

STEWARDSHIP FINANCIAL CORP

Form 10-Q

August 09, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2018

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-33377

Stewardship Financial Corporation

(Exact name of registrant as specified in its charter)

New Jersey

22-3351447

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer Identification No.)

630 Godwin Avenue, Midland Park, NJ 07432

(Address of principal executive offices) (Zip Code)

(201) 444-7100

(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of 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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

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

Smaller reporting company

Indicate by check mark whether

the registrant is an emerging

growth company as defined in

Rule 405 of the Securities Act of

1933 (§230.405 of this chapter)  
or Rule 12b-2 of the Securities  
Exchange Act of 1934  
(§240.12b-2 of this chapter).

Emerging growth company [ ]

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

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

The number of shares outstanding, net of treasury stock, of the Registrant's Common Stock, no par value, as of  
August 6, 2018 was 8,676,370.

---

Stewardship Financial Corporation  
INDEX

	PAGE NUMBER
<u>PART I - FINANCIAL INFORMATION</u>	
<u>ITEM 1 - FINANCIAL STATEMENTS</u>	
<u>Consolidated Statements of Financial Condition at June 30, 2018 (Unaudited) and December 31, 2017</u>	1
<u>Consolidated Statements of Income for the Three and Six Months ended June 30, 2018 and 2017 (Unaudited)</u>	2
<u>Consolidated Statements of Comprehensive Income for the Three and Six Months ended June 30, 2018 and 2017 (Unaudited)</u>	3
<u>Consolidated Statement of Changes in Shareholders' Equity for the Three and Six Months ended June 30, 2018 and 2017 (Unaudited)</u>	4
<u>Consolidated Statements of Cash Flows for the Three and Six Months ended June 30, 2018 and 2017 (Unaudited)</u>	5
<u>Notes to Consolidated Financial Statements (Unaudited)</u>	7
<u>ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	34
<u>ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	43
<u>ITEM 4 - CONTROLS AND PROCEDURES</u>	44
<u>PART II - OTHER INFORMATION</u>	
<u>ITEM 6 - EXHIBITS</u>	45
<u>SIGNATURES</u>	46
<u>EXHIBIT INDEX</u>	47

---

## PART I – FINANCIAL INFORMATION

## Item 1. Financial Statements

Stewardship Financial Corporation and Subsidiary  
Consolidated Statements of Financial Condition

	June 30, 2018 (Unaudited)	December 31, 2017
	(Dollars in thousands)	
Assets		
Cash and due from banks	\$ 13,199	\$ 20,558
Other interest-earning assets	330	712
Cash and cash equivalents	13,529	21,270
Securities available-for-sale	112,594	109,259
Securities held to maturity; estimated fair value of \$56,624 (at June 30, 2018) and \$51,551 (at December 31, 2017)	58,471	52,442
Other equity investments, at fair value	3,694	3,756
Federal Home Loan Bank of New York stock, at cost	3,087	3,715
Loans held for sale	607	370
Loans, net of allowance for loan losses of \$8,353 (at June 30, 2018) and \$8,762 (at December 31, 2017)	713,311	702,561
Premises and equipment, net	6,952	6,909
Accrued interest receivable	2,467	2,566
Bank owned life insurance	21,360	21,084
Other assets	5,615	4,834
Total assets	\$941,687	\$928,766
Liabilities and Shareholders' equity		
Liabilities		
Deposits:		
Noninterest-bearing	\$ 188,343	\$ 172,861
Interest-bearing	603,718	591,238
Total deposits	792,061	764,099
Federal Home Loan Bank of New York advances	46,700	63,760
Subordinated Debentures and Subordinated Notes	23,350	23,317
Accrued interest payable	1,111	1,116
Accrued expenses and other liabilities	2,277	2,809
Total liabilities	865,499	855,101
Shareholders' equity		
Common stock, no par value: 20,000,000 shares authorized at June 30, 2018 and December 31, 2017; 8,676,843 and 8,652,804 shares issued and outstanding at June 30, 2018 and December 31, 2017, respectively	60,996	60,742

Edgar Filing: STEWARDSHIP FINANCIAL CORP - Form 10-Q

Retained earnings	17,534	14,307
Accumulated other comprehensive loss, net	(2,342 )	(1,384 )
Total Shareholders' equity	76,188	73,665
Total liabilities and Shareholders' equity	\$941,687	\$928,766

See accompanying notes to unaudited consolidated financial statements.

Stewardship Financial Corporation and Subsidiary  
Consolidated Statements of Income  
(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
	(Dollars in thousands, except per share amounts)			
Interest income:				
Loans	\$7,770	\$ 7,008	\$15,288	\$ 13,594
Securities held to maturity:				
Taxable	279	247	529	487
Nontaxable	23	53	56	112
Securities available-for-sale:				
Taxable	637	547	1,230	1,007
Nontaxable	15	15	29	29
Other equity investments	26	23	51	49
FHLB dividends	58	44	122	78
Other interest-earning assets	60	6	102	11
Total interest income	8,868	7,943	17,407	15,367
Interest expense:				
Deposits	1,269	719	2,334	1,352
FHLB-NY Borrowings	198	319	457	562
Subordinated Debentures and Subordinated Notes	393	371	785	739
Total interest expense	1,860	1,409	3,576	2,653
Net interest income before provision for loan losses	7,008	6,534	13,831	12,714
Provision for loan losses	(780 )	260	(1,115 )	560
Net interest income after provision for loan losses	7,788	6,274	14,946	12,154
Noninterest income:				
Fees and service charges	551	519	1,058	1,054
Bank owned life insurance	138	129	276	244
Gain on calls and sales of securities, net	—	—	6	—
Gain on sales of mortgage loans	9	38	31	55
Gain on sales of SBA loans	59	—	59	—
Gain on sale of other real estate owned	—	13	—	13
Miscellaneous	102	114	154	246
Total noninterest income	859	813	1,584	1,612
Noninterest expenses:				
Salaries and employee benefits	3,129	2,880	6,238	5,724
Occupancy, net	403	393	845	802
Equipment	188	162	369	324
Data processing	478	456	962	925
Advertising	207	211	364	347
FDIC insurance premium	70	109	134	186
Charitable contributions	195	120	375	245
Bank-card related services	131	142	258	284
Other real estate owned, net	—	9	—	24
Miscellaneous	703	601	1,387	1,336
Total noninterest expenses	5,504	5,083	10,932	10,197

Edgar Filing: STEWARDSHIP FINANCIAL CORP - Form 10-Q

Income before income tax expense	3,143	2,004	5,598	3,569
Income tax expense	842	736	1,489	1,310
Net income	\$2,301	\$ 1,268	\$4,109	\$ 2,259
Basic and diluted earnings per common share	\$0.27	\$ 0.16	\$0.47	\$ 0.32
Weighted average number of basic and diluted common shares outstanding	8,675,868	8,174,484	8,667,235	7,155,367

See accompanying notes to unaudited consolidated financial statements.

Stewardship Financial Corporation and Subsidiary  
 Consolidated Statements of Comprehensive Income  
 (Unaudited)

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2018	
	2017	2018	2017	2018
	(In thousands)			
Net income	\$2,301	\$1,268	\$4,109	\$2,259
Other comprehensive income (loss), net of tax:				
Change in unrealized holding gains (losses) on securities available-for-sale during the period	(359 )	187	(1,352 )	392
Reclassification adjustment for gains in net income	—	—	(4 )	—
Accretion of loss on securities reclassified to held to maturity	4	6	13	13
Change in fair value of interest rate swap	55	(37 )	222	(37 )
Total other comprehensive income (loss)	(300 )	156	(1,121 )	368
Total comprehensive income	\$2,001	\$1,424	\$2,988	\$2,627

See accompanying notes to unaudited consolidated financial statements.



Stewardship Financial Corporation and Subsidiary  
Consolidated Statement of Changes in Shareholders' Equity  
(Unaudited)

	Six Months Ended June 30, 2018				
	Common Stock		Retained	Accumulated	Total
	Shares	Amount	Earnings	Other	
	Comprehen-sive				
(Dollars in thousands, except per share amounts)					
Balance -- December 31, 2017	8,652,804	\$60,742	\$14,307	\$ (1,384 )	\$73,665
Cash dividends declared on common stock	—	—	(520 )	—	(520 )
Payment of discount on dividend reinvestment plan	—	(2 )	—	—	(2 )
Common stock issued under dividend reinvestment plan	3,996	44	—	—	44
Common stock issued under stock plans	1,657	16	—	—	16
Issuance of restricted stock	28,221	301	(301 )	—	—
Amortization of restricted stock, net	(9,835 )	(105 )	102	—	(3 )
Net income	—	—	4,109	—	4,109
Other comprehensive loss	—	—	—	(1,121 )	(1,121 )
Balance -- Reclassification due to the adoption of ASU 2016-01	—	—	(163 )	163	—
Balance -- June 30, 2018	8,676,843	\$60,996	\$17,534	\$ (2,342 )	\$76,188

	Six Months Ended June 30, 2017				
	Common Stock		Retained	Accumulated	Total
	Shares	Amount	Earnings	Other	
	Comprehen-sive				
(Dollars in thousands, except per share amounts)					
Balance -- December 31, 2016	6,121,329	\$41,626	\$11,082	\$ (1,321 )	\$51,387
Cash dividends declared on common stock	—	—	(443 )	—	(443 )
Payment of discount on dividend reinvestment plan	—	(2 )	—	—	(2 )
Common stock issued under dividend reinvestment plan	5,012	44	—	—	44
Common stock issued under stock plans	1,547	14	—	—	14
Issuance of restricted stock	20,876	185	(185 )	—	—
Amortization of restricted stock, net	(13,288 )	(118 )	94	—	(24 )
Tax benefit from restricted stock vesting	—	48	—	—	48
Net income	—	—	2,259	—	2,259
Other comprehensive income	—	—	—	368	368
Balance -- June 30, 2017	8,644,566	\$60,657	\$12,807	\$ (953 )	\$72,511

See accompanying notes to unaudited consolidated financial statements.

Stewardship Financial Corporation and Subsidiary  
Consolidated Statements of Cash Flows  
(Unaudited)

	Six Months Ended June 30,	
	2018	2017
	(In thousands)	
Cash flows from operating activities:		
Net income	\$4,109	\$ 2,259
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of premises and equipment	227	190
Amortization of premiums and accretion of discounts, net	244	258
Amortization of restricted stock	(3	) (24
Amortization of subordinated debenture issuance costs	33	32
Accretion of deferred loan fees	67	69
Fair value adjustment for equity security	104	—
Provision for loan losses	(1,115	) 560
Originations of mortgage loans held for sale	(2,771	) (4,257
Proceeds from sale of mortgage loans	2,565	4,639
Gain on sale of SBA loans	(59	) —
Gain on sales of mortgage loans	(31	) (55
Gain on calls and sales of securities	(6	) —
Gain on sale of other real estate owned	—	(13
Deferred income tax expense (benefit)	173	(178
Excess tax benefit from restricted stock vesting	—	48
(Increase) decrease in accrued interest receivable	99	(194
Increase (decrease) in accrued interest payable	(5	) 171
Earnings on bank owned life insurance	(276	) (244
(Increase) decrease in other assets	(477	) 67
Decrease in other liabilities	(310	) (115
Net cash provided by operating activities	2,568	3,213
Cash flows from investing activities:		
Purchase of securities available-for-sale	(14,191)	(24,128)
Proceeds from maturities and principal repayments on securities available-for-sale	7,827	6,902
Proceeds from sales and calls on securities available-for-sale	1,006	—
Purchase of securities held to maturity	(9,829	) (3,675
Proceeds from maturities and principal repayments on securities held to maturity	3,485	3,154
Proceeds from calls on securities held to maturity	280	720
Purchase of equity securities	(42	) —
Purchase of FHLB-NY stock	(1,203	) (9,890
Redemption of FHLB-NY stock	1,831	8,236
Net increase in loans	(9,643	) (87,839)
Proceeds from sale of other real estate owned	—	414
Purchase of bank owned life insurance	—	(4,000
Additions to premises and equipment	(270	) (324
Net cash used in investing activities	(20,749)	(110,430)
Cash flows from financing activities:		
Net increase in noninterest-bearing deposits	15,482	8,372

Edgar Filing: STEWARDSHIP FINANCIAL CORP - Form 10-Q

Net increase in interest-bearing deposits	12,480	53,591
Increase in loan term borrowings	—	25,000
Repayment of long term borrowings	(20,760)	(5,000 )
Net increase in short term borrowings	3,700	14,560
Proceeds from issuance of common stock, net of costs	—	18,860

5

---

Stewardship Financial Corporation and Subsidiary  
 Consolidated Statements of Cash Flows, continued  
 (Unaudited)

	Six Months Ended	
	June 30,	
	2018	2017
	(In thousands)	
Cash flows from financing activities:		
Cash dividends paid on common stock	(520 )	(443 )
Payment of discount on dividend reinvestment plan	(2 )	(2 )
Issuance of common stock for cash	60	58
Net cash provided by financing activities	10,440	114,996
Net decrease in cash and cash equivalents	(7,741 )	7,779
Cash and cash equivalents - beginning	21,270	11,680
Cash and cash equivalents - ending	\$13,529	\$19,459
Supplemental disclosures of cash flow information:		
Cash paid during the period for interest	\$3,581	\$2,482
Cash paid during the period for income taxes	\$1,335	\$1,197

See accompanying notes to unaudited consolidated financial statements.

Stewardship Financial Corporation and Subsidiary  
Notes to Consolidated Financial Statements  
June 30, 2018  
(Unaudited)

#### Note 1. Summary of Significant Accounting Policies

Certain information and note disclosures normally included in the unaudited consolidated financial statements prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) have been omitted pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Stewardship Financial Corporation Annual Report on Form 10-K for the fiscal year ended December 31, 2017, filed with the SEC on March 23, 2018.

The interim unaudited consolidated financial statements included herein have been prepared in accordance with instructions for Form 10-Q and the rules and regulations of the SEC and, therefore, do not include information or footnotes necessary for a complete presentation of consolidated financial condition, results of operations, and cash flows in conformity with GAAP. However, all adjustments, consisting only of normal recurring adjustments, which in the opinion of management are necessary for a fair presentation of the interim consolidated financial statements, have been included. The results of operations for the six months ended June 30, 2018 are not necessarily indicative of the results which may be expected for the entire year. Certain prior period amounts have been reclassified to conform with the current period presentation.

#### Principles of consolidation

The consolidated financial statements include the accounts of Stewardship Financial Corporation and its wholly-owned subsidiary, Atlantic Stewardship Bank (the “Bank”), together referred to as “the Corporation”. The Bank includes its wholly-owned subsidiaries, Stewardship Investment Corporation, Stewardship Realty LLC, Atlantic Stewardship Insurance Company, LLC and several other subsidiaries formed to hold title to properties acquired through foreclosure or deed in lieu of foreclosure. The Bank’s subsidiaries have an insignificant impact on the Bank’s daily operations. All intercompany accounts and transactions have been eliminated in the consolidated financial statements.

The consolidated financial statements of the Corporation have been prepared in conformity with GAAP. In preparing the consolidated financial statements, management is required to make estimates and assumptions, based on available information, that affect the amounts reported in the consolidated financial statements and disclosures provided. Actual results could differ significantly from those estimates.

#### Material estimates

Material estimates that are particularly susceptible to significant changes relate to the determination of the allowance for loan losses and deferred income taxes. Management believes the Corporation’s policies with respect to the methodology for the determination of the allowance for loan losses and the evaluation of deferred income taxes involves a higher degree of complexity and requires management to make difficult and subjective judgments, which often require assumptions or estimates about highly uncertain matters. Changes in these judgments, assumptions or estimates could materially impact results of operations. These critical policies and their application are periodically reviewed with the Audit Committee and the Board of Directors.

#### Adoption of New Accounting Standards

In May 2014, the Financial Accounting Standards Board (the “FASB”) issued Accounting Standards Update (“ASU”) No. 2014-09, "Revenue from Contracts with Customers (Topic 606)". The objective of this amendment is to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP and International Financial Reporting Standards. This update affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are in the scope of other standards. The ASU is effective for public business entities for financial statements issued for fiscal years beginning after December 15, 2017, and early adoption is permitted. Subsequently, the FASB issued the following standards related to ASU 2014-09: ASU 2016-08, “Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations;” ASU 2016-10, “Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing;” ASU 2016-11, “Revenue Recognition (Topic 605) and Derivatives and

7

---

Hedging (Topic 815): Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting;” and ASU 2016-12, “Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients.” These amendments are intended to improve and clarify the implementation guidance of ASU 2014-09 and have the same effective date as the original standard. The Corporation’s implementation efforts include the identification of revenue within the scope of the guidance, as well as the evaluation of revenue contracts and the respective performance obligations within those contracts. We have evaluated the nature of our contracts with customers and determined that further disaggregation of revenue from contracts with customers into more granular categories beyond what is presented in the the Condensed Consolidated Statement of Income was not necessary. We generally satisfy our performance obligations on contracts with customers as services are rendered, and the transaction prices are typically fixed and charged either on a periodic basis or based on activity. Because performance obligations are satisfied as services are rendered and the transaction prices are fixed, there is little judgment involved in applying this ASU that significantly affect the determination of the amount and timing of the revenue from contracts with customers. The Corporation has completed its evaluation and adopted this ASU effective January 1, 2018 using the modified retrospective approach. Adoption of ASU 2014-09 did not have a material impact on our consolidated financial statements and related disclosures as our primary sources of revenues are derived from interest and dividends earned on loans, securities and other financial instruments that are not within the scope of the new standard. Our revenue recognition pattern for revenue streams within the scope of the new standard, including but not limited to service charges on deposit accounts and debit card interchange, did not change significantly from prior practice. The modified retrospective method requires application of ASU 2014-09 to uncompleted contracts at the date of adoption, however, periods prior to the date of adoption have not been retrospectively revised as the impact of the new standard on uncompleted contracts as the date of adoption was not material. As such, a cumulative effective adjustment to opening retained earnings was not deemed necessary.

In January 2016, the FASB issued ASU No. 2016-01, "Financial Instruments - Overall: Recognition and Measurement of Financial Assets and Liabilities." This ASU addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. This amendment supersedes the guidance to classify equity securities with readily determinable fair values into different categories, requires equity securities to be measured at fair value with changes in the fair value recognized through net income, and simplifies the impairment assessment of equity investments without readily determinable fair values. The amendment requires public business entities that are required to disclose the fair value of financial instruments measured at amortized cost on the balance sheet to measure that fair value using the exit price notion. The amendment requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option. The amendment requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or in the accompanying notes to the financial statements. The amendment reduces diversity in current practice by clarifying that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available for sale securities in combination with the entity’s other deferred tax assets. This amendment is effective for fiscal years, including interim periods, beginning after December 15, 2017. Entities should apply the amendment by means of a cumulative-effect adjustment as of the beginning of the fiscal year of adoption, with the exception of the amendment related to equity securities without readily determinable fair values, which should be applied prospectively to equity investments that exist as of the date of adoption. The Corporation's adoption of the guidance resulted in the reclassification from accumulated other comprehensive income (loss) to retained earnings of \$163,000, reflected in the Consolidated Statements of Changes in Shareholders' Equity. In addition, the fair value of loans has been estimated using the exit price notion as described in Note 4.

In February 2016, the FASB issued ASU 2016-02, “Leases (Subtopic 842).” This ASU requires all lessees to recognize a lease liability and a right-of-use asset, measured at the present value of the future minimum lease payments, at the lease commencement date. Lessor accounting remains largely unchanged under the new guidance. The amendments in ASU 2016-02 are effective for fiscal years, including interim periods, beginning after December 15, 2018. Early

adoption of ASU 2016-02 is permitted. The Corporation is currently assessing the impact that the adoption of the guidance will have on the Corporation's consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." The main objective of this ASU is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments by a reporting entity at each reporting date. The amendments in this ASU require financial assets measured at amortized cost to be presented at

8

---



the net amount expected to be collected. The allowance for credit losses would represent a valuation account that would be deducted from the amortized cost basis of the financial asset(s) to present the net carrying value at the amount expected to be collected on the financial asset. The income statement would reflect the measurement of credit losses for newly recognized financial assets, as well as the expected increases or decreases of expected credit losses that have taken place during the period. The measurement of expected credit losses would be based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. An entity will be required to use judgment in determining the relevant information and estimation methods that are appropriate in its circumstances. The amendments in ASU 2016-13 are effective for fiscal years, including interim periods, beginning after December 15, 2019. Early adoption of this ASU is permitted for fiscal years beginning after December 15, 2018. The Corporation is currently evaluating the potential impact of ASU 2016-13 on the Corporation's consolidated financial statements. The Corporation has formed a working group, under the direction of the Chief Financial Officer, which is currently developing an implementation plan to include assessment of processes, portfolio segmentation, model development, system requirements and the identification of data and resource needs, among other things. Also, the Corporation is currently evaluating third-party vendor solutions to assist in the application of ASU 2016-13. The adoption of ASU 2016-13 may result in an increase in the allowance for loan losses due to changing from an "incurred loss" model, which encompasses allowances for current known and inherent losses within the portfolio, to an "expected loss" model, which encompasses allowances for losses expected to be incurred over the life of the portfolio. Furthermore, ASU 2016-13 will necessitate establishing an allowance for expected credit losses on debt securities. The Corporation is currently unable to reasonably estimate the impact of adopting ASU 2016-13, and it is expected that the impact of adoption will be significantly influenced by the composition, characteristics and quality of our loan and securities portfolios as well as the prevailing economic conditions and forecasts as of the adoption date.

In August 2017, the FASB issued ASU No. 2017-12, "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities", with the objective of improving the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements. The amendments in ASU 2017-12 expand and refine hedge accounting for both nonfinancial and financial risk components and align the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements. This ASU will be effective for interim and annual periods beginning after December 15, 2018. Early adoption of ASU 2017-12 is permitted. The Corporation is currently evaluating the potential impact that the adoption of the guidance will have on the Corporation's consolidated financial statements.

## Note 2. Securities – Available-for-Sale and Held to Maturity

The amortized cost, gross unrealized gains and losses and fair value of the available-for-sale securities were as follows:

	June 30, 2018			
	Amortized	Gross Unrealized		Fair
	Cost	Gains	Losses	Value
	(In thousands)			
U.S. government-sponsored agencies	\$26,753	\$8	\$658	\$26,103
Obligations of state and political subdivisions	3,214	—	113	3,101
Mortgage-backed securities	66,736	27	2,155	64,608
Asset-backed securities (a)	5,870	19	1	5,888
Corporate debt	13,403	61	570	12,894
Total debt securities	\$115,976	\$115	\$3,497	\$112,594

	December 31, 2017			
	Amortized	Gross Unrealized		Fair
	Cost	Gains	Losses	Value
	(In thousands)			
U.S. government-sponsored agencies	\$21,699	\$30	\$396	\$21,333
Obligations of state and political subdivisions	3,221	—	56	3,165
Mortgage-backed securities	64,775	70	1,011	63,834
Asset-backed securities (a)	6,672	30	4	6,698
Corporate debt	14,437	94	302	14,229
Total debt securities	\$110,804	\$224	\$1,769	\$109,259

(a) Collateralized by student loans.

Cash proceeds from sales and calls of securities available-for-sale for the three and six months ended June 30, 2018, were \$0 and \$1,006,000, respectively. There were no cash proceeds realized from sales and calls of securities available-for-sale for the three and six months ended June 30, 2017. Gross gains realized on sales or calls during the three and six months ended June 30, 2018, were \$0 and \$6,000, respectively. There were no gross losses realized on sales or calls during the three and six months ended June 30, 2018, respectively. There were no gross gains and no gross losses realized on sales or calls during the three and six months ended June 30, 2017.

The following is a summary of the amortized cost, gross unrealized gains and losses and fair value of the held to maturity securities:

	June 30, 2018			
	Amortized	Gross Unrealized		Fair
	Cost	Gain	Losses	Value
	(In thousands)			
U.S. Treasury	\$999	\$—	\$19	\$980
U.S. government-sponsored agencies	29,567	—	1,317	28,250
Obligations of state and political subdivisions	2,563	16	33	2,546
Mortgage-backed securities	25,342	42	536	24,848
	\$58,471	\$58	\$1,905	\$56,624
	December 31, 2017			
	Amortized	Gross Unrealized		Fair
	Cost	Gains	Losses	Value
	(In thousands)			
U.S. Treasury	\$999	\$—	\$11	\$988
U.S. government-sponsored agencies	27,075	4	760	26,319
Obligations of state and political subdivisions	4,057	21	23	4,055
Mortgage-backed securities	20,311	76	198	20,189
	\$52,442	\$101	\$992	\$51,551

Cash proceeds from calls of securities held to maturity for the three and six months ended June 30, 2018 were \$0 and \$280,000, respectively. Cash proceeds from calls of securities held to maturity for the three and six months ended June 30, 2017 were \$380,000 and \$720,000, respectively. There were no gross gains and no gross losses realized on calls during the three and six months ended June 30, 2018 and June 30, 2017.

Mortgage-backed securities are a type of asset-backed security secured by a mortgage or collection of mortgages, purchased by government agencies such as the Government National Mortgage Association and government sponsored agencies such as the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, which then issue securities that represent claims on the principal and interest payments made by borrowers on the loans in the pool.

The following table presents the amortized cost and fair value of the debt securities portfolio by contractual maturity. As issuers may have the right to call or prepay obligations with or without call or prepayment premiums, the actual maturities may differ from contractual maturities. Securities not due at a single maturity date, such as mortgage-backed securities and asset-backed securities, are shown separately.

	June 30, 2018	
	Amortized Cost	Fair Value
	(In thousands)	
Available-for-sale		
Within one year	\$—	\$—
After one year, but within five years	13,515	13,275
After five years, but within ten years	25,095	24,255
After ten years	4,760	4,568
Mortgage-backed securities	66,736	64,608
Asset-backed securities	5,870	5,888
 Total	 \$115,976	 \$112,594
Held to maturity		
Within one year	\$535	\$536
After one year, but within five years	14,037	13,700
After five years, but within ten years	18,064	17,080
After ten years	493	460
Mortgage-backed securities	25,342	24,848
 Total	 \$58,471	 \$56,624

The following tables summarize the fair value and unrealized losses of those investment securities which reported an unrealized loss at June 30, 2018 and December 31, 2017, and if the unrealized loss position was continuous for the twelve months prior to June 30, 2018 and December 31, 2017.

Available-for-Sale

June 30, 2018	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
U.S. government- sponsored agencies	\$11,204	\$(221)	\$9,668	\$(437)	\$20,872	\$(658)
Obligations of state and political subdivisions	1,373	(14)	1,728	(99)	3,101	(113)
Mortgage-backed securities	35,003	(902)	24,420	(1,253)	59,423	(2,155)
Asset-backed securities	3,013	(1)	—	—	3,013	(1)
Corporate debt	—	—	8,833	(570)	8,833	(570)
 Total temporarily impaired securities	 \$50,593	 \$(1,138)	 \$44,649	 \$(2,359)	 \$95,242	 \$(3,497)



Edgar Filing: STEWARDSHIP FINANCIAL CORP - Form 10-Q

December 31, 2017	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
U.S. government- sponsored agencies	\$8,260	\$ (70 )	\$11,174	\$ (326 )	\$19,434	\$ (396 )
Obligations of state and political subdivisions	1,384	(7 )	1,781	(49 )	3,165	(56 )
Mortgage-backed securities	30,575	(201 )	26,809	(810 )	57,384	(1,011 )
Asset-backed securities	—	—	3,013	(4 )	3,013	(4 )
Corporate debt	—	—	9,135	(302 )	9,135	(302 )
Total temporarily impaired securities	\$40,219	\$ (278 )	\$51,912	\$ (1,491 )	\$92,131	\$ (1,769 )

Held to Maturity

June 30, 2018	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
U.S. Treasury	\$980	\$ (19 )	\$—	\$ —	\$980	\$ (19 )
U.S. government- sponsored agencies	12,337	(344 )	14,913	(973 )	27,250	(1,317 )
Obligations of state and political subdivisions	—	—	460	(33 )	460	(33 )
Mortgage-backed securities	14,794	(297 )	5,528	(239 )	20,322	(536 )
Total temporarily impaired securities	\$28,111	\$ (660 )	\$20,901	\$ (1,245 )	\$49,012	\$ (1,905 )

December 31, 2017	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
U.S. Treasury	\$988	\$ (11 )	\$—	\$ —	\$988	\$ (11 )
U.S. government- sponsored agencies	10,032	(139 )	15,265	(621 )	25,297	(760 )
Obligations of state and political subdivisions	—	—	474	(23 )	474	(23 )
Mortgage-backed securities	9,531	(114 )	3,896	(84 )	13,427	(198 )
Total temporarily impaired securities	\$20,551	\$ (264 )	\$19,635	\$ (728 )	\$40,186	\$ (992 )

## Other-Than-Temporary Impairment

At June 30, 2018, there were available-for-sale investments comprising twelve U.S. government-sponsored agency securities, four obligations of state and political subdivision securities, forty-two mortgage-backed securities, and nine corporate debt securities in a continuous loss position for twelve months or longer. At June 30, 2018, there were held to maturity investments comprising fifteen U.S. government-sponsored agency securities, one obligation of state and political subdivision security, and fourteen mortgage-backed securities in a continuous loss position for twelve months or longer. Management has assessed the securities that were in an unrealized loss position at June 30, 2018 and December 31, 2017 and has determined that any decline in fair value below amortized cost primarily relates to changes in interest rates and market spreads and was temporary.

In making this determination management considered the following factors: the period of time the securities were in an unrealized loss position; the percentage decline in comparison to the securities' amortized cost; any adverse conditions specifically related to the security, an industry or a geographic area; the rating or changes to the rating by a credit rating agency; the financial condition of the issuer and guarantor and any recoveries or additional declines in fair value subsequent to the balance sheet date.

The Corporation does not intend to sell securities in an unrealized loss position and it is not more likely than not that we will be required to sell these securities before the recovery of their amortized cost bases, which may be at maturity.

## Note 3. Loans and Allowance for Loan Losses

At June 30, 2018 and December 31, 2017, respectively, the loan portfolio consisted of the following:

	June 30, 2018	December 31, 2017
	(In thousands)	
Commercial:		
Secured by real estate	\$29,237	\$ 31,684
Other	61,653	57,372
Commercial real estate	498,982	493,542
Commercial construction	4,622	2,152
Residential real estate	85,427	85,760
Consumer:		
Secured by real estate	34,358	32,207
Other	410	563
Government Guaranteed Loans - guaranteed portion	7,282	8,334
Other	177	106
Total gross loans	722,148	711,720
Less: Deferred loan costs, net	484	397
Allowance for loan losses	8,353	8,762
	8,837	9,159
Loans, net	\$713,311	\$ 702,561

Included in Commercial - Other and Commercial real estate at June 30, 2018 were \$175,000 and \$714,000 of Small Business Administration ("SBA") loans originated during 2018. The guaranteed portions of these loans were sold during the three months ended June 30, 2018.

The Corporation has purchased the guaranteed portion of several Government Guaranteed loans. Due to the guarantee of the principal amount of these loans, no allowance for loan losses is established for these loans.

14

---



Activity in the allowance for loan losses is summarized as follows:

Three Months Ended June 30, 2018

	Balance beginning of period (In thousands)	Provision charged to operations	Loans charged off	Recoveries of loans charged off	Balance, end of period
Commercial	\$2,865	\$ (9 )	\$ —	\$ 75	\$ 2,931
Commercial real estate	5,349	(757 )	—	612	5,204
Commercial construction	81	(10 )	—	—	71
Residential real estate	72	(3 )	—	—	69
Consumer	67	2	—	—	69
Other loans	—	—	—	1	1
Unallocated	11	(3 )	—	—	8
<b>Total</b>	<b>\$8,445</b>	<b>\$ (780 )</b>	<b>\$ —</b>	<b>\$ 688</b>	<b>\$ 8,353</b>

Six Months Ended June 30, 2018

	Balance beginning of period (In thousands)	Provision charged to operations	Loans charged off	Recoveries of loans charged off	Balance, end of period
Commercial	\$3,058	\$ (198 )	\$ (29 )	\$ 100	\$ 2,931
Commercial real estate	5,531	(961 )	—	634	5,204
Commercial construction	33	38	—	—	71
Residential real estate	68	1	—	—	69
Consumer	64	4	—	1	69
Other loans	1	—	(1 )	1	1
Unallocated	7	1	—	—	8
<b>Total</b>	<b>\$8,762</b>	<b>\$ (1,115 )</b>	<b>\$ (30 )</b>	<b>\$ 736</b>	<b>\$ 8,353</b>

## Three Months Ended June 30, 2017

	Balance beginning of period (In thousands)	Provision charged to operations	Loans charged off	Recoveries of loans charged off	Balance, end of period
Commercial	\$2,560	\$ 84	\$ ( 1 )	\$ 19	\$ 2,662
Commercial real estate	5,149	327	—	26	5,502
Commercial construction	384	(131 )	—	—	253
Residential real estate	65	(7 )	—	—	58
Consumer	73	(10 )	—	—	63
Other loans	—	5	(1 )	1	5
Unallocated	15	(8 )	—	—	7
<b>Total</b>	<b>\$8,246</b>	<b>\$ 260</b>	<b>\$ ( 2 )</b>	<b>\$ 46</b>	<b>\$ 8,550</b>

## Six Months Ended June 30, 2017

	Balance beginning of period (In thousands)	Provision charged to operations	Loans charged off	Recoveries of loans charged off	Balance, end of period
Commercial	\$2,663	\$ (34 )	\$ ( 2 )	\$ 35	\$ 2,662
Commercial real estate	4,734	717	—	51	5,502
Commercial construction	355	(102 )	—	—	253
Residential real estate	66	(8 )	—	—	58
Consumer	75	(13 )	—	1	63
Other loans	—	5	(1 )	1	5
Unallocated	12	(5 )	—	—	7
<b>Total</b>	<b>\$7,905</b>	<b>\$ 560</b>	<b>\$ ( 3 )</b>	<b>\$ 88</b>	<b>\$ 8,550</b>

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on the impairment method as of June 30, 2018 and December 31, 2017.

	June 30, 2018								
	Commercial Real Estate	Commercial Construction	Commercial Real Estate	Residential Real Estate	Consumer	Government Guaranteed	Other Loans	Unallocated	Total
	(In thousands)								
Allowance for loan losses									
Ending allowance balance attributable to loans									
Individually evaluated for impairment	\$78	\$568	\$—	\$—	\$—	\$—	\$—	\$—	\$646
Collectively evaluated for impairment	2,853	4,636	71	69	69	—	1	8	7,707
Total ending allowance balance	\$2,931	\$5,204	\$71	\$69	\$69	\$—	\$1	\$8	\$8,353
Loans:									
Loans individually evaluated for impairment	\$891	\$6,154	\$—	\$282	\$17	\$—	\$—	\$—	\$7,344
Loans collectively evaluated for impairment	89,999	492,828	4,622	85,145	34,751	7,282	177	—	714,804
Total ending loan balance	\$90,890	\$498,982	\$4,622	\$85,427	\$34,768	\$7,282	\$177	\$—	\$722,148

Edgar Filing: STEWARDSHIP FINANCIAL CORP - Form 10-Q

December 31, 2017  
Commercial Real Estate      Commercial Construction      Residential Real Estate      Consumer      Government Guaranteed Loans      Other Loans      Unallocated  
(In thousands)

Allowance for loan losses  
Ending allowance balance  
attributable to loans

Individually evaluated for impairment	\$34	\$575	\$—	\$—	\$—	\$—	\$—	\$—	\$—	\$609
Collectively evaluated for impairment	3,024	4,956	33	68	64	—	1	7		8,153
Total ending allowance balance	\$3,058	\$5,531	\$33	\$68	\$64	\$—	\$1	\$7		\$8,762
Loans:										
Loans individually evaluated for impairment	\$549	\$6,236	\$—	\$295	\$62	\$—	\$—	\$—	\$—	\$7,142
Loans collectively evaluated for impairment	88,507	487,306	2,152	85,465	32,708	8,334	106	—		704,578
Total ending loan balance	\$89,056	\$493,542	\$2,152	\$85,760	\$32,770	\$8,334	\$106	\$—		\$711,720

The following table presents the recorded investment in nonaccrual loans at the dates indicated:

June 30, December 31,  
2018 2017  
(In thousands)

Commercial:

Secured by real estate	\$395	\$136
Commercial real estate	589	701
Residential real estate	282	295
Consumer:		
Secured by real estate	17	62
Total nonaccrual loans	\$1,283	\$1,194

At June 30, 2018 and December 31, 2017, there were no loans that were past due 90 days and still accruing.

The following table presents information regarding loans individually evaluated for impairment by class of loan at and for the periods indicated:

	At June 30, 2018		Allowance
	Unpaid Principal Balance	Recorded Investment	for Loan Losses Allocated
	(In thousands)		
With no related allowance recorded:			
Commercial:			
Secured by real estate	\$671	\$ 667	
Commercial real estate	3,384	3,059	
Residential Real Estate	288	282	
Consumer:			
Secured by real estate	21	17	
	4,364	4,025	
With an allowance recorded:			
Commercial:			
Secured by real estate	99	99	\$ 72
Other	125	125	6
Commercial real estate	3,095	3,095	568
	3,319	3,319	646
Total:			
Commercial:			
Secured by real estate	770	766	72
Other	125	125	6
Commercial real estate	6,479	6,154	568
Residential Real Estate	288	282	—
Consumer:			
Secured by real estate	21	17	—
	\$7,683	\$ 7,344	\$ 646



At December 31, 2017

Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated
--------------------------------	------------------------	---

(In thousands)

With no related allowance recorded:

Commercial:

Secured by real estate	\$389	\$ 389
------------------------	-------	--------

Commercial real estate	3,442	3,124
------------------------	-------	-------

Residential real estate	295	295
-------------------------	-----	-----

Consumer:

Secured by real estate	71	62
------------------------	----	----

	4,197	3,870
--	-------	-------

With an allowance recorded:

Commercial:

Secured by real estate	33	32	\$ 27
------------------------	----	----	-------

Other	128	128	7
-------	-----	-----	---

Commercial real estate	3,112	3,112	575
------------------------	-------	-------	-----

	3,273	3,272	609
--	-------	-------	-----

Total:

Commercial:

Secured by real estate	422	421	27
------------------------	-----	-----	----

Other	128	128	7
-------	-----	-----	---

Commercial real estate	6,554	6,236	575
------------------------	-------	-------	-----

Residential real estate	295	295	—
-------------------------	-----	-----	---

Consumer:

Secured by real estate	71	62	—
------------------------	----	----	---

	\$7,470	\$ 7,142	\$ 609
--	---------	----------	--------

	Three Months Ended June 30, 2018		2017	
	Average Recorded Investment (In thousands)	Interest Income Recognized (\$)	Average Recorded Investment (In thousands)	Interest Income Recognized (\$)
With no related allowance recorded:				
Commercial:				
Secured by real estate	\$525	\$ 4	\$1,305	\$ 21
Commercial real estate	3,076	28	3,155	31
Residential Real Estate	285	—	—	—
Consumer:				
Secured by real estate	31	—	72	—
Total	3,917	32	4,532	52
With an allowance recorded:				
Commercial:				
Secured by real estate	50	1	19	—
Other	126	2	188	3
Commercial real estate	3,099	41	3,152	32
	3,275	44	3,359	35
Total	\$7,192	\$ 76	\$7,891	\$ 87

	Six Months Ended June 30, 2018		2017	
	Average Recorded Investment (In thousands)	Interest Income Recognized (\$)	Average Recorded Investment (In thousands)	Interest Income Recognized (\$)
With no related allowance recorded:				
Commercial:				
Secured by real estate	\$480	\$ 8	\$1,321	\$ 41
Commercial real estate	3,091	55	3,156	62
Residential Real Estate	289	—	—	—
Consumer:				
Secured by real estate	42	—	74	—
Total	3,902	63	4,551	103
With an allowance recorded:				
Commercial:				
Secured by real estate	44	1	52	—
Other	126	4	200	7
Commercial real estate	3,103	80	3,160	64
	3,273	85	3,412	71
Total	\$7,175	\$ 148	\$7,963	\$ 174

During the three and six months ended June 30, 2018 and 2017, no interest income was recognized on a cash basis.





Edgar Filing: STEWARDSHIP FINANCIAL CORP - Form 10-Q

The following table presents the aging of the recorded investment in past due loans by class of loans as of June 30, 2018 and December 31, 2017. Nonaccrual loans are included in the disclosure by payment status.

	June 30, 2018			Total Past Due	Current	Total
	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due			
(In thousands)						
Commercial:						
Secured by real estate	\$61	\$ —	\$ 105	\$ 166	\$29,071	\$29,237
Other	—	—	—	—	61,653	61,653
Commercial real estate	295	—	589	884	498,098	498,982
Commercial construction	—	—	—	—	4,622	4,622
Residential real estate	—	—	—	—	85,427	85,427
Consumer:						
Secured by real estate	—	—	—	—	34,358	34,358
Other	—	—	—	—	410	410
Government Guaranteed	—	—	—	—	7,282	7,282
Other	—	—	—	—	177	177
<b>Total</b>	<b>\$356</b>	<b>\$ —</b>	<b>\$ 694</b>	<b>\$ 1,050</b>	<b>\$721,098</b>	<b>\$722,148</b>

	December 31, 2017			Total Past Due	Current	Total
	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due			
(In thousands)						
Commercial:						
Secured by real estate	\$186	\$ —	\$ —	\$ 186	\$31,498	\$31,684
Other	8	—	—	8	57,364	57,372
Commercial real estate	300	—	599	899	492,643	493,542
Commercial construction	—	—	—	—	2,152	2,152
Residential real estate	314	—	—	314	85,446	85,760
Consumer:						
Secured by real estate	—	—	28	28	32,179	32,207
Other	—	—	—	—	563	563
Government Guaranteed	—	—	—	—	8,334	8,334
Other	—	—	—	—	106	106
<b>Total</b>	<b>\$808</b>	<b>\$ —</b>	<b>\$ 627</b>	<b>\$ 1,435</b>	<b>\$710,285</b>	<b>\$711,720</b>

Troubled Debt Restructurings

In order to determine whether a borrower is experiencing financial difficulty necessitating a restructuring, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed in accordance with the Corporation's internal underwriting policy. A loan is considered to be in payment default once it is contractually 90 days past due.

At both June 30, 2018 and December 31, 2017, the Corporation had \$6.6 million of loans whose terms have been modified in troubled debt restructurings. Of these loans, \$6.1 million and \$5.9 million had demonstrated a reasonable period of performance in accordance with their new terms at June 30, 2018 and December 31, 2017, respectively. The remaining troubled debt restructurings are reported as nonaccrual loans. Specific reserves of \$646,000 and \$582,000 have been recorded for the troubled debt restructurings at June 30, 2018 and December 31, 2017,

respectively, and are included in the table above. As of June 30, 2018 and December 31, 2017, there were no additional funds committed to these borrowers.

The following table presents the number of loans and their recorded investment immediately prior to the modification date and immediately after the modification date by class that were modified as troubled debt restructuring during the three and six months ended June 30, 2018:

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2018	
	Number of Recorded Loans	Investment (Dollars in thousands)	Number of Recorded Loans	Investment (Dollars in thousands)
Commercial:				
Secured by real estate	1	\$ 100	1	\$ 100
Total	1	\$ 100	1	\$ 100

During the three and six months ended June 30, 2018, there was one loan modified as a troubled debt restructuring. The modification of the terms of the commercial - secured by real estate loan represented the term out of the remaining balance of a line of credit.

For the three and six months ended June 30, 2018, the troubled debt restructuring described above resulted in a net increase in the allowance for loan losses of \$72,000. There were no charge-offs during the three or six months ended June 30, 2018 related to this troubled debt restructuring.

There were no new loans classified as a troubled debt restructuring during the three and six months ended June 30, 2017.

#### Credit Quality Indicators

The Corporation categorizes certain loans into risk categories based on relevant information about the ability of the borrowers to service their debt, such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Corporation analyzes loans individually by classifying the loans as to credit risk. This analysis includes non-homogeneous loans, such as commercial, commercial real estate and commercial construction loans. This analysis is performed at the time the loan is originated and annually thereafter. The Corporation uses the following definitions for risk ratings.

**Special Mention** – A Special Mention asset has potential weaknesses that deserve management’s close attention, which, if left uncorrected, may result in deterioration of the repayment prospects for the asset or the Bank’s credit position at some future date. Special Mention assets are not adversely classified and do not expose the Bank to sufficient risk to warrant adverse classification.

**Substandard** – Substandard loans are inadequately protected by the current net worth and paying capacity of the borrower or by the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the repayment and liquidation of the debt. These loans are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

**Doubtful** – A Doubtful loan has all of the weaknesses inherent in those classified as Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions, and values, highly questionable or improbable. The likelihood of loss is extremely high, but because of

certain important and reasonably specific factors, an estimated loss is deferred until a more exact status can be determined.

Edgar Filing: STEWARDSHIP FINANCIAL CORP - Form 10-Q

Loss – A loan classified Loss is considered uncollectible and of such little value that its continuance as an asset is not warranted. This classification does not necessarily mean that an asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off a basically worthless asset even though partial recovery may be effected in the future.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans. As of June 30, 2018 and December 31, 2017, and based on the most recent analysis performed at those times, the risk category of loans by class is as follows:

	June 30, 2018					
	Pass	Special Mention	Substandard	Doubtful	Loss	Total
	(In thousands)					
Commercial:						
Secured by real estate	\$26,825	\$1,690	\$722	\$—	—\$	—\$29,237
Other	60,975	194	484	—	—	61,653
Commercial real estate	484,903	9,046	5,033	—	—	498,982
Commercial construction	4,622	—	—	—	—	4,622
Government Guaranteed Loans - guaranteed portion	7,282	—	—	—	—	7,282
Total	\$584,607	\$10,930	\$6,239	\$—	—\$	—\$601,776

	December 31, 2017					
	Pass	Special Mention	Substandard	Doubtful	Loss	Total
	(In thousands)					
Commercial:						
Secured by real estate	\$29,025	\$2,153	\$506	\$—	—\$	—\$31,684
Other	56,632	216	524	—	—	57,372
Commercial real estate	481,443	10,023	2,076	—	—	493,542
Commercial construction	2,152	—	—	—	—	2,152
Government Guaranteed Loans - guaranteed portion	8,334	—	—	—	—	8,334
Total	\$577,586	\$12,392	\$3,106	\$—	—\$	—\$593,084

The Corporation considers the historical and projected performance of the loan portfolio and its impact on the allowance for loans losses. For the residential real estate and consumer loan segments, the Corporation evaluates credit quality primarily based on payment activity and historical loss data. The following table presents the recorded investment in residential real estate and consumer loans based on payment activity as of June 30, 2018 and December 31, 2017.

	June 30, 2018		
	Current	Past Due or Nonaccrual	Total
	(In thousands)		
Residential real estate	\$85,145	\$282	\$85,427
Consumer:			
Secured by real estate	34,341	17	34,358
Other	410	—	410

Total	\$119,896	\$ 299	\$120,195
-------	-----------	--------	-----------

24

---

December 31, 2017

	Current	Past Due or Nonaccrual	Total
(In thousands)			
Residential real estate	\$85,446	\$ 314	\$85,760
Consumer:			
Secured by real estate	32,179	28	32,207
Other	563	—	563
Total	\$118,188	\$ 342	\$118,530

Note 4. Fair Value of Financial Instruments

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

Assets and Liabilities Measured on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis are summarized below:

	Carrying Value	Fair Value Measurements Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
At June 30, 2018 (In thousands)				
Assets:				
Available-for-sale securities				
U.S. government - sponsored agencies	\$26,103	\$—	\$ 26,103	\$ —
Obligations of state and political subdivisions	3,101	—	3,101	—
Mortgage-backed securities	64,608	—	64,608	—



Edgar Filing: STEWARDSHIP FINANCIAL CORP - Form 10-Q

Asset-backed securities	5,888	—	5,888	—
Corporate debt	12,894	—	12,894	—
Total available-for-sale securities	\$112,594	\$—	\$112,594	\$ —
Other equity investments	\$3,694	\$3,634	\$60	\$ —
Interest rate swap	\$280	\$—	\$280	\$ —

25

---

Carrying Value	Fair Value Measurements Using:			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
At December 31, 2017 (In thousands)				
Assets:				
Available-for-sale securities				
U.S. government - sponsored agencies	\$21,333	\$—	\$ 21,333	\$ —
Obligations of state and political subdivisions	3,165	—	3,165	—
Mortgage-backed securities	63,834	—	63,834	—
Asset-backed securities	6,698	—	6,698	—
Corporate debt	14,229	—	14,229	—
Total available-for-sale securities	\$ 109,259	\$—	\$ 109,259	\$ —
Other equity investments	\$3,756	\$3,696	\$ 60	\$ —
Liabilities:				
Interest rate swap	\$29	\$—	\$ 29	\$ —

There were no transfers of assets between Level 1 and Level 2 during the six months ended June 30, 2018 or during the year ended December 31, 2017. There were no changes to the valuation techniques for fair value measurements as of June 30, 2018 and December 31, 2017.

The fair values of investment securities are determined by quoted market prices, if available (Level 1). If quoted prices are not available, fair values of investment securities are determined by matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs). The Corporation performs quarterly analyses on the prices received from the pricing service to determine whether the prices are reasonable estimates of fair value. Specifically, the Corporation compares the prices received from the pricing service to a secondary pricing source. The Corporation's internal price verification procedures have not historically resulted in adjustment in the prices obtained from the pricing service.

The other equity investments primarily represent a Community Reinvestment Act (CRA) mutual fund investment.

The interest rate swaps are reported at fair values obtained from brokers who utilize internal models with observable market data inputs to estimate the values of these instruments (Level 2 inputs).

## Assets and Liabilities Measured on a Non-Recurring Basis

Assets and liabilities measured at fair value on a non-recurring basis are summarized below:

Fair Value Measurements  
Using:  
Quoted  
Prices  
in  
Active Markets  
Carrying Value for  
Identical Assets  
(Level 1)

Significant  
Other  
Observable  
Inputs  
(Level 2)

Significant  
Unobservable  
Inputs  
(Level 3)

At June 30, 2018  
(In thousands)

Assets:

Impaired loans

Commercial:

Secured by real estate	\$317	\$ —	—	\$ 317
	\$317	\$ —	—	\$ 317

Fair Value Measurements  
Using:  
Quoted  
Prices  
in  
Active Markets  
Carrying Value for  
Identical Assets  
(Level 1)

Significant  
Other  
Observable  
Inputs  
(Level 2)

Significant  
Unobservable  
Inputs  
(Level 3)

At December 31, 2017  
(In thousands)

Assets:

Impaired loans

Commercial:

Secured by real estate	\$ 109	\$ —	—	\$ 109
Commercial real estate	192	—	—	192
Residential real estate	296	—	—	296
	\$597	\$ —	—	\$ 597

Collateral-dependent impaired loans measured for impairment using fair value of the collateral had a recorded investment value of \$389,000, resulting in an increase in the allowance for loan losses of \$72,000 for the six months ended June 30, 2018.

Collateral-dependent impaired loans measured for impairment using the fair value of the collateral had a recorded investment value of \$624,000, resulting in an increase of the allowance for loan losses of \$27,000 for the year ended December 31, 2017.

There was no OREO at June 30, 2018 or December 31, 2017.

The Corporation does not record loans at fair value on a recurring basis. However, from time to time, the Corporation records non-recurring fair value adjustments to collateral dependent loans to reflect impairment. The Corporation measures impairment of collateralized loans based on the estimated fair value of the collateral less estimated costs to sell the collateral, incorporating assumptions that experienced parties might use in estimating the value of such collateral (Level 3 inputs). At the time a loan is considered impaired, it is valued at the lower of cost or fair value. Generally, impaired loans carried at fair value have been partially charged-off or receive specific allocations of the allowance for loan losses. For collateral dependent loans, fair value is commonly based on real estate appraisals.

These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. In the appraisal process, the independent appraisers routinely adjust for differences between the comparable sales and income data available. Such adjustments typically result in a Level 3 classification of the inputs for determining fair value. Methods for valuing non-real estate collateral include using an appraisal, the net book value recorded for the collateral on the borrower's financial statements, or aging reports. Collateral is then adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the borrower and borrower's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Appraisals are generally obtained to support the fair value of collateral. Appraisals for collateral-dependent impaired loans are performed by licensed appraisers whose qualifications and licenses have been reviewed and verified by the Corporation. The Corporation utilizes a third party to order appraisals and, once received, reviews the assumptions and approaches utilized in the appraisal as well as the resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics.

Real estate appraisals typically incorporate measures such as recent sales prices for comparable properties. Appraisers may make adjustments to the sales price of the comparable properties as deemed appropriate based on the age, condition or general characteristics of the subject property. Management generally applies a 12% discount to real estate appraised values to cover disposition / selling costs and to reflect the potential price reductions in the market necessary to complete an expedient sale transaction and to factor in the impact of the perception that a transaction being completed by a bank may result in further price reduction pressure.

For the Level 3 assets measured at fair value on a non-recurring basis, the significant unobservable inputs used in the fair value measurements were as follows:

June 30, 2018

Assets	Fair Value	Valuation Technique	Unobservable Inputs	Weighted Average
(Dollars in thousands)				
Impaired loans	\$ 317	Comparable real estate sales and / or the income approach.	Adjustments for differences between comparable sales and income data available.	5%
			Estimated selling costs.	7%

December 31, 2017

Assets	Fair Value	Valuation Technique	Unobservable Inputs	Weighted Average
(Dollars in thousands)				
Impaired loans	\$ 597	Comparable real estate sales and / or the income approach.	Adjustments for differences between comparable sales and income data available.	5%
			Estimated selling costs.	7%

Fair value estimates for the Corporation's financial instruments are summarized below:

	Fair Value Measurements Using:			
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
At June 30, 2018 (In thousands)				
Financial assets:				
Cash and cash equivalents	\$ 13,529	\$ 13,529	\$ —	\$ —
Securities available-for-sale	112,594	—	112,594	—
Securities held to maturity	58,471	—	56,624	—
Other equity investments	3,694	3,634	60	—
FHLB-NY stock	3,087	N/A	N/A	N/A
Loans held for sale	607	—	—	607
Loans, net	713,311	—	—	713,939
Interest rate swap	280	—	280	—
Financial liabilities:				
Deposits	792,061	585,473	204,321	—
FHLB-NY advances	46,700	—	46,088	—
Subordinated Debentures and Subordinated Notes	23,350	—	—	23,592

	Fair Value Measurements Using:			
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2017 (In thousands)				
Financial assets:				
Cash and cash equivalents	\$ 21,270	\$ 21,270	\$ —	\$ —
Securities available-for-sale	109,259	—	109,259	—
Securities held to maturity	52,442	—	51,551	—
Other equity investments	3,756	3,696	60	—
FHLB-NY stock	3,715	N/A	N/A	N/A
Loans held for sale	370	—	—	370
Loans, net	702,561	—	—	714,387
Financial liabilities:				
Deposits	764,099	565,292	197,696	—
FHLB-NY advances	63,760	—	63,340	—
Subordinated Debentures and Subordinated Notes	23,317	—	—	23,478

Interest rate swap	29	—	29	—
--------------------	----	---	----	---

The following methods and assumptions were used to estimate the fair value of financial instruments recorded at fair value on a recurring or non-recurring basis not previously described:

29

---

Loans, net – Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type such as residential and commercial mortgages, commercial and other installment loans. Fair value for loans at June 30, 2018 is based on an exit price model as required by ASU 2106-01 taxing into account inputs such as probability of default and loss given default assumptions. As of December 31, 2017, the fair value of loans is estimated by discounting cash flows using estimated market discount rates that reflect the credit and interest rate risk inherent in the loans resulting in a Level 3 classification. Fair values estimated in this manner do not fully incorporate an exit-price approach to fair value, but instead are based on a comparison to current market rates for comparable loans.

Commitments to extend credit – The fair value of commitments is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. At June 30, 2018 and December 31, 2017, the fair value of such commitments were not material.

#### Limitations

The preceding fair value estimates were made at June 30, 2018 and December 31, 2017 based on pertinent market data and relevant information concerning the financial instruments. These estimates do not include any premiums or discounts that could result from an offer to sell at one time the Corporation's entire holdings of a particular financial instrument or category thereof. Since no market exists for a substantial portion of the Corporation's financial instruments, fair value estimates were necessarily based on judgments with respect to future expected loss experience, current economic conditions, risk assessments of various financial instruments, and other factors. Given the subjective nature of these estimates, the uncertainties surrounding them and the matters of significant judgment that must be applied, these fair value estimates cannot be calculated with precision. Modifications in such assumptions could meaningfully alter these estimates.

Since these fair value estimates were made solely for on- and off-balance sheet financial instruments at June 30, 2018 and December 31, 2017, no attempt was made to estimate the value of anticipated future business. Furthermore, certain tax implications related to the realization of unrealized gains and losses could have a substantial impact on these fair value estimates and have not been incorporated into the estimates.

#### Note 5. Earnings Per Share

The following reconciles the income available to common shareholders (numerator) and the weighted average common stock outstanding (denominator) for both basic and diluted earnings per share.

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2017	
	2018	2017	2018	2017
	(Dollars in thousands)			
Net income	\$2,301	\$ 1,268	\$4,109	\$ 2,259
Weighted average common shares outstanding - basic	8,675,868	8,174,484	8,667,235	7,155,367
Effect of dilutive securities - stock options	N/A	N/A	N/A	N/A
Weighted average common shares outstanding - diluted	8,675,868	8,174,484	8,667,235	7,155,367
Basic earnings per common share	\$0.27	\$ 0.16	\$0.47	\$ 0.32



Diluted earnings per common share	\$0.27	\$ 0.16	\$0.47	\$ 0.32
-----------------------------------	--------	---------	--------	---------

There were no stock options to purchase shares of common stock for the three and six months ended June 30, 2018 and 2017.

30

---

## Note 6. Accumulated Other Comprehensive Income

The components of other comprehensive (loss) income, both gross and net of tax, are presented for the periods below:

	Three Months Ended June 30,					
	2018			2017		
	Gross	Tax Effect	Net	Gross	Tax Effect	Net
	(In thousands)					
Other comprehensive income (loss):						
Change in unrealized holding gains (losses) on securities available-for-sale	\$ (488)	\$ 129	\$ (359)	\$ 301	\$ (114)	\$ 187
Accretion of loss on securities reclassified to held to maturity	6	(2 )	4	10	(4 )	6
Change in fair value of interest rate swap	77	(22 )	55	(62 )	25	(37 )
Total other comprehensive income (loss)	\$ (405)	\$ 105	\$ (300)	\$ 249	\$ (93 )	\$ 156
	Six Months Ended June 30,					
	2018			2017		
	Gross	Tax Effect	Net	Gross	Tax Effect	Net
	(In thousands)					
Other comprehensive income (loss):						
Change in unrealized holding gains (losses) on securities available-for-sale	\$ (1,832)	\$ 480	\$ (1,352)	\$ 632	\$ (240)	\$ 392
Reclassification adjustment for gains in net income	(6 )	2	(4 )	—	—	—
Accretion of loss on securities reclassified to held to maturity	18	(5 )	13	21	(8 )	13
Change in fair value of interest rate swap	309	(87 )	222	(62 )	25	(37 )
Total other comprehensive income (loss)	\$ (1,511)	\$ 390	\$ (1,121)	\$ 591	\$ (223)	\$ 368

The following tables present the after-tax changes in the balances of each component of accumulated other comprehensive income for the three and six months ended June 30, 2018 and 2017.

Edgar Filing: STEWARDSHIP FINANCIAL CORP - Form 10-Q

	Three Months Ended June 30, 2018			Total
	Components of Accumulated			
	Other Comprehensive Income (Loss)			
	Unrealized Losses on Available-for-Sale Securities	Loss on Securities Reclassified from Available-for-Sale to Held to Maturity	Unrealized Gains on Derivatives	Accumulated Other Comprehensive Loss
	(In thousands)			
Balance at March 31, 2018	\$ (2,137)	\$ (51 )	\$ 146	\$ (2,042 )
Other comprehensive income (loss) before reclassifications	(359 )	4	55	(300 )
Amounts reclassified from other comprehensive income (loss)	—	—	—	—
Other comprehensive income (loss)	(359 )	4	55	(300 )
Balance at June 30, 2018	\$ (2,496)	\$ (47 )	\$ 201	\$ (2,342 )
	Six Months Ended June 30, 2018			Total
	Components of Accumulated			
	Other Comprehensive Income (Loss)			
	Unrealized Losses on Available-for-Sale Securities	Loss on Securities Reclassified from Available-for-Sale to Held to Maturity	Unrealized Gains on Derivatives	Accumulated Other Comprehensive Loss
	(In thousands)			
Balance at December 31, 2017	\$ (1,303)	\$ (60 )	\$ (21 )	\$ (1,384 )
Other comprehensive income (loss) before reclassifications	(1,352 )	13	222	(1,117 )
Amounts reclassified from other comprehensive income (loss)	(4 )	—	—	(4 )
Other comprehensive income (loss)	(1,356 )	13	222	(1,121 )
Reclassification due to the adoption of ASU No. 2016-01	163	—	—	163
Balance at June 30, 2018	\$ (2,496)	\$ (47 )	\$ 201	\$ (2,342 )

	Three Months Ended June 30, 2017			Total
	Components of Accumulated Other Comprehensive Income (Loss)			
	Unrealized Losses on Available-for-Sale Securities	Loss on Securities Reclassified from Available-for-Sale to Held to Maturity	Unrealized Losses on Derivatives	Accumulated Other Comprehensive Loss
	(In thousands)			
Balance at March 31, 2017	\$(1,038)	\$ (71 )	\$ —	\$ (1,109 )
Other comprehensive income (loss) before reclassifications	187	6	(37 )	156
Amounts reclassified from other comprehensive income (loss)	—	—	—	—
Other comprehensive income (loss)	187	6	(37 )	156
Balance at June 30, 2017	\$(851 )	\$ (65 )	\$ (37 )	\$ (953 )
	Six Months Ended June 30, 2017			Total
	Components of Accumulated Other Comprehensive Income (Loss)			
	Unrealized Losses on Available-for-Sale Securities	Loss on Securities Reclassified from Available-for-Sale to Held to Maturity	Unrealized Losses on Derivatives	Accumulated Other Comprehensive Loss
	(In thousands)			
Balance at December 31, 2016	\$(1,243)	\$ (78 )	\$ —	\$ (1,321 )
Other comprehensive income (loss) before reclassifications	392	13	(37 )	368
Amounts reclassified from other comprehensive income (loss)	—	—	—	—
Other comprehensive income (loss)	392	13	(37 )	368
Balance at June 30, 2017	\$(851 )	\$ (65 )	\$ (37 )	\$ (953 )

The following tables present amounts reclassified from each component of accumulated other comprehensive loss for the six months ended June 30, 2018.

Components of Accumulated Other Comprehensive Loss	Six Months Ended June 30, 2018 (In thousands)	Income Statement Line Item
Unrealized gains on securities available-for-sale, before tax	\$ 6	Gains on securities transactions, net
Tax effect	(2 )	
Total reclassifications, net of tax	\$ 4	

There were no amounts reclassified from accumulated other comprehensive loss for the three months ended June 30, 2018 or the three and six months ended June 30, 2017.

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

### Cautionary Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q contains certain “forward-looking statements” with respect to Stewardship Financial Corporation (the “Corporation”) within the meaning of the Private Securities Litigation Reform Act of 1995, which forward-looking statements may be identified by the use of such words as “expect,” “believe,” “anticipate,” “should,” “plan,” “estimate,” and “potential.” Examples of forward-looking statements include, but are not limited to, estimates with respect to the financial condition, results of operations and business of the Corporation that are subject to various factors which could cause actual results to differ materially from these estimates. These factors include: changes in general, economic and market conditions, legislative and regulatory conditions, or the development of an interest rate environment that adversely affects the Corporation’s interest rate spread or other income anticipated from operations and investments. As used in this Form 10-Q, “we”, “us” and “our” refer to the Corporation and its consolidated subsidiary, Atlantic Stewardship Bank (the “Bank”), unless the context indicates otherwise.

### Critical Accounting Policies and Estimates

“Management’s Discussion and Analysis of Financial Condition and Results of Operations,” as well as disclosures found elsewhere in this Quarterly Report on Form 10-Q, are based upon the Corporation’s consolidated financial statements, which have been prepared in conformity with U.S. generally accepted accounting principles (“GAAP”). The preparation of these financial statements requires the Corporation to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. Note 1 to the Corporation’s Audited Consolidated Financial Statements for the year ended December 31, 2017, included in the Corporation’s 2017 Annual Report on Form 10-K, contains a summary of the Corporation’s significant accounting policies. Management believes the Corporation’s policy with respect to the methodology for the determination of the allowance for loan losses involves a higher degree of complexity and requires management to make difficult and subjective judgments, which often require assumptions or estimates about highly uncertain matters. Changes in these judgments, assumptions or estimates could materially impact results of operations. This critical accounting policy and its application are periodically reviewed with the Audit Committee and the Board of Directors.

**Allowance for Loan Losses.** The allowance for loan losses is based upon management’s evaluation of the adequacy of the allowance, including an assessment of known and inherent risks in the loan portfolio, giving consideration to the size and composition of the loan portfolio, actual loan loss experience, level of delinquencies, detailed analysis of individual loans for which full collectability may not be assured, the existence and estimated net realizable value of any underlying collateral and guarantees securing the loans, and current economic and market conditions. Although

management uses the best information available, the level of the allowance for loan losses remains an estimate, which is subject to significant judgment and short-term change. Various regulatory agencies, as an integral part of their examination process, periodically review the Corporation's allowance for loan losses. Our regulators may require us to make additional provisions for loan losses based upon information available to the regulators at the time of the examination. Furthermore, the majority of the Corporation's loans are secured by real estate in the State of New

Jersey. Accordingly, the collectability of a substantial portion of the carrying value of the Corporation's loan portfolio is susceptible to changes in real estate market conditions in northern New Jersey and may be adversely affected should real estate values decline or the northern New Jersey area experience adverse economic changes. Future adjustments to the allowance for loan losses may be necessary due to economic, operating, regulatory and other conditions beyond the Corporation's control.

#### Financial Condition

Total assets increased \$12.9 million to \$941.7 million at June 30, 2018 from \$928.8 million at December 31, 2017. Cash and cash equivalents decreased \$7.7 million to \$13.5 million as funds were invested in securities and loans. Total securities (including available-for-sale, held to maturity, other equity investments and FHLBNY stock) increased \$8.7 million to \$177.8 million. Net loans increased \$10.7 million to \$713.3 million at June 30, 2018 compared to \$702.6 million at December 31, 2017. During the first six months of 2018, new loan originations were partially offset by several larger loan payoffs and normal principal amortization.

Deposits totaled \$792.1 million at June 30, 2018, an increase of \$28.0 million from \$764.1 million at December 31, 2017. The growth in deposits primarily consisted of a \$15.5 million increase in noninterest-bearing accounts and a \$12.5 million increase in interest-bearing accounts. Other borrowings decreased to \$46.7 million at June 30, 2018 compared to \$63.8 million at December 31, 2017 primarily reflecting repayment of maturing borrowings.

#### Results of Operations

##### General

The Corporation reported net income of \$2.3 million, or \$0.27 diluted earnings per common share for the three months ended June 30, 2018 compared to net income of \$1.3 million, or \$0.16 diluted earnings per share, for the three months ended June 30, 2017. For the six months ended June 30, 2018, the Corporation reported net income of \$4.1 million, or \$0.47 diluted earnings per common share, compared to net income of \$2.3 million, or \$0.32 diluted earnings per share, for the six months ended June 30, 2017. Furthermore, earnings per share for the six months ended June 30, 2017 were impacted by the 2,509,090 shares issued in the Corporation's public offering of common stock completed in April 2017.

##### Net Interest Income

Net interest income, on a tax equivalent basis, for the three and six months ended June 30, 2018 was \$7.0 million and \$13.9 million, respectively, compared to \$6.6 million and \$12.8 million recorded in the prior year periods. The net interest rate spread, on a tax equivalent basis, and net yield on interest-earning assets, on a tax equivalent basis, for the three months ended June 30, 2018 were 2.87% and 3.16%, respectively, compared to 2.91% and 3.14% for the three months ended June 30, 2017. For the six months ended June 30, 2018, the net interest rate spread, on a tax equivalent basis, and net yield on interest-earning assets, on a tax equivalent basis, were 2.89% and 3.15%, respectively, compared to 2.97% and 3.18% for the six months ended June 30, 2017.

The following tables reflect the components of the Corporation's net interest income for the three and six months ended June 30, 2018 and 2017 including: (1) average assets, liabilities and shareholders' equity based on average daily balances, (2) interest income earned on interest-earning assets and interest expense paid on interest-bearing liabilities, (3) average yields earned on interest-earning assets and average rates paid on interest-bearing liabilities and (4) net yield on interest-earning assets. Nontaxable income from investment securities and loans is presented on a tax-equivalent basis for the 2018 and 2017 periods assuming a statutory tax rate of 21% and 34%, respectively. This was accomplished by adjusting non-taxable income upward to make it equivalent to the level of taxable income required to earn the same amount after taxes.





Analysis of Net Interest Income (Unaudited)  
Three Months Ended June 30,

	2018			2017		
	Average Balance	Interest Income/ Expense	Average Rates Earned/ Paid	Average Balance	Interest Income/ Expense	Average Rates Earned/ Paid
(Dollars in thousands)						
Assets						
Interest-earning assets:						
Loans (1) (2)	\$712,880	\$7,774	4.37 %	\$673,413	\$7,017	4.18 %
Taxable investment securities (1)	156,969	974	2.49	152,285	838	2.21
Tax-exempt investment securities (1) (2)	5,817	46	3.17	8,965	102	4.56
Other interest-earning assets	16,478	86	2.09	5,540	29	2.10
Total interest-earning assets	892,144	8,880	3.99	840,203	7,986	3.81
Non-interest-earning assets:						
Allowance for loan losses	(8,716 )			(8,326 )		
Other assets	48,283			46,532		
Total assets	\$931,711			\$878,409		
Liabilities and Stockholders' Equity						
Interest-bearing liabilities:						
Interest-bearing demand deposits	\$306,523	\$472	0.62 %	\$237,947	\$129	0.22 %
Savings deposits	84,677	21	0.10	93,754	23	0.10
Time deposits	207,333	776	1.50	192,096	567	1.18
FHLB-NY borrowing	45,045	198	1.76	82,822	319	1.54
Subordinated debentures and subordinated notes	23,341	393	6.75	23,276	371	6.39
Total interest-bearing liabilities	666,919	1,860	1.12	629,895	1,409	0.90
Non-interest-bearing liabilities:						
Demand deposits	185,823			176,489		
Other liabilities	4,027			3,058		
Stockholders' equity	74,942			68,967		
Total liabilities and stockholders' equity	\$931,711			\$878,409		
Net interest income (taxable equivalent basis)		7,020			6,577	
Tax equivalent adjustment		(12 )			(43 )	
Net interest income		\$7,008			\$6,534	
Net interest spread (taxable equivalent basis)			2.87 %			2.91 %
Net yield on interest-earning assets (taxable equivalent basis)			3.16 %			3.14 %
(3)						

- (1) For purposes of these calculations, nonaccruing loans are included in the average balance. Loans and total interest-earning assets are net of unearned income. Securities are included at amortized cost.
- (2) The tax equivalent adjustments for 2018 and 2017 are based on a marginal tax rate of 21% and 34%, respectively.
- (3) Net interest income (taxable equivalent basis) divided by average interest-earning assets.

Analysis of Net Interest Income (Unaudited)  
Six Months Ended June 30,

	2018			2017		
	Average Balance	Interest Income/ Expense	Average Rates Earned/ Paid	Average Balance	Interest Income/ Expense	Average Rates Earned/ Paid
(Dollars in thousands)						
<b>Assets</b>						
Interest-earning assets:						
Loans (1) (2)	\$709,221	\$15,297	4.35 %	\$650,513	\$13,612	4.22 %
Taxable investment securities (1)	155,738	1,881	2.44	146,026	1,572	2.17
Tax-exempt investment securities (1) (2)	6,364	103	3.26	9,321	210	4.54
Other interest-earning assets	15,217	153	2.03	5,130	60	2.36
Total interest-earning assets	886,540	17,434	3.97	810,990	15,454	3.84
Non-interest-earning assets:						
Allowance for loan losses	(8,750 )			(8,154 )		
Other assets	47,942			45,538		
Total assets	\$925,732			\$848,374		
<b>Liabilities and Stockholders' Equity</b>						
Interest-bearing liabilities:						
Interest-bearing demand deposits	\$299,866	\$799	0.54 %	\$239,309	\$256	0.22 %
Savings deposits	85,241	43	0.10	91,813	47	0.10
Time deposits	205,943	1,492	1.46	184,627	1,049	1.15
FHLB-NY borrowing	52,684	457	1.75	75,754	562	1.50
Subordinated debentures and subordinated notes	23,333	785	6.78	23,268	739	6.40
Total interest-bearing liabilities	667,067	3,576	1.08	614,771	2,653	0.87
Non-interest-bearing liabilities:						
Demand deposits	180,136			170,019		
Other liabilities	4,092			2,992		
Stockholders' equity	74,437			60,592		
Total liabilities and stockholders' equity	\$925,732			\$848,374		
Net interest income (taxable equivalent basis)		13,858			12,801	
Tax equivalent adjustment		(27 )			(87 )	
Net interest income		\$13,831			\$12,714	
Net interest spread (taxable equivalent basis)			2.89 %			2.97 %
Net yield on interest-earning assets (taxable equivalent basis) (3)			3.15 %			3.18 %

- (1) For purposes of these calculations, nonaccruing loans are included in the average balance. Loans and total interest-earning assets are net of unearned income. Securities are included at amortized cost.
- (2) The tax equivalent adjustments for 2018 and 2017 are based on a marginal tax rate of 21% and 34%, respectively.
- (3) Net interest income (taxable equivalent basis) divided by average interest-earning assets.

For the three and six months ended June 30, 2018, total interest income, on a tax equivalent basis, was \$8.9 million and \$17.4 million, respectively, compared to \$8.0 million and \$15.5 million for the same prior year periods. The increase reflects an increase in the average balance of interest-earning assets coupled with an increase in the overall yield on interest-earning assets. Average interest-earning assets increased \$51.9 million and \$75.6 million for the three and six months ended June 30, 2018 compared to the prior year periods. The change in average interest-earning assets primarily reflects an increase, from the comparable prior year periods, in average loans. Average loans increased \$39.5 million and \$58.7 for the three and six months ended June 30, 2018 when compared to the prior year averages. The three and six months ended June 30, 2018 included approximately \$90,000 and \$198,000 of interest recoveries and prepayment premiums on loan payoffs compared to \$18,000 and \$134,000 for the same prior year periods. The average rate earned on interest-earning assets was 3.99% and 3.97% for the three and six months ended June 30, 2018, respectively, compared to an average rate of 3.81% and 3.84% for the three and six months ended June 30, 2017.

Interest expense increased \$451,000 and \$923,000 for the three and six months ended June 30, 2018, compared to the same period for 2017. The average balance of interest-bearing deposits increased \$74.7 million and \$75.3 million for the three and six months ended June 30, 2018 from the comparable 2017 periods. Partially offsetting, for the three and six months ended June 30, 2018, average FHLB-NY borrowings decreased \$37.8 million and \$23.1 million, respectively. The cost for total interest-bearing liabilities was 1.12% and 1.08% for the three and six months ended June 30, 2018, respectively, compared to 0.90% and 0.87% for the three and six months ended June 30, 2017, respectively.

#### Provision for Loan Losses

The Corporation maintains an allowance for loan losses at a level considered by management to be adequate to cover the probable losses to be incurred associated with its loan portfolio. The Corporation's policy with respect to the methodology for the determination of the allowance for loan losses involves judgments. The adequacy of the allowance for loan losses is based upon management's evaluation of the known and inherent risks in the portfolio, consideration of the size and composition of the loan portfolio, actual loan loss experience, the level of delinquencies, detailed analysis of individual loans for which full collectability may not be assured, the existence and estimated net realizable value of any underlying collateral and guarantees securing the loans, and current economic and market conditions.

For the three and six months ended June 30, 2018, the Corporation recorded negative loan loss provisions of \$780,000 and \$1.1 million, respectively, compared to loan loss provisions of \$260,000 and \$560,000 for the three and six months ended June 30, 2017, respectively. While growth in the loan portfolio generally requires the establishment of additional reserves, the negative loan loss provision in the current year periods reflects net recoveries of previously charged off loan balances of \$688,000 and \$706,000 for the three and six months ended June 30, 2018, respectively. The negative loan loss provision also reflects the continued improvement in the economic conditions and overall real estate climate in the primary business markets in which the Corporation operates.

Nonperforming loans were \$1.3 million at June 30, 2018, or 0.18% of total gross loans, a slight increase from \$1.2 million of nonperforming loans, or 0.17% of total gross loans, at December 31, 2017.

The allowance for loan losses was \$8.4 million, or 1.16% of total gross loans, as of June 30, 2018 compared to \$8.8 million, or 1.23% of total gross loans, as of December 31, 2017. The allowance for loan losses related to impaired loans increased slightly from \$609,000 at December 31, 2017 to \$646,000 at June 30, 2018. There were no charge-offs during the three months ended June 30, 2018. During the six months ended June 30, 2018, the Corporation charged off \$30,000 of loans compared to charge-offs of \$2,000 and \$3,000 for the three and six months ended June 30, 2017, respectively. During the three and six months ended June 30, 2018, the Corporation recovered \$688,000 and \$736,000, respectively, of previously charged-off loans compared to \$46,000 and \$88,000 during the same periods in 2017. A single recovery of \$592,000 resulted from the payoff, in full, of a commercial real estate loan

during the three months ended June 30, 2018.

The Corporation monitors its loan portfolio and intends to continue to provide for loan loss reserves based on its ongoing periodic review of the loan portfolio, charge-off activity and general market conditions. There can be no assurances that the current level of provision for loan losses will continue in the future.

See “Asset Quality” section below for a summary of the allowance for loan losses and nonperforming assets.

### Noninterest Income

Noninterest income was \$859,000 and \$1.6 million for the three and six months ended June 30, 2018 compared to \$813,000 and \$1.6 million for the comparable prior year three and six-month periods. The three and six months ended June 30, 2018 reflect \$59,000 of gains from the sale of the guaranteed portion of newly originated Small Business Administration ("SBA") loans. The three and six months ended June 30, 2018 included a negative \$29,000 and \$103,000 mark to market adjustment of a CRA investment, respectively, which is classified as an equity security. Such security has been owned for years for CRA purposes, but in connection with the adoption of ASU 2016-01, equity securities now require a quarterly mark to market through the income statement.

### Noninterest Expense

Noninterest expense for the three and six months ended June 30, 2018 was \$5.5 million and \$10.9 million, respectively, compared to \$5.1 million and \$10.2 million for the same prior year periods. The Corporation's largest expense is salaries and employee benefits, which increased \$249,000 and \$514,000 in the current three and six-month periods, respectively, when compared to the three and six months ended June 30, 2017. As the balance sheet continues to grow, the Corporation will continue to manage expenses appropriately.

### Income Tax Expense

Income tax expense totaled \$842,000 and \$1.5 million for the three and six months ended June 30, 2018, respectively, representing an effective tax rate of 26.8% and 26.6% for the respective periods. For the three and six months ended June 30, 2017, income tax expense totaled \$736,000 and \$1.3 million, respectively, equating to an effective tax rate of 36.7% for both periods. For the 2018 periods, tax expense reflects the impact of the Tax Cuts and Jobs Act that included a permanent reduction in the Federal corporate income tax rate from 35% to 21% effective January 1, 2018.

### Asset Quality

The Corporation's principal earning asset is its loan portfolio. Inherent in the lending function is the risk of deterioration in the borrowers' ability to repay loans under existing loan agreements. The Corporation manages this risk by maintaining reserves to absorb probable incurred loan losses. In determining the adequacy of the allowance for loan losses, management considers the risks inherent in its loan portfolio and changes in the nature and volume of its loan activities, along with general economic and real estate market conditions. Although management endeavors to establish a reserve sufficient to offset probable incurred losses in the portfolio, changes in economic conditions, regulatory policies and borrowers' performance could require future changes to the allowance.

Risk elements include nonaccrual loans, past due and restructured loans, potential problem loans and loan concentrations. The following table shows the composition of nonperforming assets at the end of each of the last four quarters:

	June 30, 2018	March 31, 2018	December 31, 2017	September 30, 2017	
	(Dollars in thousands)				
Nonaccrual loans (1)	\$1,283	\$1,136	\$1,194	\$806	
Loans past due 90 days or more and accruing (2)	—	—	—	—	
Total nonperforming loans	1,283	1,136	1,194	806	
Total nonperforming assets	\$1,283	\$1,136	\$1,194	\$806	
Allowance for loan losses	\$8,353	\$8,445	\$8,762	\$8,614	
Nonperforming loans to total gross loans	0.18	% 0.16	% 0.17	% 0.12	%
Nonperforming assets to total assets	0.14	% 0.12	% 0.13	% 0.09	%

Allowance for loan losses to total gross loans	1.16	%	1.19	%	1.23	%	1.24	%
--	------	---	------	---	------	---	------	---

(1) Generally represents loans as to which the payment of principal or interest is in arrears for a period of more than 90 days. Interest previously accrued on these loans and not yet paid is reversed and charged against income during the current period. Interest earned thereafter is only included in income to the extent that it is received in cash.

(2) Represents loans as to which payment of principal or interest is contractually past due 90 days or more but which are currently accruing income at the contractually stated rates. A determination is made to continue accruing income on those loans which are sufficiently collateralized and on which management believes all interest and principal owed will be collected.

A loan is generally placed on nonaccrual when, based on current information and events, it is probable that the Corporation will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. The identification of nonaccrual loans reflects careful monitoring of the loan portfolio. The Corporation is focused on resolving nonperforming loans and mitigating future losses in the portfolio. All delinquent loans continue to be reviewed by management.

At June 30, 2018, the balance of nonaccrual loans were comprised of seven loans, compared to eight loans at December 31, 2017. Nonaccrual loans increased \$89,000 to \$1,283,000 compared to \$1,194,000 at December 31, 2017 primarily due to the addition of one new nonaccrual loan partially offset by a loan returning to accruing status and the payoff of another loan.

Evaluation of all nonperforming loans includes the updating of appraisals and specific evaluation of such loans to determine estimated cash flows from business and/or collateral. We have assessed each of these loans for collectability and considered, among other things, the relevant borrower's ability to repay, the value of the underlying collateral, and other market conditions to ensure the allowance for loan losses is adequate to absorb probable losses to be incurred. All of our nonperforming loans at June 30, 2018 are secured by real estate collateral. We have continued to record appropriate charge-offs and the existing underlying collateral coverage for the nonperforming loans currently supports collection of our remaining principal.

For loans not included in nonperforming loans, at June 30, 2018, the level of loans past due 30-89 days was \$356,000, comprised of two loans, compared to \$704,000 at December 31, 2017. We will continue to monitor delinquencies for early identification of new problem loans.

The Corporation maintains an allowance for loan losses at a level considered by management to be adequate to cover the probable losses to be incurred associated with its loan portfolio. The Corporation's policy with respect to the methodology for the determination of the allowance for loan losses involves a high degree of complexity and requires management to make difficult and subjective judgments.

The adequacy of the allowance for loan losses is based upon management's evaluation of the known and inherent risks in the portfolio, consideration to the size and composition of the loan portfolio, actual loan loss experience, the level of delinquencies, detailed analysis of individual loans for which full collectability may not be assured, the existence and estimated net realizable value of any underlying collateral and guarantees securing the loans, and current economic and market conditions.

In establishing the allowance for loan losses, the Corporation utilizes a two-tier approach by (1) identifying problem loans and allocating specific loss allowances on such loans and (2) establishing a general loan loss allowance on the remainder of its loan portfolio. The Corporation maintains a loan review system that allows for a periodic review of its loan portfolio and the early identification of potential problem loans. Such a system takes into consideration, among other things, delinquency status, size of loan, type of collateral and financial condition of the borrower.

Allocations of specific loan loss allowances are established for identified loans based on a review of various information including appraisals of underlying collateral. Appraisals are performed by independent licensed appraisers to determine the value of impaired, collateral-dependent loans. Appraisals are periodically updated to ascertain any further decline in value. General loan loss allowances are based upon a combination of factors including, but not limited to, actual loss experience, composition of the loan portfolio, current economic conditions and management's judgment.

When management expects that some portion or all of a loan balance will not be collected, that amount is charged-off as a loss against the allowance for loan losses. For the three and six months ended June 30, 2018 the Corporation recorded net recoveries of \$688,000 and \$706,000, respectively, compared to net recoveries of \$44,000 and \$85,000 for the three and six months ended June 30, 2017. Recorded charge-offs reflect partial writedowns or full charge-offs on nonaccrual loans due to the initial and ongoing evaluations of market values of the underlying real estate collateral



in accordance with Accounting Standards Codification (“ASC”) 310-40. Regardless of our actions of recording partial and full charge-offs on loans, we continue to aggressively pursue collection, including legal action.

While regular monthly payments continue to be made on many of the nonaccrual loans, certain charge-offs result, nevertheless, from the borrowers’ inability to provide adequate documentation evidencing their ability to continue to service their debt. Therefore, consideration has been given to any underlying collateral and appropriate charge-offs recorded based, in general, on the deficiency of such collateral. In general, the charge-offs reflect partial writedowns and full charge-offs on nonaccrual loans due to the initial evaluation of market values of the underlying real estate collateral in accordance with ASC 310-40. Management believes the charge-off of these reserves provides a clearer indication of the value of nonaccrual loans.

At both June 30, 2018 and December 31, 2017, the Corporation had \$6.6 million of loans the terms of which have been modified in troubled debt restructurings. Of these loans, \$6.1 million and \$5.9 million were performing in accordance with their new terms at June 30, 2018 and December 31, 2017, respectively. The remaining troubled debt restructurings are reported as nonaccrual loans. Specific reserves of \$646,000 and \$582,000 have been allocated for the troubled debt restructurings at June 30, 2018 and December 31, 2017, respectively.

As of June 30, 2018, there were \$10.4 million of other loans not included in the preceding table or discussion of troubled debt restructurings where credit conditions of borrowers, including real estate tax delinquencies, caused management to have concerns about the possibility of the borrowers not complying with the present terms and conditions of repayment and which may result in disclosure of such loans as nonperforming loans at a future date. These loans have been considered by management in conjunction with the analysis of the adequacy of the allowance for loan losses.

The Corporation’s lending activities are concentrated in loans secured by real estate located in northern New Jersey. Accordingly, the collectability of a substantial portion of the Corporation’s loan portfolio is susceptible to changes in real estate market conditions in northern New Jersey.

#### Capital Adequacy

The Corporation is subject to capital adequacy guidelines promulgated by the Board of Governors of the Federal Reserve System (“FRB Board”). The Bank is subject to somewhat comparable but different capital adequacy requirements imposed by the Federal Deposit Insurance Corporation (the “FDIC”). The federal banking agencies have adopted risk-based capital guidelines for banks and bank holding companies. The risk-based capital guidelines are designed to make regulatory capital requirements more sensitive to differences in risk profiles among banks and bank holding companies, to account for off-balance sheet exposure, and to minimize disincentives for holding liquid assets. Under these guidelines, assets and off-balance sheet items are assigned to broad risk categories, each with appropriate weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance sheet items.

Federal banking regulators have also adopted leverage capital guidelines to supplement the risk-based measures. Leverage capital to average total assets is determined by dividing Tier 1 Capital as defined under the risk-based capital guidelines by average total assets (non-risk adjusted).

#### Guidelines for Banks

In December 2010 and January 2011, the Basel Committee on Banking Supervision (the “Basel Committee”) published the final texts of reforms on capital and liquidity, which are generally referred to as “Basel III”. The Basel Committee is a committee of central banks and bank supervisors and regulators from the major industrialized countries that develops broad policy guidelines for the regulation of banks and bank holding companies. In July 2013, the FDIC and the other federal bank regulatory agencies adopted final rules (the “Basel Rules”) to implement certain provisions of

Basel III and the Dodd-Frank Wall Street Reform and Consumer Protection Act. The Basel Rules revise the leverage and risk-based capital requirements and the methods for calculating risk-weighted assets. The Basel Rules apply to all depository institutions, top-tier bank holding companies with total consolidated assets of \$1 billion or more and top-tier savings and loan holding companies.

Among other things, the Basel Rules (a) establish a new common equity Tier 1 Capital (“CET1”) to risk-weighted assets ratio minimum of 4.5% of risk-weighted assets, (b) raise the minimum Tier 1 Capital to risk-based assets requirement (“Tier 1 Capital Ratio) from 4% to 6% of risk-weighted assets and (c) assign a higher risk weight of 150% to exposures

that are more than 90 days past due or are on nonaccrual status and to certain commercial real estate facilities. The minimum ratio of Total Capital to risk-weighted assets (including certain off-balance sheet activities, such as standby letters of credit) is 8%. At least 6% of the Total Capital is required to be “Tier 1 Capital”, which consists of common shareholders’ equity and certain preferred stock, less goodwill and other intangible assets. The remainder, “Tier 2 Capital,” may consist of (a) the allowance for loan losses of up to 1.25% of risk-weighted assets, (b) excess of qualifying preferred stock, (c) hybrid capital instruments, (d) debt, (e) mandatory convertible securities and (f) qualifying subordinated debt. “Total Capital” is the sum of Tier 1 Capital and Tier 2 Capital less reciprocal holdings of other banking organizations’ capital instruments, investments in unconsolidated subsidiaries and any other deductions as determined by the federal banking regulatory agencies on a case-by-case basis or as a matter of policy after formal rule-making. A small bank holding company that has the highest regulatory examination rating and is not contemplating significant growth or expansion must maintain a minimum level of Tier 1 Capital to average total consolidated assets leverage ratio of at least 3%. All other bank holding companies are expected to maintain a leverage ratio of at least 100 to 200 basis points above the stated minimum.

The Basel Rules also require unrealized gains and losses on certain available-for-sale securities to be included for purposes of calculating regulatory capital unless a one-time opt-out is exercised. Additional constraints are also imposed on the inclusion in regulatory capital of mortgage-servicing assets and deferred tax assets. The Basel Rules limit a banking organization’s capital distributions and certain discretionary bonus payments if the banking organization does not hold a “capital conservation buffer” consisting of 2.5% of CET1 to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements. The purpose of the capital conservation buffer is to ensure that banking organizations conserve capital when it is needed most, allowing them to weather periods of economic stress. Banking institutions with a CET1 Ratio, Tier 1 Capital Ratio and Total Capital Ratio above the minimum capital ratios but below the minimum capital ratios plus the capital conservation buffer will face constraints on their ability to pay dividends, repurchase equity and pay discretionary bonuses to executive officers based on the amount of the shortfall. The Basel Rules became effective for the Bank on January 1, 2015. The capital conservation buffer requirement of 0.625% became effective on January 1, 2016, to be phased in annually through January 1, 2019, when the full capital conservation buffer requirement of 2.50% will become effective. At June 30, 2018, the Bank’s capital conservation buffer requirement was 1.875%, and the actual capital conservation buffer was 5.42%.

Bank assets are given risk-weights of 0%, 20%, 50%, 100%, and 150%. In addition, certain off-balance sheet items are given similar credit conversion factors to convert them to asset equivalent amounts to which an appropriate risk-weight will apply. These computations result in the total risk-weighted assets. Most loans are assigned to the 100% risk category, except for performing first mortgage loans fully secured by residential property which carry a 50% risk-weighting. Loan exposures past due 90 days or more or on nonaccrual are assigned a risk-weighting of at least 100%. High volatility commercial real estate exposures are assigned to the 150% category. Most investment securities (including, primarily, general obligation claims of states or other political subdivisions of the United States) are assigned to the 20% category, except for municipal or state revenue bonds, which have a 50% risk-weight, and direct obligations of the U.S. Treasury or obligations backed by the full faith and credit of the U.S. government, which have a 0% risk-weight. In converting off-balance sheet items, direct credit substitutes, including general guarantees and standby letters of credit backing nonfinancial obligations, and undrawn commitments (including commercial credit lines with an initial maturity of more than one year) have a 50% risk-weighting. Short-term undrawn commitments and commercial letters of credit with an initial maturity of under one year have a 50% risk-weighting and certain short-term unconditionally cancelable commitments are not risk-weighted.

#### Guidelines for Small Bank Holding Companies

In April 2015, the FRB Board updated and amended its Small Bank Holding Company Policy Statement. Under the revised Small Bank Holding Company Policy Statement, Basel III capital rules and reporting requirements will not apply to small bank holding companies (“SBHC”), such as the Corporation, that have total consolidated assets of less

than \$1 billion. The minimum risk-based capital requirements for a SBHC to be considered adequately capitalized are 4% for Tier 1 capital and 8% for total capital to risk-weighted assets.

The regulations for SBHCs classify risk-based capital into the categories Tier 1 Capital and Tier 2 Capital. The amount of Tier 2 Capital may not exceed the amount of Tier 1 Capital. The Corporation must maintain a minimum level of Tier 1 Capital to average total consolidated assets leverage ratio of 3%, which is the leverage ratio reserved for top-tier bank holding companies having the highest regulatory examination rating and not contemplating significant growth or expansion.

Bank holding company assets are given risk-weights of 0%, 20%, 50%, and 100%. In addition, certain off-balance sheet items are given similar credit conversion factors to convert them to asset equivalent amounts to which an appropriate risk-weight will apply. These computations result in the total risk-weighted assets.

As of June 30, 2018, the Corporation and the Bank exceeded all regulatory capital requirements as follows:

	Actual	Required for Capital Adequacy Purposes	To Be Well Capitalized Under Prompt Corrective Action Regulations		
Tier 1 Leverage ratio					
Corporation	9.15	% 4.00	%	N/A	
Bank	10.36	% 4.00	%	5.00	%
Risk-based capital					
Common Equity Tier 1					
Corporation	N/A	N/A		N/A	
Bank	12.35	% 4.50	%	6.50	%
Tier 1					
Corporation	11.10	% 4.00	%	N/A	
Bank	12.35	% 6.00	%	8.00	%
Total					
Corporation	14.28	% 8.00	%	N/A	
Bank	13.42	% 8.00	%	10.00	%

#### Liquidity and Capital Resources

The Corporation's primary sources of funds are deposits, amortization and prepayments of loans and mortgage-backed securities, maturities of investment securities and funds provided from operations. While scheduled loan and mortgage-backed securities amortization and maturities of investment securities are a relatively predictable source of funds, deposit flow and prepayments on loans and mortgage-backed securities are greatly influenced by market interest rates, economic conditions and competition. The Corporation's liquidity, represented by cash and cash equivalents, is a product of its operating, investing and financing activities.

The primary source of cash from operating activities is net income. Liquidity management is both a daily and long-term function of business management. Excess liquidity is generally invested in interest-earning cash accounts or short-term investments, such as federal funds sold.

Cash and cash equivalents decreased \$7.7 million during the first six months of 2018. Net operating and financing activities provided \$2.6 million and \$10.4 million, respectively, while investing activities used \$20.8 million.

We anticipate that the Corporation will have sufficient funds available to meet its current contractual commitments. Should we need temporary funding, the Corporation has the ability to borrow overnight with the Federal Home Loan Bank-NY ("FHLB-NY"). The Corporation's overall borrowing capacity is contingent on available collateral to secure borrowings and the ability to purchase additional activity-based capital stock of the FHLB-NY. The Corporation may also borrow from the Discount Window of the Federal Reserve Bank of New York based on the market value of collateral pledged. In addition, the Corporation has available overnight variable repricing lines of credit with other correspondent banks totaling \$38 million on an unsecured basis.

The Corporation has historically paid a quarterly cash dividend on its common stock; however, management recognizes that the payment of future dividends could be impacted by losses or reduced earnings and the Corporation cannot assure the payment of future dividends. On July 18, 2018, the Corporation announced that its Board of Directors had declared a \$0.03 per share cash dividend payable on its common stock to shareholders of record as of August 1, 2018. The dividend is to be paid on August 15, 2018.

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

43

---

Not applicable to smaller reporting companies.

#### ITEM 4. Controls and Procedures

##### Evaluation of internal controls and procedures

Based on their evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, our principal executive officer and principal financial officer have concluded that our internal disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the “Exchange Act”)) are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms.

##### Changes in Internal Controls over Financial Reporting

Pursuant to Rule 13a-15(d) under the Exchange Act, our management, with the participation of our principal executive officer and principal financial officer, has evaluated our internal controls over financial reporting and based upon such evaluation concluded that there were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended June 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Part II -- Other Information

Item 6. Exhibits

See Exhibit Index following this report.

---

45

---



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.

Stewardship Financial Corporation

Date: August 9, 2018 By: /s/ Paul Van Ostenbridge

Paul Van Ostenbridge  
President and Chief Executive Officer  
(Principal Executive Officer)

Date: August 9, 2018 By: /s/ Claire M. Chadwick

Claire M. Chadwick  
Executive Vice President and Chief Financial Officer  
(Principal Financial and Accounting Officer)

EXHIBIT INDEX

Exhibit

Number Description of Exhibits

31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1 Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

The following material from Stewardship Financial Corporation's Quarterly Report on Form 10-Q for the quarter ended June 30, 2018, formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Statements of Financial Condition, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Comprehensive Income, (iv) Consolidated Statement of Changes in Shareholders' Equity, (v) Consolidated Statements of Cash Flows and (vi) Notes to Consolidated Financial Statements, tagged as blocks of text<sup>1</sup>

---

<sup>1</sup> This exhibit shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section, nor shall it be deemed incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date hereof and irrespective of any general incorporation language in any filing, except to the extent the Corporation specifically incorporates it by reference.