

SUSSEX BANCORP  
Form 10-Q  
August 12, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

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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 June 30, 2014

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 0-29030

SUSSEX BANCORP

(Exact name of registrant as specified in its charter)

New Jersey 22-3475473

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(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

399 Route 23, Franklin, NJ 07416  
(Address of principal executive offices) (Zip Code)

(844) 256-7328

(Registrant's telephone number, including area code)

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

Yes No

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

Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company  
(Do not check if a smaller reporting company)

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

As of August 7, 2014 there were 4,664,856 shares of common stock, no par value, outstanding.



SUSSEX BANCORP

FORM 10-Q

INDEX

<u>FORWARD-LOOKING STATEMENTS</u>	ii
<u>PART I – FINANCIAL INFORMATION</u>	1
<u>Item 1 - Financial Statements</u>	1
<u>Item 2 - Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	8
<u>Item 3 - Quantitative and Qualitative Disclosures about Market Risk</u>	8
<u>Item 4 - Controls and Procedures</u>	8
<u>PART II – OTHER INFORMATION</u>	8
<u>Item 1 - Legal Proceedings</u>	8
<u>Item 1A - Risk Factors</u>	8
<u>Item 2 - Unregistered Sales of Equity Securities and Use of Proceeds</u>	8
<u>Item 3 - Defaults Upon Senior Securities</u>	8
<u>Item 4 - Mine Safety Disclosures</u>	8
<u>Item 5 - Other Information</u>	8
<u>Item 6 - Exhibits</u>	8

## FORWARD-LOOKING STATEMENTS

We may, from time to time, make written or oral “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995, including statements contained in our filings with the Securities and Exchange Commission (the “SEC”), our reports to shareholders and in other communications by us. This Report on Form 10-Q contains “forward-looking statements” which may be identified by the use of such words as “believe,” “expect,” “anticipate,” “should,” “planned,” “estimated” and “potential.” Examples of forward-looking statements include, but are not limited to, estimates with respect to our financial condition, results of operation and business that are subject to various factors which could cause actual results to differ materially from these estimates. These factors include, but are not limited to:

- § changes in the interest rate environment that reduce margins;
- § changes in the regulatory environment;
  - § the highly competitive industry and market area in which we operate;
- § general economic conditions, either nationally or regionally, resulting in, among other things, a deterioration in credit quality;
- § changes in business conditions and inflation;
- § changes in credit market conditions;
- § changes in the securities markets which affect investment management revenues;
- § increases in Federal Deposit Insurance Corporation (“FDIC”) deposit insurance premiums and assessments could adversely affect our financial condition;
- § changes in technology used in the banking business;
- § the soundness of other financial services institutions which may adversely affect our credit risk;
- § our controls and procedures may fail or be circumvented;
- § new lines of business or new products and services which may subject us to additional risks;
- § changes in key management personnel which may adversely impact our operations;
- § the effect on our operations of recent legislative and regulatory initiatives that were or may be enacted in response to the ongoing financial crisis;
- § severe weather, natural disasters, acts of war or terrorism and other external events which could significantly impact our business; and
- § other factors detailed from time to time in our filings with the SEC.

Although we believe that the expectations reflected in such forward-looking statements are reasonable, actual results may differ materially from the results discussed in these forward-looking statements. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. We do not undertake any obligation to republish revised forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.



## PART I – FINANCIAL INFORMATION

## Item 1 – Financial Statements

SUSSEX BANCORP  
CONSOLIDATED BALANCE SHEETS

(Dollars In Thousands)	June 30, 2014 (Unaudited)	December 31, 2013
<b>ASSETS</b>		
Cash and due from banks	\$ 7,985	\$ 5,521
Interest-bearing deposits with other banks	3,126	7,725
Cash and cash equivalents	11,111	13,246
Interest bearing time deposits with other banks	100	100
Securities available for sale, at fair value	81,283	90,676
Securities held to maturity, at cost (fair value of \$6,173 and \$6,060 at June 30, 2014 and December 31, 2013, respectively)	6,055	6,074
Federal Home Loan Bank Stock, at cost	2,960	2,705
Loans receivable, net of unearned income	428,339	392,402
Less: allowance for loan losses	5,854	5,421
Net loans receivable	422,485	386,981
Foreclosed real estate	2,854	2,926
Premises and equipment, net	7,698	6,892
Accrued interest receivable	1,698	1,642
Goodwill	2,820	2,820
Bank-owned life insurance	12,054	11,889
Other assets	6,055	7,960
Total Assets	\$ 557,173	\$ 533,911
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Liabilities:		
Deposits:		
Non-interest bearing	\$ 67,743	\$ 58,210
Interest bearing	376,603	372,087
Total Deposits	444,346	430,297
Long-term borrowings	46,000	41,000
Accrued interest payable and other liabilities	4,259	3,302

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Junior subordinated debentures	12,887	12,887
Total Liabilities	507,492	487,486
Stockholders' Equity:		
Preferred stock, no par value, 1,000,000 shares authorized; none issued	-	-
Common stock, no par value, 10,000,000 shares authorized; 4,676,039 and 4,640,296 shares issued and 4,664,856 and 4,629,113 shares outstanding at June 30, 2014 and December 31, 2013, respectively	35,405	35,249
Treasury stock, at cost; 11,183 shares	(59)	(59)
Retained earnings	14,531	13,386
Accumulated other comprehensive loss	(196)	(2,151)
Total Stockholders' Equity	49,681	46,425
Total Liabilities and Stockholders' Equity	\$ 557,173	\$ 533,911

See Notes to Unaudited Consolidated Financial Statements



SUSSEX BANCORP  
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE (LOSS) INCOME  
(Unaudited)

(Dollars in thousands except per share data)	Three Months		Six Months Ended	
	Ended June 30, 2014	2013	June 30, 2014	2013
<b>INTEREST INCOME</b>				
Loans receivable, including fees	\$ 4,800	\$ 4,485	\$ 9,423	\$ 8,761
Securities:				
Taxable	214	126	431	280
Tax-exempt	255	246	509	508
Interest bearing deposits	4	2	7	7
Total Interest Income	5,273	4,859	10,370	9,556
<b>INTEREST EXPENSE</b>				
Deposits	415	453	805	991
Borrowings	361	273	709	535
Junior subordinated debentures	52	55	105	109
Total Interest Expense	828	781	1,619	1,635
Net Interest Income	4,445	4,078	8,751	7,921
<b>PROVISION FOR LOAN LOSSES</b>	400	700	853	1,842
Net Interest Income after Provision for Loan Losses	4,045	3,378	7,898	6,079
<b>OTHER INCOME</b>				
Service fees on deposit accounts	265	271	529	557
ATM and debit card fees	185	178	352	338
Bank-owned life insurance	82	90	165	182
Insurance commissions and fees	696	647	1,669	1,489
Investment brokerage fees	37	54	68	99
Net gain on securities transactions	94	29	94	399
Other	99	94	172	184
Total Other Income	1,458	1,363	3,049	3,248
<b>OTHER EXPENSES</b>				
Salaries and employee benefits	2,441	2,321	4,859	4,556
Occupancy, net	397	347	850	741
Data processing	432	338	812	667
Furniture and equipment	112	145	276	297
Advertising and promotion	78	95	122	135
Professional fees	211	198	364	383
Director fees	105	(13)	242	193
FDIC assessment	175	178	351	347
Insurance	72	63	148	139
Stationary and supplies	52	51	107	100
Loan collection costs	169	116	246	214
Net expenses and write-downs related to foreclosed real estate	161	597	261	1,008
Amortization of intangible assets	-	-	-	1
Other	332	253	567	486

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Total Other Expenses	4,737	4,689	9,205	9,267
Income before Income Taxes	766	52	1,742	60
EXPENSE (BENEFIT) FOR INCOME TAXES	159	(82)	457	(172)
Net Income	607	134	1,285	232
OTHER COMPREHENSIVE INCOME (LOSS):				
Unrealized gains (losses) on available for sale securities arising during the period	1,636	(3,113)	3,353	(3,757)
Reclassification adjustment for net gain on securities transactions included in net income	(94)	(29)	(94)	(399)
Income tax (expense) benefit related to items of other comprehensive income (loss)	(617)	1,258	(1,304)	1,663
Other comprehensive income (loss), net of income taxes	925	(1,884)	1,955	(2,493)
Comprehensive income (loss)	\$ 1,532	\$ (1,750)	\$ 3,240	\$ (2,261)
EARNINGS PER SHARE				
Basic	\$ 0.13	\$ 0.04	\$ 0.28	\$ 0.07
Diluted	\$ 0.13	\$ 0.04	\$ 0.28	\$ 0.07
See Notes to Unaudited Consolidated Financial Statements				

SUSSEX BANCORP  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY  
Six Months Ended June 30, 2014 and 2013  
(Unaudited)

(Dollars In Thousands)	Number of Shares Outstanding	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders' Equity
Balance December 31, 2012	3,397,873	\$ 28,117	\$ 11,958	\$ 356	\$ (59)	\$ 40,372
Net income	-	-	232	-	-	232
Other comprehensive loss	-	-	-	(2,493)	-	(2,493)
Restricted stock granted	32,940	-	-	-	-	-
Compensation expense related to stock option and restricted stock grants	-	114	-	-	-	114
Balance June 30, 2013	3,430,813	\$ 28,231	\$ 12,190	\$ (2,137)	\$ (59)	\$ 38,225
Balance December 31, 2013	4,629,113	\$ 35,249	\$ 13,386	\$ (2,151)	\$ (59)	\$ 46,425
Net income	-	-	1,285	-	-	1,285
Other comprehensive income	-	-	-	1,955	-	1,955
Restricted stock granted	36,043	-	-	-	-	-
Restricted stock forfeited	(300)	-	-	-	-	-
Compensation expense related to stock option and restricted stock grants	-	156	-	-	-	156
Dividends on common stock (\$0.03 per share)	-	-	(140)	-	-	(140)
Balance June 30, 2014	4,664,856	\$ 35,405	\$ 14,531	\$ (196)	\$ (59)	\$ 49,681

See Notes to Unaudited Consolidated Financial Statements

3

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SUSSEX BANCORP  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

(Dollars in thousands)	Six Months Ended June 30, 2014	2013
Cash Flows from Operating Activities		
Net income	\$ 1,285	\$ 232
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	853	1,842
Depreciation and amortization	326	344
Net amortization of securities premiums and discounts	924	1,782
Net realized gain on sale of securities	(94)	(399)
Net realized gain on sale of foreclosed real estate	(5)	(35)
Write-downs of and provisions for foreclosed real estate	110	742
Deferred income taxes	(4)	943
Earnings on bank-owned life insurance	(165)	(182)
Compensation expense for stock options and stock awards	156	114
(Increase) decrease in assets:		
Accrued interest receivable	(56)	24
Other assets	605	(961)
Decrease (increase) in accrued interest payable and other liabilities	957	(176)
Net Cash Provided by Operating Activities	4,892	4,270
Cash Flows from Investing Activities		
Securities available for sale:		
Purchases	(5)	(28,744)
Sales	5,033	13,029
	6,818	23,884

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Maturities, calls and principal repayments				
Securities held to maturity:				
Purchases	(577)		(573)	
Maturities, calls and principal repayments	572		532	
Net increase in loans	(37,072)		(32,307)	
Proceeds from the sale of foreclosed real estate	682		3,656	
Purchases of bank premises and equipment	(1,132)		(551)	
Increase in FHLB stock	(255)		(905)	
Net Cash Used in Investing Activities	(25,936)		(21,979)	
Cash Flows from Financing Activities				
Net increase (decrease) in deposits	14,049		(3,154)	
Increase in borrowed funds	5,000		17,500	
Dividends paid, net of reinvestments	(140)		-	
Net Cash Provided by Financing Activities	18,909		14,346	
Net Decrease in Cash and Cash Equivalents	(2,135)		(3,363)	
Cash and Cash Equivalents - Beginning	13,246		11,668	
Cash and Cash Equivalents - Ending	\$ 11,111		\$ 8,305	
Supplementary Cash Flows Information				
Interest paid	\$ 1,603		\$ 1,694	
Income taxes paid	\$ 119		\$ 31	
Supplementary Schedule of Noncash Investing and Financing Activities				
Foreclosed real estate acquired in settlement of loans	\$ 715		\$ 2,689	

See Notes to Unaudited Consolidated Financial Statements

4

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NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited consolidated financial statements include the accounts of Sussex Bancorp (“we,” “us” or “our”) and our wholly owned subsidiary Sussex Bank (the “Bank”). The Bank’s wholly owned subsidiaries are SCB Investment Company, Inc., SCBNY Company, Inc., ClassicLake Enterprises, LLC, Wheatsworth Properties Corp., PPD Holding Company, LLC, and Tri-State Insurance Agency, Inc. (“Tri-State”), a full service insurance agency located in Sussex County, New Jersey with a satellite office located in Bergen County, New Jersey. Tri-State’s operations are considered a separate segment for financial disclosure purposes. All inter-company transactions and balances have been eliminated in consolidation. The Bank operates nine banking offices, eight located in Sussex County, New Jersey and one in Orange County, New York.

Sussex Bancorp is subject to the supervision and regulation of the Board of Governors of the Federal Reserve System (the “FRB”). The Bank’s deposits are insured by the Deposit Insurance Fund (“DIF”) of the Federal Deposit Insurance Corporation (“FDIC”) up to applicable limits. The operations of Sussex Bancorp and the Bank are subject to the supervision and regulation of the FRB, FDIC and the New Jersey Department of Banking and Insurance (the “Department”) and the operations of Tri-State are subject to supervision and regulation by the Department.

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by the accounting principles generally accepted in the United States of America (“U.S. GAAP”) for full year financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and are of a normal, recurring nature. Operating results for the three and six month periods ended June 30, 2014, are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto that are included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2013.

We have evaluated events and transactions occurring subsequent to the balance sheet date of June 30, 2014, for items that should potentially be recognized or disclosed in these unaudited consolidated financial statements. The evaluation was conducted through the date these unaudited consolidated financial statements were issued.

Reclassifications

Certain amounts in the prior period financial statements have been reclassified to conform to the current period presentation. These reclassifications had no effect on previously reported net income.

New Accounting Standards



In July 2013, the Financial Accounting Standards Board (“FASB”) issued Accounting Standard Update (“ASU”) 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists, which provides guidance on financial statement presentation of an unrecognized tax benefit when a net operating loss (NOL) carryforward, a similar tax loss, or a tax credit carryforward exists. The FASB’s objective in issuing this ASU is to eliminate diversity in practice resulting from a lack of guidance on this topic in current U.S. GAAP. This ASU applies to all entities with unrecognized tax benefits that also have tax loss or tax credit carryforwards in the same tax jurisdiction as of the reporting date. For public entities, the guidance is effective for fiscal years beginning after December 15, 2013 and interim periods within those years. The adoption of this guidance did not have a material impact on our consolidated financial statements.

In January 2014, FASB issued ASU 2014-04, Receivables - Troubled Debt Restructurings by Creditors, which clarifies that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. For public entities, the guidance is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

In May 2014, FASB issued ASU 2014-09, Revenue from Contracts with Customers. The ASU’s core principle is built on the contract between a vendor and a customer for the provision of goods and services. It attempts to depict the exchange of rights and obligations between the parties in the pattern of revenue recognition based on the consideration to which the vendor is entitled. To accomplish this objective, the standard requires five basic steps: i) identify the

contract with the customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract, and (v) recognize revenue when (or as) the entity satisfies a performance obligation. For public entities, the guidance is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2016. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

In June 2014, FASB issued ASU 2014-11, Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures, to change the accounting for repurchase-to-maturity transactions and certain linked repurchase financings. This will result in accounting for both types of arrangements as secured borrowings on the balance sheet, rather than sales. Additionally, the ASU introduces new disclosures to (i) increase transparency about the types of collateral pledged in secured borrowing transactions and (ii) enable users to better understand transactions in which the transferor retains substantially all of the exposure to the economic return on the transferred financial asset throughout the term of the transaction. For public entities, the disclosure for repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions accounted for as secured borrowings is required to be presented for annual periods beginning after December 15, 2014, and for interim periods beginning after March 15, 2015. All other accounting and disclosure amendments in the ASU are effective for public business entities for the first interim or annual period beginning after December 15, 2014. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

In June 2014, FASB issued ASU 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period (a consensus of the FASB Emerging Issues Task Force), to clarify that a performance target in a share-based compensation award that could be achieved after an employee completes the requisite service period should be treated as a performance condition that affects the vesting of the award. As such, the performance target should not be reflected in estimating the grant-date fair value of the award. For all entities, the amendments are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Earlier adoption is permitted. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

## NOTE 2 – SECURITIES

### Available for Sale

The amortized cost and fair value of securities available for sale as of June 30, 2014 and December 31, 2013 are summarized as follows:

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(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2014				
U.S. government agencies	\$ 5,063	\$ -	\$ (74)	\$ 4,989
State and political subdivisions	28,822	168	(745)	28,245
Mortgage-backed securities -				
U.S. government-sponsored enterprises	47,346	483	(192)	47,637
Equity securities-financial services industry and other	378	51	(17)	412
	\$ 81,609	\$ 702	\$ (1,028)	\$ 81,283
December 31, 2013				
U.S. government agencies	\$ 5,421	\$ 8	\$ (49)	\$ 5,380
State and political subdivisions	28,788	3	(2,916)	25,875
Mortgage-backed securities -				
U.S. government-sponsored enterprises	59,640	272	(975)	58,937
Equity securities-financial services industry and other	412	85	(13)	484
	\$ 94,261	\$ 368	\$ (3,953)	\$ 90,676

Securities with a carrying value of approximately \$24.8 million and \$37.2 million at June 30, 2014 and December 31, 2013, respectively, were pledged to secure public deposits and for other purposes required or permitted by applicable laws and regulations.

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The amortized cost and fair value of securities available for sale at June 30, 2014, are shown below by contractual maturity. Actual maturities may differ from contractual maturities as issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

(Dollars in thousands)	Amortized Cost	Fair Value
Due in one year or less	\$ -	\$ -
Due after one year through five years	501	498
Due after five years through ten years	2,724	2,740
Due after ten years	25,597	25,007
Total bonds and obligations	28,822	28,245
U.S. government agencies	5,063	4,989
Mortgage-backed securities:		
U.S. government-sponsored enterprises	47,346	47,637
Equity securities-financial services industry and other	378	412
Total available for sale securities	\$ 81,609	\$ 81,283

Gross realized gains on sales of securities available for sale were \$118 thousand and \$29 thousand for the three months ended June 30, 2014 and 2013, respectively. Gross realized losses were \$24 thousand for the three months ended June 30, 2014. There were no gross realized losses on sales of securities available for sale for the three months ended June 30, 2013.

Gross realized gains on sales of securities were \$118 thousand and \$407 thousand and gross losses were \$24 thousand and \$8 thousand for the six months ended June 30, 2014 and 2013, respectively.

#### Temporarily Impaired Securities

The following table shows gross unrealized losses and fair value of securities with unrealized losses that are not deemed to be other than temporarily impaired, aggregated by category and length of time that individual available for sale securities have been in a continuous unrealized loss position at June 30, 2014 and December 31, 2013.

(Dollars in thousands)	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses

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June 30, 2014

U.S. government agencies	\$ 3,603	\$ (36)	\$ 1,386	\$ (38)	\$ 4,989	\$ (74)
State and political subdivisions	-	-	21,420	(745)	21,420	(745)
Mortgage-backed securities -				-		
U.S. government-sponsored enterprises	3,188	(27)	13,714	(165)	16,902	(192)
Equity securities-financial services industry and other	-	-	126	(17)	126	(17)
Total temporarily impaired securities	\$ 6,791	\$ (63)	\$ 36,646	\$ (965)	\$ 43,437	\$ (1,028)

December 31, 2013

U.S. government agencies	\$ 3,246	\$ (49)	\$ -	\$ -	\$ 3,246	\$ (49)
State and political subdivisions	19,610	(2,046)	6,065	(870)	25,675	(2,916)
Mortgage-backed securities -						
U.S. government-sponsored enterprises	30,830	(694)	9,147	(281)	39,977	(975)
Equity securities-financial services industry and other	-	-	130	(13)	130	(13)
Total temporarily impaired securities	\$ 53,686	\$ (2,789)	\$ 15,342	\$ (1,164)	\$ 69,028	\$ (3,953)

For each security whose fair value is less than their amortized cost basis, a review is conducted to determine if an other-than-temporary impairment has occurred. As of June 30, 2014, we reviewed our available for sale securities portfolio for indications of impairment. This review includes analyzing the length of time and the extent to which the fair value

7

has been lower than the cost, the financial condition and near-term prospects of the issuer, including any specific events which may influence the operations of the issuer and the intent and likelihood of selling the security. The intent and likelihood of sale of debt and equity securities is evaluated based upon our investment strategy for the particular type of security and our cash flow needs, liquidity position, capital adequacy and interest rate risk position.

#### U.S. Government Agencies

At June 30, 2014 and December 31, 2013, the decline in fair value and the unrealized losses for our U.S. government agencies securities were primarily due to changes in spreads and market conditions and not credit quality. At June 30, 2014, there were three securities with a fair value of \$5.0 million that had an unrealized loss that amounted to \$74 thousand. As of June 30, 2014, we did not intend to sell and it was not more-likely-than-not that we would be required to sell any of these securities before recovery of their amortized cost basis. Therefore, none of the U.S. government agency securities at June 30, 2014, were deemed to be other-than-temporarily impaired.

At December 31, 2013, there were two securities with a fair value of \$3.2 million that had an unrealized loss that amounted to \$49 thousand.

#### State and Political Subdivisions

At June 30, 2014 and December 31, 2013, the decline in fair value and the unrealized losses for our state and political subdivisions securities were caused by changes in interest rates and spreads and were not the result of credit quality. At June 30, 2014, there were 40 securities with a fair value of \$21.4 million that had an unrealized loss that amounted to \$745 thousand. These securities typically have maturity dates greater than 10 years and the fair values are more sensitive to changes in market interest rates. As of June 30, 2014, we did not intend to sell and it was not more-likely-than-not that we would be required to sell any of these securities before recovery of their amortized cost basis. Therefore, none of our state and political subdivision securities at June 30, 2014, were deemed to be other-than-temporarily-impaired.

At December 31, 2013, there were 52 securities with a fair value of \$25.7 million that had an unrealized loss that amounted to \$2.9 million.

#### Mortgage-Backed Securities

At June 30, 2014 and December 31, 2013, the decline in fair value and the unrealized losses for our mortgaged-backed securities guaranteed by U.S. government-sponsored enterprises were primarily due to changes in spreads and market conditions and not credit quality. At June 30, 2014, there were 17 securities with a fair value of \$16.9 million that had an unrealized loss that amounted to \$192 thousand. As of June 30, 2014, we did not intend to sell and it was not more-likely-than-not that we would be required to sell any of these securities before recovery of their amortized cost basis. Therefore, none of our mortgage-backed securities at June 30, 2014, were deemed to be other-than-temporarily impaired.

At December 31, 2013, there were 32 securities with a fair value of \$40.0 million that had an unrealized loss that amounted to \$975 thousand.

#### Equity Securities

Our marketable equity securities portfolio consists primarily of common stock of entities in the financial services industry. At June 30, 2014, there was one security with a fair value of \$126 thousand that had an unrealized loss of \$17 thousand. This security has been adversely impacted by the effects of the current economic environment on the financial services industry. We evaluated the underlying bank for credit impairment based on its financial condition and performance. Based on our evaluation and expectation that this security will recover within a reasonable period of time, we do not consider it to be other-than-temporarily impaired at June 30, 2014.

At December 31, 2013, there was one security with a fair value of \$130 thousand that had an unrealized loss of \$13 thousand.

We continue to closely monitor the performance of the securities we own as well as the impact from any further deterioration in the economy or in the banking industry that may adversely affect these securities. We will continue to evaluate them for other-than-temporary impairment, which could result in a future non-cash charge to earnings.

## Held to Maturity Securities

The amortized cost and fair value of securities held to maturity as of June 30, 2014 and December 31, 2013, are summarized as follows:

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2014				
State and political subdivisions	\$ 6,055	\$ 131	\$ (13)	\$ 6,173
December 31, 2013				
State and political subdivisions	\$ 6,074	\$ 78	\$ (92)	\$ 6,060

The amortized cost and carrying value of securities held to maturity at June 30, 2014, are shown below by contractual maturity. Actual maturities may differ from contractual maturities as issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

(Dollars in thousands)	Amortized Cost	Fair Value
Due in one year or less	\$ 2,126	\$ 2,126
Due after one year through five years	-	-
Due after five years through ten years	1,831	1,823
Due after ten years	2,098	2,224
Total held to maturity securities	\$ 6,055	\$ 6,173

## Temporarily Impaired Securities

The following table shows gross unrealized losses and fair value of held to maturity securities with unrealized losses that are not deemed to be other than temporarily impaired, aggregated by category and length of time that individual held to maturity securities have been in a continuous unrealized loss position at June 30, 2014 and December 31, 2013:

(Dollars in thousands)	Less Than 12 Months		12 Months or More		Total	Gross Unrealized Losses
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	



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June 30, 2014

State and political subdivisions	\$ -	\$ -	\$ 808	\$ (13)	\$ 808	\$ (13)
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December 31, 2013

State and political subdivisions	\$ 2,080	\$ (45)	\$ 780	\$ (47)	\$ 2,860	\$ (92)
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For each security whose fair value is less than their amortized cost basis, a review is conducted to determine if an other-than-temporary impairment has occurred. As of June 30, 2014, we reviewed our held to maturity securities portfolio for indications of impairment. This review includes analyzing the length of time and the extent to which the fair value has been lower than the cost, the financial condition and near-term prospects of the issuer, including any specific events which may influence the operations of the issuer and the intent and likelihood of selling the security. The intent and likelihood of sale of debt and equity securities is evaluated based upon our investment strategy for the particular type of security and our cash flow needs, liquidity position, capital adequacy and interest rate risk position.

At June 30, 2014 and December 31, 2013, the decline in fair value and the unrealized losses for our state and political subdivisions securities were caused by changes in interest rates and spreads and were not the result of credit quality. At June 30, 2014, there were two securities with a fair value of \$808 thousand that had an unrealized loss that amounted to \$13 thousand. These securities typically have maturity dates greater than 10 years and the fair values are more sensitive to changes in market interest rates. As of June 30, 2014, we did not intend to sell and it was not more-likely-than-not that we would be required to sell any of these securities before recovery of their amortized cost basis. Therefore, none of our state and political subdivision securities at June 30, 2014, were deemed to be other-than-temporarily impaired.

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At December 31, 2013, there were five securities with a fair value of \$2.9 million that had an unrealized loss that amounted to \$92 thousand.

NOTE 3 – LOANS

The composition of net loans receivable at June 30, 2014 and December 31, 2013 is as follows:

(Dollars in thousands)	June 30, 2014	December 31, 2013
Commercial and industrial	\$ 19,189	\$ 15,205
Construction	8,923	7,307
Commercial real estate	292,620	260,664
Residential real estate	106,471	107,992
Consumer and other	1,488	1,617
	428,691	392,785
Unearned net loan origination fees	(352)	(383)
Allowance for loan losses	(5,854)	(5,421)
Net loans receivable	\$ 422,485	\$ 386,981

Mortgage loans serviced for others are not included in the accompanying balance sheets. The total amount of loans serviced for the benefit of others was approximately \$536 thousand and \$546 thousand at June 30, 2014 and December 31, 2013, respectively. Mortgage servicing rights were immaterial at June 30, 2014 and December 31, 2013.

NOTE 4 – ALLOWANCE FOR LOAN LOSSES AND CREDIT QUALITY OF FINANCING RECEIVABLES

The following table presents changes in the allowance for loan losses disaggregated by the class of loans receivable for the three months ended June 30, 2014 and 2013:

(Dollars in thousands)	Commercial and Industrial	Construction	Commercial Real Estate	Residential Real Estate	Consumer and Other	Unallocated	Total
Three Months Ended: June 30, 2014							

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Beginning balance	\$ 289	\$ 315	\$ 3,687	\$ 862	\$ 19	\$ 265	\$ 5,437
Charge-offs	(1)	-	-	1	(9)	-	(9)
Recoveries	3	-	17	3	3	-	26
Provision	(34)	39	46	(29)	-	378	400
Ending balance	\$ 257	\$ 354	\$ 3,750	\$ 837	\$ 13	\$ 643	\$ 5,854

June 30, 2013

Beginning balance	\$ 275	401	3,452	899	12	267	\$ 5,306
Charge-offs	-	(80)	(273)	(38)	(6)	-	(397)
Recoveries	-	-	37	-	1	-	38
Provision	(26)	79	256	129	8	254	700
Ending balance	\$ 249	\$ 400	\$ 3,472	\$ 990	\$ 15	\$ 521	\$ 5,647

Six Months Ended:

June 30, 2014

Beginning balance	\$ 222	\$ 308	\$ 3,399	\$ 941	\$ 16	\$ 535	\$ 5,421
Charge-offs	(1)	-	(358)	(85)	(22)	-	(466)
Recoveries	15	-	21	4	6	-	46
Provision	21	46	688	(23)	13	108	853
Ending balance	\$ 257	\$ 354	\$ 3,750	\$ 837	\$ 13	\$ 643	\$ 5,854

June 30, 2013

Beginning balance	\$ 271	223	3,395	869	38	180	\$ 4,976
Charge-offs	(6)	(122)	(1,012)	(66)	(15)	-	(1,221)
Recoveries	-	-	44	-	6	-	50
Provision	(16)	299	1,045	187	(14)	341	1,842
Ending balance	\$ 249	\$ 400	\$ 3,472	\$ 990	\$ 15	\$ 521	\$ 5,647

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The following table presents the balance of the allowance of loan losses and loans receivable by class at June 30, 2014 and December 31, 2013, disaggregated on the basis of our impairment methodology.

(Dollars in thousands)	Allowance for Loan Losses			Loans Receivable		
	Balance	Balance Related to Loans Individually Evaluated for Impairment	Balance Related to Loans Collectively Evaluated for Impairment	Balance	Individually Evaluated for Impairment	Collectively Evaluated for Impairment
June 30, 2014						
Commercial and industrial	\$ 257	\$ -	\$ 257	\$ 19,189	\$ -	\$ 19,189
Construction	354	-	354	8,923	-	8,923
Commercial real estate	3,750	547	3,203	292,620	9,559	283,061
Residential real estate	837	88	749	106,471	2,229	104,242
Consumer and other loans	13	-	13	1,488	-	1,488
Unallocated	643	-	-	-	-	-
Total	\$ 5,854	\$ 635	\$ 4,576	\$ 428,691	\$ 11,788	\$ 416,903
December 31, 2013						
Commercial and industrial	\$ 222	\$ -	\$ 222	\$ 15,205	\$ -	\$ 15,205
Construction	308	-	308	7,307	-	7,307
Commercial real estate	3,399	322	3,077	260,664	10,894	249,770
Residential real estate	941	163	778	107,992	2,626	105,366
Consumer and other loans	16	-	16	1,617	-	1,617
Unallocated	535	-	-	-	-	-
Total	\$ 5,421	\$ 485	\$ 4,401	\$ 392,785	\$ 13,520	\$ 379,265

An age analysis of loans receivable which were past due as of June 30, 2014 and December 31, 2013, is as follows:

(Dollars in thousands)	30-59 Days Past Due	60-89 days Past Due	Greater Than 90 Days (a)	Total Past Due	Current	Total Financing Receivables	Recorded Investment > 90 Days
							and Accruing
June 30, 2014							
Commercial and industrial	\$ 62	\$ -	\$ -	\$ 62	\$ 19,127	\$ 19,189	\$ -

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Construction	-	-	-	-	8,923	8,923	-
Commercial real estate	2,396	338	8,375	11,109	281,511	292,620	-
Residential real estate	177	-	1,824	2,001	104,470	106,471	-
Consumer and other	6	-	1	7	1,481	1,488	-
Total	\$ 2,641	\$ 338	\$ 10,200	\$ 13,179	\$ 415,512	\$ 428,691	\$ -
December 31, 2013							
Commercial and industrial	\$ 13	\$ -	\$ -	\$ 13	\$ 15,192	\$ 15,205	\$ -
Construction	-	-	-	-	7,307	7,307	-
Commercial real estate	2,139	775	9,823	12,737	247,927	260,664	123
Residential real estate	495	247	2,192	2,934	105,058	107,992	-
Consumer and other	7	1	-	8	1,609	1,617	-
Total	\$ 2,654	\$ 1,023	\$ 12,015	\$ 15,692	\$ 377,093	\$ 392,785	\$ 123

(a) includes loans greater than 90 days past due and still accruing and non-accrual loans.

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Loans for which the accrual of interest has been discontinued at June 30, 2014 and December 31, 2013, were:

	June 30,	December
(Dollars in thousands)	2014	31, 2013
Commercial real estate	\$ 8,375	\$ 9,700
Residential real estate	1,824	2,192
Consumer and other	1	-
Total	\$ 10,200	\$ 11,892

In determining the adequacy of the allowance for loan losses, we estimate losses based on the identification of specific problem loans through our credit review process and also estimate losses inherent in other loans on an aggregate basis by loan type. The credit review process includes the independent evaluation of the loan officer assigned risk ratings by the Chief Credit Officer and a third party loan review company. Such risk ratings are assigned loss component factors that reflect our loss estimate for each group of loans. It is management's and the Board of Directors' responsibility to oversee the lending process to ensure that all credit risks are properly identified, monitored, and controlled, and that loan pricing, terms and other safeguards against non-performance and default are commensurate with the level of risk undertaken and is rated as such based on a risk-rating system. Factors considered in assigning risk ratings and loss component factors include: borrower specific information related to expected future cash flows and operating results, collateral values, financial condition, payment status and other information; levels of and trends in portfolio charge-offs and recoveries; levels in portfolio delinquencies; effects of changes in loan concentrations and observed trends in the economy and other qualitative measurements.

Our risk-rating system as defined below is consistent with the system used by regulatory agencies and consistent with industry practices. Loan classifications of Substandard, Doubtful or Loss are consistent with the regulatory definitions of classified assets.

**Pass:** This category represents loans performing to contractual terms and conditions and the primary source of repayment is adequate to meet the obligation. We have five categories within the Pass classification depending on strength of repayment sources, collateral values and financial condition of the borrower.

**Special Mention:** This category represents loans performing to contractual terms and conditions; however the primary source of repayment or the borrower is exhibiting some deterioration or weaknesses in financial condition that could potentially threaten the borrowers' future ability to repay our loan principal and interest or fees due.

**Substandard:** This category represents loans that the primary source of repayment has significantly deteriorated or weakened which has or could threaten the borrowers' ability to make scheduled payments. The weaknesses require close supervision by management and there is a distinct possibility that we could sustain some loss if the deficiencies are not corrected. Such weaknesses could jeopardize the timely and ultimate collection of our loan principal and interest or fees due. Loss may not be expected or evident, however, loan repayment is inadequately supported by current financial information or pledged collateral.

**Doubtful:** Loans so classified have all the inherent weaknesses of a substandard loan with the added provision that collection or liquidation in full is highly questionable and not reasonably assured. The probability of at least partial loss is high, but extraneous factors might strengthen the asset to prevent loss. The validity of the extraneous factors must be continuously monitored. Once these factors are questionable the loan should be considered for full or partial charge-off.

**Loss:** Loans so classified are considered uncollectible, and of such little value that their continuance as active assets is not warranted. Such loans are fully charged off.

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The following tables illustrate our corporate credit risk profile by creditworthiness category as of June 30, 2014 and December 31, 2013:

(Dollars in thousands)	Pass	Special Mention	Substandard	Doubtful	Total
June 30, 2014					
Commercial and industrial	\$ 19,170	\$ 19	\$ -	\$ -	\$ 19,189
Construction	8,923	-	-	-	8,923
Commercial real estate	274,480	6,358	11,651	131	292,620
Residential real estate	103,963	117	2,391	-	106,471
Consumer and other	1,487	-	1	-	1,488
	\$ 408,023	\$ 6,494	\$ 14,043	\$ 131	\$ 428,691
December 31, 2013					
Commercial and industrial	\$ 15,192	\$ 13	\$ -	\$ -	\$ 15,205
Construction	7,307	-	-	-	7,307
Commercial real estate	240,204	7,378	12,917	165	260,664
Residential real estate	104,383	871	2,738	-	107,992
Consumer and other	1,477	140	-	-	1,617
	\$ 368,563	\$ 8,402	\$ 15,655	\$ 165	\$ 392,785

The following table reflects information about our impaired loans by class as of June 30, 2014 and December 31, 2013:

(Dollars in thousands)	June 30, 2014			December 31, 2013		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:						
Commercial real estate	\$ 4,279	\$ 5,141	\$ -	\$ 7,394	\$ 7,967	\$ -
Residential real estate	1,687	1,712	-	1,849	1,874	-
With an allowance recorded:						
Commercial real estate	5,280	6,375	547	3,500		