Section 1: 10-Q (10-Q)

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2017

OR

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

For the transition period from _____ to _____

Commission file number: 000-51889

TWO RIVER BANCORP

(Exact Name of Registrant as Specified in Its Charter)

New Jersey	20-3700861
(State of Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
766 Shrewsbury Avenue, Tinton Falls, New Jersey	07724
(Address of Principal Executive Offices)	(Zip Code)

(732) 389-8722

(Registrant's Telephone Number, Including Area Code)

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

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

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

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

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

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

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

As of November 7, 2017, there were 8,456,930 shares of the registrant's common stock, no par value, outstanding.

TWO RIVER BANCORP

FORM 10-Q

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

TWO RIVER BANCORP
CONSOLIDATED BALANCE SHEETS (Unaudited)
(in thousands, except share data)

	September 30, 2017	December 31, 2016
ASSETS		
Cash and due from banks	**$ 24,858**	$ 19,844
Interest-bearing deposits in bank	**21,445**	22,233
Cash and cash equivalents	**46,303**	42,077
Securities available for sale	**30,061**	34,464
Securities held to maturity (fair value of $57,719 and $57,284 at September 30, 2017 and December 31, 2016, respectively)	**57,058**	57,843
Restricted investments, at cost	**5,522**	4,805
Loans held for sale	**1,082**	4,537
Loans	**816,078**	753,092
Allowance for loan losses	**(10,223)**	(9,565)
Net loans	**805,855**	743,527
Other real estate owned ("OREO")	**—**	259
Bank owned life insurance	**21,440**	21,029
Premises and equipment, net	**5,350**	4,662
Accrued interest receivable	**2,313**	2,234
Goodwill	**18,109**	18,109
Other assets	**7,152**	6,665
Total Assets	**$ 1,000,245**	$ 940,211
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest-bearing	**$ 163,841**	$ 160,104
Interest-bearing	**658,031**	616,463
Total Deposits	**821,872**	776,567
Securities sold under agreements to repurchase	**22,576**	19,915
FHLB and other borrowings	**30,300**	25,300
Subordinated debt	**9,879**	9,855
Accrued interest payable	**114**	100
Other liabilities	**8,937**	7,758
Total Liabilities	**893,678**	839,495
Shareholders' Equity		
Preferred stock, no par value; 6,500,000 shares authorized, no shares issued and outstanding	**—**	—
Common stock, no par value; 25,000,000 shares authorized;		
Issued – 8,766,577 and 8,677,536 at September 30, 2017 and December 31, 2016, respectively		
Outstanding – 8,454,483 and 8,365,442 at September 30, 2017 and December 31, 2016, respectively	**79,576**	79,056
Retained earnings	**29,580**	24,447
Treasury stock, at cost; 312,094 shares at September 30, 2017 and December 31, 2016	**(2,396)**	(2,396)
Accumulated other comprehensive loss	**(193)**	(391)
Total Shareholders' Equity	**106,567**	100,716

Total Liabilities and Shareholders' Equity	**$ 1,000,245**	$ 940,211

See notes to the unaudited consolidated financial statements.

TWO RIVER BANCORP
CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)
For the Three and Nine Months Ended September 30, 2017 and 2016
(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Interest Income				
Loans, including fees	**$ 9,227**	$ 8,337	**$ 26,363**	$ 24,335
Securities:				
Taxable	**247**	187	**715**	571
Tax-exempt	**267**	234	**831**	664
Interest-bearing deposits	**83**	19	**257**	84
Total Interest Income	**9,824**	8,777	**28,166**	25,654
Interest Expense				
Deposits	**1,069**	972	**3,170**	2,800
Securities sold under agreements to repurchase	**18**	15	**50**	44
FHLB and other borrowings	**157**	157	**449**	452
Subordinated debt	**164**	164	**493**	492
Total Interest Expense	**1,408**	1,308	**4,162**	3,788
Net Interest Income	**8,416**	7,469	**24,004**	21,866
Provision for Loan Losses	**255**	470	**855**	860
Net Interest Income after Provision for Loan Losses	**8,161**	6,999	**23,149**	21,006
Non-Interest Income				
Service fees on deposit accounts	**224**	154	**535**	427
Mortgage banking	**358**	316	**1,258**	831
Other loan fees	**188**	188	**402**	311
Earnings from investment in bank owned life insurance	**137**	118	**411**	337
Death benefit on bank owned life insurance	**—**	862	**—**	862
Gain on sale of SBA loans	**306**	116	**817**	575
Net gain on sale of securities	**—**	—	**—**	72
Other income	**240**	229	**693**	627
Total Non-Interest Income	**1,453**	1,983	**4,116**	4,042
Non-Interest Expenses				
Salaries and employee benefits	**3,641**	3,309	**10,554**	9,609
Occupancy and equipment	**1,112**	1,056	**3,215**	3,084
Professional	**366**	273	**1,102**	888
Insurance	**57**	56	**158**	160
FDIC insurance and assessments	**123**	114	**354**	324
Advertising	**110**	85	**345**	315
Data processing	**151**	135	**406**	405
Outside services fees	**120**	131	**347**	369
Amortization of identifiable intangibles	**—**	—	**—**	9
OREO expenses, impairments and sales, net	**25**	(245)	**44**	(271)
Loan workout expenses	**8**	44	**174**	142
Other operating	**462**	381	**1,324**	1,081
Total Non-Interest Expenses	**6,175**	5,339	**18,023**	16,115
Income before Income Taxes	**3,439**	3,643	**9,242**	8,933
Income tax expense	**1,202**	999	**3,075**	2,869

Net Income	**$**	**2,237**	$	2,644	**$**	**6,167**	$	6,064
Earnings Per Common Share:								
Basic	**$**	**0.27**	$	0.32	**$**	**0.74**	$	0.73
Diluted	**$**	**0.26**	$	0.31	**$**	**0.71**	$	0.71
Weighted average common shares outstanding								
Basic		**8,393**		8,323		**8,373**		8,319
Diluted		**8,656**		8,537		**8,647**		8,515

See notes to the unaudited consolidated financial statements.

TWO RIVER BANCORP
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)
For the Three and Nine Months Ended September 30, 2017 and 2016
(in thousands)

	Three Months Ended September 30,	
	2017	2016
Net income	**$ 2,237**	$ 2,644
Other comprehensive income:		
Unrealized holdings gains on securities available for sale, net of income tax expense 2017: $1; 2016: $4	**3**	7
Other comprehensive income	**3**	7
Total comprehensive income	**$ 2,240**	$ 2,651

	Nine Months Ended September 30,	
	2017	2016
Net income	**$ 6,167**	$ 6,064
Other comprehensive income:		
Unrealized holdings gains on securities available for sale, net of income tax expense 2017: $127; 2016: $169	**198**	260
Other comprehensive income	**198**	260
Total comprehensive income	**$ 6,365**	$ 6,324

See notes to the unaudited consolidated financial statements.

TWO RIVER BANCORP
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (Unaudited)
For the Nine Months Ended September 30, 2017 and 2016
(dollars in thousands, except per share data)

	Common Stock		Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
	Outstanding Shares	Amount				
Balance, January 1, 2017	8,365,442	$ 79,056	$ 24,447	$ (2,396)	$ (391)	$ 100,716
Net income	—	—	6,167	—	—	6,167
Common stock dividend – adjustment	(1,069)	—	—	—	—	—
Other comprehensive income	—	—	—	—	198	198
Stock-based compensation expense	—	202	—	—	—	202
Cash dividends on common stock ($0.125 per share)	—	—	(1,034)	—	—	(1,034)
Options exercised	65,948	266	—	—	—	266
Restricted stock awards	21,018	—	—	—	—	—
Employee stock purchase program	3,144	52	—	—	—	52
Balance, September 30, 2017	8,454,483	$ 79,576	$ 29,580	$ (2,396)	$ (193)	$ 106,567
Balance, January 1, 2016	7,929,196	$ 72,890	$ 22,759	$ (2,248)	$ (399)	$ 93,002
Net income	—	—	6,064	—	—	6,064
Other comprehensive income	—	—	—	—	260	260
Stock-based compensation expense	—	162	—	—	—	162
Cash dividends on common stock ($0.105 per share)	—	—	(875)	—	—	(875)
Options exercised	22,957	89	—	—	—	89
Restricted stock and other awards	17,000					—
Common stock repurchased	(13,232)	—	—	(148)	—	(148)
Employee stock purchase program	4,017	40	—	—	—	40
Balance, September 30, 2016	7,959,938	$ 73,181	$ 27,948	$ (2,396)	$ (139)	$ 98,594

See notes to the unaudited consolidated financial statements.

TWO RIVER BANCORP
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
For the Nine Months Ended September 30, 2017 and 2016

	Nine Months Ended September 30,	
	2017	**2016**
	(in thousands)	
Cash Flows From Operating Activities		
Net income	**$ 6,167**	$ 6,064
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**588**	586
Provision for loan losses	**855**	860
Intangible amortization	**—**	9
Amortization of subordinated debt issuance costs	**24**	23
Net amortization of securities premiums and discounts	**637**	518
Earnings from investment in bank owned life insurance	**(411)**	(337)
Proceeds from sale of mortgage loans held for sale	**56,620**	44,816
Origination of mortgage loans held for sale	**(53,429)**	(43,580)
Gain on sale of mortgage loans held for sale	**(1,003)**	(747)
Gain on sale of loans transferred from held for investment to held for sale	**(177)**	—
Net realized loss on sale of OREO	**17**	45
OREO writedown	**26**	—
Stock-based compensation expense	**202**	162
Net realized gain on sale of securities held to maturity	**—**	(72)
Proceeds from sale of SBA loans held for sale	**9,172**	6,081
Origination of SBA loans held for sale	**(7,088)**	(5,506)
Gain from sale of SBA loans held for sale	**(817)**	(575)
Death benefit on bank owned life insurance	**—**	(862)
Increase in assets:		
Accrued interest receivable	**(79)**	(16)
Other assets	**(614)**	(235)
Increase (decrease) in liabilities:		
Accrued interest payable	**14**	(29)
Other liabilities	**1,179**	1,177
Net Cash Provided by Operating Activities	**11,883**	8,382
Cash Flows From Investing Activities		
Purchase of securities available for sale	—	(2,257)
Purchase of securities held to maturity	**(3,295)**	(9,210)
Proceeds from repayments, calls and maturities of securities available for sale	**4,431**	4,598
Proceeds from repayments, calls and maturities of securities held to maturity	**3,740**	4,758
Proceeds from sales of securities held to maturity	**—**	1,076
Proceeds from sale of loans transferred from held for investment to held for sale	**8,357**	—
Net increase in loans	**(71,363)**	(60,953)
Purchases of premises and equipment	**(1,276)**	(338)
Purchase of restricted investments, net	**(717)**	(1,366)
Purchase of bank owned life insurance	**—**	(3,918)
Proceeds from death benefit of bank owned life insurance	**—**	1,522
Proceeds from sale of OREO	**216**	107
Net Cash Used In Investing Activities	**(59,907)**	(65,981)
Cash Flows From Financing Activities		
Net increase in deposits	**45,305**	30,811
Net increase (decrease) in securities sold under agreements to repurchase	**2,661**	(900)
Proceeds from FHLB and other borrowings	**7,500**	13,000
Repayment of FHLB and other borrowings	**(2,500)**	(4,200)
Cash dividends paid – common stock	**(1,034)**	(875)

Proceeds from employee stock purchase plan	**52**	40
Proceeds from exercise of stock options	**266**	89
Common stock repurchased	**—**	(148)
Net Cash Provided by Financing Activities	**52,250**	37,817
Net Increase (Decrease) in Cash and Cash Equivalents	**4,226**	(19,782)
Cash And Cash Equivalents – Beginning	**42,077**	46,727
Cash And Cash Equivalents - Ending	**$ 46,303**	$ 26,945

TWO RIVER BANCORP
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
For the Nine Months Ended September 30, 2017 and 2016

Supplementary cash flow information:				
Interest paid	**$**	**4,148**	$	3,817
Income taxes paid	**$**	**3,857**	$	3,280
Supplemental schedule of non-cash activities:				
Transfer of loans held for investment to loans held for sale	**$**	**8,180**	**$**	**—**

See notes to the unaudited consolidated financial statements.

NOTE 1 – BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements include the accounts of Two River Bancorp (the "Company"), a bank holding company, and its wholly-owned subsidiary, Two River Community Bank ("Two River" or the "Bank"); Two River's wholly-owned subsidiaries, TRCB Investment Corporation and TRCB Holdings Eight LLC. All inter-company balances and transactions have been eliminated in the consolidated financial statements.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"), including the instructions to Form 10-Q and Article 8 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for full year financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and are of a normal, recurring nature. Operating results for the three and nine months ended September 30, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017. These consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto for the year ended December 31, 2016 included in the Company's Annual Report on Form 10-K filed with the SEC on March 24, 2017 (the "2016 Form 10-K"). For a description of the Company's significant accounting policies, refer to Note 1 of the Notes to Consolidated Financial Statements in the 2016 Form 10-K.

The Company has evaluated events and transactions occurring subsequent to the balance sheet date of September 30, 2017 for items that should potentially be recognized or disclosed in these consolidated financial statements.

NOTE 2 – NEW ACCOUNTING STANDARDS

ASU 2014-09: In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU 2014-09, *Revenue from Contracts with Customers.* Subsequently, the FASB issued guidance codified in ASC 606, "Revenue from Contracts with Customers," which amends the guidance in former ASC 605 "Revenue Recognition." The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This will be achieved in a five-step process. Enhanced disclosures also will be required. This guidance is effective on a retrospective basis, either to each reporting period presented or with the cumulative effect of initially applying this guidance recognized at the date of initial application for annual reporting periods, including interim reporting periods within those annual reporting periods, beginning after December 15, 2017. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period.

The Company's revenue is comprised of net interest income and non-interest income. The scope of the guidance excludes net interest income. Accordingly, the majority of our revenues will not be affected. The Company has prepared the initial review of its contracts and other agreements that are within the scope of this guidance and will complete the process pending review of additional guidance. While we are continuing to assess all potential impacts these standards will have on our financial position and results of operations, our initial conclusions indicate that these standards will not materially change the timing of revenue recognition.

The Company will adopt the requirements of the new standard on January 1, 2018, utilizing the modified retrospective transition method. Upon adoption, the Company will recognize the cumulative effect of adopting this ASU as an adjustment to the opening balance of retained earnings. Prior periods will not be retrospectively adjusted. The Company continues to evaluate the impact of the guidance on disclosures.

NOTE 2 – NEW ACCOUNTING STANDARDS (Continued)

ASU 2016-01: In January 2016, the FASB issued ASU 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*. ASU 2016-01 requires equity investments to be measured at fair value with changes in fair value recognized in net income; provides for a practicability exception election for equity investments without readily determinable fair values; simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; eliminates the requirement for nonpublic business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; requires separate presentation of financial assets and financial liabilities by measurement category and form of financial assets on the balance sheet or the accompanying notes to the financial statements and clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. ASU 2016-01 is effective for financial statements issued for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The Company is currently evaluating the impact that ASU 2016-01 will have on its statement of financial position or financial statement disclosures.

ASU 2016-02: In February 2016, the FASB issued ASU No. 2016-02, *Leases.* From the lessee's perspective, the new standard establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement for a lessee. From the lessor's perspective, the new standard requires a lessor to classify leases as either sales-type, finance or operating. A lease will be treated as a sale if it transfers all of the risks and rewards, as well as control of the underlying asset, to the lessee. If risks and rewards are conveyed without the transfer of control, the lease is treated as a financing. If the lessor doesn't convey risks and rewards or control, an operating lease results. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. A modified retrospective transition approach is required for lessors for sales-type, direct financing, and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The Company has determined that the provisions of ASU 2016-02 will result in an increase in assets to recognize the present value of the lease obligations with a corresponding increase in liabilities, however, the Company does not expect this to have a material impact on its financial position, results of operations or cash flows.

ASU 2016-13: In June 2016, the FASB issued ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326)*. This ASU requires entities to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Entities will now use forward-looking information to better form their credit loss estimates. The ASU also requires enhanced disclosures to help financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an entity's portfolio. For public entities that are SEC filers, this ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. For public entities that are not SEC filers, this ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. For non-public entities, this ASU is effective for fiscal years beginning after December 15, 2020, and for interim periods within fiscal years beginning after December 15, 2021. Early application will be permitted for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. While the Company is currently evaluating the provisions of ASU 2016-13 to determine the potential impact the new standard will have on its consolidated financial statements, it has taken steps to prepare for the implementation when it becomes effective, such as forming an internal task force, gathering pertinent data, consulting with outside professionals and evaluating its current IT systems.

ASU 2016-15: In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*. ASU 2016-15 addresses changes to reduce the presentation diversity of certain cash receipts and cash payments in the statement of cash flows, including debt prepayment or extinguishment costs, settlement of certain debt instruments, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, and distributions received from equity method investees. The guidance becomes effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, with early adoption permitted. An entity that elects early adoption must adopt all of the amendments in the same period. The new standard will be applied retrospectively, but may be applied prospectively if retrospective application would be impracticable. The Company is currently evaluating the new guidance and has not determined the impact this standard may have on its consolidated statement of cash flows.

NOTE 2 – NEW ACCOUNTING STANDARDS (Continued)

ASU 2016-18: In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash.* ASU 2016-18 was issued to address divergence in the way restricted cash is classified and presented. The amendments in the update require that a statement of cash flows explain the change during a reporting period in the total of cash, cash equivalents, and amounts generally described as restricted cash and restricted cash equivalents. The amendments in this update apply to entities that have restricted cash or restricted cash equivalents and are required to present a statement of cash flows under Topic 230. The amendment says that transfers between cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents are not part of the entity's operating, investing, and financing activities. For public business entities, ASU 2016-18 is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The Company is currently evaluating the impact of the adoption of ASU 2016-18 on its consolidated financial statements.

ASU 2017-04: In January 2017, the FASB issued ASU 2017-04, *Intangibles—Goodwill and Other (Topic 350)*. ASU 2017-04 removes Step 2 from the goodwill impairment test. Under the amendments in this update, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. Additionally, an entity should consider income tax effects from any tax deductible goodwill on the carrying amount of the reporting unit when measuring the goodwill impairment loss, if applicable. The Board also eliminated the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform Step 2 of the goodwill impairment test. Therefore, the same impairment assessment applies to all reporting units. An entity is required to disclose the amount of goodwill allocated to each reporting unit with a zero or negative carrying amount of net assets. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. For public entities that are SEC filers, this ASU is effective for its annual, or any goodwill impairment tests in fiscal years, beginning after December 15, 2019. For public entities that are not SEC filers, this ASU is effective for its annual, or any goodwill impairment tests in fiscal years, beginning after December 15, 2020. For non-public entities, this ASU is effective for its annual, or any goodwill impairment tests in fiscal years, beginning after December 15, 2021. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company is currently evaluating the new guidance but has determined that this standard should not have a material impact on its consolidated financial statements.

ASU 2017-09: In May 2017, the FASB issued ASU No. 2017-09, *“Stock Compensation, Scope of Modification Accounting.”* This ASU clarifies when changes to the terms of conditions of a share-based payment award must be accounted for as modifications. Companies will apply the modification accounting guidance if the value, vesting conditions or classification of the award changes. The new guidance should reduce diversity in practice and result in fewer changes to the terms of an award being accounted for as modifications, as the guidance will allow companies to make certain non-substantive changes to awards without accounting for them as modifications. It does not change the accounting for modifications. ASU No. 2017-09 is effective for interim and annual reporting periods beginning after December 15, 2017; early adoption is permitted. ASU No. 2017-09 is not expected to have a material impact on the Company’s consolidated financial statements.

NOTE 3 – GOODWILL

The Company’s goodwill was recognized in connection with the acquisition of The Town Bank (“Town Bank”) in April 2006. GAAP requires that goodwill be tested for impairment annually or more frequently if impairment indicators arise utilizing a two-step methodology. However, a qualitative factor test can be performed to determine whether it is necessary to perform the two-step quantitative impairment test. If this qualitative test determines it is not likely (less than 50% probability) the fair value of the reporting unit is less than book value, then the Company does not have to perform a step one quantitative test and goodwill can be considered not impaired. The Company reviewed the requirements of ASU 350-20 and examples of qualitative assessments to determine whether the weight of evidence indicates greater than 50% likelihood exists that the carrying value of the reporting unit exceeds it's fair value. The nine qualitative assessments used are macroeconomic factors, banking industry conditions, banking industry merger and acquisition trends, bank historical performance, parent stock price, expected bank performance, change of control premium (parent), change of control premium (peer), and other factors.

The Company performed its annual qualitative factor impairment test as of August 31, 2017. Based on the results of this analysis, the Company determined that there was no impairment on the current goodwill balance of $18,109,000.

NOTE 4 – EARNINGS PER COMMON SHARE

Basic earnings per common share is calculated by dividing net income available to common shareholders by the weighted average number of shares of common stock outstanding excluding restricted stock awards outstanding during the period. Diluted earnings per common share reflects additional shares of common stock that would have been outstanding if dilutive potential shares of common stock had been issued relating to outstanding stock options and restricted stock awards. Potential shares of common stock issuable upon the exercise of stock options are determined using the treasury stock method. All share and per share data have been adjusted to reflect a 5% stock dividend paid on February 28, 2017.

The following table sets forth the computations of basic and diluted earnings per common share:

	Three Months Ended September 30, (dollars in thousands, except per share data)		Nine Months Ended September 30, (dollars in thousands, except per share data)	
	2017	**2016**	**2017**	**2016**
Net income	**$ 2,237**	$ 2,644	**$ 6,167**	$ 6,064
Weighted average common shares outstanding – Basic	**8,392,924**	8,322,542	**8,372,913**	8,318,736
Effect of dilutive stock options and restricted stock	**263,062**	214,848	**274,241**	196,034
Weighted average common shares outstanding – Diluted	**8,655,986**	8,537,390	**8,647,154**	8,514,770
Basic earnings per common share	**$ 0.27**	$ 0.32	**$ 0.74**	$ 0.73
Diluted earnings per common share	**$ 0.26**	$ 0.31	**$ 0.71**	$ 0.71

Dilutive securities in the table above exclude common stock options with exercise prices that exceed the average market price of the Company's common stock during the periods presented. Inclusion of these common stock options would be anti-dilutive to the diluted earnings per common share calculation. There were no stock options that were anti-dilutive for the three and nine months ended September 30, 2017 and 2016.

NOTE 5 – SECURITIES

The amortized cost, gross unrealized gains and losses, and fair values of the Company's securities are summarized as follows:

(in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2017:				
Securities available for sale:				
U.S. Government agency securities	$ 7,860	$ 5	$ (19)	$ 7,846
Municipal securities	496	8	—	504
U.S. Government-sponsored enterprises ("GSE") – residential mortgage-backed securities	8,956	—	(100)	8,856
U.S. Government collateralized residential mortgage obligations	8,082	10	(130)	7,962
Corporate debt securities, primarily financial institutions	2,493	11	(62)	2,442
Sub-total	27,887	34	(311)	27,610
Community Reinvestment Act ("CRA") mutual fund	2,490	—	(39)	2,451
Total securities available for sale	$ 30,377	$ 34	$ (350)	$ 30,061
Securities held to maturity:				
Municipal securities	$ 45,234	$ 887	$ (74)	$ 46,047
GSE – Residential mortgage-backed securities	7,636	3	(46)	7,593
U.S. Government collateralized residential mortgage obligations	2,363	8	(17)	2,354
Corporate debt securities, primarily financial institutions	1,825	—	(100)	1,725
Total securities held to maturity	$ 57,058	$ 898	$ (237)	$ 57,719

NOTE 5 – SECURITIES (Continued)

(in thousands)		Amortized Cost		Gross Unrealized Gains		Gross Unrealized Losses		Fair Value
December 31, 2016:								
Securities available for sale:								
U.S. Government agency securities	$	8,474	$	1	$	(62)	$	8,413
Municipal securities		501		2		—		503
GSE – residential mortgage-backed securities		11,455		2		(202)		11,255
U.S. Government collateralized residential mortgage obligations		9,731		6		(200)		9,537
Corporate debt securities, primarily financial institutions		2,493		7		(141)		2,359
Sub-total		32,654		18		(605)		32,067
CRA mutual fund		2,451		—		(54)		2,397
Total securities available for sale	$	35,105	$	18	$	(659)	$	34,464
Securities held to maturity:								
Municipal securities	$	47,806	$	224	$	(528)	$	47,502
GSE – residential mortgage-backed securities		5,414		6		(65)		5,355
U.S. Government collateralized residential mortgage obligations		2,801		1		(29)		2,773
Corporate debt securities, primarily financial institutions		1,822		—		(168)		1,654
Total securities held to maturity	$	57,843	$	231	$	(790)	$	57,284

The amortized cost and fair value of the Company's debt securities at September 30, 2017, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available for Sale				Held to Maturity			
		Amortized Cost		Fair Value		Amortized Cost		Fair Value
	(in thousands)							
Due in one year or less	**$**	**1,248**	**$**	**1,247**	**$**	**11,453**	**$**	**11,474**
Due in one year through five years		**2,118**		**2,136**		**3,183**		**3,255**
Due in five years through ten years		**—**		**—**		**8,291**		**8,448**
Due after ten years		**7,483**		**7,409**		**24,132**		**24,595**
Sub-total		**10,849**		**10,792**		**47,059**		**47,772**
GSE – residential mortgage-backed securities		**8,956**		**8,856**		**7,636**		**7,593**
U.S. Government collateralized residential mortgage obligations		**8,082**		**7,962**		**2,363**		**2,354**
Total	**$**	**27,887**	**$**	**27,610**	**$**	**57,058**	**$**	**57,719**

NOTE 5 – SECURITIES (Continued)

The Company had no security sales during the three months ended September 30, 2017 and 2016. The Company had no security sales for the nine months ended September 30, 2017 as compared to one security sale totaling $1.1 million in which the Company recorded a gross realized gain of $72,000 during the nine months ended September 30, 2016. The sale during 2016 was a municipal bond, which was carried in our held to maturity portfolio. The Company sold this bond out of its held to maturity portfolio due to significant deterioration in the issuer's creditworthiness.

Investment securities with a carrying value of $33.1 million at both September 30, 2017 and December 31, 2016, were pledged as collateral to secure securities sold under agreements to repurchase and public deposits as required or permitted by law.

The tables below indicate the length of time individual securities have been in a continuous unrealized loss position at September 30, 2017 and December 31, 2016:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
September 30, 2017:			(in thousands)			
U.S. Government agency securities	$ 1,247	$ (1)	$ 1,816	$ (18)	$ 3,063	$ (19)
Municipal securities	7,435	(63)	1,858	(11)	9,293	(74)
GSE – residential mortgage-backed securities	9,799	(56)	6,112	(90)	15,911	(146)
U.S. Government collateralized residential mortgage obligations	2,721	(12)	5,244	(135)	7,965	(147)
Corporate debt securities, primarily financial institutions	—	—	2,658	(162)	2,658	(162)
CRA mutual fund	—	—	2,451	(39)	2,451	(39)
Total temporarily impaired securities	$ 21,202	$ (132)	$ 20,139	$ (455)	$ 41,341	$ (587)

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2016:			(in thousands)			
U.S. Government agency securities	$ 7,125	$ (62)	$ —	$ —	$ 7,125	$ (62)
Municipal securities	22,036	(528)	—	—	22,036	(528)
GSE – residential mortgage-backed securities	9,632	(163)	5,949	(104)	15,581	(267)
U.S. Government collateralized residential mortgage obligations	5,630	(50)	4,990	(179)	10,620	(229)
Corporate debt securities, primarily financial institutions	—	—	3,009	(309)	3,009	(309)
CRA mutual fund	2,397	(54)	—	—	2,397	(54)
Total temporarily impaired securities	$ 46,820	$ (857)	$ 13,948	$ (592)	$ 60,768	$ (1,449)

The Company had 49 securities in an unrealized loss position at September 30, 2017. In management's opinion, the unrealized losses in corporate debt, U.S. Government agencies, U.S. Government collateralized residential mortgage obligations, GSE residential mortgage-backed securities and the CRA mutual fund reflect changes in interest rates subsequent to the acquisition of specific securities. The unrealized loss for corporate debt securities also reflects a widening of spreads due to the liquidity and credit concerns in the financial markets. The Company may, if conditions warrant, elect to sell debt securities at a loss and redeploy the proceeds into other investments in an effort to improve returns, risk profile and overall portfolio diversification. The Company will recognize any losses when the decision is made. As of September 30, 2017, the Company did not intend to sell these debt securities prior to market recovery.

NOTE 5 – SECURITIES (Continued)

Included in corporate debt securities are four individual trust preferred securities issued by large financial institutions with Moody's ratings from Baa1to Ba1. At September 30, 2017, all of these securities are current with their scheduled interest payments. These single issue securities are all from large money center banks. Management concluded that these securities were not other-than-temporarily impaired as of September 30, 2017. These four securities have an amortized cost value of $2.8 million and a fair value of $2.7 million at September 30, 2017.

There were no other-than-temporary impairments recognized during the three and nine months ended September 30, 2017 and 2016.

NOTE 6 – LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

Loans receivable, which management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at their outstanding unpaid principal balances, net of an allowance for loan losses and any deferred fees or costs. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the yield (interest income) of the related loans. The Company is generally amortizing these amounts over the contractual life of the loan.

Generally, loans held for sale are designated at time of origination, generally consist of newly originated fixed rate residential mortgage loans and are recorded at the lower of aggregate cost or estimated fair value in the aggregate. During the three months ended September 30, 2017, the Company did not transfer any loans from held for investment to held for sale, while during the nine months ended September 30, 2017, the Company transferred $8.2 million from held for investment to held for sale. During the three and nine months ended September 30, 2016, the Company did not transfer any loans from held for investment to held for sale. Gains are recognized on a settlement-date basis and are determined by the difference between the net sales proceeds and the carrying value of the loans, including any net deferred fees or costs.

The loans receivable portfolio is segmented into five categories, those being a) Commercial and industrial, b) Real estate-construction (consisting of both residential and commercial construction), c) Real estate-commercial, d) Real estate-residential, and e) Consumer.

For all classes of loans receivable, the accrual of interest is discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectability of principal or interest, even though the loan is currently performing. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. When a loan is placed on nonaccrual status, unpaid interest previously accrued on these loans is reversed from income. Interest received on nonaccrual loans, including impaired loans, generally is either applied against principal or reported as interest income, according to management's judgment as to the collectability of principal. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time (generally six months) and the ultimate collectability of the total contractual principal and interest is no longer in doubt. The past due status of all classes of loans receivable is determined based on contractual due dates for loan payments.

The allowance for credit losses consists of the allowance for loan losses and the reserve for unfunded lending commitments. The allowance for loan losses represents management's estimate of losses inherent in the loan portfolio as of the balance sheet date and is recorded as a reduction to loans. The reserve for unfunded lending commitments represents management's estimate of losses inherent in its unfunded loan commitments and is recorded in other liabilities on the consolidated balance sheet, which at September 30, 2017 and December 31, 2016, the Company had no such reserves. The allowance for loan losses is increased by the provision for loan losses, and decreased by charge-offs, net of recoveries. Loans deemed to be uncollectable are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance. All, or part, of the principal balance of loans receivable are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely.

The allowance for loan losses is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. Management performs a monthly evaluation of the adequacy of the allowance. The allowance is based on the Company's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. For loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of the loan. The specific component relates to loans that are classified as impaired. When a loan is impaired, there are three acceptable methods under ASC 310-10-35 for measuring the impairment:

1. The loan's observable market price;

2. The fair value of the underlying collateral; or

3. The present value (PV) of expected future cash flows.

Loans that are considered "collateral-dependent" should be evaluated under the "Fair market value of collateral." Loans that are still expected to be supported by repayment from the borrower should be evaluated under the "Present value of future cash flows."

For the most part, the Company measures impairment under the "Fair market value of collateral" for any loan that would rely on the value of collateral for recovery in the event of default. The individual impairment analysis for each loan is clearly documented as to the chosen valuation method.

The general component covers pools of loans by loan class including commercial and industrial, real estate-construction and real estate-commercial not considered impaired as well as smaller balance homogeneous loans such as real estate-residential and consumer.

These pools of loans are evaluated for loss exposure based upon historical loss rates for each of these categories of loans, adjusted for qualitative factors. These qualitative risk factors include:

1. Changes in lending policy and procedures, including changes in underwriting standards and collection practices not previously considered in estimating credit losses.

2. Changes in relevant economic and business conditions.

3. Changes in nature and volume of the loan portfolio and in the terms of loans.

4. Changes in experience, ability and depth of lending management and staff.

5. Changes in the volume and severity of past due loans, the volume of non-accrual loans and the volume and severity of adversely classified loans.

6. Changes in the quality of the loan review system.

7. Changes in the value of underlying collateral for collateral-dependent loans.

8. The existence and effect of any concentration of credit and changes in the level of such concentrations.

9. The effect of other external forces such as competition, legal and regulatory requirements on the level of estimated credit losses in the existing portfolio.

Each factor is assigned a risk value to reflect low, moderate or high risk assessments based on management's best judgment using current market, macro and other relevant information available at the time of the evaluation. Adjustments to the factors are supported through documentation in each factor and accompany the allowance for loan loss calculation.

An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is considered impaired when it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and industrial, real estate-commercial, real estate-construction, real estate-residential and consumer loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent.

An allowance for loan losses is established for an impaired loan if its carrying value exceeds its estimated fair value. The estimated fair values of substantially all of the Company's impaired loans are measured based on the estimated fair value of the loan's collateral.

For commercial loans secured by real estate, estimated fair values are determined primarily through third-party appraisals. When a real estate secured loan becomes impaired, a decision is made regarding whether an updated certified appraisal of the real estate is necessary. This decision is based on various considerations, including the age of the most recent appraisal, the loan-to-value ratio based on the original appraisal and the condition of the property. Appraised values are discounted to arrive at the estimated selling price of the collateral, which is considered to be the estimated fair value. The discounts also include estimated costs to sell the property.

For commercial loans secured by non-real estate collateral, such as accounts receivable, inventory and equipment, estimated fair values are determined based on the borrower's financial statements, inventory reports, accounts receivable aging or equipment appraisals or invoices. Indications of value from these sources are generally discounted based on the age of the financial information or the quality of the assets.

The allowance calculation methodology includes further segregation of loan classes into risk rating categories. The borrower's overall financial condition, repayment sources, guarantors and value of collateral, if appropriate, are evaluated annually for commercial loans or when credit deficiencies arise, such as delinquent loan payments, for commercial and consumer loans. Credit quality risk ratings include regulatory classifications of special mention, substandard, doubtful and loss. Loans classified 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 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 doubtful have all the weaknesses inherent in loans classified substandard with the added characteristics that collection or liquidation in full, on the basis of current conditions and facts, is highly improbable. Loans classified as a loss are considered uncollectable and are charged to the allowance for loan losses. Loans not classified are rated pass.

In addition, federal and state regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses and may require the Company to recognize additions to the allowance based on their judgments about information available to them at the time of their examination, which may not be currently available to management. Based on management's comprehensive analysis of the loan portfolio, management believes the current level of the allowance for loan losses is adequate.

NOTE 6 – LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES (Continued)

The components of the loan portfolio held for investment at September 30, 2017 and December 31, 2016 are as follows:

	September 30, 2017	December 31, 2016
	(In Thousands)	
Commercial and industrial	**$ 99,601**	$ 93,697
Real estate – construction	**118,553**	111,914
Real estate – commercial	**507,507**	460,685
Real estate – residential	**62,416**	59,065
Consumer	**28,773**	28,279
	816,850	753,640
Allowance for loan losses	**(10,223)**	(9,565)
Unearned fees	**(772)**	(548)
Net Loans	**$ 805,855**	$ 743,527

The performance and credit quality of the loan portfolio is monitored by analyzing the age of the loans receivable as determined by the length of time a recorded payment is past due. The following tables present the classes of the loan portfolio summarized by the past due status as of September 30, 2017 and December 31, 2016:

September 30, 2017:	30-59 Days Past Due	60-89 Days Past Due	90 Days & Greater	Total Past Due	Current	Total Loans Receivable	Loans Receivable >90 Days and Accruing
				(In Thousands)			
Commercial and industrial	**$ —**	**$ —**	**$ 756**	**$ 756**	**$ 98,845**	**$ 99,601**	**$ —**
Real estate – construction	**—**	**—**	**150**	**150**	**118,403**	**118,553**	**—**
Real estate – commercial	**—**	**152**	**252**	**404**	**507,103**	**507,507**	**—**
Real estate – residential	**—**	**—**	**717**	**717**	**61,699**	**62,416**	**—**
Consumer	**49**	**—**	**300**	**349**	**28,424**	**28,773**	**—**
Total	**$ 49**	**$ 152**	**$ 2,175**	**$ 2,376**	**$ 814,474**	**$ 816,850**	**$ —**

December 31, 2016:	30-59 Days Past Due	60-89 Days Past Due	90 Days & Greater	Total Past Due	Current	Total Loans Receivable	Loans Receivable >90 Days and Accruing
				(In Thousands)			
Commercial and industrial	$ —	$ —	$ 119	$ 119	$ 93,578	$ 93,697	**$ —**
Real estate – construction	—	—	—	—	111,914	111,914	**—**
Real estate – commercial	154	—	666	820	459,865	460,685	**—**
Real estate – residential	—	—	533	533	58,532	59,065	**—**
Consumer	—	—	—	—	28,279	28,279	**—**
Total	$ 154	$ —	$ 1,318	$ 1,472	$ 752,168	$ 753,640	**$ —**

NOTE 6 – LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES (Continued)

The following table presents non-accrual loans by classes of the loan portfolio at September 30, 2017 and December 31, 2016:

	September 30, 2017	December 31, 2016
	(In Thousands)	
Commercial and industrial	**$ 926**	$ 119
Real estate – construction	**150**	—
Real estate – commercial	**252**	666
Real estate – residential	**717**	763
Consumer	**300**	—
Total	**$ 2,345**	$ 1,548

There was one new commercial and industrial troubled debt restructured loan ("TDR's), which had a pre- and post-modification outstanding recorded investment in the amount of $170,000 that occurred during the three months ended September 30, 2017. There were no new TDR's that occurred during the three months ended September 30, 2016.

The following table presents new TDR's that occurred during the nine months ended September 30, 2017 and 2016:

	Nine months ended September 30, 2017		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
	(Dollars in Thousands)		
Troubled debt restructuring:			
Commercial and industrial	**2**	**$ 320**	**$ 320**
Real estate – construction	**1**	**150**	**150**
	3	**$ 470**	**$ 470**

	Nine months ended September 30, 2016		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
	(Dollars in Thousands)		
Troubled debt restructuring:			
Commercial and industrial	1	$ 257	$ 257

Loans whose terms are modified are classified as TDRs if the Company grants such borrowers concessions and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a TDR generally involve a temporary reduction in interest rate or a modification of a loan's amortization schedule. Non-accrual TDRs are restored to accrual status if principal and interest payments, under the modified terms, are current for six consecutive months after the modification is in place. Loans classified as TDRs, including those restored to accrual status, are designated as impaired.

The Company's TDR modifications are made on terms typically up to 12 months in order to aggressively monitor and track performance of the credit. The short-term modifications are monitored for continued performance for an additional period of time after the expiration of the concession. Balance reductions and annualized loss rates are also important metrics that are monitored. The main objective of the modification program is to reduce the payment burden for the borrower and improve the net present value of the Company's expected cash flows.

Impaired loans are individually assessed to determine that the loan's carrying value is not in excess of the estimated fair value of the collateral (less cost to sell), if the loan is collateral dependent, or the present value of the expected future cash flows, if the loan is not collateral dependent. Management performs a detailed evaluation of each impaired loan and generally obtains updated appraisals as part of the evaluation. In addition, management adjusts estimated fair value down to appropriately consider recent market conditions, our willingness to accept a lower sales price to effect a quick sale, and costs to dispose of any supporting collateral.

At September 30, 2017, TDRs totaled $8.1 million, including $7.0 million that were current and eight non-accrual loans totaling $1.1 million. As of December 31, 2016, TDRs totaled $8.2 million, including $8.1 million that were current and two non-accrual loans totaling $157,000. At September 30, 2017, the Company had no specific reserve against any loan relationship classified as TDR, while at December 31, 2016, a specific reserve of $2,000 was established against one loan relationships classified as TDR.

There were no loans receivable modified as TDRs and with a payment default occurring within 12 months of the restructure date, and the payment default occurring during the three and nine months ended September 30, 2017 and 2016, respectively.

It is the Company's policy to classify a TDR that is either 90 days or greater delinquent or that has been placed on a non-accrual status as a subsequently defaulted TDR.

The following tables summarize information in regards to impaired loans by loan portfolio class at September 30, 2017 and December 31, 2016, and for the three and nine months ended September 30, 2017 and 2016, respectively:

NOTE 6 – LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES (Continued)

	As of September 30, 2017			For the three months ended September 30, 2017		For the nine months ended September 30, 2017	
	Recorded Investment, Net of Charge-offs	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(In Thousands)						
With no related allowance recorded:							
Commercial and industrial	$ 3,629	$ 3,877	$ —	$ 3,663	$ 36	$ 3,862	$ 118
Real estate – construction	3,145	3,145	—	3,142	33	3,166	100
Real estate – commercial	1,108	1,108	—	1,131	10	1,165	30
Real estate – residential	1,088	1,088	—	1,094	5	1,111	14
Consumer	300	300	—	300	—	301	1
With an allowance recorded:							
Commercial and industrial	$ —	$ —	$ —	$ —	$ —	$ —	$ —
Real estate – construction	—	—	—	—	—	—	—
Real estate – commercial	—	—	—	—	—	—	—
Real estate – residential	—	—	—	—	—	—	—
Consumer	—	—	—	—	—	—	—
Total:							
Commercial and industrial	$ 3,629	$ 3,877	$ —	$ 3,663	$ 36	$ 3,862	$ 118
Real estate – construction	3,145	3,145	—	3,142	33	3,166	100
Real estate – commercial	1,108	1,108	—	1,131	10	1,165	30
Real estate – residential	1,088	1,088	—	1,094	5	1,111	14
Consumer	300	300	—	300	—	301	1
Total	$ 9,270	$ 9,518	$ —	$ 9,330	$ 84	$ 9,605	$ 263

NOTE 6 – LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES (Continued)

	As of December 31, 2016			For the three months ended September 30, 2016		For the nine months ended September 30, 2016	
	Recorded Investment, Net of Charge-offs	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
				(In Thousands)			
With no related allowance recorded:							
Commercial and industrial	$ 3,402	$ 3,415	$ —	$ 3,531	$ 43	$ 3,615	$ 131
Real estate – construction	3,036	3,036	—	3,217	34	3,264	103
Real estate – commercial	1,548	1,577	—	1,572	10	1,637	37
Real estate – residential	1,139	1,189	—	1,162	5	1,168	14
Consumer	—	—	—	—	—	—	—
With an allowance recorded:							
Commercial and industrial	$ 498	$ 498	$ 2	$ 505	$ 4	$ 509	$ 12
Real estate – construction	—	—	—	—	—	—	—
Real estate – commercial	—	—	—	—	—	—	—
Real estate – residential	—	—	—	—	—	—	—
Consumer	—	—	—	—	—	—	—
Total:							
Commercial and industrial	$ 3,900	$ 3,913	$ 2	$ 4,036	$ 47	$ 4,124	$ 143
Real estate – construction	3,036	3,036	—	3,217	34	3,264	103
Real estate – commercial	1,548	1,577	—	1,572	10	1,637	37
Real estate – residential	1,139	1,189	—	1,162	5	1,168	14
Consumer	—	—	—	—	—	—	—
Total	$ 9,623	$ 9,715	$ 2	$ 9,987	$ 96	$ 10,193	$ 297

NOTE 6 – LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES (Continued)

The following tables present the classes of the loan portfolio summarized by the aggregate pass rating and the classified ratings of special mention, substandard and doubtful within the Company's internal risk rating system as of September 30, 2017 and December 31, 2016:

	Pass	Special Mention	Substandard	Doubtful	Total
			(In Thousands)		
September 30, 2017:					
Commercial and industrial	$ 95,092	$ 880	$ 3,380	$ 249	$ 99,601
Real estate – construction	112,816	4,261	1,476	—	118,553
Real estate – commercial	495,578	11,143	786	—	507,507
Real estate – residential	61,699	—	717	—	62,416
Consumer	28,255	34	484	—	28,773
Total	$ 793,440	$ 16,318	$ 6,843	$ 249	$ 816,850

	Pass	Special Mention	Substandard	Doubtful	Total
			(In Thousands)		
December 31, 2016:					
Commercial and industrial	$ 88,776	$ 1,277	$ 3,644	$ —	$ 93,697
Real estate – construction	108,728	1,894	1,292	—	111,914
Real estate – commercial	452,740	6,716	1,229	—	460,685
Real estate – residential	58,302	—	763	—	59,065
Consumer	27,856	230	193	—	28,279
Total	$ 736,402	$ 10,117	$ 7,121	$ —	$ 753,640

The following tables present the balance in the allowance for loan losses at September 30, 2017 and December 31, 2016 disaggregated on the basis of the Company's impairment method by class of loans receivable along with the balance of loans receivable by class disaggregated on the basis of the Company's impairment methodology:

	Allowance for Loan Losses			Loans Receivable		
	Balance	Balance Related to Loans Individually Evaluated for Impairment	Balance Related to Loans Collectively Evaluated for Impairment	Balance	Balance Individually Evaluated for Impairment	Balance Collectively Evaluated for Impairment
			(In Thousands)			
September 30, 2017:						
Commercial and industrial	$ 887	$ —	$ 887	$ 99,601	$ 3,629	$ 95,972
Real estate – construction	1,367	—	1,367	118,553	3,145	115,408
Real estate – commercial	6,906	—	6,906	507,507	1,108	506,399
Real estate – residential	488	—	488	62,416	1,088	61,328
Consumer	174	—	174	28,773	300	28,473
Unallocated	401	—	401	—	—	—
Total	$ 10,223	$ —	$ 10,223	$ 816,850	$ 9,270	$ 807,580

NOTE 6 – LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES (Continued)

	Allowance for Loan Losses			Loans Receivable		
	Balance	Balance Related to Loans Individually Evaluated for Impairment	Balance Related to Loans Collectively Evaluated for Impairment	Balance	Balance Individually Evaluated for Impairment	Balance Collectively Evaluated for Impairment
	(In Thousands)					
December 31, 2016:						
Commercial and industrial	$ 844	$ 2	$ 842	$ 93,697	$ 3,900	$ 89,797
Real estate – construction	1,276	—	1,276	111,914	3,036	108,878
Real estate – commercial	6,315	—	6,315	460,685	1,548	459,137
Real estate – residential	463	—	463	59,065	1,139	57,926
Consumer	244	—	244	28,279	—	28,279
Unallocated	423	—	423	—	—	—
Total	$ 9,565	$ 2	$ 9,563	$ 753,640	$ 9,623	$ 744,017

The following table presents the change in the allowance for loan losses by classes of loans for the three and nine months ended September 30, 2017 and 2016:

Allowance for Loan Losses	Commercial and Industrial	Real Estate - Construction	Real Estate - Commercial	Real Estate - Residential	Consumer	Unallocated	Total
	(In Thousands)						
Beginning balance, July 1, 2017	**$ 898**	**$ 1,284**	**$ 6,781**	**$ 466**	**$ 172**	**$ 352**	**$ 9,953**
Charge-offs	**—**	**—**	**—**	**—**	**—**	**—**	**—**
Recoveries	**4**	**4**	**6**	**—**	**1**	**—**	**15**
Provision	**(15)**	**79**	**119**	**22**	**1**	**49**	**255**
Ending balance, September 30, 2017	**$ 887**	**$ 1,367**	**$ 6,906**	**$ 488**	**$ 174**	**$ 401**	**$ 10,223**

Allowance for Loan Losses	Commercial and Industrial	Real Estate - Construction	Real Estate - Commercial	Real Estate - Residential	Consumer	Unallocated	Total
	(In Thousands)						
Beginning balance, January 1, 2017	**$ 844**	**$ 1,276**	**$ 6,315**	**$ 463**	**$ 244**	**$ 423**	**$ 9,565**
Charge-offs	**(248)**	**—**	**—**	**—**	**—**	**—**	**(248)**
Recoveries	**17**	**12**	**17**	**—**	**5**	**—**	**51**
Provision	**274**	**79**	**574**	**25**	**(75)**	**(22)**	**855**
Ending balance, September 30, 2017	**$ 887**	**$ 1,367**	**$ 6,906**	**$ 488**	**$ 174**	**$ 401**	**$ 10,223**

NOTE 6 – LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES (Continued)

Allowance for Loan Losses	Commercial and Industrial	Real Estate - Construction	Real Estate - Commercial	Real Estate - Residential	Consumer	Unallocated	Total
			(In Thousands)				
Beginning balance, July 1, 2016	$ 905	$ 1,165	$ 6,495	$ 387	$ 241	$ 225	$ 9,418
Charge-offs	—	—	(444)	—	(5)	—	(449)
Recoveries	3	—	3	—	7	—	13
Provision	10	1	427	36	(7)	3	470
Ending balance, September 30, 2016	$ 918	$ 1,166	$ 6,481	$ 423	$ 236	$ 228	$ 9,452

Allowance for Loan Losses	Commercial and Industrial	Real Estate - Construction	Real Estate - Commercial	Real Estate - Residential	Consumer	Unallocated	Total
			(In Thousands)				
Beginning balance, January 1, 2016	$ 990	$ 1,283	$ 5,599	$ 304	$ 242	$ 295	$ 8,713
Charge-offs	—	—	(444)	—	(5)	—	(449)
Recoveries	9	8	249	—	62	—	328
Provision	(81)	(125)	1,077	119	(63)	(67)	860
Ending balance, September 30, 2016	$ 918	$ 1,166	$ 6,481	$ 423	$ 236	$ 228	$ 9,452

NOTE 7 – STOCK-BASED COMPENSATION PLANS

The Two River Bancorp 2007 Equity Incentive Plan (the "Plan") provides that the Compensation Committee of the Board of Directors (the "Committee") may grant to those individuals who are eligible under the terms of the Plan stock options, shares of restricted stock, or such other equity incentive awards as the Committee may determine. As of September 30, 2017, the number of shares of Company common stock remaining and available for future issuance under the Plan is 154,534 after adjusting for subsequent stock dividends. Shares reserved under the Plan will be issued out of authorized and unissued shares, or treasury shares, or partly out of cash, as determined by the Board.

From the adoption of the Plan until March 20, 2017, options awarded under the Plan were permitted to be either options that qualify as incentive stock options ("ISOs") under Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"), or options that do not, or cease to, qualify as incentive stock options under the Code ("nonqualified stock options" or "NQSOs"). However, after March 20, 2017, only NQSOs may be awarded under the Plan. Awards may be granted under the Plan to directors and employees, and to other persons who provide substantial services to the Company.

The exercise price per share purchasable under an option awarded under the Plan may not be less than the fair market value of a share of stock on the date of grant of the option. The Committee determines the vesting period and term of each option, provided that no ISO is permitted to have a term in excess of ten years after the date of grant.

Restricted stock is stock which is subject to certain transfer restrictions and to a risk of forfeiture. The Committee will determine the period over which any restricted stock which is issued under the Plan will vest, and will impose such restrictions on transferability, risk of forfeiture and other restrictions as the Committee may in its discretion determine. Unless restricted by the Committee, a participant granted restricted stock will have all of the rights of a shareholder, including the right to vote the restricted stock and the right to receive dividends with respect to that stock.

Unless otherwise provided by the Committee in the award document or subject to other applicable restrictions, in the event of a Change in Control (as defined in the Plan) all non-forfeited options and awards carrying a right to exercise that was not previously exercisable and vested will become fully exercisable and vested as of the time of the Change in Control, and all restricted stock and awards subject to risk of forfeiture will become fully vested.

Stock Options

For the three and nine months ended September 30, 2017, there were no stock option grants awarded to either directors or officers.

Stock-based compensation expense related to the stock option grants was approximately $20,000 and $60,000 during the three and nine month periods ended September 30, 2017, as compared to $29,000 and 86,000 for the same three and nine month periods in 2016, respectively, and is included in salaries and employee benefits on the statement of operations.

Total unrecognized compensation cost related to non-vested options under the Plan was $126,000 as of September 30, 2017 and will be recognized over the subsequent weighted average life of 2.6 years.

The following table presents information regarding the Company's outstanding stock options, after adjusting for subsequent stock dividends, at September 30, 2017:

	Number of Shares	Weighted Average Price	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value
Options outstanding, December 31, 2016	**432,451**	**$ 5.05**		
Options granted	—	—		
Options exercised	**(65,948)**	**4.03**		
Options forfeited	**(2,541)**	**7.81**		
Options outstanding, September 30, 2017	**363,962**	**$ 5.20**	**4.06**	**$ 4,971,641**
Options exercisable, September 30, 2017	**295,319**	**$ 4.47**	**3.30**	**$ 4,245,250**
Option price range at September 30, 2017	**$2.87 to $11.21**			

The total intrinsic value of options exercised during the three and nine months ended September 30, 2017 was $351,000 and $875,000, respectively. Cash received from such exercises was $105,000 and $266,000, respectively. The total intrinsic value of options exercised during the three and nine months ended September 30, 2016 was $28,000 and $140,000, respectively. Cash received from such exercises was $16,000 and $89,000, respectively. There was a $32,000 and $139,000 income tax benefit recognized in the three and nine months ended September 30, 2017 relating to the adoption of ASU 2016-09, *Compensation-Stock Compensation, Improvements to Employee Share-Based Payment Accounting* attributable to stock options. There was no tax benefit recognized in the three and nine months ended September 30, 2016.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model.

Restricted Stock

Restricted stock is valued at the market value on the date of grant and expense is evenly attributed to the period in which the restrictions lapse.

Compensation expense related to restricted stock was $37,000 and $142,000 for the three and nine month periods ended September 30, 2017, respectively as compared to $53,000 and $76,000 for the three and nine periods ended September 30, 2016 and is included in salaries and employee benefits on the statement of operations. There was a $0 and $38,000 income tax benefit recognized in the three and nine months ended September 30, 2017, respectively, relating to the adoption of ASU 2016-09 attributable to restricted stock awards. There was no tax benefit recognized during the three and nine months ended September 30, 2016.

Total unrecognized compensation cost related to restricted stock under the Plan as of September 30, 2017 was $431,000 and will be recognized over the subsequent weighted average life of 3.2 years.

The following table summarizes information about restricted stock, after adjusting for subsequent stock dividends, at September 30, 2017:

	Number of Shares	Weighted Average Price
Unvested at December 31, 2016	34,082	$ 8.93
Restricted stock earned	(13,650)	9.56
Granted	21,018	16.06
Unvested at September 30, 2017	41,450	$ 12.33

NOTE 8 – GUARANTEES

The Company does not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Generally, all letters of credit, when issued, have expiration dates within one year. The credit risks involved in issuing letters of credit are essentially the same as those that are involved in extending loan facilities to customers. The Company generally holds collateral and/or personal guarantees supporting these commitments. As of September 30, 2017, the Company had $5.3 million of commercial and similar letters of credit. Management believes that the current amount of the liability as of September 30, 2017 for guarantees under standby letters of credit issued is not material.

NOTE 9 – FHLB AND OTHER BORROWINGS

The Bank utilizes its account relationship with Atlantic Community Bankers Bank to borrow funds through its Federal funds borrowing line in an aggregate amount up to $10.0 million. The Bank also has $36.0 million in unsecured credit facilities with three correspondent banks. These borrowings are priced on a daily basis. The Company had no borrowings outstanding on these lines at September 30, 2017 and December 31, 2016. The Bank also has a remaining borrowing capacity with the FHLB of approximately $31.7 million based on the current loan collateral pledged of $139.2 million at September 30, 2017.

At September 30, 2017 and December 31, 2016, FHLB and other borrowings consisted of advances from the FHLB, which amounted to $30.3 million and $25.3 million, respectively. These advances had an average interest rate of 2.31% and 2.35% at September 30, 2017 and December 31, 2016, respectively. These advances are contractually scheduled for repayment as follows:

	September 30, 2017	December 31, 2016	Rate	Original Term (Years)	Maturity
	(dollars in thousands)				
Fixed Rate Note	**$ 7,500**	$ 7,500	**3.97%**	**10**	**November 2017**
Fixed Rate Note	**—**	1,500	**2.71%**	**7**	**August 2017**
Fixed Rate Note	**2,000**	2,000	**1.28%**	**4**	**October 2017**
Fixed Rate Note	**2,000**	2,000	**1.65%**	**5**	**October 2018**
Fixed Rate Note	**—**	1,000	**0.97%**	**2**	**January 2017**
Fixed Rate Note	**1,300**	1,300	**1.31%**	**3**	**January 2018**
Fixed Rate Note	**1,800**	1,800	**1.59%**	**4**	**January 2019**
Fixed Rate Note	**2,700**	2,700	**1.81%**	**5**	**January 2020**
Fixed Rate Note	**2,500**	2,500	**2.03%**	**6**	**January 2021**
Fixed Rate Note	**1,000**	1,000	**1.09%**	**3**	**July 2019**
Fixed Rate Note	**1,000**	1,000	**1.42%**	**5**	**July 2021**
Fixed Rate Note	**7,500**	—	**2.07%**	**5**	**August 2022**
Fixed Rate Note	**1,000**	1,000	**1.70%**	**7**	**July 2023**
Total FHLB borrowings	**$ 30,300**	$ 25,300			

As of September 30, 2017, the FHLB has issued $75.1 million in municipal deposit letters of credit in the name of the Bank naming the NJ Department of Banking and Insurance as beneficiary. This letter of credit will take the place of securities previously pledged to the State of New Jersey for the Bank’s various municipal deposits.

NOTE 10 – SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

The Bank enters into Sweep Account Agreements with certain of its deposit account holders for repo sweep arrangements under which funds in excess of a predetermined amount are removed from each such depositor’s account at the end of each banking day, and the Bank’s obligation to restore those funds to the account at the beginning of the following banking day is evidenced by an integrated retail repurchase agreement (a “Repurchase Agreement”) secured by a collateral interest in favor of the depositor in certain government securities held by a third party custodian. The Bank’s obligation to restore the funds under the Repurchase Agreements is accounted for as a collateralized financing arrangement (i.e., secured borrowings), and not as a sale and subsequent repurchase of securities. The obligation to restore the funds to each account is reflected as a liability in the Company's consolidated balance sheets, while the securities underlying the repurchase agreements remain in the respective securities accounts. There is no offsetting or netting of the securities against the Repurchase Agreement obligation.

NOTE 10 – SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE (Continued)

The following table presents the contractual maturities of the Repurchase Agreements as of September 30, 2017 and December 31, 2016, disaggregated by the class of collateral pledged:

	Maturity of Repurchase Agreements				
(dollars in thousands)	**Overnight and Continuous**	**Up to 30 days**	**30 to 90 days**	**Over 90 days**	**Total**
September 30, 2017					
Class of Collateral Pledged:					
U.S. Government agency securities	**$ 7,722**	**$ —**	**$ —**	**$ —**	**$ 7,722**
GSE – residential mortgage-backed securities	**11,414**	**—**	**—**	**—**	**11,414**
U.S. Government collateralized residential mortgage obligations	**7,322**	**—**	**—**	**—**	**7,322**
Total	**$ 26,458**	**$ —**	**$ —**	**$ —**	**$ 26,458**
Gross amount of recognized liabilities for repurchase agreements and securities lending					**$ 22,576**
Excess of collateral pledged over recognized liability					**$ 3,882**

	Maturity of Repurchase Agreements				
(dollars in thousands)	**Overnight and Continuous**	**Up to 30 days**	**30 to 90 days**	**Over 90 days**	**Total**
December 31, 2016					
Class of Collateral Pledged:					
U.S. Government agency securities	$ 8,371	$ —	$ —	$ —	$ 8,371
GSE – residential mortgage-backed securities	9,074	—	—	—	9,074
U.S. Government collateralized residential mortgage obligations	13,895	—	—	—	13,895
Total	$ 31,340	$ —	$ —	$ —	$ 31,340
Gross amount of recognized liabilities for repurchase agreements and securities lending					$ 19,915
Excess of collateral pledged over recognized liability					$ 11,425

The potential risks associated with the Repurchase Agreements and related pledged collateral, including obligations arising from a decline in the fair value of the pledged collateral, are minimal due to the fact that the Repurchase Agreements pertain to overnight borrowings and therefore not subject to fluctuations in fair market value.

NOTE 11 – SUBORDINATED DEBENTURES

In December 2015, the Company completed a private placement of $10 million in aggregate principal amount of fixed to floating rate subordinated debentures to certain institutional accredited investors. The subordinated debentures have a maturity date of December 31, 2025 and bear interest, payable quarterly, at the rate of 6.25% per annum until January 1, 2021. On that date, the interest rate will be adjusted to float at an annual rate equal to the prevailing three-month LIBOR rate plus 464 basis points (4.64%) until maturity. The debentures include a right of prepayment, without penalty, on or after December 14, 2020 and, in certain limited circumstances, before that date. The indebtedness evidenced by the subordinated debentures, including principal and interest, is unsecured and subordinate and junior in right to payment to general and secured creditors of the Company and depositors and all other creditors of the Bank. The subordinated debentures have been structured to qualify as Tier 2 capital for regulatory purposes. Subordinated debentures totaled $9.9 million at September 30, 2017 and December 31, 2016, which includes $121,000 and $145,000, respectively, of remaining unamortized debt issuance costs at September 30, 2017 and December 31, 2016. The debt issuance costs are being amortized over the expected life of the issue. The effective interest rate of the subordinated debentures is 6.67%.

NOTE 12 – FAIR VALUE MEASUREMENTS

Accounting guidance establishes a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

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

Level 2: Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e. supported with little or no market activity).

An asset's or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. For financial assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at September 30, 2017 and December 31, 2016 are as follows:

Description	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs	Total
		(in thousands)		
At September 30, 2017:				
Securities available for sale:				
U.S. Government agency securities	$ —	$ 7,846	$ —	$ 7,846
Municipal securities	—	504	—	504
GSE – residential mortgage-backed securities	—	8,856	—	8,856
U.S. Government collateralized residential mortgage obligations	—	7,962	—	7,962
Corporate debt securities, primarily financial institutions	—	2,442	—	2,442
CRA mutual fund	2,451	—	—	2,451
Total securities available for sale	$ 2,451	$ 27,610	$ —	$ 30,061

NOTE 12 – FAIR VALUE MEASUREMENTS (Continued)

Description	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs	Total
		(in thousands)		
At December 31, 2016:				
Securities available for sale:				
U.S. Government agency securities	$ —	$ 8,413	$ —	$ 8,413
Municipal securities	—	503	—	503
GSE – residential mortgage-backed securities	—	11,255	—	11,255
U.S. Government collateralized residential mortgage obligations	—	9,537	—	9,537
Corporate debt securities, primarily financial institutions	—	2,359	—	2,359
CRA mutual fund	2,397	—	—	2,397
Total securities available for sale	$ 2,397	$ 32,067	$ —	$ 34,464

As of September 30, 2017 and December 31, 2016, there were no securities available for sale measured at fair value on a recurring basis using significant unobservable inputs (Level 3).

For assets measured at fair value on a nonrecurring basis, the fair value measurements by level within the fair value hierarchy used at September 30, 2017 and December 31, 2016 are as follows:

Description	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs	Total
		(in thousands)		
At September 30, 2017:				
Impaired loans, net of partial charge-offs	**$ —**	**$ —**	**$ 248**	**$ 248**
At December 31, 2016:				
Impaired loans with an allowance recorded	$ —	$ —	$ 496	$ 496
OREO	—	—	259	259

The Company's policy is to recognize transfers between levels as of the beginning of the period. There were no transfers between Levels 1, 2 and 3 for the three and nine months ended September 30, 2017 and 2016.

The following valuation techniques were used to measure fair value of assets in the tables above:

- *Impaired loans* – Impaired loans measured at fair value are those loans in which the Company has measured impairment generally based on the fair value of the loan's collateral. This method of fair value measurement is used on all of the Company's impaired loans. Fair value is generally determined based upon either independent third party appraisals of the properties or discounted cash flows based upon the expected proceeds. The appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses. At September 30, 2017, there were no loans that received a discount. At December 31, 2016, two loans received a 5.0% discount to their appraised values. At September 30, 2017, there were no liquidation expenses. At December 31, 2016, the liquidation expenses were 5.0% (weighted average of 5.0%). These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements.

- *OREO* – Real estate properties acquired through, or in lieu of, loan foreclosure are carried at fair value less cost to sell. Fair value is based upon the appraised value of the collateral, adjusted by management for factors such as economic conditions and other market factors. During the third quarter of 2017, the Company sold its only OREO property for a loss of $17,000. At December 31, 2016, the discount and liquidation expenses for collateral adjustments to our one OREO property was 5.95%. These assets are included in Level 3 fair value based upon the lowest level of input that is significant to the fair value measurement. At December 31, 2016, OREO totaling $259,000 was acquired by deed in lieu of foreclosure and was carried at fair value less estimated selling costs based on current appraisals. At September 30, 2017, the Company had no residential real estate properties held in OREO. At September 30, 2017, there were two residential mortgage loan secured by real estate in the amount of $596,000 that were in process of foreclosure. At December 31, 2016, the Company initiated foreclosure proceedings on one residential mortgage loan secured by real estate in the amount of $532,000.

The following information should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only provided for a limited portion of the Company's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Company's disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of the Company's financial instruments at September 30, 2017 and December 31, 2016:

***Cash and Cash Equivalents (carried at cost)*:**

The carrying amounts reported in the balance sheet for cash and short-term instruments approximate those assets' fair values.

***Securities*:**

The fair value of securities available-for-sale (carried at fair value) and held to maturity (carried at amortized cost) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted prices. For certain securities which are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence (Level 3). At September 30, 2017 and December 31, 2016, there were no Level 3 securities.

***Restricted Investments (carried at cost)*:**

The carrying amount of restricted investment in Federal Home Loan Bank stock, Atlantic Community Bancshares, Inc. stock and Solomon Hess SBA Loan Fund approximates fair value, and considers the limited marketability of such securities.

Loans Held for Sale:

Loans held for sale are carried at the lower of aggregate cost or estimated fair value, less costs to sell. The fair value of these loans are equal to the contractual sales price.

Loans Receivable (carried at cost):

The fair values of loans, excluding collateral dependent impaired loans, are estimated using discounted cash flow analyses, using market rates at the balance sheet date that reflect the credit and interest rate-risk inherent in the loans, including liquidity. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments and prepayments of principal. The valuation of the loan portfolio reflects discounts that the Company believes are consistent with transactions occurring in the marketplace for both performing and distressed loan types. The carrying value that fair value is compared to is net of the allowance for loan losses and other associated premiums and discounts. Generally, for variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Due to the significant judgment involved in evaluating credit quality risk, loans are classified within Level 3 of the fair value hierarchy.

Accrued Interest Receivable and Payable (carried at cost):

The carrying amount of accrued interest receivable and accrued interest payable approximates its fair value.

Deposit Liabilities (carried at cost):

The fair values disclosed for demand deposits (e.g., interest and noninterest checking, passbook savings and money market 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 to a schedule of aggregated expected monthly maturities on time deposits.

Securities Sold Under Agreements to Repurchase (carried at cost):

The carrying amounts of these short-term borrowings approximate their fair values.

FHLB and Other Borrowing (carried at cost):

Fair values of FHLB advances are estimated using discounted cash flow analysis, based on quoted prices for new FHLB advances with similar credit risk characteristics, terms and remaining maturity. These prices obtained from this active market represent a market value that is deemed to represent the transfer price if the liability were assumed by a third party.

Subordinated Debentures (carried at cost):

The fair value of subordinated debentures is estimated by using a discounted cash flow analysis that, at September 30, 2017 and December 31, 2016, applies a 4.59% and 4.64% credit spread, respectively, plus the U.S. Treasury rate (all-in issue spread) to the time remaining until the issue's call option date.

Off-Balance Sheet Financial Instruments (disclosed at cost):

Fair values for the Company's off-balance sheet financial instruments (lending commitments and letters of credit) are based on fees currently charged in the market to enter into similar agreements, taking into account, the remaining terms of the agreements and the counterparties' credit standing. The fair values of such fees are not material at September 30, 2017 and December 31, 2016.

NOTE 12 – FAIR VALUE MEASUREMENTS (Continued)

The estimated fair values of the Company's financial instruments at September 30, 2017 and December 31, 2016 were as follows:

	Fair Value Measurements at September 30, 2017				
(in thousands)	**Carrying Amount**	**Estimated Fair Value**	**(Level 1) Quoted Prices in Active Markets for Identical Assets**	**(Level 2) Significant Other Observable Inputs**	**(Level 3) Significant Unobservable Inputs**
Financial assets:					
Cash and cash equivalents	**$ 46,303**	**$ 46,303**	**$ 46,303**	**$ —**	**$ —**
Securities available for sale	**30,061**	**30,061**	**2,451**	**27,610**	**—**
Securities held to maturity	**57,058**	**57,719**	**—**	**57,719**	**—**
Restricted investments	**5,522**	**5,522**	**—**	**—**	**5,522**
Loans held for sale	**1,082**	**1,130**	**—**	**—**	**1,130**
Loans receivable, net	**805,855**	**809,008**	**—**	**—**	**809,008**
Accrued interest receivable	**2,313**	**2,313**	**—**	**497**	**1,816**
Financial liabilities:					
Deposits	**821,872**	**821,432**	**—**	**821,432**	**—**
Securities sold under agreements to repurchase	**22,576**	**22,576**	**—**	**22,576**	**—**
FHLB and other borrowings	**30,300**	**30,170**	**—**	**30,170**	**—**
Subordinated debt	**9,879**	**9,879**	**—**	**9,879**	**—**
Accrued interest payable	**114**	**114**	**—**	**114**	**—**

	Fair Value Measurements at December 31, 2016				
(in thousands)	**Carrying Amount**	**Estimated Fair Value**	**(Level 1) Quoted Prices in Active Markets for Identical Assets**	**(Level 2) Significant Other Observable Inputs**	**(Level 3) Significant Unobservable Inputs**
Financial assets:					
Cash and cash equivalents	$ 42,077	$ 42,077	$ 42,077	$ —	$ —
Securities available for sale	34,464	34,464	2,397	32,067	—
Securities held to maturity	57,843	57,284	—	57,284	—
Restricted investments	4,805	4,805	—	—	4,805
Loans held for sale	4,537	4,698	—	—	4,698
Loans receivable, net	743,527	740,910	—	—	740,910
Accrued interest receivable	2,234	2,234	—	621	1,613
Financial liabilities:					
Deposits	776,567	776,404	—	776,404	—
Securities sold under agreements to repurchase	19,915	19,915	—	19,915	—
FHLB and other borrowings	25,300	25,363	—	25,363	—
Subordinated debt	9,855	9,827	—	9,827	—
Accrued interest payable	100	100	—	100	—

NOTE 13 – SHAREHOLDERS' EQUITY

On December 15, 2016, the Company announced that its Board of Directors approved a new Share Repurchase Program. This new program allows for the Company to repurchase up to $2.0 million of its common stock from January 1, 2017 to December 31, 2017. During the three and nine months ended September 30, 2017, the Company did not repurchase any shares of its common stock.

NOTE 14 – SUBSEQUENT EVENT

On October 18, 2017, the Board of Directors declared a quarterly cash dividend of $0.045 per share to common shareholders of record at the close of business on November 8, 2017, payable on November 29, 2017.

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

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. Such statements are not historical facts and include expressions about management's assumptions and strategies and management's expectations about new and existing programs and products, relationships, opportunities, taxation, technology and market conditions. When used in this and in our future filings with the SEC, in our press releases and in oral statements made with the approval of an authorized executive officer, the words or phrases "will," "will likely result," "could," "anticipates," "believes," "continues," "expects," "plans," "will continue," "is anticipated," "estimated," "project" or "outlook" or similar expressions (including confirmations by one of our authorized executive officers of any such expressions made by a third party with respect to us) are intended to identify forward-looking statements. We wish to caution readers not to place undue reliance on any such forward-looking statements, each of which speaks only as of the date made, even if subsequently made available on our website or otherwise. 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 discussed under "Business," "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the 2016 Form 10-K, under this Item 2, and in our other filings with the SEC.

Although management has taken certain steps to mitigate any negative effect of these factors, significant unfavorable changes could severely impact the assumptions used and 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.

This Report contains certain financial information determined by methods other than in accordance with generally accepted accounting policies in the United States (GAAP). These non-GAAP financial measures are "tangible book value per common share," "return on average tangible assets," "return on average tangible equity," and "average tangible equity to average tangible assets." This non-GAAP disclosure has limitations as an analytical tool and should not be considered in isolation or as a substitute for analysis of the Company's results as reported under GAAP, nor is it necessarily comparable to non-GAAP performance measures that may be presented by other companies. Our management uses these non-GAAP measures in its analysis of our performance because it believes these measures are material and will be used as a measure of our performance by investors.

The following information should be read in conjunction with the consolidated financial statements and the related notes thereto included in the 2016 Form 10-K and in this Form 10-Q.

Critical Accounting Policies and Estimates

The following discussion is based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses.

Note 1 to our audited consolidated financial statements contains a summary of the Company's significant accounting policies. Management believes the following critical accounting policies encompass the more significant judgments and estimates used in the preparation of our consolidated financial statements.

Allowance for Loan Losses. Management believes our policy with respect to the methodology for the determination of the allowance for loan losses ("ALLL") involves a high degree of complexity and requires management to make difficult and subjective judgments which often require assumptions or estimates about highly uncertain matters. Changes in these judgments, assumptions or estimates could materially impact the results of operations. This critical policy and its application are reviewed quarterly with our audit committee and Board of Directors.

Management is responsible for preparing and evaluating the ALLL on a quarterly basis in accordance with Bank policy, and the *Interagency Policy Statement on the ALLL* released by the Board of Governors of the Federal Reserve System on December 13, 2006 as well as GAAP. We believe that our allowance for loan losses is adequate to cover specifically identifiable loan losses, as well as estimated losses inherent in our portfolio for which certain losses are probable but not specifically identifiable. The allowance for loan losses is based upon management's evaluation of the adequacy of the allowance account, including an assessment of known and inherent risks in the portfolio, giving consideration to the size and composition of the loan portfolio, actual loan loss experience, level of delinquencies, detailed analysis of individual loans for which full collectability may not be assured, the existence and estimated net realizable value of any underlying collateral and guarantees securing the loans, and current economic and market conditions. Although management utilizes the best information available, the level of the allowance for loan losses remains an estimate that is subject to significant judgment and short term change. Various regulatory agencies may require us and our banking subsidiaries to make additional provisions for loan losses based upon information available to them at the time of their examination. Furthermore, the majority of our loans are secured by real estate in New Jersey, primarily in Monmouth and Union counties. Accordingly, the collectability of a substantial portion of the carrying value of our loan portfolio is susceptible to changes in local market conditions and may be adversely affected should real estate values decline or the New Jersey and/or our local market areas experience economic shock.

Stock-Based Compensation. Stock based compensation cost has been measured using the fair value of an award on the grant date and is recognized over the service period, which is usually the vesting period. The fair value of each option is amortized into compensation expense on a straight-line basis between the grant date for the option and each vesting date. The Company estimates the fair value of stock options on the date of grant using the Black-Scholes option pricing model. The model requires the use of numerous assumptions, many of which are highly subjective in nature.

Goodwill Impairment. Although goodwill is not subject to amortization, the Company must test the carrying value for impairment at least annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. Impairment testing requires that the fair value of our reporting unit be compared to the carrying amount of its net assets, including goodwill. Our reporting unit was identified as our community bank operations. If the fair value of the reporting unit exceeds the book value, no write-down of recorded goodwill is necessary. If the fair value of a reporting unit is less than book value, an expense may be required on the Company's books to write-down the related goodwill to the proper carrying value.

Investment Securities Impairment Valuation. Securities are evaluated on at least a quarterly basis, and more frequently when market conditions warrant such an evaluation, to determine whether a decline in their value is other-than-temporary. The analysis of other-than-temporary impairment requires the use of various assumptions including, but not limited to, the length of time the investment's book value has been greater than fair value, the severity of the investment's decline and the credit deterioration of the issuer. For debt securities, management assesses whether (a) it has the intent to sell the security and (b) it is more likely than not that it will be required to sell the security prior to its anticipated recovery. These steps are done before assessing whether the entity will recover the cost basis of the investment.

In instances when a determination is made that an other-than-temporary impairment exists but the investor does not intend to sell the debt security and it is more likely than not that it will not be required to sell the debt security prior to its anticipated recovery, the other-than-temporary impairment is separated into (a) the amount of the total other-than-temporary impairment related to a decrease in cash flows expected to be collected from the debt security (the credit loss) and (b) the amount of the total other-than-temporary impairment related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings. The amount of the total other-than-temporary impairment related to all other factors is recognized in other comprehensive income.

Other Real Estate Owned ("OREO"). OREO includes real estate acquired through foreclosure or by deed in lieu of foreclosure. OREO is initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Any write-downs based on fair value less costs to sell at the date of foreclosure are charged to the allowance for loan losses. If at the time of foreclosure, the fair value less costs to sell is greater than the loan balance, the resulting gain is recognized at the time of foreclosure unless there has been a prior charge-off, in which case a recovery to the allowance for loan losses is recorded. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Operating results from real estate owned, including rental income, operating expenses, and gains and losses realized from the sales of real estate owned, are recorded as incurred.

Deferred Tax Assets and Liabilities. We recognize deferred tax assets and liabilities for future tax effects of temporary differences, net operating loss carry forwards and tax credits. Deferred tax assets are subject to management's judgment based upon available evidence, primarily management's forecast of its ability to generate future earnings, that future realization is more likely than not. If management determines that we may be unable to realize all or part of net deferred tax assets in the future, a direct charge to income tax expense may be required to reduce the recorded value of the net deferred tax asset to the expected realizable amount.

Overview

The Company reported net income of $2.24 million, or $0.26 per diluted share, for the third quarter of 2017, compared to $2.64 million, or $0.31 per diluted share, for the same period in 2016, a decrease of $407,000, or 15.4%. The decrease was primarily due to the receipt of an $862,000 tax-free Bank Owned Life Insurance ("BOLI") death benefit in the third quarter of 2016. This was partially offset by higher net interest income and non-interest income, coupled with a benefit to income tax expense related to the adoption of ASU 2016-09, *Compensation-Stock Compensation, Improvement to Employee Share-Based Payment Accounting,* which increased net income by $32,000. These increases were partially offset by higher non-interest expenses. The annualized return on average assets was 0.89% for the three months ended September 30, 2017 as compared to 1.16% for the same period in 2016. The annualized return on average shareholders' equity was 8.39% for the three months ended September 30, 2017 as compared to 10.81% for the same period in 2016. Tangible book value per common share rose to $10.46 at September 30, 2017 as compared to $9.63 at September 30, 2016, as disclosed in the Non-GAAP Financial Measures table. All share and per share data for all referenced reporting periods have been adjusted for a 5% stock dividend paid on February 28, 2017.

For the nine months ended September 30, 2017, the Company reported net income of $6.17 million, or $0.71 per diluted share, an increase of $103,000, or 1.7%, over the $6.06 million, or $0.71 per diluted share, for the same period in 2016. Our results for the nine months ended September 30, 2017 were positively affected by an increase in net interest income, primarily due to higher average loans, and higher non-interest income partially offset by an increase in salary and benefits and the previously mentioned BOLI death benefit of $862,000. The annualized return on average assets was 0.84% for the nine months ended September 30, 2017 as compared to 0.91% for the same period in 2016. The annualized return on average shareholders' equity was 7.96% for the nine months ended September 30, 2017 as compared to 8.48% for the the same period in 2016.

Net interest income increased by $947,000, or 12.7%, for the quarter ended September 30, 2017 from the same period in 2016. Average interest-earning assets totaled $921.7 million, an increase of $84.4 million, or 10.1%, from the quarter ended September 30, 2016, primarily due to an increase in average loans. The Company reported a net interest margin of 3.62% for the quarter ended September 30, 2017, an increase of 7 basis points when compared to the 3.55% reported for the quarter ended September 30, 2016, and an increase of 13 basis points when compared to the 3.49% for the quarter ended June 30, 2017. The increase from the second quarter of 2017 was the result of higher yielding interest-earning assets as balances in interest-bearing deposits due from banks were deployed into higher yielding loans.

Net interest income increased $2.1 million, or 9.8%, for the nine months ended September 30, 2017 from the same period in 2016, primarily as the result of an increase in interest-earning assets. The Company reported a net interest margin of 3.52% for the nine months ended September 30, 2017, a decrease of 4 basis points from the 3.56% reported for the nine months ended September 30, 2016.

The Company recorded a provision for loan losses of $255,000 for the three months ended September 30, 2017 as compared to $470,000 for the corresponding 2016 period. The majority of the third quarter 2017 provision was to support the Company's strong loan growth. The provision for loan losses for the nine months ended September 30, 2017 was $855,000, as compared to $860,000 for the corresponding 2016 period. The Company's provision considers a number of factors, including our assessment of the current state of the economy, allowances related to impaired loans, loan growth and level of charge-offs and recoveries.

Non-interest income for the quarter ended September 30, 2017 totaled $1.45 million, a decrease of $530,000, or 26.7%, compared to the same period in 2016. This decrease was largely the result of the receipt of the BOLI benefit in the third quarter of 2016, which was partially offset by a $42,000, or 13.3%, increase in residential mortgage banking revenue, and higher gains from the sale of SBA loans of $190,000, or 163.8%. Additionally service fees on deposit accounts increased by $70,000, or 45.5%, mainly due to a realignment of fees on various products. For the nine months ended September 30, 2017, non-interest income increased $74,000, or 1.8%, to $4.1 million from the same period in 2016.

Non-interest expense for the quarter ended September 30, 2017 totaled $6.18 million, an increase of $836,000, or 15.7%, compared to the same period in 2016, largely due to higher salaries and benefits along with a one-time $250,000 expense recovery settlement from an OREO property in the third quarter of 2016. For the nine months ended September 30, 2017, non-interest expense increased $1.91 million, or 11.8%, to $18.0 million compared to the same prior year period.

Total assets at September 30, 2017 were $1.0 billion, an increase of 6.4% from $940.2 million at December 31, 2016. Total loans at September 30, 2017 were $816.1 million, an increase of $63.0 million, or 8.4%, from the $753.1 million recorded at December 31, 2016. Total deposits were $821.9 million at September 30, 2017, an increase of $45.3 million, or 5.8%, from the $776.6 million at December 31, 2016. Core checking deposits at September 30, 2017 increased $59.1 million, or 18.9%, to $372.0 million from $312.9 million at year-end 2016, while savings accounts, money market deposits and time deposits decreased $13.8 million, or 3.0%. The Company has continued to focus on building non-interest bearing deposits, as this lowers the institution’s cost of funds. Additionally, its savings accounts and other interest-bearing deposit products provide an efficient and cost-effective source to fund loan originations.

At September 30, 2017, the Company’s allowance for loan losses was $10.2 million, an increase from the $9.6 million at December 31, 2016. The allowance for loan losses as a percentage of total loans at September 30, 2017 was 1.25%, compared to 1.27% at December 31, 2016. Non-performing assets at September 30, 2017 as a percentage of total assets was 0.23% compared to 0.19% at December 31, 2016 and 0.20% at September 30, 2016. Non-performing assets increased to $2.3 million at September 30, 2017 compared to $1.8 million at both December 31, 2016 and September 30, 2016.

Results of Operations

The Company’s principal source of revenue is net interest income, which is the difference between interest income on earning assets and interest expense on deposits and borrowings. Interest-earning assets consist primarily of loans, investment securities and federal funds sold. Sources to fund interest-earning assets consist primarily of deposits and borrowed funds. The Company’s net income is also affected by its provision for loan losses, other income and non-interest expenses. Non-interest income consists primarily of service charges, commissions and fees, earnings from investment in life insurance and gains on security and loan sales, while non-interest expenses are comprised of salaries and employee benefits, occupancy costs and other operating expenses.

The following table provides information on our performance ratios for the dates indicated.

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2017	**2016**	**2017**	**2016**
Return on average assets	**0.89%**	1.16%	**0.84%**	0.91%
Return on average tangible assets (1)	**0.91%**	1.19%	**0.86%**	0.93%
Return on average shareholders' equity	**8.39%**	10.81%	**7.96%**	8.48%
Return on average tangible shareholders' equity (1)	**10.13%**	13.29%	**9.64%**	10.46%
Net interest margin	**3.62%**	3.55%	**3.52%**	3.56%
Average equity to average assets	**10.63%**	10.77%	**10.56%**	10.76%
Average tangible equity to average tangible assets (1)	**8.97%**	8.94%	**8.88%**	8.90%

(1) The following table provides the reconciliation of Non-GAAP Financial Measures for the dates indicated:

(in thousands except per share data and percentages)	For the Three Months Ended September 30, 2017	For the Three Months Ended September 30, 2016	For the Nine Months Ended September 30, 2017	For the Nine Months Ended September 30, 2016
Total shareholders' equity	**$ 106,567**	$ 98,594	**$ 102,406**	$ 98,594
Less: goodwill and other intangible assets	**(18,109)**	(18,109)	**(18,109)**	(18,109)
Tangible common shareholders' equity	**$ 88,458**	$ 80,485	**$ 84,297**	$ 80,485
Common shares outstanding (in thousands)	**8,454**	8,358	**8,454**	8,358
Book value per common share	**$ 12.60**	$ 11.80	**$ 12.60**	$ 11.80
Book value per common share	**$ 12.60**	$ 11.80	**$ 12.60**	$ 11.80
Effect of intangible assets	**(2.14)**	(2.17)	**(2.14)**	(2.17)
Tangible book value per common share	**$ 10.46**	$ 9.63	**$ 10.46**	$ 9.63
Return on average assets	**0.89 %**	1.16 %	**0.84 %**	0.91 %
Effect of intangible assets	**0.02 %**	0.03 %	**0.02 %**	0.02 %
Return on average tangible assets	**0.91 %**	1.19 %	**0.86 %**	0.93 %
Return on average equity	**8.39 %**	10.81 %	**7.96 %**	8.48 %
Effect of average intangible assets	**1.74 %**	2.48 %	**1.68 %**	1.98 %
Return on average tangible equity	**10.13 %**	13.29 %	**9.64 %**	10.46 %
Average equity to average assets	**10.63 %**	10.77 %	**10.56 %**	10.76 %
Effect of average intangible assets	**(1.66)%**	(1.83)%	**(1.68)%**	(1.86)%
Average tangible equity to average tangible assets	**8.97 %**	8.94 %	**8.88 %**	8.90 %

Three months ended September 30, 2017 compared to September 30, 2016

Net Interest Income

Net interest income for the quarter ended September 30, 2017 totaled $8.42 million, an increase of $947,000, or 12.7%, compared to $7.47 million for the corresponding period in 2016. This increase was largely due to an increase of $84.4 million, or 10.1%, in average interest-earning assets, primarily resulting from growth in the Company's loan portfolio funded by a higher level of average deposits. Average core checking deposits, which consist of non-interest demand deposits and NOW accounts, increased by $68.6 million, or 22.7%. These positives contributed to the 7 basis point increase in our net interest margin.

The net interest margin and net interest spread increased to 3.62% and 3.44%, respectively, for the three month period ended September 30, 2017, from 3.55% and 3.36%, respectively, for the same prior year period, primarily resulting from slightly higher yielding interest-earning assets coupled with a higher level of average core checking deposits.

Total interest income for the three months ended September 30, 2017 increased by $1.0 million, or 11.9%. The increase in interest income was primarily due to a volume related increase in interest income of $853,000, combined with a rate related increase in interest income of $194,000 for the third quarter of 2017 as compared to the same prior year period.

Interest and fees on loans increased $890,000, to $9.2 million for the three months ended September 30, 2017 compared to $8.3 million for the corresponding period in 2016. Volume related increases of $794,000 were combined with rate related increases of $96,000. The average balance of the loan portfolio for the three months ended September 30, 2017 increased by $68.0 million, or 9.2%, to $803.6 million from $735.6 million for the corresponding period in 2016. The average annualized yield on the loan portfolio was 4.56% for the quarter ended September 30, 2017 compared to 4.51% for the quarter ended September 30, 2016.

Additionally, the average balance of total non-accrual loans, which amounted to $2.3 million and $1.6 million for the three months ended September 30, 2017 and 2016, respectively, impacted the Company's loan yield for both periods presented.

Interest income on investment securities totaled $514,000 for the three months ended September 30, 2017 compared to $421,000 for the three months ended September 30, 2017, an increase of $93,000, or 22.1%. For the three months ended September 30, 2017, investment securities had an average balance of $92.3 million with an average annualized yield of 2.23% compared to an average balance of $83.5 million with an average annualized yield of 2.02% for the three months ended September 30, 2016.

Interest income on interest-bearing deposits was $83,000 for the three months ended September 30, 2017, representing an increase of $64,000, or 336.8%, from $19,000 for the three months ended September 30, 2016. For the three months ended September 30, 2017, interest-bearing deposits had an average balance of $25.9 million and an average annualized yield of 1.27% as compared to an average balance of $18.2 million and an average annualized yield of 0.42% for the same period in 2016. The increase in the rate was the result of the Federal Reserve raising short-term interest rates by 0.25% in December 2016, 0.25% in March 2017 and another 0.25% in June 2017.

Interest expense on interest-bearing liabilities amounted to $1.4 million for the three months ended September 30, 2017 compared to $1.3 million for the corresponding period in 2016, an increase of $100,000 or 7.6%. This increase in interest expense was comprised of a $55,000 volume related increase as well as a $45,000 rate related increase.

The Bank continues to focus on developing core deposit relationships. The average balance of interest-bearing liabilities increased to $710.5 million for the three months ended September 30, 2017 from $645.4 million for the same period last year, an increase of $65.1 million, or 10.1%. Average NOW accounts increased $51.6 million from $148.7 million with an average annualized rate of 0.45% during the third quarter of 2016, to $200.3 million with an average annualized rate of 0.47% during the third quarter of 2017. Average savings accounts increased $32.0 million from $228.9 million with an average annualized rate of 0.49% during the third quarter of 2016, to $260.9 million with an average annualized rate of 0.52% during the third quarter of 2017. These average balance increases were partially offset by a decrease in average money market deposits of $9.5 million over this same period while the average annualized rate remained unchanged at 0.17%. Average time deposits decreased by $12.5 million over this same period. During the third quarter of 2017, our average demand deposits totaled $170.3 million, an increase of $17.0 million, or 11.1%, over the same period last year. For the three months ended September 30, 2017, the average annualized cost for all interest-bearing liabilities was 0.79%, compared to 0.81% for the three months ended September 30, 2016.

Our strategies for increasing and retaining core deposit relationships, managing loan originations within our acceptable credit criteria and loan category concentrations, and our planned branch network growth have combined to meet our liquidity needs. The Company also offers agreements to repurchase securities, commonly known as repurchase agreements, to our customers as an alternative to other insured deposits. Average balances of repurchase agreements for the third quarter of 2017 were $23.2 million, with an average interest rate of 0.31%, compared to $19.0 million, with an average interest rate of 0.31%, for the third quarter of 2016.

The Company also utilizes FHLB term borrowings as an additional funding source. The average balance of such borrowings for the third quarter of 2017 and 2016 was $26.2 million and $27.0 million, respectively, with an average interest rate of 2.38% and 2.32%, respectively.

The $10 million of subordinated debentures totaled $9.9 million at September 30, 2017, which includes $121,000 of remaining unamortized debt issuance costs. The debt issuance costs are being amortized over the expected life of the issue. The effective interest rate of the subordinated debt is 6.67%.

The following tables reflect, for the periods presented, the components of our net interest income, setting forth (1) average assets, liabilities, and shareholders' equity, (2) interest income earned on interest-earning assets and interest expenses paid on interest-bearing liabilities, (3) average yields earned on interest-earning assets and average rates paid on interest-bearing liabilities, (4) our net interest spread (*i.e.*, the average yield on interest-earning assets less the average rate on interest-bearing liabilities), and (5) our net interest margin. Yields on tax-exempt assets have not been calculated on a fully tax-exempt basis.

	Three Months Ended September 30, 2017			**Three Months Ended September 30, 2016**		
(dollars in thousands)	**Average Balance**	**Interest Income/ Expense**	**Average Yield/ Rate**	**Average Balance**	**Interest Income/ Expense**	**Average Yield/ Rate**
ASSETS						
Interest-Earning Assets:						
Interest-bearing deposits in banks	**$ 25,901**	**$ 83**	**1.27%**	$ 18,179	$ 19	0.42%
Investment securities	**92,257**	**514**	**2.23%**	83,541	421	2.02%
Loans, net of unearned fees (1) (2)	**803,553**	**9,227**	**4.56%**	735,626	8,337	4.51%
Total Interest-Earning Assets	**921,711**	**9,824**	**4.23%**	837,346	8,777	4.17%
Non-Interest-Earning Assets:						
Allowance for loan losses	**(10,056)**			(9,519)		
All other assets	**83,244**			75,277		
Total Assets	**$994,899**			$903,104		
LIABILITIES & SHAREHOLDERS' EQUITY						
Interest-Bearing Liabilities:						
NOW deposits	**$200,298**	**239**	**0.47%**	$148,664	167	0.45%
Savings deposits	**260,919**	**340**	**0.52%**	228,862	281	0.49%
Money market deposits	**63,557**	**27**	**0.17%**	73,031	31	0.17%
Time deposits	**126,566**	**463**	**1.45%**	139,052	493	1.41%
Securities sold under agreements to repurchase	**23,167**	**18**	**0.31%**	18,995	15	0.31%
FHLB and other borrowings	**26,159**	**157**	**2.38%**	26,967	157	2.32%
Subordinated debt	**9,876**	**164**	**6.67%**	9,844	164	6.66%
Total Interest-Bearing Liabilities	**710,542**	**1,408**	**0.79%**	645,415	1,308	0.81%
Non-Interest-Bearing Liabilities:						
Demand deposits	**170,267**			153,274		
Other liabilities	**8,351**			7,144		
Total Non-Interest-Bearing Liabilities	**178,618**			160,418		
Shareholders' Equity	**105,739**			97,271		
Total Liabilities and Shareholders' Equity	**$994,899**			$903,104		
NET INTEREST INCOME		**$ 8,416**			$ 7,469	
NET INTEREST SPREAD (3)			**3.44%**			3.36%
NET INTEREST MARGIN (4)			**3.62%**			3.55%

(1) Included in interest income on loans are loan fees.

(2) Includes non-performing loans.

(3) The interest rate spread is the difference between the weighted average yield on average interest-earning assets and the weighted average cost of average interest-bearing liabilities.

(4) The interest rate margin is calculated by dividing annualized net interest income by average interest-earning assets.

(dollars in thousands)	Nine Months Ended September 30, 2017 Average Balance	Interest Income/ Expense	Average Yield/ Rate	Nine Months Ended September 30, 2016 Average Balance	Interest Income/ Expense	Average Yield/ Rate
ASSETS						
Interest-Earning Assets:						
Interest-bearing deposits in banks	**$ 34,824**	**$ 257**	**0.99%**	$ 22,411	$ 84	0.50%
Investment securities	**94,120**	**1,546**	**2.19%**	82,346	1,235	2.00%
Loans, net of unearned fees (1) (2)	**781,861**	**26,363**	**4.51%**	715,260	24,335	4.54%
Total Interest-Earning Assets	**910,805**	**28,166**	**4.13%**	820,017	25,654	4.18%
Non-Interest-Earning Assets:						
Allowance for loan losses	**(9,801)**			(9,117)		
All other assets	**79,867**			77,185		
Total Assets	**$980,871**			$888,085		
LIABILITIES & SHAREHOLDERS' EQUITY						
Interest-Bearing Liabilities:						
NOW deposits	**$196,748**	**682**	**0.46%**	$151,299	491	0.43%
Savings deposits	**259,109**	**1,004**	**0.52%**	226,877	829	0.49%
Money market deposits	**63,029**	**80**	**0.17%**	73,869	91	0.16%
Time deposits	**131,380**	**1,404**	**1.43%**	131,325	1,389	1.41%
Securities sold under agreements to repurchase	**22,054**	**50**	**0.30%**	18,713	44	0.31%
FHLB and other borrowings	**24,976**	**449**	**2.40%**	24,985	452	2.42%
Subordinated debt	**9,868**	**493**	**6.68%**	9,836	492	6.67%
Total Interest-Bearing Liabilities	**707,164**	**4,162**	**0.79%**	636,904	3,788	0.79%
Non-Interest-Bearing Liabilities:						
Demand deposits	**162,279**			148,139		
Other liabilities	**7,801**			7,470		
Total Non-Interest-Bearing Liabilities	**170,080**			155,609		
Shareholders' Equity	**103,627**			95,572		
Total Liabilities and Shareholders' Equity	**$980,871**			$888,085		
NET INTEREST INCOME		**$ 24,004**			$ 21,866	
NET INTEREST SPREAD (3)			**3.34%**			3.39%
NET INTEREST MARGIN (4)			**3.52%**			3.56%

(1) Included in interest income on loans are loan fees.
(2) Includes non-performing loans.
(3) The interest rate spread is the difference between the weighted average yield on average interest-earning assets and the weighted average cost of average interest-bearing liabilities.
(4) The interest rate margin is calculated by dividing annualized net interest income by average interest-earning assets.

Analysis of Changes in Net Interest Income

The following table sets forth for the periods indicated a summary of changes in interest earned and interest paid resulting from changes in volume and changes in rates:

	Three Months Ended September 30, 2017 Compared to Three Months Ended September 30, 2016			Nine Months Ended September 30, 2017 Compared to Nine Months Ended September 30, 2016		
	Increase (decrease) due to change in			Increase (decrease) due to change in		
	Volume	Rate	Net	Volume	Rate	Net
		(in thousands)			(in thousands)	
Interest Earned On:						
Interest-bearing deposits in banks	$ 11	$ 53	$ 64	$ 62	$ 111	$ 173
Investment securities	48	45	93	187	124	311
Loans, net of unearned fees	794	96	890	2,193	(165)	2,028
Total Interest Income	853	194	1,047	2,442	70	2,512
Interest Paid On:						
NOW deposits	64	8	72	155	36	191
Savings deposits	41	18	59	122	53	175
Money market deposits	(4)	—	(4)	(16)	5	(11)
Time deposits	(44)	14	(30)	1	14	15
Securities sold under agreements to repurchase	3	—	3	7	(1)	6
FHLB and other borrowings	(5)	5	—	—	(3)	(3)
Subordinated debt	—	—	—	1	—	1
Total Interest Expense	55	45	100	270	104	374
Net Interest Income	$ 798	$ 149	$ 947	$ 2,172	$ (34)	$ 2,138

The change in interest due to both volume and rate has been allocated proportionally to both, based on their relative absolute values.

Provision for Loan Losses

During the third quarter of 2017, a provision for loan losses of $255,000 was expensed as compared to $470,000 for the corresponding 2016 period. The majority of the third quarter of 2017 provision was to support the Company's strong loan growth, while the majority of the 2016 provision was to provide for loan growth, in addition to a specific allowance of $113,000 against one commercial loan, which was fully charged off during the third quarter of 2016. The Company had $15,000 in net loan recoveries during the three months ended September 30, 2017, compared to $436,000 in net loan charge-offs in the same period last year. The provision for loan losses is determined by an allocation process whereby an estimated allowance is allocated to the specific allowance for impaired loans and the general allowance for pools of loans. The allocation reflects management’s assessment of economic conditions, credit quality and other risk factors inherent in the loan portfolio. The allowance for loan losses totaled $10.2 million, or 1.25% of total loans at September 30, 2017, as compared to $9.6 million, or 1.27% at December 31, 2016.

In management’s opinion, the level of allowance for loan losses, totaling $10.2 million, is appropriate to adequately provide for known and inherent risks in the portfolio. In the current interest rate and credit quality environment, our risk management philosophy has been to stay within our established credit culture. Management will continue to review the need for additions to its allowance for loan losses based upon its ongoing review of the loan portfolio and credit quality trends, the level of delinquencies, and general market and economic conditions.

Non-Interest Income

For the three months ended September 30, 2017, non-interest income amounted to $1.45 million as compared to $1.98 million, a decrease of $530,000, or 26.7%, from the corresponding period in 2016. This decrease was largely the result of the previously mentioned $862,000 tax-free BOLI death benefit received in the third quarter of 2106. Residential mortgage banking revenue increased $42,000, or 13.3%, from the prior year period while sales from the sale of SBA loans increased $190,000. Additionally, service fees on deposit accounts increased by $70,000, or 45.5%, mainly due to a realignment of fees on various products.

Non-Interest Expenses

Non-interest expenses for the three months ended September 30, 2017 increased $836,000, or 15.7%, to $6.18 million compared to $5.34 million for the three months ended September 30, 2016. This increase was primarily due to higher salaries and benefits along with a one-time $250,000 expense recovery settlement from an OREO property in the third quarter of 2016.

Income Taxes

The Company recorded income tax expense of $1.2 million for the three months ended September 30, 2017 compared to $999,000 for the three months ended September 30, 2016. The effective tax rate for the three months ended September 30, 2017 and 2016 was 35.0% and 27.4%, respectively. During the third quarter of 2017, a $32,000 benefit to income tax expense was recorded relative to the adoption of ASU 2016-09. The lower tax rate in 2016 was primarily due to the tax-free BOLI benefit.

Nine Months Ended September 30, 2017 compared to September 30, 2016

Net Interest Income

Net interest income for the nine months ended September 30, 2017 totaled $24.0 million, an increase of $2.1 million, or 9.8%, compared to $21.9 million for the corresponding period in 2016. This increase was largely due to an increase of $90.8 million, or 11.1%, in average interest-earning assets, primarily resulting from growth in the Company's loan portfolio funded by a higher level of average deposits. Average core checking deposits, which consist of non-interest demand deposits and NOW accounts, increased by $59.6 million, or 19.9%. These positives were partially offset by the 4 basis point decrease in our net interest margin.

The net interest margin and net interest spread decreased to 3.52% and 3.34%, respectively, for the nine month period ended September 30, 2017, from 3.56% and 3.39%, respectively, for the same prior year period, primarily resulting from slightly lower yielding interest-earning assets.

Total interest income for the nine months ended September 30, 2017 increased by $2.5 million, or 9.8%. The increase in interest income was primarily due to a volume related increase in interest income of $2.4 million, combined with a rate related increase in interest income of $70,000 for the first nine months of 2017 as compared to the same prior year period.

Interest and fees on loans increased $2.1 million, to $26.4 million for the nine months ended September 30, 2017 compared to $24.3 million for the corresponding period in 2016. Volume related increases of $2.2 million were partially offset by rate related decreases of $165,000. The average balance of the loan portfolio for the nine months ended September 30, 2017 increased by $66.6 million, or 9.3%, to $781.9 million from $715.3 million for the corresponding period in 2016. The average annualized yield on the loan portfolio was 4.51% for the nine months ended September 30, 2017 compared to 4.54% for the nine months ended September 30, 2016. Additionally, the average balance of total non-accrual loans, which amounted to $2.1 million and $1.6 million for the nine months ended September 30, 2017 and 2016 respectively, impacted the Company's loan yield for both periods presented.

Interest income on investment securities totaled $1.5 million for the nine months ended September 30, 2017 compared to $1.2 million for the nine months ended September 30, 2016, an increase of $311,000, or 25.2%. For the nine months ended September 30, 2017, investment securities had an average balance of $94.1 million with an average annualized yield of 2.19% compared to an average balance of $82.3 million with an average annualized yield of 2.00% for the nine months ended September 30, 2016.

Interest income on interest-bearing deposits was $257,000 for the nine months ended September 30, 2017, representing an increase of $173,000, or 206%, from $84,000 for the nine months ended September 30, 2016. For the nine months ended September 30, 2017, interest-bearing deposits had an average balance of $34.8 million and an average annualized yield of 0.99% as compared to an average balance of $22.4 million and an average annualized yield of 0.50% for the same period in 2016. The increase in the rate was the result of the Federal Reserve raising short-term interest rates by 0.25% in December 2016, 0.25% in March 2017 and another 0.25% in June 2017.

Interest expense on interest-bearing liabilities amounted to $4.2 million for the nine months ended September 30, 2017 compared to $3.8 million for the corresponding period in 2016, an increase of $374,000, or 9.9%. This increase in interest expense was comprised of a $270,000 volume related increase as well as a $104,000 rate related increase.

The Bank continues to focus on developing core deposit relationships. The average balance of interest-bearing liabilities increased to $707.2 million for the nine months ended September 30, 2017 from $636.9 million for the same period last year, an increase of $70.3 million, or 11.0%. Average NOW accounts increased $45.4 million from $151.3 million with an average annualized rate of 0.43% during the nine months ended September 30, 2016, to $196.7 million with an average annualized rate of 0.46% during the nine months ended September 30, 2017. Average savings accounts increased $32.2 million from $226.9 million with an average annualized rate of 0.49% during the nine months ended September 30, 2016, to $259.1 million with an average annualized rate of 0.52% during the nine months ended September 30, 2017. Average time deposits increased $55,000 from $131.3 million with an average annualized rate of 1.41% for the nine months ended September 30, 2016 to $131.4 million with an average annualized rate of 1.43% for the nine months ended September 30, 2017. These average balance increases were partially offset by a decrease in average money market deposits of $10.8 million over this same period while the average annualized rate increased from 0.16% to 0.17%. During the nine months ended September 30, 2017, our average demand deposits totaled $162.3 million, an increase of $14.1 million, or 9.5%, over the same period last year. For the nine months ended September 30, 2017 and 2016, the average annualized cost for all interest-bearing liabilities remained unchanged at 0.79%.

Our strategies for increasing and retaining core deposit relationships, managing loan originations within our acceptable credit criteria and loan category concentrations, and our planned branch network growth have combined to meet our liquidity needs. The Company also offers agreements to repurchase securities, commonly known as repurchase agreements, to our customers as an alternative to other insured deposits. Average balances of repurchase agreements for the nine months ended September 30, 2017 were $22.1 million, with an average interest rate of 0.30%, compared to $18.7 million, with an average interest rate of 0.31%, for the nine months ended September 30, 2016.

The Company also utilizes FHLB term borrowings as an additional funding source. The average balance of such borrowings for both the nine months ended September 30, 2017 and 2016 was $25.0 million, with an average interest rate of 2.40% and 2.42%, respectively.

The $10 million of subordinated debentures totaled $9.9 million at September 30, 2017, which includes $121,000 of remaining unamortized debt issuance costs. The debt issuance costs are being amortized over the expected life of the issue. The effective interest rate of the subordinated debt is 6.67%

Provision for Loan Losses

There was a $855,000 provision for loan losses reported for the nine months ended September 30, 2017 as compared to a $860,000 provision for the corresponding 2016 period. The majority of the 2017 provision was to support loan growth, while the majority of the 2016 provision was to record a specific allowance of $444,000 against one commercial loan, which was subsequently charged-off during the third quarter of 2016. The Company had $197,000 in net loan charge-offs during the first nine months of 2017, compared to $121,000 in net loan charge-offs in the same period last year. The provision for loan losses is determined by an allocation process whereby an estimated allowance is allocated to the specific allowance for impaired loans and the general allowance for pools of loans. The allocation reflects management’s assessment of economic conditions, credit quality and other risk factors inherent in the loan portfolio. The allowance for loan losses totaled $10.2 million, or 1.25% of total loans at September 30, 2017, as compared to $9.6 million, or 1.27% at December 31, 2016.

In management’s opinion, the level of allowance for loan losses, totaling $10.2 million, is appropriate to adequately provide for known and inherent risks in the portfolio. In the current interest rate and credit quality environment, our risk management philosophy has been to stay within our established credit culture. Management will continue to review the need for additions to its allowance for loan losses based upon its ongoing review of the loan portfolio and credit quality trends, the level of delinquencies as well as general market and economic conditions.

Non-Interest Income

For the nine months ended September 30, 2017, non-interest income amounted to $4.1 million as compared to $4.0 million, an increase of $74,000, or 1.8%, from the corresponding period in 2016. This increase was largely the result of a $427,000, or 51.4%, increase in residential mortgage banking revenue, which included a $177,000 gain on the sale of $8.2 million of portfolio adjustable rate mortgages, coupled with higher earnings from bank owned life insurance, service fees on deposit accounts, other loan fees, and gains on the sale of SBA loans. These increases were partially offset by the previously mentioned BOLI death benefit of $862,000 received in the third quarter of 2016 and a decrease of $72,000 in net gains on the sale of securities.

Non-Interest Expenses

Non-interest expenses for the nine months ended September 30, 2017 increased $1.9 million, or 11.8%, to $18.0 million compared to $16.1 million for the nine months ended September 30, 2016. This increase was primarily due to higher salaries and benefits of $945,000 resulting from both annual merit increases along with higher commission payouts on mortgage banking volume generated during the period and a one-time $250,000 expense recovery settlement from an OREO property in the third quarter of 2016.

Income Taxes

The Company recorded income tax expense of $3.1 million for the nine months ended September 30, 2017 and $2.9 million for the same period ended, 2016. The effective tax rate for the nine months ended September 30, 2017 and 2016 was 33.3% and 32.1%, respectively. Income tax expense for the nine months ended September 30, 2017 includes a $177,000 benefit relating to the adoption of ASU 2016-09.

FINANCIAL CONDITION

Assets

At September 30, 2017, total assets were $1.0 billion, an increase of $60.0 million, or 6.4%, from $940.2 million at December 31, 2016. At September 30, 2017, total loans were $816.1 million, an increase of $63.0 million, or 8.4%, from the $753.1 million reported at December 31, 2016. Investment securities, including restricted stock, were $92.6 million at September 30, 2017 as compared to $97.1 million at December 31, 2016, a decrease of $4.5 million, or 4.6%. At September 30, 2017, cash and cash equivalents totaled $46.3 million compared to $42.1 million at December 31, 2016, an increase of $4.2 million, or 10.0%. Our liquidity position continued to remain strong. Goodwill totaled $18.1 million at both September 30, 2017 and December 31, 2016.

Liabilities

Total liabilities increased $54.2 million, or 6.5%, to $893.7 million at September 30, 2017, from $839.5 million at December 31, 2016. Total deposits increased $45.3 million, or 5.8%, to $821.9 million at September 30, 2017, from $776.6 million at December 31, 2016. FHLB and other borrowings increased by $5.0 million over this same period while securities sold under agreement to repurchase increased by $2.7 million.

Securities Portfolio

Investment securities, including restricted investments, totaled $92.6 million at September 30, 2017 compared to $97.1 million at December 31, 2016, a decrease of $4.5 million, or 4.6%. During the nine months ended September 30, 2017 and 2016, investment security purchases amounted to $3.3 million and $11.5 million, respectively, while repayments, calls and maturities amounted to $8.2 million and $9.4 million, respectively. Additionally, there were no investment security sales during the first nine months of 2017 as compared to sales of $1.1 million during the same period in 2016, in which the Company recorded a gain of $72,000.

The Company maintains an investment portfolio to fund increased loans and liquidity needs (resulting from decreased deposits or otherwise) and to provide an additional source of interest income. The portfolio is composed of obligations of the U.S. Government agencies and U.S. Government-sponsored entities, municipal securities, a limited amount of corporate debt securities and a Community Reinvestment Act (“CRA”) mutual fund. U.S. Government agencies are considered to have the lowest risk due to the “full faith and credit” guarantee by the U.S. Government. All of our mortgage-backed investment securities are collateralized by pools of mortgage obligations that are guaranteed by privately managed, U.S. Government-sponsored enterprises (“GSE”), such as Fannie Mae, Freddie Mac and Government National Mortgage Association. Due to these GSE guarantees, these investment securities are susceptible to less risk of non-performance and default than other corporate securities which are collateralized by private pools of mortgages. At September 30, 2017, the Company maintained $16.5 million of GSE residential mortgage-backed securities in the investment portfolio and $10.3 million of collateralized residential mortgage obligations, all of which are current as to payment of principal and interest and are performing in accordance with the terms set forth in their respective prospectuses. Municipal securities are evaluated by a review of the credit ratings of the underlying issuer, any changes in such ratings that have occurred, adverse conditions relating to the security or its issuer, as well as other factors.

Included within the Company’s investment portfolio are trust preferred securities, which consists of four single issue securities issued by large financial institutions with Moody’s ratings from Baa1 to Ba1. These securities have an amortized cost value of $2.8 million and a fair value of $2.7 million at September 30, 2017. The unrealized loss on these securities is related to general market conditions, the widening of interest rate spreads and downgrades in credit ratings.

Management evaluates all securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic and market concerns warrant such evaluations. As of September 30, 2017, all of these securities are current with their scheduled interest payments. Future deterioration in the cash flow of these instruments or the credit quality of the financial institution issuers could result in additional impairment charges in the future.

The Company accounts for its investment securities as available for sale or held to maturity. Management determines the appropriate classification at the time of purchase. Based on an evaluation of the probability of the occurrence of future events, we determine if we have the ability and intent to hold the investment securities to maturity, in which case we classify them as held to maturity. All other investments are classified as available for sale.

Securities classified as available for sale must be reported at fair value, with unrealized gains and losses excluded from earnings and reported as a separate component of shareholders’ equity, net of taxes. Gains or losses on the sales of securities available for sale are recognized upon realization utilizing the specific identification method. The net effect of unrealized gains or losses, caused by marking our available for sale portfolio to fair value, could cause fluctuations in the level of shareholders’ equity and equity-related financial ratios as changes in market interest rates cause the fair value of fixed-rate securities to fluctuate.

Securities classified as held to maturity are carried at cost, adjusted for amortization of premium and accretion of discount over the terms of the maturity in a manner that approximates the interest method.

Loan Portfolio

The following table summarizes total loans outstanding, by loan category and amount as of September 30, 2017 and December 31, 2016.

	September 30, 2017		December 31, 2016	
	Amount	**Percent**	**Amount**	**Percent**
	(in thousands, except for percentages)			
Commercial and industrial	**$ 99,601**	**12.2 %**	$ 93,697	12.4 %
Real estate – construction	**118,553**	**14.5 %**	111,914	14.9 %
Real estate – commercial	**507,507**	**62.3 %**	460,685	61.2 %
Real estate – residential	**62,416**	**7.6 %**	59,065	7.8 %
Consumer	**28,773**	**3.5 %**	28,279	3.8 %
Unearned fees	**(772)**	**(0.1)%**	(548)	(0.1)%
Total loans	**$ 816,078**	**100.0 %**	$ 753,092	100.0 %

For the nine months ended September 30, 2017, total loans increased by $63.0 million, or 8.4%, to $816.1 million from $753.1 million at December 31, 2016. The increase was due to growth all sectors of the portfolio during the period. Our local economy seems to reflect some strengthening in certain sectors. As such, we remain optimistic in our growth prospects for lending for the remainder of 2017 and into 2018, recognizing that we will continue to be challenged due in part to both the competitive landscape and pricing pressures. Our loan pipeline remains strong, as we continue to remain focused on growing our portfolio. We have taken the approach of opening low cost loan production offices (“LPOs”) in contiguous markets and once a certain level of business is achieved, the intention is to replace some of these LPOs with a full service branch at an appropriate location within that market. During the first quarter of 2017, the Bank relocated our Toms River, New Jersey, LPO into a new, more highly visible location that now complements our other LPO in Summit, New Jersey. Both of our LPOs are staffed by experienced seasoned loan officers who are knowledgeable within these markets and have begun to produce positive results.

The mix of our loan composition at September 30, 2017 reflects our desire to continue emphasizing commercial and industrial, commercial real estate, construction and residential lending. Within the loan portfolio, commercial real estate remains the largest component, constituting 62.3% of our total loans at September 30, 2017, up slightly from 61.2% at December 31, 2016. These loans increased $46.8 million, or 10.2%, to $507.5 million at September 30, 2017 from $460.7 million at December 31, 2016. Commercial and industrial loans increased by $5.9 million, or 6.3%, to $99.6 million at September 30, 2017 from $93.7 million at December 31, 2016. Consumer loans grew by $494,000, or 1.7%, to $28.8 million at September 30, 2017 from $28.3 million at December 31, 2016. Real estate construction loans increased by $6.7 million, or 6.0%, to $118.6 million at September 30, 2017 from $111.9 million at December 31, 2016, while real estate residential loans increased $3.3 million, or 5.6%, to $62.4 million at September 30, 2017 from $59.1 million at December 31, 2016. The increase in real estate residential loans is inclusive of the sale of $8.2 million in portfolio adjustable rate mortgages during the first nine months of 2017, which generated a gain of $177,000.

Asset Quality

One of our key operating objectives has been, and continues to be, to maintain a high level of asset quality. We continually analyze our credit quality through a variety of strategies. We have been proactive in addressing problem and non-performing assets and management believes our allowance for loan losses is adequate to cover known and potential losses. These strategies, as well as our underwriting standards for new loan originations, have resulted in relatively low levels of non-performing loans and charge-offs. Our loan portfolio composition generally consists of loans secured by commercial real estate, land development and construction of real estate projects mainly in the Monmouth, Middlesex, Union and Ocean Counties, New Jersey market area. We continue to have lending success and growth in the medical markets through our Private Banking Department. We have experienced signs of improvement in our markets as our loan pipeline remains strong. Efficient and effective asset-management strategies reflect the type and quality of assets being underwritten and originated.

The Company continues to be proactive in identifying troubled credits, to record charge-offs promptly based on current collateral values, and to maintain an adequate allowance for loan losses at all times. We closely monitor local and regional real estate markets and other risk factors related to our loan portfolio.

The Bank does not originate or purchase loans with payment options, negative amortization loans or sub-prime loans. We evaluate the classification of all our loans and the financial results of some of those loans which may be adversely impacted by changes in the prevailing economic conditions, either nationally or in our local market areas, including decreases in real estate values, adverse employment conditions, the monetary and fiscal policies of the federal and state government and other significant external events. For loans involved in a workout situation, a new or updated appraisal or evaluation, as appropriate, is ordered to address current project plans and market conditions that were considered in the development of the workout plan. The consideration includes whether there has been material deterioration in the following factors: the performance of the project; conditions of the geographic market and property type; variances between actual conditions and original appraisal assumptions; changes in project specifications (e.g., changing a planned condominium project to an apartment building); loss of a significant lease or a take-out commitment. A new appraisal may not be necessary in all instances where an internal evaluation is used to appropriately update the original appraisal assumptions reflecting current market conditions along with providing an estimate of the collateral's fair market value for impairment analysis testing.

Non-Performing Assets

Non-performing assets include loans that are not accruing interest (non-accrual loans), loans past due 90 days or more and still accruing and other real estate owned, which consists of real estate acquired as the result of a defaulted loan. A loan is placed on non-accrual status when collection of all principal or interest is considered unlikely or when principal or interest is past due for 90 days or more, unless the loan is well-secured and in the process of collection, in which case, the loan will continue to accrue interest. Any unpaid interest previously accrued on those loans is reversed from income. Interest income on other non-accrual loans is recognized only to the extent of interest payments received. A troubled debt restructuring loan ("TDR") is a loan in which the contractual terms have been modified resulting in the Bank granting a concession to a borrower who is experiencing financial difficulties in order for the Bank to have a greater opportunity of collecting the indebtedness from the borrower. Non-accruing TDRs are included in non-performing loans.

At September 30, 2017, non-accrual loans increased to $2.3 million from the $1.5 million at December 31, 2016. Our non-performing loans are primarily secured by real estate. At September 30, 2017 and December 31, 2016, the Company had no loans past due 90 days or more and still accruing.

The following table summarizes our non-performing assets as of September 30, 2017 and December 31, 2016. Total TDRs are broken out at the bottom of the table.

	September 30, 2017	December 31, 2016
	(dollars in thousands)	
Non-Performing Assets:		
Non-Accrual Loans:		
Commercial and industrial	**$ 926**	$ 119
Real estate-construction	**150**	—
Real estate-commercial	**252**	666
Real estate-residential	**717**	763
Consumer	**300**	—
Total Non-Performing Loans	**2,345**	1,548
Loans past due 90 days or more and still accruing	**—**	—
OREO	**—**	259
Total Non-Performing Assets	**$ 2,345**	$ 1,807
Ratios:		
Non-Performing loans to total loans	**0.29%**	0.21%
Non-Performing assets to total assets	**0.23%**	0.19%
Troubled Debt Restructured Loans:		
Performing	**$ 6,925**	$ 8,075
Non-performing (included in non-performing assets above)	**1,129**	157

Total non-performing loans increased by $797,000 from December 31, 2016. At September 30, 2017, fourteen loans comprise the $2.3 million as compared to nine loans for the $1.5 million at December 31, 2016. At September 30, 2017, the Company believes it has a manageable level of non-performing loans, many of which are in the final stages of loss mitigation or legal resolution.

At September 30, 2017, non-performing commercial and industrial loans from December 31, 2016, increased by $807,000 during the nine months ended September 30, 2017, primarily due to the addition of five loan relationships, totaling $823,000. The $926,000 is comprised of six commercial term loans.

At September 30, 2017, non-performing real estate commercial loans decreased by $414,000 from December 31, 2016, due primarily to one loan totaling $335,000, which paid off during the first quarter of 2017.

At September 30, 2017, non-performing real estate residential loans decreased $46,000 to $717,000 from December 31, 2016.

At September 30, 2017, non-performing consumer loans increased by $300,000 from December 31, 2016, due primarily to two loans totaling $300,000.

OREO represents real estate acquired as a result of foreclosure or by deed in lieu of foreclosure. These assets are carried at the lower of cost or fair value less estimated selling costs. When a property is acquired, the excess of the loan balance over fair value, less selling costs, is charged to the allowance for loan losses. Operating results from real estate owned, including rental income, operating expenses, and gains and losses realized from the sales of real estate owned are recorded as incurred. During the third quarter of 2017, the Bank sold its only OREO property for a loss of $17,000. At December 31, 2016, the Bank had $259,000 in OREO, which consisted of one property.

All of our OREO are aggressively marketed, and are monitored on a regular basis to ensure valuations are in line with current fair market values.

Loans whose terms are modified are classified as TDRs if the Company grants such borrowers concessions and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a TDR generally involve a temporary reduction in interest rate or a modification of a loan’s amortization schedule. Non-accrual TDRs are restored to accrual status if principal and interest payments, under the modified terms, are current for six consecutive months after the modification is in place. Loans classified as TDRs are designated as impaired from a cash flow perspective. Modifications involving troubled borrowers may include a modification of a loan’s amortization schedule, reduction in the stated interest rate and rescheduling of future cash flows.

The Company’s TDR modifications are made on terms typically up to 12 months in order to aggressively monitor and track performance of the credit. The short-term modifications are monitored for continued performance for an additional period of time after the expiration of the concession. Balance reductions and annualized loss rates are also important metrics that are monitored. The main objective of the modification program is to reduce the payment burden for the borrower and to deleverage the Company’s exposure.

As of September 30, 2017 and December 31, 2016, TDRs totaled $8.1 million and $8.2 million, respectively. Concessions made on TDRs generally involved a temporary reduction in interest rate or a modification of a loan’s amortization schedule. The main objective of the modification is to reduce the payment burden for the borrower and to deleverage the Company’s exposure. The $8.1 million is comprised of $910,000 in real estate commercial loans, $3.1 million in real estate construction loans, $3.6 million in commercial and industrial, and $371,000 in real estate residential loans. All TDRs except for one loan relationship, as of September 30, 2017, are collateral-dependent loans while one loan relationship is unsecured and on non-accrual, for which the Company took a 50% charge-off, or $248,000, during the first quarter of 2017. Of the $8.1 million, no relationships have a specific reserve in our ALLL computation.

The $910,000 in real estate commercial loans identified as TDR’s are all accruing, with the exception of one non-accrual loan totaling $54,000, which is secured by real estate. The remaining $856,000 of performing real estate commercial TDRs are amortizing on various terms. The TDR designation was given primarily due to concessions granted for interest rate or amortization. These factors were all a result of the weak economy, which resulted in the borrowers having financial and cash flow difficulties.

The $3.1 million in real estate construction loans is partially comprised of four relationships, which are currently being developed, under contract and/or amortizing, and all are accruing except for one loan for $150,000.

The $3.6 million in commercial and industrial loans are all performing, with the exception of six non-accrual loans totaling $925,000.

The $371,000 in real estate residential loans are all performing.

Potential Problem Loans

Potential problem loans consist of special mention, substandard, and doubtful loans. At September 30, 2017, the Company had $23.4 million in loans that were risk rated as special mention, substandard, or doubtful. This $23.4 million of special mention, substandard, and doubtful loans represents an increase of $6.2 million from the $17.2 million reported at December 31, 2016, primarily due to one credit downgraded to special mention during the current quarter.

At September 30, 2017, other than the loans set forth above, the Company is not aware of any loans which present serious doubts as to the ability of its borrowers to comply with present loan repayment terms and which are expected to fall into one of the risk categories set forth in the description herein.

Allowance for Loan Losses

The following table summarizes our allowance for loan losses for the nine months ended September 30, 2017 and 2016 and for the year ended December 31, 2016.

	September 30,		December 31,
	2017	**2016**	**2016**
	(in thousands, except percentages)		
Balance at beginning of year	**$ 9,565**	$ 8,713	$ 8,713
Provision charged to expense	**855**	860	515
Recoveries (charge-offs), net	**(197)**	(121)	337
Balance of allowance at end of period	**$ 10,223**	$ 9,452	$ 9,565
Ratio of net charge-offs (recoveries) to average loans outstanding (annualized)	**0.03%**	0.02%	(0.05)%
Balance of allowance as a percent of loans at period-end	**1.25%**	1.25%	1.27 %
Ratio of allowance to non-performing loans at period-end	**435.95%**	595.59%	617.89 %

At September 30, 2017 and December 31, 2016, the Company's allowance for loan losses was $10.2 million and $9.6 million, respectively. The allowance for loan losses as a percentage of total loans at September 30, 2017 was 1.25%, compared with 1.27% at December 31, 2016. The Company recorded a $855,000 provision to the allowance for loan losses for the nine month period ended September 30, 2017 as compared to a $860,000 provision for the comparable period in 2016. The majority of the 2017 provision was to support loan growth in 2017, while the majority of the 2016 provision was to record a specific allowance of $444,000 against one commercial loan, which was subsequently charged off during the third quarter of 2016. Non-performing loans at September 30, 2017 are either well-collateralized or adequately reserved for in the allowance for loan losses.

Management maintains the allowance for credit losses at a level estimated to absorb probable loan losses of the loan portfolio. The allowance is based on ongoing evaluations of the probable estimated losses inherent in the loan portfolio. Our methodology for evaluating the appropriateness of the allowance includes segmentation of the loan portfolio into its various asset components, tracking the historical levels of criticized loans and delinquencies, and assessing the nature and trends of loan charge-offs. Additionally, the volume of non-performing loans, concentration of risks by size, type, and geography, new products and markets, collateral adequacy, credit policies and procedures, staffing, underwriting consistency, and economic conditions are also taken into consideration. Risks within the loan portfolio are analyzed on a continuous basis by the Bank's senior management, outside independent loan review auditors, directors' loan committee, and board of directors. A risk system, consisting of multiple grading categories, is utilized as an analytical tool to assess risk and set appropriate reserves.

Our local economy seems to reflect some strengthening in certain sectors. As such, we remain optimistic in our growth prospects for lending for the remainder of 2017 and into 2018, recognizing that we will continue to be challenged due in part to both the competitive landscape and pricing pressures and, as such, prudent risk management practices must be maintained. Along with this conservative approach, we have further stressed our qualitative and quantitative allowance factors to primarily reflect the current state of the economy, the housing market and levels of unemployment. We apply this process and methodology in a consistent manner and reassess and modify the estimation of methods and assumptions on a regular basis.

We attempt to maintain an allowance for loan losses at a sufficient level to provide for probable losses inherent in the loan portfolio. Risks within the loan portfolio are analyzed on a continuous basis by the Bank's senior management, outside independent loan review consultants, directors' loan committee, and board of directors. The level of the allowance is determined by assigning specific allowances to impaired loans and general allowances on all other loans. The portion of the allowance that is allocated to impaired loans is determined by estimating the inherent loss on each credit after giving consideration to the value of the underlying collateral on collateral dependent loans and cash flow from operations on cash flow dependent loans. A risk rating system, consisting of multiple grading categories, is utilized as an analytical tool to assess risk and set appropriate reserves. Along with the risk system, senior management evaluates risk characteristics of the loan portfolio under current economic conditions and considers such factors as the financial condition of the borrower, past and expected loss experience, and other factors management feels deserve recognition in establishing an appropriate allowance. These estimates are reviewed at least quarterly, and as adjustments become necessary they are realized in the periods in which they become known. Although management attempts to maintain the allowance at a level deemed adequate to cover any losses, future additions to the allowance may be necessary based upon changes in market conditions, either generally or specific to our area, or changes in the circumstances of particular borrowers. In addition, various regulatory agencies periodically review our allowance for loan losses. These agencies may require the Company to take additional provisions based on their judgments about information available to them at the time of their examination.

Bank Owned Life Insurance ("BOLI")

In November 2004, the Company invested in $3.5 million of BOLI as a source of funding for additional life insurance benefits for officers and employee benefit expenses related to the Company's non-qualified Supplemental Executive Retirement Plan ("SERP") implemented for certain executive officers in 2004. The SERPs provide for payments upon retirement, death or disability. Since its initial investment in 2004, the Company has purchased an additional $17.0 million of BOLI, of which $3.9 million was purchased in the third quarter of 2016, in order to provide life insurance benefits for additional officers upon death or disability and to provide a source of funding for future enhancements of the benefits under the SERPs. Expenses related to the SERP were approximately $230,000 and $154,000 for the nine months ended September 30, 2017 and 2016, respectively. BOLI involves our purchase of life insurance on a selected group of officers. The Company is the owner and beneficiary of the policies. Increases in the cash surrender values of this investment are recorded in other income in the statement of operations. Earnings on BOLI amounted to $411,000 and $337,000 for the nine months ended September 30, 2017 and 2016, respectively. During the third quarter of 2016, the Company received an $862,000 tax-free BOLI death benefit.

Premises and Equipment

Premises and equipment totaled approximately $5.4 million and $4.7 million at September 30, 2017 and December 31, 2016, respectively. Depreciation expense totaled $588,000 and $586,000 for the nine months ended September 30, 2017 and 2016, respectively.

Goodwill and Other Intangible Assets

Intangible assets totaled $18.1 million at September 30, 2017 and December 31, 2016, which was comprised of goodwill. The Company performed its annual qualitative factor goodwill impairment test as of August 31, 2017. Based on the results of this analysis, the Company concluded that there was no impairment on the current goodwill balance of $18.1 million.

There can be no assurance that future testing will not result in material impairment charges due to further developments in the banking industry or our markets or otherwise. Additional goodwill discussion can be referenced in Note 3, "Goodwill," in the Company's financial statements.

Deposits

Deposits are the Company's primary source of funds. The deposit increase during 2017 was primarily attributable to the Company's strategic initiative to continue to remain focused on growing market share through core deposit relationships. The Company anticipates loan demand to increase during 2017 and beyond, and will depend on the expansion and maturation of the branch network as its primary funding source. As a secondary funding source, the Company intends to utilize borrowed funds, including FHLB advances, brokered certificates of deposit ("CDs"), and Listed Service CDs, at opportune times during changing rate cycles to help support its growth. The Company continues to experience change in the mix of the deposit products through its branch sales efforts, which are targeted to gain market penetration. In order to fund future loan growth, the Company intends to use the most cost-effective funding mix available within the market area.

In keeping with the Company's Strategic Plan, which includes optimizing the profitability of our branch network, the Company will be closing two branches and consolidating them into a new location, which will provide cost efficiency and greater market share potential. We opened a new branch in Sea Girt in the third quarter, along the Route 35 corridor in Monmouth County, N.J., and consolidated the operations of our Allaire office in Wall Township, N.J. and our office in Manasquan, N.J., into this new branch. The Company anticipates annual pre-tax expense savings of approximately $300,000 beginning in the fourth quarter of 2017.

At September 30, 2017, total deposits amounted to $821.9 million, reflecting an increase of $45.3 million, or 5.8%, from $776.6 million at December 31, 2016. Core checking deposits at September 30, 2017 increased $59.1 million, or 18.9%, to $372.0 million from year-end 2016, while savings accounts, money market deposits and time deposits, decreased $13.8 million, or 3.0% to $449.9 million, compared to $463.7 million at December 31, 2016. In light of the low interest rate environment and strong loan pipeline, the Company has continued to take advantage of extending the maturity of its CD portfolio by utilizing a laddered strategy of Listed Service CDs over the course of the past year. The Bank continues to focus on building non-interest-bearing deposits, as this lowers our costs of funds. Additionally, our savings accounts and other interest-bearing deposit products provide an efficient and cost-effective source to fund our loan originations.

One of the primary strategies is the accumulation and retention of core deposits. Core deposits consist of all deposits, except CDs $250,000 and over, brokered CDs and Listed Service CDs. Core deposits at September 30, 2017 amounted to $742.5 million and accounted for 90.3% of total deposits, as compared to $684.4 million and 88.1% at December 31, 2016. During 2017, we continued to price our CDs $250,000 and over at rates that did not exceed our market competition. The balance in our CDs $250,000 and over at September 30, 2017 totaled $9.4 million as compared to $8.9 million at December 31, 2016, an increase of $500,000, or 5.2%. At September 30, 2017, the Company had $31.0 million in brokered CDs as compared to $35.6 million at December 31, 2016, with rates ranging from 1.05% to 2.12% and original terms ranging from 24 to 84 months, while Listed Service CDs totaled $39.0 million compared to $47.6 million at December 31, 2016, with rates between 1.02% to 2.10% and original terms ranging from 12 to 60 months.

The Company found this strategy of placing both brokered and Listed Service CDs provides a more cost-effective source of longer-term funding, as the rates paid for these type CDs were very competitive with current fixed rate term advances at the Federal Home Loan Bank of New York ("FHLB") without any collateral requirements.

Borrowings

The Bank has unsecured lines of credit totaling $46.0 million with four correspondent financial institutions. These borrowings are priced on a daily basis. The Bank had no borrowings outstanding on these lines. The Bank also has remaining borrowing capacity with the FHLB of approximately $31.7 million based on the current loan collateral pledged of $139.2 million at September 30, 2017.

Short-term borrowings consist of Federal funds purchased and short-term borrowings from the FHLB. At September 30, 2017 and 2016, the Company had no short-term borrowings outstanding.

At September 30, 2017 and December 31, 2016, FHLB and other borrowings consisted of advances from the FHLB, which amounted to $30.3 million at September 30, 2017 compared to $25.3 million at December 31, 2016. The FHLB advances had a weighted average interest rate of 2.31% and 2.35% at September 30, 2017 and December 31, 2016, respectively. These advances are contractually scheduled for repayment as follows:

	September 30, 2017	December 31, 2016	Rate	Original Term (years)	Maturity
	(dollars in thousands)				
Fixed Rate Note	**$ 7,500**	$ 7,500	**3.97%**	**10**	**November 2017**
Fixed Rate Note	**—**	1,500	**2.71%**	**7**	**August 2017**
Fixed Rate Note	**2,000**	2,000	**1.28%**	**4**	**October 2017**
Fixed Rate Note	**2,000**	2,000	**1.65%**	**5**	**October 2018**
Fixed Rate Note	**—**	1,000	**0.97%**	**2**	**January 2017**
Fixed Rate Note	**1,300**	1,300	**1.31%**	**3**	**January 2018**
Fixed Rate Note	**1,800**	1,800	**1.59%**	**4**	**January 2019**
Fixed Rate Note	**2,700**	2,700	**1.81%**	**5**	**January 2020**
Fixed Rate Note	**2,500**	2,500	**2.03%**	**6**	**January 2021**
Fixed Rate Note	**1,000**	1,000	**1.09%**	**3**	**July 2019**
Fixed Rate Note	**1,000**	1,000	**1.42%**	**5**	**July 2021**
Fixed Rate Note	**7,500**	—	**2.07%**	**5**	**August 2022**
Fixed Rate Note	**1,000**	1,000	**1.70%**	**7**	**July 2023**
Total FHLB borrowings	**$ 30,300**	$ 25,300			

The maximum amount outstanding of FHLB advances at any month-end during the nine months ended September 30, 2017 and 2016 was $30.3 million and $35.3 million, respectively. The average interest rates paid on FHLB advances was 2.40% and 2.42% during the nine months ended September 30, 2017 and 2016, respectively.

Subordinated Debentures

In December 2015, the Company completed a private placement of $10 million in aggregate principal amount of fixed to floating rate subordinated debentures to certain institutional accredited investors. The subordinated debentures have a maturity date of December 31, 2025 and bear interest, payable quarterly, at the rate of 6.25% per annum until January 1, 2021. On that date, the interest rate will be adjusted to float at an annual rate equal to the three-month LIBOR rate plus 464 basis points (4.64%) until maturity. The debentures include a right of prepayment, without penalty, on or after December 14, 2020 and, in certain limited circumstances, before that date. The indebtedness evidenced by the subordinated debentures, including principal and interest, is unsecured and subordinate and junior in right to payment to general and secured creditors of the Company and depositors and other creditors of the Bank. The subordinated debentures have been structured to qualify as Tier 2 capital for regulatory purposes. Subordinated debentures totaled $9.9 million at September 30, 2017 and December 31, 2016, which includes $121,000 and $145,000 of remaining unamortized debt issuance costs at September 30, 2017 and December 31, 2016, respectively. The debt issuance costs are being amortized over the expected life of the issue. The effective interest rate of the subordinated debentures is 6.67%.

Repurchase Agreements

Securities sold under agreements to repurchase, which are classified as secured borrowings, generally mature within one to four days from the transaction date. Securities sold under agreements to repurchase are reflected as the amount of cash received in connection with the transaction. The Company may be required to provide additional collateral based on the fair value of the underlying securities. Securities sold under agreements to repurchase increased to $22.6 million at September 30, 2017 from $19.9 million at December 31, 2016, an increase of $2.7 million, or 13.4%.

Liquidity

Liquidity defines the Company’s ability to generate funds to support asset growth, meet deposit withdrawals, maintain reserve requirements and otherwise operate on an ongoing basis. An important component of the Company’s asset and liability management structure is the level of liquidity available to meet the needs of our customers and requirements of our creditors. The liquidity needs of the Bank are primarily met by cash on hand, Federal funds sold position, maturing investment securities and short-term borrowings on a temporary basis. The Bank invests the funds not needed to meet its cash requirements in overnight Federal funds sold and an interest-bearing account with the Federal Reserve Bank of New York. With adequate deposit inflows coupled with the above-mentioned cash resources, the Bank is maintaining short-term assets which we believe are sufficient to meet its liquidity needs. The Bank’s liquidity can be affected by a variety of factors, including general economic conditions, market disruption, operational problems affecting third parties or us, unfavorable pricing, competition, our credit rating and regulatory restrictions.

At September 30, 2017, the Company had $46.3 million in cash and cash equivalents as compared to $42.1 million at December 31, 2016. Cash and cash equivalent balances include $21.4 million and $22.2 million of interest-bearing deposits at the Federal Reserve Bank of New York at September 30, 2017 and December 31, 2016, respectively.

Off-Balance Sheet Arrangements

The Company’s financial statements do not reflect off-balance sheet arrangements that are made in the normal course of business. These off-balance sheet arrangements consist of unfunded loans and letters of credit made under the same standards as on-balance sheet instruments. These instruments have fixed maturity dates, and because many of them will expire without being drawn upon, they do not generally present any significant liquidity risk to the Company.

Management believes that any amounts actually drawn upon these commitments can be funded in the normal course of operations. The following table sets forth the Bank's off-balance sheet arrangements as of September 30, 2017 and December 31, 2016:

	September 30, 2017	December 31, 2016
	(dollars in thousands)	
Home equity lines of credit	**$ 33,345**	$ 24,255
Commitments to fund commercial real estate and construction loans	**157,155**	125,494
Commitments to fund commercial and industrial loans and other loans	**49,267**	53,979
Commercial and financial letters of credit	**5,303**	3,973
Total off-balance sheet commitments	**$ 245,070**	$ 207,701

Capital

Shareholders' equity increased by approximately $5.9 million, or 5.8%, to $106.6 million at September 30, 2017 compared to $100.7 million at December 31, 2016. Net income for the nine month period ended September 30, 2017 added $6.2 million to shareholders' equity. Additionally, stock-based compensation expense of $202,000, options exercised of $266,000, employee stock purchases of $52,000, and $198,000 in after-tax net unrealized gains on securities available for sale during the nine months ended September 30, 2017, were other major contributors to the increase. These increases were partially offset by $1.0 million in cash dividends on common stock. During the nine months ended September 30, 2017, the Company repurchased no shares under its share repurchase program.

The Company and the Bank are subject to various regulatory and capital requirements administered by the Federal banking agencies. Our federal banking regulators, the Board of Governors of the Federal Reserve System (the "Federal Reserve") (which regulates bank holding companies) and the Federal Deposit Insurance Corporation (the "FDIC") (which regulates the Bank), have issued guidelines classifying and defining capital. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification of the Company and the Bank is also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios, set forth in the following tables of Tier 1 Capital to Average Assets (Leverage Ratio), Common Equity Tier 1 Capital to Risk Weighted Assets, Tier 1 Capital to Risk Weighted Assets and Total Capital to Risk Weighted Assets.

As of September 30, 2017, the Company and the Bank met all regulatory requirements for classification as well-capitalized under the applicable regulatory framework. Management believes that there are no conditions or events that have changed the classification.

The capital ratios of the Company and the Bank, at September 30, 2017 and December 31, 2016, are presented below.

	Company	Bank	Minimum Required For Capital Adequacy Purposes	To Be Well Capitalized Under Prompt Corrective Action Regulations*
As of September 30, 2017				
Common Equity Tier 1 Capital to Risk Weighted Assets	**10.09%**	**11.11%**	**4.50%**	**6.50%**
Tier 1 Capital to Average Assets (Leverage Ratio)	**9.07%**	**10.00%**	**4.00%**	**5.00%**
Tier 1 Capital to Risk Weighted Assets	**10.09%**	**11.11%**	**6.00%**	**8.00%**
Total Capital to Risk Weighted Assets	**12.39%**	**12.27%**	**8.00%**	**10.00%**
As of December 31, 2016				
Common Equity Tier 1 Capital to Risk Weighted Assets	10.33%	11.49%	4.50%	6.50%
Tier 1 Capital to Average Assets (Leverage Ratio)	8.94%	9.95%	4.00%	5.00%
Tier 1 Capital to Risk Weighted Assets	10.33%	11.49%	6.00%	8.00%
Total Capital to Risk Weighted Assets	12.76%	12.68%	8.00%	10.00%

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* The Prompt Corrective Action rules apply to the Bank only. For the Company to be “well capitalized,” the Tier 1 Capital to Risk Weighted Assets has to be at least 6.00%.

Basel III Capital Rules. In July 2013, the federal bank regulatory agencies adopted revisions to the agencies’ capital adequacy guidelines and prompt corrective action rules, which were designed to enhance such requirements and implement the revised standards of the Basel Committee on Banking Supervision, commonly referred to as Basel III.

These revisions generally implemented higher minimum capital requirements, added a new common equity Tier 1 Capital requirement, and established criteria that instruments must meet to be considered common equity Tier 1 Capital, additional Tier 1 Capital or Tier 2 Capital. Effective January 1, 2015, the new minimum capital to risk-adjusted assets requirements are a common equity Tier 1 Capital ratio of 4.5% (6.5% for the Bank to be considered “well capitalized”) and a Tier 1 Capital ratio of 6.0%, increased from 4.0% (and increased from 6.0% to 8.0% for the Bank to be considered “well capitalized”); the total capital ratio remains at 8.0% under the new rules (10.0% to be considered “well capitalized”).

The risk-based capital rules adopted effective January 1, 2015 require that banks and holding companies maintain a “capital conservation buffer” of 250 basis points in excess of the “minimum capital ratio.” The minimum capital ratio is equal to the prompt corrective action adequately capitalized threshold ratio. The capital conservation buffer is being phased in over a four year period that began on January 1, 2016, with a required buffer of 0.625% of risk weighted assets for 2016, 1.25% for 2017, 1.875% for 2018 and 2.5% for 2019 and thereafter. Failure to maintain the required capital conservation buffer will result in limitations on capital distributions and on discretionary bonuses to executive officers.

Effective January 1, 2017, the capital levels required to avoid limitation on elective distributions applicable to the Company and the Bank were as follows:

i. a common equity Tier 1 capital ratio of 5.75%;
ii. a Tier 1 Risk based capital ratio of 7.25%; and
iii. a Total Risk based capital ratio of 9.25%.

As of September 30, 2017, the Bank had a capital conservation buffer greater than 2.5%.

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 design and operation 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, 2017 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

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

Issuer Purchases of Equity Securities

During the quarter ended September 30, 2017, no shares were repurchased under the Company's share repurchase program. In December 2016, the Board of Directors approved a new repurchase program, whereby the Company may repurchase up to $2.0 million of its common stock from January 1, 2017 to December 31, 2017.

Item 6. Exhibits

31.1	*	Certification of principal executive officer of the Company pursuant to Securities Exchange Act Rule 13a-14(a)
31.2	*	Certification of 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 the principal executive officer of the Company and the principal financial officer of the Company
101.INS		XBRL Instance Document
101.SCH		XBRL Taxonomy Extension Schema
101.CAL		XBRL Taxonomy Extension Calculation Linkbase
101.DEF		XBRL Taxonomy Extension Definition Linkbase
101.LAB		XBRL Taxonomy Extension Label Linkbase
101.PRE		XBRL Taxonomy Extension Presentation Linkbase

* Filed herewith.

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.

TWO RIVER BANCORP

Date:	November 13, 2017	By:	/s/ William D. Moss
			William D. Moss President and Chief Executive Officer (Principal Executive Officer)
Date:	November 13, 2017	By:	/s/ A. Richard Abrahamian
			A. Richard Abrahamian Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)

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Section 2: EX-31.1 (EXHIBIT 31.1)

Exhibit 31.1

CERTIFICATIONS

I, William D. Moss, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Two River Bancorp;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 13, 2017

/s/ William D. Moss

Name: William D. Moss
Title: President and Chief Executive Officer

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Section 3: EX-31.2 (EXHIBIT 31.2)

Exhibit 31.2

CERTIFICATIONS

I, A. Richard Abrahamian, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Two River Bancorp;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial

reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 13, 2017

/s/ A. Richard Abrahamian

Name:	A. Richard Abrahamian
Title:	Executive Vice President and Chief Financial Officer

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Section 4: EX-32 (EXHIBIT 32)

Exhibit 32

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with this Quarterly Report on Form 10-Q of Two River Bancorp (the "Company") for the fiscal quarter ended September 30, 2017, as filed with the Securities and Exchange Commission on the date hereof (the "Report,") each of the undersigned officers of the Company hereby certifies, pursuant to 18 U.S.C. (section) 1350, as adopted pursuant to (section) 906 of the Sarbanes-Oxley Act of 2002, that to the best of his knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ William D. Moss

Name:	William D. Moss
Title:	President and Chief Executive Officer
Date:	November 13, 2017

/s/ A. Richard Abrahamian

Name:	A. Richard Abrahamian
Title:	Executive Vice President and Chief Financial Officer
Date:	November 13, 2017

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