of the reporting unit exceeded the carrying value of the reporting unit. Accordingly, goodwill was not impaired at September 30, 2020.

The effects of the COVID-19 pandemic could cause a further and sustained decline in the Company’s stock price or the occurrence of what management would deem to be a triggering event that could, under certain circumstances, cause us to perform a new goodwill impairment test and could result in an impairment charge being necessary in the future. In the event that the Company concludes that all or a portion of its goodwill is impaired, a non-cash charge for the amount of such impairment would be recorded to earnings. It is expected that any such charge would have no impact on tangible capital or regulatory capital.

Third Quarter 2020 Highlights

- Return on average total assets and return on average shareholders' equity were 1.08% and 10.92%, respectively.
- Net interest income was $15.4 million and net interest margin was 3.67% on a tax equivalent basis.
- A provision for loan losses of $2.3 million was recorded for the third quarter of 2020 and net recoveries were $5,000.
- Total loans were $1.5 billion at September 30, 2020 and increased $100.2 million from June 30, 2020. Mortgage warehouse loans increased $76.9 million and commercial real estate loans increased $23.7 million from June 30, 2020.
- As of September 30, 2020, the Bank had funded $75.6 million in SBA PPP loans under the CARES Act.
- Total deposits were $1.5 billion at September 30, 2020 and increased $101.6 million, with non-interest demand deposits increasing $29.3 million, from June 30, 2020.
- Non-performing assets were $17.5 million, or 0.95% of total assets, at September 30, 2020, increasing $3.5 million from June 30, 2020 and included $267,000 of other real estate owned ("OREO").

The following table reflects the reconciliation of non-GAAP measures for the three and nine months ended September 30, 2020 and 2019.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (Dollars in thousands, except per share data) | 2020 | 2019 | 2020 | 2019 |
| **Adjusted net income** | | | | |
| Net income | $ 4,910 | $ 3,623 | $ 12,021 | $ 10,390 |
| Adjustments: | | | | |
| Merger-related expenses | — | 302 | 64 | 575 |
| Income tax effect of adjustments | — | (37) | (19) | (119) |
| Adjusted net income | $ 4,910 | $ 3,888 | $ 12,066 | $ 10,846 |
| | | | | |
| **Adjusted net income per diluted share** | | | | |
| Adjusted net income | $ 4,910 | $ 3,888 | $ 12,066 | $ 10,846 |
| Diluted shares outstanding | 10,268,951 | 8,722,349 | 10,260,477 | 8,698,959 |
| Adjusted net income per diluted share | $ 0.48 | $ 0.45 | $ 1.18 | $ 1.25 |
| | | | | |
| **Adjusted return on average total assets** | | | | |
| Adjusted net income | $ 4,910 | $ 3,888 | $ 12,066 | $ 10,846 |
| Average assets | 1,804,198 | 1,264,298 | 1,675,200 | 1,221,410 |
| Adjusted return on average total assets | 1.08 % | 1.22 % | 0.96 % | 1.19 % |
| | | | | |
| **Adjusted return on average shareholders' equity** | | | | |
| Adjusted net income | $ 4,910 | $ 3,888 | $ 12,066 | $ 10,846 |
| Average equity | 178,946 | 135,975 | 175,141 | 132,079 |
| Adjusted return on average shareholders' equity | 10.92 % | 11.34 % | 9.20 % | 10.98 % |
| | | | | |
| **Book value and tangible book value per common share** | | | | |
| Shareholders' equity | | | $ 182,007 | $ 138,527 |
| Less: goodwill and intangible assets | | | 36,471 | 12,165 |
| Tangible shareholders' equity | | | 145,536 | 126,362 |
| Shares outstanding | | | 10,237,520 | 8,682,401 |
| Book value per common share | | | $ 17.78 | $ 15.95 |
| Tangible book value per common share | | | $ 14.22 | $ 14.55 |

[1] The Company used the non-GAAP financial measures, Adjusted net income, Adjusted net income per diluted share, Adjusted return on average total assets, Adjusted return on average shareholders' equity and tangible book value per common share, because the Company believes that it is helpful to readers in understanding the Company's financial performance and the effect on its financial statements of the merger-related expenses related to the Shore Merger in 2019. These non-GAAP measures improve the comparability of the current period results with the results of the prior periods. The Company cautions that the non-GAAP financial measures should be considered in addition to, but not as a substitute for, the Company's GAAP financial results.

### Earnings Analysis

The Company's results of operations depend primarily on net interest income, which is primarily affected by the market interest rate environment, the shape of the U.S. Treasury yield curve and the difference between the yield on interest-earning assets and the rate paid on interest-bearing liabilities. Other factors that may affect the Company's operating results are general and local economic and competitive conditions, government policies and actions of regulatory authorities.

### Net Interest Income

Net interest income, the Company's largest and most significant component of operating income, is the difference between interest and fees earned on loans and other earning assets and interest paid on deposits and borrowed funds. This component represented 76.4% of the Company's net revenues (defined as net interest income plus non-interest income) for the three months ended September 30, 2020 compared to 83.9% of net revenues for the three months ended September 30, 2019. Net interest income also depends upon the relative amount of average interest-earning assets, average interest-bearing liabilities and the interest rate earned or paid on them, respectively.

The following table sets forth the Company's consolidated average balances of assets and liabilities and shareholders' equity, as well as interest income and interest expense on related items, and the Company's average yield or rate for the three months ended September 30, 2020 and 2019. The average rates are derived by dividing interest income and interest expense by the average balance of assets and liabilities, respectively.

| | Three months ended September 30, 2020 | | | Three months ended September 30, 2019 | | |
|---|---|---|---|---|---|---|
| (Dollars in thousands except yield/cost information) | Average Balance | Interest | Average Yield | Average Balance | Interest | Average Yield |
| **Assets** | | | | | | |
| Interest-earning assets: | | | | | | |
| Federal funds sold/short-term investments | $ 8,027 | $ 2 | 0.10 % | $ 6,452 | $ 35 | 2.15 % |
| Investment securities: | | | | | | |
| Taxable | 155,242 | 725 | 1.87 % | 161,538 | 1,130 | 2.80 % |
| Tax-exempt (1) | 83,461 | 638 | 3.06 % | 52,990 | 498 | 3.76 % |
| Total investment securities | 238,703 | 1,363 | 2.28 % | 214,528 | 1,628 | 3.04 % |
| Loans: (2) | | | | | | |
| Commercial real estate | 609,917 | 7,789 | 5.00 % | 405,885 | 5,295 | 5.10 % |
| Mortgage warehouse lines | 333,461 | 3,383 | 4.06 % | 191,812 | 2,644 | 5.39 % |
| Construction | 136,252 | 1,794 | 5.24 % | 157,752 | 2,705 | 6.80 % |
| Commercial business | 138,073 | 1,445 | 4.16 % | 117,465 | 1,731 | 5.85 % |
| SBA PPP loans | 75,484 | 470 | 2.48 % | — | — | — % |
| Residential real estate | 89,755 | 1,137 | 4.96 % | 57,026 | 624 | 4.38 % |
| Loans to individuals | 27,284 | 293 | 4.20 % | 20,555 | 260 | 4.95 % |
| Loans held for sale | 23,914 | 155 | 2.59 % | 5,160 | 49 | 3.80 % |
| All other loans | 643 | 11 | 6.69 % | 772 | 8 | 4.05 % |
| Deferred (fees) costs, net | (1,736) | — | — % | 450 | — | — % |
| Total loans | 1,433,047 | 16,477 | 4.57 % | 956,877 | 13,316 | 5.67 % |
| Total interest-earning assets | 1,679,777 | $ 17,842 | 4.23 % | 1,177,857 | $ 14,979 | 5.15 % |
| Non-interest-earning assets: | | | | | | |
| Allowance for loan losses | (12,348) | | | (8,786) | | |
| Cash and due from banks | 11,460 | | | 11,684 | | |
| Other assets | 125,309 | | | 83,543 | | |
| Total non-interest-earning assets | 124,421 | | | 86,441 | | |
| **Total assets** | $ 1,804,198 | | | $ 1,264,298 | | |
| **Liabilities and shareholders' equity** | | | | | | |
| Interest-bearing liabilities: | | | | | | |
| Money market and NOW accounts | $ 425,401 | $ 542 | 0.51 % | $ 335,997 | $ 720 | 0.85 % |
| Savings accounts | 290,055 | 461 | 0.63 % | 190,985 | 491 | 1.02 % |
| Certificates of deposit | 350,654 | 1,168 | 1.33 % | 291,674 | 1,693 | 2.30 % |
| Federal Reserve Bank PPPLF borrowings | 35,296 | 33 | 0.37 % | — | — | — % |
| Short-term borrowings | 63,175 | 62 | 0.39 % | 45,378 | 268 | 2.34 % |
| Redeemable subordinated debentures | 18,557 | 90 | 1.90 % | 18,557 | 185 | 3.99 % |
| Total interest-bearing liabilities | 1,183,138 | $ 2,356 | 0.79 % | 882,591 | $ 3,357 | 1.51 % |
| Non-interest-bearing liabilities: | | | | | | |
| Demand deposits | 413,350 | | | 221,166 | | |
| Other liabilities | 28,764 | | | 24,566 | | |
| Total non-interest-bearing liabilities | 442,114 | | | 245,732 | | |
| Shareholders' equity | 178,946 | | | 135,975 | | |
| **Total liabilities and shareholders' equity** | $ 1,804,198 | | | $ 1,264,298 | | |
| Net interest spread (3) | | | 3.44 % | | | 3.54 % |
| Net interest income and margin (4) | | $ 15,486 | 3.67 % | | $ 11,622 | 3.91 % |

(1) Tax equivalent basis, using federal tax rate of 21% in 2020 and 2019.

(2) Loan origination fees are considered an adjustment to interest income. For the purpose of calculating loan yields, average loan balances include non-accrual loans with no related interest income and the average balance of loans held for sale.

(3) The net interest spread is the difference between the average yield on interest-earning assets and the average rate paid on interest-bearing liabilities.

(4) The net interest margin is equal to net interest income divided by average interest-earning assets.

The following table sets forth the Company's consolidated average balances of assets and liabilities and shareholders' equity, as well as interest income and interest expense on related items, and the Company's average yield or rate for the nine months ended September 30, 2020 and 2019. The average rates are derived by dividing interest income and interest expense by the average balance of assets and liabilities, respectively.

| | Nine months ended September 30, 2020 | | | Nine months ended September 30, 2019 | | |
|---|---|---|---|---|---|---|
| (Dollars in thousands except yield/cost information) | Average Balance | Interest | Average Yield | Average Balance | Interest | Average Yield |
| **Assets** | | | | | | |
| Interest-earning assets: | | | | | | |
| Federal funds sold/short-term investments | $ 16,433 | $ 95 | 0.77 % | $ 7,140 | $ 129 | 2.42 % |
| Investment securities: | | | | | | |
| Taxable | 163,979 | 2,633 | 2.14 % | 162,809 | 3,615 | 2.96 % |
| Tax-exempt (1) | 77,145 | 1,821 | 3.15 % | 56,723 | 1,590 | 3.74 % |
| Total investment securities | 241,124 | 4,454 | 2.46 % | 219,532 | 5,205 | 3.16 % |
| Loans: (2) | | | | | | |
| Commercial real estate | 588,145 | 22,935 | 5.12 % | 400,096 | 15,494 | 5.11 % |
| Mortgage warehouse lines | 244,470 | 7,702 | 4.20 % | 155,962 | 6,682 | 5.71 % |
| Construction | 141,428 | 5,965 | 5.63 % | 157,245 | 8,135 | 6.92 % |
| Commercial business | 142,010 | 4,815 | 4.53 % | 120,774 | 5,386 | 5.96 % |
| SBA PPP loans | 43,374 | 818 | 2.52 % | — | — | — % |
| Residential real estate | 89,333 | 3,085 | 4.54 % | 50,562 | 1,682 | 4.39 % |
| Loans to individuals | 28,857 | 1,001 | 4.56 % | 21,748 | 827 | 5.01 % |
| Loans held for sale | 14,160 | 304 | 2.86 % | 3,556 | 107 | 4.01 % |
| All other loans | 872 | 31 | 4.67 % | 799 | 29 | 4.79 % |
| Deferred (fees) costs, net | (345) | — | — % | 233 | — | — % |
| Total loans | 1,292,304 | 46,656 | 4.82 % | 910,975 | 38,342 | 5.63 % |
| Total interest-earning assets | 1,549,861 | $ 51,205 | 4.41 % | 1,137,647 | $ 43,676 | 5.13 % |
| **Non-interest-earning assets:** | | | | | | |
| Allowance for loan losses | (10,684) | | | (8,693) | | |
| Cash and due from banks | 12,182 | | | 11,270 | | |
| Other assets | 123,841 | | | 81,186 | | |
| Total non-interest-earning assets | 125,339 | | | 83,763 | | |
| **Total assets** | $ 1,675,200 | | | $ 1,221,410 | | |
| **Liabilities and shareholders' equity** | | | | | | |
| Interest-bearing liabilities: | | | | | | |
| Money market and NOW accounts | $ 417,557 | $ 1,913 | 0.61 % | $ 337,004 | $ 1,977 | 0.78 % |
| Savings accounts | 275,679 | 1,612 | 0.78 % | 190,589 | 1,380 | 0.97 % |
| Certificates of deposit | 354,551 | 4,608 | 1.74 % | 268,851 | 4,535 | 2.26 % |
| Federal Reserve Bank PPPLF borrowings | 13,169 | 36 | 0.37 % | — | — | — % |
| Short-term borrowings | 39,344 | 169 | 0.58 % | 36,992 | 698 | 2.52 % |
| Redeemable subordinated debentures | 18,557 | 348 | 2.46 % | 18,557 | 575 | 4.13 % |
| Total interest-bearing liabilities | 1,118,857 | $ 8,686 | 1.04 % | 851,993 | $ 9,165 | 1.44 % |
| Non-interest-bearing liabilities: | | | | | | |
| Demand deposits | 351,291 | | | 214,618 | | |
| Other liabilities | 29,911 | | | 22,720 | | |
| Total non-interest-bearing liabilities | 381,202 | | | 237,338 | | |
| Shareholders' equity | 175,141 | | | 132,079 | | |
| **Total liabilities and shareholders' equity** | $ 1,675,200 | | | $ 1,221,410 | | |
| Net interest spread (3) | | | 3.37 % | | | 3.69 % |
| Net interest income and margin (4) | | $ 42,519 | 3.66 % | | $ 34,511 | 4.06 % |

(1) Tax equivalent basis, using federal tax rate of 21% in 2020 and 2019.

(2) Loan origination fees are considered an adjustment to interest income. For the purpose of calculating loan yields, average loan balances include non-accrual loans with no related interest income and the average balance of loans held for sale.

(3) The net interest spread is the difference between the average yield on interest-earning assets and the average rate paid on interest-bearing liabilities.

(4) The net interest margin is equal to net interest income divided by average interest-earning assets.

***Three months ended September 30, 2020 compared to three months ended September 30, 2019***

Net interest income was $15.4 million for the third quarter of 2020 and increased $3.8 million compared to net interest income of $11.5 million for the third quarter of 2019. Total interest income was $17.7 million for the three months ended September 30, 2020 compared to $14.9 million for the three months ended September 30, 2019. The increase in total interest income was primarily due to a net increase of $476.2 million in average loans, reflecting growth in all segments of the loan portfolio except construction loans and included $75.5 million in average SBA PPP loans. The growth in average loans included approximately $193.4 million of loans from the Shore Merger.

Average interest-earning assets were $1.7 billion with a tax-equivalent yield of 4.23% for the third quarter of 2020 compared to average interest-earning assets of $1.2 billion, with a tax-equivalent yield of 5.05%, for the third quarter of 2019. The yield on average interest-earning assets for the third quarter of 2020 declined 82 basis points to 4.23%, primarily due to the steep decline in market interest rates beginning in the third quarter of 2019 and continuing for the first nine months of 2020.

The Federal Reserve reduced the targeted federal funds rate 50 basis points in the third quarter of 2019, 25 basis points in the fourth quarter of 2019 and, in response to the COVID-19 pandemic, further reduced the targeted federal funds rate by 150 basis points in March 2020. The prime rate was 5.00% at September 30, 2019. As a result of the reductions in the targeted federal funds rate in 2019, the prime rate declined to 4.75% in October 2019 and declined further to 3.25% in March 2020. The Bank had approximately $571.8 million of loans with an interest rate tied to the prime rate and approximately $49.2 million of loans with an interest rate tied to either 1 or 3-month LIBOR at September 30, 2020.

Interest expense on average interest-bearing liabilities was $2.4 million, with an interest cost of 0.79%, for the third quarter of 2020, compared to $2.9 million, with an interest cost of 1.04%, for the second quarter of 2020 and $3.4 million, with an interest cost of 1.51%, for the third quarter of 2019. Despite an increase of $300.5 million in average interest-bearing liabilities for the third quarter of 2020 compared to the third quarter of 2019, interest expense declined $1.0 million largely due to the decline in interest rates paid on deposits, borrowings and the redeemable subordinated debentures resulting from the falling interest rate environment. The average cost of interest-bearing deposits was 0.81% for the third quarter of 2020, 1.04% for the second quarter of 2020 and 1.41% for the third quarter of 2019. The lower interest cost of interest-bearing deposits for the third quarter of 2020 compared to the third quarter of 2019 primarily reflects a steep decline in deposit market interest rates beginning in the fourth quarter of 2019 and continuing for the first nine months of 2020. The interest rates paid on deposits generally do not adjust quickly to rapid changes in market interest rates and tend to decline over time in a falling interest rate environment.

The growth in average interest-bearing liabilities included average interest-bearing deposits of $174.0 million acquired in the Shore Merger. Of the total increase in average interest-bearing liabilities, certificates of deposit which generally have a higher interest cost than other types of interest-bearing deposits, increased by $59.0 million at September 30, 2020 as compared to September 30, 2019. At September 30, 2020, there were $260.0 million of certificates of deposit with an average interest cost of 1.33% that mature within the following nine months. Management will continue to adjust the interest rates paid on deposits to reflect the then current interest rate environment and competitive factors.

The net interest margin on a tax-equivalent basis decreased 24 basis points to 3.67% for the third quarter of 2020 compared to 3.91% for the third quarter of 2019 due primarily to the 82 basis point decline in the yield of average interest-earning assets, partially offset by the 72 basis points decline in the interest cost of average interest-bearing liabilities. Due to the decline in the prime rate in the third and fourth quarters of 2019 followed by the further decline in the prime rate in March 2020, the yield of loans declined 95 basis points to 4.57% and the interest cost of interest-bearing liabilities was not reduced to the same extent as the decline in the yield of loans.

***Nine months ended September 30, 2020 compared to the nine months ended September 30, 2019***

For the nine months ended September 30, 2020, net interest income increased $8.0 million, or 23.3%, to $42.1 million compared to $34.2 million for the comparable period in 2019. Total interest income was $50.8 million for the nine months ended September 30, 2020 compared to $43.3 million for the nine months ended September 30, 2019. This increase was due primarily to the $381.3 million increase in average loans, reflecting growth in all segments of the loan portfolio except construction loans and includes $43.4 million in average SBA PPP loans. The increase in average loans included approximately $200.7 million of average loans acquired from the Shore Merger.

Average interest-earning assets increased $412.2 million to $1.55 billion for the nine months ended September 30, 2020 compared to $1.14 billion for the same period in 2019. This increase was due primarily to the $381.3 million increase in average loans, a $21.6 million increase in average total investment securities and a $9.3 million increase in average federal funds sold/short-term investments.

The tax-equivalent yield on average interest earnings assets was 4.41% for the nine months ended September 30, 2020 compared to 5.13% for the same period in the prior year. The decline of 72 basis points in tax-equivalent yield year over year was due primarily to the steady decline in market interest rates beginning in the third quarter of 2019 and continuing into the first nine months of 2020. The Federal Reserve reduced the targeted federal funds rate 50 basis points in the third quarter of 2019, 25 basis points in the fourth quarter of 2019 and, in response to the COVID-19 pandemic, further reduced the targeted federal funds rate by 150 basis points in March 2020. The prime rate was 5.00% at September 30, 2019. As a result of the reductions in the targeted federal funds rate in 2019, the prime rate declined to 4.75% in October 2019 and declined further to 3.25% in March 2020.

Interest expense on average interest-bearing liabilities was $8.7 million, with an interest cost of 1.04%, for the nine months ended September 30, 2020 compared to $9.2 million, with an interest cost of 1.44%, for the same period in the prior year. The average interest cost declined 40 basis points largely due to lower market interest rates. The increase in average interest-bearing liabilities included average interest-bearing deposits of $174.0 million acquired in the Shore Merger. Of the total increase in average interest-bearing liabilities of $266.9 million, certificates of deposit, which generally have a higher interest cost than non-maturity deposits, increased $85.7 million. Management will continue to monitor the interest rates paid on deposits and adjust them based on then current market conditions.

The net interest margin on a tax-equivalent basis was 3.66% for the nine months ended September 30, 2020 compared to 4.06% for the nine months ended September 30, 2019. The 40 basis points decline in the net interest margin year over year was a result of a decline of 72 basis points in the yield of average interest-bearing assets, which was partially offset by a decline of 40 basis points in interest cost of the average interest-bearing liabilities.

**Provision for Loan Losses**

Management considers a complete review of the following specific factors in determining the provisions for loan losses: historical losses by loan category, the level of non-accrual loans and problem loans as identified through internal review and classification, collateral values and the growth, size and risk elements of the loan portfolio. In addition to these factors, management takes into consideration current economic conditions and local real estate market conditions. As a result of the economic and social disruption caused by the COVID-19 pandemic, in the third quarter of 2020, management reviewed construction, commercial business and commercial real estate loans that had been modified to defer interest and or principal for up to 90 days with special emphasis on hotel and restaurant-food service industries as most likely to be adversely impacted by the economic disruption caused by the pandemic. Prior to March 2020, when the impacts of the COVID-19 pandemic began to be realized, the general economic environment in New Jersey and the New York City metropolitan area had been positive with stable and expanding economic activity, and the Company had generally experienced stable loan credit quality over the past five years.

***Three months ended September 30, 2020 compared to three months ended September 30, 2019***

The Company recorded a provision for loan losses of $2.3 million for the third quarter of 2020 compared to a provision for loan losses of $350,000 for the third quarter of 2019. The significant increase in the provision for loan losses in the third quarter of 2020 included an additional provision of approximately $1.5 million to increase specific reserves on impaired loans. The higher provision also reflects changes in loan ratings and the growth and change in mix of the loan portfolio. At September 30, 2020, total loans were $1.5 billion and the allowance for loan losses was $14.5 million, or 0.99% of total loans, compared to total loans of $1.0 billion and an allowance for loan losses of $9.0 million, or 0.88% of total loans, at September 30, 2019. Included in total loans at September 30, 2020 were $186.6 million of loans that were acquired in the Shore Merger. Acquisition accounting for the Shore Merger in 2019 and the merger with New Jersey Community Bank ("NJCB") in 2018 resulted in the Shore and NJCB loans being recorded at their fair value and no allowance for loan losses as of the effective time of the respective mergers. The unaccreted general credit fair value discounts related to the former Shore and NJCB loans were approximately $1.8 million and $0.5 million at September 30, 2020, respectively. In addition, at September 30, 2020, there were $75.6 million of SBA PPP loans which are 100% guaranteed by the SBA and, accordingly, no reserve was provided.

***Nine months ended September 30, 2020 compared to nine months ended September 30, 2019***

For the nine months ended September 30, 2020, the Company recorded a provision for loan losses of $5.3 million, representing an increase of $4.3 million from a provision for loan losses of $1.0 million for the nine months ended September 30, 2019. The significant increase in the provision for loan losses for the first nine months of 2020 was to reserve for the estimated increase in incurred loan losses due primarily to the economic disruption caused by the COVID-19 pandemic. The principal components of the increase were: a provision of approximately $1.5 million to increase specific reserves, a provision of $388,000, which reflected an increase in the qualitative factors for national and local economic conditions due to the weakening economic operating environment; a provision of $1.1 million for an increase in the qualitative factors attributed to the modification of loans and deferral of principal and or interest on $149.3 million of loans; and an $850,000 provision related to the down-grade of the credit ratings on certain loans.

The higher provision also reflects, to a lesser extent, the growth and change in mix of the loan portfolio. Net charge-offs were $161,000 for the nine months ended September 30, 2020 compared to $475,000 for the nine months ended September 30, 2019.

**Non-Interest Income**

***Three months ended September 30, 2020 compared to three months ended September 30, 2019***

Non-interest income was $4.7 million for the third quarter of 2020, representing an increase of $2.5 million, or 114.7%, compared to $2.2 million for the third quarter of 2019. The significant increase in non-interest income was driven primarily by a $2.0 million increase in gain on sale of loans.

For the third quarter of 2020, residential mortgage banking operations originated approximately $118.0 million of residential mortgages, sold $97.5 million of residential mortgages and recorded $2.9 million of gain on sale of loans compared to $53.3 million of residential mortgages originated, $38.8 million of residential mortgage loans sold and $1.1 million of gain on sale of loans recorded in the third quarter of 2019. The residential mortgage loan pipeline was $71.7 million at September 30, 2020 and was comprised 64% and 36% of refinance and purchase loan applications and commitments for mortgages, respectively. Management believes that the increase in residential mortgage loans originated and sold was due primarily to increased residential mortgage lending activity as a result of significantly lower mortgage interest rates in the 2020 period compared to the 2019 period. In the third quarter of 2020, $5.1 million of SBA loans were sold and gain of $463,000 was recorded compared to $2.4 million of SBA loans sold and gain of $205,000 recorded in the third quarter of 2019.

For the third quarter of 2020 compared to the third quarter of 2019, service charges on deposit accounts decreased $39,000, due primarily to lower overdraft fees and income on bank-owned life insurance ("BOLI") increased $39,000 due primarily to the increase in BOLI acquired in the Shore Merger. Gain on sales and calls of securities increased $63,000 for the third quarter of 2020 as a result of sales and calls of approximately $14.4 million of investment securities. Other income increased $422,000 in the third quarter of 2020 compared to the third quarter of 2019 primarily due to an interest rate swap fee collected of $172,000, an expired loan commitment fee of $59,000, gain from the sale of OREO of $71,000 and general increases in other income components.

In future periods, sales of residential mortgages may decline due to a lower level of refinancing activity and or a lower level of residential home purchases due to the economic and social disruption caused by the COVID-19 pandemic. A decline in sales of residential mortgages would result in lower gain on sales of loans and a decline of non-interest income. The future origination and sale of SBA loans may be negatively affected by the pandemic.

***Nine months ended September 30, 2020 compared to nine months ended September 30, 2019***

Total non-interest income for the nine months ended September 30, 2020 increased $4.1 million, or 64.9%, to $10.3 million compared to total non-interest income of $6.2 million for the nine months ended September 30, 2019 due primarily to increases in gain on the sales of loans.

For the nine months ended September 30, 2020, $233.8 million of residential mortgages were originated and $208.1 million of residential mortgages were sold, which generated gain on sales of loans of $6.3 million, as compared to $107.4 million of residential mortgages originated and $86.7 million of residential mortgage sold, which generated gain on sales of loans of $2.7 million, for the nine months ended September 30, 2019. The increase in residential mortgage loans sold was due primarily to increased residential mortgage lending activity attributable to a lower interest rate environment for the first nine months of 2020 compared to the same period in 2019.

For the nine months ended September 30, 2020, SBA loan sales, excluding SBA PPP loans, were $7.8 million and gain on sales of loans of $688,000 was recorded compared to $10.4 million of SBA loans sold and gain on sales of loans of $817,000 recorded for the nine months ended September 30, 2019.

Service charges on deposit accounts decreased to $471,000 for the nine months ended September 30, 2020 from $490,000 for the nine months ended September 30, 2019.

For the nine months ended September 30, 2020, income on BOLI increased $195,000 to $632,000, due primarily to the increase in BOLI acquired in the Shore Merger compared to $437,000 for the nine months ended September 30, 2019. Other income increased $362,000 to $2.1 million compared to $1.7 million for the nine months ended September 30, 2019 in part due to an interest rate swap fee collected of $172,000, an expired loan commitment fee of $59,000 and general increases in other income components.

**Non-Interest Expenses**

For the three months ended September 30, 2020, non-interest expenses were $11.0 million compared to $8.4 million for the three months ended September 30, 2019, representing an increase of $2.5 million, or 30.0%. The primary reasons for the increase were higher commissions related to the origination of residential mortgages for sale of $1.2 million and $941,000 of expenses due to the inclusion of the former Shore operations in the third quarter of 2020.

The following table presents the major components of non-interest expenses for the three and nine months ended September 30, 2020 and 2019:

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| (Dollars in thousands) | 2020 | 2019 | 2020 | 2019 |
| Salaries and employee benefits | $ 7,106 | $ 5,231 | $ 19,276 | $ 15,472 |
| Occupancy expense | 1,222 | 972 | 3,597 | 2,984 |
| Data processing expenses | 486 | 379 | 1,402 | 1,072 |
| Equipment expense | 388 | 323 | 1,211 | 942 |
| Marketing | 21 | 62 | 99 | 253 |
| Telephone | 124 | 97 | 378 | 290 |
| Regulatory, professional and consulting fees | 575 | 426 | 1,536 | 1,259 |
| Insurance | 118 | 96 | 364 | 283 |
| Supplies | 67 | 65 | 275 | 188 |
| FDIC insurance expense | 225 | (47) | 484 | 113 |
| Other real estate owned expenses | 27 | 52 | 58 | 134 |
| Merger-related expenses | — | 302 | 64 | 575 |
| Amortization of intangible assets | 91 | 30 | 304 | 93 |
| Other expenses | 512 | 447 | 1,544 | 1,438 |
| Total | $ 10,962 | $ 8,435 | $ 30,592 | $ 25,096 |

***Three months ended September 30, 2020 compared to three months ended September 30, 2019***

Salaries and employee benefits expense, which represents the largest portion of non-interest expenses, increased $1.9 million, or 35.8%, to $7.1 million for the third quarter of 2020 compared to $5.2 million for the third quarter of 2019, due primarily to a $1.2 million increase in mortgage commissions resulting from significantly higher residential mortgage lending activity, salaries and benefits for former Shore employees ($478,000) who joined the Company, merit increases and increases in employee benefit expenses, which amounts were partially offset by higher deferred loan origination expenses of approximately $142,000 related to the origination of loans.

Occupancy expense increased $250,000, or 25.7%, to $1.2 million for the three months ended September 30, 2020, due primarily to the addition of the five former Shore branch offices compared to $1.0 million for the three months ended September 30, 2019.

Data processing expenses increased $107,000, or 28.2%, to $486,000 for the third quarter of 2020 compared to $379,000 for the third quarter of 2019, due primarily to the addition of the Shore operations and increases in loans, deposits and other customer services.

Regulatory, professional and consulting fees increased $149,000, or 35.0%, to $575,000 in the third quarter of 2020 compared to $426,000 for the third quarter of 2019 due primarily to an increase in legal services.

FDIC insurance expense increased $272,000 for the third quarter of 2020, due primarily to the acquisition of Shore, the growth of assets, a credit of $87,000 from the FDIC applied to the second quarter of 2019 assessment and an increase in the FDIC assessment rate in 2020.

For the third quarter of 2020, there were no merger-related expenses compared to $302,000 for the third quarter of 2019 related to legal and financial advisory fees incurred for the Shore Merger.

Amortization of intangible assets increased $61,000, or 203.3%, to $91,000 for the three months ended September 30, 2020 compared to $30,000 for the three months ended September 30, 2019 due primarily to the $67,000 of amortization expense for the core deposit intangible related to the Shore Merger.

Other expenses increased $65,000, or 14.5%, due to general increases in other operating expenses.

Non-interest expenses may increase, if there is a significant increase in non-performing loans, as a result of higher expenses incurred in connection with loan collection and recovery costs. In addition, FDIC insurance expense may increase if the Bank's financial condition is adversely impacted by a higher level of non-performing loans and assets.

***Nine months ended September 30, 2020 compared to nine months ended September 30, 2019***

Non-interest expenses were $30.6 million for the nine months ended September 30, 2020 compared to $25.1 million for the nine months ended September 30, 2019, representing an increase of $5.5 million, or 21.9%, due primarily to $2.0 million in higher commissions related to the origination of residential mortgages for sale and $2.9 million of expenses related to the inclusion of the former Shore operations and general increases year-over-year due to the growth of the Company.

Salaries and employee benefits, which represent the largest portion of non-interest expenses, increased $3.8 million, or 24.6%, to $19.3 million for the nine months ended September 30, 2020 compared to $15.5 million for the nine months ended September 30, 2019, due primarily to salaries and benefits for former Shore employees ($1.4 million) who joined the Company, higher commissions of $2.0 million related to the higher origination volume of residential mortgage loans primarily for sale, merit increases and increases in employee benefit expenses.

Occupancy expense increased $613,000 or 20.5% to $3.6 million for the nine months ended September 30, 2020 compared $3.0 million for the nine months ended September 30, 2019, due primarily to the addition of the five former Shore branch offices.

Data processing expenses increased $330,000, or 30.8%, to $1.4 million for the nine months ended September 30, 2020 compared to $1.1 million for the nine months ended September 30, 2019, due primarily to the addition of the Shore operations ($272,000) and increases in loans, deposits and other customer services.

Equipment expense increased $269,000, or 28.6%, to $1.2 million for the nine months ended September 30, 2020 compared to $942,000 for the nine months ended September 30, 2019, due primarily to additional equipment and maintenance agreements related to the inclusion of the Shore operations.

Regulatory, professional and consulting fees increased $277,000, or 22.0%, to $1.5 million for the nine months ended September 30, 2020 compared to $1.3 million for the nine months ended September 30, 2019, due primarily to an increase in legal services.

Supplies increased $87,000, or 46.3%, to $275,000 for the nine months ended September 30, 2020 compared to $188,000 for the nine months ended September 30, 2019, due primarily to growth of the Company, the inclusion of the former Shore operations and the purchase of COVID-19-related protective supplies.

FDIC insurance expense increased $371,000 to $484,000 for the nine months ended September 30, 2020 compared to $113,000 for the nine months ended September 30, 2019, due primarily to the acquisition of Shore, the growth in assets, the $87,000 credit from the FDIC for the third quarter of 2019 and an increase in the FDIC assessment rate.

Merger-related expenses declined to $64,000 for the nine months ended September 30, 2020 compared to $575,000 for the nine months ended September 30, 2019, due to the legal and financial advisory fees incurred in connection with the Shore Merger in 2019.

Amortization of intangible assets increased $211,000 to $304,000 for the nine months ended September 30, 2020 compared to $93,000 for the nine months ended September 30, 2019, due primarily to the amortization of the core deposit intangible related to the Shore Merger.

## Income Taxes

***Three months ended September 30, 2020 compared to three months ended September 30, 2019***

Income tax expense was $1.9 million for the third quarter of 2020, resulting in an effective tax rate of 27.9%, compared to income tax expense of $1.3 million, which resulted in an effective tax rate of 26.6% for the third quarter of 2019. The increase in the effective tax rate for the third quarter of 2020 was due primarily to the lower percentage of the total of income on BOLI and tax-exempt interest to pre-tax income in the third quarter of 2020 compared to the third quarter of 2019.

***Nine months ended September 30, 2020 compared to nine months ended September 30, 2019***

Income tax expense was $4.5 million for the nine months ended September 30, 2020, which resulted in an effective tax rate of 27.1%, compared to income tax expense of $3.9 million, which resulted in an effective tax rate of 27.2% for the nine months ended September 30, 2019. The reduction in the effective tax rate for 2020 was due primarily to the effect of non-deductible merger expenses in the 2019 period.

## FINANCIAL CONDITION

***September 30, 2020 compared to December 31, 2019***

Total consolidated assets were $1.84 billion at September 30, 2020, representing an increase of $257.8 million from total consolidated assets of $1.59 billion at December 31, 2019. This increase was due primarily to a $239.7 million increase in total loans, a $22.3 million increase in loans held for sale and a $5.2 million increase in total cash and cash equivalents partially offset by a $9.5 million decrease in total investment securities. The increase in assets was funded primarily by a $233.7 million increase in deposits and a $13.8 million increase in short-term borrowings.

## Cash and Cash Equivalents

Cash and cash equivalents totaled $20.1 million at September 30, 2020 compared to $14.8 million at December 31, 2019, representing an increase of $5.2 million. The increase in cash and cash equivalents reflects an increase in cash and due from banks, partially offset by a decrease in interest-earning deposits, due to the timing of cash flows.

## Loans Held for Sale

Loans held for sale were $28.2 million at September 30, 2020 compared to $5.9 million at December 31, 2019, representing an increase of $22.3 million. The amount of loans held for sale varies from period to period due to changes in the amount and timing of sales of residential mortgage loans and SBA guaranteed commercial loans.

## Investment Securities

Investment securities represented approximately 12.1% of total assets at September 30, 2020 and approximately 14.7% of total assets at December 31, 2019. Total investment securities decreased $9.5 million to $222.9 million at September 30, 2020 from $232.4 million at December 31, 2019. Purchases of investment securities totaled $56.1 million during the nine months ended September 30, 2020 and proceeds from sales, calls, maturities and payments totaled $66.7 million during this same period.

Securities available for sale are investments that may be sold in response to changing market and interest rate conditions or for other business purposes. Activity in this portfolio is undertaken primarily to manage liquidity and interest rate risk and to take advantage of market conditions that create economically attractive returns. At September 30, 2020, securities available for sale were $135.1 million, representing a decrease of $20.7 million from securities available for sale of $155.8 million at December 31, 2019.

At September 30, 2020, the securities available for sale portfolio had net unrealized gains of $2.4 million compared to net unrealized gains of $414,000 at December 31, 2019. These net unrealized gains were reflected, net of tax, in shareholders’ equity as a component of accumulated other comprehensive income (loss).

Securities held to maturity, which are carried at amortized historical cost, are investments for which there is the positive intent and ability to hold to maturity. At September 30, 2020, securities held to maturity were $87.8 million, representing an increase of $11.2 million from $76.6 million at December 31, 2019. The fair value of the held to maturity portfolio was $90.7 million at September 30, 2020.

## Loans

The loan portfolio, which represents the Company's largest asset, is a significant source of both interest and fee income. Elements of the loan portfolio are subject to differing levels of credit and interest rate risk. The Company's primary lending focus continues to be the financing of mortgage warehouse lines, construction loans, commercial business loans, owner-occupied commercial mortgage loans and commercial real estate loans on income-producing assets.

The following table represents the components of the loan portfolio at September 30, 2020 and December 31, 2019:

| | September 30, 2020 | | December 31, 2019 | |
|---|---|---|---|---|
| (Dollars in thousands) | Amount | % | Amount | % |
| Commercial real estate | $ 615,957 | 42 % | $ 567,655 | 47 % |
| Mortgage warehouse lines | 374,007 | 26 | 236,672 | 20 |
| Construction loans | 141,583 | 10 | 148,939 | 12 |
| Commercial business | 210,004 | 14 | 139,271 | 11 |
| Residential real estate | 88,206 | 6 | 90,259 | 7 |
| Loans to individuals | 27,432 | 2 | 32,604 | 3 |
| Other loans | 122 | — | 137 | — |
| Total loans | 1,457,311 | 100 % | 1,215,537 | 100 % |
| Deferred loan (fees) costs, net | (1,627) | | 491 | |
| Total loans, including deferred loans (fees) costs, net | $ 1,455,684 | | $ 1,216,028 | |

Total loans increased $239.7 million, or 19.7%, to $1.5 billion at September 30, 2020 compared to $1.2 billion at December 31, 2019. Commercial business loans increased $70.7 million, which included $75.6 million in SBA PPP loans, mortgage warehouse loans increased $137.3 million and commercial real estate loans increased $48.3 million. Partially offsetting these increases, construction loans decreased $7.4 million, loans to individuals decreased $5.2 million and residential real estate loans decreased $2.1 million.

Commercial real estate loans totaled $616.0 million at September 30, 2020, representing an increase of $48.3 million compared to $567.7 million at December 31, 2019. Commercial real estate loans consist primarily of loans to businesses that are collateralized by real estate assets employed in the operation of the business and loans to real estate investors to finance the acquisition and/or improvement of income-producing commercial properties.

The Bank's mortgage warehouse funding group provides revolving lines of credit that are available to licensed mortgage banking companies. The warehouse line of credit is used by the mortgage banker to finance the origination of one-to-four family residential mortgage loans that are pre-sold to the secondary mortgage market, which includes state and national banks, national mortgage banking firms, insurance companies and government-sponsored enterprises, including the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and the Government National Mortgage Association. On average, an advance under the warehouse line of credit remains outstanding for a period of less than 30 days, with repayment coming directly from the sale of the loan into the secondary mortgage market. The Bank collects interest and a transaction fee at the time of repayment. Mortgage warehouse loans totaled $374.0 million at September 30, 2020 compared to $236.7 million at December 31, 2019. In the first nine months of 2020, $3.6 billion of residential mortgage loans were financed through the mortgage warehouse funding group compared to $2.5 billion during the first nine months of 2019. The higher level of funding activity was due primarily to the lower interest rate environment in 2020 than in 2019, which resulted in an increase in refinance activity in 2020 compared to 2019.

Construction loans totaled $141.6 million at September 30, 2020 compared to $148.9 million at December 31, 2019. Construction financing is provided to businesses to expand their facilities and operations and to real estate developers for the acquisition, development and construction of residential properties and income-producing properties. First mortgage construction loans are made to developers and builders for single family homes or multi-family buildings that are pre-sold or are to be sold or leased on a speculative basis. The Bank lends to developers and builders with established relationships, successful operating histories and sound financial resources. In many cases the Bank also provides the mortgage loan to the customer upon completion of the project.

Commercial business loans totaled $210.0 million at September 30, 2020 compared to $139.3 million at December 31, 2019. As a SBA preferred lender, the Bank is participating in the SBA PPP loan program, which was established under the CARES Act and has funded $75.6 million in SBA PPP loans for the nine months ended September 30, 2020. Commercial business loans consist primarily of loans to small and middle market businesses and are typically working capital loans used to finance inventory, receivables or equipment needs. These loans are generally secured by business assets of the commercial borrower.

Residential real estate loans totaled $88.2 million at September 30, 2020 compared to $90.3 million at December 31, 2019. Loans to individuals, which are comprised primarily of home equity loans, totaled $27.4 million at September 30, 2020 compared to $32.6 million at December 31, 2019.

The ability of the Company to enter into larger loan relationships and management's philosophy of relationship banking are key factors in the Company's strategy for loan growth. The ultimate collectability of the loan portfolio and recovery of the carrying amount of real estate are subject to changes in the economic environment and real estate market in the Company's primary market area of northern and central New Jersey, communities along the New Jersey shore, primarily New Jersey and the New York City metropolitan area.

If the economic disruption caused by the COVID-19 pandemic continues for an extended period of time, the Company may experience a decline in the origination of new loans and total loans could decline.

**Non-Performing Assets**

Non-performing assets consist of non-performing loans and other real estate owned. Non-performing loans are composed of (1) loans on non-accrual basis and (2) loans which are contractually past due 90 days or more as to interest and principal payments but which have not been classified as non-accrual. Included in non-accrual loans are loans, the terms of which have been restructured to provide a reduction or deferral of interest and/or principal because of deterioration in the financial position of the borrower and have not performed in accordance with the restructured terms. Loan payments that are deferred due to COVID-19 continue to accrue interest and are not presented as past due in the table below.

The Bank's policy with regard to non-accrual loans is that, generally, loans are placed on non-accrual status when they are 90 days past due, unless these loans are well secured and in process of collection or, regardless of the past due status of the loan, when management determines that the complete recovery of principal or interest is in doubt. Consumer loans are generally charged off after they become 120 days past due. Subsequent payments on loans in non-accrual status are credited to income only if collection of principal is not in doubt.

At September 30, 2020, non-performing loans increased by $12.7 million to $17.2 million from $4.5 million at December 31, 2019, and the ratio of non-performing loans to total loans increased to 1.18% at September 30, 2020 compared to 0.37% at December 31, 2019. During the nine months ended September 30, 2020, $2.2 million of non-performing loans were resolved, net charge-offs were $161,000 and $14.9 million of loans were placed on non-accrual status. For the nine months ended September 30, 2020, a $7.5 million participation in a construction loan, $6.9 million in commercial real estate loans, a $84,000 commercial business loan, $248,000 of loans to individuals and a $160,000 residential loan were placed on non-accrual status.

The major segments of non-accrual loans consist of commercial business, commercial real estate and residential real estate loans, which are in the process of collection. The table below sets forth non-performing assets and risk elements in the Bank's portfolio at the dates indicated.

| (Dollars in thousands) | September 30, 2020 | December 31, 2019 |
|---|---|---|
| Non-performing loans: | | |
| Loans 90 days or more past due and still accruing | $ 92 | $ — |
| Non-accrual loans | 17,153 | 4,497 |
| Total non-performing loans | 17,245 | 4,497 |
| Other real estate owned | 267 | 571 |
| Other repossessed assets | — | — |
| Total non-performing assets | 17,512 | 5,068 |
| Performing troubled debt restructurings | 6,092 | 6,132 |
| Performing troubled debt restructurings and total non-performing assets | $ 23,604 | $ 11,200 |

| | | |
|---|---|---|
| Non-performing loans to total loans | 1.18 % | 0.37 % |
| Non-performing loans to total loans excluding mortgage warehouse lines | 1.59 % | 0.46 % |
| Non-performing assets to total assets | 0.95 % | 0.32 % |
| Non-performing assets to total assets excluding mortgage warehouse lines | 1.19 % | 0.38 % |
| Total non-performing assets and performing troubled debt restructurings to total assets | 1.28 % | 0.71 % |

Non-performing assets increased by $12.4 million to $17.5 million at September 30, 2020 from $5.1 million at December 31, 2019. OREO totaled $267,000 at September 30, 2020 compared to $571,000 at December 31, 2019. Three residential lots acquired in the Shore Merger with a carrying value of $304,000 were sold in the nine months ended September 30, 2020. OREO at September 30, 2020 was comprised of three residential lots acquired in the Shore Merger with a carrying value of $174,000 and land with a carrying value of $93,000 that was foreclosed in the second quarter of 2018.

At September 30, 2020, the Bank had 12 loans totaling $6.2 million that were troubled debt restructurings. Two of these loans totaling $146,000 are included in the above table as non-accrual loans and the remaining ten loans totaling $6.1 million were performing. At December 31, 2019, the Bank had 13 loans totaling $6.4 million that were troubled debt restructurings. Three of these loans totaling $345,000 are included in the above table as non-accrual loans and the remaining nine loans totaling $6.1 million were performing.

In accordance with U.S. GAAP, the excess of cash flows expected at acquisition over the initial investment in the purchase of a credit impaired loan is recognized as interest income over the life of the loan. At September 30, 2020, there were 12 loans acquired with evidence of deteriorated credit quality totaling $5.2 million that were not classified as non-performing loans. At December 31, 2019, there were 13 loans acquired with evidence of deteriorated credit quality totaling $5.4 million that were not classified as non-performing loans.

Management takes a proactive approach in addressing delinquent loans. The Company's President and Chief Executive Officer meets weekly with all loan officers to review the status of credits past due 10 days or more. An action plan is discussed for delinquent loans to determine the steps necessary to induce the borrower to cure the delinquency and restore the loan to a current status. In addition, delinquency notices are system-generated when loans are five days past due and again at 15 days past due.

In most cases, the Company's collateral is real estate. If the collateral is foreclosed upon, the real estate is carried at fair market value less the estimated selling costs. The amount, if any, by which the recorded amount of the loan exceeds the fair market value of the collateral, less estimated selling costs, is a loss that is charged to the allowance for loan losses at the time of foreclosure or repossession. Resolution of a past-due loan through foreclosure can be delayed if the borrower files a bankruptcy petition because a collection action cannot be continued unless the Company first obtains relief from the automatic stay provided by the United States Bankruptcy Reform Act of 1978, as amended.

**Allowance for Loan Losses and Related Provision**

The allowance for loan losses is maintained at a level sufficient to absorb estimated credit losses in the loan portfolio as of the date of the financial statements. The allowance for loan losses is a valuation reserve available for losses incurred or inherent in the loan portfolio and other extensions of credit. The determination of the adequacy of the allowance for loan losses is a critical accounting policy of the Company.

The Company's primary lending emphasis is the origination of commercial business, construction and commercial real estate loans and mortgage warehouse lines of credit. Based on the composition of the loan portfolio, the inherent primary risks are deteriorating credit quality, a decline in the economy and a decline in New Jersey and New York City metropolitan area real estate market values. Any one, or a combination, of these events may adversely affect the loan portfolio and may result in increased delinquencies, loan losses and increased future provision levels.

Due to the economic disruption and uncertainty caused by the pandemic, the allowance for loan losses may increase in future periods as borrowers are affected by the severe contraction of economic activity and the dramatic increase in unemployment. This may result in increases in loan delinquencies, downgrades of loan credit ratings and charge-offs in future periods. The allowance for loan losses may increase significantly to reflect the decline in the performance of the loan portfolio and the higher level of incurred losses.

All, or part, of the principal balance of commercial business and commercial real estate loans and construction loans are charged off against the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely. Consumer loans are generally charged off no later than 120 days past due on a contractual basis, earlier in the event of bankruptcy, or if there is an amount deemed uncollectible. Because all identified losses are charged off, no portion of the allowance for loan losses is restricted to any individual loan or groups of loans and the entire allowance is available to absorb any and all loan losses.

Management reviews the adequacy of the allowance on at least a quarterly basis to ensure that the provision for loan losses has been charged against earnings in an amount necessary to maintain the allowance at a level that is adequate based on management's assessment of probable estimated losses. The Company's methodology for assessing the adequacy of the allowance for loan losses consists of several key elements and is consistent with U.S. GAAP and interagency supervisory guidance. The allowance for loan losses methodology consists of two major components. The first component is an estimation of losses associated with individually identified impaired loans, which follows ASC Topic 310. The second major component is an estimation of losses under ASC Topic 450, which provides guidance for estimating losses on groups of loans with similar risk characteristics. The Company's methodology results in an allowance for loan losses that includes a specific reserve for impaired loans, an allocated reserve and an unallocated portion.

When analyzing groups of loans, the Company follows the Interagency Policy Statement on the Allowance for Loan and Lease Losses. The methodology considers the Company's historical loss experience adjusted for changes in trends, conditions and other relevant factors that affect repayment of the loans as of the evaluation date. These adjustment factors, known as qualitative factors, include:

- Delinquencies and non-accruals;
- Portfolio quality;
- Concentration of credit;
- Trends in volume of loans;
- Quality of collateral;
- Policy and procedures;
- Experience, ability and depth of management;
- Economic trends - national and local; and
- External factors - competition, legal and regulatory.

The methodology includes the segregation of the loan portfolio into loan types with a further segregation into risk rating categories, such as special mention, substandard, doubtful and loss. This allows for an allocation of the allowance for loan losses by loan type; however, the allowance is available to absorb any loan loss without restriction. Larger-balance, non-homogeneous loans representing significant individual credit exposures are evaluated individually through the internal loan review process. This process produces the watch list. The borrower's overall financial condition, repayment sources, guarantors and value of collateral, if appropriate, are evaluated. Based on this evaluation, an estimate of probable losses for the individual larger-balance loans is determined, whenever possible, and used to establish specific loan loss reserves. In general, for non-homogeneous loans not individually assessed and for homogeneous groups of loans, such as residential mortgages and consumer credits, the loans are collectively evaluated based on delinquency status, loan type and historical losses. These loan groups are then internally risk rated.

The watch list includes loans that are assigned a rating of special mention, substandard, doubtful and loss. Loans classified as special mention have potential weaknesses that deserve management's close attention. If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They include loans that are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified as doubtful have all the weaknesses inherent in loans classified as substandard with the added characteristic that collection or liquidation in full, on the basis of current conditions and facts, is highly improbable. Loans rated as doubtful are placed in non-accrual status. Loans classified as a loss are considered uncollectible and are charged-off against the allowance for loan losses.

The specific allowance for impaired loans is established for specific loans that have been identified by management as being impaired. These loans are considered to be impaired primarily because the loans have not performed according to payment terms and there is reason to believe that repayment of the loan principal in whole, or in part, is unlikely. The specific portion of the allowance is the total amount of potential unconfirmed losses for these individual impaired loans. To assist in determining the fair value of loan collateral, the Company often utilizes independent third-party qualified appraisal firms, which employ their own criteria and assumptions that may include occupancy rates, rental rates and property expenses, among others.

The second category of reserves consists of the allocated portion of the allowance. The allocated portion of the allowance is determined by taking pools of outstanding loans that have similar characteristics and applying historical loss experience for each pool. This estimate represents the potential unconfirmed losses within the portfolio. Individual loan pools are created for commercial business loans, commercial real estate loans, construction loans, warehouse lines of credit and various types of loans to individuals. The historical estimation for each loan pool is then adjusted to account for current conditions, current loan portfolio performance, loan policy or management changes or any other qualitative factor that management believes may cause future losses to deviate from historical levels.

The Company also maintains an unallocated allowance. The unallocated allowance is used to cover any factors or conditions that may cause a potential loan loss but are not specifically identifiable. It is prudent to maintain an unallocated portion of the allowance because no matter how detailed an analysis of potential loan losses is performed, these estimates, by definition, lack precision. Management must make estimates using assumptions and information that is often subjective and changing rapidly. The following discusses the risk characteristics of each of our loan portfolios.

Commercial Business

The Company offers a variety of commercial loan services, including term loans, lines of credit and loans secured by equipment and receivables. A broad range of short-to-medium term commercial loans, both secured and unsecured, are made available to businesses for working capital (including inventory and receivables), business expansion (including acquisition and development of real estate and improvements) and the purchase of equipment and machinery. Commercial business loans are granted based on the borrower's ability to generate cash flow to support its debt obligations and other cash related expenses. A borrower's ability to repay commercial business loans is substantially dependent on the success of the business itself and on the quality of its management. As a general practice, the Company takes, as collateral, a security interest in any available real estate, equipment, inventory, receivables or other personal property of its borrowers, although the Company occasionally makes commercial business loans on an unsecured basis. Generally, the Company requires personal guarantees of its commercial business loans to offset the risks associated with such loans.

Much of the Company's lending is in northern and central New Jersey, communities along the New Jersey shore, and the New York City metropolitan area. As a result of this geographic concentration, a significant broad-based deterioration in economic conditions in New Jersey and the New York City metropolitan area could have a material adverse impact on the Company's loan portfolio. A prolonged decline in economic conditions in our market area could restrict borrowers' ability to pay outstanding principal and interest on loans when due. The value of assets pledged as collateral may decline and the proceeds from the sale or liquidation of these assets may not be sufficient to repay the loan.

Commercial Real Estate

Commercial real estate loans are made to businesses to expand their facilities and operations and to real estate operators to finance the acquisition of income producing properties. The Company's loan policy requires that borrowers have sufficient cash flow to meet the debt service requirements and the value of the property meets the loan-to-value criteria set in the loan policy. The Company monitors loan concentrations by borrower, by type of property and by location and other criteria.

In response to the COVID-19 pandemic, management identified hotel and restaurant-food service as industries that were most likely to be adversely impacted in the near-term by the economic disruption caused by the pandemic. The following table, which presents information as of September 30, 2020, summarizes the amount of loan modifications and forbearance granted and the amount of SBA PPP loans funded.

| (Dollars in thousands) | Balance | % of Total Loans | COVID-19 Deferrals through September 30, 2020 | COVID-19 Deferrals at September 30, 2020 | PPP Loans |
|---|---|---|---|---|---|
| Hotel | $ 68,487 | 4.7% | $ 43,096 | $ 3,338 | $ 662 |
| Restaurant-food service | 58,218 | 4.0% | 13,745 | 1,424 | 10,818 |

The Company's commercial real estate portfolio is largely secured by real estate collateral located in New Jersey and the New York City metropolitan area. Conditions in the real estate markets in which the collateral for the Company's loans are located strongly influence the level of the Company's non-performing loans. A decline in the New Jersey and New York City metropolitan area real estate markets could adversely affect the Company's loan portfolio. Decreases in local real estate values would adversely affect the value of property used as collateral for the Company's loans. Adverse changes in the economy also may have a negative effect on the ability of our borrowers to make timely repayments of their loans.

Construction Financing

Construction financing is provided to businesses to expand their facilities and operations and to real estate developers for the acquisition, development and construction of residential and commercial properties. First mortgage construction loans are made to developers and builders primarily for single family homes and multi-family buildings that are presold or are to be sold or leased on a speculative basis.

The Company lends to builders and developers with established relationships, successful operating histories and sound financial resources. Management has established underwriting and monitoring criteria to minimize the inherent risks of real estate construction lending. The risks associated with speculative construction lending include the borrower's inability to complete the construction process on time and within budget, the sale or rental of the project within projected absorption periods and the economic risks associated with real estate collateral. Such loans may include financing the development and/or construction of residential subdivisions. This activity may involve financing land purchases and infrastructure development (such as roads, utilities, etc.), as well as construction of residences or multi-family dwellings for subsequent sale by the developer/builder. Because the sale or rental of developed properties is integral to the success of developer business, loan repayment may be especially subject to the volatility of real estate market values.

Mortgage Warehouse Lines of Credit

The Company’s Mortgage Warehouse Funding Group provides revolving lines of credit that are available to licensed mortgage banking companies. The warehouse line of credit is used by the mortgage banker to originate one-to-four family residential mortgage loans that are pre-sold to the secondary mortgage market, which includes state and national banks, national mortgage banking firms, insurance companies and government-sponsored enterprises, including the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, the Government National Mortgage Association and others. On average, an advance under the warehouse line of credit remains outstanding for a period of less than 30 days, with repayment coming directly from the sale of the loan into the secondary mortgage market. Interest and a transaction fee are collected by the Bank at the time of repayment.

As a separate class of the total loan portfolio, the warehouse loan portfolio is individually analyzed as a whole for allowance for loan losses purposes. Warehouse lines of credit are subject to the same inherent risks as other commercial lending, but the overall degree of risk differs. While the Company’s loss experience with this type of lending has been non-existent since the product was introduced in 2008, there are other risks unique to this lending that still must be considered in assessing the adequacy of the allowance for loan losses. These unique risks may include, but are not limited to, (i) credit risks relating to the mortgage bankers that borrow from us, (ii) the risk of intentional misrepresentation or fraud by any of such mortgage bankers, (iii) changes in the market value of mortgage loans originated by the mortgage banker, the sale of which is the expected source of repayment of the borrowings under a warehouse line of credit, due to changes in interest rates during the time in warehouse or (iv) unsalable or impaired mortgage loans so originated, which could lead to decreased collateral value and the failure of a purchaser of the mortgage loan to purchase the loan from the mortgage banker.

Consumer

The Company's consumer loan portfolio is comprised of residential real estate loans, home equity loans and other loans to individuals. Individual loan pools are created for the various types of loans to individuals. The principal risk is the borrower becomes unemployed or has a significant reduction in income.

In general, for homogeneous groups such as residential mortgages and consumer credits, the loans are collectively evaluated based on delinquency status, loan type and historical losses. These loan groups are then internally risk rated.

The Company considers the following credit quality indicators in assessing the risk in the loan portfolio:

- Consumer credit scores;
- Internal credit risk grades;
- Loan-to-value ratios;
- Collateral; and
- Collection experience.

The following table presents, for the periods indicated, an analysis of the allowance for loan losses and other related data:

| (Dollars in thousands) | Nine Months Ended September 30, 2020 | Year Ended December 31, 2019 | Nine Months Ended September 30, 2019 |
|---|---|---|---|
| Balance, beginning of period | $ 9,271 | $ 8,402 | $ 8,402 |
| Provision charged to operating expenses | 5,340 | 1,350 | 1,050 |
| Loans charged off: | | | |
| Residential real estate loans | — | — | — |
| Commercial business and commercial real estate | (165) | (463) | (438) |
| Loans to individuals | — | (7) | — |
| All other loans | (3) | (43) | (43) |
| Total loans charged off | (168) | (513) | (481) |
| Recoveries: | | | |
| Commercial business and commercial real estate | 7 | 26 | — |
| Loans to individuals | — | 6 | 6 |
| All other loans | — | — | — |
| Total recoveries | 7 | 32 | 6 |
| Net charge offs | (161) | (481) | (475) |
| Balance, end of period | $ 14,450 | $ 9,271 | $ 8,977 |
| Loans: | | | |
| At period end | $ 1,455,684 | $ 1,216,028 | $ 1,025,031 |
| Average during the period | 1,292,650 | 964,920 | 910,975 |
| Net charge offs to average loans outstanding | (0.01)% | (0.05)% | (0.05)% |
| Net charge offs to average loans outstanding, excluding mortgage warehouse loans | (0.02)% | (0.06)% | (0.06)% |
| Allowance for loan losses to: | | | |
| Total loans at period end | 0.99 % | 0.76 % | 0.88 % |
| Total loans at period end excluding mortgage warehouse loans | 1.18 % | 0.84 % | 1.16 % |
| Non-performing loans | 83.79 % | 206.16 % | 170.47 % |

The following table represents the allocation of the allowance for loan losses among the various categories of loans and certain other information as of September 30, 2020 and December 31, 2019, respectively. The total allowance is available to absorb losses from any portfolio of loans.

| | September 30, 2020 | | | December 31, 2019 | | |
|---|---|---|---|---|---|---|
| (Dollars in thousands) | Amount | As a % of Loan Class | Loans as a % of Total Loans | Amount | As a % of Loan Class | Loans as a % of Total Loans |
| Commercial real estate loans | $ 6,077 | 0.99 % | 42 % | $ 4,524 | 0.80 % | 47 % |
| Commercial Business | 2,571 | 1.22 % | 14 % | 1,409 | 1.01 % | 11 % |
| Construction loans | 3,219 | 2.27 % | 10 % | 1,389 | 0.93 % | 12 % |
| Residential real estate loans | 524 | 0.59 % | 6 % | 412 | 0.46 % | 7 % |
| Loans to individuals | 179 | 0.65 % | 2 % | 185 | 0.57 % | 3 % |
| Subtotal | 12,570 | 1.16 % | 74 % | 7,919 | 0.81 % | 80 % |
| Mortgage warehouse lines | 1,707 | 0.46 % | 26 % | 1,083 | 0.46 % | 20 % |
| Unallocated reserves | 173 | — | — | 269 | — | — |
| Total | $ 14,450 | 0.99 % | 100 % | $ 9,271 | 0.76 % | 100 % |

For the nine months ended September 30, 2020, the Company recorded a provision for loan losses of $5.3 million, and net charge-offs of $161,000 compared to a provision for loan losses of $1.1 million, and net charge-offs of $461,000 recorded for the first nine months of 2019. The higher provision for loan losses recorded for the first nine months of 2020 was due primarily to (i) a reserve for the estimated increase in incurred loan losses resulting from the economic and social disruption caused by the COVID-19 pandemic; (ii) the increase in the qualitative factors attributed to the modification of loans, including the deferral of principal and or interest payments and downgrades of the credit ratings on certain loans, (iii) additional provision to increase specific reserves and, (iv) to a lesser extent, the growth and change in the mix of the loan portfolio.

As part of the review of the adequacy of the allowance for loan losses at September 30, 2020, management reviewed over 95% of the $140.9 million of commercial business and commercial real estate loans that had been modified to defer interest and or principal for up to 90 days. Loans excluded from the review had a balance less than $250,000.

As a result of this review,management had concluded that although loans with modifications and deferrals of loan payments were credit rated “Pass-Watch,” the deferral of payments indicated a somewhat weaker financial strength than loans that were credit rated “Pass”. Therefore, an additional reserve for incurred losses of $1.0 million was maintained at September 30, 2020 for loans that were rated Pass-Watch and had received a deferral.

Management previously identified the hotel and restaurant-food service industries as most likely to be adversely impacted in the near-term by the economic disruption caused by the COVID-19 pandemic. At September 30, 2020 loans to hotel and restaurant-food service industries were $68.5 million and $58.2 million, respectively. Management reviewed over 99% of the hotel loans and over 95% of the restaurant-food service loans. Loans excluded from this review had a balance of less than $250,000.

Management also evaluated the potential that incurred losses had increased with respect to the concentrations in hotel and restaurant-food service loans. In reviewing the loans in the hotel concentration, management noted that the weighted average loan to value of the hotel loans was 55% and all loans were current, except for three loans with a balance of $5.9 million that was on non-accrual.

With the respect to the restaurant-food service concentration, management observed that the weighted average loan to value of these restaurant-food service loans was 63% and all loans with balances greater than $400,000 in this concentration were current, except for one loan with a balance of $0.5 million that was on non-accrual.

On the basis of this review and the evaluation of the loans in the hotel and restaurant-food service concentrations, management concluded that, at September 30, 2020, an increase in loan defaults would require a substantial decrease in the value of the collateral supporting these loans for there to be a significant increase in incurred losses in the hotel and restaurant-food service concentrations.

Construction loans are closely monitored on a quarterly basis and are reviewed to assess the progress of construction relative to the plan and budget and lease-up or sales of units.

Management also expanded its loan level review for the third quarter of 2020 to include a review of loans to schools that are private educational institutions that are generally sponsored or affiliated with religious organizations. The loans totaled $28.8 million at September 30, 2020, 99% of which were reviewed by management.

The expanded review also included commercial loans made under the SBA 7(a) loan program with loan balances greater than $250,000. These loans were not reviewed in the second quarter of 2020 because the SBA was making the loan payments through September 30, 2020 as part of the CARES Act financial assistance. $6.7 million, or 45% of the total loans of $14.8, million were reviewed.

In connection with management's review for the third quarter of 2020, loans totaling $2.7 million and $7.5 million were downgraded to "Special Mention" and "Substandard," respectively. Two hotel loans totaling $4.6 million were placed on non-accrual status during the third quarter of 2020.

At September 30, 2020, the allowance for loan losses was $14.5 million, or 0.99% of loans, compared to $9.3 million, or 0.76% of loans, at December 31, 2019 and $9.0 million, or 0.88% of loans, at September 30, 2019. The allowance for loan losses was 83.79% of non-performing loans at September 30, 2020 compared to 206.16% of non-performing loans at December 31, 2019 and 170.47% of non-performing loans at September 30, 2019.

Management believes that the allowance for loan losses is adequate in relation to credit risk exposure levels and the estimated incurred and inherent losses in the loan portfolio at September 30, 2020. However, it is expected that the economic disruption occurring due to the COVID-19 pandemic will continue to impact businesses, borrowers, employees and consumers in the near term, which may continue with increasing severity in future periods. Management may further increase the provision for loan losses and the allowance for loan losses in response to changes in economic conditions and the performance of the loan portfolio in future periods.

**Deposits**

Deposits, which include demand deposits (interest bearing and non-interest bearing), savings deposits and time deposits, are a fundamental and cost-effective source of funding. The flow of deposits is influenced significantly by general economic conditions, changes in market interest rates and competition. The Company offers a variety of products designed to attract and retain customers, with the Company's primary focus on the building and expanding of long-term relationships.

The following table summarizes deposits at September 30, 2020 and December 31, 2019:

| (Dollars in thousands) | September 30, 2020 | December 31, 2019 |
|---|---|---|
| Demand | | |
| Non-interest bearing | $ 426,528 | $ 287,555 |
| Interest bearing | 429,020 | 393,392 |
| Savings | 299,583 | 259,033 |
| Certificates of deposit | 355,902 | 337,382 |
| Total | $ 1,511,033 | $ 1,277,362 |

At September 30, 2020, total deposits were $1.5 billion, representing an increase of $233.7 million, or 18.3%, from $1.3 billion at December 31, 2019.

The increase in deposits from December 31, 2019 was due primarily to a $139.0 million increase in non-interest-bearing demand deposits, a $35.6 million increase in interest-bearing demand deposits, a $40.6 million increase in savings deposits and an $18.5 million increase in certificates of deposit. Consistent with observed trends in the banking industry, the Company experienced a significant increase in deposits during the nine months ended September 30, 2020. The primary source of the growth of deposits was the increase in deposits from existing customers. In addition, certificates of deposit originated through internet deposit listing services increased approximately $54.4 million during 2020, which was partially offset by decreases in other certificates of deposit.

The COVID-19 pandemic may impact the Bank's ability to increase and or retain customers' deposits. As the pandemic continues, businesses may experience a loss of revenue and consumers may experience a reduction of income, which may in turn cause them to withdraw their funds to pay expenses or reduce their ability to increase their deposits.

**Borrowings**

Borrowings are mainly comprised of Federal Home Loan Bank of New York ("FHLB") borrowings and overnight funds purchased. These borrowings are primarily used to fund asset growth not supported by deposit generation. At September 30, 2020, the Company had $105.9 million of short-term borrowings compared to $92.1 million of short-term borrowings December 31, 2019. In April 2020, the Bank began participating in the Federal Reserve's PPPLF, which is a liquidity and borrowing program to allow participating banks to borrow 100% of the SBA PPP loans funded through the SBA at an interest rate of 0.35% for up to two years. The borrowing under the Federal Reserve PPPLF was $75.5 million at September 30, 2020.

**Liquidity**

At September 30, 2020, the amount of liquid assets and the Bank's access to off-balance sheet liquidity remained at a level management deemed adequate to ensure that contractual liabilities, depositors' withdrawal requirements and other operational and customer credit needs could be satisfied.

Liquidity management refers to the Company's ability to support asset growth while satisfying the borrowing needs and deposit withdrawal requirements of customers. In addition to maintaining liquid assets, factors such as capital position, profitability, asset quality and availability of funding affect a bank's ability to meet its liquidity needs. On the asset side, liquid funds are maintained in the form of cash and cash equivalents, federal funds sold, investment securities held to maturity maturing within one year, securities available for sale and loans held for sale. Additional asset-based liquidity is derived from scheduled loan repayments as well as investment repayments of principal and interest. Investment securities and loans may also be pledged to the FHLB to collateralize additional borrowings. On the liability side, the primary source of liquidity is the ability to generate core deposits. Long-term and short-term borrowings are used as supplemental funding sources when growth in the core deposit base does not keep pace with that of interest-earning assets.

The Bank has established a borrowing relationship with the FHLB that further supports and enhances liquidity. The FHLB provides member banks with a fully secured line of credit of up to 50% of a bank's quarter-end total assets. Under the terms of this facility, the Bank's total credit exposure to the FHLB cannot exceed 50% of its total assets, or $922.0 million, at September 30, 2020. In addition, the aggregate outstanding principal amount of the Bank's advances, letters of credit, the dollar amount of the FHLB's minimum collateral requirement for off-balance sheet financial contracts and advance commitments cannot exceed 30% of the Bank's total assets, unless the Bank obtains approval from the FHLB's Board of Directors or its Executive Committee. These limits are further restricted by a member's ability to provide eligible collateral to support its obligations to the FHLB as well as the ability to meet the FHLB's stock requirement. At September 30, 2020 and December 31, 2019, the Bank pledged approximately $492.6 million and $308.5 million of loans, respectively, to support the FHLB borrowing capacity. At September 30, 2020 and December 31, 2019, the Bank had available borrowing capacity of $281.1 million and $131.2 million, respectively, at the FHLB. The Bank also maintains unsecured federal funds lines of $46.0 million with two correspondent banks, all of which were unused and available at September 30, 2020.

The Bank has access to the Federal Reserve Bank of New York Discount Window facility. At this time the Bank has not pledged investment securities or loans, which would be required, to support borrowings through the Discount Window facility.

The Consolidated Statements of Cash Flows present the changes in cash from operating, investing and financing activities. At September 30, 2020, the balance of cash and cash equivalents was $20.1 million.

Net cash used by operating activities totaled $12.4 million for the nine months ended September 30, 2020 compared to net cash provided by operating activities of $6.9 million for the nine months ended September 30, 2019. A source of funds is net income from operations adjusted for activity related to loans originated for sale and sold, the provision for loan losses, depreciation and amortization expenses and net amortization of premiums and discounts on securities. The increase in cash used by operating activities for the nine months ended September 30, 2020 compared to net cash provided by operating activities for the nine months ended September 30, 2019 was due primarily to the increase in net income and the higher provision for loan losses for 2020 less the net funding (cash used) of loans held for sale of approximately $15.1 million for the first nine months of 2020 compared to net sales (cash used) of loans held for sale of approximately $162,000 for the first nine months of 2019.

Net cash used in investing activities totaled $226.9 million for the nine months ended September 30, 2020 compared to $139.6 million for the nine months ended September 30, 2019. The loans and securities portfolios are a source of liquidity, providing cash flows from maturities and periodic payments of principal. The primary use of cash by investing activities for the nine months ended September 30, 2020 was the purchase of $56.1 million of investment securities compared to $37.6 million in the first nine months of 2019. Sales, calls, payments, and maturities of investment securities for the first nine months of 2020 were $66.7 million compared to $41.6 million of payments, calls and maturities for the first nine months of 2019. During the nine months ended September 30, 2020, net loans increased $239.5 million compared to an increase in net loans of $142.1 million during the nine months ended September 30, 2019.

Net cash provided by financing activities was $244.5 million for the nine months ended September 30, 2020 compared to $136.6 million for the nine months ended September 30, 2019. The primary source of funds for the 2020 period was the increase in both the deposits and short-term borrowings of $233.7 million and $13.8 million, respectively. The primary source of funds for the nine months ended September 30, 2019 was the $72.4 million increase in deposits and the $66.0 million increase in short-term borrowings. Management believes that the Company's and the Bank's liquidity resources are adequate to provide for the Company's and the Bank's planned operations over the next 12 months following September 30, 2020.

**Shareholders' Equity and Dividends**

Shareholders' equity increased by $11.4 million, or 6.7%, to $182.0 million at September 30, 2020 from $170.6 million at December 31, 2019. The increase in shareholders' equity was due primarily to an increase of $9.3 million in retained earnings and a $1.5 million increase in accumulated other comprehensive income.

The Company began declaring and paying cash dividends on its common stock in September 2016 and has declared and paid a cash dividend for each quarter since then. The timing and the amount of the payment of future cash dividends, if any, on the Company's common stock will be at the discretion of the Company's Board of Directors and will be determined after consideration of various factors, including the level of earnings, cash requirements, regulatory capital and financial condition.

The Company's common stock is quoted on the Nasdaq Global Market under the symbol, "FCCY."

On January 21, 2016, the Board of Directors of the Company authorized a common stock repurchase program. Under the common stock repurchase program, the Company may repurchase in the open market or privately negotiated transactions up to 5% of its common stock outstanding on the date of approval of the stock repurchase program, which limitation is adjusted for any subsequent stock dividends. For the nine months ended September 30, 2020, the Company withheld 14,411 shares of common stock in connection with the vesting of restricted stock awards to satisfy applicable tax withholding obligations.

See Part II, Item 2 of this Form 10-Q, "Unregistered Sales of Equity Securities and Use of Proceeds," for additional information regarding the Company's purchases of equity securities.

**Capital Resources**

The Company and the Bank are subject to various regulatory capital requirements administered by federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of the Company's and the Bank's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Company's and the Bank's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios of Common Equity Tier 1, Total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined) and Tier I capital to average assets (Leverage ratio, as defined). As of September 30, 2020 and December 31, 2019, the Company and the Bank met all capital adequacy requirements to which they were subject.

To be categorized as adequately capitalized, the Company and the Bank must maintain minimum Common Equity Tier 1, Total capital to risk-weighted assets, Tier 1 capital to risk-weighted assets and Tier I leverage capital ratios as set forth in the below table. As of September 30, 2020 and December 31, 2019, the Bank's capital ratios exceeded the regulatory standards for well-capitalized institutions. Certain bank regulatory limitations exist on the availability of the Bank's assets for the payment of dividends by the Bank without prior approval of bank regulatory authorities.

In July 2013, the Federal Reserve Board and the FDIC approved revisions to their capital adequacy guidelines and prompt corrective action rules that implemented and addressed the revised standards of Basel III and addressed relevant provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The Federal Reserve Board's final rules and the FDIC's interim final rules (which became final in April 2014 with no substantive changes) apply to all depository institutions, top-tier bank holding

companies with total consolidated assets of $500 million or more (which was subsequently increased to $1 billion or more in May 2015) and top-tier savings and loan holding companies ("banking organizations"). Among other things, the rules established a Common Equity Tier 1 minimum capital requirement (4.5% of risk-weighted assets) and increased the minimum Tier 1 capital to risk-based assets requirement (from 4% to 6% of risk-weighted assets). Banking organizations are also required to have a total capital ratio of at least 8% and a Tier 1 leverage ratio of at least 4%.
The rules also limited a banking organization's ability to pay dividends, engage in share repurchases or pay discretionary bonuses if the banking organization does not hold a "capital conservation buffer" consisting of 2.5% of Common Equity Tier 1 capital to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements. The rules became effective for the Company and the Bank on January 1, 2015. The capital conservation buffer requirement began phasing in on January 1, 2016 at 0.625% of Common Equity Tier 1 capital to risk-weighted assets and increased by that amount each year until fully implemented in January 2019 at 2.5% of Common Equity Tier 1 capital to risk-weighted assets. At September 30, 2020, the Company and the Bank maintained a capital conservation buffer in excess of 2.5%.

Management believes that the Company's and the Bank's capital resources are adequate to support the Company's and the Bank's current strategic and operating plans. However, if the financial position of the Company and the Bank are materially adversely impacted by the economic disruption caused by the COVID-19 pandemic, the Company and or the Bank may be required to increase its regulatory capital position.

The Company's actual capital amounts and ratios are presented in the following table:

| | Actual | | For Capital Adequacy Purposes | | To Be Well Capitalized Under Prompt Corrective Action Provision | |
|---|---|---|---|---|---|---|
| (Dollars in thousands) | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| **As of September 30, 2020** | | | | | | |
| Common equity Tier 1 (CET1) | $ 146,678 | 9.44 % | $ 68,276 | 4.50 % | N/A | N/A |
| Total capital to risk-weighted assets | 179,128 | 11.58 % | 121,380 | 8.00 % | N/A | N/A |
| Tier 1 capital to risk-weighted assets | 164,678 | 10.62 % | 91,035 | 6.00 % | N/A | N/A |
| Tier 1 leverage capital | 164,678 | 9.32 % | 69,186 | 4.00 % | N/A | N/A |
| **As of December 31, 2019:** | | | | | | |
| Common equity Tier 1 (CET1) | $ 133,046 | 9.70 % | $ 61,604 | 4.50 % | N/A | N/A |
| Total capital to risk-weighted assets | 160,317 | 11.69 % | 109,519 | 8.00 % | N/A | N/A |
| Tier 1 capital to risk-weighted assets | 151,046 | 11.01 % | 82,139 | 6.00 % | N/A | N/A |
| Tier 1 leverage capital | 151,046 | 10.56 % | 57,245 | 4.00 % | N/A | N/A |

The Bank's actual capital amounts and ratios are presented in the following table:

| | Actual | | For Capital Adequacy Purposes | | To Be Well Capitalized Under Prompt Corrective Action Provision | |
|---|---|---|---|---|---|---|
| (Dollars in thousands) | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| **As of September 30, 2020** | | | | | | |
| Common equity Tier 1 (CET1) | $ 164,500 | 10.62 % | $ 68,251 | 4.50% | $ 98,585 | 6.50% |
| Total capital to risk-weighted assets | 178,950 | 11.57 % | 121,335 | 8.00% | 151,669 | 10.00% |
| Tier 1 capital to risk-weighted assets | 164,500 | 10.62 % | 91,002 | 6.00% | 121,335 | 8.00% |
| Tier 1 leverage capital | 164,500 | 9.31 % | 69,164 | 4.00% | 86,454 | 5.00% |
| **As of December 31, 2019:** | | | | | | |
| Common equity Tier 1 (CET1) | $ 150,725 | 10.99 % | $ 61,579 | 4.50% | $ 88,948 | 6.50% |
| Total capital to risk-weighted assets | 159,996 | 11.67 % | 109,474 | 8.00% | 136,843 | 10.00% |
| Tier 1 capital to risk-weighted assets | 150,725 | 10.99 % | 82,106 | 6.00% | 109,474 | 8.00% |
| Tier 1 leverage capital | 150,725 | 10.54 % | 57,222 | 4.00% | 71,528 | 5.00% |

**Interest Rate Sensitivity Analysis**

The largest component of the Company's total income is net interest income, and the majority of the Company's financial instruments are composed of interest rate-sensitive assets and liabilities with various terms and maturities. The primary objective of management is to maximize net interest income while minimizing interest rate risk. Interest rate risk is derived from timing differences and the magnitude of relative changes in the repricing of assets and liabilities, loan prepayments, deposit withdrawals and differences in lending and funding rates. Management actively seeks to monitor and control the mix of interest rate-sensitive assets and interest rate-sensitive liabilities.

Under the interest rate risk policy established by the Company's Board of Directors, the Company established quantitative guidelines with respect to interest rate risk and how interest rate shocks are projected to affect net interest income and the economic value of equity. Summarized below is the projected effect of a parallel shift of an increase of 200 and 300 basis points, respectively, in market interest rates on net interest income and the economic value of equity. Due to the historically low interest rate environment at September 30, 2020 a parallel shift down was not presented.

Based upon the current interest rate environment, as of September 30, 2020, sensitivity to interest rate risk was as follows:

| (Dollars in thousands) | Next 12 Months Net Interest Income | | | Economic Value of Equity [2] | | |
|---|---|---|---|---|---|---|
| Interest Rate Change in Basis Points [1] | Dollar Amount | $ Change | % Change | Dollar Amount | $ Change | % Change |
| +300 | $ 68,939 | $ 5,198 | 8.15 % | $ 210,420 | $ 715 | 0.34 % |
| +200 | 66,706 | 2,965 | 4.65 % | 210,988 | 1,283 | 0.61 % |
| — | 63,741 | — | — % | 209,705 | — | — % |

(1) Assumes an instantaneous and parallel shift in interest rates at all maturities.
(2) Economic value of equity is the discounted present value of expected cash flows from assets, liabilities and off-balance sheet contracts.

The Company employs many assumptions to calculate the impact of changes in interest rates on assets and liabilities, and actual results may not be similar to projections due to several factors, including the timing and frequency of rate changes, market conditions and the shape of the yield curve. Actual results may also differ due to management's actions, if any, in response to changing rates. In calculating these exposures, the Company utilized an interest rate simulation model that is validated by third-party reviewers periodically.

**Off-Balance Sheet Arrangements and Contractual Obligations**

As of September 30, 2020, there were no material changes to the Company's off-balance sheet arrangements and contractual obligations disclosed under Part II, Item 7 of the 2019 Form 10-K. Management continues to believe that the Company has adequate capital and liquidity available from various sources to fund projected contractual obligations and commitments.

## Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company's Asset Liability Committee ("ALCO") is responsible for developing, implementing and monitoring asset liability management strategies and advising the Company's Board of Directors on such strategies, as well as the related level of interest rate risk. Interest rate risk simulation models are prepared on a quarterly basis. These models demonstrate balance sheet gaps and predict changes to net interest income and the economic market value of equity under various interest rate scenarios.

ALCO is generally authorized to manage interest rate risk through the management of capital, cash flows and duration of assets and liabilities, including sales and purchases of assets, as well as additions of borrowings and other sources of medium or longer-term funding.

The following strategies are among those used to manage interest rate risk:

- Actively market commercial business loan originations, which tend to have adjustable rate features and which generate customer relationships that can result in higher core deposit accounts;
- Actively market commercial mortgage loan originations, which tend to have shorter maturity terms and higher interest rates than residential mortgage loans and which generate customer relationships that can result in higher core deposit accounts;
- Actively market core deposit relationships, which are generally longer duration liabilities;
- Utilize short term and long-term certificates of deposit and/or borrowings to manage liability duration;
- Closely monitor and actively manage the investment portfolio, including management of duration, prepayment and interest rate risk;
- Maintain adequate levels of capital; and
- Utilize loan sales and/or loan participations.

ALCO uses simulation modeling to analyze the Company's net interest income sensitivity as well as the Company's economic value of portfolio equity under various interest rate scenarios. The model is based on the actual maturity and estimated repricing characteristics of rate sensitive assets and liabilities. The model incorporates certain prepayment and interest rate assumptions, which management believes to be reasonable as of September 30, 2020. The model assumes changes in interest rates without any proactive change in the balance sheet by management. In the model, the forecasted shape of the yield curve remained static as of September 30, 2020.

In an immediate and sustained 200 basis point increase in market interest rates at September 30, 2020, net interest income for the next 12 months would increase approximately 4.7%, when compared to a flat interest rate scenario.

Certain shortcomings are inherent in the methodologies used in determining interest rate risk. Simulation modeling requires making certain assumptions that may or may not reflect the manner in which actual yields and costs respond to changes in market interest rates. In this regard, the modeling assumes that the composition of our interest-sensitive assets and liabilities existing at the beginning of a period remains constant over the period being measured and assumes that a particular change in interest rates is reflected uniformly across the yield curve regardless of the duration or repricing of specific assets and liabilities. Accordingly, although the information provides an indication of our interest rate risk exposure at a particular point in time, such measurements are not intended to, and do not, provide a precise forecast of the effect of changes in market interest rates on our net interest income and will differ from actual results.

Model simulation results indicate the Company is asset sensitive, which indicates the Company's net interest income should increase in a rising rate environment and decline in a falling interest rate environment. Management believes the Company's interest rate risk position is balanced and reasonable.

## Item 4. Controls and Procedures

### Evaluation of Disclosure Controls and Procedures

The Company has established disclosure controls and procedures designed to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act, is (i) recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and (ii) accumulated and communicated to management, including the principal executive officer and principal financial officer, to allow timely decisions regarding required disclosure.

The Company's principal executive officer and principal financial officer, with the assistance of other members of management, have evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this Form 10-Q. Based upon such evaluation, the Company's principal executive officer and principal financial officer have concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this Form 10-Q.

Because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving disclosure controls and procedures objectives. Management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

### Changes in Internal Control Over Financial Reporting

The Company's principal executive officer and principal financial officer have concluded that there was no change in the Company's internal control over financial reporting (as such term is defined in Rule 13a-15(f) under the Exchange Act) that occurred during the quarter ended September 30, 2020 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

The Company may, in the ordinary course of business, become a party to litigation involving collection matters, contract claims and other legal proceedings relating to the conduct of its business. Management is not aware of any material pending legal proceedings against the Company which, if determined adversely, would have a material adverse effect on the Company’s financial condition or results of operations.

### Item 1A. Risk Factors

As of September 30, 2020, there has been no material change in the risk factors previously disclosed under Part I, Item 1A of the 2019 Form 10-K and Part II, Item 1A of the Company's Form 10-Q for the quarter ended June 30, 2020.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

**Issuer Purchases of Equity Securities**

On January 21, 2016, the Board of Directors of the Company authorized a common stock repurchase program. Under this common stock repurchase program, the Company may repurchase in the open market or privately negotiated transactions up to 396,141 shares of its common stock, representing 5% of the shares of common stock outstanding on January 21, 2016, as adjusted for subsequent common stock dividends. At September 30, 2020, 394,141 shares remained available for repurchase under the common stock repurchase program. The following table sets forth information regarding the Company's repurchases of its common stock for the three months ended September 30, 2020.

| Period | | Total Number of Shares Purchased[(1)] | Average Price Paid Per Share | Total Number of Shares Purchased As Part of Publicly Announced Program | Maximum Number of Shares That May Yet be Purchased Under the Program |
|---|---|---|---|---|---|
| Beginning | Ending | | | | |
| July 1, 2020 | July 31, 2020 | 3,998 | $ 12.46 | — | 394,141 |
| August 1, 2020 | August 31, 2020 | 4,385 | 13.23 | — | 394,141 |
| September 1, 2020 | September 30, 2020 | — | — | — | 394,141 |
| | Total | 8,383 | $ 12.86 | — | 394,141 |

[(1)] Represents shares withheld in connection with the vesting of restricted stock awards to satisfy tax withholding obligations.

### Item 3. Defaults Upon Senior Securities

None.

### Item 4. Mine Safety Disclosures

Not applicable.

### Item 5. Other Information

None.

**Item 6. Exhibits.**

| | | |
|---|---|---|
| 3(i) | | Certificate of Incorporation of the Company (conformed copy) (incorporated by reference to Exhibit 3(i)(A) to the Company's Annual Report on Form 10-K (SEC File No. 000-32891) filed with the SEC on March 27, 2009) |
| 3(ii) | | By-laws of the Company, as amended (conformed copy) (incorporated by reference to Exhibit 3(ii) to the Company's Annual Report on Form 10-K (SEC File No. 000-32891) filed with the SEC on March 15, 2019) |
| 31.1 | * | Certification of Robert F. Mangano, principal executive officer of the Company, pursuant to Securities Exchange Act Rule 13a-14(a) |
| 31.2 | * | Certification of Stephen J. Gilhooly, principal financial officer of the Company, pursuant to Securities Exchange Act Rule 13a-14(a) |
| 32 | ** | Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002, signed by Robert F. Mangano, principal executive officer of the Company, and Stephen J. Gilhooly, principal financial officer of the Company |
| 101.INS | * | Inline XBRL Instance Document |
| 101.SCH | * | Inline XBRL Taxonomy Extension Schema Document |
| 101.CAL | * | Inline XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.DEF | * | Inline XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB | * | Inline XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE | * | Inline XBRL Taxonomy Extension Presentation Linkbase Document |
| 104 | | Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101) |

* Filed herewith.
** Furnished herewith.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**1ST CONSTITUTION BANCORP**

Date: November 6, 2020

By: /s/ ROBERT F. MANGANO

Robert F. Mangano
President and Chief Executive Officer
(Principal Executive Officer)

Date: November 6, 2020

By: /s/ STEPHEN J. GILHOOLY

Stephen J. Gilhooly
Senior Vice President, Treasurer and
Chief Financial Officer
(Principal Financial Officer)

**Exhibit 31.1**

**CERTIFICATIONS**

I, Robert F. Mangano, certify that:

1. I have reviewed this quarterly report on Form 10-Q of 1st Constitution Bancorp;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 6, 2020

/s/ ROBERT F. MANGANO

Name: Robert F. Mangano

Title: President and Chief Executive Officer

Exhibit 32

**CERTIFICATIONS PURSUANT TO**
**18 U.S.C. SECTION 1350,**
**AS ADOPTED PURSUANT TO**
**SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with this Quarterly Report on Form 10-Q of 1st Constitution Bancorp (the "Company") for the fiscal quarter ended September 30, 2020 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), each of the undersigned officers of the Company hereby certifies, pursuant to 18 U.S.C. (section) 1350, as adopted pursuant to (section) 906 of the Sarbanes-Oxley Act of 2002, that to the best of his knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ ROBERT F. MANGANO

Name: Robert F. Mangano

Title: President and Chief Executive Officer

Date: November 6, 2020

/s/ STEPHEN J. GILHOOLY

Name: Stephen J. Gilhooly
Title: Senior Vice President, Treasurer and Chief Financial Officer

Date: November 6, 2020

**Exhibit 31.2**

# CERTIFICATIONS

I, Stephen J. Gilhooly, certify that:

1. I have reviewed this quarterly report on Form 10-Q of 1st Constitution Bancorp;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 6, 2020

/s/STEPHEN J. GILHOOLY

Name: Stephen J. Gilhooly

Title: Senior Vice President, Treasurer and Chief Financial Officer