BLACKROCK DEBT STRATEGIES FUND, INC.
Form 4
October 19, 2016

FORM 4

Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

OMB APPROVAL
OMB Number: 3235-0287
Expires: January 31, 2005
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(Print or Type Responses)

1. Name and Address of Reporting Person *
Saba Capital Management, L.P.

(Last) (First) (Middle)

405 LEXINGTON AVENUE, 58TH FLOOR

(Street)

NEW YORK, NY 10174

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
BLACKROCK DEBT STRATEGIES FUND, INC. [DSU]

3. Date of Earliest Transaction (Month/Day/Year)
10/17/2016

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

_____ Director __X__ 10% Owner
_____ Officer (give title below) _____ Other (specify below)

6. Individual or Joint/Group Filing(Check Applicable Line)
___ Form filed by One Reporting Person
_X_ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Common Stock	10/17/2016		P		103,600	A	$ 3.61	25,860,421	I	See footnotes 1 and 2 (1) (2)

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)		8. Price of Derivative Security (Instr. 5)	9. Nu Deriv Secur Bene Owne Follo Repo Trans (Instr
				Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares		

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
Saba Capital Management, L.P. 405 LEXINGTON AVENUE 58TH FLOOR NEW YORK, NY 10174		X		
Weinstein Boaz 405 LEXINGTON AVENUE 58TH FLOOR NEW YORK, NY 10174		X		

Signatures

Muqu Karim	10/19/2016
**Signature of Reporting Person	Date
Boaz Weinstein	10/19/2016
**Signature of Reporting Person	Date
William Manzolillo	10/19/2016
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) The securities reported herein are held by (i) Saba Capital Master Fund, Ltd., a Cayman Islands exempted company (ii) Saba II AIV, L.P., a Delaware limited partnership, (iii) Saba Capital Leveraged Master Fund, Ltd., a Cayman Islands exempted company, (iv) Saba Capital Series LLC Series 1, a Delaware series limited liability company, (v) Saba Capital CEF Opportunities 1 Ltd., a Cayman Islands exempted

company, (vi) Saba Capital CEF Opportunities 2, Ltd., a Cayman Islands exempted company. Collectively, the "Saba Funds".

(2) Mr. Boaz R. Weinstein ("Mr. Weinstein") serves as the managing member of Saba Capital Management GP, LLC, the general partner of Saba Capital Management, L.P., a Delaware limited partnership ("Saba Capital"). Saba Capital serves as the investment manager of the Saba Funds. Each Reporting Person disclaims beneficial ownership of the securities reported herein except to the extent of his or its pecuniary interest therein.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number. yle="font-family:inherit;font-size:10pt;">

894

Total

$
19,176

$
83,938

$
—

$
103,114

(Dollars in thousands)	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
December 31, 2015:				
Securities available for sale:				
U. S. Treasury securities and obligations of U.S. Government sponsored corporations (“GSE”) and agencies	$—	$5,481	$ —	$5,481
Residential collateralized mortgage obligations- GSE	—	8,287	—	8,287
Residential mortgage backed securities – GSE	—	32,635	—	32,635
Obligations of state and political subdivisions	—	21,436	—	21,436
Trust preferred debt securities – single issuer	—	2,136	—	2,136
Corporate debt securities	14,043	6,379	—	20,422
Other debt securities	—	971	54	1,025
Total	$14,043	$77,325	$ 54	$91,422

Certain assets and liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). Assets and financial liabilities measured at fair value on a nonrecurring basis, where there was evidence of impairment, at September 30, 2016 and December 31, 2015 were as follows:

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(Dollars in thousands)	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
September 30, 2016:				
Impaired loans	$ —	$ —	$3,963	$3,963
December 31, 2015:				
Impaired loans	$ —	$ —	$3,960	$3,960
Other real estate owned	—	—	966	966

Impaired loans measured at fair value and included in the above table at September 30, 2016 consisted of nine loans having an aggregate recorded investment of $4.3 million and specific loan loss allowances of $340,000. Impaired loans measured at fair value and included in the above table at December 31, 2015 consisted of nine loans having an aggregate balance of $4.3 million with a specific loan loss allowance of $326,000.

The following table presents additional qualitative information about assets measured at fair value on a nonrecurring basis, where there was evidence of impairment, and for which the Company has utilized Level 3 inputs to determine fair value:

Quantitative Information about Level 3 Fair Value Measurements

(Dollars in thousands)	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range (Weighted Average)
September 30, 2016				
Impaired loans	$ 3,963	Appraisal of collateral (1)	Appraisal adjustments (2)	5% - 34% (19.8%)
December 31, 2015				
Impaired loans	$ 3,960	Appraisal of collateral (1)	Appraisal adjustments (2)	11%-44% (29.6%)
Other real estate owned	$ 966	Appraisal of collateral (1)	Appraisal adjustments (2)	11%

(1) Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various Level 3 inputs which are not identifiable.

(2) Includes qualitative adjustments by management and estimated liquidation expenses.

The following is a summary of fair value versus carrying value of all of the Company's financial instruments. For the Company and the Bank, as with most financial institutions, the bulk of their assets and liabilities are considered financial instruments. Many of the financial instruments lack an available trading market as characterized by a willing buyer and willing seller engaging in an exchange transaction. Therefore, significant estimations and present value calculations were used for the purpose of this note. Changes in assumptions could significantly affect these estimates. Estimated fair values have been determined by using the best available data and an estimation methodology suitable for each category of financial instruments as follows:

Cash and Cash Equivalents, Accrued Interest Receivable and Accrued Interest Payable (Carried at Cost). The carrying amounts reported in the balance sheet for cash and cash equivalents, accrued interest receivable and accrued interest payable approximate fair value.

Securities Held to Maturity (Carried at Amortized Cost). The fair values of securities held to maturity are determined in the same manner as for securities available for sale.

Loans Held For Sale (Carried at Lower of Aggregated Cost or Fair Value). The fair values of loans held for sale are determined, when possible, using quoted secondary market prices. If no such quoted market prices exist, fair values are determined using quoted prices for similar loans, adjusted for the specific attributes of the loans.

Gross Loans Receivable (Carried at Cost). The fair values of loans, excluding impaired loans subject to specific loss reserves, are estimated using discounted cash flow analyses that use market rates as of the balance sheet date that reflect the credit and interest rate-risk inherent in the loans. Projected future cash flows are calculated based upon

contractual maturity or call dates,

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projected repayments and prepayments of principal. Generally, for variable rate loans that re-price frequently and with no significant change in credit risk, fair values are based on carrying values.

Deposit Liabilities (Carried at Cost). The fair values disclosed for demand deposits (e.g., interest and non-interest demand and savings accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered in the market on certificates of deposit to a schedule of aggregated expected monthly maturities on time deposits.

Borrowings and Subordinated Debt (Carried at Cost). The carrying amounts of short-term borrowings approximate their fair values. The fair values of long-term FHLB advances are estimated using discounted cash flow analysis, based on quoted or estimated interest rates for new borrowings with similar credit risk characteristics, terms and remaining maturity. For subordinated debt, which reprices quarterly, the fair value is based on inputs that are observable either directly or indirectly for similar debt obligations.

The estimated fair values and carrying amounts of financial assets and liabilities as of September 30, 2016 and December 31, 2015 were as follows:

September 30, 2016

(Dollars in thousands)	Carrying Value	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Fair Value
Cash and cash equivalents	$16,947	$16,947	$ —	$ —	$16,947
Securities available for sale	103,114	19,176	83,938	—	103,114
Securities held to maturity	121,236	—	125,841	—	125,841
Loans held for sale	10,416	—	10,573	—	10,573
Net loans	741,950	—	—	754,114	754,114
Accrued interest receivable	2,855	—	2,855	—	2,855
Deposits	(827,062)	—	(805,238)	—	(805,238)
Borrowings	(97,099)	—	(97,360)	—	(97,360)
Redeemable subordinated debt	(18,557)	—	(11,641)	—	(11,641)
Accrued interest payable	(794)	—	(794)	—	(794)

December 31, 2015

(Dollars in thousands)	Carrying Value	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Fair Value
Cash and cash equivalents	$11,368	$11,368	$ —	$ —	$11,368
Securities available for sale	91,422	14,043	77,325	54	91,422
Securities held to maturity	123,261	—	127,157	—	127,157
Loans held for sale	5,997	—	6,115	—	6,115
Net loans	674,561	—	—	680,719	680,719
Accrued interest receivable	2,853	—	2,853	—	2,853
Deposits	(786,757)	—	(786,594)	—	(786,594)
Borrowings	(58,896)	—	(59,347)	—	(59,347)
Redeemable subordinated debt	(18,557)	—	(11,641)	—	(11,641)
Accrued interest payable	(846)	—	(846)	—	(846)

Loan commitments and standby letters of credit as of September 30, 2016 and December 31, 2015 were based on fees charged for similar agreements; accordingly, the estimated fair value of loan commitments and standby letters of credit was nominal.

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

This discussion and analysis of the operating results for the three and nine months ended September 30, 2016 and financial condition at September 30, 2016 is intended to help readers analyze the accompanying financial statements, notes and other supplemental information contained in this document. Results of operations for the three and nine month periods ended September 30, 2016 are not necessarily indicative of results to be attained for any other period. This discussion and analysis should be read in conjunction with the consolidated financial statements, notes and tables included elsewhere in this report and Part II, Item 7 of the Company’s Form 10-K (Management’s Discussion and Analysis of Financial Condition and Results of Operation) for the year ended December 31, 2015, as filed with the Securities and Exchange Commission (the “SEC”) on March 22, 2016.

General

Throughout the following sections, the “Company” refers to 1ST Constitution Bancorp and, as the context requires, its wholly-owned subsidiary, 1ST Constitution Bank (the “Bank”), and the Bank’s wholly-owned subsidiaries, 1ST Constitution Investment Company of New Jersey, Inc., FCB Assets Holdings, Inc., LLC, 204 South Newman Street Corp. and 249 New York Avenue, LLC. 1ST Constitution Capital Trust II (“Trust II”), a subsidiary of the Company, is not included in the Company’s consolidated financial statements as it is a variable interest entity and the Company is not the primary beneficiary.

Trust II, a subsidiary of the Company, was created in May 2006 to issue trust preferred securities to assist the Company in raising additional capital.

The Company is a bank holding company registered under the Bank Holding Company Act of 1956, as amended. The Company was organized under the laws of the State of New Jersey in February 1999 for the purpose of acquiring all of the issued and outstanding stock of the Bank, a full service commercial bank which began operations in August 1989, thereby enabling the Bank to operate within a bank holding company structure. The Company became an active bank holding company on July 1, 1999. Other than its ownership interest in the Bank, the Company currently conducts no other significant business activities.

The Bank operates nineteen branches, four residential mortgage loan production offices and manages an investment portfolio through its subsidiary, 1ST Constitution Investment Company of New Jersey, Inc. FCB Assets Holdings, Inc., a subsidiary of the Bank, is used by the Bank to manage and dispose of repossessed real estate.

When used in this Quarterly Report on Form 10-Q for the three and nine month periods ended September 30, 2016 (this "Form 10-Q"), the words "the Company," "we," "our," and "us" refer to 1st Constitution Bancorp and its wholly-owned subsidiaries, unless we indicate otherwise.

Forward-Looking Statements

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). The Private Securities Litigation Reform Act of 1995 provides a “safe harbor” for forward-looking statements. When used in this and in future filings by the Company with the SEC, in the Company’s press releases and in oral statements made with the approval of an authorized executive officer of the Company, the words or phrases “will,” “will likely result,” “could,” “anticipates,” “believes,” “continues,” “expects,” “plans,” “will continue,” “is anticipated,” “estimated,” “project” or “outlook” expressions (including confirmations by an authorized executive officer of the Company of any such expressions made by a third party with respect to the Company) are intended to identify forward-looking statements. The Company cautions readers not to place undue reliance on any such forward-looking statements, each of which speaks only as of the date made. Such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from historical earnings and those presently anticipated or projected.

Factors that may cause actual results to differ from those results expressed or implied, include, but are not limited to, those listed under “Business”, “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015 filed with the SEC on March 22, 2016, such as the overall economy and the interest rate environment; the ability of customers to repay their obligations; the adequacy of the allowance for loan losses; competition; significant changes in accounting, tax or regulatory practices and requirements; certain interest rate risks; risks associated with

investments in mortgage-backed securities; risks associated with speculative construction lending; and risks associated with safeguarding information technology systems. Although management has taken certain steps to mitigate any negative effect of the aforementioned items, significant unfavorable changes could severely impact the assumptions used and could have an adverse effect on profitability. The Company undertakes no obligation to publicly revise any forward-looking statements to reflect anticipated or unanticipated events or circumstances occurring after the date of such statements, except as required by law.

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RESULTS OF OPERATIONS

Three and Nine Months Ended September 30, 2016 Compared to Three and Nine Months Ended September 30, 2015

Summary

The Company reported net income of $2.7 million for three months ended September 30, 2016 and $2.5 million for the three months ended September 30, 2015. Net income per diluted share was $0.33 for the third quarter of 2016 compared to net income per diluted share of $0.30 for the third quarter of 2015. Net income per diluted share increased 10% due to an increase of $233,000, or 9.5%, in net income.

The Company reported net income of $7.2 million or $0.89 per diluted share for the nine month period ended September 30, 2016 compared to net income of $7.0 million or $0.87 per diluted share for the nine month period ended September 30, 2015.

Return on average assets and return on average equity were 1.03% and 10.45%, respectively, for the three months ended September 30, 2016 compared to return on average assets and return on average equity of 0.98% and 10.56%, respectively, for the three months ended September 30, 2015. Book value and tangible book value per share were $13.02 and $11.39, respectively at September 30, 2016.

Return on average assets and return on average equity were 0.97% and 9.68%, respectively, for the nine months ended September 30, 2016 compared to return on average assets and return on average equity of 0.96% and 10.46%, respectively, for the nine months ended September 30, 2015.

Third Quarter Highlights

- Net income was $2.7 million in the third quarter of 2016 compared to $2.5 million in the third quarter of 2015.
- Net interest income was $9.5 million in the third quarter of 2016, a decrease of $175,000 from $9.7 million in the third quarter of 2015, and the net interest margin was 3.92% and 4.19% on a tax equivalent basis for the respective periods.
- Return on average assets and return on average equity were 1.03% and 10.45%, respectively, for the three months ended September 30, 2016 compared to 0.98% and 10.56%, respectively, for the three months ended September 30, 2015.
- Non-performing assets were $5.4 million and 0.51% of assets at September 30, 2016 compared to $7.0 million and 0.72% of assets at December 31, 2015.
- The Bank did not record a provision for loan losses in the third quarter of 2016 due to lower historical loan loss factors that reflected the continued improvement in loan credit quality and the current economic and operating environment.
- On September 16, 2016, the Company announced that its Board of Directors declared a quarterly cash dividend of $0.05 per common share which was paid on October 21, 2016 to all shareholders of record as of the close of business on September 28, 2016. This action represented the first cash dividend declared by the Company on its common shares.

Earnings Analysis

The Bank's results of operations depend primarily on net interest income, which is primarily affected by the market interest rate environment, the shape of the U.S. Treasury yield curve, and the difference between the yield on interest-earning assets and the rate paid on interest-bearing liabilities. Other factors that may affect the Bank's operating results are general and local economic and competitive conditions, government policies and actions of regulatory authorities.

Net Interest Income

Net interest income, the Company's largest and most significant component of operating income, is the difference between interest and fees earned on loans and other earning assets and interest paid on deposits and borrowed funds. This component represented 84.4% of the Company's net revenues (defined as net interest income plus non-interest income) for the three months ended September 30, 2016 compared to 87.1% of net revenues for the three months ended September 30, 2015. Net interest income also depends upon the relative amount of average interest-earning assets, average interest-bearing liabilities, and the interest rate earned or paid on them, respectively.

For the nine months ended September 30, 2016, net interest income represented 84.5% of the Company's net revenues compared to 83.3% of net revenues for the nine months ended September 30, 2015.

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The following tables set forth the Company's consolidated average balances of assets and liabilities and shareholders' equity as well as interest income and expense on related items, and the Company's average yield or rate for the three and nine month periods ended September 30, 2016 and 2015. The average rates are derived by dividing interest income and expense by the average balance of assets and liabilities, respectively.

(Dollars in thousands)	Three months ended September 30, 2016			Three months ended September 30, 2015		
	Average Balance	Interest	Average Yield	Average Balance	Interest	Average Yield
Assets:						
Federal Funds Sold/Short-Term Investments	$12,434	$13	0.40 %	$15,381	$7	0.19 %
Investment Securities:						
Taxable	148,715	827	2.22 %	119,047	776	2.61 %
Tax-exempt (4)	79,917	760	3.81 %	76,975	773	4.02 %
Total	228,632	1,587	2.78 %	196,022	1,549	3.16 %
Loan Portfolio: (1)						
Construction	89,509	1,364	6.06 %	93,953	1,469	6.20 %
Residential real estate	45,919	523	4.30 %	41,828	445	4.25 %
Home Equity	23,286	279	4.76 %	22,314	272	4.84 %
Commercial and commercial real estate	335,887	4,692	5.59 %	311,411	4,609	5.94 %
Mortgage warehouse lines	245,654	2,600	4.21 %	243,273	2,634	4.30 %
Installment	616	7	4.48 %	516	5	4.11 %
All Other Loans	5,869	24	1.63 %	13,590	90	2.64 %
Total	746,740	9,489	5.06 %	726,885	9,527	5.20 %
Total Interest-Earning Assets	987,806	$11,089	4.47 %	938,288	$11,083	4.68 %
Allowance for Loan Losses	(7,552)			(7,661)		
Cash and Due From Bank	5,019			5,253		
Other Assets	59,886			65,138		
Total Assets	$1,045,159			$1,001,018		
Liabilities and Shareholders' Equity:						
Money Market and NOW Accounts	$296,554	$281	0.38 %	$295,479	$248	0.33 %
Savings Accounts	209,703	316	0.60 %	195,051	231	0.47 %
Certificates of Deposit	173,652	454	1.04 %	170,500	442	1.03 %
Other Borrowed Funds	64,463	197	1.22 %	52,081	159	1.21 %
Redeemable Subordinated Debt	18,557	107	2.32 %	18,557	89	1.89 %
Total Interest-Bearing Liabilities	762,929	$1,355	0.71 %	731,668	$1,169	0.63 %
Net Interest Spread (2)			3.76 %			4.05 %
Demand Deposits	171,631			167,526		
Other Liabilities	7,962			9,536		
Total Liabilities	942,522			908,730		
Shareholders' Equity	102,637			92,288		
Total Liabilities and Shareholders' Equity	$1,045,159			$1,001,018		
Net Interest Margin (3)		$9,734	3.92 %		$9,914	4.19 %

(1) Loan origination fees are considered an adjustment to interest income. For the purpose of calculating loan yields, average loan balances include non-accrual loans with no related interest income and the average balance of loans held for sale. Please refer to Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation under the heading "Non-Performing Assets" for a discussion of the Bank's policy with regard to non-accrual loans.

(2)

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

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

(4) Tax-equivalent basis. The tax equivalent adjustment was $246 and $251 for the three months ended September 30, 2016 and September 30, 2015, respectively.

(Dollars in thousands)	Nine months ended September 30, 2016			Nine months ended September 30, 2015		
	Average Balance	Interest	Average Yield	Average Balance	Interest	Average Yield
Assets:						
Federal Funds Sold/Short-Term Investments	$24,508	$79	0.43 %	$22,042	$38	0.23 %
Investment Securities:						
Taxable	144,534	2,459	2.27 %	128,404	2,383	2.47 %
Tax-exempt (4)	80,203	2,299	3.82 %	82,207	2,380	3.86 %
Total	224,737	4,758	2.82 %	210,611	4,763	3.02 %
Loan Portfolio: (1)						
Construction	92,795	4,026	5.80 %	95,936	4,551	6.34 %
Residential real estate	42,375	1,352	4.19 %	43,796	1,381	4.16 %
Home Equity	23,454	769	4.38 %	22,308	777	4.66 %
Commercial and commercial real estate	319,748	13,606	5.68 %	308,697	13,391	5.80 %
Mortgage warehouse lines	201,322	6,436	4.27 %	205,753	6,714	4.36 %
Installment	582	19	4.35 %	468	16	4.54 %
All Other Loans	6,078	106	2.34 %	12,715	224	2.36 %
Total	686,354	26,314	5.12 %	689,673	27,054	5.24 %
Total Interest-Earning Assets	935,599	$31,151	4.45 %	922,326	$31,855	4.62 %
Allowance for Loan Losses	(7,534)			(7,532)		
Cash and Due From Bank	5,086			7,816		
Other Assets	59,652			62,475		
Total Assets	$992,803			$985,085		
Liabilities and Shareholders’ Equity:						
Money Market and NOW Accounts	$295,776	$821	0.37 %	$302,777	$754	0.33 %
Savings Accounts	206,355	888	0.58 %	196,266	686	0.47 %
Certificates of Deposit	153,544	1,280	1.11 %	162,085	1,325	1.09 %
Other Borrowed Funds	46,257	498	1.44 %	41,767	438	1.40 %
Trust Preferred Securities	18,557	311	2.23 %	18,557	263	1.87 %
Total Interest-Bearing Liabilities	720,489	$3,798	0.70 %	721,452	$3,466	0.64 %
Net Interest Spread (2)			3.75 %			3.98 %
Demand Deposits	164,963			164,867		
Other Liabilities	7,612			8,782		
Total Liabilities	893,064			895,101		
Shareholders’ Equity	99,739			89,984		
Total Liabilities and Shareholders’ Equity	$992,803			$985,085		
Net Interest Margin (3)		$27,353	3.89 %		$28,389	4.11 %

(1) Loan origination fees are considered an adjustment to interest income. For the purpose of calculating loan yields, average loan balances include non-accrual loans with no related interest income and the average balance of loans held for sale. Please refer to Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operation under the heading “Non-Performing Assets” for a discussion of the Bank’s policy with regard to non-accrual loans.

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

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

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(4) Tax-equivalent basis. The tax equivalent adjustment was $745 and $772 for the nine months ended September 30, 2016 and September 30, 2015, respectively.

Three months ended September 30, 2016 compared to three months ended September 30, 2015

Net interest income was $9.5 million for the three months ended September 30, 2016, which represented a decrease of $175,000 compared to net interest income of $9.7 million for the three months ended September 30, 2015. The decrease in net interest income in the third quarter of 2016 compared to the third quarter of 2015 was due primarily to an increase of $186,000 in interest expense on interest-bearing liabilities. Interest income on average interest-earning assets, on a tax-equivalent basis, was $11.1 million for the three months ended September 30, 2016 and the three months ended September 30, 2015. Average interest-earning assets increased to $987.8 million for the three month period ended September 30, 2016 from $938.3 million for the three month period ended September 30, 2015 and the average yield on interest-earning assets decreased to 4.47% for the three months ended September 30, 2016 compared to the average yield on interest-earning assets of 4.68% for the three months ended September 30, 2015. The yield on loans and investments declined due to the continued low interest rate environment as new loans were originated at yields lower than the average yield on loans in the prior period and investments were purchased at yields lower than the average yield on investments in the prior period.

Interest expense on average interest-bearing liabilities was $1.4 million, or 0.71%, for the third quarter of 2016 compared to $1.2 million, or 0.63%, for the third quarter of 2015. The increase of $186,000 in interest expense on interest-bearing liabilities for the third quarter of 2016 compared to the third quarter of 2015 primarily reflects higher short-term market interest rates in 2016 and increased competition for deposits compared to 2015. The Board of the Federal Reserve increased the targeted federal funds rate in December 2015 by 25 basis points, which impacted short-term market rates in 2016.

The net interest margin, on a tax-equivalent basis, declined to 3.92% for the three months ended September 30, 2016 compared to 4.19% for the three months ended September 30, 2015, primarily due to the lower yield on interest-earning assets and the higher cost of average interest-bearing liabilities.

Average interest-earning assets increased by $49.5 million, or 5.28%, to $987.8 million for the three month period ended September 30, 2016 from $938.3 million for the three month period ended September 30, 2015 due to the increase in average loans and average investment securities balances. The overall yield on interest-earning assets, on a tax-equivalent basis, decreased 21 basis points to 4.47% for the three month period ended September 30, 2016 compared to 4.68% for the three month period ended September 30, 2015 due primarily to the decreases in the average yield on loans and investments for the quarter ended September 30, 2016 compared to the quarter ended September 30, 2015.

Average interest-bearing liabilities increased by $31.3 million, or 4.3%, to $762.9 million for the three months ended September 30, 2016 from $731.7 million for the three months ended September 30, 2015 due primarily to increases in savings accounts, other borrowed funds, certificates of deposit and money market and NOW accounts. Overall, the cost of total interest-bearing liabilities increased 8 basis points to 0.71% for the three months ended September 30, 2016 from 0.63% for the three months ended September 30, 2015.

Nine months ended September 30, 2016 compared to nine months ended September 30, 2015

For the nine months ended September 30, 2016, the Company's net interest income decreased by $1.0 million, or 3.7%, to $26.6 million compared to $27.6 million for the nine months ended September 30, 2015. This decrease was due primarily to the decrease in the average yield on interest-earning assets and an increase in interest expense on average interest-bearing liabilities.

Interest expense on average interest-bearing liabilities was $3.8 million, or 0.70%, for the nine months ended September 30, 2016 compared to $3.5 million, or 0.64%, for the nine months ended September 30, 2015. The increase of $332,000 in interest expense on interest-bearing liabilities for the first nine months of 2016 compared to the first nine months of 2015 primarily reflects higher short-term market interest rates and increased competition for deposits in 2016 compared to 2015. The Board of the Federal Reserve increased the targeted federal funds rate in December 2015 by 25 basis points, which impacted short-term market rates in 2016.

For the nine months ended September 30, 2016, the net interest margin, on a tax-equivalent basis, was 3.89% compared to 4.11% for the nine months ended September 30, 2015.

Average interest-earning assets increased by $13.3 million, or 1.4%, to $935.6 million for the nine month period ended September 30, 2016 from $922.3 million for the nine month period ended September 30, 2015. The overall yield on interest-earning assets, on a tax-equivalent basis, decreased 17 basis points to 4.45% for the nine months ended September 30, 2016 compared to 4.62% for the nine months ended September 30, 2015, primarily due to the decline in the yield on average loans to 5.12% for the nine months ended September 30, 2016 compared to the yield on average loans of 5.24% for the nine months ended

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September 30, 2015 and the $3.3 million decrease in the average balance of the loan portfolio for the nine months ended September 30, 2016 compared to the nine months ended September 30, 2015.

Average interest-bearing liabilities decreased by $963,000, or 0.13%, to $720.5 million for the nine months ended September 30, 2016 compared to $721.5 million for the nine months ended September 30, 2015 due primarily to decreases in money market and NOW accounts and certificates of deposit that were partially offset by increases in savings accounts and other borrowed funds. The total cost of interest-bearing liabilities increased by 6 basis points to 0.70% for the nine months ended September 30, 2016 from 0.64% for the nine months ended September 30, 2015 primarily due to higher short-term market interest rates in 2016.

Provision for Loan Losses

Three months ended September 30, 2016 compared to three months ended September 30, 2015

Management considers a complete review of the following specific factors in determining the provisions for loan losses: historical losses by loan category, the level of non-accrual loans and problem loans as identified through internal review and classification, collateral values and the growth, size and risk elements of the loan portfolio. In addition to these factors, management takes into consideration current economic conditions and local real estate market conditions.

In general, over the last three years, the Bank experienced an improvement in loan credit quality and achieved a steady resolution of non-performing loans and assets related to the severe recession, which was reflected in the current lower level of non-performing loans at September 30, 2016. Net charge-offs of commercial and commercial real estate loans in 2015 and 2016 have declined significantly, which has resulted in a reduction of the historical loss factors for these segments of the loan portfolio that were applied by management to estimate the allowance for loan losses at September 30, 2016. For the third quarter of 2016, net recoveries of $4,000 were recorded. The lower historical loss factors due to the improvement in loan credit quality resulted in a lower estimated allowance for loan losses of $7.5 million at September 30, 2016. Accordingly, a provision for loan losses was not required for the third quarter of 2016 compared to a provision for loan losses in the amount of $100,000 for the third quarter of 2015.

At September 30, 2016, non-performing loans decreased by $782,000, or 13.0%, to $5.2 million from $6.0 million at December 31, 2015 and the ratio of non-performing loans to total loans decreased to 0.70% at September 30, 2016 compared to 0.88% at December 31, 2015.

Nine months ended September 30, 2016 compared to nine months ended September 30, 2015

A credit (negative) provision for loan losses of $300,000 was recorded for the nine months ended September 30, 2016 compared to a provision for loan losses in the amount of $600,000 for the nine months ended September 30, 2015. The credit provision for loan losses for the first nine months of 2016 reflected gross recoveries of loans previously charged-off of $387,000, gross charge-offs of $161,000 and net recoveries of $226,000 compared to net charge-offs of $393,000 for the first nine months of 2015. Non-performing loans declined to $5.2 million at September 30, 2016 compared to $6.0 million at December 31, 2015.

Non-Interest Income

Three months ended September 30, 2016 compared to three months ended September 30, 2015

Total non-interest income was $1.8 million for the third quarter of 2016, an increase of $333,000, or 23.3%, compared to $1.4 million for the third quarter of 2015. The increase in non-interest income for the third quarter of 2016 was due primarily to an increase of $272,000 in other income to $586,000 compared to other income of $314,000 for the third quarter of 2015 and an increase in gains on sales of loans of $93,000 to $876,000 compared to gains of $783,000 for the third quarter of 2015.

The Bank originates and sells commercial loans guaranteed by the Small Business Administration ("SBA") and residential mortgage loans in the secondary market. SBA guaranteed commercial lending activity and loan sales vary from period to period. In the third quarter of 2016, $3.5 million of SBA loans were sold and gains of $347,000 were recorded compared to $2.2 million of loans sold and gains of $193,000 recorded in the third quarter of 2015.

In the third quarter of 2016, $12.2 million of residential mortgages were sold and $529,000 of gains were recorded compared to $38.0 million of loans sold and $590,000 of gains recorded in the third quarter of 2015. Residential mortgage lending activity was lower in the third quarter of 2016 compared to the third quarter of 2015 due principally to the turnover of employees in the Bank's residential mortgage unit earlier in the year. Gain on sale of residential

mortgages for the third quarter of 2016 included $173,000, which represented the estimated fair value of the derivative for locked-rate residential mortgage loan commitments to borrowers. Gain on sale of residential mortgages in the third quarter of 2015 did not include an amount for the estimated fair value of the derivative for locked-rate residential mortgage loan commitments to borrowers because the amount was immaterial. Changes in the pricing of the Bank's residential mortgage loan offerings in the third quarter of 2016 contributed approximately $111,000 to gain on sale of residential mortgages.

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To replace the loss of personnel and enhance the Bank's residential lending capabilities, the Bank hired 20 employees on July 25, 2016, including residential mortgage loan originators and operating personnel. The addition of this experienced and productive residential mortgage lending team is expected to enhance the Bank's residential mortgage lending capabilities and broaden its lending products to include Federal Housing Administration insured residential mortgages.

Service charge revenues were slightly lower at $185,000 for the three months ended September 30, 2016 compared to $186,000 for the three months ended September 30, 2015.

Non-interest income also includes income from bank-owned life insurance ("BOLI"), which amounted to $113,000 for the three months ended September 30, 2016 compared to $144,000 for the three months ended September 30, 2015.

The other income component of non-interest income increased to $586,000 for the three months ended September 30, 2016 compared to $314,000 for the three months ended September 30, 2015. The increase in other income was due primarily to an insurance recovery of $125,000 and a recovery of $75,000 in excess of the carrying value of an acquired non-performing loan. The Bank also generates non-interest income from a variety of fee-based services. These include safe deposit box rental fees, wire transfer service fees and automated teller machine fees for non-Bank customers.

Nine months ended September 30, 2016 compared to nine months ended September 30, 2015

Total non-interest income for the nine months ended September 30, 2016 was $4.9 million, a decrease of $655,000, or 11.8%, compared to total non-interest income of $5.5 million for the nine months ended September 30, 2015. This decrease was due primarily to a decrease of $753,000 in gains on the sale of loans, which was partially offset by an increase of $161,000 in other income.

Service charge revenues decreased to $558,000 for the nine months ended September 30, 2016 from $615,000 for the nine months ended September 30, 2015. This decrease was due primarily to lower monthly service charges and lower overdraft fees collected on deposit accounts.

Gains on sales of loans originated for sale decreased by $753,000 to $2.5 million for the nine months ended September 30, 2016 compared to $3.3 million for the nine months ended September 30, 2015. The Bank sells both loans guaranteed by the SBA and residential mortgage loans in the secondary market. For the nine months ended September 30, 2016, SBA loan sales were $13.3 million and generated gains on sales of loans of approximately $1.2 million compared to SBA loan sales of $14.1 million that generated gains on sales of $1.4 million for the nine months ended September 30, 2015.

For the nine months ended September 30, 2016, the Bank's residential mortgage banking operation sold $50.7 million of residential mortgage loans, which generated gains from the sales of loans of $1.3 million. For the nine months ended September 30, 2015, the Bank's residential mortgage banking operation sold $116.0 million of residential mortgage loans, which generated gains on sale of loans of $1.9 million. The decline in the residential lending activity and gains on the sale of loans was due to the turnover of personnel that occurred in the first two quarters of 2016, which significantly reduced the volume of loans originated and sold for the first three quarters of 2016. Gain on sale of residential mortgages for the first three quarters of 2016 included $225,000, which represented the estimated fair value of the derivative for locked-rate residential mortgage loan commitments to borrowers. Gain on sale of residential mortgages for the first three quarters of 2015 did not include an amount for the estimated fair value of the derivative for locked-rate residential mortgage loan commitments to borrowers because the amount was immaterial.

Non-interest income also includes income from BOLI, which amounted to $414,000 for the nine months ended September 30, 2016 compared to $420,000 for the nine months ended September 30, 2015.

The Bank also generates non-interest income from a variety of fee-based services. These include safe deposit box fees, wire transfer fees and automated teller machine fees for non-Bank customers. The other income component of non-interest income increased to $1.4 million for the nine months ended September 30, 2016 compared to $1.2 million for the nine months ended September 30, 2015. The increase in other income in 2016 was due primarily to an insurance recovery of $125,000 and a recovery of $75,000 in excess of the carrying value of an acquired non-performing loan.

Non-Interest Expenses

Non-interest expenses were $7.1 million for the three months ended September 30, 2016 compared to $7.4 million for the three months ended September 30, 2015. The decrease of $283,000, or 3.8% in total non-interest expense, was due primarily to a $331,000, or 31.7%, decrease in other operating expenses and a decrease in other real estate owned expenses of $107,000, or 90.0%, which were partially offset by an increase of $159,000, or 3.6%, in salaries and benefits expense and an increase of $61,000, or 33.0%, in regulatory, professional and other fees.
Non-interest expenses were $21.0 million for the nine months ended September 30, 2016 compared to $22.2 million for the nine months ended September 30, 2015 . The decrease of $1.3 million, or 5.7%, was due primarily to a $555,000, or 88.0%, decrease

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in other real estate owned expenses, a $440,000, or 15.8%, decrease in other operating expenses and a $202,000, or 38.1%, decrease in FDIC insurance expense.
The following table presents the major components of non-interest expenses for the three and nine months ended September 30, 2016 and 2015:
Non-interest Expenses

(Dollars in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2015	2015
Salaries and employee benefits	$4,532	$4,373	$13,138	$13,037
Occupancy expense	1,006	963	2,946	3,121
Data processing expenses	314	326	941	951
FDIC insurance expense	105	160	328	530
Other real estate owned expenses	12	119	76	631
Equipment expense	4	14	18	46
Marketing	44	69	127	179
Regulatory, professional and other fees	246	185	656	533
Directors' fees	20	21	67	69
Amortization of intangible assets	101	106	303	321
Other expenses	713	1,044	2,351	2,791
Total	$7,097	$7,380	$20,951	$22,209

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Three months ended September 30, 2016 compared to three months ended September 30, 2015
Salaries and employee benefits, which represent the largest portion of non-interest expenses, increased by $159,000, or 3.6%, to $4.5 million for the three months ended September 30, 2016 compared to $4.4 million for the three months ended September 30, 2015. The increase in salaries and employee benefits was a result of an increase in full-time equivalent employees, primarily in the residential lending group, which was partially offset by lower commissions in the amount of $142,000 paid to residential loan officers as a result of the lower volume of residential mortgage loans originated in the third quarter of 2016. Full-time equivalent employees at September 30, 2016 increased to 198.5 compared to 184 full-time equivalent employees at September 30, 2015.
Occupancy expense increased by $43,000, or 4.5%, to $1.0 million for the three months ended September 30, 2016 compared to $963,000 for the three months ended September 30, 2015. The increase for the three months ended September 30, 2016 compared to the three months ended September 30, 2015 was due primarily to the addition of four residential loan production offices in the third quarter of 2016.
The cost of data processing services decreased slightly to $314,000 for the three months ended September 30, 2016 from $326,000 for the three months ended September 30, 2015.
FDIC insurance expense decreased $55,000 to $105,000 for the three months ended September 30, 2016 compared to $160,000 for the three months ended September 30, 2015 primarily due to a lower assessment rate that reflected the improvement in asset quality and the improved financial performance of the Bank in the last two years.
Other real estate owned expenses decreased by $107,000 to $12,000 for the three months ended September 30, 2016 compared to $119,000 for the three months ended September 30, 2015 due to the significant reduction in OREO assets in 2016 compared to 2015. At September 30, 2016, the Company held one commercial property with a carrying value of $166,000 as OREO compared to three properties with an aggregate carrying value of $4.9 million at September 30, 2015.
Regulatory, professional and other fees increased by $61,000, or 33.0%, to $246,000 for the three months ended September 30, 2016 compared to $185,000 for the three months ended September 30, 2015 due primarily to an increase in internal and external professional audit fees related to management's required year-end 2016 attestation regarding internal controls over financial reporting (Section 404 of the Sarbanes-Oxley Act).

Other expenses decreased by $331,000 to $713,000 for the three months ended September 30, 2016 compared to $1.0 million for the three months ended September 30, 2015 due primarily to decreases of $88,000 in expenses incurred for the collection and recovery of non-performing assets, $63,000 in telephone and communications expense due to the termination of certain services, and $24,000 in insurance premiums.

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Nine months ended September 30, 2016 compared to nine months ended September 30, 2015
Salaries and employee benefits, which represent the largest portion of non-interest expenses, increased by $101,000, or 0.8%, to $13.1 million for the nine months ended September 30, 2016 compared to $13.0 million for the nine months ended September 30, 2015. The increase in salaries and employee benefits was the result of an increase in the number of full-time equivalent employees, which was partially offset by lower commissions in the amount of $156,000 paid to residential loan officers as a result of the lower volume of residential mortgage loans originated in the first nine months of 2016.
Occupancy expense decreased by $175,000, or 5.6%, to $2.9 million for the nine months ended September 30, 2016 compared to $3.1 million for the nine months ended September 30, 2015. The decrease in occupancy expense resulted primarily from decreases in building maintenance expense and depreciation expense.
The cost of data processing services decreased slightly to $941,000 for the nine months ended September 30, 2016 from $951,000 for the nine months ended September 30, 2015.
FDIC insurance expense decreased to $328,000 for the nine months ended September 30, 2016 compared to $530,000 for the nine months ended September 30, 2015 primarily as a result of a lower assessment rate, which reflected the lower level of net charge-offs, the lower level of non-performing assets and the improved financial performance of the Bank in the last two years.
Other real estate owned expenses decreased by $555,000 to $76,000 for the nine months ended September 30, 2016 compared to $631,000 for the nine months ended September 30, 2015 primarily due to the $382,000 writedown of one OREO property in the second quarter of 2015 and the reduction in OREO assets. At September 30, 2016, there was one commercial property with a carrying value of $166,000 as OREO compared to three properties with an aggregate carrying value of $4.9 million at September 30, 2015.
Regulatory, professional and other fees increased by $123,000, or 23.1%, to $656,000 for the nine months ended September 30, 2016 compared to $533,000 for the nine months ended September 30, 2015 due primarily to increases in consulting and internal and external professional audit fees related to management's required year-end 2016 attestation regarding internal controls over financial reporting.
Other expenses decreased $440,000 to $2.4 million for the nine months ended September 30, 2016 compared to $2.8 million for the nine months ended September 30, 2015 as a result of decreases in legal fees and expenses incurred for the collection and recovery of non-performing assets, telephone and communications expense, insurance expense and various other operating expenses. All other operating expenses are comprised of a variety of operating expenses as well as expenses associated with lending activities.

Income Taxes

Three months ended September 30, 2016 compared to three months ended September 30, 2015

Pre-tax income was $4.2 million for the three months ended September 30, 2016 and $3.6 million for the three months ended September 30, 2015.

The Company recorded income tax expense of $1.5 million for the three months ended September 30, 2016 compared to $1.1 million for the three months ended September 30, 2015. The effective income tax rate was 35.1% for the three months ended September 30, 2016 compared to 31.8% for the three months ended September 30, 2015. The effective tax rate increased due primarily to higher pre-tax income and the lower total amount of tax-exempt interest income and income on Bank-owned life insurance as a percentage of pre-tax income in the third quarter of 2016 compared to the third quarter of 2015.

Nine months ended September 30, 2016 compared to nine months ended September 30, 2015

Pre-tax income increased $494,000 to $10.8 million for the nine months ended September 30, 2016 compared to pre-tax income of $10.4 million for the nine months ended September 30, 2015.

The Company recorded income tax expense of $3.6 million for the nine months ended September 30, 2016, which resulted in an effective tax rate of 33.3%, compared to income tax expense of $3.3 million and an effective tax rate of 32.0% for the nine months ended September 30, 2015. The effective tax rate increased due primarily to higher pre-tax income and the lower total amount of tax-exempt interest income and income on Bank-owned life insurance as a percentage of pre-tax income for the nine months ended September 30, 2016 compared to the nine months ended September 30, 2015.

Financial Condition

September 30, 2016 Compared with December 31, 2015

Total consolidated assets at September 30, 2016 were $1.06 billion, representing an increase of $87.3 million, or 9.0%, from total consolidated assets of $968.0 million at December 31, 2015. The increase in assets was primarily attributable to an increase of $67.4 million in net loans and a $9.7 million increase in investment securities, which were funded primarily by a $40.3 million increase in deposits, an increase of $38.2 million in borrowed funds and an increase of $8.0 million in shareholders' equity.

Cash and Cash Equivalents

Cash and cash equivalents at September 30, 2016 totaled $16.9 million compared to $11.4 million at December 31, 2015, an increase of $5.6 million, or 49.1%. To the extent that the Bank does not utilize funds for loan originations or securities purchases, the cash inflows are invested in overnight deposits at the Federal Reserve Bank of New York.

Loans Held for Sale

Loans held for sale at September 30, 2016 were $10.4 million compared to $6.0 million at December 31, 2015. The amount of loans held for sale varies from period to period due to changes in the amount and timing of sales of residential mortgages.

Investment Securities

Investment securities represented approximately 21.3% of total assets at September 30, 2016 and approximately 22.2% of total assets at December 31, 2015. Total investment securities increased $9.7 million, or 4.5%, to $224.4 million at September 30, 2016 from $214.7 million at December 31, 2015. Purchases of investment securities totaled $44.7 million during the nine months ended September 30, 2016, and proceeds from calls, maturities and repayments totaled $35.5 million during the period.

Securities available for sale are investments that may be sold in response to changing market and interest rate conditions or for other business purposes. Activity in this portfolio is undertaken primarily to manage liquidity and interest rate risk and to take advantage of market conditions that create economically attractive returns. At September 30, 2016, securities available for sale totaled $103.1 million, an increase of $11.7 million, or 12.8%, compared to securities available for sale totaling $91.4 million at December 31, 2015.

At September 30, 2016, the securities available for sale portfolio had net unrealized gains of $1.3 million compared to net unrealized gains of $203,000 at December 31, 2015. These unrealized gains were reflected, net of tax, in shareholders' equity as a component of accumulated other comprehensive income.

Securities held to maturity, which are carried at amortized historical cost, are investments for which there is the positive intent and ability to hold to maturity. At September 30, 2016, securities held to maturity were $121.2 million, a decrease of $2.0 million from $123.3 million at December 31, 2015. The fair value of the held to maturity portfolio at September 30, 2016 was $125.8 million.

Loans

The loan portfolio, which represents the Bank's largest asset, is a significant source of both interest and fee income. Elements of the loan portfolio are subject to differing levels of credit and interest rate risk. The Bank's primary lending focus continues to be financing mortgage warehouse lines, construction loans, commercial business loans, owner-occupied commercial mortgage loans and commercial real estate loans on income producing assets.

The following table represents the components of the loan portfolio at September 30, 2016 and December 31, 2015:

Loan Portfolio Composition
(Dollars in thousands)

	September 30, 2016			December 31, 2015		
Component	Amount	%		Amount	%	
Construction loans	$93,839	13	%	$93,745	14	%
Residential real estate loans	44,974	6	%	40,744	6	%
Commercial business	98,147	13	%	99,277	15	%
Commercial real estate	232,813	31	%	207,250	30	%
Mortgage warehouse lines	254,168	34	%	216,572	32	%
Loans to individuals	23,503	3	%	23,074	3	%
All other loans	220	—	%	233	—	%
Gross loans	747,664			680,895		
Deferred loan fees and costs, net	1,772			1,226		
Total loans	$749,436	100	%	$682,121	100	%

Total loans increased by $67.3 million, or 9.9%, to $749.4 million at September 30, 2016 compared to $682.1 million at December 31, 2015.

Mortgage warehouse lines' outstanding balances increased $37.6 million to $254.2 million at September 30, 2016 compared to $216.6 million at December 31, 2015, reflecting higher levels of residential mortgage originations by the Bank's mortgage banking customers that were due to the seasonality of home purchase activity in our markets.

The Bank's mortgage warehouse funding group provides revolving lines of credit that are available to licensed mortgage banking companies. The warehouse line of credit is used by the mortgage banker to finance the origination of one-to-four family residential mortgage loans that are pre-sold to the secondary mortgage market, which includes state and national banks, national mortgage banking firms, insurance companies and government-sponsored enterprises, including the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and

the Government National Mortgage Association. On average, an advance under the warehouse line of credit remains outstanding for a period of less than 30 days, with repayment coming directly from the sale of the loan into the secondary mortgage market. Interest and a transaction fee are collected by the Bank at the time of repayment.

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The Bank funded $1.1 billion of residential mortgages through customers' warehouse lines of credit in the third quarter of 2016 and the third quarter of 2015.

Commercial business loans decreased $1.1 million, or 1.1%, to $98.1 million during the first nine months of 2016. Commercial business loans consist primarily of loans to small and middle market businesses and are typically working capital loans used to finance inventory, receivables or equipment needs. These loans are generally secured by business assets of the commercial borrower.

Commercial real estate loans increased $25.6 million, or 12.3%, to $232.8 million during the first nine months of 2016. Commercial real estate loans consist primarily of loans to businesses collateralized by real estate employed in the business and loans to finance income producing properties.

Construction loans increased $94,000 to $93.8 million during the first nine months of 2016. Construction financing is provided to businesses to expand their facilities and operations and to real estate developers for the acquisition, development and construction of residential properties and income producing properties. First mortgage construction loans are made to developers and builders for single family homes or multi-family buildings that are presold, or are to be sold or leased on a speculative basis. The Bank lends to developers and builders with established relationships, successful operating histories and sound financial resources.

The Bank also finances the construction of individual, owner-occupied single family homes. These loans are made to qualified individual borrowers and are generally supported by a take-out commitment from a permanent lender.

The ability of the Company to enter into larger loan relationships and management’s philosophy of relationship banking are key factors in the Company’s strategy for loan growth. The ultimate collectability of the loan portfolio and recovery of the carrying amount of real estate are subject to changes in the economic environment and real estate market in the Company’s market region.

Non-Performing Assets

Non-performing assets consist of non-performing loans and other real estate owned. Non-performing loans are composed of (1) loans on a non-accrual basis and (2) loans which are contractually past due 90 days or more as to interest and principal payments but which have not been classified as non-accrual. Included in non-accrual loans are loans whose terms have been restructured to provide a reduction or deferral of interest and/or principal because of deterioration in the financial position of the borrower and which have not performed in accordance with the restructured terms.

The Bank's policy with regard to non-accrual loans is that, generally, loans are placed on a non-accrual status when they are 90 days past due, unless these loans are well secured and in process of collection or, regardless of the past due status of the loan, when management determines that the complete recovery of principal or interest is in doubt. Consumer loans are generally charged off after they become 120 days past due. Subsequent payments on loans in non-accrual status are credited to income only if collection of principal is not in doubt.

Non-accrual loans decreased $782,000 to $5.2 million at September 30, 2016 from $6.0 million at December 31, 2015. During the third quarter of 2016, $748,000 of non-performing loans were resolved and $829,000 of loans were placed on non-accrual. The major segments of non-accrual loans consist of commercial real estate loans and residential real estate loans, which are in the process of collection. The table below sets forth non-performing assets and risk elements in the Bank's portfolio for the periods indicated.

Non-Performing Assets and Loans (Dollars in thousands)	September 30, 2016	December 31, 2015
Non-performing loans:		
Loans 90 days or more past due and still accruing	$—	$—
Non-accrual loans	5,238	6,020
Total non-performing loans	5,238	6,020
Other real estate owned	166	966
Other repossessed assets	—	—
Total non-performing assets	5,404	6,986
Performing troubled debt restructurings	1,178	1,535
Performing troubled debt restructurings and total non-performing assets	$6,582	$8,521
Non-performing loans to total loans	0.70 %	0.88 %
Non-performing loans to total loans excluding mortgage warehouse lines	1.06 %	1.29 %
Non-performing assets to total assets	0.51 %	0.72 %
Non-performing assets to total assets excluding mortgage warehouse lines	0.67 %	0.93 %
Total non-performing assets and performing troubled debt restructurings to total assets	0.62 %	0.88 %

Non-performing loans to total loans decreased to 0.70% at September 30, 2016 from 0.88% at December 31, 2015 principally due to the improvement in loan credit quality and a decrease in non-performing loans. Loan quality is considered to be sound. This was accomplished through quality loan underwriting, a proactive approach to loan monitoring and aggressive workout strategies.

Non-performing assets decreased by $1.6 million to $5.4 million at September 30, 2016 from $7.0 million at December 31, 2015. Other real estate owned totaled $166,000 at September 30, 2016 compared to $966,000 at December 31, 2015. OREO at September 30, 2016 was comprised of one commercial real estate property with a carrying value of $166,000.

At September 30, 2016, the Bank had ten loans totaling $4.7 million which were troubled debt restructurings. Four of these loans totaling $3.5 million are included in the above table as non-accrual loans and the remaining six loans totaling $1.2 million are considered performing. At December 31, 2015, the Bank had ten loans totaling $4.7 million that were troubled debt restructurings. Three of these loans totaling $3.2 million are included in the above table as non-accrual loans and the remaining loans totaling $1.5 million are considered performing.

As provided by ASC 310-30, the excess of cash flows expected at acquisition over the initial investment in the loan is recognized as interest income over the life of the loan. Accordingly, loans acquired with evidence of deteriorated credit quality totaling $449,000 at September 30, 2016 and $759,000 at December 31, 2015 were not classified as non-performing loans.
Non-performing assets represented 0.51% of total assets at September 30, 2016 compared to 0.72% of total assets at December 31, 2015.

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Management takes a proactive approach in addressing delinquent loans. The Company's President and Chief Executive Officer meets weekly with all loan officers to review the status of credits past-due 10 days or more. An action plan is discussed for delinquent loans to determine the steps necessary to induce the borrower to cure the delinquency and restore the loan to a current status. In addition, delinquency notices are system-generated when loans are five days past-due and again at 15 days past-due.

In most cases, the Company's collateral is real estate. If the collateral is foreclosed upon, the real estate is carried at fair market value less the estimated selling costs. The amount, if any, by which the recorded amount of the loan exceeds the fair market value of the collateral, less estimated selling costs, is a loss which is charged to the allowance for loan losses at the time of foreclosure or repossession. Resolution of a past-due loan through foreclosure can be delayed if the borrower files a bankruptcy petition because a collection action cannot be continued unless the Company first obtains relief from the automatic stay provided by the bankruptcy code.

Summary of Real Estate Owned Activity
(in thousands)

	Three months ended September 30, 2016		Nine months ended September 30, 2016
Balance - June 30, 2016	$ 166	Balance - January 1, 2016	$ 966
Transfers into real estate owned	—	Transfer into real estate owned	142
Sale of real estate owned	—	Sale of real estate owned	(1,002)
Cost of improvements on real estate owned	—	Cost of improvements on real estate owned	60
Balance - September 30, 2016	$ 166	Balance - September 30, 2016	$ 166

During the three months ended September 30, 2016, there was no activity related to other real estate owned assets. For the nine months ended September 30, 2016, changes in other real estate owned consisted primarily of the sale of one residential property with a fair value of $1.0 million.

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Allowance for Loan Losses and Related Provision

The allowance for loan losses is maintained at a level sufficient to absorb estimated credit losses in the loan portfolio as of the date of the financial statements. The allowance for loan losses is a valuation reserve available for losses incurred or inherent in the loan portfolio and other extensions of credit. The determination of the adequacy of the allowance for loan losses is a critical accounting policy of the Company.

The Company's primary lending emphasis is the origination of commercial and commercial real estate loans and mortgage warehouse lines of credit. Based on the composition of the loan portfolio, the inherent primary risks are deteriorating credit quality, a decline in the economy, and a decline in New Jersey real estate market values. Any one, or a combination, of these events may adversely affect the loan portfolio and may result in increased delinquencies, loan losses and increased future provision levels.

All, or part, of the principal balance of commercial and commercial real estate loans and construction loans are charged off against the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely. Consumer loans are generally charged off no later than 120 days past due on a contractual basis, earlier in the event of bankruptcy, or if there is an amount deemed uncollectible. Because all identified losses are charged off, no portion of the allowance for loan losses is restricted to any individual loan or groups of loans and the entire allowance is available to absorb any and all loan losses.

Management reviews the adequacy of the allowance on at least a quarterly basis to ensure that the provision for loan losses has been charged against earnings in an amount necessary to maintain the allowance at a level that is adequate based on management's assessment of probable estimated losses. The Company's methodology for assessing the adequacy of the allowance for loan losses consists of several key elements and is consistent with U.S. GAAP and interagency supervisory guidance. The allowance for loan losses methodology consists of two major components. The first component is an estimation of losses associated with individually identified impaired loans, which follows Accounting Standards Codification ASC Topic 310. The second major component is an estimation of losses under ASC Topic 450, which provides guidance for estimating losses on groups of loans with similar risk characteristics. The Company's methodology results in an allowance for loan losses that includes a specific reserve for impaired loans, an allocated reserve and an unallocated portion.

When analyzing groups of loans under ASC Topic 450, the Bank follows the Interagency Policy Statement on the Allowance for Loan and Lease Losses. The methodology considers the Company's historical loss experience adjusted for changes in trends, conditions, and other relevant factors that affect repayment of the loans as of the evaluation date. These adjustment factors, known as qualitative factors, include:

- Delinquencies and non-accruals
- Portfolio quality
- Concentration of credit
- Trends in volume of loans
- Quality of collateral
- Policy and procedures
- Experience, ability, and depth of management
- Economic trends – national and local
- External factors – competition, legal and regulatory

The methodology includes the segregation of the loan portfolio into loan types with a further segregation into risk rating categories, such as special mention, substandard, doubtful and loss. This allows for an allocation of the allowance for loan losses by loan type; however, the allowance is available to absorb any loan loss without restriction. Larger-balance, non-homogeneous loans representing significant individual credit exposures are evaluated individually through the internal loan review process. It is this process that produces the watch list. The borrower's overall financial condition, repayment sources, guarantors and value of collateral, if appropriate, are evaluated. Based on these reviews, an estimate of probable losses for the individual larger-balance loans is determined, whenever possible, and used to establish specific loan loss reserves. In general, for non-homogeneous loans not individually assessed and for homogeneous groups of loans, such as residential mortgages and consumer credits, the loans are collectively evaluated based on delinquency status, loan type, and historical losses. These loan groups are then

internally risk rated.

The watch list includes loans that are assigned a rating of special mention, substandard, doubtful and loss. Loans classified as special mention have potential weaknesses that deserve management's close attention. If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They include loans that are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified as doubtful have all the weaknesses inherent in loans classified as substandard with the added characteristic that collection or liquidation in full, on the basis of current conditions and facts, is highly improbable. Loans rated as doubtful in whole, or in part, are placed in non-accrual status. Loans classified as a loss are considered uncollectible and are charged-off against the allowance for loan losses.

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The specific allowance for impaired loans is established for specific loans which have been identified by management as being impaired. These loans are considered to be impaired primarily because the loans have not performed according to payment terms and there is reason to believe that repayment of the loan principal in whole, or in part, is unlikely. The specific portion of the allowance is the total amount of potential unconfirmed losses for these individual impaired loans. To assist in determining the fair value of loan collateral, the Company often utilizes independent third party qualified appraisal firms, which employ their own criteria and assumptions that may include occupancy rates, rental rates, and property expenses, among others.

The second category of reserves consists of the allocated portion of the allowance. The allocated portion of the allowance is determined by taking pools of outstanding loans that have similar characteristics and applying historical loss experience for each pool. This estimate represents the potential unconfirmed losses within the portfolio. Individual loan pools are created for commercial and commercial real estate loans, construction loans, warehouse lines of credit, and various types of loans to individuals. The historical estimation for each loan pool is then adjusted to account for current conditions, current loan portfolio performance, loan policy or management changes, or any other qualitative factor which may cause future losses to deviate from historical levels.

The Company also maintains an unallocated allowance. The unallocated allowance is used to cover any factors or conditions which may cause a potential loan loss but are not specifically identifiable. It is prudent to maintain an unallocated portion of the allowance because no matter how detailed an analysis of potential loan losses is performed, these estimates, by definition, lack precision. Management must make estimates using assumptions and information that is often subjective and changing rapidly.

The following discusses the risk characteristics of each of our loan portfolio segments-commercial, mortgage warehouse lines of credit, and consumer.

Commercial

The Company’s primary lending emphasis is the origination of commercial and commercial real estate loans. Based on the composition of the loan portfolio, the inherent primary risks are deteriorating credit quality, a decline in the economy, and a decline in New Jersey real estate market values. Any one, or a combination, of these events may adversely affect the loan portfolio and may result in increased delinquencies, loan losses and increased future provision levels.

Mortgage Warehouse Lines of Credit

The Company’s Mortgage Warehouse Unit provides revolving lines of credit that are available to licensed mortgage banking companies. The warehouse line of credit is used by the mortgage banker to originate one-to-four family residential mortgage loans that are pre-sold to the secondary mortgage market, which includes state and national banks, national mortgage banking firms, insurance companies and government-sponsored enterprises, including the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and others. On average, an advance under the warehouse line of credit remains outstanding for a period of less than 30 days, with repayment coming directly from the sale of the loan into the secondary mortgage market. Interest and a transaction fee are collected by the Bank at the time of repayment.

As a separate segment of the total portfolio, the warehouse loan portfolio is individually analyzed as a whole for allowance for loan loss purposes. Warehouse lines of credit are subject to the same inherent risks as other commercial lending, but the overall degree of risk differs. While the Company’s loss experience with this type of lending has been non-existent since the product was introduced in 2008, there are other risks unique to this lending that still must be considered in assessing the adequacy of the allowance for loan losses. These unique risks may include, but are not limited to, (i) credit risks relating to the mortgage bankers that borrow from the Bank, (ii) the risk of intentional misrepresentation or fraud by any of such mortgage bankers, (iii) changes in the market value of mortgage loans originated by the mortgage banker, the sale of which is the expected source of repayment of the borrowings under a warehouse line of credit, due to changes in interest rates during the time in warehouse, or (iv) unsalable or impaired mortgage loans so originated, which could lead to decreased collateral value and the failure of a purchaser of the mortgage loan to purchase the loan from the mortgage banker.

These factors, along with the other qualitative factors such as economic trends, concentrations of credit, trends in the volume of loans, portfolio quality, delinquencies and non-accruals, are also considered and may have positive or

negative effects on the allocated allowance. The aggregate amount resulting from the application of these qualitative factors determines the overall risk for the portfolio and results in an allocated allowance for warehouse lines of credit.

Consumer

The Company’s consumer loan segment is comprised of residential real estate loans, home equity loans and other loans to individuals. Individual loan pools are created for the various types of loans to individuals.

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In general, for homogeneous groups such as residential mortgages and consumer credits, the loans are collectively evaluated based on delinquency status, loan type and historical losses. These loan groups are then internally risk rated. The Company considers the following credit quality indicators in assessing the risk in the loan portfolio:

- Consumer credit scores
- Internal credit risk grades
- Loan-to-value ratios
- Collateral
- Collection experience

The following table presents, for the periods indicated, an analysis of the allowance for loan losses and other related data:

Allowance for Loan Losses (Dollars in thousands)

	Nine Months Ended September 30, 2016	Year Ended December 31, 2015	Nine Months Ended September 30, 2015
Balance, beginning of period	$7,560	$6,925	$6,925
(Credit) provision charged to operating expenses	(300)	1,100	600
Loans charged off :			
Construction loans	—	—	—
Residential real estate loans	—	—	—
Commercial business and commercial real estate	(161)	(477)	(402)
Loans to individuals	—	(14)	(14)
Lease financing	—	—	—
All other loans	—	—	—
	(161)	(491)	(416)
Recoveries			
Construction loans	—	—	—
Residential real estate loans	—	—	—
Commercial business and commercial real estate	383	20	19
Loans to individuals	4	6	4
Lease financing	—	—	—
All other loans	—	—	—
	387	26	23
Net recoveries (charge offs)	226	(465)	(393)
Balance, end of period	$7,486	$7,560	$7,132
Loans :			
At period end	$749,436	$682,121	$709,398
Average during the period	681,976	675,531	682,401
Net recoveries (charge offs) to average loans outstanding	0.03%	(0.07)%	(0.06)%
Net recoveries (charge offs) to average loans outstanding, excluding mortgage warehouse loans	0.05%	(0.10)%	(0.08)%
Allowance for loan losses to :			
Total loans at period end	1.00%	1.11%	1.01%
	1.28%	1.44%	1.33%

Total loans at period end excluding mortgage warehouse loans			
Non-performing loans	142.90 %	125.59 %	162.24 %

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The following table represents the allocation of the allowance for loan losses (“ALL”) among the various categories of loans and certain other information as of September 30, 2016 and December 31, 2015, respectively. The allocation is made for analytical purposes and is not necessarily indicative of the categories in which future losses may occur. The total allowance is available to absorb losses from any segment of loans.

(Dollars in thousands)

	September 30, 2016			December 31, 2015		
	Amount	ALL as a % of Loans	% of Loans	Amount	ALL as a % of Loans	% of Loans
Commercial real estate loans	$2,702	1.16%	31 %	3,049	1.47%	30 %
Commercial business	1,719	1.75%	13 %	2,005	2.02%	15 %
Construction loans	1,165	1.24%	13 %	1,025	1.09%	14 %
Residential real estate loans	299	0.66%	6 %	288	0.71%	6 %
Loans to individuals	111	0.47%	3 %	109	0.47%	3 %
Subtotal	5,996	1.22%	66 %	6,476	1.39%	68 %
Mortgage warehouse lines	1,144	0.45%	34 %	866	0.40%	32 %
Unallocated reserves	346	—	—	218	—	—
Total	$7,486	1.00%	100%	$7,560	1.11%	100%

The Company did not record a provision for loan losses for the three months ended September 30, 2016 compared to a $100,000 provision for loan losses for the three months ended September 30, 2015. A provision for loan losses was not required, in general, for the third quarter of 2016 due to lower historical loss factors for commercial business loans and commercial real estate loans resulting from the resolution and reduction of non-performing loans and the improvement in loan credit quality over the last three years. Net recoveries on loans that were previously charged-off were $4,000 and $226,000 for the three and nine month periods ended September 30, 2016, respectively, compared to net charge-offs of $319,000 and $393,000 for the three and nine month periods ended September 30, 2015, respectively.

In the first and second quarters of 2016, there were significant favorable impacts (reduction or release of the allocated allowance) on the amount of the allowance for loan losses allocated to commercial business loans in each quarter due to the significant reduction of net charge-offs in the respective two year historical loss calculation period. The effect of the lower historical loss factors and the corresponding reduction of the allocated loan loss reserve for commercial business loans of $392,000 in the first quarter and $284,000 in the second quarter contributed to the credit provision for loan losses of $200,000 and $100,000 in those respective periods.

In the third quarter of 2016, the amount of the allowance for loan losses allocated to commercial business loans increased due primarily to the decline in credit quality of a $4.0 million commercial business loan to one borrower that was fully performing, but rated "special mention." The increase in the allocation of this allowance for loan losses for commercial business loans was substantially offset by the reduction of the allocation of loan loss reserve for commercial real estate loans.

In the second and third quarters of 2016, there were also significant favorable impacts on the amount of the allowance for loan losses allocated to commercial real estate loans in each quarter due to the significant decline in net charge-offs in the respective two year historical loss calculation period. In the second quarter of 2016, the reduction in the allowance for loan losses allocated to commercial real estate loans and the $378,000 recovery of loans previously charged-off also contributed to the credit provision for loan losses in that quarter.

In the third quarter of 2016, the allowance for loan losses allocated to construction loans increased by $190,000 due primarily to adjustments in risk factors by management to reflect changes in the nature and risk elements of the current construction loan portfolio.

At September 30, 2016, the allowance for loan losses was $7.5 million, a $74,000 decrease from the allowance for loan losses at December 31, 2015. As a percentage of total loans, the allowance was 1.00% at the end of the third quarter of 2016 compared to 1.11% at year-end 2015. The allowance for loan losses was 143% of non-accrual loans

at September 30, 2016 compared to 126% of non-accrual loans at December 31, 2015. Management believes that the quality of the loan portfolio remains sound considering the economic climate in the State of New Jersey and that the allowance for loan losses is adequate in relation to credit risk exposure levels and the estimated incurred and inherent losses in the loan portfolio.

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Deposits

Deposits, which include demand deposits (interest bearing and non-interest bearing), savings deposits and time deposits, are a fundamental and cost-effective source of funding. The flow of deposits is influenced significantly by general economic conditions, changes in market interest rates and competition. The Bank offers a variety of products designed to attract and retain customers, with the Bank's primary focus on the building and expanding of long-term relationships.

The following table summarizes deposits at September 30, 2016 and December 31, 2015.

(Dollars in thousands)

	September 30, 2016	December 31, 2015
Demand		
Non-interest bearing	$ 173,946	$ 159,918
Interest bearing	295,563	284,547
Savings	211,431	196,324
Time	146,122	145,968
Total	$ 827,062	$ 786,757

At September 30, 2016, total deposits were $827.1 million, an increase of $40.3 million, or 5.1%, from $786.8 million at December 31, 2015. Overall, the increase in deposits was due primarily to an increase of $14.0 million in non-interest bearing demand deposits, an increase of $15.1 million in savings deposits and an increase of $11.0 million in interest-bearing demand deposits.

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Borrowings
Borrowings are mainly comprised of Federal Home Loan Bank ("FHLB") borrowings and overnight funds purchased. These borrowings are primarily used to fund asset growth not supported by deposit generation. The balance of borrowings was $97.1 million at September 30, 2016, consisting of $77.0 million of overnight borrowings from the FHLB and $20.1 million of long-term FHLB borrowings, compared to $58.9 million at December 31, 2015, which consisted of $38.6 million of overnight borrowings from the FHLB and $20.3 million of long-term FHLB borrowings.
Liquidity
At September 30, 2016, the amount of liquid assets and the Bank's access to off-balance sheet liquidity remained at a level management deemed adequate to ensure that contractual liabilities, depositors' withdrawal requirements, and other operational and customer credit needs could be satisfied.
Liquidity management refers to the Company's ability to support asset growth while satisfying the borrowing needs and deposit withdrawal requirements of customers. In addition to maintaining liquid assets, factors such as capital position, profitability, asset quality and availability of funding affect a bank's ability to meet its liquidity needs. On the asset side, liquid funds are maintained in the form of cash and cash equivalents, federal funds sold, investment securities held to maturity maturing within one year, securities available for sale and loans held for sale. Additional asset-based liquidity is derived from scheduled loan repayments as well as investment repayments of principal and interest. Investment securities and loans may also be pledged to the FHLB to collateralize additional borrowings. On the liability side, the primary source of liquidity is the ability to generate core deposits. Long-term and short-term borrowings are used as supplemental funding sources when growth in the core deposit base does not keep pace with that of earnings assets.
The Bank has established a borrowing relationship with the FHLB which further supports and enhances liquidity. During 2010, the FHLB replaced its Overnight Line of Credit and One-Month Overnight Repricing Line of Credit facilities available to member banks with a fully secured line of up to 50 percent of a bank's quarter-end total assets. Under the terms of this facility, the Bank's total credit exposure to the FHLB cannot exceed 50 percent of its total assets, or $527.7 million, at September 30, 2016. In addition, the aggregate outstanding principal amount of the Bank's advances, letters of credit, the dollar amount of the FHLB's minimum collateral requirement for off-balance sheet financial contracts and advance commitments cannot exceed 30 percent of the Bank's total assets, unless the Bank obtains approval from the FHLB's Board of Directors or its Executive Committee. These limits are further restricted by a member's ability to provide eligible collateral to support its obligations to the FHLB as well as the ability to meet the FHLB's stock requirement. At September 30, 2016, the Bank pledged collateral to the FHLB to support additional borrowing capacity of $106.8 million. The Bank also maintains unsecured federal funds lines of $46.0 million with two correspondent banks.
The Consolidated Statements of Cash Flows present the changes in cash from operating, investing and financing activities. At September 30, 2016, the balance of cash and cash equivalents was $16.9 million.
Net cash provided by operating activities totaled $4.8 million for the nine months ended September 30, 2016 compared to net cash provided by operating activities of $12.6 million for the nine months ended September 30, 2015. A source of funds is net income from operations adjusted for activity related to loans originated for sale and sold, the provision for loan losses, depreciation and amortization expenses, and net amortization of premiums and discounts on securities. Net cash provided by operating activities for the nine months ended September 30, 2016 was lower than net cash provided by operating activities for the nine months ended September 30, 2015 due primarily to a lower amount of net proceeds from the origination and sale of loans of approximately $8.2 million.
Net cash used in investing activities totaled $77.7 million for the nine months ended September 30, 2016 compared to net cash used in investing activities of $28.3 million for the nine months ended September 30, 2015. The primary use of cash in investing activities for the first nine months of 2016 was the net increase in loans of $67.3 million compared to a net increase in loans of $56.5 million for the first nine months of 2015. The securities portfolios are also a source of liquidity, providing cash flows from maturities and periodic repayments of principal. For the nine months ended September 30, 2016 and September 30, 2015, prepayments and maturities of investment securities totaled $35.5 million and $43.9 million, respectively. Cash was used to purchase investment securities of $44.7 million for the nine

months ended September 30, 2016 compared to purchases of $14.6 million of investment securities for the nine months ended September 30, 2015.
Net cash provided by financing activities was $78.5 million for the nine months ended September 30, 2016 compared to $16.1 million of net cash provided by financing activities for the nine months ended September 30, 2015. The primary source of funds for the 2016 period was the increase in deposits of $40.3 million and an increase in borrowed funds of $38.2 million. The primary source of funds in the 2015 period was the increase in borrowed funds of $40.1 million, which was partially offset by a decrease in deposits of $23.9 million.

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Shareholders’ Equity and Dividends

Shareholders’ equity increased by $8.0 million, or 8.3%, to $103.9 million at September 30, 2016 from $96.0 million at December 31, 2015. Tangible book value per common share increased by $0.96 to $11.39 at September 30, 2016 from $10.43 at December 31, 2015. The ratio of average shareholders’ equity to total average assets was 10.05% at September 30, 2016 compared to 9.34% at December 31, 2015.

Shareholders’ equity increased $8.0 million due to an increase of $6.8 million in retained earnings, an increase of $631,000 in accumulated other comprehensive income, and $549,000 from the exercise of options and share based compensation, which were partially offset by $24,000 in treasury stock purchases for the nine months ended September 30, 2016.

In the past, in lieu of cash dividends to common shareholders, the Company (and its predecessor, the Bank) paid common stock dividends every year since 1993 (except 2014 due to the acquisition of Rumson). On December 18, 2015, the Board of Directors of the Company declared a five percent common stock dividend to common shareholders of record as of the close of business on January 14, 2016, which was paid on February 1, 2016. Per share amounts for the prior periods have been adjusted to reflect the common stock dividend.

On September 15, 2016, the Board of Directors of the Company declared a cash dividend of $0.05 per common share. The cash dividend was paid on October 21, 2016 to all shareholders of record as of the close of business on September 28, 2016. This action represented the first cash dividend declared by the Company on its common shares. The timing and the amount of the payment of future cash dividends, if any, on the Company's common shares will be at the discretion of the Company's Board of Directors and will be determined after consideration of various factors, including the level of earnings, cash requirements, regulatory capital and financial condition.

The Company’s common stock is quoted on the Nasdaq Global Market under the symbol “FCCY."

On January 21, 2016, the Board of Directors of the Company authorized a new common stock repurchase program. Under the new common stock repurchase program, the Company may repurchase in open market or privately negotiated transactions up to five (5%) percent of its common stock outstanding on the date of approval of the stock repurchase program, which limitation will be adjusted for any future stock dividends. This new repurchase program replaces the repurchase program authorized on August 3, 2005.

Disclosure of repurchases of Company shares made during the quarter ended September 30, 2016 is set forth under Part II, Item 2 of this report, “Unregistered Sales of Equity Securities and Use of Proceeds.”

Actual capital amounts and ratios for the Company and the Bank as of September 30, 2016 and December 31, 2015 were as follows:

(Dollars in thousands)	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provision	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of September 30, 2016						
Company						
Common equity Tier 1 (CET1)	$91,113	9.90%	$41,402	>4.5%	N/A	N/A
Total Capital to Risk Weighted Assets	116,599	12.67%	73,603	>8%	N/A	N/A
Tier 1 Capital to Risk Weighted Assets	109,113	11.86%	55,202	>6%	N/A	N/A
Tier 1 Leverage Capital	109,113	10.56%	41,313	>4%	N/A	N/A
Bank						
Common equity Tier 1 (CET1)	$106,659	11.59%	$41,402	>4.5%	$59,803	≥6.5%
Total Capital to Risk Weighted Assets	114,145	12.41%	73,603	>8%	92,004	≥10%
Tier 1 Capital to Risk Weighted Assets	106,659	11.59%	55,202	>6%	73,603	≥8%
Tier 1 Leverage Capital	106,659	10.33%	41,313	>4%	51,641	>5%

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As of December 31, 2015						
Company						
Common equity Tier 1 (CET1)	$83,994	10.03%	$37,628	>4.5%	N/A	N/A
Total Capital to Risk Weighted Assets	$109,554	13.08%	$66,894	>8%	N/A	N/A
Tier 1 Capital to Risk Weighted Assets	101,994	12.18%	50,170	>6%	N/A	N/A
Tier 1 Leverage Capital	101,994	10.80%	37,765	>4%	N/A	N/A
Bank						
Common equity Tier 1 (CET1)	$99,631	11.90%	$37,628	>4.5%	$54,431	≥6.5%
Total Capital to Risk Weighted Assets	$107,191	12.80%	$66,894	>8%	$83,739	>10%
Tier 1 Capital to Risk Weighted Assets	99,631	11.90%	50,170	>6%	66,991	≥8%
Tier 1 Leverage Capital	99,631	10.55%	37,765	>4%	47,211	>5%

In July 2013, the Federal Reserve Board and the FDIC approved revisions to their capital adequacy guidelines and prompt corrective action rules that implemented and addressed the revised standards of Basel III and addressed relevant provisions of the Dodd-Frank Act. The Federal Reserve Board’s final rules and the FDIC’s interim final rules (which became final in April 2014 with no substantive changes) apply to all depository institutions, top-tier bank holding companies with total consolidated assets of $500 million or more, and top-tier savings and loan holding companies (“banking organizations”). Among other things, the rules established a common equity Tier 1 minimum capital requirement (4.5% of risk-weighted assets) and increased the minimum Tier 1 capital to risk-weighted assets requirement (from 4% to 6% of risk-weighted assets). Banking organizations are also required to have a total capital ratio of at least 8% and a Tier 1 leverage ratio of at least 4%.

The rules also limit a banking organization’s ability to pay dividends, engage in share repurchases or pay discretionary bonuses if the banking organization does not hold a “capital conservation buffer” consisting of 2.50% of common equity Tier 1 capital to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements. The capital conservation buffer requirements began phasing in on January 1, 2016 at 0.625% of common equity Tier 1 capital to risk-weighted assets and will increase by that amount each year until fully implemented in January 2019 at 2.50% of common equity Tier 1 capital to risk-weighted assets. At September 30, 2016, the Company's and the Bank's common equity Tier 1 capital ratio of 9.90% and 11.59%, respectively, exceeded the combined common equity Tier 1 minimum capital and capital conservation buffer of 5.125%.

At September 30, 2016, the capital ratios of the Company exceeded the minimum Basel III capital requirements. It is management’s goal to monitor and maintain adequate capital levels to continue to support asset growth and the expansion of the Bank and to continue its status as a well-capitalized institution.

Interest Rate Sensitivity Analysis

The largest component of the Company’s total income is net interest income, and the majority of the Company’s financial instruments are composed of interest rate-sensitive assets and liabilities with various terms and maturities. The primary objective of management is to maximize net interest income while minimizing interest rate risk. Interest rate risk is derived from timing differences and the magnitude of relative changes in the repricing of assets and liabilities, loan prepayments, deposit withdrawals, and differences in lending and funding rates. Management actively seeks to monitor and control the mix of interest rate-sensitive assets and interest rate-sensitive liabilities.

Under the interest rate risk policy established by the Company's Board of Directors, the Company established quantitative guidelines with respect to interest rate risk and how interest rate shocks are projected to affect net interest income and economic value of equity. Due to the current low level of market interest rates, the current monetary policy of the Federal Reserve Board and recent communications from the Federal Reserve Board, management believes that is is more likely that market interest rates may increase than decrease over the intermediate term. Summarized below is the projected effect of a parallel shift of an increase of 200 and 300 basis points, respectively, in market interest rates on net interest income and economic value of equity.

Based upon the current interest rate environment, as of September 30, 2016, sensitivity to interest rate risk was as follows:

(Dollars in thousands)		Next 12 Months Net Interest Income			Economic Value of Equity [2]	
Interest Rate Change in Basis Points [1]	Dollar Amount	$ Change	% Change	Dollar Amount	$ Change	% Change
+300	$42,599	$3,865	10.0 %	$134,890	$3,166	2.4 %
+200	41,172	2,438	6.3 %	134,665	2,941	2.2 %
—	38,734	—	— %	131,724	—	— %

[1] Assumes an instantaneous and parallel shift in interest rates at all maturities.

[2] EVE is the discounted present value of expected cash flows from assets, liabilities and off-balance sheet contracts.

The Company employs many assumptions to calculate the impact of changes in interest rates on assets and liabilities, and actual results may not be similar to projections due to several factors, including the timing and frequency of rate changes, market conditions and the shape of the yield curve. Actual results may also differ due to management's actions, if any, in response to changing rates. In calculating these exposures, the Company utilized an interest rate simulation model which is validated by third-party reviewers on an annual basis.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Not required.

Item 4. Controls and Procedures.

The Company has established disclosure controls and procedures designed to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms and is accumulated and communicated to management, including the principal executive officer and principal financial officer, to allow timely decisions regarding required disclosure.

The Company’s principal executive officer and principal financial officer, with the assistance of other members of the Company’s management, have evaluated the effectiveness of the Company’s disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this quarterly report. Based upon such evaluation, the Company’s principal executive officer and principal financial officer have concluded that the Company’s disclosure controls and procedures are effective as of the end of the period covered by this quarterly report.

The Company’s principal executive officer and principal financial officer have also concluded that there was no change in the Company’s internal control over financial reporting (as such term is defined in Rule 13a-15(f) under the

Exchange Act) that occurred during the quarter ended September 30, 2016 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

Issuer Purchases of Equity Securities

On January 21, 2016, the Board of Directors of the Company authorized a new common stock repurchase program. Under the new common stock repurchase program, the Company may repurchase in open market or privately negotiated transactions up to five (5%) percent of its common stock outstanding on the date of approval of the stock repurchase program, which limitation will be adjusted for any future stock dividends. This new repurchase program replaced the repurchase program authorized on August 3, 2005.

The following table provides common stock repurchases made by or on behalf of the Company during the three months ended September 30, 2016.

Issuer Purchases of Equity Securities [1]

Period		Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased As Part of Publicly Announced Plan or Program	Maximum Number of Shares That May Yet be Purchased Under the Plan or Program
Beginning	Ending				
July 1, 2016	July 31, 2016	—	$	——	394,141
August 1, 2016	August 31, 2016	—	$	——	394,141
September 1, 2016	September 30, 2016	—	$	——	394,141
Total		—	$	——	394,141

(1) The Company’s common stock repurchase program covers a maximum of 396,141 shares of common stock of the Company, representing 5% of the outstanding common stock of the Company on January 27, 2016, as adjusted for subsequent common stock dividends.`

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Item 6. Exhibits.

3(i)(A)		Certificate of Incorporation of the Company (conformed copy) (incorporated by reference to Exhibit 3(i)(A) to the Company's Form 10-K (SEC File No. 000-32891) filed with the SEC on March 27, 2009)
3(ii)(A)		By-laws of 1st Constitution Bancorp, as amended (conformed copy) (incorporated by reference to Exhibit 3(ii)(A) to the Company's Form 8-K filed with the SEC on March 23, 2016)
31.1	*	Certification of Robert F. Mangano, principal executive officer of the Company, pursuant to Securities Exchange Act Rule 13a-14(a)
31.2	*	Certification of Stephen J. Gilhooly, principal financial officer of the Company, pursuant to Securities Exchange Act Rule 13a-14(a)
32	*	Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002, signed by Robert F. Mangano, principal executive officer of the Company, and Stephen J. Gilhooly, principal financial officer of the Company
101.INS	*	XBRL Instance Document
101.SCH	*	XBRL Taxonomy Extension Schema Document
101.CAL	*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	*	XBRL Taxonomy Extension Presentation Linkbase Document

* Filed herewith.

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SIGNATURES

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

1ST CONSTITUTION BANCORP

Date: November 10, 2016 By: /s/ ROBERT F. MANGANO
Robert F. Mangano
President and Chief Executive Officer
(Principal Executive Officer)

Date: November 10, 2016 By: /s/ STEPHEN J. GILHOOLY
Stephen J. Gilhooly
Senior Vice President, Treasurer and Chief Financial Officer
(Principal Financial Officer)

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1ST CONSTITUTION BANCORP
FORM 10-Q
Index to Exhibits

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