1ST CONSTITUTION BANCORP
Form 10-K
March 19, 2018

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K

(Mark One)
ý ANNUAL REPORT UNDER SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2017

o TRANSITION REPORT UNDER 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 or Other Jurisdiction of Incorporation or Organization)	IRS Employer Identification Number)

2650 Route 130, P.O. Box 634, Cranbury, NJ 08512
(Address of Principal Executive Offices, including Zip Code)

(609) 655-4500
(Registrant’s telephone number, including area code)

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

Title of each class	Name of each exchange on which registered
Common stock, no par value	NASDAQ

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:

None
(Title of Class)

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

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, 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 ý No o

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

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. (Check one):

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

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

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

The aggregate market value of the registrant's common stock held by non-affiliates of the registrant, computed by reference to the price at which the common stock was last sold, or the average bid and asked price of such common stock, as of the last business day of the registrant's most recently completed second quarter, is $121,300,666.

As of February 28, 2018, 8,112,292 shares of the registrant's common stock were outstanding.

Portions of the registrant's definitive Proxy Statement for its 2018 Annual Meeting of Shareholders are incorporated by reference into Part III of this Annual Report on Form10-K.

FORM 10-K

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When used in this Annual Report on Form 10-K for the year ended December 31, 2017 (this "Form 10-K"), the words the "Company," "we," "our," and "us" refer to 1ST Constitution Bancorp and its wholly owned subsidiaries, unless we indicate otherwise.

Forward-Looking Statements

This Form 10-K contains "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 relating to, without limitation, our future economic performance, plans and objectives for future operations, and projections of revenues and other financial items that are based on our beliefs, as well as assumptions made by and information currently available to us. The words "may," "will," "anticipate," "should," "would," "believe," "contemplate," "could," "project," "predict," "expect," "estimate," "continue," and "intend," as well as other similar words and expressions of the future, are intended to identify forward-looking statements.

These forward-looking statements generally relate to our plans, objectives and expectations for future events and include statements about our expectations, beliefs, plans, objectives, intentions, assumptions and other statements that are not historical facts. These statements are based upon our opinions and estimates as of the date they are made. 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 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; legislation or regulatory changes, including the Dodd-Frank Act; changes in monetary and fiscal policies of the U.S. Government; 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 FDIC’s need to increase the Deposit Insurance Fund assessments; technological changes; the effect of 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 Securities and Exchange Commission (the "SEC"); and our ability to manage the risks involved in the foregoing. Although management has taken certain steps to mitigate any negative effect of the aforementioned items, significant unfavorable changes could severely impact the assumptions used and have an adverse effect on profitability. Additional information concerning the factors that could cause actual results to differ materially from those in the forward-looking statements is contained in Item 1. "Business," Item 7. "Management’s Discussion and Analysis of Financial Condition and Results of Operations," and elsewhere in this Annual Report on Form 10-K and in our other filings with the SEC. However, other factors besides those listed in Item 1A. Risk Factors or discussed in this Annual Report also could adversely affect our results and you should not consider any such list of factors to be a complete list of all potential risks or uncertainties. Any forward-looking statements made by us or on our behalf speak only as of the date they are made. We undertake no obligation to publicly revise any forward-looking statements or cautionary factors, except as required by law.

PART I
Item 1. Business.

1ST Constitution Bancorp

1ST Constitution Bancorp is a bank holding company registered under the Bank Holding Company Act of 1956, as amended. 1ST Constitution Bancorp 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 1ST Constitution Bank (the "Bank") and thereby enabling the Bank to operate within a bank holding company structure. The Company became an active bank holding company on July 1, 1999. As of December 31, 2017, the Company has two employees, both of whom are full-time. The Bank is a wholly-owned subsidiary of the Company. Other than its investment in the Bank, the Company currently conducts no other significant business activities.

The main office of the Company and the Bank is located at 2650 Route 130 Cranbury, New Jersey 08512, and the telephone number is (609) 655-4500.

1ST Constitution Bank

The Bank is a commercial bank formed under the laws of the State of New Jersey and engages in the business of commercial and retail banking. As a community bank, the Bank offers a wide range of services (including demand, savings and time deposits and commercial and consumer/installment loans) to individuals, small businesses and not-for-profit organizations principally in the Fort Lee area of Bergen County and in Middlesex, Mercer, Somerset and Monmouth Counties of New Jersey. The Bank conducts its operations through its main office located in Cranbury, New Jersey, and operates 17 additional branch offices in downtown Cranbury, Hamilton Square, Hightstown, Hillsborough, Hopewell, Jamesburg, Lawrenceville, Perth Amboy, Plainsboro, Fort Lee, Princeton, Rumson, Fair Haven, Shrewsbury, Skillman, Little Silver and Asbury Park, New Jersey. The Bank also operates two residential mortgage loan production offices in Forked River and Jersey City, New Jersey. The Bank’s deposits are insured up to applicable legal limits by the Federal Deposit Insurance Corporation "FDIC"). As of December 31, 2017, the Bank had 183 employees, of which 174 were full-time employees.

Management efforts focus on positioning the Bank to meet the financial needs of the communities in Middlesex, Mercer, Somerset and Monmouth Counties and the Fort Lee area of Bergen County and to provide financial services to individuals, families, institutions and small businesses. To achieve this goal, the Bank is focusing its efforts on:

•expansion of the Bank;
•personal service; and
•technological advances and e-commerce.

Expansion of the Bank

The Bank continually evaluates opportunities to expand its products and services to existing and new customers and expand into new markets through the acquisition of other banks and bank offices within and contiguous to its existing markets and/or by opening new branch offices.

On November 6, 2017, the Company and the Bank entered into an Agreement and Plan of Merger (the "Merger Agreement") with New Jersey Community Bank ("NJCB"), providing for the merger of NJCB with and into the Bank, with the Bank as the surviving entity (the "Merger"). If the Merger is completed, shareholders of NJCB will be entitled to receive, for each outstanding share of NJCB common stock that they own at the effective time of the Merger, a combination of common stock of the Company and cash as follows:

(i) 0.1309 of a share of common stock of the Company, subject to the payment of cash in lieu of fractional shares, which stock exchange ratio was based on the average closing price of $19.25 for a share of common price of the Company during the measurement period specified in the Merger Agreement; and

(ii) $1.60 in cash, subject to $0.21 being placed in escrow in accordance with the terms and conditions of the merger agreement to cover costs and expenses that may be incurred by the Company after the effective time of the merger as a result of specific pending litigation against NJCB.

The Company and the Bank have submitted and received all required regulatory approvals and waivers. The Company has filed a registration statement on Form S-4, which includes a proxy statement of NJCB and a prospectus of the Company, with the Securities and Exchange Commission (the "SEC") to register shares of common stock of the Company to be issued to shareholders of NJCB. The registration statement on Form S-4 was declared effective on February 15, 2018 by the SEC and the proxy statement-prospectus was mailed to shareholders of NJCB on or about February 22, 2018. The closing of the Merger remains subject to a number of conditions, including approval of the Merger Agreement by NJCB shareholders at a special meeting of shareholders scheduled to be held on March 22, 2018. The closing of the Merger is anticipated to take place during the second quarter of 2018.

On December 31, 2017, NJCB had approximately $103.1 million in assets, approximately $79.0 million in loans, approximately $93.7 million in deposits and approximately $8.9 million in shareholders' equity. NJCB operates two offices in Monmouth County, New Jersey: its main office in Freehold and a branch office in Neptune City.

Personal Service

The Bank provides a wide range of commercial and consumer banking services to individuals, families, institutions and small businesses in central and coastal New Jersey and the Fort Lee area of Bergen County. The Bank’s focus is to understand the needs of the community and its customers and tailor products, services and advice to meet those needs. The Bank seeks to provide a high level of personalized banking services, emphasizing quick and flexible responses to customer demands.

Technological Advances and e-Commerce

The Bank recognizes that customers want to receive service via their most convenient delivery channel, be it the traditional branch office, by telephone, ATM, or the Internet. For this reason, the Bank continues to enhance its e-commerce capabilities. At www.1stconstitution.com, customers have easy access to online banking, including account access, and to the Bank’s bill payment system. Consumers and businesses may also access their accounts and make deposits through their mobile devices. Consumers can apply online for loans and interact with senior management through the e-mail system. Business customers have access to cash management information and transaction capability through the Bank’s online Cash Manager product which permits business customers to make deposits, originate ACH payments, initiate wire transfers, retrieve account information and place “stop payment” orders. This overall expansion in electronic banking provides the Bank’s customers with the means to access the Bank’s services easily and at their own convenience.

Competition

The Bank experiences substantial competition in attracting and retaining deposits and in making loans. In attracting deposits and borrowers, the Bank competes with commercial banks, savings banks, and savings and loan associations, as well as regional and national insurance companies and non-bank financial institutions, mutual funds, regulated small loan companies and local credit unions, regional and national sponsors of money market funds and corporate and government borrowers. Within the direct market area of the Bank, there are a significant number of offices of competing financial institutions. In New Jersey generally, and in the Bank’s local market specifically, the Bank’s most direct competitors are large commercial banks including Bank of America, PNC Bank, JP Morgan Chase, Wells Fargo and Santander Bank, as well as savings banks and savings and loan associations, including Provident Bank and Investors Bank.

The Bank is at a competitive disadvantage compared with these larger national and regional commercial and savings banks. By virtue of their larger capital, asset size and reserves, many of such institutions have substantially greater lending limits (ceilings on the amount of credit a bank may provide to a single customer that are linked to the institution's capital) and other resources than the Bank. Many such institutions are empowered to offer a wider range of services, including trust services, than the Bank and, in some cases, have lower funding costs (the price a bank must pay for deposits and other borrowed monies used to make loans to customers) than the Bank. In addition to having established deposit bases and loan portfolios, these institutions, particularly large national and regional commercial and savings banks, have the financial ability to finance extensive advertising campaigns and to allocate considerable resources to locations and products perceived as profitable.

In addition, non-bank financial institutions offer services that compete for customers' investable funds and deposits with the Bank. For example, brokerage firms and insurance companies offer such instruments as short-term money market funds, corporate and government securities funds, mutual funds and annuities. It is expected that competition in these areas will continue to increase. Some of these competitors are not subject to the same degree of regulation and supervision as the Company and the Bank and therefore may be able to offer customers more attractive products than the Bank.

However, management of the Bank believes that loans to small and mid-sized businesses and professionals, which represent the main commercial loan business of the Bank, are not always of primary importance to the larger banking institutions. The Bank competes for this segment of the market by providing responsive personalized services, making timely local decisions, and acquiring in depth knowledge of its customers and their businesses.

Lending Activities

The Bank’s lending activities include both commercial and consumer loans. Loan originations are derived from a number of sources, including real estate broker referrals, mortgage loan companies, direct solicitation by the Bank’s loan officers, existing depositors and borrowers, builders, attorneys, walk-in customers and, in some instances, other lenders. The Bank has established disciplined and systematic procedures for approving and monitoring loans that vary depending on the size and nature of the loans.

Commercial Business

The Bank 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 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 loans is substantially dependent on the success of the business itself and on the quality of its management. As a general practice, the Bank takes, as collateral, a security interest in any available real estate, equipment, inventory, receivables or other personal property of its borrowers, although the Bank occasionally makes commercial loans on an unsecured basis. Generally, the Bank requires personal guarantees of its commercial loans to offset the risks associated with such loans. The Bank also offers loans of which a portion, generally 75% to 85%, are guaranteed by the Small Business Administration ("SBA"), which is a United States government agency. The Bank generally sells the guaranteed portion of these loans into the secondary market.

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. The Company's commercial real estate portfolio is largely secured by real estate collateral located in the State of New Jersey.

Commercial 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 or smaller multi-family buildings (less than ten units) that are presold, or are to be sold or leased on a speculative basis. The Bank lends to builders and developers with established relationships, successful operating histories and sound financial resources.

Residential Lending

A portion of the Bank’s lending activities consists of the origination of fixed and adjustable rate residential first mortgage loans secured by owner-occupied property located in the Bank’s primary market areas. Home mortgage lending is unique in that a broad geographic territory may be serviced by originators working from strategically placed offices either within the Bank’s traditional banking facilities or from affordable office locations in commercial buildings. The Bank also offers construction loans, reverse mortgages, second mortgage home improvement loans and home equity lines of credit.

The Bank finances the construction of individual, owner-occupied single-family houses on the basis of written underwriting and construction loan management guidelines. These loans are made to qualified individual borrowers and are generally supported by a take-out commitment from a permanent lender. The construction phase of these loans has certain risks, including the viability of the contractor, the contractor’s ability to complete the project within the budget and changes in interest rates.

The Bank will generally sell its originated residential mortgage loans in the secondary market. The decision to sell is made prior to origination. The sale into the secondary market allows the Bank to mitigate its interest rate risks related to such lending operations. This brokerage arrangement allows the Bank to accommodate its clients’ demands while eliminating the interest rate risk for the 15 to 30-year period generally associated with such loans.

For commercial and residential mortgage loans, the Bank, in most cases, requires borrowers to obtain and maintain title, fire, and extended casualty insurance, and, where required by applicable regulations, flood insurance. The Bank maintains its own errors and omissions insurance policy to protect against loss in the event of failure of a mortgagor to pay premiums on fire and other hazard insurance policies. Mortgage loans originated by the Bank customarily include a "due on sale" clause, which gives the Bank the right to declare a loan immediately due and payable in certain circumstances, including, without limitation, upon the sale or other disposition by the borrower of the real property subject to a mortgage. In general, the Bank enforces "due on sale" clauses.

Non-Residential Consumer Lending

Non-residential consumer loans made by the Bank include loans for automobiles, recreation vehicles, and boats, as well as personal loans (secured and unsecured) and deposit account secured loans. Non-residential consumer loans are attractive to the Bank because they typically have a shorter term and carry higher interest rates than are charged on other types of loans. However, non-residential consumer loans pose an additional risk of collectability when compared to traditional loans, such as residential mortgage loans.

Consumer loans are granted based on employment and financial information solicited from prospective borrowers, as well as credit records collected from various reporting agencies. The stability of the borrower, willingness to pay and credit history are the primary factors to be considered. The availability of collateral is also a factor considered in making such a loan. The Bank seeks collateral that can be assigned and has good marketability with a clearly adequate margin of value. The geographic area of the borrower is another consideration, with preference given to borrowers in the Bank's primary market areas.

Supervision and Regulation

Banking is a complex, highly-regulated industry. The primary goals of the bank regulatory scheme are to maintain a safe and sound banking system and to facilitate the conduct of monetary policy. In furtherance of those goals, Congress has created several largely autonomous regulatory agencies and enacted a myriad of legislation that governs banks, bank holding companies and the banking industry. This regulatory framework is intended primarily for the protection of depositors and not for the protection of the Company's shareholders or creditors. Descriptions of, and references to, the statutes and regulations below are brief summaries thereof, and do not purport to be complete. The descriptions are qualified in their entirety by reference to the specific statutes and regulations discussed.

Regulation of the Bank Holding Company

The Company is a bank holding company within the meaning of the Bank Holding Company Act of 1956, as amended (the "BHCA"). As a bank holding company, the Company is subject to inspection, examination and supervision by the Board of Governors of the Federal Reserve System (the "Federal Reserve Board") and is required to file with the Federal Reserve Board an annual report and such additional information as the Federal Reserve Board may require pursuant to the BHCA. The Federal Reserve Board may also make examinations of the Company and its subsidiaries. The Company is subject to capital standards similar to, but separate from, those applicable to the Bank.

Under the BHCA, bank holding companies that are not financial holding companies generally may not acquire the ownership or control of more than 5% of the voting shares, or substantially all of the assets, of any company, including a bank or another bank holding company, without the Federal Reserve Board's prior approval. The Company has not applied to become a financial holding company but did obtain such approval to acquire the shares of the Bank. A bank holding company that does not qualify as a financial holding company is generally limited in the types of activities in which it may engage to those that the Federal Reserve Board had recognized as permissible for bank holding companies prior to the date of enactment of the Gramm-Leach- Bliley Financial Services Modernization Act of 1999. For example, a holding company and its banking subsidiary are prohibited from engaging in certain tie-in arrangements in connection with any extension of credit or lease or sale of any property or the furnishing of services. At present, the Company does not engage in any significant activity other than owning the Bank.

In addition to federal bank holding company regulation, the Company is registered as a bank holding company with the New Jersey Department of Banking and Insurance (the "NJ Banking Department"). The Company is required to file with the NJ Banking Department copies of the reports it files with the federal banking and securities regulators.

Regulation of the Bank Subsidiary

As a New Jersey-chartered commercial bank, the Bank is subject to supervision and examination by the NJ Banking Department. The Bank is also subject to regulation and examination by the FDIC, which is its principal federal bank regulator.

The Bank must comply with various requirements and restrictions under federal and state law, including the maintenance of reserves against deposits, restrictions on the types and amounts of loans that may be granted and the interest that may be charged thereon, limitations on the types of investments that may be made and the services that may be offered, and restrictions on dividends as described in the below section titled "Restrictions on Dividends and Redemption of Stock for the Company and the Bank." The Bank must also comply with the capital regulations promulgated by the FDIC as described in the section below titled "Capital Adequacy of the Company and the Bank." Consumer laws and regulations also affect the operations of the Bank. In addition to the impact of regulation, commercial banks are affected significantly by the actions of the Federal Reserve Board which influence the money supply and credit availability in the national economy.

For additional information on laws and regulations affecting the Bank, please refer to the below section titled "Banking Legislation and Regulations."

Capital Adequacy of the Company and the Bank

The Company is required to comply with minimum capital adequacy standards established by the Federal Reserve Board. There are two basic measures of capital adequacy for bank holding companies and the depository institutions that they own: a risk based measure and a leverage measure. All applicable capital standards must be satisfied for a bank holding company to be considered in compliance.

The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") requires each federal banking agency to revise its risk-based capital standards to ensure that those standards take adequate account of interest rate risk, concentration of credit risk and the risks of non-traditional activities. In addition, pursuant to FDICIA, each federal banking agency has promulgated regulations specifying the levels at which a bank would be considered "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," or "critically undercapitalized" and requiring that certain mandatory and discretionary supervisory actions be taken based on the capital level of the institution.

In December 2010, the Group of Governors and Heads of Supervisors of the Basel Committee on Banking Supervision, the oversight body of the Basel Committee, published its “calibrated” capital standards for major banking institutions, referred to as Basel III. Subsequently, 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 address relevant provisions of the Dodd-Frank Act. The Federal Reserve Board’s and the FDIC’s rules 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 establish a new Common Equity Tier 1 minimum capital requirement (4.5% of risk-weighted assets) and increase 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 limit 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 (subject to phase-in periods for certain components). 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 increases by that amount each year until fully implemented in January 2019 at 2.5% of Common Equity Tier 1 capital to risk-weighted assets. As of January 1, 2018, the Company and the Bank were required to maintain a capital conservation buffer of 1.875%.

With respect to the Bank, the FDIC's regulations implementing these provisions of FDICIA provide that an institution will be classified as "well capitalized" if it (i) has a total risk-based capital ratio of at least 10.0 percent, (ii) has a Tier 1 risk-based capital ratio of at least 8.0 percent, (iii) has a Common Equity Tier 1, or CET1, ratio of at least 6.5 percent, (iv) has a Tier 1 leverage ratio of at least 5.0 percent, and (v) meets certain other requirements. An institution will be classified as "adequately capitalized" if it (i) has a total risk-based capital ratio of at least 8.0 percent, (ii) has a Tier 1 risk-based capital ratio of at least 6.0 percent, (iii) has a CET1 ratio of at least 4.5 percent, (iv) has a Tier 1 leverage ratio of at least 4.0 percent, and (v) does not meet the definition of "well capitalized." An institution will be classified as "undercapitalized" if it (i) has a total risk-based capital ratio of less than 8.0 percent, (ii) has a Tier 1 risk-based capital ratio of less than 6.0 percent, (iii) has a CET1 ratio of less than 4.5 percent or (iv) has a Tier 1 leverage ratio of less than 4.0 percent. An institution will be classified as "significantly undercapitalized" if it (i) has a total risk-based capital ratio of less than 6.0 percent, (ii) has a Tier 1 risk-based capital ratio of less than 4.0 percent, (iii) has a CET1 ratio of less than 3.0 percent or (iv) has a Tier 1 leverage ratio of less than 3.0 percent. An institution will be classified as "critically undercapitalized" if it has a Tier 1 leverage ratio that is equal to or less than 2.0 percent. An insured depository institution may be deemed to be in a lower capitalization category if it receives an unsatisfactory examination rating. Similar categories apply to bank holding companies. When the capital conservation buffer is fully phased in, the capital ratios applicable to depository institutions will exceed the ratios to be considered well-capitalized under the prompt corrective action regulations.

Under these capital rules, the Bank’s CET1 risk-based capital, Tier 1 risk-based capital, total risk-based capital and leverage capital ratios were 11.74%, 11.74% ,12.55%, and 10.96%, respectively, at December 31, 2017. The Bank is classified as a non-advanced approaches bank for regulatory purposes and has permanently opted out of including the amount of accumulated other comprehensive income in the computation of regulatory capital.

Restrictions on Dividends and Redemption of Stock for the Company and the Bank

The primary source of cash to pay dividends, if any, to the Company’s shareholders and to meet the Company’s obligations is dividends paid to the Company by the Bank. Dividend payments by the Bank to the Company are subject to the New Jersey Banking Act of 1948 (the "Banking Act") and the Federal Deposit Insurance Act (the "FDIA"). Under the Banking Act, the Bank may not pay dividends unless, following the dividend payment, the capital stock of the Bank will be unimpaired and (i) the Bank will have a surplus of not less than 50% of its capital stock or, if not, (ii) the payment of such dividend will not reduce the surplus of the Bank. Under the FDIA, the Bank may not pay any dividends, if after paying the dividend, it would be undercapitalized under applicable capital requirements. In addition to these explicit limitations, the federal regulatory agencies are authorized to prohibit a banking subsidiary or bank holding company from engaging in an unsafe or unsound banking practice. Depending upon the circumstances, the agencies could take the position that paying a dividend would constitute an unsafe or unsound banking practice. The Bank is also limited in paying dividends if it does not maintain the necessary "capital conservation buffer' as discussed below.

It is the policy of the Federal Reserve Board that bank holding companies should pay cash dividends on common stock only out of income available over the immediately preceding year and only if prospective earnings retention is consistent with the organization’s expected future needs and financial condition. The policy provides that bank holding companies should not maintain a level of cash dividends that undermines the bank holding company’s ability to serve as a source of strength to its banking subsidiary. A bank holding company may not pay dividends when it is insolvent.

The Federal Reserve Board has issued a supervisory letter to bank holding companies that contains guidance on when the board of directors of a bank holding company should eliminate or defer or severely limit dividends, including, for example, when net income available for shareholders for the past four quarters, net of dividends paid during that period, is not sufficient to fully fund the dividends. The letter also contains guidance on the redemption of stock by bank holding companies which urges bank holding companies to advise the Federal Reserve Board of any such redemption or repurchase of common stock for cash or other value that results in the net reduction of a bank holding company’s capital at the beginning of the quarter below the capital outstanding at the end of the quarter. The Company’s payment of cash dividends to date were within the guidelines set forth in the Federal Reserve Board’s supervisory letter.

Subsequent to the issuance of the supervisory letter, the Federal Reserve Board adopted regulations requiring bank holding companies to give prior written notice to the Federal Reserve Board before purchasing or redeeming its stock if the gross consideration for the purchase or redemption, when aggregated with the net consideration (i.e., gross consideration paid for purchases and redemptions minus gross consideration received for all stock sold) paid for all purchases or redemptions of stock during the preceding 12 months, is equal to 10 percent or more of the bank holding company’s consolidated net worth. However, if a bank holding company (i) will be well-capitalized before and immediately after the purchase or redemption, (ii) is well-managed and (iii) is not the subject of any unresolved supervisory issues, then the bank holding company will not be required to give any prior written notice to the Federal Reserve Board. At this time, the Company fits within the above exception and is not required to give prior written notice to the Federal Reserve Board before purchasing or redeeming its stock.

The Federal Reserve Board’s capital adequacy rules also limit a banking organization’s ability to pay dividends or to engage in share repurchases 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 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 will increase by that amount each year until fully implemented in January 2019 at 2.5% of common equity Tier 1 capital to risk-weighted assets. For further discussion of regulatory capital rules, please refer to the discussion under the above section titled "Capital Adequacy of the Company and the Bank." As of January 1, 2018, the Company and the Bank were required to maintain a capital conservation buffer of 1.875%.

The timing and the amount of the payment of future dividends, if any, on the Company's common shares 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.

Priority on Liquidation

The Company is a legal entity separate and distinct from the Bank. The rights of the Company as the sole shareholder of the Bank, and therefore the rights of the Company's creditors and shareholders, to participate in the distributions and earnings of the Bank when the Bank is not in receivership under Federal banking laws, are subject to various state and federal law restrictions as discussed above under the heading "Restrictions on Dividends and Redemption of Stock for the Company and the Bank." In the event of a liquidation or other resolution of an insured depository institution such as the Bank, the claims of depositors and other general or subordinated creditors are entitled to a priority of payment over the claims of holders of an obligation of the institution to its shareholders (the Company) or any shareholder or creditor of the Company. The claims on the Bank by creditors include obligations in respect of federal funds purchased and certain other borrowings, as well as deposit liabilities.

Financial Institution Legislation

Dodd-Frank Act

The Dodd-Frank Act has had a broad impact on the financial services industry, including significant regulatory and compliance requirements, including, among other things, (i) enhanced resolution authority of troubled and failing banks and their holding companies; (ii) increased capital and liquidity requirements; (iii) increased regulatory examination fees; (iv) changes to assessments to be paid to the FDIC for federal deposit insurance; and (v) numerous other provisions designed to improve supervision and oversight of, and strengthen safety and soundness for, the financial services sector. Additionally, the Dodd-Frank Act established a framework for systemic risk oversight within the financial system to be distributed among federal regulatory agencies, including the Financial Stability Oversight Council, the Federal Reserve Board, the Office of the Comptroller of the Currency, and the FDIC.

Effective in July 2011, the Dodd-Frank Act eliminated federal prohibitions on paying interest on demand deposits, thus allowing businesses to have interest bearing checking accounts. As of the date of this Form 10-K, the Bank does not pay interest on demand deposits. This significant change to existing law has not had an adverse impact on our net interest margin for the years ended December 31, 2017, 2016 and 2015.

The Dodd-Frank Act also changed the base for FDIC deposit insurance assessments. Assessments are based on average consolidated total assets less tangible equity capital of a financial institution, rather than on deposits. The Dodd-Frank Act also increased the maximum amount of deposit insurance for banks, savings institutions and credit unions to $250,000 per account owner. However, if an Interest on Lawyer Trust Account ("IOLTA") qualifies for pass-through coverage as a fiduciary account, then each separate client for whom a law firm holds funds in such IOLTA may be insured up to $250,000 for his or her funds. The legislation also increased the required minimum reserve ratio for the Deposit Insurance Fund, from 1.15% to 1.35% of insured deposits, and directed the FDIC to offset the effects of increased assessments on depository institutions with less than $10 billion in assets, including the Bank.

The Dodd-Frank Act requires publicly traded companies to give their stockholders a non-binding vote on executive compensation ("say on pay") and so-called "golden parachute" payments. It also provides that the listing standards of the national securities exchanges shall require listed companies to implement and disclose "clawback" policies mandating the recovery of incentive compensation paid to executive officers in connection with accounting restatements. Such listing standards have yet to be implemented. For further discussion of incentive compensation rules, please refer to the discussion under the below section titled "Incentive Compensation."

The Dodd-Frank Act created the Consumer Financial Protection Bureau with broad powers to supervise and enforce consumer protection laws. The Consumer Financial Protection Bureau has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit "unfair, deceptive or abusive" acts and practices. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks and savings institutions with more than $10 billion in assets, which authority does not extend to the Bank at this time since we do not meet the asset threshold.

The Dodd-Frank Act also weakens the federal preemption rules that have been applicable to national banks and federal savings associations, and gives state attorneys general the ability to enforce federal consumer protection laws. The Dodd-Frank Act requires minimum leverage (Tier 1) and risk based capital requirements for bank and savings and loan holding companies, which exclude certain instruments that previously have been eligible for inclusion by bank holding companies as Tier 1 capital, such as trust preferred securities; however, bank holding companies with assets of less than $15 billion as of December 31, 2009 are permitted to include trust preferred securities that were issued before May 19, 2010 as Tier 1 capital.

The Dodd-Frank Act and the rules and regulations promulgated under the Dodd-Frank Act have impacted the Bank, as well as all community banks, by increasing our operating and compliance costs. To the extent the Dodd-Frank Act remains in place, it is likely to further increase our operating and compliance costs as certain yet to be written implementing rules and regulations are enacted.

Volcker Rule

On December 10, 2013, the Federal Reserve, the Office of the Comptroller of the Currency, the FDIC, the Commodity Futures Trading Commission and the SEC issued final rules to implement the Volcker Rule contained in Section 619 of the Dodd-Frank Act, which became effective on July 21, 2015, for investments in covered funds made after December 31, 2013. The Volcker Rule prohibits an insured depository institution and its affiliates from: (i) engaging in "proprietary trading" and (ii) investing in or sponsoring certain types of funds (defined as "Covered Funds") subject to certain limited exceptions. The rule also effectively prohibits short-term trading strategies by any U.S. banking entity if those strategies involve instruments other than those specifically permitted for trading and prohibits the use of some hedging strategies. The Company identified no investments that met the definition of Covered Funds and that were required to be divested by July 21, 2015 under the foregoing rules.

Incentive Compensation

The Dodd-Frank Act requires the federal bank regulatory agencies and the SEC to establish joint regulations or guidelines prohibiting incentive-based payment arrangements at specified regulated entities with at least $1 billion in total assets, such as the Company and the Bank, that encourage inappropriate risks by providing an executive officer, employee, director or principal shareholder with excessive compensation, fees, or benefits or that could lead to material financial loss to the entity. In addition, these agencies must establish regulations or guidelines requiring enhanced disclosure to regulators of incentive-based compensation arrangements. The agencies proposed such regulations in April 2011 and subsequently proposed revised regulations in May 2016, but the revised regulations have not been finalized. If the revised regulations are adopted in the form proposed, they will impose limitations on the manner in which the Company may structure compensation for its executives and employees.

In 2010, the Federal Reserve, the Office of the Comptroller of the Currency and the FDIC issued comprehensive final guidance on incentive compensation policies intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The guidance, which covers all employees that have the ability to materially affect the risk profile of an organization, either individually or as part of a group, is based on the key principles that a banking organization’s incentive compensation arrangements should (i) provide incentives that do not encourage risk-taking beyond the organization’s ability to effectively identify and manage risks, (ii) be compatible with effective internal controls and risk management, and (iii) be supported by strong corporate governance, including active and effective oversight by the organization’s board of directors. These three principles are incorporated into the proposed joint compensation regulations under the Dodd-Frank Act.

The Federal Reserve will review, as part of its regular, risk-focused examination process, the incentive compensation arrangements of banking organizations, such as the Company, that are not "large, complex banking organizations." These reviews will be tailored to each organization based on the scope and complexity of the organization’s activities and the prevalence of incentive compensation arrangements. The findings of the supervisory initiatives will be included in reports of examination. Deficiencies will be incorporated into the organization’s supervisory ratings, which can affect the organization’s ability to make acquisitions and take other actions. Enforcement actions may be taken against a banking organization if its incentive compensation arrangements, or related risk-management control or governance processes, pose a risk to the organization’s safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

Gramm-Leach-Bliley Financial Services Modernization Act of 1999

The Gramm-Leach-Bliley Financial Services Modernization Act of 1999 (the "Modernization Act") became effective in early 2000. The Modernization Act:

- allows bank holding companies meeting management, capital and Community Reinvestment Act standards to engage in a substantially broader range of non-banking activities, including insurance underwriting and making merchant banking investments in commercial and financial companies; if a bank holding company elects to become a financial holding company, it files a certification, effective in 30 days, and thereafter may engage in certain financial activities without further approvals;
- allows banks to establish subsidiaries to engage in certain activities that a financial holding company could engage in, provided that the bank meets certain management, capital and Community Reinvestment Act standards;
- allows insurers and other financial services companies to acquire banks and removes various restrictions applicable to bank holding company ownership of securities firms and mutual fund advisory companies; and establishes the overall regulatory structure applicable to financial holding companies that also engage in insurance and securities operations.

The Modernization Act also amended the BHCA and the Bank Merger Act to require the federal banking agencies to consider the effectiveness of a financial institution’s anti-money laundering activities when reviewing an application under these acts. The Modernization Act modified other laws, including laws related to financial privacy and community reinvestment.

Additional proposals to change the laws and regulations governing the banking and financial services industry are frequently introduced in Congress, in state legislatures and before the various bank regulatory agencies. The likelihood and timing of any such changes and the impact such changes might have on the Company cannot be determined at this time.

Public Company Legislation

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley Act”), which became law on July 30, 2002, added new legal requirements affecting corporate governance, accounting and corporate reporting for companies with publicly traded securities.

The Sarbanes-Oxley Act provides for, among other things:

- a prohibition on personal loans made or arranged by the issuer to its directors and executive officers (except for loans made by a bank subject to Regulation O of the Federal Reserve Board);
- independence requirements for audit committee members;
- disclosure of whether at least one member of the audit committee is a "financial expert" (as such term is defined by the SEC and if not, why not;
- independence requirements for outside auditors;
- a prohibition on a company’s registered public accounting firm from performing statutorily mandated audit services for the company if the company’s chief executive officer, chief financial officer, comptroller, chief accounting officer or any person serving in equivalent positions had been employed by such firm and participated in the audit of such company during the one-year period preceding the audit initiation date;
- certification of financial statements and annual and quarterly reports by the principal executive officer and the principal financial officer;
-

the forfeiture of bonuses or other incentive-based compensation and profits from the sale of an issuer's securities by directors and senior officers in the twelve month period following initial publication of any financial statements that later require restatement due to corporate misconduct;

- disclosure of off-balance sheet transactions;
- two-business day filing requirements for insiders filing Forms 4;
- disclosure of a code of ethics for financial officers and filing a Form 8-K for a change or waiver of such code;
- "real time" filing of periodic reports;
- posting of certain SEC filings and other information on the company's website;
- the reporting of securities violations "up the ladder" by both in-house and outside attorneys;
- restrictions on the use of non-GAAP financial measures;

- the formation of a public accounting oversight board; and
- various increased criminal penalties for violations of securities laws.

Additionally, Section 404 of the Sarbanes-Oxley Act requires that a public company subject to the reporting requirements of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), include in its annual report (i) a management's report on internal control over financial reporting assessing the company's internal controls, and (ii) if the company is an "accelerated filer" or a "large accelerated filer", an auditor's attestation report, completed by the registered public accounting firm that prepares or issues an accountant's report which is included in the company's annual report, attesting to the effectiveness of management's internal control assessment.

The Company met the "accelerated filer" requirements as of the end of its fiscal year ended December 31, 2016 pursuant to Rule 12b-2 of the Exchange Act. However, pursuant to Rule 12b-2 and SEC Release No. 33-8876, the Company (as a smaller reporting company transitioning to the larger reporting company system) was not required to satisfy the larger reporting company disclosure requirements until its first Quarterly Report on Form 10-Q for the fiscal year ended December 31, 2017. The Company was further required to include an attestation report of the Company's independent registered public accounting firm regarding the Company's internal control over financial reporting in its Annual Report on Form 10-K for the year ended December 31, 2016. Going forward, the Company will continue to include attestation reports of the Company's independent registered public accounting firm regarding the Company's internal control over financial reporting in its Annual Reports on Form 10-K for so long as the Company is an "accelerated filer."

Each of the national stock exchanges, including the Nasdaq Global Market where the Company's common stock is listed, have in place corporate governance rules, including rules requiring director independence, and the adoption of charters for the nominating, corporate governance, and audit committees. These rules are intended to, among other things, make the board of directors independent of management and allow shareholders to more easily and efficiently monitor the performance of companies and directors. These burdens increase the Company's legal and accounting fees and the amount of time that the Board of Directors and management must devote to corporate governance issues.

Section 302(a) of the Sarbanes-Oxley Act requires the Company's principal executive officer and principal financial officer to certify that the Company's Quarterly and Annual Reports do 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 circumstances under which they were made, not misleading. The rules have several requirements, including having these officers certify that: they are responsible for establishing, maintaining and regularly evaluating the effectiveness of the Company's disclosure controls and procedures and internal control over financial reporting; they have made certain disclosures to the Company's auditors and the audit committee of the Board of Directors about the Company's internal control over financial reporting; and they have included information in the Company's Quarterly and Annual Reports about their evaluation of disclosure controls and procedures and whether there have been significant changes in the Company's internal controls over financial reporting.

Banking Legislation and Regulations

Anti-Money Laundering

As part of the USA PATRIOT Act, signed into law on October 26, 2001, Congress adopted the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001 (the "Act"). The Act authorizes the Secretary of the Treasury, in consultation with the heads of other government agencies, to adopt special measures applicable to financial institutions such as banks, bank holding companies, broker-dealers and insurance companies. Among its other provisions, the Act requires each financial institution: (i) to establish an anti-money laundering program; (ii) to establish due diligence policies, procedures and controls that are reasonably designed to detect and report instances of money laundering in United States private banking accounts and correspondent accounts maintained for non-United States persons or their representatives; and (iii) to avoid establishing, maintaining, administering, or managing correspondent accounts in the United States for, or on behalf of, a foreign shell bank that does not have a physical presence in any country. In addition, the Act expands the circumstances under which funds in a bank account may be forfeited and requires covered financial institutions to respond under certain circumstances to requests for information from federal banking agencies within 120 hours.

The Department of Treasury has issued regulations implementing the due diligence requirements. These regulations require minimum standards to verify customer identity and maintain accurate records, encourage cooperation among financial institutions, federal banking agencies, and law enforcement authorities regarding possible money laundering or terrorist activities, prohibit the anonymous use of "concentration accounts," and require all covered financial institutions to have in place an anti- money laundering compliance program.

Community Reinvestment Act

Under the Community Reinvestment Act ("CRA"), as implemented by FDIC regulations, a bank has a continuing and affirmative obligation, consistent with its safe and sound operation, to help meet the credit needs of its entire community, including low- and moderate-income neighborhoods. CRA does not establish specific lending requirements or programs for financial institutions, nor does it limit an institution's discretion to develop the types of products and services that it believes are best suited to its particular community, consistent with CRA. CRA requires the FDIC to assess an institution's record of meeting the credit needs of its community and to take such record into account in its evaluation of certain applications by the applicable institution. CRA requires public disclosure of an institution's CRA rating and requires that the FDIC provide a written evaluation of an institution's CRA performance utilizing a four-tiered descriptive rating system. An institution's CRA rating is considered in determining whether to grant charters, branches and other deposit facilities, relocations, mergers, consolidations and acquisitions. Performance less than satisfactory may be the basis for denying an application. At its last CRA examination, the Bank was rated "satisfactory" under CRA.

FIRREA

Under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"), a depository institution insured by the FDIC can be held liable for any loss incurred by, or reasonably expected to be incurred by, the FDIC in connection with (i) the default of a commonly controlled FDIC-insured depository institution or (ii) any assistance provided by the FDIC to a commonly controlled FDIC-insured depository institution in danger of default. These provisions have commonly been referred to as FIRREA's "cross guarantee" provisions. Further, under FIRREA, the failure to meet capital guidelines could subject a bank to a variety of enforcement remedies available to federal regulatory authorities.

FIRREA also imposes certain independent appraisal requirements upon a bank's real estate lending activities and further imposes certain loan-to-value restrictions on a bank's real estate lending activities. Banking regulators have promulgated regulations in these areas.

Insurance of Deposits

The Bank's deposits are insured up to applicable limits by the Deposit Insurance Fund of the FDIC. This limit is $250,000 per account owner. FDICIA is applicable to depository institutions and deposit insurance. The FDIC established a risk-based assessment system for all insured depository institutions and established an insurance premium assessment system based upon: (i) the probability that the insurance fund will incur a loss with respect to the institution, (ii) the likely amount of the loss, and (iii) the revenue needs of the insurance fund. The resulting matrix sets the assessment premium for a particular institution in accordance with its capital level and overall rating by the primary regulator.

As a result of the Dodd-Frank Act, the FDIC modified its assessment rules so that an institution's deposit insurance assessment base changed from total deposits to total assets less tangible equity. These assessment base rates range from 2.5 to 9 basis points for Risk Category I banks and up to 45 basis points for Risk Category IV banks. Risk Category II and III banks have assessment base rates ranging from 9 to 33 basis points, respectively. If the risk category of the Bank changes adversely, our FDIC insurance premiums could increase.

Lending Limits

In January 2013, the NJ Banking Department issued an order requiring a New Jersey chartered bank's calculation of lending limits to any person or entity to include credit exposure to such person or entity arising from a derivative transaction, repurchase agreement, reverse repurchase agreement, securities lending transaction or securities borrowing transaction. Previously, such credit exposure was not included in a New Jersey chartered bank's calculation of lending limits. New Jersey chartered banks must comply with the operative provisions of the order, which include compliance with all of the rules set forth in the Office of the Comptroller of the Currency's rules on lending limits (codified at 12 C.F.R pts. 32, 159 and 160). This change in the calculation of lending limits did not have a significant impact on the Bank's operations.

Available Information

The Internet website address of the Company is http://www.1stconstitution.com. The information on our website is not incorporated into this Annual Report. The Company's Annual Reports on Form 10-K and Quarterly Reports on Form 10-Q are made available free of charge, on or through our Internet website, as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC. All filings we make with the SEC are also available free of charge via EDGAR through the SEC's website at http://www.sec.gov.

We also make available, free of charge, through the investors page on our website, charters of the committees of our Board of Directors, as well as other information and materials, including information about how to contact our Board of Directors, its committees and their members.

Item 1A. Risk Factors.

The following are some important factors that could cause the Company's actual results to differ materially from those referred to or implied in any forward-looking statement. These are in addition to the risks and uncertainties discussed elsewhere in this Form 10-K and the Company's other filings with the SEC.

An economic downturn or the return of negative developments in the financial services industry could negatively impact our operations.

The recent U.S. economic downturn resulted in uncertainty in the financial markets in general. While the U.S. economy has gradually improved over the past few years, the recovery has been slow and the possibility of a fall-back into recession currently exists. The Federal Reserve, in an attempt to help the overall economy, has kept interest rates historically low through its targeted federal funds rate even though it has increased the federal funds rate once in each of 2015 and 2016 and three times in 2017 and anticipates raising the federal funds rate three or four times in 2018. If the Federal Reserve increases the federal funds rate three or four times in 2018, overall interest rates will likely rise, which may negatively impact the housing markets and the U.S. economic recovery. An economic downturn or the return of negative developments in the financial services industry could negatively impact our operations by causing an increase in our provision for loan losses and a deterioration of our loan portfolio. Such a downturn may also adversely affect our ability to originate or sell loans. The occurrence of any of these events could have an adverse impact on our financial performance.

A downturn affecting the economy and/or the real estate market in our primary market area would adversely affect our loan portfolio and our growth potential.

Much of the Company's lending is in northern and central New Jersey. As a result of this geographic concentration, a significant broad-based deterioration in economic conditions in the New Jersey metropolitan area could have a material adverse impact on the quality of the Company's loan portfolio, results of operations and future growth potential. A prolonged decline in economic conditions in our market area could restrict borrowers' ability to pay outstanding principal and interest on loans when due, and consequently, adversely affect the cash flows and results of operations of the Company's business.

The Company's loan portfolio is largely secured by real estate collateral located in the State of New Jersey. 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 and results of operations. A decline in the New Jersey 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, which would have an adverse impact on our earnings.

The Company faces significant competition.

The Company faces significant competition from many other banks, savings institutions and other financial institutions that have branch offices or otherwise operate in the Company's market area. Non-bank financial institutions, such as securities brokerage firms, insurance companies and money market funds, engage in activities which compete directly with traditional bank business, which has also led to greater competition. Many of these competitors have substantially greater financial resources than the Company, including larger capital bases that allow them to attract customers seeking larger loans than the Company is able to accommodate and the ability to aggressively advertise their products and to allocate considerable resources to locations and products perceived as profitable. There can be no assurance that the Company and the Bank will be able to successfully compete with these entities in the future.

The Company is subject to interest rate risk.

The Company's earnings are largely dependent upon its net interest income. Net interest income is the difference between interest income earned on interest-earning assets such as loans and securities and interest expense paid on interest-bearing liabilities such as deposits and borrowed funds. Interest rates are highly sensitive to many factors that are beyond the Company's control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the Federal Reserve Board. Changes in monetary policy, including changes in interest rates, could influence not only the interest the Company receives on loans and securities and the amount of interest it pays on deposits and borrowings, but such changes could also affect (i) the Company's ability to originate loans and obtain deposits, (ii) the fair value of the Company's financial assets and liabilities, and (iii) the average duration of the Company's mortgage-backed securities portfolio. If the spread between the interest rates paid on deposits and other borrowings and the interest rates received on loans and other investments narrows, the Company's net interest income, and therefore earnings, could be adversely affected. This also includes the risk that interest-earning assets may be more responsive to changes in interest rates than interest-bearing liabilities, or vice versa (repricing risk), the risk that the individual interest rates or rate indices underlying various interest-earning assets and interest-bearing liabilities may not change in the same degree over a given time period (basis risk), and the risk of changing interest rate relationships across the spectrum of interest-earning asset and interest-bearing liability maturities (yield curve risk).

Although management believes it has implemented effective asset and liability management strategies to reduce the potential effects of changes in interest rates on the Company's results of operations, any substantial, unexpected, prolonged change in market interest rates could have a material adverse effect on the Company's financial condition and results of operations.

Historically low interest rates may adversely affect our net interest income and profitability.

During the last nine years, it has been the policy of the Federal Reserve Board to maintain interest rates at historically low levels through its targeted federal funds rate and the purchase of mortgage-backed securities and Treasury securities. As a result, yields have been at levels lower than were available prior to 2008 on securities we have purchased and loans we have originated. Consequently, the average yield on our interest-earning assets has decreased during the low interest rate environment. As a general matter, our interest-bearing assets re-price or mature more quickly than our interest-bearing liabilities. Our ability to lower our interest expense is limited at these interest rate levels, while the average yield on our interest-earning assets may continue to decrease. While the Federal Reserve Board raised the targeted federal funds rate and discount rate in 2015, 2016 and 2017, and may further raise the targeted federal funds rate and discount rate in 2018, we believe that interest rates may remain relatively low for the near future. Accordingly, our net interest margin may decline, which may have an adverse effect on our profitability.

The Company is subject to risks associated with speculative 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 of the project within projected absorption periods, the economic risks associated with real estate collateral, and the potential of a rising interest rate environment. Such loans may include financing the development and/or construction of residential subdivisions. This activity may involve financing land purchases, infrastructure development (i.e., roads, utilities, etc.), as well as construction of residences or multi-family dwellings for subsequent sale by the developer/builder. Because the sale 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. Management has established underwriting and monitoring criteria to minimize the inherent risks of speculative commercial real estate construction lending. Further, management concentrates lending efforts with developers demonstrating successful performance on marketable projects within the Bank's lending areas.

Our mortgage warehouse lending business represents a significant portion of our overall lending activity and is subject to numerous risks.

Our primary lending emphasis is the origination of commercial and commercial real estate loans and mortgage warehouse lines of credit. Based on the composition of our loan portfolio, the inherent primary risks are deteriorating credit quality, a decline in the economy, and a decline in New Jersey 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.

A significant portion of our loan portfolio consists of the mortgage warehouse lines of credit. Risks associated with these loans include, without limitation, (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.

The impact of interest rates on our mortgage warehouse business can be significant. Changes in interest rates can impact the number of residential mortgages originated and initially funded under mortgage warehouse lines of credit and thus our mortgage warehouse related revenues. A decline in mortgage rates generally increases the demand for mortgage loans. Conversely, in a constant or increasing rate environment, we would expect fewer loans may be originated. Although we use models to assess the impact of interest rates on mortgage related revenues, the estimates of net income produced by these models are dependent on estimates and assumptions of future loan demand, prepayment speeds and other factors which may overstate or understate actual subsequent experience. Further, the concentration of our loan portfolio on loans originated through our mortgage warehouse business increases the risk associated with our loan portfolio because of the concentration of loans in a single line of business, namely one-to-four family residential mortgage lending, and in a particular segment of that business, namely mortgage warehouse lending.

If our allowance for loan losses is not sufficient to cover actual loan losses, our earnings could decrease.

We make various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. In determining the amount of the allowance for loan losses, we review our loans and our loan and delinquency experience, and we evaluate economic conditions. If our assumptions are incorrect, our allowance for loan losses may not be sufficient to cover losses inherent in our loan portfolio, resulting in additions to our allowance. Material additions to our allowance would materially decrease our net income.

In addition, bank regulators periodically review our loan portfolio and our allowance for loan losses and may require us to increase our provision for loan losses or recognize further loan charge-offs or reclassify loans. Any increase in our allowance for loan losses or loan charge-offs or loan reclassifications as required by these regulatory authorities might have a material adverse effect on our financial condition and results of operations.

If our acquisition of NJCB closes and we do not successfully integrate NJCB, or we do not successfully integrate any other banks that we may acquire in the future, the combined bank may be adversely affected.

If the merger of NJCB with and into the Bank is completed, and if we make additional acquisitions in the future, we will need to integrate the acquired entities into our existing business and systems. We may experience difficulties in accomplishing this integration or in effectively managing the combined bank after the merger with NJCB, and after any future acquisition. Any actual cost savings or revenue enhancements that we may anticipate from the merger with NJCB or any future acquisition will depend on future expense levels and operating results, the timing of certain events and general industry, regulatory and business conditions. Many of these events will be beyond our control, and we cannot assure you that if the merger of NJCB with and into the Bank is consummated or if we make any additional acquisitions in the future, we will be successful in integrating those businesses into our own business.

If the acquisition of NJCB closes, the expected benefits of the merger of NJCB with and into the Bank, or the expected benefits from acquiring another entity, may not be realized if the combined bank does not achieve certain cost savings and other benefits.

Our belief that cost savings and revenue enhancements are achievable as a result of the anticipated merger of NJCB with and into the Bank or in any future acquisition is a forward-looking statement that is inherently uncertain. The combined bank’s actual cost savings and revenue enhancements, if any, cannot be quantified at this time. Any actual cost savings or revenue enhancements will depend on future expense levels and operating results, the timing of certain events and general industry, regulatory and business conditions. Many of these events will be beyond the control of the combined bank.

We depend on our executive officers and key personnel to implement our strategy and could be harmed by the loss of their services.

We believe that the implementation of our strategy will depend in large part on the skills of our executive management team and our ability to motivate and retain these and other key personnel. Accordingly, the loss of service of one or more of our executive officers or key personnel could reduce our ability to successfully implement our business strategy and materially and adversely affect us. Leadership changes will occur from time to time, and if significant resignations occur, we may not be able to recruit additional qualified personnel. We believe our executive management team possesses valuable knowledge about the banking industry and that their knowledge and relationships would be very difficult to replicate. Although our Chief Executive Officer and President has entered into an employment agreement with us, it is possible that he may not complete the term of his employment agreement or may choose not to renew it upon expiration.

Our customers also rely on us to deliver personalized financial services. Our success depends on the experience of our branch managers and lending officers and on their relationships with the customers and communities they serve. The loss of the service of these individuals could undermine the confidence of our customers in our ability to provide such personalized services. We need to continue to attract and retain these individuals and to recruit other qualified individuals to ensure continued growth. In addition, competitors may recruit these individuals in light of the value of the individuals' relationships with their customers and communities and we may not be able to retain such relationships absent the individuals. If we are unable to attract and retain our branch managers and lending officers, and recruit individuals with appropriate skills and knowledge to support our business, our business strategy, business, financial condition and results of operations may be adversely affected.

Our directors and executive officers own a significant percentage of our stock and will be able to exert significant control over matters subject to shareholder approval.

As of December 31, 2017, our directors and executive officers, together with their affiliates and related persons, beneficially own, in the aggregate, approximately 14.5% of our outstanding shares of common stock. These shareholders, if acting together, may have the ability to determine the outcome of matters submitted to our shareholders for approval, including the election and removal of directors and any merger, consolidation, or sale of all or substantially all of our assets. In addition, these persons, acting together, may have the ability to control the management and affairs of our company. Accordingly, this concentration of ownership may harm the market price of our common stock by:

- delaying, deferring, or preventing a change in control;
- entrenching our management and/or the board of directors;
- impeding a merger, consolidation, takeover, or other business combination involving us; or
- discouraging a potential acquirer from making a tender offer or otherwise attempting to obtain control of us.

Federal and state government regulation impacts the Company's operations.

The operations of the Company and the Bank are heavily regulated and will be affected by present and future legislation and by the policies established from time to time by various federal and state regulatory authorities. In particular, the monetary policies of the Federal Reserve Board have had a significant effect on the operating results of banks in the past and are expected to continue to do so in the future. Among the instruments of monetary policy used by the Federal Reserve Board to implement its objectives are changes in the discount rate charged on bank borrowings. It is not possible to predict what changes, if any, will be made to the monetary policies of the Federal Reserve Board or to existing federal and state legislation or the effect that such changes may have on the future business and earnings prospects of the Company.

The Company and the Bank are subject to examination, supervision and comprehensive regulation by various federal and state agencies. Compliance with the rules and regulations of these agencies may be costly and may limit growth and restrict certain activities, including payment of dividends, investments, loans and interest rate charges, interest rates paid on deposits, and locations of offices. The Bank is also subject to capitalization guidelines set forth in federal legislation and regulations.

The laws and regulations applicable to the banking industry could change at any time, and we cannot predict the impact of these changes on our business and profitability. Because government regulation greatly affects the business and financial results of all commercial banks and bank holding companies, the cost of compliance could adversely affect the Company's results of operations.

Legislative and regulatory reforms may materially adversely impact our financial condition, results of operations, liquidity, or stock price.

The Dodd-Frank Act restructures the regulation of depository institutions. The Dodd-Frank Act contains various provisions designed to enhance the regulation of depository institutions and prevent the recurrence of a financial crisis such as occurred in 2008-2009. Also included was the creation of the Consumer Financial Protection Bureau, a new federal agency administering consumer and fair lending laws, a function that was previously performed by the depository institution regulators. The federal preemption of state laws currently accorded federally chartered depository institutions has been reduced as well. We expect that many of the requirements called for in the Dodd-Frank Act will be implemented over time, and most will be subject to implementing regulations over the course of several years. Given the uncertainty associated with the manner in which the provisions of the Dodd-Frank Act will be implemented by the various regulatory agencies and through regulations, the full extent of the impact such requirements will have on financial institutions’ operations is unclear. The changes resulting from the Dodd-Frank Act may impact the profitability of our business activities, require changes to certain of our business practices, impose upon us more stringent capital, liquidity and leverage ratio requirements or otherwise adversely affect our business. These changes may also require us to invest significant management attention and resources to evaluate and make necessary changes in order to comply with new statutory and regulatory requirements.

In addition, international banking industry regulators have largely agreed upon significant changes in the regulation of capital required to be held by banks and their holding companies to support their businesses. The international rules, known as Basel III, generally increased the capital required to be held and narrow the types of instruments which will qualify as providing appropriate capital and imposed a new liquidity measurement. The Basel III requirements are complex and will be phased in over many years.

The Basel III rules do not apply to U.S. banks or holding companies automatically. Among other things, the Dodd-Frank Act requires U.S. regulators to reform the system under which the safety and soundness of banks and other financial institutions, individually and systemically, are regulated. That reform effort included the regulation of capital and liquidity.

On July 2, 2013, the Federal Reserve approved a final rule (the “Final Rule”) to establish a new comprehensive regulatory capital framework for all U.S. banking organizations. On July 9, 2013, the FDIC approved an interim final rule (which became final in April 2014 with no substantive changes) that was substantially similar to the Final Rule. Effective January 1, 2015, these new requirements established the following minimum capital ratios: (1) a common equity Tier 1 (“CET1”) capital ratio of 4.5% of risk-weighted assets; (2) a Tier 1 capital ratio of 6.0% of risk-weighted assets; (3) a total capital ratio of 8.0% of risk-weighted assets; and (4) a leverage ratio of 4.0%. In addition, there is a requirement to maintain a capital conservation buffer, comprised of CET1 capital, in an amount greater than 2.5% of risk-weighted assets over the minimum capital required by each of the minimum risk-based capital ratios in order to avoid limitations on the organization’s ability to pay dividends, repurchase shares or pay discretionary bonuses. The capital conservation buffer requirement began phasing in on January 1, 2016, and initially required a buffer amount greater than 0.625% during 2016 in order to avoid these limitations. Following 2016, the required amount of the capital conservation buffer continues to increase each year until January 1, 2019 when the buffer amount must be greater than 2.5% in order to avoid the above limitations.

These regulations define what qualifies as capital for purposes of meeting these various capital requirements, as well as the risk weight of certain assets for purposes of the risk-based capital ratios.

Under these regulations, in order to be considered well-capitalized for prompt corrective action purposes, the Bank will be required to maintain the following ratios: (1) a CET1 ratio of at least 6.5% of risk-weighted assets; (2) a Tier 1 capital ratio of at least 8.0% of risk weighted assets; (3) a total capital ratio of a least 10.0% of risk-weighted assets; and (4) a leverage ratio of at least 5.0%. The Bank’s CET1 risk-based capital, Tier 1 risk-based capital, total risk-based capital and leverage capital ratios were 11.74%, 11.74%, 12.55%, and 10.96%, respectively, at December 31, 2017.

The application of these capital requirements could increase the Company’s required capital levels and the cost of capital, among other things. Any permanent significant increase in the Company’s cost of capital could have significant adverse impacts on the profitability of many of our products, the types of products we could offer profitably, our overall profitability, and our overall growth opportunities, among other things. Implementation of changes to asset risk weightings for risk based capital calculations or items included or deducted in calculating regulatory capital and/or additional capital conservation buffers could also result in management modifying the Company’s business strategy and limiting the Company’s ability to repurchase our common stock. Furthermore, the imposition of liquidity requirements in connection with the implementation of Basel III could result in us having to lengthen the term of our funding, restructure our business models, and/or increase our holdings of liquid assets. Although most financial institutions would be affected, these business impacts could be felt unevenly, depending upon the business and product mix of each institution. Other potential adverse effects could include higher dilution of common shareholders if we had to issue additional shares and a higher risk that we might fall below regulatory capital thresholds in an adverse economic cycle.

Any additional changes in the regulation and oversight of the Company, in the form of new laws, rules and regulations, could make compliance more difficult or expensive or otherwise materially adversely affect our business, financial condition or operations.

The price of our common stock may fluctuate.

The price of our common stock on the NASDAQ Global Market constantly changes and recently, given the uncertainty in the financial markets, has fluctuated widely. From the beginning of fiscal year 2016 through the end of fiscal year 2017, our stock price fluctuated between a high of $20.80 per share and a low of $11.27 per share. We expect that the market closing price of our common stock will continue to fluctuate. Consequently, the current market price of our common stock may not be indicative of future market prices, and we may be unable to sustain or increase the value of an investment in our common stock.

Our common stock price can fluctuate as a result of a variety of factors, many of which are beyond our control. These factors include:

- quarterly fluctuations in our operating and financial results;
- operating results that vary from the expectations of management, securities analysts and investors;
- changes in expectations as to our future financial performance, including financial estimates by securities analysts and investors;
- events negatively impacting the financial services industry which result in a general decline in the market valuation of our common stock;
- announcements of material developments affecting our operations or our dividend policy;
- future sales of our equity securities;
- new laws or regulations or new interpretations of existing laws or regulations applicable to our business;
- changes in accounting standards, policies, guidance, interpretations or principles; and
- general domestic economic and market conditions.

In addition, recently, the stock market generally has experienced extreme price and volume fluctuations. Industry factors and general economic and political conditions and events, such as economic slowdowns or recessions, interest rate changes or credit loss trends, could also cause our stock price to decrease regardless of our operating results.

The Bank is subject to liquidity risk.

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

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

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

Our access to funding sources in amounts adequate to finance our activities could be impaired by factors that affect us specifically or the financial services industry in general. Factors that could detrimentally impact our access to liquidity sources include a decrease in the level of our business activity due to a market downturn or adverse regulatory action against us. Our ability to borrow could also be impaired by factors that are not specific to us, such as a severe disruption of the financial markets or negative views and expectations about the prospects for the financial services industry as a whole. If we become unable to obtain funds when needed, it could have a material adverse effect on our business and in turn, our consolidated financial condition and results of operations.

The Company is subject to liquidity risk.

Our recurring cash requirements, at the holding company level, primarily consist of interest expense on junior subordinated debentures issued to capital trusts. Holding company cash needs are routinely satisfied by dividends collected from the Bank.

While we expect that the holding company will continue to receive dividends from the Bank sufficient to satisfy holding company cash needs, in the event that the Bank has insufficient resources or is subject to legal or regulatory restrictions on the payment of dividends, the Bank may be unable to provide dividends or a sufficient level of dividends to the holding company; in that event, the holding company may have insufficient funds to satisfy its obligations as they become due.

Future growth, operating results or regulatory requirements may require us to raise additional capital but that capital may not be available.

We are required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations. To the extent our future operating results erode capital or we elect to expand through loan growth or acquisition, we may be required to raise additional capital. Our ability to raise capital will depend on conditions in the capital markets, which are outside of our control, and on our financial performance. Accordingly, we cannot be assured of our ability to raise capital when needed or on favorable terms. If we cannot raise additional capital when needed, we will be subject to increased regulatory supervision and the imposition of restrictions on our growth and business. These actions could negatively impact our ability to operate or further expand our operations and may result in increases in operating expenses and reductions in revenues that could have a material effect on our consolidated financial condition and results of operations.

Higher FDIC deposit insurance premiums and assessments could adversely affect our financial condition.

As a result of the Dodd-Frank Act, the FDIC modified its assessment rules so that an institution’s deposit insurance assessment base changed from total deposits to total assets less tangible equity. These assessment base rates range from 2.5 to 9 basis points for Risk Category I banks and up to 45 basis points for Risk Category IV banks. Risk Category II and III banks have assessment base rates ranging from 9 to 33 basis points, respectively. If the risk category of the Bank changes adversely, our FDIC insurance premiums could increase.

Insured depository institution failures, as well as deterioration in banking and economic conditions, could significantly increase the loss provisions of the FDIC, resulting in a decline in the designated reserve ratio of the Deposit Insurance Fund to historical lows. Effective January 1, 2011, the FDIC increased the designated reserve ratio from 1.25% to 2.00%. In addition, the Dodd-Frank Act permanently increased the deposit insurance limit on FDIC deposit insurance coverage to $250,000 per insured depositor, retroactive to January 1, 2008, which may result in even larger losses to the Deposit Insurance Fund.

The FDIC may further increase or decrease the assessment rate schedule in order to manage the Deposit Insurance Fund to prescribed statutory target levels. An increase in the risk category for the Bank or in the assessment rates could have an adverse effect on the Bank's earnings. The FDIC may terminate deposit insurance for an institution if it determines that such institution has engaged in or is engaging in unsafe or unsound banking practices, is in an unsafe or unsound condition, or has violated applicable laws, regulations or orders.

Future offerings of debt or other securities may adversely affect the market price of our stock.

In the future, the Company may attempt to increase its capital resources or, if the Company’s or the Bank’s capital ratios fall below the required minimums, the Company or the Bank could be forced to raise additional capital by making additional offerings of debt or preferred equity securities, including medium-term notes, trust preferred securities, senior or subordinated notes and preferred stock. Upon liquidation, holders of our debt securities and shares of preferred stock and lenders with respect to other borrowings will receive distributions of our available assets prior to the holders of our common stock.

The Company may issue additional shares of common stock which may dilute the ownership and voting power of our shareholders and the book value of our common stock.

The Company is currently authorized to issue up to 30,000,000 shares of common stock, of which 8,112,292 shares were outstanding on February 28, 2018. We may decide to issue additional shares of common stock for any corporate purposes. Our Board of Directors has the authority, without action or vote of our shareholders, to issue all or part of the authorized but unissued shares of common stock in public offerings or up to 20% of our outstanding common stock in non-public offerings. Any issuance of shares of our common stock will dilute the percentage ownership interest of our common shareholders and may reduce the market price of our common stock or dilute the book value of our common stock, or both. Holders of our common stock are not entitled to preemptive rights or other protections against dilution.

The Company may lose lower-cost funding sources.

Checking, savings, and money market deposit account balances and other forms of customer deposits can decrease when customers perceive alternative investments, such as the stock market, as providing a better risk/return tradeoff. If customers move money out of bank deposits and into other investments, the Company could lose a relatively low-cost source of funds, increasing its funding costs and reducing the Company's net interest income and net income.

There may be changes in accounting policies or accounting standards.

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

From time to time the Financial Accounting Standards Board ("FASB") and the SEC change the financial accounting and reporting standards that govern the form and content of the Company's external financial statements. FASB recently adopted new accounting standards related to fair value accounting, measurement of credit losses on financial instruments and accounting for leases that could materially change the Company's financial statements in the future. In addition, accounting standard setters and those who interpret the accounting standards (such as the FASB, SEC, banking regulators and the Company's independent auditors) may change or even reverse their previous interpretations or positions on how these standards should be applied. Changes in financial accounting and reporting standards and changes in current interpretations may be beyond the Company's control, can be hard to predict and could materially impact how the Company reports its financial results and condition. In certain cases, the Company could be required to apply a new or revised standard retroactively or apply an existing standard differently (also retroactively), which may result in the Company restating prior period financial statements in material amounts.

In addition, the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") updated the criteria in its Internal-Control Integrated Framework for assessing the effectiveness of internal controls over financial reporting. The Company adopted such updated criteria, which changed the manner in which the Company assesses its internal controls over financial reporting, effective December 31, 2016. In the future, there may be further changes to the criteria used to assess the effectiveness of internal controls, which may result in the Company expending more resources to assess its internal controls.

Failure to maintain effective systems of internal controls over financial reporting could have a material adverse effect on our results of operations and financial condition disclosures.

We must have effective internal controls over financial reporting in order to provide reliable financial reports, to effectively prevent fraud, and to operate successfully as a public company. If we were unable to provide reliable financial reports or prevent fraud, our reputation and operating results would be harmed. As part of our ongoing monitoring of our internal controls over financial reporting, we may discover material weaknesses or significant deficiencies requiring remediation. A "material weakness" is a deficiency, or a combination of deficiencies, in internal controls over finanical reporting, such that there is a reasonable possibility that a material misstatement of a company's annual or interim financial statements will not be prevented or detected on a timely basis.

We continually work to improve our internal controls; however, we cannot be certain that these measures will ensure appropriate and adequate controls over our future financial processes and reporting. Any failure to maintain effective controls or to timely implement any necessary improvement of our internal controls could, among other things, result in losses from fraud or error, harm our reputation, or cause investors to lose confidence in our reported financial information, each of which could have a material adverse effect on our results of operations and financial condition and the market value of our common stock.

We may be required to increase our allowance for credit losses as a result of a recent change to an accounting standard.

In 2016, the FASB released a new standard for determining the amount of the allowance for credit losses. The new standard will be effective for the Company for reporting periods beginning January 1, 2020. The new credit loss model will be a significant change from the standard in place today, as it requires the allowance for credit losses to be calculated based on current expected credit losses (commonly referred to as the "CECL model") rather than losses inherent in the portfolio as of a point in time. Because the new CECL model focuses on the life of the loan concept, more data will be required to support allowance estimates, including that loan portfolios will need to be broken down by origination year. As a result, audit and disclosure requirements will increase. The extent of the increase is under evaluation, but will depend upon the nature and characteristics of the Company’s loan portfolio at the adoption date, and the macroeconomic conditions and forecasts at that date. As a result, the potential financial impact is currently unknown.

The fair value of our investment securities can flucutate due to market conditions out of our control.

As of December 31, 2017, approximately 80% of our investment securities portfolio was comprised of U.S. government agency and sponsored enterprises obligations, U.S. government agency and sponsored enterprises' mortgage backed securities and municipal securities. As of December 31, 2017, the fair value of our investment portfolio was approximately $217.3 million. Factors beyond our control can significantly influence the fair value of securities in our portfolio and can cause potential adverse changes to the fair value of these securities. These factors include, but are not limited to, ratings agency downgrades of the securities, defaults by the issuer or with respect to the underlying securities, changes in market interest rates and instability in the credit markets. Any of these mentioned factors, among others, could cause other-than-temporary impairments in future periods and result in a realized loss, which could have a material adverse effect on our business. The process for determining whether impairment is other-than-temporary usually requires complex, subjective judgements about the future financial performance of the issuer and any collateral underlying the security in order to assess the probability of receiving all contractual principal and interest payments on the security.

Because of changing economic and market conditions affecting issuers and the performance of underlying collateral, we may recognize realized and/or unrealized losses in future periods, which could have an adverse effect on our financial condition and results of operations.

The Company encounters continuous technological change.

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

The Company is subject to operational risk.

We rely on certain external vendors to provide products and services necessary to maintain our day-to-day operations. These third parties provide key components of our business operations such as data processing, recording and monitoring transactions, online banking interfaces and services, Internet connections and network access. While we have selected these third-party vendors carefully, we do not control their actions. Any complications caused by these third parties, including those resulting from disruptions in communication or electrical services provided by a vendor, failure of a vendor to handle current or higher volumes, cyber-attacks and security breaches at a vendor, failure of a vendor to provide services for any reason or poor performance of services, could adversely affect our ability to deliver products and services to our customers and otherwise conduct our business. Financial or operational difficulties of a third-party vendor could also hurt our operations if those difficulties interfere with the vendor's ability to provide services. Furthermore, our vendors could also be sources of operational and information security risk, including from breakdowns or failures of their own systems or capacity constraints. Replacing these third-party vendors could also create significant delay and expense. Problems caused by external vendors could be disruptive to our operations, which could have a material adverse impact on our business, financial condition and results of operations.

Loss of, or failure to adequately safeguard, confidential or proprietary information may adversely affect the Company's operations, net income or reputation.

The Company regularly collects, processes, transmits and stores significant amounts of confidential information regarding its customers, employees and others. This information is necessary for the conduct of the Company's business activities, including the ongoing maintenance of deposit, loan and other account relationships for our customers, and receiving instructions and affecting transactions for those customers and other users of the Company's products and services. In addition to confidential information regarding its customers, employees and others, the Company compiles, processes, transmits and stores proprietary, non-public information concerning its own business, operations, plans and strategies. In some cases, this confidential or proprietary information is collected, compiled, processed, transmitted or stored by third parties on behalf of the Company.

Information security risks have generally increased in recent years because of the proliferation of new technologies and the increased sophistication and activities of perpetrators of cyber-attacks. A failure in or breach of the Company's operational or information security systems, or those of the Company's third-party service providers, as a result of cyber-attacks or information security breaches or due to employee error, malfeasance or other disruptions could adversely affect our business, result in the disclosure or misuse of confidential or proprietary information, damage our reputation, increase our costs and/or cause losses. As a result, cyber security and the continued development and enhancement of the controls and processes designed to protect the Company's systems, computers, software, data and networks from attack, damage or unauthorized access are a very high priority for the Company.

If this confidential or proprietary information were to be mishandled, misused or lost, the Company could be exposed to significant regulatory consequences, reputational damage, civil litigation and financial loss. Mishandling, misuse or loss of this confidential or proprietary information could occur, for example, if the confidential or proprietary information were erroneously provided to parties who are not permitted to have the information, either by fault of the systems or employees of the Company, or the systems or employees of third parties which have collected, compiled, processed, transmitted or stored the information on the Company's behalf, where the information is intercepted or otherwise inappropriately taken by third parties or where there is a failure or breach of the network, communications or information systems which are used to collect, compile, process, transmit or store the information.

Although the Company employs a variety of physical, procedural and technological safeguards to protect this confidential and proprietary information from mishandling, misuse or loss, these safeguards do not provide absolute assurance that mishandling, misuse or loss of the information will not occur, or that if mishandling, misuse or loss of the information did occur, those events would be promptly detected and addressed. Additionally, as information security risks and cyber threats continue to evolve, the Company may be required to expend additional resources to continue to enhance its information security measures and/or to investigate and remediate any information security vulnerabilities.

We may not be able to detect money laundering and other illegal or improper activities fully or on a timely basis, which could expose us to additional liability and could have a material adverse effect on us.

We are required to comply with anti-money laundering, anti-terrorism and other laws and regulations in the United States. These laws and regulations require us, among other things, to adopt and enforce "know-your-customer" policies and procedures and to report suspicious and large transactions to applicable regulatory authorities. These laws and regulations have become increasingly complex and detailed, require improved systems, sophisticated monitoring and compliance personnel and have become the subject of enhanced government supervision.

While we have adopted policies and procedures aimed at detecting and preventing the use of our banking network for money laundering and related activities, those policies and procedures may not completely eliminate instances in which we may be used by customers to engage in money laundering and other illegal or improper activities. To the extent we fail to fully comply with applicable laws and regulations, the FDIC and/or with other banking agencies have the authority to impose fines and other penalties on us. In addition, our business and reputation could suffer if customers use our banking network for money laundering or illegal or improper purposes.

There may be claims and litigation.

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

Severe weather, acts of terrorism and other external events could significantly impact our business.

A significant portion of our primary markets are located near coastal waters which could generate naturally occurring severe weather, or in response to climate change, that could have a significant impact on our ability to conduct business. Additionally, surrounding areas, including New Jersey, may be central targets for potential acts of terrorism against the United States. Such events could affect the stability of our deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue and/or cause additional expenses. Although the Company has established disaster recovery policies and procedures, the occurrence of any such event in the future could have a material adverse effect on our business, which, in turn, could have a material adverse effect on our financial condition and results of operations.

Item 1B. Unresolved Staff Comments.

Not applicable.

Item 2. Properties.

We currently operate 18 bank branch offices in New Jersey, including the Bank's main office in Cranbury, New Jersey. In addition, there is an Operations Center which is leased in Cranbury, New Jersey. The following table provides certain information with respect to our bank branch offices as of February 28, 2018:

Location	Leased or Owned	Original Year Leased or Acquired	Year of Lease Expiration
Main Office 2650 Route 130 Cranbury, New Jersey	Leased	1989	2027
Village Office 74 North Main Street Cranbury, New Jersey	Owned	2005	—
Plainsboro Office Plainsboro Village Center 11 Shalks Crossing Road Plainsboro, New Jersey	Leased	1998	2021
Hamilton Square Office 3659 Nottingham Way Hamilton, New Jersey	Leased	1999	2024
Princeton Office The Windrows at Princeton Forrestal 2000 Windrow Drive Princeton, New Jersey	Leased	2001	2018
Perth Amboy Office 145 Fayette Street Perth Amboy, New Jersey	Leased	2003	2019
Jamesburg Office 1 Harrison Street Jamesburg, New Jersey	Owned	2002	—
Fort Lee Office 180 Main Street Fort Lee, New Jersey	Leased	2006	2019
Hightstown Office 140 Mercer Street Hightstown, New Jersey	Leased	2007	2024
Lawrenceville Property 150 Lawrenceville-Pennington Road Lawrenceville, New Jersey	Owned	2009	—
South River Operations Center 1246 South River Road, Bldg. 2 Cranbury, New Jersey	Leased	2010	2020
Rocky Hill Office 995 Route 518 Skillman, New Jersey	Owned	2011	—
Hopewell Office 86 East Broad Street Hopewell, New Jersey	Owned	2011	—

Hillsborough Office 32 New Amwell Road Hillsborough, New Jersey	Owned	2011	—
Rumson Office 20 Bingham Avenue Rumson, New Jersey	Leased	2014	2026

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Location	Leased or Owned	Original Year Leased or Acquired	Year of Lease Expiration
Fair Haven Office 636 River Road Fair Haven, New Jersey	Leased	2014	2022
Asbury Park Office 511 Cookman Avenue Asbury Park, New Jersey	Owned	2014	—
Shrewsbury Office 500 Broad Street Shrewsbury, New Jersey	Leased	2014	2031
Little Silver Office 517 Prospect Avenue Little Silver, New Jersey	Leased	2015	2019

Management believes the foregoing facilities are suitable for the Company's and the Bank's present and projected operations.

Item 3. 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 4. Mine Safety Disclosures.

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities.

The common stock of the Company trades on the Nasdaq Global Market under the trading symbol FCCY. The following sets forth, for the periods indicated, the reported high and low sale prices on known trades and cash dividends declared per share by the Company.

	High	Low	Dividend Per Share
2017			
First Quarter	**$20.80**	**$15.75**	**$ 0.05**
Second Quarter	**18.80**	**16.75**	**0.05**
Third Quarter	**18.55**	**16.50**	**—**
Fourth Quarter	**18.50**	**17.10**	**0.06**
2016			
First Quarter	$13.30	$11.27	$ —
Second Quarter	12.85	11.71	—

Third Quarter	13.78	11.78	0.05
Fourth Quarter	20.85	13.25	0.05

Holders

On February 28, 2018, there were approximately 277 registered shareholders of record.

Performance

The following graph compares the cumulative total return on a hypothetical $100 investment made on December 31, 2012 in (a) the Company's common stock; (b) the SNL US Bank & Thrift Index; (c) the SNL US Bank $500M-$1B Index; and (d) the SNL US Bank $1B-$5B Index. The graph is calculated assuming that all dividends are reinvested during the relevant periods. The graph shows how a $100 investment would increase or decrease in value over time, based on dividends (stock or cash) and increases or decreases in the market price of the stock.

	Period Ending					
Index	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017
1st Constitution Bancorp	100.00	131.85	130.53	161.98	248.72	245.59
SNL US Bank & Thrift	100.00	136.92	152.85	155.94	196.87	231.49
SNL US Bank $500M-$1B	100.00	129.67	142.26	160.57	216.81	264.51
SNL US Bank $1B-$5B	100.00	145.41	152.04	170.20	244.85	261.04

On December 31, 2017, the last reported sale price of the Company's common stock was $18.30.

In the past, in lieu of cash dividends to common shareholders, the Company (and its predecessor, the Bank) paid common stock dividends every year from 1993 to 2016, except 2014 due to the acquisition of Rumson-Fair Haven Bank and Trust Company, a New Jersey state commercial bank ("Rumson").

On September 15, 2016, the Board of Directors of the Company declared a cash dividend of $0.05 per common share. The cash dividend was paid on October 21, 2016 to all shareholders of record as of the close of business on September 28, 2016. This action represented the first cash dividend declared by the Company on its common shares.

The timing and the amount of the payment of future cash dividends, if any, on the Company's common shares 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.

In addition, please refer to the discussion under the heading "Shareholders’ Equity and Dividends" under Item 7. "Management’s Discussion and Analysis of Financial Condition and Results of Operations" for additional restrictions on cash dividends.

Issuer Purchases of Equity Securities

On January 21, 2016, the Board of Directors of the Company authorized a new common stock repurchase program. Under the new common stock repurchase program, the Company may repurchase in open market or privately negotiated transactions up to five (5%) percent of its common stock outstanding on the date of approval of the stock repurchase program, which limitations will be adjusted for any future stock dividends. The Company's common stock repurchase program covers a maximum of 396,141 shares of common stock of the Company, representing 5% of the outstanding common stock of the Company on January 21, 2016, as adjusted for subsequent common stock dividends. There were no repurchases under the plan during 2017.

Period		Total Number of Shares Purchased	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				
October 1, 2017	October 31, 2017	—	$ ——		394,141
November 1, 2017	November 30, 2017	—	—	—	394,141
December 1, 2017	December 31, 2017	—	—	—	394,141
Total		—	$ ——		394,141

Sales of Unregistered Securities

None.

Equity Compensation Plan Information

The following table shows information at December 31, 2017 for all equity compensation plans under which shares of our common stock may be issued.

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options (a)	Weighted-Average Exercise Price of Outstanding Options (b)	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (excluding securities reflected in column (a)) (c)
Equity Compensation Plans Approved by Security Holders	142,005	$ 7.86	127,736
Equity Compensation Plans Not Approved by Security Holders	—	—	—

Total	—	$ 7.86	127,736

Item 6. Selected Financial Data

	As of and for the years ended December 31,				
(In thousands, except per share data)	**2017**	2016	2015	2014	2013
Summary earnings:					
Interest income	**$41,663**	$39,135	$39,323	$35,888	$27,979
Interest expense	**5,498**	5,158	4,636	4,658	4,255
Net interest income	**36,165**	33,977	34,687	31,230	23,724
Provision for loan losses	**600**	(300)	1,100	5,750	1,077
Net interest income after provision for loan losses	**35,565**	34,277	33,587	25,480	22,647
Non-interest income	**8,240**	6,922	6,586	6,814	5,827
Non-interest expense	**31,006**	27,291	27,447	26,865	20,409
Income before income tax expense	**12,799**	13,908	12,726	5,429	8,065
Income tax expense	**5,871**	4,623	4,062	1,073	2,285
Net income	**$6,928**	$9,285	8,664	$4,356	$5,780
Per share data:					
Basic earnings per share	**$0.86**	$1.17	$1.10	$0.56	$0.88
Diluted earnings per share	**0.83**	1.14	1.07	0.55	0.86
Cash dividends declared	**0.16**	0.10	—	—	—
Book value end-of-period (1)	**13.81**	13.11	12.72	12.21	11.36
Basic weighted average shares outstanding	**8,049,981**	7,962,121	7,901,278	7,366,955	6,271,989
Common stock equivalents (dilutive)	**262,803**	215,318	174,474	368,348	313,599
Fully diluted weighted average shares outstanding	**8,312,784**	8,177,439	8,075,752	7,735,303	6,585,588
Balance sheet data (at period end):					
Total assets	**$1,079,274**	$1,038,213	$967,991	$956,779	$742,325
Securities, available for sale	**105,458**	103,794	91,422	80,161	99,199
Investment securities	**110,267**	126,810	123,261	143,638	152,817
Total loans	**789,906**	724,808	682,121	654,297	373,336
Allowance for loan losses	**(8,013)**	(7,494)	(7,560)	(6,925)	(7,039)
Total deposits	**922,006**	834,516	786,757	817,761	638,552
Shareholders' equity	**111,653**	104,801	95,960	87,110	68,357
Common cash dividends	**1,690**	399	—	—	—
Selected performance ratios:					
Return on average total assets	**0.67%**	0.93%	0.89%	0.46%	0.72%
Return on average shareholders' equity	**6.36%**	9.21%	9.49%	5.34%	8.73%
Dividend payout ratio (2)	**18.59%**	8.62%	n/a	n/a	n/a
Net interest margin	**3.81%**	3.70%	3.90%	3.84%	3.44%
Non-interest income to average assets	**0.80%**	0.69%	0.67%	0.61%	0.73%
Non-interest expenses to average assets	**3.01%**	2.72%	2.81%	2.89%	2.67%
Nonperforming loans to total loans	**0.90%**	0.72%	0.88%	0.74%	1.69%
Nonperforming assets to total assets	**0.66%**	0.52%	0.72%	1.11%	1.14%
Allowance for loan losses to nonperforming loans	**112.64%**	144.17%	125.59%	143.08%	111.34%
Allowance for loan losses to total loans	**1.01%**	1.03%	1.11%	1.06%	1.89%
Net recoveries/(charge-offs) to average loans	**(0.01)%**	0.03%	(0.07)%	(1.04)%	(0.30)%

(1) Book value at end-of-period calculated by dividing shareholders' equity by number of outstanding common shares at end of period.
(2) Dividend payout ratio calculated by dividing dividends declared during the year by net income.

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	As of and for the years ended December 31,				
(In thousands, except per share data)	**2017**	2016	2015	2014	2013
Liquidity and capital ratios:					
Average loans to average deposits	**81.80 %**	84.58 %	83.39 %	69.15 %	57.15 %
Total shareholders' equity to total assets	**10.35 %**	10.09 %	9.91 %	9.1 %	9.21 %
Total capital to risk-weighted assets	**12.84 %**	13.24 %	13.08 %	12.28 %	19.29 %
Tier 1 capital to risk-weighted assets	**12.02 %**	12.41 %	12.18 %	11.41 %	18.04 %
Common equity tier 1 capital ratio to risk-weighted assets	**10.19 %**	10.4 %	10.03 %	n/a	n/a
Tier 1 leverage ratio	**11.23 %**	10.93 %	10.8 %	9.53 %	10.89 %

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Overview

The following discussion and analysis is intended to provide information about the financial condition and results of operations of 1st Constitution Bancorp and its subsidiaries on a consolidated basis and should be read in conjunction with the consolidated financial statements and the related notes and supplemental financial information appearing elsewhere in this report.

1st Constitution Bancorp (the "Company"), formed in 1999, is the parent holding company for 1st Constitution Bank (the "Bank"), a commercial bank formed in 1989 that provides a wide range of financial services to consumers, businesses and government entities. The Bank's branch network primarily serves Central New Jersey and offers consumer and business banking products delivered through a network of well-trained staff dedicated to a positive client experience and enhancing shareholder value. For purposes of the discussion below, 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.

Critical Accounting Policies and Estimates

Management's Discussion and Analysis of Financial Condition and Results of Operations is based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"). The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. Note 1 to the Company's Consolidated Financial Statements for the year ended December 31, 2017 contains a summary of the Company's significant accounting policies.

Management believes that the Company's policies with respect to the methodologies for the determination of the allowance for loan losses and for determining other-than-temporary security impairment involve a higher degree of complexity and requires management to make difficult and subjective judgments, which often require assumptions or estimates about highly uncertain matters. Changes in these judgments, assumptions or estimates could materially impact results of operations. These critical policies and their application are periodically reviewed with the Audit Committee and the Board of Directors.

The provision for loan losses is based upon management's evaluation of the adequacy of the allowance, including an assessment of known and inherent risks in the portfolio, after giving consideration to the size and composition of the loan portfolio, actual loan loss experience, level of delinquencies, detailed analysis of individual loans for which full collectability may not be assured, the existence and estimated net realizable value of any underlying collateral and guarantees securing the loans and current economic and market conditions. Although management uses the best information available, the level of the allowance for loan losses remains an estimate, which is subject to significant judgment and short-term change. Various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to make additional provisions for loan losses based upon information available to them at the time of their examination. Furthermore, the majority of the Company's loans are secured by real estate in the State of New Jersey. Accordingly, the collectability of a substantial portion of the carrying value of the Company's loan portfolio is susceptible to changes in local market conditions and may be adversely affected should real estate values decline or should the New Jersey market area experience adverse economic conditions. Future adjustments to the allowance for loan losses may be necessary due to economic, operating, regulatory and other conditions beyond the Company's control.

Real estate acquired through foreclosure, or a deed-in-lieu of foreclosure, is recorded at fair value less estimated selling costs at the date of acquisition or transfer and, subsequently, fair value less estimated selling costs. Adjustments to the carrying value at the date of acquisition or transfer are charged to the allowance for loan losses. The carrying value of the individual properties is subsequently adjusted to estimated fair value less estimated selling costs, at which time a provision for losses on such real estate is charged to operations if it is lower. Appraisals are critical in determining the fair value of the other real estate owned ("OREO") amount. Assumptions for appraisals are instrumental in determining the value of properties. Overly optimistic assumptions or negative changes to assumptions could significantly affect the valuation of a property. The assumptions supporting such appraisals are carefully reviewed by management to determine that the resulting values reasonably reflect amounts realizable.

Debt securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Debt securities are classified as available for sale when they might be sold before maturity due to changes in interest rates, prepayment risk, liquidity or other factors. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax.

Management utilizes various inputs to determine the fair value of its investment portfolio. To the extent they exist, unadjusted quoted market prices in active markets for identical investments (level 1) or quoted prices on similar assets (level 2) are utilized to determine the fair value of each investment in the portfolio. In the absence of quoted prices, valuation techniques would be used to determine fair value of any investments that require inputs that are both significant to the fair value measurement and unobservable (level 3). Valuation techniques are based on various assumptions, including, but not limited to, cash flows, discount rates, rate of return, adjustments for nonperformance and liquidity and liquidation values. A significant degree of judgment is involved in valuing investments using level 3 inputs. The use of different assumptions could have a positive or negative effect on the Company's consolidated financial condition or results of operations.

Securities are evaluated on at least a quarterly basis to determine whether a decline in fair value is other-than-temporary. To determine whether a decline in value is other-than-temporary, management considers the reasons underlying the decline, including, but not limited to, the length of time an investment’s book value is greater than fair value, the extent and duration of the decline and the near-term prospects of the issuer as well as any credit deterioration of the investment. If the decline in value of an investment is deemed to be other-than-temporary, the entire difference between amortized cost and fair value is recognized as impairment through earnings.

The Company records income taxes using the asset and liability method. Accordingly, deferred tax assets and liabilities are recognized for the expected future tax consequences of events that have been recognized in the financial statements or tax returns; are attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases; and are measured using enacted tax rates expected to apply in the years when those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income tax expense in the period of enactment.

Deferred tax assets are recorded on the consolidated balance sheet at net realizable value. The Company periodically performs an assessment to evaluate the amount of deferred tax assets that it is more likely than not to realize. Realization of deferred tax assets is dependent upon the amount of taxable income expected in future periods as tax benefits require taxable income to be realized. If a valuation allowance is required, the deferred tax asset on the consolidated balance sheet is reduced via a corresponding income tax expense in the consolidated statement of income.

Earnings Summary

2017 compared to 2016

The Company reported net income of $6.9 million or $0.83 per diluted share for the year ended December 31, 2017 compared to net income of $9.3 million or $1.14 per diluted share for the year ended December 31, 2016. For the year ended December 31, 2017, net income decreased $2.4 million, or 25.4%, and net income per diluted share decreased $0.31.

The decrease in net income for 2017 compared to 2016 included additional estimated income tax expense of $1.7 million, or $0.21 per diluted share, due to the revaluation of the Company's net deferred tax assets. As a result of the enactment of the Tax Cuts and Jobs Act ("Tax Act") on December 22, 2017, which reduced the maximum federal corporate income tax rate from 35% to 21% beginning in 2018, the Company revalued its net deferred tax assets to reflect the lower federal corporate income tax rate that would be in effect in future years. Additionally, merger-related expenses on an after-tax basis of $188,000, or $0.02 per diluted share, related to the pending merger of New Jersey Community Bank with and into the Bank, were incurred during the fourth quarter of 2017.

Excluding the additional income tax expense and the merger-related expenses, adjusted net income for the year ended December 31, 2017 was $8.8 million, or $1.06 per diluted share, compared to net income for the year ended December 31, 2016 of $9.3 million, or $1.14 per diluted share, reflecting a decrease of $457,000, or 4.9%, compared to 2016. This decrease was due primarily to an increase of $900,000 in the provision for loan losses and an increase in non-interest expense of $3.7 million, which were partially offset by an increase in net interest income of $2.2 million and an increase of $1.3 million in non-interest income.

Return on average assets ("ROAA") and return on average equity ("ROAE") were 0.67% and 6.36%, respectively, for the year ended December 31, 2017 compared to 0.93% and 9.21%, respectively, for the year ended December 31, 2016. Excluding the additional income tax expense and the merger-related expense, ROAA and ROAE for the year ended December 31, 2017 would have been 0.86% and 8.10%, respectively.

If the lower federal corporate income tax rate had been in effect in 2017, the Company's reported 2017 income tax expense of $5.9 million, excluding the $1.7 million of tax expense due to the revaluation of the net deferred tax assets, would have been approximately $2.9 million, or $1.3 million lower.

Adjusted net income and adjusted net income per diluted share are non-GAAP measures. The table below shows the major components of net income for the years ended December 31, 2017 and 2016 and a reconciliation of the non-GAAP measures to reported net income discussed above.

			Change in	
(Dollars in thousands)	**2017**	2016	$	%
Net interest income	**$36,165**	$33,977	$2,188	6.4 %
Provision for loan losses	**600**	(300)	900	(300.0)
Non-interest income	**8,240**	6,922	1,318	19.0
Non-interest expense	**31,006**	27,291	3,715	13.6
Net income before income taxes	**12,799**	13,908	(1,109)	(8.0)
Income taxes	**5,871**	4,623	1,248	27.0
Net income	**6,928**	9,285	(2,357)	(25.4)%
Adjustments:				
Revaluation of deferred tax assets	**1,712**	—	1,712	N/A
Merger-related expenses	**265**	—	265	N/A
Income tax effect of adjustments	**(77)**	—	(77)	N/A
Total adjustments	**1,900**	—	1,900	N/A
Adjusted net income	**$8,828**	$9,285	$(457)	(4.9)%
Earnings per share:				
Basic, as reported	**$0.86**	$1.17	$(0.31)	(26.5)%
Adjustments	**0.24**	—	0.24	N/A
Basic, as adjusted	**$1.10**	$1.17	$(0.07)	(6.0)%
Diluted, as reported	**$0.83**	1.14	$(0.31)	(27.2)%
Adjustments	**0.23**	—	0.23	N/A
Diluted, as adjusted	**$1.06**	$1.14	$(0.08)	(7.0)%
Return on average assets:				
As reported	**0.67 %**	0.93 %		
Adjusted net income	**$8,828**	$9,285		
Average assets	**1,031,796**	1,001,769		
As adjusted	**0.86 %**	0.93 %		
Return on average shareholders' equity:				
As reported	**6.36 %**	9.21 %		
Adjusted net income	**$8,828**	$9,285		
Average shareholders' equity	**108,925**	100.807		
As adjusted	**8.10 %**	9.21 %		

2016 compared to 2015

The Company reported net income of $9.3 million or $1.14 per diluted share for the year ended December 31, 2016 compared to net income of $8.7 million or $1.07 per diluted share for the year ended December 31, 2015. For the year ended December 31, 2016 net income per diluted share increased 6.5% due to a $621,000, or 7.2%, increase in net income.

The increase in net income for 2016 compared to 2015 was due primarily to the reduction of $1.4 million in the provision for loan losses and a $336,000 increase in non-interest income, which were partially offset by decreases of $710,000 in net interest income and $156,000 in non-interest expense.

ROAA and ROAE were 0.93% and 9.21%, respectively, for the year ended December 31, 2016 compared to 0.89% and 9.49%, respectively, for the year ended December 31, 2015.

The table below shows the major components of net income for the years ended December 31, 2016 and 2015.

			Change in	
(Dollars in thousands	2016	2015	$	%
Net interest income	$33,977	$34,687	$(710)	(2.0)%
(Credit) provision for loan losses	(300)	1,100	(1,400)	(127.3)
Non-interest income	6,922	6,586	336	5.1
Non-interest expense	27,291	27,447	(156)	(0.6)
Net income before income taxes	13,908	12,726	1,182	9.3
Income taxes	4,623	4,062	561	13.8
Net income	9,285	8,664	621	7.2 %
Earnings per share:				
Basic	$1.17	$1.10	$0.07	6.4 %
Diluted	1.14	1.07	0.07	6.5

Net Interest Income and Net Interest Margin

Net interest income, the Company’s largest and most significant component of operating income, is the difference between interest and fees earned on loans, investment securities and other earning assets and interest paid on deposits and borrowed funds. This component represented 81%, 83% and 84% of the Company’s net revenues (net interest income plus non-interest income) for the years ended December 31, 2017, 2016 and 2015, respectively. Net interest income is determined by the difference between the yields earned on earning assets and the rates paid on interest-bearing liabilities ("Net Interest Spread") and the relative amounts of average earning assets and average interest-bearing liabilities. The Company's net interest spread is affected by regulatory, economic and competitive factors that influence interest rates, loan demand and deposit flows as well as general levels of nonperforming assets.

The following table summarizes the Company's net interest income and related spread and margin for the periods indicated:

	Years ended December 31,		
(Dollars in thousands)	**2017**	2016	2015
Net interest income	**$36,165**	$33,977	$34,687
Interest rate spread	**3.58 %**	3.50 %	3.74 %
Net interest margin	**3.81**	3.70	3.90

The following tables compare the Company’s consolidated average balance sheets, interest income and expense, net interest spreads and net interest margins for the years ended December 31, 2017, 2016 and 2015 (on a fully tax-equivalent basis). The average rates are derived by dividing interest income and expense by the average balance of assets and liabilities, respectively.

	December 31, 2017		
(In thousands except yield/cost information)	Average Balance	Interest	Average Yield/Cost
Assets			
Interest earning assets:			
Federal funds sold/short term investments	$27,533	$230	0.84 %
Investment securities:			
Taxable	140,431	3,326	2.37
Tax-exempt (4)	90,186	3,167	3.51
Total investment securities	230,617	6,493	2.82
Loans: (1)			
Commercial real estate	274,192	13,851	4.98
Mortgage warehouse lines	160,756	6,937	4.26
Construction	115,913	6,780	5.77
Commercial business	96,193	5,474	5.63
Residential real estate	41,898	1,777	4.24
Loans to individuals	22,171	903	4.07
Loans held for sale	4,197	202	4.81
Other	1,690	43	2.51
Total loans	717,010	35,967	4.96
Total interest earning assets	975,160	42,690	4.33 %
Non-interest earning assets:			
Allowance for loan losses	(7,703)		
Cash and due from bank	5,371		
Other assets	58,968		
Total non-interesting earning assets	56,636		
Total assets	$1,031,796		
Liabilities and Shareholders' Equity			
Interest-bearing Liabilities:			
Money market and NOW accounts	$336,445	$1,440	0.43 %
Savings accounts	210,798	1,332	0.63
Certificates of deposit	145,539	1,778	1.22
Borrowed funds	21,139	429	2.03
Redeemable subordinated debentures	18,557	519	2.80
Total interest bearing liabilities	732,478	5,498	0.75 %
Non-interest bearing liabilities:			
Demand deposits	183,802		
Other liabilities	6,591		
Total non-interest bearing liabilities	190,393		
Shareholders' equity	108,925		
Total liabilities and shareholders' equity	$1,031,796		
Net interest spread (2)			3.58 %
Net interest margin (3)		$37,192	3.81 %

(1) Loan origination fees and costs 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. Please refer to Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations under the heading “Non-Performing Assets” for a discussion of the Company’s policy with regard to non-accrual loans.

(2) The net interest rate spread is the difference between the average yield on interest earning assets and the average rate paid on interest bearing liabilities.
(3) The net interest margin is equal to net interest income divided by average interest earning assets.
(4) The tax-equivalent adjustment was $1.0 million for the year ended December 31, 2017.

	December 31, 2016		
(In thousands except yield/cost information)	Average Balance	Interest	Average Yield/Cost
Assets			
Interest earning assets:			
Federal funds sold/short term investments	$21,041	$88	0.42 %
Investment securities:			
Taxable	143,461	3,268	2.28
Tax-exempt (4)	81,570	3,075	3.77
Total investment securities	225,031	6,343	2.82
Loans: (1)			
Commercial real estate	220,700	12,435	5.56
Mortgage warehouse lines	205,711	8,425	4.04
Construction	93,648	4,896	5.16
Commercial business	102,810	4,953	4.77
Residential real estate	42,694	1,828	4.28
Loans to individuals	23,250	933	4.01
Loans held for sale	7,256	176	2.43
Other	2,367	55	2.29
Total loans	698,436	33,701	4.77
Total interest earning assets	944,508	40,132	4.21 %
Non-interest earning assets:			
Allowance for loan losses	(7,538)		
Cash and due from bank	5,120		
Other assets	59,679		
Total non-interesting earning assets	57,261		
Total assets	$1,001,769		
Liabilities and Shareholders' Equity			
Interest-bearing Liabilities:			
Money market and NOW accounts	$301,086	$1,128	0.37 %
Savings accounts	206,208	1,208	0.59
Certificates of deposit	152,078	1,708	1.12
Borrowed funds	48,448	687	1.42
Redeemable subordinated debentures	18,557	427	2.30
Total interest bearing liabilities	726,377	5,158	0.71 %
Non-interest bearing liabilities:			
Demand deposits	166,380		
Other liabilities	8,205		
Total non-interest bearing liabilities	174,585		
Shareholders' equity	100,807		
Total liabilities and shareholders' equity	$1,001,769		
Net interest spread (2)			3.50 %
Net interest margin (3)		$34,974	3.70 %

(1) Loan origination fees and costs 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. Please refer to Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations under the heading "Non-Performing Assets" for a discussion of the Company's policy with regard to non-accrual loans.

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

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

(4) The tax-equivalent adjustments was $1 million for the year ended December 31, 2016.

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	December 31, 2015			
(In thousands except yield/cost information)	Average Balance	Interest	Average Yield/Cost	
Assets				
Interest earning assets:				
Federal funds sold/short term investments	$23,516	$50	0.21	%
Investment securities:				
Taxable	125,446	3,167	2.52	
Tax-exempt (4)	81,612	3,153	3.86	
Total investment securities	207,058	6,320	3.05	
Loans: (1)				
Commercial real estate	202,939	11,936	5.80	
Mortgage warehouse lines	203,074	8,549	4.15	
Construction	95,766	5,334	5.49	
Commercial business	106,632	5,126	4.75	
Residential real estate	43,048	1,796	4.17	
Loans to individuals	22,217	934	4.20	
Loans held for sale	8,954	246	2.75	
Other	1,855	54	2.87	
Total loans	684,485	33,975	4.90	
Total interest earning assets	915,059	40,345	4.36	%
Non-interest earning assets:				
Allowance for loan losses	(7,484)			
Cash and due from bank	5,887			
Other assets	64,563			
Total non-interesting earning assets	62,966			
Total assets	$978,025			
Liabilities and Shareholders' Equity				
Interest-bearing Liabilities:				
Money market and NOW accounts	$300,813	$1,013	0.34	%
Savings accounts	196,915	950	0.48	
Certificates of deposit	158,754	1,741	1.10	
Borrowed funds	38,472	577	1.50	
Redeemable subordinated debentures	18,557	355	1.91	
Total interest bearing liabilities	713,511	4,636	0.62	%
Non-interest bearing liabilities:				
Demand deposits	164,348			
Other liabilities	8,859			
Total non-interest bearing liabilities	173,207			
Shareholders' equity	91,307			
Total liabilities and shareholders' equity	$978,025			
Net interest spread (2)			3.74	%
Net interest margin (3)		$35,709	3.90	%

(1) Loan origination fees and costs 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. Please refer to Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations under the heading "Non-Performing Assets" for a discussion of the Company's policy with regard to non-accrual loans.
(2) The net interest rate spread is the difference between the average yield on interest earning assets and the average rate paid on interest bearing liabilities.
(3) The net interest margin is equal to net interest income divided by average interest earning assets.
(4) The tax-equivalent adjustments was $1.0 million for the year ended December 31, 2015.

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Changes in net interest income and net interest margin result from the interaction between the volume and composition of interest earning assets, interest bearing liabilities, related yields and funding costs. The effect of volume and rate changes on net interest income (on a tax-equivalent basis) for the periods indicated are shown below:

	Year ended 2017 compared with 2016 Due to Change in:			Year ended 2016 compared with 2015 Due to Change in:		
(Dollars in thousands)	Volume	Rate	Total	Volume	Rate	Total
Assets						
Federal funds sold/short term investments	$27	$115	$142	$(5)	$43	$38
Investment securities:						
Taxable	(69)	127	58	455	(354)	101
Tax-exempt	325	(233)	92	(2)	(76)	(78)
Total investment securities	256	(106)	150	453	(430)	23
Loans:						
Commercial real estate	2,973	(1,576)	1,416	1,037	(538)	499
Mortgage warehouse lines	(1,816)	348	(1,488)	108	(232)	(124)
Construction	1,148	710	1,884	(122)	(316)	(438)
Commercial business	(316)	833	521	(187)	14	(173)
Residential real estate	(34)	(17)	(51)	(15)	47	32
Loans to individuals	(43)	13	(30)	43	(44)	(1)
Loans held for sale	(74)	100	26	(47)	(23)	(70)
Other	(16)	4	(12)	15	(14)	1
Total loans	1,822	415	2,266	832	(1,106)	(274)
Total Interest Income	$2,105	$424	$2,558	$1,280	$(1,493)	$(213)
Liabilities						
Money market and NOW accounts	132	180	312	1	114	115
Savings accounts	27	97	124	45	213	258
Certificates of deposit	(73)	143	70	(73)	40	(33)
Other Borrowed Funds	(387)	129	(258)	150	(40)	110
Redeemable Subordinated Debentures	—	92	92	—	72	72
Total Interest Expense	(301)	641	340	123	399	522
Net Interest Income	$2,406	$(217)	$2,218	$1,157	$(1,892)	$(735)

2017 compared to 2016

For the year ended December 31, 2017, the Company's net interest income, on a fully tax-equivalent basis, increased by $2.2 million, or 6.3%, to $37.2 million compared to $35.0 million for the year ended December 31, 2016. This increase was due primarily to an increase in average earning assets as well as an increase in the average yield on earning assets, which were partially offset by an increase in interest expense on average interest-bearing liabilities.

Average earning assets were $975.2 million with a yield of 4.33% for 2017 compared to average earning assets of $944.5 million with a yield of 4.21% for 2016. The 75 basis point increase in the Federal Reserve's targeted federal funds rate and the corresponding increase in the Prime Rate since December of 2016 has had a positive effect on the yields of construction, commercial business and warehouse loans with variable interest rate terms.

For the year ended December 31, 2017, interest income on interest bearing assets increased by $2.6 million and interest income on average loans increased by $2.3 million as the average balances of commercial real estate and construction loans grew by $53.5 million and $22.2 million, respectively. For 2017, average loans increased $18.6 million to $717.0 million.

Interest expense on average interest-bearing liabilities was $5.5 million, or 0.75%, for the year ended December 31, 2017 compared to $5.2 million, or 0.71%, for the year ended December 31, 2016. The increase of $340,000 in interest expense on interest-bearing liabilities for 2017 compared to 2016 primarily reflects higher short-term market interest rates and increased competition for deposits in 2017 compared to 2016.

2016 compared to 2015

For the year ended December 31, 2016, the Company's net interest income, on a tax-equivalent basis, decreased by $735,000, or 2.1%, to $35.0 million compared to $35.7 million for the year ended December 31, 2015. This decrease was due primarily to the decrease in the average yield on interest-earning assets and an increase in interest expense on average interest-bearing liabilities.

Interest expense on average interest-bearing liabilities was $5.2 million, or 0.71%, for the year ended December 31, 2016 compared to $4.6 million, or 0.62%, for the year ended December 31, 2015. The increase of $522,000 in interest expense on interest-bearing liabilities for 2016 compared to 2015 primarily reflects higher short-term market interest rates and increased competition for deposits in 2016 compared to 2015. The Federal Reserve Board increased the targeted federal funds rate in December 2015 by 25 basis points, which impacted short-term market interest rates in 2016.

The lower yield on average interest-earning assets for 2016 reflected primarily the lower yield earned on loans and investments. The yield on loans and investments declined due to the continued low interest rate environment as new loans were originated and investment securities were purchased at yields lower than the average yield on loans and investments, respectively, in the prior year period.

The net interest margin for the year ended December 31, 2016 was 3.70% compared to the 3.90% net interest margin recorded for the year ended December 31, 2015, reflecting a decrease of 20 basis points. The decrease in the Company’s net interest income and net interest margin for the year ended December 31, 2016 compared with the corresponding 2015 period was primarily due to the decrease of 15 basis points in the average yield of interest-earning assets to 4.21% for the year ended December 31, 2016 compared to 4.36% for the year ended December 31, 2015 and the increase in the cost of average interest bearing liabilities to 0.71% for the year ended December 31, 2016 compared to 0.62% for the year ended December 31, 2015.

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, non-accrual loans and problem loans as identified through internal classifications, 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.

In general, over the last three years, the Company experienced an improvement in loan credit quality and achieved a steady resolution of non-performing loans and assets related to the severe recession, which were reflected in the current level of non-performing loans at December 31, 2017. Net charge-offs of commercial business and commercial real estate loans in 2017 and 2016 declined significantly compared to prior years, which resulted in a reduction of the historical loss factors for these segments of the loan portfolio that were applied by management to estimate the allowance for loan losses at December 31, 2017.

2017 compared to 2016

The Company recorded a provision for loan losses of $600,000 for the year ended December 31, 2017 and a credit (negative) provision of $300,000 for the year ended December 31, 2016. For 2017, net charge-offs of $81,000 were recorded compared to net recoveries of $234,000 in 2016. The allowance for loan losses at December 31, 2017 and 2016 totaled $8.0 million and $7.5 million, respectively. The increase in the provision for loan losses for 2017 was primarily attributed to loan growth and an increase in nonperforming loans while the credit (negative) provision for loan losses for 2016 was primarily attributed to the net recovery of loans previously charged off.

At December 31, 2017, non-performing loans totaled $7.1 million compared to $5.2 million at December 31, 2016, an increase of $1.9 million, or 37.5%, and the ratio of non-performing loans to total loans increased to 0.90% at December 31, 2017 from 0.72% at December 31, 2016.

2016 compared to 2015

The Company recorded a credit (negative) provision of $300,000 for the year ended December 31, 2016 and a provision of $1.1 million for the year ended December 31, 2015. Net recoveries of $234,000 were recorded for the year ended December 31, 2016 compared to net charge-offs of $465,000 recorded for the year ended December 31, 2015. The allowance for loan losses at December 31, 2016 and 2015 totaled $7.5 million and $7.6 million, respectively. The decrease in the provision for loan losses for 2016 was primarily attributed to the net recovery of loans previously charged off and the lower historical loan loss factors, which reflected the improvement in loan credit quality, the resolution of non-performing loans and the significant reduction of net charge-offs of commercial and commercial real estate loans in 2016.

At December 31, 2016, non-performing loans decreased by $822,000, or 13.7%, to $5.2 million from $6.0 million at December 31, 2015 and the ratio of non-performing loans to total loans decreased to 0.72% at December 31, 2016 compared to 0.88% at December 31, 2015.

Non-Interest Income

2017 compared to 2016

Total non-interest income for the year ended December 31, 2017 increased to $8.2 million from $6.9 million for the year ended December 31, 2016. This revenue component represented 19% and 17% of the Company's net revenues for the years ended December 31, 2017 and 2016, respectively.

Service charges on deposit accounts decreased by $119,000 to $596,000 for the year ended December 31, 2017 compared to $715,000 for the year ended December 31, 2016 due primarily to declines in insufficient funds charges.

Gains on sales of loans held for sale increased $1.3 million to $5.1 million for the year ended December 31, 2017 compared to $3.8 million for the year ended December 31, 2016. The Company sells both residential mortgage loans and portions of commercial business loans guaranteed by the Small Business Administration ("SBA") in the secondary market.

Gains on the sale of residential mortgage loans were $3.9 million in 2017 compared to $2.2 million in 2016. In 2017, $121.1 million of residential mortgage loans were sold compared to $88.1 million in 2016. The increase in the residential lending activity and gains on the sale of loans was due primarily to the hiring of a new residential lending team in July of 2016.

In 2017, $13.3 million of SBA loans were sold and generated net gains of $1.2 million compared to SBA loans sold and net gains of $17.0 million and $1.6 million, respectively, in 2016.

Non-interest income also includes income from Bank-owned life insurance ("BOLI"), which totaled $522,000 for the year ended December 31, 2017 compared to $549,000 for the year ended December 31, 2016.

The Company also generates non-interest income from a variety of fee-based services. These include safe deposit box rentals, wire transfer service fees and Automated Teller Machine fees for non-Bank customers. The other income component of non-interest income was $1.8 million for the year ended December 31, 2017 compared to $1.9 million for the year ended December 31, 2016.

2016 compared to 2015

Total non-interest income for the year ended December 31, 2016 increased to $6.9 million from $6.6 million for the year ended December 31, 2015. This revenue component represented 17% and 16% of the Company's net revenues for the years ended December 31, 2016 and 2015, respectively. In 2015, total non-interest income was negatively impacted by a $692,000 loss on the sale of OREO that was included in other income. Excluding the effect of the loss, non-interest income would have declined $270,000 in 2016 compared to 2015.

Service charges on deposit accounts decreased by $103,000 to $715,000 for the year ended December 31, 2016 compared to $818,000 for the year ended December 31, 2015 due primarily to declines in insufficient funds charges.

Gains on sales of loans held for sale decreased $254,000 to $3.8 million for the year ended December 31, 2016 compared to $4.0 million for the year ended December 31, 2015. The Company sells both residential mortgage loans and portions of commercial business loans guaranteed by the SBA in the secondary market.

Gains on the sale of residential mortgage loans were $2.2 million in 2016 compared to $2.3 million in 2015. In 2016, $88.1 million of residential loans were sold compared to $136.4 million in 2015. The decline in the residential lending activity and gains on the sale of loans was due primarily to the turnover of personnel that occurred in the first two quarters of 2016, which significantly reduced the volume of loans originated and sold in 2016. In July 2016, the Bank hired a new residential lending team of 20 employees, which included residential mortgage loan originators and operations personnel, and the pace of residential lending activity and gains on the sale of loans increased.

In 2016, $17.0 million of SBA loans were sold and generated net gains of $1.6 million compared to SBA loans sold and net gains of $17.5 million and $1.7 million, respectively, in 2015.

Income from BOLI totaled $549,000 for the year ended December 31, 2016 compared to $558,000 for the year ended December 31, 2015.

Other income, including safe deposit box rental income, wire transfer service fees and Automated Teller Machine fees, totaled $1.9 million and $1.2 million for the years ended December 31, 2016 and 2015, respectively. Other income in 2015 was negatively impacted by the loss on the sale of OREO of $692,000.

Non-Interest Expenses

The following table presents the major components of non-interest expense:

	Year ended December 31,		
(In thousands)	**2017**	2016	2015
Salaries and employee benefits	**$18,804**	$16,543	$15,589
Occupancy expense	**3,169**	3,243	3,362
Data processing expenses	**1,314**	1,277	1,211
Equipment expense	**1,008**	917	939
Marketing	**225**		