Bankwell Financial Group, Inc.
Form 10-K
March 16, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K
(Mark One)

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

For the fiscal year ended December 31, 2016

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

For the transition period from _________to________
Commission File Number: 001-36448
Bankwell Financial Group, Inc.
(Exact Name of Registrant as specified in its Charter)

Connecticut	20-8251355
(State or other jurisdiction of Incorporation or organization)	(I.R.S. Employer Identification No.)

220 Elm Street
New Canaan, Connecticut 06840
(203) 652-0166
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes No
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 Website, 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 if disclosure of delinquent filers pursuant to item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K
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 smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Aggregate market value of the voting stock held by non-affiliates of the registrant as of June 30, 2016 based on the closing price of the common stock as reported on the NASDAQ Global Market: $126,477,348

As of February 28, 2017, there were 7,629,315 shares of the registrant's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive proxy statement for its Annual Meeting of Stockholders, expected to be filed pursuant to Regulation 14A within 120 days after the end of the 2016 fiscal year, are incorporated by reference into Part III of this report on form 10-K

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BANKWELL FINANCIAL GROUP, INC.
FORM 10-K
PART 1
Item 1.
Business

Cautionary Note Regarding Forward-Looking Statements

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 or the Securities Act, and Section 21E of the Exchange Act. These statements are often, but not always, made with the words or phrases such as "may," "should," "believe," "likely result in," "expect," "would," "intend," "could," "predict," "poter "continue," "will," "anticipate," "seek," "estimate," "plan," "projection," and "outlook" or the negative version of those words similar words of a forward-looking nature. These forward-looking statements are not historical facts, and are based on current expectations, estimates and projections about our industry, management's beliefs and certain assumptions made by management, many of which, by their nature, are inherently uncertain and beyond our control. Accordingly, we caution you that any such forward-looking statements are not guarantees of future performance and are subject to risks, assumptions, uncertainties and other factors that could cause the actual results to differ materially from those contemplated by these forward-looking statements. Important factors that may cause actual results to differ from those contemplated by these forward-looking statements include, but are not limited to, those disclosed under "Risk Factors" in Part I Item 1A as well as the following factors:

- local, regional and national business or economic conditions may differ from those expected;
- we are subject to credit risk and could incur losses in our loan portfolio;
- our allowance for loan losses may not be adequate to absorb loan losses;
- changes in real estate values could also increase our credit risk;
- we could experience changes in our key management personnel;
- we may not be able to successfully execute our management team's strategic initiatives;
- our ability to successfully execute our growth initiatives such as branch openings and acquisitions;
- volatility and direction of market interest rates;
- increased competition within our market area may limit our growth and profitability;
- economic, market, operational, liquidity, credit and interest rate risks associated with our business;
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the effects of and changes in trade, monetary and fiscal policies and laws, including the Federal Reserve Board's interest rate policies;

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changes in accounting policies and practices, as may be adopted by regulatory agencies, the Public Accounting Oversight Board or the Financial Accounting Standards Board;

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changes in law and regulatory requirements (including those concerning taxes, banking, securities and insurance); and

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further governmental intervention in the U.S. financial system.

The foregoing factors should not be construed as exhaustive. If one or more events related to these or other risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results may differ materially from what we anticipate. Accordingly, you should not place undue reliance on any such forward-looking statements. Any forward-looking statement speaks only as of the date on which it is made, and we do not undertake any obligation to publicly update or review any forward-looking statement, whether as a result of new information, future developments or otherwise. New factors emerge from time to time, and it is not possible for us to predict which will arise. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

General

Bankwell Financial Group, Inc. (the Company, we, our, us) is a bank holding company, headquartered in New Canaan, Connecticut and offers a broad range of financial services through our banking subsidiary, Bankwell Bank (the Bank), a Connecticut state non-member bank founded in 2002. Our primary market is the New York metropolitan area, including Fairfield and New Haven Counties, Connecticut, which we serve from our main banking office located in New Canaan, Connecticut and eight other branch offices located throughout the Fairfield and New Haven County area. As of December 31, 2016, on a consolidated basis, we had total assets of approximately $1.6 billion, net loans of approximately $1.3 billion, total deposits of approximately $1.3 billion, and shareholders' equity of approximately $145.9 million.

We are committed to being the premier "Hometown" bank in Fairfield and New Haven Counties and surrounding areas. We believe that our market exhibits highly attractive demographic attributes and presents favorable competitive dynamics, thereby offering long-term opportunities for growth. We have a history of building long-term customer relationships and attracting new customers through what we believe is our superior customer service and our ability to deliver a diverse product offering. In addition, we believe that our strong capital position and extensive local ownership, coupled with a highly respected and experienced executive management team and board of directors, give us credibility with our customers and potential customers in our market. Our focus is on building a franchise with meaningful market share and consistent revenue growth complemented by operational efficiencies that we believe will produce attractive risk-adjusted returns for our shareholders.

On May 15, 2014, Bankwell Financial Group, Inc. priced 2,702,703 common shares in its IPO at $18.00 per share, and on May 15, 2014, Bankwell common shares began trading on the Nasdaq Stock Market. The net proceeds from the IPO were approximately $44.7 million, after deducting the underwriting discount of approximately $2.5 million and approximately $1.3 million of expenses.

Our History and Growth

Bankwell Bank was originally chartered as two separate banks, The Bank of New Canaan (including a separate division, Stamford First Bank) and The Bank of Fairfield, which were subsequently merged and rebranded as "Bankwell Bank." It was chartered with a commitment to building the premier community bank in the market we serve. We began operations in April 2002 with an initial capitalization of $8.6 million. On November 5, 2013, we acquired The Wilton Bank, and it was merged into Bankwell Bank. On October 1, 2014, we acquired Quinnipiac Bank and Trust Company and it was merged into Bankwell Bank.

With the efforts of our strong management team, we continued our growth and maintained a strong track record of performance. From December 31, 2012 through December 31, 2016, our total assets grew from $610.0 million to approximately $1.6 billion; our gross loans outstanding grew from $530.1 million to approximately $1.4 billion and our noninterest bearing deposits grew from $78.1 million to approximately $187.6 million. We believe this growth was driven by our ability to provide superior service to our customers and our financial stability. This loan growth was achieved while maintaining our focus on our strong underwriting standards, which has been reflected in our low net charge-off levels.

Business Strategy

We are focused on being the "Hometown" bank and banking provider of choice in our highly attractive market areas through:

- Responsive, Customer-Centric Products and Services and a Community Focus. We offer a broad array of products and services which we customize to allow us to focus on building long-term relationships with our customers through high-quality, responsive and personal customer service. By focusing on the entire customer relationship, we build the trust of our customers which leads to long-term relationships and generates our organic growth. In addition, we are committed to meeting the needs of the communities that we serve. Our employees are involved in many civic and community organizations which we support through sponsorships. As a result, customers and potential customers within our market know about us and frequently interact with our employees which allows us to develop long-term customer relationships without extensive advertising.

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- Strategic Acquisitions. To complement our organic growth, we focus on strategic acquisitions in or around our existing markets that further our objectives. We believe there are banking institutions that continue to face credit challenges, capital constraints and liquidity issues and that lack the scale and management expertise to manage the increasing regulatory burden and will likely need to partner with an institution like ours. As we evaluate potential acquisitions, we will continue to seek acquisitions that provide meaningful financial benefits, long-term organic growth opportunities and expense reductions, without compromising our risk profile.

- Utilization of Efficient and Scalable Infrastructure. We employ a systematic and calculated approach to increasing our profitability and improving our efficiencies. We continually upgrade our operating infrastructure particularly in the areas of technology, data processing, compliance and personnel. We believe that our scalable infrastructure provides us with an efficient operating platform from which to grow in the near term, while continuing to deliver our high-quality, responsive customer service, which will enhance our ability to grow and increase our returns.

- Disciplined Focus on Risk Management. Effective risk management is a key component of our strong corporate culture. We use our strong risk management process to monitor our existing loan and investment securities portfolios, support operational decision-making and improve our ability to generate earning assets with strong credit quality. To maintain our strong credit quality, we use a comprehensive underwriting process and we seek to maintain a diversified loan portfolio and a conservative investment securities portfolio. Board-approved policies contain approval authorities, as appropriate, and are reviewed at least annually. We have a Risk Management Steering Committee comprised of executive officers who oversee new business initiatives and other activities that warrant oversight of risk and related mitigants. Internal review procedures are performed regarding anti-money laundering and consumer compliance requirements. Our Chief Risk Officer reports directly to the Chair of our Audit Committee.

Our Competitive Strengths

We believe that we are especially well-positioned to create value for our shareholders as a result of the following competitive strengths:

- Our Market. Our current market is defined as the New York metropolitan area, including Fairfield and New Haven Counties, Connecticut. The Stamford market area includes numerous affluent suburban communities of professionals who work and commute into New York City, approximately 50 miles from our headquarters, and many small to mid-sized businesses which support these communities. Fairfield County is the wealthiest county in Connecticut, with a 2011 – 2015 median household income of $84,233 according to estimates from United States Census Bureau. We believe that this market has economic and competitive dynamics that are favorable to executing our growth strategy.

- Experienced and Respected Management Team with a Proven and Successful Track Record. Our executive management team is comprised of seasoned professionals with significant banking experience, a history of high performance at local financial institutions and success in identifying, acquiring and integrating financial institutions. Our senior management team includes Christopher R. Gruseke, Chief Executive Officer (two years with us), Heidi S. DeWyngaert, Executive Vice President, Chief Lending Officer (twelve years with us), Penko Ivanov, Executive Vice President, Chief Financial Officer (joined in September 2016), David Dineen, Executive Vice President, Head of Community Banking (one year with us) Christine A. Chivily, Executive Vice President, Chief Credit Officer (four years with us), Michele Johnson, Senior Vice President, Chief Risk Officer (eight years with us), John Adams, Senior Vice President, Chief Information Officer (three years with us).

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Dedicated Board of Directors with Strong Community Involvement. Our board of directors is comprised of a group of local business leaders who understand the need for strong community banks that focus on serving the financial needs of their customers. The interests of our executive management team and directors are aligned with those of our shareholders through common

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stock ownership. By capitalizing on the close community ties and business relationships of our executive management team and directors, we are positioned to continue taking advantage of the market opportunity present in our primary market.

- Strong Capital Position. At December 31, 2016, we had an 8.78% tangible common equity ratio, and the Bank had a 10.10% tier 1 leverage ratio and an 11.59% tier 1 risk-based ratio. We believe that our ability to attract capital has facilitated our growth and is an integral component to the execution of our business plan.

- Scalable Operating Platform. We provide banking technology, including remote deposit capture, internet banking and mobile banking, to provide our customers with maximum flexibility and create a scalable platform to accommodate our future growth aspirations. We believe that our advanced technology combined with responsive and personal service provides our customers with a superior banking experience.

Employees

At December 31, 2016, we had a total of 124 full-time employees, 2 part-time employees and 1 temporary employee. None of our employees are subject to a collective bargaining agreement.

Company Website and Availability of Securities and Exchange Commission Filings

Information regarding the Company is available through the Investor Relations tab at www.mybankwell.com. The Company’s annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports filed pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available free of charge at www.sec.gov and at www.mybankwell.com under the Investor Relations tab. Information on the website is not incorporated by reference and is not a part of this annual report on Form 10-K.

Competition

The financial services industry in our market and the surrounding area is highly competitive. We compete with commercial banks, savings banks, savings associations, money market funds, mortgage brokers, finance companies, credit unions, insurance companies, investment firms and private lenders in various segments of our business. Many of these competitors have more assets, capital and higher lending limits, and more resources than we do and may be able to conduct more intensive and broader-based promotional efforts to reach both commercial and individual customers. Competition for deposit products can depend heavily on pricing because of the ease with which customers can transfer deposits from one institution to another.

We focus our marketing efforts on small to medium-sized businesses, professionals and individuals and their employees. This focus includes retail, service, wholesale distribution, manufacturing and international businesses. We attract these customers based on relationships and contacts that our management and our board of directors have within and beyond the market area. We do not expect to compete with large institutions for the primary banking relationships of large corporations. Rather, we compete for niches in this business segment and for the consumer business of employees of such entities. Many of our larger commercial bank competitors have greater name recognition and offer certain services that we do not. However, we believe that our presence in our primary market area and focus on providing superior service to professionals at small to medium sized businesses and individual employees of such businesses are instrumental to our success.

We emphasize personalized banking services and the advantage of local decision-making in our banking businesses, and this emphasis has been well received by the public in our market area. We derive a majority of our business from our local market area which includes our primary market area of the New York metropolitan area, including Fairfield and New Haven Counties, Connecticut.

Lending Activities

General. Our primary lending focus is to serve commercial and middle-market businesses and their executives, high net worth individuals, not-for-profit organizations and consumers with a variety of

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financial products and services, while maintaining strong and disciplined credit policies and procedures. We offer a full array of commercial and retail lending products to serve the needs of our customers. Commercial lending products include owner-occupied commercial real estate loans, commercial real estate investment loans, commercial loans (such as business term loans, equipment financing and lines of credit) to small and mid-sized businesses and real estate construction and development loans. Retail lending products include residential mortgage loans, home equity lines of credit and consumer installment loans. Our retail lending products are offered to the community in general and as an accommodation to our commercial customers, and their executives and employees. We focus our lending activities on loans that we originate from borrowers located in our market. We have established an informal, internal lending limit to one relationship of up to 40% of unimpaired capital and allowance for loan losses, if secured by commercial real estate. A relationship in this instance is defined as loans made to different entities but with a shared borrower principal(s). For individual loans, limits are set so as not to exceed the statutory maximum of 15% of unimpaired capital and allowance for loan losses.

We market our lending products and services to qualified borrowers through conveniently located banking offices, relationship networks and high touch personal service. We target our business development and marketing strategy primarily on small to medium businesses. Our relationship managers actively solicit the business of companies entering our market areas as well as long-standing businesses operating in the communities we serve. We seek to attract new lending customers through professional service, relationship networks, competitive pricing and innovative structure, including the utilization of federal and state tax incentives. We pride ourselves on smart, efficient underwriting and timely decision making for new loan requests due to our leaner approval structure and local decision-making. We believe this gives us a competitive advantage over larger institutions that are not as nimble.

Total loans before deferred loan fees and the allowance for loan losses were $1.4 billion at December 31, 2016. Since December 31, 2012, total loans have increased $835.9 million from $530.1 million, reflecting expansion of our branch network, including $70.1 million of acquired loans from The Wilton Bank and Quinnipiac Bank and Trust Company.

The following table summarizes the composition of our loan portfolio for the dates indicated.

	At December 31,					
	2016		2015		2014	
	Amount	Percent of Loan Portfolio	Amount	Percent of Loan Portfolio	Amount	Percent of Loan Portfolio
	(In thousands)					
Real estate loans:						
Residential	$ 181,310	13.27%	$ 177,184	15.44%	$ 175,031	18.83%
Commercial	845,322	61.89	697,542	60.79	521,181	56.06
Construction	107,441	7.87	82,273	7.17	63,229	6.80
Home equity	14,419	1.05	15,926	1.39	18,166	1.95
	1,148,492	84.08	972,925	84.79	777,607	83.64
Commercial business	215,914	15.81	172,853	15.06	149,259	16.05
Consumer	1,533	0.11	1,735	0.15	2,896	0.31
Total loans	$ 1,365,939	100.00%	$ 1,147,513	100.00%	$ 929,762	100.00%

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	At December 31,			
	2013		2012	
	Amount	Percent of Loan Portfolio	Amount	Percent of Loan Portfolio
	(In thousands)			
Real estate loans:				
Residential	$ 155,874	24.66%	$ 144,288	27.22%
Commercial	316,533	50.08	284,763	53.72
Construction	51,545	8.16	33,148	6.26
Home equity	13,892	2.20	11,030	2.08
	537,844	85.10	473,229	89.28
Commercial business	93,566	14.80	56,764	10.71
Consumer	602	0.10	57	0.01
Total loans	$ 632,012	100.00%	$ 530,050	100.00%

Commercial loans. We offer a wide range of commercial loans, including business term loans, equipment financing and lines of credit to small and midsized businesses. Our target commercial loan market is retail and professional establishments and small to medium sized businesses. The terms of these loans vary by purpose and by type of underlying collateral. The commercial loans primarily are underwritten on the basis of the borrower's ability to service the loan from cash flow. We make equipment loans with conservative margins generally for a term of ten years or less, supported by the useful life of the equipment, at fixed or variable rates, with the loan fully amortizing over the term. Loans to support working capital typically have terms not exceeding one year and usually are secured by accounts receivable, inventory and personal guarantees of the principals of the business and at times by the commercial real estate of the borrower. For loans secured by accounts receivable or inventory, principal typically is repaid as the assets securing the loan are converted into cash, and for loans secured with other types of collateral, principal is typically due at maturity. The quality of the commercial borrower's management and its ability both to properly evaluate changes in the supply and demand characteristics affecting its markets for products and services and to effectively respond to such changes are significant factors in a commercial borrower's creditworthiness. Risks associated with our commercial loan portfolio include those related to the strength of the borrower's business, which may be affected not only by local, regional and national market conditions, but also changes in the borrower's management and other factors beyond the borrower's control; those related to fluctuations in value of any collateral securing the loan; and those related to terms of the commercial loan, which may include balloon payments that must be refinanced or paid off at the end of the term of the loan. Our commercial loan portfolio presents a higher risk than our consumer real estate and consumer loan portfolios.

Commercial real estate loans. We offer real estate loans for commercial property that is owner occupied as well as commercial property owned by real estate investors. Commercial loans that are secured by owner-occupied commercial real estate and primarily collateralized by operating cash flows are also included in this category of loan. Commercial real estate loan terms generally are limited to ten years or less, although payments may be structured on a longer amortization basis of 20 to 30 years. The interest rates on our commercial real estate loans may be fixed or adjustable, although rates typically are not fixed for a period exceeding five to ten years. We generally charge an origination fee for our services. We typically require personal guarantees from the principal owners of the business or real estate supported by a review of the principal owners' personal financial statements. Risks associated with commercial real estate loans include fluctuations in the value of real estate, the overall strength of the economy, new job creation trends, tenant vacancy rates, environmental contamination, and the quality of the borrower's management. We make efforts to limit our risk by analyzing borrowers' cash flow and collateral value as well as all of the sponsors' investment activities. The real estate securing our existing commercial real estate loans includes a

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wide variety of property types, such as owner-occupied offices/warehouses/production facilities, office buildings, industrial, mixed-use residential/commercial, retail centers and multifamily properties. Our commercial real estate loan portfolio presents a higher risk than our consumer real estate and consumer loan portfolios.

Construction loans. Our construction portfolio includes loans to small and midsized businesses to construct owner-used properties, loans to developers of commercial real estate investment properties and residential developments and, to a lesser extent, loans to individual clients for construction of single family homes in our market. Construction and development loans are generally made with a term of one to two years and interest is paid monthly. The ratio of the loan principal to the value of the collateral, as established by independent appraisal, typically will not exceed industry standards. Loan proceeds are disbursed based on the percentage of completion and only after the project has been inspected by an experienced construction lender or third-party inspector. Risks associated with construction loans include fluctuations in the value of real estate, project completion risk and change in market trends. We are also exposed to risk based on the ability of the construction loan borrower to refinance the debt or sell the property upon completion of the project, which may be affected by changes in market trends since the time that we funded the construction loan.

Consumer real estate loans. We offer first lien one-to-four family mortgage loans, as well as home equity lines of credit, in each case primarily on owner-occupied primary residences. We also originate for resale one-to-four family mortgage loans, which are classified as loans held for sale until sold to investors. Although our consumer real estate loan portfolio presents lower levels of risk than our commercial, commercial real estate and construction loan portfolios, we are exposed to risk based on fluctuations in the value of the real estate collateral securing the loan, as well as changes in the borrower’s financial condition, which could be affected by numerous factors, including divorce, job loss, illness or other personal hardship.

Consumer loans. We offer consumer loans as an accommodation to our existing customers, but do not market consumer loans to persons who do not have a pre-existing relationship with us. As of December 31, 2016, our consumer loans represented less than 1% of our total loan portfolio. We do not expect our consumer loans to become a material component of our loan portfolio at any time in the foreseeable future. Although we do not engage in any material amount of consumer lending, our consumer loans, which are underwritten primarily based on the borrower’s financial condition and, in many cases, are unsecured credits, subject us to risk based on changes in the borrower’s financial condition, which could be affected by numerous factors, including those discussed above.

Credit Policy and Procedures

General. We adhere to what we believe are disciplined underwriting standards, but also remain cognizant of the need to serve the credit needs of customers in our primary market areas by offering flexible loan solutions in a responsive and timely manner. We also seek to maintain a broadly diversified loan portfolio across customer, product and industry types. However, our lending policies do not provide for any loans that are highly speculative, subprime, or that have high loan-to-value ratios. These components, together with active credit management, are the foundation of our credit culture, which we believe is critical to enhancing the long term value of our organization to our customers, employees, shareholders and communities.

We have a service-driven, relationship-based, business-focused credit culture, rather than a price-driven, transaction-based culture. Accordingly, substantially all of our loans are made to borrowers located or operating in our primary market with whom we have ongoing relationships across various product lines. The limited number of loans secured by properties located in out-of-market areas that we have made are generally to borrowers who are well-known to us. These borrowers typically have strong deposit relationships with the Bank.

Credit concentrations. In connection with the management of our credit portfolio, we actively manage the composition of our loan portfolio, including credit concentrations. We monitor borrower and loan product concentrations on at least a quarterly basis. Loan product concentrations are reviewed annually in conjunction with the portfolio’s credit quality and the business plan for the coming year. All concentrations are monitored by our Chief Credit Officer and our Loan Committee. We have also established an informal,

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internal lending limit to one relationship of up to 40% of unimpaired capital and allowance for loan losses, if secured by commercial real estate. A relationship in this instance is defined as loans made to different entities but with a shared borrower principal(s). For individual loans, limits are set so as not to exceed the statutory maximum of 15% of unimpaired capital and allowance for loan losses. Our top 20 borrowing relationships range in exposure from $12.4 million to $56.0 million and are monitored on an on-going basis.

Loan approval process. We seek to achieve an appropriate balance between prudent, disciplined underwriting, on the one hand, and flexibility in our decision-making and responsiveness to our customers, on the other hand. Our credit approval policies have a tiered approval process, with larger exposures referred to the Bank's internal loan committee and the Directors' Loan Committee, as appropriate, based on the size of the loan. Smaller exposures are approved under a three-signature system. Loans with policy exceptions require the next higher level of approval authority, the highest of which is the Directors' Loan Committee, depending on dollar amount. These authorities are periodically reviewed and updated by our board of directors. We believe that our credit approval process provides for thorough underwriting and efficient decision making.

Credit risk management. Credit risk management involves a partnership between our relationship managers and our credit approval, credit administration and collections personnel. Portfolio monitoring and early problem recognition are an important aspect of maintaining our high credit quality standards. Past due reports are reviewed on an ongoing basis and insurance and tax payment monitoring is in place. Our evaluation and compensation program for our relationship managers includes significant goals that we believe motivate the relationship managers to focus on high quality credit consistent with our strategic focus on asset quality.

It is our policy to review all non-amortizing commercial loans in excess of $50 thousand and amortizing commercial loans in excess of $750 thousand on an annual basis, or more frequently through the receipt of interim and annual financial statements and borrowing base certificates depending on loan structure and covenants. Our policies require rapid notification of delinquency and prompt initiation of collection actions. Relationship managers, credit administration personnel and senior management proactively support collection activities in order to maximize accountability and efficiency.

As part of these annual review procedures, we analyze recent financial statements of the collateral property, business and/or borrower to determine the current level of occupancy, revenues and expenses and to investigate any deterioration in the value of the real estate collateral or in the borrower's or Company's financial condition. Upon completion, we update or confirm the risk rating assigned to each loan. Relationship managers are encouraged to bring potential credit issues to the attention of our Chief Credit Officer immediately upon any sign of deterioration in the performance of the borrower. We maintain a list of loans that receive additional attention if we believe there may be a potential credit risk via our Watch List report.

Loans that are upgraded or downgraded are reviewed by our Chief Credit Officer, while classified loans undergo a detailed quarterly analysis prepared by the lending officer and reviewed by management, our Internal Loan Committee and Directors' Loan Committee. This review includes an evaluation of the market conditions, the property's or company's trends, the borrower and guarantor status, the level of reserves required and loan accrual status. Additionally, we have an independent, third-party loan review performed which includes loan grades and our credit administration functions each year. Finally, we perform an annual stress test of our commercial real estate portfolio, in which we evaluate the impact on the portfolio of declining economic conditions, including lower values and decline in net operating income which may result from lower rental rates, lower occupancy rates and higher interest rates. Management reviews these reports and presents them to our Loan Committees. These asset review procedures provide management with additional information for assessing our asset quality.

Investment Activities

We manage our investment portfolio primarily for liquidity purposes. Our investment portfolio's primary purpose is to provide adequate liquidity necessary to meet any reasonable decline in deposits and any anticipated increase in the loan portfolio. The majority of these securities are classified as available for sale. The portfolio's secondary purpose is to generate earnings adequate to provide and contribute to stable income and to generate a profitable return while minimizing risk. Additionally, our investment portfolio is used to provide adequate collateral for various regulatory or statutory requirements and to manage our interest rate risk. We invest in a variety of high-grade securities, including government agency securities, government guaranteed mortgage backed securities, highly rated corporate bonds and municipal securities. We regularly evaluate the composition of our portfolio as changes occur with respect to the interest rate yield curve. Although we may sell investment securities from time to time to take advantage of changes in interest rate spreads, it is our policy not to sell investment securities unless we can reinvest the proceeds at a similar or higher spread, so as not to take gains to the detriment of future income.

The investment policy is reviewed annually by our board of directors. Overall investment goals are established by our board of directors, Chief Financial Officer and our asset/liability management committee, or ALCO. Our board of directors has delegated the responsibility of monitoring our investment activities to ALCO. Day-to-day activities pertaining to the investment portfolio are conducted within our accounting department under the supervision of our Chief Financial Officer.

Deposits

Deposits are our primary source of funds to support our earning assets. We offer traditional depository products, including checking, savings, money market and certificates of deposit with a variety of rates. Deposits at the Bank are insured by the FDIC up to statutory limits. We price our deposit products with a view to maximizing our share of each customer’s financial services business, and our loan pricing gives value to deposits from our loan customers.

We have built out a network of nine deposit-taking branch offices and attracted significant transaction account business through our relationship-based approach. As a result of our significant deposit growth in transaction accounts, which we define as demand, NOW and money market deposits, we have achieved a favorable deposit mix between transaction accounts and certificates of deposit.

Borrowed Funds

The Bank is a member of the Federal Home Loan Bank of Boston (FHLB), which is part of a twelve district Federal Home Loan Bank System. Members are required to own capital stock of the FHLB, and borrowings are collateralized by qualifying assets not otherwise pledged (principally single family residential mortgage loans and securities). The maximum amount of credit that the FHLB will extend varies from time to time, depending on its policies and the amount of qualifying collateral the member can pledge. We utilize advances from the FHLB as part of our overall funding strategy and to meet short-term liquidity needs

On August 19, 2015 the Company completed a private placement of $25.5 million in aggregate principal amount of fixed rate subordinated notes (the “Notes”) to certain institutional investors. The Notes are non-callable for five years, have a stated maturity of August 15, 2025, and bear interest at a quarterly pay fixed rate of 5.75% per annum to the maturity date or the early redemption date.

The Notes have been structured to qualify for the Company as Tier 2 capital under regulatory guidelines. We used the net proceeds for general corporate purposes, which included maintaining liquidity at the holding company, providing equity capital to the Bank to fund balance sheet growth, our working capital needs, and funding acquisitions of branches and whole financial institutions in or around our existing market that furthered our objectives.

Enterprise Risk Management

We place significant emphasis on risk mitigation as an integral component of our organizational culture. We believe that our emphasis on risk management is manifested in our solid asset quality statistics. Risk management with respect to our lending philosophy focuses, among other things, on structuring credits to provide for multiple sources of repayment, coupled with strong underwriting undertaken by experienced bank officers and credit policy personnel.

We perform quarterly loan impairment analyses on criticized loans and criticized asset action plans for those borrowers who display deteriorating financial conditions in order to monitor those relationships and implement corrective measures on a timely basis to minimize losses. In addition, we perform an annual stress test of our commercial real estate portfolio, in

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which we evaluate the impact on the portfolio of declining property values and lower net operating incomes as a result of economic conditions, including lower rental rates and lower occupancy rates. The stress test focuses only on the cash flow and valuation of the properties and ignores the liquidity, net worth and cash flow of any guarantors related to the credits.
We also focus on risk management in other areas throughout our organization. The Chief Risk Officer oversees the Risk Management function and chairs a Risk Management Steering Committee. We currently outsource our asset/liability management process to a reputable third party, and on a quarterly basis, we run the full interest rate risk model. Results of the model are reviewed and validated by our ALCO.
Supervision and Regulation
General
The Bank, a Connecticut state-chartered commercial bank, is subject to extensive regulation by the Connecticut Department of Banking, as its chartering agency, and by the FDIC, as its deposit insurer. The Bank’s deposits are insured up to applicable limits by the FDIC through the Deposit Insurance Fund. The Bank is required to file reports with, and is periodically examined by, the FDIC and the Connecticut Department of Banking concerning its activities and financial condition and must obtain regulatory approvals prior to entering into certain transactions, such as mergers with, or acquisitions of, other financial institutions.
The primary goals of the bank regulatory scheme are to maintain a safe and sound banking system and to facilitate the conduct of sound monetary policy. This scheme is intended primarily for the protection of the Deposit Insurance Fund and bank depositors, rather than our shareholders and creditors. The banking agencies have broad enforcement power over bank holding companies and banks, including the authority, among other things, to enjoin “unsafe or unsound” practices, require affirmative action to correct any violation or practice, issue administrative orders that can be judicially enforced, direct increases in capital, direct the sale of subsidiaries or other assets, limit dividends and distributions, restrict growth, assess civil money penalties, remove officers and directors, and, with respect to banks, terminate deposit insurance or place the bank into conservatorship or receivership. In general, these enforcement actions may be initiated for violations of laws and regulations or unsafe or unsound practices.
The following discussion is a summary of the material laws and regulations applicable to our operations, but does not purport to be a complete summary of all applicable laws, rules and regulations. These laws and regulations may change from time to time and the regulatory agencies often have broad discretion in interpreting them. Any change in such laws or regulations, whether by the Connecticut Department of Banking, the FDIC or the Federal Reserve Board could have a material adverse impact on the financial markets in general, and our operations and activities, financial condition, results of operations, growth plans and future prospects specifically.
Dodd-Frank Wall Street Reform and Consumer Protection Act
The Dodd-Frank Act has significantly changed the current bank regulatory structure and will affect into the immediate future the lending and investment activities and general operations of depository institutions and their holding companies.
The current United States Administration has announced that it intends to slow down the adoption of new Dodd-Frank Act regulations and to consider proposing changes to the legislation. The following summary assumes no changes to the Dodd-Frank Act and regulations adopted to date.
The Dodd-Frank Act also created the Consumer Financial Protection Bureau with extensive powers to implement and enforce consumer protection laws. The Consumer Financial Protection Bureau has broad rulemaking authority for a wide range of consumer protection laws that apply to all banks and savings associations including, among other things, the authority to prohibit “unfair, deceptive or abusive” acts and practices. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks and savings associations with more than $10 billion in assets. Banks and savings associations with $10 billion or less in assets will continue to be examined for compliance with federal consumer protection

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and fair lending laws by their applicable primary federal bank regulators. The Dodd-Frank Act also weakens the federal preemption available for national banks and federal savings associations and gives state attorneys general certain authority to enforce applicable federal consumer protection laws.
The Dodd-Frank Act made many other changes to banking regulations including authorizing depository institutions, for the first time, to pay interest on business checking accounts, requiring originators of securitized loans to retain a percentage of the risk for transferred loans, establishing regulatory rate-setting for certain debit card interchange fees, establishing a number of reforms for mortgage originations, requiring bank holding companies and banks to be "well capitalized" and "well managed" in order to acquire banks located outside of their home state, requiring any bank holding company electing to be treated as a financial holding company to be "well capitalized" and "well managed" and authorizing national and state banks to establish de novo branches in any state that would permit a bank chartered in that state to open a branch at that location.
The Dodd-Frank Act also broadened the base for the FDIC insurance assessments. The FDIC was required to promulgate rules revising its assessment system so that insurance assessments are based on the average consolidated total assets less tangible equity capital of an insured depository institution instead of deposits. That rule took effect April 1, 2011. The Dodd-Frank Act also permanently increased the maximum amount of deposit insurance for banks, savings institutions and credit unions to $250,000 per depositor, retroactive to January 1, 2008.
The Dodd-Frank Act increased shareholder influence over boards of directors by requiring companies to give shareholders a nonbinding vote on executive compensation and so-called "golden parachute" payments, and by authorizing the SEC to promulgate rules that would allow shareholders to nominate and solicit votes for their own candidates using a company's proxy materials.
Many of the provisions of the Dodd-Frank Act require various federal agencies to promulgate numerous and extensive implementing regulations over the next several years. It is therefore challenging to predict at this time the full impact the Dodd-Frank Act and implementing regulations will have on community banks and their holding companies. It is expected that the legislation and implementing regulations, particularly those provisions relating to the Consumer Financial Protection Bureau, has and will increase our operating and compliance costs.
Connecticut Banking Laws and Supervision
Connecticut Department of Banking. The Connecticut Department of Banking regulates internal organization as well as the deposit, lending and investment activities of state-chartered banks, including the Bank. The approval of the Connecticut Department of Banking is required for, among other things, the establishment of branch offices and business combination transactions. The Connecticut Department of Banking conducts periodic examinations of Connecticut chartered banks. The FDIC also regulates many of the areas regulated by the Connecticut Department of Banking, and federal law may limit some of the authority provided to Connecticut chartered banks by Connecticut law.
Lending Activities. Connecticut banking laws grant banks broad lending authority. With certain limited exceptions, loans to any one obligor under this statutory authority may not exceed 15% and fully secured loans may not exceed an additional 10% of a bank's equity capital and allowance for loan losses.
Dividends. The Bank may pay cash dividends out of its net profits. For purposes of this restriction, "net profits" represents the remainder of all earnings from current operations. Further, the total amount of all dividends declared by a bank in any year may not exceed the sum of a bank's net profits for the year in question combined with its retained net profits from the preceding two years. Federal law also prevents an institution from paying dividends or making other capital distributions that, if by doing so, would cause it to become "undercapitalized". Beginning January 1, 2016, the Basel III Capital Rules limit the amount of dividends the Bank can pay if its capital ratios are below the threshold levels of the capital conservation buffer established by the rules. The capital conservation buffer is being phased in from January 1, 2016 to January 1, 2019, when the full capital conservation buffer of 2.5% (as a percentage of risk-weighted assets) will be effective. The capital conservation buffer is in addition to the minimum risk-based capital requirement. The FDIC may further limit a bank's ability to pay dividends. Moreover, the federal agencies have issued policy statements that provide that insured banks should generally only pay dividends out of current operating earnings.

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Powers. Connecticut law permits Connecticut banks to sell insurance and fixed and variable rate annuities if licensed to do so by the Connecticut Insurance Department. With the prior approval of the Connecticut Department of Banking, Connecticut banks are also authorized to engage in a broad range of activities related to the business of banking, or that are financial in nature or that are permitted under the Bank Holding Company Act or the Home Owners' Loan Act, both federal statutes, or the regulations promulgated as a result of these statutes. Connecticut banks are also authorized to engage in any activity permitted for a national bank or a federal savings association upon filing notice with the Connecticut Department of Banking unless the Connecticut Department of Banking disapproves the activity.

Assessments. Connecticut banks are required to pay annual assessments to the Connecticut Department of Banking to fund the Connecticut Department of Banking's operations. The general assessments are paid pro-rata based upon a bank's asset size.

Enforcement. Under Connecticut law, the Connecticut Department of Banking has extensive enforcement authority over Connecticut banks and, under certain circumstances, affiliated parties, insiders, and agents. The Connecticut Department of Banking's enforcement authority includes cease and desist orders, fines, receivership, conservatorship, removal of officers and directors, emergency closures, dissolution and liquidation.

Federal Bank Holding Company Regulation

General. As a bank holding company, we are subject to comprehensive regulation and regular examinations by the Federal Reserve Board. The Federal Reserve Board also has extensive enforcement authority over bank holding companies, including, among other things, the ability to assess civil money penalties, to issue cease and desist or removal orders and to require that a bank holding company divest subsidiaries (including its bank subsidiaries). In general, enforcement actions may be initiated for violations of law and regulations and unsafe or unsound practices.

Under Federal Reserve Board policy which has been codified by the Dodd-Frank Act, a bank holding company must serve as a source of strength for its subsidiary bank. Under this policy, the Federal Reserve Board may require, and has required in the past, a bank holding company to contribute additional capital to an undercapitalized subsidiary bank. A bank holding company must obtain Federal Reserve Board approval before: (1) acquiring, directly or indirectly, ownership or control of any voting securities of another bank or bank holding company if, after such acquisition, it would own or control more than 5% of such securities (unless it already owns or controls the majority of such securities); (2) acquiring all or substantially all of the assets of another bank or bank holding company; or (3) merging or consolidating with another bank holding company. Under Connecticut banking law, no person may acquire beneficial ownership of more than 10% of any class of voting securities of a Connecticut chartered bank, or any bank holding company of such a bank, without prior notification of, and lack of disapproval by, the Connecticut Department of Banking.

The Bank Holding Company Act also prohibits a bank holding company, with certain exceptions, from acquiring direct or indirect ownership or control of more than 5% of the voting shares of any company which is not a bank or bank holding company, or from engaging directly or indirectly in activities other than those of banking, managing or controlling banks, or providing services for its subsidiaries. The principal exceptions to these prohibitions involve certain non-bank activities which, by statute or by Federal Reserve Board regulation or order, have been identified as activities closely related to the business of banking or managing or controlling banks. The list of activities permitted by the Federal Reserve Board includes, among other things: (1) operating a savings institution, mortgage company, finance company, credit card company or factoring company; (2) performing certain data processing operations; (3) providing certain investment and financial advice; (4) underwriting and acting as an insurance agent for certain types of credit-related insurance; (5) leasing property on a full-payout, non-operating basis; (6) selling money orders, travelers' checks and United States savings bonds; (7) real estate and personal property appraising; (8) providing tax planning and preparation services; (9) financing and investing in certain community development activities; and (10) subject to certain limitations, providing securities brokerage services for customers.

Dividends. The Federal Reserve Board has issued a policy statement on the payment of cash dividends by bank holding companies, which expresses the Federal Reserve Board's view that a bank

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holding company should pay cash dividends only to the extent that the Bank Holding Company's net income for the past year is sufficient to cover both the cash dividends and a rate of earnings retention that is consistent with the Bank Holding Company's capital needs, asset quality and overall financial condition. The Federal Reserve Board also indicated that it would be inappropriate for a bank holding company experiencing serious financial problems to borrow funds to pay dividends.

Substantially all of our income is derived from, and the principal source of our liquidity is, dividends from the Bank. The ability of the Bank to pay dividends to us is also restricted by federal and state laws, regulations and policies. The Bank may pay cash dividends out of its net profits. For purposes of this restriction, "net profits" represents the remainder of all earnings from current operations. Further, the total amount of all dividends declared by a bank in any year may not exceed the sum of a bank's net profits for the past two fiscal years, plus the portion of the year in which the dividend is paid.

Under federal law, the Bank may not pay any dividend to us if the Bank is undercapitalized or the payment of the dividend would cause it to become undercapitalized. Beginning January 1, 2016, the Basel III Capital Rules limit the amount of dividends the Bank can pay to us if its capital ratios are below the threshold levels of the capital conservation buffer established by the rules. The capital conservation buffer is being phased in from January 1, 2016 to January 1, 2019, when the full capital conservation buffer of 2.5% (as a percentage of risk-weighted assets) will be effective. The capital conservation buffer is in addition to the minimum risk-based capital requirement. The FDIC may further restrict the payment of dividends by requiring the Bank to maintain a higher level of capital than would otherwise be required for it to be adequately capitalized for regulatory purposes. Moreover, if, in the opinion of the FDIC, the Bank is engaged in an unsafe or unsound practice (which could include the payment of dividends), the FDIC may require, generally after notice and hearing, it to cease such practice. The FDIC has indicated that paying dividends that deplete a depository institution's capital base to an inadequate level would be an unsafe banking practice. The FDIC has also issued policy statements providing that insured depository institutions generally should pay dividends only out of current operating earnings.

Redemption. Bank holding companies are required to give the Federal Reserve Board prior written notice of any purchase or redemption of its outstanding equity securities if the gross consideration for the purchase or redemption, when combined with the net consideration paid for all such purchases or redemptions during the preceding 12 months, is equal to 10% or more of the consolidated net worth of the Bank Holding Company. The Federal Reserve Board may disapprove such a purchase or redemption if it determines that the proposal would constitute an unsafe or unsound practice or would violate any law, regulation, Federal Reserve Board order or any condition imposed by, or written agreement with, the Federal Reserve Board. This notification requirement does not apply to any bank holding company that meets the well capitalized standard for commercial banks, is "well managed" within the meaning of the Federal Reserve Board regulations and is not subject to any unresolved supervisory issues.

Federal Bank Regulation

Safety and Soundness. The federal banking agencies, including the FDIC, have implemented rules and guidelines concerning standards for safety and soundness required pursuant to Section 39 of the Federal Deposit Insurance Corporation Improvement Act, or FDICIA. In general, the standards relate to (1) operational and managerial matters; (2) asset quality and earnings; and (3) compensation. The operational and managerial standards cover (a) internal controls and information systems, (b) internal audit systems, (c) loan documentation, (d) credit underwriting, (e) interest rate exposure, (f) asset growth, and (g) compensation, fees and benefits. Under the asset quality and earnings standards, the Bank is required to establish and maintain systems to (i) identify problem assets and prevent deterioration in those assets, and (ii) evaluate and monitor earnings and ensure that earnings are sufficient to maintain adequate capital reserves. Finally, the compensation standard states that compensation will be considered excessive if it is unreasonable or disproportionate to the services actually performed by the individual being compensated. If an insured state-chartered bank fails to meet any of the standards promulgated by regulation, then such institution will be required to submit a plan within 30 days to the FDIC specifying the steps it will take to correct the deficiency. In the event that an insured state-chartered bank fails to submit or fails in any material respect to implement a compliance plan within the time allowed by the federal banking agency, Section 39 of the FDICIA provides that the FDIC must order the institution to correct the deficiency and

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may (1) restrict asset growth; (2) require the bank to increase its ratio of tangible equity to assets; (3) restrict the rates of interest that the bank may pay; or (4) take any other action that would better carry out the purpose of prompt corrective action. We believe that the Bank has been and will continue to be in compliance with each of the standards as they have been adopted by the FDICIA.

Capital Requirements. The Federal Reserve Board monitors our capital adequacy, on a consolidated basis, and the FDIC and Connecticut Department of Banking monitor the capital adequacy of the Bank.

The Federal Reserve, the FDIC and the other federal and state bank regulatory agencies establish regulatory capital guidelines for U.S. banking organizations.

As of January 1, 2015, the Company and the Bank became subject to new capital rules set forth by the Federal Reserve, the FDIC and the other federal and state bank regulatory agencies. The new capital rules revise the banking agencies' leverage and risk-based capital requirements and the method for calculating risk weighted assets to make them consistent with agreements that were reached by the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act (the Basel III Capital Rules).

The Basel III Capital Rules establish a new minimum common equity Tier 1 capital requirement of 4.5% of risk-weighted assets; set the minimum leverage ratio at 4% of total assets; increased the minimum Tier 1 capital to risk-weighted assets requirement from 4% to 6%; and retained the minimum total capital to risk weighted assets requirement at 8.0%. A "well-capitalized" institution must generally maintain capital ratios 200 basis points higher than the minimum guidelines.

The Basel III Capital Rules also change the risk weights assigned to certain assets. The Basel III Capital Rules assigned a higher risk weight (150%) to loans that are more than 90 days past due or are on nonaccrual status and to certain commercial real estate facilities that finance the acquisition, development or construction of real property. The Basel III Capital Rules also alter the risk weighting for other assets, including marketable equity securities that are risk weighted generally at 300%. The Basel III Capital Rules require certain components of accumulated other comprehensive income (loss) to be included for purposes of calculating regulatory capital requirements unless a one-time opt-out is exercised. The Bank did exercise its opt-out option and will exclude the unrealized gain (loss) on investment securities component of accumulated other comprehensive income (loss) from regulatory capital.

The Basel III Capital Rules limit a banking organization's capital distributions and certain discretionary bonus payments to executive officers if the banking organization does not hold a "capital conservation buffer" of 2.5% in addition to the minimum risk based capital requirement. The "capital conservation buffer" is being phased in from January 1, 2016 to January 1, 2019, when the full capital conservation buffer will be effective.

Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements.

Liquidity. We are required to maintain a sufficient amount of liquid assets to ensure our safe and sound operation. The final Basel III framework also requires banks and bank holding companies to measure their liquidity against specific liquidity tests. Although similar in some respects to liquidity measures historically applied by banks and banking agencies for management and supervisory purposes, the Basel III framework would require specific liquidity tests by rule.

Transactions with Affiliates. Under current federal law, transactions between depository institutions and their affiliates are governed by Sections 23A and 23B of the Federal Reserve Act, or FRA, and the Federal Reserve Board's Regulation W. In a holding company context, at a minimum, the parent holding company of a bank and any companies which are controlled by such parent holding company is an affiliate of the bank. Generally, Section 23A limits the extent to which the bank or its subsidiaries may engage in "covered transactions" with any one affiliate to 10% of such bank's capital stock and surplus, and contains an aggregate limit on all such transactions with all affiliates to 20% of capital stock and surplus. The term "covered transaction" includes, among other things, the making of loans or other extensions of credit to an affiliate and the purchase of assets from an affiliate. Section 23A also establishes specific collateral

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requirements for loans or extensions of credit to, or guarantees, acceptances on letters of credit issued on behalf of an affiliate. Section 23B requires that covered transactions and a broad list of other specified transactions be on terms substantially the same, or no less favorable, to the bank or its subsidiary as similar transactions with non-affiliates.

The Dodd-Frank Act has expanded the definition of covered transactions and increased the timing and other aspects of the collateral requirements associated with covered transactions, including an expansion of the covered transactions to include credit exposures related to derivatives, repurchase agreements and securities lending arrangements and an increase in the amount of time for which collateral requirements regarding covered transactions must be satisfied.

Loans to Insiders.   Further, Section 22(h) of the FRA restricts a depository institution with respect to loans to directors, executive officers, and principal shareholders (or insiders). Under Section 22(h), loans to insiders and their related interests may not exceed, together with all other outstanding loans to such persons and affiliated entities, the depository institution’s total unimpaired capital and unimpaired surplus. Loans to insiders above specified amounts must receive the prior approval of the board of directors. Further, under Section 22(h), loans to directors, executive officers and principal shareholders must be made on terms substantially the same as offered in comparable transactions to other persons, except that such insiders may receive preferential loans made under a benefit or compensation program that is widely available to the depository institution’s employees and does not give preference to the insider over the employees. Section 22(g) of the FRA places additional limitations on loans to executive officers. In addition to enhancing restrictions on insider transactions, the Dodd-Frank Act increases the types of transactions with insiders subject to restrictions, including certain asset sales with insiders.

Enforcement.   The FDIC has extensive enforcement authority over insured banks, including the Bank. This enforcement authority includes, among other things, the ability to assess civil money penalties, issue cease and desist orders and remove directors and officers. In general, these enforcement actions may be initiated in response to violations of laws and regulations and unsafe or unsound practices.

The FDIC has authority under federal law to appoint a conservator or receiver for an insured bank under limited circumstances. The FDIC is required, with certain exceptions, to appoint a receiver or conservator for an insured state nonmember bank if that bank was “critically undercapitalized” on average during the calendar quarter beginning 270 days after the date on which the institution became “critically undercapitalized.” The FDIC may also appoint itself as conservator or receiver for an insured state non-member institution under specific circumstances on the basis of the institution’s financial condition or upon the occurrence of other events, including: (1) insolvency; (2) substantial dissipation of assets or earnings through violations of law or unsafe or unsound practices; (3) existence of an unsafe or unsound condition to transact business; and (4) insufficient capital, or the incurring of losses that will deplete substantially all of the institution’s capital with no reasonable prospect of replenishment without federal assistance.

Insurance of Deposit Accounts.   Deposit accounts at the Bank are insured by the Deposit Insurance Fund, generally up to a maximum of $250,000 per separately insured depositor, pursuant to changes made permanent by the Dodd-Frank Act. The FDIC assesses insured depository institutions to maintain the Deposit Insurance Fund. No institution may pay a dividend if in default of its deposit insurance assessment.

Under the FDIC’s risk-based assessment system, insured depository institutions are assigned to a risk category based on supervisory evaluations, regulatory capital levels and other factors. A depository institution’s assessment rate depends upon the category to which it is assigned and certain adjustments specified by the FDIC, with less risky institutions paying lower assessments.

On February 7, 2011, as required by the Dodd-Frank Act, the FDIC published a final rule to revise the deposit insurance assessment system. The rule, which took effect April 1, 2011, changed the assessment base used for calculating deposit insurance assessments from deposits to average consolidated total assets less average tangible equity capital. Since the new base is larger than the previous base, the FDIC also lowered assessment rates so that the rule would not significantly alter the total amount of revenue collected from the industry. The range of adjusted assessment rates is now 2.5 to 45 basis points of the new assessment base. The rule is expected to benefit smaller financial institutions, which typically rely more on deposits for funding, and shift more of the burden for supporting the Deposit Insurance Fund to larger financial institutions, which are thought to have greater access to nondeposit funding.

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The Dodd-Frank Act increased the minimum target Deposit Insurance Fund ratio from 1.15% of estimated insured deposits to 1.35% of estimated insured deposits. The FDIC must seek to achieve the 1.35% ratio by September 30, 2020. In setting the assessments necessary to achieve the 1.35% ratio, the FDIC is supposed to offset the effect of the increased ratio on insured institutions with assets of less than $10 billion. The Dodd-Frank Act eliminated the 1.5% maximum fund ratio, instead leaving it to the discretion of the FDIC. The FDIC has exercised that discretion by establishing a long range fund ratio of 2%.

A material increase in insurance premiums would likely have an adverse effect on the operating expenses and results of operations of the Bank. Management cannot predict what insurance assessment rates will be in the future.

Insurance of deposits may be terminated by the FDIC upon a finding that a depository institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC. We do not know of any practice, condition or violation that might lead to termination of the Bank's deposit insurance.

Deposit Operations. In addition to the regulations above, the Bank's deposit operations are subject to other federal laws applicable to depository accounts, such as the:

- Truth-In-Savings Act, requiring certain disclosures for consumer deposit accounts;
- Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records;
- Electronic Funds Transfer Act and Regulation E issued by the Federal Reserve to implement that act, which govern automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services; and
- Rules and regulations of the various federal banking agencies charged with the responsibility of implementing these federal laws.

Federal Reserve System. The Federal Reserve Board regulations require depository institutions to maintain noninterest earning reserves against their transaction accounts (primarily NOW and regular checking accounts). The Federal Reserve Board regulations generally require that reserves be maintained against aggregate transaction accounts. We are in compliance with these requirements.

Federal Home Loan Bank of Boston (FHLB). The Bank is a member of the FHLB, which is one of the regional Federal Home Loan Banks composing the Federal Home Loan Bank System. Each Federal Home Loan Bank serves as a central credit facility primarily for its member institutions. The Bank, as a member of the FHLB, is required to acquire and hold shares of capital stock in the FHLB.

Community Reinvestment Act (CRA). Under the CRA, as amended by FDIC regulations, a bank has a continuing and affirmative obligation, consistent with its safe and sound operation, to help meet the credit needs of its entire community, including low and moderate income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution's discretion to develop the types of products and services that it believes are best suited to its particular community. The CRA does require the FDIC, in connection with its examination of a bank, to assess the bank's record of meeting the credit needs of its community and to take such record into account in its evaluation of certain applications by such bank, including applications to acquire branches and other financial institutions. The CRA requires the FDIC to provide a written evaluation of a bank's CRA performance utilizing a four-tiered descriptive rating system. In particular, the system focuses on three tests:

- A lending test, to evaluate the bank's record of making loans in its assessment areas;

- An investment test, to evaluate the bank’s record of investing in community development projects, affordable housing, and programs benefiting low or moderate income individuals and businesses; and

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- A service test, to evaluate the bank's delivery of services through its branches, ATMs, and other offices.

Connecticut has its own statutory counterpart to the CRA which is applicable to the Bank. The Connecticut version is generally similar to the CRA but utilizes a five-tiered descriptive rating system. Connecticut law requires the Connecticut Department of Banking to consider, but not be limited to, a bank's record of performance under Connecticut law in considering any application by the Bank to establish a branch or other deposit-taking facility, to relocate an office or to merge or consolidate with or acquire the assets and assume the liabilities of any other banking institution. In our most recent evaluation under Connecticut law Bankwell received a CRA rating of "satisfactory".

Consumer Protection and Fair Lending Regulations. We are subject to a variety of federal and Connecticut statutes and regulations that are intended to protect consumers and prohibit discrimination in the granting of credit. These statutes and regulations provide for a range of sanctions for non-compliance with their terms, including imposition of administrative fines and remedial orders, and referral to the Attorney General for prosecution of a civil action for actual and punitive damages and injunctive relief. Certain of these statutes authorize private individual and class action lawsuits and the award of actual, statutory and punitive damages and attorneys' fees for certain types of violations.

At the federal level, these laws include, among others, the following:

- Federal Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;

- Home Mortgage Disclosure Act of 1975, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;

- Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed, or other prohibited factors in extending credit;

- Fair Credit Reporting Act of 1978, governing the use of consumer credit reports and the provision of information to credit reporting agencies;

- Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies;

- Real Estate Settlement Procedures Act, governing closing costs and settlement procedures and disclosures to consumers related thereto;

- Service members Civil Relief Act of 2004, governing the repayment terms of, and property rights underlying, secured obligations of persons in military service; and

- Rules and regulations of the various federal agencies charged with the responsibility of implementing these federal laws.

Additional Considerations

Regulatory Enforcement Authority. Federal banking agencies have substantial enforcement authority over the financial institutions that they regulate including, among other things, the ability to assess civil money penalties, to issue cease-and-desist or removal orders and to initiate injunctive actions against banking organizations and institution-affiliated parties, as defined. In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports filed with regulatory authorities. Except under certain circumstances, federal law requires public disclosure of final enforcement actions by the federal banking agencies.

Incentive Compensation Guidance. The federal banking agencies have released comprehensive guidance on incentive compensation policies focused on ensuring that financial institutions' incentive compensation policies do not undermine the safety and soundness of those institutions by encouraging excessive risk taking. The incentive compensation guidance sets expectations for financial institutions concerning their incentive compensation arrangements and related risk management, control and governance processes. All employees that have the ability to materially affect the risk profile of a financial

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institution, either individually or as part of a group, are covered by the guidance. The guidance is based upon three core concepts: (1) balanced risk-taking incentives; (2) effective controls and risk management compatibility; and (3) strong corporate governance. Deficiencies in compensation practices that are identified may be incorporated into the institution's supervisory ratings, which can affect the organization's ability to take certain actions, including the ability to make acquisitions or take other actions. Enforcement actions by the institution's primary federal banking agency may be initiated if the institution's incentive compensation programs pose a risk to the safety and soundness of the organization. In addition, beginning January 1, 2016, the Basel III Capital Rules limit discretionary bonus payments to the Bank's executive officers if its capital ratios are below the threshold levels of the capital conservation buffer established by the rules. The capital conservation buffer is being phased in from January 1, 2016 to January 1, 2019, when the full capital conservation buffer of 2.5% (as a percentage of risk-weighted assets) will be effective. The capital conservation buffer is in addition to the minimum risk-based capital requirement.

Sarbanes-Oxley Act of 2002. The Sarbanes-Oxley Act of 2002 generally established a comprehensive framework to modernize and reform the oversight of public company auditing, improve the quality and transparency of financial reporting by those companies and strengthen the independence of auditors. Among other things, the legislation (1) created the Public Company Accounting Oversight Board, which is empowered to set auditing, quality control and ethics standards, to inspect registered public accounting firms, to conduct investigations and to take disciplinary actions, subject to SEC oversight and review; (2) strengthened auditor independence from corporate management by, among other things, limiting the scope of consulting services that auditors can offer their public company audit clients; (3) heightened the responsibility of public company directors and senior managers for the quality of the financial reporting and disclosure made by their companies; (4) adopted a number of provisions to deter wrongdoing by corporate management; (5) imposed a number of new corporate disclosure requirements; (6) adopted provisions which generally seek to limit and expose to public view possible conflicts of interest affecting securities analysts; and (7) imposed a range of new criminal penalties for fraud and other wrongful acts, as well as extended the period during which certain types of lawsuits can be brought against a company or its insiders. The Sarbanes-Oxley Act applies generally to all companies that file or are required to file periodic reports with the SEC under the Exchange Act.

Financial Modernization. The Gramm-Leach-Bliley Act, or the GLB Act, permits greater affiliation among banks, securities firms, insurance companies, and other companies under a type of financial services company known as a "financial holding company". A financial holding company essentially is a bank holding company with significantly expanded powers. Financial holding companies are authorized by statute to engage in a number of financial activities previously impermissible for bank holding companies, including securities underwriting, dealing and market making; sponsoring mutual funds and investment companies; insurance underwriting and agency; and merchant banking activities. The GLB Act also permits the Federal Reserve Board and the Treasury Department to authorize additional activities for financial holding companies if they are "financial in nature" or "incidental" to financial activities. A bank holding company may become a financial holding company if each of its subsidiary banks is well capitalized, well managed, and has at least a "satisfactory" CRA rating. A financial holding company must provide notice to the Federal Reserve Board within 30 days after commencing activities previously determined by statute or by the Federal Reserve Board and Department of the Treasury to be permissible. We have not submitted notice to the Federal Reserve Board of our intent to be deemed a financial holding company. However, we are not precluded from submitting a notice in the future should we wish to engage in activities only permitted to financial holding companies.

Privacy Requirements. Under the GLB Act, all financial institutions are required to establish policies and procedures to restrict the sharing of non-public customer data with non-affiliated parties and to protect customer data from unauthorized access. In addition, the Fair Credit Reporting Act of 1970, or FCRA, includes many provisions concerning national credit reporting standards and permits consumers, including customers of the Bank, to opt out of information-sharing for marketing purposes among affiliated companies. The Fair and Accurate Credit Transactions Act of 2004 amended certain provisions of the FCRA and requires banks and other financial institutions to notify their customers if they report negative information about them to a credit bureau or if they are granted credit on terms less favorable than those generally available. The Bank currently has a privacy protection policy in place and believes such policy is in compliance with the regulations.

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The Bank Secrecy Act and Related Anti-Money Laundering and Anti-Terrorist Financing Legislation. The Bank Secrecy Act, or the BSA, provides, in part, for the facilitation of information sharing among governmental entities and financial institutions for the purpose of combating terrorism and money laundering by enhancing anti-money laundering and financial transparency laws, as well as enhanced information collection tools and enforcement mechanics for the U.S. government, including: (1) requiring standards for verifying customer identification at account opening; (2) rules to promote cooperation among financial institutions, regulators, and law enforcement entities in identifying parties that may be involved in terrorism or money laundering; (3) reports by nonfinancial trades and businesses filed with the Treasury Department's Financial Crimes Enforcement Network for transactions exceeding $10,000; (4) filing suspicious activities reports by brokers and dealers if they believe a customer may be violating U.S. laws and regulations; and (5) requiring enhanced due diligence requirements for financial institutions that administer, maintain, or manage private bank accounts or correspondent accounts for non-U.S. persons.

Title III of the USA PATRIOT Act of 2001 amended the BSA and incorporates anti-terrorist financing provisions into the requirements of the BSA and its implementing regulations. Among other things, the USA PATRIOT Act requires all financial institutions, including us, to institute and maintain a risk-based anti-money laundering compliance program that includes a customer identification program, provides for information sharing with law enforcement and between certain financial institutions by means of an exemption from the privacy provisions of the GLB Act, prohibits U.S. banks and broker-dealers from maintaining accounts with foreign "shell" banks, establishes due diligence and enhanced due diligence requirements for certain foreign correspondent banking and foreign private banking accounts and imposes additional record keeping requirements for certain correspondent banking arrangements. The USA PATRIOT Act also grants broad authority to the Secretary of the Treasury to take actions to combat money laundering, and federal bank regulators are required to evaluate the effectiveness of an applicant in combating money laundering in determining whether to approve any application submitted by a financial institution.

The Office of Foreign Assets Control, or OFAC, which is a division of the Treasury Department, is responsible for helping to ensure that U.S. entities do not engage in transactions with "enemies" of the United States, as defined by various Executive Orders and Acts of Congress. OFAC has sent, and will send, our banking regulatory agencies lists of names of persons and organizations suspected of aiding, harboring or engaging in terrorist acts. If the Bank finds a name on any transaction, account or wire transfer that is on an OFAC list, the Bank must freeze such account, file a suspicious activity report and notify OFAC. We have established policies and procedures to ensure compliance with the federal anti-laundering provisions.

Proposed Legislation and Regulatory Action. New statutes, regulations and guidance are regularly proposed that contain wide-ranging potential changes to the statutes, regulations and competitive relationships of financial institutions operating and doing business in the United States. We cannot predict whether or in what form any proposed regulation or statute will be adopted or the extent to which our business may be affected by any new regulation or statute.

Effect of Governmental Monetary Policies. Our earnings will be affected by domestic economic conditions and the monetary and fiscal policies of the U.S. government and its agencies. The Federal Reserve Board's monetary policies have had, and are likely to continue to have, an important impact on the operating results of commercial banks through its power to implement national monetary policy in order, among other things, to curb inflation or combat a recession. The monetary policies of the Federal Reserve Board affect the levels of bank loans, investments and deposits through its control over the issuance of U.S. government securities, its regulation of the discount rate applicable to member banks and its influence over reserve requirements to which member banks are subject. We cannot predict the nature or impact of future changes in monetary and fiscal policies.

Taxation

Federal Taxation

General: We are subject to federal income taxation in the same general manner as other corporations, with limited exceptions. The following discussion of federal taxation is intended only to summarize certain pertinent federal income tax matters and is not a comprehensive description of the tax rules applicable to us.

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Method of Accounting: For Federal income tax purposes, we report income and expenses on the accrual method of accounting and use tax year ending December 31 for filing federal income tax returns.
Alternative Minimum Tax: The Internal Revenue Code of 1986, as amended (the “Code”), imposes an alternative minimum tax (“AMT”) at a rate of 20.0% on a base of regular taxable income plus certain tax preferences which we refer to as “alternative minimum taxable income.” The AMT is payable to the extent such alternative minimum taxable income is in excess of an exemption amount and the AMT exceeds the regular income tax. Net operating losses can offset no more than 90.0% of alternative minimum taxable income. Certain AMT payments may be used as credits against regular tax liabilities in future years. We have not been subject to the AMT and have no such amounts available as credits for carryover.
Net Operating Loss Carryovers: A corporation may carry back net operating losses to the preceding two taxable years and forward to the succeeding 20 taxable years. At December 31, 2016, we had $2.8 million of net operating loss carryforwards for federal income tax purposes. The carryovers were transferred to the Company upon the merger with The Wilton Bank.
Corporate Dividends-Received Deduction: The Company may exclude from its income 100.0% of dividends received from the Bank as a member of the same affiliated group of corporations. The corporate dividends received deduction is 80.0% in the case of dividends received from corporations with which a corporate recipient does not file a consolidated tax return, and corporations which own less than 20.0% of the stock of a corporation distributing a dividend may deduct only 70.0% of dividends received or accrued on their behalf.
The Company and the Bank are not currently under audit with respect to their federal tax returns.
State Taxation
We are subject to the Connecticut corporation business tax. The Connecticut corporation business tax is based on the federal taxable income before net operating loss and special deductions and makes certain modifications to federal taxable income to arrive at Connecticut taxable income. Connecticut taxable income is multiplied by the state tax rate (7.5% for the fiscal years ending December 31, 2016 and 2015) to arrive at Connecticut income tax. We are also subject to state income tax in other states as a result of loan originations made in other states.
On October 8, 2015, the Bank formed a passive investment company, Bankwell Loan Servicing Group, Inc., in accordance with Connecticut tax laws, which permit transfers of real estate collateralized loans to such subsidiaries. The related earnings of the subsidiary, and any dividends it pays to the parent, are not subject to Connecticut income tax. The formation of the passive investment company reduced state income tax in 2016 and will continue to reduce state income tax in the future.
The Company and the Bank are not currently under audit with respect to their state tax returns.
Item 1A.
Risk Factors

Risks Relating to Our Business
As a business operating in the financial services industry, our business and operations may be adversely affected in numerous and complex ways by weak economic conditions.
Our businesses and operations, which primarily consist of lending money to customers in the form of loans, borrowing money from customers in the form of deposits and investing in securities, are sensitive to general business and economic conditions in the United States. If the U.S. economy weakens, our growth and profitability from our lending, deposit and investment operations could be constrained. Uncertainty about the federal fiscal policymaking process, the medium and long term fiscal outlook of the federal government, and future tax rates is a concern for businesses, consumers and investors in the United States. In addition, economic conditions in foreign countries, including uncertainty over the stability of the euro currency, could affect the stability of global financial markets, which could hinder U.S. economic growth. Weak economic conditions are characterized by deflation, fluctuations in debt and equity capital markets, a lack of liquidity and/or depressed prices in the secondary market for mortgage loans, increased

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delinquencies on mortgage, consumer and commercial loans, residential and commercial real estate price declines and lower home sales and commercial activity. The current economic environment is also characterized by interest rates at historically low levels, which impacts our ability to attract deposits and to generate attractive earnings through our investment portfolio. All of these factors are detrimental to our business, and the interplay between these factors can be complex and unpredictable. Our business is also significantly affected by monetary and related policies of the U.S. federal government and its agencies. Changes in any of these policies are influenced by macroeconomic conditions and other factors that are beyond our control. Adverse economic conditions and government policy responses to such conditions could have a material adverse effect on our business, financial condition, results of operations and prospects.

We may not be able to adequately measure and limit our credit risk, which could lead to unexpected losses.

The business of lending is inherently risky, including risks that the principal of or interest on any loan will not be repaid timely or at all or that the value of any collateral supporting the loan will be insufficient to cover our outstanding exposure. These risks may be affected by the strength of the borrower’s business sector and local, regional and national market and economic conditions. Our risk management practices, such as monitoring the concentration of our loans within specific industries and our credit approval practices, may not adequately reduce credit risk, and our credit administration personnel, policies and procedures may not adequately adapt to changes in economic or any other conditions affecting customers and the quality of the loan portfolio. Finally, many of our loans are made to middle market businesses that may be less able to withstand competitive, economic and financial pressures than larger borrowers. A failure to effectively measure and limit the credit risk associated with our loan portfolio could have a material adverse effect on our business, financial condition, results of operations and future prospects.

Our allowance for loan losses may not be adequate to absorb losses inherent in our loan portfolio, which could have a material adverse effect on our financial condition and results of operations.

We maintain an allowance for loan losses to provide for nonperforming loans. Maintaining an adequate allowance for loan losses is critical to our financial results and condition. The level of our allowance for loan losses reflects management’s continuing evaluation of general economic conditions, diversification and seasoning of the loan portfolio, historic loss experience, identified credit problems, delinquency levels and adequacy of collateral. The determination of the appropriate level of the allowance for loan losses is inherently highly subjective and requires us to make significant estimates of and assumptions regarding current credit risks and future trends, all of which may undergo material changes. Inaccurate management assumptions, continuing deterioration of economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of our control, may require us to increase our allowance for loan losses. In addition, our regulators, as an integral part of their examination process, review our loans and the adequacy of our allowance for loan losses and may direct us to make additions to our allowance for loan losses based on their judgments about information available to them at the time of their examination. Further, if actual charge-offs in future periods exceed the amounts allocated to our allowance for loan losses, we may need additional provision for loan losses to restore the adequacy of our allowance for loan losses. If we are required to materially increase our level of allowance for loan losses for any reason, such increase could have a material adverse effect on our business, financial condition, results of operations and future prospects.

Our concentration of large loans to certain borrowers may increase our credit risk.

Our growth over the last several years has been partially attributable to our ability to originate and retain loans. Many of these loans have been made to a small number of borrowers, resulting in a high concentration of large loans to certain borrowers. We have established an informal, internal lending limit to one relationship of up to 40% of unimpaired capital and allowance for loan losses, if secured by commercial real estate. A relationship in this instance is defined as loans made to different entities but with a shared borrower principal(s). For individual loans, limits are set so as not to exceed the statutory maximum of 15% of unimpaired capital and allowance for loan losses. However, we may, under certain circumstances, consider going above this internal limit in situations where we are confident that (1) the loan to value ratio,

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other characteristics or the structure of the loan is such that it is a lower risk than standard, (2) we will be able to sell to another institution some portion of the relationship debt as either a whole loan or participation, (3) there is sufficient diversification in the ownership structure of the proposed borrowing entity that the involvement of one party to whom we have extended other debt will not significantly negatively impact the proposed loan's performance in a downturn or (4) the proposed loan is secured by particularly strong collateral, for example, a commercial real estate loan secured by strong tenants with long-term leases, thereby reducing the reliance on the principals of the borrowing entity. As of December 31, 2016, our five largest relationships ranged from approximately $26.0 million to $56.0 million, and comprised in the aggregate, approximately 13% of our loan portfolio. In addition to other typical risks related to any loan, such as deterioration of the collateral securing the loans, this high concentration of borrowers presents a risk to our lending operations. If any one of these borrowers becomes unable to repay their loan obligations for any reason, our nonperforming loans and our allowance for loan losses could increase significantly, which could adversely and materially affect our business, financial condition and results of operations.

Our commercial real estate loan, commercial loan and construction loan portfolios expose us to risks that may be greater than the risks related to our other mortgage loans.

Our loan portfolio includes non-owner-occupied commercial real estate loans for individuals and businesses for various purposes, which are secured by commercial properties. These loans typically involve repayment dependent upon income generated, or expected to be generated, by the property securing the loan in amounts sufficient to cover operating expenses and debt service. Commercial real estate loans may be affected to a greater extent than residential loans by adverse conditions in real estate markets or the economy because commercial real estate borrowers' ability to repay their loans depends on successful development of their properties, in addition to the factors affecting residential real estate borrowers. These loans also involve greater risk because they generally are not fully amortizing over the loan period, but have a balloon payment due at maturity. A borrower's ability to make a balloon payment typically will depend on being able to either refinance the loan or sell the underlying property in a timely manner.

These loans expose a lender to greater credit risk than loans secured by residential real estate because the collateral securing these loans typically cannot be liquidated as easily as residential real estate. If we foreclose on these loans, our holding period for the collateral typically is longer than for a 1 – 4 family residential property because there are fewer potential purchasers of the collateral. Additionally, non-owner-occupied commercial real estate loans generally involve relatively large balances to single borrowers or related groups of borrowers. Accordingly, charge-offs on non-owner occupied commercial real estate loans may be larger on a per loan basis than those incurred with our residential or consumer loan portfolios.

Commercial loans are typically based on the borrowers' ability to repay the loans from the cash flow of their businesses. These loans may involve greater risk because the availability of funds to repay each loan depends substantially on the success of the business itself. In addition, the assets securing the loans have the following characteristics: (a) they depreciate over time, (b) they are difficult to appraise and liquidate, and (c) they fluctuate in value based on the success of the business.

Risk of loss on a construction loan depends largely upon whether our initial estimate of the property's value at completion of construction equals or exceeds the cost of the property construction (including interest), the availability of permanent takeout financing and the builder's ability to ultimately sell the property. During the construction phase, a number of factors can result in delays and cost overruns. If estimates of value are inaccurate or if actual construction costs exceed estimates, the value of the property securing the loan may be insufficient to ensure full repayment when completed through a permanent loan or by seizure of collateral.

Our underwriting, review and monitoring cannot eliminate all of the risks related to these loans. Unexpected deterioration in the credit quality of our commercial real estate loan, commercial loan or construction loan portfolios would require us to increase our provision for loan losses, which would reduce our profitability and could have a material adverse effect on our business, financial condition, results of operations and future prospects.

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Lack of seasoning of our loan portfolio could increase risk of credit defaults in the future.
As a result of our growth over the past recent years, a large portion of loans in our loan portfolio and of our lending relationships are of relatively recent origin. In general, loans do not begin to show signs of credit deterioration or default until they have been outstanding for some period of time, a process referred to as "seasoning". As a result, a portfolio of older loans will usually behave more predictably than a newer portfolio. Because a large portion of our portfolio is relatively new, the current level of delinquencies and defaults may not represent the level that may prevail as the portfolio becomes more seasoned and may not serve as a reliable basis for predicting the health and nature of our loan portfolio, including net charge-offs and the ratio of nonperforming assets in the future. Our limited experience with these loans does not provide us with a significant payment history pattern with which to judge future collectability. As a result, it may be difficult to predict the future performance of our loan portfolio. If delinquencies and defaults increase, we could experience an increase in delinquencies and charge-offs and we may be required to increase our allowance for loan losses, which could have a material adverse effect on our business, financial condition, results of operations and prospects.
A prolonged downturn in the real estate market could result in losses and adversely affect our profitability.
As of December 31, 2016, approximately 84% of our loan portfolio was composed of commercial and consumer real estate loans. The sale of real estate collateral in each case provides an alternate source of repayment in the event of default by the borrower and may deteriorate in value during the time the credit is extended. A decline in real estate values could impair the value of our collateral and our ability to sell the collateral upon any foreclosure, which would likely require us to increase our provision for loan losses. In the event of a default with respect to any of these loans, the amounts we receive upon sale of the collateral may be insufficient to recover the outstanding principal and interest on the loan. If we are required to re-value the collateral securing a loan to satisfy the debt during a period of reduced real estate values or to increase our allowance for loan losses, our profitability could be adversely affected, which could have a material adverse effect on our business, financial condition, results of operations and prospects.
We are subject to interest rate risk that could negatively impact our profitability.
Our profitability, like that of most financial institutions, depends to a large extent on our net interest income, which is the difference between our interest income on interest earning assets, such as loans and investment securities, and our interest expense on interest-bearing liabilities, such as deposits and borrowings.
Interest rates are highly sensitive to many factors that are beyond our control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the U.S. Federal Reserve Board, or the Federal Reserve, or the Federal Reserve Board. Changes in monetary policy, including changes in interest rates, could influence not only the interest we receive on loans and securities and the interest we pay on deposits and borrowings, but such changes could also affect our ability to originate loans and obtain deposits, the fair value of our financial assets and liabilities, and the average duration of our assets. If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and other investments, our net interest income, and therefore net income, could be adversely affected. A continuation of the current levels of historically low interest rates could cause the spread between our loan yields and our deposit rates paid to compress our net interest margin and our net income could be adversely affected. Further, any substantial, unexpected, prolonged change in market interest rates could have a material adverse effect on our business, financial condition, results of operations and future prospects.
In addition, an increase in interest rates could also have a negative impact on our results of operations by reducing the ability of borrowers to repay their current loan obligations. These circumstances could not only result in increased loan defaults, foreclosures and charge-offs, but also necessitate further increases to our allowance for loan losses, each of which could have a material adverse effect on our business, results of operations, financial condition and future prospects.

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Our business is concentrated in Fairfield and New Haven Counties, Connecticut and the surrounding areas, and we are more sensitive than our more geographically diversified competitors to adverse changes in the local economy.

We conduct a majority of our operations in the New York metropolitan area, including Fairfield and New Haven Counties, Connecticut. A majority of the real estate loans in our loan portfolio are secured by properties located in the New York metropolitan area, including Fairfield and New Haven Counties. In addition, as of December 31, 2016, the majority of the loans in our loan portfolio (measured by dollar amount) were made to borrowers who live or conduct business in the New York metropolitan area. We compete against a number of financial institutions who maintain significant operations located outside of the New York metropolitan area and outside the State of Connecticut. Accordingly, any regional or local economic downturn, or natural or man-made disaster, that affects Connecticut or the New York metropolitan area or existing or prospective property or borrowers in Connecticut or the New York metropolitan area may affect us and our profitability more significantly and more adversely than our more geographically diversified competitors, which could cause a material adverse effect on our business, financial condition, results of operations and prospects.

Strong competition within our market area could reduce our profits and slow growth.

Competition in the financial services industry in our market and the surrounding area is strong. Numerous commercial banks, savings banks and savings associations maintain offices or are headquartered in or near our primary market area. Commercial banks, savings banks, savings associations, money market funds, mortgage brokers, finance companies, credit unions, insurance companies, investment firms and private lenders compete with us for various segments of our business. These competitors often have far greater resources than we do and are able to conduct more intensive and broader based promotional efforts to reach both commercial and individual customers.

Our ability to compete successfully will depend on a number of factors, including, among other things:

- Our ability to build and maintain long-term customer relationships while ensuring high ethical standards and safe and sound banking practices;
- The scope, relevance and pricing of products and services that we offer;
- Customer satisfaction with our products and personalized services;
- Industry and general economic trends; and
- Our ability to keep pace with technological advances and to invest in new technology.

Increased competition could require us to increase the rates we pay on deposits or lower the rates we offer on loans, which could reduce our profitability. We derive a majority of our business from our primary market area, the New York metropolitan area, including Fairfield and New Haven Counties, Connecticut. Our failure to compete effectively in our primary market could cause us to lose market share and could have a material adverse effect on our business, financial condition, results of operations and future prospects.

We are a community bank and our ability to maintain our reputation is critical to the success of our business.

We are a community bank, and our reputation is one of the most valuable components of our business. We strive to conduct our business in a manner that enhances our reputation. This is done, in part, by recruiting, hiring and retaining employees who share our core values of being an integral part of the communities we serve, delivering superior service to our customers and caring about our customers and associates. If our reputation is negatively affected, by the actions of our employees or otherwise, our business and, therefore, our operating results may be materially adversely affected.

We may not be able to execute our management team’s growth strategy.

As part of our management team's growth strategy, we pursue a business plan focused on the development and growth of our franchise in our existing market and surrounding areas. In addition to pursuing organic growth, another element of our management team's strategy will be to acquire other branches, whole financial institutions or related lines of business. We intend to actively seek potential

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acquisition opportunities. There are numerous risks that may make it difficult for us to execute this growth strategy and we cannot assure you that we will be successful in executing any part of our management team's strategy or that we will be able to maintain our historical rate of growth. Challenges we will face include obtaining regulatory approvals with respect to acquisitions, assuring that we will not become subject to regulatory actions in the future that could restrict our growth, identifying appropriate targets for acquisitions, negotiating acquisitions on terms that are acceptable to us, and encountering competition for acquisitions from financial institutions and other entities with similar business strategies that have greater financial resources, relevant experience and more personnel than us. Accordingly, there can be no assurance that we will be successful in completing future acquisitions at all or on terms that are acceptable to us. Our ability to grow will be limited if we are unable to successfully make acquisitions in the future.

Some institutions we may acquire may have distressed assets and there can be no assurance that we would be able to realize the value we predict from these assets or that we would make sufficient provision for future losses in the value of, or accurately estimate the future write downs taken in respect of, these assets.

Declines in home prices and/or weak general economic conditions may result in increases in delinquencies and losses in the loan portfolios and other assets of financial institutions that we may acquire in amounts that exceed our initial forecasts developed during the due diligence investigation prior to acquiring those institutions. In addition, the loss reserves of institutions we may acquire may prove inadequate or be negatively affected, and asset values may be impaired, in the future due to factors we cannot predict, including significant deterioration in economic conditions and further declines in collateral values and credit quality indicators. Any of these events could adversely affect the financial condition, liquidity, capital position and value of any institutions that we acquire and of the Bank as a whole.

We may not be able to overcome the integration and other risks associated with acquisitions, which could adversely affect our growth and profitability.

We may from time to time consider acquisition opportunities that we believe complement our activities and have the ability to enhance our profitability. In addition to The Wilton Bank and Quinnipiac transactions completed in 2013 and 2014, our acquisition activities could be material to our business and involve a number of risks, including the following:

- Incurring time and expense associated with identifying and evaluating potential acquisitions and negotiating potential transactions, resulting in our attention being diverted from the operation of our existing business;
- Using inaccurate estimates and judgments to evaluate credit, operations, management and market risks with respect to the target institution or assets;
- Intense competition from other banking organizations and other inquirers for acquisitions;
- Potential exposure to unknown or contingent liabilities of banks and businesses we acquire;
- The time and expense required to integrate the operations and personnel of the combined businesses;
- Experiencing higher operating expenses relative to operating income from the new operations;
- Creating an adverse short-term effect on our results of operations;
-

Losing key employees and customers as a result of an acquisition that is poorly received;

- Significant problems relating to the conversion of the financial and customer data of the entity;

- Inconsistencies in standards, controls, procedures and policies that adversely affect our ability to maintain relationships with clients, customers, depositors and employees or to achieve the anticipated benefits of the acquisition; or

- Risks of impairment to goodwill or other than temporary impairment.

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Depending on the condition of any institution or assets or liabilities that we may acquire, that acquisition may, at least in the near term, adversely affect our capital and earnings and, if not successfully integrated with our organization, may continue to have such effects over a longer period. We may not be successful in overcoming these risks or any other problems encountered in connection with pending or potential acquisitions, and any acquisition we may consider will be subject to prior regulatory approval. Our inability to overcome these risks could have an adverse effect on our profitability, return on equity and return on assets, our ability to implement our business strategy and enhance shareholder value, which, in turn, could have a material adverse effect on our business, financial condition, results of operations and prospects. Further, if we experience difficulties with the integration process, the anticipated benefits of the investment or acquisition transaction may not be realized fully or at all or may take longer to realize than expected. As a result of an investment or acquisition transaction, we may be required to take write-downs or write-offs, restructuring and impairment or other charges that could have a significant negative effect on our financial condition and results of operations, which could cause you to lose some or all of your investment.

We must conduct due diligence investigations of target institutions we intend to acquire. Intensive due diligence is time consuming and expensive due to the operations, accounting, finance and legal professionals who must be involved in the due diligence process. Even if we conduct extensive due diligence on a target institution with which we combine, this diligence may not reveal all material issues that may affect a particular target institution, and factors outside the control of the target institution and outside of our control may later arise. If, during our diligence process, we fail to identify issues specific to a target institution or the environment in which the target institution operates, we may be forced to later write down or write off assets, restructure our operations, or incur impairment or other charges that could result in our reporting losses. These charges may also occur if we are not successful in integrating and managing the operations of the target institution with which we combine. In addition, charges of this nature may cause us to violate net worth or other covenants to which we may be subject as a result of assuming preexisting debt held by a target institution or by virtue of our obtaining debt financing.

Resources could be expended in considering or evaluating potential acquisitions that are not consummated, which could materially and adversely affect subsequent attempts to locate and acquire or merge with another business.

We anticipate that the process of identifying and investigating institutions for potential acquisitions and the negotiation, drafting and execution of relevant agreements, disclosure documents and other instruments will require substantial management time and attention and substantial costs for accountants, attorneys and others. If a decision is made not to complete a specific acquisition transaction, the costs incurred up to that point for the proposed transaction likely would not be recoverable. Furthermore, even if an agreement is reached relating to a specific target institution, we may fail to consummate the transaction for any number of reasons, including those beyond our control. Any such event will result in a loss to us of the related costs incurred, which could materially and adversely affect subsequent attempts to locate and acquire or merge with another institution.

Our lending limit may restrict our growth and prevent us from effectively implementing our business strategy.

We are limited in the amount we can loan to a single borrower by the amount of our capital. Under Connecticut banking law, the total direct or indirect liabilities of any one obligor that are not fully secured, however incurred, to any Connecticut bank, exclusive of such bank’s investment in the investment securities of such obligor, shall not exceed at the time incurred 15% of the equity capital and allowance for loan and lease losses of such bank. The total direct or indirect liabilities of any one obligor that are fully secured, however incurred, to any Connecticut bank, exclusive of such bank’s investment in the investment securities of such obligor, shall not exceed at the time incurred 10% of the equity capital and allowance for loan and lease losses of such bank, provided this limitation shall be separate from and in addition to the limitation on liabilities that are not fully secured. We have also established an informal, internal lending limit to one relationship of up to 40% of unimpaired capital and allowance for loan losses, if secured by commercial real estate. A relationship in this instance is defined as loans made to different entities but with a shared borrower principal(s). For individual loans, limits are set so as not to exceed the statutory maximum of 15%

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of unimpaired capital and allowance for loan losses. Based upon our current capital levels and our informal, internal limit on loans, the amount we may lend both in the aggregate and to any one borrower is significantly less than that of many of our competitors and may discourage potential borrowers who have credit needs in excess of our lending limit from doing business with us. We accommodate larger loans by selling participations in those loans to other financial institutions, but this strategy may not always be available. If we are unable to compete effectively for loans from our target customers, we may not be able to effectively implement our business strategy, which could have a material adverse effect on our business, financial condition, results of operations and future prospects.

We are dependent on our executive management team and other key employees and we could be adversely affected by the unexpected loss of their services.

We are led by an experienced core management team with substantial experience in the market that we serve, and our operating strategy focuses on providing products and services through long-term relationship managers. Accordingly, our success depends in large part on the performance of our key personnel, as well as on our ability to attract, motivate and retain highly qualified senior and middle management. Competition for employees is intense, and the process of locating key personnel with the combination of skills and attributes required to execute our business plan may be lengthy. In particular, we believe that retaining the services and skills of our management team, including Mr. Gruseke, Ms. DeWyngaert, Ms. Chivily, Mr. Dineen and Mr. Ivanov is important to our success. The unexpected loss of services of any of these or other key personnel could have an adverse impact on us because of their skills, knowledge of our market, years of industry experience and the difficulty of promptly finding qualified replacement personnel. If the services of any of our key personnel should become unavailable for any reason, we may not be able to identify and hire qualified persons on terms acceptable to us, which could cause a material adverse effect on our business, financial condition, results of operations and prospects.

The fair value of our investment securities can fluctuate due to factors outside of our control.

Factors beyond our control can significantly influence the fair value of securities in our portfolio and can cause potential adverse changes to the fair value of these securities. These factors include, but are not limited to, rating agency actions with respect to individual securities, defaults by the issuer or with respect to the underlying securities, and changes in market interest rates and continued instability in the capital markets. Any of these factors, among others, could cause other-than-temporary impairments and realized and/or unrealized losses in future periods and declines in other comprehensive income, which could materially and adversely affect our business, results of operations, financial condition and prospects. The process for determining whether impairment of a security is other-than-temporary usually requires complex, subjective judgments about the future financial performance and liquidity of the issuer and any collateral underlying the security in order to assess the probability of receiving all contractual principal and interest payments on the security.

We may be required to repurchase mortgage loans or indemnify buyers against losses in some circumstances, which could harm liquidity, results of operations and financial condition.

When mortgage loans are sold, whether as whole loans or pursuant to a securitization, we are required to make customary representations and warranties to purchasers, guarantors and insurers, including government-sponsored entities, about the mortgage loans and the manner in which they were originated. Whole loan sale agreements require us to repurchase or substitute mortgage loans, or indemnify buyers against losses, in the event we breach these representations or warranties. In addition, we may be required to repurchase mortgage loans as a result of early payment default of the borrower on a mortgage loan. If repurchase and indemnity demands increase and such demands are valid claims and are in excess of our provision for potential losses, our liquidity, results of operations and financial condition may be adversely affected.

Our financial results depend on management's selection of accounting methods and certain assumptions and estimates.

Our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with Accounting Principles Generally Accepted in the United

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States, or GAAP, and with general practices within the financial services industry. The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of certain assets and liabilities, disclosure of contingent assets and liabilities and the reported amount of related revenues and expenses. Certain accounting policies inherently are based to a greater extent on estimates, assumptions and judgments of management and, as such, have a greater possibility of producing results that could be materially different than originally reported. They require management to make subjective or complex judgments, estimates or assumptions, and changes in those estimates or assumptions could have a significant impact on our consolidated financial statements. These critical accounting policies include the fair value of acquired assets, the allowance for loan losses, stock-based compensation and derivative instrument valuation. Because of the uncertainty of estimates involved in these matters, we may be required to significantly increase the allowance for loan losses or sustain loan losses that are significantly higher than the reserve provided or otherwise incur charges that could have a material adverse effect on our business, financial condition, results of operations and future prospects.

We may be adversely affected by the soundness of other financial institutions.

Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services companies are interrelated as a result of trading, clearing, counterparty, and other relationships. We have exposure to different industries and counterparties, and through transactions with counterparties in the financial services industry, including broker-dealers, commercial banks, investment banks, and other financial intermediaries. Further, our private banking channel relies on relationships with a number of other financial institutions for referrals. As a result, declines in the financial condition of, or even rumors or questions about, one or more financial institutions, financial service companies or the financial services industry generally, may lead to market-wide liquidity, asset quality or other problems and could lead to losses or defaults by us or by other institutions. These problems, losses or defaults could have a material adverse effect on our business, financial condition, results of operations and future prospects.

We rely on third parties to provide key components of our business infrastructure, and failure of these parties to perform for any reason could disrupt our operations.

Our business depends on the successful and uninterrupted functioning of our information technology and telecommunications systems and third-party servicers. The failure of these systems, or the termination of a third-party software license or service agreement on which any of these systems is based, could interrupt our operations. Because our information technology and telecommunications systems interface with and depend on third-party systems, we could experience service denials if demand for such services exceeds capacity or such third-party systems fail or experience interruptions. If significant, sustained or repeated, a system failure or service denial could compromise our ability to operate effectively, damage our reputation, result in a loss of customer business, and subject us to additional regulatory scrutiny and possible financial liability, any of which could have a material adverse effect on our business, financial condition, results of operations and prospects.

We face various technological risks that could adversely affect our business.

We rely on communication and information systems to conduct business. Potential failures, interruptions or breaches in system security could result in disruptions or failures in our key systems, such as general ledger, deposit or loan systems. The risk of electronic fraudulent activity within the financial services industry, especially in the commercial banking sector due to cyber criminals targeting bank accounts and other customer information is on the rise. We have developed policies and procedures aimed at preventing and limiting the effect of failure, interruption or security breaches, including cyber-attacks of information systems; however, there can be no assurance that these incidences will not occur, or if they do occur, that they will be appropriately addressed. The occurrence of any failures, interruptions or security breaches, including cyber-attacks of our information systems could damage our reputation, result in the loss of business, subject us to increased regulatory scrutiny or subject us to civil litigation and possible financial liability, any of which could have an adverse effect on our results of operation and financial condition.

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We are subject to losses due to fraudulent and negligent acts on the part of loan applicants, our borrowers, other vendors and our employees.

When we originate loans, we rely heavily upon information supplied by third parties, including the information contained in the loan application, property appraisal, title information and employment and income documentation. If any of this information is intentionally or negligently misrepresented and such misrepresentation is not detected prior to loan funding, the value of the loan may be significantly lower than expected. Whether a misrepresentation is made by the loan applicant, the borrower, another third party or one of our employees, we generally bear the risk of loss associated with the misrepresentation. A loan subject to a material misrepresentation is typically unsaleable or subject to repurchase if it is sold prior to detection of the misrepresentation, and the persons and entities involved are often difficult to locate and it is often difficult to collect any monetary losses that we have suffered from them. We have controls and processes designed to help us identify misrepresented information in our loan origination operations. We cannot assure you, however, that we have detected or will detect all misrepresented information in our loan originations.

Unauthorized access, cyber-crime and other threats to data security may require significant resources, harm our reputation, and adversely affect our business.

We necessarily collect, use and hold personal and financial information concerning individuals and businesses with which we have a banking relationship. Threats to data security, including unauthorized access and cyber-attacks rapidly emerge and change, exposing us to additional costs for protection or remediation and competing time constraints to secure our data in accordance with customer expectations, statutory and regulatory privacy and other requirements. It is difficult or impossible to defend against every risk being posed by changing technologies, as well as criminal intent on committing cyber-crime. Increasing sophistication of cyber-criminals and terrorists make keeping up with new threats difficult and could result in a breach. Controls employed by our information technology department and our other employees and vendors could prove inadequate. We could also experience a breach due to intentional or negligent conduct on the part of employees or other internal sources, software bugs or other technical malfunctions, or other causes. As a result of any of these threats, our customer accounts may become vulnerable to account takeover schemes or cyber-fraud. Our systems and those of our third-party vendors may also become vulnerable to damage or disruption due to circumstances beyond our or their control, such as from catastrophic events, power anomalies or outages, natural disasters, network failures, and viruses and malware.

A breach of our security that results in unauthorized access to our data could expose us to a disruption or challenges relating to our daily operations as well as to data loss, litigation, damages, fines and penalties, significant increases in compliance costs, and reputational damage, any of which could have a material adverse effect on our business, results of operations, financial condition and future prospects.

We are subject to environmental liability risk associated with our lending activities.

In the course of our business, we may purchase real estate, or we may foreclose on and take title to real estate. As a result, we could be subject to environmental liabilities with respect to these properties. We may be held liable to a governmental entity or to third parties for property damage, personal injury, investigation and clean-up costs incurred by these parties in connection with environmental contamination or may be required to investigate or clean up hazardous or toxic substances or chemical releases at a property. The costs associated with investigation or remediation activities could be substantial. In addition, if we are the owner or former owner of a contaminated site, we may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from the property. Any significant environmental liabilities could cause a material adverse effect on our business, financial condition, results of operations and future prospects.

We may incur impairment to goodwill.

We test our goodwill for impairment at least annually. Significant negative industry or economic trends, reduced estimates of future cash flows or disruptions to our business, could indicate that goodwill might be impaired. Our valuation methodology for assessing impairment requires management to make judgments

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and assumptions based on historical experience and to rely on projections of future operating performance. Projections of future operating results and cash flows may vary significantly from actual results. Additionally, if our analysis results in impairment to our goodwill, we would be required to record a non-cash charge to earnings in our financial statements during the period in which such impairment is determined to exist. Any such charge could have a material adverse effect on our results of operations.

Risks Applicable to the Regulation of our Industry

We operate in a highly regulated environment, which could have a material and adverse impact on our operations and activities, financial condition, results of operations, growth plans and future prospects.

Banking is highly regulated under federal and state law. We are subject to extensive regulation and supervision that governs almost all aspects of our operations. As a registered bank holding company, we are subject to supervision, regulation and examination by the Federal Reserve. As a commercial bank chartered under the laws of Connecticut, the Bank is subject to supervision, regulation and examination by the State of Connecticut Department of Banking and the FDIC.

The primary goals of the bank regulatory system are to maintain a safe and sound banking system and to facilitate the conduct of sound monetary policy. This system is intended primarily for the protection of the FDIC's Deposit Insurance Fund and bank depositors, rather than our shareholders and creditors. The banking agencies have broad enforcement power over bank holding companies and banks, including the authority, among other things, to enjoin "unsafe or unsound" practices, require affirmative action to correct any violation or practice, issue administrative orders that can be judicially enforced, direct increases in capital, direct the sale of subsidiaries or other assets, limit dividends and distributions, restrict growth, assess civil monetary penalties, remove officers and directors, and, with respect to banks, terminate our charter, terminate our deposit insurance or place the Bank into conservatorship or receivership. In general, these enforcement actions may be initiated for violations of laws and regulations or unsafe or unsound practices.

Compliance with the myriad of laws and regulations applicable to our organization can be difficult and costly. In addition, these laws, regulations and policies are subject to continual review by governmental authorities, and changes to these laws, regulations and policies, including changes in interpretation or implementation of these laws, regulations and policies, could affect us in substantial and unpredictable ways and often impose additional compliance costs. Further, any new laws, rules and regulations, such as the Dodd-Frank Act, could make compliance more difficult or expensive. All of these laws and regulations, and the supervisory framework applicable to our industry, could have a material adverse impact on our operations and activities, financial condition, results of operations, growth plans and future prospects.

Federal and state regulators periodically examine our business and we may be required to remediate adverse examination findings.

The Federal Reserve, the FDIC and the Connecticut Department of Banking periodically examine our business, including our compliance with laws and regulations. If, as a result of an examination, a regulatory agency were to determine that our financial condition, capital resources, asset quality, earnings prospects, management, liquidity or other aspects of any of our operations had become unsatisfactory, or that we were in violation of any law or regulation, it may take a number of different remedial actions as it deems appropriate. These actions include the power to enjoin "unsafe or unsound" practices, to require affirmative action to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in our capital, to restrict our growth, to assess civil monetary penalties against our officers or directors, to remove officers and directors and, if it is concluded that such conditions cannot be corrected or there is an imminent risk of loss to depositors, to terminate our deposit insurance and place us into receivership or conservatorship. Any regulatory action against us could have a material adverse effect on our business, results of operations, financial condition and future prospects.

The Bank's FDIC deposit insurance premiums and assessments may increase.

The deposits of the Bank are insured by the FDIC up to legal limits and, consequently, subject it to the payment of FDIC deposit insurance assessments. The Bank's regular assessments are determined by its risk

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classification, which is based on its regulatory capital levels and the level of supervisory concern that it poses. Any future special assessments, increases in assessment rates or required prepayments in FDIC insurance premiums could reduce our profitability or limit our ability to pursue certain business opportunities, which could materially and adversely affect our business, financial condition, results of operations and prospects.

New capital rules that were issued in 2015 generally require insured depository institutions and their holding companies to hold more capital. The impact of the new rules on our financial condition and operations is uncertain but could be materially adverse.

On July 2, 2013, the Federal Reserve adopted a final rule for the Basel III capital framework and, on July 9, 2013, the OCC also adopted a final rule and the FDIC adopted the same provisions in the form of an "interim final rule". These rules substantially amend the regulatory risk-based capital rules applicable to us. The rules phase in over time and began in 2015 and will become fully effective in 2019. The rules apply to the Company as well as the Bank. See "Supervision and Regulation" under Item I Business for further details.

The Bank is subject to further reporting requirements under FDIC regulations.

We are subject to further reporting requirements under the rules of the FDIC for the year ended December 31, 2016 as the Bank's total assets exceed $1.0 billion, including a requirement for management to prepare a report that contains an assessment by management of the Bank's effectiveness of internal control structure and procedures for financial reporting as of the end of such fiscal year. In addition, we are required to obtain an independent public accountant's attestation report concerning our internal control structure over financial reporting. The rules for management to assess the Bank's internal controls over financial reporting are complex, and require significant documentation, testing and possible remediation. The effort to comply with regulatory requirements relating to internal controls cause us to incur increased expenses and a diversion of management's time and other internal resources. If the Bank cannot favorably assess the effectiveness of its internal controls over financial reporting, or if its independent registered public accounting firm is unable to provide an unqualified attestation report on the Bank's internal controls, the price of our common stock as well as investor confidence could be adversely affected and we may be subject to additional regulatory scrutiny.

We are subject to numerous laws designed to protect consumers, including the Community Reinvestment Act, or CRA, and fair lending laws, and failure to comply with these laws could lead to a wide variety of sanctions.

Various laws impose nondiscriminatory lending requirements on financial institutions, including the CRA, the Equal Credit Opportunity Act and the Fair Housing Act. A successful regulatory challenge to an institution's performance under the CRA or fair lending laws and regulations could result in a wide variety of sanctions, including damages and civil money penalties, injunctive relief, restrictions on mergers and acquisitions activity, restrictions on expansion, and restrictions on entering new business lines. Private parties may also have the ability to challenge an institution's performance under fair lending laws in private class action litigation. Such actions could have a material adverse effect on our business, financial condition, results of operations and prospects.

We face a risk of noncompliance and enforcement action with the Bank Secrecy Act and other anti-money laundering statutes and regulations.

Financial institutions are required to institute and maintain an effective anti-money laundering program and file suspicious activity and currency transaction reports as appropriate under The Bank Secrecy Act, The USA PATRIOT ACT of 2001 and certain other laws and regulations. Significant civil penalties can be assessed by a variety of regulators and governmental agencies for violations of these laws and regulations. If our policies, procedures and systems are deemed deficient, we would be subject to liability, including fines and regulatory actions, which may include restrictions on our ability to pay dividends and the necessity to obtain regulatory approvals to proceed with certain aspects of our business plan, including our acquisition plans. Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have serious reputational consequences for us. Any of these results could materially and adversely affect our business, financial condition, results of operations and prospects.

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Item 1B.
Unresolved Staff Comments

None.

Item 2.
Properties

The Bank’s main office is located at 208 Elm Street in New Canaan, Connecticut. The property is leased by us until 2021, with two remaining five-year renewal options. In July 2012, we inititally leased additional space adjacent to 208 Elm Street at 220 Elm Street primarily for our executive management offices. The property located at 220 Elm Street was purchased by the Bank in December of 2016.

We also lease office space for each of our branch offices in New Canaan, Stamford, Norwalk, Fairfield and North Haven Connecticut, and our loan production office in Bridgeport. The leases for our facilities have terms expiring at dates ranging from 2017 to 2029, although certain of the leases contain options to extend beyond these dates. We own the Wilton and Hamden branch offices. We believe that our current facilities are adequate for our current level of operations. Each lease is at market rate based on similar properties in the applicable market area. We believe that we have the necessary infrastructure in place to support our projected growth.

Our branch offices are located as follows:

Branch	Address	Owned or Leased
Elm Street	208 Elm Street New Canaan, CT 06840	Lease (expires 2021)
Cherry Street	156 Cherry Street New Canaan, CT 06840	Lease (expires 2021)
Stamford	612 Bedford Street Stamford, CT 06901	Lease (expires 2020)
Sasco Hill	One Sasco Hill Road Fairfield, CT 06824	Lease (expires 2023)
Black Rock	2220 Black Rock Turnpike Fairfield, CT 06825	Lease (expires 2024)
Wilton	47 Old Ridgefield Road Wilton, CT 06897	Own
Norwalk	370 Westport Avenue Norwalk, CT 06851	Lease (expires 2029)
Hamden	2704 Dixwell Avenue Hamden, CT 06518	Own
North Haven	24 Washington Avenue North Haven, CT 06473	Lease (expires 2017)

Item 3.
Legal Proceedings

From time to time we are a party to various litigation matters incidental to the conduct of our business. We are not presently party to any legal proceedings the resolution of which we believe would have a material adverse effect on our business, future prospects, financial condition, liquidity, results of operation, cash flows or capital levels.

Item 4.
Mine Safety Disclosures

Not applicable.

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PART II

Item 5.

Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The Company's Common Stock has traded on the NASDAQ Global Market under the Symbol "BWFG" since the completion of its initial public offering on May 15, 2014.

The following table sets forth the high and low sales price and the dividends per share of the Company's Common Stock for the last two fiscal years for each quarter as reported on the NASDAQ Global Market.

	2016			2015		
	Sales Price		Cash Dividends Declared	Sales Price		Cash Dividends Declared
	High	Low		High	Low	
Quarter Ended						
March 31	$ 20.00	$ 18.48	$ 0.05	$ 21.12	$ 18.03	$ —
June 30	24.85	19.60	$ 0.05	20.13	17.59	—
September 30	23.74	21.61	$ 0.05	19.79	17.33	—
December 31	34.80	23.00	$ 0.07	20.00	18.00	0.05

There were approximately 383 shareholders of record of BWFG Common Stock as of December 31, 2016. This number does not reflect the number of persons or entities holding stock in nominee name through banks, brokerage firms or other nominees.

The Company's shareholders are entitled to dividends when and if declared by the board of directors, out of funds legally available. The ability of the Company to pay dividends depends, in part, on the ability of the Bank to pay dividends to the Company. In accordance with Connecticut statutes, regulatory approval is required for the Bank to pay dividends in excess of the Bank's profits retained in the current year plus retained profits from the previous two years. The Bank is also prohibited from paying dividends that would reduce its capital ratios below minimum regulatory requirements.

Common Stock Performance Graph

The performance graph below compares the Company's cumulative shareholder return on its common stock since May 15, 2014, the IPO date to the cumulative return of the NASDAQ Composite Index and the NASDAQ Bank Index. Cumulative return assumes the reinvestment of dividends, and is expressed in dollars based on an assumed investment of $100.

There can be no assurance that our stock performance in the future will continue with the same or similar trend depicted in the graph below. We will not make or endorse any predictions as to future stock performance.

Index	05/15/14	12/31/14	12/31/15	12/31/16
Bankwell Financial Group, Inc.	100.00	116.67	110.28	180.56
Nasdaq Composite Index	100.00	116.39	123.05	132.29
Nasdaq Bank Index	100.00	109.89	117.17	158.21

In accordance with the rules of the SEC, this section captioned “Common Stock Performance Graph”, shall not be incorporated by reference into any of our future filings made under the Securities Exchange Act of 1934 or the Securities Act of 1933. The Common Stock Performance Graph, including its accompanying table and footnotes, is not deemed to be soliciting material or to be filed under the Exchange Act or the Securities Act.

Item 6.

Selected Financial Data

The following table sets forth selected consolidated financial data as of the dates and for the periods presented. The selected consolidated statement of financial condition data as of December 31, 2016 and 2015 and the selected consolidated statement of income data for the years ended December 31, 2016, 2015 and 2014 have been derived mainly from our audited consolidated financial statements and related notes that we have included elsewhere in this Annual Report. The selected consolidated statement of financial condition data as of December 31, 2014, 2013 and 2012 and the selected consolidated statement of income data for the years ended December 31, 2013 and 2012 have been derived mainly from audited consolidated financial statements that are not presented in this Annual Report.
The selected historical consolidated financial data as of any date and for any period are not necessarily indicative of the results that may be achieved as of any future date or for any future period. You should read the following selected statistical and financial data in conjunction with the more detailed information contained in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our consolidated financial statements and the related notes that we have presented elsewhere in this Annual Report.

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Selected Financial Data

	At or For the Years Ended December 31,				
	2016	2015	2014	2013	2012
	(Dollars in thousands, except per share data)				
Statements of Income:					
Interest income	$ 60,990	$ 50,754	$ 35,589	$ 28,092	$ 24,397
Interest expense	11,898	7,966	3,929	2,765	3,192
Net interest income	49,092	42,788	31,660	25,327	21,205
Provision for loan losses	3,914	3,230	2,152	585	1,821
Net interest income after provision for loan losses	45,178	39,558	29,508	24,742	19,384
Noninterest income	2,676	3,484	3,041	4,723	345
Noninterest expense	29,544	29,171	25,812	22,120	17,858
Income before income tax	18,310	13,871	6,737	7,345	1,871
Income tax expense	5,960	4,841	2,169	2,184	657
Net income	12,350	9,030	4,568	5,161	1,214
Net income attributable to common shareholders	$ 12,350	$ 8,905	$ 4,458	$ 5,050	$ 1,082
Per Share Data:					
Basic earnings per share	$ 1.64	$ 1.23	$ 0.78	$ 1.46	$ 0.39
Diluted earnings per share	1.62	1.21	0.78	1.44	0.38
Book value per share (end of period)(a)	19.39	17.87	16.84	15.58	14.50
Tangible book value per share (end of period)(a)(b)	18.98	17.43	16.35	15.46	14.50
Shares outstanding (end of period)(a)	7,524,069	7,372,968	7,019,620	3,754,253	2,797,200
Weighted average shares outstanding – basic	7,396,019	7,071,550	5,577,942	3,395,779	2,767,850
Weighted average shares outstanding – diluted	7,491,052	7,140,558	5,605,512	3,451,393	2,864,700
Performance Ratios:					
Return on average assets(c)	0.85%	0.75%	0.52%	0.77%	0.22%
Return on average common shareholders’ equity	8.94%	6.67%	5.13%	9.68%	2.73%
Return on average shareholders’ equity(c)	8.94%	6.76%	4.66%	8.17%	2.40%
Average shareholders’ equity to average assets	9.47%	11.08%	11.14%	9.32%	9.34%
Net interest margin	3.54%	3.77%	3.84%	3.94%	4.11%
Efficiency ratio(b)	56.5%	62.3%	68.7%	75.7%	82.8%
Asset Quality Ratios:					

Total past due loans to total loans(d)	0.47%	0.51%	0.86%	0.73%	0.75%
Nonperforming loans to total loans(d)	0.22%	0.33%	0.36%	0.16%	0.75%
Nonperforming assets to total assets(e)	0.20%	0.38%	0.39%	0.23%	0.81%
Allowance for loan losses to nonperforming loans	612.26%	373.76%	323.02%	835.69%	200.84%
Allowance for loan losses to total loans(d)	1.32%	1.23%	1.17%	1.33%	1.50%
Net charge-offs (recoveries) to average loans(d)	0.01%	(0.01)%	(0.05)%	0.03%	0.07%
Statements of Financial Condition:					
Total assets	$ 1,628,919	$ 1,330,372	$ 1,099,531	$ 779,618	$ 610,016
Gross portfolio loans(d)	1,365,939	1,147,513	929,762	632,012	530,050
Investment securities	104,610	50,807	76,463	42,413	46,412
Deposits	1,289,037	1,046,942	835,439	661,545	462,081
FHLB borrowings	160,000	120,000	129,000	44,000	91,000
Subordinated debt	25,051	25,000	—	—	—
Total equity	145,895	131,769	129,210	69,485	51,534
Capital Ratios:					
Tier 1 capital to average assets(f)					
Bankwell Bank	10.10%	10.84%	11.12%	7.91%	—%
The Bank of New Canaan	—%	—%	—%	—%	7.88%
The Bank of Fairfield	—%	—%	—%	—%	8.39%
Tier 1 capital to risk-weighted assets(f)					
Bankwell Bank	11.59%	12.18%	12.47%	9.49%	—%
The Bank of New Canaan	—%	—%	—%	—%	9.09%
The Bank of Fairfield	—%	—%	—%	—%	10.80%
Total capital to risk-weighted assets(f)					
Bankwell Bank	12.85%	13.39%	13.55%	10.74%	—%
The Bank of New Canaan	—%	—%	—%	—%	10.34%
The Bank of Fairfield	—%	—%	—%	—%	12.05%
Total shareholders' equity to total assets	8.96%	9.90%	11.75%	8.91%	8.45%
Tangible common equity ratio(b)	8.78%	9.68%	10.47%	7.45%	6.65%

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(a)
Excludes preferred stock and unvested restricted stock awards

(b)
This measure is not a measure recognized under GAAP and is therefore considered to be a non-GAAP financial measure. See “Non-GAAP Financial Measures” for a description of this measure and a reconciliation of this measure to its most directly comparable GAAP measure.

(c)
Calculated based on net income before preferred stock dividends

(d)
Calculated using the principal amounts outstanding on loans

(e)
Nonperforming assets consist of nonperforming loans and other real estate owned

(f)
Represents bank ratios. During 2013, The Bank of New Canaan and The Bank of Fairfield were merged into Bankwell Bank.

NON-GAAP FINANCIAL MEASURES

We identify “efficiency ratio”, “tangible common equity ratio”, “tangible book value per share”, “total revenue” and “return on average common shareholders’ equity” as “non-GAAP financial measures.” In accordance with the SEC’s rules, we classify a financial measure as being a non-GAAP financial measure if that financial measure excludes or includes amounts, or is subject to adjustments that have the effect of excluding or including amounts, that are included or excluded, as the case may be, in the most directly comparable measure calculated and presented in accordance with generally accepted accounting principles as in effect from time to time in the United States in our statements of income, balance sheet or statements of cash flows. Non-GAAP financial measures do not include operating and other statistical measures or ratios or statistical measures calculated using exclusively either financial measures calculated in accordance with GAAP, operating measures or other measures that are not non-GAAP financial measures or both.

The non-GAAP financial measures that we discuss in this annual report should not be considered in isolation or as a substitute for the most directly comparable or other financial measures calculated in accordance with GAAP. Moreover, the manner in which we calculate the non-GAAP financial measures that we discuss in this annual report may differ from that of other companies reporting measures with similar names. You should understand how such other banking organizations calculate their financial measures similar or with names similar to the non-GAAP financial measures we have discussed in this annual report when comparing such non-GAAP financial measures.

Efficiency ratio is defined as non-interest expenses, less merger and acquisition related expenses, other real estate owned expenses and amortization of intangible assets, divided by our operating revenue, which is equal to net interest income plus non-interest income excluding gains and losses on sales of securities, gains and losses on other real estate owned and gain on bargain purchase. In our judgment, the adjustments made to operating revenue allow investors and analysts to better assess our operating expenses in relation to our core operating revenue by removing the volatility that is associated with certain one-time items and other discrete items that are unrelated to our core business.

Tangible common equity is defined as total shareholders’ equity, excluding preferred stock, less goodwill and other intangible assets. We believe that this measure is important to many investors in the marketplace who are interested in changes from period to period in common shareholders’ equity exclusive of changes in intangible assets. Goodwill, an intangible asset that is recorded in a purchase business combination, has the effect of increasing both common equity and assets while not increasing our tangible common equity or tangible assets.

Tangible common equity ratio is defined as the ratio of tangible common equity divided by total assets less goodwill and other intangible assets. We believe that this measure is important to many investors in the marketplace who are interested in relative changes from period to period in common equity and total assets, each exclusive of changes in intangible assets. We believe that the most directly comparable GAAP financial measure is total shareholders' equity to total assets.

Tangible book value per share is defined as book value, excluding the impact of goodwill and other intangible assets, if any, divided by shares of our common stock outstanding.

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Total revenue is defined as the sum of net interest income before provision of loan losses and noninterest income.
Return on average common shareholders' equity is defined as net income attributable to common shareholders divided by total average shareholders' equity less average preferred stock.
The information provided below presents a reconciliation of each of our non-GAAP financial measures to the most directly comparable GAAP financial measure.

	Years Ended December 31,		
	2016	2015	2014
Efficiency Ratio			
Noninterest expense	$ 29,544	$ 29,171	$ 25,812
Less: foreclosed real estate expenses	157	168	36
Less: Amortization of Intangibles	151	196	133
Less: merger and acquisition expenses	—	2	1,801
Adjusted noninterest expense (numerator)	$ 29,236	$ 28,805	$ 23,842
Net interest income	$ 49,092	$ 42,788	$ 31,660
Noninterest income	2,676	3,484	3,041
Less: losses on sales of securities	(115)	—	—
Less: gains on sale of foreclosed real estate	128	—	—
Adjusted operating revenue (denominator)	$ 51,755	$ 46,272	$ 34,701
Efficiency ratio	56.5%	62.3%	68.7%
Tangible Common Equity and Tangible Common Equity/Tangible Assets			
Total shareholders' equity	$ 145,895	$ 131,769	$ 129,210
Less: preferred stock	—	—	10,980
Common shareholders' equity	145,895	131,769	118,230
Less: Intangible assets	3,090	3,241	3,437
Tangible Common shareholders' equity	$ 142,805	$ 128,528	$ 114,793
Total assets	$ 1,628,919	$ 1,330,372	$ 1,099,531
Less: Intangible assets	3,090	3,241	3,437
Tangible assets	$ 1,625,829	$ 1,327,131	$ 1,096,094
Tangible common shareholders' equity to tangible assets	8.78%	9.68%	10.47%
Tangible Book Value per Share			
Total shareholders' equity	$ 145,895	$ 131,769	$ 129,210
Less: preferred stock	—	—	10,980
Common shareholders' equity	145,895	131,769	118,230
Less: Intangible assets	3,090	3,241	3,437
Tangible common shareholders' equity	$ 142,805	$ 128,528	$ 114,793
Common shares issued	7,620,663	7,516,291	7,185,482
Less: shares of unvested restricted stock	96,594	143,323	165,862
Common shares outstanding	7,524,069	7,372,968	7,019,620
Book value per share	$ 19.39	$ 17.87	$ 16.84
Less: effects of intangible assets	0.41	0.44	0.49

Tangible Book Value per Common Share	$ 18.98	$ 17.43	$ 16.35

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	Years Ended December 31,		
	2016	2015	2014
Total Revenue			
Net Interest income	$ 49,092	$ 42,788	$ 31,660
Add: noninterest income	2,676	3,484	3,041
Total Revenue	$ 51,768	$ 46,272	$ 34,701
Noninterest income as a percentage of total revenue	5.17%	7.53%	8.76%
Return on Average Common Shareholders' Equity			
Net Income Attributable to Common Shareholders	$ 12,350	$ 8,905	$ 4,458
Total average shareholders' equity	$ 138,131	$ 133,553	$ 97,921
Less: average preferred stock	—	—	10,980
Average common shareholders' equity	$ 138,131	$ 133,553	$ 86,941
Return on Average Common Shareholders' Equity	8.94%	6.67%	5.13%

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

This section presents management's perspective on our financial condition and results of operations. The following discussion and analysis should be read in conjunction with the consolidated financial statements and related notes contained elsewhere in this annual report. To the extent that this discussion describes prior performance, the descriptions relate only to the periods listed, which may not be indicative of future financial outcomes. In addition to historical information, this discussion contains forward looking statements that involve risks, uncertainties and assumptions that could cause results to differ materially from management's expectations. Factors that could cause such differences are discussed in the sections titled "Cautionary Note Regarding Forward-Looking Statements" and "Risk Factors". We assume no obligation to update any of these forward-looking statements.

General

Bankwell Financial Group, Inc. is a bank holding company headquartered in New Canaan, Connecticut. Through our wholly owned subsidiary, Bankwell Bank, or the Bank, we serve small and medium-sized businesses and retail customers in the New York metropolitan area, including Fairfield and New Haven Counties, Connecticut. We have a history of building long-term customer relationships and attracting new customers through what we believe is our strong customer service and our ability to deliver a diverse product offering.

The following discussion and analysis presents our results of operations and financial condition on a consolidated basis. However, because we conduct all of our material business operations through the Bank, the discussion and analysis relates to activities primarily conducted at the Bank.

We generate most of our revenue from interest on loans and investments and fee-based revenues. Our primary source of funding for our loans is deposits. Our largest expenses are interest on these deposits and salaries and related employee benefits. We measure our performance primarily through our net interest margin, efficiency ratio, ratio of allowance for loan losses to total loans, return on average assets and return on average equity, among other metrics, while maintaining appropriate regulatory leverage and risk-based capital ratios.

Executive Overview

We are focused on being the "Hometown" bank and the banking provider of choice in our highly attractive market area, and to serve as a locally based alternative to our larger competitors. We aim to do this through:

- Responsive, customer-centric products and services and a community focus;

-

Strategic acquisitions;

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- Utilization of efficient and scalable infrastructure;

- Disciplined focus on risk management; and

- Organic growth.

On November 5, 2013 we completed the merger of The Wilton Bank into Bankwell Bank. The Wilton Bank had one branch located in Wilton, Connecticut.

On May 15, 2014, Bankwell Financial Group, Inc. priced 2,702,703 common shares in its IPO at $18.00 per share, and on May 15, 2014, Bankwell common shares began trading on the Nasdaq Stock Market. The net proceeds from the IPO were approximately $44.7 million, after deducting the underwriting discount of approximately $2.5 million and approximately $1.3 million of expenses. We used the net proceeds for general corporate purposes, which included maintaining liquidity at the holding company, providing equity capital to the Bank to fund balance sheet growth, our working capital needs, and funding acquisitions of branches and whole financial institutions in or around our existing market that furthered our objectives.

On October 1, 2014 we completed the merger of Quinnipiac Bank and Trust Company into Bankwell Bank. Quinnipiac had one branch located in Hamden, Connecticut and a second branch located in the neighboring town of North Haven, Connecticut.

On August 19, 2015 the Company completed a private placement of $25.5 million in aggregate principal amount of fixed rate subordinated notes (the "Notes") to certain institutional investors. The Notes are non-callable for five years, have a stated maturity of August 15, 2025, and bear interest at a quarterly pay fixed rate of 5.75% per annum to the maturity date or the early redemption date.

On November 20, 2015 the Company redeemed $10.98 million (10,980 shares) of preferred stock issued pursuant to the United States Department of Treasury ("Treasury") under the Small Business Lending Fund Program (the "SBLF"). The shares were redeemed at their liquidation value of $1,000 per share plus accrued dividends through November 20, 2015. The redemption was approved by the Company's primary federal regulator and was funded with the Company's surplus capital. With this redemption, the Company has redeemed all of its outstanding SBLF stock.

On January 27, 2016 the Company's Board of Directors declared a $0.05 per share cash dividend, payable February 22, 2016 to shareholders of record on February 12, 2016. On April 27, 2016 the Company's Board of Directors declared a $0.05 per share cash dividend, payable May 26, 2016 to shareholders of record on May 16, 2016. On July 27, 2016 the Company's Board of Directors declared a $0.05 per share cash dividend, payable August 26, 2016 to shareholders of record on August 16, 2016. On October 26, 2016 the Company's Board of Directors declared a $0.07 per share cash dividend, payable November 28, 2016 to shareholders of record on November 18, 2016, representing a 40% increase when compared to the last quarter.

The primary measures we use to evaluate and manage our financial results are set forth in the table below. Although we believe these measures are meaningful in evaluating our results and financial condition, they may not be directly comparable to similar measures used by other financial services companies and may not provide an appropriate basis to compare our results or financial condition to the results or financial condition of our competitors. The following table sets forth the key financial measures we use to evaluate the success of our business and our financial position and operating performance.

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Key Financial Measures

	Key Financial Measures(a)		
	At or For the Years Ended December 31,		
	2016	2015	2014
	(Dollars in thousands, except per share data)		
Selected balance sheet measures:			
Total assets	$ 1,628,919	$ 1,330,372	$ 1,099,531
Gross portfolio loans	1,365,939	1,147,513	929,762
Deposits	1,289,037	1,046,942	835,439
FHLB borrowings	160,000	120,000	129,000
Subordinated debt	25,051	25,000	—
Total equity	145,895	131,769	129,210
Selected statement of income measures:			
Total revenue(c)	51,768	46,272	34,701
Net interest income before provision for loan losses	49,092	42,788	31,660
Income before income tax expense	18,310	13,871	6,737
Net income	12,350	9,030	4,568
Basic earnings per share	1.64	1.23	0.78
Diluted earnings per share	1.62	1.21	0.78
Other financial measures and ratios:			
Return on average assets(d)	0.85%	0.75%	0.52%
Return on average common shareholders' equity(c)(d)	8.94%	6.67%	5.13%
Net interest margin	3.54%	3.77%	3.84%
Efficiency ratio(c)	56.5%	62.3%	68.7%
Tangible book value per share (end of period)(c)(e)	$ 18.98	$ 17.43	$ 16.35
Net charge-offs (recoveries) to average loans(b)	0.01%	(0.01)%	(0.05)%
Nonperforming assets to total assets(f)	0.20%	0.38%	0.39%
Allowance for loan losses to nonperforming loans	612.26%	373.76%	323.02%
Allowance for loan losses to total loans(b)	1.32%	1.23%	1.17%

(a)
We have derived the selected balance sheet measures as of December 31, 2016 and 2015 and the selected statement of income measures for the years ended December 31, 2016, 2015 and 2014 from our audited consolidated financial statements included elsewhere in this annual report. We have derived the selected balance sheet measures as of December 31, 2014 from our audited consolidated statement of financial condition not included in this annual report. Average balances have been computed using daily averages. Our historical results may not be indicative of our results for any future period.

(b)
Calculated using the principal amounts outstanding on loans.

(c)

This measure is not a measure recognized under GAAP and is therefore considered to be a non-GAAP financial measure. See “Non-GAAP Financial Measures” for a description of this measure and a reconciliation of this measure to its most directly comparable GAAP measure.

(d)
Calculated based on net income before preferred stock dividends.

(e)
Excludes preferred stock and unvested restricted stock awards.

(f)
Nonperforming assets consist of nonperforming loans and other real estate owned.

The Wilton Bank Acquisition

On November 5, 2013, we acquired all of the outstanding common shares of The Wilton Bank. The Wilton Bank was a state chartered commercial bank located in Wilton, Connecticut, which operated as one

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branch. As a result of the transaction, The Wilton Bank merged into the Bank. This business combination expanded our presence in Fairfield County and enhanced opportunities for businesses, customer relationships, employees and the communities we serve.

On the acquisition date, The Wilton Bank had shareholders' equity of $6.3 million, with a book value per share of $17.00. As part of the acquisition, The Wilton Bank shareholders received $13.50 per share resulting in an aggregate deal value of $5.0 million. In accordance with applicable accounting guidance, the amount paid was allocated to the fair value of the net assets acquired, with any excess amounts recorded as goodwill. If the fair value of the net assets is greater than the amount paid, the excess amount is recorded to noninterest income as a gain on the purchase. We recorded a gain of $1.3 million in conjunction with the acquisition, representing the amount that the net assets exceeded the amount paid. Fair values of certain balance sheet items were cash of $35.9 million, loans of $25.1 million and deposits of $64.2 million. The results of The Wilton Bank's operations have been included in our Consolidated Statement of Income from the acquisition date.

Quinnipiac Acquisition

On October 1, 2014, the Company acquired all of the outstanding common shares of Quinnipiac Bank & Trust Company ("Quinnipiac"). Quinnipiac had one branch located in Hamden, Connecticut, and a second branch in the neighboring town of North Haven. Both towns are in New Haven County, Connecticut, which represented a new market for us.

Quinnipiac shareholders received 510,122 shares of the Company common stock and $3.6 million in cash. As of September 30, 2014, Quinnipiac had assets with a carrying value of approximately $117.8 million, including loans outstanding with a carrying value of approximately $97.1 million, as well as deposits with a carrying value of approximately $100.4 million and a book value of $10.1 million. The results of Quinnipiac's operations are included in the Company's Consolidated Statement of Income from the date of acquisition. The Company incurred $1.7 million of merger and acquisition expenses related to the Quinnipiac merger for the year ended December 31, 2014. As a result of the merger the Company recorded $2.6 million of goodwill.

Critical Accounting Policies and Estimates

The discussion and analysis of our results of operations and financial condition are based on our consolidated financial statements, which have been prepared in accordance with GAAP and with general practices within the financial services industry. The preparation of financial statements in conformity with GAAP requires us to make significant estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Actual results could differ from our current estimates, as a result of changing conditions and future events.

We believe that accounting estimates related to the initial measurement of goodwill and intangible assets and subsequent impairment analyses, the allowance for loan losses, stock-based compensation and derivative instrument valuation are particularly critical and susceptible to significant near-term change.

Goodwill and Intangibles

Goodwill represents the excess of the purchase price over the fair value of the net assets acquired in a business combination. Intangible assets are assets acquired in a business combination that lack physical substance but can be distinguished from goodwill because the intangible asset is capable of being sold or exchanged on its own or in combination with related contracts, assets or liabilities. Intangible assets are amortized on a straight-line or accelerated basis over estimated lives. Goodwill is not amortized. Goodwill and identifiable intangible assets are evaluated for impairment annually or whenever events or changes in circumstances indicate the carrying value of these assets may not be recoverable. When these assets are evaluated for impairment, if the carrying amount exceeds fair value, an impairment charge is recorded to income. The fair value is based on observable market prices, when practicable. Other valuation techniques may be used when market prices are unavailable, including estimated discounted cash flows. This type of analysis contains uncertainties because it requires management to make assumptions and to apply judgment to estimate industry economic factors and the profitability of future business strategies. In the event of future changes in fair value, the Company may be exposed to an impairment charge that could be material.

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Allowance for Loan Losses

Determining an appropriate level of allowance for loan losses involves a high degree of judgment. We use a methodology to systematically measure the amount of estimated loan loss exposure inherent in the loan portfolio for purposes of establishing a sufficient allowance for loan losses. The methodology includes elements for specific reserves on impaired loans and loss allocations for non-impaired loans:

Loss allocations are identified for individual loans deemed to be impaired in accordance with GAAP. Impaired loans are loans for which it is probable that the Bank will not be able to collect all amounts due according to the contractual terms of the loan agreements, including non-accrual loans and all loans restructured in a troubled debt restructuring. Impaired loans do not include large groups of smaller-balance homogeneous loans that are collectively evaluated for impairment, which consist of most residential mortgage loans and consumer loans. Impairment is measured on a discounted cash flow method based upon the loan's contractual effective interest rate, or at the loan's observable market price, or if the loan is collateral dependent, at the fair value of the collateral less costs to sell. For collateral dependent loans, management may adjust appraised values to reflect estimated market value declines or apply other discounts to appraised values for unobservable factors resulting from its knowledge of circumstances associated with the property.

Loss allocations for non-impaired loans are based on historical charge-offs adjusted for qualitative factors. Qualitative factors include, but are not limited to, risk ratings, delinquency levels, the value of underlying collateral, concentrations of credit, current economic conditions, the state of the business cycle and competitive and regulatory issues.

Loss allocations for non-impaired commercial loans and commercial mortgage loans are based on an internal rating system and the application of loss allocation factors. The loan rating system is described under the caption "Credit quality indicators" in Note 6 of the Notes to Consolidated Financial Statements. The loan rating system and the related loss allocation factors take into consideration parameters including the borrower's financial condition, the borrower's performance with respect to loan terms, and the adequacy of collateral. The loss allocation factors also take into account general and regional economic statistics, trends, and portfolio characteristics such as age of portfolio and the Bank's experience with a particular loan product. We periodically reassess and revise the loss allocation factors used in the assignment of loss exposure to appropriately reflect our analysis of migrational loss experience.

Portfolios of residential mortgages and consumer loans are assigned loss allocations as groups taking into account delinquency ratios and other indicators and our historical loss experience for each type of credit product. We analyze historical loss experience over periods deemed to be relevant to the inherent risk of loss in loan portfolios as of the balance sheet date. We periodically update these analyses and adjust the loss allocations for various factors that we believe are not adequately presented in historical loss experience including trends in real estate values, changes in unemployment levels and increases in delinquency levels. These factors are also evaluated taking into account the geographic location of the underlying loans.

Because the methodology is based upon peer bank data and trends, current economic data as well as management's judgment, factors may arise that result in different estimations. Adversely different conditions or assumptions could lead to increases in the allowance. In addition, various regulatory agencies periodically review the allowance for loans losses. Such agencies may require additions to the allowance based on their judgments about information available to them at the time of their examination. As of December 31, 2016, management believes that the allowance is adequate and consistent with asset quality and delinquency indicators.

Stock-based Compensation

The Company measures and recognizes compensation cost relating to share-based payment transactions based on the grant-date fair value of the equity instruments issued. The fair value of time-based restricted stock is recorded based on the grant date fair value of the Company's common stock. The fair value of market-based restricted stock is based on values derived using a Monte Carlo based pricing model. The fair value of stock options is determined using the Black-Sholes Option Pricing model. Stock-based compensation costs are recognized over the requisite service period for the awards. Compensation expense reflects the number of awards expected to vest and is adjusted based on awards that ultimately vest.

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Derivative Instrument Valuation
The Company enters into interest rate swap agreements as part of the Company's interest rate risk management strategy. Management applies the hedge accounting provisions of Accounting Standards Codification ("ASC") Topic 815, and formally documents at inception all relationships between hedging instruments and hedged items, as well as its risk management objectives and strategies for undertaking the various hedges. Additionally, the Company uses dollar offset or regression analysis at the hedge's inception and for each reporting period thereafter, to assess whether the derivative used in its hedging transaction is expected to be and has been highly effective in offsetting changes in the fair value or cash flows of the hedged item. The Company discontinues hedge accounting when it is determined that a derivative is not expected to be or has ceased to be highly effective as a hedge, and then reflects changes in fair value of the derivative in earnings after termination of the hedge relationship.
The Company has characterized all of its interest rate swaps that qualify under Topic 815 hedge accounting as cash flow hedges. Cash flow hedges are used to minimize the variability in cash flows of assets or liabilities, or forecasted transactions caused by interest rate fluctuations, and are recorded at fair value in other assets within the consolidated balance sheet. Changes in the fair value of these cash flow hedges are initially recorded in accumulated other comprehensive income and subsequently reclassified into earnings when the forecasted transaction affects earnings. Any hedge ineffectiveness assessed as part of the Company's quarterly analysis is recorded directly to earnings.
Emerging Growth Company
The JOBS Act permits us, as an "emerging growth company", to take advantage of an extended transition period to comply with new or revised accounting standards and not commence complying with new or revised accounting standards until private companies must do so. Under the JOBS Act, we may make an irrevocable election to "opt out" of that extended transition period and comply with new or revised accounting standards when public companies that are not emerging growth companies must commence complying with those standards. We have elected to "opt out" of the extended transition period.
Earnings Overview
2016 Earnings Overview
Our net income for the year ended December 31, 2016 was $12.4 million, an increase of $3.3 million, or 36.8%, compared to the year ended December 31, 2015. Net income available to common shareholders for the year ended December 31, 2016, was $12.4 million, or $1.62 per diluted share, compared to net income available to common shareholders of $8.9 million, or $1.21 per diluted share, for the year ended December 31, 2015. Our returns on average equity and average assets for the year ended December 31, 2016, were 8.94% and 0.85%, respectively, compared to 6.76% and 0.75%, respectively for the year ended December 31, 2015.
The increase in net income for 2016 compared to 2015 was primarily due to an increase of interest and fees on loans as a result of continued strong organic loan growth. Net interest income for the year ended December 31, 2016 was $49.1 million, an increase of $6.3 million compared to the year ended December 31, 2015. Our net interest margin decreased 23 basis points to 3.54% for the year ended December 31, 2016 compared to the year ended December 31, 2015 reflecting higher rates on interest bearing deposits driven by promotional rate increases to remain competitive in the market place and the addition of $25.5 million of 5.75% fixed rate subordinated debentures in August of 2015. Our efficiency ratio was 56.5% for the year ended December 31, 2016 compared to 62.3% for the year ended December 31, 2015. The improvement in our efficiency ratio was attributable to our continued focus on expense control.
2015 Earnings Overview
Our net income for the year ended December 31, 2015 was $9.0 million, an increase of $4.5 million, or 97.7%, compared to the year ended December 31, 2014. Net income available to common shareholders for the year ended December 31, 2015, was $8.9 million, or $1.21 per diluted share, compared to net income

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available to common shareholders of $4.5 million, or $0.78 per diluted share, for the year ended December 31, 2014. Our returns on average equity and average assets for the year ended December 31, 2015, were 6.76% and 0.75%, respectively, compared to 4.66% and 0.52%, respectively for the year ended December 31, 2014.

The increase in net income for 2015 compared to 2014 was primarily due to an increase of interest and fees on loans as a result of strong organic loan growth. Net interest income for the year ended December 31, 2015 was $42.8 million, an increase of $11.1 million compared to the year ended December 31, 2014. Our net interest margin decreased 7 basis points to 3.77% for the year ended December 31, 2015 compared to the year ended December 31, 2014 reflecting an increase in rates on interest bearing deposits driven by promotional rate increases to remain competitive in the market place and to attract additional deposits and the addition of $25.5 million of 5.75% fixed rate subordinated debentures in the third quarter of 2015.

Our efficiency ratio was 62.7% for the year ended December 31, 2015 compared to 69.1% for the year ended December 31, 2014. The improvement in our efficiency ratio was attributable to our focus on expense control and achieving economies of scale.

Results of Operations

Net Interest Income

Net interest income is the difference between interest earned on loans and securities and interest paid on deposits and other borrowings, and is the primary source of our operating income. Net interest income is affected by the level of interest rates, changes in interest rates and changes in the amount and composition of interest-earning assets and interest-bearing liabilities. Included in interest income are certain loan fees, such as deferred origination fees and late charges. We convert tax-exempt income to a FTE basis using the statutory federal income tax rate adjusted for applicable state income taxes net of the related federal tax benefit. The average balances are principally daily averages. Interest income on loans includes the effect of deferred loan fees and costs accounted for as yield adjustments. Premium amortization and discount accretion are included in the respective interest income and interest expense amounts.

Year ended December 31, 2016 compared to year ended December 31, 2015

FTE net interest income for the years ended December 31, 2016 and 2015 was $49.7 million and $43.2 million, respectively. Net interest income increased due to increases in earning assets offset by higher rates and volume on interest bearing deposits driven by promotional rate increases to remain competitive in the market place and the addition of $25.5 million of 5.75% fixed rate subordinated debentures in August of 2015.

FTE basis interest income for the year ended December 31, 2016 increased by $10.3 million to $61.6 million, or 20%, compared to FTE basis interest income for the year ended December 31, 2015 due primarily to growth in interest earning assets, specifically, loan growth in our commercial real estate and commercial business portfolios. Average interest earning assets were $1.4 billion for the year ended December 31, 2016 up by $258.1 million, or 23%, from the year ended December 31, 2015. The average balance of total loans increased $214.3 million, or 21%, contributing $10.1 million to the increase in interest income. The total average balance of securities for the year ended December 31, 2016 increased by $40.9 million, or 69%, from the year ended December 31, 2015, as a result of purchases. The total yield in earnings assets decreased to 4.31% at December 31, 2016 compared to 4.41% at December 31, 2015. The decrease in yield was primarily driven by a decrease in yields on commercial real estate loans and investment securities.

Interest expense for the year ended December 31, 2016, increased by $3.9 million, or 49%, compared to interest expense for 2015 due to an increase in volume and increases in rates on interest bearing deposits driven by promotional rate increases to remain competitive in the market place and the addition of $25.5 million of 5.75% fixed rate subordinated debentures in August of 2015. The weighted average cost of deposits increased 13 basis points to 0.86% due to an increase in rates to attract additional deposits and a change in deposit mix to higher cost time deposits. The weighted average cost of borrowed money increased

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by 42 basis points to 2.19%, due to the addition of the subordinated debt in August of 2015. Average funding liabilities for the year ended December 31, 2016, increased by $223.8 million, or 25%, from the year ended December 31, 2015, primarily due to higher average balances of $159.1 million in time deposits, $53.3 million in money market accounts and $35.1 million in borrowed money.

Year ended December 31, 2015 compared to year ended December 31, 2014

FTE net interest income for the years ended December 31, 2015 and 2014 was $43.2 million and $32.1 million, respectively. Net interest income increased due to increases in earning assets offset by increases in rates on interest bearing deposits driven by promotional rate increases to remain competitive in the market place and to attract additional deposits and the addition of $25.5 million of 5.75% fixed rate subordinated debentures in the third quarter of 2015.

FTE basis interest income for the year ended December 31, 2015 increased by $15.2 million to $51.2 million, or 42%, compared to FTE basis interest income for the year ended December 31, 2014 due primarily to growth in interest earning assets, specifically, loan growth in our commercial real estate and commercial business portfolios. Average interest earning assets were $1.1 billion for the year ended December 31, 2015 up by $310.3 million, or 37%, from the year ended December 31, 2014. The average balance of total loans increased $320.6 million, or 45%, contributing $15.3 million to the increase in interest income. The total average balance of securities for the year ended December 31, 2015 decreased by $2.4 million, or 4%, from the year ended December 31, 2014, as a result of maturities and calls. The total yield in earnings assets increased to 4.41% at December 31, 2015 compared to 4.25% at December 31, 2014. The increase in yield was driven by a shift in the loan portfolio to higher yielding commercial real estate loans as well as increased rates on commercial business loans.

Interest expense for the year ended December 31, 2015, increased by $4.0 million, or 103%, compared to interest expense for 2014 due to increases in rates on interest bearing deposits driven by promotional rate increases to remain competitive in the market place and to attract additional deposits and the addition of $25.5 million of 5.75% fixed rate subordinated debentures in the third quarter of 2015. The weighted average cost of deposits increased 15 basis points to 0.73% due to an increase in rates to attract additional deposits. The weighted average cost of borrowed money increased by 81 basis points to 1.77%, due to the addition of the subordinated debt in the third quarter of 2015. Average funding liabilities for the year ended December 31, 2015, increased by $297.8 million, or 39%, from the year ended December 31, 2014, primarily due to higher average balances of $126.5 million in time deposits, $81.2 million in money market accounts and $63.4 million in borrowed money.

Average balance sheet, FTE basis interest income, interest expense, average yields earned and rates paid

The following table presents average balance sheet information, FTE basis interest income, interest expense and the corresponding average yields earned and rates paid for the years ended December 31, 2016, 2015 and 2014. Tax-exempt income is converted to a FTE basis using the statutory federal income tax rate adjusted for applicable state income taxes net of the related federal tax benefit. The average balances are principally daily averages. Interest income on loans includes the effect of deferred loan fees and costs accounted for as yield adjustments. Premium amortization and discount accretion are included in the respective interest income and interest expense amounts.

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	Years Ended December 31,							
	2016			2015			2014	
	Average Balance	Interest	Yield / Rate	Average Balance	Interest	Yield / Rate	Average Balance	Inte
	(Dollars in thousands)							
Assets:								
Cash and fed funds sold	$ 41,838	$ 173	0.41%	$ 39,632	$ 97	0.25%	$ 49,152	$ 1
Securities(1)	99,905	3,046	3.05	59,009	2,243	3.80	61,398	2
Loans:								
Commercial real estate	772,100	36,496	4.65	611,289	29,835	4.81	378,345	1
Residential real estate	179,096	6,410	3.58	174,527	6,282	3.60	164,598	5
Construction(2)	100,611	4,602	4.50	76,292	3,505	4.53	49,212	2
Commercial business	185,523	9,791	5.19	156,039	8,089	5.11	109,121	5
Home equity	14,951	621	4.16	17,163	649	3.78	14,529	5
Consumer	1,560	81	5.17	2,350	115	4.88	1,270	8
Acquired loans (net of mark)	790	76	9.57	2,672	225	8.42	2,707	5
Total loans	1,254,631	58,077	4.55	1,040,332	48,700	4.62	719,782	3
Federal Home Loan Bank stock	7,366	255	3.46	6,715	168	2.50	5,078	7
Total earning assets	1,403,740	$ 61,551	4.31%	1,145,688	$ 51,208	4.41%	835,410	$ 3
Other assets	54,580			60,191			43,535	
Total assets	$ 1,458,320			$ 1,205,879			$ 878,945	
Liabilities and shareholders' equity:								
Interest-bearing liabilities:								
NOW	$ 56,123	$ 109	0.19%	$ 55,696	$ 62	0.11%	$ 53,041	$ 5
Money market	317,210	1,836	0.58	263,900	1,411	0.53	182,676	8
Savings	72,800	315	0.43	96,841	693	0.72	91,058	3
Time	524,237	6,040	1.15	365,179	3,515	0.96	238,710	2
Total interest-bearing deposits	970,370	8,300	0.86	781,616	5,681	0.73	565,485	3
Borrowed money	164,450	3,598	2.19	129,390	2,285	1.77	65,953	6
Total interest-bearing liabilities	1,134,820	$ 11,898	1.05%	911,006	$ 7,966	0.87%	631,438	$ 3

Noninterest-bearing deposits	172,098			154,950			136,748	
Other liabilities	13,271			6,370			12,838	
Total liabilities	1,320,189			1,072,326			781,024	
Shareholders’ equity	138,131			133,553			97,921	
Total liabilities and shareholders’ equity	$ 1,458,320			$ 1,205,879			$ 878,945	
Net interest income(3)		$ 49,653			$ 43,242			$ 3
Interest rate spread			3.26%			3.54%		
Net interest margin(4)			3.54%			3.77%		

(1)
Average balances and yields for securities are based on amortized cost.

(2)
Includes commercial and residential real estate construction loans.

(3)
The adjustment for securities and loans taxable equivalency was $561 thousand, $454 thousand and $447 thousand, respectively, for the years ended December 31, 2016, 2015 and 2014.

(4)
Net interest income as a percentage of total earning assets.

Effect of changes in interest rates and volume of average earning assets and average interest-bearing liabilities
The following table shows the extent to which changes in interest rates and changes in the volume of average earning assets and average interest-bearing liabilities have affected net interest income. For each category of earning assets and interest-bearing liabilities, information is provided relating to: changes in volume (changes in average balances multiplied by the prior year’s average interest rates); changes in rates (changes in average interest rates multiplied by the prior year’s average balances); and the total change. Changes attributable to both volume and rate have been allocated proportionately based on the relationship of the absolute dollar amount of change in each.
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	Year Ended December 31, 2016 vs 2015 Increase (Decrease)			Year Ended December 31, 2015 vs 2014 Increase (Decrease)		
	Volume	Rate	Total	Volume	Rate	Total
	(In thousands)					
Interest and dividend income:						
Cash and fed funds sold	$ 6	$ 70	$ 76	$ (24)	$ (6)	$ (30)
Securities	1,315	(512)	803	(93)	(88)	(181)
Loans:						
Commercial real estate	7,611	(950)	6,661	11,369	(49)	11,320
Residential real estate	164	(36)	128	358	13	371
Construction	1,110	(13)	1,097	1,245	(40)	1,205
Commercial business	1,550	152	1,702	2,427	166	2,593
Home equity	(88)	60	(28)	100	(15)	85
Consumer	(41)	7	(34)	56	(22)	34
Acquired loans (net of mark)	(176)	27	(149)	(7)	(313)	(320)
Total loans	10,130	(753)	9,377	15,548	(260)	15,288
Federal Home Loan Bank stock	17	70	87	29	66	95
Total change in interest and dividend income	11,468	(1,125)	10,343	15,460	(288)	15,172
Interest expense:						
Deposits:						
NOW	1	46	47	3	1	4
Money market	302	123	425	417	158	575
Savings	(146)	(232)	(378)	20	371	391
Time	1,738	787	2,525	1,201	215	1,416
Total deposits	1,895	724	2,619	1,641	745	2,386
Borrowed money	698	615	1,313	883	768	1,651
Total change in interest expense	2,593	1,339	3,932	2,524	1,513	4,037
Change in net interest income	$ 8,875	$ (2,464)	$ 6,411	$ 12,936	$ (1,801)	$ 11,135

Provision for Loan Losses

The provision for loan losses is based on management’s periodic assessment of the adequacy of our allowance for loan losses which, in turn, is based on such interrelated factors as the composition of our loan portfolio and its inherent risk characteristics, the level of nonperforming loans and net charge-offs, both current and historic, local economic and credit conditions, the direction of real estate values, and regulatory guidelines. The provision for loan losses is charged against earnings in order to maintain our allowance for loan losses and reflects management’s best estimate of probable losses inherent in our loan portfolio at the balance sheet date.

Under accounting standards for business combinations, acquired loans are recorded at fair value with no loan loss allowance on the date of acquisition. A provision for loan losses will be recorded for the emergence of new probable and estimable losses on acquired loans which were not impaired as of the acquisition date. As of and for the year ended December 31, 2016, there was a $99 thousand provision or allowance for loan losses related to the loan portfolio that we acquired.

The provision for loan losses for the year ended December 31, 2016 was $3.9 million compared to a $3.2 million provision for loan losses for the year ended December 31, 2015. The higher 2016 provision for loan losses is attributable to growth in our loan portfolio.

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Noninterest Income

Noninterest income is a component of our revenue and is comprised primarily of fees generated from loan and deposit relationships with our customers, fees generated from sales and referrals of loans, income earned on bank-owned life insurance and gains on sales of investment securities. The following table compares noninterest income for the years ended December 31, 2016, 2015 and 2014.

	Years Ended December 31,			2016/2015 Change		2015/2014 Change	
	2016	2015	2014	$	%	$	%
	(Dollars in thousands)						
Service charges and fees	$ 963	$ 933	$ 643	$ 30	3%	$ 290	45%
Bank owned life insurance	693	727	497	(34)	(5)	230	46
Gains and fees from sales of loans	466	1,113	1,313	(647)	(58)	(200)	(15)
Gain on sale of foreclosed real estate	128	—	—	128	100	—	—
Net loss on sale of available for sale securities	(115)	—	—	(115)	100	—	—
Other	541	711	588	(170)	(24)	123	21
Total noninterest income	$ 2,676	$ 3,484	$ 3,041	$ (808)	(23)%	$ 443	15%

Year ended December 31, 2016 compared to year ended December 31, 2015

Noninterest income totaled $2.7 million for the year ended December 31, 2016, compared to $3.5 million for the year ended December 31, 2015. This decrease was primarily due to a reduction in the gains and fees from the sales of loans and a net loss on the sale of investment securities.

Service charges and fees. We earn fees from our customers for deposit-related services. For the year ended December 31, 2016, service charges and fees totaled $963 thousand. The increase of $30 thousand, or 3%, over the year ended December 31, 2015 was primarily due to increases in ATM and debit card fees, as well as higher volume levels.

Bank Owned Life Insurance. In the fourth quarter of 2016 the Company purchased an additional $9.0 million in bank-owned life insurance coverage. Income earned on bank-owned life insurance decreased $34 thousand, or 5%, from December 31, 2015 compared to December 31, 2016 due to a decline in the average yield in 2016 compared to 2015.

Gains and fees from sales of loans. Loan sales are dependent on sales volume. During the year ended December 31, 2016, the Company recorded $0.5 million in gains on the sale of $7.6 million of loans. For the year ended December 31, 2015, gains and fees from sales of loans totaled $1.1 million on the sale of $31.0 million of loans.

Gain on sale of foreclosed real estate. During the year ended December 31, 2016, the Company recorded $0.1 million in gains on the sale of foreclosed real estate. The Company did not record any gains on the sale of foreclosed real estate in 2015.

Net loss on sale of available for sale securities. During the year ended December 31, 2016, the Company recorded $0.1 million in net losses on the sale of available for sale securities primarily driven by a loss on the sale of a Commonwealth of Puerto Rico senior lien sales tax financing corporate bond. The Company did not record any gains or losses on the sale of available for sale securities in 2015.

Other. We recorded other income of $541 thousand during the year ended December 31, 2016, a decrease of $170 thousand compared to the year ended December 31, 2015. The decrease is primarily due to a decrease in income recognized on the early pay-off of purchased credit impaired loans.

Year ended December 31, 2015 compared to year ended December 31, 2014

Noninterest income totaled $3.5 million for the year ended December 31, 2015, compared to $3.0 million for the year ended December 31, 2014. This increase was primarily due to increases in service charges and fees, and income earned from bank owned life insurance.

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Service charges and fees. We earn fees from our customers for deposit-related services. For the year ended December 31, 2015, service charges and fees totaled $933 thousand. The increase of $290 thousand, or 45%, over the year ended December 31, 2014 was primarily due to increases in ATM fees, debit card fees and non-sufficient fund charges, as well as higher volume levels.

Bank Owned Life Insurance. In the third quarter of 2014 the Company purchased an additional $12.5 million in bank-owned life insurance coverage. Income earned on bank-owned life insurance increased $230 thousand, or 46%, from December 31, 2014 compared to December 31, 2015 due to the full year effect of the purchase executed in the third quarter of 2014.

Gains and fees from sales of loans. Loan sales are dependent on origination volume and are sensitive to interest rates, housing and market conditions. During the year ended December 31, 2015, the Company recorded $1.1 million in gains on the sale of $31.0 million of loans. For the year ended December 31, 2014, gains and fees from sales of loans totaled $1.3 million on the sale of $26.8 million of loans.

Other. We recorded other income of $711 thousand during the year ended December 31, 2015, an increase of $123 thousand compared to the year ended December 31, 2014. The increase is primarily due to income recognized on the early pay-off of purchased credit impaired loans.

Noninterest Expense

The following table compares noninterest expense for the years ended December 31, 2016, 2015 and 2014.

	Years Ended December 31,			2016/2015 Change		2015/2014 Change	
	2016	2015	2014	$	%	$	%
	(Dollars in thousands)						
Salaries and employee benefits	$ 15,956	$ 16,065	$ 13,534	$ (109)	(1)%	$ 2,531	19%
Occupancy and equipment	5,811	5,341	4,422	470	9	919	21
Professional services	1,654	1,447	1,194	207	14	253	21
Data processing	1,603	1,523	1,289	80	5	234	18
Marketing	948	985	674	(37)	(4)	311	46
FDIC insurance	660	672	488	(12)	(2)	184	38
Director fees	558	622	650	(64)	(10)	(28)	(4)
Foreclosed real estate	157	168	36	(11)	(7)	132	367
Amortization of intangibles	151	196	133	(45)	(23)	63	47
Merger and acquisition related expenses	—	2	1,801	(2)	(100)	(1,799)	(100)
Other	2,046	2,150	1,591	(104)	(5)	559	35
Total noninterest expense	$ 29,544	$ 29,171	$ 25,812	$ 373	1%	$ 3,359	13%

Year ended December 31, 2016 compared to year ended December 31, 2015

Noninterest expense was $29.5 million for the year ended December 31, 2016, compared to $29.2 million for the year ended December 31, 2015. The increase of $0.4 million, or 1%, largely reflects higher occupancy and equipment expense, reflecting IT related expenses to support growth initiatives, rent expense related to the opening of the Norwalk branch in March of 2015 and higher professional services expense as a result of an increase in fees paid in relation to strategic initiatives.

Salaries and employee benefits. Salaries and employee benefit costs are the largest component of noninterest expense and include employee payroll expense, equity and non-equity incentive compensation, health insurance, benefit plans and payroll taxes. Salaries and employee benefits decreased by $0.1 million, or 1%, for the year ended December 31, 2016 compared to the year ended December 31, 2015, largely reflecting a slight decline in average full time equivalent employees when compared to the prior year and an increase in the deferral of the salary component of loan origination costs. Average full time equivalent employees totaled 124 at December 31, 2016 and 127 at December 31, 2015.

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Occupancy and equipment. Rent, depreciation and maintenance costs comprise the majority of occupancy and equipment expenses, which increased by $470 thousand, or 9%, for the year ended December 31, 2016, compared to the year ended December 31, 2015. The increase primarily related to IT related expenses to support growth initiatives and rent expense related to the opening of the Norwalk branch in March of 2015.
Professional services. Professional services include legal, audit and professional fees paid to external parties. For the year ended December 31, 2016 professional services increased by $207 thousand, or 14%, compared to the year ended December 31, 2015. The increase in the 2016 expense is primarily driven by an increase in fees paid related to strategic initiatives.
Year ended December 31, 2015 compared to year ended December 31, 2014
Noninterest expense was $29.2 million for the year ended December 31, 2015, compared to $25.8 million for the year ended December 31, 2014. The increase of $3.4 million, or 13%, largely reflects higher salaries and employee benefits, reflecting key staffing additions and higher incentive accruals; and higher occupancy and equipment expense, reflecting higher depreciation as a result of the properties acquired from The Quinnipiac Bank acquisition and depreciation on leasehold improvements from our Norwalk branch that opened in the first quarter of 2015.
Salaries and employee benefits. Salaries and employee benefit costs are the largest component of noninterest expense and include employee payroll expense, equity and non-equity incentive compensation, health insurance, benefit plans and payroll taxes. Salaries and employee benefits increased by $2.5 million, or 19%, for the year ended December 31, 2015 compared to the year ended December 31, 2014, largely reflecting a full year of salary expense recognized from the former Quinnipiac employees who had joined the Bank in the fourth quarter of 2014, key staffing additions, increases in stock-based compensation expense and higher incentive accruals. Average full time equivalent employees totaled 127 at December 31, 2015 and 110 at December 31, 2014.
Occupancy and equipment. Rent, depreciation and maintenance costs comprise the majority of occupancy and equipment expenses, which increased by $919 thousand, or 21%, for the year ended December 31, 2015, compared to the year ended December 31, 2014. The increase primarily related to depreciation associated with the properties acquired from The Quinnipiac Bank, depreciation on leasehold improvements from our Norwalk branch that opened in the first quarter of 2015 and higher rent expense due mainly to the Norwalk Branch.
Professional services. Professional services include legal, audit and professional fees paid to external parties. For the year ended December 31, 2015 professional services increased by $253 thousand, or 21%, compared to the year ended December 31, 2014. The increase in the 2015 expense is primarily driven by increased outsourced internal audit fees.
Marketing. Marketing expenses for the years ended December 31, 2015 and 2014 totaled $985 thousand and $674 thousand, respectively. The increase of $311 thousand, or 46%, reflects costs associated with increased advertising.
FDIC insurance. We are subject to risked-based assessment fees by the FDIC for deposit insurance. For the years ended December 31, 2015 and 2014, FDIC insurance expense was $672 thousand and $488 thousand, respectively. The increase in FDIC insurance expense is driven by increased assessments as a result of increases in our asset base and deposits.
Amortization of intangibles. Amortization of intangibles for the years ended December 31, 2015 and 2014 totaled $196 thousand and $133 thousand, respectively. The increase in amortization of intangibles largely reflects amortization of the core deposit intangible recorded as a result of the Quinnipiac acquisition.
Merger and acquisition related expenses. Merger and acquisition expenses for the years ended December 31, 2015 and 2014 totaled $2 thousand and $1.8 million, respectively. The decrease of $1.8 million reflects legal, consulting, system conversion, severance and marketing expenses incurred as a result of the Quinnipiac acquisition in 2014.

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Other expenses. Other expenses for the years ended December 31, 2015 and 2014 totaled $2.2 million and $1.6 million, respectively. The increase of $559 thousand reflects increases in operating expenses and insurance.

Income Taxes

Income tax expense for the years ended December 31, 2016, 2015 and 2014 totaled $6.0 million, $4.8 million and $2.2 million, respectively. The effective tax rates for the years ended December 31, 2016, 2015 and 2014, were 32.6%, 34.9% and 32.2%, respectively. The decrease in the effective tax rate for the year ended December 31, 2016 is primarily due to the formation of the Passive Investment Company "PIC" (see below).

Our net deferred tax asset at December 31, 2016, was $9.1 million, compared to $8.3 million, at December 31, 2015. The increase in the deferred tax asset at December 31, 2016 is primarily related to increases in deferred tax assets associated with the allowance for loan losses. At December 31, 2016, there were federal net operating loss carry forwards of approximately $2.8 million for which there is no valuation allowance.

On October 8, 2015, the Bank established a new wholly-owned subsidiary, Bankwell Loan Servicing Group, Inc. (a Passive Investment Company "PIC"). The PIC was organized in accordance with Connecticut statutes to hold and manage certain loans that are collateralized by real estate. Income earned by the PIC is exempt from Connecticut income tax and any dividends paid by the PIC to the Bank are not taxable income for Connecticut income tax purposes. See Note 12 to our Consolidated Financial Statements for further information regarding income taxes.

Financial Condition

Summary

Total assets at December 31, 2016 were $1.6 billion, an increase of $298.5 million, or 22%, from the December 31, 2015 balance of $1.3 billion. This increase was primarily due to strong organic loan growth. Loans were $1.3 billion at December 31, 2016, up by $214.1 million from December 31, 2015.

Total liabilities at December 31, 2016 were $1.5 billion, an increase of $284.4 million from the December 31, 2015 balance of $1.2 billion. This increase was primarily due to an increase in deposits and advances from the Federal Home Loan Bank. Shareholders' equity totaled $145.9 million at December 31, 2016, an increase of $14.1 million from December 31, 2015, largely due to net income of $12.4 million and increases in capital due to stock-based compensation and proceeds from the exercise of stock options and warrants, offset by cash dividends declared. The Bank exceeded the regulatory minimum capital levels to be considered well-capitalized with total risk-based capital of 12.85%, tier 1 risk-based capital of 11.59% and tier 1 capital to average assets ratio of 10.10% at December 31, 2016.

Loan Portfolio

The following table compares the composition of our loan portfolio for the dates indicated:

	2016		2015		Change
	Total	%	Total	%	
	(In thousands)				
Real estate loans:					
Residential	$ 181,310	13.27%	$ 177,184	15.44%	$ 4,126
Commercial	845,322	61.89	697,542	60.79	147,780
Construction	107,441	7.87	82,273	7.17	25,168
Home equity	14,419	1.05	15,926	1.39	(1,507)
	1,148,492	84.08	972,925	84.79	175,567
Commercial business	215,914	15.81	172,853	15.06	43,061
Consumer	1,533	0.11	1,735	0.15	(202)
Total loans	$ 1,365,939	100.00%	$ 1,147,513	100.00%	$ 218,426

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Primary loan categories

Residential real estate. Residential real estate loans increased by $4.1 million, or 2% at December 31, 2016 compared to December 31, 2015 and amounted to $181.3 million, representing 13% of total loans at December 31, 2016. We originate residential real estate mortgages for our loan portfolio and for sale in the secondary market. Loans may be sold with servicing retained or released. The mix and volume of residential mortgage loan originations vary in response to changes in market interest rates and customer preferences. During the years ended December 31, 2016 and 2015, the majority of our mortgage originations were comprised of adjustable-rate loans for our loan portfolio. Interest only adjustable-rate mortgage loans comprise 35% of residential real estate loans and 5% of total loans. These loans are underwritten to the same standards as amortizing residential mortgage loans and generally have the same risk profile. We do not believe that these loans present any special risk due, in part, to good borrower demographics (geographic location and per capita income).

Commercial real estate. Commercial real estate loans were $845.3 million and represented 62% of our total loan portfolio, at December 31, 2016, a net increase of $147.8 million, or 21%, from December 31, 2015. Commercial real estate loan growth during these periods largely reflects strong production from experienced lenders in the marketplace and the ability to source quality opportunities, enhanced lending to existing customers and continued economic improvement in our market. Commercial real estate loans are secured by a variety of property types, including office buildings, retail facilities, commercial mixed use and multi-family dwellings.

Commercial business. Commercial business loans were $215.9 million and represented 16% of our total loan portfolio at December 31, 2016, compared to $172.9 million and 15%, of the total portfolio at December 31, 2015. Growth in our commercial business loans largely reflects our commitment to this segment, including small business lending. Commercial business loans primarily provide working capital, equipment financing, financing for leasehold improvements and financing for expansion and are generally secured by assignments of corporate assets, real estate and personal guarantees of the business owners.

Construction. Construction loans were $107.4 million at December 31 2016, up by $25.2 million from December 31, 2015, with $103.2 million attributable to commercial construction and $4.2 million attributable to residential construction. Construction loans totaled $82.3 million at December 31, 2015, of which $70.2 million were commercial construction and $12.1 million were residential construction. Commercial construction loans consist of commercial development projects, such as condominiums, apartment building and single-family subdivisions as well as office buildings, retail and other income producing properties and land loans, while residential construction loans are to individuals to finance the construction of residential dwellings for personal use.

We evaluate the appropriateness of our underwriting standards in response to changes in national and regional economic conditions, including such matters as market interest rates, energy prices, trends in real estate values, and employment levels. Based on our assessment of these matters, underwriting standards and credit monitoring activities are enhanced from time to time in response to changes in these conditions.

The following table presents an analysis of the maturity of our commercial real estate, commercial construction and commercial business loan portfolios as of December 31, 2016.

	December 31, 2016			
	Commercial Real Estate	Commercial Construction	Commercial Business	Total
	(In thousands)			
Amounts due:				
One year or less	$ 13,423	$ 49,113	$ 15,436	$ 77,972
After one year:				
One to five years	188,355	10,890	112,127	311,372
Over five years	643,544	43,236	88,351	775,131
Total due after one year	831,899	54,126	200,478	1,086,503
Total	$ 845,322	$ 103,239	$ 215,914	$ 1,164,475

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The following table presents an analysis of the interest rate sensitivity of our commercial real estate, commercial construction and commercial business loan portfolios due after one year as of December 31, 2016.

	December 31, 2016		
	Adjustable Interest Rate	Fixed Interest Rate	Total
	(In thousands)		
Commercial real estate	$ 301,099	$ 530,800	$ 831,899
Commercial construction	13,461	40,665	54,126
Commercial business	87,102	113,376	200,478
Total loans due after one year	$ 401,662	$ 684,841	$ 1,086,503

Asset Quality

We actively manage asset quality through our underwriting practices and collection operations. Our board of directors monitors credit risk management through two committees, the loan committee and the audit committee. The loan committee has primary oversight responsibility for the credit granting function including approval authority for credit granting policies, review of management’s credit granting activities and approval of large exposure credit requests. The audit committee oversees management’s systems and procedures to monitor the credit quality of our loan portfolio and the loan review program. These committees report the results of their respective oversight functions to our board of directors. In addition, our board of directors receives information concerning asset quality measurements and trends on a monthly basis. While we continue to adhere to prudent underwriting standards, our loan portfolio is not immune to potential negative consequences arising as a result of general economic weakness such as, a prolonged downturn in the housing market on a national scale. Decreases in real estate values could adversely affect the value of property used as collateral for loans. In addition, adverse changes in the economy could have a negative effect on the ability of borrowers to make scheduled loan payments, which would likely have an adverse impact on earnings.

The Company has established credit policies applicable to each type of lending activity in which it engages. The Company evaluates the creditworthiness of each customer and extends credit of up to 80% of the market value of the collateral, depending on the borrowers’ creditworthiness and the type of collateral. The borrower’s ability to service the debt is monitored on an ongoing basis. Real estate is the primary form of collateral. Other important forms of collateral are business assets, time deposits and marketable securities. While collateral provides assurance as a secondary source of repayment, the Company ordinarily requires the primary source of repayment to be based on the borrower’s ability to generate continuing cash flows. The Company’s policy for residential lending allows that, generally, the amount of the loan may not exceed 80% of the original appraised value of the property. In certain situations, the amount may exceed 80% LTV either with private mortgage insurance being required for that portion of the residential loan in excess of 80% of the appraised value of the property or where secondary financing is provided by a housing authority program second mortgage, a community’s low/moderate income housing program, a religious or civic organization. Private mortgage insurance may be required for that portion of the residential first mortgage loan in excess of 80% of the appraised value of the property.

Credit risk management involves a partnership between our relationship managers and our credit approval, credit administration and collections personnel. Disciplined underwriting, portfolio monitoring and early problem recognition are important aspects of maintaining our high credit quality standards and low levels of nonperforming assets since our inception in 2002.

Acquired Loans. Loans acquired in acquisitions are initially recorded at fair value with no carryover of the related allowance for credit losses. Acquired loans that have evidence of deterioration in credit quality since origination and for which it is probable, at acquisition, that all contractually required payments will not be collected are initially recorded at fair value without recording an allowance for loan losses. Determining the fair value of the loans is determined using market participant assumptions in estimating the amount and timing of principal and interest cash flows initially expected to be collected on the loans and discounting those cash flows at an appropriate market rate of interest.

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Under the accounting model for acquired loans, the excess of cash flows expected to be collected over the carrying amount of the loans, referred to as the "accretable yield", is accreted into interest income over the life of the loans using the effective yield method. Accordingly, acquired loans are not subject to classification as nonaccrual in the same manner as originated loans. Rather, acquired loans are considered to be accruing loans because their interest income relates to the accretable yield recognized and not to contractual interest payments. The excess of the loan's contractually required payments over the cash flows expected to be collected is the nonaccretable difference. As such, charge-offs on acquired loans are first applied to the nonaccretable difference and then to any allowance for loan losses recognized subsequent to the acquisition. A decrease in expected cash flows in subsequent periods may indicate that the loan pool is impaired, which would require the establishment of an allowance for loan losses by a charge to the provision for loan losses.

Nonperforming Assets. Nonperforming assets include nonaccrual loans and property acquired through foreclosures or repossession. The following table presents nonperforming assets and additional asset quality data for the dates indicated:

	At December 31,				
	2016	2015	2014	2013	2012
	(In thousands)				
Nonaccrual loans:					
Real estate loans:					
Residential	$ 969	$ 970	$ —	$ 1,003	$ 2,137
Commercial	446	1,264	3,220	—	1,817
Home equity	643	395	—	—	—
Commercial business	538	1,160			
Consumer	341	2	142	—	—
Total non accrual loans	2,937	3,791	3,362	1,003	3,954
Property acquired through foreclosure or repossession, net	272	1,248	950	829	962
Total nonperforming assets	$ 3,209	$ 5,039	$ 4,312	$ 1,832	$ 4,916
Nonperforming assets to total assets	0.20%	0.38%	0.39%	0.23%	0.81%
Nonaccrual loans to total loans	0.22%	0.33%	0.36%	0.16%	0.75%
Total past due loans to total loans	0.47%	0.51%	0.86%	0.73%	0.75%
Accruing loans 90 days or more past due	$ —	$ 1,105	$ 1,998	$ 3,620	$ —

Nonperforming assets totaled $3.2 million and represented 0.20% of total assets at December 31, 2016, compared to $5.0 million and 0.38% of total assets at December 31, 2015.

Nonaccrual loans totaled $2.9 million at December 31, 2016, a decrease of $0.9 million from December 31, 2015. Foreclosed real estate was $0.3 million at December 31, 2016, a decrease of $1.0 million compared to December 31, 2015, as a result of sales of foreclosed real estate during 2016.

Nonaccrual Loans. Loans greater than 90 days past due are put on nonaccrual status (excluding certain acquired credit impaired loans). Loans are also placed on nonaccrual status when, in the opinion of management, full collection of principal and interest is doubtful. Interest previously accrued, but uncollected, is reversed against current period income. Subsequent payments are recognized on the cash basis or principal recapture basis depending on a number of factors including probability of collection and if impairment is identified. A nonaccrual loan is restored to accrual status when it is no longer delinquent and collectability of interest and principal is no longer in doubt. Total nonaccrual loans were $2.9 million at December 31, 2016.

At December 31, 2016 and 2015, there were $0 and $169 thousand in commitments to lend additional funds to any borrower on nonaccrual status, respectively.

Interest income on originated loans that would have been recognized if loans on nonaccrual status had been current in accordance with their original terms for the years ended December 31, 2016, 2015 and 2014 was $17 thousand, $25 thousand and $8 thousand, respectively. The amount of actual interest income recognized on these loans was $74 thousand, $43 thousand and $190 thousand for the years ended December 31, 2016, 2015 and 2014, respectively.

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Past Due Loans. When a loan is 15 days past due, the Company sends the borrower a late notice. The Company also contacts the borrower by phone if the delinquency is not corrected promptly after the notice has been sent. When the loan is 30 days past due, the Company mails the borrower a letter reminding the borrower of the delinquency, and attempts to contact the borrower personally to determine the reason for the delinquency and ensure the borrower understands the terms of the loan. If necessary, subsequent delinquency notices are issued and the account will be monitored on a regular basis thereafter. By the 90th day of delinquency, the Company will send the borrower a final demand for payment or may take other appropriate legal action. A summary report of all loans 30 days or more past due is provided to the board of directors of the Company each month. A loan is considered to be no longer delinquent when timely payments are made for a period of at least six months (one year for loans providing for quarterly or semi-annual payments) by the borrower in accordance with the contractual terms.

The following table presents past due loans as of December 31, 2016 and 2015:

	31 – 60 Days Past Due	61 – 90 Days Past Due	Greater Than 90 Days	Total Past Due
	(In thousands)			
As of December 31, 2016				
Originated Loans				
Residential real estate	$ —	$ —	$ 969	$ 969
Commercial real estate	147	1,848	302	2,297
Home equity	—	173	—	173
Commercial business	—	—	378	378
Total originated loans	147	2,021	1,649	3,817
Acquired Loans				
Commercial real estate	866	722	143	1,731
Home equity	—	—	453	453
Commercial business	99	249	—	348
Consumer	6	—	—	6
Total acquired loans	971	971	596	2,538
Total loans	$ 1,118	$ 2,992	$ 2,245	$ 6,355
As of December 31, 2015				
Originated Loans				
Residential real estate	$ —	$ —	$ 969	$ 969
Commercial real estate	—	311	—	311
Home equity	198	—	—	198
Commercial business	1,078	100	343	1,521
Total originated loans	1,276	411	1,312	2,999
Acquired Loans				
Commercial real estate	333	—	762	1,095
Construction	—	—	801	801
Home equity	100	162	191	453
Commercial business	262	71	101	434
Consumer	17	—	—	17
Total acquired loans	712	233	1,855	2,800

Total loans	$ 1,988	$ 644	$ 3,167	$ 5,799

Troubled Debt Restructurings. Loans are considered restructured in a troubled debt restructuring when the Bank has granted concessions to a borrower due to the borrower's financial condition that we otherwise would not have considered. These concessions may include modifications of the terms of the debt such as reduction of the stated interest rate other than normal market rate adjustments, extension of maturity dates, or reduction of principal balance or accrued interest. The decision to restructure a loan, rather than aggressively enforcing the collection of the loan, may benefit us by increasing the ultimate probability of collection.

Restructured loans are classified as accruing or non-accruing based on management's assessment of the collectability of the loan. Loans which are already on nonaccrual status at the time of the restructuring

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generally remain on nonaccrual status for approximately six months before management considers such loans for return to accruing status. Accruing restructured loans are placed into nonaccrual status if and when the borrower fails to comply with the restructured terms and management deems it unlikely that the borrower will return to a status of compliance in the near term. Except for one non-accrual loans totaling $66 thousand, all TDRs at December 31, 2016 were performing in compliance under their modified terms and therefore, were on accrual status.

Troubled debt restructurings are reported as such for at least one year from the date of the restructuring. In years after the restructuring, troubled debt restructured loans are removed from this classification if the restructuring did not involve a below market rate concession and the loan is not deemed to be impaired based on the terms specified in the restructuring agreement.

The following table presents information on troubled debt restructured loans:

	December 31,				
	2016	2015	2014	2013	2012
	(In thousands)				
Accruing troubled debt restructured loans:					
Residential real estate	$ —	$ 864	$ 1,965	$ 864	$ 864
Commercial real estate	402	4,518	216	—	194
Home equity	69	80	92	97	—
Commercial business	893	779	1,338	642	794
Accruing troubled debt restructured loans	1,364	6,241	3,611	1,603	1,852
Nonaccrual troubled debt restructured loans:					
Commercial real estate	—	970	—	—	—
Commercial business	66	90	—	—	—
Nonaccrual troubled debt restructured loans	66	1,060	—	—	—
Total troubled debt restructured loans	$ 1,430	$ 7,301	$ 3,611	$ 1,603	$ 1,852

As of December 31, 2016 and 2015, loans classified as troubled debt restructurings totaled $1.4 million and $7.3 million, respectively. The $1.4 million balance at December 31, 2016 consists of 10 loans. The $7.3 million balance at December 31, 2015 consisted of 12 loans. The decline in troubled debt restructurings was driven by payoffs.

Potential Problem Loans. We classify certain loans as “special mention”, “substandard”, or “doubtful”, based on criteria consistent with guidelines provided by our banking regulators. Potential problem loans represent loans that are currently performing, but for which known information about possible credit problems of the related borrowers causes management to have doubts as to the ability of such borrowers to comply with the present loan repayment terms and which may result in disclosure of such loans as nonperforming at some time in the future. These loans are not included in the amounts of nonaccrual or restructured loans presented above. We cannot predict the extent to which economic conditions or other factors may impact borrowers and the potential problem loans. Accordingly, there can be no assurance that other loans will not become 90 days or more past due, be placed on nonaccrual, become restructured, or require increased allowance coverage and provision for loan losses. Potential problem loans are assessed for loss exposure using the methods described in Note 6 to our Consolidated Financial Statements under the caption “Credit Quality Indicators”.

We expect the levels of non-performing assets and potential problem loans to fluctuate in response to changing economic and market conditions, and the relative sizes of the respective loan portfolios, along with our degree of success in resolving problem assets. We take a proactive approach with respect to the identification and resolution of problem loans.

Allowance for Loan Losses

We evaluate the adequacy of the allowance at least quarterly, and in determining our allowance for loan losses, we estimate losses on specific loans, or groups of loans, where the probable loss can be

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identified and reasonably determined. The balance of our allowance for loan losses is based on internally assigned risk classifications of loans, historical loan loss rates and subsequent recoveries, changes in the nature of the loan portfolio, overall portfolio quality, industry concentrations, delinquency trends, current economic factors and the estimated impact of current economic conditions on certain historical loan loss rates. See additional discussion regarding our allowance for loan losses under the caption “Critical Accounting Policies and Estimates.”

Our general practice is to identify problem credits early and recognize full or partial charge-offs as promptly as practicable when it is determined that it is probable that the loan will not be repaid according to its original contractual terms, including principal and interest. Full or partial charge-offs on collateral dependent impaired loans are recognized when the collateral is deemed to be insufficient to support the carrying value of the loan. We do not recognize a recovery when an updated appraisal indicates a subsequent increase in value of the collateral.

Our charge-off policies, which comply with standards established by our banking regulators, are consistently applied from period to period. Charge-offs are recorded on a monthly basis, as incurred. Partially charged-off loans continue to be evaluated on a monthly basis and additional charge-offs or loan loss provisions may be recorded on the remaining loan balance based on the same criteria.

The following table presents the activity in our allowance for loan losses and related ratios:

	December 31,				
	2016	2015	2014	2013	2012
	(Dollars in thousands)				
Balance at beginning of period	$ 14,169	$ 10,860	$ 8,382	$ 7,941	$ 6,425
Charge-offs:					
Residential real estate	—	—	—	—	(261)
Commercial real estate	—	—	—	(166)	—
Construction	(7)	—	(100)	—	(60)
Commercial business	(69)	(15)	—	—	—
Consumer	(35)	(15)	(3)	(4)	(5)
Total charge-offs	(111)	(30)	(103)	(170)	(326)
Recoveries:					
Consumer	10	9	425	26	21
Commercial Business	—	100	4	—	—
Total recoveries	10	109	429	26	21
Net charge-offs (recoveries)	101	(79)	(326)	144	305
Provision charged to earnings	3,914	3,230	2,152	585	1,821
Balance at end of period	$ 17,982	$ 14,169	$ 10,860	$ 8,382	$ 7,941
Net charge-offs (recoveries) to average loans	0.01%	(0.01)%	(0.05)%	0.03%	0.07%
Allowance for loan losses to total loans	1.32%	1.23%	1.17%	1.33%	1.50%

At December 31, 2016, our allowance for loan losses was $18.0 million and represented 1.32% of total loans, compared to $14.2 million and 1.23% of total loans, at December 31, 2015. The increase in the ratio of allowance for loan losses to total loans is driven by a shift in the loan portfolio to a higher percentage of commercial loans that require higher reserve allocations due to higher levels of risk. For the years ended December 31, 2016, 2015 and 2014, the provision for loan losses charged to earnings totaled $3.9 million, $3.2 million and $2.2 million, respectively. Net charge-offs for the year ended December 31, 2016 were $101 thousand and represented 0.01% of average loans, primarily reflecting $69 thousand of charge-offs of commercial business loans. For the year ended December 31, 2015, net recoveries were $79 thousand and represented 0.01% of average loans, primarily reflecting a recovery on a commercial business loan.

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The carrying amount of total impaired loans at December 31, 2016 was $4.8 million. This compares to a carrying amount of $10.9 million for total impaired loans at December 31, 2015. The decline in total impaired loans was driven by loan payoffs. The amount of allowance for loan losses related to impaired loans was $418 thousand and $111 thousand, respectively, at December 31, 2016 and 2015.

The following tables present the allocation of the allowance for loan losses and the percentage of these loans to total loans:

	At December 31,					
	2016		2015		2014	
	Amount	Percent of Loan Portfolio	Amount	Percent of Loan Portfolio	Amount	Percent of Loan Portfolio
	(Dollars in thousands)					
Residential real estate	$ 1,646	13.27%	$ 1,444	15.44%	$ 1,431	18.83%
Commercial real estate	9,415	61.89	7,705	60.79	5,480	56.06
Construction	2,105	7.87	1,504	7.17	1,102	6.80
Home equity	156	1.05	174	1.39	205	1.95
Commercial business	4,283	15.81	3,334	15.06	2,638	16.05
Consumer	377	0.11	8	0.15	4	0.31
Total allowance for loan losses	$ 17,982	100.00%	$ 14,169	100.00%	$ 10,860	100.00%

	At December 31,			
	2013		2012	
	Amount	Percent of Loan Portfolio	Amount	Percent of Loan Portfolio
	(Dollars in thousands)			
Residential real estate	$ 1,310	24.66%	$ 1,230	27.22%
Commercial real estate	3,616	49.96	3,842	53.73
Construction	1,032	8.15	929	6.25
Home equity	190	2.14	220	2.08
Commercial business	2,225	14.96	1,718	10.71
Consumer	9	0.13	2	0.01
Total allowance for loan losses	$ 8,382	100.00%	$ 7,941	100.00%

The allocation of the allowance for loan losses at December 31, 2016 reflects our assessment of credit risk and probable loss within each portfolio. We believe that the level of the allowance for loan losses at December 31, 2016 is appropriate to cover probable losses.

Investment Securities

We manage our investment securities portfolio to provide a readily available source of liquidity for balance sheet management, to generate interest income and to implement interest rate risk management strategies. Investment securities are designated as either available for sale, held to maturity or trading at the time of purchase. We do not currently maintain a portfolio of trading securities. Investment securities available for sale may be sold in response to changes in market conditions, prepayment risk, rate fluctuations, liquidity, or capital requirements. Investment securities available for sale are reported at fair value, with any unrealized gains and losses excluded from earnings and reported as a separate component of shareholders' equity, net of tax, until realized. Investment securities held to maturity are reported at amortized cost.

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The amortized cost and fair value of investment securities as of the dates indicated are presented in the following table:

	December 31,					
	2016		2015		2014	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In thousands)					
Securities available for sale:						
U.S. Government and agency obligations	$ 62,457	$ 62,698	$ 7,239	$ 7,143	$ 24,554	$ 24,418
State agency, U.S. Territories and municipal obligations	14,495	14,763	17,060	17,504	17,797	18,584
Corporate bonds	10,167	10,290	11,256	11,437	16,035	16,325
Government mortgage-backed securities	—	—	4,400	4,497	5,567	5,682
Total securities available for sale	$ 87,119	$ 87,751	$ 39,955	$ 40,581	$ 63,953	$ 65,009
Securities held to maturity:						
U.S. Government and agency obligations	$ —	$ —	$ —	$ —	$ 1,010	$ 1,010
State agency, U.S. Territories and municipal obligations	15,710	15,710	9,026	9,026	9,179	9,179
Corporate bonds	1,000	977	1,000	981	1,000	985
Government mortgage-backed securities	149	164	200	221	265	296
Total securities held to maturity	$ 16,859	$ 16,851	$ 10,226	$ 10,228	$ 11,454	$ 11,470

At December 31, 2016, the carrying value of our investment securities portfolio totaled $104.6 million and represented 6% of total assets, compared to $50.8 million and 4% of total assets at December 31, 2015. This increase of $53.8 million primarily reflects purchases. For the year ended December 31, 2016, the Company realized a net loss of $115 thousand from the sales of investment securities, primarily driven by the sale of a Commonwealth of Puerto Rico senior lien sales tax financing corporate bond or “COFINA” bond on November 2, 2016 resulting in a $251.6 thousand realized loss.

The net unrealized gain position on our investment portfolio at December 31, 2016 and 2015 was $624 thousand and $628 thousand, respectively and included gross unrealized losses of $200 thousand and $461 thousand, respectively, as of December 31, 2016 and 2015. The gross unrealized losses at December 31, 2016 and 2015 were concentrated in U.S. Government and agency obligations and state agency, U.S. Territories and municipal obligations reflecting interest rate fluctuation. At December 31, 2016, we determined that there had been no deterioration in credit quality subsequent to purchase and believe that all unrealized losses are temporary. All of our investment securities are investment grade.

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The following tables summarize the amortized cost and weighted average yield of debt securities in our investment securities portfolio as of December 31, 2016 and 2015, based on remaining period to contractual maturity. Information for mortgage-backed securities is based on the final contractual maturity dates without considering repayments and prepayments.

	Due Within 1 Year		Due 1 – 5 Years		Due 5 – 10 Years		Due After 10 Years	
At December 31, 2016	Amortized Cost	Yield	Amortized Cost	Yield	Amortized Cost	Yield	Amortized Cost	Yield
	(In thousands)							
Securities available for sale:								
U.S. Government and agency obligations	$ —	—%	$ 62,357	1.99%	$ —	—%	$ 100	2.50%
State agency and municipal obligations	—	—	827	2.68	8,045	3.54	5,623	4.03
Corporate bonds	2,022	4.78	8,145	2.43	—	—	—	—
Total securities available for sale	$ 2,022	4.78%	$ 71,329	2.05%	$ 8,045	3.54%	$ 5,723	4.00%
Securities held to maturity:								
State agency and municipal obligations	$ —	—%	$ 2,135	3.02%	$ —	—%	$ 13,575	4.96%
Corporate bonds	—	—	1,000	2.00	—	—	—	—
Government mortgage-backed securities	—	—	—	—	—	—	149	5.32
Total securities held to maturity	$ —	—%	$ 3,135	2.70%	$ —	—%	$ 13,724	4.96%

	Due Within 1 Year		Due 1 – 5 Years		Due 5 – 10 Years		Due After 10 Years	
At December 31, 2015	Amortized Cost	Yield	Amortized Cost	Yield	Amortized Cost	Yield	Amortized Cost	Yield
	(In thousands)							
Securities available for sale:								
U.S. Government and agency obligations	$ —	—%	$ 6,198	1.49%	$ 394	2.30%	$ 647	2.91%
State agency, U.S. Territories and municipal obligations	—	—	520	3.00	9,762	3.38	6,778	3.79
Corporate bonds	1,010	4.27	9,233	3.05	1,013	2.60	—	—

Government mortgage-backed securities	—	—	68	3.36	240	2.62	4,092	2.60
Total securities available for sale	$ 1,010	4.27%	$ 16,019	2.44%	$ 11,409	3.20%	$ 11,517	3.32%
Securities held to maturity:								
U.S. Government and agency obligations	$ —	—%	$ —	—%	$ —	—%	$ —	—%
State agency and municipal obligations	—	—	—	—	—	—	9,026	4.65
Corporate bonds	—	—	1,000	2.14	—	—	—	—
Government mortgage-backed securities	—	—	—	—	—	—	200	5.24
Total securities held to maturity	$ —	—%	$ 1,000	2.14%	$ —	—%	$ 9,226	4.89%

Bank Owned Life Insurance or BOLI

BOLI amounted to $33.4 million as of December 31, 2016, reflecting our purchase of $9.0 million in life insurance coverage in the fourth quarter of 2016. The purchase of life insurance policies results in an income-earning asset on our consolidated balance sheet that provides monthly tax-free income to us. We expect to benefit from the BOLI contracts as a result of the tax-free growth in cash surrender value and

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death benefits that are expected to be generated over time. BOLI is included in our Consolidated Balance Sheets at its cash surrender value. Increases in the cash surrender value are reported as a component of noninterest income in our Consolidated Statements of Income.

Deposit Activities and Other Sources of Funds

Our sources of funds include deposits, brokered certificates of deposit, FHLB borrowings, subordinated debt and proceeds from the sales, maturities and payments of loans and investment securities. Total deposits represented 79% of our total assets at December 31, 2016. While scheduled loan and securities repayments are a relatively stable source of funds, loan and investment security prepayments and deposit inflows are influenced by prevailing interest rates and local economic conditions and are inherently uncertain.

Deposits

We offer a wide variety of deposit products and rates to consumer and business customers consistent with FDIC regulations. Our pricing committee meets regularly to determine pricing and marketing initiatives. In addition to being an important source of funding for us, deposits also provide an ongoing stream of fee revenue.

We participate in the Certificate of Deposit Account Registry Service, or CDARS, program. We use CDARS to place customer funds into certificate of deposit accounts issued by other participating banks. These transactions occur in amounts that are less than FDIC insurance limits to ensure that deposit customers are eligible for FDIC insurance on the full amount of their deposits. Reciprocal amounts of deposits are received from other participating banks that do the same with their customer deposits, and, we also execute one-way buy transactions. CDARS deposits are considered to be brokered deposits for bank regulatory purposes. We consider the reciprocal deposit balances to be in-market deposits as distinguished from traditional out-of-market brokered deposits.

Time deposits may also be generated through the use of a listing service. We subscribe to a listing service, accessible to financial institutions, in which we may advertise our time deposit rates in exchange for a set subscription fee. Interested financial institutions then contact us directly to acquire a time certificate of deposit. There is no third party brokerage service involved in this transaction.

The following table sets forth the composition of our deposits for the dates indicated:

	At December 31,					
	2016			2015		
	Amount	Percent	Weighted Average Rate	Amount	Percent	Weighted Average Rate
	(Dollars in thousands)					
Noninterest-bearing demand	$ 187,593	14.55%	—%	$ 164,553	15.72%	—%
NOW	53,851	4.18	0.19	51,008	4.87	0.11
Money market	349,131	27.09	0.58	296,838	28.35	0.53
Savings	96,601	7.49	0.43	97,846	9.35	0.72
Time	601,861	46.69	1.15	436,697	41.71	0.96
Total deposits	$ 1,289,037	100.00%	0.86%	$ 1,046,942	100.00%	0.73%

Total deposits were $1.3 billion at December 31, 2016, an increase of $242.1 million, or 23%, from December 31, 2015.

Time deposits, excluding CDARS and brokered deposits, increased by $162.6 million, or 43%, from year-end 2015, reflecting increased volume driven by promotional rates. Time deposits, excluding CDARS and brokered deposits were $543.7 million at December 31, 2016 compared to the December 31, 2015 balance of $381.1 million and CDARS and brokered deposits were $58.2 million at December 31, 2016 compared to $55.6 million at December 31, 2015.

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During 2016, money market accounts increased $52.3 million, or 18%, reflecting promotions for our premium money market accounts. Noninterest bearing demand deposits increased $23.0 million, or 14%, and NOW accounts increased $2.8 million, or 6%. Savings accounts were $96.6 million at December 31, 2016, down slightly by $1.2 million, or 1%, from December 31, 2015.

At December 31, 2016 and 2015, time deposits, excluding CDARS and brokered deposits, with a denomination of $100 thousand or more totaled $438.7 million and $310.1 million, respectively, maturing during the periods indicated in the table below:

	December 31,	
	2016	2015
	(Dollars in thousands)	
Maturing:		
Within 3 months	$ 54,546	$ 33,685
After 3 but within 6 months	80,091	43,778
After 6 months but within 1 year	81,205	72,090
After 1 year	222,877	160,552
Total	$ 438,719	$ 310,105

The Bank is a member of the FHLB, which is part of a twelve district Federal Home Loan Bank System. Members are required to own capital stock of the FHLB, and borrowings are collateralized by qualifying assets not otherwise pledged (principally single-family residential mortgage loans and securities). The maximum amount of credit that the FHLB will extend varies from time to time, depending on its policies and the amount of qualifying collateral the member can pledge. The Bank had satisfied its collateral requirement at December 31, 2016.

We utilize advances from the FHLB as part of our overall funding strategy and to meet short-term liquidity needs. Total FHLB advances were $160.0 million at December 31, 2016 compared to $120.0 million at December 31, 2015. The increase of $40.0 million reflects normal fluctuations in our borrowings.

Advances from the FHLB include short-term advances with original maturity dates of one year or less. The following table sets forth certain information concerning short-term FHLB advances as of and for the periods indicated in the following table:

	Year Ended December 31,		
	2016	2015	2014
	(Dollars in thousands)		
As of and for the period ending:			
Average amount outstanding during the period	$ 114,426	$ 80,248	$ 37,129
Amount outstanding at end of period	135,000	75,000	107,000
Highest month end balance during the period	150,000	101,000	107,000
Weighted average interest rate at end of period	0.73%	0.46%	0.26%
Weighted average interest rate during the period	0.69%	0.34%	0.23%

The table above includes short term borrowings in a hedging relationship.

On August 19, 2015 the Company completed a private placement of $25.5 million in aggregate principal amount of fixed rate subordinated notes (the “Notes”) to certain institutional investors. The Notes are non-callable for five years, have a stated maturity of August 15, 2025, and bear interest at a quarterly pay fixed rate of 5.75% per annum to the maturity date or the early redemption date.

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Derivative Instruments

The Company uses interest rate swap instruments to fix the interest rate on certain FHLB borrowings, all of which are designated as cash flow hedges. The hedge strategy converts the floating rate of interest on certain FHLB advances to fixed interest rates, thereby protecting the Bank from floating interest rate variability. At December 31, 2016, the Company held derivative financial instruments with a total notional amount of $100.0 million.

Information about derivative instruments at December 31, 2016 and 2015 was as follows:

December 31, 2016:

	Notional Amount	Original Maturity	Received	Paid	Fair Value Asset (Liability)
	(Dollars in thousands)				
Cash flow hedge:					
Interest rate swap on FHLB advance	$ 25,000	4.7 years	3-month LIBOR	1.62%	$ (91)
Interest rate swap on FHLB advance	$ 25,000	5.0 years	3-month LIBOR	1.83%	(138)
Interest rate swap on FHLB advance	$ 25,000	5.0 years	3-month LIBOR	1.48%	249
Interest rate swap on FHLB advance	$ 25,000	5.0 years	3-month LIBOR	1.22%	717
					$ 737

December 31, 2015:

	Notional Amount	Original Maturity	Received	Paid	Fair Value Asset (Liability)
	(Dollars in thousands)				
Cash flow hedge:					
Interest rate swap on FHLB advance	$ 25,000	4.7 years	3-month LIBOR	1.62%	$ (181)
Interest rate swap on FHLB advance	$ 25,000	5.0 years	3-month LIBOR	1.83%	(276)
Interest rate swap on FHLB advance	$ 25,000	5.0 years	3-month LIBOR	1.48%	181
					$ (276)

Liquidity and Capital Resources

Liquidity Management

Liquidity is defined as the ability to generate sufficient cash flows to meet all present and future funding requirements at reasonable costs. Our primary source of liquidity is deposits. While our generally preferred funding strategy is to attract and retain low cost deposits, our ability to do so is affected by competitive interest rates and terms in the marketplace. Other sources of funding include discretionary use of purchased liabilities (e.g., FHLB term advances and other borrowings), cash flows from our investment securities portfolios, loan sales, loan repayments and earnings. Investment securities designated as available for sale may also be sold in response to short-term or long-term liquidity needs.

The Company’s liquidity positions are monitored daily by management. The Asset Liability Committee or ALCO establishes guidelines to ensure maintenance of prudent levels of liquidity. ALCO reports to the Company’s board of directors.

The Bank has a detailed liquidity funding policy and a contingency funding plan that provide for the prompt and comprehensive response to unexpected demands for liquidity. We employ a stress testing methodology to estimate needs for contingent funding that could result from unexpected outflows of funds in excess of “business as usual” cash flows. The Bank has established unsecured borrowing capacity with the

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Bankers' Bank Northeast and also maintains additional collateralized borrowing capacity with the FHLB in excess of levels used in the ordinary course of business. Our sources of liquidity include cash, unpledged investment securities, borrowings from the FHLB and the brokered deposit market.

Capital Resources

Total shareholders' equity was $145.9 million at December 31, 2016, compared to $131.8 million at December 31, 2015. The $14.1 million, or 11%, increase is primarily a result of net income for the year ended December 31, 2016 of $12.4 million and increases in capital due to stock-based compensation and proceeds from the exercise of stock options and warrants, offset by cash dividends declared. The ratio of total equity to total assets was 8.96% at December 31, 2016, which compares to 9.90% at December 31, 2015. Tangible book value per common share at December 31, 2016 and 2015 was $18.98 and $17.43, respectively.

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

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of total and Tier 1 capital to risk weighted assets and of Tier 1 capital to average assets, as defined by regulation. At December 31, 2016, the Bank met all capital adequacy requirements to which it was subject and exceeded the regulatory minimum capital levels to be considered well-capitalized under the regulatory framework for prompt corrective action. At December 31, 2016, the Bank's ratio of common equity tier 1 capital to risk-weighted assets was 11.59%, total capital to risk-weighted assets was 12.85%, Tier 1 capital to risk weighted assets was 11.59% and Tier 1 capital to average assets was 10.10%.

On November 20, 2015 the Company redeemed $10.98 million (10,980 shares) of preferred stock issued pursuant to the United States Department of Treasury ("Treasury") under the Small Business Lending Fund Program (the "SBLF"). The shares were redeemed at their liquidation value of $1,000 per share plus accrued dividends through November 20, 2015. The redemption was approved by the Company's primary federal regulator and was funded with the Company's surplus capital. With this redemption, the Company has redeemed all of its outstanding SBLF stock.

Our shareholders are entitled to dividends when and if declared by our board of directors out of funds legally available. Connecticut law prohibits us from paying cash dividends except from our net profits, which are defined by state statutes. On January 27, 2016 the Company's Board of Directors declared a $0.05 per share cash dividend, payable February 22, 2016 to shareholders of record on February 12, 2016. On April 27, 2016 the Company's Board of Directors declared a $0.05 per share cash dividend, payable May 26, 2016 to shareholders of record on May 16, 2016. On July 27, 2016 the Company's Board of Directors declared a $0.05 per share cash dividend, payable August 26, 2016 to shareholders of record on August 16, 2016. The Company's Board of Directors declared a $0.07 per share cash dividend, payable November 28, 2016 to shareholders of record on November 18, 2016, representing a 40% increase when compared to the last quarter. We did not repurchase any of our common stock during the years ended December 31, 2016, 2015 or 2014.

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Contractual Obligations

The following table summarizes our contractual obligations to make future payments as of December 31, 2016. Payments for borrowings do not include interest. Payments related to leases are based on actual payments specified in the underlying contracts.

	Payments Due by Period				
	Total	Less Than 1 Year	1 – 3 Years	4 – 5 Years	After 5 Years
	(in thousands)				
Contractual Obligations:					
FHLB advances	$ 160,000	$ 135,000	$ —	$ 25,000	$ —
Subordinated Debt	25,500	—	—	—	25,500
Operating lease agreements	19,246	1,687	3,068	2,758	11,733
Time deposits with stated maturity dates	601,861	323,742	277,295	824	—
Total contractual obligations	$ 806,607	$ 460,429	$ 280,363	$ 28,582	$ 37,233

Off-Balance Sheet Instruments

In the normal course of business, we are a party to financial instruments with off-balance sheet risk to meet the financing needs of our customers. These financial instruments include commitments to extend credit and involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the financial statements. The contractual amounts of these instruments reflect the extent of involvement we have in particular classes of financial instruments.

We enter into contractual commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. Substantially all of the Bank’s commitments to extend credit are contingent upon customers maintaining specific credit standards at the time of loan funding. The Bank minimizes its exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures.

Commitments to extend credit totaled $168.4 million and $153.4 million, respectively at December 31, 2016 and 2015. The following table summarizes our commitments to extend credit as of the dates indicated. Since commitments associated with letters of credit and commitments to extend credit may expire unused, the amounts shown do not necessarily reflect the actual future cash funding requirements. We manage our liquidity in light of the aggregate amounts of commitments to extend credit and outstanding standby letters of credit in effect from time to time to ensure that we will have adequate sources of liquidity to fund such commitments and honor drafts under such letters of credit.

As of December 31, 2016

	Amount of Commitment Expiration per Period				
	Total	Less Than 1 Year	1 – 3 Years	4 – 5 Years	After 5 Years
	(in thousands)				
Other Commitments:					
Loan commitments	$ 89,825	$ 32,418	$ 37,681	$ 3,601	$ 16,125
Undisbursed construction loans	70,526	17,878	18,167	6,211	28,270
Unused home equity lines of credit	8,083	367	33	456	7,227
Total other commitments	$ 168,434	$ 50,663	$ 55,881	$ 10,268	$ 51,622

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As of December 31, 2015

	Amount of Commitment Expiration per Period				
	Total	Less Than 1 Year	1 – 3 Years	4 – 5 Years	After 5 Years
	(in thousands)				
Other Commitments:					
Loan commitments	$ 77,181	$ 44,148	$ 10,778	$ 1,110	$ 21,145
Undisbursed construction loans	66,974	12,110	34,628	2,638	17,598
Unused home equity lines of credit	9,258	562	364	376	7,956
Total other commitments	$ 153,413	$ 56,820	$ 45,770	$ 4,124	$ 46,699

Recently Issued Accounting Pronouncements

See Note 1 to our Consolidated Financial Statements for details of recently issued accounting pronouncements and their expected impact on our financial statements.

Item 7A.

Quantitative and Qualitative Disclosures About Market Risk

Asset/Liability Management and Interest Rate Risk

An effective asset/liability management process must balance the risks and rewards from both short and long-term interest rate risks in determining management strategy and action. Our ALCO facilitates and manages this process with the primary goal of maximizing net income and net economic value over time in changing interest rate environments, subject to board of director approved risk limits. ALCO regularly reviews various earnings at risk scenarios for changes in rates, as well as longer-term earnings at risk greater than five years.

The principal strategies we use to manage interest rate risk include (i) emphasizing the origination, purchase and retention of adjustable rate loans, and the origination and purchase of loans with maturities appropriate under the Board of Directors approved risk limits, (ii) investing in debt securities with relatively short maturities and/or average lives and (iii) classifying a significant portion of its investment portfolio as available for sale so as to provide sufficient flexibility in liquidity management. By our strategy of limiting the Bank’s risk to rising interest rates, we are also limiting the benefit of falling interest rates.

We measure interest rate risk using simulation analysis to calculate earnings and equity at risk. These risk measures are quantified using simulation software from one of the leading firms in the field of asset/ liability modeling. Key assumptions relate to the behavior of interest rates and spreads, prepayment speeds and the run-off of deposits. From such simulations, interest rate risk, or IRR, is quantified and appropriate strategies are formulated and implemented.

We model IRR by using two primary risk measurement techniques: simulation of net interest income and simulation of economic value of equity. These two measurements are complementary and provide both short-term and long-term risk profiles for the Company. Because both simulations assume that our balance sheet will remain static over the simulation horizon, the results do not reflect adjustments in strategy that ALCO could implement in response to rate shifts.

We use net interest income at risk simulation to measure the sensitivity of net interest income to changes in market rates. This simulation captures underlying product behaviors, such as asset and liability repricing dates, balloon dates, interest rate indices and spreads, rate caps and floors, as well as other behavioral attributes. The simulation of net interest income also requires a number of key assumptions such as: (i) prepayment projections for loans and securities that are projected under each interest rate scenario using internal and external mortgage analytics; (ii) new business loan rates that are based on recent new business origination experience; and (iii) deposit pricing assumptions that are based on Office of the Comptroller of the Currency, or OCC, guidelines for non-maturity deposits reflecting the Bank’s limited history and management judgment. Combined, these assumptions can be inherently uncertain, and as a result, actual results may differ from simulation forecasts due to the timing, magnitude and frequency of interest rate changes, future business conditions, as well as unanticipated changes in management strategies.

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We use two sets of standard scenarios to measure net interest income at risk. For the “core” scenario, rate changes are ramped over a twelve-month horizon based upon a parallel yield curve shift and then maintained at those levels over the remainder of the simulation horizon. Parallel shock scenarios assume instantaneous parallel movements in the yield curve compared to a flat yield curve scenario. Simulation analysis involves projecting a future balance sheet structure and interest income and expense under the various rate scenarios. Internal policy regarding internal rate risk simulations currently specifies that for instantaneous parallel shifts of the yield curve, estimated net interest income at risk for the subsequent one-year period should not decline by more than: 6% for a 100 basis point shift; 12% for a 200 basis point shift; and 18% for a 300 basis point shift.

The following tables set forth the estimated percentage change in our net interest income at risk over one-year simulation periods beginning December 31, 2016 and 2015:

Parallel Ramp

	Estimated Percent Change in Net Interest Income	
	At December 31,	
Rate Changes (basis points)	2016	2015
-100	(1.60)%	(1.49)%
+200	(2.23)	(2.49)

Parallel Shock

	Estimated Percent Change in Net Interest Income	
	At December 31,	
Rate Changes (basis points)	2016	2015
-100	(3.36)%	(3.47)%
+100	(1.86)	(2.36)
+200	(4.13)	(4.94)
+300	(6.78)	(8.65)

The net interest income at risk simulation results indicate that as of December 31, 2016, we remain liability sensitive. The liability sensitivity is due to the fact that there are more liabilities than assets subject to repricing as market rates change.

We conduct economic value of equity at risk simulation in tandem with net interest income simulations, to ascertain a longer term view of our interest rate risk position by capturing longer-term re-pricing risk and options risk embedded in the balance sheet. It measures the sensitivity of economic value of equity to changes in interest rates. Economic value of equity at risk simulation values only the current balance sheet and does not incorporate the growth assumptions used in income simulation. As with the net interest income simulation, this simulation captures product characteristics such as loan resets, repricing terms, maturity dates, rate caps and floors. Key assumptions include loan prepayment speeds, deposit pricing elasticity and non-maturity deposit attrition rates. These assumptions can have significant impacts on valuation results as the assumptions remain in effect for the entire life of each asset and liability. All key assumptions are subject to a periodic review.

Base case economic value of equity at risk is calculated by estimating the net present value of all future cash flows from existing assets and liabilities using current interest rates. The base case scenario assumes that future interest rates remain unchanged.

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The following table sets forth the estimated percentage change in our economic value of equity at risk, assuming various shifts in interest rates:

Parallel Shock

	Estimated Percent Change in Economic Value of Equity	
	At December 31,	
Rate Changes (basis points)	2016	2015
-100	0.00%	(3.80)%
+100	(9.90)	(7.80)
+200	(21.70)	(17.20)
+300	(31.30)	(25.40)

While ALCO reviews and updates simulation assumptions and also periodically back-tests the simulation results to ensure that the assumptions are reasonable and current, income simulation may not always prove to be an accurate indicator of interest rate risk or future net interest margin. Over time, the repricing, maturity and prepayment characteristics of financial instruments and the composition of our balance sheet may change to a different degree than estimated. Due to the low current level of market interest rates, the banking industry has experienced relatively strong growth in low-cost FDIC insured core savings deposits over the past several years. ALCO recognizes that a portion of these increased levels of low-cost balances could shift into higher yielding alternatives in the future, particularly if interest rates rise and as confidence in financial markets strengthens, and has modeled increased amounts of deposit shifts out of these low-cost categories into higher-cost alternatives in the rising rate simulation scenarios presented above.

It should be noted that the static balance sheet assumption does not necessarily reflect our expectation for future balance sheet growth, which is a function of the business environment and customer behavior. Another significant simulation assumption is the sensitivity of core savings deposits to fluctuations in interest rates. Income simulation results assume that changes in both core savings deposit rates and balances are related to changes in short-term interest rates. Lastly, mortgage-backed securities and mortgage loans involve a level of risk that unforeseen changes in prepayment speeds may cause related cash flows to vary significantly in differing rate environments. Such changes could affect the level of reinvestment risk associated with cash flow from these instruments, as well as their market value. Changes in prepayment speeds could also increase or decrease the amortization of premium or accretion of discounts related to such instruments, thereby affecting interest income.

Impact of Inflation

Our financial statements and related data contained in this annual report have been prepared in accordance with GAAP, which require the measure of financial position and operating results in terms of historic dollars, without considering changes in the relative purchasing power of money over time due to inflation.

Inflation generally increases the costs of funds and operating overhead, and to the extent loans and other assets bear variable rates, the yields on such assets. Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates generally have a more significant effect on the performance of a financial institution than the effects of general levels of inflation. In addition, inflation affects a financial institution’s cost of goods and services purchased, the cost of salaries and benefits, occupancy expense and similar items. Inflation and related increases in interest rates generally decrease the market value of investments and loans held and may adversely affect liquidity, earnings and shareholders’ equity.

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Item 8.

Financial Statements and Supplementary Data

The financial statements and supplementary data required by this item are presented in the order shown below:

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Report of Independent Registered Public Accounting Firm
To the Board of Directors and Shareholders of
Bankwell Financial Group, Inc. and Subsidiary
We have audited the accompanying consolidated balance sheets of Bankwell Financial Group, Inc. and Subsidiary (the “Company”) as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, changes in shareholders’ equity, and cash flows for each of the years in the three-year period ended December 31, 2016. The Company’s management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.
We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.
In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Bankwell Financial Group, Inc. and Subsidiary as of December 31, 2016 and 2015, and the consolidated results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2016, in conformity with accounting principles generally accepted in the United States of America.
/s/ Whittlesey & Hadley, P.C.
Hartford, Connecticut
March 9, 2017

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Bankwell Financial Group, Inc.
Consolidated Balance Sheets
(Dollars in thousands, except share data)

	December 31, 2016	2015
ASSETS		
Cash and due from banks	$ 96,026	$ 49,562
Federal funds sold	329	39,035
Cash and cash equivalents	96,355	88,597
Held to maturity investment securities, at amortized cost	16,859	10,226
Available for sale investment securities, at fair value	87,751	40,581
Loans held for sale	254	—
Loans receivable (net of allowance for loan losses of $17,982 and $14,169 at December 31, 2016 and 2015, respectively)	1,343,895	1,129,748
Foreclosed real estate	272	1,248
Accrued interest receivable	4,958	4,071
Federal Home Loan Bank stock, at cost	7,943	6,554
Premises and equipment, net	17,835	11,163
Bank-owned life insurance	33,448	23,755
Goodwill	2,589	2,589
Other intangible assets	501	652
Deferred income taxes, net	9,085	8,337
Other assets	7,174	2,851
Total assets	$ 1,628,919	$ 1,330,372
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Deposits		
Noninterest bearing deposits	$ 187,593	$ 164,553
Interest bearing deposits	1,101,444	882,389
Total deposits	1,289,037	1,046,942
Advances from the Federal Home Loan Bank	160,000	120,000
Subordinated debentures	25,051	25,000
Accrued expenses and other liabilities	8,936	6,661
Total liabilities	1,483,024	1,198,603
Commitments and contingencies (Note 11)	—	—
Shareholders' equity		
Common stock, no par value; 10,000,000 shares authorized, 7,620,663 and 7,516,291 shares issued at December 31, 2016 and 2015, respectively	115,353	112,579
Retained earnings	29,652	18,963
Accumulated other comprehensive income	890	227
Total shareholders' equity	145,895	131,769

Total liabilities and shareholders' equity	$ 1,628,919	$ 1,330,372

See Notes to Consolidated Financial Statements

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Bankwell Financial Group, Inc.
Consolidated Statements of Income
(Dollars in thousands, except per share amounts)

	Year Ended December 31,		
	2016	2015	2014
Interest and dividend income			
Interest and fees on loans	$ 58,077	$ 48,692	$ 33,403
Interest and dividends on securities	2,740	1,964	2,058
Interest on cash and cash equivalents	173	98	128
Total interest and dividend income	60,990	50,754	35,589
Interest expense			
Interest expense on deposits	8,300	5,681	3,295
Interest on borrowings	3,598	2,285	634
Total interest expense	11,898	7,966	3,929
Net interest income	49,092	42,788	31,660
Provision for loan losses	3,914	3,230	2,152
Net interest income after provision for loan losses	45,178	39,558	29,508
Noninterest income			
Service charges and fees	963	933	643
Bank owned life insurance	693	727	497
Gains and fees from sales of loans	466	1,113	1,313
Gain on sale of foreclosed real estate	128	—	—
Loss on sale of available for sale securities, net	(115)	—	—
Other	541	711	588
Total noninterest income	2,676	3,484	3,041
Noninterest expense			
Salaries and employee benefits	15,956	16,065	13,534
Occupancy and equipment	5,811	5,341	4,422
Professional services	1,654	1,447	1,194
Data processing	1,603	1,523	1,289
Marketing	948	985	674
FDIC insurance	660	672	488
Director fees	558	622	650
Foreclosed real estate	157	168	36
Amortization of intangibles	151	196	133
Merger and acquisition related expenses	—	2	1,801
Other	2,046	2,150	1,591
Total noninterest expense	29,544	29,171	25,812
Income before income tax expense	18,310	13,871	6,737
Income tax expense	5,960	4,841	2,169
Net income	$ 12,350	$ 9,030	$ 4,568

Net income attributable to common shareholders	$ 12,350	$ 8,905	$ 4,458
Earnings Per Common Share:			
Basic	$ 1.64	$ 1.23	$ 0.78
Diluted	$ 1.62	$ 1.21	$ 0.78
Weighted Average Common Shares Outstanding:			
Basic	7,396,019	7,071,550	5,577,942
Diluted	7,491,052	7,140,558	5,605,512
Dividends per common share	$ 0.22	$ 0.05	$ —

See Notes to Consolidated Financial Statements

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Bankwell Financial Group, Inc.
Consolidated Statements of Comprehensive Income
(In thousands)

	Year Ended December 31,		
	2016	2015	2014
Net income	$ 12,350	$ 9,030	$ 4,568
Other comprehensive income (loss):			
Unrealized gains (losses) on securities:			
Unrealized holding (losses) gains on available for sale securities	(109)	(431)	361
Reclassification adjustment for loss realized in net income	115	—	—
Net change in unrealized gain (loss)	6	(431)	361
Income tax effect – (expense) benefit	(2)	192	(141)
Unrealized gains (losses) on securities, net of tax	4	(239)	220
Unrealized gains (losses) on interest rate swaps:			
Unrealized gain (losses) on interest rate swaps designated as cash flow hedges	1,013	(89)	(186)
Tax effect – (expense) benefit	(354)	24	73
Unrealized gains (losses) on interest rate swaps, net of tax	659	(65)	(113)
Total other comprehensive income (loss), net of tax	663	(304)	107
Comprehensive income	$ 13,013	$ 8,726	$ 4,675

See Notes to Consolidated Financial Statements

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Bankwell Financial Group, Inc.
Consolidated Statements of Shareholders' Equity
(In thousands, except share data)

	Number of Outstanding Shares	Preferred Stock	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance at January 1, 2014	3,876,393	$ 10,980	$ 52,105	$ 5,976	$ 424	$ 69,485
Net income	—	—	—	4,568	—	4,568
Other comprehensive income, net of tax	—	—	—	—	107	107
Preferred stock cash dividends	—	—	—	(110)	—	(110)
Stock-based compensation expense	—	—	573	—	—	573
Capital from exercise of stock options	—	—	207	—	—	207
Issuance of 2,702,703 shares, net of expenses	2,702,703	—	44,704	—	—	44,704
Issuance of restricted stock	127,610	—	—	—	—	—
Forfeitures of restricted stock	(51,651)	—	—	—	—	—
Stock options exercised	20,305	—	—	—	—	—
Stock issuance from acquisition of Quinnipiac Bank and Trust Company	510,122	—	9,676	—	—	9,676
Balance at December 31, 2014	7,185,482	10,980	107,265	10,434	531	129,210
Net income	—	—	—	9,030	—	9,030
Other comprehensive loss, net of tax	—	—	—	—	(304)	(304)
Cash dividends declared ($0.05 per share)	—	—	—	(376)	—	(376)
Preferred stock cash dividends	—	—	—	(125)	—	(125)
Redemption of SBLF preferred stock	—	(10,980)	—	—	—	(10,980)
Stock-based compensation expense	—	—	1,033	—	—	1,033

Warrants exercised	269,992	—	3,780	—	—	3,780
Issuance of restricted stock	51,800	—	—	—	—	—
Forfeitures of restricted stock	(25,573)	—	—	—	—	—
Stock options exercised	34,590	—	501	—	—	501
Balance at December 31, 2015	7,516,291	—	112,579	18,963	227	131,769
Net income	—	—	—	12,350	—	12,350
Other comprehensive income, net of tax	—	—	—	—	663	663
Cash dividends declared ($0.22 per share)	—	—	—	(1,661)	—	(1,661)
Stock-based compensation expense	—	—	1,188	—	—	1,188
Warrants exercised	11,200	—	200	—	—	200
Issuance of restricted stock	29,935	—	—	—	—	—
Forfeitures of restricted stock	(883)	—	—	—	—	—
Stock options exercised	64,120	—	1,106	—	—	1,106
Net tax benefit related to stock-based compensation	—	—	280	—	—	280
Balance at December 31, 2016	7,620,663	$ —	$ 115,353	$ 29,652	$ 890	$ 145,895

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Bankwell Financial Group, Inc.
Consolidated Statements of Cash Flows
(In thousands)

	Year Ended December 31,		
	2016	2015	2014
Cash flows from operating activities			
Net income	$ 12,350	$ 9,030	$ 4,568
Adjustments to reconcile net income to net cash provided by operating activities:			
Net amortization of premiums and discounts on investment securities	1,737	99	124
Provision for loan losses	3,914	3,230	2,152
Provision for deferred taxes	(1,104)	(966)	(696)
Net loss on sales of available for sale securities	115	—	—
Depreciation and amortization	1,729	1,685	1,239
Amortization of debt issuance costs	51	—	—
Increase in cash surrender value of bank-owned life insurance	(693)	(727)	(497)
Loan principal sold	(7,636)	(30,309)	(27,282)
Proceeds from sales of loans	7,848	32,008	28,109
Net gain on sales of loans	(466)	(1,113)	(1,313)
Stock-based compensation	1,188	1,033	573
Net (accretion) amortization of purchase accounting adjustments	(136)	(104)	656
Loss on sale and write-downs of foreclosed real estate	25	184	—
Net change in:			
Deferred loan fees	466	668	1,120
Accrued interest receivable	(887)	(748)	(619)
Other assets	(3,006)	(519)	58
Accrued expenses and other liabilities	2,275	779	978
Net cash provided by operating activities	17,770	14,230	9,170
Cash flows from investing activities			
Proceeds from principal repayments on available for sale securities	770	1,877	10,189
Proceeds from principal repayments on held to maturity securities	205	220	2,353
Net proceeds from sales and calls of available for sale securities	60,696	22,030	15,920
Net proceeds from sales and calls of held to maturity securities	—	1,000	—
Purchases of available for sale securities	(110,485)	—	(53,772)
Purchase of held to maturity securities	(6,835)	—	—
Purchase of bank-owned life insurance	(9,000)	—	(12,500)
Acquisition, net of cash paid	—	—	2,546
Net increase in loans	(218,603)	(218,772)	(200,118)
Purchases of premises and equipment	(8,401)	(938)	(2,042)

Purchase of Federal Home Loan Bank stock	(1,389)	(445)	(1,275)
Proceeds from sale of foreclosed real estate	951	400	—
Net cash used by investing activities	(292,091)	(194,628)	(238,699)
Cash flows from financing activities			
Net change in time certificates of deposit	165,224	128,379	111,247
Net change in other deposits	76,930	83,257	(37,973)
Net change in FHLB advances	40,000	(9,000)	78,000
Proceeds from issuance of common stock	200	3,780	44,704
Proceeds from exercise of options	1,106	501	207
Issuance of subordinated debt	—	25,000	—
Redemption of SBLF preferred stock	—	(10,980)	—
Dividends paid on common stock	(1,661)	(376)	—
Dividends paid on preferred stock	—	(125)	(110)
Net tax benefit related to stock-based compensation	280	—	—
Net cash provided by financing activities	282,079	220,436	196,075
Net increase (decrease) in cash and cash equivalents	7,758	40,038	(33,454)
Cash and cash equivalents:			
Beginning of year	88,597	48,559	82,013
End of period	$ 96,355	$ 88,597	$ 48,559
Supplemental disclosures of cash flows information:			
Cash paid for:			
Interest	$ 11,793	$ 7,544	$ 3,985
Income taxes	8,584	6,136	2,222
Acquisition of noncash assets and liabilities:			
Assets acquired	—	—	112,498
Liabilities assumed	—	—	(107,958)
Noncash investing and financing activities			
Loans transferred to foreclosed real estate	—	883	—

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Bankwell Financial Group, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1.

Nature of Operations and Summary of Significant Accounting Policies

Bankwell Financial Group, Inc. (the "Company" or "Bankwell") is a bank holding company headquartered in New Canaan, Connecticut. The Company offers a broad range of financial services through its banking subsidiary, Bankwell Bank, (the "Bank"). In November 2013, the Bank acquired The Wilton Bank ("Wilton"), which added one branch and approximately $25.1 million in loans and $64.2 million in deposits. In addition, in October 2014, the Bank acquired Quinnipiac Bank and Trust Company ("Quinnipiac") which added two branches and approximately $97.8 million in loans and $100.6 million in deposits.

The Bank is a Connecticut state chartered commercial bank, founded in 2002, whose deposits are insured under the Deposit Insurance Fund administered by the Federal Deposit Insurance Corporation ("FDIC"). The Bank provides a full range of banking services to commercial and consumer customers, primarily concentrated in the New York metropolitan area, including the Fairfield and New Haven County regions of Connecticut, with branch locations in New Canaan, Stamford, Fairfield, Wilton, Norwalk, Hamden and North Haven Connecticut.

Many of the Company's activities are with customers located in the New York Metropolitan area, including Fairfield and New Haven Counties and the surrounding region of Connecticut, and declines in property values in these areas could significantly impact the Company. The Company has significant concentrations in commercial real estate loans. Management does not believe they present any special risk. The Company does not have any significant concentrations in any one industry or customer.

Principles of consolidation

The consolidated financial statements include the accounts of the Company and the Bank. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of estimates

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America ("GAAP") and general practices within the banking industry. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosures of contingent assets and liabilities as of the date of the consolidated balance sheet and revenue and expenses for the period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to estimates related to the initial measurement of goodwill and intangible assets and subsequent impairment analyses; the allowance for loan losses; stock-based compensation; and derivative instrument valuation.

Segments

The Company has one reportable segment. All of the Company's activities are interrelated, and each activity is dependent and assessed based on how each of the activities of the Company supports the others. For example, lending is dependent upon the ability of the Company to fund itself with deposits and borrowings while managing the interest rate and credit risk. Accordingly, all significant operating decisions are based upon analysis of the Bank as one segment or unit.

Basis of consolidated financial statement presentation

The consolidated financial statements have been prepared in accordance with GAAP and general practices within the banking industry. Such policies have been followed on a consistent basis.

Cash and Cash Equivalents and Statement of Cash Flows

Cash and due from banks and federal funds sold are recognized as cash equivalents in the consolidated statements of cash flows. Federal funds sold generally mature in one day. For purposes of reporting cash flows, all highly liquid debt instruments purchased with an original maturity of three months or less are considered to be cash equivalents. Cash flows from loans and deposits are reported net. The balances of cash and due from banks and federal funds sold, at times, may exceed federally insured limits. The Company has not experienced any losses from such concentrations.

Investment Securities

Management determines the appropriate classifications of investment securities at the date individual investment securities are acquired, and the appropriateness of such classifications is reaffirmed at each balance sheet date. The Company's investment securities are categorized as either available for sale or held to maturity. Held to maturity investments are carried at amortized cost; available for sale securities are carried at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income (loss) as a separate component of capital, net of estimated income taxes.

Investment securities in the available for sale and held-to-maturity portfolios are reviewed quarterly for other-than-temporary impairment (OTTI). If a debt security is below amortized cost, other-than-temporary impairment is deemed to exist if the present value of the expected future cash flows is less than the amortized cost basis of the security. OTTI is required to be recognized regardless of the credit loss component if the Company intends to sell the security or if it is "more-likely-than-not" that the Company will be required to sell the security before recovery of its amortized cost basis. The credit loss component of an other-than-temporary impairment write-down is recorded in earnings, while the remaining portion of the impairment loss is recognized in other comprehensive income (loss), provided the Company does not intend to sell the underlying debt security and it is more-likely-than-not that the Company will not be required to sell the debt security prior to recovery.

In determining whether a credit loss exists and the period over which the fair value of the debt security is expected to recover, management considers the following factors: the length of time and extent that fair value has been less than cost, the financial condition and near term prospects of the issuer, any external credit ratings, the level of excess cash flows generated from the underlying collateral supporting the principal and interest payments of the debt securities and the level of credit enhancement provided by the structure.

The sale of a held to maturity security within three months of its maturity date or after collection of at least 85% of the principal outstanding at the time the security was acquired is considered a maturity for purposes of classification and disclosure.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Gains or losses on the sales of securities are recognized at trade date utilizing the specific identification method.

Bank Owned Life Insurance

The investment in bank owned life insurance ("BOLI") represents the cash surrender value of life insurance policies on the lives of certain Bank employees who have provided positive consent allowing the Bank to be the beneficiary of such policies. Increases in the cash value of the policies, as well as insurance proceeds received, are recorded in noninterest income, and are not subject to income taxes. The financial strength of the insurance carrier is reviewed prior to the purchase of BOLI and annually thereafter.

Federal Home Loan Bank Stock

Federal Home Loan Bank of Boston ("FHLB") stock is a non-marketable equity security that is carried at cost. There are no quoted market prices for this security and the security is not liquid. The Company can sell these securities back to the FHLB at par.

Loans Held For Sale

Loans held for sale are those loans which management has the intent to sell in the foreseeable future, and are carried at the lower of aggregate cost or market value. Net unrealized losses, if any, are recognized by a valuation allowance through a charge to noninterest income. Realized gains and losses on the sale of loans are recognized on the settlement date and are determined by the difference between the sale proceeds and the carrying value of the loans.

Loans may be sold with servicing rights released or retained. At the time of the sale, management records a servicing asset for the value of any retained servicing rights, which represents the present value of the differential between the contractual servicing fee and adequate compensation, defined as the fee a sub-servicer would require to assume the role of servicer, after considering the estimated effects of prepayments.

Loans Receivable

Loans receivable that management has the ability and intent to hold for the foreseeable future or until maturity or payoff are stated at their current unpaid principal balances, net of the allowance for loan losses, charge-offs, recoveries, net deferred loan origination fees and unamortized loan premiums.

Past due or delinquency status for all loans is based on the number of days past due in accordance with its contractual payment terms.

A loan is considered impaired when it is probable that all contractual principal or interest payments due will not be collected in accordance with the terms of the loan agreement. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan’s effective interest rate or, as a practical expedient, at the loan’s observable market price or the fair value of the collateral, if the loan is collateral dependent. The amount of impairment, if any, and any subsequent changes are recorded as adjustments to the allowance for loan losses. Management reviews all nonaccrual loans, other loans past due 90 days or more, and restructured loans for impairment. In most cases, loan payments that are past due less than 90 days are considered minor collection delays and the related loans are not considered to be impaired. Consumer installment loans are considered to be pools of small balance homogeneous loans, which are collectively evaluated for impairment.

Modifications to a loan are considered to be a troubled debt restructuring (“TDR”) when two conditions are met: 1) the borrower is experiencing financial difficulties and 2) the modification constitutes a concession. Modified terms are dependent upon the financial position and needs of the individual borrower. Debt may be bifurcated with separate terms for each tranche of the restructured debt. The decision to restructure a loan, versus aggressively enforcing the collection of the loan, may benefit the Company by increasing the ultimate probability of collection.

If a performing loan is restructured into a TDR it remains in performing status. If a nonperforming loan is restructured into a TDR, it continues to be carried in nonaccrual status. Nonaccrual classification may be removed if the borrower demonstrates compliance with the modified terms for a minimum of six months. TDR’s are reported as such for at least one year from the date of restructuring. In years after the restructuring, troubled debt restructured loans are removed from this classification if the restructuring agreement specifies a market rate of interest equal to that which would be provided to a borrower with similar credit at the time of restructuring and the loan is not deemed to be impaired based on the modified terms.

Acquired Loans

Loans that the Company acquires in acquisitions are initially recorded at fair value with no carryover of the related allowance for credit losses. Determining the fair value of acquired loans involves estimating the amount and timing of principal and interest cash flows initially expected to be collected on the loans and discounting those cash flows at an appropriate market rate of interest.

For loans which meet the criteria stipulated in Accounting Standards Codification (“ASC”) 310-30, “Loans and Debt Securities Acquired with Deteriorated Credit Quality”, the Company recognizes an accretable yield, which is defined as the excess of all cash flows expected at acquisition over the initial fair

value of the loan, as interest income on a level-yield basis over the expected remaining life of the loan. The excess of the loan's contractually required payments over the cash flows expected to be collected is the nonaccretable difference. The nonaccretable difference is not recognized as an adjustment of yield, a loss accrual, or a valuation allowance.
After the initial acquisition, the Company continues to evaluate whether the timing and the amount of cash to be collected are reasonably estimated. Subsequent significant increases in cash flows the Company expects to collect will first reduce previously recognized valuation allowance and then be reflected prospectively as an increase to the level yield. Subsequent decreases in expected cash flows may result in the loan being considered impaired. Interest income is not recognized to the extent that the net investment in the loan would increase to an amount greater than the estimated payoff amount.
For ASC 310-30 loans, the expected cash flows reflect anticipated prepayments, determined on a loan by loan basis, according to the anticipated collection plan of these loans. Prepayments result in the recognition of the nonaccretable balance as current period yield. Changes in prepayment assumptions may change the amount of interest income and principal expected to be collected. The expected prepayments used to determine the accretable yield are consistent between the cash flows expected to be collected and projections of contractual cash flows so as to not affect the nonaccretable difference.
For loans that do not meet the ASC 310-30 criteria, the Company records interest income on a level yield basis using the contractually required cash flows. The Company subjects loans that do not meet the ASC 310-30 criteria to ASC Topic 450, "Contingencies", by collectively evaluating these loans for an allowance for loan loss, using the same methodology as loans originated by the Company.
Acquired loans that met the criteria for nonaccrual of interest prior to the acquisition are considered performing upon acquisition, regardless of whether the customer is contractually delinquent, if the Company can reasonably estimate the timing and amount of the expected cash flows on such loans and if the Company expects to fully collect the new carrying value of the loans. As such, the Company may no longer consider the loan to be nonaccrual or nonperforming and may accrue interest on these loans, including the impact of any accretable yield. The Company has determined that it can reasonably estimate future cash flows on the Company's current portfolio of acquired loans that are past due 90 days or more, and on which the Company is accruing interest and the Company expects to fully collect the carrying value of the loans.

Allowance For Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance for loan losses when management believes the non-collectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance for loan losses.
The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.
The allowance for loan losses consists of specific and general components. The specific component relates to impaired loans that are classified as doubtful, substandard or special mention. For these loans, an allowance is established when the discounted cash flows, collateral value or observable market price of the impaired loan is lower than the carrying value of that loan. The general component covers non classified loans and is based on historical loss experience adjusted for qualitative factors, and includes unallocated components maintained to cover uncertainties that could affect management's estimation of probable losses, and reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

Management believes the allowance for loan losses is adequate. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the allowance for loan losses. Such agencies have the authority to require additions to the allowance or charge-offs based on the agencies' judgments about information available to them at the time of their examination.

Interest and Fees on Loans

Interest on loans is accrued and included in income based on contractual rates applied to principal amounts outstanding. Accrual of interest is discontinued when loan payments are 90 days or more past due, based on contractual terms, or when, in the judgment of management, collectability of the loan or loan interest becomes uncertain. When interest accrual is discontinued, all unpaid accrued interest is reversed against interest income. Subsequent recognition of income occurs only to the extent payment is received subject to management's assessment of the collectability of the remaining interest and principal. A nonaccrual loan is restored to accrual status when it is no longer delinquent and collectability of interest and principal is no longer in doubt.

Loan origination fees, net of direct loan origination costs, are deferred and amortized as an adjustment to the loan's yield generally over the contractual life of the loan, utilizing the interest method.

Goodwill and Intangibles

Goodwill represents the excess of the purchase price over the fair value of the net assets acquired in a business combination. Intangible assets are assets acquired in a business combination that lack physical substance but can be distinguished from goodwill because the intangible asset is capable of being sold or exchanged on its own or in combination with related contracts, assets or liabilities. Intangible assets are amortized on a straight-line or accelerated basis over estimated lives. Goodwill is not amortized. Goodwill and identifiable intangible assets are evaluated for impairment annually or whenever events or changes in circumstances indicate the carrying value of these assets may not be recoverable. When these assets are evaluated for impairment, if the carrying amount exceeds fair value, an impairment charge is recorded to income. The fair value is based on observable market prices, when practicable. Other valuation techniques may be used when market prices are unavailable, including estimated discounted cash flows. This type of analysis contains uncertainties because it requires management to make assumptions and to apply judgment to estimate industry economic factors and the profitability of future business strategies. In the event of future changes in fair value, the Company may be exposed to an impairment charge that could be material.

Foreclosed Real Estate

Assets acquired through deed in lieu or loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Operating costs after acquisition are expensed.

Premises and Equipment

Premises and equipment are stated at cost, net of accumulated depreciation and amortization. Leasehold improvements are capitalized and amortized over the shorter of the terms of the related leases or the estimated economic lives of the improvements. Depreciation and amortization is charged to operations using the straight-line method over the estimated useful lives of the related assets which range from three to thirty nine years. Gains and losses on dispositions are recognized upon realization. Maintenance and repairs are expensed as incurred and improvements are capitalized.

Income Taxes

Deferred income taxes are recognized for the tax consequences of temporary differences by applying enacted statutory tax rates applicable for future years to differences between financial statement and tax bases of existing assets and liabilities. The effect of tax rate changes on deferred taxes is recognized in the income tax provision in the period that includes the enactment date. A tax valuation allowance is established, as needed, to reduce net deferred tax assets to the amount expected to be realized. In the event it becomes more-likely-than-not that some or all of the deferred tax asset allowances will not be needed, the valuation allowance will be adjusted.

In the ordinary course of business there is inherent uncertainty in quantifying the Company's income tax positions. Income tax positions and recorded tax benefits assessed for all years are subject to examination based upon management's evaluation of the facts, circumstances, and information available at the reporting date. For those tax positions where it is more-likely-than-not that a tax benefit will be sustained, we have determined the amount of the tax benefit to be recognized by estimating the largest amount of tax benefit that has a greater than 50% likelihood of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. For those income tax positions where it is not more-likely-than-not that a tax benefit will be sustained, no tax benefit has been recognized in the financial statements. Where applicable, associated interest and penalties have also been recognized. We recognize accrued interest and penalties related to unrecognized tax benefits as a component of income tax expense.

Stock Compensation

The Company measures and recognizes compensation cost relating to share-based payment transactions based on the grant-date fair value of the equity instruments issued. The fair value of time-based restricted stock is recorded based on the grant date fair value of the Company's common stock. The fair value of market-based restricted stock is based on values derived using a Monte Carlo based pricing model. The fair value of stock options is determined using the Black-Sholes Option Pricing model. Stock-based compensation costs are recognized over the requisite service period for the awards. Compensation expense reflects the number of awards expected to vest and is adjusted based on awards that ultimately vest.

Income tax benefits related to stock compensation in excess of grant date fair value, less any proceeds on exercise, are recognized as an increase to additional paid-in capital upon vesting or exercising and delivery of the stock. Any income tax benefits that are less than grant date fair value less any proceeds on exercise would be recognized as a reduction of additional paid-in capital to the extent of previously recognized income tax benefits and then as compensation expense for the remaining amount.

Earnings Per Share

Basic earnings per share ("EPS") is computed by dividing income available to common shareholders by the weighted-average number of shares of common stock outstanding for the period. Diluted EPS reflects the potential dilution that could occur if dilutive stock options and restricted stock awards were exercised and resulted in the issuance of common stock. Unvested share-based payment awards, that include the right to receive non forfeitable dividends, are considered participating securities and therefore considered to be outstanding in the computation of earnings per share. EPS is calculated using the two class method, under which calculations (1) exclude from the numerator any dividends paid or owed on participating securities and any undistributed earnings considered to be attributable to participating securities and (2) exclude from the denominator the dilutive impact of the participating securities.

Comprehensive Income

Accounting principles generally require that recognized revenues, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities and cash flow hedge transactions, are reported as a separate component of the stockholders' equity section of the balance sheets, such items, along with net income, are components of comprehensive income.

Fair Values of Financial Instruments

The Company is required to disclose the fair value for all financial instruments.

The following methods and assumptions were used by management in estimating the fair value of its financial instruments:

Cash and due from banks, federal funds sold and accrued interest receivable: The carrying amount is a reasonable estimate of fair value.

Investment securities: Fair values are based on quoted market prices or dealer quotes, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities. The fair value of securities is further classified in accordance with the framework specified in GAAP as discussed in Note 19, Fair Value Measurements.

FHLB stock: The carrying value of FHLB stock approximates fair value based on the most recent redemption provisions of the FHLB.

Loans held for sale: The fair value is based upon prevailing market prices.

Loans receivable: For variable rate loans which reprice frequently and have no significant change in credit risk, fair values are based on carrying values. The fair value of fixed rate loans are estimated by discounting the future cash flows using the year end rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

Derivative asset (liability): The valuation of the Company’s interest rate swaps is obtained from a third party pricing service and is determined using a discounted cash flow analysis on the expected cash flows of each derivative. The pricing analysis is based on observable inputs for the contractual terms of the derivatives, including the period to maturity and interest rate curves.

Deposits: The fair value of demand deposits, regular savings and certain money market deposits is the amount payable on demand at the reporting date. The fair value of certificates of deposit and other time deposits is estimated using a discounted cash flow calculation that applies interest rates currently being offered for deposits of similar remaining maturities to a schedule of aggregated expected maturities on such deposits.

Borrowings and Subordinated Debentures: The fair value of the Company’s borrowings and subordinated debentures is estimated using a discounted cash flow calculation that applies discount rates currently offered based on similar maturities.

Derivative Instruments

The Company enters into interest rate swap agreements as part of the Company’s interest rate risk management strategy. Management applies the hedge accounting provisions of Accounting Standards Codification (“ASC”) Topic 815, and formally documents at inception all relationships between hedging instruments and hedged items, as well as its risk management objectives and strategies for undertaking the various hedges. Additionally, the Company uses dollar offset or regression analysis at the hedge’s inception and for each reporting period thereafter, to assess whether the derivative used in its hedging transaction is expected to be and has been highly effective in offsetting changes in the fair value or cash flows of the hedged item. The Company discontinues hedge accounting when it is determined that a derivative is not expected to be or has ceased to be highly effective as a hedge, and then reflects changes in fair value of the derivative in earnings after termination of the hedge relationship.

The Company has characterized all of its interest rate swaps that qualify under Topic 815 hedge accounting as cash flow hedges. Cash flow hedges are used to minimize the variability in cash flows of assets or liabilities, or forecasted transactions caused by interest rate fluctuations, and are recorded at fair value in other assets within the consolidated balance sheet. Changes in the fair value of these cash flow hedges are initially recorded in accumulated other comprehensive income and subsequently reclassified into earnings when the forecasted transaction affects earnings. Any hedge ineffectiveness assessed as part of the Company's quarterly analysis is recorded directly to earnings.

Reclassification

Certain prior period amounts have been reclassified to conform to the 2016 financial statement presentation. These reclassifications only changed the reporting categories and did not affect the results of operations or consolidated financial position.

Recent accounting pronouncements

The following section includes changes in accounting principles and potential effects of new accounting guidance and pronouncements.

ASU No. 2014-09 — Revenue from Contracts with Customers (Topic 606). The ASU establishes a single comprehensive model for an entity to recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled, and will supersede nearly all existing revenue recognition guidance, to clarify and converge revenue recognition principles under US GAAP and IFRS. The update outlines five steps to recognizing revenue: (i) identify the contracts with the customer; (ii) identify the separate performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the separate performance obligations; (v) recognize revenue when each performance obligation is satisfied. The update requires more comprehensive disclosures, relating to quantitative and qualitative information for amounts, timing, the nature and uncertainty of revenue, and cash flows arising from contracts with customers, which will mainly impact construction and high-tech industries. The most significant potential impact to banking entities relates to less prescriptive derecognition requirements on the sale of OREO property. In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date. The amendments in ASU 2015-14 defer the effective date of ASU 2014-09 for all entities by one year. Accordingly, the amendments are effective for annual and interim periods beginning after December 15, 2017. Early adoption is permitted for annual and interim reporting periods beginning after December 15, 2016. An entity may elect either a full retrospective or a modified retrospective application. The Company does not expect the application of this guidance to have a material impact on the Company's financial statements.

ASU No. 2014-12, Compensation — Stock Compensation (Topic 718): "Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period (a consensus of the FASB Emerging Issues Task Force)." The ASU provides explicit guidance to account for a performance target that could be achieved after the requisite service period as a performance condition. For awards within the scope of this update, the Task Force decided that an entity should apply existing guidance in Topic 718 as it relates to share-based payments with performance conditions that affect vesting. Consistent with that guidance, performance conditions that affect vesting should not be reflected in estimating the fair value of an award at the grant date. Compensation cost should be recognized when it is probable that the performance target will be achieved and should represent the compensation cost attributable to the period for which the requisite service has already been rendered. If the performance target becomes probable of being achieved before the end of the requisite service period, the remaining unrecognized compensation cost should be recognized prospectively over the remaining requisite service period. The total amount of compensation cost recognized during and after the requisite service period should reflect the number of awards that are expected to vest and should be adjusted to reflect those awards that ultimately vest. The amendments were effective for the Company as of January 1, 2016. This ASU did not impact the Company's financial statements and the Company does not expect the application of this guidance will have a material impact on the Company's financial statements in the future.

ASU No. 2015-03, Interest Imputation of Interest (Subtopic 835-20): "Simplifying the Presentation of Debt Issuance Costs." The amendments in this ASU require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this ASU. The amendments are effective for annual and interim periods beginning after December 15, 2015, with early adoption permitted. The Company elected to early adopt the provisions of ASU 2015-03 upon issuance of its subordinated debentures on August 19, 2015 and recorded $0.5 million of debt issuance costs incurred as a direct deduction from the debt liability.

ASU No. 2016-01, Financial Instruments — Overall (Subtopic 825-10): “Recognition and Measurement of Financial Assets and Financial Liabilities.” The ASU has been issued to improve the recognition and measurement of financial instruments by requiring 1) equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; 2) separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements; 3) the use of the exit price notion when measuring fair value of financial instruments for disclosure purposes; and 4) separate presentation by the reporting organization in other comprehensive income for the portion of the total change in the fair value of a liability resulting from the change in the instrument-specific credit risk (also referred to as “own credit”) when the organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. The standard is effective for the Company beginning on January 1, 2018. The Company does not expect the application of this guidance to have a material impact on the Company’s financial statements.

ASU 2016-02, Leases (Topic 842). The amendments in this ASU require lessees to recognize, on the balance sheet, assets and liabilities for the rights and obligations created by leases. Accounting by lessors will remain largely unchanged. The guidance will be effective for the Company, on January 1, 2019, with early adoption permitted. Adoption will require a modified retrospective transition where the lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented. The Company does not expect the application of this guidance to have a material impact on the Company’s financial statements.

ASU 2016-09, Compensation Stock — Compensation (Topic 718): “Improvements to Employee Share Based Payment Accounting.” This ASU changes how companies account for certain aspects of share based payments to employees. Entities will be required to recognize all excess tax benefits and tax deficiencies (including tax benefits of dividends on share-based payment awards) as income tax expense or benefit in the income statement and the tax effects of exercised or vested awards will be treated as discrete items in the reporting period in which they occur. This ASU also simplifies several other aspects of accounting for share-based payments including; classification of excess tax benefits on the statement of cash flows; forfeitures; statutory tax withholding requirements; classification of awards and; classification of employee taxes paid on the statement of cash flows when an employer withholds shares for tax-withholding purposes. The amendments in this update were effective for the Company on January 1, 2017 and interim periods within that annual period. The Company does not expect the application of this guidance to have a material impact on the Company’s financial statements.

ASU No. 2016-13, Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The ASU changes the impairment model for most financial assets and certain other instruments. For trade and other receivables, held-to-maturity debt securities, loans and other instruments, entities will be required to use a new forward-looking “expected loss” model that will replace today’s “incurred loss” model and can result in the earlier recognition of credit losses. For available-for-sale debt securities with unrealized losses, entities will measure credit losses in a manner similar to current practice, except that the losses will be recognized as an allowance. The amendments in this update will be effective for the Company on January 1, 2020, including interim periods within that fiscal year. Early adoption is permitted as of the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Management is currently evaluating the impact of its pending adoption of this guidance on the Company’s financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

ASU No. 2016-15, Statement of Cash Flows (Topic 230): “Classification of Certain Cash Receipts and Cash Payments.” This ASU changes how certain cash receipts and cash payments are presented and classified in the statement of cash flows under Topic 230, Statement of Cash Flows, and other Topics. The amendments address the classification of the following eight items in the statement of cash flows; debt prepayment or debt extinguishment costs, settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies, distributions received from equity method investees, beneficial interests in securitization transactions and separately identifiable cash flows and application of the Predominance Principle. The amendments in this update are effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The Company does not expect the application of this guidance to have a material impact on the Company’s financial statements.

ASU No. 2016-18, Statement of Cash Flows (Topic 230): “Restricted Cash” This ASU provide guidance on the presentation of restricted cash or restricted cash equivalents in the statement of cash flows. The amendments in this Update require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The amendments in this Update are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. The Company does not expect the application of this guidance to have a material impact on the Company’s financial statements.

2. Shareholders’ Equity

Common stock

On May 15, 2014, the Company priced 2,702,703 common shares in its initial public offering (“IPO”) at $18.00 per share, and on May 15, 2014, Bankwell common shares began trading on the Nasdaq Stock Market. The Company issued a total of 2,702,703 common shares in its IPO, which closed on May 20, 2014. The net proceeds from the IPO were approximately $44.7 million, after deducting the underwriting discount of approximately $2.5 million and approximately $1.3 million of expenses.

Prior to the public offering, the Company issued shares in various offerings.

Warrants

Bank of New Canaan’s October 26, 2006 Stock Offering and the July 10, 2007 Private Placement (the “Offerings”) called for the issuance of Units. Each Unit issued pursuant to the Offerings represented one share of common stock and one nontransferable warrant. The warrants were exercisable at any time from and including October 1, 2009 and prior to or on November 30, 2009, unless extended or accelerated by the board of directors in their discretion. The board of directors extended the exercise period to October 5, 2015 through December 5, 2015. Each warrant allowed a holder to purchase .3221 shares of common stock at an exercise price of $14.00 per share. 945,789 Warrants were available to purchase up to 304,639 shares of common stock at $14.00 per share for a maximum offering of $4,264,946. As a result of the offering, 838,369 warrants were exercised for 269,992 shares of common stock for total gross proceeds of $3,779,888. There are no longer any outstanding warrants following the close of this offering.

As a result of the acquisition of Quinnipiac on October 1, 2014 the Company issued 68,600 warrants to former Quinnipiac warrant holders in accordance with the merger agreement. Each warrant was automatically converted into a warrant to purchase 0.56 shares of the Company’s common stock for an exercise price of $17.86. A total of 11,200 warrants have been exercised as of December 31, 2016. The warrants expire on March 6, 2018.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Dividends

The Company's shareholders are entitled to dividends when and if declared by the board of directors, out of funds legally available. The ability of the Company to pay dividends depends, in part, on the ability of the Bank to pay dividends to the Company. In accordance with Connecticut statutes, regulatory approval is required to pay dividends in excess of the Bank's profits retained in the current year plus retained profits from the previous two years. The Bank is also prohibited from paying dividends that would reduce its capital ratios below minimum regulatory requirements. The Company did not repurchase any of its common stock during 2016 or 2015.

3.
Restrictions on cash and due from banks

The Bank is required to maintain $125 thousand in the Federal Reserve Bank for clearing purposes.

4.
Goodwill and other intangible assets

Information on goodwill for the year ended December 31, 2016 and 2015 is as follows:

	Year Ended December 31, 2016	Year Ended December 31, 2015
	(In thousands)	
Balance, beginning of the period	$ 2,589	$ 2,589
Impairment	—	—
Balance, end of the period	$ 2,589	$ 2,589

The Company tests for goodwill impairment annually as of June 30th. No impairment was recorded on goodwill for 2016 or 2015.

The table below provides information regarding the carrying amounts and accumulated amortization of amortized intangible assets as of the dates set forth below.

	Gross Intangible Asset	Accumulated Amortization	Net Intangible Asset
	(In thousands)		
December 31, 2016			
Core deposit intangible	$ 1,029	$ 528	$ 501
December 31, 2015			
Core deposit intangible	$ 1,029	$ 377	$ 652

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Bankwell Financial Group, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5.
Investment Securities

The amortized cost, gross unrealized gains and losses and fair values of available for sale and held to maturity securities segregated by contractual maturity at December 31, 2016 were as follows:

	December 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Available for sale securities:				
U.S. Government and agency obligations				
Due from one through five years	$ 62,357	$ 295	$ (49)	$ 62,603
Due after ten years	100	—	(5)	95
	62,457	295	(54)	62,698
State agency and municipal obligations				
Due from one through five years	827	24	(3)	848
Due from five through ten years	8,045	189	(1)	8,233
Due after ten years	5,623	178	(119)	5,682
	14,495	391	(123)	14,763
Corporate bonds				
Due in less than one year	2,022	56	—	2,078
Due from one through five years	8,145	67	—	8,212
	10,167	123	—	10,290
Total available for sale securities	$ 87,119	$ 809	$ (177)	$ 87,751
Held to maturity securities:				
State agency, U.S. Territories and municipal obligations				
Due from one through five years	$ 2,135	$ —	$ —	$ 2,135
Due after ten years	13,575	—	—	13,575
	15,710	—	—	15,710
Corporate bonds				
Due from one through five years	1,000	—	(23)	977
Government-sponsored mortgage backed securities				
No contractual maturity	149	15	—	164
Total held to maturity securities	$ 16,859	$ 15	$ (23)	$ 16,851

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The amortized cost, gross unrealized gains and losses and fair values of available for sale and held to maturity securities segregated by contractual maturity at December 31, 2015 were as follows:

	December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Losses	Fair Value
	(In thousands)			
Available for sale securities:				
U.S. Government and agency obligations				
Due in less than one year	$ 6,198	$ —	$ (77)	$ 6,121
Due from one through five years	394	4	(2)	396
Due from five through ten years	647	—	(21)	626
Due after ten years	7,239	4	(100)	7,143
State agency, U.S. Territories and municipal obligations	520	39	—	559
Due from five through ten years	9,762	361	(322)	9,801
Due after ten years	6,778	367	(1)	7,144
	17,060	767	(323)	17,504
Corporate bonds				
Due in less than one year	1,010	22	—	1,032
Due from one through five years	9,233	156	(9)	9,380
Due from five through ten years	1,013	12	—	1,025
	11,256	190	(9)	11,437
Government-sponsored mortgage backed securities				
No contractual maturity	4,400	107	(10)	4,497
Total available for sale securities	$ 39,955	$ 1,068	$ (442)	$ 40,581
Held to maturity securities:				
U.S. Government and agency obligations				
Due in less than one year	$ —	$ —	$ —	$ —
State agency, U.S. Territories and municipal obligations				
Due after ten years	9,026	—	—	9,026
Corporate bonds				
Due from five through ten years	1,000	—	(19)	981
Government-sponsored mortgage backed securities				
No contractual maturity	200	21	—	221
Total held to maturity securities	$ 10,226	$ 21	$ (19)	$ 10,228

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Bankwell Financial Group, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the year ended December 31, 2016, the Company realized a net loss of $115 thousand from the sales of investment securities, primarily driven by the sale of a Commonwealth of Puerto Rico senior lien sales tax financing corporate bond or "COFINA" bond on November 2, 2016. Gross gains from the sales of investment securities totaled $129.4 thousand and gross losses from the sales of investment securities totaled $244.6 thousand. There were no sales of, or realized gains or losses on, investment securities for the years ended December 31, 2015 and 2014.
At December 31, 2016 and 2015, securities with approximate fair values of $60.0 million and $5.9 million were pledged as collateral with the FHLB. The collateral is pledged for general purposes and for public deposits.
The following table provides information regarding investment securities with unrealized losses, aggregated by investment category and length of time that individual securities had been in a continuous unrealized loss position at December 31, 2016 and 2015:

	Length of Time in Continuous Unrealized Loss Position					
	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
	(In thousands)					
December 31, 2016						
U.S. Government and agency obligations	$ 3,045	$ (54)	$ —	$ —	$ 3,045	$ (54)
State agency and municipal obligations	2,756	(123)	—	—	2,756	(123)
Corporate bonds	978	(23)	—	—	978	(23)
Total investment securities	$ 6,779	$ (200)	$ —	$ —	$ 6,779	$ (200)
December 31, 2015						
U.S. Government and agency obligations	$ 5,486	$ (60)	$ 1,259	$ (40)	$ 6,745	$ (100)
State agency, U.S. Territories and municipal obligations	126	(1)	665	(322)	791	(323)
Corporate bonds	1,970	(28)	—	—	1,970	(28)
Government-sponsored mortgage backed securities	768	(4)	413	(6)	1,181	(10)
Total investment securities	$ 8,350	$ (93)	$ 2,337	$ (368)	$ 10,687	$ (461)

There were 11 and 29 individual investment securities, respectively, in which the fair value of the security was less than the amortized cost of the security at December 31, 2016 and December 31, 2015.
The U.S. Government and agency obligations owned are either direct obligations of the U.S. Government or are issued by one of the shareholder-owned corporations chartered by the U.S. Government, therefore the contractual cash flows are guaranteed and as a result the unrealized losses in this portfolio are not considered other than temporarily impaired.
The Company continually monitors its state agency, U.S. Territories, municipal and corporate bond portfolios and at this time these portfolios have minimal default risk because state agency, U.S. Territories, municipal and corporate bonds are all rated above investment grade.

6.
Loans Receivable and Allowance for Loan Losses

Loans acquired in connection with The Wilton acquisition in November 2013 and The Quinnipiac acquisition in October 2014 are referred to as “acquired” loans as a result of the manner in which they are accounted for. All other loans are referred to as “originated” loans. Accordingly, selected credit quality disclosures that follow are presented separately for the original loan portfolio and the acquired loan portfolio.

The following table sets forth a summary of the loan portfolio at December 31, 2016 and 2015:

	December 31, 2016			December 31, 2015		
	Originated	Acquired	Total	Originated	Acquired	Total
	(In thousands)					
Real estate loans:						
Residential	$ 178,549	$ 2,761	$ 181,310	$ 174,311	$ 2,873	$ 177,184
Commercial	802,156	43,166	845,322	643,524	54,018	697,542
Construction	107,329	112	107,441	81,242	1,031	82,273
Home equity	8,549	5,870	14,419	9,146	6,780	15,926
	1,096,583	51,909	1,148,492	908,223	64,702	972,925
Commercial business	198,456	17,458	215,914	150,479	22,374	172,853
Consumer	672	861	1,533	117	1,618	1,735
Total loans	1,295,711	70,228	1,365,939	1,058,819	88,694	1,147,513
Allowance for loan losses	(17,883)	(99)	(17,982)	(14,128)	(41)	(14,169)
Deferred loan origination fees, net	(4,071)	—	(4,071)	(3,605)	—	(3,605)
Unamortized loan premiums	9	—	9	9	—	9
Loans receivable, net	$ 1,273,766	$ 70,129	$ 1,343,895	$ 1,041,095	$ 88,653	$ 1,129,748

Lending activities are conducted principally in the New York metropolitan area, including the Fairfield and New Haven County regions of Connecticut, and consist of residential and commercial real estate loans, commercial business loans and a variety of consumer loans. Loans may also be granted for the construction of residential homes and commercial properties. All residential and commercial mortgage loans are collateralized by first or second mortgages on real estate.

The following table summarizes activity in the accretable yields for the acquired loan portfolio for the years ended December 31, 2016 and 2015:

	2016	2015
	(In thousands)	
Balance at beginning of period	$ 871	$ 1,382
Acquisition	—	—
Accretion	(154)	(157)
Other(a)	(51)	(354)
Balance at end of period	$ 666	$ 871

(a)
Represents changes in cash flows expected to be collected due to loan sales or payoffs.

Risk management

The Company has established credit policies applicable to each type of lending activity in which it engages. The Company evaluates the creditworthiness of each customer and extends credit of up to 80% of the market value of the collateral, depending on the borrowers' creditworthiness and the type of collateral. The borrower's ability to service the debt is monitored on an ongoing basis. Real estate is the primary form of collateral. Other important forms of collateral are business assets, time deposits and marketable securities. While collateral provides assurance as a secondary source of repayment, the Company ordinarily requires the primary source of repayment to be based on the borrower's ability to generate continuing cash flows. The Company's policy for residential lending allows that, generally, the amount of the loan may not exceed 80% of the original appraised value of the property. In certain situations, the amount may exceed

80% LTV either with private mortgage insurance being required for that portion of the residential loan in excess of 80% of the appraised value of the property or where secondary financing is provided by a housing authority program second mortgage, a community's low/moderate income housing program, a religious or civic organization. Private mortgage insurance may be required for that portion of the residential first mortgage loan in excess of 80% of the appraised value of the property.

Credit quality of loans and the allowance for loan losses

Management segregates the loan portfolio into portfolio segments which is defined as the level at which the Company develops and documents a systematic method for determining its allowance for loan losses. The portfolio segments are segregated based on loan types and the underlying risk factors present in each loan type. Such risk factors are periodically reviewed by management and revised as deemed appropriate.

The Company's loan portfolio is segregated into the following portfolio segments:

Residential Real Estate: This portfolio segment consists of the origination of first mortgage loans secured by one-to-four family owner occupied residential properties and residential construction loans to individuals to finance the construction of residential dwellings for personal use located in our market area.

Commercial Real Estate: This portfolio segment includes loans secured by commercial real estate, non-owner occupied one-to-four family and multi-family dwellings for property owners and businesses. Loans secured by commercial real estate generally have larger loan balances and more credit risk than owner occupied one-to-four family mortgage loans.

Construction: This portfolio segment includes commercial construction loans for commercial development projects, including condominiums, apartment buildings, and single family subdivisions as well as office buildings, retail and other income producing properties and land loans, which are loans made with land as security. Construction and land development financing generally involves greater credit risk than long-term financing on improved, owner-occupied real estate. Risk of loss on a construction loan depends largely upon the accuracy of the initial estimate of the value of the property at completion of construction compared to the estimated cost (including interest) of construction and other assumptions. If the estimate of construction cost proves to be inaccurate, the Company may be required to advance additional funds beyond the amount originally committed in order to protect the value of the property. Moreover, if the estimated value of the completed project proves to be inaccurate, the borrower may hold a property with a value that is insufficient to assure full repayment. Construction loans also expose the Company to the risks that improvements will not be completed on time in accordance with specifications and projected costs and that repayment will depend on the successful operation or sale of the properties, which may cause some borrowers to be unable to continue with debt service which exposes the Company to greater risk of non-payment and loss.

Home Equity: This portfolio segment primarily includes home equity loans and home equity lines of credit secured by owner occupied one-to-four family residential properties. Loans of this type are written at a combined maximum of 80% of the appraised value of the property and the Company requires a first or second lien position on the property. These loans can be affected by economic conditions and the values of the underlying properties.

Commercial Business: This portfolio segment includes commercial business loans secured by assignments of corporate assets and personal guarantees of the business owners. Commercial business loans generally have higher interest rates and shorter terms than other loans, but they also may involve higher average balances, increased difficulty of loan monitoring and a higher risk of default since their repayment generally depends on the successful operation of the borrower's business.

Consumer: This portfolio segment includes loans secured by savings or certificate accounts, or automobiles, as well as unsecured personal loans and overdraft lines of credit. This type of loan entails greater risk than residential mortgage loans, particularly in the case of loans that are unsecured or secured by assets that depreciate rapidly.

Bankwell Financial Group, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Allowance for loan losses
The following tables set forth the activity in the Company's allowance for loan losses for the years ended December 31, 2016, 2015 and 2014, by portfolio segment:

	Residential Real Estate	Commercial Real Estate	Construction	Home Equity	Commercial Business	Consumer	Total
	(In thousands)						
December 31, 2016							
Originated							
Beginning balance	$ 1,444	$ 7,693	$ 1,504	$ 174	$ 3,310	$ 3	$ 14,128
Charge-offs	—	—	—	—	(59)	(10)	(69)
Recoveries	—	—	—	—	—	8	8
Provisions	202	1,693	601	(18)	989	349	3,816
Ending balance	$ 1,646	$ 9,386	$ 2,105	$ 156	$ 4,240	$ 350	$ 17,883
Acquired							
Beginning balance	$ —	$ 12	$ —	$ —	$ 24	$ 5	$ 41
Charge-offs	—	—	(7)	—	(10)	(25)	(42)
Recoveries	—	—	—	—	—	2	2
Provisions	—	17	7	—	29	45	98
Ending balance	$ —	$ 29	$ —	$ —	$ 43	$ 27	$ 99
Total							
Beginning balance	$ 1,444	$ 7,705	$ 1,504	$ 174	$ 3,334	$ 8	$ 14,169
Charge-offs	—	—	(7)	—	(69)	(35)	(111)
Recoveries	—	—	—	—	—	10	10
Provisions	202	1,710	608	(18)	1,018	394	3,914
Ending balance	$ 1,646	$ 9,415	$ 2,105	$ 156	$ 4,283	$ 377	$ 17,982

	Residential Real Estate	Commercial Real Estate	Construction	Home Equity	Commercial Business	Consumer	Total
	(In thousands)						
December 31, 2015							
Originated							
Beginning balance	$ 1,431	$ 5,480	$ 1,102	$ 205	$ 2,638	$ 4	$ 10,860

Charge-offs	—	—	—	—	—	(6)	(6)
Recoveries	—	—	—	—	—	7	7
Provisions	13	2,213	402	(31)	672	(2)	3,267
Ending balance	$ 1,444	$ 7,693	$ 1,504	$ 174	$ 3,310	$ 3	$ 14,128
Acquired							
Beginning balance	$ —	$ —	$ —	$ —	$ —	$ —	$ —
Charge-offs	—	—	—	—	(15)	(9)	(24)
Recoveries	—	—	—	—	100	2	102
Provisions	—	12	—	—	(61)	12	(37)
Ending balance	$ —	$ 12	$ —	$ —	$ 24	$ 5	$ 41
Total							
Beginning balance	$ 1,431	$ 5,480	$ 1,102	$ 205	$ 2,638	$ 4	$ 10,860
Charge-offs	—	—	—	—	(15)	(15)	(30)
Recoveries	—	—	—	—	100	9	109
Provisions	13	2,225	402	(31)	611	10	3,230
Ending balance	$ 1,444	$ 7,705	$ 1,504	$ 174	$ 3,334	$ 8	$ 14,169

Bankwell Financial Group, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Residential Real Estate	Commercial Real Estate	Construction	Home Equity	Commercial Business	Consumer	Total
	(In thousands)						
December 31, 2014							
Originated							
Beginning balance	$ 1,310	$ 3,616	$ 1,032	$ 190	$ 2,225	$ 9	$ 8,382
Charge-offs	—	—	—	—	—	(3)	(3)
Recoveries	—	—	—	—	4	425	429
Provisions	121	1,864	70	15	409	(427)	2,052
Ending balance	$ 1,431	$ 5,480	$ 1,102	$ 205	$ 2,638	$ 4	$ 10,860
Acquired							
Beginning balance	$ —	$ —	$ —	$ —	$ —	$ —	$ —
Charge-offs	—	—	(100)	—	—	—	(100)
Recoveries	—	—	—	—	—	—	—
Provisions	—	—	100	—	—	—	100
Ending balance	$ —	$ —	$ —	$ —	$ —	$ —	$ —
Total							
Beginning balance	$ 1,310	$ 3,616	$ 1,032	$ 190	$ 2,225	$ 9	$ 8,382
Charge-offs	—	—	(100)	—	—	(3)	(103)
Recoveries	—	—	—	—	4	425	429
Provisions	121	1,864	170	15	409	(427)	2,152
Ending balance	$ 1,431	$ 5,480	$ 1,102	$ 205	$ 2,638	$ 4	$ 10,860

Loans evaluated for impairment and the related allowance for loan losses as of December 31, 2016 and 2015 were as follows:

	Originated Loans		Acquired Loans		Total	
	Portfolio	Allowance	Portfolio	Allowance	Portfolio	Allowance
	(In thousands)					
December 31, 2016						
Loans individually evaluated for impairment:						
Residential real estate	$ 969	$ —	$ —	$ —	$ 969	$ —
Commercial real estate	774	1	144	7	918	8
Home equity	259	—	453	—	712	—

Commercial business	920	5	962	37	1,882	42
Consumer	341	341	27	27	368	368
Subtotal	3,263	347	1,586	71	4,849	418
Loans collectively evaluated for impairment:						
Residential real estate	177,580	1,646	2,761	—	180,341	1,646
Commercial real estate	801,382	9,385	43,022	22	844,404	9,407
Construction	107,329	2,105	112	—	107,441	2,105
Home equity	8,290	156	5,417	—	13,707	156
Commercial business	197,536	4,235	16,496	6	214,032	4,241
Consumer	331	9	834	—	1,165	9
Subtotal	1,292,448	17,536	68,642	28	1,361,090	17,564
Total	$ 1,295,711	$ 17,883	$ 70,228	$ 99	$ 1,365,939	$ 17,982

	Originated Loans		Acquired Loans		Total	
	Portfolio	Allowance	Portfolio	Allowance	Portfolio	Allowance
	(In thousands)					
December 31, 2015						
Loans individually evaluated for impairment:						
Residential real estate	$ 1,833	$ 2	$ —	$ —	$ 1,833	$ 2
Commercial real estate	4,291	—	762	12	5,053	12
Home equity	422	—	197	—	619	—
Commercial business	1,977	71	1,433	21	3,410	92
Consumer	—	—	7	5	7	5
Subtotal	8,523	73	2,399	38	10,922	111
Loans collectively evaluated for impairment:						
Residential real estate	172,478	1,442	2,873	—	175,351	1,442
Commercial real estate	639,233	7,692	53,256	—	692,489	7,692
Construction	81,242	1,504	1,031	—	82,273	1,504
Home equity	8,724	174	6,583	—	15,307	174
Commercial business	148,502	3,239	20,941	3	169,443	3,242
Consumer	117	4	1,611	—	1,728	4
Subtotal	1,050,296	14,055	86,295	3	1,136,591	14,058
Total	$ 1,058,819	$ 14,128	$ 88,694	$ 41	$ 1,147,513	$ 14,169

Credit quality indicators

The Company's policies provide for the classification of loans into the following categories: pass, special mention, substandard, doubtful and loss. Consistent with regulatory guidelines, loans that are considered to be of lesser quality are classified as substandard, doubtful, or loss assets. A loan is considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard loans include those loans characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Loans classified as doubtful have all of the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. Loans classified as loss are those considered uncollectible and of such little value that their continuance as loans is not warranted. Loans that do not expose the Company to risk sufficient to warrant classification in one of the aforementioned categories, but which possess potential weaknesses that deserve close attention, are designated as special mention.

Loans that are considered to be impaired are analyzed to determine whether a loss is probable and if so, a calculation is performed to determine the possible loss amount. If it is determined that the loss amount is $0, no reserve is held against the asset. If a loss is calculated, then a specific reserve for that asset is determined.

Bankwell Financial Group, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following tables are a summary of the loan portfolio quality indicators by portfolio segment at December 31, 2016 and 2015:

	Commercial Credit Quality Indicators							
	At December 31, 2016				At December 31, 2015			
	Commercial Real Estate	Construction	Commercial Business	Total	Commercial Real Estate	Construction	Commercial Business	Total
	(In thousands)							
Originated loans:								
Pass	$ 797,249	$ 107,329	$ 196,436	$ 1,101,014	$ 638,709	$ 81,242	$ 148,748	$ 868
Special mention	4,605	—	115	4,720	1,595	—	1,118	2,7
Substandard	302	—	1,905	2,207	3,220	—	549	3,7
Doubtful	—	—	—	—	—	—	—	—
Loss	—	—	—	—	—	—	64	64
Total originated loans	802,156	107,329	198,456	1,107,941	643,524	81,242	150,479	875
Acquired loans:								
Pass	41,582	112	16,836	58,530	52,427	230	20,794	73,
Special mention	1,584	—	86	1,670	—	—	598	598
Substandard	—	—	536	536	1,591	801	982	3,3
Doubtful	—	—	—	—	—	—	—	—
Loss	—	—	—	—	—	—	—	—
Total acquired loans	43,166	112	17,458	60,736	54,018	1,031	22,374	77,
Total loans:								
Pass	838,831	107,441	213,272	1,159,544	691,136	81,472	169,542	942
Special mention	6,189	—	201	6,390	1,595	—	1,716	3,3
Substandard	302	—	2,441	2,743	4,811	801	1,531	7,1
Doubtful	—	—	—	—	—	—	—	—
Loss	—	—	—	—	—	—	64	64
Total loans	$ 845,322	$ 107,441	$ 215,914	$ 1,168,677	$ 697,542	$ 82,273	$ 172,853	$ 952

	Residential and Consumer Credit Quality Indicators	
	At December 31, 2016	At December 31, 2015

	Residential Real Estate	Home Equity	Consumer	Total	Residential Real Estate	Home Equity	Consumer	Total
	(In thousands)							
Originated loans:								
Pass	$ 176,961	$ 8,291	$ 331	$ 185,583	$ 172,478	$ 8,725	$ 117	$ 181,320
Special mention	147	69	—	216	864	80	—	944
Substandard	1,441	189	—	1,630	969	341	—	1,310
Doubtful	—	—	—	—	—	—	—	—
Loss	—	—	341	341	—	—	—	—
Total originated loans	178,549	8,549	672	187,770	174,311	9,146	117	183,574
Acquired loans:								
Pass	2,229	5,417	835	8,481	2,873	6,545	1,539	10,957
Special mention	49	—	—	49	—	—	—	—
Substandard	483	453	2	938	—	235	79	314
Doubtful	—	—	—	—	—	—	—	—
Loss	—	—	24	24	—	—	—	—
Total acquired loans	2,761	5,870	861	9,492	2,873	6,780	1,618	11,271
Total loans:								
Pass	179,190	13,708	1,166	194,064	175,351	15,270	1,656	192,277
Special mention	196	69	—	265	864	80	—	944
Substandard	1,924	642	2	2,568	969	576	79	1,624
Doubtful	—	—	—	—	—	—	—	—
Loss	—	—	365	365	—	—	—	—
Total loans	$ 181,310	$ 14,419	$ 1,533	$ 197,262	$ 177,184	$ 15,926	$ 1,735	$ 194,845

Loan portfolio aging analysis

The following tables set forth certain information with respect to our loan portfolio delinquencies by portfolio segment and amount as of December 31, 2016 and December 31, 2015:

	As of December 31, 2016					
	31 – 60 Days Past Due	61 – 90 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans
	(In thousands)					
Originated Loans						
Real estate loans:						
Residential real estate	$ —	$ —	$ 969	$ 969	$ 177,580	$ 178,549
Commercial real estate	147	1,848	302	2,297	799,859	802,156
Construction	—	—	—	—	107,329	107,329
Home equity	—	173	—	173	8,376	8,549
Commercial business	—	—	378	378	198,078	198,456
Consumer	—	—	—	—	672	672
Total originated loans	147	2,021	1,649	3,817	1,291,894	1,295,711
Acquired Loans						
Real estate loans:						
Residential real estate	—	—	—	—	2,761	2,761
Commercial real estate	866	722	143	1,731	41,435	43,166
Construction	—	—	—	—	112	112
Home equity	—	—	453	453	5,417	5,870
Commercial business	99	249	—	348	17,110	17,458
Consumer	6	—	—	6	855	861
Total acquired loans	971	971	596	2,538	67,690	70,228
Total loans	$ 1,118	$ 2,992	$ 2,245	$ 6,355	$ 1,359,584	$ 1,365,939

	As of December 31, 2015					
	31 – 60 Days Past Due	61 – 90 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans
	(In thousands)					
Originated Loans						
Real estate loans:						
Residential real estate	$ —	$ —	$ 969	$ 969	$ 173,342	$ 174,311
Commercial real estate	—	311	—	311	643,213	643,524
Construction	—	—	—	—	81,242	81,242

Home equity	198	—	—	198	8,948	9,146
Commercial business	1,078	100	343	1,521	148,958	150,479
Consumer	—	—	—	—	117	117
Total originated loans	1,276	411	1,312	2,999	1,055,820	1,058,819
Acquired Loans						
Real estate loans:						
Residential real estate	—	—	—	—	2,873	2,873
Commercial real estate	333	—	762	1,095	52,923	54,018
Construction	—	—	801	801	230	1,031
Home equity	100	162	191	453	6,327	6,780
Commercial business	262	71	101	434	21,940	22,374
Consumer	17	—	—	17	1,601	1,618
Total acquired loans	712	233	1,855	2,800	85,894	88,694
Total loans	$ 1,988	$ 644	$ 3,167	$ 5,799	$ 1,141,714	$ 1,147,513

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There were no loans delinquent greater than 90 days and still accruing as of December 31, 2016 and there were $1.1 million of loans delinquent greater than 90 days and still accruing as of December 31, 2015.

Loans on nonaccrual status

The following is a summary of nonaccrual loans by portfolio segment as of December 31, 2016 and 2015:

	December 31,	
	2016	2015
	(In thousands)	
Residential real estate	$ 969	$ 970
Commercial real estate	446	1,264
Home equity	643	395
Commercial business	538	1,160
Consumer	341	2
Total	$ 2,937	$ 3,791

The amount of income that was contractually due but not recognized on originated nonaccrual loans totaled $17 thousand, $25 thousand and $8 thousand for the years ended December 31, 2016, 2015 and 2014, respectively. The amount of actual interest income recognized on these loans was $74 thousand, $43 thousand and $190 thousand for the years ended December 31, 2016, 2015 and 2014, respectively.

At December 31, 2016 and 2015, there were $0 and $169 thousand in commitments to lend additional funds to borrowers on nonaccrual status, respectively.

Impaired loans

An impaired loan generally is one for which it is probable, based on current information, the Company will not collect all the amounts due under the contractual terms of the loan. Loans are individually evaluated for impairment. When the Company classifies a problem loan as impaired, it provides a specific valuation allowance for that portion of the asset that is deemed uncollectible.

The following table summarizes impaired loans by portfolio segment and the average carrying amount and interest income recognized on impaired loans by portfolio segment as of December 31, 2016, 2015 and 2014:

	As of and for the Year Ended December 31, 2016				
	Carrying Amount	Unpaid Principal Balance	Associated Allowance	Average Carrying Amount	Interest Income Recognized
	(In thousands)				
Originated					
Impaired loans without a valuation allowance:					
Residential real estate	$ 969	$ 969	$ —	$ 969	$ —
Commercial real estate	651	651	—	668	29
Home equity	259	269	—	267	10
Commercial business	551	584	—	987	76
Total impaired loans without a valuation allowance	$ 2,430	$ 2,473	$ —	$ 2,891	$ 115
Impaired loans with a valuation allowance:					
Residential real estate	$ —	$ —	$ —	$ —	$ —
Commercial real estate	123	123	1	128	6
Commercial business	369	369	5	417	22
Consumer	341	341	341	341	—
Total impaired loans with a valuation allowance	833	833	347	886	28
Total originated impaired loans	$ 3,263	$ 3,306	$ 347	$ 3,777	$ 143
Acquired					
Impaired loans without a valuation allowance:					
Home Equity	$ 453	$ 462	$ —	$ 456	$ 9
Commercial Business	572	593	—	629	36
Total impaired loans without a valuation allowance	$ 1,025	$ 1,055	$		