SIFCO INDUSTRIES INC
Form 10-Q
May 09, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2011

or

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

For the transition period from ______ to ______

Commission file number 1-5978

SIFCO Industries, Inc.

(Exact name of registrant as specified in its charter)

Ohio	**34-0553950**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**
970 East 64th Street, Cleveland Ohio	**44103**
(Address of principal executive offices)	**(Zip Code)**

(216) 881-8600

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨

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

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	x

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

The number of the Registrant s Common Shares outstanding at March 31, 2011 was 5,275,757.

Part I. Financial Information

Item 1. Financial Statements

SIFCO Industries, Inc. and Subsidiaries

Consolidated Condensed Statements of Operations

(Unaudited)

(Amounts in thousands, except per share data)

	Three Months Ended March 31,		Six Months Ended March 31,	
	2011	**2010**	**2011**	**2010**
Net sales	**$ 26,804**	$ 19,886	**$ 48,200**	$ 41,188
Operating expenses:				
Cost of goods sold	**19,878**	15,735	**36,299**	31,016
Selling, general and administrative expenses	**3,318**	2,806	**6,494**	5,743
Amortization of intangible assets	**685**	0	**742**	0
Total operating expenses	**23,881**	18,541	**43,535**	36,759
Operating income	**2,923**	1,345	**4,665**	4,429
Interest income	**(11)**	(16)	**(33)**	(23)
Interest expense	**44**	16	**64**	33
Foreign currency exchange (gain) loss, net	**5**	(14)	**9**	(16)
Other income, net	**(117)**	(119)	**(234)**	(235)
Income before income tax provision	**3,002**	1,478	**4,859**	4,670
Income tax provision	**1,007**	474	**1,658**	1,653
Net income	**$ 1,995**	$ 1,004	**$ 3,201**	$ 3,017
Net income per share				
Basic	**$ 0.38**	$ 0.19	**$ 0.61**	$ 0.57
Diluted	**$ 0.38**	$ 0.19	**$ 0.60**	$ 0.56
Weighted-average number of common shares (basic)	**5,275**	5,307	**5,268**	5,304
Weighted-average number of common shares (diluted)	**5,319**	5,362	**5,305**	5,353

See notes to unaudited consolidated condensed financial statements.

SIFCO Industries, Inc. and Subsidiaries

Consolidated Condensed Balance Sheets

(Amounts in thousands, except per share data)

	March 31, 2011 (unaudited)	September 30, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 7,457**	$ 18,671
Short-term investments	**0**	3,020
Receivables, net	**17,409**	17,182
Inventories, net	**10,912**	6,272
Refundable income taxes	**0**	692
Deferred income taxes	**1,502**	1,502
Prepaid expenses and other current assets	**675**	627
Total current assets	**37,955**	47,966
Property, plant and equipment, net	**27,412**	20,749
Intangible assets, net	**9,681**	0
Goodwill	**3,493**	0
Other assets	**976**	935
Total assets	**$ 79,517**	$ 69,650
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Current maturities of long-term debt	**$ 84**	$ 108
Accounts payable	**11,690**	7,939
Accrued liabilities	**3,625**	4,287
Total current liabilities	**15,399**	12,334
Long-term debt, net of current maturities	**3,377**	35
Deferred income taxes	**2,410**	2,359
Other long-term liabilities	**6,558**	6,883
Shareholders equity:		
Serial preferred shares, no par value, authorized 1,000 shares	**0**	0
Common shares, par value $1 per share, authorized 10,000 shares; issued shares 5,335 at March 31, 2011 and 5,325 at September 30, 2010; outstanding shares 5,286 at March 31, 2011 and 5,258 at September 30, 2010	**5,335**	5,325
Additional paid-in capital	**6,984**	6,983
Retained earnings	**50,934**	47,733
Accumulated other comprehensive loss	**(10,823)**	(11,310)
Unearned compensation restricted common shares	**(145)**	0
Common shares held in treasury at cost, 49 shares at March 31, 2011 and 66 shares at September 30, 2010	**(512)**	(692)
Total shareholders equity	**51,773**	48,039
Total liabilities and shareholders equity	**$ 79,517**	$ 69,650

See notes to unaudited consolidated condensed financial statements.

SIFCO Industries, Inc. and Subsidiaries

Consolidated Condensed Statements of Cash Flows

(Unaudited)

(Amounts in thousands)

	Six Months Ended March 31, 2011	Six Months Ended March 31, 2010
Cash flows from operating activities:		
Net income	**$ 3,201**	$ 3,017
Adjustments to reconcile net income to net cash provided by operating activities of operations:		
Depreciation and amortization	**2,005**	906
LIFO provision	**225**	180
Share transactions under employee stock plans	**47**	206
Other	**7**	(36)
Changes in operating assets and liabilities:		
Receivables	**1,078**	2,307
Inventories	**(2,015)**	412
Refundable income taxes	**692**	814
Accounts payable	**2,120**	172
Accrued liabilities	**(68)**	232
Other	**115**	(200)
Net cash provided by operating activities	**7,407**	8,010
Cash flows from investing activities:		
Acquisition of business	**(22,566)**	0
Maturity of short-term investments	**3,000**	0
Capital expenditures	**(1,642)**	(3,470)
Net cash used for investing activities	**(21,208)**	(3,470)
Cash flows from financing activities:		
Proceeds from revolving credit agreement	**12,914**	0
Repayments of revolving credit agreement	**(9,540)**	0
Dividends paid	**(789)**	(529)
Other	**(56)**	(53)
Net cash provided by (used for) financing activities	**2,529**	(582)
Increase (decrease) in cash and cash equivalents	**(11,272)**	3,958
Cash and cash equivalents at the beginning of the period	**18,671**	19,875
Effect of exchange rate changes on cash and cash equivalents	**58**	(64)
Cash and cash equivalents at the end of the period	**$ 7,457**	$ 23,769
Supplemental disclosure of cash flow information of continuing operations:		
Cash paid for interest	**$ (19)**	$ (29)
Cash paid for income taxes, net	**(813)**	(364)

See notes to unaudited consolidated condensed financial statements.

SIFCO Industries, Inc. and Subsidiaries

Notes to Unaudited Consolidated Condensed Financial Statements

(Dollars in thousands, except share and per share data)

1. Summary of Significant Accounting Policies

A. Principles of Consolidation

The accompanying unaudited consolidated condensed financial statements include the accounts of SIFCO Industries, Inc. and its wholly-owned subsidiaries (the Company). All significant intercompany accounts and transactions have been eliminated.

The U.S. dollar is the functional currency for all of the Company s U.S. operations and its Irish subsidiary. For these operations, all gains and losses from completed currency transactions are included in income currently. For the Company s other non-U.S. subsidiaries, the functional currency is the local currency. Assets and liabilities are translated into U.S. dollars at the rates of exchange at the end of the period, and revenues and expenses are translated using average rates of exchange. Foreign currency translation adjustments are reported as a component of accumulated other comprehensive loss in the unaudited consolidated condensed financial statements.

These unaudited consolidated condensed financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company s fiscal 2010 Annual Report on Form 10-K. The results of operations for any interim period are not necessarily indicative of the results to be expected for other interim periods or the full year. Certain prior period amounts may have been reclassified in order to conform to current period classifications.

2. Inventories

Inventories consist of:

	March 31, 2011	September 30, 2010
Raw materials and supplies	**$ 3,999**	$ 1,846
Work-in-process	**3,986**	2,624
Finished goods	**2,927**	1,802
Total inventories	**$ 10,912**	$ 6,272

Inventories are stated at the lower of cost or market. Cost is determined using the last-in, first-out (LIFO) method for 58% of the Company s inventories at both March 31, 2011 and September 30, 2010. The first-in, first-out (FIFO) method is used for the remainder of the inventories. If the FIFO method had been used for the inventories for which cost is determined using the LIFO method, inventories would have been $7,720 and $7,495 higher than reported at March 31, 2011 and September 30, 2010, respectively.

3. Comprehensive Income and Accumulated Other Comprehensive Loss

Total comprehensive income is as follows:

	Three Months Ended March 31,	Six Months Ended March 31,	9,008

Interest expense:

Interest on deposits	3,569	3,849	1,206	1,184
Interest on borrowings	638	582	201	156
Total interest expense	4,207	4,431	1,407	1,340
Net interest income	24,552	22,844	8,010	7,668
Provision for loan losses	2,250	2,200	250	200
Net interest income after provision for loan losses	22,302	20,644	7,760	7,468
Noninterest income:				
Gain on sale of SBA loans	4,142	2,225	2,810	757
Loan fees	763	523	302	200
Net income from BOLI	269	281	90	95
Service fees on deposit accounts	191	188	76	73
(Loss) gain on sale and write-down of real estate owned	(173)	(508)	261	(53)
Realized gain on sale of AFS securities	178	—	—	—
Other	1,146	710	359	387
Total noninterest income	6,516	3,419	3,898	1,459
Noninterest expense:				
Compensation and benefits	5,234	5,035	1,629	1,653
Professional services	1,086	1,211	339	456
Occupancy and equipment	879	770	287	287
Data processing	363	363	118	120
FDIC insurance	692	801	201	257
OREO expense	3,387	2,807	1,379	2,019
Other operating expense	2,616	2,374	868	615
Total noninterest expense	14,257	13,361	4,821	5,407
Income before income tax expense	14,561	10,702	6,837	3,520
Income tax expense	4,575	3,950	2,149	1,304
Net income attributable to Company and noncontrolling interest	9,986	6,752	4,688	2,216
Net income attributable to noncontrolling interest	(1,719)	(595)	(1,233)	(183)
Net income attributable to Company	8,267	6,157	3,455	2,033
Preferred stock dividend and discount accretion	900	773	300	263
Net income available to common shareholders	$7,367	$5,384	$3,155	$1,770
Earnings per common share:				
Basic	$1.23	$0.90	$0.53	$0.30
Diluted	$1.04	$0.90	$0.44	$0.30
Weighted average shares outstanding:				
Basic	5,990,831	5,957,685	5,991,859	5,982,810
Diluted	7,925,889	5,958,702	7,933,251	5,988,686

See accompanying notes to consolidated financial statements

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Parke Bancorp Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited)

	For the nine months ended September 30,		For the three months ended September 30,	
	2014	2013	2014	2013
	(in thousands)		(in thousands)	
Net income attributable to Company	$8,267	$6,157	$3,455	$2,033
Unrealized gains (losses) on securities:				
Non-credit related unrealized gains on securities with OTTI	—	34	—	19
Unrealized gains (losses) on securities without OTTI	543	(329)	(214)	(25)
Less re-class adjustment for gains on securities included in net income	(178)	—	—	—
Tax Impact	(146)	118	86	3
Total unrealized gains (losses) on securities	219	(177)	(128)	(3)
Gross pension liability adjustments	—	172	—	72
Tax Impact	—	(68)	—	(29)
Total pension liability adjustment	—	104	—	43
Total other comprehensive income (loss)	219	(73)	(128)	40
Total comprehensive income	$8,486	$6,084	$3,327	$2,073

See accompanying notes to consolidated financial statements

Parke Bancorp, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF EQUITY
(unaudited)

	Preferred Stock	Shares of Common Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total Shareholders Equity	Non-Controlling Interest	Total Equity
	(in thousands except share data)									
Balance, December 31, 2013	$20,000	6,193,710	$619	$51,204	$24,308	$(235)	$(2,180)	$93,716	$248	$93,964
Capital withdrawals by noncontrolling interest									(1,191)	(1,191)
Stock options exercised		9,049	1	60				61		61
Net income					8,267			8,267	1,719	9,986
Changes in other comprehensive income						219		219		219
Dividend on preferred stock					(900)			(900)		(900)
Dividend on common stock					(597)			(597)		(597)
Balance, September 30, 2014	$20,000	6,202,759	$620	$51,264	$31,078	$(16)	$(2,180)	$100,766	$776	$101,542

See accompanying notes to consolidated financial statements

Parke Bancorp Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	For the nine months ended September 30,	
	2014	2013
	(amounts in thousands)	
Cash Flows from Operating Activities:		
Net income	$9,986	$6,752
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	266	253
Provision for loan losses	2,250	2,200
Provision for OREO	1,493	1,200
Net gain from sales of investment securities	(178)	—
Bank owned life insurance	(269)	(281)
Supplemental executive retirement plan expense	—	17
Gain on sale of SBA loans	(4,142)	(2,225)
SBA loans originated for sale	(25,605)	(20,822)
Proceeds from sale of SBA loans originated for sale	40,101	20,122
Loss on sale & write down of OREO	173	507
Net accretion of purchase premiums and discounts on securities	8	30
Contribution of OREO property	22	—
Deferred income tax benefit	(575)	(117)
Changes in operating assets and liabilities:		
Increase in accrued interest receivable and other assets	(5,411)	673
Decrease in accrued interest payable and other accrued liabilities	(408)	(493)
Net cash provided by operating activities	17,711	7,816
Cash Flows from Investing Activities:		
Purchases of investment securities available for sale	—	(2,022)
Redemptions (purchases) of restricted stock	401	(272)
Proceeds from sale and call of securities available for sale	3,974	1,000
Proceeds from maturities and principal payments on mortgage backed securities	3,234	3,434
Proceeds from sale of OREO	11,706	3,572
Advances on OREO	(217)	(168)
Net increase in loans	(31,400)	(39,339)
Purchases of bank premises and equipment	(144)	(110)
Net cash used in investing activities	(12,446)	(33,905)
Cash Flows from Financing Activities:		
Payment of dividend on preferred stock	(956)	(612)
Cash payment of fractional shares on 10% stock dividend	—	(2)
Minority interest capital withdrawal, net	(1,191)	(1,320)
Proceeds from exercise of stock options and warrants	61	290
Redemption payment for TARP Warrant	—	(1,650)
Net (decrease) increase in FHLBNY and short term borrowings	(4,482)	9,874
Net decrease in other borrowed funds	—	(10,000)
Net (decrease) increase in noninterest-bearing deposits	(1,118)	966
Net increase (decrease) in interest-bearing deposits	15,968	(26,757)
Net cash provided by (used in) financing activities	8,282	(29,211)
Net increase (decrease) in cash and cash equivalents	13,547	(55,300)

Cash and Cash Equivalents, January 1,	45,661	76,866
Cash and Cash Equivalents, September 30,	$59,208	$21,566
Supplemental Disclosure of Cash Flow Information:		
Cash paid during the year for:		
Interest on deposits and borrowed funds	$4,181	$4,546
Income taxes	$4,300	$3,908
Supplemental Schedule of Noncash Activities:		
Real estate acquired in settlement of loans	$2,124	$6,925

See accompanying notes to consolidated financial statements

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Notes to Consolidated Financial Statements (Unaudited)

NOTE 1. ORGANIZATION

Parke Bancorp, Inc. ("Parke Bancorp" or the "Company") is a bank holding company incorporated under the laws of the State of New Jersey in January 2005 for the sole purpose of becoming the holding company of Parke Bank (the "Bank").

The Bank is a commercial bank which commenced operations on January 28, 1999. The Bank is chartered by the New Jersey Department of Banking and Insurance (the "Department") and insured by the Federal Deposit Insurance Corporation ("FDIC"). Parke Bancorp and the Bank maintain their principal offices at 601 Delsea Drive, Washington Township, New Jersey. The Bank also conducts business through branches in Galloway Township, Northfield and Washington Township, New Jersey and Philadelphia, Pennsylvania.

The Bank competes with other banking and financial institutions in its primary market areas. Commercial banks, savings banks, savings and loan associations, credit unions and money market funds actively compete for savings and time certificates of deposit and all types of loans. Such institutions, as well as consumer financial and insurance companies, may be considered competitors of the Bank with respect to one or more of the services it renders.

The Bank is subject to the regulations of certain state and federal agencies, and accordingly, the Bank is periodically examined by such regulatory authorities. As a consequence of the regulation of commercial banking activities, the Bank's business is particularly susceptible to future state and federal legislation and regulations.

The FDIC and the Department Consent Orders: On April 9, 2012, the Bank entered into Consent Orders with the FDIC and the Department. Under the Consent Orders, the terms of which are substantially identical, the Bank was required to (i) to adopt and implement a plan to reduce the Bank's position in delinquent or classified assets; (ii) to adopt and implement a program providing for a periodic independent review of the Bank's loan portfolio and the identification of problem credits; (iii) to review and revise the Bank's loan policies and procedures to address identified lending deficiencies; and (iv) to adopt and implement a plan to reduce and manage each of the concentrations of credit identified by the FDIC and the Department. Effective May 19, 2014, the FDIC and the Department terminated the Consent Orders entered into between Parke Bank, the Company's wholly owned subsidiary, and the FDIC and the Department.

Federal Reserve Bank Memorandum of Understanding: On December 18, 2012, the Company entered into a Memorandum of Understanding ("MOU") with the Federal Reserve Bank of Philadelphia (the "Federal Reserve Bank"). Pursuant to the terms of the MOU, the Company: (i) was required to submit an updated comprehensive capital plan to address the Bank's long-term capital needs and the repayment of the Series A Preferred Stock; (ii) was prohibited from paying any common stock dividend or paying interest on our outstanding trust preferred securities without prior Federal Reserve Bank approval if the Bank was less than well capitalized or the payment would cause it to be less than well capitalized; (iii) was prohibited from redeeming any securities without prior Federal Reserve Bank approval or incurring any debt with a maturity greater than one year; and (iv) required to submit various budget and cash flow projections and other reports. Effective August 4, 2014, the MOU was lifted by the Federal Reserve Bank.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Financial Statement Presentation: The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America (“GAAP”) and predominant practices within the banking industry.

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary the Bank. Also included are the accounts of 44 Business Capital Partners LLC, a joint venture formed in 2009 to originate and service SBA loans. The Bank has a 51% ownership interest in the joint venture. Parke Capital Trust I, Parke Capital Trust II and Parke Capital Trust III are wholly-owned subsidiaries but are not consolidated because they do not meet the requirements for consolidation under applicable accounting guidance. All significant inter-company balances and transactions have been eliminated.

The accompanying interim financial statements should be read in conjunction with the annual financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013 since they do not include all of the information and footnotes required by GAAP. The accompanying interim financial statements for the nine months and three months ended September 30, 2014 and 2013 are unaudited. The balance sheet as of December 31, 2013, was derived from the audited financial statements. In the opinion of management, these financial statements include all normal and recurring adjustments necessary for a fair statement of the results for such interim periods. Results of operations for the nine months ended September 30, 2014 are not necessarily indicative of the results for the full year. Certain reclassifications have been made to prior period amounts to conform to the current year presentation, with no impact on current earnings or shareholders’ equity.

Use of Estimates: The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term include the allowance for loan losses, other than temporary impairment losses on investment securities, the valuation of deferred income taxes, servicing assets and carrying value of OREO.

Recently Issued Accounting Pronouncements:

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, “Revenue from Contracts with Customers (ASU 2014-09),” which supersedes nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, more judgment and estimates may be required within the revenue recognition process than are required under existing U.S. GAAP. The standard is effective for annual periods beginning after December 15, 2016, and interim periods therein, using either of the following transition methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients, or (ii) a retrospective approach with the cumulative effect of initially adopting ASU 2014-09 recognized at the date of adoption (which includes additional footnote disclosures). We are currently evaluating the impact of our pending adoption of ASU 2014-09 on our consolidated financial statements and have not yet determined the method by which we will adopt the standard in 2017.

In January 2014, the FASB issued ASU 2014-04, "Receivables-Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure." ASU 2014-04 clarifies that an in-substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (a) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (b) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, ASU 2014-04 requires interim and annual disclosure of both (a) the amount of foreclosed residential real estate property held by the creditor and (b) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in ASU 2014-04 are effective for fiscal years, and interim periods within those years, beginning after December 15, 2014. An entity can elect to adopt the amendments using either a modified retrospective transition method or a prospective transition method. Early adoption is permitted. The Company is currently evaluating the impact of these amendments.

NOTE 3. INVESTMENT SECURITIES

The following is a summary of the Company's investments in available for sale and held to maturity securities as of September 30, 2014 and December 31, 2013:

As of September 30, 2014	Amortized cost	Gross unrealized gains	Gross unrealized losses	Other-than-temporary impairments in OCI	Fair value
			(amounts in thousands)		
Available for sale:					
Corporate debt obligations	$500	$19	$—	$—	$519
Residential mortgage-backed securities	27,310	497	105	—	27,702
Collateralized mortgage obligations	405	19	—	—	424
Collateralized debt obligations	806	—	—	457	349
Total available for sale	$29,021	$535	$105	$457	$28,994
Held to maturity:					
States and political subdivisions	$2,131	$204	$—	$—	$2,335

As of December 31, 2013	Amortized cost	Gross unrealized gains	Gross unrealized losses	Other-than-temporary impairments in OCI	Fair value
			(amounts in thousands)		
Available for sale:					
Corporate debt obligations	$500	$6	$—	$—	$506
Residential mortgage-backed securities	30,422	285	257	—	30,450
Collateralized mortgage obligations	564	31	—	—	595
Collateralized debt obligations	4,601	—	—	457	4,144
Total available for sale	$36,087	$322	$257	$457	$35,695
Held to maturity:					
States and political subdivisions	$2,103	$52	$—	$—	$2,155

The amortized cost and fair value of debt securities classified as available for sale and held to maturity, by contractual maturity as of September 30, 2014 are as follows:

	Amortized Cost	Fair Value
	(amounts in thousands)	
Available for sale:		
Due within one year	$ —	$ —
Due after one year through five years	—	—
Due after five years through ten years	—	—
Due after ten years	1,306	868
Residential mortgage-backed securities and collateralized mortgage obligations	27,715	28,126
Total available for sale	$ 29,021	$ 28,994
Held to maturity:		
Due within one year	$ —	$ —
Due after one year through five years	—	—
Due after five years through ten years	—	—
Due after ten years	2,131	2,335
Total held to maturity	$ 2,131	$ 2,335

Expected maturities will differ from contractual maturities for mortgage related securities because the issuers of certain debt securities do have the right to call or prepay their obligations without any penalty.

There were no securities pledged as collateral for borrowed funds as of September 30, 2014 and December 31, 2013. Securities with a carrying value of $10.6 million and $12.3 million were pledged to secure public deposits at September 30, 2014 and December 31, 2013, respectively.

The following tables show the gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other than temporarily impaired ("OTTI"), aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at September 30, 2014 and December 31, 2013:

As of September 30, 2014	Less Than 12 Months		12 Months or Greater		Total	
Description of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
			(amounts in thousands)			
Available for sale:						
Residential mortgage backed securities and collateralized mortgage obligations	4,190	105	—	—	4,190	105
Total available for sale	$4,190	$105	$—	$—	$4,190	$105

As of December 31, 2013	Less Than 12 Months		12 Months or Greater		Total	
Description of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
			(amounts in thousands)			
Available for sale:						

Residential mortgage-backed securities	25,286	257	—	—	25,286	257
Total available for sale	$25,286	$257	$—	$—	$25,286	$257

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Residential Mortgage-Backed Securities and Collateralized Mortgage Obligations: The unrealized losses on the Company's investment in mortgage-backed securities relates to four securities. The losses were caused by movement in interest rates. The securities were issued by FNMA, a government sponsored entity. It is expected that the U.S. government will guarantee all contractual cash flows. Because the Company does not intend to sell the investment and it is not more likely than not that the Company will be required to sell the investment before recovery of its amortized cost basis, which may be maturity, it does not consider the investment in these securities to be other-than-temporarily impaired at September 30, 2014.

Other Than Temporarily Impaired Debt Securities

We assess whether we intend to sell or it is more likely than not that we will be required to sell a security before recovery of its amortized cost basis less any current-period credit losses. For debt securities that are considered other than temporarily impaired and that we do not intend to sell and will not be required to sell prior to recovery of our amortized cost basis, we separate the amount of the impairment into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is the difference between the security's amortized cost basis and the present value of its expected future cash flows. The remaining difference between the security's fair value and the present value of future expected cash flows is due to factors that are not credit related and is recognized in other comprehensive income.

The present value of expected future cash flows is determined using the best estimate of cash flows discounted at the effective interest rate implicit to the security at the date of purchase or the current yield to accrete an asset-backed or floating rate security. The methodology and assumptions for establishing the best estimate cash flows vary depending on the type of security. The asset-backed securities cash flow estimates are based on bond specific facts and circumstances that may include collateral characteristics, expectations of delinquency and default rates, loss severity and prepayment speeds and structural support, including subordination and guarantees. The corporate bond cash flow estimates are derived from scenario-based outcomes of expected corporate restructurings or the disposition of assets using bond specific facts and circumstances including timing, security interests and loss severity.

We have a process in place to identify debt securities that could potentially have a credit impairment that is other than temporary. This process involves monitoring late payments, pricing levels, downgrades by rating agencies, key financial ratios, financial statements, revenue forecasts and cash flow projections as indicators of credit issues. On a quarterly basis, we review all securities to determine whether an OTTI exists and whether losses should be recognized. We consider relevant facts and circumstances in evaluating whether a credit or interest rate-related impairment of a security is other than temporary. Relevant facts and circumstances considered include: (1) the extent and length of time the fair value has been below cost; (2) the reasons for the decline in value; (3) the financial position and access to capital of the issuer, including the current and future impact of any specific events; and (4) for fixed maturity securities, our intent to sell a security or whether it is more likely than not we will be required to sell the security before the recovery of its amortized cost which, in some cases, may extend to maturity.

The following table presents a roll-forward of the credit loss component of the amortized cost of debt securities that we have written down for OTTI and the credit component of the loss that is recognized in earnings. OTTI recognized in earnings for credit-impaired debt securities is presented as additions in two components based upon whether the current period is the first time the debt security was credit-impaired (initial credit impairment) or is not the first time the debt security was credit impaired (subsequent credit impairments). The credit loss component is reduced if we sell, intend to sell or believe we will be required to sell previously credit-impaired debt securities. Additionally, the credit loss component is reduced if we receive cash flows in excess of what we expected to receive over the remaining life of the credit-impaired debt security, the security matures or is fully written down. Changes in the credit loss component of credit-impaired debt securities were as follows for the nine month and three month periods ended September 30, 2014 and 2013:

	For the Nine Months Ended September 30,	
	2014	2013
	(amounts in thousands)	
Beginning balance	$1,126	$1,219
Initial credit impairment	—	—
Subsequent credit impairments	—	—
Reductions for amounts recognized in earnings due to intent or requirement to sell	—	—
Reductions for securities sold	(955)	—
Reductions for securities deemed worthless	—	(54)
Reductions for increases in cash flows expected to be collected	—	—
Ending balance	$171	$1,165

	For the Three Months Ended September 30,	
	2014	2013
	(amounts in thousands)	
Beginning balance	$171	$1,165
Initial credit impairment	—	—
Subsequent credit impairments	—	—
Reductions for amounts recognized in earnings due to intent or requirement to sell	—	—
Reductions for securities sold	—	—
Reductions for securities deemed worthless	—	—
Reductions for increases in cash flows expected to be collected	—	—
Ending balance	$171	$1,165

During the nine months ended September 30, 2014, the Bank sold three Trust Preferred securities, which resulted in a $178,000 gain reflected in the income statement.

NOTE 4. LOANS

The portfolio of loans outstanding consists of the following:

	September 30, 2014			December 31, 2013		
	Amount	Percentage of Total Loans		Amount	Percentage of Total Loans	
	(amounts in thousands)					
Commercial and Industrial	$27,240	4.0	%	$23,001	3.5	%
Real Estate Construction:						
Residential	5,965	0.9		7,389	1.1	
Commercial	38,012	5.6		43,749	6.7	
Real Estate Mortgage:						
Commercial – Owner Occupied	170,707	25.1		170,122	26.0	
Commercial – Non-owner Occupied	233,554	34.3		220,364	33.7	
Residential – 1 to 4 Family	162,435	23.9		148,160	22.6	
Residential – Multifamily	25,476	3.7		24,103	3.7	
Consumer	17,341	2.5		17,653	2.7	
Total Loans	$680,730	100.0	%	$654,541	100.0	%

Loan Origination/Risk Management: In the normal course of business the Company is exposed to a variety of operational, reputational, legal, regulatory, and credit risks that could adversely affect our financial performance. Most of our asset risk is primarily tied to credit (lending) risk. The Company has lending policies, guidelines and procedures in place that are designed to maximize loan income within an acceptable level of risk. The Board of Directors reviews and approves these policies, guidelines and procedures. When we originate a loan we make certain subjective judgments about the borrower's ability to meet the loan's terms and conditions. We also make objective and subjective value assessments on the assets we finance. The borrower's ability to repay can be adversely affected by economic changes. Likewise, changes in market conditions and other external factors can affect asset valuations. The Company actively monitors the quality of its loan portfolio. A reporting system supplements the credit review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit risk, loan delinquencies, troubled debt restructures, nonperforming and potential problem loans. Diversification in the loan portfolio is another means of managing risk associated with fluctuations in economic conditions.

With respect to construction loans to developers and builders that are secured by non-owner occupied properties. Construction loans are underwritten utilizing feasibility studies, independent appraisal reviews, sensitivity analysis of absorption and lease rates and financial analyses of the developers and property owners. Construction loans are generally underwritten based upon estimates of costs and value associated with the completed project. These estimates may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property or an interim loan commitment from the Company until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions and the availability of long-term financing.

Commercial real estate loans are subject to underwriting standards and processes similar to commercial loans, in addition to those of real estate loans. Commercial real estate loans may be riskier than loans for one-

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to-four family residences and are typically larger in dollar size. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. The repayment of these loans is generally largely dependent on the successful operation and management of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Company’s commercial real estate portfolio are diverse in terms of type and geographic location within our market area. This diversity helps reduce the Company's exposure to adverse economic events that affect any single market or industry. Management monitors and evaluates commercial real estate loans based on collateral, geography and risk grade criteria. The Company also monitors economic conditions and trends affecting market areas it serves. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans.

The Company originates adjustable and fixed-rate residential mortgage loans. Such mortgage loans are generally originated under terms, conditions and documentation acceptable to the secondary mortgage market. Although the Company has placed all of these loans into its portfolio, a substantial majority of such loans can be sold in the secondary market or pledged for potential borrowings.

Consumer loans may carry a higher degree of repayment risk than residential mortgage loans. Repayment is typically dependent upon the borrower’s financial stability which is more likely to be adversely affected by job loss, illness, or personal bankruptcy. To monitor and manage consumer loan risk, policies and procedures have been developed and modified as needed. This activity, coupled with relatively small loan amounts that are spread across many individual borrowers, minimizes risk. Additionally, trend and outlook reports are reviewed by management on a regular basis. Underwriting standards for home equity loans are heavily influenced by statutory requirements, which include, but are not limited to, a maximum loan-to-value percentage of 80%, collection remedies, the number of such loans a borrower can have at one time and documentation requirements. Historically the Company’s losses on consumer loans have been negligible.

The Company maintains an outsourced independent loan review program that reviews and validates the credit risk assessment program on a periodic basis. Results of these external independent reviews are presented to management. The external independent loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit risk management personnel.

Nonaccrual and Past Due Loans: Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on non-accrual status when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when a loan is 90 days past due, unless the loan is well secured and in the process of collection, as required by regulatory provisions. Loans may be placed on non-accrual status regardless of whether or not such loans are considered past due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received in excess of principal due. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

An age analysis of past due loans by class at September 30, 2014 and December 31, 2013 follows:

September 30, 2014

	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days and Not Accruing	Total Past Due	Current	Total Loans
	(amounts in thousands)					
Commercial and Industrial	$ 99	$ —	$ 61	$ 160	$ 27,080	$ 27,240
Real Estate Construction:						
Residential	—	—	367	367	5,598	5,965
Commercial	—	—	13,060	13,060	24,952	38,012
Real Estate Mortgage:						
Commercial – Owner Occupied	72	—	860	932	169,775	170,707
Commercial – Non-owner Occupied	—	623	8,891	9,514	224,040	233,554
Residential – 1 to 4 Family	490	867	8,779	10,136	152,299	162,435
Residential – Multifamily	—	—	—	—	25,476	25,476
Consumer	—	—	94	94	17,247	17,341
Total Loans	$ 661	$ 1,490	$ 32,112	$ 34,263	$ 646,467	$ 680,730

December 31, 2013

	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days and Not Accruing	Total Past Due	Current	Total Loans
	(amounts in thousands)					
Commercial and Industrial	$ —	$ —	$ 122	$ 122	$ 22,879	$ 23,001
Real Estate Construction:						
Residential	—	—	967	967	6,422	7,389
Commercial	—	—	9,908	9,908	33,841	43,749
Real Estate Mortgage:						
Commercial – Owner Occupied	710	1,438	976	3,124	166,998	170,122
Commercial – Non-owner Occupied	—	478	10,853	11,331	209,033	220,364
Residential – 1 to 4 Family	1,013	—	12,914	13,927	134,233	148,160
Residential – Multifamily	—	—	99	99	24,004	24,103
Consumer	32	—	115	147	17,506	17,653
Total Loans	$ 1,755	$ 1,916	$ 35,954	$ 39,625	$ 614,916	$ 654,541

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Impaired Loans: Loans are considered impaired when, based on current information and events, it is probable the Company will be unable to collect amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments.

All impaired loans have are assessed for recoverability based on an independent third-party full appraisal to determine the net realizable value (“NRV”) based on the fair value of the underlying collateral, less cost to sell and other costs, such as unpaid real estate taxes, that have been identified, or the present value of discounted cash flows in the case of certain impaired loans that are not collateral dependent. The appraisal will be based on an "as-is" valuation and will follow a reasonable valuation method that addresses the direct sales comparison, income, and cost approaches to market value, reconciles those approaches, and explains the elimination of each approach not used. Appraisals are generally updated every 12 months or sooner if we have identified possible further deterioration in value. Prior to receiving the updated appraisal, we will establish a specific reserve for any estimated deterioration, based upon our assessment of market conditions, adjusted for estimated costs to sell and other identified costs. If the NRV is greater than the loan amount, then no impairment loss exists. If the NRV is less than the loan amount, the shortfall is recognized by a specific reserve. If the borrower fails to pledge additional collateral in the ninety day period, a charge-off equal to the difference between the loan carrying value and NRV will occur. In certain circumstances, however, a direct charge-off may be taken at the time that the NRV calculation reveals a shortfall. All impaired loans are evaluated based on the criteria stated above on a quarterly basis and any change in the reserve requirements are recorded in the period identified. All partially charged-off loans remain on nonaccrual status until they are brought current as to both principal and interest and have at least nine months of payment history and future collectability of principal and interest is assured.

Impaired loans at September 30, 2014 and December 31, 2013 are set forth in the following tables.

September 30, 2014	Recorded Investment	Unpaid Principal Balance	Related Allowance
		(amounts in thousands)	
With no related allowance recorded:			
Commercial and Industrial	$ 61	$ 456	$ —
Real Estate Construction:			
Residential	—	—	—
Commercial	6,252	6,303	—
Real Estate Mortgage:			
Commercial – Owner Occupied	474	657	—
Commercial – Non-owner Occupied	7,791	8,717	—
Residential – 1 to 4 Family	2,155	2,189	—
Residential – Multifamily	—	—	—
Consumer	94	94	—
	16,827	18,416	—
With an allowance recorded:			
Commercial and Industrial	480	480	8
Real Estate Construction:			
Residential	367	1,108	142
Commercial	10,127	10,184	135
Real Estate Mortgage:			
Commercial – Owner Occupied	5,671	5,700	339
Commercial – Non-owner Occupied	22,979	24,419	677
Residential – 1 to 4 Family	8,342	11,312	807
Residential – Multifamily	365	365	6
Consumer	—	—	—
	48,331	53,568	2,114
Total:			
Commercial and Industrial	541	936	8
Real Estate Construction:			
Residential	367	1,108	142
Commercial	16,379	16,487	135
Real Estate Mortgage:			
Commercial – Owner Occupied	6,145	6,357	339
Commercial – Non-owner Occupied	30,770	33,136	677
Residential – 1 to 4 Family	10,497	13,501	807
Residential – Multifamily	365	365	6
Consumer	94	94	—
	$ 65,158	$ 71,984	$ 2,114

December 31, 2013	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(amounts in thousands)		
With no related allowance recorded:			
Commercial and Industrial	$ —	$ —	$ —
Real Estate Construction:			
Residential	780	1,521	—
Commercial	9,568	9,592	—
Real Estate Mortgage:			
Commercial – Owner Occupied	787	842	—
Commercial – Non-owner Occupied	10,853	13,153	—
Residential – 1 to 4 Family	9,892	10,084	—
Residential – Multifamily	99	306	—
Consumer	65	65	—
	32,044	35,563	—
With an allowance recorded:			
Commercial and Industrial	622	622	131
Real Estate Construction:			
Residential	187	661	21
Commercial	2,168	2,225	290
Real Estate Mortgage:			
Commercial – Owner Occupied	5,752	5,782	331
Commercial – Non-owner Occupied	22,234	22,234	801
Residential – 1 to 4 Family	5,430	5,857	338
Residential – Multifamily	370	370	6
Consumer	49	49	23
	36,812	37,800	1,941
Total:			
Commercial and Industrial	622	622	131
Real Estate Construction:			
Residential	967	2,182	21
Commercial	11,736	11,817	290
Real Estate Mortgage:			
Commercial – Owner Occupied	6,539	6,624	331
Commercial – Non-owner Occupied	33,087	35,387	801
Residential – 1 to 4 Family	15,322	15,941	338
Residential – Multifamily	469	676	6
Consumer	114	114	23
	$ 68,856	$ 73,363	$ 1,941

The following tables present by loan portfolio class, the average recorded investment and interest income recognized on impaired loans for the nine months and three months ended September 30, 2014 and 2013:

	Nine Months Ended September 30,			
	2014		2013	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(amounts in thousands)			
Commercial and Industrial	$ 851	$ 13	$ 691	$ 17
Real Estate Construction:				
Residential	766	—	1,099	—
Commercial	17,882	285	14,846	76
Real Estate Mortgage:				
Commercial – Owner Occupied	6,449	202	6,540	198
Commercial – Non-owner Occupied	32,633	903	47,960	1,314
Residential – 1 to 4 Family	13,208	180	16,265	303
Residential – Multifamily	367	16	2,237	77
Consumer	94	1	252	3
Total	$ 72,250	$ 1,600	$ 89,890	$ 1,988

	Three Months Ended September 30,			
	2014		2013	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(amounts in thousands)			
Commercial and Industrial	$ 742	$ 4	$ 663	$ 4
Real Estate Construction:				
Residential	810	—	1,516	—
Commercial	17,399	54	14,837	25
Real Estate Mortgage:				
Commercial – Owner Occupied	6,296	69	6,536	67
Commercial – Non-owner Occupied	32,246	277	46,778	441
Residential – 1 to 4 Family	12,409	62	16,316	60
Residential – Multifamily	366	4	1,448	17
Consumer	94	—	252	—
Total	$ 70,362	$ 470	$ 88,346	$ 614

Troubled debt restructurings: Periodically management evaluates our loans in order to determine the appropriate risk rating, interest accrual status and potential classification as a TDR, some of which are performing and accruing interest. A TDR is a loan on which we have granted a concession due to a borrower's financial difficulty. These are concessions that would not otherwise be considered. The terms of these modified loans may include extension of maturity, renewals, changes in interest rate, additional collateral requirements or infusion of additional capital into the project by the borrower to reduce debt or to support future debt service. On construction and land development loans we may modify the loan as a result of delays or other project issues such as slower than anticipated sell-outs, insufficient leasing activity and/or a decline in the value of the underlying collateral securing the loan. Management believes that working with a borrower to restructure a loan provides us with a better likelihood of collecting our loan. It is our policy not to renegotiate the terms of a commercial loan simply because of a delinquency status. However, we will use our Troubled Debt Restructuring Program to work with delinquent borrowers when the delinquency is temporary. We consider all loans modified in a troubled debt restructuring to be impaired.

At the time a loan is modified in a TDR, we consider the following factors to determine whether the loan should accrue interest:

- Whether there is a period of current payment history under the current terms, typically 6 months;
- Whether the loan is current at the time of restructuring; and
- Whether we expect the loan to continue to perform under the restructured terms with a debt coverage ratio that complies with the Bank's credit underwriting policy of 1.25 times debt service.

We also review the financial performance of the borrower over the past year to be reasonably assured of repayment and performance according to the modified terms. This review consists of an analysis of the borrower's historical results; the borrower's projected results over the next four quarters; current financial information of the borrower and any guarantors. The projected repayment source needs to be reliable, verifiable, quantifiable and sustainable. In addition, all TDRs are reviewed quarterly to determine the amount of any impairment. At the time of restructuring, the amount of the loan principal for which we are not reasonably assured of repayment is charged-off, but not forgiven.

A borrower with a restructured loan must make a minimum of six consecutive monthly payments at the restructured level and be current as to both interest and principal to be returned to accrual status.

Performing TDRs (not reported as non-accrual loans) totaled $33.0 million and $32.9 million with related allowances of $902,453 and $1.1 million as of September 30, 2014 and December 31, 2013, respectively. Nonperforming TDRs totaled $12.0 million and $18.1 million with related allowances of $555,000 and $71,000 as of September 30, 2014 and December 31, 2013, respectively. All TDRs are classified as impaired loans and are included in the impaired loan disclosures above.

There were no loans modified as a TDR during the nine months ended September 30, 2014 and 2013.

There were no loans that were modified and deemed TDRs that subsequently defaulted during the nine and three months ended September 30, 2014. One loan with a recorded investment of $187,000 subsequently defaulted during the six months ended June 30, 2013. Some loans classified as TDRs may not ultimately result in the full collection of principal and interest, as modified, and result in potential incremental losses. These potential incremental losses have been factored into our overall allowance for loan losses estimate. The level of any re-defaults will likely be affected by future economic conditions. Once a loan becomes a TDR, it will continue to be reported as a TDR until it is repaid in full, foreclosed, sold or it meets the criteria to be removed from TDR status.

Credit Quality Indicators: As part of the on-going monitoring of the credit quality of the Company's loan portfolio, management tracks certain credit quality indicators including trends related to the risk grades of loans, the level of classified loans, net charge-offs, nonperforming loans (see details above) and the general economic conditions in the region.

The Company utilizes a risk grading matrix to assign a risk grade to each of its loans. Loans are graded on a scale of 1 to 7. Grades 1 through 4 are considered “Pass”. A description of the general characteristics of the seven risk grades is as follows:

1. Good: Borrower exhibits the strongest overall financial condition and represents the most creditworthy profile.

2. Satisfactory (A): Borrower reflects a well-balanced financial condition, demonstrates a high level of creditworthiness and typically will have a strong banking relationship with the Bank.

3. Satisfactory (B): Borrower exhibits a balanced financial condition and does not expose the Bank to more than a normal or average overall amount of risk. Loans are considered fully collectable.

4. Watch List: Borrower reflects a fair financial condition, but there exists an overall greater than average risk. Risk is deemed acceptable by virtue of increased monitoring and control over borrowings. Probability of timely repayment is present.

5. Other Assets Especially Mentioned (OAEM): Financial condition is such that assets in this category have a potential weakness or pose unwarranted financial risk to the Bank even though the asset value is not currently impaired. The asset does not currently warrant adverse classification but if not corrected could weaken and could create future increased risk exposure. Includes loans which require an increased degree of monitoring or servicing as a result of internal or external changes.

6. Substandard: This classification represents more severe cases of #5 (OAEM) characteristics that require increased monitoring. Assets are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Assets are inadequately protected by the current net worth and paying capacity of the borrower or of the collateral. Asset has a well-defined weakness or weaknesses that impairs the ability to repay debt and jeopardizes the timely liquidation or realization of the collateral at the asset’s net book value.

7. Doubtful: Assets which have all the weaknesses inherent in those assets classified #6 (Substandard) but the risks are more severe relative to financial deterioration in capital and/or asset value; accounting/evaluation techniques may be questionable and the overall possibility for collection in full is highly improbable. Borrowers in this category require constant monitoring, are considered work-out loans and present the potential for future loss to the Bank.

An analysis of the credit risk profile by internally assigned grades as of September 30, 2014 and December 31, 2013 is as follows:

At September 30, 2014	Pass	OAEM	Substandard	Doubtful	Total
			(amounts in thousands)		
Commercial and Industrial	$ 24,236	$ 2,531	$ 473	$ —	$ 27,240
Real Estate Construction:					
Residential	5,598	—	367	—	5,965
Commercial	22,030	2,922	13,060	—	38,012
Real Estate Mortgage:					
Commercial – Owner Occupied	164,427	4,221	2,059	—	170,707
Commercial – Non-owner Occupied	214,676	6,776	12,102	—	233,554
Residential – 1 to 4 Family	150,292	1,410	10,733	—	162,435
Residential – Multifamily	24,832	279	365	—	25,476
Consumer	17,247	—	94	—	17,341
Total	$ 623,338	$ 18,139	$ 39,253	$ —	$ 680,730

At December 31, 2013	Pass	OAEM	Substandard	Doubtful	Total
			(amounts in thousands)		
Commercial and Industrial	$ 20,270	$ 1,916	$ 815	$ —	$ 23,001
Real Estate Construction:					
Residential	6,422	—	967	—	7,389
Commercial	25,519	—	18,230	—	43,749
Real Estate Mortgage:					
Commercial – Owner Occupied	162,606	2,293	5,223	—	170,122
Commercial – Non-owner Occupied	198,321	10,835	11,208	—	220,364
Residential – 1 to 4 Family	131,792	1,925	14,443	—	148,160
Residential – Multifamily	22,580	1,054	469	—	24,103
Consumer	17,538	—	115	—	17,653
Total	$ 585,048	$ 18,023	$ 51,470	$ —	$ 654,541

NOTE 5. ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is a reserve established through a provision for loan losses charged to expense, which represents management's best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The Company's allowance for loan loss methodology includes allowance allocations calculated in accordance with ASC Topic 310, "Receivables" and allowance allocations calculated in accordance with ASC Topic 450, "Contingencies." Accordingly, the methodology is based on historical loss experience by type of credit and internal risk grade, specific homogeneous risk pools and specific loss allocations, with adjustments for current events and conditions. The Company's process for determining the appropriate level of the allowance for loan losses is designed to account for credit deterioration as it occurs. The provision for loan losses reflects loan quality trends, including the levels of, and trends related to, nonaccrual loans, past due loans, potential problem loans, criticized loans and net charge-offs or recoveries, among other factors. The provision for possible loan losses also reflects the totality of actions taken on all loans for a particular period. In other words, the amount of the provision reflects not only the necessary increases in the allowance for loan losses related to newly identified criticized loans, but it also reflects actions taken related to other loans including, among other things, any necessary increases or decreases in required allowances for specific loans or loan pools.

The level of the allowance reflects management's continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management's judgment, should be charged off. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Company’s control, including, among other things, the performance of the Company's loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

The allowances established for probable losses on specific loans are based on a regular analysis and evaluation of problem loans. Loans are classified based on an internal credit risk grading process that evaluates, among other things: (i) the obligor's ability to repay; (ii) the underlying collateral, if any; and (iii) the economic environment and industry in which the borrower operates. This analysis is performed at the relationship manager level for all commercial loans. When a loan has a grade of 6 or higher, the loan is analyzed to determine whether the loan is impaired and, if impaired, whether there is a need to specifically allocate a portion of the allowance for loan losses to the loan. Specific valuation allowances are determined by analyzing the borrower's ability to repay amounts owed, any collateral deficiencies, the relative risk grade of the loan and economic conditions affecting the borrower's industry, among other things.

Historical valuation allowances are calculated based on the historical loss experience of specific types of loans. The Company calculates historical loss ratios for pools of similar loans with similar characteristics based on the proportion of actual charge-offs experienced to the total population of loans in the pool. The historical loss ratios are periodically updated based on actual charge-off experience. A historical valuation allowance is established for each pool of similar loans based upon the product of the historical loss ratio and the total dollar amount of the loans in the pool. The Company's pools of similar loans include similarly risk-graded groups of commercial loans, commercial real estate loans, consumer real estate loans and consumer and other loans.

General valuation allowances are based on general economic conditions and other qualitative risk factors both internal and external to the Company. In general, such valuation allowances are determined by evaluating, among other things: (i) the experience, ability and effectiveness of the Bank's lending management and staff; (ii) the effectiveness of the Bank's loan policies, procedures and internal controls; (iii)

changes in asset quality; (iv) changes in loan portfolio volume; (v) the composition and concentrations of credit; (vi) the impact of competition on loan structuring and pricing; (vii) the effectiveness of the internal loan review function; (viii) the impact of environmental risks on portfolio risks; and (ix) the impact of rising interest rates on portfolio risk. Management evaluates the degree of risk that each one of these components has on the quality of the loan portfolio on a quarterly basis. Each component is determined to have either a high, high-moderate, moderate, low-moderate or low degree of risk. The results are then input into a "general allocation matrix" to determine an appropriate general valuation allowance.

An analysis of the allowance for loan losses for the nine month and three month periods ended September 30, 2014 and 2013 is as follows:

Allowance for Loan Losses:	For the nine months ended September 30, 2014				
	Beginning Balance	Charge-offs	Recoveries	Provisions (Credits)	Ending Balance
	(amounts in thousands)				
Commercial and Industrial	$591	$(395)	$—	$476	$672
Real Estate Construction:					
Residential	414	—	5	(182)	237
Commercial	948	—	—	(423)	525
Real Estate Mortgage:					
Commercial – Owner Occupied	4,735	(263)	5	79	4,556
Commercial – Non-owner Occupied	7,530	—	—	(1,550)	5,980
Residential – 1 to 4 Family	3,612	(2,437)	24	3,851	5,050
Residential – Multifamily	389	—	—	23	412
Consumer	341	(26)	—	(24)	291
Unallocated	—	—	—	—	—
Total	$18,560	$(3,121)	$34	$2,250	$17,723

Allowance for Loan Losses:	For the nine months ended September 30, 2013				
	Beginning Balance	Charge-offs	Recoveries	Provisions (Credits)	Ending Balance
	(amounts in thousands)				
Commercial and Industrial	$470	$—	$—	$110	$580
Real Estate Construction:					
Residential	845	—	—	(64)	781
Commercial	1,115	—	—	98	1,213
Real Estate Mortgage:					
Commercial – Owner Occupied	4,095	—	1	567	4,663
Commercial – Non-owner Occupied	7,379	—	—	460	7,839
Residential – 1 to 4 Family	4,384	(1,659)	202	741	3,668
Residential – Multifamily	312	—	—	37	349
Consumer	336	—	—	67	403
Unallocated	—	—	—	184	184
Total	$18,936	$(1,659)	$203	$2,200	$19,680

Allowance for Loan Losses:	For the three months ended September 30, 2014				
	Beginning Balance	Charge-offs	Recoveries	Provisions (Credits)	Ending Balance
	(amounts in thousands)				
Commercial and Industrial	$700	$—	$—	$(28)	$672
Real Estate Construction:					
Residential	89	—	—	148	237
Commercial	676	—	—	(151)	525
Real Estate Mortgage:					
Commercial – Owner Occupied	4,295	—	3	258	4,556
Commercial – Non-owner Occupied	6,026	—	—	(46)	5,980
Residential – 1 to 4 Family	4,996	—	13	41	5,050
Residential – Multifamily	382	—	—	30	412
Consumer	295	(2)	—	(2)	291
Unallocated	—	—	—	—	—
Total	$17,459	$(2)	$16	$250	$17,723

Allowance for Loan Losses:	For the three months ended September 30, 2013				
	Beginning Balance	Charge-offs	Recoveries	Provisions (Credits)	Ending Balance
	(amounts in thousands)				
Commercial and Industrial	$575	$—	$—	$5	$580
Real Estate Construction:					
Residential	573	—	—	208	781
Commercial	1,386	—	—	(173)	1,213
Real Estate Mortgage:					
Commercial – Owner Occupied	4,368	—	—	295	4,663
Commercial – Non-owner Occupied	8,571	(1,391)	—	659	7,839
Residential – 1 to 4 Family	4,545	—	4	(881)	3,668
Residential – Multifamily	316	—	—	33	349
Consumer	332	—	—	71	403
Unallocated	201	—	—	(17)	184
Total	$20,867	$(1,391)	$4	$200	$19,680

Allowance for Loan Losses, at September 30, 2014	Individually evaluated for impairment	Collectively evaluated for impairment	Total
		(amounts in thousands)	
Commercial and Industrial	$ 8	$ 664	$ 672
Real Estate Construction:			
Residential	142	95	237
Commercial	135	390	525
Real Estate Mortgage:			
Commercial – Owner Occupied	339	4,217	4,556
Commercial – Non-owner Occupied	677	5,303	5,980
Residential – 1 to 4 Family	807	4,243	5,050
Residential – Multifamily	6	406	412
Consumer	—	291	291
Unallocated	—	—	—
Total	$ 2,114	$ 15,609	$ 17,723

Allowance for Loan Losses, at December 31, 2013	Individually evaluated for impairment	Collectively evaluated for impairment	Total
		(amounts in thousands)	
Commercial and Industrial	$ 131	$ 460	$ 591
Real Estate Construction:			
Residential	21	393	414
Commercial	290	658	948
Real Estate Mortgage:			
Commercial – Owner Occupied	331	4,404	4,735
Commercial – Non-owner Occupied	801	6,729	7,530
Residential – 1 to 4 Family	338	3,274	3,612
Residential – Multifamily	6	383	389
Consumer	23	318	341
Unallocated	—	—	—
Total	$ 1,941	$ 16,619	$ 18,560

Loans, at September 30, 2014:	Individually evaluated for impairment	Collectively evaluated for impairment	Total
		(amounts in thousands)	
Commercial and Industrial	$ 541	$ 26,699	$ 27,240
Real Estate Construction:			
Residential	367	5,598	5,965
Commercial	16,379	21,633	38,012
Real Estate Mortgage:			
Commercial – Owner Occupied	6,145	164,562	170,707
Commercial – Non-owner Occupied	30,770	202,784	233,554
Residential – 1 to 4 Family	10,497	151,938	162,435
Residential – Multifamily	365	25,111	25,476
Consumer	94	17,247	17,341
Total	$ 65,158	$ 615,572	$ 680,730

Loans, at December 31, 2013:	Individually evaluated for impairment	Collectively evaluated for impairment	Total
		(amounts in thousands)	
Commercial and Industrial	$ 622	$ 22,379	$ 23,001
Real Estate Construction:			
Residential	967	6,422	7,389
Commercial	11,736	32,013	43,749
Real Estate Mortgage:			
Commercial – Owner Occupied	6,539	163,583	170,122
Commercial – Non-owner Occupied	33,087	187,277	220,364
Residential – 1 to 4 Family	15,322	132,838	148,160
Residential – Multifamily	469	23,634	24,103
Consumer	114	17,539	17,653
Total	$ 68,856	$ 585,685	$ 654,541

NOTE 6. REGULATORY RESTRICTIONS

The Company and the Bank are subject to various regulatory capital requirements of federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Company and the Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined).

	Actual		For Capital Adequacy Purposes		To be Well- Capitalized Under Prompt Corrective Action Provisions	
Parke Bancorp, Inc.	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of September 30, 2014 (amounts in thousands except ratios)						
Total Risk Based Capital (to Risk Weighted Assets)	$121,022	17.56%	$55,139	8%	N/A	N/A
Tier 1 Capital (to Risk Weighted Assets)	$112,294	16.29%	$27,570	4%	N/A	N/A
Tier 1 Capital (to Average Assets)	$112,294	14.02%	$32,040	4%	N/A	N/A

	Actual		For Capital Adequacy Purposes		To be Well- Capitalized Under Prompt Corrective Action Provisions	
Parke Bancorp, Inc.	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2013 (amounts in thousands except ratios)						
Total Risk Based Capital (to Risk Weighted Assets)	$115,554	17.04$	$54,259	8%	N/A	N/A
Tier 1 Capital (to Risk Weighted Assets)	$106,952	15.77%	$27,130	4%	N/A	N/A
Tier 1 Capital	$106,952	13.94%	$30,463	4%	N/A	N/A

(to Average Assets)

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Parke Bank	Actual Amount	Actual Ratio	For Capital Adequacy Purposes Amount	For Capital Adequacy Purposes Ratio	To be Well- Capitalized Under Prompt Corrective Action Provisions Amount	To be Well- Capitalized Under Prompt Corrective Action Provisions Ratio
As of September 30, 2014 (amounts in thousands except ratios)						
Total Risk Based Capital (to Risk Weighted Assets)	$120,717	17.51%	$55,139	8%	$68,924	10%
Tier 1 Capital (to Risk Weighted Assets)	$111,989	16.25%	$27,570	4%	$41,355	6%
Tier 1 Capital (to Average Assets)	$111,989	13.98%	$32,040	4%	$40,050	5%

Parke Bank	Actual Amount	Actual Ratio	For Capital Adequacy Purposes Amount	For Capital Adequacy Purposes Ratio	To be Well- Capitalized Under Prompt Corrective Action Provisions Amount	To be Well- Capitalized Under Prompt Corrective Action Provisions Ratio
As of December 31, 2013 (amounts in thousands except ratios)						
Total Risk Based Capital t Risk Weighted Assets)	$114,744	16.92%	$54,259	8%	$67,824	10%
Tier 1 Capital (to Risk Weighted Assets)	$106,142	15.65%	$27,130	4%	$40,694	6%
Tier 1 Capital (to Average Assets)	$106,142	13.94%	$30,463	4%	$38,079	5%

On October 3, 2008 Congress passed the Emergency Economic Stabilization Act of 2008 (EESA), which provides the U.S. Secretary of the Treasury with broad authority to implement certain actions to help restore stability and liquidity to the U.S. markets. One of the provisions resulting from the EESA was the Treasury Capital Purchase Program (CPP) which provided for the direct equity investment of perpetual preferred stock by the U.S. Treasury in qualified financial institutions. This program was voluntary and required an institution to comply with several restrictions and provisions, including limits on executive compensation, stock redemptions, and declaration of dividends. The perpetual preferred stock has a dividend rate of 5% per year until the fifth anniversary of the Treasury investment and a dividend rate of 9%, thereafter. The CPP also required the Treasury to receive a warrant to purchase shares of common stock equal to 15% of the capital invested by the U.S. Treasury. The Company received an investment in perpetual preferred stock of $16,288,000 on January 30, 2009. These proceeds were allocated between the preferred stock and the warrant based on relative fair value in accordance with FASB ASC Topic 470-20, “Debt with Conversion and Other Options.” The allocation of proceeds resulted in a discount on the preferred stock that is being accreted over five years. The Company issued a warrant to purchase 329,757 shares of common stock to the U.S. Treasury and $930,000 of those proceeds was allocated to the warrant. The warrant was accounted for as equity securities. The warrant had a contractual life of 10 years and an exercise price of $6.12 per share of common stock. In November of 2012, the U.S. Treasury held an auction and sold its investment in the preferred stock to institutional investors. Restrictions related to the CPP have been lifted. In June of 2013, the U.S. Treasury held an auction to sell the warrant and the Company was the successful bidder thereby redeeming the outstanding warrant from the U.S. Treasury at a cost of $1.7 million.

In December of 2013, the Company completed a private placement of newly designated 6.00% Non-Cumulative Perpetual Convertible Preferred Stock, Series B, with a liquidation preference of $1,000 per share. The Company sold 20,000 shares in the placement for gross proceeds of $20.0 million. Each share of Series B Preferred Stock is convertible, at the option of the holder into 93.9496 shares of Common Stock. Upon full conversion of the Series B Preferred Stock, the Company will issue up to 1,878,992 shares of Common Stock assuming that the Conversion Rate does not change. The Conversion Rate and the total number of shares to be issued would be adjusted for stock dividends, stock splits and other corporate actions. The Conversion Rate was set using a conversion price for the common stock of $10.6440, which was approximately 20% over the closing price of the common stock on October 10, 2013, the day the Series B Preferred Stock was priced. Proceeds after expenses were $18.5 million. Parke Bancorp utilized a portion of the proceeds to repurchase and retire 16,288 shares of outstanding Fixed Rate Cumulative Perpetual Preferred Stock, Series A. The Company was able to repurchase these shares for an aggregate price of $14.34 million, a discount of $1.9 million.

NOTE 7. OTHER COMPREHENSIVE INCOME

The Company’s accumulated other comprehensive income consisted of the following at September 30, 2014 and December 31, 2013:

	September 30, 2014	December 31, 2013
	(amounts in thousands)	
Securities:		
Non-credit unrealized losses on securities with OTTI	$ (457)	$ (457)
Unrealized gains on securities without OTTI	430	65
Tax impact	11	157
Accumulated other comprehensive income	$ (16)	$ (235)

NOTE 8. FAIR VALUE

Fair Value Measurements

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with the Fair Value Measurements and Disclosures Topic 820 of FASB ASC, the fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

The fair value guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the

range that is most representative of fair value under current market conditions. In accordance with this guidance, the Company groups its assets and liabilities carried at fair value in three levels as follows:

Level 1 Input:

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

Level 2 Inputs:

1) Quoted prices for similar assets or liabilities in active markets.
2) Quoted prices for identical or similar assets or liabilities in markets that are not active.
3) Inputs other than quoted prices that are observable, either directly or indirectly, for the term of the asset or liability (e.g., interest rates, yield curves, credit risks, prepayment speeds or volatilities) or “market corroborated inputs.”

Level 3 Inputs:

1) Prices or valuation techniques that require inputs that are both unobservable (i.e. supported by little or no market activity) and that are significant to the fair value of the assets or liabilities.
2) These assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

Fair Value on a Recurring Basis:

The following is a description of the Company’s valuation methodologies for assets carried at fair value. These methods may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Company believes that its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting measurement date.

Investment Securities Available for Sale:

Where quoted prices are available in an active market, securities are classified in Level 1 of the valuation hierarchy. Securities in Level 1 are exchange-traded equities. If quoted market prices are not available for the specific security, then fair values are provided by independent third-party valuations services. These valuations services estimate fair values using pricing models and other accepted valuation methodologies, such as quotes for similar securities and observable yield curves and spreads. As part of the Company’s overall valuation process, management evaluates these third-party methodologies to ensure that they are representative of exit prices in the Company’s principal markets. Securities in Level 2 include U.S. Government agencies, mortgage-backed securities, state and municipal securities and TruPS.

Securities in Level 3 include thinly-traded and collateralized debt obligations. With the assistance of competent third-party valuation specialists, the Company utilized the following methodology to determine the fair value:

Cash flows were developed based on the estimated speeds at which the TruPS are expected to prepay (a range of 1% to 2%), the estimated rates at which the TruPS are expected to defer payments, the estimated rates at which the TruPS are expected to default (a range of 0.57% to 0.66%), and the severity of the losses on securities which default (95%). TruPS generally allow for prepayment by the issuer without a prepayment

penalty any time after five years. Due to the lack of new TruPS and the relatively poor conditions of the financial institution industry, a relatively modest rate of prepayment was assumed going forward. Estimates for the Constant Default Rate ("CDR") are based on the payment characteristics of the TruPS themselves (e.g. current, deferred, or defaulted) as well as the financial condition of the TruPS issuers in the pool. Estimates for the near-term rates of deferral and CDR are based on key financial ratios relating to the financial institutions' capitalization, asset quality, profitability and liquidity. Finally, we consider whether or not the financial institution has received TARP funding, and if it has, the amount. Longer-term rates of deferral and defaults are based on historical averages. The fair value of each bond was assessed by discounting its projected cash flows by a discount rate. The discount rates were based on the yields of publicly traded TruPS and preferred stock issued by comparably rated banks (3 month LIBOR plus a spread of 400 to 959 basis points).

The table below presents the balances of assets and liabilities measured at fair value on a recurring basis.

Financial Assets	Level 1	Level 2	Level 3	Total
		(amounts in thousands)		
Securities Available for Sale				
As of September 30, 2014				
Corporate debt obligations	$—	$519	$—	$519
Residential mortgage-backed securities	—	27,702	—	27,702
Collateralized mortgage-backed securities		424	—	424
Collateralized debt obligations	—	—	349	349
Total	$—	$28,645	$349	$28,994
As of December 31, 2013				
Corporate debt obligations	$—	$506	$—	$506
Residential mortgage-backed securities	—	30,450	—	30,450
Collateralized mortgage-backed securities		595	—	595
Collateralized debt obligations	—	—	4,144	4,144
Total	$—	$31,551	$4,144	$35,695

For the nine months ended September 30, 2014, there were no transfers between the levels within the fair value hierarchy.

The changes in Level 3 assets measured at fair value on a recurring basis are summarized as follows for the nine months ended September 30:

	Securities Available for Sale	
	2014	2013
	(amounts in thousands)	
Beginning balance at January 1,	$ 4,144	$ 3,942
Total net gains included in:		
Net gain	—	—
Other comprehensive income	—	83
Settlements	(3,795)	—
Net transfers into Level 3	—	—
Ending balance	$ 349	$ 4,025

Fair Value on a Non-recurring Basis:

Certain assets and liabilities are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment).

Financial Assets	Level 1	Level 2	Level 3	Total
		(amounts in thousands)		
As of September 30, 2014				
Collateral dependent impaired loans	$—	$—	$39,115	$39,115
OREO	—	—	17,857	17,857
As of December 31, 2013				
Collateral dependent impaired loans	$—	$—	$41,311	$41,311
OREO	—	—	28,910	28,910

Collateral dependent impaired loans, which are measured in accordance with FASB ASC Topic 310 “Receivables”, for impairment, had a carrying amount of $39.1 million and $41.3 million at September 30, 2014 and December 31, 2013 respectively, with a valuation allowance of $1.4 million and $1.0 million at September 30, 2014 and December 31, 2013, respectively. The valuation allowance for collateral dependent impaired loans is included in the allowance for loan losses on the balance sheet. All collateral dependent impaired loans have an independent third-party full appraisal to determine the NRV based on the fair value of the underlying collateral, less cost to sell (a range of 5% to 10%) and other costs, such as unpaid real estate taxes, that have been identified, or the present value of discounted cash flows in the case of certain impaired loans that are not collateral dependent. The appraisal will be based on an "as-is" valuation and will follow a reasonable valuation method that addresses the direct sales comparison, income, and cost approaches to market value, reconciles those approaches, and explains the elimination of each approach not used. Appraisals are updated every 12 months or sooner if we have identified possible further deterioration in value.

OREO consists of commercial real estate properties which are recorded at fair value based upon current appraised value less estimated disposition costs, which is adjusted based upon management’s review and changes in market conditions (Level 3 inputs). Properties are reappraised annually.

Fair Value of Financial Instruments

The Company discloses estimated fair values for its significant financial instruments in accordance with FASB ASC Topic 825, "Disclosures about Fair Value of Financial Instruments". The methodologies for estimating the fair value of financial assets and liabilities that are measured at fair value on a recurring or non-recurring basis are discussed above. The methodologies for estimating the fair value of other financial assets and liabilities are discussed below.

For certain financial assets and liabilities, carrying value approximates fair value due to the nature of the financial instrument. These instruments include cash and cash equivalents, restricted stock, accrued interest receivable, demand and other non-maturity deposits and accrued interest payable.

The Company used the following methods and assumptions in estimating the fair value of the following financial instruments:

Investment Securities: Fair value of securities available for sale is described above. Fair value of held to maturity securities is based upon quoted market prices.

Loans (other than impaired): Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type such as commercial, residential mortgage and other consumer. Each loan category is further segmented into groups by fixed and adjustable rate interest terms and by performing and nonperforming categories. The fair value of performing loans is calculated by discounting scheduled cash flows through their estimated maturity using estimated market discount rates that reflect the credit and interest rate risk inherent in each group of loans. The estimate of maturity is based on contractual maturities for loans within each group, or on the Company's historical experience with repayments for each loan classification, modified as required by an estimate of the effect of current economic conditions.

Deposits: The fair value of time deposits is based on the discounted value of contractual cash flows, where the discount rate is estimated using the market rates currently offered for deposits of similar remaining maturities.

Borrowings: The fair values of FHLB borrowings, other borrowed funds and subordinated debt are based on the discounted value of estimated cash flows. The discounted rate is estimated using market rates currently offered for similar advances or borrowings.

Bank premises and equipment, customer relationships, deposit base and other information required to compute the Company's aggregate fair value are not included in the above information. Accordingly, the above fair values are not intended to represent the aggregate fair value of the Company.

The following table summarizes the carrying amounts and fair values for financial instruments at September 30, 2014 and December 31, 2013:

	Level in Fair Value Hierarchy	September 30, 2014 Carrying Value	Fair Value	December 31, 2013 Carrying Value	Fair Value
		(amounts in thousands)			
Cash and cash equivalents	Level 1	$59,208	$59,208	$45,661	$45,661
Investment securities AFS	(1)	28,994	28,994	35,695	35,695
Investment securities HTM	Level 2	2,131	2,335	2,103	2,155
Restricted stock	Level 2	3,217	3,217	3,618	3,618
Loans held for sale	Level 2	1,715	1,715	12,069	12,069
Loans, net	(2)	663,007	666,173	635,981	641,449
Accrued interest receivable	Level 2	2,823	2,823	2,717	2,717
Financial Liabilities:					
Demand and savings deposits	Level 2	$375,298	$375,298	$383,412	$383,412
Time deposits	Level 2	266,321	267,976	243,356	245,094
Borrowings	Level 2	64,201	61,068	68,683	64,185
Accrued interest payable	Level 2	449	449	423	423

(1) See the recurring fair value table above.
(2) For non-impaired loans, Level 2; for impaired loans, Level 3.

NOTE 9. INCOME TAXES

	For the nine months ended September 30, 2014	2013	For the three months ended September 30, 2014	2013
	(amount in thousands)			
Income Taxes				
Pre-tax Income	$14,561	$10,702	$6,837	$3,520
Income Tax Expense	4,575	3,950	2,149	1,304

NOTE 10. EARNINGS PER SHARE ("EPS")

The following tables set forth the calculation of basic and diluted EPS for the nine month and three month periods ended September 30, 2014 and 2013.

	For the nine months ended September 30,		For the three months ended September 30,	
	2014	2013	2014	2013
	(amounts in thousands, except share data)		(amounts in thousands, except share data)	
Basic earnings per common share				
Net income available to common shareholders	$7,367	$5,384	3,155	1,770
Average common shares outstanding	5,990,831	5,957,685	5,991,859	5,982,810
Basic earnings per common share	$1.23	$0.90	0.53	0.30
Diluted earnings per common share				
Net income available to common shareholders	$7,367	$5,384	3,155	1,770
Dividend on Preferred Series B	900	773	300	263
Average common shares outstanding	5,990,831	5,957,685	5,991,859	5,982,810
Dilutive potential common shares	1,935,058	1,017	1,941,392	5,876
Total diluted average common shares outstanding	7,925,889	5,958,702	7,933,251	5,988,686
Diluted earnings per common share	$1.04	$0.90	0.44	0.30

On September 23, 2014, the Company declared a quarterly cash dividend of $0.05 per share to shareholders on record as of October 14, 2014 and payable on October 28, 2014.

NOTE 11. SUBSEQUENT EVENTS

Accounting guidance establishes general standards of accounting for, and disclosure of, events that occur after the balance sheet date but before financial statements are issued or are available to be issued. Accordingly, Management has evaluated subsequent events after September 30, 2014 through the date the financial statements were issued and determined that no subsequent events warranted recognition in or disclosure in the interim financial statements.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

The Company may from time to time make written or oral "forward-looking statements" including statements contained in this Report and in other communications by the Company which are made in good faith pursuant to the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements, such as statements of the Company's plans, objectives, expectations, estimates and intentions, involve risks and uncertainties and are subject to change based on various important factors (some of which are beyond the Company's control). The following factors, among others, could cause the Company's financial performance to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements: the strength of the United States economy in general and the strength of the local economies in which the Company conducts operations; the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System, the impact of the Bank’s compliance with the Consent Orders entered into with the FDIC and the Department, inflation, interest rate, market and monetary fluctuations; the timely development of and acceptance of new products and services of the Company and the perceived overall value of these products and services by users, including the features, pricing and quality compared to competitors' products and services; the impact of changes in financial services laws and regulations (including laws concerning taxes, banking, securities and insurance); technological changes; acquisitions; changes in consumer spending and saving habits; and the success of the Company at managing the risks involved in the foregoing.

The Company cautions that the foregoing list of important factors is not exclusive. The Company also cautions readers not to place undue reliance on these forward-looking statements, which reflect management's analysis only as of the date on which they are given. The Company is not obligated to publicly revise or update these forward-looking statements to reflect events or circumstances that arise after any such date.

General

The Company's results of operations are dependent primarily on net interest income, which is the difference between the interest income earned on its interest-earning assets, such as loans and securities, and the interest expense paid on its interest-bearing liabilities, such as deposits and borrowings. The Company also generates non-interest income such as service charges, gains from the sale of loans, earnings from BOLI, loan exit fees and other fees. The Company's non-interest expenses primarily consist of employee compensation and benefits, occupancy expenses, marketing expenses, data processing costs and other operating expenses. The Company is also subject to losses in its loan portfolio if borrowers fail to meet their obligations. The Company's results of operations are also significantly affected by general economic and competitive conditions, particularly changes in market interest rates, government policies and actions of regulatory agencies.

The Company is intently focused on managing its nonperforming assets. The deterioration of the local real estate market and the continued high levels of unemployment have had a significant negative impact on the credit quality of our loan portfolio. Management has allocated significant resources to resolve these issues, either through foreclosure or working with borrowers to bring the loans current. New processes have been implemented to identify and monitor impaired loans. New appraisals of the collateral securing impaired loans have been obtained to identify any potential exposure. The lengthy process of foreclosure has had a negative impact on earnings due to higher levels of legal fees.

Comparison of Financial Condition at September 30, 2014 and December 31, 2013

At September 30, 2014, the Company's total assets increased to $813.9 million from $794.9 million at December 31, 2013, an increase of $19.0 million or 2.4%.

Cash and cash equivalents increased $13.5 million to $59.2 million at September 30, 2014 from $45.7 million at December 31, 2013.

Total investment securities decreased to $31.1 million at September 30, 2014, from $37.8 million at December 31, 2013, a decrease of $6.7 million or 17.7%. The decrease was due to the sale of three TruPS collateralized debt investment securities. Due to the recently enacted Volcker Rule, financial institutions are no longer permitted to hold these securities in portfolio.

Management evaluates the investment portfolio for OTTI on a quarterly basis. Factors considered in the analysis include, but are not limited to, whether an adverse change in cash flows has occurred, the length of time and the extent to which the fair value has been less than cost, whether the Company intends to sell, or will more likely than not be required to sell, the investment before recovery of its amortized cost basis, which may be maturity, credit rating downgrades, the percentage of performing collateral that would need to default or defer to cause a break in yield or a temporary interest shortfall, and management's assessment of the financial condition of the underlying issuers. For the nine and three months ended September 30, 2014, the Company did not recognize any credit-related OTTI charges.

Total gross loans increased to $680.7 million at September 30, 2014 from $654.5 million at December 31, 2013, an increase of $26.2 million or 4.0%.

Delinquent loans totaled $34.3 million or 5.0% of total loans at September 30, 2014, a decrease of $5.3 million from December 31, 2013. Delinquent loan balances by number of days delinquent at September 30, 2014 were: 30 to 89 days --- $2.2 million; 90 days and greater not accruing interest --- $32.1 million.

At September 30, 2014, the Company had $32.1 million in nonaccrual loans or 4.7% of total loans, a decrease from $36.0 million or 5.5% of total loans at December 31, 2013. The three largest nonperforming loans are a $6.7 million land development loan, a $4.5 million retail center construction loan, and a $2.9 residential home loan.

The composition of nonaccrual loans as of September 30, 2014 and December 31, 2013 was as follows:

	September 30, 2014	December 31, 2013
	(amounts in thousands except ratios)	
Commercial and Industrial	$ 61	$ 122
Real Estate Construction:		
Residential	367	967
Commercial	13,060	9,908
Real Estate Mortgage:		
Commercial – Owner Occupied	860	976
Commercial – Non-owner Occupied	8,891	10,853
Residential – 1 to 4 Family	8,779	12,914
Residential – Multifamily	—	99
Consumer	94	115
Total	$ 32,112	$ 35,954
Nonperforming loans to total loans	4.7 %	5.5 %

At September 30, 2014, the allowance for loan losses was $17.7 million, as compared to $18.6 million at December 31, 2013. The ratio of allowance for loan losses to total loans was 2.6% at September 30, 2014, compared to 2.8% at December 31, 2013. The decrease is due to continuing improvements in the credit quality of the loan portfolio. The ratio of allowance for loan losses to non-performing loans improved to 55.2% at September 30, 2014, compared to 51.6% at December 31, 2013. During the nine month period ended September 30, 2014, the Company charged-off $3.1 million in loans, and recovered $34,000, compared to $1.7 million in loans charged off in the nine months ended September 30, 2013, and $203,000 in recoveries. Specific allowances for loan losses have been established in the amount of $2.1 million on impaired loans totaling $65.2 million at September 30, 2014, as compared to $1.9 million at December 31, 2013. We have provided for all losses that are both probable and reasonably estimable at September 30, 2014 and December 31, 2013. There can be no assurance, however, that further additions to the allowance will not be required in future periods.

The negative economic trends that began in 2008, including the weakness in the residential and commercial real estate markets and high levels of unemployment, have had a significant impact on the credit quality of our loan portfolio. We are aggressively managing all loan relationships and have enhanced our credit monitoring and tracking systems. We are working closely with borrowers to resolve these nonperforming loans. Updated appraisals are being obtained, where appropriate, to ensure that collateral values are sufficient to cover outstanding loan balances, and we are establishing specific reserves for any potential shortfall. With all these measures in place, our nonperforming assets have decreased from 8.2% of total assets at December 31, 2013 to 6.1% at September 30, 2014. See Note 4 – Loans for additional information. Cash flow-dependent commercial real estate properties are being visited to inspect current tenant lease status. Where necessary, we will apply our loan work-out experience to protect our collateral position.

OREO at September 30, 2014 was $17.9 million, compared to $28.9 million at December 31, 2013, the largest being a condominium development valued at $9.1 million.

An analysis of OREO activity is as follows:

	For the Nine Months Ended September 30,	
	2014	2013
	(Amounts in thousands)	
Balance at beginning of period	$ 28,910	$ 26,057
Real estate acquired in settlement of loans	2,124	6,925
Allowance for OREO	(1,493)	(1,200)
Sales of real estate	(11,706)	(3,572)
Gain (loss) on sale of real estate	722	(43)
Write-down of real estate carrying values	(895)	(464)
Donated property	(22)	—
Capitalized improvements to real estate	217	168
Balance at end of period	$ 17,857	$ 27,871

At September 30, 2014, the Bank's total deposits increased to $641.6 million from $626.8 million at December 31, 2013, an increase of $14.8 million or 2.4%.

At September 30, 2014, total shareholders' equity increased to $100.8 million from $93.7 million at December 31, 2013, an increase of $7.1 million, or 7.5%, due to the retention of earnings from the period.

Comparison of Operating Results for the Nine Months Ended September 30, 2014 and 2013

General: Net income available to common shareholders for the nine months ended September 30, 2014 was $7.4 million, compared to $5.4 million for the same period in 2013. The change was impacted by the following:

Interest Income: Interest income increased $1.5 million, or 5.4%, to $28.8 million for the nine months ended September 30, 2014, from $27.3 million for the nine months ended September 30, 2013. The increase is attributable to an increase in average loan balances, partially offset by a decrease in the average yield. Average loans for the nine month period ended September 30, 2014 were $673.0 million compared to $640.2 million for the same period last year. The average yield on loans was 5.54% for the nine months ended September 30, 2014 compared to 5.56% for the same period in 2013.

Interest Expense: Interest expense decreased $224,000 to $4.2 million for the nine months ended September 30, 2014, from $4.4 million for the nine months ended September 30, 2013. The decrease is primarily attributable to a lower average cost of deposits as the Bank has been able to re-price deposits at lower rates due to the current, historically low, interest rate environment, partially offset by an increase in average deposit balances. The average rate paid on deposits for the nine month period ended September 30, 2014 was 0.79% compared to 0.87% for the same period last year. In addition, the average rate on borrowings decreased to 1.36% for the nine months ended September 30, 2014, from 1.93% for the same period last year, as higher rate advances have matured and been replaced with lower cost borrowings.

Net Interest Income: Net interest income increased $1.7 million to $24.5 million for the nine months ended September 30, 2014, as compared to $22.8 million for the same period last year. We experienced an increase in our net interest rate spread of 2 basis points to 4.22% for the nine months ended September 30, 2014, from 4.20% for the same period last year. Our net interest margin increased 3 basis points to 4.33% for the nine months ended September 30, 2014, from 4.30% for the same period last year.

Provision for Loan Losses: We recorded a provision for loan losses of $2.2 million for the nine months ended September 30, 2014, unchanged from the same period last year.

Non-interest Income: Non-interest income was $6.5 million for the nine months ended September 30, 2014, compared to $3.4 million for the same period last year. The increase was primarily attributable to an increase in the gain on sale of SBA loans due to an increase in sales volume, loans that had been originated in prior quarters, of $1.9 million. Also contributing to the increase was a $178,000 increase in gain on the sale of investment securities and a $240,000 increase in other loan fee income, which was the result of several large prepayment fees.

Non-interest Expense: Non-interest expense increased $896,000 to $14.3 million for the nine months ended September 30, 2014, from $13.4 million for the nine months ended September 30, 2013. The increase was primarily due to a $580,000 increase in OREO expenses which included a $1.5 million loss reserve established against a condominium project in Absecon, NJ. Also contributing to the increase was an increase in compensation and benefits of $199,000 resulting from additional staff, salary increases and increased benefit costs.

Income Taxes: The Company recorded income tax expense of $4.6 million, on income before taxes of $14.6 million for the nine months ended September 30, 2014, resulting in an effective tax rate of 31.4%, compared to income tax expense of $4.0 million on income before taxes of $10.7 million for the same period of 2013, resulting in an effective tax rate of 36.9%. The decrease is due to an immaterial over accrual in a prior period that was corrected during the current period.

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	For the Nine Months Ended September 30,					
	2014			2013		
	Average Balance	Interest Income/ Expense	Yield/ Cost	Average Balance	Interest Income/ Expense	Yield/ Cost
	(Amounts in thousands, except percentages)					
Assets						
Loans	$ 672,965	$ 27,864	5.54 %	$ 640,182	$ 26,632	5.56 %
Investment securities	37,014	811	2.93 %	22,590	551	3.26 %
Federal funds sold and cash equivalents	48,826	84	0.23 %	47,114	92	0.26 %
Total interest-earning assets	758,805	$ 28,759	5.07 %	708,776	$ 27,275	5.14 % %
Other assets	62,899			60,750		
Allowance for loan losses	(18,937)			(20,237)		
Total assets	$ 802,767			$ 750,399		
Liabilities and Shareholders' Equity						
Interest bearing deposits:						
NOWs	$ 27,395	$ 103	0.50 %	$ 23,319	$ 95	0.54 %
Money markets	98,569	416	0.56 %	84,084	422	0.67 %
Savings	214,507	961	0.60 %	233,550	1,226	0.70 %
Time deposits	254,174	2,045	1.08 %	235,384	1,990	1.13 %
Brokered certificates of deposit	7,288	44	0.81 %	13,311	116	1.17 %
Total interest-bearing deposits	601,933	3,569	0.79 %	589,648	3,849	0.87 %
Borrowings	62,703	638	1.36 %	40,374	582	1.93 %
Total interest-bearing liabilities	664,636	4,207	0.85 %	630,022	4,431	0.94 %
Non-interest bearing deposits	34,997			30,002		
Other liabilities	5,346			4,516		
Total non-interest bearing liabilities	40,343			34,518		
Shareholders' equity	97,788			85,859		
Total liabilities and shareholders' equity	$ 802,767			$ 750,399		
Net interest income		$ 24,552			$ 22,844	
Interest rate spread			4.22 %			4.20 %
Net interest margin			4.33 %			4.304.31 %

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Comparison of Operating Results for the Three Months Ended September 30, 2014 and 2013

General: Net income available to common shareholders for the three months ended September 30, 2014 was $3.2 million, compared to $1.8 million for the same period in 2013. The change was impacted by the following:

Interest Income: Interest income increased $409,000, or 4.5%, to $9.4 million for the three months ended September 30, 2014, from $9.0 million for the three months ended September 30, 2013. The increase is attributable to an increase in average loan balances, partially offset by a decrease in the average yield. Average loans for the three month period ended September 30, 2014 were $676.3 million compared to $6649.9 million for the same period last year. The average yield on loans was 5.36% for the three months ended September 30, 2014 compared to 5.38% for the same period in 2013.

Interest Expense: Interest expense increased $67,000 to $1.4 million for the three months ended September 30, 2014, from $1.3 million for the three months ended September 30, 2013. The increase is primarily attributable to an increase in average deposit balances partially offset by lower average cost of deposits. Average deposits for the three month period ended September 30, 2014 were $604.9 million, compared to $581.4 million for the same period last year. The average rate paid on deposits for the three month period ended September 30, 2014 was 0.79%, compared to 0.81% for the same period last year. The average rate on borrowings decreased to 1.35% for the three months ended September 30, 2014, from 1.69% for the same period last year, as higher rate advances have matured and been replaced with lower cost borrowings.

Net Interest Income: Net interest income increased $342,000 to $8.0 million for the three months ended September 30, 2014, as compared to $7.7 million for the same period last year. We experienced a decrease in our net interest rate spread of 19 basis points to 4.05% for the three months ended September 30, 2014, from 4.24% for the same period last year. Our net interest margin decreased 18 basis points to 4.16% for the three months ended September 30, 2014, from 4.34% for the same period last year.

Provision for Loan Losses: We recorded a provision for loan losses of $250,000 for the three months ended September 30, 2014, compared to $200,000 for the same period last year.

Non-interest Income: Non-interest income was $3.9 million for the three months ended September 30, 2014, compared to $1.5 million for the same period last year. The increase was primarily attributable to an increase in the gain on sale of SBA loans due to an increase in sales volume, loans that had been originated in prior quarters, of $2.1 million. Also contributing to the increase was a $314,000 increase in gain on the sale of OREO and a $102,000 increase in other loan fee income, which was the result of several large prepayment fees.

Non-interest Expense: Non-interest expense decreased $586,000 to $4.8 million for the three months ended September 30, 2014, from $5.4 million for the three months ended September 30, 2013. The decrease was primarily due to a $640,000 decrease in OREO expenses, offset by a $253,000 increase in other operating expenses associated with nonperforming loans.

Income Taxes: The Company recorded income tax expense of $2.1 million on income before taxes of $6.8 million for the three months ended September 30, 2014, resulting in an effective tax rate of 31.4%, compared to income tax expense of $1.3 million on income before taxes of $3.5 million for the same period of 2013, resulting in an effective tax rate of 37.0%. The decrease is due to an immaterial over accrual in a prior period that was corrected during the current period.

	For the Three Months Ended September 30,					
	2014			2013		
	Average Balance	Interest Income/ Expense	Yield/ Cost	Average Balance	Interest Income/ Expense	Yield/ Cost
	(Amounts in thousands, except percentages)					
Assets						
Loans	$ 676,266	$ 9,132	5.36 %	$ 649,891	$ 8,821	5.38 %
Investment securities	34,970	256	2.90 %	21,237	168	3.14 %
Federal funds sold and cash equivalents	53,050	29	0.22 %	29,502	19	0.26 %
Total interest-earning assets	754,698	$ 9,417	4.89 %	699,572	$ 9,008	5.101 %
Other assets	60,720			60,908		
Allowance for loan losses	(17,959)			(20,745)		
Total assets	$ 807,047			$ 740,793		
Liabilities and Shareholders' Equity						
Interest bearing deposits:						
NOWs	$ 28,654	$ 36	0.50 %	$ 23,645	$ 31	0.52 %
Money markets	103,445	144	0.55 %	82,776	131	0.63 %
Savings	207,812	307	0.59 %	238,820	386	0.64 %
Time deposits	259,627	713	1.09 %	228,659	613	1.06 %
Brokered certificates of deposit	5,364	6	0.44 %	7,488	23	1.22 %
Total interest-bearing deposits	604,902	1,206	0.79 %	581,388	1,184	0.81 %
Borrowings	58,863	201	1.35 %	36,620	156	1.69 %
Total interest-bearing liabilities	663,765	1,407	0.84 %	618,008	1,340	0.86 %
Non-interest bearing deposits	37,038			31,492		
Other liabilities	5,112			4,864		
Total non-interest bearing liabilities	42,150			36,356		
Shareholders' equity	101,132			86,429		
Total liabilities and shareholders' equity	$ 807,047			$ 740,793		
Net interest income		$ 8,010			$ 7,668	
Interest rate spread			4.05 %			4.24 %
Net interest margin			4.16 %			4.345 %

Critical Accounting Policies

In the preparation of our consolidated financial statements, management has adopted various accounting policies that govern the application of accounting principles generally accepted in the United States. The significant accounting policies are described in Note 2 to the Consolidated Financial Statements.

Certain accounting policies involve significant judgments and assumptions by management that have a material impact on the carrying value of certain assets and liabilities. Management considers these accounting policies to be critical accounting policies. The judgments and assumptions used are based on historical experience and other factors, which management believes to be reasonable under the circumstances. Actual results could differ from these judgments and estimates under different conditions, resulting in a change that could have a material impact on the carrying values of assets and liabilities and results of operations.

Allowance for Loan Losses: The allowance for loan losses is considered a critical accounting policy. The allowance for loan losses is the amount estimated by management as necessary to cover losses inherent in the loan portfolio at the balance sheet date. The allowance is established through the provision for loan losses, which is charged to income. Determining the amount of the allowance for loan losses necessarily involves a high degree of judgment.

In evaluating the allowance for loan losses, management considers historical loss factors, the mix of the loan portfolio (types of loans and amounts), geographic and industry concentrations, current national and local economic conditions and other factors related to the collectability of the loan portfolio, including underlying collateral values and estimated future cash flows. All of these estimates are susceptible to significant change. Large groups of smaller balance homogeneous loans, such as residential real estate, home equity loans, and consumer loans, are evaluated in the aggregate under FASB ASC Topic 450, “Accounting for Contingencies”, using historical loss factors adjusted for economic conditions and other qualitative factors which include trends in delinquencies, classified and nonperforming loans, loan concentrations by loan category and by property type, seasonality of the portfolio, internal and external analysis of credit quality, peer group data, loan charge offs, local and national economic conditions and single and total credit exposure. Large balance and/or more complex loans, such as multi-family and commercial real estate loans, commercial business loans, and construction loans are evaluated individually for impairment in accordance with FASB ASC Topic 310 “Receivables”. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan’s effective interest rate or at the fair value of collateral if repayment is expected solely from the collateral. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available or as projected events change.

Management reviews the level of the allowance monthly. Although management used the best information available to establish the allowance for loan losses, future adjustments to the allowance may be necessary if economic conditions differ substantially from the assumptions used in making the evaluation. In addition, the FDIC and the Department, as an integral part of their examination process, periodically review the allowance for loan losses. Such agencies may require us to recognize adjustments to the allowance based on judgments about information available to them at the time of their examination. A large loss could deplete the allowance and require increased provisions to replenish the allowance, which would adversely affect earnings.

Other Than Temporary Impairment on Investment Securities: Management periodically performs analyses to determine whether there has been an OTTI in the value of one or more securities. The available for sale securities portfolio is carried at estimated fair value, with any unrealized gains or losses, net of taxes, reported as accumulated other comprehensive income or loss in stockholder’s equity. The held to maturity securities portfolio, consisting of debt securities for which there is a positive intent and ability to hold to maturity, is carried at amortized cost. Management conducts a quarterly review and evaluation of the securities portfolio to determine if the value of any security has declined below its cost or amortized cost, and whether such decline is other-than-temporary. If such decline is deemed other-than-temporary, the cost basis of the security is adjusted by writing down the security to estimated fair market value through a charge to current period earnings to the extent that such decline is credit related. All other changes in unrealized gains or losses for investment securities available for sale are recorded, net of tax effect, through other comprehensive income.

Income Taxes: Deferred taxes are provided on a liability method whereby deferred tax assets are recognized for deductible temporary differences and operating loss carryforwards and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the difference between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. Realization of deferred tax assets is dependent on generating sufficient taxable income in the future.

When tax returns are filed, it is highly likely that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that ultimately would be sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. The evaluation of a tax position taken is considered by itself and not offset or aggregated with other positions. Tax positions that meet the more likely than not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination.

Liquidity: Liquidity describes the ability of the Company to meet the financial obligations that arise out of the ordinary course of business. Liquidity addresses the Company's ability to meet deposit withdrawals on demand or at contractual maturity, to repay borrowings as they mature, and to fund current and planned expenditures. Liquidity is derived from increased repayment and income from interest-earning assets. The loan to deposit ratio was 106.1% and 104.4% at September 30, 2014 and December 31, 2013, respectively. Funds received from new and existing depositors provided a large source of liquidity for the nine month period ended September 30, 2014. The Company seeks to rely primarily on core deposits from customers to provide stable and cost-effective sources of funding to support loan growth. The Company also seeks to augment such deposits with longer term and higher yielding certificates of deposit. To the extent that retail deposits are not adequate to fund customer loan demand, liquidity needs can be met in the short-term funds market. Longer term funding can be obtained through advances from the FHLB. As of September 30, 2014, the Company maintained lines of credit with the FHLB of $98.6 million, of which $50.8 million was outstanding at September 30, 2014.

As of September 30, 2014, the Company's investment securities portfolio included $27.3 million of residential mortgage-backed securities that provide cash flow each month. The majority of the investment portfolio is classified as available for sale, is marketable, and is available to meet liquidity needs. The Company's residential real estate portfolio includes loans, which are underwritten to secondary market criteria, and accordingly could be sold in the secondary mortgage market if needed as an additional source of liquidity. The Company's management is not aware of any known trends, demands, commitments or uncertainties that are reasonably likely to result in material changes in liquidity.

Capital: A strong capital position is fundamental to support the continued growth of the Company. The Company and the Bank are subject to various regulatory capital requirements. Regulatory capital is defined in terms of Tier I capital (shareholders' equity as adjusted for unrealized gains or losses on available for sale securities), Tier II capital (which includes a portion of the allowance for loan losses) and total capital (Tier I plus Tier II). Risk-based capital ratios are expressed as a percentage of risk-weighted assets. Risk-weighted assets are determined by assigning various weights to all assets and off-balance sheet associated risk in accordance with regulatory criteria. Regulators have also adopted minimum Tier I leverage ratio standards, which measure the ratio of Tier I capital to total assets.

At September 30, 2014, management believes that the Company and the Bank are "well-capitalized" and in compliance with all applicable regulatory requirements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable as the Company is a smaller reporting company.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Evaluation of disclosure controls and procedures. Based on their evaluation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, (the "Exchange Act")), the Company's principal executive officer and principal financial officer have concluded that as of the end of the period covered by this Quarterly Report on Form 10-Q, such disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the required time periods specified in the SEC’s rules and forms.

Internal Controls

Changes in internal control over financial reporting. During the last quarter, there was no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The Company was not a party to any material legal proceedings other than routine matters in the ordinary course of business.

ITEM 1A. RISK FACTORS

Not applicable as the Company is a smaller reporting company.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

31.1	Certification of CEO required by Rule 13a-14(a).
31.2	Certification of CFO required by Rule 13a-14(a).
32	Certification required by 18 U.S.C. §1350.
101.INS	XBRL Instance Document *
101.SCH	XBRL Schema Document *
101.CAL	XBRL Calculation Linkbase Document *
101.LAB	XBRL Labels Linkbase Document *
101.PRE	XBRL Presentation Linkbase Document *
101.DEF	XBRL Definition Linkbase Document *

* Submitted as Exhibits 101 to this Form 10-K are documents formatted in XBRL (Extensible Business Reporting Language). .

SIGNATURES

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

PARKE BANCORP, INC.

Date: November 14, 2014	/s/ Vito S. Pantilione Vito S. Pantilione President and Chief Executive Officer (Principal Executive Officer)
Date: November 14, 2014	/s/ John F. Hawkins John F. Hawkins Senior Vice President and Chief Financial Officer (Principal Accounting Officer)